



U.S. Department of Agriculture
Office of Inspector General
Western Region
Audit Report

Rural Development
Lender Servicing of Business and Industry
Guaranteed Loans – State of California
Lender A



Report No.
34601-3-SF
December 2001



UNITED STATES DEPARTMENT OF AGRICULTURE
OFFICE OF INSPECTOR GENERAL
Western Region - Audit
75 Hawthorne Street, Suite 200
San Francisco, California 94105
TEL: 415-744-2851 FAX: 415-744-2871



DATE: December 12, 2001

REPLY TO
ATTN OF: 34601-3-SF

TO: Charles M. Clendenin
Acting State Director
California State Office
Rural Development

SUBJECT: Lender Servicing of Business and Industry Guaranteed Loans
State of California – Lender A

This report presents the results of our audit of lender A's servicing and administration of a Business and Industry (B&I) guaranteed loan made to Tri Star Brick & Block Company. We performed this audit to determine if the lender properly serviced the B&I guaranteed loan and if loan proceeds were used as specified in the loan agreement. During the audit, nothing came to our attention that indicated reportable problems in these two areas.

BACKGROUND

The Rural Business-Cooperative Service, an agency within the U.S. Department of Agriculture's Rural Development mission area, operates B&I loan programs that are intended to (a) finance business projects that create or retain jobs in rural areas and (b) finance projects in all segments of the economy. A B&I loan can either be a direct Government-funded loan or a loan made by another lender on which Rural Development guarantees repayment in the event of a loss. Loan guarantees are typically provided by traditional lenders, such as commercial banks, and to a lesser extent, on loans made by other (nontraditional) lenders. Program regulations require that the lender take all servicing actions that a prudent lender would perform in servicing its own portfolio of loans that are not guaranteed.

In December 1995, Rural Development awarded an 80-percent Loan Note Guarantee to lender A for a \$1.75 million loan used for the construction and operation of a concrete brick and block making plant. The lender restructured the loan on two separate occasions to accommodate the borrower's financial

difficulties. The borrower is currently submitting interest payments at a reduced interest rate and is scheduled to resume making regular monthly principal and interest payments beginning January 2002.

OBJECTIVES

Our objectives were to determine if (1) the lender properly serviced the B&I guaranteed loan by monitoring collateral and submitting required documents to the agency in a timely manner, and (2) loan proceeds were used as specified in the loan agreement.

SCOPE

We performed this audit as part of a nationwide review of the B&I guaranteed loan program. California was selected based on the number of loans outstanding and the dollar value of those loans, the total delinquent amount, and the total loss payments made by Rural Development to honor its guarantees. As of November 1, 2000, the Rural Development California State Office had issued 142 loan note guarantees involving 135 different borrowers with 43 different lending institutions on loans totaling nearly \$220 million.

We judgmentally selected for review 8 of 135 borrowers who received loan note guarantees. We reviewed the 8 borrower loan files considering factors such as (a) loan amount, (b) borrower's location, (c) type of industry, and (d) borrower's fiscal history to select a sample of two borrowers. We reviewed the servicing actions of the corresponding lenders for these two borrowers. Our review of lender A covered servicing actions from FY 1998 to FY 2000. Fieldwork was conducted from December 2000 through June 2001. This report presents the results of our review of lender A. The review of lender B was reported under audit no. 34601-5-SF.

The audit was conducted in accordance with generally accepted government auditing standards.

METHODOLOGY

To accomplish our objectives, we performed the following procedures:

- At the Rural Development California State Office, located in Davis, California, we reviewed Tri Star Brick & Block Company's files to obtain a historical perspective of the case and to determine whether State office controls over the servicing of B&I guaranteed loans were adequate.
- We visited the lender in Fairfield, California, to discuss problems and concerns with the loan and obtain information about its recent purchase of the previous lender. We also reviewed the borrower's financial statements

and lists of collateral securing the loan to determine if loan proceeds were properly used.

- We interviewed the previous lender's Senior Vice President to obtain background information on the loan.
- We visited the borrower in Colusa, California, to conduct a physical inventory of items pledged as collateral and to verify that loan proceeds were used as specified in the conditional commitment.
- We interviewed the borrower's CPA to determine if the correct financial statements were prepared.

AUDIT RESULTS

During our audit, nothing came to our attention to indicate that the borrower did not use the loan proceeds as specified in the loan agreement and that the lender did not properly service the loan. Since we have no findings or recommendations in the report, no further action is required by Rural Development.

We appreciate the assistance and cooperation of your staff during this review.

\s\
SAM W. CURRIE
Regional Inspector General
for Audit