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Highlights

Highlights of GAO-04-647, a report to the Chairman, Subcommittee on Energy Policy, Natural Resources and Regulatory Affairs, House Committee on Government Reform

June 2004

RURAL UTILITIES SERVICE

Opportunities to Better Target Assistance to Rural Areas and Avoid Unnecessary Financial Risk

Why GAO Did This Study

The Agriculture Department's Rural Utilities Service (RUS) makes loans and provides loan guarantees to improve electric service to rural areas. Beyond guaranteeing loans, under a yet-to-be-implemented provision of the 2002 Farm Bill, RUS is also to guarantee the bonds and notes that lenders use to raise funds for making loans for electric and telecommunications services. Fees on these latter guarantees are to be used for funding rural economic development loans and grants. GAO was asked to examine (1) the extent to which RUS' borrowers provide electricity service to nonrural areas and (2) the potential financial risk to taxpayers and amount of loans and grants that the guarantee fees will fund. GAO also identified an alternative for funding rural economic development.

What GAO Recommends

To better target RUS' lending, Congress may wish to consider specifying that the rural area criterion apply to subsequent loans. To provide added funding for rural economic development while avoiding risk, Congress may wish to consider adding a small fee on electricity and telecommunication loans, and repealing the debt guarantee provision. USDA said that Congress has been aware of its lending practices but has not changed them, and that its budget proposes borrowers recertify they serve rural areas; it did not comment on GAO's rural development funding suggestions.

www.gao.gov/cgi-bin/getrpt?GAO-04-647.

To view the full product, including the scope and methodology, click on the link above. For more information, contact Larry Dyckman, 202-512-3841, dyckmanl@gao.gov.

What GAO Found

While the Rural Electrification Act authorizes RUS' lending only in rural areas, borrowers that receive RUS loans and loan guarantees serve not only rural areas but also highly populated metropolitan areas. This condition stems from RUS' loan approval practices. RUS requires that borrowers serve rural areas when they apply for their first loans, but it approves subsequent loans without applying this criterion. Thus, RUS applies a "once a borrower, always a borrower" standard. Since the 1930s when the program began, substantial population growth has occurred in areas served by many RUS borrowers; 187 of the counties in which RUS borrowers provide service are in metropolitan areas with populations of 1 million or more. For example, three borrowers that received over $400 million in loans in fiscal years 1999 through 2003 distribute electricity in the immediate vicinity of Atlanta, Georgia. In contrast, about 24 percent of the counties served by RUS borrowers are completely rural, while the remainder have a mix of rural and urban populations.

RUS estimates, in a worst-case scenario, that the requirement to guarantee lenders' debt could lead to taxpayer losses of $1.5 billion—and GAO estimated that in return for this risk, fees on the guarantees would add about $15 million per year in rural economic development loans and grants. RUS officials believe that while risks are involved, losses are unlikely given the past stability of both the electricity market and the lender that might receive the guarantees. Only one lender is both qualified and interested in obtaining these guarantees. According to financial rating services, that lender is well-regarded, but worked through financial concerns in 2002 and 2003, and faces longer-term risks associated with the changes taking place in the electricity and telecommunications markets that it serves. Recognizing the risks of guaranteeing this lender's debt, RUS proposed certain risk mitigation requirements, such as a reserve against losses. However, the lender's officials have stated that RUS' proposed requirements would make the program unattractive.

GAO identified an alternative with no additional taxpayer risk to add funds for rural economic development loans and grants. If RUS were authorized to charge borrowers a small loan-origination fee of one-fourth of 1 percent on loans it expects to make and guarantee in fiscal year 2005, $24 million in rural economic development loans and grants might be made available. This amount is almost equal to the level provided by USDA's 2005 budget request for rural economic development loans and grants, and would likely have a minimal cost impact on customers of distribution borrowers. This alternative would not include guarantees of lenders' debt. Furthermore, the lender expected to use the guarantees has indicated that, even without such guarantees, it expects to continue being very successful at accessing capital for lending.