

Analysis of Mortgage Default Clients and Mortgage Default Counseling at a Housing Counseling Agency

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The purposes of the study were to create a profile of the mortgage default clientele and to examine how clientele were utilizing the counseling services at a housing counseling center. Aspects considered were loan type, time of delinquency when clients sought counseling, referrals of clients, and the point in counseling when an outcome was achieved (keeping the home or losing the home to foreclosure). Descriptive statistics were used to create a profile of clients, and Kaplan-Meier survival analysis was used to examine the utilization of services. In the context of survival analysis, clients were divided into three groups: survival (kept the home), foreclosure/bankruptcy (lost the home), and lost-to-follow up. Findings indicate that the role of the housing counselor might evolve according to the outcome of the default as well as the type of loan.

Key Words: default counseling, mortgage default, survival analysis

Introduction

Since 1968, housing counseling and education (HCE) has been available to aid households in the decision, process, and sustainability of homeownership (Joint Center for Housing Studies [JCHS], 2003; Quercia & Wachter, 1996). HCE consists of either pre- or post-purchase efforts (Mallach, 2001; Research Institute for Housing America [RIHA], 2000). Pre-purchase efforts prepare potential homeowners to make the decision to either pursue homeownership or take more time to adequately prepare for homeownership. The goal of pre-purchase counseling and education has been to produce informed homeowners who are better equipped to handle the responsibilities of homeownership. It is thought that prepared homeowners present less risk to lenders and provide more secure and stable neighborhoods and families. Hiram & Zorn (2001) found that pre-purchase counseling improves loan performance. Elliehausen, Lundquist, and Staten (2003) reported that credit counseling improved the financial behavior of clientele. Post-purchase efforts typically have two purposes: (a) to help owners maintain their homes and (b) to provide aid in delinquency situations (RIHA, 2000). Often borrowers seek counseling late in their delinquency and, as a consequence, reduce the possibility of retaining the home (JCHS, 2003). Delinquency counseling can assist the

owner with a debt reduction plan and explore options to cure the delinquency (e.g., how to contact and negotiate with the loan servicer). If necessary, the counselor can also help borrowers determine the best exit strategy (RIHA, 2000; JCHS, 2003).

The purposes of the current study were two-fold: (a) to describe characteristics of individuals who sought post-purchase counseling, including the length of time delinquent borrowers remained in delinquency before they sought counseling and the length of time or number of counseling sessions it took to produce an outcome of counseling and (b) to determine whether differences existed in the utilization of counseling services by loan type. Aspects considered in the study included the type of loan [Federal Housing Administration (FHA), Veterans Administration (VA), United States Department of Agriculture (USDA) rural housing loans, or conventional] held by the clients, the circumstances that led to default, the referrals of the clients to the services, and the point at which counseling produced a positive outcome (keeping the home or not damaging credit through foreclosure or bankruptcy) or a negative outcome (surrendering the home to foreclosure or bankruptcy) for the owner.

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Literature Review

Borrowers Susceptible to Default

Households struggling to maintain ownership have been characterized as having little savings and unstable or low incomes (JCHS, 2003). Researchers have found that length of time in homeownership is important; compared to longer-term owners, those who have owned a home for 5 years or less were more likely to experience financial difficulty, delinquency, and foreclosure (Gardner & Mills, 1989; O'Neill, Lytton, & Parrott, 1995; Phillips & Vanderhoff, 2004). Unexpected events, or as Getter (2003) described, *trigger events* such as a decrease in income or assets or marital instability (divorce or separation), were significant factors in determining the risk of default (Gardner & Mills, 1989; Getter, 2003; JCHS, 2003). Increases in monthly payments, insolvency, depreciation, extraction of equity, and increasing loan-to-value ratios have also been found to have a relationship with mortgage default (Case & Shiller, 1996; Deng, 1997; Elmer & Seelig, 1999).

Researchers have reported that the risk of default varies by loan type. Conventional loans have had a historically low risk of default, less than 1% per year (Phillips & Vanderhoff, 2004). Factors contributing to the risk of default on FHA loans were local unemployment rates, number of dependents, and negative equity (Lusk Center for Real Estate [LCRE], 2005). Both markets, conventional and FHA, have experienced over a 50% workout rate on homes that may have otherwise been lost to foreclosure (Capone, 2001).

Two major guides have been used to explain default and delinquency. First, the equity or put option holds that borrowers with enough equity will never find themselves in default even if they lack the income to maintain mortgage payments. They would sell the home to pay off the loan and redeem any remaining equity. If there is insufficient equity or negative equity in the property and even if the borrowers can make the mortgage payment, default may still occur. It would be rational for the borrower to return the home to the lender (put option or deed in lieu) instead of continuing payments (Clauret & Sirmans, 2003). The second guide, known as ability to pay, refers to households entering mortgage default because they are unable to meet their monthly mortgage payment. This situation could be due to unexpected events that affect the homeowner's ability to meet their monthly mortgage obligation (Clauret & Sirmans, 2003). Such trigger events were significant in determining that the risk of

default was a factor, whereas a debt-to-income ratio was not significant.

Studies have been conducted that support both explanations (i.e., equity or put option and ability to pay) on the causes of default. Home equity and loan-to-value ratios have been reported to have a primary influence on the decision to default (Jackson & Kaserman, 1980; LCRE, 2005; Morton, 1975; Springer & Waller, 1993; von Furstenberg, 1969). Unexpected events that limit a household's ability to pay were found to be important in determining the risk of default (Gardner & Mills, 1989; Getter, 2003; JCHS 2003).

Sustaining Homeownership Through Counseling and Education

Homeownership education differs from homeownership counseling. Education typically occurs in a classroom setting, provides general information on home buying, and is delivered through various methods (written, verbal, and kinesthetic). Counseling is more direct, time consuming, and focused on the specific needs of the individual buyer (Hirad & Zorn, 2001; JCHS, 2003; Mallach, 2001; RIHA, 2000).

There are two types of HCE: pre-purchase and post-purchase. Pre-purchase programs focus on helping borrowers make the decision to purchase or wait, whereas post-purchase programs focus on sustaining homeownership (RIHA, 2000). There are two main categories of post-purchase HCE. First, post-purchase education programs cover topics such as financial management, maintenance and repair, and buyer awareness of programs and other resources that help to protect and maintain assets (JCHS, 2003; RIHA, 2000). The second type of post-purchase counseling and education relates to default prevention and foreclosure. Default prevention counseling and education is designed to provide borrowers with the knowledge to seek help when facing default and, consequently, avoid default (Quercia & Wachter, 1996). Foreclosure counseling is designed to assist borrowers facing foreclosure by providing assistance in exploring options, contacting the servicer, and determining the best exit strategy (JCHS, 2003). Delinquent borrowers are commonly referred to such counseling through delinquency letters sent by loan servicers that provide agency contact information. This contact is required for FHA mortgages but not necessarily for other mortgages. Borrowers who do not respond to this contact are unlikely to visit a counseling agency until the onset of foreclosure (JCHS, 2003).

Measuring Housing Counseling and Education's Effectiveness

Attempts to measure the effectiveness of HCE have been difficult, and the findings were limited in their generalizability (JCHS, 2004; Quercia & Wachter, 1996; RIHA, 2000). Previous researchers suggested using a controlled experiment with both a treatment and a control group (Quercia & Wachter, 1996; RIHA, 2000). Using such a research design is difficult because housing counseling agencies are frequently short staffed and lack necessary resources. In addition, it is considered unethical to take a sample of delinquent borrowers and provide counseling to only half (JCHS, 2004). It would also be difficult to administer a controlled experiment to underserved populations (low income and minorities) because they would likely qualify for affordable housing programs where HCE is typically required (RIHA, 2000).

Due to these limitations the majority of counseling agencies and their practitioners are not evaluating mortgage default counseling (JCHS, 2004). However, it is important that agencies at least learn who makes up their clientele. In response to this need, the current study provides a profile of delinquent borrowers who seek default counseling. Due to the minimal research concerning the timing between initial delinquency and the final outcome of counseling and the limitations found within housing counseling research, the study contributed to the current literature by analyzing mortgage default counseling during the delinquency period until a final outcome was reached.

Methodology and Procedures

Research Questions

The specific research questions addressed were as follows:

1. What were the demographic and mortgage profiles of clients who sought default counseling?
2. How were clients referred to the Housing Counseling Center¹ (HCC)?
3. What percentage of clients had positive outcomes after the counseling sessions? (Positive outcome was operationalized as the number of clients who did not lose their homes and whose credit was not damaged by foreclosure or bankruptcy.)
4. Were there differences in the length of time the three groups of clients (survival group: those who did not lose their home; foreclosure/bankruptcy group: those who experienced foreclosure or filed for bankruptcy; and lost-to-follow up: those who withdrew from counseling and for which the final

outcome is unknown) utilized the services at the HCC?

5. Were there differences in the utilization of services by type of loan?

Sample

The sample was obtained from the mortgage default clientele inventory at the HCC and consisted of 213 cases no longer engaged in active counseling. Files included households who were expecting to default, already in default, or engaged in the foreclosure or bankruptcy process. Prior to receiving counseling, clients at the HCC signed a consent form stating that they understood that individual information would remain confidential and any published information would only represent group data.

Variables

Variables collected upon intake were used to create a profile of the clientele. The variables included (a) marital status (married, single, divorced, separated, or widowed); (b) age; (c) race or ethnicity including Caucasian, Hispanic, Asian Pacific Islander, or American Indian/Alaska Native; (d) number of dependents; (e) employment status (full-time, part-time, seasonal, self-employed, unemployed/retired); (f) income (gross or net as reported by client); (g) amount in saving and checking accounts; and (h) behind on other debt, not including the mortgage.

Additional variables collected upon intake were used to describe the individual borrower's housing situation. The variables included (a) number of years the owner had been in the home; (b) amount of consumer debt, not including the mortgage; (c) original mortgage amount; (d) current mortgage balance; (e) stated reason for default (trigger events as declared by the client); (f) the month of default in which counseling was sought; (g) second mortgage (yes or no); (h) housing ratio (percentage of income devoted to house payment); (i) loan type (FHA, VA, USDA rural housing, or conventional); and (j) source of referral to the HCC (loan servicer, friend—includes religious leader, spouse, coworker, or other friend—non-profit agencies, phone book or newspaper, lawyer, and court ordered).

Data Analysis

Descriptive statistics, cross tabulations, and chi-square were used to create a profile of the mortgage default clientele, the typical referral source, and loan type. These procedures were used to answer research questions 1-4. To answer research question 5, Kaplan-Meier survival analysis² and the Wilcoxon pairwise comparison test were used.

Clients were separated into three groups: survival, foreclosure/bankruptcy, or lost-to-follow up. The survival group was composed of clients who experienced a positive resolution to their default situation. This included a repayment plan, partial claim, payment assistance, pre-foreclosure sale, special forbearance, deed in lieu, renting the home, refinance, working with the loan servicer in the future, or working with an attorney. The foreclosure/bankruptcy group was defined as having experienced foreclosure or bankruptcy. The lost-to-follow up group referred to clients who withdrew from counseling and for whom the final outcome was unknown.

Results

Profile of Clients Seeking Default Counseling

Table 1 shows the demographic and mortgage profiles of clients who sought default counseling. The median age of the mortgage default clientele was 36.0 years old, which resembled the national median age of 36.2 years old (U.S. Bureau of the Census, 2004). Two thirds of the sample (66.1%) were married, and 19% were divorced. The average number of dependents was 2.3, which was lower than the reported U.S. household size (3.07) (U.S. Bureau of the Census, 2004). The majority of the clientele (88.4%) were Caucasian, 8.4% were Hispanic, and the remaining 3.2% belonged to other minority groups.

Almost two thirds (62.4%) of the mortgage default clientele had no savings at all. Less than 3% of clients reported \$50 in savings, a slightly higher percent (3.8%) reported \$100 in savings, and 6% reported having between \$700 and \$2,500 in savings. Almost half (48.4%) were employed full-time, 3.3% were employed part-time, 4.7% were seasonally employed, and 3.3% were self-employed.

The most common reason for the mortgage default was a reduction in income followed by job loss, marital instability, or divorce. On average, clientele had a housing ratio of 40%. More than half of the clientele (65.5%) sought counseling in the first 3 months of default. Of the clientele who sought counseling in the first 3 months of default, 54.5% were able to keep their home. Over half of the clientele (57.3%) were behind on other debt in addition to their mortgage obligation.

Method of Referral to the Housing Counseling Center

Most clients (81.0%) with government insured loans were referred to the HCC by their loan servicer, whereas 11.1% were referred by a friend, 3.2% were referred by another non-profit agency, and 4.8% learned about the Center through the phone book or newspaper ads. Clients with conventional loans were most likely (63.2%) to be referred to the Center by their servicer and equally likely to be

Table 1. Individual Borrower and Housing Characteristics (N = 213)

Description	Min	Max	<i>M</i>	<i>Mdn</i>	Mode	<i>SD</i>
Age of borrower	20.00	60.00	37.23	36.00	36.00	8.97
Number of dependents	0.00	7.00	2.27	2.00	2.00	1.67
Monthly gross income (\$)	0.00	6136.33	1835.39	1733.45	0.00	1403.17
Savings (\$)	0.00	2500.00	137.52	0.00	0.00	343.93
Amount of debt, not including mortgage (\$)	400.00	89000.00	13454.92	8670.00	0.00	16953.02
Original mortgage amount (\$)	20000.00	164500.00	90699.80	90445.50	75000.00 ^a	25813.07
Balance on mortgage (\$)	32000.00	138750.00	87948.05	90000.00	93000.00 ^a	24829.06
House payment (\$)	340.00	1456.89	776.27	750.00	750.00	219.06
Month of default sought counseling	0.00	9.00	3.24	3.00	2.00	1.98
Housing ratio	0.13	1.15	0.40	0.36	0.13 ^a	0.19

^aMultiple modes exist. The smallest value is shown.

Table 2. Referral Source by Loan Type (N = 213)

Loan type	Referral source			
	Servicer (%)	Friend (%)	Non-profit services (%)	Phone book or newspaper (%)
Government loan	81.0	11.1	3.2	4.8
Conventional loan	63.2	5.3	10.5	10.5

referred by non-profit agencies (10.5%) or by newspaper ads and phone book (10.5%). Table 2 shows the referral source by loan type.

Clients Experiencing a Positive Outcome

A positive outcome was operationalized as clients that did not lose their homes and did not have their credit damaged by foreclosure or bankruptcy. Half of the clients (50.7%) had a positive outcome following their counseling sessions. Those experiencing a positive outcome were placed in the survival group. Of those who were in the survival group, 78.1% had a government insured loan (FHA, VA, or USDA rural housing loan).

Relationship of Utilization of the HCC and Reaching an Outcome

There was a significant difference in the length of time clients utilized the services among the survival group, foreclosure/bankruptcy group, and the lost-to-follow up group [$\chi^2 = 20.06, p = .001$]. The length of time clients utilized the HCC was separated into two categories: those who attended one to four appointments and those who attended five or more appointments before reaching an outcome of counseling. The percentage of clients in the survival, foreclosure/bankruptcy, and lost-to-follow up groups who reached an outcome of counseling in one to four appointments was 71.3%, 72.7%, and 95.6% respectively. The percentage of those who attended five or more appointments before reaching an outcome was much lower (see Table 3).

Relationship of Utilization of the HCC and Type of Loan

Overall, borrowers holding government loans used the services the most. Those in the survival group with government loans took longer to reach an outcome of counseling than those in the foreclosure/bankruptcy group or the lost-to-follow up group. Regarding conventional loans, those in the foreclosure/bankruptcy group took an even longer period of time and still failed to maintain their homes. Concerning both loan types, the survival group used the services for longer periods of time than the lost-to-follow up group but not than the foreclosure/bankruptcy group (see Table 4).

Table 5 shows the utilization of services by loan type among the three groups. The Wilcoxon comparison test was used to address pairwise statistical significance. The results indicated that significant differences existed in the utilization of services between the survival group and the lost-to-follow up group that had government insured loans. A significant difference also existed between the lost-to-follow up and the survival group and between the lost-to-follow up and foreclosure/bankruptcy group with conventional loans (see Table 5).

Conclusions and Implications

The profile of defaulting clientele indicates that borrowers who sought counseling were married, were in their mid-30s, were employed full-time, and had at least two dependents. Primary reasons for the default included a reduction of income, job loss, and marital disruption. The majority

Table 3. Utilization of Services by Outcome of Counseling (n = 209)

Outcome	One to four appointments		Five or more appointments		Total %
	Count	% within outcome	Count	% within outcome	
Bankruptcy/foreclosure	8	72.7	3	27.3	100
Survival	77	71.3	31	28.7	100
Lost-to-follow up	86	95.6	4	4.4	100
Total	171	-	38	-	-

Table 4. Means and Medians for Utilization of Services by Loan Type (n = 209)

Loan type and outcome of counseling	<i>M</i>		<i>Mdn</i>	
	Estimate	<i>SE</i>	Estimate	<i>SE</i>
Government insured loans				
Foreclosure/bankruptcy	3.000	0.707	2.000	-
Survival	4.070	0.360	4.000	0.617
Lost-to-follow up	2.400	0.260	2.000	0.236
Overall	3.366	0.242	3.000	0.213
Conventional loans				
Foreclosure/bankruptcy	6.333	2.603	6.000	3.266
Survival	3.750	0.788	2.000	0.500
Lost-to-follow up	1.600	0.221	1.000	-
Overall	3.276	0.559	2.000	0.238

Note. Dashes indicate that the standard error was not estimated.

of clients (75.2%) were homeowners of 5 years or less, which is similar to other studies reporting that homeowners defaulting on mortgage loans are likely to experience financial difficulty in the first 5 years of ownership (O'Neill et al., 1995; von Furstenberg, 1970; von Furstenberg & Green, 1974).

Overall, half of the clientele who sought counseling (50.7%) were able to maintain their homeownership status. In this study, most of the clientele sought counseling at the onset of delinquency (first 3 months) and were able to keep their homes. The most common source of referral was from delinquency letters sent by loan servicers. Such contact is required on government loans but may not be required on other loans (JCHS, 2003).

Statistical significance was found in the utilization of services by loan type. The findings indicate that it took

more contacts to help clients with government loans save their homes than it did for those with government loans who did not save their homes. However, it took even more contacts to help clients with conventional loans whose homes were foreclosed or who decided to file for bankruptcy as compared to FHA or government loan clients who faced foreclosure. There are plausible explanations for these findings with clear implications for counselors.

Prior to knowing whether a client with a government loan has the ability to save their home, the role of the counselor is usually to provide education about loss mitigation options. However, once the government loan borrower knows that they are going to save their home, the role of the counselor changes. The counselor then becomes a liaison between the borrower and the lender. FHA loans, as well as other government loans, require more documentation than conventional loans. Some conventional loan

Table 5. Utilization of Services by Loan Type (n = 209)

Loan type and outcome of counseling	Survival		Lost-to-follow up	
	W-test	<i>p</i>	W-test	<i>p</i>
Government insured loans				
Foreclosure/bankruptcy	0.334	.564	1.006	.316
Survival	-	-	11.359	.001*
Conventional loans				
Foreclosure/bankruptcy	0.951	.329	4.294	.038*
Survival	-	-	6.942	.008*

companies will do loss mitigation over the phone with no paperwork. Government loan servicers are usually more proactive in working with the clients and the counselor on loss mitigation options. Conventional loan servicers are not required to work with counseling agencies. This may explain why there are more contacts between the counselor and borrower regarding government loans in the process of saving their homes. A counselor and borrower will continue to meet until a plan for curing the loan with the lender is finalized.

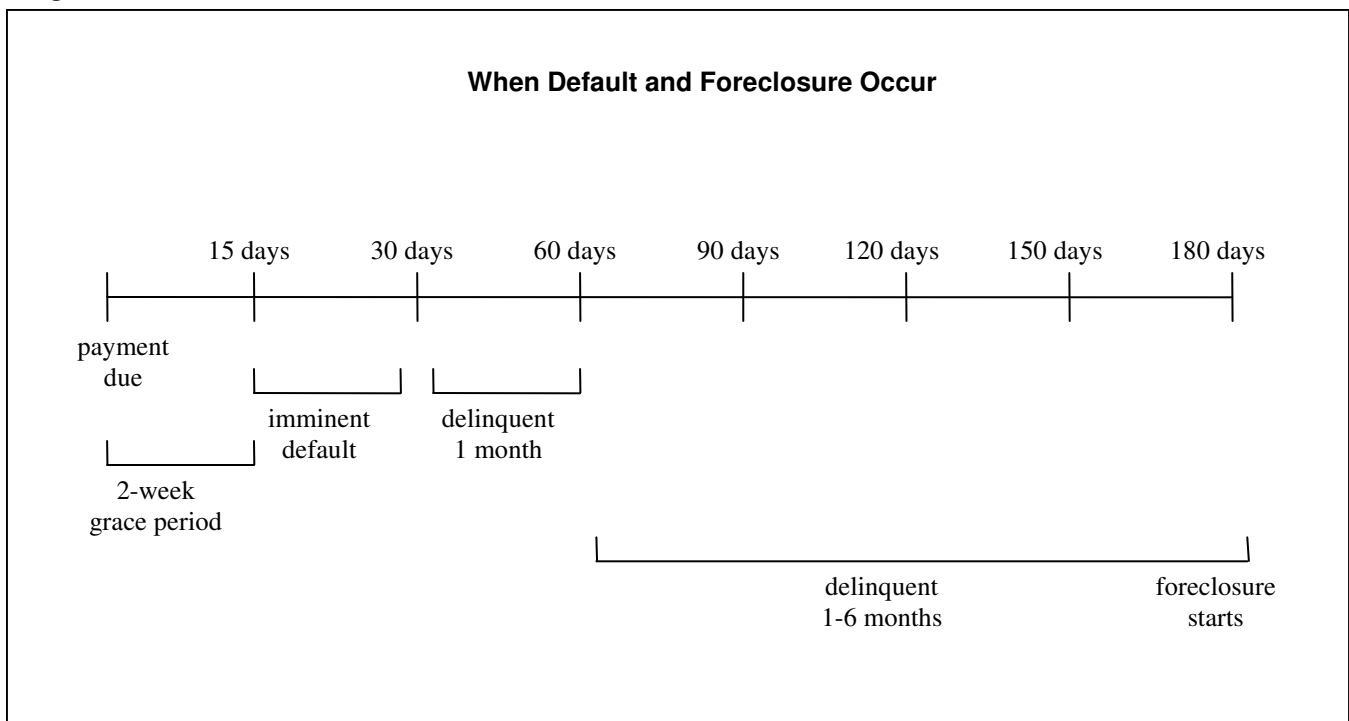
As far as conventional loan clients having more contacts with their counselor when going through foreclosure or bankruptcy, the evidence seems to indicate that conventional loan clients hold riskier loans that are more complicated to understand than government loans, and, as a result, clients end up in worse situations even after losing their homes. The counselor may serve as a guiding hand to help clients through the foreclosure process and as an educator on financial management and credit repair after the foreclosure has occurred. Many clients who lose their homes learn through their mistakes and want further education and assistance to minimize the likelihood of a repeat experience. This may explain why conventional loan clients had more contacts with their counselors when going through foreclosure or bankruptcy.

Given the dynamics presented above in which not all the clients who seek default counseling will be able to save their homes, the main implication for default counseling practitioners is that the role of the counselor might evolve according to the outcome of the default as well as the type of loan. However, all of the clients will need education and counseling to either cure their loan or go through the foreclosure or post-foreclosure process.

In light of the findings of this study, a recommendation is to provide more efficient services to default clients by gathering sufficient information on each client's housing situation. This may require revising client data to include information such as interest rate, down payment, and pre- or post-purchase education obtained. This type of information could aid counselors as they negotiate on behalf of the client. Knowing the length of time it will take to assist default clientele can help counselors to avoid overload and burnout. Counselors can better space the intake of new clientele and give the client an idea of the time involved in such counseling.

The findings of this study also provide evidence (a) that post-purchase counseling is as important as pre-purchase counseling and (b) that the time for default counseling is of the essence. The sooner defaulting borrowers seek help, the greater the likelihood they will cure their loans. An-

Figure 1. Time Line for Default and Foreclosure



other implication for HCE is that information on default options should be given as early as pre-purchase HCE or during the time of closing. If this is not possible due to the large amount of information, paperwork, and disclosures, practitioners should advise borrowers to contact their mortgage servicing companies at what the authors call the *stage of imminent default*. Figure 1 provides a timeline for default and foreclosure. Usually mortgage payments are due the 1st day of the month; however, borrowers can have a grace period of up to 14 days to make their payments without a penalty. If borrowers fail to make their payment during the grace period they could incur a penalty of approximately 0.5% of their payment amount. The 15 days following the grace period (16th day to 30th day) is referred to by the authors as the stage of imminent default. During the stage of imminent default, if borrowers know that they will not be able to make the mortgage payment by the end of the month, they should contact their mortgage service provider immediately. During the same time period of imminent default, mortgage servicing companies should mail a letter providing the borrower with contact information for housing counseling and information on available pre-foreclosure workout agreements.

Limitations of the Study

The study was limited only to clientele who had not received counseling from the HCC, thus limiting the generalizability of the results. Also, the client files did not contain mortgage information such as interest rate, down payment, or whether pre-purchase education was received. This information would have enhanced the profile of default clientele at the HCC as well as the implications that could be drawn on behalf of HCE.

Recommendations for Future Research

First, this study should be replicated at other housing counseling agencies to create specific profiles of the clientele served. Second, downpayment information should be included for borrowers in default so that an estimation of equity could be calculated. As noted in previous research, equity is a determinant in the decision to default (Clauret & Sirmans, 2003; Lusk Center, 2005; Quercia, McCarthy, & Stegman, 1995; Springer & Waller, 1993). Third, in an era where limited funds for counseling agencies exist, figuring the cost of counseling per client would help counseling agencies accomplish their individual missions, allocate their resources more efficiently, and further their funding efforts. Fourth, longitudinal studies would allow tracking of clientele beyond their utilization of counseling services to determine if default occurs again.

The results of the current study provide evidence that mortgage default counseling efforts are accomplishing what they were intended to do, which is to aid in the sustainability of homeownership. Positive outcomes are occurring in the housing counseling industry, and success is being seen in the lives of the clients. However, further research would help the housing counseling industry work more efficiently in order to meet the needs of their clientele.

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Endnotes

¹The Utah State University Family Life Center Housing and Financial Counseling (HCC) is a nonprofit, U.S. Department of Housing and Urban Development approved agency that provides counseling to residents of three counties in Northern Utah and university students free of charge.

²Survival analysis is a collection of statistical procedures for data analysis for which the outcome variable of interest is time until an event occurs. Time in the current study referred to the number of counseling appointments from the beginning of default counseling until an event of interest occurred. The event of interest was the outcome of the counseling session(s). Those experiencing an outcome (in the study a positive outcome was keeping the home or not damaging their credit through foreclosure or bankruptcy, and a negative outcome was surrendering the home to foreclosure or bankruptcy) were used to estimate the probability of the outcome occurring at different points in time in the default experience (SPSS, 2004).