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CHAPTER 8

THE BORROWERS' GOOD DEAL

> **I am now most emphatically concerned with the fact that I am about to lose that which is most dear to me—MY HOME. This house is solid brick, ten rooms, hot water heat, slate roof, and although I built it twenty four years ago, it is still in excellent condition, for I have always taken good care of it, and it is well worth saving.**
>
> **— HOLC applicant Anna Cobb, writing to Eleanor Roosevelt, October 28, 1935**

Anna Cobb, quoted above, expressed despair at losing her house, a possession that was "most dear" to her.[1] Her lender, the First National Bank of Detroit, had failed, and she wrote Eleanor Roosevelt in a final but unlikely attempt to get her debts refinanced with the HOLC after her application was rejected. In the early 1930s, Anna's family was one of about five million nonfarm households in the United States that owed mortgage debts on their homes, and the HOLC refinanced roughly 20 percent of those between late 1933 and 1936. By 1933, private lending institutions across the country had failed, and surviving mortgage lenders were severely curtailing their lending. Hundreds of thousands of borrowers sought refinancing. To families that defaulted on their mortgage debts, the damage went well beyond the loss of property and savings invested in their homes. In Senate testimony, a New York mortgage industry official noted how often foreclosures struck "despair in the heart of the wife. It brings illnesses on. We contact cases that are virtually mental borderline cases." Sometimes "malnutrition [is] brought on by making oversize [mortgage] payments at the deprivation of [food on] the table."[2] The emotional distress to a family of losing its home should not be overlooked.

Hundreds of boxes containing the HOLC's correspondence at the National Archives yield many stories like Anna's. The HOLC described its borrowers as "in trouble through no fault of their own," and its internal correspondence backs that claim up. A real estate broker in Detroit, Lee Crane, was "living on money contributed to him by his mother" when he applied to the HOLC for refinancing in 1933. His business failed as the real estate industry fell apart. The bad economy forced his lender, the National Life Insurance Company of the United States of America, to foreclose on his mortgage in April 1933. By Michigan law he had the option to regain ownership if he could pay the amount he owed on the mortgage during the "redemption period," which lasted two years, until April 1935. Since his lender could not sell the property during that period, Lee was able to stay in the house as a rent tenant. He sought ways to borrow the funds necessary to exercise his redemption option, but mortgage credit was scarce; in fact, according to a federal report, none of the Detroit-area lenders were "making any mortgage loans whatsoever at this time." Eventually, Lee was able to find a new job (with the HOLC, in fact), but he still could not find a lender that would lend him the funds to pay off his old debt and buy back his property. One reason was that he still owed three years' worth of back taxes on the property. The HOLC's mortgage refinance program provided him the opportunity to stay in the house and get back on track toward paying off what he owed.[3]

Raymond Carswell had worked in the executive offices of department stores for twenty years. By 1933, though, Raymond had been out of work so long that he was "on his uppers," an old euphemism about someone being in such dire straits that their shoe soles had completely worn out. He was being considered for management at a large department store, but that job was likely to materialize only when the economy improved, and until then he was spending much time and expense attempting to make a contact anywhere in the country. With his deep experience, he was hoping that there would be a "recognition that gray hair carries something that is lacking in black hair stem." Raymond had "his chin up," but without a source of income he came to owe two years of taxes and interest on his mortgage. He thought he might be able to keep the house for a while if his daughter and her husband moved in and contributed to the mortgage payments. Yet this would not pay off the back debt, and with his lender considering foreclosure, Raymond was in grave danger of losing his home. The HOLC eventually stepped in to save Raymond's home.[4]

To deliver relief to these borrowers, the HOLC changed how the debt was paid back and, in some cases, lowered the amount of debt itself.

Changing How Debts Were Repaid

Fundamentally, the HOLC offered relief by simply acting as a lender at a time when existing lenders were informing their borrowers that their cases had no hope and that the lenders were no longer interested in carrying them.

Affordable monthly payments were important in keeping borrowers away from foreclosure. The form of relief the HOLC offered in this regard depended on the structure of borrowers' previous loans. Among the broad menu of loans offered in the 1920s, we compare the HOLC loan with two common loans. The first is a short-term interest-only loan lasting five years; loan lengths often ranged from two to six years. Since this loan required only interest payments during the five years, the entire principal debt was left to be repaid or refinanced at the end of the loan. The second was a loan offered by B&Ls that featured equal payments each month, usually for a period of about eleven to thirteen years. Technically, these payments would be used to buy shares in the B&L, and when those shares finally totaled the amount of the principal, the principal was repaid and the B&L's lien on the property removed.

Borrowers faced problems with each of these loans in the 1930s. Although borrowers could typically refinance short-term loans with ease in normal times, lenders in the frozen mortgage market of the early 1930s often asked borrowers to pay down a substantial amount of the outstanding principal, or to fully repay the principal when short-term loans reached maturity.[5] With refinancing difficult, many borrowers fell into delinquency. In the case of the B&L loan, as B&L profitability fell, so did the value of B&L shares in which loan repayments were invested. As a result, a borrower in good standing saw the value of shares that he had paid into the sinking fund fall in value. Since he could not pay off the principal of the loan until the value of the shares added up to the principal, he had to make more payments than expected to pay off the principal and obtain full ownership of the home.

For those with the B&L loan, one of the HOLC contract's strongest forms of relief came from an option to reduce monthly payments for the first three years, while times were still tough, by not paying any principal. These three years lasted from June 13, 1933, to June 13, 1936, that is, the first three years after the HOLC Act was passed rather than the first three years of any given borrower's loan. This forbearance option was available at the borrower's discretion until April 1934 and "was claimed by practically all" borrowers who received loans up to that point. In April 1934, Congress opted to put such decisions under the discretion of the HOLC instead.[6] Regardless, throughout the program, the HOLC retained the power to grant extensions on principal or interest at any time according to the judgment of its officials, and members of Congress indicated that they believed the forbearance option was unnecessary given this authority. During the three-year period without principal payments, an HOLC loan was easier for the borrower to handle than, for example, a B&L loan, which would have continued to require share purchases along with the interest payment each month. The forbearance option given by the HOLC was not free, though, because the loan still needed to be paid off in fifteen years. After those first three years, payments rose enough so that borrowers could fully repay the principal over the remaining life of their fifteen-year contracts.

The idea behind the three-year moratorium on principal payments was that the borrower would be in a better position to repay after three years. In fact, the economy did improve some in the mid-1930s, as unemployment rates had fallen from 25 to 14 percent from 1934 to 1937, but unemployment rates of 14 percent meant that many people were still in tough economic times.[7] In addition, this three-year option probably made less of a difference for borrowers who previously had short-term interest-only loans, as they were not paying regular payments to retire principal on those loans. Indeed, if borrowers were not able to pay the monthly payments on interest-only loans, there would be little hope they would be able to make the monthly payments on the HOLC loans either. However, these borrowers were likely in trouble because their lenders were demanding repayment of a substantial portion, or the entire amount, of their original loan.

Other features of the HOLC loan delivered relief, including the loan-to-value ratio, the interest rate, the payment plan, and the length. First mortgage loans during the 1920s were typically limited to 40–60 percent of property value, whereas HOLC loans had a higher limit of 80 percent. This eliminated the need for borrowers to find second mortgages at interest rates of 11 or

12 percent in order to borrow larger amounts. The HOLC charged an interest rate of 5 percent, notably below the rates available from private lenders at the time. For example, a national survey of sixty-four cities in 1934 found that most interest rates on existing first mortgages were between 6 and 8 percent. To show how all of these features brought substantial relief to borrowers, table 8.1 compares the HOLC loan with loans from the 1920s and early 1930s.

In terms of the payment plan, the HOLC's loan was in many ways more like a B&L loan than a short-term loan. Like the B&L loan, the HOLC loan featured equal payments each month that would gradually repay the entire debt. The length of the HOLC was a bit longer, so the monthly payments could be a bit smaller. The other major difference was the treatment of the monthly payments. Recall that B&L borrowers paid down the principal on their loans by buying B&L shares on monthly installments, which served as a sinking fund until enough was accumulated to pay the entire principal. The principal was

Table 8.1. Terms on HOLC loans and common private-sector loans in the 1920s

	HOLC loan	*Common short-term loan*	*Typical B&L loan*
Interest rate[a]	5%	6–8%	6–8%
Length	15 years	5 years	11–12 years
Payment plan	Equal payments each month that paid interest and gradually extinguished debt	Interest payments only; entire principal paid or refinanced at end of contract	Equal payments each month that paid interest and gradually accumulated B&L membership shares
Maximum loan-to-value ratio	80%	60%	60%
Other features	Option for interest-only payments until June 1936, then slightly higher payments		Length and cost not certain: depended on profitability of the B&L as a whole

[a]Effective interest rates are from Wickens (1941, 250), which contains Civil Works Administration surveys for cities taken in January 1934.

then repaid at that time. These investments remained at risk, therefore, in contrast to the monthly principal payments on an HOLC loan, which were immediately applied to reducing the amount of principal owed each month. Unlike the B&L borrower, therefore, the HOLC borrower knew for sure that the loan repayment would last only fifteen years.

To demonstrate the difference created by the HOLC loan plan, table 8.2 builds on the example of Joshua Clark's debt from chapter 1 and summarizes the experience he would have had with six different payment plans, including the two private-sector loan plans just mentioned and four variants of the HOLC contract.

Recall that Joshua owed a total debt of $2,272 when he refinanced in 1935, and that he had been paying 8 percent interest on his defaulted loan, which at the time was the prevailing market rate in nearby Boise, Idaho.[8] In interpreting the table, keep in mind that Joshua's income in 1933 was about $100 a month, higher than in the previous two years but below his earnings during the 1920s. Beside his mortgage debt, he also had the burden of medical debt that is not included in the table. The average monthly income for home owners in Boise at the time was around $96, so Joshua is close to a typical case.[9]

The first two lines of table 8.2 compare the two loans with the lowest monthly payments that a distressed borrower like Joshua could have hoped for. A five-year balloon loan (line A) from the private sector with an interest rate of 8 percent would have required a monthly interest payment of $15.15 and repayment of the entire principal of $2,272 in 1940. He could try to refinance again in 1940, but Joshua and all other borrowers who had faced so much trouble refinancing between 1932 and 1935 would have seen this as a risky proposition. Nevertheless, he probably would have taken such a loan if it were offered to him and if the HOLC had not existed. Joshua may not have viewed refinancing in 1940 as all that risky since most Americans would have had little experience to tell them that the economy would remain depressed for the rest of the decade.

The HOLC loan with interest-only payments until June 1936 (line B) required a considerably lower monthly payment of $9.47 during the first eighteen months. The forbearance period lasted only eighteen months because Joshua's loan started in January 1935, relatively late for the HOLC. Whether Joshua actually received this initial forbearance period is unclear from the

Table 8.2. Monthly payments required by different types of loans with principal of $2,272

	Type of loan	*Years to repay*	*Interest rate (%)*	*Monthly payment, Jan. 1935–June 1936*	*Monthly payment, July 1936 to end of loan*	*Balance in Jan. 1940*
A	Interest-only balloon loan	5	8	$15.15	$15.15	$2,272
B	HOLC loan with interest only payments until June 1936 and amortized payments thereafter	15	5	$9.47	$19.31	$1,821
C	B&L loan with equal monthly payments	11–13	8	$26.65	$26.65	$1,444–1,582
D	Amortized HOLC loan	15	5	$17.97	$17.97	$1,704
E	Amortized HOLC loan at market rate	15	8	$21.71	$21.71	$2,047
F	Like row D, with liberalized terms after August 1939	25	4.5	$17.97	$10.95	$1,730

records we have; because his loan is dated after April 1934, the decision was up to the HOLC and not necessarily a privilege for every borrower after that date. This initial monthly payment is lower than the payment required by the private-sector interest-only loan because of the lower interest rate on the HOLC loan. The difference is fairly large, showing the extent to which the HOLC's low interest rates really did make a difference for its borrowers. Joshua's required payments would have jumped to $19.31 in July 1937, though, when the HOLC began to require regular amortization payments. If he was unable to meet this condition, he once again would face foreclosure, but the HOLC had the authority to extend his payments at their discretion. If he was successful in meeting the payments, on the other hand, by 1940 his payments would have reduced the loan balance from the original principal of $2,722 to $1,821. He would also have this payment locked in, so that he could continue to pay $19.31 a month until the loan was fully repaid on January 1, 1950. This HOLC loan, therefore, provided borrowers with very low-cost mortgages during this period of extreme distress, and an opportunity for permanent refinancing.

Had Joshua commanded sufficient income and resources in 1935, he might have preferred to pay more of the principal debt immediately. In the private sector, a B&L share-accumulation loan (line C) would have provided him such a payment plan. Under this arrangement, Joshua would have simultaneously taken out an interest-only balloon loan of $2,272 with the monthly interest payment of $15.15 and pledged to purchase $2,272 in B&L shares with payments for the shares spread over equal value of shares in monthly installments (twenty-three shares with $100 maturity value each, for example). We have assumed in the table that Joshua's association, like most others, would have required him to pay $0.50 each month on each of the twenty-three shares, totaling an additional $11.50 each month. Therefore, the total monthly payment would have been about $26.65. The value of Joshua's shares would have grown over time as these installment payments accumulated and dividends were paid on his existing balances. When his share accumulations reached their face value of $100, these would be used to pay off the entire loan. The dividends paid on shares were uncertain, of course, and we calculate the remaining balance on the combined loan and share contracts in this case by assuming semiannual dividend payments in a range from a minimum of 0 percent (leaving $1,582 of principal) to a maximum of 8 percent (leaving $1,444 of principal). In the latter case Joshua's loan would have been paid off after eleven years, while the duration would have been thirteen years if dividends were paid at the lower 0 percent rate.

Line D in the table shows the monthly payments for the HOLC's standard fifteen-year, fully amortized loan without any initial forbearance on principal payments. In this case the HOLC contract provided relief in the form of a monthly payment that would have been one-third lower than the payment on the B&L loan, with the difference attributable to the HOLC loan's longer amortization period and its lower interest rate. To give a sense for the importance of the HOLC's interest rate subsidy by itself, line E gives the monthly payment that would have been required at market interest rates but with the same fifteen-year duration. In either case, the HOLC's loan was much more affordable than the B&L loan on a monthly basis, while still providing amortization. In fact, the HOLC loan was only a few dollars a month more expensive than the interest-only loan in line A. Compared to the B&L loan, another advantage was that the amount outstanding in 1940 would have been known in advance with certainty. The HOLC loan also had a liberal prepayment feature, so its borrowers could pay the loan off as quickly as their resources allowed with no additional cost.

HOLC loan terms were liberalized even more in 1939, as discussed below, after the unemployment rate had spiked to 19 percent during 1938, and after many borrowers demonstrated difficulty in meeting the higher payments that kicked in after June 1936. After August 1939, the HOLC allowed loan durations to be extended up to twenty-five years, and it lowered the interest rate on all of its loans to 4.5 percent. The new loan terms lowered Joshua's monthly payment to $10.95 (line F in table 8.2), while delaying the time to full ownership of the home for an additional ten years. The corporation practiced even more leniency during the war buildup by reducing payments required for families who were in danger of falling behind because of lost income when a family member was inducted into the military.[10]

Altogether, HOLC loans provided borrowers with clear advantages relative to private alternatives, especially for borrowers who were in distress in 1933 and 1934. It is also important to keep in mind that private lenders were not eager to make new loans in many, if not most, local markets in 1934. If they had been willing and able, they would have almost certainly offered much less attractive terms to a borrower like Joshua Clark, who had medical debts, owed back interest and tax payments, and who needed to put new roof shingles and fresh paint on his property.

Given the debt that Joshua had to refinance with the HOLC and the drops in housing values, it seems that Joshua potentially could have been better off by not applying to the HOLC, and instead giving up the house to foreclosure and rebuying it in a distress sale. For example, say the distress sale cut the house price to $1,500. By not applying to the HOLC, maybe Joshua could have bought the house for $1,500 and avoided having to repay the $333 in missed loan payments and the $379 in taxes and insurance. Although this sounds as if he could have avoided his debts, he faced two problems. First, the lender might sue him for a deficiency judgment. Second, where was he going to get the money for the purchase price? If no one was going to lend him money for the refinance, once any lender discovered Joshua's scheme, they were even less likely to lend him money for the repurchase.

HOLC borrowers who had consistently made their loan payments had built up a good credit history, making them attractive to other lenders. By not charging a penalty for early payment, the HOLC encouraged borrowers to pay off their loans early. By 1941 roughly 8 percent of the loans had been fully paid off; by the end of the war in 1945, 30 percent had been prepaid. This benefited the HOLC as well, because reductions in the number of loans they serviced meant they could cut staff.[11]

To help borrowers stay current on their taxes and insurance, the HOLC also provided additional services. In the late 1930s the HOLC made advances to its borrowers for the purpose of paying insurance bills or taxes. This ensured that borrowers did not lose their homes due to tax troubles or lose their savings due to a disaster. Later the HOLC provided an alternative service in which it collected extra monthly amounts to cover taxes and insurance, similar to the way modern loans typically create escrow accounts for those purposes. In 1945 this service was being provided to roughly two-thirds of the HOLC's borrowers. The HOLC found this practice less costly than having to search through tax and insurance records for delinquencies if a borrower fell further behind on loan payments.[12]

The Debts Home Owners Needed to Refinance

We turn now to the *amount* of debt to be repaid, rather than *how* repayment of the debt was structured. Delinquent mortgage borrowers accumulated a variety of debts beyond their original loans. Missed interest payments added up over time, and property taxes fell by the wayside, especially in this earlier era when loan servicers did not keep constant tabs on tax payments as they do today. Sometimes lenders stepped in to pay these taxes and prevent the property from being seized by a local government, but a borrower would eventually need to compensate their lender for this. Often, borrowers also delayed important maintenance and repair jobs on their houses and properties.

As seen in chapter 7, when the HOLC negotiated with lenders, it tried to offer them attractive prices. This usually involved paying first mortgage holders nearly all the principal and interest they were owed, as well as any back property taxes on the property. The loans also funded critical repairs when necessary. These policies led to HOLC loans that were written for higher amounts than on the borrower's previous mortgage loans, although the borrower's total debt was not increased by the consolidation.

A good way to illustrate how debt loads accumulated is to return to the example of Joshua Clark. He originally borrowed $1,250 from the Citizens Savings and Loan Society in May 1929 at an 8 percent interest rate. By the time the HOLC refinanced his mortgage, all of his debts added up to $2,272. Table 8.3 contains a summary of these debts, all of which require a bit of explanation.

The first line of table 8.3 indicates that Joshua still owed $1,149 of his principal debt, which started at $1,250. In fact, he never made any principal payments, but at some point his lender appears to have insisted that he liquidate an insurance policy to reduce his debt. It should be noted that Joshua's contract had not required principal payments, either. The loan had one of the short-term contracts described above. It was scheduled to last for three years, calling for interest payments of $8.33 each month but no principal payments until the entire principal of $1,250 came due and could be renewed in May 1932. In terms of the interest payments, Joshua had made sixteen monthly payments until stopping in October 1931. From October 1931 until February 1935 when the HOLC refinanced his loan, Joshua missed forty monthly interest payments of $8.33, totaling $341.67.

Five years of unpaid taxes were a nontrivial part of Joshua's debt, adding up to $416 by the time the HOLC closed the loan in February 1935. The house had fallen into disrepair, as Joshua clearly did not have the funds to cover the costs of fixing it up. As a result, the HOLC added another $310 for repairs it considered necessary to protect the value of the home as collateral—a new roof and paint for the outside walls. Finally, $55 in closing costs rounded out the total to $2,272.

It is worth pausing here to note the good deal that HOLC was able to give

Table 8.3. Sources of Joshua Clark's debt, refinanced by the HOLC in February 1935

Source of debt	*Amount*
Outstanding loan amount (principal)	$1,149
40 months of missed interest payments ($8.33 per month from October 1931 to February 1935)	$342
City and county property taxes and insurance costs, 1929–1930 (paid by lender)	$126
City and county property taxes, 1931–1934 (unpaid)	$290
Funds for repairs provided by the HOLC	$310
Closing costs on the HOLC loan	$55
Total	$2,272

Source: Home Owners' Loan Corporation Papers, Regional Correspondence, Box 150, National Archives II, College Park, MD.

Joshua's lender, Citizens Savings and Loan. Citizens received every last cent of principal debt and accrued interest owed and was fully compensated for the taxes that it had paid to protect its collateral from seizure by the city or county. In turn, Joshua received no debt reduction, because he was the sort of borrower whose debts fell below the 80 percent limit discussed in chapter 7. As a result, the HOLC did not ask his lender to forgive any debt.

Joshua Clark's case also underscores why HOLC loans were not made to remedy recklessness by individual borrowers. When Joshua purchased the house in 1929, he had paid $3,000. The house likely fell in value over the next four years. In nearby Boise, Idaho, for example, the average value of single-family homes fell by 25.5 percent. A similar fall in Coeur d'Alene prices would have cut the value of Joshua's house to $2,235, slightly less than the principal of $2,272 on the new HOLC loan.[13] In 1929, Joshua had paid for more than half of his house in cash, but lost a substantial chunk of that equity after not having paid taxes or interest for such a long time. Joshua, like most HOLC borrowers, was largely a victim of reduced income and housing prices from the Depression, and of the large debts imposed on him by his wife's illness.

The HOLC judged the market value of Joshua's house as $2,500 but raised it to $2,850, given the new repairs that were made. With a loan of $2,272 from the HOLC (including the $310 in repairs), Joshua's debt load relative to market value in 1935 was roughly 79 percent, right around the norm for HOLC borrowers. In general, the best evidence available on borrowers' debt burdens comes from a sample of HOLC loans from Connecticut, New Jersey, and New York that was provided to C. Lowell Harriss and the National Bureau of Economic Research in the early 1950s. Figure 8.1 shows the distribution of the debt loads as a percentage of the mid-1930s market price estimated by HOLC officials at the time of each borrower's application. These price estimates are estimates of current market value, which is not necessarily the same as the HOLC appraisals, which were designed to estimate longer-run value.[14] The debt load came from unpaid interest, taxes, insurance, costs of repair, and the principal necessary to finish the loan, as for Joshua. While Joshua had

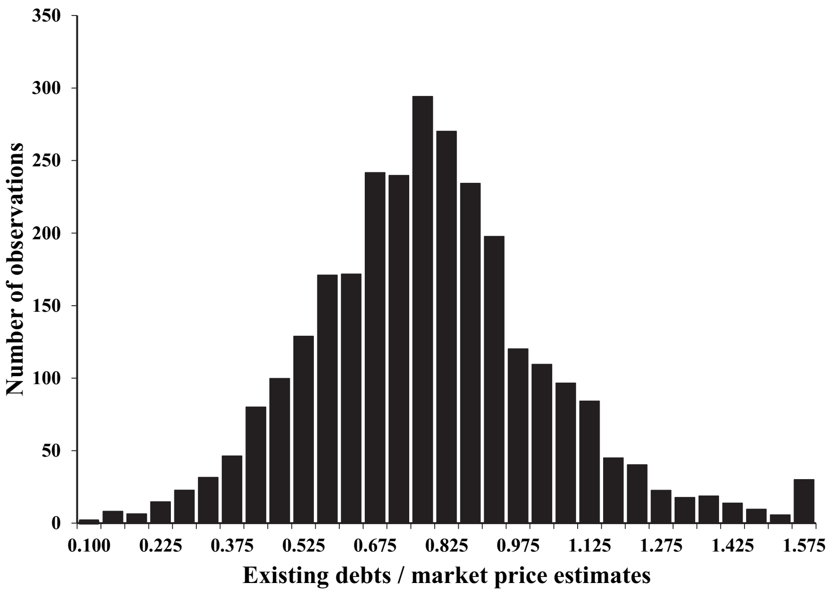

Figure 8.1. *Distribution of existing debt burdens relative to market prices for HOLC borrowers. The market prices were estimated by the HOLC. Existing debts include principal debts and unpaid interest and taxes. (Sample of HOLC loans in New York, New Jersey, and Connecticut. Data from National Bureau of Economic Research 1947.)*

only one mortgage loan, about 40 percent of the borrowers in the sample had a second mortgage loan as well.

One reason that the average HOLC borrower had a debt load around 80 percent of mid-1930s property value was that first mortgage loans allowed these people to borrow up to only 50 or 60 percent of the value of their homes. With housing prices having fallen a long way, and with enough mortgage and tax payments missed, it is easy to conceive of a 20–30 percentage-point increase in debts relative to the value of the property. If borrowers had second mortgages and incurred some additional tax debts or other debts, they could easily fall into the higher indebtedness range in the right side of figure 8.1. More of these borrowers likely existed but were not served by the HOLC, as debt forgiveness would have been required by their lenders. Unfortunately, we have never been able to find data on rejected applications aside from what is shown in table 7.1 (see p. 73), which suggests that perhaps 18 percent of borrowers were rejected because their debts were too high and their lenders refused to forgive enough of it.

Roughly 20 percent of the HOLC borrowers in the tristate sample mentioned above were underwater when they approached the HOLC. They were in especially fragile positions if they were unable to make their regular mortgage payments, because they could not fully pay off their debt simply by selling their properties. This essentially barred them from refinancing through the private sector, making them natural candidates for refinancing through the HOLC. In these cases, the HOLC would have been forced to negotiate with lenders for some debt forgiveness.

In Joshua's case, the HOLC estimated his property's market value at $2,500, while the appraisal ended up only a bit higher at $2,540. Of course, this is consistent with what we know about HOLC appraisals—they were more likely to raise the final appraisal significantly above market price if the appraisal was going to be a deciding factor in what they could pay lenders. In Joshua's case, they were able to pay his lender 100 percent of what was owed, so there was no need to adjust the appraisal upward too much in order to enlist the lender's participation. Nevertheless, the appraisal policies put in place did result in an appraisal slightly higher than the estimated market price.

Even though Joshua's loan amount came in under the 80 percent loan-to-appraisal ratio, there were still quite a few borrowers whose accumulated debts were more than 80 percent of the appraisals. In these cases, lenders granted debt reductions to avoid going over the 80 percent figure. The key constraint on the HOLC's ability to accept such cases was the need to induce lender participation. Principal reductions occurred only if lenders forgave the debt, as the HOLC was not willing take immediate losses of this sort. In about 50 percent of the mortgages in the tristate sample, the borrowers had their debt loads reduced by varying amounts to bring the principal on the new HOLC loan into line with the 80 percent ratio to the appraisal of long-run value. The amounts typically forgiven were not large, but the sheer number of cases in which debt was partially forgiven suggests a sizable subsidy to borrowers. The HOLC estimated that across all of its loans, 7 percent of borrowers' outstanding debts were forgiven, on average.[15]

To modern readers, figure 8.1 may be surprising, even confusing, as it shows that slightly more than half of the HOLC's borrowers had substantial equity in their properties, that is, owed debts that added up to less than 80 percent of their property's estimated market values. It seems that they ought to have been able to sell their homes for enough money to clear their debts and therefore avoid foreclosure. One factor to keep in mind, though, is the defunct state of credit markets in this period. Mortgage borrowers could only have sold their homes if buyers could have obtained loans to finance their purchases. The market prices in figure 8.1 are estimates using prices from market transactions of similar properties. By definition, those are transactions in which buyers actually did obtain loans, but such was the inexact science of appraisals in a deeply dysfunctional housing market that no borrower could have been sure of finding a buyer able to pay the same price because no buyer could have been assured of obtaining a loan. In contrast, in the years since 2008, the modern mortgage loan market has had a significant backstop in the presence of Fannie Mae and Freddie Mac, which (due to the backing of the US Treasury) have been able to buy loans from all types of lenders that meet the two companies' underwriting standards. This has helped keep the loan market alive, but no similar backstops existed during the early 1930s. These factors may explain why so many borrowers with relatively low debts still ended up refinancing with the HOLC, as it was the only creditor in town.

The HOLC's Leniency in Dealing with Widespread Delinquencies

With unemployment rates remaining high through the end of the 1930s, times were still tough for many HOLC borrowers. By July 1936, three years

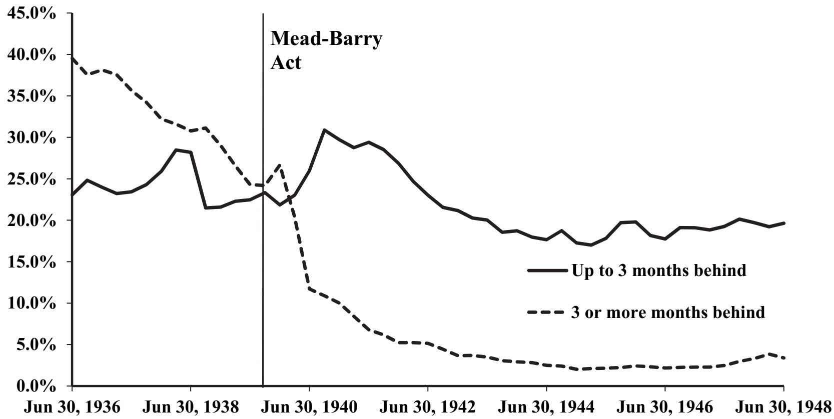

Figure 8.2. *Percent of outstanding HOLC borrowers behind on payments. Data before June 1936 are not available (Harriss 1951, 201).*

into the HOLC program, nearly 40 percent of borrowers were more than three months behind in their payments on their HOLC loans, and this rate was still 35 percent the next year (figure 8.2). The HOLC eventually foreclosed on only about 19.4 percent of its borrowers, however.

Delinquencies were high in 1936 partly because the temporary three-year forbearance period ended. When the forbearance period ended in June 1936, unemployment was lower than in 1933 but still widespread, and many borrowers could not afford the higher monthly payments. Most HOLC foreclosures took place in the few years after 1936.[16] This was a major problem for the HOLC, and sentiment in Congress built up for a moratorium on HOLC foreclosures, though none was ever implemented.[17] Without action, it looked like the HOLC experiment could have ended in widespread foreclosure, just what it was trying to avoid.

Ultimately, the foreclosure rate totaled 19 percent, a significant rate but much lower than the delinquency rate of over 65 percent in early 1936. Without a doubt, a great help came from the economic growth after the 1937–1938 recession that continued into the 1940s, and more help came from the increase in house prices during the war years. Some of the improvement is also likely attributable to a further liberalization of loan terms in 1939 as a result of new legislation. In that year, the Mead-Barry Act allowed the HOLC to extend its loans' durations to as long as twenty-five years. The HOLC, by a vote of its board, also lowered its loan interest rates to 4.5 percent from 5 percent.[18] About one-quarter of the HOLC's original loans had their durations extended, many after extended periods of delinquency.[19] In fact, about half of the extended loans had been in arrears by twelve months or more. After extension, the HOLC treated all extended loans as new loans, thereby erasing past delinquencies and providing borrowers with yet another chance to start over.

These liberalizations explain the rapid drop in serious delinquencies in figure 8.2 (the dashed line) in the months after the Mead-Barry bill was made into law. They also explain the increase in short-run delinquencies (the solid line), as some of the borrowers fell behind on their loan payments once again. Nevertheless, serious delinquencies were never again as large a problem for the HOLC, as the dashed line fell to low levels and stayed there. Borrowers found their monthly payments to be more affordable because of the longer amortization period and lower interest rates. Economic recovery, before and after the buildup to the war, likely helped buoy borrowers' incomes as well. Housing prices also rose during the war, due to restrictions on new construction.

On those loans it foreclosed, HOLC officials clearly gave borrowers a long time in which to avoid foreclosure. Instead of moving these borrowers quickly into foreclosure, the HOLC practiced a great deal of patience, delaying foreclosure as long as a loan had any hope. The HOLC was known as a lenient servicer, although some contemporaries disagreed with that statement, and certainly not every borrower's experience was the same. In particular, the HOLC was slow to foreclose when borrowers fell behind on their loan payments. Many of the HOLC loan officers acted as social workers in helping borrowers find jobs or obtain work relief and other resources through other government programs.[20] In 88 percent of the nearly 100,000 foreclosures that had occurred by July 1937, HOLC loan service officers held off taking the action for more than a year after borrowers had stopped making mortgage and tax payments. They waited more than eighteen months in 63 percent of the cases.[21] Some foreclosures were inevitable, regardless, as nearly a quarter of foreclosures occurred in cases where the houses had been abandoned or the owners died and their heirs refused to assume the mortgages.

This leniency before foreclosure continued in the late 1930s and the 1940s, but the speed of foreclosure picked up a bit compared to earlier practice. Of the foreclosures that had occurred by 1941 (almost all of the HOLC's eventual total), the loan officers waited more than a year after delinquency to foreclose in 64 percent of the cases (as compared to 88 percent of the cases up to July 1937), and more than two years in 24 percent.[22]

As an example of the HOLC's servicing practices, documents in the HOLC collection at the National Archives describe the story of Frank White from Los Angeles, an HOLC borrower who suffered an eye injury that laid him up for a year and caused him to fall behind by about $150 on payments for taxes and street assessments. Using its authority to extend payments "if the circumstances of the home owner justify such an extension," the HOLC accepted lower payments during that year. The HOLC loan officer supported him because his attitude was "excellent and pride of home ownership is borne out by condition of home and grounds." He was demonstrating good faith by "raising rabbits, chickens, and pigeons to help with living," and once he returned to work, the loan officer expressed confidence that Frank's "account will rapidly be brought up to date and the slate cleared of all delinquencies." This was part of a pattern of behavior in which the HOLC looked beyond a borrower's payment history and focused more on the character of the borrower and ability to pay in the future.[23]

This leniency had its limits, though. When borrowers failed to demonstrate good character, the HOLC was just as punishing as a private lender would have been. After borrowing from the HOLC, Katherin Cooper of Whitman, Massachusetts, was confined to the Taunton Hospital for the Insane, and her mortgage payments to the HOLC soon stopped. The field representative suspected that the father owned the home and was using his daughter's mental illness to avoid repaying the loan, describing Katherin as "a straw for her father. This is substantiated by the fact the father is collecting rent, but he will not admit ownership." Eventually, with knowledge of the father's behavior, HOLC officials decided to foreclose. This case also exemplifies the difficulty that lenders had in collecting information about their borrowers, even when the lender had the time, patience, and resources that the HOLC did. Some decisions were inevitably difficult because HOLC loan officers had trouble determining the exact circumstances underlying default.[24]

Those at the receiving end of skeptical treatment from the HOLC likely did not appreciate it. One critic of the HOLC described it as a lender that "viewed almost every default as a prima-facie effort to cheat the government."[25] This, it seems, is a bit of an exaggeration, yet it likely reflects the attitude of some loan officers with certain borrowers. It also captures the tricky politics inherent to a government-backed entity foreclosing loans on its own citizens.

Once the HOLC had foreclosed, the officials had to decide whether to pursue a deficiency judgment, which involves suing the borrower for the difference between her debt and the proceeds received from the sale of the property via foreclosure. In practice, these decisions appear to have been conducted on the basis that any lender would conduct them, whether or not the deficiency judgments were likely to yield any income. For example, the HOLC did not seek a deficiency judgment against Antonio Cristiano from West New York, New Jersey, because they decided it would have been fruitless. The HOLC official reviewing the case argued that Cristiano was "too old to work, and the possibility of the 17 year old nephew procuring work, which would not be sufficient to liquidate, cannot be expected. Efforts have been made to sell, and the property has been listed, with no results." Cristiano could "not make any payment plan. He seems to have a number of relatives to support, and they pay nothing towards maintenance of household." Cristiano had tried to rent some rooms to generate income, but claimed that his tenants had been delinquent in paying the rent for three months. Ultimately, he conveyed the home to the HOLC, and no deficiency judgment was sought.[26]

Similarly, Miriam Connor had obtained an HOLC loan on a house in Ocean City, New Jersey, but she had been required to move to Philadelphia to find a job even before the loan was closed. In the field representative's view, "All efforts to rehabilitate [the] loan have failed. The home owner appears to be hopelessly in debt, her arrears totaling over $1200. . . . She states that she cannot meet the expenses on the property and does not intend to live there again, and is willing to give a deed to the HOLC." Since the market value of the property was less than the debt owed, the HOLC accepted the deed to the home and did not pursue a deficiency judgment.[27]

On the other hand, HOLC loan officers were quite unsympathetic with borrowers who had sufficient assets or income to pay the HOLC but remained delinquent, and pursued deficiency judgments in those cases. When refinancing in November 1934, Edwin Corday, of Memphis, Tennessee, elected for the fifteen-year loan with a monthly payment of $78 for a home that was worth roughly four times the value of the home of Joshua Clark, discussed earlier. Even after switching to the option to pay only interest until 1936, Edwin was delinquent on his payments and had not paid his taxes for two years. When the borrower offered to give up the house to cover his debt to the HOLC, the district service supervisor investigated and discovered that the borrower was "planning to purchase the property next door as quickly as he is released from his obligation to the Corporation," and thus was no more than a "typical chiseler." HOLC officials decided to foreclose and seek a deficiency judgment for the difference.[28]

Transition to the Modern Mortgage Contract

From today's perspective, the features of an HOLC mortgage outlined in table 8.1 look fairly standard. Many mortgage borrowers today can almost take for granted the availability of a conventional fifteen-year loan, at 5 percent interest, for 80 percent of the value of the property, and with regular monthly payments on both principal and interest. In fact, this would be a relatively conservative loan by today's standards. When the HOLC adopted this loan for its borrowers, though, it was unusual. The closest approximation was probably the traditional loan from a B&L, but these loans did not truly pay off the principal each month, instead allowing borrowers to buy equity shares in the B&L. The whole structure had been popular and successful for decades but utterly fell apart during the Depression. Other loan contracts, typically with terms up to five years and featuring no regular payments except for interest, likewise had their deficiencies exposed.

The fundamental change in the contract terms that the HOLC offered borrowers is critical to understanding how it gave both lenders and borrowers good deals. The federal guarantees, funded by taxpayers, permitted the agency to write loans with much more liberal lending terms than existing loans, including lower interest rates. As a result, the HOLC was able to give lenders a good deal while borrowers benefited with loans that offered lower monthly payments, longer terms to maturity, and lower risk than the loans they had originally signed.

The HOLC's role in the evolution of the modern residential mortgage contracts is a subject of interest in its own right. These modern loan contracts have a history dating back to the 1880s in the US residential mortgage market, and earlier in foreign residential markets and in farm markets.[29] The HOLC's adoption was part of a broad change in contracts across the mortgage finance industry during the 1930s, driven by dissatisfaction with the existing contracts in light of the burdens they placed on borrowers after 1929. However, we do not want to overstate the HOLC's contribution here. The HOLC did not compete with private lenders, and therefore it is difficult to explain changes in contract use among private lenders on the basis of the HOLC's competitive influence. The modern loan contract was adopted widely by the private sector over the rest of the 1930s for a variety of reasons, and by the 1940s such loans dominated the industry. In general, the primary impact of the HOLC's adoption of this loan contract came through demonstrations that the contract could be used successfully in a large number of cases. After all, the HOLC provided this type of loan to 20 percent of all mortgaged nonfarm home owners in America in the mid-1930s.