

COMMENTS
to the
Department of Housing & Urban Development

regarding

Docket No. FR-5786-N-01

79 Fed. Reg. 27,896 (May 15, 2014)

FHA Homeowners Armed With Knowledge (HAWK) for New Homebuyers

by the
National Consumer Law Center
on behalf of its low income clients

and the

National Association of Consumer Advocates

July 14, 2014

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The National Consumer Law Center ("NCLC")¹ submits the following comments, on behalf of its low-income clients, with the National Association of Consumer Advocates.²

I. Introduction

We compliment the Federal Housing Administration for its innovative proposal to expand new homebuyer participation in housing counseling. The HAWK program has the potential to protect both homebuyers and the FHA insurance program. These comments describe our recommendations for improving the HAWK program and increasing the possibility that the pilot program will succeed. In particular, we recommend:

- Require housing counselors to mentor borrowers through the loan-shopping process.
- Take measures to prevent unjustified steering to FHA loans.
- Prioritize counseling agencies that serve low-income borrowers and communities of color for the pilot program.
- Require the counseling agency to send borrowers written reminders of the need to participate in post-closing counseling.

II. Mentoring loan applicants will help borrowers get the best possible loan.

A. Teaching borrowers about the process is only the first step.

Shopping for a mortgage is a complicated and confusing process. Pre-contract housing counseling courses are an important step toward helping borrowers navigate this process. But borrowers still need to apply those lessons to their own mortgage hunt. Doing so is complicated by factors including consumers' natural disinclination to apply to multiple

¹ The **National Consumer Law Center**® (NCLC®) is a non-profit Massachusetts corporation specializing in low-income consumer issues, with an emphasis on consumer credit. Since 1969, NCLC has used its expertise in consumer law and energy policy to work for consumer justice and economic security for low-income and other disadvantaged people, including older adults, in the United States. NCLC's expertise includes policy analysis and advocacy; consumer law and energy publications; litigation; expert witness services, and training and advice for advocates. NCLC works with nonprofit and legal services organizations, private attorneys, policymakers, and federal and state government and courts across the nation to stop exploitive practices, help financially stressed families build and retain wealth, and advance economic fairness. NCLC publishes a series of consumer law treatises including Mortgage Lending, Truth in Lending and Foreclosures. These comments are written by NCLC attorneys Andrew Pizor and Odette Williamson.

² The **National Association of Consumer Advocates** (NACA) is a non-profit corporation whose members are private and public sector attorneys, legal services attorneys, law professors, and law students, whose primary focus involves the protection and representation of consumers. NACA's mission is to promote justice for all consumers.

lenders, lack of experience with credit markets, and the complexity of even simple mortgages.

Shopping for a mortgage is particularly difficult for borrowers in communities with a limited history of homeownership. The history of redlining and reverse redlining, as well as other economic disadvantages in some communities, has left many families unexperienced in credit markets. Because prime credit has been less available, these consumers may have a skewed view of what loan terms or interest rates are reasonable or customary. Some consumers have been wrongly led to believe that they have bad credit and cannot get prime rates. Others may be likely to apply to predatory or subprime lenders because such lenders market to lower-income communities more than prime lenders.

Limited funds for down payments, lower incomes, and limited educational backgrounds are other factors that may drive borrowers to predatory or subprime lenders. While borrowers may be eligible for better loans elsewhere, borrowers need help finding these opportunities and navigating the complexities of demonstrating compensating factors in the application process. This will be increasingly important as consumers who previously lost homes to foreclosure try to return to homeownership.³

B. Housing counselors can facilitate effective mortgage shopping and negotiation.

Borrowers who participate in pre-contract counseling will have a better chance of effectively applying their newly found knowledge if the counseling agency continues to serve as a resource through the borrower's shopping process. To do so, counselors should mentor borrowers as they shop for an actual loan. Shopping includes selecting a lender, completing an actual application, explaining to the lender what terms the borrower wants, evaluating loan offers, and negotiating over loan terms.

The mentoring process should include several steps, detailed below, that could be incorporated into the existing pre-contract curriculum.

1. Help the borrower prepare a loan application.

Most lenders use the Uniform Residential Loan Application (Form 1003) promulgated by Fannie Mae and Freddie Mac. The information provided on this form is a crucial factor in determining whether a borrower can get a mortgage and, if so, the terms of that mortgage. The form is designed to be completed by the borrower, but it can be confusing for those not familiar with it. As a result, most loan originators help borrowers complete the form--often by asking the borrower questions and filling in the answers for the borrower. The borrower often then receives the form and is told to sign it. Borrowers who accidentally omit income, misunderstand the loan originator's questions, or provide erroneous information can harm their chances of getting the right mortgage. Housing counselors can help borrowers avoid this problem by helping them complete an application

³ We support FHA's decision to define "first-time homebuyer" as someone who has not owned a primary residence for at least three years. *See* 79 Fed. Reg. at 27898 n.10.

before the borrower applies for a loan. The borrower could then submit this completed application to lenders or use it to answer questions on the lender's form.

As part of the pre-contract counseling program, housing counselors should walk each borrower through completing their own loan application and compiling the relevant documentation. Borrowers will likely be more willing to ask questions of a counselor than of a loan originator. Completing an application and compiling documentation in advance will also help speed the application process when the borrower is ready to contact a lender.

2. Create a shopping list.

Once a borrower learns about mortgages and the home buying process, the borrower still must decide where to apply for a loan. Recent experience has shown that this is possibly the most important factor in determining whether the borrower will be able to get an affordable loan. A borrower who applies to a good lender will likely be offered a loan that fairly reflects the borrower's creditworthiness and that will not include terms that increase the risk of default. But a borrower who applies to a subprime lender is likely to be offered a subprime loan regardless of whether the borrower could qualify for something less expensive.⁴

Many borrowers only contact a single lender or broker.⁵ And even those who contact more usually stop shopping after submitting an application.⁶ But, unless the borrower lucks upon a good lender, submitting only a single application reduces the borrower's ability to benefit from market competition and comparison shopping. Housing counselors can greatly help borrowers by explaining the benefit of applying to multiple lenders.

While counselors cannot tell borrowers where to apply, counselors can facilitate borrowers in developing their own personal shopping lists. For example, counselors could organize group meetings during which borrowers would share their knowledge and experience of lenders. The housing counselor could ask appropriate questions to encourage discussion (such as "where do you and your friends bank?" and "Did your friend have any problems or regrets about that lender?" etc.). The information generated by such a group discussion would help borrowers decide where to apply. It may also generate feedback that could be useful to HUD regarding problems with certain lenders. The counselor could also provide standardized research materials, such as information about determining credit union eligibility and special loan programs. In some communities, the counselor may be able to

⁴ See Diana B. Henriques & Lowell Bergman, *Mortgaged Lives: A Special Report; Profiting from Fine Print with Wall Street's Help*, N.Y. Times, Mar. 15, 2000, at A1 (subprime mortgage lenders charge borrowers with "A" credit the same rates and fees they charge borrowers with "D" credit).

⁵ ICF Macro, Summary of Findings: Design and Testing of Truth in Lending Disclosures for Closed-end Mortgages at 5 (July 16, 2009) (report submitted to Federal Reserve Board), available at www.federalreserve.gov/boarddocs/meetings/2009/20090723/Full%20Macro%20CE%20Report.pdf.

⁶ *Id.* at 6.

compile a list of local lenders. Each borrower would be tasked with producing a personalized list by the end of the meeting.

At this meeting the counselor could also provide borrowers with information about current interest rates, such as the Freddie Mac Primary Mortgage Market Survey rates, the TILA higher-cost and HOEPA loan thresholds, and other cost indicators.⁷ This information would enable borrowers to request market rates when they apply to lenders, thereby signaling that the borrower is a savvy consumer and reducing the chance that the lender will offer an unreasonable loan.

The counselor could also respond to common questions about applying to multiple lenders. Some borrowers believe that applying to multiple lenders hurts your credit score. This is not true, however, if the applications are all submitted within a relatively short period of time.⁸ Other borrowers believe that paying multiple application fees is a poor use of funds. But the money may be well spent if it helps the borrower get a loan with a lower APR.⁹ Information about shopping for closing services could also be provided.

3. Compare and discuss loan estimates.

After applying for a loan, each borrower will receive preliminary disclosures from each lender. (This is currently called the “Good Faith Estimate,” but beginning August 2015 it will be called the “Loan Estimate”.) While the Consumer Financial Protection Bureau has gone to great lengths to make the Loan Estimate easier to understand, borrowers will inevitably still have questions. Even those that understand the Loan Estimate may not be able to put the offered terms in context and will, therefore, not know whether the offer is fair. Even if a borrower has applied to multiple lenders, that lack of context could result in the borrower accepting a loan that is unreasonably expensive.

Housing counselors can address this problem in a number of ways, including by inviting borrowers to meet as a group and share their loan estimates. The counselor would facilitate comparison of the key terms of everyone’s loan disclosures by preparing a chart. (This would also provide the borrowers some anonymity and reduce privacy concerns). The counselor would also provide updated market interest rates that the group could compare

⁷ In some communities, newspapers publish weekly surveys of current mortgage rates.

⁸ See FAQs on credit inquiries from the *myFico* website (operated by Fair Issac Corp., owner of the FICO score). “[Q.] Will my FICO Score drop if I apply for new credit? [A.] ... most Credit Scores are not affected by multiple inquiries from auto, mortgage or student loan lenders within a short period of time. Typically, these are treated as a single inquiry and will have little impact on the credit score.” www.myfico.com/CreditEducation/CreditChecks/Inquiries.aspx

⁹ Merely inquiring about loan terms is not sufficient. The lender’s response to such an inquiry is not binding. Selecting a lender and submitting a single application based on the results of such a non-binding inquiry exposes the borrower to great risk. The loan terms offered may differ greatly from the original response due to information in the borrower’s loan application that was not originally known to the lender. Or the lender may engage in bait-and-switch. Submitting multiple applications reduces this risk.

against what they have been offered. This would help borrowers gauge whether the offers they received are reasonable. They could then discuss any problems they had in the application process and get advice or coaching on negotiating with lenders for better terms.¹⁰

III. Incorporate additional safeguards.

A. Take steps to prevent steering.

While the proposal to give borrowers a discount on FHA insurance premiums does not, on its face, have fair lending implications, it does increase the risk that borrowers may be pressured to select an FHA loan. This could occur in a number of ways. Counseling agencies that receive payments or grant funding for participating in the HAWK program may have an incentive to promote FHA loans, particularly if the agency receives less income if the borrower selects a non-FHA loan or decides not to buy a house. Lenders may have a greater incentive to promote FHA loans to low-income borrowers eligible for the HAWK program because the discounts will be a marketing tool. And the borrowers themselves may believe that the discount automatically makes the loan a better option than loans with private mortgage insurance or because the HAWK program implies a “seal of approval” for FHA lenders.

HUD must include safeguards to counteract this risk. Borrowers should be given assistance in comparing FHA and non-FHA loans. The contents of the counseling and educational programs should not imply that FHA loans are better or cheaper. Instead, borrowers should be explicitly advised that participating in the counseling classes or the HAWK program in does not require them to get an FHA loan. HUD should also encourage conventional lenders to offer similar incentives for participating in housing counseling.

B. Require counseling agencies or loan servicers to send a written reminder of the need to participate in post-closing counseling.

HUD has proposed requiring borrowers to have at least one hour of post-closing counseling in order to receive the maximum possible discount on their FHA insurance. To qualify, the borrower must complete this counseling no earlier than thirty days after closing and no later than one year after the closing.¹¹ HUD’s proposal, however, does not appear to include any requirement that someone remind borrowers to obtain this counseling.

In the excitement of purchasing and moving into a home, borrowers are likely to forget about the need to schedule post-closing counseling. A borrower who fails to do so by the one-year deadline will miss out on substantial savings on the cost of MIP and will not benefit from the counseling. For those reasons, HUD should require either the counseling agency or the borrower’s loan servicer to send the borrower a written reminder of the post-closing requirement. The reminder should be sent thirty days after closing (the earliest at

¹⁰ For example, a borrower could be encouraged to call a lender and say “Bank X offered me a lower APR. Can you beat their offer?”).

¹¹ 79 Fed. Reg. 27896, 27899.

which the borrower can obtain the counseling). Another reminder should also be sent at six and eleven months, if necessary.

IV. Prioritize counseling agencies serving low-income borrowers for the pilot program.

FHA loans are best suited to borrowers who cannot afford the large down payments required by non-agency lenders. Such borrowers are often low-income families. Because such borrowers have fewer opportunities elsewhere, and because this pilot program is a limited resource, HUD should prioritize access to the program for low-income borrowers.

Low-income borrowers, particularly in communities of color, have limited experience with credit and homeownership. This means they are more likely to benefit from the program than higher-income borrowers. Their income level, lack of homeownership experience, and the history of predation on such communities also increase their risk of default. So prioritizing their access to the pilot program will offer the greatest benefit to FHA as well. While the need to avoid steering remains important, it must also be acknowledged that borrowers of color have recently been obtaining FHA loans with increasing frequency. Therefore, so long as an FHA loan is the lowest-cost option for a given borrower, it makes sense to offer the pilot program to those communities most interested in FHA lending.