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Maritime Administration's Federal Ship Financing Program

Statement of
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Before the
Subcommittee on Merchant Marine
Committee on Merchant Marine and Fisheries
House of Representatives

GAO/T-RCED-88-1

Mr. Chairman and Members of the Subcommittee:

We appreciate this opportunity to testify on our recent report on the Maritime Administration's (Marad) Federal Ship Financing Program.[1] We performed our review at the request of this Subcommittee, and focused our work on (1) the program's financial condition, (2) certain data used to manage the program, and (3) Marad's reporting on the program's condition.

As the Subcommittee is aware, the program is experiencing serious financial difficulties. This is due in large measure to economic conditions in the energy- and agriculture-related segments of the maritime industry. By the end of fiscal year 1985, the program was no longer self-supporting[2], and this condition worsened in fiscal year 1986 when default payments exceeded $1.2 billion, the highest level in the program's 15-year history of guaranteeing loans. Default payments in fiscal year 1987 have dropped dramatically from a year ago, but program revenues continue to be substantially less than those necessary to cover defaults.

We also identified several problems related to the completeness and accuracy of Marad's program, financial, and budget data. The Department of Transportation and Marad have since taken or plan to take action to improve program data and reporting. When

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[1]Maritime Administration: Efforts to Improve Data on the Federal Ship Financing Program (GAO/RCED-87-58, August 28, 1987).

[2]As used here, self-supporting refers to the ability of the Federal Ship Financing Fund during the fiscal year to draw upon the Fund's balance and/or to generate revenues in amounts sufficient to pay all expenses, including default payments and Treasury borrowings, without congressional appropriations.

these improvements are in place, the Congress and other decision makers will have more useful and credible data on which to base key program decisions.

BACKGROUND

The Federal Ship Financing Program (commonly called the title XI program) was established by title XI of the Merchant Marine Act of 1936 primarily to encourage the construction of vessels in the United States. The act was amended in 1972 to, among other things, attract more private capital for vessel construction. Under the 1972 amendments, guarantees backed by the United States government are issued to U.S. citizen shipowners for the construction of a vessel or vessels. Guarantees mature in up to 25 years and the vessels usually form the security for the government's guarantee of the loans. The loans themselves are provided by private sector entities, such as banks. By law, the total amount in outstanding loan guarantees for vessels cannot exceed $9.5 billion at any given time.

The Federal Ship Financing Fund underwrites the program. The Fund receives income primarily from (1) fees paid by shipowners whose loans are guaranteed (these are determined by Marad in accordance with statutory limits), (2) interest on investments in United States Treasury securities, (3) the repayment of loans, and (4) proceeds from the sale of vessels acquired by Marad after it makes default payments to the private sector lender.

In the event a shipowner defaults, the U.S. government pays in full the unpaid principal and accrued interest of the guaranteed loan. Program expenses, including those to pay loan defaults and maintain vessels acquired through default, are paid from the Federal Ship Financing Fund. If the Fund's resources are not sufficient to cover these costs, Marad is authorized to borrow the money from the Treasury. The Fund is required to repay this money, with interest.

FINANCIAL CONDITION

The program's outstanding loan guarantees and commitments (loan portfolio) were less than $2 billion at the end of fiscal year 1973. They rose to a peak of more than $8 billion in fiscal year 1982 and declined to about $4.4 billion as of August 31, 1987. The expansion in the 1970s and troubles in the 1980s were due largely to the shifting fortunes of two industries--energy and agriculture.

Increases in oil prices in the 1970s led to a national effort to decrease U.S. dependence on imported energy sources. As part of this effort, Marad extended loan guarantees for energy-related vessels, including domestic tankers and drill rigs. During the same period, a significant increase in agricultural exports led to requests for loan guarantees to construct inland tugs and barges. However, a sharp decline in oil prices in the 1980s reduced the demand for drill rigs and other energy-related vessels. Similarly, agricultural exports were not sustained at expected levels. Lower demand for vessels in both markets resulted in lower freight prices, reduced economic viability, and increased defaults.

Buffeted by these external forces, the program's financial condition has changed dramatically in the last few years. This change was due to a surge of defaults during fiscal years 1985 through 1987. During the 12 years from the loan guarantee program's inception in 1972 through fiscal year 1984, cumulative defaults were about $341 million. During fiscal years 1985 through 1987, defaults were about $1.9 billion. Thus, about 86 percent of the defaults in the program's 15-year history of guaranteeing loans were recorded in the past 3 years. (See att. I.)

Although companies with vessels operating in all segments of the maritime industry suffered some defaults from fiscal year 1985 through fiscal year 1987, the companies in the energy and agricultural segments accounted for a large share of the default payments that Marad made. For example, according to data obtained from Marad, loans for drill rigs and drill supply vessels accounted for about 42 percent of the total, those for liquefied natural gas vessels for about 19 percent, and others for agriculture-related vessels for at least 7 percent. In all, loan guarantees for these types of vessels accounted for about 68 percent of the total.

These defaults have had an effect on both the size and composition of the title XI portfolio. During the period September 1983 through August 1987, the total value of the portfolio declined from about $7.8 billion to about $4.4 billion. Energy-related segments were hit particularly hard. In another example, loan guarantees outstanding for drill rig vessels declined from nearly $1 billion to $228 million and guarantees for drill supply vessels declined from \$362 million to \$74 million.[3] The remaining figures in the attachment support these examples. Moreover, commitments to guarantee new loans each year steadily declined between fiscal years 1980 and 1985. A slight increase occurred in fiscal year 1986, but Marad did not commit itself to issue any new loan guarantees in fiscal year 1987. Attachments II and III present segment-by-segment detail on the portfolio's value and composition for fiscal years 1983-87.

The increase in defaults also has had repercussions for the program's operating budget. Fiscal year 1984 was the last year the Fund's revenues exceeded expenses--by about \$27 million. Expenses exceeded revenues by about \$250 million in fiscal year 1985, and about \$755 million in fiscal year 1986.

These shortfalls used up the surplus that the Fund had accumulated in previous years. Marad, therefore, borrowed almost \$1.4 billion from the Treasury by the end of fiscal year 1986 to cover these shortfalls. Since the Fund was not in a position to pay this money back, the Department of Transportation requested and the Congress later approved a supplemental appropriation of almost \$1.4 billion to cover the shortfalls.

Another shortfall occurred in fiscal year 1987. Through August 1987, Marad had received revenues of about \$95 million, but borrowed over \$400 million from the Treasury to cover default

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[3]On June 2, 1987, the House of Representatives passed H.R. 953, which provides, among other things, that through the end of fiscal year 1989, loan guarantees will not be available for drill ships, supply boats, or other vessels designed or intended primarily for offshore oil or gas exploration and development.

payments and other expenses. Although default payments have dropped significantly from a year ago, Fund revenues will not be sufficient to repay these Treasury borrowings. Marad is seeking a fiscal year 1988 supplemental appropriation to repay this debt.

FINANCIAL REPORTING AND PROGRAM MANAGEMENT INFORMATION

In addition to the title XI program's financial difficulties, several problems exist with financial reporting and program management data. These include inconsistencies in the value of outstanding loan guarantees and commitments and in reports on the Federal Ship Financing Fund's financial condition, and incomplete data on the extent of the portfolio at risk of default.

Financial reporting

In fiscal year 1985, Marad reported inconsistent data in its reports and other documents--one of which was sent to the Congress. These reports sometimes contained significant disparities in the number of loan guarantees and value of Marad's portfolio. Although these data are basic to program management and oversight, the discrepancies in the reports and other documents differed by up to $400 million. Marad has taken corrective action in this area and is now reporting consistent figures.

Marad also recorded a liability in its fiscal year 1986 financial statements and budget documents for the amount of default payments it expected to incur in fiscal year 1987. No such liability was shown for prior fiscal years, although generally accepted accounting principles for federal agencies required that one be estimated. Our report recommended that Marad document the process used for estimating the liability for potential future defaults; Marad has agreed to carry out this recommendation. Use of the documentation during the independent review of the estimating process would provide Marad management with an internal control to assure that the process is working as intended.

We also recommended that Marad's annual report clearly state that the Fund is no longer self-supporting. This statement is needed because revolving funds are intended to be generally self-supporting rather than being maintained with Treasury borrowings. Marad believes that the Fund's condition is clearly displayed, since its fiscal year 1986 annual report (dated June 1987) shows that expenses exceeded revenues and indicated borrowings from the Treasury.

We agree this would be sufficient if the Fund was in a position to repay its borrowings without the aid of appropriations. Prior to fiscal year 1985, Marad borrowed four times from the Treasury to cover default payments and in each case repaid the borrowings without seeking an appropriation. However, Marad has not generated sufficient revenues to repay the borrowings that started in fiscal year 1985 and continued through 1987.

Since 1985, Marad has not been able to repay its borrowings from the Treasury, relying instead on congressional appropriations. Therefore, we continue to believe that Marad's annual report should acknowledge its reliance on congressional appropriations by clearly stating in its annual report that the Federal Ship Financing Fund is no longer self-supporting. Marad officials advised us on October 7, 1987, that the 1987 annual report will contain a statement that the Fund was not self-supporting in fiscal year 1987. The report is scheduled to be issued in 1988.

Management Information On Extent Of Portfolio At Risk Of Default

The identification of companies with loan guarantees that are at risk of default is critical to assessing how much of the title XI portfolio is at risk. Marad usually prepares a monthly report--called the credit watch report--as a management information and tracking tool to monitor the companies judged to be at risk of default and their progress in overcoming their financial difficulties.[4]

Although Marad officials initially told us that the report contained a complete list of companies at risk of default, we later learned that the report omitted certain companies. The examples below illustrate the discrepancies we found for two of the reports:

Date of report	Companies in report	Loan guarantee balances (in millions)	Companies omitted from report	Loan guarantee balances of omitted companies (in millions)
Nov. 1985	44	$939	14	$700
Dec. 1986	21	351	34	603

4In addition to information on companies at risk of default, this report contains other data, including the value and composition of the portfolio, and types and status of vessels obtained from companies that have defaulted on their loan repayments.

When this additional information was added, the portion at risk of default increased from $939 million to $1.6 billion for November 1985, and from $351 million to $954 million for December 1986. (See att. IV for further information on the portion at risk of default on September 30, 1986.)

When we asked Marad officials why they did not routinely compile complete data on companies at risk of default, they told us they were satisfied to rely on their staff to provide data as needed. They also said that program managers were aware that no complete list of companies at risk of default existed, and therefore this would not hinder Marad in managing the program. However, we believe the credit watch report would be a more useful management tool if it reflected all of the companies Marad considers at risk of default.

The process by which its loan examiners determine that a company is at risk of default and should therefore be placed on the credit watch report also needs to be documented. This action will provide better assurances that management judgments about the extent of the portfolio at risk of default, including needs for Treasury borrowings, are based on complete and credible information. This in turn would provide Marad management with a better basis to determine whether Treasury borrowings are needed.

Both the Department of Transportation's comments on a draft of our August report and Marad officials' January 1987 comments advised us that action will be taken to make the credit watch report complete. We met with Marad officials on October 7, 1987;

they advised us that a complete listing of companies at risk of default with information on their circumstances has been prepared. We will evaluate that listing to determine whether it complies with our recommendation.

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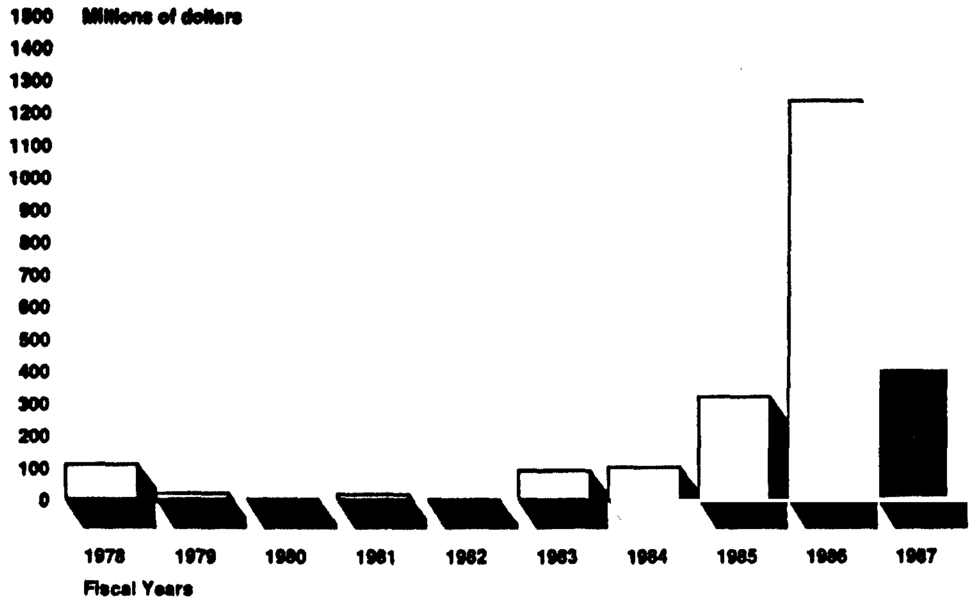
In summary, Mr. Chairman, the pace of defaults has declined over the past year, but the Fund continues to experience serious financial difficulty. The Fund is not currently in a position to repay its expenses, including Treasury borrowings, without the aid of congressional appropriations. The corrective actions Marad has taken or plans to take to improve its financial reporting and management information will yield benefits to the Congress. They will result in more useful and complete information being available to support congressional policy-making on the future of this program and Marad requests for supplemental appropriations.

This concludes my testimony, Mr. Chairman. I will be happy to answer any questions you or other Subcommittee members may have at this time.

DEFAULT PAYMENTS FROM THE FEDERAL SHIP FINANCING FUND, FISCAL YEARS 1978-87



Note: 1987 data represents payments through Sep. 24, 1987, only.

ATTACHMENT II

VALUE OF TITLE XI LOAN GUARANTEES AND COMMITMENTS, FOR SELECTED PERIODS, BY INDUSTRY SEGMENT

Segment	Year end, fiscal year				
	1983	1984	1985	1986	1987[a]/
	-----	-----	in millions	-----	-----
Liner[b]/	$1,113	$1,087	$ 985	$ 822	$ 546
Bulk					
Tanker	2,032	1,903	1,772	1,603	1,396
Dry bulk	394	378	363	340	383
Liquefied natural gas	1,225	1,182	1,013	772	744
Drill rig	996	869	698	306	228
Drill supply	362	330	258	91	74
Inland[c]/	1,493	619	567	448	344
Coastal[c]/		709	631	483	381
Other	228	225	235	166	283
Total[d]/	$7,843	$7,302	$6,522	$5,031	$4,378

a/Through August 31, 1987.
b/Includes lighter aboard ship (LASH) and Seabee barges.
c/Figure for fiscal year 1983 includes inland and coastal.
d/Individual components may not sum to total, due to rounding.

Source: Maritime Administration.

PORTION OF TITLE XI GUARANTEED LOANS AND COMMITMENTS, BY INDUSTRY SEGMENT, FOR SELECTED PERIODS

Segment	Year end, fiscal year				
	1983	1984	1985	1986	1987[a]
Liner[b]	14%	15%	15%	16%	12%
Bulk					
Tanker	26	26	27	32	32
Dry	5	5	6	7	9
Liquefied natural gas	16	16	16	15	17
Drill rig	13	12	11	6	5
Drill supply	5	5	4	2	2
Inland[c]	19	8	9	9	8
Coastal[c]		10	10	10	9
Other	3	3	4	3	6
Total[d]	100%	100%	100%	100%	100%

a/Through August 31, 1987.
b/Includes lighter aboard ship (LASH) and Seabee barges.
c/Figure for fiscal year 1983 includes inland and coastal.
d/Individual components may not sum to total, due to rounding.

Source: Maritime Administration.

ATTACHMENT IV

PORTION OF TITLE XI LOAN GUARANTEES AND COMMITMENTS, COMPANIES, AND VESSELS AT RISK OF DEFAULT, AS OF SEPTEMBER 30, 1986

Figure 2.2: Troubled Loan Guarantees as a Portion of the Total, as of September 30, 1986