Mortgage Borrowers Know that They Don't Know Much

You wouldn't believe what homeowners don't know about mortgages. No, scratch that. Yes, you would.

Some recent industry-commissioned polls show that consumers don't feel knowledgeable about home loans and they don't know what to do if they fall behind on their monthly payments. Furthermore, they view their homes as secure piggy banks -- a notion with some merit, as long as they realize that loans against equity have to be repaid with interest.

The most refreshing message coming out of these polls is this: People are aware of their gaps in knowledge. What's less clear is whether they know where to go to get the information they need. They certainly aren't seeking advice from the debt-averse generation that grew up during the Depression.

Want to try your knowledge before continuing?

Blind to the options
In a survey conducted by Radian Guaranty, a mortgage insurance company, 52 percent of the homeowners said they didn't know much about the mortgage options that were available when they bought their homes.

The question, "How much did you know about your mortgage options" leaves a lot of room for interpretation, but it's unambiguous that a lot of borrowers wish they had known more when they signed on the dotted line.

Although they felt like they didn't know enough, these homeowners weren't dummies. Homeowners were asked what two pieces of advice they would give to prospective home buyers. More than half of the respondents would tell home buyers to figure out how much house they could afford. Another 45 percent would suggest that the buyer find out about all the various mortgage options, and 36 percent would recommend getting pre-approved for a mortgage before looking for a house.

That's the right idea, says Radian's executive vice president for mortgage insurance, Mark Casale, in a press release. "Certainly, having the foresight to get pre-approved will help prospective buyers focus on the right price range."

Delinquent? Pick up the phone
While about half of home buyers say they didn't know about all of their mortgage options, things are worse for those unfortunate homeowners who fall at least a month behind on their payments. More than 60 percent of these delinquent borrowers don't know of the various workout options available to them, according to a survey commissioned by Freddie Mac, the mortgage funding giant.

People don't know their options because they don't call their loan servicer. Three-quarters of delinquent borrowers recall being contacted by their servicers. It's hard to forget those intimidating collection calls. But fewer than half of the delinquent borrowers ever contacted their lender. Presumably, they let the answering machine pick up, and they never called back.

Bad move. Freddie Mac and rival Fannie Mae require mortgage servicers to explore workout options with delinquent borrowers. Sometimes something can be worked out, and sometimes it can't. But if you have fallen behind by one or two months, it can't hurt to call the company that collects the mortgage payments and see if something can be worked out.

"That's the key thing," says Brad German, spokesman for Freddie Mac. "How do we get more borrowers to follow up on those opportunities, on those contacts?"

Reaching out earlier
The survey found that delinquent borrowers are eager to know of their options when they are informed they actually have options. The mystery is how to convey this information to people who are too anxious, frightened or embarrassed to call their lenders.

Freddie Mac is changing its guidelines to persuade loan servicers to reach out earlier to delinquent borrowers, German says. Maybe people will be more likely to explore their options when they're one month late on their mortgage payments instead of two months late.

Or maybe some folks will explore more exotic options, such as catching up on late mortgage payments by borrowing against the home's equity. Generally speaking, that would be a dumb thing to do because it would mean swapping low-rate debt for higher-rate debt. But you can't rule out that some people would do such a thing in a moment of desperation after you read "Living With

Debt," a report written by Robert Manning, a professor of finance at the Rochester Institute of Technology. Manning, a critic of how debt is marketed to young people, is the author of the book "Credit Card Nation."

Manning's "Living With Debt" report, underwritten by LendingTree.com, is ambitious (143 pages plus three appendixes) and covers much more than merely mortgages. The project examines peoples' attitudes about personal finance in six stages of life -- college students, young singles, young families, mature families, empty nesters and seniors.

Equity as comfort blanket

This might be oversimplifying, but Manning found that young singles tend to want to buy a home first, then do long-term financial planning afterward, and they say they will use home equity to bail themselves out of any trouble. Manning quotes a 29-year-old named Jason as saying, "the equity in my house provides a little comfort blanket, and you definitely take that into consideration in your consumption habits."

Translation: Eat, drink and be merry, for tomorrow you may charge it to the home equity line of credit. OK, that's a cheap shot, but there is some truth to it: Manning makes note of what he calls "competitive consumption pressure." People go into debt earlier in life, and they feel pressure to go further into debt to keep up with their peers. For spring break, he says, "people used to drive to Daytona Beach. Now they fly to Cancun, because people have credit cards."

Manning says he was intrigued by the different attitudes people have about money depending on their stage in life and by how rapid increases in home values have changed people's attitudes about "good" and "bad" debts.

Regardless of age or life stage, consumers are still coming to grips with what Manning calls the democratization of credit -- the introduction of financial products that weren't widely available a generation ago. Examples include piggyback mortgages, home equity loans and home equity lines of credit. Young people aren't disposed to seek their parents' advice about credit, and the parents are just as confused about these new forms of debt as their children are.

Education's the key

The need for consumer education underlies all three of these surveys: Radian's, which found that homeowners wish they knew more about mortgages; Freddie Mac's, which reported that delinquent borrowers don't know their options, and LendingTree's, which uncovered confusion about all kinds of debt.

But who should do the educating? Radian recommends "lenders and others in the financial services arena." Freddie Mac devotes a section of its Web site to consumer education, including tips on avoiding foreclosure. LendingTree has a section of its Web site called the Knowledge Center.

"We want to be the consumers' advocate and adviser," says Doug Lebda, chief executive of LendingTree. "We think we're in a better position to do that the more we know about what consumers need and want in the market."

That, he says, is why the company commissioned Manning's report. It's the first part of a multiyear program to teach people money-management skills.

No quick fixes

For his part, Manning has no quick solutions. He has helped develop financial literacy programs for college students, and he concludes his report by writing that "it's never been more important for borrowers to arm themselves with knowledge and build sound financial-management skills."

But getting consumers to arm themselves with knowledge is a difficult task.

Radian's survey was conducted online by Harris Interactive. It is a self-selected sample and so is not a random sample of Americans. Freddie Mac's telephone poll was conducted by Roper among 2,031 homeowners age 18 and older. The margin of error of the total sample is plus or minus 3 percentage points. Manning's study took the form of questionnaires, interviews and focus group sessions involving 145 people in various stages of life in Rochester, N.Y.; Alexandria, Va., and Orlando, Fla.