
CHAPTER 3. CREDIT INVESTIGATION AND COLLECTIONS

- 3-1. CREDIT INVESTIGATION AND APPROVAL. In applying for and accepting a contract of insurance, the lending institution assumes the responsibility of applying sound principles in the evaluation of credit. The lending institution, in considering the credit of the applicant, is advised that HUD insurance coverage does not relieve it of the responsibility of exercising the care that a prudent lender would take if the loan were not being offered for insurance. The institution's profit depends upon the type of credit approved; to make a loan to a borrower knowing that the additional indebtedness cannot be repaid benefits no one.
- a. Credit Application. The applicant shall furnish the lending institution with an executed Credit Application, Form HUD-56001, (See Appendix 1), approved or provided by HUD for each loan made or note purchased. The lending institution must assure that all questions are answered and that the form is dated and executed by the eligible borrower(s), that if the proceeds are to be disbursed to a dealer-contractor, the persons selling the improvements have signed; and that if prepared by other than the applicant, the person preparing the application has signed. Where a borrower occupies property under a lease, the lessor must give consent in writing to the making of the improvements and procurement of the loan. Lenders are reminded that the appropriate social security numbers of the applicants must be placed on the credit application.
 - b. Credit Investigation. The application must be supplemented by either a commercial credit report on the borrower or evidence of the lender's investigation of the borrower's credit to satisfy the lender that the applicant represents an acceptable credit risk. Such other information as is considered desirable must be obtained and on the basis of all information in its possession, the lending institution must then pass upon the acceptability of the credit risk.
 - c. Credit Approval. With possession of the credit application and a commercial credit report, the loan officer is in a position to make a credit judgment. A determination that the applicant has a steady and sufficient income that will allow, after the payment of living expenses, plus other obligations, sufficient coverage to make payments on the loan can be generally ascertained with a systematic review of credit information. Points to be considered in reviewing the application are as follows:

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- (1) The same basic review and criteria utilized by the loan manager should be made regardless of the amount borrowed and the length of time required for repayment.
 - (2) The name and address of the applicants, their length of residence and number of dependents provide specific credit information, such as,
 - (a) The name and address establishes the identity of the person being checked and can prove a valuable aid to the collection department in the event of default.
 - (b) Generally, stability of the applicant may be determined by the length of residence at one address.
 - (c) The number of dependents provides a good insight, since assuming a like income, it is not probable that a young couple with 4 children can afford to incur as much debt as an older couple without dependents.
 - (3) The borrower's employment, other income, his/her length of employment and the type of business also provide key insights into his/her ability to repay the debt.
 - (a) Most people work for salary and wages and it is relatively easy to verify income with their employers. Verified income amounts should be noted in writing on the application.
 - (b) The length of employment, the probability of continued employment and the employing firm are all important. The loan officer should know the major employers in the locality and should be aware of seasonal or other layoff policies. Employment by a government agency, national, state or local is usually a good indicator of continued income.
 - (c) When an applicant has held a position for only a short time, the previous employment record will provide additional useful information. A switch from one employer to another in the same line should not be regarded as a warning against credit worthiness, though a complete change of field might be so construed.
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- (3-1) (d) Some applicants will, of course, be self-employed, and it is not always possible to obtain financial statements, copies of tax returns, or other data to verify income. In some cases a Commercial Credit Reference Book can be of great assistance. The listing gives the type of business, when the firm was started or came under its present control, the net worth and a rating of its credit performance. Another source of information on self-employed individuals is the commercial bank which holds the applicant's checking account. The bank will usually verify the length of time the account has been established, the average balance and the number of overdrafts, if any.
- (4) The next portion of the application provides the applicant's credit background.
- (a) The names of lenders or merchants who have previously extended credit are obtained, as well as information about checking and savings accounts. Occasionally this section will also provide clues to unreported obligations. For some reason, the applicant who is trying to conceal an outstanding obligation will often give the name of the creditor as a reference.
- (b) If the applicant is not currently in debt, this part of the application may be the only source of credit information. In such cases, a call to the lender holding his/her checking account may reveal instances of repeated return of checks.
- (5) Perhaps the most important part of the application is the outstanding debts. With this information it is possible to establish a ratio of income to outstanding debts.
- (a) In some instances, the information in this part of the application is sufficient for on-the-spot rejection of the loan.
- (b) A lack of debts is not, in itself, justification for making the loan. It may be that the information has been omitted, or factors such as litigation may change the situation.
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- (c) Never make the assumption that no debts exist merely because none are listed.
- (6) Security. A loan in excess of \$2,500, exclusive of financing charges, must be secured by a lien on the improved property. Liens may, of course, be obtained on loans of a lesser amount if so desired.
- (1) Normally this is accomplished by obtaining a mortgage or deed of trust. UCC-1 Financing Statement, Assignment of Rents and Agreements Not to Encumber or Land Contract Equity Liens do not satisfy this requirement.
 - (2) To obtain a lien, all owners of the property must sign the mortgage instrument. It is not however, required that all owners obligate themselves on the note.
 - (3) Reasonable expenses incurred by the lender in obtaining a lien may be passed on to the borrower. These expenses must be collected in cash, are limited to those allowed in Section 201.4(b), and may not be included in the loan proceeds.
 - (4) All liens obtained, whether required or not, may not be released without the prior approval of the Commissioner.
- (7) Inflated Prices. It is important that the lending institution determine that the amount of credit applied for is in proper proportion to the value of the work to be done. Lending institutions are expected to exercise diligence to detect the inflated charges for work to be done with proceeds of the Title I loan. It is obvious that loans which finance excessive costs represent unsound credit advances on which collection will be difficult. More important than this consideration, however, is the fact that lending money under such conditions is a grave disservice to homeowners. Lenders must limit the approval of such dealers.
- 3-2. ELIGIBLE NOTES. A note must bear the genuine signature of the borrower(s) and be valid and enforceable against the borrower(s) as defined in the regulations. Any signature in addition to that of the borrower(s), such as the co-makers or endorsers, must be genuine. If the note is executed for or on behalf of a corporation, or in a representative capacity, the note must

create a binding obligation of the principal. The name of the payee must be stated, and the numerical and written face amounts must be in agreement. The note must stipulate the number and amount of the equal periodic payments, and if the note calls for monthly installments, the first payment must be due no later than two calendar months from the date of the note.

- a. It is suggested that the date fixed for the first and subsequent payments should be made agreeable to the borrower and correspond whenever possible with the date on which the borrower receives his/her income. The note must contain a provision for acceleration of maturity upon default.
- b. Note Forms. HUD does not furnish the lending institution with note forms. Lending institutions have the responsibility of drafting note forms that are valid and enforceable in the jurisdiction where the loans are made. if it is a dealer loan, and the dealer is the designated payee, the reverse of the note must bear a complete with or without recourse endorsement by the dealer-contractor. The note must also contain the proper consumer claim and defense notice as required by the Federal Trade Commission.

Example:

WITHOUT RECOURSE

Pay to the Order of the Doe Bank
ABC Home Improvement Company

BY: _____ TITLE: _____ MANAGER: _____

- 3-3. FINANCE CHARGES. The maximum finance charge allowed by the regulations is intended to cover all expenses that may be incurred by this institution in placing the transaction on its books, except the following expenses which may be incurred in taking security for the loan; recording or filing fees, documentary stamp taxes, title examination charges, and satisfaction fees. These costs may not be included in the face amount of the note, nor paid out of the proceeds of the loan. However, they may be paid by the borrower as a separate item. The recovery is limited to the actual cost to the lender. No points or discounts of any kind may be assessed or collected in connection with the loan transaction.
- 3-4. PREPAYMENT REBATE. Where the prepayment of an installment is merely a voluntary payment prior to its due date, such payment

shall not be construed as increasing the rate provided for in the regulations. However, if the entire balance outstanding on

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the note is paid in advance, the lending institution must calculate a rebate of the full unearned portion of the total financing charge. The prepayment rebate will be calculated in the same manner as a refinancing rebate, commonly identified as the rule of 78's.

- a. Acquisition charge. Where the law of the jurisdiction permits an acquisition or minimum retained charge, such charge may be deducted from the rebate. See booklet HUD-91355, Table of Factors, for applicable factors.
- b. In computing the prepayment rebate the lender is not required to make a rebate of less than \$1.00 except on application of the borrower.

This section is not applicable to any loans wherein the earned charges are calculated by the actuarial method.

3-5. REFINANCING. HUD recommends that lending institutions utilize the refinancing privilege permitted by the regulations in cases where the facts and circumstances justify retention of the borrower to pay out the obligation in full. Care must be taken in refinancing to be certain that security is not released. The dropping of a signature in refinancing is considered a release of security. Each refinancing transaction should be reported within 31 days from the date of refinancing on the Title I Refinancing Report, Form FH-5, (See Chapter 4).

- a. All loans previously insured may be refinanced in accordance with the provisions of the regulations in effect at the date of refinancing. However, fire safety equipment loans may not include an additional advance and will not be covered by the provisions of (b) and (c) below since the earned interest charges will be calculated by the actuarial method.
- b. In refinancing notes previously reported for insurance, with or without an additional advance, the unearned portion of the financing charge must be subtracted from the total charge. If no additional advance of funds is made, the financing institution may assess the borrower a handling charge as authorized by the regulations. For simplicity in handling, it is suggested in the refinancing of an account that it be effective on the due date of an installment.

- c. For all Title I loans, if all of the provisions of a loan will remain intact, with the exception of the interest rate and the payments, a simple modification agreement may be used to reduce the annual percentage rate and monthly payments. Under these conditions, no insurance reporting to HUD is required.

Refinancing and modification transactions only apply to borrowers previously obligated on the loan being refinanced or modified. The maximum interest rate in effect on the date of the application for refinancing.

Since modification procedures can only be used to reduce interest rates on loans, the parties can agree on any rate of interest below the FHA maximum rate which was in effect at the time of the application for the existing loan.

- d. The formula for computing the amount of unearned charge is:

- (1) Charge for full term x appropriate factor * = unearned charge.

* The appropriate factor for any loan being refinanced may be obtained from booklet HUD-91355.

- (2) Example:

Date of note: September 2, 1976
Face amount: \$5,413.51
Net Proceeds: \$4,000.00
Financing Charges: \$1,413.51
84 Monthly Payments: \$64.46 commencing October 2, 1976
Loan Refinanced: May 2, 1980

.22297* x \$1,413.51 = \$324.68 (unearned charge)

*Factor of 84 payment loans, 44 payments of which have become due.

- 3-6. COLLECTIONS. A lending institution is expected to pursue an aggressive policy in the collection of HUD property improvement loans. In carrying out such a policy, it is suggested that form notices, dictated letters, telegrams, telephone calls, and personal contacts be used. A system should be established calling for automatic follow-up, such as the fifth, tenth and fifteenth day after default occurs. If this does not produce results, the account should receive special handling. The use of the telephone is recommended, but if results are not obtained, the borrower should be personally contacted by a

collector. Every effort should be made to discover the reason for default and to effect reinstatement of the account. It is of the utmost importance to keep in close touch with the borrower when a note has become delinquent. Constant follow-up is essential to a successful collection program.

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- (3-6) a. Definitions-Delinquency and Default. A loan is considered in default when all collection efforts have failed to produce further payments and future collectibility of the loan is in doubt as determined by the lender. The date of default is the date of the earliest unpaid installment. A loan is considered delinquent any time a payment is due and not paid.
- b. Lender Collection Attitude. Effective loan servicing techniques call for an awareness of lender personnel of the psychological differences and varying lifestyles among borrowers. Servicing practices which are effective with one borrower may not be effective with another. However, the lender is expected to pursue an aggressive collection policy. The lender, in communicating with the borrower, should work with the borrower in correcting the delinquency.
- c. Delinquency Control.
1. The lender shall have an organized means of identifying, on a daily basis, the payment status of delinquent loans.
 2. The system employed shall provide current information to permit collection personnel, wherever located, to initiate and follow-up on collection activities.
 3. The lender's records shall be documented to reflect all of their collection activities.
 4. As a means of delinquency control, the lender shall accept from the borrower and credit to the borrowers account, a partial payment of any amount due at the time the partial payment is tendered, including late charges.
- d. Staffing. A successful collection department is one which utilizes understanding and flexibility in its operations. There is no substitute for human judgment in loan servicing and that function should not be relegated to a computer or encased in a rigid system.

1. Collection personnel shall be qualified to evaluate delinquent accounts in relation to the circumstances of the borrower in order to make sound decisions regarding the possibility of avoiding defaults.
2. The collection staff shall be familiar with HUD Regulations.

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3. The staff shall be accessible to delinquent borrowers for personal interviews.
 4. The collection staff shall be knowledgeable of community organizations which can provide services to the borrower, treat the causes of the default, and help the borrower to become current.
- e. Lender Collection Techniques. Delinquent borrowers generally fall into three categories: Occasional delinquents, chronic delinquents and critical delinquents. Collection techniques must be adapted for each category. Contact with borrowers is the most basic collection tool and must be attempted as early as possible. Some techniques for contacting the delinquent borrower are listed below:
1. Letters and Automatic Notices. Computer-prepared cards and form letters are sometimes effective, particularly with occasional delinquents. If form letters are used, adequate controls should be established to avoid sending duplicates to the same borrower, especially in the same situation. Personal letters obviously, cover a much broader area than the form letter.
 2. Telephone Calls. The simplest form of direct communication with a delinquent borrower is by telephone. In conducting telephone interviews it is important to be both firm and courteous, and to contact the delinquent at a time most appropriate, make reference to the loan provisions and the methods of legal recourse available to the lender. Successful telephone interviews will generally preclude the necessity of a personal interview. All pertinent information developed during the telephone call shall be fully documented in the collection records. A system should be established calling for automatic follow-up, such as the fifth, tenth, and fifteenth day after delinquency occurs. If this does not bring results, the account should receive special handling.

3. Personal Interviews with Delinquent Borrowers. A face-to-face interview with the borrower prior to filing a claim is a recommended procedure. These interviews have historically played an important role in reinstating accounts that otherwise would result in a claim. Personnel representing the lender at such meetings should be empowered to propose reasonable repayment plans and should be familiar with the limits of their authority. If a lender's employee, either in

a face-to-face meeting, in correspondence, or by telephone, agrees to a repayment plan, the fact that he had no authority to do so should not serve as justification for later unilateral abrogation of the plan by the lender,

4. Delinquency Counseling. When normal collection techniques are not effective, consideration may be given to professional or community service counseling for the delinquent borrower.
- f. Legal Action. In the case of recalcitrant borrowers who have the ability to pay, and if warranted by the facts of the transaction, the lending institution should consider the advisability of instituting legal action. An insured lending institution may claim reimbursement for legal expenses within the amounts set out in the regulations.
- g. Extensions. A lender is prohibited from extending payments beyond the original maturity of a loan. This does not prevent lenders from accepting late loan payments, carrying a loan past due, or deferring payments to be repaid within the original maturity period. If it is desired to defer all remaining installments of a loan, it is recommended that it be refinanced. If refinancing is not practicable, lending institutions may request an extension of the claim period to carry the account delinquent for a longer time in order to work out a satisfactory plan of liquidation. Requests for such extensions should be made on HUD Form 9229, Requests for Extension of Title I Claim Period, (See Appendix 1), prior to the expiration of the allowable period.
- h. Assumption Agreements. Where circumstances warrant, a lender may permit the assumption of the balance of a Title I note to a third party. It should be made clear, however, to all parties that the terms of the note must remain in full force and effect and the assumption cannot relieve the

original borrower(s) of liability on the note, unless the prior approval of the Commissioner is obtained. In the event of a subsequent default and necessity to make claim for reimbursement of loss, the claim file must contain evidence of a demand for payment for all parties.

- 3-7. ADVANCE PAYMENTS. The acceptance of a voluntary payment of note or more installments prior to the due date shall not be construed as increasing the maximum permissible financing charge as provided in the regulations. However, if the prepayment sum exceeds two full installments it is recommended that the lending institution have a clear understanding with the borrower as to

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the date of the next payment. Too long a period should not elapse between the application of a lump sum payment and the date for continuation of regular payments unless there are legitimate reasons for an extended lapse of time. It is important to maintain the paying habit of the borrower.

- 3-8. PERMISSIBLE LATE CHARGES. Late charges are limited to 5 cents for each \$1.00 of each installment more than 10 days in arrears. No late charge on a past due installment may be accrued in excess of \$5.00. A late charge is to reimburse the insured for work involved following the borrower for a delinquent payment. It is not a part of the original finance charge, which is determined at the time the loan is granted on the basis that the note will be paid in accordance with its terms. The collection of late charges shall not be considered in computing the maximum financing charge which the insured institution may charge the borrower. Late charges may not be collected if daily interest charges are being assessed.
- a. Application of Late Charge. If the borrower makes a payment to be applied to his regular installment it is not permissible for the lender to deduct late charges that have been billed unless the borrower specifies such deductions. However, if in the absence of specific instructions from the borrower, the lender advised the borrower in writing that a portion of a payment will be applied to late charges and the borrower expresses no objection, such application shall be considered permissible insofar as HUD Regulations are concerned.
- b. Evidence of Billing. Evidence supporting the application of late charges collected must be included in the file when a claim for loss is made. HUD does not reimburse the institution for uncollected late charges.

c. Provisions for Interest after Maturity. It is not intended that late charges shall take the place of interest on the principal after the maturity of the whole obligation. Thus, a provision for such interest after maturity will not conflict with the limitations set forth in the Regulations which refer only to interest or late charges taken on a specific installment for failure to make that payment on time.

3-9. PRE-CLAIM COLLECTION ASSISTANCE. Pre-claim collection assistance is available when the financial institution determines that all collection efforts on a defaulted account has been exhausted. Upon proper request HUD Form-55083, (See Appendix 1), HUD writes to the borrower(s) advising of the

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seriously delinquent condition of the account and urging that they immediately contact the financial institution to arrange a satisfactory repayment schedule. Detailed information about this plan may be obtained from the local HUD Field Office. Lending institutions are requested to use this plan only as a last measure prior to filing a claim for loss with HUD. The plan should not be used when the lending institution knows the borrower is a "skip" or knows there is a dispute or complaint by the borrower.

3-10. FORECLOSURE. Except for fire safety equipment loans, an insured may proceed against security taken and file a claim for deficiency, if any, provided the prior approval of the Commissioner is obtained. In the case of a fire safety loan, the lender may elect to assign the loan to the Commissioner in exchange for payment of insurance benefits or it may exercise its right under the note and security instrument in lieu of making a claim for insurance benefits. In the case of the latter option, the lender may not file for any deficiency which may result.

3-11. CLAIM FOR LOSS. Claim for reimbursement of loss on an eligible note maybe made to the Commissioner after default, provided written demand has been made upon the borrower for the full unpaid balance of the note. (Suggested phrasing of the demand letter is given in Chapter 4.) With the exception of fire safety equipment loans for nursing home facilities, the allowable claim period will run to 6 months after the due date of the final installment unless an extension of the claim filing period has been requested. On a fire safety equipment loan, the claim filing period shall be 9 months and 31 days after the due

date of the earliest unpaid installment unless an extension is requested and approved by the Commissioner.

- A. When all efforts to collect a defaulted Title I account have been exhausted, Title I lenders are required to notify the appropriate Credit Bureau that a default exists and a loss claim will be filed with the United States Department of Housing and Urban Development. See Chapter 5 for claim filing procedures.