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Counseling for borrowers didn't achieve its goals

By Jim Weiker

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The strategy seems to make sense: Require high-risk mortgage borrowers to have their loan documents independently reviewed to save them from agreeing to bad loans.

But like a lot of well- intentioned legislative efforts, this one failed to achieve its goal, according to a new study by an Ohio State University researcher and others.

Although the study is narrowly focused, its findings could have broad implications for housing policy.

In the study, five researchers — including Itzhak Ben-David, a professor of finance at OSU's Fisher College of Business and the director of the university's Center for Real Estate — examined the effects of an Illinois pilot program on the South Side of Chicago.

The team looked at 1,200 borrowers who went through the program in 2006 until its end the following year, during the final gasps of the housing boom.

Under the program, mortgage borrowers with credit scores of less than 621 were required to have their loan documents reviewed by third-party counselors. The goal was to keep them from agreeing to the types of bad loans that contributed to the housing crisis.

Borrowers with higher credit scores were required to undergo counseling only if they chose "risky" mortgages such as interest-only loans or loans with rates that reset within three years.

Even though counselors found plenty of red flags in the loans to which the borrowers were agreeing, researchers found that very few borrowers changed their loans after being cautioned about the terms.

"Those who went through a counseling session did not appear, on average, to follow the counselor's advice," according to the study. "They tended not to walk away from the original offer following counseling nor to reapply for a different mortgage — either of which would have required another counseling session."

The counseling program did, however, have two unintended consequences.

For starters, it resulted in "substantial reduction in lending activity," with some high-risk lenders halting lending altogether while the program was in effect.

The other consequence: Even though homebuyers didn't change their loan terms after the counseling, many seemed to change their loan terms to avoid the counseling sessions.

"I think it's an interesting study of the unintended consequences of regulation," Ben-David said. "In this case, it attempted to achieve one thing but achieved something else."

The study's finding that borrowers "view counseling as a burden" could have implications for housing moving forward.

Counseling has become one of the go-to answers for housing's ills. Even today, long after housing's crash and the tightening of loan standards, first-time homebuyers and at-risk homebuyers are encouraged to get taxpayer-funded counseling.

The study illustrates a simple challenge with counseling: People want to avoid it.

It isn’t hard to imagine why. As benign as it seems, counseling extracts a cost beyond the obvious cost to taxpayers.

There is the cost of time. The Chicago sessions took an hour or two while some central Ohio classes take up to eight hours. That is a big commitment, especially for young working families.

In addition, researchers speculate that some buyers find counseling an insulting and unnecessary intrusion into a private matter. This is especially true because counseling tends to be targeted at low-income buyers.

In fact, the Chicago program was challenged by community activists who saw it as discriminatory toward low- income and minority buyers.

Ben-David isn’t opposed to some counseling programs. Indeed, in another study in which he was involved, in Indiana, researchers found that counseling helped prepare buyers for homeownership.

But before launching into counseling, policymakers must understand the full cost of such a requirement.

“It depends on the setting,” Ben-David said. “Yes, there are successful counseling programs, but . . . the borrowers need to cooperate. Counseling shouldn’t be a drag on the transaction.”

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