Report Dept

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UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D C 20548

CIVIL DIVISION

JUN 18 1969

Dear Mr. Smith:

The General Accounting Office has reviewed the manner in which the Farmers Home Administration (FHA) is carrying out its policies and procedures in Hawaii for providing credit only to applicants who are unable to obtain funds from other sources at reasonable rates and terms. Our review involved primarily an examination of farm ownership, farm operating, and rural housing loans made during the period June 23, 1968, to October 20, 1968. Our review was made pursuant to the Budget and Accounting Act, 1921 (31 U.S C. 53), and the Accounting and Auditing Act of 1950 (31 U.S.C. 67).

On the basis of our review of 61 loans approved by FHA in 3 counties in the State of Hawaii, we concluded that there is a need for more effective reviews by Hawaii county supervisors for the purpose of determining the inability of applicants to obtain credit elsewhere.

The details our finding follow:

REQUIREMENTS THAT FHA LOANS BE MADE ONLY TO APPLICANTS WHO ARE UNABLE TO OBTAIN SUFFICIENT CREDIT ELSEWHERE AT REASONABLE RATES AND TERMS

The laws governing various loan programs administered by FHA were enacted to provide credit for farmers, ranchers, and rural residents who are unable to obtain sufficient credit elsewhere at reasonable rates and terms. Pertinent sections of the law pertaining to the types of loans we reviewed are quoted below.

Sections 302 and 311 of the Consolidated Farmers Home Administration Act of 1961, as amended (7 U.S.C. 1921), which pertain to farm ownership and farm operating loans respectively, authorize FHA to make loans to eligible farmers and ranchers:

> "*** who are unable to obtain sufficient credit elsewhere to finance their actual needs at reasonable rates and terms, taking into consideration prevailing private and cooperative rates and terms in the community in or near which the applicant resides for loans for similar purposes and periods of time."

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Section 501(c) of Title V of the Housing Act of 1949, as amended (42 U.S.C. 1471), which pertains to rural housing loans, authorizes FHA to extend financial assistance to an applicant who must show.

> "*** (2) that he is without sufficient resources to provide the necessary housing and buildings on his own account; and (3) that he is unable to secure the credit necessary for such housing and buildings from other sources upon terms and conditions which he could reasonably be expected to fulfill."

To insure that FHA credit programs do not supplant or compete with suitable credit available from other reliable credit sources, FHA has issued a series of instructions which require each county supervisor to be thoroughly familiar with other sources of credit in his area, and to keep other lenders informed of FHA credit policies. These instructions also require each county supervisor to provide applicants with needed assistance in contacting other credit sources, to verify the financial information furnished by the applicant, and to investigate and document their efforts to obtain private or cooperative financing.

## NEED FOR MORE DILIGENT EFFORT IN REQUIRING APPLICANTS TO OBTAIN CREDIT ELSEWHERE

We examined 61 loans totaling about $774,000 made during the period June 23, 1968, to October 20, 1968. We discussed 34 of the 61 loans with private or cooperative lenders because the information in the loan files indicated that adequate determinations may not have been made to establish that the applicants were unable to obtain sufficient credit elsewhere.

On the basis of our discussions with representatives of lending institutions and our review of the financial information furnished to FHA by these applicants, it appears that for 13 of these loans totaling $136,900, the individuals may have been able to obtain such financing at rates and terms which were generally available to farmers and rural residents in the area. The 13 loans represent about 21 percent of the total number of the loans we examined.

In our opinion, none of the 61 loan files that we examined contained satisfactory evidence showing that adequate determinations had been made to establish that the applicants were unable to obtain sufficient credit elsewhere. In this connection, we found that in 36 of the 61 cases, the county supervisors only required the applicants to furnish loan rejection letters from one private lending institution as evidence of a lack of the availability of outside credit, even though there were other lending institutions in their respective county area. In the remaining 25 cases, we found either no evidence in the loan files that the county supervisors required the applicants to seek credit elsewhere or only an unsupported statement by the county supervisors that the applicants were unable to obtain credit from sources other than FHA.

In discussing 34 of the 61 cases with representatives of private lending institutions, the representatives stated that they would have initially granted loans to 13 of these applicants, providing the applicants were of good character and possessed a satisfactory credit rating. We noted that these same requirements, the applicant's reputation for honesty and meeting his obligations, are prescribed by FHA regulations for use in determining an applicant's eligibility for assistance. These representatives also stated that they would consider refinancing the outstanding FHA indebtedness on 9 of the 13 loans.

In our opinion, the following two cases show a need for more diligent efforts by the county supervisors to require applicants to obtain credit from sources other than FHA.

1. FHA made a $16,320 rural housing loan to an applicant to purchase a house and lot costing $21,320. The individual's family budget showed that at January 24, 1968, he had cash on hand of $11,000, investments and bonds of $3,000, and had a family income of $8,400 in 1967.

   The loan file showed that a local bank granted a loan rejection letter to the applicant because they understood that he could not meet the bank's down payment requirement of about $7,100. Although FHA files contained evidence of other individuals with similar financial conditions obtaining outside credit despite being turned down by this particular bank, there was no evidence of any request made by the county supervisor to have this applicant seek credit elsewhere.

   The manager of another local bank and the assistant manager of a local savings and loan association both advised us that they would have provided the necessary financing to this applicant.

2. An applicant received a $570 operating loan for 1 year at 5 percent annual interest. During the 12 months preceding the time the loan was made, the applicant had a non-farm income of $7,000 and had experienced a $660 net loss in his part-time farming venture. The loan file contained only an unsupported statement by the county supervisor that the applicant had approached his bank for a loan but payments had to be on a monthly basis. The borrower informed us that he had not attempted to obtain financing elsewhere because he understood that banks require monthly repayments and he could only make annual payments.

   An official of a bank in the area reviewed the borrower's application at our request and advised us that his bank would have made a loan to the individual with quarterly interest payments and payment of the principal at the end of the year.

After we brought the 13 loans which we questioned to the attention of the FHA Hawaii State Supervisor, he advised us that his county supervisors will review all borrower's accounts for the purpose of evaluating refinancing opportunities, and that he will personally visit the county offices to assure that diligent attempts will be made to have the borrowers refinance the loans which we questioned during our review.

## Conclusions

We believe that our review has shown a need for more effective management control to insure that funds from private and cooperative credit sources are used in lieu of Government funds to the maximum extent possible as required by FHA policy and instructions which were promulgated to implement the intent of the applicable laws.

To the extent that FHA loans are made when such other financing could be obtained, loan funds may not be available to help other applicants who are solely dependent on FHA for financial assistance, or, if such funds are not needed elsewhere, they could be returned to the Treasury to reduce FHA's borrowings.

## Recommendations

Accordingly, we recommend that the Administrator, FHA, require that the necessary action be taken to see that adequate reviews are made by the county supervisors in Hawaii in determining whether applicants are unable to obtain their financing from private or cooperative credit sources. We recommend also that the Administrator follow-up on the action proposed by the Hawaii State Supervisor concerning the loans which we questioned during our review.

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We would appreciate your advising us of any action which you take regarding the matters discussed in this report, including the results of the review made by the FHA Hawaii State Supervisor concerning the possibility of refinancing existing loans.

Copies of this report are being forwarded to the Inspector General, Department of Agriculture.

Sincerely yours,

Victor L. Lowe

Victor L. Lowe
Associate Director

Mr. James V. Smith, Administrator
Farmers Home Administration
Department of Agriculture