

# Credit Counseling and Mortgage Termination by Low Income Households

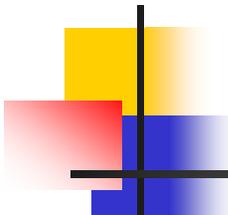


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Pitfalls: As Consumer Finance Options Multiply, Who Is Being  
Served and at What Cost?

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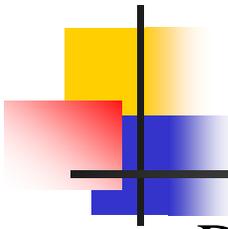


# Objectives of the study

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Mortgage loan costs include

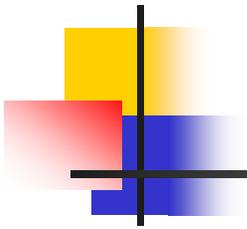
- default risk premium (focus of previous studies)
- early prepayment risk premium
- Does credit counseling influence default and prepayment hazards?
- Are low-income borrowers financially sophisticated?
  - Do default and prepayment occur when it makes financial sense to default or prepay?
  - Do shock events and transaction costs affect termination?



# Methodology and Data

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- Default and Prepayment are two options:
  - Default is an *option* to surrender the house in exchange for cancellation of the debt. It has value if the house is worth less than the loan balance
  - Prepayment is an *option* to repay the loan in advance. It has value if market interest rate is lower than contract interest rate
- Default and Prepayment are competing risks
- Data: A specific program implemented in Mid-West states during 1992-1995. Adequate treatment and control groups



# Results

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- Low-income borrowers default and prepay when it makes financial sense to do so
- Default remains a problem
  - counseled borrowers may default less often
  - their default is more optimal; may be costlier to the lender
- Counseling leads to higher prepayment hazard
  - counseled borrowers prepay more often
  - prepayment is not optimal; it is not costlier to the lender
- Other factors also affect mortgage loan termination