

Community Advantage Program

Does Homeownership Education and Counseling affect
the Prepayment and Default Behavior of Affordable
Mortgage Borrowers?

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Center for Community Capital
*Research and analysis on the
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Assumed Risks of Affordable Loans

- Limited liquidity
 - Secondary market is less likely to purchase
- Higher default/foreclosure rates
 - Borrowers and/or loans are more risky
- Lower prepayment risks
 - Borrowers are less likely to prepay because of limited borrowing opportunities
 - Believe to compensate for higher default risks

Homeownership Education and Counseling

- Believe to reduce risks in affordable lending
- Prepare homebuyers for homeownership
 - Homebuying process
 - Financial literacy (how to avoid predatory lenders)
 - Get potential borrowers mortgage ready
- Education & Counseling (HEC)
- Pre-purchase & Post-purchase

Pre-purchase HEC Affects Many Borrowers

- 800,000 borrowers completed HEC in 2004
- HUD funding for HEC continues to rise:
 - \$18 million in 1999
 - \$50 million in 2007
- GSE requirements:
 - Fannie Mae implemented requirements in 1993
 - Requirements abolished in 2006

Little is Known About HEC Effectiveness

- Classroom-based counseling reduces default.
(Hirad and Zorn 2001)
- Individual counseling increases prepayment.
(Hartarska and Gonzalez-Vega 2005)
- Individual counseling affects exercise of the default option (Hartarska and Gonzalez-Vega 2005, 2006).

Research Questions

- Does homeownership education and counseling (HEC) affect prepayment and default decisions?
- Does the type of HEC program matter?

Expected HEC Impacts and Hypotheses

- 1) HEC completion increases awareness of prepayment.
 - increases prepayment incidence.

- 2) HEC completion decreases insolvency-related default.
 - decreases default incidence.

- 3) HEC improves borrower understanding of the value of mortgage products and options.
 - increases responsiveness to the value of mortgage options.

Community Advantage Program (CAP)

- Partnership between Self-Help, Fannie Mae, and the Ford Foundation.

- CAP data includes:
 - Demographic characteristics from CAP survey
 - Loan characteristics at origination
 - Loan performance data from Self-Help
 - Updated home value estimates from Fannie Mae

CAP Includes Many HEC Experiences

HEC Type:	Classroom Only	23%
	+ Counseling	29%
	Home Study Only	27%
	+ Telephone	21%
Provider Type:	Bank/Lender	45%
	Government	17%
	Community Org	25%
	DK/Other	13%

Classroom-based HEC is More Intensive

	Number of Hours
Classroom Only	6.8
Counseling (+ Class)	3.0 (7.4)
Home Study Only	2.9
Telephone (+ Study)	0.7 (3.4)

Estimation Equation

- $Y_{ikt} = \alpha_k + HEC_{ik}\beta_k + X_{it}\gamma_k + \Theta(t) + \mu_k + \varepsilon_{ikt}$
 - Beta is the average treatment effect of HEC
 - Theta are quarter of origination dummies
 - The error term is split into random error and unobserved selection factors

Covariates

X = Call Option
Put Option
Home Purchase Price
Income
Age
Education
Marital Status
Number of Children
Number of Adults
Race/Ethnicity

Credit Score Fixed Effects
State Dummies

Estimation Strategy

- 1) Compare classroom/counseling (CLCO) and home study/telephone (STTE) participants to no HEC.
 - Assume covariates capture baseline risk.

- 2) Compare CLCO to STTE.
 - Assume unobserved baseline risk is constant across CLCO and STTE.

Findings

- Classroom-based HEC programs improve borrower prepayment decisions.
- Other HEC program types do not.
- Regardless of type, no evidence links HEC completion to default.

Policy Implications

- Classroom-based HEC is effective and should be required
- Support community based organizations that offer classroom based HEC
- Impact of HEC on prepayment should be considered when evaluating affordable loans