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Analyzing Service Delivery: Homebuyer Education

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December 30, 2004

Abstract

Consumers of homebuyer education services can be segmented into categories based on their motivation for seeking services, as well as the source of their referral to the program. Motivations for attending a homebuyer program include needing information, support to repair credit problems, and access to subsidy programs. Consumers referred by real estate professionals are typically at a different point in the process and have more specific motivations. Using a modified version of a value chain analysis, the alternative processes consumers use to gain information to make decisions can be modeled. This provides a useful framework to consider how to deliver services to each market segment. Finally, homeownership education is best understood within the context of lifelong financial learning.

This paper was supported by the Fannie Mae Foundation.

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1.0 Introduction

Only a small portion of first-time homebuyers receive homebuyer counseling or education from nonprofit providers. Of an estimated 2 million first-time homeowners each year, fewer than one in four receives services (Weicher, 2004). The process of how consumers make the decision to purchase a home, and the extent to which they seek out information, is poorly understood. A basic tenant of consumer theory in the marketplace is that consumers have sufficient and accurate information to make a rational decision. It is unclear both how well consumers develop their knowledge or behave consistent with theory. This paper provides a critical analysis of homeownership education and counseling by examining how and why individuals participate in nonprofit counseling programs.

This paper begins with a typology of three motivations for participants in nonprofit homebuyer programs: (1) the student seeking knowledge, (2) the credit rebuilder hoping to fix a poor credit history, and (3) the subsidy seeker utilizing a special loan or grant program. For each type of consumer, their motivations, service needs and pace of delivery suggest a need for divergent approaches from nonprofit providers. Another factor affecting each category is how the consumer became involved in the program. Participants referred by a lender or real estate agent have a different motivation from those referred by friends and family.

After detailing these customer types, this paper continues to define the steps of the homebuyer service delivery process, using a modified version of a value chain analysis—breaking down the relative value of homebuyer services at each step of the home-buying process. Each type of customer receives varying degrees of value from each step. Some customers have many alternatives to nonprofit providers. If the nonprofit wishes to best serve the needs of the range of potential buyers, it will consider the costs and benefits of a "one-size-fits-all" approach. Some consumers to choose other alternatives if their specific needs are not met by the nonprofit program.

Finally, this paper suggests an overall life cycle financial literacy model, with homebuyer education as an important, but by no means the only, component. The better that homebuyer programs can clarify their role within this broader context, the better consumers can receive support for sustainable asset-building over time. This paper also suggests several potential implications for nonprofit homebuyer programs, as well as recommendations for future research.

2.0 A Working Typology of Customers

Experts in the financial education field, of which homeownership education and counseling are a subset, cite the importance of timing in helping to determine motivation for individuals to participate in financial education (National Endowment for Financial Education, 2002). In general, people are most receptive to financial education when information is immediately relevant and applicable in a "teachable moment." While arguably all first-time homebuyers experience teachable moments, not all experience teachable moments at the same time, nor are they all equally motivated to learn. This paper suggests three types of consumers: students, credit rebuilders and subsidy-seekers. Consumers in each of these categories of potential homebuyers have needs that can be fulfilled by a nonprofit program, but varying levels of motivation to participate in formal homeownership education and counseling programs. Moreover, since motivation is not always entirely self-motivated, external factors, such as referrals from friends, family members and private-sector professionals, can help create enough momentum to lead individuals to a teachable moment. Thus the combination of external factors and self-interest would likely cause the greatest motivation for an individual to participate in homeownership education and counseling. However, the impetus for participation varies across the range of consumers. Experts in the field agree that delivery of a program in terms of who, what, where, when, why and how must be tailored to different target audiences according to their needs and preferences and balanced by practical constraints (FDIC, 2004).

A recent study by economists from the Federal Reserve Board examines how individuals gain knowledge about personal finances. A variety of sources are cited in surveys, but the most frequently mentioned way consumers learn about how to manage their finances is personal experience, suggesting that most "learn by doing." Another source of information is peers, friends and family, with parents serving as key sources of information and models of behavior. Interestingly, media sources such as television, radio, magazines and newspapers are also popular for gaining knowledge on personal finance (Hilgert and Hogarth, 2003). When asked how they prefer to learn information, consumers say they most like "do-it-yourself" style approaches, including media, informational videos and brochures. Further research suggests, however, that special populations, including females, minorities and seniors, prefer learning in the communal environment of a course or seminar (Rhine and Toussaint-Comeau, 2002). Similarly, individuals with low levels of education, which typically is correlated with low incomes, also prefer more classroom or individual instruction to self-study.

While this research sheds important light on how people find information and suggests what modes of learning they may prefer, consumers contemplating the purchase of a home will have different needs depending on how they came into the homebuying process. Generally, there are two main referral sources for most customers of nonprofit providers: peers/family and private-sector professionals, such as real estate agents and mortgage lenders.

The table below presents an illustration of six categories of individuals who typically participate in homeownership education and counseling based on motivation and referral source. Each category involves a different level of effort, motivation and flexibility. Sections 2.1 through 2.6 provide more detail on each category.

Table 1: Motivation and Referral Source Homeownership Education and Counseling

How Referred to Services	**MOTIVATION FOR PARTICIPATION**		
	Student	**Credit Rebuilder**	**Subsidy Seeker**
Friends and Family Members	"I Need To Know What I'm Doing" ■ Self-motivated ■ Varied needs ■ Low cost; short term ■ Flexible timing	"I Need To Fix My Problems" ■ Self-motivated ■ Specific needs ■ Higher cost; longer term ■ Some time pressure	"I Have To Do This To Get Something" ■ Incentive-motivated ■ Varied needs and timing ■ High cost ■ Willing to be flexible
Private Sector Professionals / Outreach	"My Agent Told Me I Need To Learn This" ■ Low motivation ■ Varied needs ■ Low cost; short term ■ Pressured timing	"I Cannot Qualify for the Loan" ■ Highly motivated ■ Specific needs ■ Higher cost; long term ■ Highly pressured	"I Have To Do This To Finish the Deal" ■ Incentive-motivated ■ Varied needs ■ High cost ■ Pressure to close deal
Alternative to Nonprofit Provider	Many: Self-study; peers; banking and real estate industry professionals	Few: Credit counseling; financial planners; bank-affiliated workshops	None: Limited sources of subsidy

2.1 The Student: "I Need to Know What I'm Doing"

According to the 2003 Fannie Mae National Housing Survey, only about a third of all U.S. households think they have a good understanding of the homebuying process. First-time buyers in particular lack confidence in their ability to navigate the process, as well as to qualify for a loan. Somehow, however, nearly two million households become first-time homeowners each year.

Referred by Friends and Family

Although there is a paucity of research on what triggers renters to gather information and successfully buy a home for the first time, parents and family appear to play a strong role. For example, one study shows that children of homeowners, even controlling for education and income among other factors, are more likely to buy a home (Boehm and Scholtman, 1999). Friends or peers are another trusted source of information. First-time buyers will garner information from anyone around them who is perceived to have the expertise needed, but these sources may provide poor or even incorrect information. However, in cases where a friend or family member has had a positive experience with a nonprofit homebuyer program, it may be their urging which motivates a consumer to go to a formal homebuyer workshop.

However, despite the encouragement from friends and family members, consumers in the "student" category typically have the least motivation to participate in homeownership education and counseling. They are largely self-motivated and can procrastinate regarding the decision to attend a class, as well as whether or not to buy a home. Even if they do attend the class, the information provided may not be totally relevant and applicable to them given that they are at an early stage in the homebuying process.

Delivery Methods

In general, individuals seeking information are the most flexible types of learners and need only learn basic terms and the steps of the homebuying process. Appropriate delivery methods for these individuals include face-to-face workshops, Internet or computer-based education programs, video or Web conferencing, videos or DVDs, and self-study programs. The ubiquitous "how to buy a home" book (Amazon.com lists hundreds) also seems to be a popular self-study option, as are the many Web sites offering advice to would-be homebuyers.

Content

As this audience needs only general information about the homebuying process, suitable content would include how to decide whether to buy a home, the steps in the purchase process, how to qualify for a mortgage loan, how to choose a loan, and how to shop for a location and a home. In large part, these learners are interested in learning terms and definitions, as well as what to expect. They fear looking stupid to real estate agents or lenders, and they also want to get a good deal — that is, avoid pitfalls such as paying too much for a home, choosing the wrong home, or getting stuck in a bad loan.

Alternatives to Nonprofit Providers

The primary alternative to nonprofit programs for these consumers are informal sources, such as personal experience, peers or industry professionals, and the media.

Outcomes
From the perspective of the potential homebuyer, short-term indicators of program effectiveness would be more knowledge and increased confidence about the homebuying process. These could both be measured through pre- and post-education tests and surveys.

2.2 Student: "My Agent Told Me I Needed To Learn This"

Professional Referral
Once consumers are working with lenders or real estate professionals, they are unlikely to be referred to homeownership education and counseling. While consumers may benefit from acquiring more information, real estate brokers seeking a sale are reluctant to slow down the process by referring a customer to an external service. Lenders may refer a customer seeking pre-approval for a loan to counseling, but once a loan applicant has signed a purchase contract lenders are unlikely to refer a customer to an external counselor unless they have problems qualifying for a loan. (Customers referred for credit problems or subsidy are discussed in Sections 2.4 and 2.6.) On the rare occasion when a consumer is referred by a real estate agent or lender, the consumer is likely to have an obvious information deficit. The lender or agent makes a determination that the nonprofit provider can provide education or counseling more efficiently than they can in-house. Additionally, they must trust that the nonprofit will not steer the customer to another firm or discourage them from buying a home at all.

In general, consumers in the "student" category are more apt to learn about the process through informal ways: personal experience, friends and family, media, and especially the private-sector professionals with whom they are already working.

2.3 Credit Rebuilders: "I Need To Fix My Problems"

Referred by Friends and Family
According to the 2003 Fannie Mae National Housing Survey, "there is still a perceived credit gap, as many minority respondents believe they cannot access the credit needed to a buy a home." Anecdotal evidence from homeownership counselors confirms that credit is a significant barrier — both perceived and real — to individuals pursuing homeownership. Most potential homebuyers are aware of the fact that their credit history affects their ability to qualify for a mortgage or that poor credit will increase the interest rate and fees on the loan. Consumers with impaired credit records are motivated to improve their creditworthiness. While some may recognize their credit problems, others will only seek help after failing to qualify for a mortgage loan at an affordable rate. For those realizing their credit record is a potential problem, friends and family members are a likely referral source for nonprofit programs. Typically, word of mouth from past customers who were helped through such a program generates interest in these credit-rebuilding services.

Delivery Methods
One-on-one counseling could be delivered in person, online or via telephone. Typical services included in credit counseling are budget review, credit education, advice, referrals to social service agencies or other institutions to solve specific problems, and recommendations for specific behavioral changes (Staten, Elliehausen and Lundquist, 2002). Individuals who do not receive counseling can improve their credit ratings informally based on information gained through personal experience, friends and family, private-sector professionals and the media.

Content

Individuals with negative credit ratings need more than knowledge. They need to learn financial management skills and make behavioral changes in their credit management practices. Services typically require a combination of informational classes, skill-building exercises, individual counseling and motivational sessions to maintain and reinforce desired changes in behavior. Because each individual's credit situation is unique, one-on-one counseling is the structured delivery method most important for this target audience.

Alternatives to Nonprofit Providers

Attorneys, credit counseling firms, specialized Web sites, books, financial planners and other entities resources all advertise widely to help consumers raise their credit scores or remove problems from credit records. There are so many firms — public, private and nonprofit — offering to fix credit problems, but with questionable results, that the Federal Trade Commission has issued warnings to consumers. Many of these programs offer low-quality services with little effect for a high fee. In fact, the FTC has found abuses to be so widespread that it is urging consumers to help themselves rather than use formal programs (see www.ftc.gov/bcp/conline/pubs/credit/repair.htm). Because a consumer's goal of buying a home can be hampered by poor credit, credit rebuilders are often referred to homebuyer education programs. Many of those consumers who do not receive counseling will improve their credit ratings simply through the passage of time, as they learn how to avoid late payments and restrain borrowing.

Outcomes

Research shows that counseling can improve individuals' credit ratings. Troubled credit-card debtors in a consumer credit counseling program demonstrated increased credit scores, fewer late payments, decreased credit card balances and less frequent use of credit lines relative to non-counseled borrowers over a three-year period (Staten, Elliehausen and Lundquist, 2002). Programs offering credit repair can track similar measures of program effectiveness, including credit scores before and after counseling services.

2.4 Credit Rebuilders: "I Need Help To Qualify for a Loan"

Referred by Lending or Real Estate Professionals

Individuals with negative credit histories who are referred by private-sector professionals are motivated to participate in homeownership education and counseling to enhance their credit-worthiness in order to qualify for mortgage loans. Since lenders and real estate professionals have recommended these programs to individuals as a means to increase their ability to obtain a loan, individuals may be motivated to participate based on their perception that the program is a "requirement" to secure financing.

While their motivation may not be the same as credit rebuilders referred by friends and family, these consumers are similar in their needs make behavioral changes. Individual counseling, administered in person, online or via telephone is the most appropriate delivery method. The credit counseling services needed for this target audience are the same as for individuals who need to rebuild credit and were referred by friends and family members: budget review, credit education, advice, referrals to social service agencies or other institutions to solve specific problems, and recommendations for specific behavioral changes.

2.5 Subsidy Seekers: "I Have To Do This To Get Something"

Referred by Friends and Family

Money is a powerful incentive. For consumers who lack sufficient income or savings, the only avenue to homeownership in the short term is a grant or subsidized loan provided by a nonprofit program. In an effort to qualify for financial assistance or special loan product, people are very willing to participate in homeownership education and counseling. Research suggests that low-income individuals, in particular, are receptive to financial education when facing an immediate incentive (Jacob, Hudson and Bush, 2000).

Delivery Methods

Consumers interested in loan subsidies first need to learn how to qualify for assistance. But their motivation to participate in education and counseling provides an opportunity to teach general information about the homebuying process. These consumers often also require personalized assessments of their financial situations to ensure that they qualify for the subsidy programs. To the extent that counseling prepares borrowers to make timely payments, agencies making loans can protect their loan portfolios by requiring extensive education and counseling for these customers. One study of mortgages in Freddie Mac's portfolio originated in the early and mid-1990s found 90-day delinquency rates 19 percent lower for counseled borrowers compared to noncounseled borrowers (Hirad and Zorn, 2001). A combination of group education and individual counseling benefit both the lender and individuals interested in subsidies. The loan subsidies serve as useful incentives for getting individuals to participate in comprehensive homeownership education and counseling programs, particularly if completion of such a program is a requirement to obtain the subsidy. Group education about the homebuying process using the loan subsidy program can be delivered via face-to-face courses, Internet or computer education programs, video or Web conferencing, videos or DVDs, and self-study programs depending on learners' preferences. One-on-one financial counseling can be delivered in person, online or via telephone

Outcomes

From the perspective of a potential homebuyer, a successful outcome would be obtaining the loan subsidy. This could be measured through loan application and approval rates. From the perspective of an agency offering subsidies, a successful outcome would be to ration subsidies to the consumers most in need and to provide a sufficient amount of funding to each customer. For lenders, mortgage portfolio performance should improve enough to more than cover the costs of providing counseling.

2.6 Subsidy Seekers: "I Have To Do This To Finish the Deal"

Referred by Real Estate or Lending Professionals

Individuals who are referred by private-sector professionals to qualify for a mortgage loan subsidy or special loan product are motivated to participate in homeownership education and counseling as a requirement to obtain financial assistance. Because these individuals have already made the decision to buy, they have a financial incentive in the subsidy, and/or they could not afford to buy the homes without assistance, this target audience is the most motivated group to attend homeownership education and counseling.

Delivery Methods

As with individuals who are referred by friends and family members for loan subsidies, a combination of general education and one-on-one counseling meets the needs of this consumer category's needs. Delivery methods for education about the homebuying process and financing specifics include face-to-face courses, Internet or computer education programs, video or Web conferencing, videos or DVDs, and self-study programs, depending on learners' preferences. Financial counseling can be delivered in person, online or via telephone. Most of these consumers will be in the middle of the purchase process; many will even have signed purchase contracts. Information on how to shop for a home and location are unlikely to be relevant to these consumers. Individuals may still be able to purchase homes without subsidies and the required homeownership education and counseling if they can find alternative financing.

3.0 Analysis of Homebuyer Service Delivery Methods

> **Defining Education vs. Counseling**
>
> **Homebuyer education**
> - Buyer readiness
> - Money management
> - Credit
> - Financing a home
> - Shopping for a home
> - Maintaining a home and finances
>
> **Counseling sessions** (if needed)
> - Budget review
> - Credit education
> - Advice
> - Referrals to social service agencies or other institutions to solve specific problems
> - Recommendations for specific behavioral changes

Homebuyer education and training programs traditionally have been provided seminar style, using a predeveloped curriculum. This is an efficient method of delivering information, familiar to anyone who has been a student in a classroom setting. As shown in table 2, below, face-to-face courses, seminars, workshops and other classroom-style group education provide a number of benefits. Participants can gain insights from interactions with each other, as well as from the instructor. Face-to-face sessions also allow for a variety of learning activities, including audio and visual demonstrations and interactive applications of concepts. But this method presents costs to the nonprofit provider and the participants. For agencies, there are significant fixed costs to providing a program, including hiring trainers, developing curricula, renting a classroom and registering students. There are also variable costs, such materials and refreshments. Low-volume programs have fewer students over which to spread fixed costs, but at a larger scale group classes can efficiently provide education at a lower cost per participant. The result is that organizations have an incentive to attract larger numbers of participants for each session, and to cancel sessions with low attendance. Most nonprofit programs require participants to pay a small fee to attend a homebuyer class, with financial support from partners and the remainder solicited from foundations. But beyond the monetary costs, participants have to make time to travel to and attend the session. There is also a cost for participants if they have to wait to attend the class. If they want to start house-hunting next weekend, but cannot take the class for three weeks, that delay has a cost. Thus there is a conflict between some participants who want a session conveniently and quickly, versus agencies which want to offer a course only when enough participants can be recruited to be cost-effective.

Internet or computer-based programs overcome the problem of consumers having to wait for service delivery. As long as a computer is available, education can be provided. Instruction can be customized to the needs of the learner, and interactive tools can be used. Computers also permit testing and evaluation so that concepts or terms that are not understood can be repeated. But developing computer-based education capacity involves very expensive fixed costs (although the cost of additional users is quite low). At very large scales, computer-based training can be very cost-effective. Participants must have time to devote to the training and must have access to a computer and the Internet.

Videoconferencing through phone lines or the Internet offers a combination of computer and classroom-based training. Students can interact with a trainer, much like in a classroom. But this approach has the high fixed costs of classroom and computer-based education, as well as reduced flexibility in terms of timing. Participants have to make time for the course and have access to a videoconferencing facility.

DVDs and videos are a form of one-way training. Unlike classroom, computer or videoconferencing, videos are not interactive. What this method loses in interactivity it gains in the ability to be engaging. Footage of classroom training is one format, but videos can also provide documentary-style information, including images of homes and documents, and interviews with experts. Production costs can be steep, but the cost per copy of the DVD or video is low. The cost for participants includes making time to watch, even passively, the video. Access to a VCR or DVD player is also required. Video-based training is convenient and can be delivered within hours of information being needed. Existing videos on homebuying are typically developed by private-sector entrepreneurs and sold at a profit.

The final method of delivery is a workbook or textbook. Again, this is a one-way, passive form of learning. But it can provide highly flexible information in a convenient form. The cost of a text per copy is generally low, although the development of books incurs high fixed costs. Books on homebuying are typically developed by private-sector entrepreneurs and sold at a profit, although many lenders and real estate professionals provide copies of how-to books at no cost to customers.

Individualized one-on-one counseling can be delivered in an office setting face-to-face, online through e-mail and instant messaging, and via the telephone. All three methods involve dialogue between the counselor and the consumer. The cost to the agency providing services is similar in all three cases, provided a computer and phone are available. Online and telephone delivery allow for reduced transition time between clients, and provide the ability to handle more cases per day. But the Internet and telephone impede nonverbal communication, and also hamper review of documents. Participants have to make time for one-on-one sessions. In an office setting, they have to make time to schedule an appointment and get to the office. The Internet and telephone provide more on-demand–style services, but consumers need to have a computer or telephone.

Table 2: Costs and Benefits of Delivery Methods for Education and Counseling

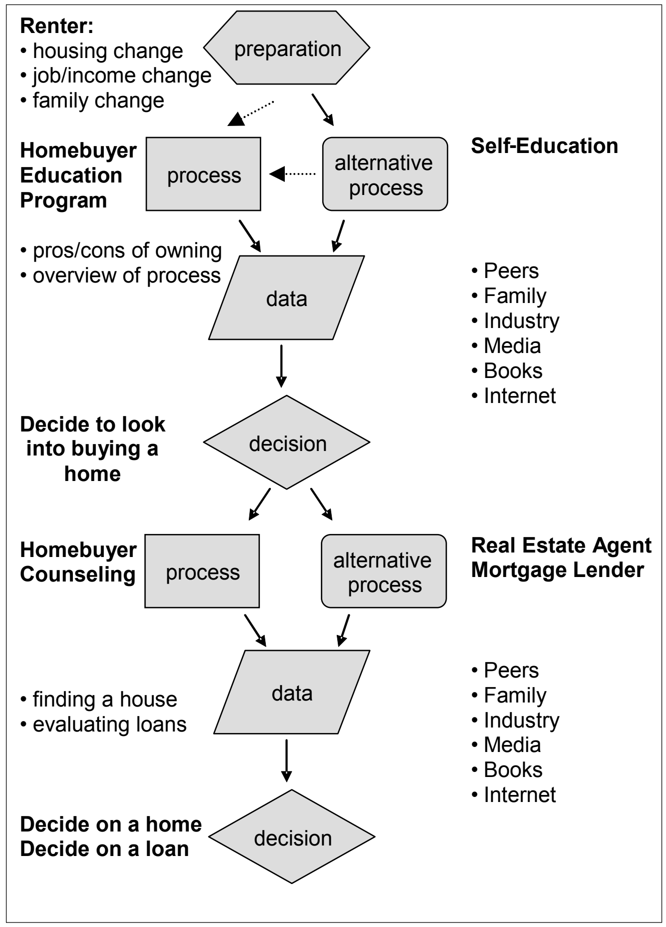
Delivery Method	Benefits	Costs To Agency	Costs To Participants
Education			
Face-to-face courses	▪ Group interaction ▪ Visual demonstrations ▪ "Hands-on" activities ▪ Variety of training methods	▪ Qualified trainers ▪ Space ▪ Refreshments ▪ Training materials and AV equipment	▪ Time to attend ▪ Transportation/travel ▪ Have to wait for next available class
Internet or computer	▪ "On demand" access ▪ Visual demonstrations ▪ Customized activities ▪ Automated testing	▪ Acquisition or development of online course or computer program	▪ Time ▪ Computers with Internet access
Video- or Web conferencing	▪ Group interaction ▪ Visual demonstrations	▪ Qualified trainers ▪ Videoconferencing equipment ▪ Conferencing technology and network	▪ Time ▪ Access to video-conferencing ▪ Have to wait for next available session
Videos or DVDs	▪ "On demand" access ▪ Visual demonstrations	▪ Acquisition or development of videos or DVDs	▪ Time ▪ TV/VCR or DVD player
Self-study	▪ "On demand" access	▪ Acquisition or development of self-study manual	▪ Time ▪ Motivation
Counseling			
Face-to-face	▪ Live interaction	▪ Qualified counselors ▪ Confidential office ▪ Credit reports ▪ Client management software	▪ Block of time ▪ Transportation ▪ Waiting for appointment
Online	▪ "On demand" access	▪ Qualified counselors ▪ Online application and high speed Internet	▪ Time ▪ Computer with Internet access
Telephone	▪ "On demand" access	▪ Qualified counselors ▪ High-volume telephone system ▪ Client management software	▪ Time ▪ Telephone

4.0 Service Value Chain

Figure 1 presents a simplified form of two major decisions current renters go through as they move to homeownership. The first is to decide to shift from renting to owning. This decision (represented by the diamond in the flowchart) comes after a preparation and then a process to gather data. For existing renters, the expiration of a lease, desire for a different type of housing, change in employment or income, or household change such as marriage or having children can trigger the process of considering homeownership. Consumers then start a process of gathering information useful to make their decision. For the majority of first-time buyers, this is a self-education process, aided by friends and family, the media, industry publications and privately provided books and Web sites.

In most cases, it is the referral from these sources that steers a consumer into a formal homebuyer education program provided by a nonprofit organization. Of course some consumers may enter directly into the program due to direct outreach and marketing. But anecdotally, most nonprofit providers suggest that marketing efforts tend to leverage existing word-of-mouth referrals.

Figure 1: Homebuyer Value Chain



Regardless of the process, consumers gather varying levels of data regarding the appropriateness of homeownership. This may take a few hours or months. Some consumers may feel they need more information to make a decision, while others are willing to make a decision quickly based on scant data.

Once the decision to buy a home is made, consumers opt to either work with a nonprofit to receive counseling and guidance as they select a real estate agent, home, and mortgage loan, or do these activities on their own. In some cases, as described in Section 2.2, industry professionals refer a customer to a nonprofit program, but this is rare in cases of creditworthy borrowers with no need for subsidies.

The data collected at this last stage is the most critical. Lenders and real estate agents benefit from customers having enough information to make for an efficient transaction. But consumers are better off if they have different kinds of information. Armed with data and questions from an objective third party such as a nonprofit, consumers can negotiate lower prices for their home and their mortgage, avoid junk fees and generally better protect their interests. Unscrupulous agents and lenders prefer that their customers do not have this level of information.

5.0 Implications: Matching Delivery Methods to Customer Types

There are several question nonprofit homebuyer programs should consider:

- How does our formal homebuyer education process compete with other options for consumers?
- Are the benefits to consumers clear? Do they outweigh the costs for consumers?
- Which customers do we lose by using a one-size-fits-all approach? What are the costs and benefits of customizing programs to attract more consumer market segments?

- Why should we concede services to private, profit-motivated providers, or even to do-it-yourself programs?

Table 4 provides one example of how the consumer segmentation model introduced in Section 2 can be applied to delivering homebuyer services. For some consumer markets, the most common form of nonprofit-provided service — a group homebuyer education course — may not be an ideal format. Self-study or technology-based methods may be more efficient and effective. Likewise, for some consumer markets, especially those under time pressure, telephone and Internet counseling may be preferred to office-based counseling.

Table 4: Analyzing Consumer Segments and Service Approaches

✓✓✓✓ = Most Appropriate		Face-to-face courses	Internet or computer	Video/ Web conference	Videos or DVDs	Self-study	Face-to-face counseling	Online counseling	Telephone counseling
Student	"I Need To Know What I'm Doing"	✓	✓✓	✓	✓✓	✓✓			
Student	"My Agent Told Me I Need To Learn This"	✓	✓✓	✓	✓✓✓	✓✓✓			
Credit Rebuilder	"I Need To Fix My Problems"	✓	✓	✓	✓	✓✓	✓✓✓	✓✓✓	✓✓✓
Credit Rebuilder	"I Cannot Qualify for the Loan"	✓	✓	✓	✓	✓	✓✓✓	✓✓✓✓	✓✓✓✓
Subsidy Seeker	"I Have To Do This To Get Something"	✓✓✓	✓	✓			✓✓✓	✓	✓
Subsidy Seeker	"I Have To Do This To Finish the Deal"	✓✓✓	✓	✓			✓✓✓	✓	✓✓

6.0 The Life Cycle of Financial Literacy

In 1954, Nobel prize–winning economist Franco Modigliani, with Richard Brumberg, suggested the so-called life-cycle hypothesis to explain how and why households create assets. In theory, given rational expectations and perfect information, people will maintain enough savings to smooth consumption over their life cycle (Browning and Lusardi, 1996). In this model, failures of households to accumulate assets would be explained by an underestimation of life expectancy, low perceived probabilities of a crisis, or even the expectation that family, friends and government programs will provide income in a crisis (welfare) or in retirement (social security).

Other research has approached asset-building through the perspective of psychology and behavioral economics. Some consumers cannot exert self-control to restrain their current consumption, even if they highly value the future. Lowenstein and colleagues (2004) suggest that individuals are of "two minds," the rational actor and the affect-driven, impulsive decision-maker. The affect-driven side leads people to always prefer to consume today rather than defer consumption to the future, even when they know they will be better off in the future by saving today. In animal and human studies these behaviors can be shown to lead to almost a complete disregard for the future. Consumers find ways to betray their future selves, by breaking their promises or running up liabilities that offset their assets.

Beverly, Moore and Schreiner (2001) provide a framework with respect to how low-income households accumulate assets. First, households have to decide to reallocate their consumption. For many low-income households, fixed necessities such as food, clothing, housing, utilities and transportation absorb most of their paychecks. People must find ways to reduce the cost of their consumption and reduce their level of consumption altogether. Second, assets need to be converted from liquid forms, such as a checking account, into an illiquid account, which makes spending more difficult. The process of determining how to allocate savings into various types of assets is called "investment." Third, assets need to be maintained over time, which means not only refraining from consuming savings in the current period, but investing in ways that provide a positive risk-adjusted return accounting for inflation. As a result the consumer should have an asset in the future period which exceeds their value of that consumption in the current period.

Of course, an important issue is that any household with financial assets can also borrow. A low-income family with $5,000 in savings but

The Financial Education Life Cycle

Financial Education (Knowledge)
- How to use a bank
- What checks are
- Why save

Money Management (Skills)
- How do I save
- How do I budget
- How do I spend less and save more
- How do I think about the future (discount rates)

Savings
- Setting up an account
- Saving habits — using auto deposit
- Maintaining savings
- Establishing a reserve account
- Converting savings (liquid) into investment (less liquid)

Investing — asset allocation
- Mutual funds
- Stocks
- Bonds
- Retirement accounts: 401ks, IRAs, pensions

Insurance — managing risk
- Life
- Health
- Disability

Borrowing — leveraging assets
- Credit cards
- Consumer debt
- Managing balances

Homebuying and Taking on a Mortgage
- Ready to buy — lifestyle
- How to pick a home — location
- How to pick a loan
- Understanding terms and steps

Asset Management of a Home
- Repair
- Refinance
- Tapping home equity
- Preparing financially for a shortfall
- Dealing with creditors
- Making mortgage payments
- Dealing with default, bankruptcy or foreclosure

Selling Your Home
- Getting a good price
- Finding a new home

Dealing with Loss — divorce, death, disability
- Managing assets, houses
- Getting help
- Expected life span and spending needs

Managing Retirement Savings
- Pre-retirement
- Post-retirement
- Managing funds
- Budgeting and spending
- Expected life span and spending needs

$12,000 in debt may quickly have financial problems if there is a disruption in income. Increasingly households are able to convert illiquid home equity into credit, which can be consumed in the present period (Bi 2003). While this may be a good choice for someone with no precautionary savings, households might rely on home equity to fund current consumption, liquidating their nonfinancial assets and running up large liabilities.

Many asset-building programs are narrowly focused on either low-return savings accounts or highly leveraged investments such as a home or small business. Financial planners typically suggest that clients pursue a balanced approach to their portfolios, with a mixture of savings and high-risk investments (Hensel, 1991). Insurance can play much the same role as an emergency savings account, providing funds to cover expenses when an unexpected life event or crisis occurs. In fact, holding insurance can help preserve assets for households by keeping precautionary savings reserved for only those unexpected expenses not covered. Homeownership and financial literacy programs might consider promoting affordable insurance contracts as part of their program design.

Figure 2: Asset-Building Strategies

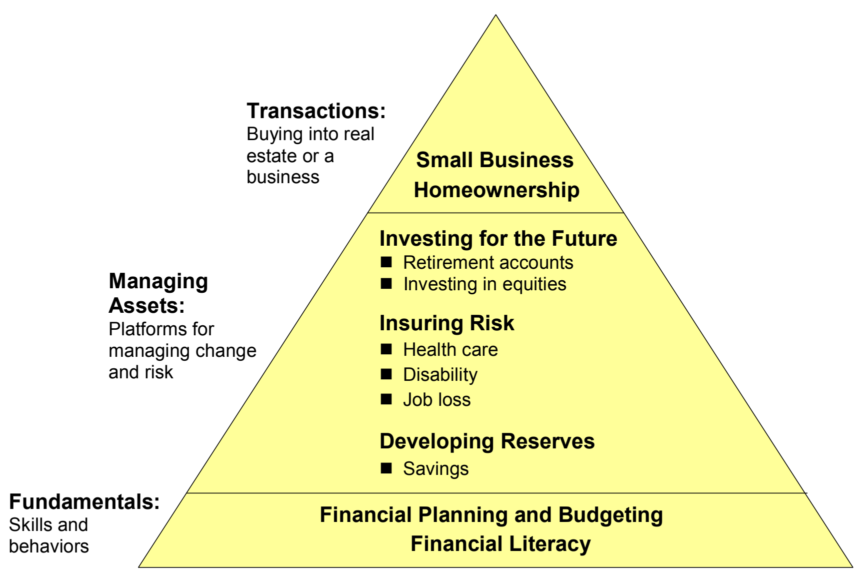


Figure 2 provides an illustrative framework for considering policies to promote assets. The base of the model contains knowledge and financial literacy. Building on that knowledge, consumers learn skills such as budgeting and how to manage their consumption. These are the fundamental components of a consumer's ability to accumulate and maintain assets, which undergird all savings and investment. After acquiring knowledge and skills, households are ready to begin saving, initially as a reserve for emergencies. After establishing a precautionary "rainy day fund," households can begin to take out the appropriate level of insurance policies to protect them from random events which reduce income or incur high expenses. After these building blocks are in place, consumers can begin to save for retirement, allocating their portfolio as is appropriate for their risk tolerance and time horizon. At the peak of the pyramid are the most risky activities — borrowing to purchase a home or start a business. Often consumers in the U.S. seem to approach this model upside down. Hearing peers, the media and industry promote homeownership, or taking advantage of government support for small businesses, some consumers start by taking on highly leveraged assets with no investments, insurance, savings or financial literacy skills. Most quickly work to develop skills in these areas, but some will struggle. When income losses occur, these families are among the first to default on loans or declare bankruptcy.

7.0 Recommendations for Future Research

Many of the concepts introduced in this paper are based on consumer theory and academic evidence. But the best way to understand consumer behavior is to conduct surveys and focus groups with representative individuals. This type of analysis has been rarely employed in the homeownership and mortgage lending fields, however.

One issue worthy of research using these methods is how consumers engage in decisions of financial planning. If, or how, homeownership fits into these decisions is also not well understood, especially for low-income consumers. A better understanding of consumer attitudes and motivations is needed to better craft programs promoting homeownership as an asset-building strategy.

There is emerging evidence that restrictions are helpful to some consumers to prevent them from behaving contrarily to their future self-interest. Layering in how consumers manage their assets and incur liabilities complicates the dimensions required to regulate behavior. More research is needed on ways to successfully merge education with welfare-enhancing prohibitions. For example, pre-payment penalties, often derided as unfair to borrowers, may actually help some consumers to provide restrictions which curtail their spending and borrowing behavior.

A broader understanding of how consumers learn and make decisions is needed, and precious "teachable moments" need to be identified. The role of homeownership as an important teachable moment in the financial education life cycle needs to be better articulated. Ultimately the effectiveness of various approaches to increase knowledge and change behavior also need more through evaluation.

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