



U.S. SMALL BUSINESS ADMINISTRATION
OFFICE OF INSPECTOR GENERAL
WASHINGTON, DC 20416

AUDIT REPORT
ISSUE DATE: September 22, 2003
REPORT NUMBER: 3-38

To: Lavan D. Alexander, District Director
Dallas/Fort Worth District Office

From: *Robert G. Seabrooks*
Robert G. Seabrooks, Assistant Inspector General
For Auditing

Subject: Audit of a SBA Guaranteed Loan to [FOIA Ex. 4]

Attached is a copy of the subject audit report. The report contains one finding and recommendation addressed to your office. Your comments have been synopsized in the report and included in their entirety at Appendix A.

The recommendation in this report is subject to review and implementation of corrective action by your office in accordance with the existing Agency procedures for audit follow-up. Please provide your management decision for the recommendation to our office within 30 days of the date of this report using the attached SBA Form 1824, Recommendation and Action Sheet. Since the final action has been taken, only your signature and the date of the final action are needed at the bottom the form.

Any questions or discussion of the finding and recommendation contained in the report should be directed to Garry Duncan, Director, Credit Programs Group, at (202) 205-7732.

Attachment

AUDIT OF
AN EARLY DEFAULTED LOAN TO
[FOIA EX. 4]
FORT WORTH, TEXAS
AUDIT REPORT NO. 3-38
SEPTEMBER 22, 2003

The finding in this report is the conclusion of the OIG's Auditing Division based on testing of SBA operations. The finding and recommendation are subject to review, management decision, and corrective action in accordance with existing Agency procedures for follow-up and resolution. This report may contain proprietary information subject to the provisions of 18 USC 1905 and must not be released to the public or another agency without permission of the Office of Inspector General.

**AUDIT OF AN
EARLY DEFAULTED LOAN TO
[FOIA Ex. 4]**

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BACKGROUND

The Small Business Administration (SBA) is authorized under Section 7(a) of the Small Business Act to provide financial assistance to small business concerns in the form of government guaranteed loans. SBA guaranteed loans are made by participating lenders under an agreement (SBA Form 750) to originate, service, and liquidate loans in accordance with Administration rules and regulations. SBA is released from liability on a loan guaranty, in whole or in part, within SBA's exclusive discretion, if a lender failed to comply materially with SBA regulations, the Loan Authorization, or did not make close, service, or liquidate a loan in a prudent manner.

Bank United (lender) was authorized to make guaranteed loans under the Preferred Lenders Program (PLP). PLP lenders are allowed to process, close, service, and liquidate SBA loans with reduced requirements for documentation and prior approval by SBA. In February 2001, the lender was acquired by Washington Mutual Bank.

In January 2000, the lender approved a SBA guaranteed loan in the amount of \$1,750,000 [FOIA Ex. 4] to [FOIA Ex. 4] (borrower) under the PLP program. The purpose of the loan was to purchase an existing gas station and convenience store in Southlake, Texas. Loan proceeds were disbursed in January 2000 and the borrower defaulted 18 months later. The loan was placed in liquidation in October 2001. On August 4, 2003, the lender agreed to a reduced guaranty of \$341,234 due to underwriting and closing deficiencies. On September 4, 2003, the lender released SBA from the guaranty as a result of the audit.

AUDIT OBJECTIVE AND SCOPE

The audit objective was to determine if the early loan default was caused by lender or borrower non-compliance with SBA requirements. SBA and lender loan files were reviewed and district office personnel were interviewed. The loan was judgmentally selected for review as part of the Office of Inspector General's ongoing program to audit SBA loans charged off or transferred to liquidation within 24 months of origination (early default). The audit was accomplished during March through May 2003 in accordance with generally accepted Government Auditing Standards.

RESULTS OF AUDIT

Finding 1 - The Lender Disbursed Loan Proceeds in Violation of the Loan Authorization

The lender disbursed loan proceeds before completing a required environmental study. The borrower defaulted on the loan 1 ½ years after disbursement during which time the value of collateral diminished significantly, primarily due to property contamination. Consequently, SBA was not obligated to honor the guaranty due to the lender's imprudent actions. When these issues were brought to the lender's attention, the lender withdrew its request for payment on the guaranty and released SBA from the guaranty.

The lender was required by the loan agreement to perform an environmental study on the borrowing business property to assess possible environmental risks. Furthermore, no loan proceeds could be disbursed until the lender had sufficiently minimized the risk of any adverse environmental findings. The lender contracted with a private firm to perform a Phase I Environmental Site Assessment to determine if evidence existed at the business site indicating the potential or absence of hazardous substances.

According to SOP 50 10 (4), Subpart A, Chapter 7, “Environmental Considerations,”

“Due diligence and prudent lending practice require a lender to pursue more in-depth investigation when an investigation method indicates a risk of environmental contamination.... If a Phase I Audit indicates more than minimal risk of environmental contamination, the loan officer must either decline the loan or require a Phase II Audit to determine whether there is actual contamination.”

During the Phase I assessment, the contractor found that the Auto Tank Gauging (ATG) control module designed to monitor the tightness of the underground fuel storage system was not working. The contractor recommended that a manual tank and line tightness test be performed at the same time the control module was repaired to ensure that the underground fuel storage system was not leaking. The contractor further advised that a Phase II subsurface investigation may be warranted if the underground storage system fails the tightness test.

In its response to the environmental assessment report, the lender agreed to schedule a tightness test for the week of December 20, 1999. There was no evidence, however, that the test was performed prior to October 2001, the date the loan was placed in liquidation. In January 2002, a Phase II environmental assessment found that there was a release of fuel from the underground storage system which appeared to have impacted the shallow groundwater. The contractor recommended a more in-depth assessment to determine the extent of the groundwater release and what corrective action, if any, was necessary.

According to the lender, the business continued to operate while in liquidation. In March 2003, the lender attempted to recover the personal property from the business, but the borrower stated he had a party interested in buying the property for \$50,000. The sale never took place and the lender recently advised the OIG that it would not perform a risk assessment and planned to abandon the collateral.

Because the environmental assessment performed at loan origination did not include a tightness test for possible fuel leakage and contamination, there was no assurance that the groundwater contamination identified at liquidation did not exist at the time of loan origination. If the contamination had been detected at origination, the loan most likely would have been denied in accordance with prudent lending practices and the loan authorization.

In conclusion, the lender's imprudent actions regarding the assessment of the environmental risks posed by the underground fuel storage system placed SBA at unnecessary and unacceptable risk. Accordingly, under Title 13, part 120 of the Code of Federal Regulations, SBA is not obligated to honor the guaranty.

SBA Released from the Guaranty

The lender released SBA from its obligation on the guaranty as a result of the audit. Therefore, the audit report does not include a recommendation since corrective action has been taken. The final report was modified based on discussions with the Dallas District Office officials and the written response to the audit.

District Office Response

On September 11, 2003, the District Office notified the OIG that the lender had released SBA from the guaranty on the loan to [FOIA Ex. 4].

Evaluation of District Office Comments

The District Office comments are responsive to our audit.

Appendix A



U. S. SMALL BUSINESS ADMINISTRATION
DALLAS/FORT WORTH DISTRICT OFFICE
4300 AMON CARTER BLVD. SUITE 114
FORT WORTH, TEXAS 76155
(817) 684-5500 • (817) 684-5516 (FAX)

DATE: September 11, 2003

FROM: Lavan D. Alexander
District Director
Office of District Director

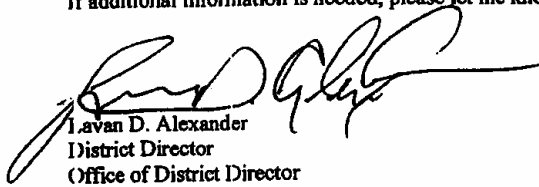
TO: Robert G. Seabrooks
Assistant Inspector General for Auditing

SUBJECT: Audit of an Early Defaulted Loan to [FOIA Ex. 4]

CC: Regional Administrator VI
Office of Field Operation
Office of Financial Assistance

As per our telephonic conversation of 9/04/03, this is to officially notify the Inspector General that Washington Mutual (WAMU) has released SBA of the guarantee on subject loan.

If additional information is needed, please let me know.



Lavan D. Alexander
District Director
Office of District Director
(817) 684-5502

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