THE COST-EFFECTIVENESS OF COMMUNITY-BASED FORECLOSURE PREVENTION

Summary of Findings and Recommendations

Background

With funding from the Ford Foundation, the Family Housing Fund (the Fund) commissioned a study on the cost-effectiveness of mortgage foreclosure prevention. The study was intended to build on two earlier Fund studies on the cost-effectiveness of the Mortgage Foreclosure Prevention Program (MFP Program) that operates in Minneapolis and Saint Paul. To accomplish this task, the Family Housing Fund contracted with Roberto G. Quercia and Spencer M. Cowan of the University of North Carolina at Chapel Hill and Ana B. Moreno, consultant to the Fund. Their work resulted in a paper titled *The Cost-Effectiveness of Community-Based Foreclosure Prevention*, completed in December 2005.

As the title indicates, the paper assessed the cost-effectiveness of community-based foreclosure prevention interventions. It did so by examining two measures: 1) **time to resolution—**the time it takes to resolve a homeowner's mortgage default; and 2) **recidivism—**the tendency of some homeowners to miss mortgage payments again after having cured a mortgage default.[1] The authors analyzed data on over 4,200 homeowners who received intensive case management, post-purchase counseling and/or assistance loans through the three agencies that operate the MFP Program—Northside Residents Redevelopment Council and Twin Cities Habitat for Humanity in Minneapolis, and the City of Saint Paul's Department of Planning and Economic Development. The data used in the study was collected over a twelve-year period, July 1, 1991 through June 30, 2003.

Findings

Time to resolution. Homeowners who received services from the MFP Program were able to reinstate their mortgages in 11 months,[2] on average, compared with 12 months reported in another mortgage industry study.

Especially encouraging is the fact that the MFP Program's time to resolution has declined to just over 9.5 months in the last two-year period of program data included in the study. This is particularly good news to the program given that in recent years homeowners coming to the program for services were, on average, further behind on their mortgage payments and had larger arrearages.

[1] A home mortgage is considered in default once a homeowner has missed a monthly payment deadline and has not brought it current. In contrast, a mortgage is delinquent, when 30 days have elapsed from the day a monthly payment was due and not made. In other words, a delinquent mortgage is also a mortgage in default but a mortgage in default is not necessarily delinquent.
[2] Time to resolution is the sum of the time elapsed before the homeowner sought help from the MFP Program (5.5 months on average) plus the time it took to cure the default after he/she came to the program (5.7 months on average).

Recidivism. Approximately 60 percent of the households that reported on the status of their mortgages were current both 12 and 36 months after coming to the program. This compares well with a cure rate of 32 percent after 12 months reported in a study of defaulted loans purchased by Freddie Mac (Cutts and Green 2003).

The results were even better for homeowners that avoided foreclosure and received loans as part of the MFP Program intervention. Over 70 percent of the reporting households in this category were still current 12 months after intake.

Additional Findings

The study also analyzed several demographic, loan and program factors that were associated with the two key measures—time to resolution and recidivism—with the following results:

Factors that shorten the time to resolution include having more financial resources relative to the amount past due and having received post-purchase mortgage counseling.

Factors that lengthen the time to resolution include the number of mortgages a homeowner has when entering the MFP Program, his or her participation in financial counseling and the number of counseling hours while in the program.

Factors that decrease the likelihood of recidivism include having more home equity and having gone through pre-purchase counseling.

Factors that increase the likelihood of recidivism include having experienced crisis events, such as job and income losses, and relationship and health problems.

Demographic factors that affect the risk of foreclosure include the employment status and the race of the homeowner. Working full time decreased the likelihood of foreclosure; being Black increased it. It should be noted that the race of the homeowner is often associated with other foreclosure risk factors. For example, in the case of Black homeowners in the analysis sample, they pay higher interest rates and have less equity than other-race homeowners. Black homeowners in the sample were also 50 percent more likely to have mortgages with a key characteristic of subprime loans, such as having an interest rate over 2 percent higher than the average lending rate at the time of loan origination. Twenty-one percent of Black owners had such loans, compared with only 14 percent of other-race borrowers.[3]

Recommendations

The following recommendations apply to community-based foreclosure prevention programs generally:

- Pre-purchase, budget and credit counseling have a positive correlation with avoiding foreclosure and reducing recidivism. This finding suggests that foreclosure prevention

[3] A HUD study, *Unequal Burden: Income & Racial Disparities in Subprime Lending in America*, 2000, found that subprime loans are five times more likely in Black neighborhoods than in White neighborhoods. Locally, recent experiences with high rates of foreclosure in the Northside of Minneapolis corroborate the race and geographic targeting of high-interest and predatory loans that can eventually lead to foreclosure.

programs should encourage or require all of their clients to avail themselves of those services.

- Program assistance loans are another major factor associated with avoiding foreclosure. The extremely strong correlation suggests that foreclosure prevention programs need to be able to lend money when appropriate.
- The study also shows that the MFP Program, a community-based foreclosure prevention program, has a shorter time to resolution and a lower rate of recidivism, a finding that is likely to apply to similar programs and agencies. Community-based foreclosure prevention agencies should use these findings to make a case for continued funding from industry stakeholders. These findings are key indicators of how much money the programs can save foreclosure stakeholders overall.

Recommendations for future research:

- More research is needed to examine the impact of other types of organizations that offer help to borrowers in default. For example, there needs to be an assessment of how the performance of community-based foreclosure prevention agencies compares with the performance of consumer credit counseling agencies and what the advantages or disadvantages of one type of organization might be over the other. It would be important also to examine the potential of partnerships between the two types of agencies or of a hybrid model that combines the strengths of both.
- There is also a need for research that addresses the impact of foreclosure prevention programs in states other than Minnesota with different laws about deficiency judgments and the foreclosure process.

Conclusions

Overall, the study suggests that community-based foreclosure prevention services are cost effective. In addition, it finds that pre-purchase counseling is often associated with lower risk of foreclosure. As such, the study also reinforces the effectiveness of pre-purchase counseling as a key tool for achieving successful home ownership.