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Report to the Chairman, Government Information, Justice, and Agriculture Subcommittee, Committee on Government Operations, House of Representatives

July 1992

RURAL DEVELOPMENT ADMINISTRATION

Patterns of Use in the Business and Industry Loan Guarantee Program

147388

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Resources, Community, and Economic Development Division

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July 29, 1992

The Honorable Bob Wise
Chairman, Government Information,
Justice, and Agriculture Subcommittee
Committee on Government Operations
House of Representatives

Dear Mr. Chairman:

Concerned with the economic disparity between the nation's rural and urban areas and the resulting steady migration of the rural population to the cities, the Congress passed the Rural Development Act of 1972 (P.L. 92-419). This act established the Business and Industry (B&I) Loan Guarantee Program within the U.S. Department of Agriculture's (USDA) Farmers Home Administration (FmHA) with the aim of improving the rural economy by creating jobs, maintaining and attracting businesses, and providing services comparable to those available in urban areas. With an annual budget of $100 million, the program provides for government guarantees of loans by private lending institutions to businesses located in communities with fewer than 50,000 people and gives priority to businesses located in communities with fewer than 25,000 people.

This report responds to your request that we determine (1) the extent to which states and territories are using the B&I program and why some are not using the program, (2) the types of industries that have received B&I loan guarantees, and (3) the impact of the program on rural development. To respond to these objectives, we, among other things, met with FmHA state office representatives in four states—Minnesota, Missouri, North Carolina, and West Virginia—that actively participate in the program, and we conducted a telephone survey of the 11 FmHA state offices representing the 13 states that had not used any B&I loan guarantee authority in fiscal years 1989-91. (See app. I for a complete discussion of our methodology.)

During the period of our review, FmHA administered the B&I program. In this report, references to the national office and state office staff apply to FmHA's structure.

On December 31, 1991, the Secretary of Agriculture created the Rural Development Administration (RDA), as mandated by the Food, Agriculture, Conservation, and Trade Act of 1990 (P.L. 101-624). This act required the transfer of certain rural development programs—including the B&I loan guarantee program—to RDA. National office personnel were transferred to RDA on April 5, 1992, while regional and state office personnel expect to be transferred sometime during October 1992.

Results in Brief

Many rural areas are not using funds available under the B&I program. Of the 50 states and 3 territories included in the B&I program, 26 states and territories—represented by 19 FmHA state offices—did not use any of the funds allocated to guarantee B&I loans in 1991. Thirteen states and two territories did not use the program in fiscal years 1989-91, including several states that are among the nation's largest in terms of the percentage of their population living in rural areas. The number of loans guaranteed in the states that participated in the program during these fiscal years ranged from 1 in seven states to 31 in one state. According to some national office staff and FmHA officials we surveyed in state offices active in the program, the lack of use of the program resulted from individual FmHA state directors' preferences for emphasizing other FmHA programs. However, FmHA state office staff in the 13 states that did not use the program cited a variety of reasons why their offices did not obligate their loan guarantee authority. These reasons included competition from other federal and state rural development programs, application costs that may be prohibitive to potential borrowers, and restrictive program regulations. For example, program funds may not be used for businesses related to tourism, an industry on which a large portion of the rural economy of many states depends.

B&I loan guarantees are being used by both small and large industries, ranging from small family entrepreneurs to high technology firms. Manufacturing businesses received the largest dollar amount in loan guarantees during fiscal years 1989-91—45 percent; retail businesses received the next largest share—17 percent; service industries received 10 percent; and wholesale businesses received 9 percent. The remaining 18 percent went to other industries. Seventy-eight percent of the funds backed by B&I guarantees went to established businesses that primarily emphasize retaining existing employment in rural areas. The relatively small proportion of loan guarantee funds used for new businesses—22 percent—may reflect the inability of entrepreneurs to meet the program's equity requirements.

The impact of the B&I program on rural development is difficult to quantify, in part because FmHA does not have accurate data to indicate the program's impact, such as the number of jobs created or retained. In the four states we visited, the B&I program helped to create jobs and establish services comparable to those in urban areas, as the program intended. However, B&I loan guarantees may not be going to areas where unemployment is most widespread. For example, 61 percent of the loan guarantees obligated in fiscal years 1989-91 went to communities whose unemployment rate was below that of the state's nonmetropolitan rate.

Background

Several federal agencies, including the Small Business Administration (SBA) and the Department of Commerce's Economic Development Administration (EDA), have programs to aid rural development. In addition, many states have programs making loans, grants, and technical expertise available to rural businesses. But FmHA has taken the leading role in federal economic lending programs serving rural America, covering water and waste disposal and the development of community facilities, business, and industry. The B&I program works principally by providing guarantees to private lending institutions to insure against losses on certain loans made to rural businesses and industries. FmHA may contract to reimburse the lender a maximum of 90 percent of principal and interest, although most guarantees are currently limited to 80 percent.

The amount of loan guarantee authority is allocated among the states on the basis of population, unemployment, and income criteria. Individual FmHA state offices have great autonomy in promoting and administering the B&I program. The state director evaluates all B&I loan guarantee applications and is responsible for assigning priority points to projects for the purpose of obligating loan guarantees. Priority points are based upon several factors, including the population and unemployment rate of the area where the applicant is located. In 17 states, the state director can approve guarantees for loans under $2 million, and in 1 state, the state director can approve guarantees for loans under $1 million.[1] For loans above that amount to the maximum of $10 million or in states without approval authority, applications must be forwarded to FmHA's national office for approval.

Approval authority for loan guarantees is granted to an FmHA state office on the basis of the office's experience in using the B&I program, including whether the B&I chief has used the program previously; whether the staff members, including the FmHA state director, have financial training; how

[1] FmHA state directors in Illinois, Kansas, Maine, Michigan, Minnesota, Mississippi, Missouri, Nebraska, New York, North Carolina, Ohio, South Carolina, South Dakota, Tennessee, West Virginia, Wisconsin, and Wyoming have authority to approve loan guarantees up to $2 million. The director of FmHA's Kentucky state office has authority to approve guarantees up to $1 million.

many loan applications the state office has submitted to the national office; and whether the state office has an active program to promote the use of B&I loan guarantees.

In fiscal year 1980, the B&I program guaranteed over $1 billion in loans, but a congressional report criticized the program's improper lending criteria, poor loan servicing, and subsequent high default rates. Following congressional criticism, funding for the program was severely reduced: In fiscal year 1991, the B&I program obligated approximately $100 million for 92 loan guarantees. Loan losses within the B&I program have decreased in recent years. FmHA national office data show that of the over $4.8 billion in loans guaranteed between fiscal year 1974 and fiscal year 1991, 13 percent of these funds were lost as a result of loan defaults but less than 4 percent were lost on loans made since 1985. (See app. II for data on loan losses within the B&I program.)

On April 5, 1992, the B&I program's national office staff was transferred to RDA. RDA—charged with administering USDA's rural economic development efforts—will be organized around seven geographic regions, each with a regional office. (See app. III.) Regional offices are expected to become operational by October 1, 1992. Additionally, Rural Development Area offices will be created to serve as the primary point of contact with the public. However, exactly how many Rural Development Area offices there will be and whether an office will be located in each state have not been determined. USDA has been criticized recently for its large and duplicative program delivery structure. Efforts are under way within the agency to downsize and consolidate many of its local and district offices.

States Vary Widely in Their Use of the B&I Program

Nineteen of the 46 FmHA state and territory offices—representing the 50 states and 3 territories (Puerto Rico, the Virgin Islands, and the Western Pacific Areas)—did not obligate any B&I loan guarantees in fiscal year 1991. FmHA offices in 13 states and 2 territories did not obligate any B&I loan guarantees in fiscal years 1989-91. (App. IV shows the number of B&I loan guarantees made in each state in fiscal years 1989-91.) Several of the FmHA offices not using the program are located in states, such as Arkansas and North Dakota, that are among the nation's largest in terms of the percentage of their populations living in rural areas.

Some FmHA staff in the national office as well as staff in state offices that participate in the program attribute this lack of activity to each state director's individual preference for the programs he or she chooses to emphasize.[2] However, according to FmHA state directors and B&I program chiefs in the states that are not active in the program, certain features of the B&I program restrict potential borrowers and lenders from participating. These features include costly fees associated with loan application requirements and restrictions on the use of loans for tourism. The availability of other economic development programs has also limited the use of the B&I program in some states.

State Directors' Preferences May Influence Program Use

Some state directors vigorously promote the B&I program to foster rural development in their states while others do not. FmHA staff in state offices active in the B&I program and in the national office—as well as representatives of rural development organizations—attributed the differences in how the FmHA state offices use the program to the different attitudes and philosophies of the state directors. One FmHA state director told us that his counterparts in other FmHA state offices promote the agency's farmer programs more diligently than the Community and Business Programs, believing that the farmer programs alone will result in adequate rural development. In fact, 12 of the 13 FmHA state offices in our telephone survey placed the B&I program last when asked to rank the FmHA programs they promote most often. Some of the directors of these FmHA state offices expressed concern about overpromoting the program because they feared that they would not have adequate funding to meet any increased loan demand.

Those FmHA state directors who actively promote the program benefit when other FmHA state offices do not use the program. FmHA has established a system in which half of any funds not used by states and territories after the first two quarters of the fiscal year are placed in a pool. States that have depleted their fund allocation can draw additional funding from this pool. In August of each fiscal year, the remaining funds from each state are also pooled and made available to other states. Because of this approach, six states were able to exceed 100 percent of their original allocation each fiscal year during fiscal years 1989-91; two of these states have received over 10 times their original loan allocation during at least one of these fiscal years. (App. V summarizes the extent to which each state and territory obligated its loan guarantee authority for fiscal years 1989-91.)

[2]Other FmHA programs available to the state director include direct and guaranteed loans for farmer programs, rural housing loans, water and waste grants and loans to municipalities, and loan and grant funds for the construction of community facilities.

FmHA state office directors in two of the four states we visited noted that their efforts to promote program use are aided if they have the authority to approve loan guarantees without national review. More specifically, the directors told us they use the shorter loan-processing time that approval authority at the FmHA state office level affords to promote the program with lenders. FmHA officials in 10 of the states least active in the B&I program agreed that there are benefits associated with state approval authority. One of these state offices—Vermont, which also represents New Hampshire and the Virgin Islands—said that it had considered applying for approval authority but was discouraged from applying because the office lacked the experience in processing B&I loan guarantees required by the program regulations.

Competing Federal and State Programs Contribute to Lack of B&I Program Use

Lenders and borrowers can also choose from several other federal and state rural economic programs, including SBA and EDA programs as well as state-sponsored grants and loans. Ten of the FmHA state offices contacted in our telephone survey attributed their not using B&I loan guarantees to the availability of such programs. For example, Oregon's lottery earmarks funds for loans and grants for rural development. The state director for the combined FmHA state office representing both Maryland and Delaware reported that these two states are very aggressive in providing state-funded loans and grants to businesses in rural areas, which may account for the lack of activity in the B&I program in these two states.

The largest program competing with the B&I program is SBA's 7(a) guaranteed loan program. Under FmHA regulations, loans under $750,000 should be referred to the SBA program. Three of the FmHA state directors we surveyed stated that because their B&I allocations are below $750,000, the regulations restrict them from obligating any loan guarantees. According to the B&I program director at the national office, such statements clearly reflected misunderstandings on the part of the state directors. He said the regulations only require that FmHA make the borrower aware that the SBA program exists; the choice of agency used for the guarantee is left to the lender and borrower. However, language in the B&I program regulations states that borrowers "will be encouraged to apply to that agency [SBA]."

Lenders and FmHA staff in the states we visited that actively participate in the B&I program said that whether a borrower uses SBA or FmHA depends on the lender's experience in dealing with each program. Five of the FmHA state offices in our telephone survey said that one reason they have not made any B&I loan guarantees is that lenders are more familiar with the SBA program. In fact, seven lenders we interviewed agreed that lenders will tend to work with the program they have the most experience in.

Three FmHA state offices in our telephone survey said that SBA can process the loan guarantees more quickly than FmHA. Two other FmHA state offices agreed, stating that the B&I loan guarantee process is cumbersome in comparison to SBA's. In addition, one lender we interviewed gave an example of two loans—each for the same amount and to the same borrower—with dramatically different guarantee approval times: The SBA loan approval took 2 weeks; the B&I guarantee took 6 months. SBA's program is more workable for some lenders because it uses a preferred lender program in which banks are authorized to approve loans that are subsequently reviewed by SBA. Furthermore, when certified lenders submit loan applications to SBA, the agency agrees to make an approval decision within 3 business days. SBA markets its approved lender program to borrowers and lenders as a means of encouraging participation.

FmHA uses a preferred lender approach in its farmer loan program but not in the B&I program. FmHA officials agreed that an approved lender approach might reduce the loan-processing time for B&I loan guarantees but believed that speeding up the process could reduce the quality of the loan review. Because the program allows for loan guarantees as high as $10 million, the quality of the loan review is of great concern to FmHA staff.

Some Program Features Deter Borrowers

Application costs to borrowers who want to participate in the B&I program can be prohibitive. Applicants are required to produce feasibility studies—averaging between $5,000 and $10,000 in cost—and audited financial statements, and to have extensive equity—20 to 25 percent of the loan amount for new businesses. Still other projects require environmental assessments that could increase costs to the borrower. These costs, coupled with borrowers' costs for appraisal fees and credit reports, may impede participation by small borrowers. Three FmHA state office representatives surveyed by telephone said they believe the program is designed for larger businesses that can absorb these costs more easily than newly founded businesses. In fact, one FmHA state office representative told us that for loans under $400,000, the borrower is advised not to participate because these accompanying costs are too high to make the project worthwhile. Another FmHA state office reported that its state per capita income is so low that very few businesses have the cash necessary to apply for a B&I loan.

Some FmHA state offices are taking steps aimed at reducing application costs. For example, for loans under $2 million, the B&I program regulations allow the state director to waive feasibility studies. Several offices active in the B&I program told us that they use this authority to make the program more flexible so that smaller borrowers are included. Additionally, one state office will internally conduct market and feasibility studies using available resources, thus providing the state director with the information for making a decision on the loan without imposing the high cost of such studies on the borrower. Staff from another state office have developed a computer program to analyze the financial condition of the office's borrowers, eliminating the need for audited financial statements in some cases.

Prohibition of Tourism Loans May Restrict Potential Borrowers

Many states may be affected by the restriction on using loan guarantee authority for activities related to tourism because a major portion of their rural economy is dependent on tourism. Twelve of the 13 states in our telephone survey of states not active in the program responded that the restriction on tourism may exclude potential borrowers in their states. The four active states we visited shared these views, noting that they continue to receive inquiries from potential borrowers for projects related to tourism.

FmHA restricted loans for projects promoting recreation and tourism in 1983. The agency based its decision on the belief that recreation and tourism projects are capital-intensive and create very few jobs—many of which are seasonal. However, a December 1990 study by the Tourism Policy Council cited a federal task force report on rural tourism that recommended that "rural tourism . . . be recognized for what it is—a legitimate means to enhance economic development in, and the competitiveness of, rural America." The study pointed out that, in the past, rural development experts have dismissed tourism as seasonal and frivolous, lacking the potential to help raise the low income levels of rural areas. In recent years, however, because of the high unemployment rates in rural areas, experts have begun to consider tourism "in a more favorable light." The task force concluded that "tourism can be a contributor to rural economic development—the same as agriculture and manufacturing."[3]

[3]Rural Tourism Enterprise Zones, Final Report of the Policy Committee on Rural Tourism Development to the Tourism Policy Council (Washington, D.C.: Dec. 12, 1990).

B&I Loan Guarantees Are Being Used for a Variety of Purposes

Numerous industries and services use funds from the B&I program. Forty-five percent of the loan funds guaranteed in the past 3 fiscal years were used by the manufacturing sector, which creates a large number of relatively high-paying jobs and provides competitive benefits to employees. Other industries receiving guaranteed loan funds include retail and wholesale businesses (17 and 9 percent, respectively) and service industries (10 percent). The remaining 18 percent of the funds are spread among five other categories. (See app. VI for a list of the types of industries funded through the B&I program for fiscal years 1989-91 and the percentage of guaranteed loan funds they received.) Seventy-eight percent of the funds guaranteed went to established businesses, whereas only 22 percent went to new businesses. Some state FmHA officials, as well as lenders and rural development planners, cited the equity requirements—20 to 25 percent for new businesses—associated with start-up ventures as the reason for this disparity.

Businesses that received B&I loan guarantees in fiscal years 1989-91 range from small, family-owned business operations—a convenience store, for example—to large, highly skilled industries employing the latest management techniques and advanced technologies, such as robotics. Some of the industries represented were already associated with the rural areas where they are located—textile manufacturers in North Carolina or a meat packing plant in Minnesota, for example. Other industries relocated to rural areas to take advantage of abundant labor and lower costs of living as well as the many available federal credit programs. Some companies funded by the B&I program are competitive not only in the U.S. market but also abroad.

One of the purposes of the B&I program is to encourage the development of services in rural areas comparable to those being offered in more urban areas. In recent debate, the Congress has expressed concern that many of rural America's young adults are emigrating from rural areas to areas that offer these services. We visited two areas where B&I program guarantees had been used to establish such services—one a full-service grocery store, the other a rehabilitation hospital.

The grocery store serves Brookfield, Missouri, a town of 5,555. It features a bakery and delicatessen as well as a comprehensive meat/seafood section, a produce department offering a variety of exotic fruits and vegetables, a floral shop, and a video rental service. The store's owners believed that the town's residents—many of whom are younger and choose to live in rural areas to provide a better standard of living for their children—would frequent a store with "all the amenities" rather than drive an hour to the nearest grocery store.

The rehabilitation hospital—located in Morgantown, West Virginia—is a modern facility specializing in treating patients suffering from brain and spinal injuries. The 60-bed facility is designed to address all aspects of the patient's recovery, both physical and emotional. Before the hospital opened, patients in the northern half of West Virginia had to travel to Pittsburgh to obtain comparable services.

Impact of the B&I Program Is Difficult to Quantify

The impact of the B&I program is difficult to measure, in part because FmHA lacks accurate information on the program's success. For example, FmHA's statistics on the number of jobs each B&I project creates or saves are not reliable. Other program statistics—including the number and purposes of loans guaranteed—are similarly inaccurate. Furthermore, one indicator of the program's success is the extent to which loans are targeted to rural areas with high unemployment. In this regard, our analysis, as well as analysis by others, raises questions about the effectiveness of FmHA's targeting efforts.

FmHA Does Not Have the Information It Needs to Measure Program Impact

The data that FmHA maintains for monitoring and evaluating the B&I program on its Rural Community Facilities Tracking System (RCFTS) are sometimes inaccurate and unsuitable for program evaluation. FmHA's primary measure of the impact of the program is the number of jobs created or saved since the program's inception. RCFTS contains figures on both estimated and verified gains in employment. However, national office staff acknowledge that neither of these figures may reliably indicate the program's success.

Estimates are figures supplied by borrowers at the time of the application. These figures may over- or underestimate the actual potential of the project for creating employment. FmHA staff in the state offices are required to annually verify these estimates using tax records for each borrower. In all four states we reviewed, applicants overestimated the number of jobs to be created or saved, according to actual job totals verified by FmHA. In two states we visited, the borrowers' estimates exceeded FmHA's figures by nearly 9,000 jobs and by over 10,000 jobs in fiscal years 1989-91: In North Carolina, borrowers estimated that 34,592 jobs could be created or saved, while FmHA staff verified only 25,606 existing jobs. In West Virginia, borrowers estimated a gain or savings of 27,833 jobs, while FmHA staff verified only 17,174 existing jobs.

Even employment data verified by FmHA may not be accurate or current because once a loan has been paid off, FmHA stops verifying the borrower's employment records. Thus, any changes in employment that occur after the loan has been paid will not be reflected in the data base.

Furthermore, national office staff noted that the state offices do not always update RCFTS program statistics—for employment or other program characteristics—in a timely manner. As a result, program information is incomplete, making management of the program difficult. The reliability of the system is thus further weakened.

A review of other B&I program indicators tracked on RCFTS and other FmHA information systems revealed other inaccuracies in B&I program data. Loans were categorized under incorrect Standard Industrial Classification (SIC) codes; statistics on the populations of towns where loan guarantees were distributed were inconsistent; and the actual number of loans made during the 3-year period covered by our review was inconsistent. For example, when categorizing loans into SIC codes, FmHA incorrectly assigned loans for service-related industries to the finance, insurance, and real estate category 20 times, creating the misconception that these loans had not been made to service industries. Out of 231 loans reviewed, we found 78 that had been assigned to the incorrect category. In addition, RCFTS and FmHA finance office data differ on the number of loans made during the period of our review—231, according to RCFTS, and 262, according to the finance office. We have previously reported that, throughout USDA, managers do not have the information necessary to effectively manage their programs.[4]

Effectiveness of FmHA Loan Targeting Is Questionable

FmHA is mandated by law to target loan funds by population: Businesses must be located in communities with fewer than 50,000 people and priority given to firms in areas with fewer than 25,000 people. The program also excludes businesses in areas adjacent to cities of 50,000 or more that are urban or becoming urban. Beyond the mandated criteria for targeting, FmHA regulations require that the state office complete a priority point scoring sheet indicating the relative need for each project. Priority points are based on the population of the nearest town, the unemployment rate

[4]U.S. Department of Agriculture: Revitalizing Structure, Systems, and Strategies (GAO/RCED-91-168, Sept. 3, 1991).

for the area, and the number of jobs to be saved and/or created by the intended project. According to B&I program regulations, one of the purposes of the priority point system is to help target the loan guarantee to small communities with relatively high rates of unemployment.

FmHA is adequately targeting the loan funds according to the congressional criteria—90 percent of the funds go to businesses located in communities of fewer than 25,000 people. (See app. VII.) However B&I loan guarantees may not always be distributed to areas with the highest unemployment. Targeting issues may become more critical if demand for B&I loan guarantees increases.

In 1988, the Center for Community Change, a private policy analysis organization, analyzed the distribution of FmHA's B&I loan guarantees and concluded "that targeting of assistance to poorer rural communities is not strong."[5] This conclusion was based on an analysis of the relative income and unemployment levels of the counties where B&I borrowers are located. The study indicated that many of the areas where B&I loan guarantees were granted had both income and employment levels above the statewide nonmetropolitan average.

B&I borrowers during the period of our review demonstrated the same pattern described in the Center for Community Change study. We reviewed 220 loan guarantees in 37 states during fiscal years 1989-91 and found that 39 percent of the loan guarantees went to areas with income and employment levels above the statewide nonmetropolitan average. For the four states we visited, 46 percent of the loan guarantees and 56 percent of the total dollar amount of these loans went to areas with the same characteristics: per capita income above the statewide nonmetropolitan average and unemployment below the statewide nonmetropolitan average. (App. VIII shows how the B&I guaranteed loans were distributed nationwide and in the four states we visited.)

State directors and program chiefs in the states we visited provided at least a partial explanation for why the B&I guaranteed loans may not reach areas that could benefit most. In their view, ranking loan applications according to unemployment is unnecessary unless the amount of the loan exceeds the state's approval authority or the state has exhausted its allocation and the application must be approved at the national level.

[5]Searching for "The Way That Works": An Analysis of FmHA Rural Development Policy and Implementation, the Center for Community Change, prepared with support from the Ford Foundation and the Aspen Institute (Washington, D.C.: 1990), p. 52.

Rather, loans are evaluated on the basis of the financial soundness of the project and are processed on a first-come, first-served basis.

Furthermore, FmHA national office staff report that preapplications and applications for B&I loan guarantees increased dramatically during the first 5 months of fiscal year 1992, up 70 percent from the same period in fiscal year 1991—from 89 preapplications and applications at the end of February 1991 to 151 as of February 29, 1992. Because of this increased demand, reserve funds for the program held in the national pool were nearly depleted by April 1992. This required the national office to move up the pooling of remaining state funds—normally carried out in August—to June 1. As of June 19, 1992, the B&I program had $215,000 in its reserve fund. National office staff attribute this increase in demand for loan guarantees to current economic conditions.

Six of the 11 lenders we contacted predicted that the demand for any government loan guarantee—including B&I loan guarantees—will probably increase in the near future. One reason is the further tightening of banking regulations, which forces banks to obtain a federal guarantee for any loan perceived as risky. The lenders contacted were unanimous in their reason for obtaining B&I loan guarantees: to reduce their institution's exposure to risk.

Conclusions

The states' participation in the B&I program has been uneven. Despite having large rural populations that could benefit from the program, some states have not used B&I loan funds for several years. The reasons cited by FmHA officials in those states—the availability of rural development funds from other programs, the high application costs, and the restriction on using B&I funds for activities related to tourism—can inhibit use of the B&I program. However, the reasons cited for lack of program use are common to all states participating in the program. Yet many states have been able to overcome these obstacles and exceed their original allocation of loan guarantee funds, some by considerable amounts. Limited participation in the program reflects, at least in part, a lack of emphasis by individual state directors.

The newly created RDA may address the issue of how some state directors choose to promote the program. Because RDA combines all FmHA rural development programs into one agency, staff will have a clear rural development mission. In addition, allowing funds to be used for certain businesses related to tourism, which is particularly important to rural development in many states, would likely expand participation in the program.

As RDA is established, one of its fundamental needs will be an accurate and complete information system. Program officials currently have little reliable information on the actual number of jobs created by this program and the types of industries that receive the loans. Without accurate information on these issues, the agency cannot measure the impact of the program or ensure that the program's loan guarantees are being distributed to the areas that could benefit most. As demand for the program funds continues to grow, loan targeting will become an important issue.

Recommendations

The Secretary of Agriculture should direct the Administrator, RDA, to

- consider revising the regulations to allow the selective use of guarantees for activities related to tourism and
- determine why the agency's information systems contain inaccurate and incomplete data and correct existing problems so that RDA can effectively manage the program.

Agency Comments

We discussed the facts in this report with RDA officials, including the Assistant Administrator and the Deputy Assistant Administrator for Community and Business Programs and the Director, Business and Industry Loan Guarantee Program. They agreed with the facts presented and provided comments that we incorporated into the report where appropriate. As requested, we did not obtain written agency comments on this report.

Our work was performed between July 1991 and April 1992 in accordance with generally accepted government auditing standards. Appendix I contains details on the objectives, scope, and methodology of our review.

As arranged with your office, unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days after the date of this letter. At that time, we will send copies of this report to appropriate Senate and House committees; interested Members of Congress; the Secretary of Agriculture; the Administrator, FmHA; the

Administrator, RDA; and other interested parties. We will make copies available to others on request.

This work was performed under the direction of John W. Harman, Director, Food and Agriculture Issues, who can be reached at (202) 275-5138 if you or your staff have any questions. Other major contributors to this report are listed in appendix IX.

Sincerely yours,

for Keith O. Fultz

J. Dexter Peach
Assistant Comptroller General

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Figures

Abbreviations

B&I	Business and Industry
EDA	Economic Development Administration
FmHA	Farmers Home Administration
GAO	General Accounting Office
RCFTS	Rural Communities Facilities Tracking System
RDA	Rural Development Administration
SBA	Small Business Administration
SIC	Standard Industrial Classification
USDA	U.S. Department of Agriculture

Objectives, Scope, and Methodology

On May 29, 1991, the Chairman of the Government Information, Justice, and Agriculture Subcommittee, House Committee on Government Operations, asked us to review FmHA's Community and Business loan and grant programs. After discussions with the requester's office, we narrowed the scope of the review to the Business and Industry Loan Guarantee Program. Specifically, we determined (1) what states and territories are using the B&I program, (2) what types of industries have received B&I loan guarantees, and (3) how the program has affected rural development.

We agreed to focus our work on the program's activities within the past 3 fiscal years—1989, 1990, and 1991. We obtained program data from FmHA's national office detailing—by state—the number of loans guaranteed, the percentage of B&I loan guarantee authority used by state, the Standard Industrial Classification (SIC) code for each loan recipient, the loan amount for each loan recipient, and the population of each area in which a firm received a loan. The data for these five variables are from two sources: FmHA's Rural Community Facility Tracking System (RCFTS) and FmHA's finance office. We used the RCFTS data for three of the five variables. Data for the number of loans guaranteed and the percentage of B&I loan guarantee authority used by state came from the finance office. According to FmHA national office officials, because the accuracy of the RCFTS data depends upon each FmHA state office's entering the data correctly, the finance office data are more reliable than the RCFTS data for the number of loans guaranteed and the percentage of the loan guarantee authority used by state. The finance office did not have data for the other three variables. Because the RCFTS and finance office data do not show the same number of loans guaranteed, the baseline numbers for the charts and graphs are different. The baseline number from FmHA's finance office is 262 loans (apps. IV and V), and the baseline numbers from RCFTS are 230 (app. VII) and 231 (app. VI).

To address the first objective, we interviewed FmHA officials in the national office and four state offices—Minnesota, Missouri, North Carolina, and West Virginia. These states were selected because each had been active in the program within the past 3 fiscal years—North Carolina and West Virginia being the most active nationwide in terms of the number of loans guaranteed—and because their programs represent a variety of industries.

To determine why some states have not used the program, we developed and conducted a telephone survey of 13 FmHA state offices or states that have not participated in the program during the 3 fiscal years covered in our review. These states are Alaska, Arkansas, Colorado, Connecticut, Delaware, Idaho, Maryland, Nevada, New Hampshire, North Dakota, Oregon, Rhode Island, and Utah. The survey included questions on each state's activity in the B&I program. Specifically, we asked for data indicating the demand for the program, including the number of preapplications and applications for B&I funding and the number of other inquiries about the program. We also asked about the emphasis that each state office places on promoting the program relative to other FmHA programs and what techniques are used to market the program. In addition, we inquired about other rural development programs available in each state. Finally, we asked why the state had not used the program.

We conducted the telephone survey from February 10, 1992, through February 18, 1992. Questions were mailed to the respondents beforehand. In every case, the FmHA state director responded directly or through B&I staff. The results were tabulated and are summarized throughout this report.

To address the second objective, we met with 18 borrowers and 11 lenders in the four states we visited. These borrowers represent a variety of industries, ranging from manufacturing firms (10 businesses) to service industries (5 businesses). The lending institutions that provided information about their assets ranged in size from $15 million in assets to $2 billion in assets.

To conduct our own analysis of the distribution of loan guarantees for the B&I program, we performed analyses similar to those performed by the Center for Community Change. We chose that study because it examined the distribution of B&I loans during fiscal years 1986-88, the 3 years preceding the period we were examining. The study's authors chose two variables to measure the impact of loan guarantee distribution: unemployment data (because the priority point scoring sheet gives greater weight to areas of small size and high unemployment) and per capita income (because communities in need of economic growth also tend to have lower incomes).

First, for the four states we visited, we reviewed the loan files in order to determine the number of loans made by county within each state. For the remaining states, we relied on data supplied by FmHA's national office. These data listed by state the name and population of each community in which a B&I loan guarantee had been granted in fiscal years 1989-91. Using the Congressional District Atlas we identified the county where each community was located.

The location of six loan guarantee recipients could not be identified on any atlas, and these loans were excluded from our total. Also, for 11 loans, the community named had its border running through two adjoining counties. In these instances, both counties were credited with receiving the loan because the exact location of the borrower was unavailable. In addition, a loan granted in Puerto Rico was excluded because data were not available on per capita income and unemployment rate for our subsequent calculations, and two loans made in New Jersey were excluded because there are no nonmetropolitan counties in that state. Our total number of loans for the 3 fiscal years was thus 220.

Using available data, we determined the 1988 per capita income and the 1990 unemployment rate for each county where a B&I loan had been guaranteed. In order to make the study as relative as possible, these figures were then compared with figures from the Bureau of Economic Analysis on the nonmetropolitan per capita income rates for each state for 1988 and from the Bureau of Labor Statistics on the nonmetropolitan unemployment rates for each state for 1990. The counties were then grouped into four categories: counties where loan guarantee recipients had (1) per capita income below the state's nonmetropolitan average; (2) per capita income above the state's nonmetropolitan average; (3) an unemployment rate below the state's nonmetropolitan average; and (4) an unemployment rate above the state's nonmetropolitan average.

We also obtained information about other rural development lending programs sponsored by SBA and EDA and three regional rural development lending organizations.

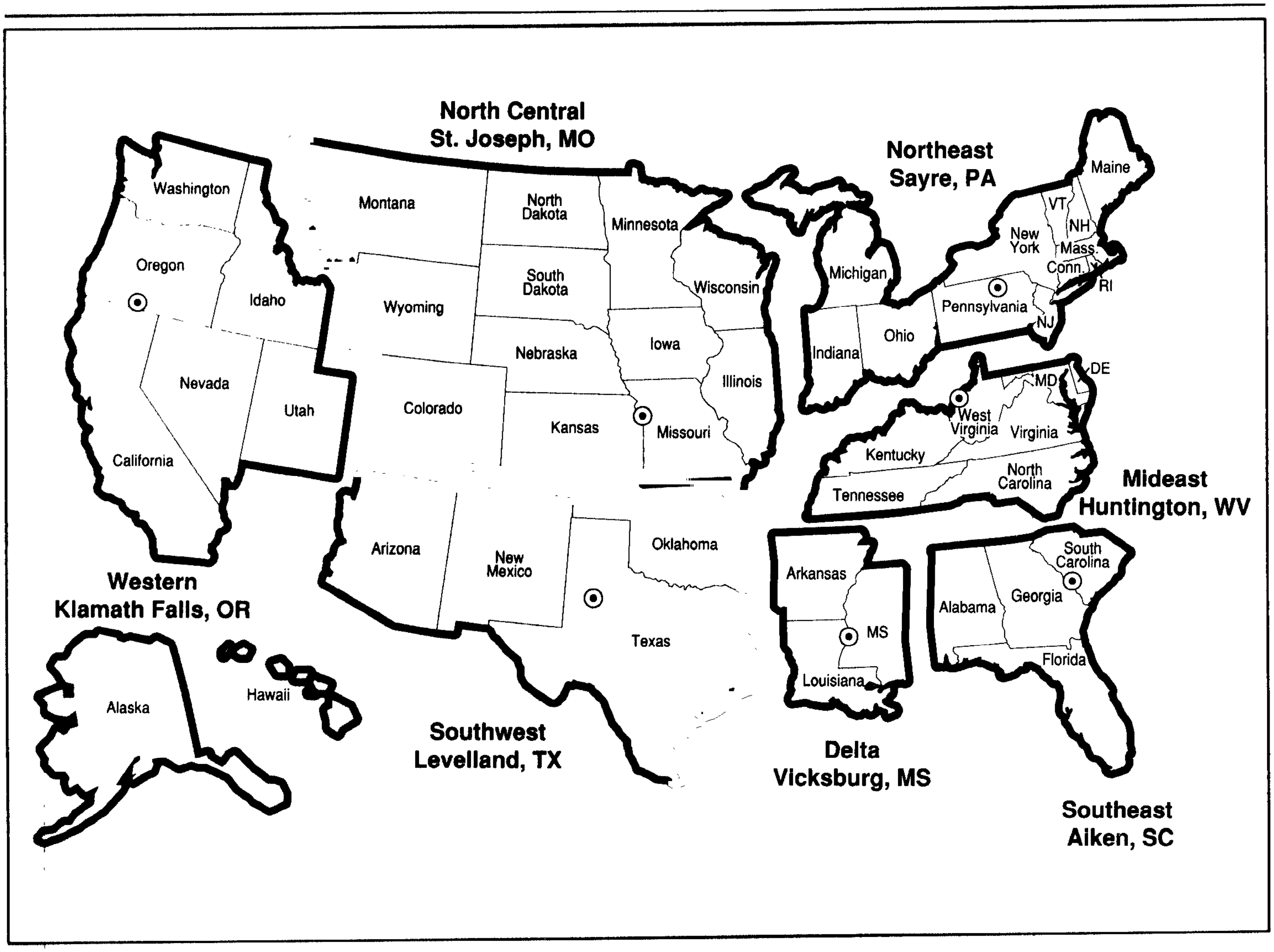
Losses in the Business and Industry Loan Program, by Fiscal Year

Fiscal year closed	Number of loans closed	Dollars closed[a]	Number of loan defaults	Dollars lost	Percent of loan defaults	Percent of dollars lost
1974	146	$35,373,578	31	$7,193,247	21.2	20.3
1975	391	141,463,158	59	16,595,353	15.1	11.7
1976	452	293,217,876	90	29,989,127	19.9	10.2
1977	549	359,813,001	97	33,254,782	17.7	9.2
1978	880	577,656,967	179	69,745,922	20.3	12.1
1979	1,307	859,790,592	279	133,364,084	21.3	15.5
1980	1,157	867,905,422	276	134,421,135	23.9	15.5
1981	621	518,314,613	142	77,031,273	22.9	14.9
1982	278	328,796,632	45	34,104,453	16.2	10.4
1983	112	189,246,742	20	69,715,045	17.9	36.8
1984	67	110,895,131	10	5,010,755	14.9	4.5
1985	65	116,279,220	2	2,733,681	3.1	2.4
1986	36	71,488,649	4	16,302,407	11.1	22.8
1987	46	71,437,995	2	1,894,845	4.3	2.7
1988	82	105,504,976	2	1,738,175	2.4	1.6
1989	78	76,512,446	0	0	0.0	0.0
1990	67	67,905,140	0	0	0.0	0.0
1991	79	74,640,190	0	0	0.0	0.0
Total	**6,413**	**$4,866,242,328**	**1,238**	**$633,094,284**	**19.5**	**13.2**

[a]Figures in this column reflect the dollar amount of loans obligated for that fiscal year that have closed. Because some loans close after construction of a project has been completed, these figures may not represent the total number and dollar amount of loans obligated for that year.

Source: FmHA.

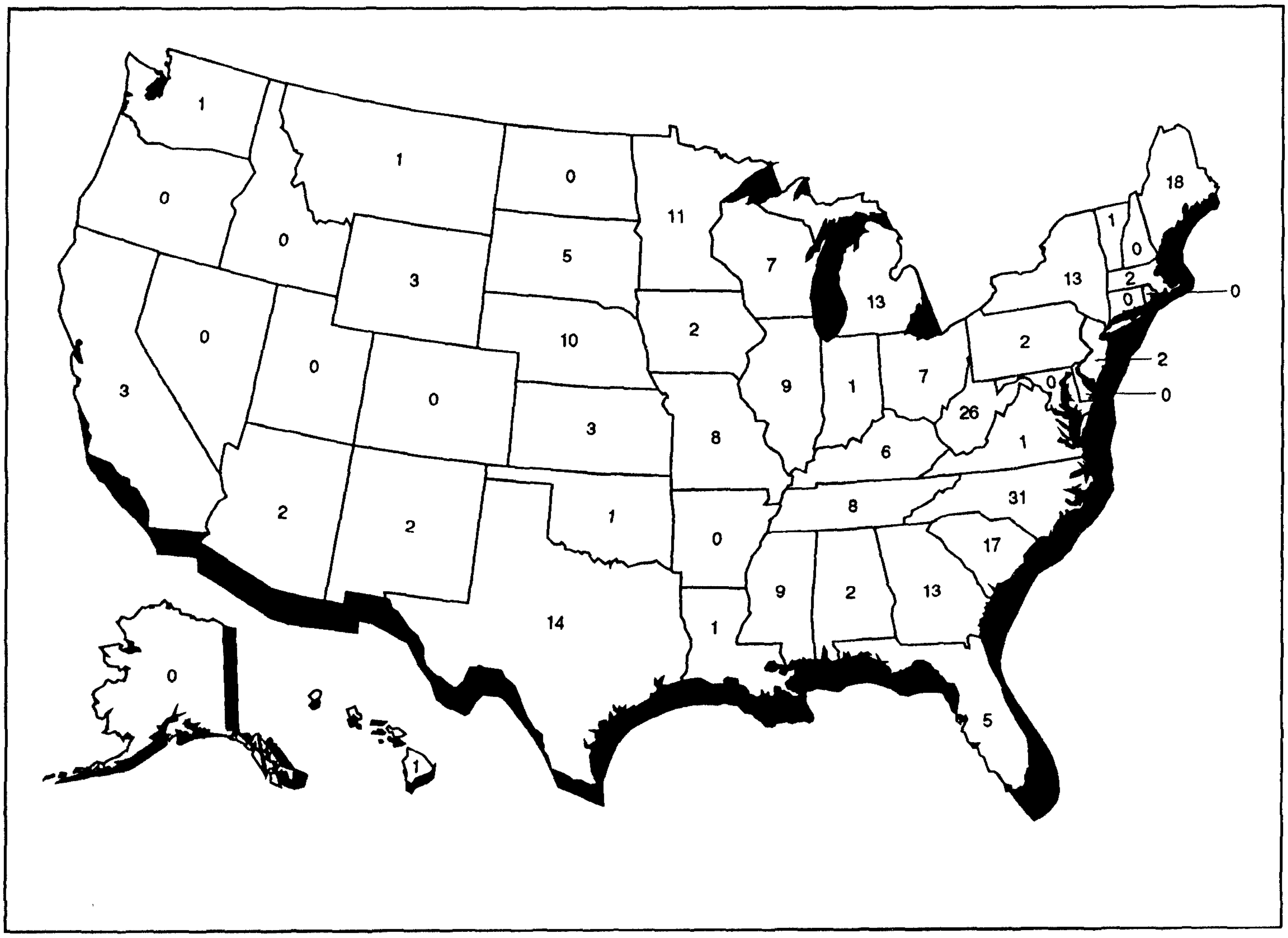
Rural Development Administration's (RDA) Planned Regions and Regional Offices



Note: Circle indicates location of planned regional office.

Source: RDA.

Number of Loans Guaranteed Under the B&I Program, by State and Territory, Fiscal Years 1989-91



Note: Western Pacific Areas - 0 Puerto Rico - 1 Virgin Islands - 0

Note: This figure is based on the FmHA finance office's record of 262 loans guaranteed.

Source: FmHA's finance office.

Percent of B&I Loan Guarantee Authority Used, by State and Territory, Fiscal Years 1989-91

State/Territory	Fiscal year 1989	1990	1991
Alabama	108	152	0
Alaska	0	0	0
Arizona	41	206	0
Arkansas	0	0	0
California	0	81	113
Colorado	0	0	0
Connecticut	0	0	0
Delaware	0	0	0
Florida	32	80	179
Georgia	32	129	179
Hawaii	0	0	145
Idaho	0	0	0
Illinois	278	55	258
Indiana	0	0	16
Iowa	161	0	0
Kansas	424	147	0
Kentucky	41	144	33
Louisiana	28	0	0
Maine	761	1,336	2,089
Maryland	0	0	0
Massachusetts	172	0	0
Michigan	102	94	176
Minnesota	122	193	194
Mississippi	106	163	101
Missouri	81	73	133
Montana	0	0	253
Nebraska	237	363	0
Nevada	0	0	0
New Hampshire	0	0	0
New Jersey	176	0	166
New Mexico	0	0	38
New York	79	263	18
North Carolina	224	109	200
North Dakota	0	0	0
Ohio	51	71	11
Oklahoma	18	0	0
Oregon	0	0	0

(continued)

	Fiscal year		
State/Territory	**1989**	**1990**	**1991**
Pennsylvania	64	111	0
Rhode Island	0	0	0
South Carolina	629	324	284
South Dakota	475	0	413
Tennessee	47	53	50
Texas	111	287	80
Utah	0	0	0
Vermont	0	130	0
Virginia	21	0	0
Washington	0	0	189
West Virginia	1,086	400	573
Wisconsin	97	113	143
Wyoming	0	0	294
Western Pacific Areas	0	0	0
Puerto Rico	0	0	135
Virgin Islands	0	0	0

Note: The percentages presented in this appendix are based on the FmHA finance office's total of 262 loans guaranteed during fiscal years 1989-91.

Note: FmHA's pooling system allows states/territories that need more B&I funds to request funds from the reserves. When these requests are approved, states/territories may guarantee more than 100 percent of their allocation. FmHA has established a system in which half of any funds not used by states/territories after the first two quarters of the year are placed in a pool. States/territories that have depleted their fund allocation can draw additional funding from this pool. In August of each year, the remaining funds from each state/territory are also pooled and made available to other states/territories.

Source: FmHA's finance office.

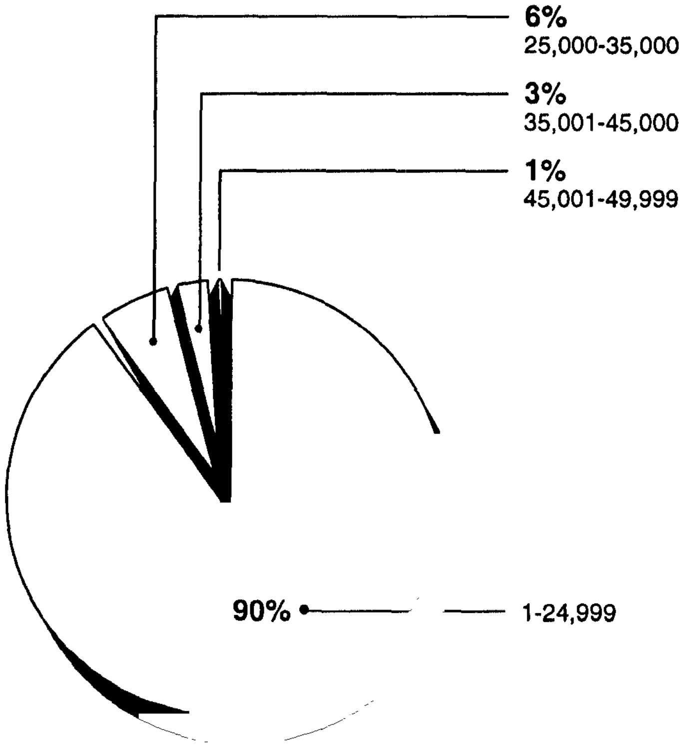
Types of Industries Receiving Loans Guaranteed Under the B&I Program, Fiscal Years 1989-91

Recipient	Number	Amount	Percent
Manufacturing	95	$111,083,500	45
Retail trade	42	41,858,950	17
Services	20	25,539,000	10
Wholesale trade	22	22,844,720	9
Agriculture, forestry, and fishing	20	16,302,400	7
Finance, insurance, and real estate	12	10,421,190	4
Construction	7	8,528,000	3
Mining	4	5,858,000	2
Transportation and public utilities	9	4,597,500	2
Total	**231**	**$247,033,260**	**99**

Note: Figures in the percent column do not add to 100 percent because of rounding. Figures in this chart were obtained by analyzing and recoding existing FmHA data. The total of 231 loans was obtained from FmHA's Rural Community Facility Tracking System (RCFTS).

Source: FmHA's RCFTS.

Percent of Loans Guaranteed Under the B&I Program, by Population of Community Where Project Was Located, Fiscal Years 1989-91



Note: The percentages presented in this figure are based on the FmHA Rural Community Facility Tracking System's (RCFTS) record of 230 loans guaranteed during fiscal years 1989-91.

Source: FmHA's RCFTS.

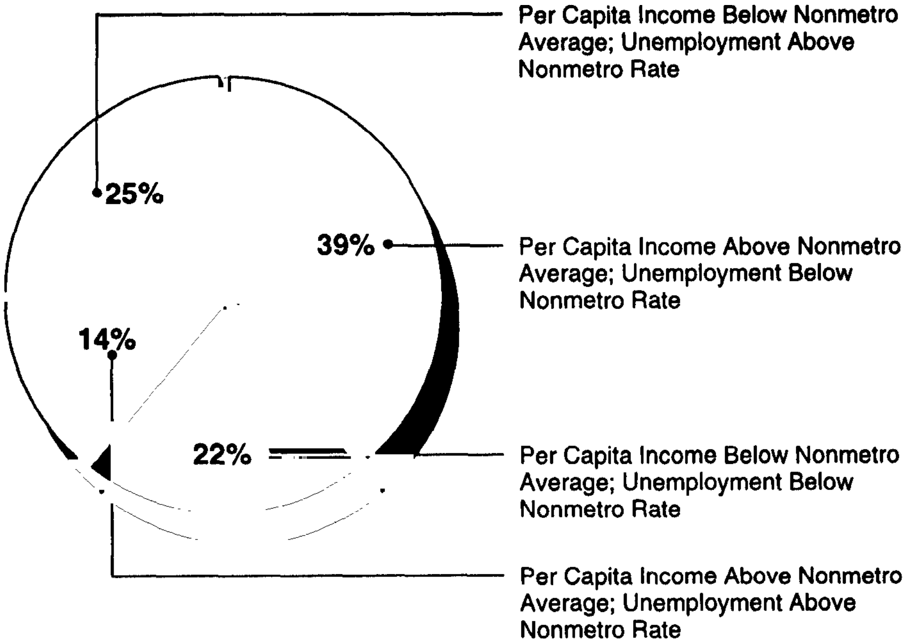
Distribution of B&I Guaranteed Loans, by Counties' Per Capita Income and Unemployment Rate

This appendix presents the results of our analysis of whether the B&I program distributed its loan guarantees to counties that could benefit most. Many variables could be indicators of need, but for purposes of this analysis, we selected unemployment and per capita income: unemployment because B&I program regulations state that the guarantees should be directed toward areas with high unemployment and per capita income because it is one indicator of economic need. Specifically, we identified counties with the potential to benefit most from B&I loan guarantees as those where per capita income was low and unemployment was high. We grouped counties into categories according to whether the county was higher or lower than the (1) state's average per capita income for nonmetropolitan ("nonmetro") areas and (2) the state's unemployment rate in nonmetropolitan areas. Under this approach, counties fell into four categories.[1]

We then performed three separate analyses. First, using FmHA data for the nation as a whole, we calculated how many counties had been the location of recipients of loans guaranteed under the B&I program. (See app. I for details on our methodology.) We then determined what percentage of the total number of loans guaranteed nationwide was granted in counties where the per capita income was above the nonmetropolitan average but the unemployment rate was below the nonmetropolitan rate. As figure VIII.1 shows, 39 percent of the loans guaranteed during fiscal years 1989-91 fell in this category.

[1]None of the loan guarantees went to counties with an unemployment rate or per capita income equal to its state's nonmetropolitan baseline.

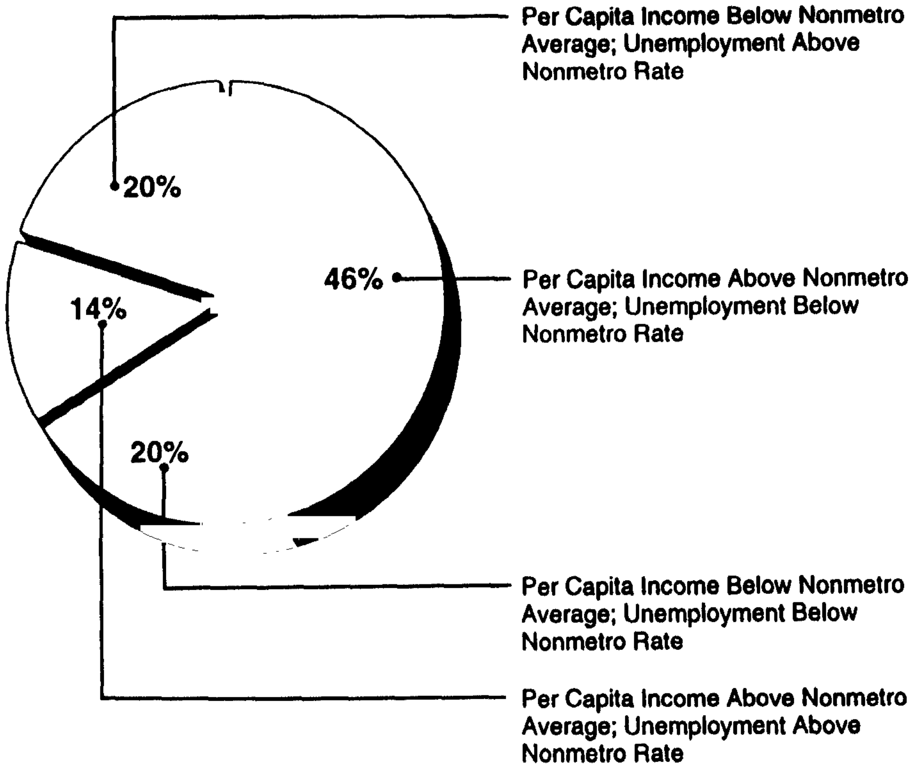
Figure VIII.1: Distribution Nationwide of Loans Guaranteed Under the B&I Program, Fiscal Years 1989-91



Note: When need was determined on the basis of the unemployment variable alone, 61 percent of the counties had an unemployment rate below their state's nonmetropolitan unemployment rate. When need was determined on the basis of each county's per capita income, 53 percent of the counties had a per capita income rate above their state's nonmetropolitan per capita income average.

We performed the same analysis for the four states that we visited. As figure VIII.2 shows, 46 percent of the total number of loans guaranteed during fiscal years 1989-91 were granted in counties where the per capita income was above the nonmetropolitan average and the unemployment rate was below the nonmetropolitan rate.

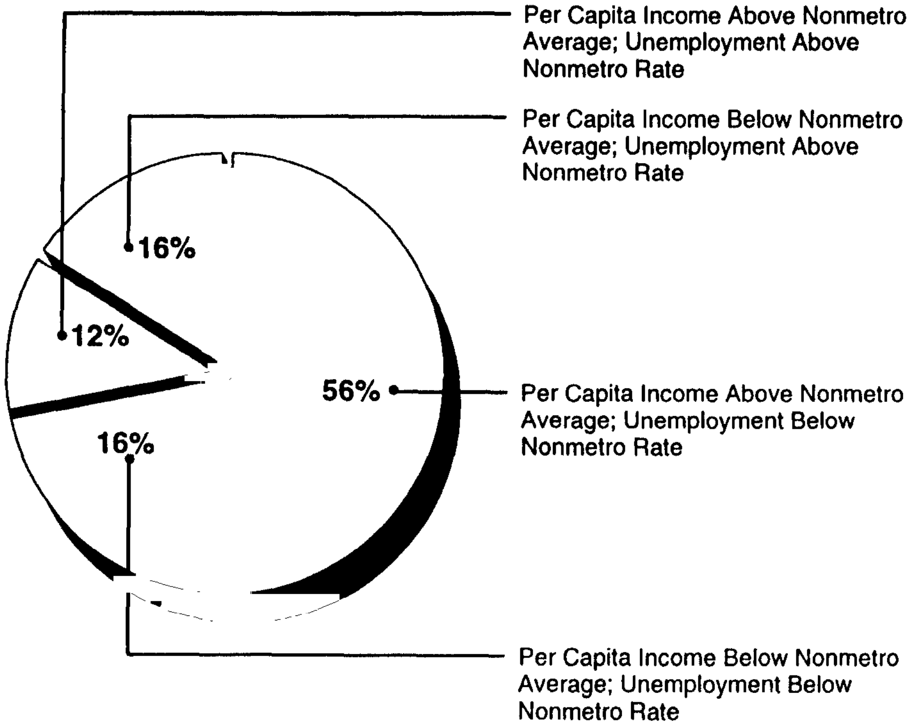
Figure VIII.2: Distribution of Loans Guaranteed Under the B&I Program in Minnesota, Missouri, North Carolina, and West Virginia, Fiscal Years 1989-91



Note: These four states were selected on the basis of their use of the B&I program. In the example of West Virginia, all of the state's counties may be below the nation's nonmetropolitan averages for per capita income and unemployment rate. This analysis is meant to demonstrate only the distribution of the loans and is not meant to address the allocation of funds among the individual states.

Finally, in the four states we visited, we analyzed the distribution of loans guaranteed under the B&I program by total dollar amount. As figure VIII.3 shows, 56 percent of the loan funds went to counties where the per capita income was above the nonmetropolitan average and the unemployment rate was below the nonmetropolitan rate.

Figure VIII.3: Distribution of B&I Loan Funds in Minnesota, Missouri, North Carolina, and West Virginia, Fiscal Years 1989-91



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