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UNITED STATES
GENERAL ACCOUNTING OFFICE

REPORT TO THE CONGRESS

OCT 15 1975

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Substantial Losses Projected For The Small Business Administration's Lease Guarantee Program

The law requires the lease guarantee program to be self-sustaining; however, GAO projects losses of \$17 million on policies issued through fiscal year 1974. Many policies were issued to businesses with major deficiencies and for special limited-use properties which were difficult to re-rent. The fund's solvency has not been monitored and premium rates have not been reassessed since January 1971. Additional appropriations may be needed to cover the agency's projected losses on lease guarantees.

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COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

B-178344

To the President of the Senate and the
Speaker of the House of Representatives

This is the third in a series of reports to be issued pursuant to Public Law 93-386, which requires us to conduct a full-scale audit of the Small Business Administration. This report discusses the substantial losses projected for the lease guarantee program.

We are sending copies of this report to the Director, Office of Management and Budget, and the Administrator, Small Business Administration.

A handwritten signature in cursive script that reads "James B. Atwater".

Comptroller General
of the United States

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ABBREVIATIONS

GAO	General Accounting Office
SBA	Small Business Administration

COMPTROLLER GENERAL'S
REPORT TO THE CONGRESS

SUBSTANTIAL LOSSES PROJECTED
FOR THE SMALL BUSINESS
ADMINISTRATION'S LEASE
GUARANTEE PROGRAM

D I G E S T

Under its lease guarantee program, the Small Business Administration helps small businesses obtain leases of commercial and industrial space which, because of insufficient credit standing, they would otherwise not be able to obtain at reasonable terms.

The agency does this by guaranteeing rent payments to landlords, either directly or in participation with a private insurer. As of June 30, 1974, the agency's contingent liability was about \$337 million.

The program is required to be self-sustaining. Administrative expenses and payments to landlords must be covered by premiums charged the small businessman or the landlord.

The program is not self-sustaining for policies issued through fiscal year 1974. GAO projects that net losses may be about \$17 million by the end of the average life of the currently outstanding leases (fiscal year 1987).

The Congress should be aware that:

--Additional appropriations may be needed to cover projected losses on lease guarantees already issued.

--New actuarial studies will likely show that the 2.5-percent legal limitation on loss premiums will have to be increased if the program is to be self-sustaining.

The Small Business Administration's Administrator should (1) give the Congress estimates of total losses on policies issued to date for future funding purposes and (2) have new actuarial studies made to determine the self-sustaining premium rates.

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If, as expected, these studies show that the portion of the premium necessary to cover default payment must exceed the 2.5-percent legal limitation, the Small Business Administration should ask the Congress to consider amending the enabling legislation.

The report also contains a series of recommendations to improve program administration. This report--the third in a series pursuant to Public Law 93-386, which requires GAO to conduct a full-scale audit of the agency--concludes that the Small Business Administration:

- Has not updated actuarial studies on which premiums are based since January 1971, even though experience has shown that some assumptions underlying previous studies were in error. (See p. 10.)
- Has not monitored the program's solvency. (See p. 11.)
- Used poor judgment in approving guarantees for businesses which could not reasonably be expected to succeed. (See pp. 14 to 21.)
- Does not have an adequate system for screening high-risk applicants with major deficiencies and has guaranteed rents on specialized properties which are difficult to re-rent when defaults occur. (See pp. 24 to 25.)

The Small Business Administration agreed to act on GAO's recommendations but pointed out that a new study, if performed by professional actuaries on a contract basis, would be expensive and require an estimated 1-1/2 years to complete. The agency believes that further discussions with the appropriate committees of the Congress are necessary before such a study is initiated.

CHAPTER 1

INTRODUCTION

The purpose of the lease guarantee program is to help small businesses obtain leases of commercial and industrial space which, because of insufficient credit standing, they would otherwise be unable to get on reasonable terms. Under the program, the Small Business Administration (SBA) guarantees rent payments by small business tenants.

LEGISLATIVE PROVISIONS

The program was established in 1965, when Public Law 89-117 added a new title IV to the Small Business Investment Act of 1958. This legislation applied only to small businesses displaced by federally aided public projects and to those eligible for Economic Opportunity loans. Title IV was amended by Public Law 90-104 on October 11, 1967, to include all small businesses.

SBA interprets the law to require that the program be self-sustaining, which means that the fees--hereafter called premiums--for lease guarantees must cover the program's expenses, primarily default payments and administrative expenses. The law requires SBA to fix a uniform premium using sound actuarial practices. The portion charged to cover default payments cannot exceed 2.5 percent of the total rent guaranteed over the life of the lease. According to SBA, the premium may be increased above 2.5 percent to cover administrative expenses.

Authorizing legislation requires SBA to determine whether there is reasonable expectation that the small business will fulfill lease covenants and conditions, before a guarantee is issued. Accordingly, SBA established a risk-analysis system to screen out applicants who could not reasonably be expected to fulfill lease requirements. The system is designed to determine probability of business success by analyzing management capability, financial position, location suitability, and risks involved in the overall transaction.

PROGRAM PROCEDURES

SBA considers the lease guarantee program to be an insurance program and refers to fees charged for lease guarantees as "premiums." SBA requires the small businessman or his landlord to pay a one-time premium before the lease

guarantee policy is issued. Premiums collected must cover administrative expenses and default payments for the term of the guarantees.

In addition to the premium, SBA requires that 3 months advance rent be placed in escrow or that the landlord absorb the rent loss for the first 3 months after a default occurs. This practice gives the landlord and/or SBA 3 months to re-rent the property or help the small business overcome its problems before SBA incurs losses.

SBA may guarantee a lease directly or participate in a guarantee issued by a surety company or other qualified company which has entered into a participation agreement with SBA. To encourage maximum private participation, SBA requires that an applicant attempt to get a guarantee on reasonable terms from private sources before requesting a direct guarantee from SBA. We were told SBA had signed participation agreements with 22 companies, 8 of which had issued policies with SBA.

Upon issuance of a participating policy, SBA receives 21.55 percent of the premiums to cover its share of the risk. In case of default, the agreement usually requires the participating company to pay 6 months of guaranteed rentals before SBA becomes liable for any payments. The participating company then pays 20 percent of all subsequent rent payments, and SBA pays the remaining 80 percent.

SBA's direct guarantees are limited to a range of 10 to 20 years. The average direct guarantee term is about 16 years. SBA may participate in guarantees of 5 years minimum.

The SBA district offices may approve direct lease guarantees with aggregate rents up to \$500,000, and regional offices may approve lease guarantees with aggregate rents up to \$1 million. SBA's central office approves lease guarantees over \$1 million and handles activities associated with participating insurers. SBA limits the aggregate guaranteed rent on any one lease guarantee policy to \$2,500,000.

SBA has issued direct lease guarantees to many businesses which need specialized facilities, including restaurants, theaters, car washes, manufacturing plants, and motels. SBA officials said participating insurers usually restrict their guarantees to multiple-use properties.

PROGRAM ACTIVITY

The first lease guarantee was issued in November 1967. As of June 30, 1974, SBA had 501 direct policies outstanding, with guaranteed rents amounting to \$210,740,404 and was participating in 525 policies where its share of the liability was \$126,092,817. Through June 30, 1974, SBA had collected \$8,029,982 in premiums, charged \$2,780,948 in administrative expenses, and paid \$2,469,610 on 90 defaulted leases.

The actual number of lease guarantees issued has fallen far short of original expectations. In March 1968, SBA's Administrator estimated 3,000 lease guarantees would be issued during fiscal year 1969. Actually, only about 1,000 policies were issued in the first 7 years of the program.

CHAPTER 2

SUBSTANTIAL LOSSES PROJECTED FOR THE PROGRAM

Our projections, based on SBA's default payment experience, show that for lease guarantee policies issued through fiscal year 1974:

- Reserves available to pay landlords will be exhausted in fiscal year 1976, about 12 years before the average direct policy expires.
- Net losses may be about \$17 million by the end of the average life of the currently outstanding leases (fiscal year 1987).

Thus, our projections show the program is not self-sustaining as required.

SBA has not monitored the program's financial condition to see if it is self-sustaining. Further, the actuarial studies that premium rates are based on have not been updated since January 1971, even though some assumptions used in the studies have proven incorrect.

SBA has had to make substantial default payments because:

- SBA underwriters used poor judgment in evaluating and approving applicants. (See ch. 3.)
- SBA's risk-analysis system is not properly designed to reject high-risk applicants. (See ch. 4.)

LOSSES MAY BE ABOUT \$17 MILLION

For the lease guarantee program to be self-sustaining, premiums collected--on a one-time basis--and interest earned thereon must be sufficient to cover all administrative expenses and default payments for the life of the policies. Expenses have already exceeded income for policies issued in each fiscal year from 1969 to 1971.

The following table summarizes the financial condition of the lease guarantee program through fiscal year 1974. As indicated, cumulative expenses have exceeded income by \$1,052,656 for all policies issued from the program's inception, in fiscal year 1968, through fiscal year 1972.

Fiscal year of issue	Income		Expenses		Remaining reserves or deficit (-)	
	Premiums (note a)	Interest (note b)	Administrative (note c)	Defaults (note d)	Annual	Cumulative
1968	\$ 12,607	\$ 5,059	\$ -	\$ -	\$ 17,666	\$ 17,666
1969	362,019	-109,000	553,751	367,623	-668,355	-650,689
1970	480,658	-81,084	596,000	343,639	-540,065	-1,190,754
1971	880,536	32,645	450,000	567,053	-103,872	-1,294,626
1972	1,233,752	105,605	342,000	755,387	241,970	-1,052,656
1973	2,385,992	184,464	338,161	419,108	1,813,187	760,531
1974	<u>2,674,418</u>	<u>70,736</u>	<u>501,036</u>	<u>16,800</u>	2,227,318	<u>\$2,987,849</u>
	<u>\$8,029,982</u>	<u>\$208,425</u>	<u>\$2,780,948</u>	<u>\$2,469,610</u>		

a/Total premiums received from direct and participating guarantees.

b/Interest income applicable to the policies issued in each fiscal year was estimated by GAO. SBA does not account for interest income in this manner. In fiscal years 1969 and 1970 administrative expenses exceeded premiums so no reserves existed on which interest could be earned. Therefore we estimated interest expenses on funds borrowed to cover deficits (-) for those years.

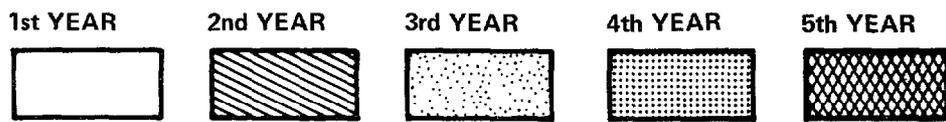
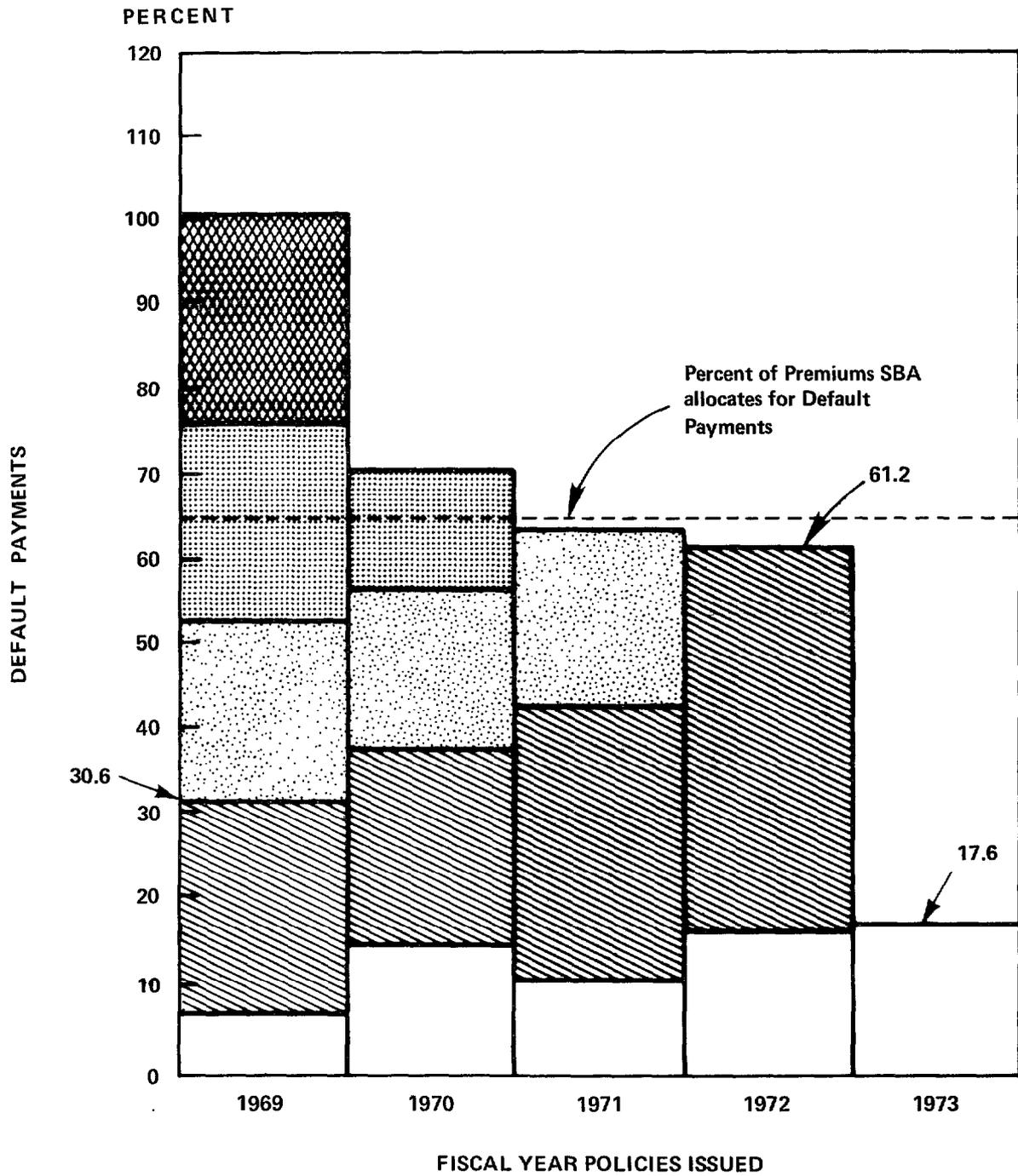
c/The amounts shown are the charges SBA made to the program. SBA does not account for actual administrative expenses but allocates a portion of SBA's total administrative expenses to the program. We could not determine whether the charges were reasonable, because supporting records were lacking.

d/Includes default payments less rental income, losses on properties purchased and resold by SBA, and cash settlements SBA made with landlords to release SBA from lease guarantee agreements.

The program's reserves of \$2.99 million at the end of fiscal year 1974 resulted from a significant rise in premium income in fiscal years 1973 and 1974. Over 60 percent of all premium income received in the first 7 years of the program was received in fiscal years 1973 and 1974. It is likely default payments on 1973 and 1974 policies will be greater than on policies issued in prior years, since default payments, as a percentage of premiums, have generally been higher on policies issued in recent years.

For policies issued in fiscal year 1973, default payments in the following year were 17.6 percent of premiums, the highest first-year default payment rate the program had experienced. Payments in the first 2 years after policies were issued rose from 30.6 percent of premiums for policies issued in fiscal year 1969 to 61.2 percent of premiums for policies issued in fiscal year 1972. Default payment rates are shown in the following chart.

**ANNUAL DEFAULT PAYMENTS AS A
PERCENT OF PREMIUMS FOR POLICIES
ISSUED IN FISCAL YEARS 1969 - 1973**



SBA has charged about 35 percent of one-time premium income to pay administrative expenses. This leaves 65 percent of premiums for default payments. The preceding chart shows payments on defaults have exceeded the 65-percent reserve available to pay for defaults in the fourth year after policies were issued. Since the average direct lease guarantee is for a 16-year term, no reserve remains to cover default payments for the guarantee's last 12 years.

We used two separate methods to project losses on policies issued through fiscal year 1974. Neither includes administrative or interest expenses the program will incur once it is in a deficit position, because no practical method to estimate these expenses could be determined. If these expenses were included, our projected losses would be greater. However, both methods include interest income the program will earn while it retains a positive reserve balance. Both methods show that about \$17 million may be lost by the end of fiscal year 1987.

Method A for projecting losses

In the first quarter of fiscal year 1975, SBA default payments averaged \$134,825 a month, having increased every year since the program's inception, as shown in the chart on page 8.

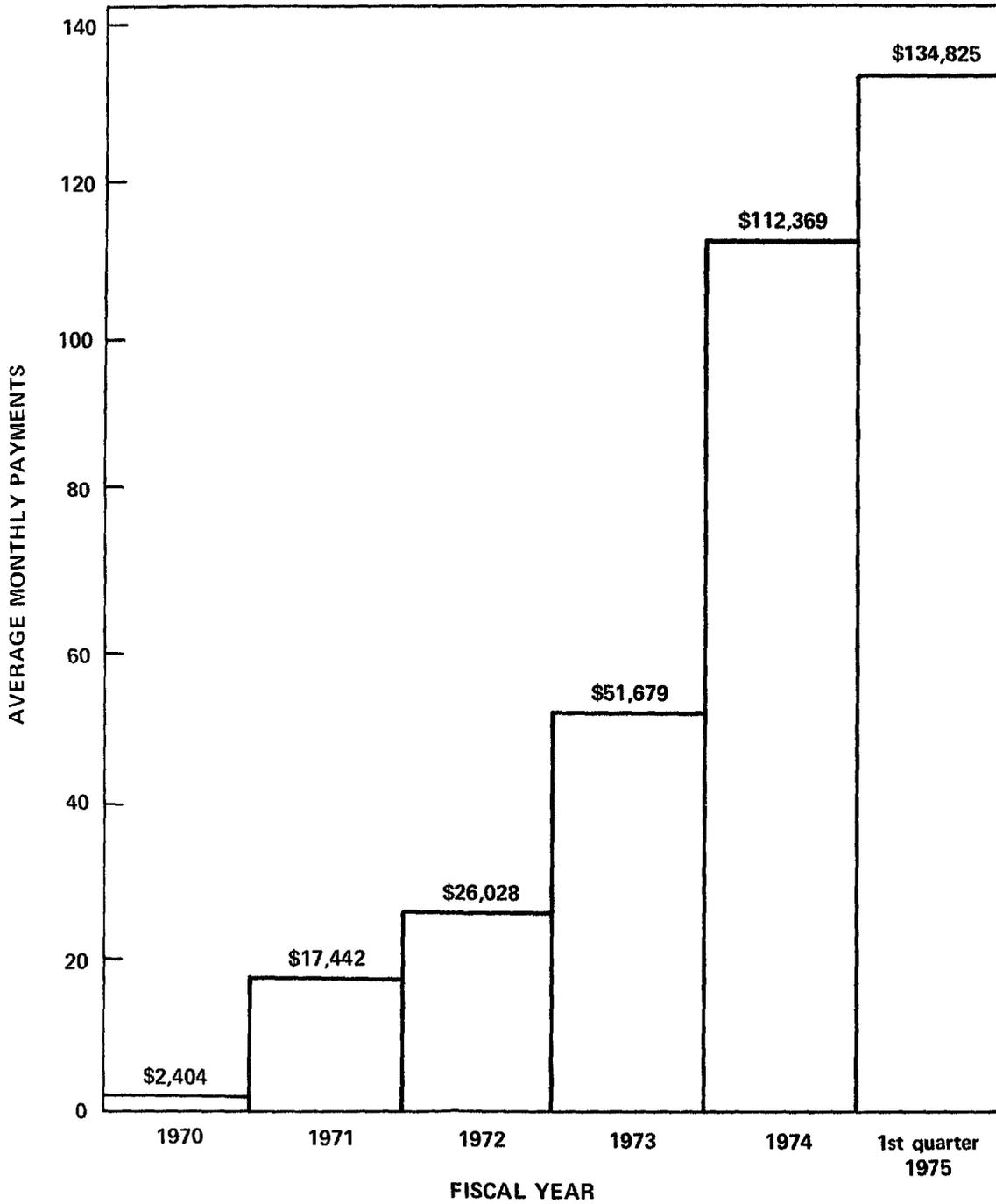
As the chart on page 6 shows, default payments increased substantially in the second year after policies were issued. Thus, monthly default payments may increase significantly in fiscal years 1975 and 1976, as more defaults occur on the policies issued in fiscal years 1973 and 1974, and default payments continue on policies issued before fiscal year 1973. However, even if default payments average \$134,825 a month on policies issued through fiscal year 1974, the remaining reserves on these policies, \$2.99 million on June 30, 1974, will be completely exhausted in fiscal year 1976,^{1/} and losses to the program will be about \$17.8 million by the end of fiscal year 1987.^{2/} Projected losses are shown in the chart on page 9.

^{1/}Information received after our review showed that net default payments during fiscal year 1975 averaged \$136,838 a month.

^{2/}The average direct lease guarantee issued before June 30, 1974, expires in fiscal year 1988. Direct lease guarantees accounted for about 93 percent of default payments at the end of fiscal year 1974.

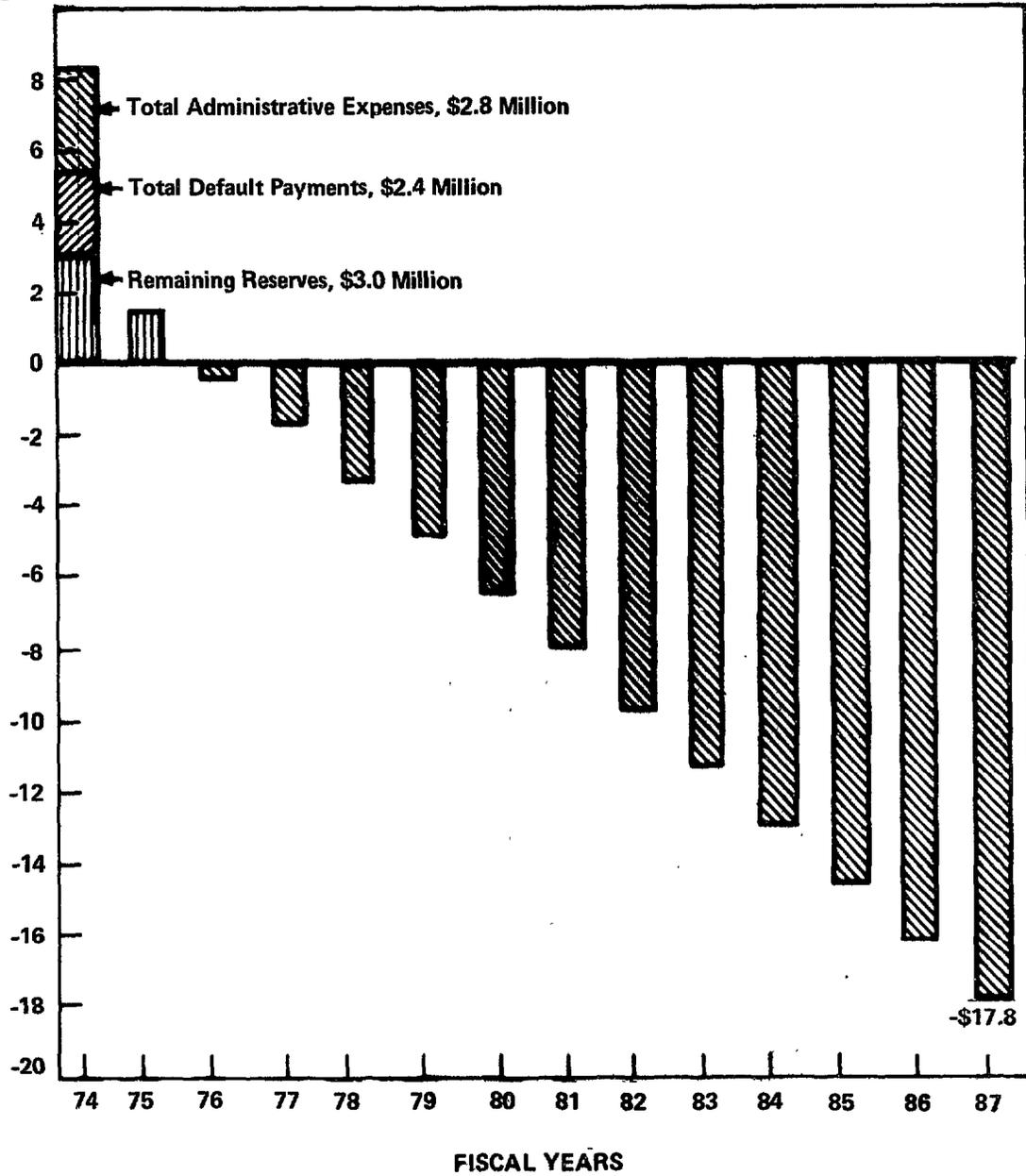
**AVERAGE MONTHLY DEFAULT PAYMENTS
ON POLICIES ISSUED**

THOUSANDS OF
DOLLARS



PROJECTED LOSSES ON POLICIES ISSUED THROUGH FISCAL YEAR 1974

Millions of
Dollars



Method B for projecting losses

Our second method of projecting default payments on policies issued through fiscal year 1974 was to examine prior default payments as a percent of premiums, as shown in the chart on page 6 and make some assumptions about future default payments. For policies issued in fiscal year 1974, we assumed the first-year default payments would be 7.7 percent of premiums, the lowest first-year default payment rate experienced in the program. With the above exception, we assumed annual default payments would average 20 percent of premiums for each year through fiscal year 1987. To arrive at this assumption, we considered the actual program performance: default payment rates after the first year ranged from 14.6 percent to 44.6 percent, exceeded 20 percent in 8 of 10 annual periods, and averaged 24.7 percent.

This method of projection shows that losses on policies issued through fiscal year 1974 may be about \$17.3 million in fiscal year 1987. This projection considers only future default payments and does not include administrative or interest expenses.

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In formal comments provided in July 1975, the Administrator, SBA, agreed that the program will not be self-sustaining with respect to the lease guarantees already made. However, he believed that the losses projected by us were exaggerated. SBA's reasons for its position and our responses are contained in appendix II.

NEED FOR REEVALUATION OF PREMIUM RATES

SBA is required by law to fix lease guarantee premiums. The premium must be determined according to sound actuarial practices, and premiums charged to cover default payments cannot exceed 2.5 percent of total rent guaranteed.

The portion of guaranteed rent SBA charges to cover default payments ranges from 1.9 percent on a 20-year guarantee to 2.5 percent on a 10-year guarantee. Thus, SBA can make only minor increases in some rates before reaching the 2.5-percent legal limitation. In view of substantial losses we project on policies issued through fiscal year 1974, it appears premium rates may have to be increased substantially to make future lease guarantees self-sustaining.

The latest actuarial study of the program was made in January 1971. Current premium rates are based on assumptions made in SBA's actuarial studies, which experience has proven incorrect. For example, an assumption in the studies was that default payments would be greater in the first year and would subsequently decline. This assumption has not proven correct. As the chart on page 6 shows, default payments after the first year have usually increased significantly as policies issued in a given year mature. Successive tenants have defaulted on the same piece of property, a possibility not considered in the original actuarial studies.

Further, SBA officials informed us that it was not anticipated in the actuarial studies that SBA would make cash settlements with landlords or purchase properties to mitigate losses on those which were difficult to re-rent. Of the 21 defaults reviewed, 9 were cases in which SBA either purchased for resale or made a cash settlement to be released from the lease agreements. Losses on the properties bought and resold ranged from about \$92,000 to \$325,000. There have been no gains. Settlements of lease agreements ranged from nothing to \$325,000.

NEED FOR BETTER MONITORING
OF PROGRAM'S FINANCIAL CONDITION

SBA has no system to determine whether the lease guarantee program is self-sustaining. SBA needs such a system to estimate future default payments and administrative expenses for policies already issued and to determine if existing reserves and interest earned thereon will be sufficient to cover these payments and expenses.

SBA informed the Subcommittee on Small Business, House Committee on Banking and Currency, on March 20, 1974, that the lease guarantee program was self-sustaining because it had a positive reserve balance. SBA's conclusion was not entirely correct because it was based solely on the program's remaining cash reserves and did not consider future default payments on existing lease guarantees.

On March 5, 1975, SBA told the Subcommittee on SBA Oversight and Minority Enterprise, House Committee on Small Business, that:

--Most SBA lease guarantees are for special-purpose properties, instead of the general-purpose properties envisioned by the Congress.

--Losses under the program have dramatically increased from \$1.2 million in September 1973 to \$3.3 million through December 1974.

--The program has never been and is not now actuarially sound according to calculations GAO reported in January 1975.

In August 1972, we suggested, in a letter to SBA's Associate Administrator for Financial Assistance, that SBA establish a system to monitor the program's solvency. Had SBA established such a system, it might have avoided the substantial losses now projected for the program.

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In January 1975, we made an oral presentation to the Administrator, SBA, on the results of our examination. In a March 28, 1975, letter, the Administrator informed us that SBA

--agreed with the preliminary finding that the program was not self-sustaining;

--agreed that the cure for this condition rests in either raising premiums based on new studies, restricting the amount guaranteed to limit SBA's exposure, or some combination of both;

--had not decided to initiate new actuarial studies; and

--recognized the need for congressional action either to amend the statutes toward a more liberal approach to lease guarantees or to terminate the existing program.

CONCLUSIONS, AGENCY COMMENTS,
AND OUR EVALUATION

Our projections show the lease guarantee program is not self-sustaining as required in that, for policies issued through fiscal year 1974:

--Reserves available to pay landlords will be exhausted in fiscal year 1976.

--Net losses may be about \$17 million by the end of fiscal year 1987.

Premium income has obviously not been adequate to cover these projected losses. The actuarial studies on which premiums are based have not been updated since January 1971. Subsequent experience in the program has shown some incorrect assumptions made in those studies.

Had SBA developed a system for monitoring the program's financial condition, it would have recognized that premium rates needed reassessment or taken other corrective actions before projected losses reached their present level.

The Administrator, SBA, agreed that even if the problems discussed in this report are corrected, the program will not be self-sustaining for lease guarantees already made. It is even questionable whether future guarantees can be self-sustaining without raising the premium to cover default payments above the 2.5-percent legal limitation and correcting the problems discussed in this report.

In commenting on our suggestion that new actuarial studies be performed, the Administrator said a new study, if performed by professional actuaries on a contract basis, would be expensive and require an estimated 1-1/2 years to complete. He said that further discussions with the appropriate committees of the Congress should precede such action.

Although the Administrator's proposal is a commendable approach in dealing with the program's deficiencies, we believe that self-sustaining premium rates would be needed if the Congress considers changing the enabling legislation.

RECOMMENDATIONS

We recommend that the Administrator of SBA:

- Present the Congress with estimates of total losses on policies issued to date, so it will be aware of SBA's future funding needs.
- Make new actuarial studies to determine self-sustaining premium rates.
- Monitor the program's financial condition systematically and continuously.

CHAPTER 3

POOR JUDGMENT USED IN APPROVING LEASE GUARANTEES

Significant losses have been incurred in the lease guarantee program because:

- SBA officials used poor judgment and insufficient care in evaluating many high-risk applicants.
- SBA's risk-analysis system is not properly designed to reject applicants who have no reasonable chance of success.

This chapter deals with the first problem, and chapter 4 deals with the second.

SBA is required to issue lease guarantees only to businesses with a reasonable expectation of success. SBA officials used poor judgment in approving guarantees for businesses which, in our opinion, did not have this reasonable expectation. SBA officials apparently ignored available information, failed to obtain sufficient information to support their evaluations, or accepted as fact highly questionable information provided by applicants. These actions resulted in lease guarantees being issued even though:

- The contract rent and guaranteed rent were significantly higher than the fair market rent.
- The management had no prior related experience.
- The location was poor.
- The business had inadequate equity or working capital to begin operations.
- The market for the product or service was not reasonably assured.

We reviewed 21 of the 74 direct lease guarantees in default as of June 30, 1974. Even though any 1 of the problems listed above could reasonably be expected to prevent a business from succeeding, 12 of the 21 cases had 2 or more. A summary of the problems for the 21 cases is shown in appendix III.

The 21 cases accounted for 63.3 percent of all losses paid through June 30, 1974. They were selected for

- coverage of a large percentage of default payments,
- broad geographical distribution, and
- wide variation of type of business.

The following three cases typify the kinds of problems we found.

CASE A

This case involved a tavern located in a small suburb. SBA approved the 15-year direct lease guarantee on March 24, 1972, with a monthly lease payment of \$2,200 for land, building, fixtures, and equipment. SBA issued this guarantee even though:

- Guaranteed rent was over 250 percent of market rent.
- The tenant had not met SBA's working capital requirements and had insufficient working capital to pay even the first month's rent.

Excessive rent guaranteed

The landlord had a private appraisal made of the leased property before applying for an SBA lease guarantee. The private appraiser estimated the land value at \$5.00 a square foot but included no comparable land sales to support this valuation. In October 1974, 2-3/4 years after the first appraisal, SBA had a second private appraisal made. The second appraiser valued the land at \$2.50 to \$2.60 a square foot, or about half the original appraised value. The second appraisal was based on sales of three comparable properties within 2 blocks of the leased property.

The first appraiser estimated the monthly return on fixtures and equipment by dividing the annual figure by 10 instead of 12. Therefore, the first appraiser's estimates of comparable monthly rents were about \$200 too high.

The first appraiser estimated market rent at a rate of return of 7 percent for land and 12 percent for buildings. Applying these rates to the land and building values in the second appraisal indicates the market rent of the leased property should have been about \$850 a month. If the second appraisal is correct, the guaranteed rent of \$2,200 is 250 percent of the market rent. Even \$850 a month may be too high. An SBA official from another district office, after reviewing this case, made this statement:

"According to the analysis made by [another SBA official from the other district office], the estimated gross income for this property for the first year was in the range of \$150,000 to \$187,250, and the industry rent figures for this type of business with this volume would range from \$350 to \$436 per month. The guaranty by SBA of a monthly rent figure of \$2,200 is thus over four times the industry average."

Excessive rent may have been a major factor in the business's default. In November 1972, when the tenant applied for a loan from SBA, he submitted an income statement showing a net loss of \$3,793 for the first 5 months of operation. If the rent had been \$850 instead of \$2,200 per month, the business would have shown a profit of \$2,957 during the same 5 months.

Guarantee approved even though working capital requirements not met

SBA approved the lease guarantee with the conditional requirement that the business have \$22,000 for working capital, inventory, and expenses when the business opened. However, the business had only about \$6,300 for these items when it opened, and only \$1,100 was in cash. Rent of \$2,200 due on the opening date was waived for 10 days. If the payment date had not been extended 10 days, the business would have opened in a deficit cash position of \$1,100.

The SBA official who recommended approval of the lease guarantee said he had made an oversight in issuing the lease guarantee when the conditional requirement had not been met. He also stated that the landlord's allowing a delayed payment of the first month's rent should have been a warning sign the tenant's cash and working capital were insufficient. He further stated he would not have recommended issuance of the lease guarantee if he had known the business had only \$1,100 in cash when it opened.

The tenant's insufficient working capital did not cover a loss of \$3,800 incurred over the first 5 months. To obtain working capital, he applied for and received an SBA direct loan for \$23,000. Subsequently he defaulted on both loan and lease payments. SBA paid a net of \$3,600 for defaulted lease payments through December 31, 1974. Although a negotiated settlement of the lease was underway, no final action had been taken by December 31, 1974.

CASE B

This case involves a company incorporated in May 1968 to manufacture and market livestock insecticide applicators. In December 1972, an SBA regional office notified the landlord that SBA would guarantee quarterly lease payments of \$10,200 for 15 years. The lease provided the business with an office building and manufacturing plant.

SBA officials did not use good judgment in approving this lease guarantee because:

- The existence of a market for the new product was not reasonably assured.
- Statements supporting the small business' financial position were inaccurate and incomprehensible.

The Chief and Acting Chief of SBA's Central Office Underwriting Division reviewed the case file before the lease guarantee policy was issued in January 1973. They concluded the case would result in a default, but a commitment had already been made by the regional office.

No assurance of a market for the product

The tenant's balance sheet as of September 30, 1972, listed component parts for the product of \$13,000 and patents of \$30,000. The SBA Central Office Acting Chief Underwriter commented in a memorandum to the file:

"The file reveals that lessee has had the patent on the insecticide applicator for 13 years. The limited financial data submitted indicates no income from this product, although an inventory of 1,000 insecticide applicator component parts has been carried on the lessee's financial statement for the last three years."

The SBA underwriter in the district office who recommended approval of the lease guarantee said in his analysis of the business' volume potential:

"The market for this product is expected to have considerable growth. Since the projections were made for the lease guarantee, the first two years planned production has been pre-sold. Applicant has now also received a request for 5,000 more units for [customer name omitted]. Plans are now being revised to add more assembly lines to handle these orders."

This underwriter told us that perhaps the tenant did not have firm orders, but only letters of intent to purchase the livestock insecticide applicators when they were produced. The underwriter could remember the name of only one potential customer (referred to in the previous quote) but said copies of the orders or letters of intent should be in the case file, unless he forgot to obtain them. We found no orders or letters of intent in the file, nor did we find any indication that market studies were made of whether the proposed product could compete with similar products already being sold. In summary, SBA guaranteed the lease of a business planning to produce a new product, without sufficient reason to believe a market for the product existed.

Financial statements inaccurate
and incomprehensible

The SBA Acting Chief Underwriter in the Central Office wrote in a memorandum:

"The financial data submitted is not comprehensible. At best it would appear that applicant is projecting 66+ percent of gross profit. No analysis has been made of the amount of working capital required or the assurance that working capital will be available. It is the writer's opinion that this case will result in a default."

After reviewing this memo, the SBA Chief Underwriter wrote:

"Concur. No verification of orders. Reasonableness of costs questionable. * * * Value of net worth shown is not ascertainable. Substantial lack of analysis by field office."

Our review of financial statements disclosed that the tenant wholly owned one subsidiary, whose net worth was shown on its balance sheet as \$1,450,000. However, the tenant's balance sheet did not reflect this fact and listed investments of only \$926,000 and total assets of \$1,049,000. In addition, the financial statements

- contained an addition error of nearly \$10,000,
- included an unexplained line item "profit recapture" of \$200,000 (on the balance sheet of the wholly owned subsidiary), and
- added beginning inventory to net earnings to get a total earnings figure.

The district office underwriter was unaware of the addition error, could not explain the "profit recapture" item, and agreed that adding beginning inventory to net income was not an acceptable accounting practice. Nevertheless, the SBA underwriter in the district office thought the financial statements were sufficient because the tenant had tremendous potential and a large volume of advance orders. As stated earlier, we could not substantiate the large volume of advance orders.

The business failed to make the first lease payment. The SBA district official servicing this lease guarantee informed us in March 1975 that SBA had

- made lease payments totaling \$40,800,
- refused in November 1974 to make further lease payments after visiting the facility and finding it in full operation, and
- referred the matter to its security and investigation division for appropriate action.

CASE C

This case involves a drive-in restaurant franchise with a 15-year lease of \$1,150 a month guaranteed by SBA. The tenant also paid the landlord \$250 a month for adjoining property used to provide access to the restaurant. Thus, total rent payments were \$1,400 a month. The lease guarantee was effective October 15, 1969. Eleven months later, the tenant defaulted on his rent payments and, in December 1970, closed the business and returned the keys to the landlord.

The property was subsequently rented for 3 months at \$500 a month and then for 1 month at \$350. On November 10, 1971, SBA paid the landlord \$50,000 to cancel the lease guarantee contract. On December 31, 1974, SBA had not exercised its right to recover any of its \$60,800 loss from the tenant, although the tenant had substantial assets when he applied for the lease guarantee.

SBA officials used poor judgment in approving this lease guarantee application because:

- The management was inexperienced.
- The site was undesirable.
- The rent was excessive.

After rejecting the first application, SBA's Central Office was contacted by the franchise distributor. The Central Office reviewed the application a second time and approved it on March 20, 1969, even though the deficiencies still existed.

Inexperienced management

SBA's regional and area office evaluation of the proposed management stated the tenant intended to continue as active head of his meatpacking plant and hire a manager to run the drive-in restaurant. The manager's principal experience had been managing a family grocery store. SBA's Central Office management analysis of January 13, 1969, stated that the tenant or the proposed manager should have experience in the fast-food business before the application could be approved. SBA area and Central Office management analysts recommended the application be rejected. We found on file no new management analysis made between the application's rejection and its subsequent approval.

In its reevaluation of the application, SBA's Central Office made no mention of the tenant's or manager's lack of experience.

Undesirable site

SBA regional, area, and Central Office appraisers all agreed the site was undesirable.

The SBA regional office appraiser stated on October 31, 1968:

"The site is less desirable than the corner sites occupied by Perkins, Red Barn, Bonanza and Morgans, or the unusual site occupied by Arby's. As this is a poorly planned strip growth area, it is doubtful that long-term leases are desirable. Over-saturation appears to be a definite possibility."

The SBA area office appraisal coordinator stated on December 27, 1968:

"Access to the facility is apparently adequate although overall it is less desirable than some of its competitors * * *."

The SBA Central Office appraiser stated on January 8, 1969:

"The location is a corner on an uncut street and as such, it is just an inside lot abutting a residential area. It is not desirable for the use intended and does not conform to the highest and best use."

SBA's Central Office appraiser recommended that the application be rejected on January 8, 1969, but reversed the recommendation on March 13, 1969. In recommending the location, the appraiser said he had talked with a realtor who informed him that a 1,000-unit apartment complex would be built behind the proposed site and the uncut street would be developed into a boulevard providing access to the proposed site. The SBA appraiser did not mention the numerous competitors in the area nor the inadequacy of the proposed site. When the tenant went out of business, the street was still uncut.

Excessive rent guaranteed

The tenant originally requested a lease guarantee for \$1,350 a month. On December 20, 1968, the SBA regional director described the proposed rent as follows:

"Rent for these premises, compared with the level and trend in the trade area, is considered very poor."

The SBA Central Office appraiser in Washington, D.C., stated on January 8, 1969:

"The rental is not economic and is based on a maximum return on inflated and unrealistic construction costs and land values. At first reading, one would believe the \$43 per square foot construction cost included the equipment and site improvements, but it does not. I cannot believe this type of business warrants this size investment."

Both the regional director and the SBA Central Office appraiser recommended that the application be rejected.

Two months later, the SBA Central Office appraiser made a second location evaluation and stated:

"My previous analysis indicated the rental was exorbitant and based on an inflated land value and construction costs.

"* * * the location does appear to have a potential not formerly realized, and in view of escalating land values and mortgage interest rates, the

proposed rental of \$1,150 per month or \$13,800 per annum is an economic [sic] rental."

The approved lease guarantee of \$1,150 a month was \$200 less than the \$1,350 which was considered excessive. However, the approved lease guarantee did not account for the adjoining property, which had been included in the original appraisal submitted with the lease guarantee application. This fact was not mentioned by SBA's Central Office appraiser. The adjoining property was also rented to the tenant for an additional \$250 a month--not covered by SBA's lease guarantee. Thus, total rent was \$1,400 a month, \$50 more than the \$1,350 which was considered excessive and uneconomical by SBA.

On November 10, 1971, SBA paid the landlord \$50,000 to cancel the lease guarantee agreement. Prior default payments to the landlord amounted to a net of \$10,800. The \$50,000 settlement was based on an evaluation using an economical rent of \$500 a month. This was considerably less than the \$1,150 a month which SBA approved as economical rent over 2-1/2 years earlier.

No recovery attempt

The tenant stated his net worth to be about \$180,000 on September 24, 1968, when he applied for the lease guarantee. SBA paid the landlord a net of \$10,800 to cover defaulted lease payments. In addition, SBA agreed to pay \$50,000 to cancel the lease guarantee policy as discussed above. An SBA district office official informed us SBA had the right to recover from the tenant rental payments made to the landlord, but had taken no action to do so as of December 31, 1974.

In response to our letter inquiring into this matter, SBA's Administrator informed us, in August 1975, that recovery is not possible as the former tenant is deceased, the estate probated, and the time for filing a claim against the estate has past.

GENERAL REASONS PROVIDED BY SBA PERSONNEL

There appear to be many factors contributing to SBA underwriters using poor judgment in most of the 21 defaulted lease guarantees we reviewed. SBA officials informed us that:

- Some high-risk lease guarantees were issued because there was a greater emphasis on increasing program volume than on issuing low-risk lease guarantees.
- In prior years, there was a strong emphasis on issuing lease guarantees to minority businesses, even when the businesses were high risks.

--SBA has provided very little training in the use of the risk-analysis system to SBA underwriters.

--SBA district officials are unaware of the lease guarantee program's financial condition and of how the lease guarantees they issued affected that condition.

CONCLUSIONS

SBA underwriters used poor judgment and insufficient care in evaluating many of the lease guarantees we reviewed. As a result, lease guarantees were approved for businesses which could not reasonably be expected to succeed. These approvals are a primary cause of losses in the lease guarantee program.

Small businesses which are unable to lease desirable space at a reasonable cost without assistance by nature represent higher-than-average risks. However, when a business does not have a reasonable chance of success, assistance by SBA benefits neither the small businessman nor the Government. The ensuing business failure loses money for both parties.

Poor judgment, such as that exercised by underwriters mentioned in this chapter, is a difficult problem to correct. We think a system could be devised to monitor judgmental decisions by evaluating underwriters on the quality of lease guarantees issued.

RECOMMENDATION

We recommend that the Administrator of SBA establish a system to evaluate underwriter performance according to the quality of lease guarantees issued, in order to indicate the quality of the underwriters' judgment.

The Administrator agreed that, if the program is to continue in its present form, SBA will consider making appropriate changes in its standard operating procedures.

CHAPTER 4

DESIGN OF RISK-ANALYSIS SYSTEM SHOULD BE IMPROVED

Substantial default payments are being made in the lease guarantee program because SBA has approved lease guarantees for many businesses having no reasonable chance of success. SBA attempted to screen out these businesses by establishing a risk-analysis system to evaluate the management capability, financial position, location suitability, and overall risk of each applicant. We found the risk-analysis system was not properly designed to reject applicants who have no reasonable chance of success.

SBA's risk on each lease guarantee depends on

1. Probability of business success.
2. How quickly the property can be re-rented if the business fails.

SBA's risk-analysis system is designed to evaluate major determinants of business success or failure. However, the system averages high-risk factors with low-risk factors, which results in the approval of lease guarantees for many businesses with major deficiencies. In addition, the risk-analysis system does not adequately consider how quickly a property can be re-rented, resulting in some very sizeable losses for SBA.

RISK-ANALYSIS SYSTEM AVERAGES OUT HIGH RISKS

SBA evaluates each applicant in three major categories--management, financing, and location. Points are assigned to factors within these major categories. High scores on some factors may offset low scores on other factors.

For example, an applicant's financial evaluation is based on four factors:

1. Quality of credit reputation.
2. Adequacy of equity capital.
3. Capability in using financial resources.
4. Ability to meet obligations to creditors, lessors, and owners.

An applicant with little or no equity capital but with maximum scores on the other three factors would receive an about average financial rating. Similarly, an applicant with no prior background or experience in a proposed new business, but with above average scores on other management factors, would be considered an average management risk. Further, a location with low scores for volume potential and accessibility would be rated average if the other location factors received maximum scores.

SBA's risk-analysis system should be modified. Low-risk characteristics should not offset high-risk characteristics.

RE-RENTABILITY OF PROPERTIES NOT ADEQUATELY CONSIDERED

SBA's risk-analysis system does not adequately consider how quickly a property can be re-rented in case of default. The more alternative uses a facility has, the easier it is to re-rent. Defaulted facilities which have limited, specialized uses result in greater losses to SBA because they are usually more difficult to re-rent. Special-purpose facilities which SBA has guaranteed include motels, hotels, restaurants, car washes, an aeronautical school, and a potato processing plant.

SBA considers alternate use a minor factor (10 percent) of location risk in evaluating an applicant's proposed site. As a result, SBA has approved lease guarantees on many limited, special-purpose facilities.

The chief underwriter of one of the three largest participating insurers told us re-rentability is one of the most important factors he considers in evaluating a lease guarantee application. If the facility does not have multiple uses, the application is turned down. His company does not guarantee lease payments on any motels or car washes, and very few restaurants.

Special-purpose facilities accounted for 57 percent of defaults, but 81 percent of SBA's losses, through fiscal year 1974. Furthermore, as of June 30, 1974, SBA had paid out an average of 14.4 months' rent, or \$35,100, on special-purpose facilities versus 7.2 months' rent, or \$10,898, on multi-purpose facilities.

The following cases are examples of losses incurred because SBA does not adequately consider re-rentability in its risk-analysis system.

Case A

A 2,000-seat theater was constructed for a small business, which operated about 3 months before defaulting on its lease payments. In the location-suitability analysis made before the lease guarantee was approved, the SBA appraiser stated:

"Potential uses of this proposed structure are quite limited. Without modification, this building could be utilized as a movie theatre, a lecture hall, or a convention hall. It should be pointed out, however, that at the present time, [this city] has no need or demand for any of these." (Emphasis added.)

"It should be noted that the time element involved in finding a lessee for these facilities would, in all probability, be extensive."

SBA made lease payments of \$74,200. Then, about 2 years after the default, SBA purchased the property for \$345,000 and sold it for \$110,000, losing \$235,000 on the transaction.

Case B

A drive-in restaurant was constructed for a small business, which operated 8 months before defaulting on its lease payments. An SBA district office report stated that one factor which deterred potential tenants from renting the facility was:

"* * * the fact that it is a singular design A-type building. Therefore, extensive expenditures would be required in order to have it conform to the design of another franchiser. The only franchisers whose building design is similar are [two franchisers listed]."

One of the franchisers mentioned rented the property for 9 months and then ceased operations.

On December 31, 1974, vacancy periods for the property exceeded 4 years, and SBA had made lease payments of \$75,911.

Case C

A meatpacking plant was constructed for a small business which operated 9 months before defaulting on its lease payments. In the location-suitability analysis, the SBA district appraiser stated:

"This proposed structure is a highly specialized, single-purpose building. It would not be economically feasible to renovate it for some other business endeavor."

SBA made lease payments of \$2,410. Then SBA purchased the property for about \$128,000 and sold it for \$36,000, losing \$92,000 on the transaction.

Case D

A motel was renovated and expanded for a small business which operated about 6 months before defaulting on its lease payments. In the location-suitability analysis, the SBA appraiser stated:

"Your writer cannot think of any other purpose for which this highly specialized property could be used. This becomes even more apparent when one considers the location, that being [sic] a small town."

On December 31, 1974, the property had been in default for over 2 years, and SBA had made lease payments totaling \$157,638.

CONCLUSIONS AND AGENCY COMMENTS

SBA's risk-analysis system is not properly designed to

--screen applicants who have no reasonable chance of success, because the system averages an applicant's high-risk and low-risk characteristics, resulting in the approval of many businesses with major deficiencies or

--minimize SBA losses in case of default, because the system does not adequately consider how quickly a property can be re-rented if the applicant's business fails.

In January 1975, we discussed with the Administrator of SBA and program officials the importance of re-rentability of properties being considered for lease guarantee applications. In March 1975, SBA amended its operating procedures to limit the guaranteed rent on single- and special-purpose properties to the rent, as determined by SBA, that can be expected from an alternate or general use.

The Administrator advised us that further changes in SBA's standard operating procedures will be considered if the program is to continue in its present structure and form.

RECOMMENDATIONS

GAO recommends that the Administrator of SBA have the risk-analysis system modified to

- establish minimum standards for key risk characteristics which must be met for a lease guarantee to be issued and
- include a property's re-rentability as a separate, important factor in the risk-analysis system.

CHAPTER 5

SCOPE OF REVIEW

During our review, we examined applicable legislation and its history; lease guarantee program regulations, procedures, and guidelines; lease guarantee files; and other pertinent documents. We also examined SBA's risk-analysis system.

We reviewed 21 direct default cases at SBA headquarters, Washington, D.C., and at SBA district offices in Albuquerque, New Mexico; Cleveland, Ohio; Helena, Montana; Lubbock, Texas; Richmond, Virginia; San Francisco, California; Seattle, Washington; Sioux Falls, South Dakota; Spokane, Washington; and Washington, D.C. We also reviewed two case files provided by the SBA Boston and Providence district offices. We selected all these offices because they included 9 of the 10 lease guarantees with the largest default losses, broad geographic distribution, and wide variation of types of small businesses. The 21 cases represented 63.3 percent of SBA's default payments to landlords as of June 30, 1974.

We also discussed the program with SBA officials and the chief underwriter for one of the larger private insurers participating in the program.



U.S. GOVERNMENT
SMALL BUSINESS ADMINISTRATION
WASHINGTON, D.C. 20416

July 8, 1975

OFFICE OF THE ADMINISTRATOR

Mr. Victor L. Lowe
Director, General Government Division
United States General Accounting Office
Washington, D. C. 20548

Dear Mr. Lowe:

This is in reply to Draft of Report to the Congress of the United States prepared by you and entitled, "Substantial Losses Projected for Lease Guarantee Program."

The findings and recommendations of the report we now have in hand are essentially the same as presented to us on a preliminary basis in mid-January of this year. Your report acknowledges that SBA has taken certain corrective actions since January. Those actions were taken as a result of your briefing in January and because we had drawn similar conclusions for slightly different reasons on our own. A very key paragraph is contained in your report which is located on page 18 which states:

"Even if the problems discussed in this report are corrected, the program will not be self-sustaining with respect to the lease guarantees already made. It is even questionable whether future guarantees can be self-sustaining without raising the premium to cover default payments above the 2.5 percent legal limitation and correcting the problems discussed in this and the next two chapters."

We agree with the questions and doubts raised. However, we suggest that the recommendations enumerated on pages 34 and 40, if implemented, would not lead to productive or positive solutions to the overall problem. Nevertheless, the following actions have or will be taken on the recommendations made in the report.

The first of two recommendations on page 18 will be implemented. In connection with that recommendation, we believe

the losses projected by your report are exaggerated for the following reasons:

1. Your chart of projected losses is based on the erroneous factor that there will be a constant increase of losses sustained and no defaults will ever be cured. It is our opinion defaulted leases will be cured through releasing the premises at a rental approximating our guarantee. Therefore, at some future date the amount of monthly payments will level off or decrease appreciably.
2. Since experience has proven that the major losses will occur during the early portion of a lease, the greatest loss on the existing portfolio has already been sustained.
3. The projected loss chart is misleading as it neglects to reflect offsetting income in the form of premium receipts and investment income. There will be further premium income even though your report academically assumes there will not be.
4. The projected cost chart gives no consideration to the adverse economic conditions that have been in evidence for the last several years.
5. The projected loss chart gives no consideration to the inflationary factor which will influence the rerental value of properties in the future. As inflation appreciates real estate values generally, rentals could easily be higher than originally contracted.

6.

[See GAO note 1, p. 32.]

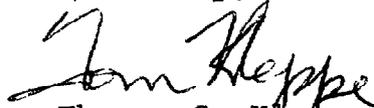
For the above reasons and as previously stated, it is our opinion the losses to be sustained on our existing portfolio will be substantially less than projected. This opinion is borne out by the fact that the net monthly average default payments for the eleven month period ending May 31, 1975 was \$126,586, as opposed to the average monthly default payment of \$170,950 for the first six months of Fiscal Year 1975, as reported on page 12 of the Report. The net default payments for the month of May, 1975 were \$82,731. The steep downward curve of losses, therefore, shows evidence of flattening out.

The second recommendation on page 18 must be viewed and carefully considered in light of the key paragraph we have previously referred to above. A new study, if accomplished by professional actuaries on a contract basis, would involve substantial expense and an estimated year and a half to complete. Before we initiate such action, we believe further discussion with the appropriate committees of Congress is the proper course to follow.

The recommendations made on pages 34 and 40 to upgrade future underwriting of lease guarantees by evaluating underwriters' judgments, declining applications with major deficiencies and analyzing separately the rereatability of facilities, we agree are well founded. Therefore, if the program is to continue in its present structure and form, we will consider making appropriate changes in our Standard Operating Procedures.

While we disagree with the amount of projected default losses, the report represents a professional effort and we appreciate the opportunity to respond to this draft. If you have need for comment or discussion, do not hesitate to contact us.

Sincerely,


Thomas S. Kleppe
Administrator

- GAO notes:
1. Material deleted at SBA's request.
 2. Page references in this appendix may not agree with page numbers of the final report.

REASONS SBA DISAGREES WITH PROJECTION
OF PROGRAM LOSSES--GAO COMMENTS

We used two separate methods in projecting losses on policies issued through fiscal year 1974. Both methods show that about \$17 million may be lost by the end of fiscal year 1987. We recognize that our projections are not precise. For example, neither method includes administrative or interest expenses the program will incur once it is in a deficit position, because no practical method to estimate these expenses could be determined. However, SBA gave the following reasons it thought our projections are exaggerated.

CONTINUATION OF LOSS RATE

"Your chart of projected losses is based on the erroneous factor that there will be a constant increase of losses sustained and no defaults will ever be cured. It is our opinion defaulted leases will be cured through releasing the premises at a rental approximating our guarantee. Therefore, at some future date the amount of monthly payments will level off or decrease appreciably."

Contrary to SBA's statement, our projection assumes that losses have already leveled off at \$134,825 per month and that defaults will continue to occur and be cured--primarily through re-rental--at about the same rate as in the past. In the chart showing average monthly default payments on page 8, there is no indication that default payments will "decrease appreciably" in the near future.

The 21 cases we examined did not support SBA's opinion that defaulted leases would be cured through re-renting the premises at a rate approximating its guarantee. The table below shows the disposition of the 21 properties after default.

<u>Number of properties</u>	<u>Disposition</u>
5	Re-rented at a lower rate
6	Remained vacant
3	Purchased the properties
6	Settlement made on lease obligations
<u>1</u>	Re-rented at same rate
<u><u>21</u></u>	

LOSS RATE AS A FUNCTION OF MATURATION

"Since experience has proven that the major losses will occur during the early portion of a lease, the greatest loss on the existing portfolio has already been sustained."

We disagree. Actual program experience has proven that there is no significant decline in default payments as policies mature (See pp. 6 and 10.) Default payments continue to be about 15 to 25 percent of premiums even in the fourth and fifth year after policies are issued. If this trend continues, the greatest losses on SBA's lease guarantee portfolio are yet to come.

EXCLUSION OF FUTURE PREMIUMS

"The projected loss chart is misleading as it neglects to reflect offsetting income in the form of premium receipts and investment income. There will be further premium income even though your report academically assumes there will not be."

For the lease guarantee program to be self-sustaining, one-time premiums and interest earned thereon must be sufficient to cover all administrative expenses and default payments for the life of the policies. Therefore, our projection of losses for policies issued through June 30, 1974, does not include premium and investment income from future policies. SBA advocates the use of current premium income for defaults on past leases. SBA must follow this practice, since the lease guarantee program is not self-sustaining. Our projection showed that, based on past experience, expenses and default payments on future policies will be about three times as great as premium and investment income on those policies. (See p. 9.)

RECENT ECONOMIC CONDITIONS

"The projected cost chart gives no consideration to the adverse economic conditions that have been in evidence for the last several years."

SBA's actuarial studies, on which lease guarantee premiums are based, fully considered "adverse economic conditions." For example, one actuarial study assumed a depression would occur in the year after each policy was issued. Thus, the occurrence of adverse economic conditions should not have affected the self-sufficiency of the lease guarantee program.

INFLATIONARY FACTOR

"The projected loss chart gives no consideration to the inflationary factor which will influence the re-rental value of properties in the future. As inflation appreciates real estate values generally, rentals could easily be higher than originally contracted."

We agree that appreciation in property values and higher rents may occur. The reverse may also occur, thus resulting in lower rents. Further, economic obsolescence may also affect appreciation of property values. This would apply to those leases SBA issued on special-purpose facilities, which accounted for 81 percent of program losses through fiscal year 1974.

We also found that significant losses were incurred because SBA officials used poor judgment in evaluating high-risk applicants. When leases are insured in excess of market value, extensive inflation would be needed to recover losses.

Thus, some benefits may occur as a result of appreciation of property values, but we believe that this will not occur for those leases SBA has already insured.

TREND OF LOSSES

Although the Administrator agreed the program will not be self-sustaining with respect to the lease guarantees already made, he said losses will be less than our projection. He showed that the net monthly average default payments for the 11-month period ending May 31, 1975, was \$126,586, as opposed to the average monthly default payment of \$170,950 for the first 6 months of fiscal year 1975. For May 1975, the payments were \$82,731. Accordingly, the Administrator said the downward curve of losses shows evidence of flattening out.

We disagree that losses are decreasing. After receiving SBA's formal comments, we reviewed payment activities for fiscal year 1975. For June 1975, SBA records show that net default payments amounted to \$249,609. Average monthly net default payments for fiscal year 1975 amounted to \$136,838, exceeding default payments of \$134,825 a month we used to compute program losses. In August 1975, discussions were held with SBA officials about the wide variance in monthly default payments. We mutually agreed that the amount of the monthly default payment primarily depends on how expeditiously SBA is billed by landlords.

Also, we learned that through June 30, 1975, SBA had made payments totaling \$275,418 on four properties when the mortgage notes were transferred to SBA. SBA has paid about \$31,990 per month in this way since January 1975. Although SBA does not recognize these expenditures as default payments, they represent disbursements from premium income. Accordingly, these payments would increase the average default payment shown above.

SUMMARY OF PROBLEMS OF DEFAULTED LEASE GUARANTEES

<u>Case no.</u>	<u>Guaranteed rent higher than fair market rent</u>	<u>Management had no prior related experience</u>	<u>Poor location</u>	<u>Inadequate equity or working capital</u>	<u>Product market not reasonably assured</u>	<u>Other</u>
1	x					
2	x			x		
3		x		x		
4				x		
5	x				x	
6	x		x	x		
7	x	x	x	x		
8					x	
9		x	x			
10						x
11						x
12		x			x	
13	x	x				
14	x				x	
15				x		
16				x	x	
17						x
18	x					
19	x		x			
20						x
21	x	x	x			

PRINCIPAL SBA OFFICIALS RESPONSIBLE FOR
THE ACTIVITIES DISCUSSED IN THIS REPORT

	<u>Tenure of office</u>	
	<u>From</u>	<u>To</u>
ADMINISTRATOR:		
Thomas S. Kleppe	Jan. 1971	Present
Hilary Sandoval, Jr.	Mar. 1969	Jan. 1971
DEPUTY ADMINISTRATOR:		
Louis F. Laun	Sept. 1973	Present
Anthony Chase	Feb. 1971	Sept. 1973
Einar Johnson	June 1970	Feb. 1971
W. Donald Brewer	Oct. 1969	June 1970
Richard B. Blankenship	Mar. 1969	Oct. 1969
Howard Greenberg	Aug. 1967	Mar. 1969
ASSOCIATE ADMINISTRATOR FOR		
FINANCE AND INVESTMENT (note a):		
Ronald G. Coleman (acting)	Feb. 1975	Present
Einar Johnson (acting)	Jan. 1975	Feb. 1975
David A. Wollard	Feb. 1973	Jan. 1975
Anthony S. Stasio (acting)	Jan. 1973	Feb. 1973
Jack Eachon, Jr.	Dec. 1969	Jan. 1973
Howard G. Rogerson (acting)	Aug. 1969	Dec. 1969
Logan B. Hendricks	Aug. 1964	July 1969
DEPUTY ASSOCIATE ADMINISTRATOR		
FOR FINANCE (note b):		
Anthony S. Stasio	July 1970	Oct. 1974
Howard G. Rogerson	Dec. 1966	July 1970
DIRECTOR, OFFICE OF COMMUNITY		
DEVELOPMENT:		
Earl L. Chambers	Jan. 1975	Present
Einar Johnson	Feb. 1971	Jan. 1975
Glenn A. Swanson (acting)	July 1970	Feb. 1971
Anthony S. Stasio	Nov. 1966	July 1970

a/Before February 1973 this position was Associate Administrator for Financial Assistance.

b/This position was abolished in October 1974.

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