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RURAL DEVELOPMENT

Financial Condition of the
Rural Utilities Service's
Electricity Loan Portfolio

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Mr. Chairman and Members of the Committee:

We are pleased to be here today to discuss the electricity loan program of the U.S. Department of Agriculture's (USDA) Rural Utilities Service (RUS). You asked us to summarize our April 1997 report,¹ which discusses, among other things, (1) the financial condition of the electricity loan portfolio and (2) the financial characteristics of borrowers having electricity loans.² Our report presents data on the financial condition of the electricity loan portfolio as of the end of fiscal year 1996 and on the financial characteristics of borrowers having electricity loans as of the end of calendar year 1995, which was the most recent year for which RUS had information available on the program's borrowers. The report did not focus on evaluating the potential impact of increasing competition on RUS' loan portfolio.

In summary, the total amount of the outstanding principal on RUS' electricity loans was \$32.3 billion at the end of fiscal year 1996. Of this amount, about \$8 billion, or almost 25 percent, was owed by 12 borrowers that were experiencing financial problems (i.e., they were delinquent, in bankruptcy, or likely to default on loan repayment in the future). These 12 electricity loan borrowers represent less than 2 percent of the total number of electricity loan borrowers.

This relatively high dollar amount of problem loans exists even though RUS had written off some borrowers' debts in recent years. Specifically, RUS wrote off almost \$1.05 billion in electricity loans during the 5-year period from fiscal year 1992 through fiscal year 1996.

Our April 1997 report also assessed selected financial characteristics for RUS' electricity loan borrowers at the end of calendar year 1995. The financial characteristics for most of the borrowers were favorable, but some were not. Specifically, the year-end reports from the borrowers to RUS showed the following:

- Almost 99 percent of the 855 electricity loan borrowers had positive equity at the end of 1995. A total of 841 borrowers had equity of \$1 million or more.

¹Rural Development: Financial Condition of the Rural Utilities Service's Loan Portfolio (GAO/RCED-97-82, Apr. 11, 1997).

²RUS operates the loan programs formerly administered by other USDA agencies. In this statement and in our April 1997 report, we refer to these loans and programs as RUS' loans and programs.

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- About 96 percent of the 855 electricity loan borrowers made a profit in 1995. A total of 789 borrowers made a profit of \$100,000 or more.
 - However, 10 electricity loan borrowers had negative equity at the end of 1995. Also, 38 electricity loan borrowers did not make a profit in 1995.

Background

USDA is the federal government's principal provider of loans used to assist the nation's rural areas in developing their utility infrastructure. Through RUS, USDA finances the construction, improvement, and repair of electrical systems. In addition, RUS provides financing for telecommunications and water and waste disposal systems. The agency provides credit assistance through direct loans and through repayment guarantees on loans made by other lenders.

Electricity loans are made primarily to electric cooperatives; more than 99 percent of the borrowers with electricity loans are nonprofit cooperatives. Direct loans are made to construct and maintain the distribution facilities that provide electricity to users. RUS also places guarantees on loans to finance the construction, repair, and improvement of facilities that generate and transmit electricity.

During fiscal years 1992 through 1996, RUS made or provided USDA guarantees on 880 electricity loans, which totaled about \$4.4 billion. Direct loans accounted for 835 of the total loans and about \$3.3 billion of the total loan amount. The other 45 loans, valued at about \$1.1 billion, had USDA guarantees. All electricity loans that received USDA repayment guarantees during this 5-year period were made by the Treasury's Federal Financing Bank.

RUS' cost for the electricity loans made during these years totaled about \$551 million. This cost consists of two components: (1) federal subsidy costs, which under credit reform (post-fiscal year 1991 credit) includes net present value estimates of the interest costs associated with the loans made at rates below the rate at which RUS borrows from the Treasury, default costs, fees, and other costs and revenues and (2) administrative costs for salaries and other expenses. The subsidy costs totaled about \$446 million, and the administrative costs totaled about \$105 million.

Financial Condition of RUS' Electricity Loan Portfolio

The outstanding principal on RUS' direct and guaranteed electricity loans totaled about \$32.3 billion at the end of fiscal year 1996.³ About \$8 billion, or almost 25 percent, was owed by 12 borrowers that were delinquent (at least 30 days past due on loan repayment) or otherwise in financial distress. These 12 borrowers made up less than 2 percent of the total number of RUS' electricity loan borrowers.

About \$618 million of principal was owed by three delinquent borrowers. These three borrowers, each of which had been delinquent since the mid-1980s, also owed almost \$400 million in unpaid interest. Table 1 shows the amount of principal owed by all borrowers, and the portion owed by delinquent borrowers, on electricity loans at the end of fiscal year 1996.

Table 1: Amount of Outstanding Principal on Electricity Loans Made or Guaranteed by RUS, and Portion Owed by Delinquent Borrowers, as of September 30, 1996

Dollars in millions		
Loan type	Outstanding principal owed by all borrowers	Outstanding principal owed by delinquent borrowers
RUS' direct loans	\$11,475.2	\$ 29.6
Guaranteed Federal Financing Bank loans	13,328.6	572.0
Other guaranteed loans	664.7	16.3
Restructured loans ^a	6,841.1	0
Total	\$32,309.6	\$617.9

^aIncludes previously issued (1) direct loans made by RUS, (2) guaranteed loans made by the Federal Financing Bank, (3) guaranteed loans made by commercial lenders on which RUS agreed to be directly liable for repaying the loan, and (4) loans that had been owed by borrowers now assumed by other utilities. The amounts cover the principal and the capitalized interest owed on the loans. The loans in this category are not included in the other direct and guaranteed loan categories.

In addition to the loans held by delinquent borrowers, about \$7.4 billion of the outstanding electricity loan principal at the end of fiscal year 1996 was also at risk because it was owed by nine other borrowers that, according to RUS officials, were experiencing financial distress; for example, they were in bankruptcy or were likely to default on loan repayment in the near future. Four of these borrowers, owing a total of \$5.7 billion, continued to experience severe financial problems despite having their loans restructured (the original loan agreements were altered, including revised

³The information in this section discusses the outstanding principal on the loans made or guaranteed by RUS. We have not adjusted the outstanding loan amounts to reflect the allowance for losses that RUS includes in its financial statements. Also, while borrowers have pledged collateral property as security for the loans, we did not determine the extent to which such property protects the government's investments in the outstanding utility loans.

repayment schedules and changes in interest rates) at least once during the 1980s or the early part of 1990. Another borrower whose loans had been restructured requested in October 1996 that RUS consider renegotiating its almost \$0.6 billion debt because it does not expect to remain financially viable due to increasing competition and a high debt-service expense.

RUS has a relatively high dollar amount of problem loans even though it wrote off some borrowers' debts in recent years. Specifically, RUS wrote off \$1,047.4 million for three borrowers from fiscal years 1992 through 1996: \$13.7 million for one borrower in February 1994, \$51.7 million for another borrower in August 1995, and about \$982 million for a third borrower in September 1996. (In addition, in the early part of fiscal year 1997, one of the problem borrowers discussed above made a lump-sum payment to RUS and, in exchange, the agency forgave slightly more than \$500 million of debt.)

RUS' electricity loan portfolio faces the possibility of additional financial stress because of increasing competition among the providers of electricity. For example, competition in the wholesale electricity market is increasing as a result of the legislation that was enacted in the early 1990s, such as the Energy Policy Act of 1992 (P.L. 102-486, Oct. 24, 1992). The act encouraged additional wholesale suppliers to enter the electricity market and provided greater access to other utilities' transmission lines.

Financial Characteristics of RUS' Electricity Borrowers

For the financial characteristics that we assessed, we found that most of the electricity loan borrowers were in a favorable position at the end of calendar year 1995. However, some were not.⁴ Specifically, the overwhelming majority of borrowers had positive equity at the end of 1995; however, 10 borrowers, or 1.2 percent, had negative equity. Also, while most made a profit in 1995, 38 borrowers, or 4.4 percent, had a loss.⁵ Furthermore, 12 of the 38 borrowers that had losses in 1995 also had losses in at least 1 year between 1992 and 1994.

RUS' automated files contained financial information for 804 distribution borrowers and 51 power supply borrowers with outstanding electricity loans (direct and/or guaranteed loans) at the end of 1995. On the basis of

⁴The information presented in this section on borrowers' financial characteristics is calendar year data taken from RUS' databases.

⁵RUS refers to the profits made by electricity loan borrowers that are nonprofit cooperatives as "net margins" and to the losses as "deficits in net margins."

the measures we used, which included net worth and net income, we found that even though the dollar amount of problem electricity loans was relatively large, the problems were concentrated in a small number of borrowers. Most electricity loan borrowers had generally favorable financial characteristics. For example, the distribution borrowers had average assets of \$37.4 million, liabilities of \$21.6 million, and a net worth of \$15.8 million. All but five of these borrowers had \$1 million or more of net worth; however, two had a negative net worth. Overall, the distribution borrowers had a total profit of \$1 billion, or about \$1.3 million on average. All but 34, or 4.2 percent, of these borrowers had a profit in 1995.

In comparison, power supply borrowers had average assets of \$633 million, liabilities of \$622.1 million, and a net worth of \$10.9 million. Of the power suppliers, 42 had \$1 million or more of net worth, but 8 had a negative net worth. Overall, the power suppliers had \$234 million in total profit, or about \$4.6 million on average. However, four borrowers, or 7.8 percent, did not have a profit in 1995.

Mr. Chairman, this completes my prepared statement. I would be pleased to respond to any questions that you or Members of the Committee may have.

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