Counseling and Education for Home Owners

Introduction

Given the events of the late 2000s, when homeownership rates rose to historic records followed by record numbers of people losing their homes to foreclosure, there has been increasing interest in homeownership education and counseling. This brief summarizes the current literature in this field. Throughout this brief, peer-reviewed research is noted as such.

Pre-purchase Homeownership Counseling

As of mid-2010, there were seven evaluations that analyzed pre-purchase homeownership counseling. All the studies reviewed associate pre-purchase homeownership counseling to positive outcomes for mortgage borrowers. Three studies specifically evaluated one-on-one counseling alone, one study analyzed classroom *and* one-on-one services, and then two studies analyzed counseling delivered via four common channels: one-on-one, telephone, home study, and classroom.

Evaluations that Measure Loan Outcomes

Six of the pre-purchase studies we identified evaluated whether pre-purchase counseling affects loan outcomes. The earliest of these studies is Hirad and Zorn's (2002) chapter on pre-purchase counseling. Their quasi-experimental evaluation analyzed pre-purchase counseling's impact on 90-day delinquency rates. Their dataset was comprised of nearly 40,000 loans under Freddie Mac's Affordable Gold program. The dataset allowed them to compare a non-randomized comparison group to borrowers who completed four modes of counseling: in-person, classroom, home-study, and telephone. Face-to-face counseling was associated with a 34% reduction in 90-day delinquency rates, while classroom and home-study counseling were associated with 26% and 21% reductions, respectively. Telephone counseling had no effect on 90-day delinquency rates. When selection and assignment processes are modeled, however, only classroom counseling led to a statistically significant decline in 90-day delinquency rates. This suggests that borrowers who enroll into counseling may have positive characteristics (motivation, attitude, social networks etc) that are not observed in other data. Hirad and Zorn note that the results are not definitive because the data did not come from a randomized experiment. Furthermore, the data were collected between 1993 and 1998, so the results may not be generalizable to the contemporary mortgage market. Nonetheless, the findings are supportive of the efficacy of classroom counseling, but the analysis of telephone and one-to-one counseling is muddled due to selection and assignment processes. It is notable that this study has yet to be published in a peer-reviewed journal.

In a pair of related peer-reviewed articles, Hartarska and Gonzalez-Vega (2005, 2006) evaluated a pre-purchase mortgage loan program that spanned several states in the Midwest. The loan program offered mortgages to low-income individuals and required that participants meet with a financial counselor. Hartarska and Gonzalez-Vega's 2005 study, which analyzed the performance of 919 loans, shows a small increase in prepayment and a decrease in mortgage default relative to a non-random comparison group. Prepayment generally entails refinancing for a lower rate, which could be viewed as a positive outcome. The 2006 study, with a sample of 233 loans, confirms the earlier findings for default, as counseled borrowers had a default rate that was significantly lower than non-counseled borrowers. Both of these quasi-experiments model selection processes. The 2006 study's sample size of 233, with 127 counseled borrowers, could be viewed as small for a selection model. Given the nature of these

specialized loan products, the measured effects could be due to loan terms rather than to counseling. There could also be more serious unobserved selection effects given the financial circumstances of borrowers who enrolled in the program relative to non-participating borrowers.
Quercia and Spader's (2008) peer-reviewed journal article analyzed pre-purchase homeownership education and counseling services delivered by providers across 42 states. This study examined a unique secondary market loan purchase program. Of the 2,688 mortgage borrowers in the dataset, 1,155 received pre-purchase counseling. Loan performance was measured for at least 21 months and up to 79 months. The authors evaluate counseling's impact on prepayment and default across four modes of counseling delivery: classroom, individual, home-study, and telephone. The authors find that no form of counseling affects borrowers' propensity to default. Based on a competing risks model, both classroom and individual counseling increased prepayment by 3 percentage points to 56%, about a 6% marginal effect. Since the mode of counseling was not randomly assigned, the potential for selection bias remains. The authors tested for selection, but do not explicitly model it. Due to the historically low interest rates and the booming housing market during the study period, the results may not be replicable in other market contexts.

Agarwal et al. (2009a) analyzed an Illinois pilot program that required high-risk mortgage borrowers in 10 targeted zip codes to attend pre-purchase counseling within 10 days of filing a mortgage application. Counseling was mandatory for borrowers whose credit scores were sufficiently low or whose mortgage application choices included factors legislators had identified as high-risk. Agarwal et al. used borrowers from zip codes with similar demographics as a matched comparison group, measuring loan default status one-year after loan origination. Counseling was delivered by HUD-accredited agencies and lasted one to two hours. Counseling was associated with about a 30% decrease in default. The authors conclude that this result is primarily due to lenders' responses to increased oversight, including changes in their screening procedures, and to a lesser extent counseled applicants renegotiating their mortgage terms. Some borrowers chose less risky mortgages to avoid counseling.

In addition to their study of mandated counseling, Agarwal et al. (2009b) recently evaluated a voluntary pre-purchase counseling program provided by a nonprofit organization. Clients (n=359) attended an introductory class about money management, participated in one-on-one counseling sessions, and completed an eight-hour capstone class. Once clients finished the pre-purchase counseling program and became homeowners, the agency reached out to borrowers who fell 15 days behind on their payments and offered post-purchase counseling when loans were deemed non-performing. The authors conclude that the program significantly decreased default rates. They attribute this finding to the pre-purchase counseling program, the type of mortgage offered to clients, and the proactive post-purchase counseling component.

Evaluation that Measures Self-reported Behavior

One pre-purchase counseling evaluation measured self-reported behavior rather than loan outcomes. Recognizing that loan outcomes are limited measures of the success of pre-purchase counseling, Carswell's (2009) peer-reviewed article presents findings from a survey of 1,720 mortgage borrowers who had participated in nonprofit programs in Philadelphia. This evaluation is notable because the survey was administered five years after counseling. In light of the lengthy follow-up period, the 24% response rate (405 responses) is low yet still quite remarkable. Carswell observes that since long-term improvements in loan outcomes are facilitated by intermediate behavior changes, researchers should devote more attention to measuring changes in financial behavior. Over 72% of respondents reported they had no difficulty paying their mortgages, 85% reported they prioritized mortgage payments over other bills, and 64% reported they had made financial sacrifices since becoming homeowners. Since each client attended one of 26 counseling agencies, Carswell analyzed whether agency characteristics were associated with the outcome measures. This portion of Carswell's analysis yielded few statistically significant findings other than some evidence that borrowers with more financial problems attended more intensive services.

Post-purchase Mortgage Counseling

As of mid-2010, three peer-reviewed journal articles evaluated post-purchase counseling's impact on loan outcomes. Each of these evaluations used a quasi-experimental research design. Two evaluations utilized exposure modeling, and one evaluation employed a selection model. One study analyzed face-to-face counseling, one study analyzed telephone counseling, and one study analyzed counseling delivered face-to-face and via the telephone. Each of the three studies concluded that post-purchase counseling improves mortgage outcomes.

While several studies about post-purchase homeownership counseling were published from 1970 to 1980, these studies are outdated and are generally unconvincing (Quercia and Wachter 1996; Hirad and Zorn 2002). Of the more recent post-purchase counseling evaluations, the earliest peer-reviewed study we identified was published by Collins (2007). The dataset includes a small sample of 299 clients who received face-to-face and/or telephone-based counseling. The author consulted public records to determine foreclosure outcomes six to nine months after counseling. Because the number of hours in counseling could be endogenous with loan outcomes, the author constructed an instrumental variable using the number of marketing materials the city used to promote counseling in each zip code. This instrument proved a correlation with the number of hours in counseling, but not with individual foreclosures. Each additional hour of counseling reduced the probability of negative foreclosure outcomes by 3.5%. This study examines counseling that was delivered in a crisis context, a time when clients may have received other services that impact foreclosure rates, making the impact of counseling difficult to disentangle. The use of an instrumental variable illustrates one useful approach for estimating causality, however.

Ding, Quercia, and Ratcliffe's (2008) peer-reviewed article evaluated post-purchase counseling delivered via telephone. The authors used the same dataset as Quercia and Spader (2008), but this subset included 1,689 borrowers, of whom 924 received default counseling. The counseling referrals were proactive; borrowers who were 45-days delinquent were contacted through the mail and by telephone. The program's level of contact with borrowers ranged from no contact to a one-hour session, with 350 borrowers receiving services. The odds of curing the defaulted loan (that is getting caught up on payments) were 50% higher for borrowers who received counseling than for non-counseled borrowers. This is an unusual research design, since counseling was offered to borrowers directly and in response to late payments. The potential for selection bias is significant due to the high number of borrowers who were unreachable. The variables used to model which borrowers responded to the counseling offer are likely related to the outcome of curing the loan.

The final peer-reviewed article on post-purchase counseling was published by Quercia and Cowan (2008), who examine the Mortgage Foreclosure Prevention Program (MFPP) in Minneapolis. The MFPP provides case management, post-purchase counseling, and/or assistance loans. The dataset included 4,274 households that received intensive services. For each additional hour the program spent on a client's case, the client's odds of avoiding foreclosure increased by 10%. Given that the program's effects were cumulative, spending eight additional hours on a case more than doubled a client's odds of avoiding foreclosure. Homeowners who received budget/credit counseling were twice as likely to avoid foreclosure than those who did not. However, this study did not control for selection by number of hours, nor did the authors examine the mode of delivery or address attrition.

In addition to these three peer-reviewed journal articles on post-purchase counseling, a preliminary evaluation of the National Foreclosure Mitigation Counseling Program (NFMCP) was published in late 2009 (Mayer et al. 2009). Because the findings from this report are preliminary. The early findings indicate that default counseling provided through the NFMCP reduces the number of moderately delinquent (two to three months) borrowers who enter the foreclosure process, increases the rate at which homeowners cure existing foreclosures, and helps borrowers with loan modifications reduce their monthly payments.

Given that troubled borrowers may not fully understand their options for modifying their mortgages, lenders and policymakers have reacted to rising foreclosures by increasing the use of third-party default counseling programs. Collins and Schmeiser (2010) utilized several identification strategies to assess the impact of default counseling on receiving a loan modification and on keeping one's home. They found strong evidence of negative selection into counseling, as borrowers in the most difficult predicaments were most likely to participate in default counseling. However, once negative selection is controlled for in their models, counseling is consistently linked to an increase in the probability that borrowers will receive a modification. In contrast, they found mixed evidence on the effectiveness of counseling in terms of reducing the probability that borrowers will lose their homes to foreclosure; however, among borrowers who received a loan modification, counseled borrowers were less likely to subsequently default. Collins and Schmeiser concluded that the timing of default counseling is an important determinant of loan outcomes. Borrowers who receive counseling in the early stages of default are far more likely to receive a modification and/or keep their homes than those who receive counseling when they are seriously delinquent.

Conclusions

Like many domains within financial literacy research, homeownership education and counseling have never been rigorously evaluated through a randomized field experiment. It is notable that the Housing & Economic Recovery Act of 2008 mandated an evaluation of pre-purchase education. Abt Associates has released reports describing the housing counseling industry, but the field evaluation has yet to begin. Given current non-experimental evidence, a few findings are evident:

1. ***Homeownership Education and Counseling are Highly Varied.*** This makes generalizing about this field challenging. Even among pre-purchase counseling programs, there are a wide array of approaches and models.
2. ***Selection into Services is Important.*** The most motivated borrowers appear to be the most willing to attend pre-purchase sessions; the most distressed borrowers are most likely to attend post-purchase counseling.
3. ***The Timing of Service Delivery is Important.*** The offer of counseling or education needs to be well timed in relation to purchase and financing decisions. In terms of post-purchase counseling, the earlier counseling is provided the better the client's odds of recovery.
4. ***Loan Outcomes are not the Only Outcomes of Interest.*** Many studies use loan outcomes because they are readily available in loan data—but other decisions, including the choice not to buy a home, may be as important to observe.
5. ***Education and Counseling Seem to Have Modest Effects Overall but Large Benefits Relative to Costs.*** The data do not suggest counseling or education have overwhelmingly large impacts on borrower behavior. However, the effects are generally positive. Given the very high personal and social costs of foreclosure, in many cases the relatively low costs of services may be justified.

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