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United States
General Accounting Office
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Resources, Community, and
Economic Development Division

B-252064

March 8, 1993



The Honorable Ron Wyden
Chairman, Subcommittee on Regulation,
Business Opportunities, and Energy
Committee on Small Business
House of Representatives

Dear Mr. Chairman:

The Small Business Administration's (SBA) New England Lending and Recovery Project (Project) is a pilot program to provide financial assistance to small businesses in the New England area which have loans with banks that have failed. The Project is an outgrowth of SBA's efforts to determine how its general business loan program--the 7(a) loan program--could be used to help small businesses affected by the record number of bank failures. Initiated by SBA in New Hampshire in December 1991, the Project uses SBA's 7(a) loan program to provide federal loan guarantees¹ to lenders who are willing to refinance small business loans acquired by the Federal Deposit Insurance Corporation (FDIC) when it took over the failed banks. Because the FDIC is not in the business of making new loans or refinancing existing loans, SBA initiated the Project because it was concerned that (1) many of the FDIC-held small business loans were creditworthy and (2) FDIC's efforts to liquidate such loans by demanding total payment from the small businesses could force many firms out of business. In SBA's view, finding new lenders to refinance these loans with federal guarantees would help to keep the small businesses in operation and provide them

¹SBA provides financing to small businesses primarily by guaranteeing to pay part of the loss on a loan made to a small business by a bank or other financial institution. The 7(a) loan program, authorized by section 7(a) of the Small Business Act, is SBA's largest financial assistance program and can provide a guarantee of up to 90 percent of the loan amount.

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with potential sources of future financial assistance. SBA initially estimated that the total value of loans in the New England area to be guaranteed by the Project could reach \$900 million. SBA envisioned that the Project would provide it with the experience to expand the program to other areas of the country should the need arise.

Your July 1992 letter expressed concern about (1) the Project's overall cost and its financial impact on SBA's 7(a) loan program and (2) New Hampshire businesses getting assistance from SBA that is not available to borrowers in any other state. You requested that we analyze the Project's activities and asked specifically (1) whether SBA had expanded the Project to states beyond New Hampshire and if not, the reasons why; (2) how many SBA employees have been detailed to the Project from other SBA offices and at what cost; (3) how many additional people were hired and assigned to the Project and over what period of time; and (4) how many loans SBA had examined and guaranteed during the Project.

In summary, our work showed the following:

- In addition to New Hampshire, during the first 3 months of 1992, SBA expanded the Project to the five other New England states in SBA's Region I--Connecticut, Maine, Massachusetts, Rhode Island, and Vermont. As of December 1992 SBA had not made a final decision as to whether it would expand the Project outside New England.
- Beginning in January 1992 SBA detailed 19 SBA employees from eight of the other nine SBA regions to work on Project loans in Connecticut, Maine, Massachusetts, New Hampshire, and Rhode Island. Because Vermont was not in the same economic condition as the other New England states and the number of FDIC-held loans was small, SBA decided to rely on its existing staff at the Vermont District Office to review Project loans. As of August 1992 all the detailed employees had returned to their home offices. Salary, overtime, and travel costs for the 19 employees while on detail to the Project totaled \$143,937, or about 15 percent of the \$984,833 in total Project operating costs.
- Beginning in January 1992 SBA temporarily hired a total of 33 individuals for the Project--29 former bank and loan officers to review loans and 4 clerical workers. As

of September 1992 no temporary employees were working on the Project.

- As of December 1992 SBA had examined 12,701 FDIC-held loans in Connecticut, Maine, Massachusetts, New Hampshire, and Rhode Island and had approved and guaranteed 277 loans totaling \$82.8 million. No loans were examined or guaranteed in Vermont. SBA is no longer examining FDIC-held loans in any of the New England states and has completed all of its loan review activities and refinancing decisions in New Hampshire and Maine. In Connecticut, Massachusetts, and Rhode Island, 78 loans, totaling about \$31 million, were still pending and could be guaranteed by SBA.

PROJECT COVERS ALL
NEW ENGLAND STATES

SBA's New England Lending and Recovery Project covered all six New England states in SBA's Region I--Connecticut, Maine, Massachusetts, New Hampshire, Rhode Island, and Vermont. While SBA has received several requests, it has yet to make a final decision on whether the Project will be expanded to states outside New England.

According to SBA, New England was selected for the Project because it was the most seriously affected of any region in the country in terms of unemployment levels and the number of bank failures. SBA initiated the Project in New Hampshire in December 1991, selecting it as the initial New England state because five of the seven major banks in the state had failed. According to SBA's Director, Office of Financing, SBA expanded the Project to Maine and Massachusetts in January 1992 and to Connecticut and Rhode Island around mid-March 1992. SBA expanded the Project to Vermont at the end of March 1992.

No Decision to Expand Project
Beyond New England States

According to SBA's Director, Office of Financing, SBA has received several requests to expand the Project to the states of California and Texas but has yet to make a final decision as to whether the Project will be expanded to any other areas of the country. This official cited several factors that will affect SBA's decision. One is that SBA's 7(a) loan guarantee appropriation for fiscal year 1993 is about \$2.5 billion below the level SBA received for fiscal year 1992, and this reduction will severely reduce the

number and dollar value of loans that SBA can guarantee. Another is the impact on bank failures of new banking requirements² that took effect in late December 1992. Bank regulators are required to take prompt corrective action when an insured lending institution's capital falls below a certain level. According to the SBA official, it is unclear whether there will be a need to expand the Project as a result of the new banking requirements because, while some people contend that they will have no impact on bank failures, others believe that the requirements will result in thousands of additional bank failures.

PROJECT STAFFED BY PERMANENT
AND TEMPORARY EMPLOYEES

SBA used a combination of 19 SBA loan officers, detailed from SBA offices in eight of the other nine SBA regions, and 33 temporary employees to staff the Project and review loans in Connecticut, Maine, Massachusetts, New Hampshire, and Rhode Island. Because Vermont was not in the same economic condition as the other New England states and the number of FDIC-held loans was small, SBA decided to rely on its existing staff at the Vermont District Office to review the loans. Total salaries, travel, and other Project operating costs were \$984,833 as of the end of fiscal year 1992.

Permanent SBA Staff
Detailed to Project

According to SBA's Director, Secondary Market Activities, the 19 SBA loan officers were detailed to the Project, at various times beginning in January 1992, for periods ranging from 10 days to 30 days. The individuals were selected from SBA offices where loan activity was below last year's levels. They were used primarily to supervise the temporary employees that SBA hired to review loans. SBA data show that one employee was detailed from Region II; three from each of Regions III, IV, and V; five from Region VI; two from Region VII; and one from each of Regions VIII and X. No staff were detailed from SBA's Region IX. According to SBA's Director, Office of Financing, as of August 1992 all the detailed SBA employees had returned to their home

²The regulations, issued in response to the FDIC Improvement Act of 1991, define five categories of capital for purposes of determining the adequacy of a bank's capital and triggering the prompt corrective action requirements of the act.

offices, and SBA had designated a permanent staff member in each of the six New England states' district offices to coordinate Project activities.

SBA budgeted a total of \$1 million to cover salaries, travel, rent, supplies, and other Project operating costs. SBA data show that as of the end of fiscal year 1992, Project operating costs totaled \$984,833. The data also show that the costs of the 19 SBA employees while they were detailed to the Project totaled \$143,937--\$70,981 in salaries, \$19,322 in overtime, and \$53,634 in travel costs--or about 15 percent of the Project's total operating costs.

Temporary Project Staff Hired

In addition to the 19 permanent staff, SBA hired a total of 33 temporary employees at various times, beginning in January 1992, to work on the Project. The temporary employees included 29 former loan officers and bankers hired to review loan files and 4 clerical workers. SBA's Director, Office of Financing, told us that because the loans were housed at various locations across the New England area, SBA tried to hire individuals from the areas where the loans would be examined in order to limit travel costs. SBA data show that the Project reached its peak of 33 temporary employees at the end of April 1992 and that, as of September 1992, none of the temporary employees was working on the Project.

SMALL BUSINESS LOANS WERE REFINANCED BY THE PROJECT

SBA examined a total of 12,701 FDIC-held loans in Connecticut, Maine, Massachusetts, New Hampshire, and Rhode Island and approved and guaranteed 277 loans totaling \$82.8 million. Because economic conditions were not as bad in Vermont as in the other New England states, no loans were examined or guaranteed in Vermont. SBA is no longer examining loans in any of the New England states. Also, SBA has completed all of its loan review activities and refinancing decisions in New Hampshire and Maine. In Connecticut, Massachusetts, and Rhode Island, 78 loan applications, totaling about \$31 million, were still pending and could still be guaranteed by SBA.

SBA's first step in implementing the Project was to examine all the FDIC-held loans to identify those loans that appeared to meet its 7(a) loan criteria and qualify for refinancing as guaranteed loans. SBA notified each small

business whose loan appeared to be a candidate for guaranteed-loan refinancing and informed the firm that, if it so desired, it could complete a loan application and submit it to SBA. According to SBA's Director, Office of Financing, SBA processed these applications in the same manner and subjected them to the same credit standards as any other 7(a) guaranteed loan application that SBA might receive, with one exception: In the case of the Project applications, SBA matched the business with a bank or other lending institution rather than requiring the business to have a lender committed to making the loan at the time of application, as is normally the case with 7(a) guaranteed loans.

Of the 12,701 loans SBA initially examined, it identified 2,819 loans, totaling \$501.8 million, that appeared to qualify as 7(a) guaranteed loans. SBA mailed out applications for 1,793 of the loans. No applications were mailed for the remaining 1,026 loans--all of which were in New Hampshire--because, according to SBA's Director, Secondary Market Activities, the loans had already been sold by the FDIC to banks or other lending institutions. As of December 7, 1992, small businesses had returned 600 loan applications to SBA. Of these,

- 277 applications, totaling \$82.8 million, were approved and guaranteed by SBA;
- 245 applications had been either (1) declined or screened out by SBA because information accompanying the application showed that the small business did not qualify for a loan or (2) withdrawn by the small business; and
- 78 applications, totaling \$30.6 million, were still pending--60 applications, for \$21 million, had been approved by SBA but were awaiting a final lender decision, and 18 applications, for \$9.6 million, were still being processed by SBA or were awaiting additional information from the small businesses before SBA could make a final decision.

Table I.1 in enclosure I provides a state-by-state breakdown of the loan data for Connecticut, Maine, Massachusetts, New Hampshire, and Rhode Island. According to SBA's Director, Secondary Market Activities, no loans were examined or guaranteed in Vermont primarily because economic conditions in the state were not as serious as in the other New England

states, and the FDIC did not take over banks in Vermont to the extent it did in the other states.

According to SBA's Director, Office of Financing, SBA is no longer examining loans at FDIC sites in any of the New England states. This official also told us that in early December 1992 SBA had exhausted its 7(a) loan funding for the first quarter of fiscal year 1993, but that SBA will resume guaranteeing Project loans when funds become available.

OBJECTIVES, SCOPE, AND METHODOLOGY

We conducted our work between August 1992 and December 1992 in accordance with generally accepted government auditing standards. To determine which states in addition to New Hampshire were involved in the Project, we (1) interviewed SBA's Director, Office of Financing, and the Director, Secondary Market Activities, concerning the Project's coverage and SBA's future Project plans and (2) reviewed the record of February and March 1992 congressional hearings that covered the Project's activities. For information on the number and the cost of SBA staff detailed to the Project, as well as information on individuals temporarily hired for the Project, we (1) interviewed SBA officials and (2) obtained SBA data on the Project's total cost and the cost associated with SBA loan officers while on detail to the Project. To determine how many Project loans SBA examined and guaranteed, we obtained from SBA data showing state-by-state information, such as (1) the number of FDIC-held loans initially examined and accepted by SBA, (2) the number and dollar value of loan applications SBA approved and guaranteed, and (3) the number and dollar value of loan applications that were awaiting a final SBA or lender decision.

AGENCY COMMENTS

We discussed this correspondence with SBA's Director, Office of Financing, and SBA's Director, Secondary Marketing Activities, who generally agreed with the facts presented. We incorporated their suggested revisions where appropriate.

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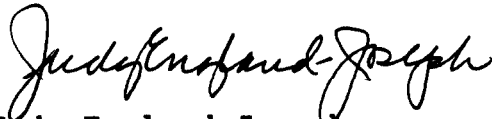
As agreed with your office, unless you publicly release its contents earlier, we plan no further distribution of this correspondence until 30 days after the date of this letter. At that time, we will send copies to the Administrator, SBA;

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the Director, Office of Management and Budget; and other interested parties. We will make copies available to others upon request.

Should you require any additional information, please contact me at (202) 512-7631. Major contributors to this product were James Yeager and Stanley Ritchick.

Sincerely yours,

A handwritten signature in cursive script that reads "Judy England-Joseph".

Judy England-Joseph
Director, Housing and Community
Development Issues

Table I.1: Status of New England Lending and Recovery Project Loan Application Reviews by State, as of December 7, 1992

	New Hampshire	Massachusetts	Maine	Connecticut	Rhode Island	Total
Number of loans reviewed	4,258	5,205	1,037	2,141	60	12,701
Number of loans initially accepted for restructuring	1,256	742	414	364	43	2,819
Dollars value of loans accepted for restructuring (in millions)	\$184.5	\$143	\$74.5	\$86.3	\$13.5	\$501.8
Number of applications sent to small businesses	230	742	414	364	43	1,793
Dollar value of applications sent to small businesses (in millions)	\$57.9	\$143	\$74.5	\$86.3	\$13.5	\$375.2
Number of applications returned by small businesses	150	188	162	77	23	600
Number of returned applications screened out/withdrawn	19	31	5	18	6	79
Number of returned applications accepted for processing	131	157	157	56	17	518
Number of returned applications declined by SBA	12	49	83	17	5	166

Number of returned applications approved and funded by SBA	119	55	74	21	8	277
Dollar value of loans funded (in millions)	\$36.2	\$16.3	\$16.3	\$9.9	\$4.1	\$82.8
Number of jobs saved by funded loans	2,242	1,226	812	448	434	5,162
Number of returned applications approved by SBA and awaiting lender decision	0	46	0	12	2	60
Dollar value of returned applications approved by SBA and awaiting lender decision (in millions)	\$0	\$14.7	0	\$4	\$2.3	\$21
Number of returned applications awaiting additional information from small businesses	0	6	0	8	0	14
Dollar value of returned applications awaiting additional information from small businesses (in millions)	\$0	\$3.2	\$0	\$3.1	\$0	\$6.3
Number of returned applications still in processing	0	1	0	1	2	4

Dollar value of returned applications still in processing (in millions)	\$0	\$0.4	0	\$0.1	\$2.8	\$3.3
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Source: SBA Office of Financing.

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