NeighborWorks®
AMERICA

Measuring the Delivery Costs of Prepurchase Homeownership Education and Counseling

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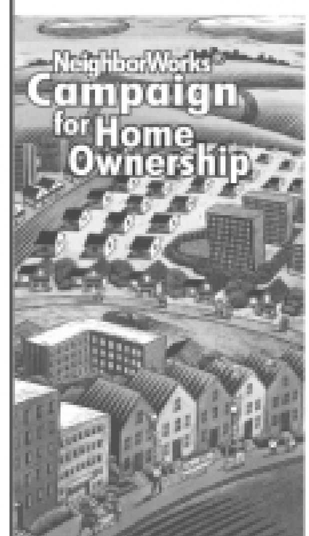

NEIGHBORWORKS® AMERICA, THE NEIGHBORWORKS® NETWORK AND THE NEIGHBORWORKS® CAMPAIGN FOR HOME OWNERSHIP

NeighborWorks® America was established by an act of Congress in 1978 (Public Law 95-557). A primary objective of NeighborWorks® America is to increase the capacity of local community-based organizations to revitalize their communities, particularly by expanding and improving housing opportunities.

These local organizations, known as NeighborWorks® organizations, are independent, resident-led, nonprofit partnerships that include business leaders and government officials. All together they make up the NeighborWorks® network.

The NeighborWorks® Campaign for Home Ownership is the largest national initiative of its kind: a joint effort by private industry and government working with community-based NeighborWorks® organizations to bring more families into home ownership. NeighborWorks® organizations participating in the campaign use the NeighborWorks Full-Cycle Lending® system. Under this system, prepurchase education, innovative loan products and early-intervention delinquency counseling are combined into a system that helps create successful homebuyers who take charge of their neighborhoods as well as their homes.

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NEIGHBORHOOD REINVESTMENT CORPORATION BOARD OF DIRECTORS

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1.0 Introduction

In order to understand the roles that public policy and the business and consumer sectors play in paying for homeownership education and counseling, the costs, benefits and beneficiaries of the education and training must be fully accounted for. This paper estimates the total costs of delivering homeownership education and counseling and discusses proven and implied benefits to stakeholders. Based on one set of assumptions, and depending on the level of activities offered, homeownership education and counseling costs range from $500 to $1,500. Empirical and anecdotal evidence suggest that homeownership education and counseling offer important benefits to borrowers, lenders, real estate professionals and communities. Many nonprofit organizations providing such services, however, remain underfunded. Providers, financial institutions and policy makers must increase their knowledge of what works, what costs are incurred, who benefits, and what value is created by homeownership education and counseling activities in order to develop a sustainable delivery system.

This paper uses information from NeighborWorks® organizations that offer homeownership education and counseling programs as illustration of the cost structure of the homeownership education and counseling industry. Part 2 provides background information on the homeownership education and counseling industry. Part 3 explains the methodology and assumptions used for this analysis. Part 4 reviews cost accounting and presents a framework for the cost analysis. Part 5 discusses the value proposition for homeownership education and counseling while Part 6 offers conclusions and implications.

2.0 Background

Homeownership is a primary means for working families to build assets, and has played an important role in housing policy and community-development strategies in the United States. Homeownership education and counseling is often included in programs promoting homeownership.

The term “homeownership education and counseling” includes several activities that vary according to curriculum content, delivery methods and timing. These activities include prepurchase education, prepurchase counseling, and postpurchase education and postpurchase counseling. Prepurchase education provides instruction about the homebuying process to a group of potential homebuyers, usually in a classroom setting. Prepurchase counseling offers resolution of barriers to homeownership to homebuyers through one-on-one, face-to-face meetings, advice or telephone sessions. Postpurchase education gives homeowners instruction to make homeownership sustainable in a classroom setting, while postpurchase counseling involves one-on-one crisis intervention to help homeowners who are in trouble of maintaining homeownership.

2.1 History of the homeownership education and counseling industry

Homeownership education and counseling dates back more than three decades. It was developed in response to high defaults and foreclosures associated with HUD’s section 235 loan program (Quercia and Watcher 1996, Strauss and Phillips 1997, McCarthy and Quercia 2000, Hirad and Zorn 2001, Mallach 2001). After problems arose with the loan program, HUD began certifying counseling providers starting in 1971 and then funding demonstration default-prevention programs in 1972. In 1974 HUD began providing direct funding to homeownership education and counseling programs. Thus, the nascent homeownership education and counseling industry primarily focused on postpurchase programs designed to help existing homeowners retain homeownership.

About a decade ago, the homeownership education and counseling industry shifted its concentration from postpurchase to prepurchase programs, largely due to the advent of lending programs for underserved markets. These included Community Reinvestment Act (CRA) amendments in 1989, followed by the Federal Housing Enterprise Financial Safety and Soundness Act in 1992 that established affordable housing goals for Fannie Mae and Freddie Mac. Lenders providing relaxed mortgage underwriting criteria, viewed homeownership education and counseling as both a screening device and mechanism to reduce the risk associated with more flexible underwriting standards.

Concerns about financial literacy have also focused the industry on prepurchase programs. In an increasingly complex financial services marketplace, with changing consumer demographics and the emergence of predatory lending, personal finance education has become even more important (Braunstein and Welch, 2002). Financial-literacy training providers range from those that provide comprehensive information to those that focus on a specific goal, such as homeownership (Braunstein and Welch, 2002).

2.2 Size, scale and funding of the industry

Today, approximately 2,000 nonprofit organizations, private sector companies and government agencies provide a varied set of homeownership education and counseling programs and approaches to consumers (Baker and Hornburg, 2003). HUD has historically played a prominent role in shaping the industry's infrastructure and supplying the bulk of ongoing financial support for homeownership education and counseling programs (Weicher, 2004, McCarthy and Quercia, 2000, HUD, FY2002–2003). Information on HUD-approved agencies can be used to estimate the scale and funding of the homeownership education and counseling industry. As of 2004, over 1,600 nonprofit organizations and government agencies were HUD-approved counseling agencies nationwide (Weicher, 2004), and approximately one-fifth of those HUD-approved agencies received HUD housing counseling funds through a competitive process.

HUD estimates that approximately 500,000 potential homebuyers will receive prepurchase education or counseling annually from the agencies it certifies and/or funds (Weicher, 2004). This averages 300 individuals per agency; thus, we project that the entire industry serves approximately 600,000 individuals annually. According to HUD's analysis of national trends from the 2003 American Housing Survey, of the approximately 2.1 million first-time homebuyers annually, approximately half were low- to moderate-income buyers. These statistics indicate that the prepurchase education and counseling industry is serving only a portion of all lower-income first-time buyers.

Assuming that the average annual homeownership education and counseling program budget per provider is $100,000[1], the annual cost of the entire industry of 2,000 programs is approximately $200 million per year. For the last several years, HUD has awarded an average of $40 million in housing counseling grants annually to approximately 350 local, state and national housing agencies (Weicher, 2004). HUD funding does not cover all costs of homeownership education and counseling and limits organizations' ability to collect fees for their services. In addition to HUD funding, homeownership education and counseling providers rely on funding from local government agencies, national and local foundations, the financial and housing industry, and fees (often small) from consumers. Researchers speculate that the private sector contributes only a small share of funding to homeownership education and counseling efforts nationwide (McCarthy and Quercia, 2000). Even if industry stakeholders' support matched HUD's, homeownership education and counseling industry would be severely underfunded if services were expanded to include a larger share of first-time buyers.

[1] This assumption is based on information from NeighborWorks® organizations that run homeownership education and counseling programs.

3.0 Methodology and Assumptions

To understand the delivery costs of prepurchase homeownership education and counseling by NeighborWorks® organizations, basic program elements and customer types need to be identified. The typology of program elements and customers included in this paper are based on reviews of printed materials and annual surveys from NeighborWorks® America and NeighborWorks® organizations, as well as discussions with experts.

3.1 Basic program elements

Prepurchase education provides general information that is designed to prepare potential homebuyers in a group setting for the responsibilities of homeownership. It includes topics such as homebuying, financing, financial planning and money management, and home maintenance and repairs. National homeownership-education certification programs, such as those from NeighborWorks® America, require a minimum of eight hours of face-to-face classroom training. NeighborWorks® organizations generally offer a one-hour group orientation session as an efficient means to introduce potential homebuyers to their homeownership programs, services and the homebuying process. In addition, at least eight hours of prepurchase education (one-on-one) is generally provided.

Prepurchase counseling offers guidance tailored to the individual's unique concerns and addresses his or her specific obstacles to successfully achieve homeownership. Depending on customer need, NeighborWorks® organizations usually deliver prepurchase counseling to individuals through one or more face-to-face meetings. The typical counseling session lasts one hour. Counseling is clearly more time-intensive and expensive per person than group education. However, the average number of counseling sessions per customer varies according to customer type and specific needs as described below.

This paper distinguishes between prepurchase education and counseling as two separate functions, with the average customer receiving nine hours of education (the one-hour orientation and standard eight-hour class) and one hour of counseling per session.

3.2 Customer types and needs

Most nonprofits that provide homeownership education and counseling services find that customers vary widely in their readiness to buy. Some customers will take time to achieve homeownership and require substantial assistance to rebuild negative credit, accumulate savings and reduce high debt, while others may be able to buy sooner and need minimal help to address minor credit problems or increase their savings. Using the NeighborWorks® network's experience in working with a variety of customers who required different levels of service, NeighborWorks® America categorized buyer types according to homeownership readiness and assistance required, and thereby it standardized and streamlined the network's service-delivery system for homeownership education and counseling.

NeighborWorks® organizations now commonly differentiate customers into one of three categories:

- "near ready" for customers who will be ready for homeownership within three months;

- “short term” for customers who will be ready for homeownership within three to six months; and
- “long term” for customers who be ready for homeownership in more than six months.[2]

We assumed that all customers need the same general information to prepare them for the responsibilities of homeownership and could thus receive it through the same amount of prepurchase education. The amount of individual attention, which is typically provided as one-on-one counseling, varies depending upon customer type and addresses customers’ specific or overcome specific obstacles. Near-ready customers need a minimal number of individual counseling sessions to analyze their finances and address specific concerns. Short-term customers require a moderate number of counseling sessions to evaluate their financial circumstances and address minor obstacles and prepare for homeownership. Long-term customers need the maximum number of counseling sessions to assess their situations, resolve serious financial obstacles and plan for homeownership.

Normally, NeighborWorks® organizations serve all three customer types and try to create a pipeline of prospective buyers who are progressing toward homeownership at different paces through short- and long-term counseling programs. The percentage of customer type served, however, varies depending on a variety of environmental factors, including outreach strategies, organizational focus and geographic location. The mix of customers served by a particular organization strongly affects prepurchase counseling and delivery costs because customer type drives the number of counseling sessions and the number of customers served annually by one full-time counselor. To maximize efficiency and productivity, a balance between near-ready, short-term and long-term customers is essential.

3.3 Assumptions

The calculations of prepurchase counseling and education delivery costs presented in this paper include assumptions based on general information about the NeighborWorks® network. The table below shows the factors and the assumptions we used. Please refer to the Appendix, Table 8 for more detailed information.

Table 1: Factors and Assumptions Used to Calculate Prepurchase Education and Counseling Delivery Costs

Factors	Assumptions	Details
Activities offered	Group education and counseling	
Preparation and delivery time for a counseling session (hours)	Two hours	One hour for delivery; preparation time equal to delivery
Preparation and delivery time for an education class (hours)	18 hours	Nine hours for delivery of one-hour orientation and standard eight-hour class; preparation equal to delivery *(continued)*

[2] “Long term” covers a wide range of customers, from those who will ready for homeownership in seven months to those who will be ready for homeownership after several years. The analysis assumed that the average long-term customer would be ready for homeownership after one year.

Table 1 continued

Factors	Assumptions	Details
Number of group education classes per year (sessions)	12 sessions	One session per month
Number of homeownership education and counseling program staff full-time equivalents (FTEs)	One FTE	
Available staff labor per year (hours)	1,920 hours	40 hours per week for 48 weeks
Organizational mix of customers and weighted average hours of counseling per customer[3]	• 6.2 hours for organizations focusing on near-ready customers • 13.2 hours for organizations with an even mix of customers • 17.4 for organizations serving mostly short- and long-term customers	

As discussed in the previous section, NeighborWorks® organizations normally serve different mixes of the three customer types, and that mix affects capacity and delivery costs. The cost structure analysis considered three representative organizational scenarios to estimate the impact of customer diversity on delivery costs:

- an organization focusing on near-ready customers with 80 percent near-ready, 15 percent short-term and 5 percent long-term;
- an organization with an even mix of customers (34 percent near-ready, 33 percent short-term and 33 percent long-term); and
- an organization serving mostly short- and long-term customers with 15 percent who are near-ready, 30 percent who are short-term and 55 percent who are long-term.

We assumed that every customer received the same amount of group education, but the number counseling hours varied for each customer type. For example, we assumed that near-ready customers would need an average of two sessions, or four hours, to analyze their finances and address specific concerns. Short-term customers would need an average of six sessions, or 12 hours, while long-term customers would need an average of 12 sessions, or 24 hours. We assumed that each counseling session had a delivery time of one hour, and that preparation time for the counseling session was equal to the delivery time. Based on customer mix and the number of counseling hours needed per customer type, we calculated a weighted average number of hours of counseling per customer for each representative organizational scenario.

[3] See Appendix, Table 6 for details.

4.0 Cost Structure Analysis

Understanding service-delivery costs refines decision making about pricing and service mix. For nonprofit organizations, cost control significantly affects service levels and organizational sustainability. Cost accounting requires organizations to research and calculate the actual costs for services they provide to others.

4.1 Cost accounting background

Cost accounting methods often involve significant creativity. They vary widely and are difficult to define for nonprofit organizations. Some basic concepts, however, are essential to designing, understanding and using such systems (Bruns, 1999). The first involves the behavior of different cost types and volume. Variable costs, for instance, change proportionally with volume: if volume increases by 25 percent, a variable cost also will increase by 25 percent. Nonvariable or fixed costs do not change with volume. Nonvariable costs are independent of the number of activities offered and the number of costs served. They may change over time, but not in relation to the volume of activities.

Another important classification of costs is direct versus indirect costs. Direct costs result from an activity or product and are expended by supporting activities and programs. Direct costs may include but are not limited to a program's staff salaries and supply costs. Direct costs can be variable or nonvariable.

Indirect costs are not directly linked to a product or activity. Indirect costs are overhead costs and are associated with fundraising and sustaining operations. For example, office space rental costs, and director's salaries for nonprofit organizations that deliver multiple activities, are indirect costs. To account for an activity's full cost, some portion of overhead cost must be associated with the activity.

4.2 Cost accounting application for prepurchase homeownership education and counseling

Below is an application of the basic cost accounting concepts to calculate delivery cost of prepurchase homeownership education and counseling. This simplified model calculates total cost, and based on the average total cost then a total cost per customer (TC / number of clients) can be calculated. This model does not estimate marginal costs.

Total Cost Equation for the Delivery Cost of Homeownership Education and Counseling:

$$\boxed{TC = FC + (Hg*W*C) + (M*Q) + (Hi*W*Q)}$$

The definitions for the equation are as follows:

- TC = total costs
- FC = nonvariable costs for the organization's general operations (see Table 2 below for a detailed list of fixed costs)
- Hg = number of hours for group education class

- W = wages, as direct labor cost per hour for full-time homeownership education and counseling program staff (including benefits)
- C = number of classes per year
- M = cost of materials for group education class, per customer
- Q = number of customers served per year by one FTE[4]
- Hi = weighted average number of hours of individual counseling per customer based on organizational mix of customers

The delivery cost of homeownership and counseling includes nonvariable and variable costs as well as direct and indirect costs, as shown in detail in Table 2 below. The majority of the nonvariable costs for homeownership education and counseling are indirect costs incurred to sustain the organization's general operations, including portions of management and support staff salaries, rent and utilities and other administrative functions. The other nonvariable costs are direct costs incurred to support homeownership education and counseling activities, and costs for marketing, staff training, and supplies and materials. The variable costs that change proportionally with customer volume and intensity, both of which are direct costs, are program staff labor and class materials.

Table 2: Types of Costs Associated with Homeownership Education and Counseling

Nonvariable costs for homeownership education and counseling include:	**Variable costs for homeownership education and counseling include:**
Portion of executive director's annual salary and benefits	Homeownership education and counseling program staff labor (including benefits)
Portion of administrative assistant's annual salary and benefits	Materials for group education class per customer (tri-merged credit reports, refreshments, manuals and handouts)
Portion of homeownership education and counseling program director's annual salary and benefits	
Portion of annual rent and utilities (including telephone)	
Portion of annual management information system's costs	
Portion of annual auditing and accounting costs	
Annual marketing costs	
Annual staff training costs	
Other annual costs (office supplies and equipment, postage, dues and subscriptions)	

Indirect costs   Direct costs

[4] Q = number of households and assumes that the number of people in classes = the number of people counseled.

A relatively large number of fixed costs could easily make up a large share of the total costs of delivering prepurchase homeownership education and counseling; this implies that organizational scale is significant. In other words, an organization could lower its delivery cost per customer by reducing its fixed costs. Elements affecting the total amount of fixed costs include location (which especially affect area rents and salaries), presence of program management staff, and program marketing strategies.

4.3 Analysis of delivery costs of prepurchase homeownership education and counseling for representative organizations

Using the three representative organizational scenarios listed earlier, assumptions based on NeighborWorks® network information, and the cost equation presented above, we calculated estimates of the delivery costs of prepurchase homeownership education and counseling.[5] The cost structure analysis is a "back-of-the-envelope calculation" representing costs per customer. We used reasonable cost assumptions, a fairly standardized customer typology and representative programmatic mixes (see Table 3).

Table 3: Cost per Customer for Representative Organizations

Representative Organization		Weighted Average # of Counseling Hours/ Customer	Total Costs	Max. # of Potential Customers Served/Year with 1 FTE	Cost per Customer
High volume/ low intensity	Organization focusing on near-ready customers	6.2	$160,324	275	$583
Moderate volume/ moderate intensity	Organization with even mix of customers	13.2	$154,565	129	$1,198
Low volume/ high intensity	Organization serving mostly short- and long-term customers	17.4	$153,195	98	$1,564

Annual volume for each representative organization was projected by dividing the weighted average number of hours of counseling per customer by the available hours per year for counseling given one FTE, and assuming that the FTE is being fully utilized. As indicated in the cost estimates shown above, customer volume and mix are related and are key drivers of costs per customer. For example, organizations with large portions of customers who require low-intensity counseling will be able to serve more customers and have lower costs per customer than organizations serving mostly customers that need high-intensity counseling.

In general, the analysis includes fixed costs that are about two-thirds of the total costs for program delivery, which underscores the importance of organizational scale. An organization could also lower its per-customer delivery costs by increasing the number of customers served without increasing operation size and scale. For example, if a high-intensity program could have two FTE staff to increase volume without expanding its general operations, cost per customer would be lowered by a third. Adding a third FTE to serve more customers at the

[5] See Appendix for detailed calculations and assumptions.

same operational scale would lower the cost by half. Thus organizations that focus on customers requiring high-intensity counseling ought to be fairly large-scale to be efficient.

The relationship between fixed costs and relevant range needs additional research to determine when an organization's operations must be increased as its activity grows. Nonvariable costs generally remain the same for a wide activity range, and then jump to a new higher cost for the next activity range as new staff or more space is needed to support the increased activity. Within each relevant range of fixed costs, the cost per customer is reduced as volume increases until maximum capacity is reached with the current scale of operations. Thus, the cost per customer will peak at program start-up, because of the need for additional staff and more space, and continue to decrease until the organization's maximum capacity is reached.

5.0 Value Proposition for Homeownership Education and Counseling

Understanding the costs and value of delivering homeownership education and counseling remains an important ongoing task for the industry. The cost structure example presented in this paper provides a range of costs depending on program design, but it is important to distinguish between cost, value and fee. Cost is a measure of how much staff time and other resources are required to deliver customer services. Cost also gives the provider a basis to determine fees. Value pertains to service worthiness to customers and partners, and is normally based on all economic and social results that beneficiaries get from the services. The fee is charged to customers and partners to offset the service costs. The value of services perceived by beneficiaries impacts their willingness to pay for, or invest in, homeownership education and counseling. Thus, fee pricing can be viewed as an expression of value or an estimate of the service's worth to stakeholders.

For years, advocates of homeownership education and counseling have asserted that this service benefits its customers socially and economically. This assertion, based on anecdotal evidence, has yielded minimal support from key stakeholders. Only recently has empirical evidence emerged that demonstrates a positive and genuine impact due to the service. This helps make the case for increased funding, but much of the education and counseling value continues to be speculative. To create a truly sustainable industry, additional research is needed to demonstrate the tangible results of this service to key beneficiaries, since direct, quality data are limited.

Using both empirical and anecdotal evidence, we can estimate the major value components of homeownership education and counseling, and establish a framework to organize additional research. Such research would support the value proposition of these services. Table 4 below outlines four general suppositions concerning the service's primary impacts and beneficiaries. Noted are existence of reliable sources to support the claims. It appears that key stakeholders, particularly lenders and borrowers, benefit directly from homeownership education and counseling.

Table 4: Estimated Impacts and Beneficiaries of Homeownership Education and Counseling

Reduced loan delinquency	**Improved financial health and increased knowledge**
• Borrowers avoid penalty fees, credit blemish, default costs and emotional stress • Lenders avoid lost revenue[6] • Neighborhoods avoid vacant homes from foreclosure *Source: Hirad and Zorn (2001); Hartarska, Gonzalez-Vega and Dobos (2002); Staten, Elliehausen and Lundquist (2002)*	• Borrowers are more creditworthy and have less stress *Source: Staten, Elliehausen and Lundquist (2002)* *Additional research needed*
Increased neighborhood satisfaction • Borrowers are happier • Neighborhoods have invested residents *Research needed*	**More efficient transaction** • Borrowers obtain mortgages or homes faster • Lenders experience reduced time per customer • Real estate industry professionals experience reduced time per customer *Source: Hartarska, Gonzalez-Vega and Dobos (2002)* *Additional research needed*

Impact 1: Reduced loan delinquency

The effectiveness of prepurchase education and counseling in improving loan performance is most clearly demonstrated. Several studies that examined the effect of education and counseling[7] on default rates found lower delinquency and default rates. Only one study of Freddie Mac's affordable lending program (Hirad and Zorn, 2001) provides direct empirical evidence of the service's value, concluding that some types of prepurchase education and counseling have a significant impact on mortgage delinquency rates. Based on a group of loans from Freddie Mac's portfolio that received this service, 90-day delinquency rates were lowered by 19 percent. Borrowers who received individual counseling experienced a 34 percent reduction in delinquency rates, while borrowers who received classroom and home-study education obtained 26 and 21 percent reductions.

Another study, from Ohio State University (Hartarska, Gonzalez-Vega and Dobos, 2002) examined Fannie Mae's affordable-lending program in six states. The study showed that borrowers who had participated in a particular education and counseling program, developed around a cash flow analysis, had a default rate one-half that of noncounseled borrowers. The authors attributed lower default rates to lenders' and borrowers' increased skill in assessing ability to repay, rather than the borrowers' altered behaviors. While this study offers further evidence of the potential impact of homeownership education and counseling on mortgage delinquency rates, data applicability is skewed by data being based on a costly, nonstandardized approach to delivering education and counseling.

A third indirect study (Staten, Elliehausen and Lundquist, 2002) discovered that borrowers who had received credit counseling had reduced 30- and 60-day consumer-credit delinquency experiences (as opposed to noncounseled borrowers) within a 12-month period, three years

[6] Lenders include mortgage holders, servicers, investors and insurers.
[7] Including homeownership education and counseling and credit counseling.

after counseling. Although this study documents that credit counseling can reduce consumer-credit delinquencies, it could imply that credit counseling helps to change borrowers' payment patterns, and thus would have a positive impact on mortgage loan delinquency rates.

Lenders, borrowers and neighborhoods benefit from reduced default rates. Defaults can lead to foreclosure, which is costly to everyone involved. Lenders may incur unreimbursed expenses, such as losses beyond the insured portions of loans, and loss of servicing income stream. Borrowers may lose their homes, ruin their credit ratings and suffer emotional and financial stress. Neighborhoods risk vacant and neglected properties, instability and volatile property values.

Impact 2: Improved financial health and increased knowledge

According to the 2003 Fannie Mae National Housing Survey, gaps in information, credit and confidence persist as barriers to homeownership. Homeownership education and counseling presumably addresses those gaps, although no direct empirical evidence exists. The Staten, Elliehausen and Lundquist (2002) study offers indirect support that borrowers who received credit counseling experienced significant increases in their credit scores and/or had improved overall credit health. This was demonstrated through higher credit scores, fewer late payments, lower credit-card balances and less frequent use of credit lines, relative to noncounseled borrowers over a three-year period. Borrowers who started with the lowest level of financial health experienced the greatest impact.

Credit counseling is often a significant part of homeownership education and counseling. The findings from the Staten, et al., study suggest that this service changes borrowers' credit behavior and increases their credit scores, thus improving their likelihood of qualifying for a mortgage at a fair price. Credit scores greatly affect both the borrowers' ability to qualify for a loan and the loan price, so that they pay less for mortgage financing.[8] Assuming that a borrower selects the best interest rate for which she or he qualifies, the cost savings on a monthly basis, and over the loan's life (on a $100,000, 30-year, fixed rate mortgage[9]) is shown in Table 5.

Table 5: Cost Savings on a Loan Based on Credit Score

FICO® score range	Interest rate	Monthly principal and interest payment	Total interest paid over average life of loan (10 years)[10]	Total interest paid over term of loan (30 years)
720–850	6.00%	$600	$55,612	$116,000
500–559	9.25%	$823	$88,521	$196,280
Difference			**$32,909**	**$80,280**

Increased household wealth is another indicator of improved financial health. By helping families who are traditionally underserved by the conventional mortgage market become

[8] There are other mortgage loan pricing considerations, such as loan-to-value and financial documentation.
[9] www.myfico.com, July 29, 2004.
[10] Federal Housing Finance Board, 2004.

homeowners, homeownership education and counseling indirectly helps them build personal wealth through home equity. According to the Joint Center for Housing Studies of Harvard University's *2003 State of the Nation's Housing*, the median net wealth of the lowest-income homeowners was $68,000, while that of the lowest-income renters was only $500 in 2001. For lower-income households, in particular, home equity is an important source of household wealth. Home equity accounted for more than 80 percent of total net wealth for half of the lowest-income homeowners.

To strengthen this value proposition, which is based on anecdotal and indirect evidence, additional research about homeownership education and counseling's ability to improve financial health and increase knowledge is needed. Potential indicators of program effectiveness would be improved financial health and increased knowledge and confidence about the homebuying process. These factors could be measured through pre- and posteducation tests, surveys and financial information.

Impact 3: More efficient transaction

Another anecdotal value proposition of homeownership education and counseling, which warrants empirical research, concerns improved transactions between borrowers, lenders and real estate professionals. The study by Hartarska, Gonzalez-Vega and Dobos (2002), although flawed by the highly inefficient nature of the program, argues that in-depth counseling makes borrowers and lenders better able to measure "ability to pay" and select appropriate loan products. The findings suggest that counseling can be an important screening function for borrowers and lenders. Customers are referred to lenders and real estate professionals when they are "mortgage-ready," which could lead to easier, shorter and more effective mortgage and real estate transactions. For lenders, screening may also generate fewer denials, and give access to underserved customers and improve CRA and HMDA ratings. The same study showed that 45 percent more counseled borrowers (as compared to uncounseled borrowers) received down-payment assistance; perhaps they were more aware of financing options or lenders were more comfortable about their risks.

Impact 4: Increased neighborhood satisfaction

Many homeownership education and counseling programs attempt to help borrowers find suitable homes in acceptable neighborhoods. By teaching potential homebuyers about home and neighborhood selection and homeownership responsibility, this knowledge, presumably, would lead to better choices and increased tenure satisfaction. This premise has yet to be proven through credible research.

Homeownership has proven to be beneficial to families and communities in many ways. We infer that positive effects would accrue for households who became homeowners predominantly because of homeownership education and counseling programs. First, homeownership creates continuity and stability. Census data show that a homeowner typically lives in a community four times longer than a renter does (American Housing Survey, 1995). Second, national surveys (Rossi and Weber, 1996) show that homeownership increases confidence, happiness and self-satisfaction. Third, research demonstrates that homeownership creates more positive environments for raising families (Rohe and Stegman, 1994; Scanlon, 1996; DiPasquale and Glaser, 1997). Fourth, studies find that homeownership increases civic involvement (Rohe and Stegman, 1994; DiPasquale and Glaser, 1997; Rossi and Weber, 1996). Last, research shows that homeownership improves neighborhoods because homeowners are invested, homes are better maintained, and property values are increased (Galster, 1983; Galster, 1987; Rohe and Stewart, 1994; DiPasquale and Glaser, 1997). The challenge, however, lies in proving that education and counseling played prominent roles in a homeowner's tenure choice.

5.1 Pricing considerations

A typical pricing strategy for sustainability involves setting a price somewhere between service-delivery costs and its value to stakeholders (Corey, 1980). Based on limited evidence and reasonable speculation, this section attempts to outline the major value components of homeownership education and counseling as compared to the cost structure presented earlier in this paper.

The benefits are a starting point used to set up who pays for homeownership education and counseling services, and how much they pay given the level of benefit. The value components of this service are multilayered, and many players could conceivably receive benefits. Consumers, for instance, could get better pricing and access to different products. Lenders could reduce origination and foreclosure costs. Real estate professionals could increase efficiency by spending less time with customers (although their fees would not change).

The level and incidence of benefit for each stakeholder, at this time, has not yet been clearly quantified. All stakeholders — consumers, businesses, government and philanthropy — are impacted, and thus some combination of support from each of them is a logical way to support homeownership education and counseling. Arriving at a concrete pricing system that is generally accepted by all parties, however, requires a more rigorous study of the estimated benefit of homeownership education and counseling services per stakeholder.

6.0 Conclusions and Implications

This paper is a preliminary attempt at accounting for the delivery costs of homeownership education and counseling services. The model cost structure analysis, based on information from NeighborWorks® organizations, estimated the costs of delivering services across several program designs. The paper also outlined the value that homeownership education and counseling programs generate for different beneficiaries. A number of conclusions, which include implications for additional research, can be drawn from this study.

- **Information on counseling industry costs and benefits is lacking.** The literature review yielded little solid data on the costs, benefits and beneficiaries of homeownership education and counseling. Moreover, the cost structure analysis described in this paper is based on reasonable assumptions, but is not representative of the entire industry. More research, including additional data collection and testing, is needed on program costs as affected by scale and customer mix. The same applies to who benefits and who should pay for education and counseling to create industry sustainability. Many nonprofits appear to be underfunded for homeownership education and counseling services; this is due to a lack of solid evidence about the programs' impacts.

- **Organizations may be charging less than what it costs them to run their programs.** Based on the assumptions for the cost structure analysis, average costs per customer for homeownership education and counseling range from $500 to $1,500, depending on the level of activities offered. Who is covering these costs? Who is benefiting from the current system? Answering these questions was beyond the scope of this paper.

- **Customer triage is important.** Near-ready, short-term and long-term customers have different needs and require different levels of counseling sessions. The mix of customers determines the weighted average number of hours of counseling per customer, which simultaneously limits the maximum number of customers who can be served with one FTE and raises the cost per customer. Serving a high proportion of long-term customers will result in low volume and high costs. If policy makers want to reach such underserved markets, it will require nearly three times the present resources to do so (see Appendix, Table 7).

- **There is a trade-off between volume and intensity.** Most organizations serve different mixes of customer types. Scale and costs are functions of the portion of the long-term customers who require the maximum number of counseling sessions. Organizations must make trade-offs between volume, costs and customer mix. If they lack data to understand these relationships, they may well price their services inappropriately. What type of pricing system makes the most sense when the neediest customers are the most costly?

- **More research is needed on consumer willingness and ability to pay for services.** Borrowers receive many benefits from homeownership education and counseling, but because of low incomes and limited assets cannot always afford to pay fees that would adequately support organizations providing the services. However, as major beneficiaries of these services, borrowers should be expected to pay fees based on credible evidence of their willingness and ability.

- **Rationale for public support has equity grounds.** The neediest customers are the most expensive to serve. If reaching the underserved is a priority, as HUD and federal policies indicate through emergent programs such as the American Dream Demonstration, then more subsidies are needed. A tripartite fee system, with contributions from customers, private-sector businesses and public agencies, would appear to be the most logical funding approach. All three benefit from homeownership education and counseling, and thus should support the industry. Ideally, the funding ratio for each stakeholder would be based on benefits conferred. Such an approach, however, would be difficult with HUD's prohibition on charging counseling fees to customers of organizations receiving HUD funding.

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Appendix

Table 6: Representative Organization Scenarios

		Scenario A Organization focusing on high volume		**Scenario B** Organization with even mix of customers		**Scenario C** Organization serving mostly short- and long-term customers	
Customer Type	**Hours of Counseling**	**% of Total Customers Served**	**Weighted Hours/ Customer**	**% of Total Customers Served**	**Weighted Hours/ Customer**	**% of Total Customers Served**	**Weighted Hours/ Customer**
Near-Ready Customers Customers who need a minimal number of counseling sessions	4 (2 sessions plus prep for each session)	80%	3.2	34%	1.36	15%	0.6
Short-Term Customers Customers who need a moderate amount of counseling sessions	12 (6 sessions plus prep for each session)	15%	1.8	33%	3.96	30%	3.6
Long-Term Customers Customers who need the maximum amount of counseling sessions	24 (12 sessions plus prep for each session)	5%	1.2	33%	7.92	55%	13.2
Weighted Average Hours of Counseling/Customer			**6.2**		**13.2**		**17.4**
Available Hours Per Year for Counseling[11]		1704					
Maximum Number of Customers Served Per Year with 1 FTE			275		129		98
Average Homebuyer Education Class Size			23		11		8

[11] See methodology and assumptions. Available hours per year for counseling = available staff labor hours per year - total hours for group education (18 hours x 12 sessions).

Table 7: Calculations of Total Costs and Cost per Customer for Representative Organization Scenarios

Total Costs	FC	+	HgWC		+	MQ		+	HiWQ	
Scenario A	***6.2***	***hours of counseling per customer*** *(weighted average)*								
			Cost	# of customers		Cost	# of customers		Cost	# of customers
			$427	12		$40	275		$147	275
$160,324	$103,775		$5,124			$11,000			$40,425	
Cost per customer										
$583										
Scenario B	***13.2***	***hours of counseling per customer*** *(weighted average)*								
Total Costs										
			$427	12		$40	129		$314	129
$154,565	$103,775		$5,124			$5,160			$40,506	
Cost per customer										
$1,198										
Scenario C	***17.4***	***hours of counseling per customer*** *(weighted average)*								
Total Costs										
			$427	12		$40	98		$412	98
$153,195	$103,775		$5,124			$3,920			$40,376	
Cost per customer										
$1,563										

Table 8: Additional Assumptions about Annual Program Costs

Direct, variable costs		
$45,500[12]	Homeownership education and counseling program staff's annual salary with benefits[13]	**$23.70 = staff labor cost per hour**
$40	Materials costs	
Direct, nonvariable costs		
$2,500	Marketing costs	
$5,500	Staff training costs	
$3,500	Other costs	
Indirect, nonvariable costs		
$23,075	25% of executive director's salary with benefits[14]	**Total nonvariable costs (direct and indirect) = $103,775**
$9,100	25% of administrative assistant's salary with benefits	
$44,850	75% of homeownership education and counseling program director's salary with benefits	
$7,500	25% of rent and utilities	
$1,500	25% of MIS costs	
$6,250	25% of auditing and accounting costs	

[12] Salaries are national averages for NeighborWorks® organizations. Source: NeighborWorks® America Annual Survey, 2003.
[13] Salary with benefits = salary * 1.3.
[14] NeighborWorks® organizations typically run four programs: homeownership education and counseling; lending; real estate development; and resident services. Portion could vary depending on the type of provider and the number of other programs offered.

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