

Research Policy Brief

Family Economics Research Coordinating Committee (NCCC052)

Financial Counseling for Borrowers in Mortgage Default

The issue. In 2005, nearly 900,000 properties were in stages of the mortgage default process in the U.S.; by 2009 that number has more than doubled. Mortgage defaults are concentrated in the higher-risk subprime market, a market that more than doubled in the past decade. Because growing numbers of borrowers are losing their homes to foreclosure, the social costs and benefits of expanding mortgage lending deserve closer scrutiny. Of concern to consumer advocates is the concentration of troubled loans, and therefore foreclosures, among lower-income and minority households. Policymakers have proposed various strategies to mitigate the harms of foreclosure, including default counseling. This paper analyzes the effects of counseling provided to borrowers in mortgage default.

Research findings. More time in counseling results in more positive perceptions of counseling. This result is found even when using marketing and outreach efforts to instrument for counseling time or number of sessions; this provides an indication of an effect beyond just that people in more trouble sought more help. There is little evidence of differences in the mode of counseling delivery when comparing telephone and in-person services. However, face-to-face counseling is used more frequently and rated more highly among low-income borrowers than telephone counseling before controlling for counseling duration and the severity of the borrower's situation. The two modes appear to serve complementary roles for some borrowers, especially those with multiple problems, and both modes are rated highly by some respondents. Although the sample is small and the time period is limited, there is evidence that additional counseling reduces the probability of a negative foreclosure outcome. The results remain preliminary based on the limited follow-up period and relatively low statistical significance, but promising. The average client received about 2 hours of counseling; on average this amount of counseling is associated with about a 7% reduction in worsened foreclosure status.

Policy conclusions. This study suggests default counseling is an effective strategy for borrowers in distress, although the duration and to a lesser extent the mode of delivery are important considerations when designing a program. These results are instructive for housing counseling provided by the U.S. Department of Housing and Urban Development and for mortgages backed by FHA or other government agencies insuring against the costs of foreclosure. A well-designed default counseling program has the potential to improve the repayment behavior of borrowers in distress. Lenders and policymakers should examine default counseling services to ensure that counseling is provided for a sufficient duration to each borrower regardless of mode, and offer a variety of formats of services. Since many borrowers reported physical and emotional distress, counseling programs, lenders and public programs should carefully consider the role of stressors in preventing borrowers from seeking help and cooperating with counseling in order to achieve fuller benefits of services.

By J. Michael Collins (University of Wisconsin-Madison).

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The NCCC052 committee, functioning under the National Agricultural Experiment Station System, facilitates collaboration among family economics researchers nationally and internationally. The committee provides a forum to examine research methodology and family economic issues in depth from a multidisciplinary perspective. The committee fosters development of research related to the economic well-being of individuals and families that is of interest to multiple institutions across the nation. For more information, see <http://nimss.umd.edu/homepages/home.cfm?trackID=7036>