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General Accounting Office
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Resources, Community, and
Economic Development Division

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Congressional and Executive Agency Officials

The National Affordable Housing Act of 1990 (P.L. 101-625) requires that the General Accounting Office assess the effectiveness of a prepurchase and foreclosure-prevention counseling demonstration program and report its findings to you. This counseling was intended to (1) reduce defaults and foreclosures on single-family mortgages insured by the Federal Housing Administration (FHA),¹ (2) encourage responsible and prudent use of such mortgages, (3) help homeowners with FHA mortgages retain their homes, and (4) encourage the availability and expansion of homeownership through FHA's mortgage insurance program. The act required that the demonstration program, which was administered by HUD, include a comparison of three locations where the program operated (target areas) and three similar locations where the program was not operating (control areas). HUD funded the implementation of the demonstration program on September 30, 1992, and the program terminated on September 30, 1994.

In summary, a variety of implementation problems precluded us from assessing the impact of the demonstration program. Specifically, target and control areas were not comparable, the counseling intervention was not always implemented properly, and the demonstration program was geographically more limited than originally planned. These problems cannot practicably be overcome. Valid data does not exist, nor can it be easily developed as the basis for a study for determining whether a permanent program of mandatory counseling would be effective in reducing defaults and foreclosures on FHA-insured single-family mortgages.

¹FHA, an organizational unit within the U.S. Department of Housing and Urban Development (HUD), administers the single-family mortgage insurance program, which promotes affordable homeownership and guarantees lenders that FHA will repay the loan amount if the home buyer defaults on the mortgage.

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BACKGROUND

HUD selected three target areas in two separate metropolitan areas for the counseling demonstration program to operate. These were (1) Englewood/Marquette Park,² Chicago, Illinois; (2) South Suburban, Chicago, Illinois; and (3) South Dekalb County, Atlanta, Georgia. Also, HUD selected for comparison with the target areas three corresponding control areas that were located in the same metropolitan statistical areas. The demonstration was designed to yield a comparison between locations where individuals received mandatory counseling (target areas) and locations where individuals were not required to receive such counseling (control areas).

HUD has supported counseling for many years. HUD has provided, on a voluntary basis, various kinds of homeownership counseling, including prepurchase and default counseling. Under the demonstration program, prepurchase counseling was the same as HUD's regular counseling except that it was mandatory and had to take place prior to a sales contract. The home buyers required to have counseling were first-time buyers planning to purchase a home in a target area using an FHA mortgage with a down payment of less than 10 percent. The counseling was to include information on such issues as financial management, homeownership responsibilities, and the maximum mortgage amount that the home buyer could afford.

Under the demonstration program, default counseling called for making counseling sessions available to homeowners who were 60 or more days delinquent on their mortgage. Program requirements were the same as for HUD's regular default counseling except that lenders were required to inform delinquent mortgagors of the availability of counseling from the counseling agency for the target area and at the same time send written notice to the counseling agency in the target area. Delinquency notifications to mortgagors were to include the counseling agency's name, address, and telephone number. Similarly, notifications to counseling agencies were to include the mortgagor's name, address, and telephone number. Counseling was to include options, programs, and actions available for resolving the mortgage delinquency or default.

²The target area also includes the Ashburn and Auburn Gresham community areas.

IMPLEMENTATION PROBLEMS ADVERSELY AFFECTED THE
DEMONSTRATION AND GAO'S ABILITY TO ASSESS IT

Several implementation problems precluded us from assessing the impact of the demonstration program. Specifically, (1) target and control areas were not comparable, (2) the counseling intervention was not always implemented properly, and (3) the program was geographically more limited than originally planned. Consequently, valid data does not exist upon which to base a study for determining whether mandatory counseling would be effective in reducing defaults and foreclosures.

First, the target and control areas were not comparable. The legislation required that each target area be matched to a similar geographic area at the start of the program. Areas were to be matched on the size of the population, age of the housing stock, median income, and racial makeup of the population. However, we found statistically significant differences between the target areas and the control areas on key demographic characteristics that some studies have shown to affect homeownership. All three target and control areas differed significantly from each other on median income; two differed on racial makeup; and one differed on the age of the housing stock. Because of these circumstances, outcomes that might be observed could have been caused by differences in characteristics between the areas rather than the counseling intervention.

Second, the extent to which counseling was implemented as intended is unknown. Prepurchase counseling was supposed to be administered before the prospective FHA home buyer signed a contract. Counseling agency officials told us that in a number of cases, counseling was provided after the contract was signed. The aim of counseling was to help home buyers make more informed decisions by advising them of the responsibilities of homeownership and the maximum mortgage amount they could afford. Available data does not permit identifying precisely when counseling was provided to many of the home buyers.

For default counseling, lenders were allowed discretion in notifying counseling agencies about individual homeowner's delinquencies. Rather than require lenders to send written notices to such agencies, HUD's guidance to lenders provided that notices be sent to the extent possible. According to HUD officials, privacy act concerns precluded the agency from implementing the legislative requirement. Consequently, counseling agencies were not fully informed of homeowners who needed counseling.

Third, the demonstration was geographically more limited than originally planned. HUD suspended prepurchase counseling in the Atlanta area within 2 months of its implementation because of opposition from local real estate interests. Therefore, the prepurchase portion of the demonstration operated in two areas in the Chicago metropolitan area. It is unknown whether this portion of the demonstration can operate in any other metropolitan area because it was not tried elsewhere, and, therefore, any results from the demonstration might be unique to the characteristics of the Chicago area.

In our opinion, it is not practical to overcome these problems. Valid data upon which to draw credible conclusions about the effectiveness of counseling under the demonstration program does not exist, nor can it be easily developed. Consequently, we are unable to assess whether a mandatory counseling program would be effective in reducing defaults and foreclosures on FHA-insured mortgages.

According to HUD officials, they spent considerable time and made every reasonable effort to implement the demonstration program as called for by the legislation. The officials told us that legislative constraints made implementation difficult, however. For example, the requirement for counseling prior to the sales contract was viewed as impractical by both home buyers and local realtors because arranging for counseling might prove prohibitive if the home buyer has already decided on a particular home purchase. Also, potential home buyers might avoid searching for homes in the counseling target areas. To test the effectiveness of counseling, HUD officials believe that coupling HUD's regular (voluntary) counseling program with financial incentives would have been a more workable demonstration program than the one required by the legislation.

It should be noted that a number of changes in homeownership counseling are under way or are being considered. For example, HUD has made recent changes to its counseling program, including placing greater emphasis on providing prepurchase counseling at, or before, mortgage loan origination. The Federal National Mortgage Association (Fannie Mae), which also plays an important role in supporting homeownership, recently established the American Homeowner Education and Counseling Institute, which aims, by the year 2000, to make counseling a routine part of every first-time home buyer's purchase. In addition, HUD just announced that beginning September 3, 1996, it is reducing FHA mortgage insurance premiums for first-time home buyers who receive counseling. The Congress is also considering legislation that would reduce such premiums for first-time home buyers who receive counseling.

AGENCY COMMENTS


We provided a draft of this report to HUD for review and comment. In written comments, HUD agreed with the report's conclusion that because of the problems we found, the effectiveness of the demonstration program can not be evaluated. In addition, HUD provided technical and editorial changes as well as updated information, which we incorporated in this report where appropriate. However, HUD questioned a point in our draft report that stated that the similarity of counseling in the target and control areas would make it difficult for any expected differences between the two areas to be detected. HUD noted that the typical operation of its counseling program was to offer counseling on a voluntary basis in the control areas. Therefore, we agree with HUD that it would be appropriate to use such areas as a benchmark to measure the effects of the mandatory counseling program in the target areas. Accordingly, we deleted references to this point.

In addition, HUD commented that not enough time has passed to see much history of defaults or foreclosures, which generally occur over the first 5 years of a mortgage loan. HUD believes that even if it were possible to evaluate the demonstration program, the legislation did not provide sufficient time to allow for long-term follow-up before the program was held accountable for an outcome evaluation. We agree with this observation.

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We conducted our work from May through August 1996 in accordance with generally accepted government auditing standards. We reviewed HUD's program guidance, examined agency and grantee records, and interviewed agency and grantee officials. To determine whether the target and control areas were similar, we performed statistical tests that compared each target area and corresponding control area on key characteristics required by the legislation. We also obtained documents from Fannie Mae and reviewed available research literature on defaults and foreclosures.

We will provide copies of this report to others upon request. Please contact me at (202) 512-7631 if you or your staff have any questions.



Judy A. England-Joseph
Director, Housing and Community
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B-274101

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