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Report to the Chairman, Committee on Agriculture, House of Representatives

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RURAL DEVELOPMENT

Rural Business-Cooperative Service's Lending and the Financial Condition of Its Loan Portfolio

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Resources, Community, and Economic Development Division

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The Honorable Larry Combest
Chairman, Committee on Agriculture
House of Representatives

Dear Mr. Chairman:

The Rural Business-Cooperative Service (RBS) of the U.S. Department of Agriculture (USDA) operates a variety of loan programs that assist in the business development of the nation's rural areas and in the employment of rural residents. Specifically, the agency's

- business and industry loan program guarantees loans made by private lenders and makes direct government-funded loans at market interest rates to finance business projects that create or retain jobs in rural areas,
- intermediary relending program makes direct loans at a 1-percent interest rate for financing revolving funds from which borrowers relend the money for business and community development projects, and
- rural economic development program makes interest-free direct loans for relending for business and economic development projects.

This report provides information on the Rural Business-Cooperative Service's lending. In particular, we are providing information on (1) the number and dollar value of loans approved by the agency, (2) the federal government's costs associated with the agency's loans, and (3) the financial condition of the agency's loan portfolio, including the losses incurred.[1] We also are providing information on the geographic dispersion of these loans and the level of pending applications for guaranteed business and industry loans. The information on the number and dollar value of loans, the financial condition of the portfolio, and loan losses covers 5.5 fiscal years—including fiscal 1993 through the first half of fiscal 1998 (Mar. 31, 1998). The information on the federal government's cost of these loan programs is based on USDA's cost estimates and covers fiscal year 1993 through fiscal 1997, the year of the latest cost information readily available when we conducted our work.

Results in Brief

The Rural Business-Cooperative Service approved more than 2,900 rural business loans during fiscal year 1993 through the first 6 months of fiscal

[1]RBS operates loan programs formerly administered by other USDA agencies. In this report, we refer to these loans and programs as RBS' loans and programs.

1998; these loans totaled about $3.2 billion. More than three quarters of these loans and almost 90 percent of the total loan amount were guaranteed business and industry loans; only 2 percent of the loans were direct government-funded business and industry loans. The remaining loans were direct loans under the intermediary relending program and the rural economic development program.

The estimated total cost of these loan programs was about $290 million during fiscal year 1993 through fiscal 1997. Of this amount, the subsidy costs of the loans, which primarily involve the estimates of default costs and interest rate subsidies, were almost $195 million. Administrative costs, which cover estimates of salaries and other expenses associated with operating the programs, totaled about $95 million.

As of March 31, 1998, the unpaid principal on the Rural Business-Cooperative Service's outstanding guaranteed and direct loans totaled about $2.2 billion. Delinquent borrowers (those that are at least 30 days past due on scheduled payments) held about $116 million—$112 million on guaranteed business and industry loans and about $4 million on direct business and industry loans and intermediary relending loans—or 5.4 percent of the total outstanding principal. Furthermore, from the start of fiscal year 1993 through March 31, 1998, the agency incurred loan losses totaling about $266 million: about $264 million on guaranteed business and industry loans and about $2 million on intermediary relending loans. The agency did not experience any losses on debt associated with direct business and industry loans or with rural economic development loans.

Background

RBS operates loan programs that are intended to assist in the business development of the nation's rural areas and the employment of rural residents. Within USDA, RBS is located in the Rural Development (RD) mission area. The agency's national office in Washington, D.C., provides policy direction and guidance on the loan making and servicing aspects of the programs, and reviews and approves certain loans. Many of the loan making and servicing functions are performed by RD mission area staff who are physically located in field offices throughout the country.[2]

RBS operates the following loan programs: the business and industry (B&I) program, the intermediary relending program (IRP), and the rural economic

[2]In this report, we refer to the RD mission area's field offices and staffs who operate RBS' loan programs as the agency's field offices and staffs.

development (RED) program. The following is a general description of each program.

B&I loans. A B&I loan can be either a direct government-funded loan or a loan made by another lender on which RBS guarantees repayment in the event of a loss. These loans are made to finance almost any business project that creates or retains jobs in rural areas and to finance projects in all segments of the economy, such as mining, manufacturing, and wholesale and retail sales. There are only a few activities for which B&I loans cannot be used, such as funding gambling facilities, race tracks, and golf courses. Additionally, RBS' regulations, which, according to the agency's officials, are being revised, provide that direct B&I loans cannot be used for constructing hotels and motels, and tourism and recreational facilities. However, guaranteed B&I loans can be used for those purposes. The interest rate on a direct loan is based on the prime rate that was in effect in the quarter of a year prior to the quarter in which the loan is made. The interest rate on a guaranteed loan is the rate agreed to by the lender making the loan and the borrower. According to RBS officials, this rate is generally the lender's prime rate—the rate a lender charges its best customers—plus 1 to 1.5 additional percentage points.

IRP loans. IRP loans are direct government-funded loans made for relending, mostly to nonprofit community development organizations, and, to a lesser extent, to other borrowers, such as for-profit and nonprofit cooperatives. Specifically, the IRP loan funds are deposited into a revolving fund that an RBS borrower—an intermediary—has established. The intermediary relends the money to its borrowers—which may be individuals, public or private organizations, or any other legal entity—for financing business or community development projects in rural areas. IRP loan funds are not allowed for certain purposes, including funding gambling facilities, race tracks, and golf courses. RBS' approval is required for the intermediary's relending of the IRP loan funds. RBS charges its borrowers a 1-percent interest rate on IRP loans. The interest rate on a loan from the revolving fund is the rate agreed to by the intermediary and its borrower. RBS does not specify what this rate should be.

RED loans. RED loans are also direct loans made for relending. The loans are made only to borrowers that have outstanding electricity or telecommunications loans from USDA's Rural Utilities Service (RUS) and to former RUS borrowers that repaid their electricity loans early at a discount. Unlike IRP loans, a RED loan, when approved, is targeted to a specific project. The RED loan funds are deposited into a fund that the RUS borrower has established. The RUS borrower relends the money to other borrowers, which may be any public or private organization or other legal entity, for an economic development and job creation project. These projects include new business creation, existing business expansion, community improvements, and infrastructure development. RED loan funds cannot be used for certain purposes, including the RUS borrowers' electricity or telecommunications operations or a community's television system or facility, unless tied to an educational or medical project. RED loans are interest free, and RBS requires that loan funds be relent interest free.

(App. I provides more descriptive information on each of RBS' loan programs.)

Increasing Total Volume and Value of Loans in Recent Years

RBS approved more than 2,900 rural business loans during fiscal year 1993 through the first half of fiscal 1998.[3] The total amount of these loans was more than $3.2 billion,[4] or approximately $1.1 million, on average, per loan. Specifically, RBS approved the following loans during this 5.5-year period:

- 2,299 guaranteed B&I loans totaling almost $2.9 billion and averaging $1.2 million, and 58 direct B&I loans totaling about $17 million and averaging about $300,000 and
- 315 IRP loans totaling about $280 million and averaging about $900,000, and 256 RED loans totaling about $70 million and averaging about $275,000.

The total number and value of rural business loans approved by RBS increased during these years. In fiscal year 1993, RBS approved 298 loans totaling about $234 million, while in fiscal 1997, it approved 788 loans totaling $878 million. Most of the increase in loans stems from increases in guaranteed B&I loans, which rose by almost 250 percent over this period.

Large Increase in Guaranteed B&I Loan Activity

At almost $2.9 billion, guaranteed B&I loans constituted the largest category of loans approved by RBS during the period of fiscal year 1993 through March 31, 1998. Furthermore, the level of guaranteed B&I loan activity increased substantially during this 5.5-year period. For example, RBS approved 190 guaranteed B&I loans in fiscal year 1993 with a total value

[3]In this section of the report, loans approved refers to those loans on which obligations were established in USDA's financial records.

[4]The total dollar amount of loans in constant 1998 dollars is about $3.4 billion.

of more than $187 million. As table 1 shows, this compares with 663 loans in fiscal year 1997 and 377 loans in the first half of fiscal 1998, which have total values of more than $816 million and about $540 million, respectively.

Table 1: Number and Dollar Amount of Guaranteed B&I Loans Approved by RBS, Fiscal Year 1993 Through the First Half of Fiscal Year 1998

Loan information	1993[a]	1994	1995	1996	1997[b]	1998[b]	Total
Number of loans	190	179	327	563	663	377	**2,299**
Total dollar amount of loans (in millions)	$187.4	$249.6	$423.6	$638.4	$816.3	$539.6	**$2,854.9**[c]
Average dollar amount of loans (in thousands)	$986	$1,394	$1,295	$1,134	$1,231	$1,431	$1,242
Dollar range of loans (in thousands)	$22 to $5,350	$57 to $7,300	$20 to $9,000	$24 to $9,000	$8 to $9,000	$62 to $9,000	$8 to $9,000

[a]Includes 94 loans totaling $87.4 million that were approved in fiscal year 1993 under an emergency supplemental appropriation authorization.

[b]Includes 2 RBS guaranteed loans totaling approximately $900,000 that were approved in fiscal year 1997 and 12 loans totaling approximately $8 million that were approved in the first 6 months of fiscal 1998. These loans were made in conjunction with the North American Development Bank under the terms of the North American Free Trade Agreement.

[c]The total dollar amount of loans in constant 1998 dollars is $2,964.5 million.

Source: RBS' loan reports and GAO's analysis of records from the RD mission area's Finance Office.

While guaranteed B&I loans were approved for borrowers in every state, a large number of the approved loans were concentrated in a few states. Specifically, 33 percent of the loans approved during this 5.5-year period were for borrowers in eight states; these loans accounted for 38 percent of the $2.9 billion loan amount. In each of the top three states—California, Florida, and North Carolina—more than 100 loans were approved. In total, 400 loans with a total value of approximately $508 million were approved in these three states.

Level of Pending Applications

On top of the rapid growth in guaranteed B&I loans, RBS reported, in its appropriation request for fiscal year 1999, having a large amount—about $935 million—of pending guaranteed B&I loan requests as of September 30, 1997. However, our review disclosed that many of these requests were not ready to be approved or funded. Specifically, a large part of the backlog consisted of preapplications for loans; these are cases in which lenders expressed an interest in applying for loans and submitted some documentation but had not submitted formal applications. There were 363 preapplications, which accounted for about 71 percent of the more than 500 requests reported as pending and about 72.5 percent of the total loan amount. These preapplications included 166 cases in which the preapplicants had been told to develop and submit an application; however, in 60 cases, the notifications to submit applications were more than 6 months old, including some that were almost 3 years old.

Additionally, in mid-1998, RBS found that 127 loan requests (preapplications and applications) that it had on hand, which totaled $259.6 million, were inactive. An inactive loan request is one in which, among other things, additional information that had been requested from the lender and/or the borrower had not been provided; the loan request would not be approved because, for example, the project as proposed was not eligible for loans in the program; or the borrower no longer wanted the loan.

Relatively Few Direct B&I Loans Were Made

RBS' experience with direct B&I loans is quite different from its experience with guaranteed B&I loans. Specifically, RBS did not approve any direct loans during fiscal years 1993 through 1996 because USDA's appropriation acts did not authorize it to do so. However, as table 2 shows, in fiscal year 1997 and the first half of fiscal 1998, the agency approved 58 loans valued at $17.2 million.

Table 2: Number and Dollar Amount of Direct B&I Loans Approved by RBS, Fiscal Year 1997 Through the First Half of Fiscal Year 1998

Loan information	1997	1998	Total
Number of loans	33	25	**58**
Total dollar amount of loans (in millions)	$12.4	$4.8	**$17.2**[a]
Average dollar amount of loans (in thousands)	$376	$191	$296
Dollar range of loans (in thousands)	$50 to $2,100	$6 to $500	$6 to $2,100

[a]The total dollar amount of loans in constant 1998 dollars is $17.4 million.

Source: RBS' loan reports and GAO's analysis of records from the RD mission area's Finance Office.

The direct B&I loans that RBS approved during this 1.5-year period were for borrowers located in 24 states, Puerto Rico, and the Western Pacific Islands. Five states and Puerto Rico accounted for 60 percent of the loans and 52 percent of the loan obligations. Missouri was the top state in terms of the number of loans—12—and Puerto Rico had the highest dollar amount of loans—$2.5 million. The other four states were Arkansas, Hawaii, South Carolina and Texas.

IRP Loan Activity Mixed

IRP loans accounted for the second largest category of loans that RBS approved during fiscal year 1993 through the first half of fiscal 1998. Fiscal year 1995 was the peak year for IRP loans, when 89 loans, which totaled more than $85 million, were approved. Since then, as table 3 shows, the total value of IRP loans approved each year has declined.

Table 3: Number and Dollar Amount of IRP Loans Approved by RBS, Fiscal Year 1993 Through the First Half of Fiscal Year 1998

Loan information	1993	1994	1995	1996	1997	1998	Total
Number of loans	43	71	89	47	53	12	**315**
Total dollar amount of loans (in millions)	$33.7	$77.4	$85.2	$37.6	$37.2	$8.2	**$279.2**[a]
Average dollar amount of loans (in thousands)	$784	$1,090	$957	$801	$701	$683	$886
Dollar range of loans (in thousands)	$250 to $1,300	$250 to $2,000	$50 to $2,000	$200 to $2,000	$140 to $2,000	$200 to $1,000	$50 to $2,000

[a]The total dollar amount of loans in constant 1998 dollars is $297.5 million.

Source: RBS' loan reports and GAO's analysis of records from the RD mission area's Finance Office.

Many of the IRP loans were for borrowers in only a few of the 43 states, Puerto Rico, and the U.S. Virgin Islands, where loans were approved. Specifically, 109 of the 315 loans, or almost 35 percent, were for borrowers in six states. These 109 loans totaled over $106 million, which is over 38 percent of the total value of all IRP loans approved during this 5.5-year period. Two states—Minnesota and Oregon—accounted for 51 of these loans and $50.9 million. The other four states, which accounted for 58 loans and $55.6 million, were Arkansas, California, Maine, and Mississippi.

RED Loans Have Been Decreasing

RED loans ranked third in terms of the number of loans and value approved during fiscal year 1993 through the first half of fiscal 1998. The number of RED loans approved declined each year during this period, from 65 loans in fiscal year 1993 to 39 in fiscal 1997, and to 19 in the first half of fiscal 1998. However, as table 4 shows, the total dollar value of loans was relatively stable, ranging from more than $12 million to $13.5 million for the full fiscal years during the period.

Table 4: Number and Dollar Amount of RED Loans Approved by RBS, Fiscal Year 1993 Through the First Half of Fiscal Year 1998

Loan information	1993	1994	1995	1996	1997	1998	Total
Number of loans	65	46	45	42	39	19	**256**
Total dollar amount of loans (in millions)	$12.4	$13.5	$12.3	$13.1	$12.3	$6.8	**$70.4**[a]
Average dollar amount of loans (in thousands)	$191	$293	$274	$312	$315	$359	$275
Dollar range of loans (in thousands)	$36 to $400	$50 to $400	$24 to $400	$80 to $400	$21 to $400	$100 to $750	$21 to $750

[a]The total dollar amount of loans in constant 1998 dollars is $74.5 million.

Source: RBS' loan reports and GAO's analysis of records from the RD mission area's Finance Office.

RBS approved a total of 256 RED loans for 192 borrowers during this 5.5-year period; these borrowers were located in 32 states. A majority of the loans—136 loans, or 53.1 percent—were for borrowers in six states: Minnesota, Tennessee, North Dakota, Kansas, Iowa, and Wisconsin. The loans to these borrowers accounted for $34.2 million, or slightly less than half—48.6 percent—of the total loan obligations.

Additionally, some borrowers had both RED and IRP loans approved from the start of fiscal year 1993 through March 31, 1998. Specifically, eight borrowers had 13 RED loans, valued at about $4.1 million, approved during this period; these borrowers also had 9 IRP loans, valued at about $7.9 million, approved. This occurred because RED and IRP loans are both available to certain nonprofit cooperatives for relending purposes.

Subsidies Account for a Large Part of RBS' Costs of Operating the Loan Programs

RBS' estimated cost for the business loan programs totaled about $290 million during fiscal year 1993 through fiscal 1997. The cost of operating a federal credit program consists of two components: subsidy costs, which involve the estimates of default costs, interest rate subsidies, fees, and other costs and revenues; and administrative costs, which cover salaries and other expenses.[5]

About $195 million of RBS' total costs was the agency's estimated subsidy costs associated with its loans.[6] In addition, as table 5 shows, RBS incurred an estimated $95 million in administrative costs associated with operating the loan programs.

Table 5: RBS' Estimated Total Costs for Rural Business Loans, Fiscal Years 1993-97

Dollars in millions

Program and loan type	Subsidy costs	Administrative costs	Total costs
B&I guaranteed	$30.0	$85.5	**$115.5**
B&I direct	0.1	0.7	**0.8**
IRP direct	148.4	5.7	**154.1**
RED direct	16.2	3.1	**19.3**
Total	**$194.7**	**$95.0**	**$289.7**

Note: App. II provides annual information on the estimated subsidy and administrative costs of RBS' loan programs in each of these 5 years.

Source: Our calculation was based on information contained in USDA, Budget Explanatory Notes for Committee on Appropriations, fiscal years 1995-99, and estimates developed by us or provided by the Budget Division of USDA's RD mission area.

As shown in table 5, IRP loans, which had total costs exceeding $154 million for fiscal year 1993 through fiscal 1997, were the most expensive of the rural business loans that RBS provided. The estimated subsidy costs constituted most of the total costs for these loans, reflecting the high interest subsidy on IRP loans. Specifically, IRP loans are made at a 1-percent interest rate, which is far below the agency's cost of money. The overall subsidy rate for IRP loans over this 5-year period was 54.8 percent,

[5]The Federal Credit Reform Act of 1990, which was included as title 13B of the Omnibus Budget Reconciliation Act of 1990 (P.L. 101-508, Nov. 5, 1990) changed the way post-fiscal year 1991 credit programs are reported in the budget by ensuring that their subsidy costs were considered in making resource allocation decisions. (App. II presents a further discussion of the principles and requirements of credit reform, which apply to post-fiscal year 1991 credit.)

[6]We mostly used the subsidy cost information from USDA's budget explanatory notes from the fiscal years 1995-99 appropriations requests, the best available subsidy cost information at the time of our review. However, USDA's Office of Inspector General has issued a qualified opinion on the RD mission area's financial statements and has reported continuing problems with support for the estimated subsidy costs of the loan programs.

or about 55 cents per dollar of loan. This was the highest subsidy rate for any of the rural business loan programs.

Guaranteed B&I loans were the second most expensive of RBS' loans during this period. Unlike the costs for IRP loans, the estimated administrative costs accounted for a larger part of the total costs than the estimated subsidy costs. This difference is in part explained by the fact that the overall subsidy rate for guaranteed B&I loans is considerably lower than the subsidy rate for IRP loans. More specifically, over this 5-year period, the overall subsidy rate for these guaranteed loans was 1.3 percent, or more than 1 cent per dollar of loan.

The costs associated with RED loans totaled $19.3 million, which included $16.2 million of RBS' estimated subsidy costs. At 25.5 percent, or about 26 cents per dollar of loan, the overall subsidy rate for RED loans over this 5-year period was second only to IRP loans. The subsidy costs of these loans were funded with appropriated funds; since fiscal year 1997, the subsidy costs of RED loans have been funded from earnings received on advance payments made by RUS' borrowers on their RUS loans.[7]

Lastly, RBS' costs for direct B&I loans was small, reflecting the low level of activity in the program during the 5-year period. Specifically, the estimated costs totaled about $770,000; this total applies to the loans approved in fiscal year 1997—there were no direct B&I loans approved during fiscal year 1993 through fiscal 1996. RBS' estimated subsidy costs for the fiscal year 1997 loans was over $60,000. The subsidy rate for these loans was 0.5 percent, or less than 1 cent per dollar of loan.

Delinquent Borrowers Mostly Have Guaranteed B&I Loans

The outstanding principal on RBS' B&I, IRP, and RED loans totaled about $2.2 billion as of March 31, 1998.[8] Borrowers that were delinquent (at least 30 days past due on loan repayment) held about $116 million, or 5.4 percent, of the total outstanding principal. Of the $116 million, about $112 million was held by delinquent borrowers with guaranteed B&I loans, about

[7]The authority for the RED loan program provides that RUS' borrowers can make advance payments to USDA on their RUS loans and earn interest at a rate of 5 percent. To cover the costs of the RED loans, RBS can use (1) the differential between the earnings on these advance payments and the 5-percent interest or (2) appropriated funds. Earnings on the advance payments in excess of 5 percent reduce the cost of these loans to the government.

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

$2 million was held by delinquent borrowers with direct B&I loans, and another $2 million was held by delinquent borrowers holding IRP loans. More of the outstanding principal on RBS' loans is at risk, however, because it is held by other borrowers that the agency's officials have identified as being problem borrowers, which include those likely to default on loan repayment in the future. RBS' records show that such borrowers owed about $73.8 million on guaranteed B&I loans and over $400,000 on IRP loans as of March 31, 1998.

Furthermore, RBS had written off some borrowers' debts in recent years. Specifically, the agency lost $263.8 million on guaranteed B&I loans during fiscal year 1993 through March 31, 1998. The agency also wrote off about $2 million on IRP loans during this period. The agency did not write off any direct B&I loans or RED loans during this period.

Over $100 Million of Guaranteed B&I Loans Are at Risk

According to RBS' automated files, over $112 million, or 6.1 percent of the more than $1.8 billion in outstanding principal on guaranteed B&I loans as of March 31, 1998, was held by 76 borrowers that were delinquent. These 76 borrowers made up 5 percent of the 1,534 total borrowers having guaranteed B&I loans.

As table 6 shows, there has been a reduction in the amount of principal owed by delinquent borrowers and in the number of delinquent borrowers each year during fiscal year 1993 through the first half of fiscal 1998.

Table 6: Amount of Outstanding Principal Owed on Guaranteed B&I Loans and Portion Owed by Delinquent Borrowers, September 30, 1993, Through September 30, 1997, and March 31, 1998

Dollars in millions

Guaranteed B&I loans	1993	1994	1995	1996	1997	1998
Amount of outstanding principal						
Owed by all borrowers	$1,000.4	$942.8	$990.1	$1,180.8	$1,615.8	$1,828.7
Owed by delinquent borrowers	$224.9	$174.9	$150.9	$128.6	$128.3	$112.3
Percentage owed by delinquent borrowers	22.5	18.6	15.2	10.9	7.9	6.1
Dollar range of outstanding principal owed by delinquent borrowers[a]	<$0.1 to $17.1	<$0.1 to $11.5	<$0.1 to $11.5	<$0.1 to $11.5	<$0.1 to $17.4	<$0.1 to $11.5
Number of borrowers						
Having outstanding principal	1,043	955	942	1,053	1,348	1,534
That were delinquent	145	121	108	95	78	76
Percentage that were delinquent	13.9	12.7	11.5	9.0	5.8	5.0

[a]The low end of the range for each year is as follows: about $4,300 for 1993, $5,700 for 1994, $13,800 for 1995, $5,400 for 1996, $13,000 for 1997, and $4,500 for 1998 (dollars are not stated in millions).

Source: RBS' loan reports and GAO's analysis of records from the RD mission area's Finance Office.

Many of the loans held by delinquent borrowers were made in recent years. Specifically, as of March 31, 1998, these borrowers were past due on principal and/or interest payments on 47 loans that were made during the 1990s—17 from fiscal year 1990 through 1993 and 30 from fiscal year 1994 through 1997.

A small number of borrowers in a few states accounted for a disproportionate share of the outstanding principal on guaranteed B&I loans held by delinquent borrowers. Specifically, a total of 12 delinquent borrowers in four states—Mississippi, North Dakota, New York, and Louisiana—owed about $55 million of outstanding principal on 17 loans, or almost 50 percent of the amount owed by all delinquent borrowers, as of March 31, 1998.

In addition to the delinquent borrowers, 56 other borrowers were identified by the agency's field office officials as being problem borrowers as of March 31, 1998; these borrowers owed about $73.8 million in outstanding principal on guaranteed B&I loans. Specifically, the field office officials reported that 51 borrowers were not in full compliance with the terms and conditions of their loans or that they expect noncompliance to occur in the future. RBS officials said the agency anticipates that some of these borrowers will likely default on scheduled loan payments. This assessment was made on the basis of information provided by the lenders that made the loans and/or the borrowers. These 51 borrowers owed about $69.3 million as of March 31, 1998. Additionally, the field office officials reported that another five borrowers were involved in liquidation and/or bankruptcy proceedings; these borrowers owed about $4.5 million as of March 31, 1998.

Borrowers that failed to repay their guaranteed B&I loans caused RBS to incur losses of $263.8 million during fiscal year 1993 through March 31, 1998. Specifically, RBS incurred losses on guaranteed B&I loans for 169 borrowers during this 5.5-year period. Generally, the loans on which these losses were incurred had been made many years ago—as far back as the 1970s. However, the agency has experienced some losses on newer loans. For example, as of July 24, 1998, RBS lost $24.2 million on 53 loans that had closed since the start of fiscal year 1990, including losses of $6.6 million on 15 loans closed since fiscal 1993.

Some Direct B&I Loans Are at Risk

The outstanding principal owed by 27 borrowers with direct B&I loans totaled $10.1 million as of March 31, 1998. Of this amount, as table 7 shows, two delinquent borrowers owed principal of $1.8 million, or 17.4 percent.

Table 7: Amount of Outstanding Principal Owed on Direct B&I Loans and Portion Owed by Delinquent Borrowers, September 30, 1993, Through September 30, 1997, and March 31, 1998

Dollars in millions

Direct B&I loans	1993	1994	1995	1996	1997	1998
Amount of outstanding principal						
Owed by all borrowers	$7.0	$5.8	$5.1	$4.3	$4.7	$10.1
Owed by delinquent borrowers	$0.6	$0	$0	$1.3	$1.3	$1.8
Percentage owed by delinquent borrowers	8.4	0	0	29.8	27.4	17.4
Dollar range of outstanding principal owed by delinquent borrowers	$0.6	$0	$0	$0.4 and $0.9	$0.4 and $0.9	$0.9 and $0.9
Number of borrowers						
Having outstanding principal	14	13	11	8	12	27
That were delinquent	1	0	0	2	2	2
Percentage that were delinquent	7.1	0	0	25.0	16.7	7.4

Source: RBS' loan reports and GAO's analysis of records from the RD mission area's Finance Office.

Concerning the two delinquent borrowers, one, located in Kentucky, owed slightly more than $900,000 on two loans that had been made in the early 1980s. The other, located in Oregon, owed about $850,000 on a loan made in mid-1997.

According to RBS-provided information, the agency's field office officials have not identified any nondelinquent borrowers as being problem borrowers as of March 31, 1998. Also, RBS did not write off the debt of any direct B&I loan borrowers during fiscal year 1993 through March 31, 1998.

Few Problems Exist With IRP Loans

The outstanding principal on IRP loans totaled $268.5 million as of March 31, 1998. As table 8 shows, $1.9 million, or less than 1 percent, was owed by three borrowers that were delinquent.

Table 8: Amount of Outstanding Principal Owed on IRP Loans and Portion Owed by Delinquent Borrowers, September 30, 1993, Through September 30, 1997, and March 31, 1998

Dollars in millions

IRP loans	1993	1994	1995	1996	1997	1998
Amount of outstanding principal						
Owed by all borrowers	$154.6	$220.7	$268.8	$275.2	$272.0	$268.5
Owed by delinquent borrowers	$3.2	$3.2	$3.2	$2.8	$1.9	$1.9
Percentage owed by delinquent borrowers	2.1	1.5	1.2	1.0	0.7	0.7
Dollar range of outstanding principal owed by delinquent borrowers	$0.5 to $1.2	$0.5 to $1.2	$0.5 to $1.2	$0.5 to $0.9	$0.5 to $0.7	$0.5 to $0.7
Number of borrowers						
Having outstanding principal	157	220	275	308	330	331
That were delinquent	4	4	4	4	3	3
Percentage that were delinquent	2.5	1.8	1.5	1.3	0.9	0.9

Source: RBS' loan reports and GAO's analysis of records from the RD mission area's Finance Office.

The three borrowers that were delinquent at the end of March 1998 had loans made by the Department of Health and Human Services before the transfer of the IRP loan program and portfolio to USDA.[9] Specifically, a delinquent borrower in Michigan owed $700,000 of outstanding principal on a loan made in 1983. Two other delinquent borrowers had outstanding loans that were made from 1980 through 1983—a Louisiana borrower owed about $673,000, and a Washington State borrower owed about $550,000.

In addition to the delinquent borrowers, one other borrower had been identified by the agency's field office officials as being a problem borrower as of March 31, 1998. This borrower, which received a loan in 1989, owed about $416,000 in outstanding principal.

RBS experienced losses on two IRP loans during fiscal year 1993 through March 31, 1998. Specifically, in November 1992, the agency wrote off about $1.2 million that was owed by a borrower in Puerto Rico and, in February 1997, about $1 million owed by a borrower in Florida. Both these

[9]The IRP loan program was transferred from the Department of Health and Human Services to USDA by section 1323 of the Food Security Act of 1985 (P.L. 99-198, Dec. 23, 1985).

write-offs involved loans that had been made by the Department of Health and Human Services in the 1980s.

No Problems Identified With RED Loans

The outstanding principal on RED loans totaled $47.6 million as of March 31, 1998. There were no delinquencies on these loans.[10] Table 9 shows the outstanding principal on RED loans at the end of fiscal year 1993 through March 31, 1998.

Table 9: Amount of Outstanding Principal Owed on RED Loans, September 30, 1993, Through September 30, 1997, and March 31, 1998

Dollars in millions

RED loans	1993	1994	1995	1996	1997	1998
Amount of outstanding principal	$17.1	$29.8	$38.6	$41.5	$43.9	$47.6
Number of borrowers having outstanding principal	176	215	231	246	252	260

Source: RBS' loan reports and GAO's analysis of records from the RD mission area's Finance Office.

No RED loan borrower had been identified by the agency's field office officials as being a problem borrower as of March 31, 1998. Also, RBS did not write off the debt of any RED loan borrowers during fiscal year 1993 through March 31, 1998.

Agency Comments

We provided USDA with a draft of this report for review and comment. USDA made a number of technical comments and suggested several adjustments to the financial information in the report. We incorporated these comments and suggestions as appropriate. USDA's comments and our response are in appendix III.

We performed our review of RBS' business loan programs from May through October 1998 in accordance with generally accepted government auditing standards. Our scope and methodology are discussed in appendix IV.

[10]We do not include as delinquent those RED loan borrowers that are shown in the Finance Office's reports as being past due on repayments when the delinquency was due to billing, payment, or administrative errors.

As agreed, unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days from the date of this letter. At that time, we will send copies of this report to the appropriate Senate and House committees; interested Members of Congress; the Secretary of Agriculture; the Administrator of RBS; the Director, Office of Management and Budget; and other interested parties. We will also make copies available to others upon request.

Please call me at (202) 512-5138 if you or your staff have any questions about this report. Major contributors to this report are listed in appendix V.

Sincerely yours,

Robert E. Robertson
Associate Director, Food
and Agriculture Issues

Contents

Abbreviations

B&I	business and industry (loans)
GAO	General Accounting Office
IRP	intermediary relending program (loans)
RBS	Rural Business-Cooperative Service
RD	Rural Development (mission area)
RED	rural economic development (loans)
RUS	Rural Utilities Service
USDA	U.S. Department of Agriculture

Descriptive Information on the Rural Business-Cooperative Service's Loan Programs

The Rural Business-Cooperative Service (RBS), an agency within the U.S. Department of Agriculture's (USDA) Rural Development mission area, operates loan programs that are intended to assist in the business development of the nation's rural areas and the employment of rural residents. The agency was established by the Federal Crop Insurance Reform and Department of Agriculture Reorganization Act of 1994 (P.L. 103-354, Oct. 13, 1994). This appendix provides information on RBS' three loan programs: the business and industry (B&I) program, the intermediary relending program (IRP), and the rural economic development (RED) program.

B&I Loans

A B&I loan can be either a direct government-funded loan or a loan made by another lender on which RBS guarantees repayment in the event of a loss. These loans are made to finance almost any business project that creates or retains jobs in rural areas and to finance projects in all segments of the economy, such as mining, manufacturing, and wholesale and retail sales. There are only a few activities for which B&I loans cannot be used, such as funding gambling facilities, race tracks, and golf courses. Additionally, RBS' regulations, which, according to the agency's officials, are being revised, provide that direct B&I loans cannot be used for constructing hotels and motels, and tourism and recreational facilities. However, guaranteed B&I loans can be used for those purposes.

Direct B&I loans are made to any legal entity, such as an individual operating a sole proprietorship, a cooperative, or a corporation, including local governmental bodies. The maximum loan currently allowed by RBS is $10 million, which is also the amount of outstanding debt that a direct loan borrower may owe. The interest rate on a direct loan is based on the prime rate that was in effect in the quarter of a year prior to the quarter in which the loan is made.

Guarantees are provided on loans made by traditional lenders, such as commercial banks, and, to a lesser extent, on loans made by nontraditional lenders, which are entities using investment capital for lending and which are authorized by state law to engage in lending. The loans are made to most types of legal entities, including for-profit and nonprofit cooperatives, corporations, partnerships, individuals, public bodies, and Indian tribes. The maximum loan currently is $25 million, which is also a borrower's maximum debt level. In addition, RBS provides the following guarantee percentages: 80 percent on loans of $5 million or less, 70 percent on loans between $5 million and $10 million, and 60 percent on loans of more than $10 million. However, a guarantee of up to 90 percent can be provided on a loan of $10 million or less if RBS' Administrator approves the higher percentage. The interest rate on a guaranteed loan is the rate agreed to by the lender making the loan and the borrower. According to RBS officials, this rate is generally the lender's prime rate plus 1 to 1.5 additional percentage points.

A business financed with a B&I loan is required to be located in a rural area, which is one that can have a population of no more than 50,000. Section 310B of the Consolidated Farm and Rural Development Act, as amended (7 U.S.C. 1932), contains the basic authority for the B&I loan program.

IRP Loans

IRP loans are direct government-funded loans made mostly to nonprofit community development organizations, and, to a lesser extent, to for-profit and nonprofit cooperatives, public bodies, and Indian tribes. For example, some electricity cooperatives that borrow from USDA's Rural Utilities Service (RUS) have obtained IRP loans. Individuals are not eligible to obtain IRP loans nor are for-profit commercial companies.

All IRP loans are made for relending. Specifically, the IRP loan funds are deposited into a revolving fund that the RBS borrower—an intermediary—has established. The intermediary relends the money in the revolving fund to its borrowers, which may be individuals, public or private organizations, or any other legal entity. A recipient can use the funds it obtains from the revolving fund to finance just about any project related to business or community development in rural areas. IRP loan funds are not allowed for certain purposes, including funding gambling facilities, race tracks, and golf courses. RBS' approval is required for the relending of the IRP loan funds.

The maximum loan currently allowed is $2 million for the first loan that an IRP borrower obtains and $1 million per fiscal year for any subsequent loans. The maximum total IRP debt that a borrower can have outstanding is $15 million.

RBS charges borrowers a 1-percent interest rate on all IRP loans. The interest rate on a loan from the revolving fund is the rate agreed to by the intermediary and its borrower. RBS does not specify what this rate should be; the agency's regulations state that intermediary borrowers should charge the recipients the lowest rate necessary to cover the debt service costs on outstanding IRP loans, a reserve for bad debts, and administrative costs. However, RBS does not track the rates charged by its borrowers to revolving fund recipients.

An IRP borrower does not have to be located in a rural area to obtain a loan. The intermediary's borrower, however, is to be located in a rural area, which, for this program, is an unincorporated area or an incorporated area that has a population of no more than 25,000. The basic authority for the IRP loan program is 42 U.S.C. 9812, as amended by section 1323 of the Food Security Act of 1985 (P.L. 99-198, Dec. 23, 1985), as amended.

RED Loans

RED loans, which are also direct loans, are made to entities that have outstanding RUS electricity or telecommunications loans or to former RUS borrowers that repaid their electricity loans early at a discount. RED loans are not available to former RUS borrowers that repaid their loans with scheduled payments.

All RED loans are made for relending, and the loan funds are targeted to a specific project. Specifically, the RED loan funds are deposited into a fund that the RUS borrower has established. The RUS borrower relends the money to other borrowers, which may be any public or private organization or other legal entity, for an economic development and job creation project. These projects include new business creation, existing business expansion, community improvements, and infrastructure development. RED loan funds cannot be used for certain purposes, including the RUS borrowers' electricity or telecommunications operations or a community's television system or facility, unless tied to an educational or medical project. RBS' approval is required for the relending of the RED loan funds.

The maximum RED loan in any year to an RBS borrower is 3 percent of the appropriated loan level for the year, rounded to the nearest $10,000. For example, the maximum RED loan in fiscal year 1998 is $750,000, which is 3 percent of the $25 million appropriated loan level for the year. There is no maximum number of RED loans that an RBS borrower may receive nor a maximum debt level that an RBS borrower may accumulate.

RED loans are interest free, and RBS requires that loan funds be relent interest free. However, RBS' borrowers are allowed to charge a loan-servicing fee equal to 1 percent of the unpaid principal owed on the loan.

Section 313 of the Rural Electrification Act of 1936, as amended (7 U.S.C. 940c), which authorizes the RED loans, provides that RUS' borrowers are allowed to make advance payments to USDA on their RUS loans and to earn interest at a rate of 5 percent on the advance payments. RBS is authorized to use the differential between the earnings on these advance payments and the 5-percent interest or to use other available funds to cover the costs of the RED loans. Rather than allowing RBS to use the differential to cover the subsidy costs of RED loans during fiscal years 1993 through 1997, the Congress provided USDA with separate appropriations.

A rural area for a loan in the RED program parallels a rural area for an initial RUS electricity loan, which is an area that has less than 2,500 residents. However, RBS officials said that a RED loan can be made for a project that is located in an area that has a higher population level if the project serves or provides employment for residents of an area that meets the 2,500-population threshold.

Subsidy and Administrative Costs of RBS' Loan Programs

This appendix contains information on RBS' estimated subsidy cost for loans made during fiscal year 1993 through fiscal 1997. The appendix also includes estimates of the administrative cost of operating each of the loan programs during these 5 fiscal years. Information that describes the credit reform procedures in the Federal Credit Reform Act of 1990 is also provided.

RBS' Costs for Operating the Rural Business Loan Programs

Tables II.1 through II.3 contain information on RBS' estimated subsidy cost for making and guaranteeing rural business loans and its estimated administrative costs for operating the business loan programs during fiscal year 1993 through fiscal 1997. For example, table II.1 shows that a large part of the estimated subsidy costs in each year were for IRP loans. Table II.2 shows that the estimated administrative costs were highest with the guaranteed B&I loans. Table II.3 shows that RBS' estimated costs totaled about $290 million.

Table II.1: RBS' Subsidy Costs for Rural Business Loans, Fiscal Years 1993-97

Dollars in millions

Program and loan type	1993	1994	1995	1996	1997	Total
B&I guaranteed	$10.2	$2.3	$4.0	$5.9	$7.6	**$30.0**
B&I direct	0	0	0	0	0.1	**0.1**
IRP direct	18.3	44.5	46.0	22.4	17.3	**148.4**
RED direct	3.2	3.4	3.1	3.7[a]	2.8	**16.2**
Total	**$31.6**	**$50.3**	**$53.1**	**$32.0**	**$27.7**	**$194.7**

Note: Totals may not add because of rounding.

[a]This amount was provided in USDA's written comments on a draft of this report. (See app. III.)

Source: Except as noted above, estimates contained in USDA, Budget Explanatory Notes for Committee on Appropriations, fiscal years 1995-99.

Table II.2: RBS' Administrative Costs for the Rural Business Loan Programs, Fiscal Years 1993-97

Dollars in millions

Program and loan type	1993	1994	1995	1996	1997	Total
B&I guaranteed	$18.3[a]	$21.4	$14.9	$14.9[b]	$16.1[b]	**$85.5**
B&I direct	0	0	0	0	0.7[b]	**0.7**
IRP direct	0.5	1.5	1.5	1.5	0.7[b]	**5.7**
RED direct	0.6[c]	0.6	0.6	0.7	0.7	**3.1**
Total	**$19.5**	**$23.4**	**$16.9**	**$17.0**	**$18.2**	**$95.0**

Note: Totals may not add because of rounding.

[a]This estimate is based on transfers from the Rural Development Insurance Fund program account to cover the salaries and expenses associated with various USDA rural credit programs.

[b]These amounts are estimates provided by the Budget Division of USDA's Rural Development mission area.

[c]This estimate is based on an average for the succeeding 4 years.

Source: Except as noted above, estimates contained in USDA, Budget Explanatory Notes for Committee on Appropriations, fiscal years 1995-99.

Table II.3: RBS' Total Costs for the Rural Business Loan Programs, Fiscal Years 1993-97

Dollars in millions

Program and loan type	1993	1994	1995	1996	1997	Total
B&I guaranteed	$28.5	$23.7	$18.9	$20.7	$23.7	**$115.5**
B&I direct	0	0	0	0	0.8	**0.8**
IRP direct	18.8	46.0	47.5	23.9	18.0	**154.1**
RED direct	3.8	4.0	3.7	4.4	3.5	**19.3**
Total	**$51.1**	**$73.7**	**$70.0**	**$49.0**	**$45.9**	**$289.7**

Note: Totals may not add because of rounding.

Source: GAO's calculation.

Credit Reform

The two key principles of credit reform contained in the Federal Credit Reform Act of 1990 center on the (1) definition of cost in terms of the present value of the estimated cash flow over the life of a credit instrument and (2) inclusion in the budget of the costs of credit programs before direct or guaranteed loans are made or modified.

Credit reform requirements separate the government's cost of extending or guaranteeing credit, called the subsidy cost, from administrative and unsubsidized program costs. Administrative expenses receive separate appropriations; they are treated on a cash basis and reported separately in the budget. The unsubsidized portion of a direct loan or loan guarantee is expected to be recovered from the borrower.

The Credit Reform Act defines the subsidy cost of direct loans as the present value of estimated loan disbursements, repayments of principal, and payments of interest and other payments by or to the government—over the loan's life—after adjusting for projected defaults, prepayments, fees, penalties, and other recoveries. It defines the subsidy cost of loan guarantees as the present value of cash flows from estimated payments by the government (for defaults and delinquencies, interest rate subsidies, and other payments) minus estimated payments to the government (for loan origination and other fees, penalties, and recoveries). Permanent, indefinite appropriations are available should the appropriated subsidy cost be less than the estimates in a later fiscal year.

Before credit reform, credit programs—like other programs—were reported in the budget on a cash basis. As a result, it was difficult to make appropriate cost comparisons between direct loan and loan guarantee programs and between credit and noncredit programs. Credit programs had different economic effects than most budget outlays, such as the purchase of goods and services, income transfers, and grants. In the case of direct loans, for example, the fact that the loan recipient was obligated to repay the government over time meant that the budgetary impact of a direct loan disbursement could be much less than other budget transactions of the same dollar amount. This lower budgetary impact also created a bias in favor of loan guarantees over direct loans. Loan guarantees appeared to be free, while direct loans appeared to be expensive because the budget did not recognize that at least some of the loan guarantees would default and that some of the direct loans would be repaid.

The Credit Reform Act changed this treatment for direct loans and loan guarantees made on or after October 1, 1991.

Comments From USDA

Note: GAO comments supplementing those in the report text appear at the end of this appendix.

USDA

United States Department of Agriculture
Rural Development

Rural Business–Cooperative Service • Rural Housing Service • Rural Utilities Service
Washington, DC 20250

NOV -9 1998

Mr. Robert E. Robertson
Associate Director
Food and Agriculture Issues
General Accounting Office
441 G Street, NW.
Washington, D.C. 20548

Dear Mr. Robertson:

This is in response to your Draft Proposed Report B-281089 on Rural Development: Rural Business-Cooperative Service Lending and the Financial Condition of its Loan Portfolio (GAO/RCED-99-10). The Rural Business-Cooperative Service has reviewed the subject draft report and have the following comments:

Now on p. 3.
See comment 1.

- Page 4, last line of first paragraph should read: "customers--plus 1 **to 1.5** additional percentage points."

Now on p. 3.
See comment 1.

- Page 5, seventh line under "RED loans.", delete the word "revolving".

Now on p. 5.
See comment 2.

- Page 7, Table 1:

  * "Number of loans" for 1993 should be **97** instead of 190 and correct total to **2,206.** Also, the "Total dollar amount of loans" should be **$100** instead of $187.4. The "Average dollar amount of loans" would then be **$1,030.9** instead of $986.

See comment 3.

  * "Total dollar amount of loans" for 1995 should be **$423.6** instead of $421.6 and correct total to **$2,854.9.**

    The Totals should then be:

- Number of loans	2,206
- Total dollar amount	$2,767.5
- Average dollar amount	$1,251.65

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Now on p. 8.
See comment 4.

- Page 11, Table 4:
    * "Total dollar amount of loans" for Fiscal Year (FY) 1998 through March 31, 1998, should be **$6.8** (not $8.5) and correct total to **$70.4** (not $72.1).

Now on p. 9.
See comment 5.

- Page 13, table at top of page:
    * Correct "RED direct" "Subsidy costs" to **16.2** (not 15.1) and correct "Total costs" to **19.3** (not 18.2).
    * Correct final total to **$289.7** (not $288.6).

Now on p. 10.
See comment 1.

- Page 14, last sentence ("The subsidy costs . . . their RUS loans.") should be revised to read: "Since Fiscal Year 1997, the subsidy costs have been funded from earnings received on advance payments made by RUS borrowers on their RUS loans."

Now on p. 12.
See comment 6.

- Page 16: Of the total loans made in the 1990s, 15 percent were made between 1990 and 1993; 85 percent were made between 1994 and 1998. There was a 4.6 percent delinquency rate for the 1990-1993 corresponding period and a 1.5 percent delinquency for the corresponding period between 1994-1998. As the number of loans in the B&I portfolio has increased, the number of borrowers delinquent as a percentage have continued to decrease.

Now on p. 13.
See comment 7.

- Page 18, second line should read: "million on . . . fiscal year 1993**, which constitutes only 0.237 percent of the total dollars lend during this same period.**" This will show the magnitude of losses compared to dollars spent.

Now on p. 21.
See comment 1.

- Page 26, last line of first full paragraph should read: "plus 1 **to 1.5** additional percentage points."

Now on p. 22.
See comment 1.

- Page 28:
    * First full paragraph, line 3, should read: "located in a rural area, which, for this program, is an **unincorporated area or an incorporated** area that".

See comment 1.

    * Second paragraph under RED LOANS:, line 3, delete "revolving"

Now on p. 24.
See comment 8.

- Page 30, Table II.1:
    * "IRP direct" total should be **148.5** (not 148.4).

See comment 5.

    * "RED direct" for 1996 should be **3.7** (not 2.6) and correct total to **16.2** (not 15.1).

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See comment 9.

* The following "Totals" should be: 1993 - 31.**7**
1994 - 50.**2**
1996 - **32.0**
1997 - 27.**8**
Total - 19**4.8**

- Page 31, Table II.3:

Now on p. 25.
See comment 5.

* "RED direct" for 1996 should be **4.4** (not 3.2) and correct total to **19.4**.

See comment 9.

* The following "Totals" should be: 1995 - $70.**1**
1996 - **49.0**
1997 - **46.0**
Total - **289.9**

Thank you for the opportunity to review the subject report.

Jill Long Thompson 11-9-98
JILL LONG THOMPSON
Under Secretary

cc: Rural Development Financial Management Division

The following are GAO's comments on USDA's letter dated November 9, 1998.

GAO's Comments

1. The final report was revised to reflect USDA's comment.

2. USDA's comment on the number and total dollar value of guaranteed B&I loans approved in fiscal year 1993 overlooks 94 loans valued at $87,401,900, which were approved under an emergency supplemental appropriation authorization. These additional loans are contained in the automated obligation records that we obtained from the Finance Office of USDA's Rural Development (RD) mission area and were reported in a USDA appropriation request as having been approved in fiscal 1993. We have added a note to table 1 stating that the fiscal year 1993 information includes loans made under this emergency appropriation provision.

3. Our report is based on the automated obligation records that the RD mission area's Finance Office provided us for each fiscal year. These automated records show that RBS obligated $421.6 million of guaranteed B&I loans for fiscal year 1995. However, USDA commented that it obligated $2 million more, for a total of $423.6 million. We rechecked the automated records that we had been provided and did not identify additional obligations totaling $2 million. Subsequently, officials in the Finance Office said that the fiscal year 1995 automated record that we were provided did not include adjustments that had been made to the agency's master loan file, which increased the total obligations by approximately $2 million. We have adjusted the financial statistics on the guaranteed B&I loans to include these additional obligations.

4. We agree and have adjusted the financial statistics accordingly. Reports from the RD mission area's Finance Office show that 19 loans with a total value of $6,825,000 had been obligated in the first half of fiscal year 1998. The draft reviewed by USDA included four additional loans valued at $1,680,000 that had been approved but not obligated in the first half of fiscal year 1998.

5. We agree and have adjusted the subsidy cost amount and other appropriate statistics. The draft reviewed by USDA had the subsidy costs that USDA reported in its annual appropriation requests, including $2.6 million for fiscal year 1996.

6. USDA states that, as more loans are made, the delinquency rate decreases, implying that the most recent loans are more financially secure. Our view is that there has simply been less time for delinquencies to occur on loans made most recently, and the delinquency rate for these loans may well increase as time passes.

7. USDA states that only a small portion of loans made in recent years has resulted in losses. It is reasonable to expect a low level of losses on recently made loans. (See comment 6.)

8. We correctly rounded $148,447,000 as $148.4 million.

9. Differences between the amounts that we present and those suggested by USDA are due to rounding as stated in the report.

Objectives, Scope, and Methodology

This appendix contains information on our objectives, scope, and methodology in conducting this review. Concerned about the financial status of RBS' business loan programs, the former Chairman of the House Committee on Agriculture asked that we report on (1) the number and dollar value of loans approved by the agency, (2) the federal government's costs associated with the agency's loans, and (3) the financial condition of the agency's loan portfolio, including the losses incurred.

In order to provide relatively current information on RBS' lending and portfolio, we focused on fiscal year 1993 through the first 6 months of fiscal 1998; for information on the subsidy and administrative costs of the loan programs, we focused on fiscal year 1993 through fiscal 1997 (the latest cost information readily available when we conducted our work).

To compile background information and to gain an understanding of how the business loan programs operate, we interviewed numerous RBS officials, including the Deputy Administrator for Business Programs, the Directors of the Processing and the Servicing Divisions, and the Acting Director and a Rural Development Specialist in the Speciality Lenders Division. We reviewed the basic statutory authority for the programs—the Consolidated Farm and Rural Development Act contains the basic statutory authority for the B&I loans; 42 U.S.C. 9812, as amended by the Food Security Act of 1985, authorizes the IRP loans; and the Rural Electrification Act authorizes the RED loans. We also reviewed RBS' implementing regulations and operating instructions, and its various publications, pamphlets, and reports that describe the loan programs. Additionally, we reviewed USDA's Budget Explanatory Notes for Committee on Appropriations for fiscal years 1995 through 1999. Furthermore, we reviewed prior reports addressing the loan programs that were issued by USDA's Office of Inspector General and by us. Finally, we reviewed the provisions that apply to RBS and its loan programs that are contained in the Federal Crop Insurance Reform and Department of Agriculture Reorganization Act of 1994.

To compile information on the number and dollar amount of loans that RBS approved (both direct and guaranteed) during fiscal year 1993 through the first half of fiscal 1998, we used RBS' automated files and its various loan reports.

To compile information on RBS' estimated subsidy costs and administrative costs, we used USDA's budget explanatory notes. Where information on the administrative costs was not available in the notes, we made estimates that were based on, for example, reported transfers of funds from the Rural Development Insurance Fund to RBS or obtained estimates from the Budget Division in the Rural Development mission area. The descriptive information on credit reform was extracted from our prior reports. To compile information on preapplications and applications for guaranteed B&I loans at the end of fiscal year 1997, we used a report from the Rural Community Facilities Tracking System, which is an automated information system used by RBS to manage the loan programs.

Our analysis of the financial conditions of RBS' portfolio covered fiscal year 1993 through the first half of fiscal 1998. To determine the financial condition of the three loan programs, we reviewed data contained in RBS' automated files, the agency's financial loan reports, and other information that RBS provided us. We used these data sources to compile information on the outstanding principal in each program and the portion of outstanding principal that was owed by delinquent borrowers at the end of fiscal year 1993 through the first half of fiscal 1998 and the losses that RBS has incurred during these years. We did not adjust the outstanding loan amounts to reflect the allowance for losses that RBS includes in its financial statements nor did we assess the adequacy of reserves on the loans.

Additionally, to obtain information on borrowers that were not delinquent but were identified by the agency's field office officials as being problem borrowers, we obtained reports from the Rural Community Facilities Tracking System. We also cross-matched these borrowers with RBS' automated loan files to determine the outstanding principal owed by each borrower.

Most of the financial data presented in this report are unaudited information that we extracted from RBS' reports and automated records. We did not verify the accuracy of the information contained in the agency's reports and automated records. However, we did cross-match information in the various automated files that we used, and we also cross-matched the information we developed with the agency's financial loan reports.

We conducted our review from May through October 1998 in accordance with generally accepted government auditing standards. USDA reviewed a draft of this report. The Department's comments are contained in appendix III.

Major Contributors to This Report

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