A government program that reduces mortgage defaults

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If one of these houses has an HFA mortgage, the owners may be less likely to default than their neighbors. Credit: The Ohio State University

Lower-income households that received mortgages through state affordable mortgage programs were less likely to default or foreclose than similar households that received conventional financing, a national study found.

Researchers examined the outcomes of homeownership programs administered by Housing Finance Agencies (HFAs), which are state chartered agencies operating in all 50 states that work to provide affordable housing to low- and moderate-income households.

The study of 140,000 households showed that HFA borrowers had a 29 percent lower risk of default and a 32 percent lower risk of foreclosure than similar households they were matched with that didn't receive loans through HFAs. Within the first two years after closing on the home, this translates into just over a 2-percentage point reduction in the default rate of 8 percent.

Surprisingly, it wasn't the structure of the loan itself—such as the lower interest rates offered to HFA customers—that was the main driver in their better performance, said Stephanie Moulton, lead author of the study and associate professor in The Ohio State University's Glenn College of Public Affairs.

It had to do with the supportive services HFAs provided customers, including direct loan servicing and homebuyer education and counseling.

"There's been a lot of talk that where you get your loan doesn't matter—you just have to get a good loan," Moulton said.

"But at least with these lower-income borrowers, it does seem to matter where they get their loans."

Moulton conducted the study with Eric Hembre of the University of Illinois-Chicago and Matthew Record of San Jose State University. Their results were published online recently in the *Journal of Policy Analysis and Management.*

The researchers used data from Fannie Mae, the government-sponsored mortgage financier, on 30-year, fixed-rate mortgages for single-family homes from across the country that were originated between 2005 and

2014.

The researchers matched 70,000 households that received HFA mortgages with similar households in the same geographic area with comparable income, credit, and other characteristics but who got their mortgages through the private market.

"Despite their reported superior performance, there had been no rigorous studies comparing HFA mortgages with loans of similar borrowers," Moulton said. "That's what we were trying to do here."

The fact that HFA borrowers had lower rates of default and foreclosure suggests big impacts on local economies, the researchers found.

Applying the results of the study to the 800,000 HFA loans originated between 2005 and 2014 suggests that there would have been 53,000 more defaults and 33,000 more foreclosures had those loans been originated through private lenders.

That translates to up to $232 million in saved local costs, Moulton said.

"That is a significant benefit to communities hit hard by the housing crisis during the time of our study," she said.

The researchers identified two ways that HFAs helped consumers. One was the structural characteristics of the loans themselves, including lower interest rates. But that corresponds to only about a 5.5 percent reduction in mortgage default. Specific types of down payment assistance and having loans originated through banks rather than third party originators also helped HFA borrowers.

The other type of impact came from the service delivery practices of HFAs, Moulton said. Each state's HFA services its loans differently, so the researchers were able to examine changes in practices over time and between HFAs to see which ones were most successful.

Some states require home buyer education and counseling, which helped HFA borrowers. "Some states match you with a counselor who you can contact even after the purchase if you run into problems. That helps a lot," she said.

In some of the state HFAs interviewed for the study, for example, counselors reach out to borrowers as soon as they miss a payment to see what's going on, Moulton said. In contrast, most private servicers wait until mortgage holders are 60 days behind, by which time it may be more difficult to help the homeowners.

"Those HFAs that build in these channels of communication mean that when something goes wrong, there is more likely to be quick action that can keep borrowers from spiraling into foreclosure," Moulton said.

These results suggest that government can have a significant impact in helping low- and moderate-income households afford and keep their own homes, she said.

"These HFAs are still leveraging the private market to originate the loans. But they have an important role in delivering services that make sure that these lower-income households have the help they need to succeed."

More information: Erik Hembre et al, Low-Income Homeownership and the Role of State Subsidies: A Comparative Analysis of Mortgage Outcomes, *Journal of Policy Analysis and Management* (2020). DOI: 10.1002/pam.22240

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