



UNITED STATES GENERAL ACCOUNTING OFFICE

WASHINGTON, D.C. 20548

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COMMUNITY AND ECONOMIC
DEVELOPMENT DIVISION

June 9, 1981

Mr. Edwin T. Holloway
Acting Associate Administrator
for Financial Assistance
Small Business Administration



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Dear Mr. Holloway:

As you are aware, the President in his revised fiscal year 1982 budget request has proposed to eliminate the Displaced Business Loan Program. Given this proposed action, together with competing demands for our staff resources, we are terminating our review of this program. However, we want to bring to your attention certain problems that we noted regarding the loan servicing function.

The Small Business Administration (SBA) is authorized by section 7(b)(3) of the Small Business Act, as amended, to make loans to small businesses suffering substantial economic injury caused by construction projects supported in whole or in part by Federal, State, or local government entities having eminent domain authority. Displaced business loans (DBLs) are made to assist businesses to continue in operation at existing locations or to re-establish the business elsewhere.

In performing this review, we identified several problems pertaining to loan servicing associated with 31 loans administered by SBA district offices located in Boston, Massachusetts; Atlanta, Georgia; and Chicago, Illinois. These 31 loans all had a history of delinquency and were selected because we assumed that problem loans would receive the most intensive servicing. We recognize that we reviewed servicing for a rather limited number of loans. However, we believe that the extent of servicing deficiencies for these sample loans may indicate that problems we have identified in previous reports ^{1/} still exist. These servicing inadequacies include: (1) nonreceipt of borrowers' financial statements, (2) infrequent field visits,

^{1/}"The Small Business Administration Needs To Improve Its 7(a) Loan Program" (GGD-76-24; Feb. 23, 1976).

"Most Borrowers Of Economic Opportunity Loans Have Not Succeeded In Business" (CED-81-3; Dec. 8, 1980).

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and (3) insufficient management assistance. Because of the implications of inadequate servicing, both in terms of the Government's financial liability should the loans go into liquidation, and the ramifications for the businesses themselves, we believe it worthwhile to again stress the need for correcting these problems.

We noted, in connection with our review of DBLs, that although SBA procedures require borrowers to submit periodic financial statements, these procedures were not being complied with. Consequently, SBA often lacks a good tool for readily identifying businesses which may need more intensive servicing or management assistance. The extent of this problem is demonstrated by the fact that financial statements were missing for 28 of the 31 loans in our sample. Many of these loan files did not contain financial statements for several years.

Another means for early recognition of a problem or potential problem is field visits to the borrower. Although SBA procedures provide that field visits should be conducted to the fullest extent practicable, we found that field visits were made for only 7 of the 31 cases we reviewed. SBA did not make any field visits to one business that was delinquent on its loan payments 18 times over a period of 16 years and it made only one visit to a firm that had 19 delinquencies over a 9-year period.

When SBA gets indications of a problem loan, in many instances it is not providing the firm with needed management assistance. SBA procedures provide that cases may be referred to the Management Assistance Division when certain early warning signals appear and must be referred when a borrower fails to submit financial statements or requests a loan payment deferral. However, we found that only 14 of the 28 loan cases with missing financial statements were referred for management assistance during the history of the loan. In addition, Portfolio Management personnel had granted many loan deferments without referral of the cases for management assistance. In several cases, we found a combination of factors which should have caused referrals to the Management Assistance Division but no such referrals were made. The following is an example of early warning signals, including nonreceipt of financial statements, where referral for management assistance was not made.

In January 1974, SBA granted a \$375,000 displaced business loan to the owners of a wholesale grocery business. The proceeds of this loan were used to construct a larger and more modern facility. It was anticipated that the firm's profit would increase from \$7,100 to \$54,700 during the first year of operation due to an increase in sales and cost

reductions made possible by the new facility. However, the firm was unable to meet these objectives. From 1976 through 1978, the firm experienced net losses ranging from \$49,011 to \$63,426 and depleted all retained earnings.

Despite evidence of serious financial problems, SBA granted this firm 6-month deferments in both 1978 and 1980. In approving the latter deferment, SBA officials stated that the borrower was unable to make up missed payments because sales had not materialized as expected. Our review disclosed, however, that SBA approved this deferment without the benefit of recent financial statements and without any assessment by management assistance. At the time this deferment was approved, SBA had not received any financial statements in over 2 years. We also found that SBA did not refer this case to the Management Assistance Division and the decision to grant the second deferment was made without any input from the Division regarding the firm's long-term chances of recovery.

In our previous reports we recognized that loan specialists have heavy caseloads contributing to the loan servicing deficiencies. Accordingly, we recommended that the SBA Administrator

"Determine the staffing level which would permit effective servicing, including initial field visits of the required scope to all borrowers and intensive followup on delinquent loans. Once this staffing need is determined, the Administrator should attempt to meet it through personnel realignments, changes in methods of operations to free personnel for servicing duties, or a proposal to the Congress for additional staff. If all other approaches fail, the only remaining alternative would be to limit the number of loans approved." 1/

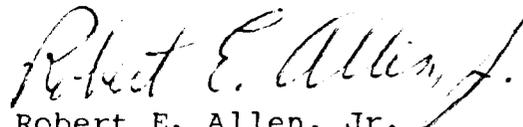
We recognize that SBA has taken certain actions which may have a positive impact on loan servicing. Perhaps the most significant was the implementation in February 1979, of the Bank Certification Program. This program's primary objective is to provide more timely credit decisions for borrowers who use SBA's certified banks' services. Under this program, SBA can provide faster credit decisions by relying on the certified bank to

1/"Efforts To Improve Management Of The Small Business Administration Have Been Unsatisfactory--More Aggressive Action Needed" (CED-79-103; Aug. 21, 1979).

determine a prospective borrower's creditworthiness. SBA plans to eventually decrease its role in delivering guaranteed financial assistance by increasing the lending institution's role. This would be accomplished by delegating greater authority to certified banks in the approval and administration of loans. Aside from the primary objective of providing more timely credit decisions, this operational change may permit SBA to devote more of its staff resources to loan servicing.

We would appreciate your advising us of any efforts taken to improve loan servicing, including the impact of operational changes such as the bank certification program. We thank you for the cooperation extended to us during our review.

Sincerely yours,

A handwritten signature in cursive script that reads "Robert E. Allen, Jr." The signature is written in dark ink and is positioned above the typed name and title.

Robert E. Allen, Jr.
Senior Group Director