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RURAL DEVELOPMENT

REA Telephone Borrowers'  
Cash Holdings and Rural  
Development Investments

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Mr. Chairman and Members of the Subcommittee:

We are pleased to be here today to discuss, among other things, the investments and rural development activities of Rural Electrification Administration (REA) borrowers. Our testimony today summarizes results of our ongoing review of (1) the reasons why rural telephone companies that hold REA loans--REA telephone borrowers--have large amounts of cash and cash equivalents, such as certificates of deposit; (2) the extent to which REA borrowers are investing in their local rural areas; and (3) the status of REA's implementation of its 1987 and 1990 legislative mandates for rural economic development.

Our testimony is based on preliminary information gathered from REA headquarters and on visits to 15 REA telephone borrowers that had cash and investments totaling 52 percent of the value of their plant and equipment--5 borrowers had cash and investments exceeding 100 percent of the value of their plant and equipment. The borrowers we visited are located in six midwestern states and serve about 300 to 15,000 customers. In summary, we found the following:

- In the past few years, some rural telephone companies' revenues, and consequently their cash and investments, have increased because they received revenues from access charges--payments from long-distance companies to use the local system--on an increased volume of long-distance calls. Borrowers were holding large amounts of cash for future uses such as upgrading plant and equipment, expanding into other telecommunications services, and providing contingencies for natural disasters and accidents.
- REA telephone borrowers generally do not make large financial investments in their rural areas--outside of telephone or related projects--because they are hesitant to become financially involved in businesses in which they have no expertise. When borrowers do invest in the local community, their investments are usually concentrated in upgrading or expanding their existing telephone business or diversifying into related business opportunities, such as cellular telephone and cable television.
- REA has implemented less than half of seven 1987 and 1990 rural economic development legislative mandates. For example, it has not completed implementing a telecommunications program intended to enhance educational opportunities and medical benefits in rural areas. However, it has staffed the rural development technical assistance unit and established a no-interest loan program under which REA borrowers can receive and, in turn, can provide interest-free loans to third parties for rural development purposes.

## BACKGROUND

REA helps rural electric and telephone utilities obtain financing to provide electric and telephone service in rural areas. REA's financial assistance includes direct loans, guarantees of loans made by others, and approval of security arrangements that permit borrowers to obtain financing without a guarantee. In 1991, REA made about \$186 million in direct loans and \$177 million in Rural Telephone Bank (RTB) loans to telephone borrowers. REA also guaranteed loans amounting to about \$73 million. RTB loans differ from direct REA loans in that RTB charges interest rates based on the cost of money to RTB rather than the 5 percent rate for direct REA loans.

Since its inception, REA has been viewed as having rural development responsibilities. These responsibilities were highlighted in 1987 and 1990 legislative provisions that mandated, among other things, several rural economic development programs.

### CASH FROM LONG-DISTANCE ACCESS REVENUE GENERALLY HELD FOR FUTURE BUSINESS NEEDS

Telephone industry changes during the early 1980s, including the divestiture of the Bell Telephone System, contributed to an increase in revenue and profitability for independent telephone companies. The borrowers we visited cited a variety of reasons for their relatively high levels of cash, which were to be used primarily for anticipated equipment upgrades to provide better service.

### Reasons for Increased Revenues

Borrowers and Federal Communications Commission (FCC) officials told us that both the divestiture of the Bell Telephone System in 1984 and subsequent FCC decisions increased the revenues of some REA telephone borrowers. After the divestiture, the FCC ordered the establishment of the National Exchange Carriers Association (NECA) to act on behalf of small, independent telephone companies. NECA works with FCC to determine long-distance telephone access charges and disburses access charge revenue to these small companies. With lower long-distance rates, the number of long-distance calls increased substantially; so some rural telephone companies received more revenue, and profitability and cash levels increased. According to NECA officials, this increased volume of long-distance calls was the primary reason for increased revenues and profitability.

In 1990, REA telephone borrowers received about 65 percent of their revenues from these long-distance revenues. Some REA borrowers may benefit slightly more than non-REA borrowers. This occurs because some REA borrowers pay a loan interest rate of 5

percent or less and NECA may reimburse borrowers for interest expense at a rate higher than 5 percent.

In addition, some REA borrowers have increased their revenues through interest income from investments and by diversifying into other telecommunications services, such as cellular phone and cable television. For example, in one case a borrower we visited sold its \$252,000 investment in a cellular telephone partnership for about \$6.8 million.

### Reasons for Holding Large Cash Balances

The 15 borrowers that we visited had cash and investments totaling 52 percent of the total value of their plant and equipment. These borrowers held a total of \$16.4 million in cash and \$29.1 million in other investments.

REA borrowers told us that they plan to use accumulated cash to meet planned or unanticipated business expenses. For example, 14 of the 15 borrowers we visited stated that they had plans to upgrade and enhance their existing telephone service with new equipment, such as digital switches and fiber optic cable. We did not verify anticipated uses because, for the most part, plans were not available for review. Borrowers also held large amounts of cash because they (1) planned to expand into cellular telephones or cable television, (2) wanted a contingency fund for emergencies, (3) had financially conservative management styles, and (4) were uncertain of future REA loan funds. To determine why borrowers maintain cash requires a review of anticipated uses on a case-by-case basis.

In general, borrowers stated that they did not plan to apply for a new REA loan unless expenses were higher than anticipated. Nevertheless, borrowers are eligible to apply for new REA loans regardless of their cash balances.

### TELEPHONE BORROWERS MADE LIMITED RURAL DEVELOPMENT INVESTMENTS

REA telephone borrowers are not mandated to make specific levels of rural development investments. The borrowers we visited made limited financial rural development investments that were not related to telecommunications. Nevertheless, borrowers told us that they do contribute to rural development by (1) providing telephone services to their rural areas and (2) providing leadership on local community initiatives and participating in community activities. Examples include five borrowers who provided discounted phone service to fire departments, hospitals and schools, and eight borrowers who are involved with the local chamber of commerce or rural development committees.

The borrowers' primary investments were in related services, such as cellular telephone or cable television. Borrowers we visited invested in these services because they possess the necessary technical expertise and want to prevent competitors from providing these services. Additionally, borrowers want to ensure that their rural areas have access to modern technologies and that local businesses remain competitive. Several borrowers we visited were especially interested in using the benefits of interactive video--technology that allows long-distance audiences to view and communicate with each other--to enhance their communities' access to educational and health resources. For example, borrowers in one state belonged to a state-wide industry group coordinating efforts to link their schools through telecommunications and video. Another borrower installed fiber-optic cable to a school to help the school meet expanded curriculum requirements through interactive video. And one borrower is underwriting the transportation costs for local doctors to attend a conference on how interactive video can be used in diagnosing illnesses.

Three telephone borrowers we visited had obtained interest-free REA rural development loans to lend funds to third parties to (1) revitalize a downtown shopping district, (2) expand a nursing home facility, and (3) attract a new business. Ten other borrowers said they will consider applying for an interest-free loan if third parties indicate that they want such loans. For example, one borrower is considering a loan for a business incubator project--to provide common space or equipment, such as computers, for multiple small businesses--and another borrower is considering a loan for a school district to teach students using remote telecommunications equipment. The other two borrowers said that they were not interested in interest-free loans because their service areas were primarily agricultural and did not present opportunities for rural development.

#### IMPLEMENTATION OF REA'S RURAL ECONOMIC DEVELOPMENT LEGISLATIVE MANDATES NOT COMPLETED

REA has implemented less than half of the rural development initiatives cited in regard to its 1987 and 1990 legislative mandates. The mandates, REA's responses to the mandates, and other related actions are summarized below.

#### 1987 Rural Economic Development Legislative Mandates

On December 22, 1987, the Omnibus Budget Reconciliation Act of 1987 amended the Rural Electrification Act of 1936 to establish a Rural Economic Development Loan and Grant Program. The 1987 act authorized the REA Administrator to make grants or zero-interest loans to REA electric and telephone borrowers for the purpose of promoting rural economic development.

On February 15, 1989, REA published final regulations in the Federal Register to initiate the loan portion of the program. REA provided borrowers with regulations and copies of forms to apply for the program. The program provides an interest-free loan to an REA electric or telephone borrower. The borrower, in turn, lends the funds at no interest to a business or another third-party organization that will undertake the rural development initiative. As with any REA loan, the borrower is required to repay the loan to REA even if the third party does not repay the borrower. REA made its first loans in May 1989 and, through September 1991, it had approved a total of 217 loans--about \$18.7 million--to borrowers in 37 states. REA electric borrowers received about \$13.4 million in loans and telephone borrowers received about \$5.3 million. For fiscal year 1992, \$8.4 million was appropriated for telephone and electric loans.

REA did not make any grants under the program through September 1991. REA officials stated that they had received a large number of loan applications and preferred to make loans rather than grants. They said that unlike grants, loan repayments can be used to make additional loans. However, in July 1991, the Senate Agriculture Appropriations Committee directed REA to also make grants. For fiscal year 1992, about \$5 million will be available for grants. On May 15, 1992, REA officials informed us that proposed regulations relating to the grant portion of the program are being reviewed within the U.S. Department of Agriculture (USDA). The officials expect REA to submit the proposed regulations to the Office of Management and Budget (OMB) for review and approval by the end of this month.

#### 1990 Rural Economic Development Legislative Mandates

The Food, Agriculture, Conservation and Trade Act of 1990 (1990 Farm Bill) expanded REA's rural development role by requiring the REA Administrator to establish (1) a position of assistant administrator for economic development, (2) a technical assistance unit to provide rural economic development advice to REA borrowers, (3) a Distance Learning and Medical Link Program, (4) a Rural Business Incubator Fund Program, and (5) an REA Loan Payment Deferral for Rural Development Program. In addition, the 1990 Farm Bill allowed REA telephone borrowers to invest up to one-third of their net worth in rural development projects without REA's approval.<sup>1</sup>

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<sup>1</sup>The 1990 Farm Bill also authorizes loans to REA borrowers to provide water and waste services in areas served by the borrowers. The Secretary of Agriculture determined that the Farmers Home Administration (FmHA) will administer this program. No funds were appropriated for this program for fiscal year 1992.

In late 1991, REA filled the mandated position of the Assistant Administrator for Economic Development and Technical Services and established the Rural Development Assistance Staff. The staff consists of 13 employees who are responsible for processing rural development loan applications and writing regulations for REA's rural development programs.

REA has not provided any grants under the mandated Distance Learning and Medical Link Program. These grants are to encourage and improve the use of telecommunications, computer networks, and related advanced technologies to provide educational and medical benefits to people living in rural areas. The grants are to be made directly to the organizations who use the services, such as schools or hospitals. The REA Administrator was to publish final regulations to implement this program not later than 160 days after enactment--by May 7, 1991. However, REA has not yet published the regulations. REA officials told us that OMB has approved the proposed regulations and REA expects to publish them in the Federal Register this week. The Congress first provided funding--a \$5 million appropriation--for this program for fiscal year 1992.

The Congress has not appropriated any funds for the Rural Business Incubator Fund Program. However, REA has begun preparing regulations for it. This program will provide grants and reduced interest rate loans--not more than 5 percent--for the creation or operation of business incubators in rural areas.

REA has not begun operating the Loan Payment Deferment for Rural Development Program. This program allows REA electric and telephone borrowers to request deferral of principal and interest payments on their existing direct and insured loans if they make an equal investment in a rural development project. REA sent proposed regulations for this program to OMB for its review and approval on April 2, 1992. As of May 15, 1992, OMB had not approved the proposed regulations.

REA has not issued regulations concerning the 1990 Farm Bill provision authorizing borrowers to invest up to one-third of their net worth in rural development. REA officials told us that these regulations are currently being reviewed within USDA.

#### REA Economic Development Conferences

In conjunction with its legislative mandates, REA has also held three rural economic development conferences for borrowers to become acquainted with REA programs and to exchange ideas on economic development issues and projects. In July 1990, REA held its first conference in Denver, Colorado. Representatives from more than 550 REA borrowers attended the conference. In 1991, REA held conferences in Oklahoma City, Oklahoma, and in Raleigh, North Carolina. Representatives from about 120 REA borrowers

attended each of these conferences. For 1992, REA has scheduled conferences for Minneapolis, Minnesota, and Nashville, Tennessee.

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That concludes my statement. I appreciate the opportunity to present this information to the Committee. I would be happy to respond to any questions you and the other Members of the Committee may have.

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