

Loan Delinquency in Community Lending Organizations: Case Studies of NeighborWorks Organizations

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Abstract

This article reports on qualitative data gathered through interviews conducted in 1996 with key leadership and staff from 13 community lending organizations. Loan servicing and collection procedures within the organizations were examined. Findings suggest that several organizational factors of nonprofit lenders are related to their loan delinquency rates: social networks, business culture, funding sources, composition of the board and loan committees, staff structure, loan intake, and collection tools.

The study also finds that the nonprofit sector's institutional environment and its partnership with the private sector in a mutually beneficial process influence the loan delinquency rate. More specifically, active participation of local bankers in NeighborWorks¹ loan committees, diverse funding sources (from both the public and private sectors), and a diffusion of business practices through dense social networks are related to NeighborWorks' loan servicing and collection policy and procedures. These factors in turn influence NeighborWorks' rehabilitation loan delinquency rates.

Keywords: Low-income housing; Banking; Nonprofit sector

Introduction

Social capital has emerged in the view of many as a critical factor in the stability of neighborhoods and in their potential for revitalization. Generally defined as the level of involvement of residents in the life of their community, social capital has many manifestations. As noted by Hornburg and Lang (1997), social capital has two main dimensions: *social glue* and *social bridges*. In this article, the latter aspect of social capital is referred to as social networks. In particular, social bridges are regarded as the links between a neighborhood group and the larger community. Hornburg and Lang discuss com-

¹ NeighborWorks is a registered trademark.

munity development corporations, foundations, other nonprofits, local governments, public housing authorities, businesses, and voluntary associations as being among the organizations involved in building social bridges.

Temkin and Rohe refer to institutional infrastructure as an element of social capital and include among the attributes of this infrastructure the respect that neighborhood groups receive from “elected officials, bankers, real estate and insurance agents, and other powerful actors whose decisions help shape the future of the neighborhood” (Temkin and Rohe 1997, 10. Keyes et al. (1996) have addressed the institutional networks of nonprofits—including the Local Initiatives Support Corporation (LISC), the Enterprise Foundation, and the Neighborhood Reinvestment Corporation—as creators and users of social capital in the relationships among corporations, philanthropies, investors, and others.

This article examines the institutional factors that contribute to the loan delinquency performance of nonprofit housing organizations and provides insight into the roles these organizations play in the building of social capital and the acquisition of resources by residents of their communities. In other words, an important aspect of delinquency performance is the role played by nonprofit community development corporations in creating and sustaining linkages or social bridges across public agencies, lending institutions, and other organizations. Community development corporations serve as intermediaries between these organizations and community residents through the operation of loan programs. In turn, those linkages allow the community development corporations to facilitate improved housing and homeownership, which is viewed as being a major foundation of social capital because it creates roots and stability in a community as well as connection to the neighborhood (Hornburg and Lang 1997). Conflicting objectives are an issue for these organizations as they work through networks to enhance community building.

This article is based on a collaborative project between the Neighborhood Reinvestment Corporation and the Shimberg Center for Affordable Housing at the University of Florida. The objectives of this research are to examine organizational attributes that influence NeighborWorks organizations’ loan delinquency rates and to show how social networks influence these rates. Much of the literature on loan delinquency and default addresses factors related to the loan, borrower, or property as factors leading to default and does not address the characteristics of the organizations making loans. This article examines the relationship between organizational characteristics and delinquency and draws implications on the importance of social networks.

NeighborWorks organizations and loan delinquency

NeighborWorks organizations are chartered community-based affordable housing and community revitalization organizations affiliated with the Neighborhood Reinvestment Corporation. To its affiliates, Neighborhood Reinvestment provides comprehensive technical assistance for its programmatic services as well as organizational development, training, a specialized secondary market operation, and some equity grants. Some of these organizations also receive grants and support from other national intermediaries such as LISC and the Enterprise Foundation.

Most NeighborWorks organizations have community loan funds that they own and service. The funds make affordable loans available for home rehabilitation, emergency home repair, and down payment assistance for home purchases. Although NeighborWorks organizations are involved heavily in homeownership promotion, their demand for first-mortgage loans is met mostly by private lending institutions. The bulk of NeighborWorks organizations' in-house portfolios consists of rehabilitation loans, some of which are sold to the network's secondary market, Neighborhood Housing Services of America (NHTSA). Community Development Block Grants (CDBGs) have been the major funding source for NeighborWorks loan funds. Other main contributors include corporations, lending institutions, insurance companies, and Neighborhood Reinvestment. In recent years, the federal HOME program has also contributed to NeighborWorks loan funds.

According to Neighborhood Reinvestment's annual survey of its affiliated network organizations, 74 percent of NeighborWorks' loan customers are low-income or very low income households, 61 percent are of ethnic minority backgrounds, and 47 percent are female. At the end of 1996, 171 NeighborWorks organizations had a total loan portfolio of 15,697 loans worth \$182.9 million. During 1996, the network organizations made 3,624 loans amounting to \$67.7 million, with an average loan size of \$18,680 (Neighborhood Reinvestment 1996a). The NeighborWorks in-house loan fund also plays a significant role in leveraging investment from other sources. The results of Neighborhood Reinvestment's quarterly production surveys show that in 1996, the total investment leveraged by the network organizations was \$420.1 million. Fifty-five percent of the leveraged investment came from financial institutions as first-mortgage loan originations and 22 percent came from the public sector, mostly from local/city governments through CDBGs (Neighborhood Reinvestment 1996b). Incentives for financial institutions' investment in NeighborWorks' affordable housing programs can be attributed to the expanding market in low- and moderate-income

homeownership, as well as to the need to comply with the Community Reinvestment Act (CRA).

It should be emphasized from the outset that a NeighborWorks organization's loan portfolio performance, whether it has a low or high delinquency rate, does not tell us much about its overall success or impact on community revitalization. In fact, among the sample of organizations with high loan delinquency rates selected for this study, some are highly successful in providing affordable housing and community revitalization services. In this study, then, when we refer to a "high-performing organization" or an "organization with a high delinquency rate," our focus is only on its lending activity, not on its overall organizational performance.

Motivation for this project came from a concern that loan portfolio delinquency rates varied widely across NeighborWorks organizations. In fact, this concern extends beyond these organizations to nonprofit housing organizations in general, as well as to lenders and others supporting affordable housing. A better understanding of the factors associated with loan delinquencies and the approaches organizations are taking to limit delinquencies can contribute to changes in the practices of all organizations. The loan delinquency rate of a community lending organization is directly related to its capital turnover rate—that is, the productivity of its loan portfolio. Further, additional organizations and resources may be attracted to the affordable housing arena if concerns regarding high delinquency rates in affordable housing lending can be alleviated. Thus, the delinquency performance of the organization can have a direct effect on its ability to build social networks and support structure and, through this activity, to provide affordable housing and homeownership opportunities.

Delinquency is an unavoidable outcome for some loans in a loan portfolio, regardless of the clientele group. Changes in employment and income, divorce, and health problems are among the factors that contribute to loans being in delinquency or default. These factors generally cannot be anticipated regardless of the underwriting process and criteria. Although households in the affordable housing group may have less of a financial cushion and therefore be less likely to avoid delinquency, unforeseeable events that interfere with the repayment of a loan can befall anyone. Given such a situation, the duration and course of the delinquency may be determined by the response of the lending organization as much as by the actions of the client.

Other delinquencies may be more avoidable. Some delinquencies may result from the criteria and standards applied in loan origination (for example, ratios of income-to-housing cost, credit history,

property appraisal, and stability of income). Delinquencies may be the result of housing expenses that were not anticipated by the household or debt taken on after receiving the loan. Finally, delinquencies may result from the servicing and collection practices of the lending organization, the assistance available from the lenders or others to help avoid delinquencies, and the resulting assumptions made by borrowers concerning the lenders and the consequences of delinquencies.

This study examines some of the *avoidable* factors associated with loan delinquency. More specifically, by focusing on NeighborWorks organizations' 90-days-or-more delinquent loans, our objective is to identify organizational factors that are associated with loan portfolio performance. The underlying assumption of this study is that to the extent lenders have control over some of their pertinent organizational attributes and are active partners in their communities, they can reduce their loan delinquency rates.

The following sections describe our research approach, review the literature, discuss the results of our qualitative case analysis, and present conclusions drawn from the study as well as recommendations for loan servicing and collection practices.

Research approach

Although an extensive literature exists on home mortgage loan default and delinquency, it does not address nonprofit organizations' involvement in originating and servicing the loans. Most studies have focused on the characteristics of the borrowers, the loans, and the purchased properties. By contrast, we have looked at NeighborWorks organizations, which are nonprofit community lenders, and their organizational characteristics associated with loan portfolio performance. These are factors over which leadership of the organization has significant control. They include the following characteristics of local loan programs: corporate mission, programmatic services, oversight, loan administration, tools and practices, and staff.

It should be noted that such organizational factors play a greater role in a nonprofit community-lending setting than in the private market. Differences in community lenders' missions and business cultures, underwriting standards, servicing, collection practices, and social networks increase the role of organizational factors that are associated with loan portfolio performance. In this study we use a qualitative case study approach. Fourteen NeighborWorks organizations were selected for day-long site visits. To ensure the selection of organizations with certain key attributes and geographical distribution, we used a purposive sampling. Using Neighborhood Rein-

vestment's annual survey data, we divided the NeighborWorks organizations into three groups: those whose loan delinquency rate was below 5 percent; those whose delinquency rate was from 5 to 10 percent; and those whose delinquency rate was above 10 percent. The first group was defined as *low delinquency* and the third as *high delinquency*.

We selected seven organizations each from the first and third groups. Other determining factors in the selection of case study sites were the size of the loan portfolio, organizational age, organizational size, and geographic location. We attempted to select as representative a sample as possible. Case studies were conducted at 13 sites across the nation;² one organization refused to participate.

The methodology for the case studies involved examining both low- and high-delinquency portfolios. We hypothesized that the organizational characteristics associated with low-delinquency portfolios should be different from high-delinquency portfolios. The site visits involved a series of interviews with NeighborWorks leadership and staff who play key roles in lending and servicing activity. Included were interviews with the executive director, the chair of the loan committee, loan officers or managers, and other appropriate personnel.

The interviews were semistructured. Specific sets of questions were directed to the respondents depending on their functions and areas of responsibility, but all the questions were open-ended, which allowed probing. Responses to the questions were recorded, and after the interviews were completed transcripts were prepared. The transcripts provided the basis for data analysis to determine the commonalities and differences across organizations related to loan portfolio performance.

Literature review

A significant literature has developed around home-purchase loan performance in the private market, focusing on the characteristics of individual borrowers and loan instruments as they relate to loan defaults. There has been less research on loan delinquency (Quercia and Stegman 1992). A default loan, however, has to pass a delinquent status before it is declared in default. Thus, research findings on loan default are pertinent to a loan delinquency study. Loan delinquency and default are both decisions made by a borrower, with

² These sites are Chelsea, MA; Springfield, MA; Buffalo, NY; Ithaca, NY; Trenton, NJ; Charleston, SC; Chattanooga, TN; Chicago, IL; St. Louis, MO; Great Falls, MT; Santa Fe, NM; Inglewood, CA; and Fort Worth, TX.

delinquency indicating a missed payment or payments and default a decision to stop mortgage payments. A declaration of default is a lender's decision about whether to allow a loan to remain delinquent by exercising forbearance. Forbearance may be limited to the extent that loans have been sold in the secondary market.³ The literature rarely addresses the loan servicing, collection, and related activities of the lender as determinants of loan delinquency or default.

Quercia and Stegman (1992) provide a review of the mortgage-default literature. That literature addresses characteristics of the loan, the borrower, or the property as factors leading to default.

Loan factors

Factors cited in the literature as contributing to default include the following:

1. Loan-to-value ratio
2. Interest rate on the loan
3. Term of the loan
4. Age of the mortgage (up to three or four years after origination)
5. Presence of secondary or junior financing
6. Region of the country in which the loan is made
7. Type of loan (i.e., adjustable or fixed rate, Federal Housing Administration [FHA], U.S. Department of Veterans Affairs [VA], or conventional)
8. Transaction costs of the loan
9. Contract rate compared with market interest rate
10. As an indicator of default, foreclosure costs and state laws governing foreclosure

Once again, to the extent that loan delinquency and default are intrinsically related, a brief discussion of key factors that appear to be

³ We thank an anonymous referee for making this point.

pertinent to both would suffice. A review of the literature on loan factors shows that the higher the loan-to-value ratio, the greater the potential for loan delinquency or default. This is because the borrower has less equity at risk and, therefore, less financial incentive to avoid default. Concern about credit, and possibly the magnitude of transaction costs, serves to partially offset the advantages of default for households with low equity.

The higher the interest rate on a loan, the greater the payments for a given loan amount. Thus, higher interest rates increase the possibility of delinquency or default. Lenders may charge higher interest rates for greater perceived risks, implying that low-income households may pay higher rates and therefore have increased potential for default. As the term of a loan lengthens, the risk of delinquency or default also increases.

One key finding of the mortgage-default literature is that default is most likely to occur three to four years into a loan rather than near its origination date (Mills 1993). This finding may be related to the characteristics of borrowers and properties. Additional loans on a property also increase risk by increasing the total indebtedness of a borrower. As regions proceed differently through economic cycles, default may increase in one region relative to others. Average housing prices and related factors may also affect differences across regions.

Borrower factors

The literature names these borrower factors as contributing to default:

1. Borrower income
2. Variability of borrower income (such as self-employment or commission-based versus salaried)
3. Ratio of payment to income
4. Income from public assistance
5. Personal or family crises, such as loss of employment, death, or divorce
6. Poor credit history
7. Whether the borrower has been required to complete a counseling program

8. Household income and, more important, variability of income, related to borrowers' discretionary income and job security

The higher the payment-to-income ratio, the greater the risk of delinquency and default. With respect to variability of income, certain occupations are more likely to cause fluctuations in household income. Personal or household crises may also affect income directly or indirectly and therefore affect the borrower's ability to make loan payments.

Property factors

Property-related factors that influence delinquency and default are primarily those that affect or measure the extent of appreciation in property value. Delinquency and default are more likely if a borrower's equity is negative (market value of the property is less than the book value of the loan). Factors that lead to a decline in the value of a house include the following:

1. Location (city, suburban, or rural)
2. Local market conditions and expectations of house values
3. Neighborhood characteristics
4. Condominium versus single-family unit
5. Rental rather than owner-occupied unit

Quercia, McCarthy, and Stegman (1995) performed one of the few studies of mortgage default among low-income borrowers. They examined rural, low-income borrowers participating in the Farmers Home Administration (now Rural Economic and Community Development) Section 502 program. They found that the interest rate subsidy provided by the Section 502 program minimized default risk. As Section 502 is phased out with rising income, the default risk increases.

The authors of that study also found that minority and female-headed households had no higher risk of default and that mortgage payment-to-income ratio is a significant factor in default. It has been argued that transfer income (such as welfare), because it is fairly steady, may result in lower delinquency rates than other income sources (Housing Assistance Council 1989),⁴ but the authors

⁴ Note that the impact of welfare reform may change this conclusion, as noted by an anonymous reviewer.

found no positive or negative effect. In general, low-income borrowers have good repayment performance. The authors suggest that early detection and referral to counseling are important for addressing delinquencies, especially those that result from crisis events.

Lender decisions and practices

Little of the literature has examined the role of lender actions in precipitating or preventing delinquency. Lender actions include the underwriting process prior to making a loan, counseling and follow-up after a loan is made, collection practices should a borrower fall behind in payments, and forbearance or movement to default and foreclosure.

Springer and Waller (1993) addressed the issue of lender forbearance—the decision by a lender to work to bring a loan current or to proceed to default. The lender has costs in delinquency situations, including lost interest, opportunity cost of principal, legal fees, and related costs. The lender's decision to forbear is influenced by property value relative to outstanding loan balance; presence of insurance on the loan; market interest rate relative to contract rate (if current rates are higher, the lender wants to be able to capture the higher rate and will foreclose more quickly); local market conditions; the crisis that triggered delinquency and the likelihood of curing the problem; and transaction costs. For the borrower, the decision to default is a trade-off between the penalty in lost reputation from default versus the opportunity cost of foregone investments due to working out the current loan (Lawrence and Arshadi 1995).

A study by the Woodstock Institute and the National Association of Affordable Housing Lenders (Mills 1993) examined community reinvestment loans. These are bank loans to targeted low- and moderate-income households and communities. The study found that delinquency rates are lower than for single-family loans as a whole and that such loans do not appear to be a higher risk than other loans. Lenders interviewed in the study cited the following reasons for the success of community reinvestment loans: knowledge of the borrower, underwriting practices, commitment to the property on the part of the borrower, and banks' willingness to restructure such loans.

Knight, in an article addressing the risks involved in affordable-home-purchase lending, notes: "The lending process itself contributes to risk. Poorly educated consumers increase risk. Most important, with respect to affordable-housing lending, the industry's lack of understanding about this market and its inability to segment it from other home lending is perhaps the greatest harbinger of risk"

(Knight 1996, 69). Knight presents selected data from nonprofit community lenders pertaining to home purchase and rehabilitation loans to show low delinquency rates ranging between 0.9 and 3.2 percent. Consumer education including both pre- and postpurchase counseling, Knight notes, is essential for low delinquency and default rates.

The extant literature does not explicitly address nonprofit organizations and their loan origination, servicing, and collection practices. Also, its primary focus has been on loan default at the expense of loan delinquency, and its research methodology has exclusively been quantitative aggregate-data analysis. By focusing on a section of nonprofit community lenders and their organizational attributes associated with loan delinquencies, and by using a qualitative case-study methodology, we attempt to fill a gap observed in the literature.

Discussion of site visits

The questions on the interview instrument were organized into categories for the purpose of data analysis (the interview instrument is available from the authors by request). These categories are as follows:

1. Organizational history, mission, and services
2. Neighborhood (service area) demographics and dynamics
3. Networks with other organizations
4. Funding sources
5. Role of the board of directors
6. Oversight and accountability
7. Role of the loan committee
8. Staff training and experiences
9. Loan underwriting, servicing, and collection practices
10. Counseling provided
11. Information systems and reporting
12. Causes of loan default and delinquency

Altogether, 50 people from 13 NeighborWorks organizations were interviewed: 7 loan committee chairs; 13 executive directors; and 30 loan officers, collection staff, and other personnel. On average, each interview lasted for one and one-half hours. Our approach to data analysis was to identify commonalities and differences in the organizational attributes of low- and high-delinquency organizations. We then categorized those findings into three types of organizational attributes: business culture and mission; structural elements; and policies, tools, and processes. The following sections summarize our observations and interviews from the site visits.

Business culture and mission

The basis for a soundly performing loan portfolio is set in the approach the organization takes to lending as a component of its package of services offered to the community. The responses of an organization to the following three questions provide an indication of whether it is likely to be a low- or high-delinquency organization.

First, what is the attitude of the organization's leadership and staff toward the lending function? Specifically, are loans treated as loans, with collection considered important to the organization, or are they treated more as a means to an end—the goal being to place funding in neighborhoods to improve the community and its housing stock, while maintenance of a low delinquency rate is seen as less important? Second, what is the overall mission of the organization, and how is lending seen to relate to the mission? Third, are delinquencies and the collection process important to the organization? (For example, is a 10 percent delinquency rate of concern to the organization in terms of its impact on the organization's overall programmatic activities?)

We found that organizations that treat loans strictly as loans and view collections as very important are more likely to have a low delinquency rate than are other organizations. Moreover, these organizations view a high delinquency rate as detrimental to their programs and their relationships with constituents and institutional supporters. Lending activity in these organizations is seen as a central element of their programs. Sending the fiscal discipline message to staff and clients is critical in setting the tone for the importance of timely collection of loans.

The extent to which such an outlook is shared among the leadership as well as the staff is important. In one organization with a high delinquency rate, the executive director held views associated with high-performing organizations, but the second person in command

(a high-level loan manager) and the collection staff reflected contrary views.

Clearly, program goals vary among NeighborWorks organizations and other nonprofit community-based organizations, as is reflected in their portfolio performances. Another way of thinking about this issue was described by two executive directors in high-performing organizations. They saw their organizations as specialized banks and had clear business-oriented outlooks. The basic difference they saw between their organizations and a private-market lender was that they specialized in serving low-income households, providing them with affordable loans. In contrast, organizations with high loan delinquency rates tended to see themselves primarily as community service agencies.

When we asked, “With respect to 90-days-or-more delinquent loans, how would a 10 percent or more delinquency rate affect your organization?” typical answers from executive directors and loan committee chairs of low-delinquency portfolios included comments such as these: “It just would not happen,” “Such a high rate cannot be tolerated,” “We won’t be able to stay in the business. . . . We have to collect in order to make loans,” and “We will lose our funding sources, we have worked hard and long to establish credibility with the bankers here.” To summarize, interviewees in six of the seven low-delinquency organizations indicated that a 10 percent or more delinquency rate would have very serious consequences. Respondents at three of the six high-delinquency organizations said the same. Table 1 summarizes the data presented in the findings that follow.

Structural elements

Structural factors of the organization found to be associated with loan portfolio performance include funding source, staff structure, and the roles of the board and the loan committee chair.

Funding source

Funding source emerged as one of the central factors associated with loan portfolio performance. NeighborWorks organizations receive funds for making loans from a variety of sources, including public funds (predominately federal CDBG funds), banks and other lenders, foundations, insurance companies, and other private sources. Some NeighborWorks organizations rely almost exclusively on CDBG funds, whereas others have a mix of funds available to them. Our site visit observations indicated that low-delinquency

Table 1. Summary of Data Analysis

Organizational Attributes ^a	Organizations with Low Loan Delinquency		Organizations with High Loan Delinquency	
	Yes N = 7	No	Yes N = 6	No
Business culture: "10% delinquency would have very serious consequences"	6	1	3	3
Diversified funding	5	2	1	5
Board/loan committee actively involved	7	0	2	4
Loan/collection committee chair is a banker	5	2	2	4
Functionally specialized loan staff	4	3	2	4
Written loan policy/underwriting guidelines	7	0	4	2
Applying all loan policy/underwriting guidelines	5	2	2	4
Applying all written collection policy guidelines	7	0	1	5
Prompt and regular reports on loan status	5	2	2	4
Average overall staff tenure ^b (# of months in job)	56		25	
Average executive director tenure (# of months in job)	92		61	

Sources: ^aInterviews with 50 staff members and loan committee chairs from 13 organizations.

^bNeighborhood Reinvestment, Annual Survey 1996.

portfolios tended to have a mix of funding sources, a significant number of which were located in the private sector. In some low-delinquency organizations, public funds constituted less than 25 percent of the total. That private sector funding is contributed to a loan portfolio may suggest the role that officials from these organizations play in overseeing that portfolio. This process involves a social network facilitating leverage for the organization (Briggs 1997), as the organization can use the expertise of others in order to more effectively manage its loan portfolio.

Based on our observations, public funding sources provide less oversight for the use of their funds by a community-based organization. In some cases, according to our interviewees, local public agencies

were more concerned with the dispersal of funds than with loan payments. With little oversight or accountability to a funding source, community-based organizations have little incentive to hold delinquency rates down.

One organization with a high-delinquency portfolio was discouraged from taking legal action on properties financed with CDBG funds because “it would send the signal of government kicking low-income families out of their houses.” All 13 organizations we visited used CDBG funds provided by their local public agencies. Irrespective of the amount they received, none of the organizations reported a serious review and follow-up of their portfolio reports by the local CDBG funding agencies. In contrast, organizations that make extensive use of private funds are more likely to be subject to strict oversight by those funding sources and held to higher portfolio performance and reporting standards.

Participation of the private sector in an organization’s programmatic activities is one of the key elements in the NeighborWorks approach to community revitalization, which is based on partnership building among neighborhood residents and the local public and private sectors. Such participation might include serving on a committee and being actively involved in loan and other decisions made by the committee, sharing expertise with employees, or advocating for the organization in business and government forums. Thus, the concept of social capital, defined as accumulated benefits resulting from institutional partnership, is rooted in NeighborWorks organizations’ approach to community-building efforts. Based on our observation of the relationship between sources of funding and portfolio performance, it would be advantageous for a community-based organization to expand its partnership-building efforts and to enhance its effectiveness by means of diffusion of oversight, building goodwill in the community, portfolio management techniques, and know-how from the private sector.

Board and loan committee

Oversight and accountability expectations also come from the board of directors and committees of the organization, especially the loan committee. Lower loan delinquency rates were associated with several board factors, such as having a board chair who is from the private business community, who is in regular communication with the executive director, or who has a significant amount of information on the loan portfolio regularly presented to the board.

One other factor found to be systematically associated with low delinquency rates is the role of the loan committee, and particularly

its chair. Indicators of that association are as follows: an active loan committee that holds regular monthly meetings; the chair of the loan committee being from the financial or banking industry; strong bankers' presence on the committee; and active participation of loan committee members in coaching and training the NeighborWorks loan servicing and collection staff.

Although one low-delinquency organization did not have a loan committee, a finance committee served similar functions. Two years prior to our site visit, one other low-delinquency organization had created a subcommittee to focus on its loan collection, while the committee itself provided oversight on loan approval. The head of the collection department at a local bank chaired this collection subcommittee. Through the persistent efforts of this subcommittee over the last two years, the loan delinquency rate fell dramatically. Through its highly successful and long-term relation-building effort, another low-delinquency organization was able to receive loan servicing for its entire portfolio free of charge from a local bank.

In addition to being a funding source, the private sector's participation in NeighborWorks organizations' boards, in particular the active presence of the banking community on loan committees, provides one other mechanism for the expansion of the social network. That is, NeighborWorks organizations' boards and loan committees serve as a means for the diffusion of business culture, professional skills, and know-how from the private sector to the nonprofit sector. In this way, an organization's staff can understand the implications of delinquency for the operation of the loan program as well as for the organization's ability to attract additional capital. In addition, community lenders' staff learn about the tools and processes that are involved in the private sector's lending. Also important, participation by members of the banking community on the committees allows them to learn about the special problems that confront housing organizations and to spread that knowledge within their business networks. In this way, the committees serve as a means to strengthen the ties between the organization and the broader business community, thereby benefiting neighborhood residents. In this case, the social contacts that come from civic engagement translate into higher human capital (or skill sets) among community lenders and strengthen networks.

By being an active partner in the NeighborWorks community-building effort, the private sector increases its knowledge and awareness of the challenges and opportunities in low-income communities. The partnership also gives the business community an opportunity to become part of the solution in the nation's distressed neighborhoods. And the expansion of home mortgage and home insurance markets into low-income households and ethnic minority

populations constitutes another benefit drawn by the private sector from this partnership.

Staff structure

Another key element associated with loan portfolio performance is staff structure. In contrast to high-delinquency organizations in which staff may only stay on average one or two years, most of the organizations with low delinquency rates have greater loan staff stability, with a typical tenure of five to six years. Promotion within the organization is often used to fill vacancies, and staff has more experience in private lending. We also observed a higher degree of skill and specialization among staff in organizations with high-performing portfolios. Specifically, loan origination and servicing were separate from collection.

Policies, tools, and processes

The third category of organizational attributes—policies, tools, and processes—comprises mechanisms the organization uses to carry out its lending activities. In particular, the tools examined are application intake, underwriting, collections tools and practices, management information systems, and counseling activities.

Intake and underwriting

As discussed previously, some delinquencies are unavoidable. Minimizing the risks of loan delinquency and default, however, begins with the initial contact with potential borrowers and continues through the collection process. In the initial intake, it is key to introduce the borrower to the lender's expectations in making a loan and to commence an ongoing education process. Low-delinquency organizations take care to explain their expectations about timely monthly payments and inform borrowers about the processes involved in housing rehabilitation, loan servicing, and other aspects of the lender-borrower relationship. They also make additional counseling available and recommend solutions if clients have problems making payments.

After an application is taken, the underwriting process begins. All organizations we visited had written loan criteria, but differences existed in the use of those criteria—specifically, with regard to flexibility in their application. Organizations with low-delinquency rates were likely to allow little flexibility in the use of loan criteria, and when flexibility was allowed, it usually required review and ap-

proval by an actively involved loan committee rather than by a staff member. Moreover, the staff in low-delinquency organizations tended to interpret flexibility as negotiating and setting the initial terms of the loan to make it affordable to the borrower. This was facilitated by officers' involvement within their respective communities, which enabled them to make well-informed, although subjective, assessments of what nontraditional factors to count in an applicant's favor when assessing risk. But once the terms were agreed on and the loan was made, it was seen as a strictly binding contract unless an unexpected life crisis occurred. In that case, the lender would be willing to evaluate the situation and, if necessary, restructure the loan.

In contrast, the staff in most of the high-delinquency organizations tended to interpret flexibility as something that is applicable throughout the lending process—from intake and underwriting through collection. As a result, not just the terms of loans but the underwriting criteria, collection policy, and procedures all were subject to negotiation between the lender and the borrower.

Collection

All low-delinquency organizations, without exception, establish and diligently follow a clear course of action when a payment is past due. Typically, by the end of the second week of a payment's past-due date, the first phase of this course of action is completed: a phone call by the collection staff or loan officer is made or a reminder postcard is mailed. In some organizations, both are done. If staff does not hear from the borrower by the end of the 15th day, a formal letter, usually signed by the executive director, is sent, and more phone calls follow.

A common view in low-delinquency organizations is that once a loan becomes more than 60 days delinquent, it is very difficult to return to up-to-date status. As one highly effective collection staff member noted, "The more a past-due loan ages, the more difficult it is to bring it back current." Each organization has developed its own strategy to prevent a past-due loan from passing this critical 60-day mark. In most organizations, a second or even a third personal letter is sent, and an interview with the borrower is conducted to discuss the situation.

If delinquency continues beyond 90 days, some organizations send their staff to visit and assess the property; others may send a letter signed by a lawyer reminding the borrower of the possibility of legal action. In our sample, one low-delinquency organization had initiated three foreclosures a few months before our visit.

Low-delinquency organizations have developed and effectively use one other collection mechanism: a loan write-off and forbearance policy, with the ultimate decision resting with the board or loan committee. Once all collection options are exhausted and the loan is defined as uncollectible after 120 or more days of delinquency, the write-off procedure is initiated. Or given special circumstances of a delinquent situation—such as an unexpected life crisis—the organization may initiate a forbearance procedure or restructure the loan. This provides the organization with a legitimate procedure for avoiding accumulation of loans that are more than 120 days delinquent and that cannot be collected.

In contrast, most of the organizations with a high-delinquency rate had not developed adequate collection policy tools. And those few who had such tools did not systematically use them. For example, all six high-delinquency portfolios in our sample had loans that were past due by six months or more. In some cases, the borrowers could not even be located. For this and other reasons, these loans were clearly uncollectible. However, four organizations simply did not have any write-off or forbearance policy, and the other two that had write-off policies on paper had never used them. In short, when dealing with loan delinquency, having a past-due reminder postcard or a delinquency form letter are not enough. Systematic, persistent, and coordinated use of collection policies and tools are critical.

Concerning collection, one staff member from a low-delinquency organization summed it up: “You don’t have to be a rocket scientist to know what has to be done. If you have made a loan and the payment is not received when it is supposed to [be], you just have to go after it. Go after it and be very, very persistent about it. Remember, the borrower has signed a contract to make the payments on time.”

Management information and reporting

Our site visits indicated that the effectiveness of an organization’s reporting capability and information dissemination—not necessarily using a fully automated electronic system—was closely associated with its delinquency rate. In most of the low-delinquency organizations, a loan status was identified and reported within two weeks of a payment’s due date. In sharp contrast, in most high-delinquency organizations it took more than a month, and in some cases two months, before a past-due payment could be identified and reported. In one such organization, a loan was already 60 days past due by the time the executive director received the first delinquency report. In many instances, the loan committee might not even get and review a delinquency report until a loan had reached its 90-day past-due mark.

In our sample of low-delinquency organizations we found a wide range of computerization. Two organizations either had or were developing a local area network (LAN). Most others had no more than relational database capability or spreadsheet software. Two factors, however, were clear. First, low-delinquency organizations had developed a very effective and fast way of identifying and reporting past-due loans. Second, in their overall use of computer technology, these organizations were generally ahead of those with high-delinquency portfolios.

As noted earlier, a common goal in low-delinquency organizations is to prevent aging of a delinquent loan—that is, to bring it up to date before it becomes 60 days delinquent. Most of the low-delinquency organizations expend considerable effort on the front end to prevent loan aging. Thus, it is critical to have an effective way of identifying and reporting past-due loans within a few days of a payment's due date. In one low-delinquency organization, within the second week of a loan becoming past due, the finance committee would already have received and discussed its performance during its regular bi-weekly meetings.

Management information systems and an effective electronic database are important tools in tracking loans and understanding the performance of a particular loan portfolio. Having an effective loan servicing and collection system depends, to a large extent, on the capability to generate and disseminate timely and accurate reports on the portfolio status. Availability of such information to the executive director, board, loan committee, and appropriate staff facilitates their knowledge of the portfolio and promotes their involvement in decisions and courses of action with regard to delinquent loans.

Two types of data are maintained by NeighborWorks organizations in various ways. First, potential borrowers provide information on their applications concerning household characteristics, income, wealth, debts, and anything else required by the lender to make a loan decision, as well as information on the amount, terms, and purpose of the loan. Credit reports and other information are added to this data. Many organizations use software designed to record this information and create a database for underwriting purposes. Once a loan is approved, many organizations use another software package to create a servicing profile for the borrower. This database tracks the amount owed and payments made and may generate reminder notices to borrowers.

None of the organizations we visited had integrated their application intake and servicing databases, although two low-delinquency organizations were in the process of doing so. Having such an inte-

grated database would facilitate the examination of demographic factors associated with delinquent loans.

Counseling

As indicated previously, by far the majority of NeighborWorks portfolios consist of rehabilitation loans. Rehabilitation loans typically involve the NeighborWorks organization in developing plans, writing specifications, and monitoring construction progress in addition to making the loan. In most cases, the organization selects the contractor on the basis of competitive bids. In other cases, the borrower selects a contractor from a list recommended by the organization. In either case, the NeighborWorks organization, as a lender and as a payer of the rehabilitation costs, oversees the construction process.

In our site visits, survey questions were asked about the training and counseling offered to borrowers. We did not observe a clear and systematic difference based on formal counseling between high- and low-delinquency organizations. In general, neither organization offered extensive loan counseling services. Nevertheless, staff from low-delinquency organizations were more likely to report that borrowers are counseled during loan application intake about their responsibility for making timely payments and that skilled staff are available to provide one-on-one counseling to clients having financial or other problems that affect their ability to make loan payments. Also, according to one collection staff member, “The lack of clarification of a borrower’s expectations about the rehabilitation outcome, and the quality of rehabilitation services provided by the lending organization, may create a collection problem down the road.” That is, some borrowers may refuse to make their payments simply because they are unsatisfied with the rehabilitation outcome. From a borrower’s perspective, such an action is reasonable because, in most cases, NeighborWorks organizations’ involvement includes writing rehabilitation specifications, selecting a contractor, and overseeing the construction progress.

Summary and recommendations

Business culture and approach

Community-based lending organizations that view their lending activities as a banking business and treat loans as loans, stressing the importance of servicing and collection, tend to have lower delinquency rates. These organizations view affordability and flexibility as functions of negotiating the terms of loans, not as factors in collections. To be effective, such an attitude must pervade staff

throughout the organization. In its absence, an organization may have all the necessary collection tools and policies but not produce any long-lasting effect on the rate of past-due loans.

Funding source

Organizations with multiple sources of funds, particularly non-public funds, tend to have lower delinquency rates. This, we believe, is due to the funders' oversight and their expectation of business-like performance. Further, losses in such a loan pool are more likely to result in fewer funds being available in the future. For a community-based organization, diversification of its funding sources does more than increase its loan fund; it also expands its social network by involving a broad component of the larger community in the activity of the organization.

Board and loan committee

Organizations with the active involvement of the business community on their boards—and in particular the active involvement of a financial institution and banking staff in their loan committees—tend to have lower delinquency rates. This is due to the diffusion of the businesslike corporate culture and the transference of skills from the private sector to the nonprofits. Once again, increasing the participation of the business community and banking institutions in community-based nonprofits expands the latter's social network, making more participants in the larger community aware of the work of the organization.

Stable and functionally specialized staff

Organizations with relatively low staff turnover, and with loan servicing staff separated from the collection functions, tend to have lower delinquency rates. This is due to the development of staff skills through longer tenure, a focus on learning specialized tasks, and the creation of a social distance between borrowers and collection staff.

Given the average staff size of NeighborWorks organizations (the equivalent of seven full-time employees) and the average portfolio (110 loans), for most organizations it is not cost-effective to have two staff members involved in loan intake, servicing, and collection. One possible solution is to develop a pooled collection service—that is, to have either an outside agent or a skilled collection staff located in one of the network organizations provide collection services

for several nearby organizations. Today's electronic and communication technology effectively lends itself to such an approach. Moreover, Neighborhood Reinvestment's district-based structure would also fit well with pooled regional collection services.

Intake and underwriting

All organizations we visited had the necessary intake and underwriting tools and documents on hand. However, organizations that consistently implement them in their daily business activities tend to have lower delinquency rates.

Collection

Organizations with a clear and exhaustive course of action for collection—including the possibility of legal action, write-off, and forbearance tools—and persistent follow-up of their collections policy tend to have lower delinquency rates.

Management information and reporting

Organizations with quick and accurate reporting and dissemination capabilities, whereby any past-due payments are identified and reported within 15 days, tend to have lower delinquency rates.

Counseling

Lenders who educate borrowers about the organization's business-like expectation of timely payments and who, in turn, understand borrowers' expectations about the results and quality of rehabilitation services will likely lower their loan delinquency rate.

Conclusion

To conclude, the implications of our findings are two-fold. First, community-based lending organizations can improve their loan portfolio performances by incorporating some of the attributes of organizations with low-delinquency rates. Second, active participation of the private sector—particularly of financial and banking institutions—in the efforts of community-based organizations results in the expansion of social networks and benefits all partnership groups. The net results include improving home values in low-

income neighborhoods through access to rehabilitation and home improvement loans, expanding the homeownership market to low-income households and minority populations, stabilizing and building up stressed neighborhoods, and expanding the real estate tax base.

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