C H A P T E R 5

Loan Servicing

With few exceptions, the million-odd home owners who received Home Owners' Loan Corporation aid were in financial distress at the time, and there was an overwhelming presumption that the vast majority of them would have real difficulty in making their mortgage payments to the HOLC.[1] Initially, there was an additional obstacle—the likelihood that borrowers would lack incentive to make the payments in view of their small equities in the properties. It would often profit the home owner financially to continue occupancy until compelled to move, without paying the HOLC and without paying taxes. Strengthening this likelihood in the first year or so was the lack of definite proof that the HOLC would foreclose even after continued default: some borrowers believed that debt repayment to a government agency, especially to one that had been created to grant relief, could be evaded. Another unfavorable factor was the lack of experience of mortgage borrowers with monthly payments and the inconvenience of making regular remittances to an out-of-town creditor.

The HOLC terms for loans required that the borrower make a principal as well as an interest payment each month—in other words, to perform some regular saving.[2] Many early loans, however, called for no principal repayments during the first three years; in these cases a higher rate of principal retirement was required in the final

1 Material for this chapter was obtained from the files on about 300 HOLC cases, interviews with officials of the HOLC and members of the financial community who observed the HOLC from the outside, examination of the instructions the HOLC issued to its operating personnel, study of the HOLC's official reports and the testimony given before Congressional committees, and sample investigations of the files of newspapers and magazines. Of the sources publicly available, the HOLC's annual reports and its defense of appropriation requests are the most complete.

2 Roughly, a $45 reduction per $1,000 of the original loan was required in the first year. With an average loan of just over $3,000 this called for an annual saving of about $135. Furthermore, the typical borrower probably had another commitment to save—his life insurance. Saving from incomes of the depression was likely to require very careful management and often great sacrifice.

twelve years of the loan's term. Even if no saving had been required, such insistent and direct needs as those for food, clothing, fuel, medical care, and the like, were likely to place most borrowers under continuous pressure; taxes and unavoidable repairs were additional burdens. However, since the HOLC interest charge (5 percent in the early years) was usually below the rate on the original loan, and since the principal of many loans had been cut as a condition of HOLC refinancing, it should have been easier for the borrower to reduce the face amount of his HOLC loan than it would have been to repay the loan that was refinanced, but the low level of borrowers' incomes made even this difficult.[3]

Loan-Servicing Procedures

These circumstances created for the HOLC a continuous problem of servicing delinquent loans, a problem perhaps of unique character, since the agency's objectives were both to give relief to the financially distressed home owner and to protect the government's financial interests. Under these conditions, a program to service HOLC loans eventually evolved, and it was one of the Corporation's most interesting accomplishments. In the early months of its operations, the HOLC concentrated so fully on processing loan applications that collection and servicing problems received inadequate attention. Headquarters at Washington attempted to handle all payments, but the work grew so rapidly that even the mechanical problems of sending out bills and crediting payments to the proper accounts were not being solved properly.

Eventually a central office could have been developed to handle these matters. It soon became clear, however, that direct personal contact with borrowers through widely dispersed offices would be preferable; to be useful, such contact had to rest upon up-to-date reports on the payment status of the account. During 1934, therefore, collection and servicing functions were shifted to eleven newly established regional offices, and a basis was established for the system which, in the long run, was to prove satisfactory.

The servicing system provided, first, that a bill be sent to the borrower each month, something of an innovation in the field of

[3] If the average interest charge had been cut by 2 percentage points in the refinancing program, the annual saving on a $3,000 loan would have been $60 in the first year. This reduction was 44 percent of the savings required to amortize the loan.

home mortgage finance. If the borrower became delinquent, the next bill indicated that fact. Steps were taken, through the encouragement of competition among business machine manufacturers and through experimentation with different types of installations in different regional offices, to find the most efficient mechanical equipment to prepare monthly bills and to keep records. Substantial and increasing savings were thereby realized. The economies effected by this aggressive mechanization, and some later recentralization, helped to offset the high cost of personal servicing described later in this chapter.

More important, however, was the system of personal contact that was developed for handling loans that became delinquent. Each case was handled on its own merits, with the final decision resting on the judgment of the HOLC staff. No attempt was made to substitute formulae for judgment. Established rules provided a framework within which exceptions could be, and were, made. Practice varied widely from year to year and from state to state; the description that follows is general and does not apply in all situations. In fact, flexibility was perhaps the outstanding mark of the HOLC system of loan servicing.

Servicing Delinquent Accounts[4]

Ordinarily, no special action was taken in the first month of delinquency. In the second and third months special notices were sometimes inserted with the monthly bill, and a notation was generally made on the bill, to be followed by a form letter if the delinquency continued. The next step was a personal letter and then, eventually, direct personal contact. A response by the borrower might be handled by correspondence, telephone, or personal interview. If there was no response, a visit to the borrower by a "service representative," a full-time member of the HOLC staff, was certain.

An attempt was often made to arrange a family meeting, the staff being urged to present the problem as one for the family as a whole. The prime objective of a loan-servicing visit was to obtain payment of the arrearage, but this was seldom possible and ways had

[4] A detailed account of loan servicing may be found in the *Manual of Rules and Regulations of the Home Owners' Loan Corporation,* Loan Service Division (September 1938) Chapter 2, Sec. 202-1 to 202-17, pp. 4-8.

to be devised to avoid foreclosure.[5] If the borrower and his family seemed indifferent to foreclosure, an effort was made to convince them of the value of home ownership; where there was a real desire to continue ownership, the HOLC representative sought to help work out an appropriate program of debt retirement.[6] The problem might require little more than the economical management of family finances. Family budgets were examined and rearranged where necessary and desirable, and an attempt was made, frequently too late, to discourage borrowers from incurring additional debt, for example, for automobiles and household equipment.

Other cases, often involving continued unemployment, presented much greater difficulties. Representatives of the HOLC sometimes helped find employment for members of the family and in some cases assisted in collecting insurance claims, pensions, and personal or business debts. If the property had vacant rooms or apartments, the representative might suggest ways of getting tenants, and help was sometimes given in obtaining foster children for board and room at a small profit. Help could be given if the family had a claim to relief, was supporting others with claims to relief, or could obtain private welfare aid. The problem might also be discussed with the borrower's employer and his cooperation obtained. In short, a wide variety of ideas was used to help borrowers increase and make more effective use of their incomes and to overcome difficulties that must frequently have seemed insurmountable. Where essential, the borrower might be encouraged to seek lower-cost housing and to rent the mortgaged dwelling; finally, sale of the property might be both encouraged and aided.

The assistance given by the HOLC's service representatives is difficult to summarize adequately. The closest parallel, perhaps, is found in the social worker's helping individuals and families adjust to their own problems and to the community around them. Specialized and

5 Service representatives were not encouraged to accept payments, though they were permitted to accept them when made by check, bank draft, or money order. In practice, service representatives not infrequently undertook actual collection functions and even handled currency. Occasionally, foreclosure may actually have been desired, as in the settlement of a borrower's estate.

6 On a strict accounting basis it might often have been cheaper for families to have rented housing, but the HOLC was acting on the widely accepted premise that home ownership produces other than purely financial benefits. As market prices improved in the forties, owners did, in fact, realize substantial financial gains, although this was not foreseen in the thirties.

informed guidance was provided more or less skillfully; naturally, the quality of the personnel and their competence for handling different kinds of problems was of the utmost importance. Although there must have been exceptions, the dominating spirit of HOLC loan servicing was to find ways to aid the borrower, with a strong bias toward trying to persuade him to attempt to keep ownership of the house.

Representatives were required to keep records of dealings with each borrower. Forms were provided for summarizing the results of interviews and visits. As the years passed, the HOLC came to know a great deal about its difficult cases, and its bases for judgment improved considerably. Also, the culmination of experience greatly improved the effectiveness of dealings on an individual case basis. Where leniency and help had been rewarded by determination, honesty, and some payments, further leniency seemed justified and likely to be granted. In some cases, however, where the objective facts were no worse than in other cases, but where HOLC experience had been bad, further concessions were not made. The hardest cases, of course, involved borrowers who were obviously good moral risks, who desperately wanted to hold on to their property, but whose economic prospects were too dim to justify greater risk. Eventually, sale or foreclosure was required. The bases for the HOLC's decisions in these varied types of cases improved constantly as its servicing experience accumulated. Another factor making for better loan servicing as time passed was the experience gained by the HOLC personnel at both the field and the supervisory levels. Much experience was lost, however, as the HOLC reduced the size of its staff, a process which made servicing somewhat more difficult and more expensive per case.[7]

Personal loan servicing of this type is obviously expensive; records of as many as a dozen visits to a borrower's home are not difficult to find in the HOLC files, and there were cases in which twenty or more were made, sometimes where the loan balance was only a few hundred dollars. An accurate estimate of the costs of servicing loans that presented no problems, or at least only small problems, as compared with the costs of servicing the more difficult cases cannot be made from the HOLC records. For the fiscal years 1937 and 1938 the

[7] As the HOLC cut down the number of its offices, a smaller number of its cases could be serviced directly, and representatives had to travel quite regularly.

HOLC estimated the annual average servicing cost per account in arrears at $14.50.[8] The basis of the estimate is not stated clearly, but it made some allowance for overhead. Expenditures on the more difficult accounts may have reached $200, with even larger outlays on the extreme cases.

EXTENSIONS

Beginning in 1937, the HOLC started to recast many defaulted loans, adding all or part of the arrearage of interest and principal, and sometimes of unpaid taxes, to the loan and increasing monthly payments. The terms of such "extensions," as they were called by the HOLC, varied widely from case to case. Sometimes the borrower was given only a year or two to repay the arrearage, but as a rule the period was longer, and while extensions could not at first go beyond the term of the loan (fifteen, and afterward twenty-five, years), extensions were later themselves extended.[9]

The basic purpose of the extensions was to give the borrower the psychological stimulus of starting anew, without requiring him to pay at once the full amount in default. Extensions were granted only if the borrower had demonstrated his ability to make the monthly payments needed to retire the loan with the extension, and only if justified by the condition of the property. In practice, however, these requirements were generously interpreted; an examination of cases confirms the impression that in most states extensions were granted even where there was only a moderate presumption that the borrower could meet the new payment schedule.[10] Service representatives had to have approval of the proposed adjustment; although these approvals were by no means automatic, rejections were infrequent.

Where the borrower appeared not to wish to continue the loan, the HOLC usually encouraged sale. In this way, the borrower could salvage any equity he might have in the property; foreclosure costs could be avoided; and the HOLC could avoid property management and the almost certain losses involved in foreclosure.[11] It was

[8] *Sixth Annual Report,* Federal Home Loan Bank Board (June 30, 1938) p. 76.

[9] In some cases, of course, the HOLC had to act promptly to protect itself against abuse of extensions as serious property deterioration accumulated.

[10] Experience with extensions is discussed in Chapter 8.

[11] Because of its heavy interest in the real estate market, the HOLC tried to avoid actions that would depress or demoralize the market. There was apparently some feeling that a private sale of property was better than foreclosure, which would tend to keep a property hanging over the market for a long time and lead potential buyers to reduce their bids.

necessary, of course, for the HOLC to keep close watch on such sales in order to protect its own interest and especially to prevent delay during which no payments were made and taxes, depreciation, and interest accruals continued. Furthermore, during the years in which the need to sell properties was greatest, the demand for houses did not always permit easy sale at prices that would cover the full debt.

Foreclosure became necessary in many cases. Sometimes the borrower could have avoided foreclosure had he understood the issues; other borrowers deliberately delayed action as long as possible to obtain free use of the house. These and other aspects of the problems of foreclosure are examined more fully in the next chapter.