EARLY-DEFAULTED

GULF COAST HURRICANE DISASTER LOANS

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Prepared by the
Office of Inspector General
U. S. Small Business Administration

U.S. Small Business Administration
Office of Inspector General

Memorandum

To: Herbert L. Mitchell, Associate Administrator for Office of Disaster Assistance

Grady Hedgespeth, Director Office of Financial Assistance

Date: September 12, 2008

From: **/s/ Original Signed**
Debra S. Ritt
Assistant Inspector General for Auditing

Subject: Audit of Early-Defaulted Gulf Coast Hurricane Disaster Loans, Report No. 08-19

This is the final report on our audit of *Early-Defaulted Gulf Coast Hurricane Disaster Loans*. We initiated the audit in response to the increasing number of defaulted Gulf Coast disaster loans processed by the Small Business Administration (SBA). The objectives of the audit were to determine whether Gulf Coast Hurricane disaster loans that failed within 18 months of the first due loan payment: (1) received adequate screening and credit evaluation during the application process; and (2) were serviced in accordance with loan provisions and regulations.

The audit objectives were accomplished through a review of 117 loan files, which were statistically sampled from 4,985 loans that were at least 90 days delinquent or charged-off as of September 30, 2007. To determine whether the loans received adequate screening and credit evaluation during the loan application process, we reviewed the Office of Disaster Assistance's (ODA) repayment calculations and credit bureau reports for each applicant. To determine whether loans were adequately serviced, we compared loan collection actions taken within the first 60 days of delinquency to Office of Financial Assistance (OFA) servicing standards. We conducted site visits and interviews at the Fort Worth Disaster Assistance Processing and Disbursement Center (PDC), and the El Paso and Birmingham Loan Servicing Centers. We also interviewed ODA and OFA program officials and staff at the Buffalo Customer Service Center, and consulted with representatives from SBA's Office of the Chief Information Officer.

BACKGROUND

SBA provides disaster loans to help homeowners, renters, businesses and non-profit organizations return to pre-disaster condition. As of July 3, 2008, SBA had disbursed 119,656 loans totaling approximately $6.5 billion to victims of the 2005 Gulf Coast hurricanes to help homeowners, renters, businesses and nonprofit organizations return to pre-disaster conditions. Of these loans, 117,633, or about 98 percent, have been fully disbursed.

SBA's Associate Administrator for Disaster Assistance plans, directs, and administers the disaster loan program. Loan approvals and disbursements are processed by the PDC, which is under the responsibility of ODA. SBA's regulations and operating procedures require that applicants have satisfactory credit and repayment ability in order to qualify for disaster loans.[1] However, a previous OIG audit determined that an estimated $1.5 billion in loans approved under the Expedited Disaster Loan Pilot Program were awarded to borrowers who lacked repayment ability.[2]

Once a loan has been fully disbursed, the PDC generally transfers the loan file to either the El Paso or Birmingham Loan Servicing Center, according to the borrower's geographic location. Both of the servicing centers are operated by OFA. Loan files that are missing collateral documents are kept at the PDC until all of the documents are obtained. In these cases, servicing actions must be performed by the PDC until the loan is transferred to a servicing center. We previously reported that 25,352 fully disbursed loans had not been transferred to the servicing centers as of February 8, 2008, and remained with the PDC for servicing.[3]

RESULTS IN BRIEF

Our audit determined that improper loan origination and/or servicing may have contributed to early loan defaults because all but 4 of the 117 loans reviewed were either improperly originated and/or inadequately serviced. Approximately 63 percent of the loans reviewed were approved although the applicants lacked repayment ability or were not creditworthy, and 79 percent were inadequately serviced after becoming delinquent. Projecting our sample results to the universe of 4,985 early defaulted loans, we estimate that approximately 4,815 loans, totaling $98.4 million, defaulted early due to loan origination or servicing issues.

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[1] 13 CFR 123 and SOP 50 30, *Disaster Assistance Program*.
[2] OIG Report No. 07-34, *Audit of the Quality of Loans Processed Under the Expedited Disaster Loan Program*, September 28, 2007.
[3] OIG Report No. 08-17, *Disaster Loan File Transfer and Servicing Delays,* July 18, 2008.

The majority of loans that were not properly evaluated for repayment ability were processed under expedited procedures, which did not include a repayment analysis. For those approved under standard processing procedures, the PDC used incorrect income and debt figures. Loans were approved to applicants with unsatisfactory credit because loan officers inadequately evaluated derogatory credit issues. In addition, the majority of the loans involving credit issues received system-generated pre-processing decline recommendations that were overturned by supervisory loan officers without justification. After the decline recommendations were overturned, the loan applications were forwarded to loan processing and subsequently approved without adequately addressing the derogatory credit issues. PDC managers stated that the unusually high volume of loan applications, coupled with inexperienced staff processing the applications, contributed to the inappropriate approval decisions.

The loans that were not adequately serviced were either assigned to the two disaster loan servicing centers, the PDC, or a combination of the centers. The two loan servicing centers, which were required to follow early servicing guidelines, began servicing loans after 11 days of delinquency. However, the centers did not make all of the required collection calls or distribute all collection letters. In contrast to the loan servicing centers, the PDC did not service its loans until 31 days or more after the loans became delinquent. It also did not make contact with many of the borrowers whose loans it was responsible for servicing. Finally, some loans were transferred to multiple centers during the first 60 days of loan delinquency, which disrupted the Agency's collection efforts.

To ensure that applicant repayment ability and creditworthiness are adequately evaluated, we recommended that ODA's training program re-emphasize that supervisory loan officers must thoroughly review applicant repayment ability to ensure accuracy and must address all derogatory credit issues before loan approval. We did not make recommendations about the servicing of loans as the Agency addressed the deficiencies we identified in its servicing activities during the audit. Specifically, OFA enhanced the Birmingham center's automated capability to call borrowers and transmit collection letters, and ODA agreed to apply the servicing centers' collection guidelines to the PDC operations. After these corrective actions have been fully implemented, we plan to conduct follow-up work to determine whether they have been successful in resolving the problems identified in the audit.

RESULTS

ODA Approved Loans without Properly Evaluating Applicant Repayment Ability and Creditworthiness

The audit disclosed that 74, or approximately 63 percent, of the 117 loans reviewed did not receive adequate screening and credit evaluation during application processing. These loans were approved for borrowers who lacked repayment ability, creditworthiness, or both. Consequently, these loans defaulted within 18 months of the first payment due date. As shown in Table 1 below, 32 percent of the approved borrowers lacked repayment ability, 20 percent were not creditworthy, and 11 percent lacked both repayment ability and a satisfactory credit history. Projecting our sample results to the universe of 4,985 early-defaulted loans, we estimate that approximately 3,182 loans, totaling $69 million, were made to applicants who did not meet SBA's repayment and credit requirements.

Table 1.
Deficiencies in Loan Approvals

Loan Process	Audit Sample	No Repayment Ability Only		Lack of Creditworthiness Only		Repayment & Credit Deficiencies		Total Approvals	
	No.	No.	%	No.	%	No.	%	No.	%
Expedited	46	26	57	3	7	4	9	33	72
Standard	71	13	18	20	28	8	11	41	58
Totals	**117**	**39**	**33**	**23**	**20**	**12**	**10**	**74**	**63**

Source: OIG Analysis of Sample Loans Reviewed

The majority of loans made to individuals who lacked repayment ability were approved under expedited procedures, which did not include a repayment analysis. For example, under expedited procedures, the PDC approved a $31,600 loan to a borrower who had a yearly pre-Katrina income of $3,370. This income was insufficient to cover the applicant's monthly rent and credit card payment, much less an additional loan payment. The remaining loans were approved under standard processing procedures, which included an analysis of the applicants' repayment ability. However, the PDC did not always use correct income and debt figures in its calculations, and supervisory loan officers reviewing the repayment analyses did not detect the calculation errors.

For example, the PDC's repayment analysis of an applicant that was approved for a $79,000 loan overstated the applicant's monthly income by $1,067 and understated his monthly debt by $657. This occurred because the loan officer failed to reconcile wages reported on the loan application with the applicant's pay stub, and did not verify other income used in the repayment calculation. Additionally, payments for an automobile loan, three deferred student loans, and a retail charge account were omitted by the loan officer and were not detected by the supervisory loan officer. Consequently, the PDC determined that this loan had a debt-to-income ratio of 45 percent, when the actual ratio was 98 percent.

Loans were approved to applicants with unsatisfactory credit because loan officers did not adequately assess applicant credit histories or address derogatory credit issues, as required by SOP 50 30. These issues were so significant that the PDC should have declined the loans. For example, the PDC approved a $37,200 loan to a borrower who had a credit score of 591, two unpaid collection accounts totaling $1,858, and two unpaid charged-off accounts totaling $502. In another example, the PDC approved a $40,000 loan to a husband and wife who had credit scores of 576 and 530, respectively. Their credit reports showed 8 unpaid collection accounts totaling $3,817 and three past due accounts totaling $1,012. In both examples, loan officers did not adequately address the borrowers' credit deficiencies before approving their loans.

In addition, of the 35 loans shown in Table 1 as having credit issues (i.e., 23 with only credit issues plus 12 with both credit and repayment issues), 26 received system-generated pre-processing decline recommendations based on credit scores below 580. However, the PDC overrode the pre-processing decline recommendations, and forwarded the applications onto loan processing where the credit issues should have been further evaluated. While flagged in pre-processing, these credit issues were later accepted during loan processing, and the loans were approved.

PDC management stated that the high volume of loan applications, coupled with inexperienced staff hired to handle the surge in loan volume, contributed to improper loan approval decisions. It also acknowledged that the PDC's justification for final loan approval was not adequately documented. Consequently, loan officers involved in the final processing of applications will be instructed to provide complete justifications in the future.

The Majority of Delinquent Loans Were Not Adequately Serviced

Of the 117 sample loans reviewed, 93, or 79 percent, were not adequately serviced during the first 60 days of delinquency. Projecting our sample results to the universe of 4,985 early-defaulted loans, we estimate that approximately 3,962 loans, totaling $77.9 million, were serviced inadequately. As shown in Table 2, 64 of the 93 inadequately serviced loans were assigned to OFA's loan servicing centers in El Paso and Birmingham, 16 were assigned to the PDC, and the remaining 13 were assigned to multiple centers.

Table 2.
Adequacy of Loan Servicing
By Center

Center	**Number of Loans**	**Adequate Servicing**	**Inadequate Servicing**
Birmingham Center	32	5	27
El Paso Center	53	16	37
Subtotal	*85*	*21*	*64*
PDC	16	0	16
Multiple Centers	16	3	13
Total	***117***	***24***	***93***

Source: OIG Analysis of Sample Loans Reviewed

The loan servicing centers are subject to the following time requirements for servicing and liquidating past-due or delinquent disaster loans within the first 60 days of delinquency:

- ***After 10-days past due* -** a collection letter is mailed to the borrower and weekly phone calls commence. While the phone calls are made by the appropriate servicing center, the letters are system-generated and mailed to borrowers by the Denver Finance Center once the loan becomes 10 days delinquent.

- ***At 25-days past due* -** another collection letter is mailed to the borrower and weekly phone calls continue. The appropriate servicing center is responsible for making the phone calls and manually initiating the letters, which are printed and mailed to borrowers by the Denver Finance Center.

- ***At 40-days past due*** – a third collection letter is mailed to the borrower and weekly phone calls continue. The appropriate servicing centers are responsible for making the phone calls and manually initiating the letters, which are printed and mailed by the Denver Finance Center.

- ***At 60-days past due*** **-** a pre-demand letter is mailed and weekly phone calls continue. The appropriate servicing center is responsible for making the phone calls and manually initiating the letters, which are printed and mailed to borrowers by the Denver Finance Center.

In assessing the adequacy of loan servicing, we determined that servicing was adequate if at least 5 of the 8 required calls were made and at least 3 of the 4 required letters were sent. Also, at least one collection call must have been made within 2 weeks of the first required call.

The extent of the servicing deficiencies varied based on where the loans were assigned. For example, the Birmingham center made most of the required phone contacts and initiated the letters, but did not timely execute the initial calls. Loans assigned to the El Paso center were inconsistently serviced due to its reliance on the Birmingham center to perform many of the required servicing actions. Of the 16 loans assigned to the PDC, almost half were never serviced, and the remainder were not serviced until after they were 30-days past due. Finally, an additional 16 loans were transferred between the servicing centers, the PDC, or the Agency's liquidation center during the first 60 days of delinquency, which interfered with the normal servicing cycle.

Servicing Deficiencies at the Loan Servicing Centers

The Birmingham center generally followed OFA's guidelines in servicing its assigned loans, with one exception. The center initiated most of the required letters, and made most of the servicing calls, but did not make the initial calls timely. Instead of starting the sequence of collection calls when loans were 11 days past due, the center generally did not begin making calls until the loans were 30 or more days delinquent. Once the initial call to the borrower was made, most of the subsequent calls were timely. The Birmingham Center Director explained that initial calls were untimely because the center's incoming loan volume exceeded its servicing capability. To increase its capacity to make calls, in June 2007, the center installed a new automated calling system that makes payment requests to borrowers without involvement by the center's staff.

In addition to servicing loans it was assigned, the Birmingham center was responsible for making all required collections calls on loans assigned to the El Paso center during the first 60 days of delinquency.[4] However, due to its excessive loan volume, the Birmingham center was unable to make all of the collection calls for the loans assigned to El Paso. When the Birmingham center

[4] The Birmingham center's responsibilities are outlined in the Agency's Most Efficient Organization (MEO) contract.

did make the calls, the calls were not always timely. In addition, many of the collection letters for loans assigned to El Paso were not sent due to confusion over which center was responsible for initiating the collection letters for these loans. Management at the El Paso center believed that the loan servicing assistant making the collection calls was also responsible for initiating the collection letters. Because the Birmingham center was responsible for making El Paso's collection calls, El Paso expected Birmingham to also initiate the collection letters. In contrast, Birmingham management believed that both centers shared a combined responsibility for these collection letters. According to the MEO contract, the loan assistant making the phone calls was also responsible for initiating the mailing of the letters. Therefore, because the Birmingham center was handling the calls for the El Paso center, it should have also been responsible for the letters. In response to the audit finding, OFA has automated the issuance of collection letters during the first 59 days of loan delinquency. These letters will now be initiated without interaction from the staff at either servicing center.

Servicing Deficiencies at the PDC

All 16 loans assigned to the PDC were serviced inadequately according to the servicing center guidelines. While SOP 50 30 required the PDC to take collection action on delinquent loans that had not been transferred to a servicing center, it did not specify when collection letters and calls were required. The PDC's practice was to begin collection activities when loans were 31 days past due. Consequently, the PDC's practice differed from the servicing center guidelines, which required collection activity as early as 11 days past due. This issue was addressed in a prior OIG audit report, *Disaster Loan File Transfers and Servicing Delays.*[5] In response to that report, ODA agreed to apply the servicing guidelines to its PDC operations.

Servicing Deficiencies on Loans Assigned to Multiple Centers

Finally, we identified 16 additional loans that had been inadequately serviced. These loans had been transferred between the PDC, the loan servicing centers, and the Agency's liquidation center within the first 60 days of delinquency. The transferring of these loans during their delinquency period disrupted normal servicing activities, and may have led to the servicing deficiencies observed.

Actions Taken by the Agency

In response to the audit findings and discussions with servicing center management during the course of the audit, OFA initiated steps to address the

[5] OIG Report No. 08-17, *Disaster Loan File Transfer and Servicing Delays,* July 18, 2008.

servicing issues. For example, capacity has been added to Birmingham's automated calling system so that it can now process all of the calls for loans assigned to the El Paso center. Also, OFA has arranged for the Denver Finance Center to automatically send all of the collection letters to delinquent borrowers associated with loans assigned to El Paso and Birmingham. Additionally, ODA has agreed to follow the same loan collection guidelines as those used by the loan servicing centers, and is making similar arrangements with the Denver Finance Center for the processing of their collection letters. Because management took steps to address the servicing problems identified during the audit, no recommendations were made. However, we plan to review the adequacy of the automated dialing and mailing systems implemented by OFA in the future.

RECOMMENDATION

We recommend that the Associate Administrator for Disaster Assistance:

1. Develop an enhanced training program for all loan officers and supervisory loan officers that emphasizes how to properly evaluate applicant repayment ability and creditworthiness.

AGENCY COMMENTS AND OFFICE OF INSPECTOR GENERAL RESPONSE

On August 4, 2008, we provided SBA with a draft of the report for comment. On September 9, 2008, ODA submitted its formal response, which is contained in its entirety in Appendix IV. ODA stated that it had previously launched a pilot program to expedite the home loan process that based loan approval solely on a credit scoring model. Under this program, applicants with high credit scores were determined to have repayment ability for loans up to a specified limit. However, after conducting an internal review of the loans processed under this pilot program, ODA found that a test for available cash is also needed before approving disaster loans. Therefore, ODA discontinued the pilot program.

ODA concurred with the report recommendation, stating that it had already implemented new training, procedures, and aggressive quality assurance reviews to ensure loans are approved to applicants who demonstrate repayment ability and adequate credit history.

We commend ODA staff for taking prompt action during the audit to address issues that the audit team brought to their attention, and believe ODA's comments are responsive to the report findings and recommendation.

We appreciate the courtesies and cooperation of the Office of Associate Administrator for Disaster Assistance and the Office of Financial Assistance during this audit. If you have any questions concerning this report, please call me at (202) 205-[FOIA Ex. 2] or Pamela Steele-Nelson, Director, Disaster Assistance Group, at (202) 205-[FOIA Ex. 2].

Appendix I. Scope and Methodology

The audit objectives were to determine whether defaulted Gulf Coast Hurricane disaster loans that failed within 18 months of the first due loan payment: (1) received adequate screening and credit evaluation during the loan application process; and (2) were serviced in accordance with loan provisions and regulations.

To satisfy the first objective, we reviewed a sample of 117 loan files from a universe of 4,985 that were at least 90 days delinquent or charged-off as of September 30, 2007. The sample size allowed extrapolation to the universe of loans with a 95 percent confidence level and a 15 percent precision rate. We reviewed the loan files in the Disaster Credit Management System, including loan applications, credit bureau reports, tax returns, and loan officers' decline and approval decisions. To test SBA's computation of borrowers' repayment ability, re-calculated applicant repayment ability according to SBA policy. For each sampled home loan, we followed the "Fixed Debt Method" as outlined in SOP 50-30-5, Appendix 26. For each sampled business or economic injury loan, we followed the "Cash Available to Service Additional Debt Method" outlined in SOP 50-30-5, Appendices 19, 20, and 25. Additionally, we interviewed Fort Worth Processing and Disbursement Center (PDC) officials and consulted with representatives of SBA's Office of the Chief Information Officer.

To satisfy the second objective, we reviewed the same sample of 117 loans for completeness of collateral documents, compliance with requirements for follow-up letters and calls to borrowers, and timeliness of loan file transfers to the servicing centers. Additionally, we conducted site visits and interviews at the PDC, El Paso Loan Servicing Center, and Birmingham Loan Servicing Center. We also interviewed officials at SBA's Office of Disaster Assistance, Office of Financial Assistance, and the Buffalo Customer Service Center, and consulted with SBA's Office of the Chief Information Officer.

To test the reliability of the data in SBA's Loan Accounting System, we verified the accuracy of system data on approval dates, approved loan amounts, and outstanding loan balances.

The audit was conducted between October 2007 and April 2008 in accordance with *Government Auditing Standards* as prescribed by the Comptroller General of the United States, and included such tests considered necessary to provide reasonable assurance of detecting abuse or illegal acts.

Appendix II. Statistical Sampling Methodology

From the population universe of 4,985 approved loans, we randomly selected a statistical sample of 117 to compute our estimate of population values. In statistically sampling, the estimate of attributes in the population universe has a measurable precision or sampling error. The precision is a measure of the expected difference between the value found in the sample and the value of the same characteristics that would have been found if a 100 percent review had been completed using the same techniques.

We calculated the following population point estimates and the related lower and upper limits for the selected attributes using the *Windows RAT-STATS* statistical software program at a 90 percent confidence level. Projecting our sample results to the universe of 4,985 early defaulted loans, we estimate that approximately 4,815 loans, totaling $98.4 million, defaulted early due to loan origination or servicing issues. Accordingly, 74 of 117 loans, or 63 percent, may have been approved to borrowers that lacked repayment ability, creditworthiness or both. In addition, 93 of 117 loans, or 79 percent, may have been approved to borrowers that lacked repayment ability, creditworthiness, or both, as depicted in the tables below.

Loans Approved and Serviced Inappropriately

	Occurrence in Sample of 117 Loans	Population Point Estimate	90 Percent Confidence	
			Lower Limit	Upper Limit
Number	113	4,815	4,606	4,925
Dollar value	$2,310,389	$98,438,369	$84,634,357	$112,242,381

Loans Approved Inappropriately

	Occurrence in Sample of 117 Loans	Population Point Estimate	90 Percent Confidence	
			Lower Limit	Upper Limit
Number	74	3,182	2,821	3,543
Dollar value	$1,632,314	$69,489,254	$56,064,349	$82,914,159

Loans Serviced Inappropriately				
	Occurrence in Sample of 117 Loans	**Population Point Estimate**	**90 Percent Confidence**	
			Lower Limit	**Upper Limit**
Number	93	3,962	3,613	4,255
Dollar value	$1,828,154	$77,891,861	$65,373,477	$90,410,244

Appendix III. Exception List

Legend
R = Repayment only Exception, C = Credit only Exception, B = Both Repayment and Credit Exception

Sample Loan	Loan Number	Approved Loan Amount	Current Balance/Charged-off Amount	Origination Exception	Adequate Servicing
1	FOIA Ex. 2	$15,200	$10,000	C	No
2	FOIA Ex. 2	$10,000	$10,000	B	No
3	FOIA Ex. 2	$14,900	$14,900	C	No
4	FOIA Ex. 2	$19,000	$19,000	B	No
5	FOIA Ex. 2	$31,500	$31,500	B	No
6	FOIA Ex. 2	$8,200	$8,200	C	No
7	FOIA Ex. 2	$20,900	$10,000	R	No
8	FOIA Ex. 2	$42,800	$42,800	R	No
9	FOIA Ex. 2	$21,900	$10,000		No
10	FOIA Ex. 2	$10,000	$10,000	R	No
11	FOIA Ex. 2	$10,000	$9,976	R	No
12	FOIA Ex. 2	$40,000	$40,000	C	No
13	FOIA Ex. 2	$14,800	$14,800	R	No
14	FOIA Ex. 2	$40,000	$40,000	C	No
15	FOIA Ex. 2	$5,000	$4,732		No
16	FOIA Ex. 2	$35,000	$25,500	R	No
17	FOIA Ex. 2	$2,000	$2,000	C	No
18	FOIA Ex. 2	$18,000	$18,000	R	Yes
19	FOIA Ex. 2	$21,700	$12,800	B	Yes
20	FOIA Ex. 2	$29,900	$29,900	B	No
21	FOIA Ex. 2	$29,200	$29,200	R	Yes
22	FOIA Ex. 2	$11,800	$10,800	R	No
23	FOIA Ex. 2	$100,000	$10,000		No
24	FOIA Ex. 2	$23,300	$23,300		No
25	FOIA Ex. 2	$34,500	$25,000		No
26	FOIA Ex. 2	$10,000	$10,000	R	No
27	FOIA Ex. 2	$21,400	$21,400		No
28	FOIA Ex. 2	$90,500	$10,000		No
29	FOIA Ex. 2	$42,300	$10,000		No
30	FOIA Ex. 2	$79,000	$10,000	R	No
31	FOIA Ex. 2	$28,700	$9,920	R	No
32	FOIA Ex. 2	$26,200	$26,200		No
33	FOIA Ex. 2	$2,600	$2,600		No
34	FOIA Ex. 2	$31,600	$31,600	R	No
35	FOIA Ex. 2	$117,200	$8,199		No
36	FOIA Ex. 2	$39,200	$1,280	R	No
37	FOIA Ex. 2	$24,900	$24,900	B	No

Appendix III. Exception List

Legend
R = Repayment only Exception, C = Credit only Exception, B = Both Repayment and Credit Exception

Sample Loan	Loan Number	Approved Loan Amount	Current Balance/Charged-off Amount	Origination Exception	Adequate Servicing
38	FOIA Ex. 2	$4,500	$4,500	C	Yes
39	FOIA Ex. 2	$8,000	$8,000		No
40	FOIA Ex. 2	$32,000	$32,000	C	Yes
41	FOIA Ex. 2	$40,000	$40,000	R	Yes
42	FOIA Ex. 2	$20,900	$11,700	R	No
43	FOIA Ex. 2	$10,000	$10,000	R	No
44	FOIA Ex. 2	$30,000	$10,000		No
45	FOIA Ex. 2	$16,100	$16,100	C	Yes
46	FOIA Ex. 2	$15,300	$10,000		No
47	FOIA Ex. 2	$8,000	$7,907	B	Yes
48	FOIA Ex. 2	$15,500	$15,492		No
49	FOIA Ex. 2	$1,600	$1,509		No
50	FOIA Ex. 2	$30,500	$30,500	R	No
51	FOIA Ex. 2	$29,500	$15,000	R	No
52	FOIA Ex. 2	$39,000	$38,801	R	No
53	FOIA Ex. 2	$42,700	$25,000		No
54	FOIA Ex. 2	$38,000	$38,000	C	No
55	FOIA Ex. 2	$20,400	$20,400		No
56	FOIA Ex. 2	$16,600	$9,745		No
57	FOIA Ex. 2	$12,100	$12,100		No
58	FOIA Ex. 2	$6,500	$6,500	R	No
59	FOIA Ex. 2	$10,000	$10,000	C	No
60	FOIA Ex. 2	$81,500	$10,000		No
61	FOIA Ex. 2	$23,000	$23,000	R	No
62	FOIA Ex. 2	$26,700	$10,000	C	No
63	FOIA Ex. 2	$17,100	$17,100		Yes
64	FOIA Ex. 2	$16,700	$16,700	R	No
65	FOIA Ex. 2	$18,200	$10,000		No
66	FOIA Ex. 2	$91,300	$10,000		No
67	FOIA Ex. 2	$87,200	$85,100	C	No
68	FOIA Ex. 2	$32,000	$10,000		No
69	FOIA Ex. 2	$131,200	$8,974	C	No
70	FOIA Ex. 2	$47,700	$47,975	R	Yes
71	FOIA Ex. 2	$7,200	$7,200		No
72	FOIA Ex. 2	$40,000	$40,000		No
73	FOIA Ex. 2	$7,100	$7,100	R	Yes
74	FOIA Ex. 2	$10,000	$10,000	B	No

Appendix III. Exception List

Legend
R = Repayment only Exception, C = Credit only Exception, B = Both Repayment and Credit Exception

Sample Loan	Loan Number	Approved Loan Amount	Current Balance/Charged-off Amount	Origination Exception	Adequate Servicing
75	FOIA Ex. 2	$74,300	$10,170		Yes
76	FOIA Ex. 2	$57,600	$10,000	R	No
77	FOIA Ex. 2	$24,600	$24,600	C	Yes
78	FOIA Ex. 2	$32,400	$10,000	B	Yes
79	FOIA Ex. 2	$5,100	$5,100	R	No
80	FOIA Ex. 2	$40,000	$40,000	C	No
81	FOIA Ex. 2	$21,100	$10,000		No
82	FOIA Ex. 2	$2,500	$1,978	R	Yes
83	FOIA Ex. 2	$8,100	$8,100	B	Yes
84	FOIA Ex. 2	$23,400	$22,249		No
85	FOIA Ex. 2	$13,500	$10,000	R	Yes
86	FOIA Ex. 2	$40,000	$40,000		No
87	FOIA Ex. 2	$2,500	$2,186		No
88	FOIA Ex. 2	$13,900	$13,900		Yes
89	FOIA Ex. 2	$67,400	$9,963	C	No
90	FOIA Ex. 2	$40,000	$40,000	R	No
91	FOIA Ex. 2	$20,000	$20,000	R	No
92	FOIA Ex. 2	$40,000	$40,000	C	No
93	FOIA Ex. 2	$116,600	$117,075	R	Yes
94	FOIA Ex. 2	$25,100	$18,200		No
95	FOIA Ex. 2	$1,800	$1,800		No
96	FOIA Ex. 2	$19,400	$19,400	R	No
97	FOIA Ex. 2	$101,300	$9,408	C	No
98	FOIA Ex. 2	$26,700	$26,700		Yes
99	FOIA Ex. 2	$40,000	$40,000	R	No
100	FOIA Ex. 2	$40,000	$40,000	B	No
101	FOIA Ex. 2	$38,200	$38,200		No
102	FOIA Ex. 2	$46,900	$46,900		No
103	FOIA Ex. 2	$24,000	$24,000	C	No
104	FOIA Ex. 2	$17,500	$17,500	R	Yes
105	FOIA Ex. 2	$30,200	$30,200	R	Yes
106	FOIA Ex. 2	$35,400	$35,400	C	No
107	FOIA Ex. 2	$92,600	$92,600		No
108	FOIA Ex. 2	$40,000	$10,000		No
109	FOIA Ex. 2	$3,600	$3,457	R	No
110	FOIA Ex. 2	$40,000	$40,000	C	No
111	FOIA Ex. 2	$29,500	$29,500		No

Appendix III. Exception List

Legend
R = Repayment only Exception, C = Credit only Exception, B = Both Repayment and Credit Exception

Sample Loan	Loan Number	Approved Loan Amount	Current Balance/Charged-off Amount	Origination Exception	Adequate Servicing
112	FOIA Ex. 2	$37,200	$37,200	C	Yes
113	FOIA Ex. 2	$5,600	$5,563		No
114	FOIA Ex. 2	$10,000	$10,000		No
115	FOIA Ex. 2	$17,200	$10,000	R	Yes
116	FOIA Ex. 2	$2,000	$2,000	B	No
117	FOIA Ex. 2	$40,000	$40,000	B	No

TOTALS

Loan Origination Exceptions				Loan Servicing Exceptions	
Repayment Only Exceptions	38	Credit Only Exceptions	23		
Repayment & Credit Exceptions	13	**Total Origination Exceptions**	**74**	**Total Servicing Exceptions**	**93**

U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, D.C. 20416

Date: SEP 0 9 2008

To: Debra S. Ritt
Assistant Inspector General for Auditing

From: Herbert L. Mitchell
Associate Administrator [FOIA Ex 6]
for Disaster Assistance

Subject: OIG Draft Report – Early-Defaulted Gulf Coast Hurricane Disaster Loans (Project No. 8302)

We have reviewed the Draft Report regarding the Early-Defaulted Gulf Coast Hurricane Disaster Loans, and we thank you for the opportunity to respond. Our response indicates our concurrence with your recommendation and our explanation of what we have already done to enhance training for all loan officers and supervisory loan officers. Our comments are noted below:

In response to the extraordinary and catastrophic nature of the Gulf Coast Hurricanes, ODA launched a Pilot Program which implemented the Expedited Home Loan Process. This Expedited Process based loan approval on a credit scoring model. To minimize the risk, we limited the dollar amount of the loans that could be processed under the Expedited Process. As a result, applicants with high credit scores were determined to have repayment ability for loans up to a specified limit. After an internal review of the loans processed using the Expedited Process, we determined that a cash available test was a necessary component for processing the disaster loans and, as such, we discontinued the Pilot.

OIG RECOMMENDATION:

We recommend that the Associate Administrator for Disaster Assistance:

1. *Develop an enhanced training program for all loan officers and supervisory loan officers that emphasizes how to properly evaluate applicant repayment ability and creditworthiness.*

ODA RESPONSE:

We agree with the recommendation and had previously taken steps to enhance training for all loan officers and supervisory loan officers.

ODA has made the following enhancements:

1. The entire loan processing staff has undergone comprehensive training to improve quality of the overall loan decisions. The training emphasizes how to properly evaluate applicant repayment ability and creditworthiness.

2. Target training has been developed and delivered to the entire loan processing staff, including SLO staff, on:

   - More Comprehensive Justifications regarding Creditworthiness
   - Repayment Calculations/Analysis
   - Phase II EIDL Training
   - Collateral Training

3. Training for new Loan Officers has been extended from 3 day classes to 5 day classes. This additional time will enable processing Loan Officers to have more detailed instruction to master the processes more quickly and efficiently.

4. In June 2007, the Pre-Processing Decline procedure was replaced by the Pre-LV Review process. This process created a more comprehensive review of credit and repayment on marginal files prior to sending those files for loss verification.

5. Regular Quality Assurance Reviews are performed by the QAR team to ensure files are processed in accordance with Agency guidelines.

We are confident that the enhancements to training and clarification of procedures will have a positive impact on our processing of loan applications in future disasters. As stated above, ODA has implemented new training, procedures, and aggressive quality assurance reviews to ensure loans are approved to applicants who demonstrate repayment ability and adequate credit history.