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UNITED STATES GENERAL ACCOUNTING OFFICE

WASHINGTON, D C 20548

GENERAL GOVERNMENT
DIVISION

AUG 30 1972

Dear Mr. Eachon.

The General Accounting Office has examined into the Small Business Administration's (SBA) lease guarantee program which was established to assist small businesses to secure leases for prime industrial, business or commercial space. Under the enabling legislation, SBA is required to establish a uniform fee for its share of any guarantee based upon sound actuarial practices.

- Our survey was conducted at the Washington, D C , headquarters office of SBA and was directed toward determining the adequacy of SBA's present fee structure in recovering expected losses and administrative expenses of the program. With the assistance of our actuarial science staff, default rates were developed based upon rental payments made by SBA on leases in default. Our actuarial science staff compared actual default rates we developed with those rates supporting SBA's present fee structure.

Our actuaries concluded that the limited experience of the program is not sufficient to determine whether the current fee schedule is adequate. Because further experience in the program is needed to determine the adequacy of the lease guarantee fee structure, we plan no further review work at this time.

The following matter noted during our survey is presented for your consideration.

INADEQUATE INFORMATION FOR
MONITORING THE PROGRAM

The Underwriting Division (UD) is responsible for developing policies and procedures for the lease guarantee program except for administration (servicing) of the lease guarantees which is performed by the Office of Loan Administration (OLA).

The only information on defaulted leases available to UD and OLA personnel was contained in payment history files which primarily contain requests for payment and payment vouchers. Detailed examination of these records is required to develop default rates.

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for the program. These records have little or no information on the specific problems involved in a default or the actions taken by field personnel to resolve problems and mitigate losses to SBA.

UD became concerned about the impact of losses on the revolving fund and made a detailed examination of the payment history files. In a report dated January 5, 1972, UD concluded that program losses were increasing and expressed concern as to the effect such losses would have on the solvency of the revolving fund. UD found that certain facilities such as restaurants, theaters, and car washes had a higher percentage of defaults than other types of businesses. More stringent criteria was therefore established by UD for underwriting these special purpose, high-risk facilities to reduce SBA's exposure in such facilities.

We believe that lease default information should be reported to UD on a continual basis to allow UD to adequately monitor the solvency of the revolving fund.

In addition, it appears that OLA personnel in Washington should receive information to monitor the adequacy of the actions taken by field personnel in mitigating losses when leases go into default. Our survey showed that the defaulted leases remain in default for an average of 10-1/2 months whereas actuarial studies supporting SBA's fee structure assumed an average of only 4 months. The Chief, UD, stated that efforts by field servicing personnel to mitigate losses had not been satisfactory.

As the lease guarantee program becomes larger and more complex, with a greater number of defaults, the present methods of obtaining information with which to monitor and improve the program may become time consuming and costly. Also, certain information needed to monitor the adequacy of actions taken by field personnel is not available in Washington. Both UD and OLA, in carrying out their functions, need information on leases in default. The Chief, UD, in conjunction with the Director, OLA, should consider establishment of a system to routinely obtain such information.

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We appreciate the cooperation extended to our representatives during the survey, and we will be pleased to discuss the results with you or your representatives if you so desire. We would appreciate receiving information as to any action that may be taken on the matters discussed in this letter.

A copy of this report is being forwarded to the Director,
Office of Audit.

Sincerely yours,

Donald C. Pullen
Donald C. Pullen
Assistant Director

Mr Jack Eachon, Jr.
Associate Administrator for
Financial Assistance
Small Business Administration

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