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Report to the Honorable John R. Kasich, House of Representatives

November 1990

CREDIT MANAGEMENT

Widespread Loan Origination Problems Reported

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Accounting and Financial Management Division

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November 9, 1990

The Honorable John R. Kasich
House of Representatives

Dear Mr. Kasich:

This report responds to your request that we review federal agencies' loan origination procedures and practices. We previously reported[1] to you on federal agencies' implementation of the Office of Management and Budget's (OMB) nine-point credit management program, which instructs agencies to implement certain loan origination procedures. Our current report addresses your specific concern about the adequacy of the government's loan origination practices, which must be effective so that the probability of borrower default is reduced. In responding to your concern, we analyzed numerous GAO, Office of Inspector General (OIG), and other agency reports which addressed loan origination problems for the government's largest direct and guaranteed loan programs. This report highlights loan origination problems prevalent in the government's credit programs and provides information related to previously reported loan origination problems in specific programs. The report also discusses certain planned and completed actions to correct agency loan origination problems.

Results in Brief

Federal agencies have experienced long-standing loan origination problems which have been highlighted in numerous GAO, OIG, and other reports over the past several years. The reported problems encompass agency and lender deficiencies in the determination of applicants' eligibility, credit worthiness, and repayment ability as well as the adequacy of loan security. In addition, these reports identified widespread weaknesses related to lender monitoring and instances of applicant and lender fraud and misrepresentation. As a result of these reported loan origination problems, loans were made to ineligible borrowers and the government incurred millions of dollars in losses.

Recognizing the importance of effective loan origination procedures and practices, OMB and Treasury have placed a high priority on improving the government's performance in this area and have issued guidelines and taken other actions to assist agencies. In addition, agencies have

[1] Credit Management: Deteriorating Credit Picture Emphasizes Importance of OMB's Nine-Point Program (GAO/AFMD-90-12, April 16, 1990).

taken, or plan to take, steps to correct many of the loan origination problems addressed in this report. However, some agencies are precluded by legislation from implementing certain loan origination procedures. For example, Agriculture's Farmers Home Administration (FmHA) is precluded by legislation from taking all debts into account when assessing an applicant's repayment ability on some farmer loans.

Background

The federal government makes and guarantees billions of dollars in loans for a wide variety of reasons, such as for housing, farming, education, and small business. In fiscal year 1989, federal agencies obligated over $16.2 billion in direct loans and guaranteed over $105.4 billion in loans made by private lenders. Also, at the end of fiscal year 1989, federal agencies reported that loan receivables totaled $211 billion and guaranteed loans outstanding exceeded $588 billion.

In April 1990, we reported (see footnote 1) that the federal government's credit picture has deteriorated. While the economic condition of certain industries, such as agriculture, account for a part of the deteriorating loan picture, some of the deterioration is a result of loan origination deficiencies on the part of agencies or lenders participating in agencies' guaranteed loan programs.

Loan origination is one of the most critical phases in the credit cycle. An agency's policies, standards, and procedures for extending credit directly affect the future collectibility of debt and the ultimate cost to the government. Further, the importance of monitoring lenders' loan origination procedures has become much more critical with the government's shift from direct to guaranteed loans and the resulting large number of private lenders involved—many of which have been delegated the authority to approve loans without federal involvement.

Loan origination practices encompass steps taken by agencies and lenders to ensure that loans are made to eligible applicants, that loans will be repaid, and that the government's interests are protected. OMB's nine-point credit management program instructs agencies to screen applicants to determine their credit worthiness and financial responsibility. In addition, OMB Circular A-129 and the Treasury Financial Manual credit supplement[2] instruct agencies to determine an applicant's

[2]While agencies are not legislatively required to follow OMB Circular A-129 and the Treasury Financial Manual credit supplement, OMB and Treasury consider these documents to be statements of federal policy which federal agencies should follow unless specifically prohibited by legislation.

(1) eligibility, (2) credit worthiness, and (3) repayment ability. OMB Circular A-129 also provides loan security guidelines on conducting appraisals of property pledged as loan collateral.

Objective, Scope, and Methodology

The objective of our review was to analyze previously prepared reports addressing loan origination problems at the major federal credit agencies to gain a governmentwide perspective on the pervasiveness of these problems. To accomplish this objective, we reviewed GAO and OIG reports issued between October 1, 1987, and early 1990 which detailed agency loan origination problems for the five largest direct and six largest guaranteed domestic loan programs based on their fiscal year 1989 direct loan obligations and guaranteed loan commitments. The GAO and OIG reports we reviewed ranged from overall assessments of certain programs to reviews of specific field office or lender operations. The programs in our review are part of the Departments of Agriculture, Education, Health and Human Services (HHS), Housing and Urban Development (HUD), and Veterans Affairs (VA) and the Small Business Administration (SBA). These programs accounted for 76 percent of all direct loan obligations and 82 percent of all guaranteed loan commitments during fiscal year 1989.

In order to further understand the agencies' loan origination problems, we also reviewed their fiscal year 1989 Federal Managers' Financial Integrity Act (FMFIA)[3] reports and fiscal years 1988 and 1989 internal control review reports. In addition, we reviewed the September 1988 and March 1989 President's Council on Integrity and Efficiency guaranteed loan management reports.

To determine recent governmentwide initiatives to improve federal agencies' loan origination practices, we obtained the perspectives of OMB and Department of the Treasury officials because these agencies have joint credit management oversight responsibilities. We also reviewed loan origination guidance and other pertinent documents issued by these agencies.

While we did not obtain written agency comments, we discussed the reported loan origination problems with officials of those agencies included in our review and, where appropriate, incorporated their

[3]The Federal Managers' Financial Integrity Act of 1982 requires executive agencies to report material weaknesses in agency internal control and accounting systems to the President and the Congress each year, along with plans to correct the problems [31 U.S.C. 3512(c)(3)].

responses in this report. We did not assess the adequacy of the actions officials told us their agency took in response to reported loan origination problems.

We obtained information contained in this report at the Washington, D.C., headquarters offices of the agencies included in our review. We conducted our work from August 1989 to June 1990.

Agencies Experienced Many Loan Origination Problems

Weaknesses in agency loan origination practices can lead to ineligible applicants receiving loans and losses to the government. However, despite OMB and Treasury direction for effective loan origination practices, agencies have experienced problems in this area. Over the past several years, numerous reports have detailed the deficiencies that agencies have had in implementing OMB and Treasury's loan origination instructions, as well as the agencies' own policies and procedures. In particular, (1) each agency in our review had problems ensuring that loans were made to eligible applicants, (2) Agriculture, HHS, HUD, SBA, and VA did not adequately assess applicants' credit worthiness, (3) Agriculture, HUD, and VA had problems assessing applicants' repayment ability, and (4) Agriculture, HUD, SBA, and VA had deficiencies in properly assessing loan security. Many of these deficiencies also pertained to the lenders participating in these agencies' programs. In addition, FmHA and Education are precluded by legislation from implementing certain loan origination procedures.

Appendix I summarizes the reported problem areas for each agency in our review. Except for HHS, specific examples of problems each agency in our review had in implementing OMB and Treasury loan origination instructions are discussed in appendixes II through VI. (Examples of HHS' loan origination problems, which were less extensively reported than those of the other agencies in our review, are included in the following discussion.)

Loans Made to Ineligible Applicants

OMB Circular A-129 and the Treasury Financial Manual credit supplement instruct agencies to determine whether an applicant complies with all statutory and regulatory eligibility requirements prior to loan approval. However, the OIGs reported that two agencies made or guaranteed loans to ineligible applicants and that eligibility problems at three agencies led to excessive loan amounts. In addition, reports on four agencies identified procedures which could lead to ineligible applicants receiving loans. Also, Education is precluded by legislation from screening, or requiring guaranty agencies[4] to screen, for certain eligibility requirements.

Both Agriculture and SBA made or guaranteed loans to ineligible applicants or to applicants of questionable eligibility. For example, in 1988, Agriculture's OIG reported that the Agricultural Stabilization and Conservation Service (ASCS) made $1.2 million in questionable rice loans. These loans were questioned based on several eligibility factors, such as the quality of the rice or whether the rice was grown on approved farms. Also, Agriculture's FmHA made or guaranteed loans to ineligible farmer and Single Family Housing applicants. For example, a September 1988 OIG report projected that lenders made 3,065 guaranteed farmer loans totaling $198.6 million to borrowers whose need for an FmHA guaranteed loan was questionable. In addition, SBA's OIG reported that the agency guaranteed loans even though a lender did not adequately justify the need for an SBA guarantee.

Also, eligibility problems at Agriculture, HUD, and Education resulted in loans being made for excessive amounts. For example, Agriculture's OIG reported that because of processing problems, such as incorrect calculations of disaster losses, FmHA made excessive emergency loss loans. In the case of HUD, the President's Council on Integrity and Efficiency reported, in March 1989, instances where the Single Family Housing statutory loan limit was exceeded. Similarly, Education's reviews of schools found instances where student loan limits were exceeded.

Further, weaknesses in loan origination procedures at Agriculture, Education, HHS, and VA could lead to ineligible applicants receiving loans. For example, VA's fiscal year 1989 FMFIA report disclosed that the lack of adequate centralized loan guaranty support systems prevented VA from ensuring that veterans who had exhausted their home loan guaranty eligibility were denied new loan guarantees.

In addition to eligibility determination deficiencies, Education is precluded by legislation from screening applicants for certain eligibility requirements. While the Higher Education Amendments of 1986 require students to meet certain educational or aptitude test requirements in order to receive a Stafford Student loan, the law prohibits Education from promulgating regulations defining the requirements an institution

[4]Guaranty agencies are responsible for administering Education's Stafford Student loan program within their respective states, encouraging participation by lenders, and verifying that lenders use due diligence in making loans.

must use to ensure that students meet these requirements. We have previously suggested that the Congress consider removing this restriction.[5]

Credit Worthiness Not Always Properly Assessed

OMB Circular A-129 and the Treasury Financial Manual credit supplement direct federal agencies to screen an applicant for credit worthiness. Such screening includes obtaining credit reports and determining whether an applicant owes a delinquent federal debt. A common credit worthiness deficiency disclosed in the reports we reviewed concerned detecting, and requiring applicants to resolve, delinquent federal debt. Four agencies or their lenders also experienced other problems with assessing applicants' credit worthiness. However, the Higher Education Act of 1965 does not make credit worthiness a criterion for receiving an Education Stafford loan.

Our recent report on credit management (see footnote 1) disclosed that federal agencies, because of automated system limitations, did not prescreen to determine if applicants owed debts to other federal agencies. In addition, most agencies did not require that credit be denied if an applicant owed a delinquent federal debt to another agency, where denial would be consistent with program legislation. This report also disclosed that FmHA did not adequately screen Single Family Housing applicants to determine if they owed delinquent FmHA debts. The importance of this FmHA deficiency was illustrated by a March 1989 OIG report which found that, as of July 1988, FmHA had lost $307,000 on subsequent loans made to borrowers who had received loans after defaulting on over $5 million in prior FmHA loans. In addition, in September 1988, the President's Council on Integrity and Efficiency reported that HHS' Health Education Assistance Loan applicants were not prescreened against Internal Revenue Service delinquent tax files.

Agriculture, HUD, SBA, and VA also had other credit worthiness deficiencies. For example, HUD's fiscal year 1989 FMFIA report disclosed that many lenders participating in the Title I program were falsifying buyer loan documents and not properly evaluating borrower credit worthiness. Also, although VA required lenders to obtain credit reports, several VA OIG reports identified cases where lenders obtained multiple credit reports for an applicant until a "clean" report was found. For example, in one case, a lender obtained, but did not send to VA, a credit report which showed that two of the applicant's debts were placed with a collection

[5]Guaranteed Student Loans: Potential Default and Cost Reduction Options (GAO/HRD-88-52BR, January 7, 1988).

agency. The lender subsequently obtained another credit report which did not show these two debts and sent it to VA. This applicant defaulted on the VA guaranteed loan within 1 year of loan origination.

In April 1990, we reported (see footnote 1) that Education does not require lenders to obtain credit reports and require applicants to certify that they are not delinquent on a federal debt. Further, Education does not (1) prescreen applicants to determine if they are delinquent on debts at other federal agencies or (2) deny applicants credit because they are delinquent on such debt. These conditions exist because the Higher Education Act of 1965, as amended, does not make credit worthiness a criterion for receiving an Education Stafford loan.

Applicants' Repayment Ability Not Always Adequately Assessed

OMB Circular A-129 and the Treasury Financial Manual credit supplement instruct federal agencies to assess an applicant's ability to repay the loan. However, GAO and the OIGS reported that FmHA, HUD, VA, and/or their lenders did not adequately assess applicants' repayment ability. Specifically, (1) applicants' incomes were overstated, (2) applicants' expenses were understated, and/or (3) agencies or their lenders did not perform required verifications. Education applicants, however, are not required to demonstrate repayment ability. In addition, FmHA is precluded by legislation from taking all debts into account when assessing an applicant's repayment ability for some farmer loans.

In February 1989, we reported that farmer program applicants' planned repayment ability was overstated, on average, by 24 percent.[6] Further, this report disclosed that applicants overstated total cash farm income by 18 percent and understated family living expenses by about 10 percent. Several Agriculture OIG reports on FmHA's direct and guaranteed farmer and Single Family Housing programs disclosed similar problems. In addition, in August 1988, the HUD OIG reported that lenders had not properly evaluated borrowers' repayment ability for 53 of the 124 Title I loans reviewed. In most cases, the OIG concluded that the lender should not have approved these loans because of the borrowers' insufficient income, excessive liabilities, and/or poor credit histories. Another HUD OIG report, issued in August 1989, found that in 21 of 35 Single Family Housing loans, a lender did not perform required independent verifications of employment and applicant deposits. VA's OIG issued several reports detailing problems with lenders overstating applicant

[6]Farmers Home Administration: Sounder Loans Would Require Revised Loan-Making Criteria (GAO/RCED-89-9, February 14, 1989).

income and/or understating applicant expenses. The OIG reported that many of these applications would not have met VA's loan approval guidelines, if the correct applicant income and expense amounts had been used.

Legislation precludes FmHA, on some farmer loans, from taking into account certain debts when assessing an applicant's repayment ability. The Congress, in making supplemental appropriations for fiscal year 1987 (Public Law 100-71, July 11, 1987), directed FmHA to try to keep the farmer borrower in business by extending annual production loans, provided the borrower could demonstrate repayment ability on only the new loan, plus interest. In particular, no repayment ability needs to be shown on all other debt. We have previously recommended (see footnote 6) that the Congress reconsider whether this policy is the best means to assist already heavily indebted farmers.

Deficient Loan Security Procedures Reported

OMB Circular A-129 contains general guidance for appraising collateral used to secure government loans. Loan security procedures should ensure that sufficient and adequate collateral is pledged to ensure repayment of the loan. However, inadequate appraisals were reported at four of the agencies in our review. The other agencies—Education and HHS—make unsecured loans and, therefore, loan security issues were not applicable to their programs.

Reports on Agriculture, HUD, SBA, and VA programs disclosed problems with collateral appraisals, which, in some cases, resulted in losses to the government. For example, in March 1989, Agriculture's OIG reported that for 142 of 331 (43 percent) Single Family Housing properties sold with losses, either the appraisal and/or the original loan was questionable, which, in part, contributed to losses totaling $1.4 million. In another example, HUD reported loan origination appraisals of single family homes as a material weakness in its fiscal year 1989 FMFIA report. In this report, HUD disclosed that appraisers had been inflating Single Family Housing appraisals which, if default occurred, often resulted in HUD paying a claim considerably in excess of property values. In addition, in March 1989, the President's Council on Integrity and Efficiency reported that HUD and VA OIG audits and investigations, agency reviews, and a congressional study found that faulty or fraudulent appraisals caused excessive loans and were instrumental in many of the housing fraud schemes at these two agencies.

Agency Monitoring of Lenders Inadequate

The federal government's emphasis on guaranteed rather than direct loans has increased the importance of establishing and implementing effective lender monitoring procedures. In addition, since agencies sometimes delegate the authority to make loan approval decisions to lenders, adequate monitoring of these lenders is particularly important. Treasury's June 1990 guaranteed loan management assessment found that agencies have been lax in setting and enforcing lender requirements and in monitoring lender performance. Treasury stated that lenders, knowing that loan repayment is guaranteed, have not properly screened applicants, serviced accounts, or aggressively pursued collections. Further, inadequate lender monitoring was reported for each of the agencies in our review.

Although each of the agencies in our review had lender monitoring problems, FmHA, HUD, and VA were particularly vulnerable to this deficiency. In September 1989, we reported[7] that FmHA's inadequate assessment of borrowers' financial conditions prior to loan guarantee approval and insufficient oversight of approved loan guarantees had contributed to guaranteed loan losses. In addition, a February 1990 GAO report disclosed that HUD's oversight and monitoring of its Single Family Housing lenders who approved guaranteed loans without prior HUD approval had not been effective.[8] Specifically, this report stated that HUD's reviews of these lenders had instances of flawed, deficient, or lackluster monitoring and oversight. In addition, a September 1989 VA OIG report disclosed that, although over 90 percent of all manufactured home loans were made by lenders without prior VA approval, VA did not monitor these lenders' performance closely.

Fraud and Misrepresentation Found at Most Agencies

Each of the agencies in our review had reported problems with fraud and misrepresentation in at least one of the loan origination areas—eligibility, credit worthiness, repayment ability, and/or loan security. Generally, applicants, lenders, or others made false statements or provided false documentation to the agencies. This led to (1) ineligible applicants receiving loans, (2) loans made for excessive amounts, and (3) millions of dollars in losses to the government.

[7] Farmers Home Administration: Implications of the Shift From Direct to Guaranteed Farm Loans (GAO/RCED-89-86, September 11, 1989).

[8] Financial Audit: Federal Housing Administration Fund's 1988 Financial Statements (GAO/AFMD-90-36, February 9, 1990).

The housing programs at HUD and VA were particularly vulnerable to several types of fraud and misrepresentation schemes. For example, in its semiannual report to the Congress for the 6-month period ending September 30, 1989, and in testimony before the Senate Committee on Governmental Affairs on September 18, 1990, the HUD OIG reported serious irregularities in the Single Family Housing program's loan origination phase, which resulted in substantial losses to the government. The OIG disclosed that, many times, some or all of the parties involved in the Single Family Housing transaction were actively trying to defraud the government. Also, in March 1989, the President's Council on Integrity and Efficiency reported that the most common housing fraud occurred through the following.

- Loan origination schemes: Lenders, realtors, borrowers, or their representatives submitted false income, employment, or debt information in order to secure guarantees for applicants who were unqualified or not credit worthy.
- "Straw buying" schemes: Borrowers purchased homes with the intent of immediately transferring the title to an unqualified party.
- Equity skimming schemes: Investors purchased guaranteed properties from borrowers by assuming the responsibility for the mortgage payment. These investors then rent the property but do not make the mortgage payments.
- Appraisal fraud schemes: Appraisers submitted fraudulent or inflated property appraisals.

The other agencies in our review also experienced fraud and misrepresentation, as shown in the following examples.

- The Agriculture OIG reported several instances where ASCS applicants made false representations about their loan collateral (such as pledging previously disposed collateral as security for the loan). The OIG also reported cases of fraud and misrepresentation on the part of FmHA borrowers and personnel.
- The Education OIG reported that individuals illegally obtained thousands of dollars in loans by using false identities. School officials were also involved in illegally obtaining loans based on false information. In addition, the HHS OIG reported one case of fraud by an applicant who attempted to obtain an HHS Health Education Assistance Loan as well as an Education loan by using a false identity.
- The SBA OIG reported that several businesses submitted false financial information in order to obtain over $4 million in SBA guaranteed loans. Also, in March 1989, the President's Council on Integrity and Efficiency

reported that lenders made ineligible SBA guaranteed loans in order to pay off unguaranteed loans likely to default.

Efforts to Improve Loan Origination

Most of the agencies in our review informed us that they have taken or plan to take actions, such as issuing policies or regulations, to correct the loan origination deficiencies cited in this report. For example, (1) HHS issued policy memos and audit guidelines to improve its eligibility procedures, (2) HUD plans to issue new Title I regulations that will include loan origination requirements, and (3) VA established a lender monitoring unit in March 1990. Specific agency comments on planned or completed corrective actions are included in appendixes II through VI.

In addition to individual agency actions to address their loan origination problems, OMB and Treasury have placed a high priority on improving the government's loan origination procedures and practices. To accomplish this objective, OMB and Treasury have completed, or are in the process of completing, several actions intended to improve agency loan origination practices. For example, in November 1988, OMB issued a revised Circular A-129, and, in January 1989, Treasury issued the Treasury Financial Manual credit supplement, which contains loan origination policies for the federal government. In addition, OMB and Treasury are taking steps to include other agencies' delinquent loans in HUD's Credit Alert Interactive Voice Response System. This effort is intended to give all participating agencies and lenders a means of prescreening a loan applicant's credit rating with the federal government.

Because of the shift from direct to guaranteed loans, OMB and Treasury recently began to place increased emphasis on improving the management of the government's guaranteed loan programs. For example, OMB is developing a nine-point program which will help ensure that its loan origination policies are extended to the government's guaranteed loan programs. Also, in June 1990, Treasury issued a guaranteed loan management assessment which contains loan origination standards for agencies to implement. Further, Treasury is currently undertaking an initiative, called Project USA, which will initially focus on developing and implementing financial "models of excellence." As part of this initiative, Treasury drafted a financial management model for federally guaranteed Single Family Housing loans. We believe that the actions taken by OMB and Treasury will provide agencies with the guidance necessary to strengthen their loan origination and lender monitoring procedures and practices.

Summary

Problems have been previously reported at each of the agencies in our review in the loan origination phase of the credit cycle. In general, GAO, OIG, and other agency reports showed that agencies or their lenders were not always adequately assessing applicants' eligibility, credit worthiness, repayment ability, or loan security. In addition, these reports highlighted agencies' weaknesses in monitoring lenders, especially those that made loan approval decisions. Further, the OIGs found numerous fraud and misrepresentation schemes perpetrated by borrowers, lenders, and others. In order to help agencies correct these problems, OMB and Treasury have issued guidance and taken other actions intended to help agencies strengthen their loan origination and lender monitoring procedures and practices. In addition, individual agencies have taken, or plan to take, actions to address their specific loan origination problems.

As agreed with your office, unless you publicly announce the contents of this report earlier, we will not distribute it until 30 days from its date. At that time, we will send copies to the Director of the Office of Management and Budget; the Secretaries of Agriculture, Education, Health and Human Services, Housing and Urban Development, Veterans Affairs, and the Treasury; the Administrator of the Small Business Administration; and other interested parties. Copies will also be made available to others upon request.

Please contact me at (202) 275-9454 if you or your staff have any questions concerning this report. Major contributors are listed in appendix VII.

Sincerely yours,

Jeffrey C. Steinhoff
Director, Financial Management
Systems and Audit Oversight

Contents

Abbreviations

ASCS	Agricultural Stabilization and Conservation Service
FHA	Federal Housing Administration
FMFIA	Federal Managers' Financial Integrity Act
FmHA	Farmers Home Administration
GAO	General Accounting Office
HHS	Department of Health and Human Services
HUD	Department of Housing and Urban Development
OIG	office of inspector general
OMB	Office of Management and Budget
SBA	Small Business Administration
USDA	United States Department of Agriculture
VA	Department of Veterans Affairs

Summary of Agency Loan Origination Problems

This appendix summarizes, by general issue area, the previously reported loan origination problems for each agency in our review and/or the lenders participating in their programs. Appendixes II through VI provide additional detail.

Table I.1: Loan Origination Problems Identified

	Agency					
Problem area	**USDA**	**Education**	**HHS**	**HUD**	**SBA**	**VA**
Eligibility	x	x	x	x	x	x
Credit worthiness	x	n/a	x	x	x	x
Repayment ability	x	n/a		x		x
Loan security	x	n/a	n/a	x	x	x
Lender monitoring	x	x	x	x	x	x
Fraud/misrepresentation	x	x	x	x	x	x

Loan Origination Problems at the Department of Agriculture

The Department of Agriculture's ASCS and FmHA provide credit to farmers and others in rural communities. Although we also reviewed reports on Agriculture's Rural Electrification Administration, this agency was discussed in few reports on loan origination, therefore, we did not include it in this appendix. ASCS[1] makes Commodity Credit Corporation commodity loans to producers or cooperative marketing associations of certain agricultural commodities, such as rice or wheat. FmHA provides credit to those in rural communities who are unable to obtain financial assistance from other sources at reasonable rates and terms. FmHA, through its farmer programs, makes or guarantees loans for farm ownership or operating purposes. FmHA also makes emergency loss loans to help farmers and others recover from losses due to natural disasters such as droughts. In addition, FmHA, through its rural housing programs, makes (1) Single Family Housing loans to very low, low, and moderate income families to purchase or repair homes in rural areas and (2) multifamily housing loans to provide moderate cost rental housing to persons of very low, low, and moderate incomes in rural areas.

As shown in Table II.1, Agriculture's ASCS commodity loan and FmHA's farmer and rural housing loans accounted for a significant portion of the federal government's fiscal year 1989 direct loan obligations. In addition, in fiscal year 1989, FmHA made $2.1 billion in guaranteed loan commitments, or 2 percent of the federal government's total guaranteed loan commitments.

Table II.1: Fiscal Year 1989 ASCS and FmHA Direct Loan Obligations

Dollars in millions

	Direct loan obligations	Percent of governmentwide direct loan obligations
ASCS commodity loans	$7,068	43.5
FmHA farmer loans	1,092	6.7
FmHA rural housing loans	2,253	13.9

ASCS and FmHA Loan Origination Problems

The following section includes, by general issue area, ASCS' and FmHA's loan origination problems identified between October 1987 and early 1990 by GAO, Agriculture's Office of Inspector General, and others. Although we did not include all of Agriculture's reported loan origination problems, this discussion includes representative examples of the

[1] Although these loans are Commodity Credit Corporation loans, the Corporation has no operating personnel and its programs are administered by ASCS. Because this report details loan management problems, we used the term ASCS loans.

types of problems reported. In addition to these examples, Agriculture's fiscal year 1989 FMFIA report cited FmHA's incomplete implementation of OMB Circular A-129 (including its prescreening provisions) as a material weakness.

Objective: OMB Circular A-129 and the Treasury Financial Manual credit supplement instruct agencies to determine whether an applicant complies with all statutory and regulatory eligibility requirements prior to loan approval.

Problem: ASCS and FmHA made or guaranteed loans to ineligible applicants or to applicants of questionable eligibility.

- In two 1988 reports, the OIG questioned the borrowers' eligibility for $1.2 million in rice loans. These loans were questioned based on several eligibility factors, such as rice quality or whether the rice was grown on approved farms.
- In three reports on emergency loss loans, the OIG identified several borrowers who did not meet all of FmHA's eligibility requirements. In several reports, the OIG also found that emergency loss loans were made for excessive amounts because of processing errors, such as incorrect loss calculations.
- In a September 1988 report, the OIG projected that, based on its review of 234 randomly selected guaranteed loans, 3,065 guaranteed loans totaling $198.6 million were made to borrowers whose need for FmHA's guarantee was questionable.
- OIG reports in October 1987 and March 1990 as well as a June 1989 GAO report[2] disclosed that over half of the guaranteed reduced interest rate farmer loans reviewed were made to unqualified applicants. For example, the March 1990 OIG report disclosed that 91.7 percent of the 24 borrowers of guaranteed reduced interest rate loans reviewed were ineligible for the reduced rate and 37.5 percent were ineligible for the guarantee.
- A September 1989 OIG report identified over $573,000 in Single Family Housing loans made to applicants in one state—Georgia—who did not meet one or more of FmHA's eligibility requirements.

Objective: OMB Circular A-129 and the Treasury Financial Manual credit supplement direct agencies to screen an applicant for credit worthiness.

[2]Farmers Home Administration: Status of Participation in the Interest Rate Reduction Program (GAO/RCED-89-126BR, June 15, 1989).

Problem: FmHA procedures did not necessarily detect applicants who owe delinquent debt.

- An August 1988 OIG and an April 1990 GAO report[3] disclosed that FmHA did not (1) adequately perform in-house screening for applicants who owed delinquent FmHA debt and (2) screen applicants against other federal agency delinquent debt files. Further, the GAO report disclosed that, for its rural housing loans, FmHA did not require applicants to certify that they did not owe delinquent federal debts.
- In August 1988, the OIG reported that FmHA did not obtain, or require lenders to obtain, credit bureau reports for its farmer program applicants.

Problem: FmHA had not established specific procedures to require applicants to resolve federal delinquencies prior to loan approval.

- In April 1990, we reported (see footnote 3) that rural housing regulations do not require that credit be denied to applicants with delinquent federal debts.
- The September 1988 President's Council on Integrity and Efficiency report stated that FmHA had not established specific procedures that lenders require applicants to resolve delinquencies prior to receipt of the guarantee.
- A March 1989 OIG report found that, as of July 1988, FmHA had lost $307,000 on subsequent loans made to borrowers who had received loans after defaulting on over $5 million in prior FmHA loans.

Objective: OMB Circular A-129 and the Treasury Financial Manual credit supplement instruct agencies to assess an applicant's ability to repay the loan.

Problem: FmHA's assessment of an applicant's repayment ability was deficient because the applicant's income was overstated and expenses understated.

- A February 1989 GAO report[4] on direct farmer program loans found that, on average, (1) planned repayment ability was overstated by 24 percent, (2) borrower estimates of total cash farm income were overstated by

[3] Credit Management: Deteriorating Credit Picture Emphasizes Importance of OMB's Nine-Point Program (GAO/AFMD-90-12, April 16, 1990).

[4] Farmers Home Administration: Sounder Loans Would Require Revised Loan-Making Criteria (GAO/RCED-89-9, February 14, 1989).

18 percent, and (3) borrowers understated their family living expenses by about 10 percent.

- In September 1989, we reported[5] that 13 of the 74 (17.6 percent) FmHA guaranteed loan decisions reviewed were based on inaccurate expenses and/or income amounts.
- Agriculture's OIG issued several reports where it found that farmer and Single Family Housing applicants' income was overstated and/or expenses understated.

Problem: FmHA is precluded by legislation from taking into account all debts while assessing some farmer program applicant's repayment ability.

- In February 1989, we reported (see footnote 4) that the Congress, in making supplemental appropriations for fiscal year 1987 (Public Law 100-71, July 11, 1987), directed FmHA to try to keep farmer borrowers in business by extending annual production loans, provided the borrower can demonstrate repayment ability on only the new loan, plus interest. In particular, no repayment ability needs to be shown on all other debt. We recommended that the Congress reconsider whether this policy is the best means to assist already heavily indebted farmers.

Objective: OMB Circular A-129 directs agencies to require that all appraisals be conducted in accordance with generally accepted appraisal standards. Further, the Circular and the Treasury Financial Manual credit supplement instruct agencies to ensure that the property used to secure a government loan is not pledged to other debts.

Problem: ASCS loan security procedures and practices were not always adequate.

- Several OIG reports disclosed that ASCS did not always (1) require producer certifications of certain elements of the collateral, (2) make or obtain correct collateral measurements, or (3) perform lien searches or perform them in a timely manner.
- In two 1988 reports, the OIG determined that $10.9 million in excessive rice loans were made because program operating procedures did not require ASCS personnel to verify collateral information provided by producers and cooperatives.

[5]Farmers Home Administration: Implications of the Shift From Direct to Guaranteed Farm Loans (GAO/RCED-89-86, September 11, 1989).

Problem: FmHA's collateral appraisals were not adequate.

- In March 1989, the OIG reported that inadequate and incomplete appraisals have been a recurring FmHA problem since fiscal year 1982. Further, this report found that for 142 of 331 Single Family Housing properties sold with losses (43 percent), the appraisal and/or the original loan was questionable, which, in part, contributed to losses totaling $1.4 million.
- Agriculture's fiscal year 1989 FMFIA report cited as a material weakness in the farmer program a lack of procedures to ensure consistency in review of property appraisals.

Problem: FmHA did not require sufficient collateral or document the specific loan security.

- In September 1988, the OIG determined that FmHA did not always take liens on all available security that borrowers had to offer. Specifically, the OIG projected that only 61 percent of the borrowers who produced crops had given FmHA crop liens and only 48 percent of borrowers who produced livestock had pledged their livestock as security.
- In another September 1988 report, the OIG projected that, based on a review of 234 randomly selected guaranteed loans, 6,367 loans of 15,585 guaranteed farmer loans were approved without lenders documenting the specific loan security.

Objective: OMB Circular A-129 and the Treasury Financial Manual credit supplement instruct agencies to monitor the performance of lenders participating in their programs.

Problem: FmHA's reviews of lenders' loan processing generally did not prevent, detect, or correct incomplete and/or inaccurate loan applications.

- A September 1989 GAO report (see footnote 5) concluded that FmHA's inadequate assessment of borrowers' financial conditions prior to loan guarantee and insufficient oversight of approved loan guarantees have contributed to guaranteed loan losses. We found that lenders and borrowers have ample incentive to hedge on meeting FmHA's requirements for making and servicing guaranteed loans because up to 90 percent of the risk is transferred to the government. We further stated that the problems found in the guaranteed loan program demonstrate that FmHA cannot rely on private lenders to manage the program for FmHA.

- A September 1988 OIG report found at least one loan processing problem in each of the 234 guaranteed loans reviewed. Further, in this report, the OIG projected that, of 15,585 guaranteed loans: (1) 12,137 were approved without complete background credit checks on the applicants, (2) 1,725 were approved without verifying applicants' existing debts, and (3) 10,712 loan agreements did not contain the required financial requirements.

Agency Response

ASCS and FmHA officials informed us of several actions that they have taken, or plan to take, to resolve the problems cited in this report. ASCS officials stated that they plan to provide rice and cotton cooperatives with a list of eligible farms on an annual basis. Further, ASCS is developing a system to allow its County Offices to query the eligibility of commodity applicants. In addition, in February 1990, ASCS issued a reminder to its County Offices to perform lien searches. In the case of FmHA, the agency (1) in mid-1990 required field offices and lenders to obtain credit bureau reports on farmer program applicants and (2) instituted reviews designed to correct deficiencies in assessing applicants' repayment ability and loan security appraisals. Further, FmHA plans to revise its regulations to improve its procedures for (1) verifying applicants' debts, income, and expenses and (2) taking liens on all available security. In addition, FmHA plans to provide all supervisory personnel with detailed training on credit quality in the fall of 1990. FmHA has also proposed legislation to change the legislative restriction that precludes FmHA from taking into account all debts while assessing some farmer program applicants' repayment ability.

In addition to actions FmHA has taken, or plans to take, to resolve its reported loan origination problems, FmHA officials advised us that they did not always agree with the OIG's findings. For example, FmHA generally believed that the OIG projections were based on reviews of too few loans. FmHA informed us that in-house reviews found fewer incorrectly processed loans than the OIG.

Loan Origination Problems at the Department of Education

The Department of Education guarantees student loans under the Stafford Student Loan program. Under this program, Education provides reinsurance[1] to state and nonprofit agencies which guarantee loans made by lenders. There are three types of individual student loans under the program: Stafford, Supplemental Loans for Students, and Parent Loans for Undergraduate Students. These programs enable students and parents of eligible students to take out long-term loans at low interest rates to help pay for a student's postsecondary education. In fiscal year 1989, Education made about $12 billion in guaranteed loan commitments, or 11.3 percent of the federal government's total guaranteed loan commitments.

Education Loan Origination Problems

The following section includes, by general issue area, Education's loan origination problems identified between October 1987 and early 1990 by GAO, Education's Office of Inspector General, and others. Although we did not include all of Education's reported loan origination problems, this discussion includes representative examples of the types of problems reported.

In addition to loan origination problems, in September 1988 and April 1990, the President's Council on Integrity and Efficiency and GAO,[2] respectively, reported that the Higher Education Act of 1965, as amended, does not make credit worthiness a criterion for receiving a Stafford loan. Consequently, Education does not require lenders to obtain credit reports and does not require applicants to certify that they are not delinquent on a federal debt. Further, Education does not (1) prescreen applicants to determine if they are delinquent on debts at other federal agencies or (2) deny applicants credit because they are delinquent on such debt.

Objective: OMB Circular A-129 and the Treasury Financial Manual credit supplement instruct agencies to determine whether an applicant complies with all statutory and regulatory eligibility requirements prior to loan approval.

[1] Under the Stafford Student Loan program, loans are insured by states or private guaranty agencies. Upon default, if the lender is unsuccessful in collecting the debt, the lender is reimbursed by the guaranty agency, which, in turn, may be reimbursed by Education. The guaranty agency is then responsible for collecting the defaulted loan from the borrower, retaining a portion to cover its collection costs, and remitting the remainder of the proceeds to Education.

[2] Credit Management: Deteriorating Credit Picture Emphasizes Importance of OMB's Nine-Point Program (GAO/AFMD-90-12, April 16, 1990).

Problem: Education had procedural problems in determining applicants' eligibility.

- Although Education requires applicants to submit social security numbers, the OIG estimated in March 1989 that, based on estimated trends from a 1988 report on California's guaranty agency, loans worth $24.1 million were guaranteed with unissued social security numbers during a 1-year period. The California guaranty agency had not discovered that the social security numbers were unissued because it did not use a simple editing technique. Loan collection efforts (especially the use of tax refund offset) can be significantly impaired without the correct social security number.
- Education's fiscal year 1989 FMFIA report disclosed that many institutions had enrolled unqualified students.
- Education's reviews of schools between October 1987 and April 1990 found 22 schools where student loan limits were exceeded.

Problem: Education is precluded by legislation from screening for, or requiring guaranty agencies to screen for, certain eligibility requirements.

- The Higher Education Amendments of 1986 require that students meet certain education or aptitude test requirements. This is necessary to help prevent unqualified students who are unlikely to complete courses and likely to default on their loans from being recruited and admitted by schools. However, the amendments also prohibit Education from promulgating regulations defining the requirements that an institution must use to ensure that students meet these requirements. In January 1988, we suggested[3] that the Congress consider removing this restriction.

Objective: OMB Circular A-129 and the Treasury Financial Manual credit supplement instruct agencies to monitor the performance of lenders participating in their programs.

Problem: Over the past several years, the Department of Education has steadily reduced its oversight of schools, lenders, and guaranty agencies.

- In a January 1988 report (see footnote 3), we stated that over the past several years, Education's program oversight had steadily been reduced,

[3] Guaranteed Student Loans: Potential Default and Cost Reduction Options (GAO/HRD-88-52BR, January 7, 1988).

its past program review findings had resulted in few recoveries, and the law and regulations placed more of the review responsibilities on the guaranty agencies in overseeing the schools and lenders. In this report, we suggested that Education should be given stronger program sanctions to apply against lenders and guaranty agencies.

Agency Response

Education officials advised us that the Omnibus Budget Reconciliation Act of 1989 provides for several changes to the Stafford Loan programs. For example, the act states that, in order for a student to obtain a loan under the Supplemental Loan for Students program, (1) the institution where the applicant has enrolled can not have a cohort default rate[4] for the most recent fiscal year that equals or exceeds 30 percent (unless the student was already enrolled and receiving loans on the date of the enactment of the act) and (2) students who are admitted on the basis of their ability to benefit must obtain a high school diploma or a certificate of high school equivalency. In addition, this act provides the Secretary of Education the authority to take emergency actions against lenders and institutions to prevent the misuse of federal funds.

Education officials also informed us of actions the agency has taken, or plans to take, in response to the problems cited in this report. For example, since 1987, Education has significantly increased its reviews of lenders, guaranty agencies, and institutions. In addition, Education plans to obtain valid social security numbers from HHS and match them against those contained in Stafford Loan applications.

[4]"Cohort default rate" is the percentage in any fiscal year of 30 or more current and former students at the institution who enter repayment on loans received for attendance at the institution who default before the end of the following fiscal year. In any fiscal year where less than 30 of the institution's current or former students enter repayment, the default rate is the average rate calculated for the 3 most recent fiscal years.

Loan Origination Problems at the Department of Housing and Urban Development

The purpose of HUD's Federal Housing Administration (FHA) programs are to encourage improvements in housing standards and conditions, provide an adequate home financing system through mortgage insurance, and exert a stabilizing influence on the mortgage market. FHA's Title I program insures private lenders against losses for financing manufactured (mobile) home purchases and property improvements, while the Single Family Housing program insures mortgages on one- to four-family housing units. During fiscal year 1989, FHA housing loans accounted for $54.4 billion, or 51.6 percent of the federal government's total guaranteed loan commitments.

HUD Loan Origination Problems

The following section includes, by general issue area, the major Title I and Single Family Housing program loan origination problems identified between October 1987 and early 1990 by GAO, HUD's Office of Inspector General, and others. Although we did not include all of FHA's reported loan origination problems, this discussion includes representative examples of the types of problems reported.

Objective: OMB Circular A-129 and the Treasury Financial Manual credit supplement instruct agencies to determine whether an applicant complies with all statutory and regulatory eligibility requirements prior to loan approval.

Problem: Single Family Housing loans exceeded statutory limits.

- In March 1989, the President's Council on Integrity and Efficiency reported that, since fiscal year 1985, internal and external Single Family Housing management reviews found 4,148 findings related to eligibility. The Council further stated that 542 of these findings related to lenders making guaranteed loans in excess of statutory limits.

Problem: Downpayment requirements were not met for Title I and Single Family Housing program loans.

- In August 1988, HUD's OIG reported that downpayment requirements were not met for 54 of 124 Title I manufactured home loans reviewed.
- In December 1989, HUD's OIG reported that a lender violated HUD's downpayment requirements for 33 of 34 Single Family Housing loans reviewed.

Objective: OMB Circular A-129 and the Treasury Financial Manual credit supplement direct agencies to screen an applicant for credit worthiness.

Problem: HUD did not have adequate procedures to detect applicants who owed delinquent federal debts to other agencies.

- In April 1990, we reported[1] that HUD did not cross-check with other federal agencies to determine if applicants owed delinquent federal debts.

Problem: Applicant credit histories were not sufficiently considered for Title I and Single Family Housing program loans.

- In March 1989, the President's Council on Integrity and Efficiency reported that HUD's OIG cited HUD's approval of Single Family Housing borrowers without financial histories as one of the conditions that led to losses and fraud.
- HUD's fiscal year 1989 FMFIA report disclosed that many Title I lenders were falsifying buyer loan documents and not properly evaluating borrower credit worthiness.

Objective: OMB Circular A-129 and the Treasury Financial Manual credit supplement instruct agencies to assess an applicant's ability to repay the loan.

Problem: Lenders' assessment of Title I and Single Family Housing loan applicants' repayment ability was deficient because applicants' incomes were overstated, expenses were understated, and/or required verifications were not performed.

- HUD's OIG issued several reports where it found that Title I and Single Family Housing applicants' incomes were overstated and/or expenses understated. For example, in August 1988, HUD's OIG reported that lenders had not properly evaluated 53 of 124 Title I loans reviewed. In most cases, the OIG concluded that the lenders should not have approved these loans because of borrowers' insufficient income, excessive liabilities, and/or poor credit histories.
- In August 1989, HUD's OIG reported that a lender did not ensure that independent verifications of employment and deposit were obtained for 21 of 35 Single Family Housing loans.

[1]Credit Management: Deteriorating Credit Picture Emphasizes Importance of OMB's Nine-Point Program (GAO/AFMD-90-12, April 16, 1990).

Objective: OMB Circular A-129 directs agencies to require that all appraisals be conducted in accordance with generally accepted appraisal standards. Further, the Circular and the Treasury Financial Manual credit supplement instruct agencies to ensure that the property used to secure a government loan is not pledged to other debts.

Problem: Inflated loan appraisals caused Single Family Housing loans to be guaranteed for amounts in excess of their values.

- In August 1989, HUD's OIG disclosed that a lender overvalued appraisals between 10 and 69 percent for 14 of 31 Single Family Housing properties.
- In March 1989, the President's Council on Integrity and Efficiency reported that HUD OIG audits and investigations, agency reviews, and a congressional study, had shown that faulty or fraudulent appraisals had caused excessive losses and were instrumental in many of the housing fraud schemes.
- HUD's fiscal year 1989 FMFIA report disclosed that appraisers have been inflating appraisals of single family homes. Thus, if default occurred, HUD often paid a claim considerably in excess of property value.

Problem: HUD did not adequately monitor or sanction Single Family Housing appraisers.

- In December 1988, HUD's OIG reported that HUD's reviews of fee appraisals were ineffective.
- HUD's fiscal year 1989 FMFIA report stated that poorly performing fee appraisers were not always removed or sanctioned.

Objective: OMB Circular A-129 and the Treasury Financial Manual credit supplement instruct agencies to monitor the performance of lenders participating in their programs.

Problem: HUD's Single Family Housing and Title I lender monitoring were inadequate.

- In September 1989, we testified[2] that FHA's mortgage monitoring system did not include all necessary monitoring to ensure that lender quality

[2]GAO Audits of Accounting and Financial Management Systems at the Federal Housing Administration (GAO/T-AFMD-89-14, September 13, 1989).

control plans were adequate, sanctions were imposed for poor performance, and appropriate management uses were made of the results of monitoring.

- In February 1990, we reported[3] that, for its Single Family Housing program, HUD oversight and monitoring had not been effective and must be improved to ensure that the delegation of authority to certain lenders to underwrite FHA mortgage insurance is carried out in the government's best interest. In addition, this report disclosed that HUD's review of lenders who approve guaranteed loans without prior HUD approval had instances of flawed, deficient, or lackluster monitoring and oversight. Further, we reported that FHA's management problems, including a serious lack of monitoring of responsibilities delegated to the private sector, open FHA to mismanagement and the unnecessary risk that fraud and abuse will occur and not be detected.
- A June 1988 internal control review of HUD's Title I lender monitoring found that (1) lenders were not made aware of changes in HUD regulations on a timely basis and (2) HUD had not sufficiently followed-up on reported lender policy changes.

Agency Response

HUD informed us that the Department has aggressively addressed the loan origination problems cited in this report by taking a number of corrective actions. HUD advised us that it

- banned investors from nearly all programs;
- implemented policies requiring credit checks for all persons seeking to assume an FHA-guaranteed loan;
- adopted new industry-wide standards for residential mortgage credit reports;
- requires applicants to provide their social security numbers and a picture identification;
- revised appraisal standards, published an updated appraisal handbook, and issued a notice to its field offices detailing its appraiser sanctioning policies;
- requires that all appraisers be licensed or certified in accordance with state law; and
- published, in December 1989, an extensive 56-point quality control plan that all lenders must follow and which HUD personnel monitor.

[3]Financial Audit: Federal Housing Administration Fund's 1988 Financial Statements (GAO/AFMD-90-36, February 9, 1990).

HUD also advised us that its current system does not allow a Mortgage Insurance Certificate to be printed out for a lender that will exceed the statutory limit for the area. Further, in May 1991, HUD plans to issue new regulations which will address the Title I program's loan origination problems. In addition, HUD informed us that it is working on settlements with certain lenders found to be in violation with HUD requirements.

HUD also cited other actions it has taken to improve loan origination which do not specifically relate to the deficiencies discussed in this report. For example, it implemented the Computerized Homes Underwriting Management Systems to monitor loan production and underwriting and placed restrictions on the amount of sales concessions that can be used by the seller.

Loan Origination Problems at the Small Business Administration

Under its business loan program, SBA guarantees loans made by private lenders to small businesses. These loans are provided to small businesses to finance construction, conversion, expansion, equipment acquisition, and working capital. In fiscal year 1989, SBA made $3.7 billion in guaranteed loan commitments for its business program, or 3.5 percent of the total federal government's guaranteed loan commitments.

SBA Loan Origination Problems

The following section includes, by general issue area, SBA's loan origination problems identified between October 1987 and early 1990 by GAO, SBA's Office of Inspector General, and others. Although we did not include all of SBA's reported loan origination problems, this discussion includes representative examples of the types of problems reported.

Objective: OMB Circular A-129 and the Treasury Financial Manual credit supplement instruct agencies to determine whether an applicant complies with all statutory and regulatory eligibility requirements prior to loan approval.

Problem: A lender approved loans where the need for an SBA guarantee was questionable.

- In a March 1990 report, the OIG questioned the need for 3 of 24 SBA guaranteed loans reviewed at one lender. The OIG questioned the need for the guarantees because it appeared that the applicants owned assets in excess of their business needs. The OIG, therefore, believed that these businesses did not show evidence of need, a basic eligibility criteria for an SBA guaranteed loan. In this report, the OIG also found that the lender did not fully explain or justify the necessity for 5 of the 24 loans reviewed. As a result, the OIG determined that the lender may have originated ineligible loans.

Objective: OMB Circular A-129 and the Treasury Financial Manual credit supplement direct agencies to screen an applicant for credit worthiness.

Problem: SBA did not have adequate procedures to detect whether an applicant owes a delinquent federal debt to other agencies.

- In April 1990, we reported[1] that SBA does not cross-check with other federal agencies to determine if applicants owe delinquent federal debts.

Problem: SBA did not always obtain or document a sufficient credit history on applicants.

- SBA's fiscal year 1989 internal control review found cases where the applicant's credit history was not obtained or documented in 7 of 34 offices reviewed. In 12 of 50 cases reviewed in these 7 offices, the applicant's credit information was not sufficiently documented to provide an adequate credit history.

Objective: OMB Circular A-129 directs agencies to require that all appraisals be conducted in accordance with generally accepted appraisal standards. Further, the Circular and the Treasury Financial Manual credit supplement instruct agencies to ensure that the property used to secure a government loan is not pledged to other debts.

Problem: SBA had instances where collateral was not identified or realistically assessed.

- A March 1990 OIG report stated that, in one case, the specific collateral for a $100,000 loan was not identified.
- SBA's fiscal year 1989 internal control review disclosed that, in three of eight cases reviewed in one office, a realistic assessment of the collateral was not made by the loan officer.

Objective: OMB Circular A-129 and the Treasury Financial Manual credit supplement instruct agencies to monitor the performance of lenders participating in their programs.

Problem: Lenders submitted incomplete loan packages.

- SBA's fiscal year 1989 internal control review found that loan packages submitted by Certified Lenders[2] were not always sufficiently complete or adequately analyzed at 7 of 34 offices. This occurred in 15 of the 35 cases reviewed at these 7 offices.

[1] Credit Management: Deteriorating Credit Picture Emphasizes Importance of OMB's Nine-Point Program (GAO/AFMD-90-12, April 16, 1990).

[2] SBA recognizes three levels of lenders—regular, certified, and preferred—with the lender's responsibilities for loan origination depending upon the lender's level. For example, Preferred Lenders have the maximum authority to make loans and disburse loan proceeds without prior SBA approval.

- SBA's fiscal year 1989 internal control review found incomplete loan packages submitted by Preferred Lenders in 8 of 34 offices. This occurred in 12 of the 36 cases reviewed at these offices.

Problem: SBA did not place sufficient emphasis on program compliance while reviewing lenders who were delegated the authority to make loan approval decisions.

- In March 1990, the OIG reported a number of problems with two Preferred Lenders. The OIG concluded that the SBA District Office's evaluation process needed to place more emphasis on lenders' compliance with significant SBA rules and regulations.

Agency Response

An SBA official stated that he believes that SBA has effective loan origination procedures. In addition, the official stated that SBA does not cross-check with other federal agencies to determine if applicants owe delinquent federal debts because there is no governmentwide system available for such checking. He also noted that SBA did not consider the instances of noncompliance found by SBA's internal control reviews to be material weaknesses under the Federal Managers' Financial Integrity Act.

Loan Origination Problems at the Department of Veterans Affairs

Under its Loan Guaranty program, VA guarantees loans made by private lenders to veterans and service personnel for the purchase, construction, or improvement of their homes and makes vendee loans to purchasers of VA-owned houses that have been acquired because of defaults on guaranteed loans. During fiscal year 1989, VA guaranteed loan commitments accounted for $14.4 billion, or 13.7 percent of the federal government's total guaranteed loan commitments. In addition, VA vendee loans accounted for $1.07 billion, or 6.6 percent of the federal government's total direct loan obligations during fiscal year 1989.

VA Loan Origination Problems

The following section includes, by general issue area, VA's loan origination problems identified between October 1987 and early 1990 by GAO, VA's Office of Inspector General, and others. Although we did not include all of VA's reported loan origination problems, this discussion includes representative examples of the types of problems reported.

Objective: OMB Circular A-129 and the Treasury Financial Manual credit supplement instruct agencies to determine whether an applicant complies with all statutory and regulatory eligibility requirements prior to loan approval.

Problem: VA eligibility determination procedures could lead to ineligible loans.

- In its fiscal year 1989 FMFIA report, VA disclosed that its loan guaranty support systems do not provide efficient and timely access to basic information about veterans eligibility. The FMFIA report stated that the lack of such information prevents VA from ensuring that veterans who have exhausted eligibility are denied new loan guarantees.
- A September 1988 VA internal control review report found vulnerabilities associated with eligibility determinations. The review found that VA's eligibility certificates may be issued to those not entitled to the housing benefit or may be improperly denied. In some instances, eligibility certificates were sold to ineligible persons.

Objective: OMB Circular A-129 and the Treasury Financial Manual credit supplement direct agencies to screen an applicant for credit worthiness.

Problem: VA did not adequately screen applicants to detect, nor did it require applicants to resolve, delinquent federal debts.

- The September 1988 President's Council on Integrity and Efficiency and April 1990 GAO[1] reports disclosed that VA did not screen applicants against other federal agencies' delinquent debt files. Further, VA did not have procedures to prohibit making or guaranteeing loans to applicants who owed delinquent federal debts.
- VA's fiscal year 1989 FMFIA report disclosed that its loan guaranty support systems did not provide efficient and timely access on the status of VA loans. The report stated that the lack of such information prevented VA from ensuring that veterans who had a history of default were denied new loan guarantees.

Problem: VA guaranteed loans were made to applicants who were not credit worthy and therefore more susceptible to default.

- Several VA OIG reports identified cases where lenders would obtain multiple credit reports until a "clean" report was found to support the loan. For example, in September 1988, the OIG reported one case where a lender obtained a credit report on an applicant which showed two debts placed for collection. However, the lender obtained a second credit report which did not show these two debts. The lender sent the second, "clean" report to VA for loan approval. This applicant subsequently defaulted on the VA guaranteed loan within 1 year of loan origination.
- In March 1989, the President's Council on Integrity and Efficiency stated that VA's OIG cited approval of borrowers without financial histories as a condition that led to losses and fraud.

Objective: OMB Circular A-129 and the Treasury Financial Manual credit supplement instruct agencies to assess an applicant's ability to repay the loan.

Problem: Lenders' assessments of applicants' repayment ability were deficient because the applicants' incomes were overstated and/or expenses were understated.

- The OIG issued several reports detailing problems with lenders overstating applicant income and/or understating applicant expenses. In many of these cases, if the correct applicant income and expense amount had been used, the applicant would not have met VA's loan approval guidelines. For example, in September 1988, VA's OIG reported that in 11 of 30 loans reviewed, the lender overstated veterans' income,

[1] Credit Management: Deteriorating Credit Picture Emphasizes Importance of OMB's Nine-Point Program (GAO/AFMD-90-12, April 16, 1990).

understated veterans' expenses, and/or made material mathematical errors. The OIG further stated that if the lender had used accurate and known data, 10 of these loans would not have met VA's loan approval guidelines.

Objective: OMB Circular A-129 directs agencies to require that all appraisals be conducted in accordance with generally accepted appraisal standards. Further, the Circular and the Treasury Financial Manual credit supplement instruct agencies to ensure that the property used to secure a government loan is not pledged to other debts.

Problem: Appraisals of VA loan collateral were inadequate.

- In March 1989, the President's Council on Integrity and Efficiency reported that VA OIG audits and investigations, agency reviews, and a congressional study had shown that faulty or fraudulent appraisals had caused excessive losses and were instrumental in many of the housing fraud schemes.

Objective: OMB Circular A-129 and the Treasury Financial Manual credit supplement instruct agencies to monitor the performance of lenders participating in their programs.

Problem: VA did not monitor lenders' compliance with established underwriting standards.

- In September 1989, VA's OIG reported that although over 90 percent of all manufactured home loans are made by lenders on an automatic basis (without prior VA approval), VA does not monitor these lenders' performance closely. VA's OIG also reported that, despite a foreclosure rate of 27 percent and a default rate of 20 percent on active manufactured home loans, VA has never removed any lender's automatic lending authority because of poor credit underwriting.
- VA's fiscal year 1989 FMFIA report identified as a material weakness VA's need to improve the monitoring of the private sector lenders who are responsible for making VA guaranteed loan approval decisions.

Agency Response

VA officials informed us that they have taken, or plan to take, several actions to resolve the problems cited in this report. For example, VA recently implemented new review procedures for appraisers and lenders and in March 1990 established a lender monitoring unit. Also, by December 31, 1990, VA plans to instruct its lenders and field offices to screen applicants for federal debts. These instructions will prohibit making loans to applicants with federal debt who do not have an acceptable repayment plan. The officials also informed us that VA often did not agree with the OIG's assessment of applicants' repayment ability.

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