

# Connecting Financial Education to Consumers: Addressing Foreclosures

Networks Financial Institute  
and the  
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J. Michael Collins  
jmcollins@wisc.edu



# Overview

- Changing role of consumers & credit risk
- Industry capacity unprepared for servicing new category of mortgage loans
- Consumer distrust and anxiety present barriers to loan workouts
- Role of consumer counseling in avoiding foreclosure
- Increased demand for information by consumers going forward and the role of disclosure
- Psychological spillovers of foreclosure in neighborhoods

# Changes in the Mortgage Market

## Risk Distribution Shifts: 1995 to 2005

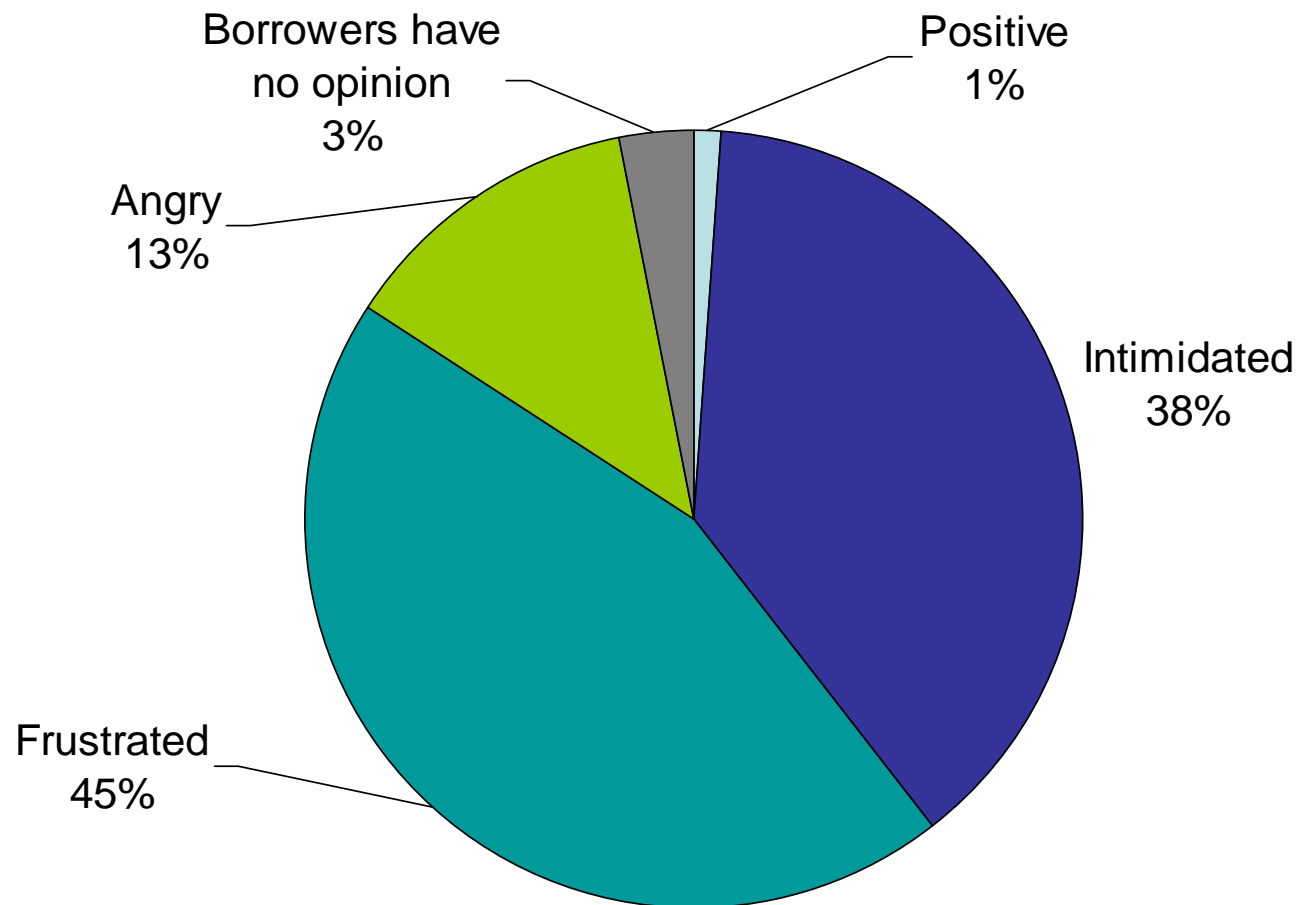
- Decrease in government-backed loans
  - Rapid growth in subprime/nonprime lending by non depository institutions not subject to CRA and generally less regulated
- Decrease in **fixed payment loans** and greater use of **adjustable rate loans**
  - Interest rate risk no longer on lender/investor and now on borrower
- Borrowers with more credit risks are in the market
  - Lowering of credit standards and verification processes
  - Lower downpayments, increasing home values, higher payments relative to income
  - Application of loans products to new groups of consumers with relatively less experience

# Implications of Shifts in Risks

- Consumers have (had) more credit options
  - ‘democratization’ of credit
- For some markets, credit access and real estate appreciation created reinforcing feedback loop
- Financial institutions and mortgage market investors taking on new product types and consumer behavior

# Borrowers View Servicers Poorly

Which best describes how borrowers in default view their lender/servicer, in general?



Source: NHS Chicago, Inc HOPI Meeting October 30, 2007

n=139 counselors representing 85 agencies nationally serving 25,000 consumers collectively in 2007

# Why do borrowers fail to contact their lender when they have trouble making payments?

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<b><u>Don't know</u></b> lenders can provide options	53%
Too depressed/ <b><u>stressed</u></b>	26%
Think they can <b><u>get by</u></b> on their own	12%
Lenders <b><u>mistreat</u></b> them (write in)	10%

Source: NHS Chicago, Inc HOPI Meeting October 30, 2007

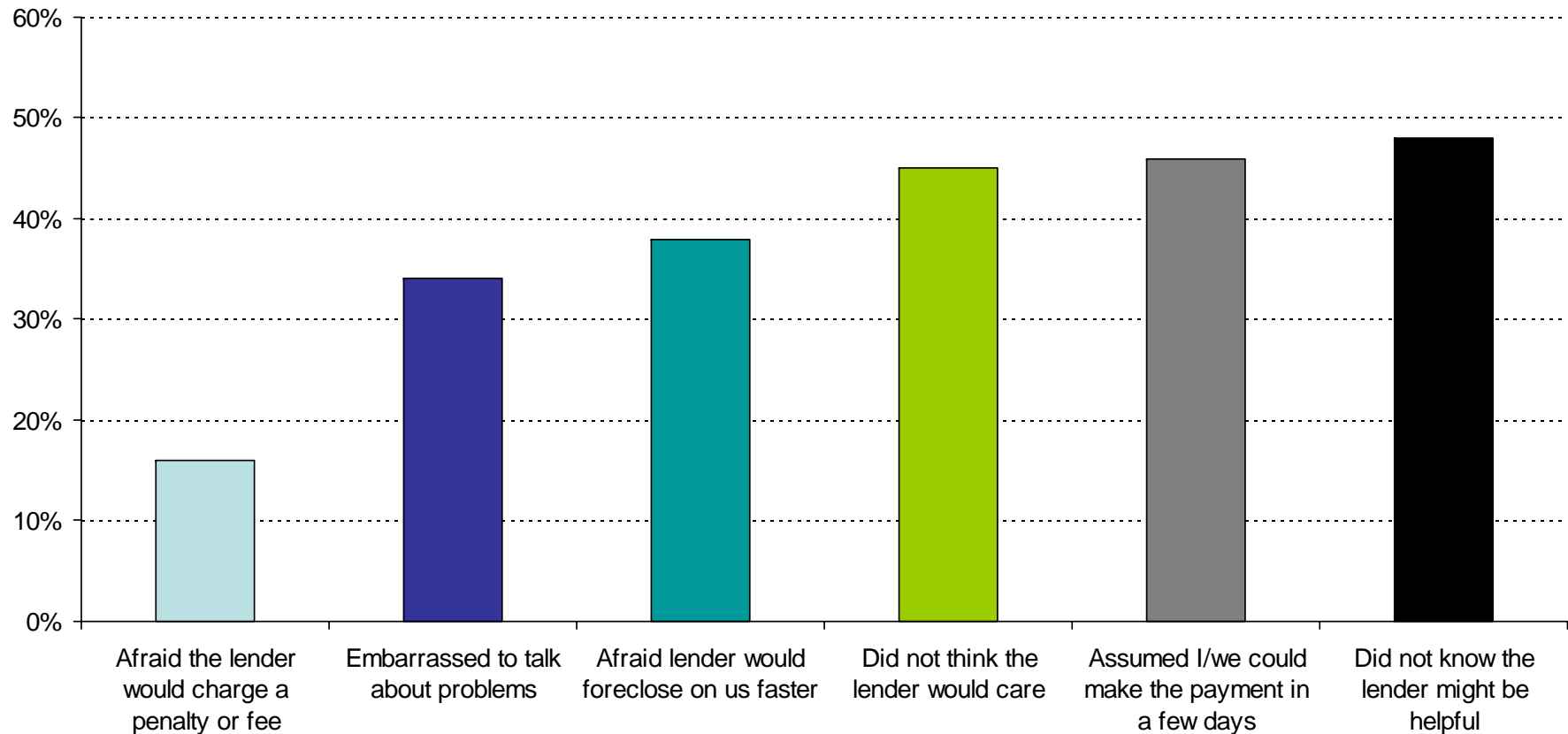
n=139 counselors representing 85 agencies nationally serving 25,000 consumers collectively in 2007

# Borrower Voices:

- **Borrowers are under stress**
  - “I was always week to week. I get paid, I pay my bills. I get paid, I pay my bills. Then the check’s not there. Then you’re in trouble. **I didn’t know which way to turn.** I didn’t know there was help out there.”
- **Borrowers feel little cooperation from their lender**
  - “They make you feel like a **deadbeat**...the way they **interrogate** you, they seem like they want to **catch you in a lie.**”
  - They want us to lose our homes. **They don’t care.**”
- **Borrowers dealing with loss mitigation staff were more favorable about their lender than those working with collections departments**

# Why Did You Not Contact Your Lender?

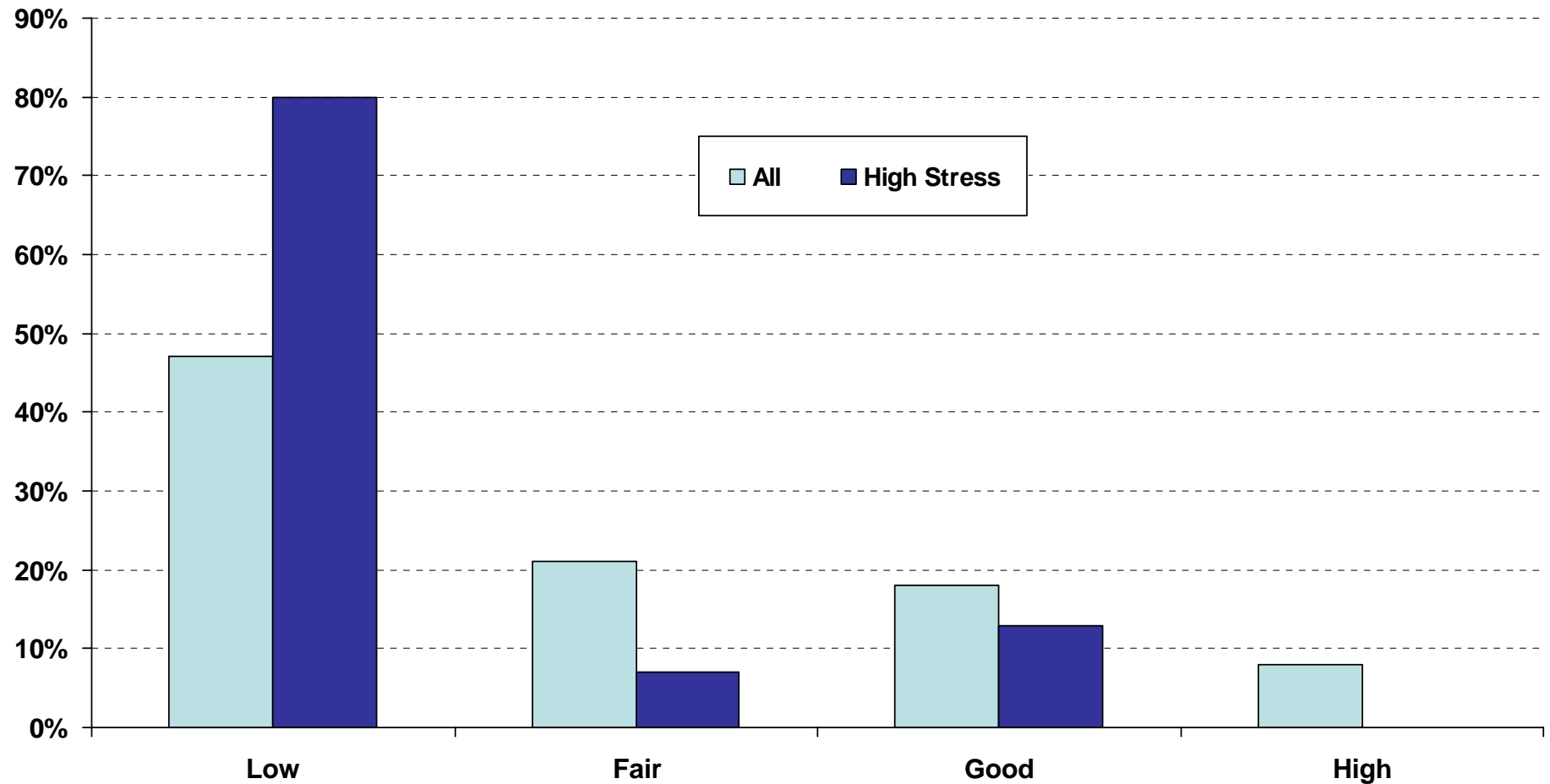
Why did you not contact your lender/servicer?



Source: NHS Chicago Inc, HOPI Mortgage Default Counseling Survey, 2005. n=299 borrowers in default.

# Most Borrowers in Default Have a Low Opinion of their Lender's Willingness to Help Especially those Under Stress

Rate lender's willingness to help (if contacted)



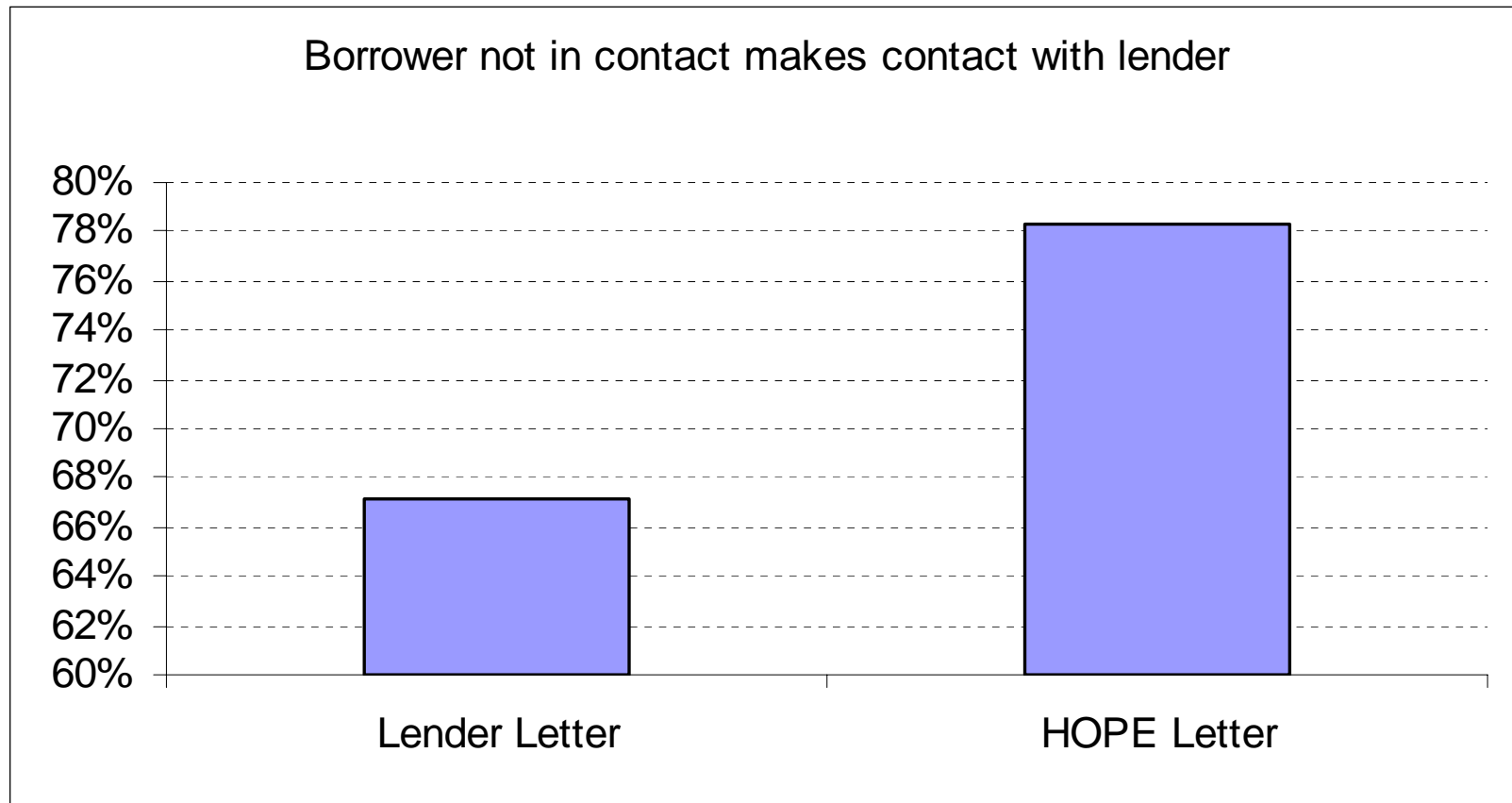
Source: NHS Chicago Inc HOPI Mortgage Default Counseling Survey, 2005. n=299 borrowers in default.

# Nonprofit Counseling Can Help

- Chicago NHS Study
  - 148 consumers in default tracked 6 months after receiving counseling
  - Mix of phone and face-to-face counseling
- Incremental effect of each additional hour of counseling of 4.1% lower probability moving from foreclosure start to completion
  - Mean 2.2 hours of counseling: ~ 9% reduction per client completing average counseling service

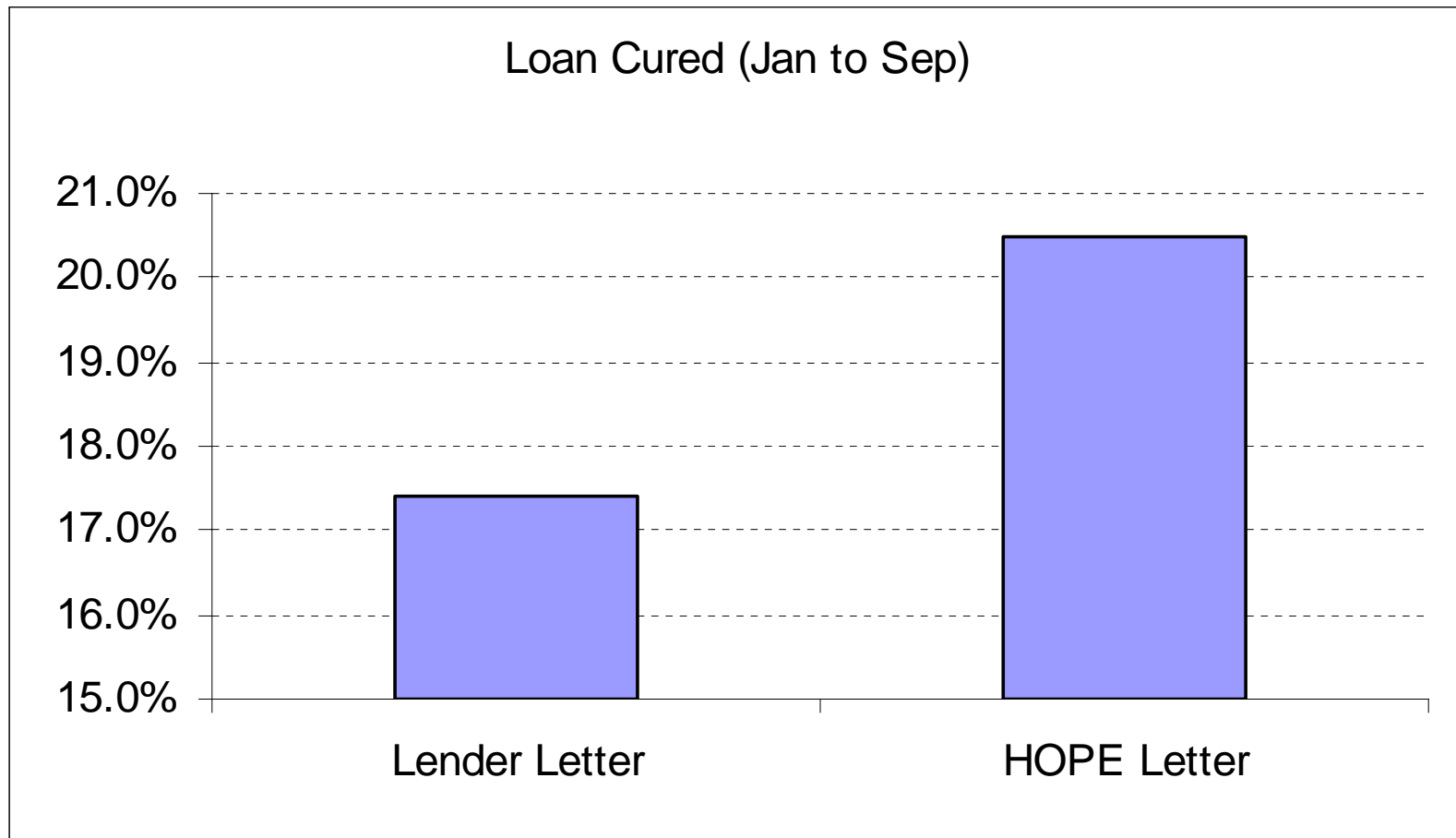
# Experiment: Lender Sends a Letter Offering 3<sup>rd</sup> Party Counseling

Borrowers at least 60 days behind



n=40,671, Letters sent in January 2007 and follow-up in September 2007; 6,995 lender letters; 35,645 HPF letters  
\* significant at 5% controlling for loan type, credit score, loan amount, baseline days delinquent and ARMs

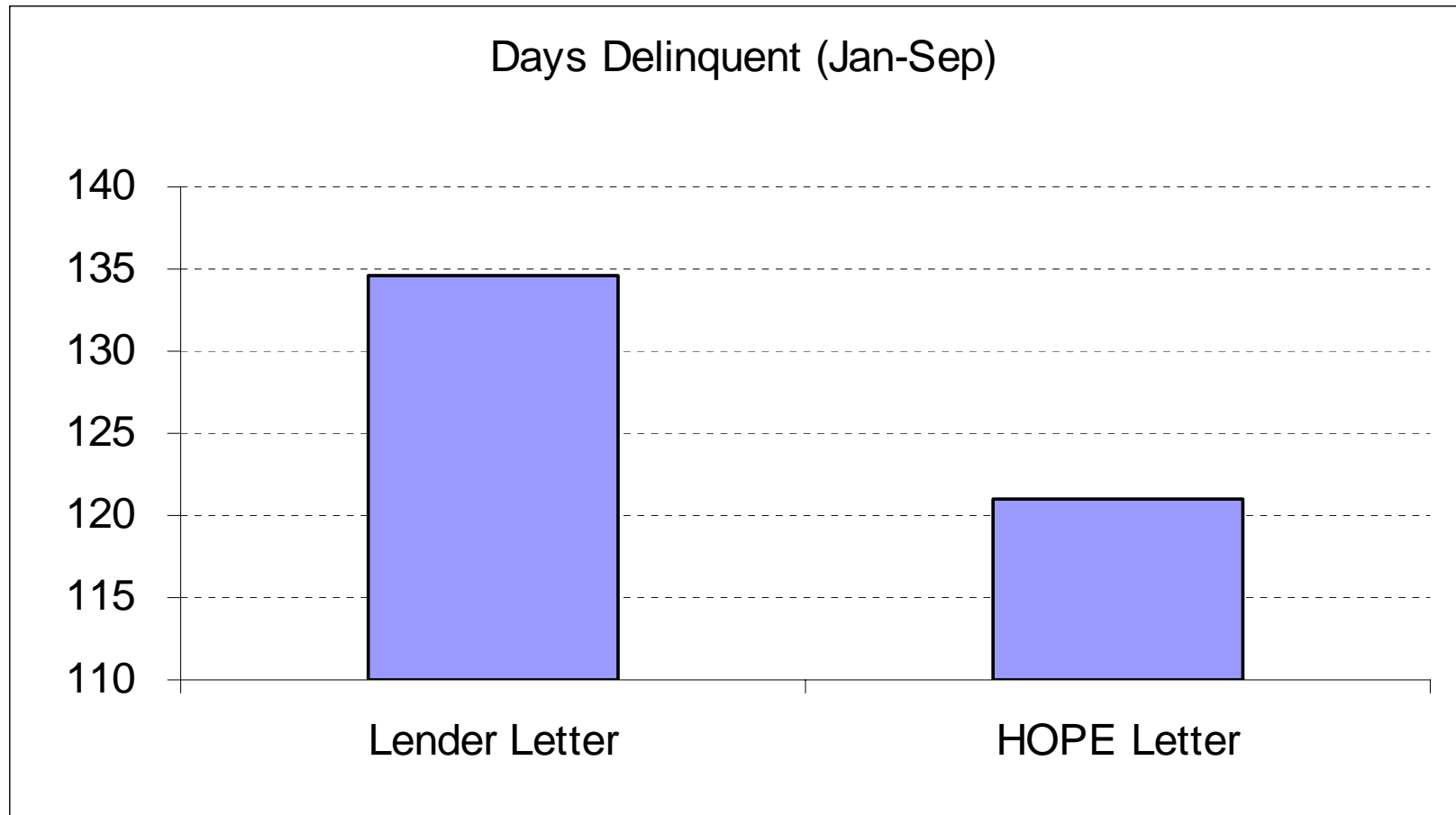
# Effects of Offer of 3<sup>rd</sup> Party Counseling on Default Status of Delinquent Borrowers



\* significant at 5% controlling for loan type, credit score, loan amount, baseline days delinquent and ARMs

# Effects of Offer of 3<sup>rd</sup> Party Counseling on Days Delinquent

Borrowers at least 60 days behind

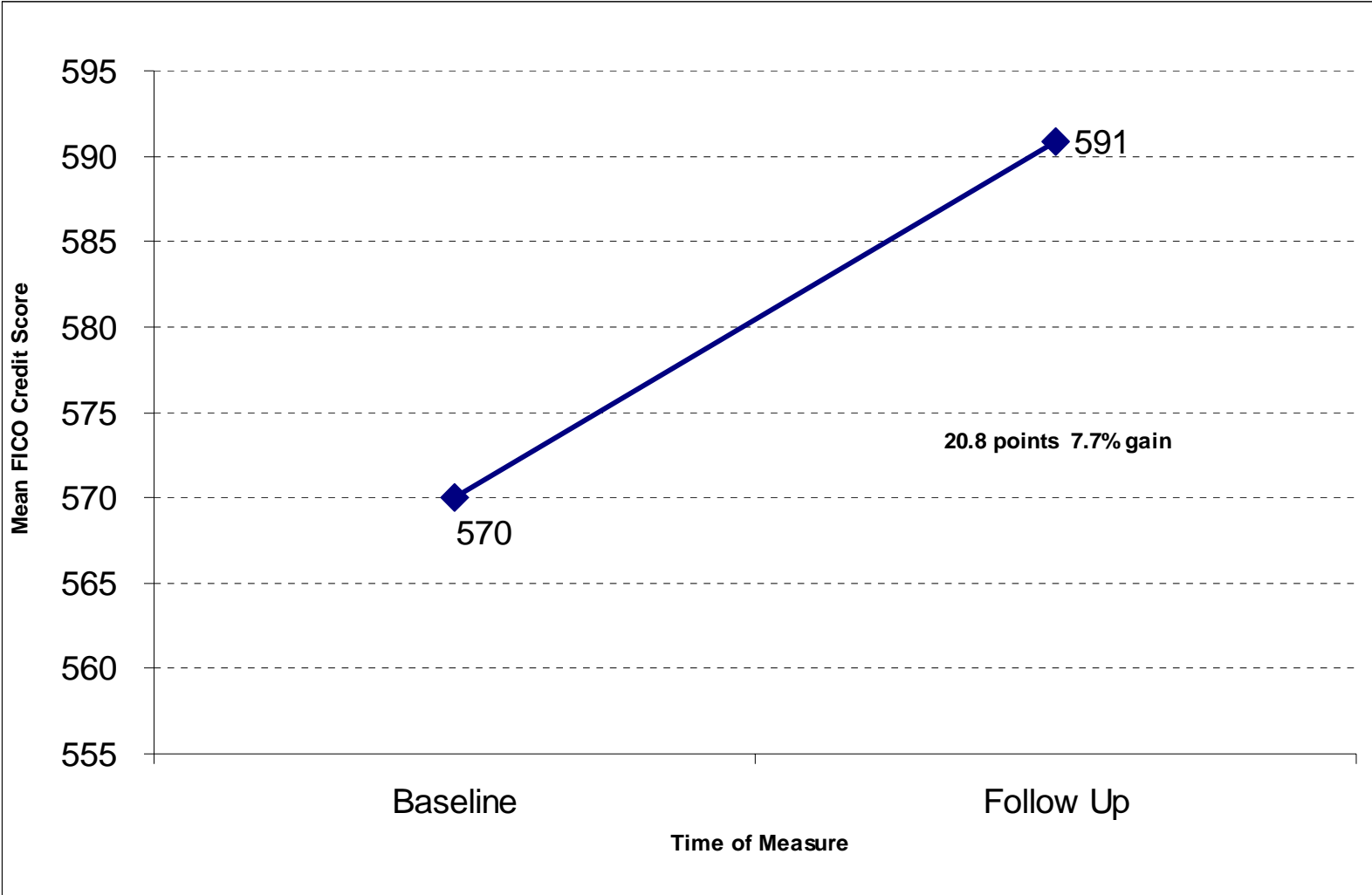


\* significant at 1% controlling for loan type, credit score, loan amount, baseline days delinquent and ARMs

# Information Matters

- Financial Literacy
  - Can provide consumers with tools and knowledge to better manage risk
- Disclosure
  - No panacea, but carefully implemented disclosures can result in consumers re-considering high-cost/high-risk credit

# Experiment: Effects on Credit Scores of Assignment to 4 Financial Literacy Sessions



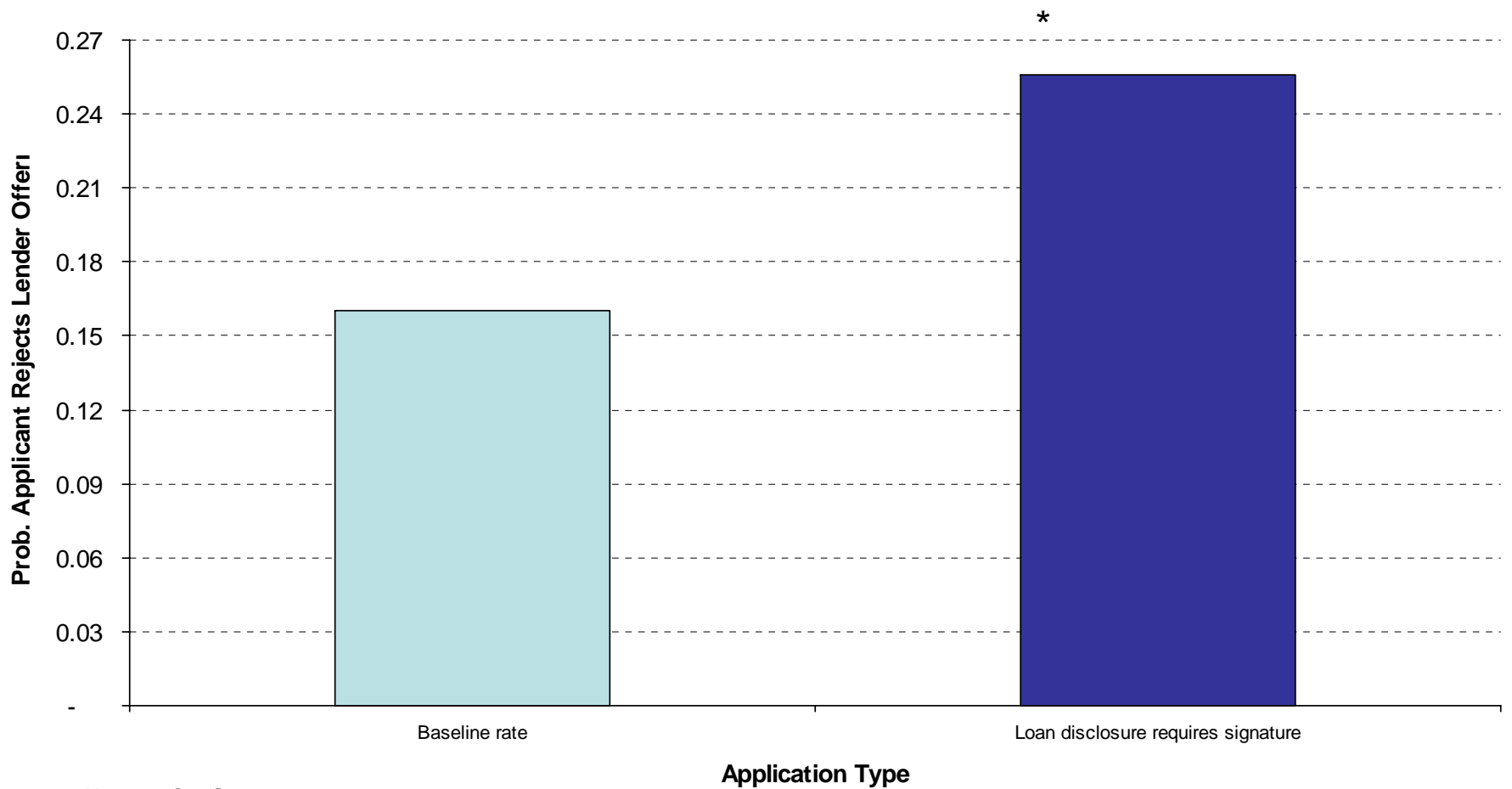
n=144, ½ of Clients randomly assigned in 2005 and follow-up 12 months later \* significant at 10%  
Source: Collins, J. M. (2008) "The Impacts of Mandatory Financial Education: Evidence from a Field Study" Working paper.

# Study of State Mortgage Mini-HOEPA Disclosure Laws

- HOEPA (high-cost subprime loans) disclosure warning:
  - “YOU COULD LOSE YOUR HOME”
    - Subjective perception of risk
    - May influence expected probability of catastrophic outcome
- 18 states require modified federal HOEPA disclosure
  - 10 states require the form to be signed
  - 4 states extend disclosures to non-HOEPA loans
  - Sets up quasi-experiment
- 4 to 10 *point* increase in the rate of applicants rejecting high-cost loan offers

# Signed Disclosures Result in More Applicant Rejections of High-cost Subprime Loan Offers

Applicant Rejects High-cost Loan Offer by State Disclosure Provisions



Fixed Effects OLS within border counties

\*  $p < 0.05$

# Chicago Consumer Survey of Foreclosure Attitudes

## Survey of lower-income consumers in Chicago Metro Area

Web-based panel run March 24-28, 2008

- 467 respondents from 180 zip codes – “high”/”low” foreclosure areas
  - 186 owners / 281 renters
- Targeted income group: \$25,000-\$75,000

### **Financial Condition:**

- 21% declared bankruptcy at some point (or spouse did)
- 91% had a bank account
- 17% of owners paid late at least one of last 24 mortgage payments
- 14% of renters paid late at least one of last 24 rent payments
- 28% knew someone in foreclosure (6% themselves)

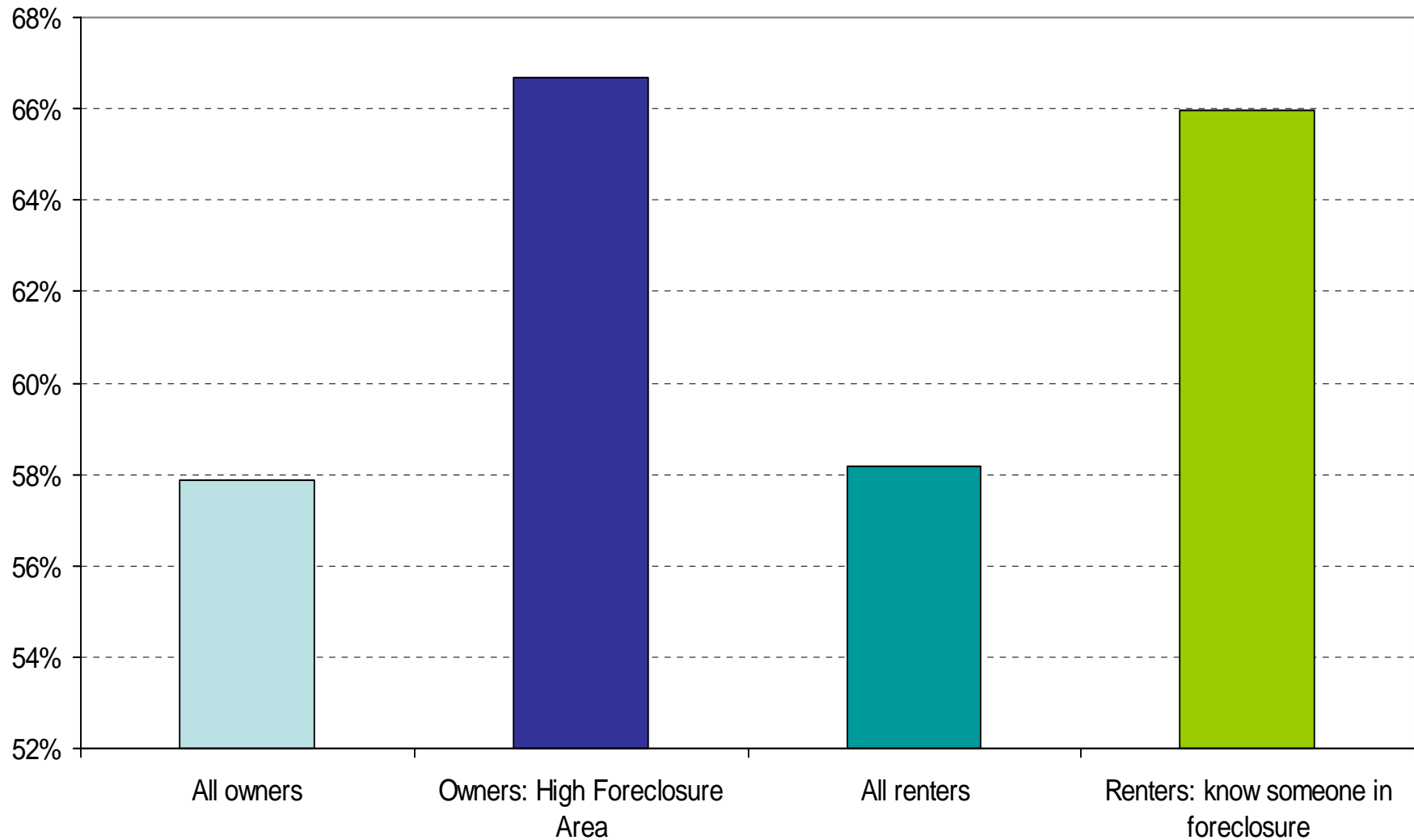
# Prevalence of Foreclosure in Community Associated with Negative Outlook

	Low Foreclosure Zip code	High Foreclosure Zip code
Out of every 100 homebuyers nationally, how many will lose their home to foreclosure	23	34
Are you likely or not likely to make major but needed repairs to your house (% not likely):	34%	49%
If asked by a friend would you recommend buying a home (% yes)	74%	61%

Source: NHS Chicago Emerging Housing Markets Consumer Survey 2008 (n=281)

# Consumer Confidence Linked to Housing Market Experience

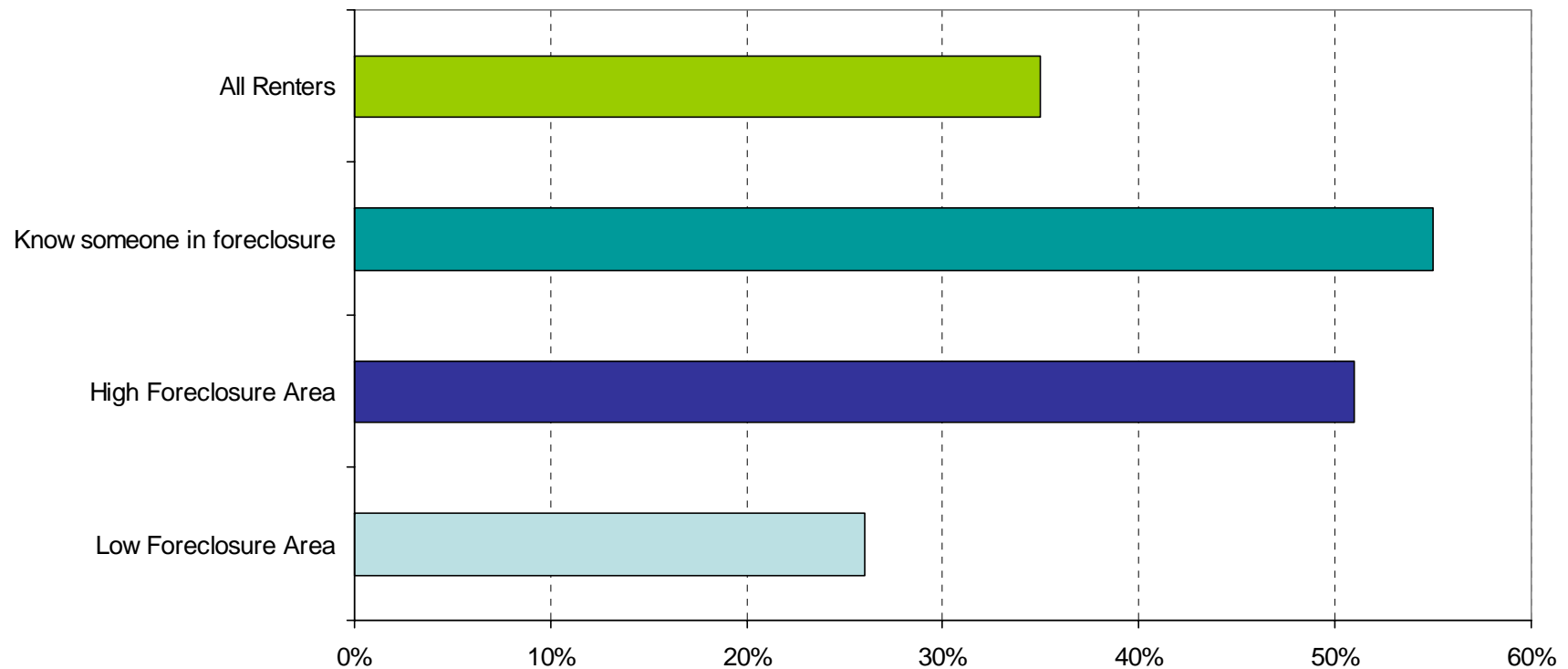
Generally speaking do you think now is a good or bad time for people to buy major household items--such as furniture, appliances and items like that?



Source: NHS Chicago Emerging Markets Consumer Survey 2008 (n=467)

# Foreclosure Experiences Promote Consumers to Seek Out Information

**Renters: Self-report interest in homebuyer education is higher than a year ago (2008 vs 2007)**



Source: NHS Chicago Emerging Housing Markets Consumer Survey 2008 (n=281)

# Conclusions

- Consumers under financial stress feel trapped and do not always look for help or take steps towards solutions
  - Lenders/servicers need to recognize systems changes are required
- Consumers need tools to manage credit risks
  - Formal education programs can work
  - Counseling also has positive effects
- Opportunities to study and understand consumer reactions to craft better regulatory and consumer information policies
  - Even if capital markets beyond comprehension/predictions