

“The Benefits of Pre-Purchase Homeownership Counseling”

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Hoa B. Nguyen is a senior economist of housing analysis and research at Freddie Mac. She specializes in housing market analysis, housing program evaluation, and fair lending issues. Her current research focuses on loan modifications, pre-purchase homeownership counseling, and underwriting models. Previously, Nguyen worked for the World Bank as an economist in the Development Research Group. She is the coauthor of many books and publications and has been the recipient of numerous academic scholarships and awards. Nguyen received a PhD in economics from Michigan State University.

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Summary and Findings: Our paper examines pre-purchase homeownership counseling’s effectiveness in reducing mortgage delinquency rates. We use a data set of almost 28,000 Freddie Mac Affordable Gold mortgages that originated between 2004 and 2008. Since our data are a nonrandom experiment, borrowers were nonrandomly assigned to receive homeownership counseling. We resolve the issue of treatment selection bias through the use of simultaneously estimating both selection into counseling and default risk. Another challenge is appropriately accounting for the widely varying credit risk characteristics of the borrowers in our study and the dramatically changing local economic environments they experienced. We address this concern by including a variety of borrower and mortgage credit risk origination attributes, plus measures of the postorigination changes in the value of the property serving as mortgage collateral. An additional challenge is to distinguish between the impact of counseling and the role of lender effects. Lenders have widely varying underwriting and servicing standards, and this can lead to significant differences in loan performance. Lenders also vary in their adoption of counseling and the type of counseling they assign. Therefore, what may initially appear to be a counseling effect may actually be a lender effect. We address this concern by using a separate data set to derive instruments for lender fixed effects and use them in our estimations.

Implications for Policy and Practice: Our findings indicate several important policy implications. First, pre-purchase homeownership counseling plays an important role in expanding affordable homeownership opportunities for America’s families. Our results demonstrate that pre-purchase homeownership counseling can significantly reduce the delinquency rates of borrowers. In particular, we find that all types of counseling programs are successful, and the most effective counseling tool is to receive individual counseling. Home study and classroom counseling are also associated with lower delinquency rates. This finding has implications for how counseling should be provided. Even though counseling should be required for high-risk borrowers in affordable lending programs, an effective strategy is to provide more counseling through individual, home study, or classroom formats. Second, our empirical evidence strongly advocates to the positive impact of counseling on first-time home buyers’ repayment behavior. It implies the crucial role of pre-purchase counseling, as we expect that having more knowledge on the home buying and financing process will help first-time homebuyers be more prepared for homeownership responsibilities. Finally, pre-purchase counseling ultimately benefits lenders. Borrowers who are counseled have significantly reduced default rates compared with those who are not counseled; therefore, lenders will bear less expected default costs and save thousands of dollars, we calculate, if they recommend counseling to their borrowers.