UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

CIVIL DIVISION

AUG 7 1970

Dear Mr. Smith:

As you know, the General Accounting Office is reviewing the manner in which the Farmers Home Administration is carrying out its policies and procedures for determining the financial feasibility of rural water and sewer projects. We plan to furnish for your review and comment a draft report summarizing the results of our review at a later date.

The purpose of this letter is to apprise you of the circumstances surrounding one instance noted during our review of a water and sewer project in the State of Washington. In this case, FHA provided loan and grant assistance to a borrower who had adequate resources to qualify for credit from a source other than FHA.

Section 306 of the Consolidated Farmers Home Administration Act of 1961, as amended (7 U.S.C. 1921) authorized FHA, among other things, to make water and sewer loans to a public or nonprofit association only when FHA determines that the association is unable to obtain sufficient credit elsewhere to finance its actual needs at reasonable rates and terms. The 1961 act provides also that FHA require a public or nonprofit association to refinance its FHA indebtedness whenever it can obtain a loan for such purpose from a responsible private or cooperative lender at reasonable rates and terms.

To ensure that FHA credit programs do not supplant or compete with suitable credit available from other reliable credit sources, FHA has issued a series of instructions which require county supervisors to make determinations regarding (1) the inability of loan applicants to obtain credit elsewhere and (2) the ability of borrowers to refinance their FHA indebtedness by obtaining loans from other sources of credit.

In February 1966, the town of Cathlamet, Washington, received FHA approval for a $150,200 insured loan and a $94,200 grant to finance the construction of new facilities and improvements to the town's existing water system. After the town had received the funds, FHA State and county officials learned that it had substantial timber assets which could have been sold or used as collateral to obtain private financing. On June 27, 1968, the timber was sold by the town for $446,000.

FHA State and county officials advised us that the loan and grant assistance to the town would not have been approved had they known that the town owned the timber.

In July 1968, FHA Washington State officials looked into the possibility of having the town use some of the timber proceeds to repay the FHA loan--no consideration was given to whether the town should repay the FHA grant. In August 1968, after learning that the town's revenue bonds securing the loan were sold by FHA in April 1967 and that the bonds were not callable prior to maturity or a period of 5-years from the date they were sold by FHA, the Washington State Office decided not to take any further action until the 5-year bond period had expired.

FHA records at the Washington State Office did not indicate any further action until January 1970 when we expressed an interest in this case and stated the view that action should be taken to recover the loan and grant funds. At that time, FHA State officials agreed to initiate further action to determine whether the town should be required to repay the FHA loan and grant.

In a letter dated May 3, 1970, to you, the Washington State Director took the position that the grant funds should be recovered from the town if the grant agreement provided a legal basis for collection. On May 28, 1970, the Acting Assistant Administrator, FHA, referred the question of recovery of the grant funds to the Office of the General Counsel, Department of Agriculture, for its consideration.

From our review of the loan and grant documents relating to this case and our discussions with FHA State and county officials, it appears that the town was ineligible for both loan and grant assistance under the provisions of the 1961 act, since the town had sufficient resources to obtain credit elsewhere to finance its needs.

On July 31, 1970, we discussed the circumstances surrounding this case with an attorney of the Department's Office of the General Counsel. It was his tentative opinion that FHA has sufficient legal basis to demand repayment by the town of both the loan and the grant. The attorney advised us that the Office of the General Counsel will furnish you with its views regarding the various courses of action available to FHA for demanding repayment of the loan and the grant.

In view of the actions already taken since we expressed an interest in this case, we are not making a recommendation at this time. We would, however, appreciate being advised of the specific actions taken or planned by FHA following receipt of the views of the Office of the General Counsel.

Copies of this letter are being sent to the Inspector General and the General Counsel, Department of Agriculture.

Sincerely yours,

Victor L. Lowe
Associate Director

Mr. James V. Smith, Administrator
Farmers Home Administration
Department of Agriculture