SEARCHING FOR "THE WAY THAT WORKS"

An Analysis of FmHA Rural Development Policy and Implementation

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By
The Center for Community Change

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CHAPTER ONE

INTRODUCTION

"The right way is the way that works."

— Local Rural Development Advocate
May, 1989

This report is the result of a year-long examination of the rural development policies and programs of the Farmers Home Administration (FmHA) of the United States Department of Agriculture. Essentially, this project had two goals: To evaluate the agency's initiatives on behalf of infrastructure and business development, particularly from the point of view of the low-income rural communities they are intended to serve; and to examine FmHA's administrative philosophy and political orientation, and the manner in which these influence program effectiveness.

How can an agency largely responsible for farm assistance reconcile that emphasis with broad-based rural development efforts, which by their nature are generally nonfarm in nature?

This question is particularly relevant in a time during which rural America is trailing behind urban areas by virtually all social measures, when fewer than thirteen percent of rural Americans rely directly or indirectly on the farm economy for their livelihoods, and when Congress, recognizing these realities, is considering various proposals to markedly change the structure or operation of the Farmers Home Administration. In pursuing answers to this question, we sought to develop a series of policy recommendations regarding administrative structure, delivery mechanisms and program design.

Of course, development is a multifaceted process. Human development programs, such as literacy and preventive health efforts, complement and strengthen more traditional approaches to rural development. Since FmHA's mission has never included these kinds of programs, however, they are not part of our analysis.

Existing programs were evaluated from several perspectives. First, detailed program descriptions were developed, based on a survey of regulations, internal government documents, articles and publications, and interviews with FmHA staff and others. Particular attention was paid to staffing patterns, funding issues, the role of supervised credit and program operations. Next, project staff conducted a series of field visits during 1989 to examine the backgrounds and outcomes of rural development initiatives funded both by FmHA and by other federal agencies. Finally, a database was assembled including relevant information on all FmHA Water and Waste Loan and Grant program and Business and Industrial Loan program projects funded between 1985 and 1988. The data were then analyzed to determine whether these funds appear to have been appropriately targeted to lower income or economically distressed communities, as required by their authorizing legislation.

Twice during the year of study, a broad-based advisory panel composed of state and local officials, local nonprofit technical assistance providers, national rural development specialists and former FmHA staff members met to discuss the results of the analyses, to add their own perspectives, and to evaluate program effectiveness based on a set of criteria developed by the panel and project staff. In addition, a meeting of four former FmHA administrators and state directors was convened to include their perspectives. While these individuals may not necessarily agree with all of our conclusions and recommendations, their involvement and perspectives were crucial and were much appreciated.

Evaluating program effectiveness requires having a good sense of the environment in which programs operate. Accordingly, this report first describes the history of the Farmers Home Administration, then highlights the needs of rural America and the

availability of tools to foster development. Next, it describes five basic models for delivering federal benefits, and develops thirteen criteria by which these delivery mechanisms can be evaluated. The infrastructure and business development programs of the Farmers Home Administration are then described in detail, incorporating information from case studies and the targeting analysis.

Because the Rural Development Policy Act charges the Department of Agriculture with coordinating all federal rural development policy, the department and its lead rural development agency, FmHA, are the focus of federal efforts in this area and of our report.[1] Of course, other federal agencies, such as the Small Business Administration (SBA), Economic Development Administration (EDA), Rural Electrification Administration (REA), Department of Health and Human Services (HHS), Department of Housing and Urban Development (HUD) and Environmental Protection Agency (EPA) also provide support to rural areas for development of infrastructure and business opportunities. A comprehensive review of their programs is beyond the scope of this report, but several are described and compared with those operated by FmHA. The report also examines FmHA internal operations, structure, staffing patterns, and funding levels. Finally, a detailed discussion of policy goals and recommendations is presented.

1 The relevant portion of the Rural Development Policy Act (amending the Consolidated Farm and Rural Development Act), Section 603, reads,

> "(a) The Secretary of Agriculture shall provide leadership within the executive branch for, and shall assume responsibility for coordinating, a nationwide rural development program using the services of executive branch departments and agencies, including, but not limited to, the agencies, bureaus, offices, and services of the Department of Agriculture, in coordination with rural development programs of State and local governments. . . .
> (c)(1) The Secretary shall prepare a comprehensive rural development strategy based on the needs, goals, objectives, plans, and recommendations of local communities, substate areas, States, and multistate regions. . . ."

CHAPTER TWO

WHY RURAL DEVELOPMENT?

Rural America is Losing Ground

The rural development programs described in this report and the people they serve are operating within a rapidly changing environment. The rural economy is rapidly changing. Today, less than three percent of the country's total population (and eight percent of its rural population) works on the farm. Of those who farm, an increasing number must supplement their income with nonfarm work. Today, major sections of rural America are more vulnerable to Chile's copper price-support policy or to Japan's demand for timber than to the price of a bushel of wheat.

Dramatic demand and supply shifts and processing changes in the international markets for raw materials, extractive minerals and energy products portend significant structural, in addition to cyclical, changes in the rural economy at home.

Moreover, over the past five years, the benefits of economic growth have hugged the coastline—growth rates in the 16 coastal states (the East Coast and California) averaged four percent per year, while the rest of the nation faced a 1.4 percent rate. We have evolved into a "bi-coastal economy."

Rural America, is, in short, entering a new era, and it is ill-equipped to survive the change:

- Unemployment in rural areas, adjusted to include underemployment, is one-third higher than in urban areas. According to the Economic Research Service, average earnings per rural worker, after adjusting for inflation, actually decreased during the decade.

- Rural Americans are more likely to be poor than citizens in other parts of the country. One-third more rural residents than urban residents live below the poverty line, and the discrepancy is widening. Rural blacks, rural Southerners and rural female-headed households are substantially more likely to live in poverty than other rural residents.

- Ninety-seven percent of rural residents rely on groundwater wells for drinking; yet a 1984 EPA study found that two-thirds of the rural wells tested were contaminated. Most often, the contamination resulted from toxic pollutants rather than bacteriological contamination.

- Almost two million rural households live in substandard housing units, usually lacking adequate plumbing.

- Maternal and infant mortality rates are substantially higher than those in urban areas and are rising at a faster rate. Rural Americans have disproportionately high rates of serious chronic illness, accidents, and disability. But the health care system is not equipped to adequately serve these needs: Access to care is threatened by acute shortages of health professionals and hospital closures.

- Federal support for rural development was reduced by 67 percent in real terms during the Reagan Administration. Federal funding for rural enterprise development programs at the Farmers Home Administration were cut by 90 percent. Related assistance for community facility development and water systems declined by 50 percent. Overall FmHA rural development funding has fallen from about $4 billion in 1981 to less than $1 billion in 1988. Rural development funding under the Economic Development Administration, Small Business Administration, and other agencies has been similarly cut.

- According to the National Governors' Association, rural residents receive 22 percent less federal support on a per-capita basis than do their urban counterparts. Moreover, support for rural areas is more heavily targeted to income maintenance than to sparking economic growth.

- Although capital reserves at rural commercial banks are on the whole quite adequate, some rural bankers continue to make financing decisions based more on acquaintance with a borrower's reputation than on objective analysis. A newcomer with a promising balance sheet and bright prospects may not get a needed expansion loan.
- In a recent survey conducted by Peter Hart Research Associates, Inc. for Rural Voice, Inc., rural Americans most commonly cited economic problems as their principal source of lifestyle dissatisfaction. Sixty-one percent felt that the government is doing only a "fair" or "poor" job of handling rural issues.

Rural residents facing some of the nation's most difficult economic challenges are forced to do so with significant disadvantages. Rural residents are, as a group, less educated, less healthy, and less skilled than their urban counterparts, they operate in a comparatively static, more conservative business environment, and they receive less help from Washington.

The Financial Climate

Long-term development strategies in rural America must place the private financial system in a central role. On an aggregate basis, rural economies are much more sensitive to changes in the private markets (such as declining interest rates or increasing oil prices) than to limited infusions of public support. Although federal and state programs should provide incentives to correct market failures and help finance "public goods," including infrastructure, the private sector must work out imperfections and provide private credit based on market forces. Are private rural financial institutions able to meet the challenge?

Although dozens of studies have been conducted regarding the availability of private credit in rural areas (see bibliography), few broad conclusions can be drawn. Regulatory agency figures indicate that most rural banks have unusually high reserves, and therefore suboptimal loan activity, at this time. But loan activity can be down for a variety of reasons.

Some argue that bank loan-to-deposit ratios are low because bankable deals are few and far between in rural communities—if good business opportunities presented themselves, banks would finance them. Safety and soundness criteria preclude banks from investing in higher risk deals.

Others argue that small rural banks often are not familiar with public sector programs that can help close the financing gap or provide appropriate terms for proposals, or do not have the resources to manage paperwork and innovative financing programs. Smaller loans generally represent lower risks to a bank, yet paperwork on a small guaranteed loan can consume profit margins to an unacceptable level.

Still others argue that some banks do not meet their obligations to provide credit to creditworthy individuals or businesses in their community. They are unsophisticated in commercial lending, discriminate based on race or favoritism, are hampered by outdated underwriting standards, or rely on inadequate financial analysis.

Like other rural people, rural bankers are operating in a fast-changing environment. Discomfort over the federal budget deficit, slowdowns and sectoral shifts in local economies, and savings and loan closures (many of which are occurring in rural locations) may lead commercial bankers to be more risk averse in their loanmaking. In many areas, deregulation of the banking industry and the rise of interstate banking mean that small rural banks are competing head-to-head with large regional banks which may transfer main office financial sophistication to the local branch, but whose commitment to rural areas may evaporate in tighter times.

These concerns all point to a fundamental premise: Any federal rural business development initiatives should expect private sector participation and support, but also must offer incentives to help banks fulfill their commitments to the community.

The Role of Capacity Building

While a scarcity of credit adversely affects prospects for successful business development, "capacity" shortages can sabotage a community's chances for any development at all.

To get any rural development project off the ground—be it a community water system, a new business or a job training program—a community must have individuals with special ability, initiative, or in certain cases, specialized training to bring the project to fruition. These special skills might include business management, technical analysis, constituency-building, proposal writing, political skills, or accounting. Supported by these skills, a rural

development initiative can gather steam, generate spin-offs and help turn a community around. Without these skills, initiatives too often lose momentum, collapse of their own weight, drop to the end of a politician's priority list, or sit in the "incomplete application" file.

Low-income or distressed rural communities frequently have less capacity than urban areas. Rural development specialists from all levels—from FmHA undersecretaries, to bankers participating at a recent Comptroller of the Currency conference, to nonprofit developers working at the community level—agree that without the grease, without the spark, without the energizing force, development efforts rarely succeed.

Capacity-building support comes from a variety of sources. A local banker might spend evenings working with other business people to offer marketing advice to emerging local businesses; an Extension Service agent might offer accounting training; or a nonprofit organization might work with a low-income community to identify water supply problems and develop a proposal to address them. Communities need the tools to improve their own capacity to develop sustainable long-term community vitality.

The following chapter develops a framework through which to evaluate the effectiveness of rural development programs organized to meet the challenge in rural areas.

CHAPTER THREE

AN EVALUATIVE FRAMEWORK

Rural policy makers continually face a key obstacle to decision making. Given a finite level of resources, how does a government agency make allocation decisions among many communities in need of some form of rural development? Can or should we pick winners and losers? Does the government practice triage, concentrating resources in communities on the margin of economic success while ignoring communities that are far from urban centers and have few natural strengths? Or do we spread resources broadly and thinly, with little anticipation that the small level of assistance will bring success to a community?

After much discussion, members of the advisory panel concluded that:

- The community in question should define its own developmental goals.
- Certain development outcomes should be considered basic human needs. Clean water, improved access to a job, and adequate health care, for instance, should be available to residents in all communities.
- Economic development efforts, on the other hand, should be viewed as opportunities, and should be targeted to communities with basic amenities that express clear commitment to development goals. Size and income alone are not predictors of success. Larger rural communities that may have airports and quality infrastructure but do not display strong commitment to development are less likely to succeed.

These principles, distinguishing between "needs-based" and "opportunity-based" development, can resolve the traditional distributive conflict. They provide part of the framework within which we assess the development programs described in this report.

Project staff and advisory panel members identified a series of delivery mechanisms that public administrators rely upon in delivering federal resources to target populations, and a list of criteria by which those delivery mechanisms can be judged for effectiveness.

Delivery Mechanisms

Domestic federal benefits have traditionally been delivered through one of several mechanisms:

1. Direct payments, services or standard setting—Benefits flow directly from the federal government to individuals or businesses, although often through intermediary federal offices located at the substate level. Examples include: Social Security, farm subsidy programs, disaster loan programs, Food and Drug Administration inspection and regulation, equal opportunity requirements.

2. Grant and loan assistance to communities (broadly defined) through a centralized federal system—Benefits flow directly from the federal government to communities, with administration handled at the national level. Examples include: Economic Development Administration loans and grants, FmHA Business and Industrial Loan program.

3. Grant and loan assistance to communities through a decentralized federal system—Benefits flow from the government to recipient communities through a decentralized (region- or state-level) federal administration. Examples: FmHA Water and Waste Disposal loans and grants, Small Business Administration loans.

4. State block grants—The federal government turns administration of federally supported programs over to the state. The federal government maintains baseline program and reporting requirements, leaving the state with substantial discretion for program design and implementation. Examples:

Small Cities Community Development Block Grant, EPA Waste Disposal Construction Grants (now State Revolving Funds), Job Training Partnership Act grants.

5. Intermediary contracts—The federal government contracts with public or private organizations to "retail" or provide direct services to recipients. Examples: FmHA Intermediary Relending Program, HUD Section 8 Housing Certificate program, FmHA Self-Help Housing program.

Of course, no one delivery mechanism best serves the needs of all federal program recipients: the delivery of programs for substance abusers legitimately differs from that of Social Security programs, while the mechanism used for remedial education programs for low-income urban children differs from those targeted to rural native American children. Indeed, many programs ought not be federally funded at all—many, such as recreation or building inspection, where benefits accrue primarily to local residents, are most appropriately funded out of state or local revenues.

Criteria for Evaluating Development Programs

In designing the most appropriate program for delivering a particular function, policymakers should take into consideration the following factors:

1. Targeting—Does the program target program benefits to that specific population identified by legislation, with little leakage to those not targeted?

2. Coverage—Once the program is properly targeted, is the target population adequately covered by the program, or will some targeted individuals be ineligible for support?

3. Accessibility—Can eligible potential recipients gain relatively easy access to the program through equitable application procedures? Is the decision-making process open enough to allow broad-based input on program structure and administration?

4. Efficiency—Is the program cost effective, or are the costs likely to exceed the benefits (broadly defined)?

5. Accountability—Can recipients and administrators demonstrate to the public that funds are being properly used and that programmatic objectives are being met and evaluated for improvement?

6. Flexibility—Does the program allow administrators and recipients the discretion they need to meet program goals, properly cover the target population, and at the same time support innovation and creativity?

7. Capacity—Do administrators have the organizational capacity to handle the paperwork, the level of programmatic sophistication, or the volume of activity to be generated by the program? Also, does the program help communities build capacity to better solve their development problems?

8. Performance—Does the program have the necessary management incentives, appropriate workload targets, and political support to help ensure that performance is up to expectations?

9. Technical Assistance—Is technical assistance and follow-up provided at the management and recipient levels to help maximize the effectiveness of the federal funds provided?

10. Leveraging—Does the program leverage nonfederal dollars for program objectives through matching requirements or other incentives for nonfederal involvement? In communities for which a leveraging requirement would prove onerous (small tax base, very low income), are in-kind matches allowed or are other accommodations made?

11. Outreach—Does the program market itself effectively to potential beneficiaries?

12. Context—Is the program integrated appropriately among other federal, state, or local programs applicable to the community?

13. Political Context—How does the political environment affect administration of the program, and with what effect upon beneficiaries?

How do the delivery mechanisms themselves measure up when evaluated by the criteria outlined above? Each mechanism has specific programs for which it works well, perhaps better than the alterna-

tives. Analyses appropriately tend to evaluate effectiveness on a program-by-program basis rather than at a broader level. Nevertheless, some conclusions can be drawn.

Direct payment programs tend to work best when eligibility criteria for the targeted population are well-defined and easily verifiable, when coverage is relatively easy to adjust, when discretion is less important, and when interaction between recipients and the government is infrequent.

For instance, there are few arguments in favor of decentralizing the Social Security retirement program. The program was established not as a need-based welfare program, with regional variations based on costs of living or political support, but rather as a variation on an annuity program. Those who pay into the system receive a basic pension in return. Given the national scope and guidelines, the program is most efficiently operated at the national level.

Centralized administration of loan and grant programs works best under similar circumstances as well as in situations in which a high level of substantive or administrative sophistication is required. As currently construed, EDA loan and grant programs are targeted to communities throughout the country exhibiting relatively straightforward characteristics—high unemployment, low income, with a project consistent with the area plan. Criteria are narrowly defined, flexibility is not a high priority, and efficiency in processing and servicing loans is enhanced through centralized operations.

Decentralized federal administration appears most appropriate for programs with a relatively well-defined target population and relatively few needs for program discretion. In contrast to the centralized administration described above, these programs might involve significantly more program follow-up and technical assistance, and administrators might want to ensure that recipients take advantage of other state or locally sponsored programs. Farm and public assistance programs both fit this delivery mechanism well.

For instance, the FmHA Water and Waste Disposal program operates primarily through the district offices. Staff are responsible for working directly with local communities to assemble a complete funding proposal, and make funding recommendations to the state community programs chief. District officials familiar with local needs, construction techniques, and state level sources of funding can generally do the job more effectively than can a remote administrative entity in Washington.

Block grants picked up increasing support as the delivery mechanism of choice in the '70s and early '80s. This was in part a response to "state's rights" pressures and local frustration with the federal bureaucracy. The shift also provided an opportunity to reduce federal spending in certain program areas. Under the block grant approach, the federal government either "folds in" several older categorical grants or creates a new program which is funded by the federal government but administered by the state government with a minimum of federal interference or oversight.

The Community Development Block Grant, for instance, offers states and localities maximum discretion in designing a structure to meet what they perceive to be the physical needs of low-income people in their communities—rather than meeting needs as defined by the federal government. There is wide latitude; programs developed by states and entitlement communities may fit many of the design criteria outlined above, or they may fall far short of meeting those goals.

This flexibility is at once the mechanism's biggest selling point and its most serious weakness. It adds a second dimension of uncertainty to predicting the delivery mechanism's success: Federal block grant program administrators may be uncertain regarding state competence and leadership, but they are also uncertain about the program's design and operation. Moreover, because members of Congress frequently are not familiar with activities funded through block grants at the state level, their political support for the programs dissipates.

Finally, federal programs (generally of a smaller scale) can be administered through state or local public or private intermediaries. In these relationships, the federal government can reserve for itself many of the benefits of centralized or decentralized federal administration, such as targeting, coverage, and accessibility, while taking advantage of an organization's local contacts, expertise, and resources.

These intermediary relationships offer the government an opportunity to fill gaps, to more successfully address a narrow but hard-to-serve portion of the target population, or to offer a limited but important service. At the same time, the government can demand greater accountability and exert leverage over performance through the prospect of discon-

tinuing the contract—an option not available under other approaches.

The Intermediary Relending Program administered by the FmHA exemplifies the intermediary contract. Nonprofit organizations with specialized management and financial skills work with a narrow segment of the business community—rural business people with good business plans and potential employment opportunities—to help them meet their financing needs and start or expand their businesses.

The next chapter describes the history of FmHA and the beginnings of its rural program.

CHAPTER FOUR

FmHA—The Agency's History

FmHA in its Historical Context

The Farmers Home Administration was created in 1946 to succeed the Farm Security Administration and the Resettlement Administration, both of which were created during the New Deal. At that time, the majority of rural Americans worked on farms, so assistance programs were targeted primarily to agricultural needs, and were only indirectly aimed at responding to broader rural needs.

Prior to 1946, the two predecessor agencies administered a range of programs which bolstered a farm economy hard-hit by the Depression: farm ownership and operating loans, resettlement programs, migrant worker assistance, medical care, and water facilities development. In 1946, the Farm Security Administration was abolished, and many of its programs, along with the Emergency Crop and Feed Program of the Farm Credit Administration, were consolidated into the Farmers Home Administration. In addition, the new agency was authorized to finance its previously authorized loan programs through loan guarantees.

In its early years, the FmHA solidified its network of county offices, and expanded its farm programs. The 1949 Housing Act authorized FmHA to administer the component of the nation's market-rate housing loan program targeted to farm families.

In the early '60s, FmHA shifted its focus away from exclusively farm-based programs toward programs intended to benefit rural communities regardless of their resource base. For example, nonfarm rural residents became eligible for single family housing assistance in 1961. The predecessor to the present Section 515 rural multifamily housing program, the low-rent senior citizen housing program, was authorized in 1962. Section 515 of the 1968 Housing Act opened participation up to all rural dwellers. The Consolidated Farmers Home Administration Act of 1961 brought FmHA's water program, which had been restricted to farm customers in the western states, to small rural communities throughout the country. Programs authorized in 1962 and 1964 augmented farmers' incomes with nonfarm sources through enterprise loans.

Since the '60s, FmHA's programs have evolved in several directions: programs formerly available to the smallest of rural communities became available to larger and larger (though still rural) communities; programs were targeted more carefully to low-income rural residents; loan programs have grown as grant programs have contracted and the federal government increasingly relies on loan guarantees; and a variety of smaller programs have been developed to fill programmatic gaps. For example, self-help housing programs were established in 1969, along with small scale enterprise loans.

The FmHA farm, housing, and rural development loan portfolio has exploded sevenfold since 1970, when outstanding loans totalled $20 billion. Over $140 billion is currently lent to nearly 10 million borrowers.

The Rural Development Act of 1972 initiated several institutional and programmatic changes that further emphasized the organization's shift from an agricultural agency to one with a broader rural focus. The Act established the position of Assistant Secretary for Rural Development (later changed in the Rural Development Policy Act of 1980 to Undersecretary for Small Community and Rural Development) and gave USDA responsibility for rural development policy coordination, supported rural planning efforts through planning grants, and authorized new loans and grants for community facilities and industrial development.

Despite the longstanding change in policy, FmHA continues to emphasize farm programs over housing or community development programs (although all FmHA programs have been cut from their 1981 funding levels). In FY 1986, total farm loan and grant obligations were twice as large as

housing obligations, and nearly eight times as large as rural development expenditures.

The Reagan years were most notable for significant cuts in funding for FmHA programs. Farm program obligations declined by half, housing programs were cut by over 50 percent, and FmHA's rural development program suffered cuts totalling 67 percent between FY 1981 and 1987.

The most recent agency initiatives, originating within the Congress rather than the administration, improved targeting to low-income rural residents and increased the range of support programs available to the ailing farm community. The 1984 Farm Credit Initiative and the Food Security Act of 1985 included support in the form of interest write-downs and loan guarantees for financially troubled farmers.

Current FmHA Rural Development Programs

The Farmers Home Administration, through its district, state, and national offices, administers six distinct loan and grant programs within the community development area: The Water and Waste Disposal Loan and Grant programs, the Community Facilities Loan program, the Business and Industrial Loan program, the Industrial Development Grant program and the Intermediary Relending Program.

The first three programs (all of which fit within the decentralized program model) are clearly aimed at bringing basic amenities to low-income rural communities, both to improve the quality of life for residents and to improve prospects for long-term economic development. Typical projects provide financing for water and waste disposal systems, or health care facilities for those at great distance from a health clinic or hospital. In a sense, these programs create the physical and social foundation upon which enterprise development can take place.

The Business and Industrial Loan (B&I) program, a centralized program, along with the more recently funded Industrial Development Grant (ID Grant) and Intermediary Relending Program (IRP), both intermediary contracting programs, were developed to address a different need. Rather than construct very tangible community assets, such as a health clinic or a water treatment facility, B&I, ID Grant, and IRP borrowers and grantees invest in new or existing local businesses, create new job opportunities, or protect scarce existing jobs. Although the investment may be physical (for example, the expansion of a production facility, construction of an industrial park), the goal is more intangible: to stimulate economic expansion and improved job prospects within the local economy.

Despite the dramatic differences between infrastructure and enterprise development, and despite the variations in administrative models designed to implement the programs, all six programs are, in practice, administered in roughly comparable ways, and in many cases, by the same FmHA personnel. In the state office, the Community Programs Chief oversees the business enterprise and infrastructure programs, and generally evaluates their success based on the same criterion—default rates.

The state directors, who are political appointees, have significant control over all funding decisions, whether the final decision is technically made at the state or national level. Although the funding process appears objective and includes criteria and a point system, state directors have discretion to guide funding to one program area over another, and from one applicant to another. All six FmHA programs are governed by broad regulations addressing concerns such as intergovernmental review, equal opportunity requirements and environmental review.

FmHA programs operate within a framework of evaluative criteria based more on financial than functional success. Administrative officers appropriately evaluate debt capacity, fiscal accountability and loan servicing, attaching comparatively little weight to functionally based criteria such as jobs produced or mortality and morbidity curtailed. Yet, from the perspective of the community served, these factors more accurately reflect the overall, long-term success of the government's effort.

Program Financing

To finance subsidized and guaranteed rural development loans, Congress established the Rural Development Insurance Fund (RDIF) as part of the Rural Development Act of 1972. In past years, FmHA sold notes comparable to mortgage-backed securities—called Certificates of Beneficial Ownership or CBOs—to the Federal Financing Bank (FFB), an arm of the Treasury Department, at the government borrowing rate. Proceeds from these sales, along with repayments from previously issued loans, were then used to finance water and waste disposal loans and community facilities loans.

The mechanism remains the same with one exception: The FFB is no longer involved in the transaction. The FmHA, through the RDIF, now borrows directly from the Treasury. Nevertheless, the FFB still holds CBOs issued by the RDIF under the old arrangement. This convoluted arrangement is atypical of most federal financing, but typical of Department of Agriculture loan program financing. Both farm and housing programs maintain comparable insurance funds. The funds have the effect of obscuring the true cost of most federally assisted lending in rural areas.

The difference between the Treasury rate and the effective rate on the RDIF loan portfolio determines the subsidy, as perceived by the Treasury, to programs financed out of the RDIF. Each year, Congress appropriates a sum of money, known as the "Reimbursement for Losses to the RDIF," to reimburse the fund for this subsidy and any losses incurred through default or delinquency on direct or guaranteed loans.

Subsidies, delinquencies and defaults in the current year are hard to predict, however. Congress gains certainty in its budget process by simply reimbursing the fund for new subsidies and losses on its entire loan portfolio two years after they occur. So, for example, the FY 1989 Appropriation Bill reimbursed the fund $1.607 billion for portfolio subsidies and losses that actually were incurred during FY 1987.

This certainty carries a price. First, because Congress does not account for subsidies or losses until two years after they occur, large potential liabilities (primarily attributable to the Business and Industrial Loan program losses and inflation effects) can build up in the fund without Congress's explicit recognition of those liabilities. Second, in times of tight budgets, Congress has intermittently declined to reimburse the fund for its losses during a program year. Although the practice has been discontinued, the fund borrowed to cover those gaps in reimbursements, and continues to roll the debt over.

Moreover, when Congress repays the fund for subsidies and losses, it does not "gross up" the payments to account for the time value of money during the two-year lag. Again, the budget reflects less than the true value of the losses by not accounting for inflation effects and the discount rate. On a typical $6 billion RDIF balance, the budget could underestimate $22 million per year in portfolio costs (assuming a three percent loan subsidy and a six percent discount rate) because of the accounting lag.

In December 1988, the General Accounting Office issued an audit of the Farmers Home Administration which concluded that problems such as those outlined above had helped build up an unacknowledged $3 billion deficit within the RDIF. The agency's entire deficit totalled $36 billion, according to the GAO.

In 1986, the Congress mandated an additional action on the part of FmHA that affected the RDIF. The Omnibus Budget Reconciliation Act of 1986 required FmHA to generate $2.1 billion in net revenues between 1987 and 1989 to reduce the deficit. In those years, FmHA met this requirement through two methods: it allowed municipal borrowers to buy back (and privately refinance) their FmHA loans at a discount, and it offered FmHA loans for sale to the public. In both cases, FmHA received cash up front, in exchange for notes which promised repayment at specified interest rates over time.

In 1987, the agency sold loans with a face value of $1.9 billion for just over $1 billion. The difference between the face value and the net proceeds (called the discount), is largely attributable to the difference between the rate the assisted borrower paid on the subsidized note and the market rate at the time of the sale for notes of comparable term and risk, along with transaction costs.[1]

Each year, the agency has agreed to offer communities the "buy back" option only with Congressional pressure. From the perspective of a community which is shortly slated to "graduate" from a subsidized loan to a private sector loan at market rates, the buy back option is a significant windfall. From the agency's perspective, the buy back or loan sale programs simply shift near-term deficits into the future. In exchange for a short term cash infusion, the agency loses long-term revenue streams. (Additionally, when the notes sold include CBOs held by FFB, the RDIF must reimburse the FFB at the time of the sale for the value of the discount from face value.) The FmHA will have to go back to Congress in future years to reimburse the RDIF for these lost revenue streams.

FmHA's needs-based programs are described and evaluated in greater detail in the next two chapters.

1 Just as in the treasury bond market, a bond buyer is willing to pay more than the face value of a bond if the interest rate is higher than the market rate, but lower than the face value if the interest rate on the bond is lower than the prevailing rate. In either case, the transaction generates a market rate yield. In almost all cases, the loans sold under the loan asset sale carried rates substantially below market, and the portfolio sold at a 50% discount.

CHAPTER FIVE

NEEDS-BASED PROGRAMS

Community Facility Loans

The Rural Development Act of 1972 authorized the Community Facility Loan program[1] which provides loans to low-income rural communities for a wide variety of purposes. Since 1972, nearly $2.4 billion has been lent to 5,200 borrowers; in Fiscal Year 1987, 217 borrowers received $95.7 million in loans. Each year, the program carries a backlog of approximately $150 million in eligible projects into the next year.

The program funds construction of health clinics, day care centers, infrastructure (bridges, certain electric and gas service), fire protection facilities, equipment, administrative offices in support of basic community needs, or activities necessary to construct these facilities such as relocation of buildings or purchase of rights of way. Communities may not use community facilities monies to refinance existing debt, except in limited circumstances.

Although community centers and cultural facilities are eligible for funding, recreational facilities and telecommunications projects (including television dishes and antennae) are not. A project must be available for public use. Moreover, if built under the auspices of a private nonprofit organization (such as a local health clinic), the facility must revert to public or nonprofit control should the original corporate owner be dissolved.

1. Administration

Responsibility for the Community Facilities program, along with the Water and Waste Disposal Grant and Loan programs which are administered under the same regulations, is shared by the FmHA state director, the district director, and the county office. The county office is theoretically responsible for working with the applicant to generate a pre-application, which is forwarded to the district office; but in fact most pre-applications are handled entirely at the district level.

The district office has 45 days to respond to the pre-application. Once the pre-application is approved, a more detailed application is submitted directly to the district office which processes and scores the application, determines need, project feasibility and eligibility, assesses any adverse environmental impacts, and assures that the application is consistent with the objectives and plans of other government entities in the area and is not discriminatory.

Projects are compared against competing proposals based on indicators of population, health impacts, income, proportion of private financing, and other factors (see Figure A in the Appendix). In addition, the state director may assign an additional 15 points for emergency situations or special circumstances.

The district office forwards completed applications, along with scoring sheets and recommendations for funding, to the state office for review by the staff engineer, architect, and community facilities chief. If the project scores well at the state level, and the state director determines that credit is not available at "reasonable" rates from local financial institutions, and if the state director expects adequate funding to be available within the coming 12 months, he/she authorizes the district director *to assemble* a project summary (including project requirements and terms), and to issue a Letter of Conditions. This letter is not an indication of loan approval, although the applicant is required to return a Letter of Intent to Meet Conditions, and applicants frequently assume that a favorable decision has been made.

At this point, the state director has a problem. On the one hand, the regulations indicate that he/she should encourage applicants to generate a range of fundable applications, so the director can pick the best among them. The regulations urge the director to identify eligible applications whose project costs total 150 percent of the state allocation. On the other hand, he/she should forward to the national office for final approval only those projects that can be

funded out of the state allocation expected over the coming 12 months.

After committing funds through the FmHA Financial Office in St. Louis, the state director may sign the grant/loan agreement. The Office of General Counsel provides the district director with loan closing instructions, although the state director must sign off on contracts involving third parties (such as architects). Any substantive changes in the project must be approved by FmHA.

2. Funding Formulae

To ensure that each state receives a baseline share of the national funds, FmHA has developed a formula by which states are allocated funds for the Community Facility and Water and Waste Disposal Loan and Grant programs in an identical manner.

First, the annual appropriation is decreased to accommodate the National Office Reserve (a discretionary account whose size varies by program), and any administrative allocations (usually for the West Pacific Territories and the Virgin Islands).[2] Then, a "State Factor" is derived by assigning 50 percent weight to the state's percentage of total U.S. rural population and 50 percent to the state's percentage of total U.S. rural population living below the poverty line, as identified by the most recent census.

Essentially, the state factor is multiplied by the amount remaining from the appropriation for each program to generate the state allocation. Each state must receive a floor amount based on the value of an average loan or grant in that state from the previous year. Unused funds, which consist of allocated but unobligated funds from states and leftover monies from previously funded projects, are pooled at mid-year and again near the end of the fiscal year. These funds, which have been averaging around $7.5 million in recent years, are deposited into the reserve and become available for reallocation based on the administrator's priorities.

3. Interest rates

Community facilities monies are available at three levels of interest rate subsidy: poverty level, intermediate level and market level. Essentially, the financial condition of the community, in conjunction with several other factors, determines the rate that a community will pay on its FmHA loan. Neither Congress nor the agency sets aside a finite proportion of funds at each interest rate.

If the community median income falls below the poverty line or below 80 percent of the statewide nonmetro median income, the funds are offered at five percent interest. If the median income is above that level but below 100 percent of nonmetro median, the rate is halfway between the poverty rate and the market rate (with a seven percent cap on the intermediate rate). All remaining eligible projects, if funded, borrow at the "market" rate, which is set quarterly and is defined as the average of the previous four weeks' Municipal Bond Buyer's Index rate. The market rate is subsidized to the extent that rural communities generally cannot secure financing at the Index rate in the private sector, and loan terms under the program are generally twice as long as the private sector's typical 20-year term.

An additional requirement applies to any project eligible for the five-percent rate: It must serve to correct health and sanitary problems which violate some applicable standard or guideline. Roughly 70 percent of Community Facilities projects in the early years and 50 percent of more recent projects involve health care facilities, which are not built in response to defined health and safety standards. As a result, less than one percent of total Community Facilities loans have been lent over the years at the five-percent interest rate, while half of the remaining projects have qualified for the intermediate rate and half have qualified for market rate financing.

In contrast, the water and waste disposal loan program (discussed below) lends 20 percent of its loan funds at the five percent rate, 50 percent at the intermediate rate, and 30 percent at the market rate.

The regulations indicate that FmHA seeks to improve the availability of needed community services in rural communities through the Community Facility program, but also to improve the management and long-term viability of existing community services or facilities. For instance, FmHA would support the consolidation of several health-related functions into a single new facility where it can be demonstrated that consolidation would improve the efficiency and quality of the services provided. Moreover, nonprofit providers often are strained by ever-increasing space costs. If an organization could amortize the costs of a new building at low interest over 30 years, its space costs would stabilize or in some cases, would actually decline. When major financial costs stabilize, of course, the organization itself is strengthened.

This feature of the program is illustrated in St. Johnsbury, Vermont, where FmHA Community Facilities funds were used to construct an administrative office for an area-wide health services agency.

Case Study: Northern Communities Health Care, Inc.

David Reynolds is the Director of Northern Communities Health Care, Inc., an organization resulting from the merger of two other organizations: a home health care agency which provided services to people, generally elderly, who would otherwise be institutionalized, and a rural health care agency employing National Health Service Corps doctors and nurses to provide primary health care in the surrounding rural areas. Reynolds is the former director of the latter organization, which itself had originally been a health care planning agency.

The two organizations worked closely together over the years. A state Health Services Agency study concluded that both could improve effectiveness and save substantially on administrative costs if they combined efforts and administrative facilities. Eventually, the two organizations merged, and, in October 1986, applied for an FmHA Community Facilities loan to build a joint administrative office.

The unified group operates in the Northeast Kingdom region of Vermont. In 1980, the two counties served by the organization reported that approximately 16 percent of the population lived below the poverty level, compared to 12 percent statewide. In 1986, per capita income averaged about 77 percent of the statewide median. While unemployment rates are now quite low, at the time the administrative building was constructed, rates in the Northeast Kingdom were 40 percent higher than in the rest of the state. Finally, the area is designated by the Department of Health and Human Services as having significant unmet health needs. Northern Communities Health Care is the only health care provider in the area that offers health services to lower-income residents.

Northern Communities Health Care, Inc. has a complex structure: there are five geographically based service areas, each with its own members and advisory committee. Members of the board of directors are elected from the advisory committees. Sources of operating income include: Medicare and insurance payments for home health care, hospice and homemaker work, a Retired Senior Volunteer Program (RSVP) grant, along with significant support from the Town of St. Johnsbury, fund drives and miscellaneous contributions.

1. The project

Prior to construction of the new facility, both precursor organizations had extreme space problems. Staff in the home health care agency maintained offices in closets and converted shower stalls, while the public health nurses operated exclusively out of their cars. Morale in both organizations was low, and the merger process was not producing positive results, particularly given that the organization continued to operate out of two separate locations.

When the space crunch came to a head, the agency's board formed a three-member Building Committee to consider options. One member was a real estate agent who suggested the possibility of buying or building a new facility. Working with a local contractor, he developed rough cost projections, and the organization began to focus on resolving the space shortage by undertaking new construction.

NCHC Director Reynolds worked with Steve Danforth, a former financial analyst and architect at a nearby community development corporation and principal in E. H. Danson Associates, a small local architectural firm. In effect, Danforth became the intermediary for the project. He had worked with FmHA staff on other projects, was familiar with Community Facilities program requirements, and was comfortable working with a nonprofit organization with a volunteer board. Rather than simply offer design options as might a conventional architectural firm, Danforth walked the board through financing alternatives, packaged the loan, and acted as project manager.

Danforth says his firm is known for its financial analysis. Because he is familiar with federal and state financing programs, he can often use those financing sources to develop a package that will "go" where conventional financing would not. He emphasizes to clients that a building is more than just construction costs. "Soft costs" such as design and engineering, site preparation and permitting can total 30 percent of overall project costs. As Danforth discusses these facets of project management with a client, he enhances the client's sophistication and understanding of the issues, and builds capacity.

The agency submitted a pre-application for a loan totalling $186,767 in early October 1986. The pre-application was informally written during an hour-

long meeting at the FmHA District Office in Laconia, New Hampshire. Danforth says that FmHA staff will often make recommendations that will improve a project's prospects in the scoring process.

David Reynolds wrote the final narrative for the proposal, while Steve Danforth completed the financial data. The proposal called for the agency to contribute $55,000 (proceeds from a grant), for a total project cost of $241,770. The final interest rate was set at 6 5/8 percent.

The 4,600 square foot facility was to be built on land leased to the agency over 99 years for $1 per year. The leasing arrangement caused some administrative delays before final project approval came in November 1986. In addition, time was consumed as the state delayed permit issuance. In Reynolds's opinion, the FmHA district director was essentially responsible for the final funding decision.

The construction contract was signed in May 1987, and work was completed by September. Only $1,200 in change orders were required for the $250,000 project. The project generated 25 short-term construction jobs, and six additional part-time staff positions.

Since this project was completed, the organization has built two other service facilities, including a project financed in part with a $160,000 grant from the Department of Health and Human Services Rural Health Initiative grant program for operating or capital "expansion opportunities." Clearly, the organization's success with the administrative facility spurred these efforts.

David Reynolds outlines the following benefits that have accrued to the agency as a result of the Community Facilities Loan project:

- substantially increased effectiveness in providing medical care and health care counseling to clients;
- operating space doubled, while space costs actually declined;
- greater sense of organizational stability (and therefore job security) for staff;
- improved image at state and local level (membership has increased substantially to 2,500—10 percent of the adult population in the service area);
- counseling is now provided in-house rather than at other agencies' facilities. The community presence has improved;
- space costs are contained as debt service payments on the building are locked in;
- much higher morale among staff (who were consulted on building design).

Reynolds emphasizes that agencies administering funds for projects like these must understand that staff of recipient organizations probably have never built a facility before, and may never build another. He has nothing but praise for the district office FmHA staff, although he relied heavily on Steve Danforth's familiarity with the FmHA process throughout the project.

2. Working relationships with the agency

Danforth has worked closely on federally assisted projects with FmHA and the Department of Housing and Urban Development (HUD). His relationship with FmHA seems comfortable. If a problem develops on a project or a program requirement seems unnecessary or counterproductive, Danforth calls the FmHA office and tries to resolve the conflict. From time to time, FmHA's Laconia, New Hampshire office has argued on Danforth's behalf for a regulatory reinterpretation in order to move a project along.

The complexity of projects administered by FmHA and HUD is roughly comparable. But Danforth sees HUD staff working on Section 8 projects as much less flexible and independent. He says that staff are unfamiliar with financial issues and do not understand construction problems in northern climates or issues peculiar to rural areas. HUD staff are, he says, unwilling to advocate local projects, in part because they are not confident of their own analysis of project costs and benefits. High staff turnover, conflicting policy decisions and numerous delays make the working relationship particularly difficult.

The population criterion in the scoring process is a problem. A high-end low-income community often has pockets of severe low-income residents, yet even if a project is planned to serve those people, it is scored based on the wider area's statistics. FmHA staff interviewed concerning this project mentioned a parallel issue. A health care center serving underserved, low-income communities is often located in a central, larger, higher-income community. Even if staff serve only residents from the low-income communities and use the office merely as a staging point, the project is scored by the demographics of the community in which the facility is located, rather than those which it serves.

According to Danforth, an initial decision on an FmHA pre-application is made within three months, by district office staff. Final approval may take an additional one to six months. If funds are unavailable at the state office, delays result, although applicants are kept informed about their position in the process. Construction financing is easily secured from a private lender, since FmHA agrees to "take out" the construction loan with permanent financing.

3. The view from FmHA

Burt McIntire, the state Community Programs Chief, works with Rhonda Shippey in administering the Community Facilities program in Vermont. McIntire and Shippey work closely with staff from HHS on joint projects. FmHA and HHS signed a Memorandum of Agreement several years ago, and the two agencies frequently split the costs of financing health care facilities in areas designated by HHS as underserved.

These hybrid projects face peculiar problems, according to FmHA staff. HHS offers operating funds to agencies located in underserved areas. If a clinic is built in that area, however, the area automatically loses its underserved designation—and its operating funds. As a result, FmHA will not finance projects that are destined to be caught in this double bind. Similarly, health care facilities located in impoverished communities do not qualify for Community Facilities five-percent "poverty rate" financing because clinics do not directly address health and safety standards, as required under the program regulations.

Shippey emphasizes that the Community Facilities program is the only mechanism by which nonprofits can build needed facilities in rural areas. These projects not only offer stable services to the community in which they are located, they also offer nonprofits a way to reduce the volatility of their operating costs. Space costs are locked in at a constant level which is effectively decreased over time by the effects of inflation.

Approximately 25-30 percent of total Community Programs funding in New Hampshire and Vermont (both served by a single state-level office) is used for projects sponsored by non-profits. The office generally obligates its entire state allocation each year, although the backlog for the Community Facilities Loan Program is not as extensive as that in the Water and Wastewater Loan Program. Once a year, the office holds an invitational meeting for nonprofits and municipalities to discuss the program. Any applications from nonprofit organizations with a track record of fewer than five years must be forwarded to the national office for consideration.

McIntire describes some of the ways state offices use game theory to increase the number of funded projects in the state. For example, a state may fund its second-tier projects out of the state allocation, forwarding its most competitive projects to the national office for consideration at repooling time.

Both McIntire and Shippey argue that outreach and marketing, including help with writing applications and troubleshooting, are FmHA responsibilities, and that if the agency does not fulfill its obligations in this area, Congress should pressure it to do so. They do not believe that responsibility for these functions should be shifted to nonprofit intermediaries.

Finally, both believe that if infrastructure programs were shifted to the states for administration, decision making would become unduly politicized. They say that in New Hampshire, for instance, projects that FmHA jointly funds with state agencies come under "excruciating" political pressure from legislators and the governor's office. According to McIntire, FmHA staff can withstand the pressure, but others—state CDBG staff, for example—"just crumple."

Water and Waste Disposal Loans

This program, essentially authorized under the Water Facilities Act of 1954, and expanded by the Consolidated Farm and Rural Development Act (the "Con Act") of 1961 and its amendments in 1972,[3] provides loans to construct water and waste disposal systems in rural communities (primarily those under 10,000 in population) that face imminent health dangers or obstacles in providing service on their own because of low median income or sparse population. The regulations target "*farmers, ranchers* and rural residents" (emphasis added) and the "most financially needy communities" for assistance. Eligible projects are identical to those funded by the grant program described below, and are administered in the same manner as the Community Facilities program described above.

Over the years, this fund has been the largest of FmHA's community development programs: nearly $9.5 billion has been borrowed by 28,000 communities for water and waste systems. In Fiscal Year 1987, $330 million was loaned to 679 communities.

Water and Waste Disposal Loan funds can be used to construct or improve, enlarge or extend water systems, or to cover certain related costs such as necessary relocation of buildings, land acquisition, purchase of equipment, or for tap fee subsidies. Combined storm and sanitary projects are not eligible, nor is the purchase or refinancing of an existing system.

Political subdivisions of a state (such as a municipality, county, or water authority) can apply for funding, as can associations, cooperatives, nonprofit organizations, Indian tribes on reservations and other federally recognized tribes.

In the past, Water and Waste Disposal Loans were often used in conjunction with EPA sewer construction grants: EPA covered up to 55 percent of construction costs (subject to fund availability), and a low-income community matched the grant with loan proceeds from the FmHA Loan program. Farmers Home Administration staff in Washington have remarkably little data concerning the use of Water and Waste Disposal monies, and particularly jointly funded projects. FmHA has only anecdotal information on the frequency of joint projects, the other programs most often utilized with FmHA programs, or problems with administrative incompatibility. Moreover, a project may be funded in two pieces—say a treatment project and associated feeder lines—but FmHA's information system treats the project as two separate projects, and, once they are entered into the accounting system, FmHA has great difficulty joining the two for purposes of analysis.

Out of the approximately 1,200 Water and Waste proposals annually under consideration by the FmHA, nearly 25 percent are generated by four states with significant water system deficiencies: Arkansas, Texas, Mississippi, and Kentucky. On the other hand, applications are rarely received from New Mexico and Wyoming, each of which offers communities better financial terms under state programs than would be available under the FmHA programs.

Water and Waste Disposal Grants

Since its inception, the grant program has conveyed over $3 billion to 13,600 low-income communities for water and waste systems. In 1987, $117,663,000 was granted to 300 communities. The program remains oversubscribed. According to FmHA staff, the agency regularly carries a backlog of $800 million in Water and Waste Disposal loan applications and $350 million in unfunded (but eligible) grant applications.

The application process and administration run parallel to those of the Water and Waste Disposal Loan program and the Community Facilities Loan program, although eligibility requirements are tighter for the grant program.

In essence, a community must pass a dual test for grant eligibility: Members of the community must be of low income, and the debt service on the proposed project must constitute a financial burden to the ratepayers.

If a community's median income is below the poverty level or 80 percent of the state's nonmetro median income, the community can apply for a grant covering up to 75 percent of total project costs (although 100 percent of the FmHA contribution to a jointly funded project might be in grant form). Remaining costs might be covered by the Water and Waste Disposal Loan program, by a state program, or, theoretically, through market-rate financing. Only 55 percent of total costs are eligible for grant funding if the community's median income falls between 80 percent and 100 percent of the nonmetro median.

Does debt service on the project constitute a financial burden for residents? If the facility's annual debt service, on a per-user basis, totals more than 0.5 percent of the average income in a community with a median income between the poverty level and 80 percent of nonmetro median (i.e., a community eligible for a 75 percent grant as outlined above), it can be considered for a grant. If debt service constitutes 1 percent of median income in a higher-income community, it likewise remains in the running.

Rate determination is a sensitive issue for these projects. The rate must be "reasonable," or comparable to the rate charged on a similar system in a similar community in the area. The rate must cover all costs of the facility including debt service, operation and maintenance, a replacement reserve and a working capital reserve equivalent to the value of one annual loan installment.

While the *debt service* on a project in a poverty-level community may be within the means of its residents on a per user basis, the *rate* may be unacceptably high because of high operating and maintenance costs. The regulations used to authorize FmHA to adjust the rate and the state director could increase the grant level to generate a "reasonable rate." This waiver provision was dropped in the mid-80s, however.

If a Water and Waste Disposal project is eligible for the grant program, it is scored by the district director and forwarded to the FmHA state director for a funding decision (see Figure B, Appendix). The project is then compared to other eligible projects competing for the state's allocation of grant funds, or, if state funds are otherwise committed, the proposal is forwarded to the National Office for consideration by its staff at repooling time.

This process is further complicated by projects eligible for loan *and* grant funds. A low priority loan-only project may be funded more quickly than a high priority loan and grant project if adequate grant funds are not available. Moreover, a lower priority loan project can be repeatedly passed over if new high priority projects are submitted in the interim. The complexity of the process and the number of administrative hurdles lead to confusion and frustration on the part of applicants and agency officials alike. Applicants complain of extensive processing delays, when in fact the state office may simply be waiting for a new infusion of funds from the National Office. Applicants whose pre-applications have been approved are dismayed to hear that funds cannot be released until a formal application is approved as well. Understandably, communities perceive the FmHA's funding process as capricious and prone to favoritism, and the charge is hard to disprove, given the multiple layers of the process and the many opportunities for subjective decisions.

The Community Facilities and Water and Waste programs have been cut by roughly 50 percent during the past eight years: Community Facilities obligations declined in nominal terms from $260 million in 1981 to $95.7 million in 1987, Water and Waste Grants dropped from $210 million to $117 million, and Loans were cut from $750 million to $330 million.[4]

Despite these problems, some communities have had relatively positive experiences with the FmHA Water and Waste Loan and Grant program. The experience of Moncure, North Carolina, is representative.

Case Study: Moncure, North Carolina

The Joint Orange-Chatham Community Action Agency (JOCCAA), established in 1966 with a grant from the Office of Economic Opportunity, serves Orange and Chatham counties, just west of the Raleigh/Durham/Chapel Hill triangle in central North Carolina.

In a 1980 survey prepared for the Southeast Rural Community Assistance Program (which helped JOCCAA staff its water and wastewater technical assistance projects), JOCCAA reported that 33 percent of Chatham County housing units were substandard. Twenty-seven percent of Chatham County families used outhouses and 32.7 percent lacked complete plumbing. Those without water hauled it from neighbors or from local gas stations.

Minority families (who make up 27 percent of Chatham County residents) faced particularly difficult circumstances. Twenty-three percent of large black families and 20 percent of black elderly households were inadequately housed. Of all those in the county who were inadequately housed, 50 percent were black.

Wells in the county are traditionally not capped or protected from contamination. Chatham County has a high water table, and few areas in the county pass percolation tests. A health department study from the late '70s reported that approximately 80 percent of wells that were tested were contaminated.

Moncure, North Carolina lies in southern Chatham County. Quite a vibrant community in the early part of the century, it reported 136 residents in 1920. Today, half of Moncure's population of 150 have incomes below the poverty level; 35 percent have incomes below the county median, and 30 percent are black.

1. The Moncure water project

In 1975, the all-white Moncure Lions Club began to focus its attention on the significant water problem plaguing the town. Downtown Moncure consists of a post office, a couple of underutilized stores, and approximately 30 houses predominantly occupied by whites. The town's significant black population resides just beyond the downtown area. From the start, the Lions Club was interested in providing a centralized water system to the entire community. At the time, every family in town relied on individual wells, most of which were contaminated, and many of which had gone dry. Most of the black residents, however, hauled water.

Three individuals played key roles in bringing a water system to the town of Moncure: Reverend Samuels; Thurmond Nance, a retired engineer who worked for JOCCAA; and Sheila Crump, a lifelong resident of the town who at the time ran the JOCCAA community center in Moncure. Nance and Crump

handled most of the legwork for the project, while Samuels concentrated on the politics.

The trio's first task was to collect a $35 membership fee from each household in Moncure, to be earmarked for the new East Chatham Water System. Working with other community members, they raised $5,340 from among 147 residential customers and 16 commercial customers. A board was selected, which quickly met with FmHA staff. At the time, the FmHA chief for the Water and Wastewater program in the state office had a reputation for aggressively funding projects.

In the beginning, the project went smoothly. In May 1976, the Farmers Home Administration closed on a $180,000 Water and Wastewater Program loan (at five percent), and a $144,000 grant for the project. (These loan and grant amounts were generated from an FmHA worksheet in use at the time which included formulae concerning average community incomes, imputed utility rates, and comparable rates in nearby communities.) With these funds, the East Chatham Water System (assisted by its engineering firm) built a system that included five wells, one 75,000-gallon storage tank, and distribution lines to 97 percent of Moncure's population, spread out over a four square mile area. Residents were encouraged to tap into the system at the outset to reduce per capita rates: A $25 tap fee was charged to customers just after construction was completed, while latecomers were charged $150.

The rate structure, typical of systems of this size, was:

	Residential[5]	Commercial[6]
First 2,000 gallons/mo.	$3.50/K	$5.75/K
Next 3,000	1.75/K	2.00/K
Next 5,000	1.20/K	1.50/K
Next 15,000	.75/K	.75/K
All usage above 25,000	.50/K	.50/K

The system performed satisfactorily for several years, although water pressure at the outlying areas of the system tended to drop in the summer. These pressure drops, unanticipated and unexplained by the system board, generated dissention among the water system members. Those at the end of the line felt that they were paying full rates but not getting full service. Residents of a mobile home park located at the end of a distribution line filed a complaint with FmHA, arguing that each resident, rather than the single mobile home park owner, should have voting rights at system meetings. The FmHA rejected the complaint, but squabbles continued to plague the group. The FmHA district office in Raleigh reports that the system made its loan payments on a relatively regular basis. (Systems generally build up a payment reserve of one year's payments, so while a payment might have been two weeks late, the system never lapsed into delinquency.)

By 1979, however, the capacity of two wells in particular had declined dramatically. (Former Water System board members say that the design of the system was not responsible for the problems.) Articles in the Pittsboro, North Carolina paper explained that the wells and pumps were operating around the clock at their reduced capacity, but system demand was greater than the wells could supply. Water was trucked in for a time. A county construction project ruptured a distribution line, draining the storage tank and again disrupting service. The local elementary school and health clinic reverted back to their own water systems, reducing system revenues.

In August, 1980, the Farmers Home Administration closed on a second loan of $8,700 (at the five percent "poverty" rate), along with a $24,400 grant. The funds were used to dig two new wells and tie them into the balance of the system. In addition, some significant capital repairs were performed on equipment already in use.

2. Consolidation

Around this time Bill Coleman, the Chatham county manager, began an initiative to buy out and rationalize the county's five separate community water systems. Each was having problems, and all but the system serving the county seat employed part-time operators with little experience. In Moncure, water bills were written out by hand each month. Coleman felt that significant efficiencies could be generated if the individual water systems were combined into a countywide water system, competent staff were hired, and the billing systems were consolidated and computerized.

A bond referendum vote was scheduled for the fall of 1980. It failed by a significant majority, primarily because residents were misinformed. Those without water systems assumed they would have to share in the system payments, along with those households with access to the five water systems.

Coleman immediately scheduled a second vote for the spring of 1981. Sheila Crump and JOCCAA

were informally recruited to organize a campaign to support consolidation. The county government produced literature and statistics, and JOCCAA set up community meetings and hearings, involved local churches and organized publicity. The second bond referendum passed by a two-to-one margin. The countywide system purchase and renovation cost $3.3 million. The state contributed $800,000 in loan funds, FmHA contributed a $538,000 grant, and the bond proceeds covered the remaining $1.98 million cost.[7]

Once the bonds were issued, the county bought out the various systems and hired a water department with technicians and engineers who oversee operations and maintenance of the system, plan for long term capital repairs and replacement, and manage the computerized billing system.

Since that time, several bond referenda have passed and the county has upgraded its water system. The county also established a Revolving Water Assessment Fund totalling $50,000. Low-income county residents can borrow, at no interest for up to 18 months, funds to pay for tapping into a county water system. No grants are authorized. Western Orange County has recently seen the construction of a sewer system, jointly funded by the county, the EPA, FmHA, and the HHS Office of Community Services.

According to Coleman, the county considered applying to the Economic Development Administration for funding, but did not meet the agency's guidelines. Its relationship with the FmHA was positive, although FmHA proved inflexible when some last-minute changes were required in the project. Coleman says, in fact, that the biggest problem he sees with federal and state assistance programs is their inflexibility. Program criteria are often inappropriate, he says. On the other hand, he also feels that increased flexibility in the state CDBG program has led to politicization.

Despite its upgraded water system, Chatham County still has difficulty attracting business. Developers tend to require sewer as well as water systems. The county is home to several large manufacturing plants, including Boise-Cascade, Weyerhauser, and Allied Chemical, but all of these plants have installed their own water and sewer systems.

3. The view from the agency

Willard Dean is responsible for water and waste systems covered by the FmHA district office in Raleigh. He clearly is committed to his job and, in fact, complains that some younger FmHA employees are only interested in a "nine-to-five" job. Although he grew up on a farm more than forty years ago, and worked in the relatively distant past as a county supervisor, he seems to have successfully shifted from the farm world to the world of present values and high-tech financial calculators.

In early March 1989, Dean was working on two Community Facility loans and five Water and Wastewater loans or grants. This workload has remained quite stable despite the cutbacks in overall funding for the program, in part because the district regularly taps into the national repooling process for additional loan authority. Dean boasts that in FY 1988, he lent out twice as much as the state was assigned under the allocation formula.

Each project typically requires a one-year construction period, and roughly two years from the initial meeting with the community to closing. Generally, funds are obligated within 90 days. Delays, which are frequent, usually occur because of conflicts over rights of way and easements.

Of the 15 to 20 projects that Dean has followed through his office over the past five years, he estimated that only four or five had been jointly funded with the state EPA Construction Grant Program. Most of these had been innovative design projects. Without that "hook," these projects would not have been financed.

The delinquency rate among FmHA Water and Wastewater borrowers is near nil. FmHA staff give part of the credit to the state Local Government Commission. The Commission strictly enforces an eight percent cap on bonding authority among public bodies (including sanitary districts and water and sewer service districts).

In the '70s, FmHA funded a mosaic of small water systems throughout the state.[8] By the early '80s, however, staff were increasingly supportive of system rationalization and consolidation. Some North Carolina communities have taken advantage of the water and waste loan buy-back provisions authorized by FmHA in conjunction with its recent asset sales. (A community can buy back its note from FmHA at a significant discount based on the present value of anticipated loan payments at subsidized rates. In turn, the owner of the system can refinance the loan, even at conventional rates, and debt service payments will be lower than would have been the case under the FmHA loan.)

Although this project was targeted to a low-income community, many in North Carolina are not.

The following chapter takes a look at targeting in the Water and Waste Disposal programs.

1 With regulations at 7 CFR 1942.1–50.

2 If the Administrator feels that the program objectives cannot be appropriately met for certain states under the formula, he/she may override the system and assign an "administrative allocation" to those states. They are not eligible for additional basic formula allocations (but the administrative allocations reduce funds available to remaining states).

3 Regulations at 7 CFR 1942.352–400.

4 The FY 1990 Appropriation Bill was the first to reverse the trend. After accounting for across-the-board cuts required under the Gramm-Rudman Act, the Water and Waste Disposal Grant program was appropriated $203.5 million and the Loan program received $335 million.

5 Minimum bill: $7, average: $7–8.

6 Minimum bill: $11.

7 The new rate structure was: Fewer than 3,000 gallons, $10.73 minimum; next 27,000 gallons, $1.25/K; over 30,000 gallons, $1.00/K.

8 FmHA finances systems run by nonprofits as well as local governments. The state programs will only fund local governments.

CHAPTER SIX

Distribution of Water and Waste Funds

This chapter analyzes the distribution of FmHA water and waste funds between 1985 and 1988, examining the manner in which assistance was distributed geographically and by community characteristics, particularly relative community income levels, in an effort to determine if there were any change in the pattern of this distribution over the four-year period.

A major focus of the analysis is the extent to which the distribution of program assistance has favored low-income communities. There are several reasons for this focus. The most basic is that in a time of scarce public-sector resources for community development, it is a generally accepted principle that, other things being equal, communities with the least ability to pay should be given priority for available resources.

Targeting of FmHA water and waste funds by community income level has been a feature of the program for over a decade and has been reinforced several times, usually at the insistence of Congress. In the mid-1970s, partly because of pressure from the Office of Management and Budget (OMB), the agency introduced its "one-percent rule" restricting grant assistance to communities in which the debt service burden on utility system customers exceeds one percent of the median community income. In addition, the project scoring sheet includes criteria giving priority to projects serving lower-income communities and small communities.

While data are available on the size of the communities served, the agency's policy of supporting consolidation of utility systems makes this analysis difficult. An areawide system may be headquartered in a larger town, although covering a series of small communities. The FmHA has no system that accurately assesses the typical size of an assisted community. As a result, this analysis does not evaluate the distribution of funds based on community size.

The Data

The analysis that follows is based on the annual "205C" reports compiled by FmHA, along with data from FmHA's computerized "tracking system." These data include information on service area population, community median household income level, amount and purpose of each loan and grant, and, in the case of loans, the interest rate charged.

There are minor differences between the two data sources. The tracking system data reflect a larger number of "projects" than the 205C reports. The tracking system may divide a project in a single community into several entries in order to distinguish between component purposes (water, sewerage collection, sewerage treatment, or storm drainage) or because of different loan or grant "closing" dates.[1]

At the same time, it is important to note that this analysis is limited by the kinds of information that are available to FmHA. For example, the agency database does not include information that would provide indicators of need—either the availability or affordability of current services or the nature or severity of water quality or public health problems. Nor does it indicate relative service costs. It does not provide information on who was *not* served by a project, although that is obviously relevant when considering the targeting aspects of a program. In short, because of data limitations, our analysis is unavoidably limited but provides some basis for evaluating, in a general way, the impact of geographic and income targeting factors in the program.

1. FmHA's "rubber ruler" on poverty

One key aspect of this analysis differs from FmHA practice. In administering the program, FmHA uses an annually updated definition of poverty which of course increases over time, although most community income data (generally taken from the most recent census) remain unchanged. Over the course of a

decade, increasing numbers of communities fall below the "poverty level" as their static income figure is topped by the dynamic poverty figure. In some cases, communities become eligible for grant or loan assistance for which they would not have qualified a year or two earlier. When new census data are released, the cycle begins again. The impact is significant. By FY '88, the poverty level figure used by FmHA was *above* the statewide nonmetro median income level from the 1980 census in two states, Arkansas and Mississippi.

The raw data on the distribution of FmHA water and waste funds indicates that an increasing share of communities served by the program are poverty-level communities. Yet when the data are adjusted to correct the statistical problem identified above, the trend reverses.

2. The rubber ruler's impact

How important is the impact of this expanding or "rubber" ruler used to classify poverty level communities? In each of the four years studied, more than 300 communities with funded projects shifted from a point above the poverty level to below it. The impact on distribution patterns is less dramatic than one might think, since a majority of the communities involved have incomes which do not exceed 80 percent of their statewide median incomes, and thus would still be eligible for five-percent loans. Nevertheless, in FY '87 and FY '88, the number of communities which, except for the rubber ruler, would not otherwise have been eligible for loans at five percent, was 60 and 58 respectively.

These communities comprised more than 30 percent of all those receiving loans at the five-percent rate during those years.

To avoid this distortion, the analysis uses a constant definition of poverty ($7,412 for a family of four) to complement the constant community income figures. Both figures are from 1980.

Geographic Distribution

Over the four years from Fiscal Year 1985 to Fiscal Year 1988, the Farmers Home Administration made available a total of nearly $1.8 billion in Water and Waste Loan and Grant funding. In analyzing the geographic distribution of that assistance, we use five regional divisions. Three of them (Northeast, North Central and West) are identical to those used by the Bureau of the Census. We created two others, South Atlantic and South Central, from the region defined as the South by the Bureau of the Census.

Tables 1 and 2 display the funding data for the state or states with the largest amount of activity in the programs for each of these five regions. The analysis indicates that the ten biggest states (in program terms)[2] account for more than 40 percent of all FmHA water and waste assistance each year.

Just over 31 percent of all funding during the four-year period was utilized by the South Central region, which contains 22 percent of the nation's population living outside of urbanized areas. The region includes half of the ten states receiving the most assistance. Nearly one-fourth of all funding was targeted to the South Atlantic region, with 18 percent of the non-urbanized population, and three more of the 'Big Ten' user states. The West, with about 14 percent of all people outside of urbanized areas, received just under $130 million, or seven percent of total funding. The North Central region received one-fifth of all assistance and the Northeast slightly less, both of which are roughly comparable to their proportions of nonurbanized population.

These regional funding patterns have been quite consistent over the period studied. On a year-to-year basis, funding levels shifted, but over the four-year period, they were remarkably consistent.

Grant funds accounted for $464 million, or 26 percent of total program funding. Projects in the West received an average 35 percent of assistance over the period in grant form, however, with California projects, which account for one-third of that region's total expenditures, receiving 32 percent of funds in the form of grants.

Among the 'Big Ten' user states, California, Arkansas, and Ohio regularly received more than one-fourth of all assistance in grant form, while South Carolina and Kentucky projects received less than one-fifth of all assistance in the form of grants. Lower grant utilization rates can be caused by many things: applying communities may simply have higher incomes, lower income communities can be deterred by the bureaucratic maze, or subjective criteria (such as the discretionary points available to the state director) can be used in a manner which steers funds to higher-income communities, which are ineligible for grant funds. One possible factor behind the below-average use of grant funds by the states with the largest overall program activity might be their reliance on repooled funds, which consist largely of loan, rather than grant, dollars.

Table 1 Distribution of Water-Sewer Funds by Fiscal Year

STATE/REGION	Percent Distribution of Total Funding FY 85	FY 86	FY 87	FY 88
Pennsylvania	4.6%	4.7%	5.5%	4.6%
Rest of Region	8.9%	14.5%	12.2%	14.8%
NORTHEAST	13.5%	19.2%	17.7%	19.4%
Ohio	3.7%	3.4%	3.7%	3.7%
Rest of Region	15.8%	16.5%	16.6%	17.7%
NORTH CENTRAL	19.5%	19.9%	20.4%	21.4%
North Carolina	6.3%	7.3%	5.2%	4.5%
Virginia	4.0%	5.1%	3.6%	3.9%
South Carolina	2.3%	2.8%	4.8%	3.4%
Rest of Region	12.2%	10.0%	9.0%	10.1%
SOUTH ATLANTIC	24.9%	25.1%	22.6%	21.9%
Kentucky	6.6%	4.8%	5.5%	5.1%
Texas	7.4%	4.6%	4.5%	4.2%
Arkansas	4.7%	3.7%	5.7%	4.8%
Louisiana	3.8%	4.8%	4.8%	2.5%
Mississippi	4.4%	3.5%	4.0%	3.1%
Rest of Region	8.1%	8.2%	8.2%	8.2%
SOUTH CENTRAL	35.0%	29.6%	32.6%	28.1%
California	2.5%	1.7%	2.4%	3.2%
Rest of Region	4.6%	4.5%	4.3%	6.0%
WEST	7.1%	6.2%	6.7%	9.2%
U. S. TOTAL	100.0%	100.0%	100.0%	100.0%

Source: Farmers Home Administration, 205C Reports FY '85 through '88.

Distribution Based on Water or Waste System Need

The FmHA has no measure of community need in rural areas, does not conduct a need survey (as does the EPA), and does not know if its efforts are addressing the communities facing the most serious water shortages or contamination problems. Through its state-by-state allocation formula, FmHA in essence maintains that the proportional share of rural population and rural population below the poverty level are adequate indicators of need for water and waste assistance.[3] Through the repooling process, funds are shifted among the states to better reflect program *demand*, though not necessarily *need*. In the process, the West utilized only two-thirds of its allocated "share" over the four-year period while the South Central region garnered 124 percent of its population-based share.

Table 2 Geographic Distribution of Water-Sewer Funds

($ 000s)

STATE/REGION	Total FY 85-88	Grants FY 85-88	% Distrib'n Grants	% Distrib'n Total	Grant Share
Pennsylvania	$85,915.8	$20,967.0	4.5%	4.8%	24.4%
Rest of Region	$222,933.8	$47,676.8	10.3%	12.6%	21.4%
NORTHEAST	$308,849.6	$68,643.8	14.8%	17.4%	22.2%
Ohio	$64,280.6	$16,724.6	3.6%	3.6%	26.0%
Rest of Region	$295,464.5	$96,262.0	20.7%	16.6%	32.6%
NORTH CENTRAL	$359,745.1	$112,986.6	24.3%	20.3%	31.4%
North Carolina	$103,642.6	$23,956.2	5.2%	5.8%	23.1%
Virginia	$73,531.9	$17,097.7	3.7%	4.1%	23.3%
South Carolina	$59,311.0	$9,555.8	2.1%	3.3%	16.1%
Rest of Region	$183,374.8	$47,426.8	10.2%	10.3%	25.9%
SOUTH ATLANTIC	$419,860.3	$98,036.4	21.1%	23.7%	23.3%
Kentucky	$98,046.8	$18,558.7	4.0%	5.5%	18.9%
Texas	$92,174.9	$20,033.5	4.3%	5.2%	21.7%
Arkansas	$83,908.7	$23,956.4	5.2%	4.7%	28.6%
Louisiana	$70,548.8	$17,566.7	3.8%	4.0%	24.9%
Mississippi	$66,352.6	$15,944.6	3.4%	3.7%	24.0%
Rest of Region	$145,264.1	$42,960.2	9.3%	8.2%	29.6%
SOUTH CENTRAL	$556,295.9	$139,020.1	30.0%	31.3%	25.0%
California	$43,645.4	$13,819.2	3.0%	2.5%	31.7%
Rest of Region	$86,228.0	$31,579.8	6.8%	4.9%	36.6%
WEST	$129,873.4	$45,399.0	9.8%	7.3%	35.0%
U. S. TOTAL	$1,774,624.4	$464,085.9	100.0%	100.0%	26.2%

Source: Farmers Home Administration, 205C Reports FY '85 through '88.

There are other logical proxies of the need for program assistance. One is the number of housing units lacking a public water supply. Or, in order to exclude housing in very sparsely settled communities that are unsuitable for public water service through central system facilities, one could look only at units located in small towns that lack public water supply facilities. Alternatively, a combination of these factors could be used.

Table 3 compares the regional distribution of FmHA Water and Wastewater funding with the distribution pattern for each of these possible measures of need. The figures suggest that according to these measures of need, the West and, to a lesser extent, the North Central regions are underfunded in the Water and Wastewater program, while the South Central region gets a good deal more than its "share" of funding by any of the three measures.

Table 3 Funding Compared with Alternative Measures of Need

	Non-Urbanized Popul'n	FmHA Funding FY 85-8	FmHA Initial Allocation Formula	Units w/o Public Water: All Nonmetro Areas	Units w/o Public Water: Small Towns (2,500-to -10,000)
NORTHEAST	15.7%	17.4%	16.0%	14.8%	21.8%
NORTH CENTRAL	29.6%	20.3%	26.6%	31.8%	25.5%
SOUTH ATLANTIC	18.5%	23.7%	21.2%	24.3%	27.8%
SOUTH CENTRAL	22.4%	31.3%	25.2%	19.7%	12.1%
WEST	13.8%	7.3%	11.0%	9.4%	12.8%
TOTAL U. S.	100.0%	100.0%	100.0%	100.0%	100.0%

Source: Funding from 205C Reports; Initial Allocation from FmHA Instruction 1940–1, Appendix A; Other distributions from 1980 Census of Population and Housing.

Results are mixed for the Northeast and the South Atlantic regions.

Table 4 compares funding information for the ten states with the largest programs, and their regions, against the various indicators of need for program assistance. None of the states appears to be underfunded, measured by these particular criteria. The five South Central states appear to receive a significantly greater-than-warranted share of funding on the basis of all three measures of need.

Several factors can explain the differences in utilization rates among states. The most important is probably the past experience of the FmHA state office and field staffs with the program. In some states, the program has been heavily promoted, while in others it has not.

Distribution Based on Community Income Level

As explained above, FmHA funding for water and waste disposal systems can be provided in a number of forms. Both grant assistance and loan funds are available. In most projects, these are combined in a variety of ways that affect the extent to which the utility system customers themselves must pay for the facilities involved. In short, there are seven different versions of assistance provided: grant only; loan without grant at any of three interest rates; and grant in combination with a loan at any of those three rates.

Agency rules governing the amount of subsidized assistance—grant funds or below-market interest rates on loan financing—that an individual project may be eligible to receive are complex. In addition, the regulations are subject to considerable interpretation by field staff and have changed several times over the past ten years, complicating the task of judging whether intended targeting goals have been achieved.

In the absence of a single yardstick that would combine the effects of both community ability to pay and relative per-capita project cost, this analysis examines the distribution of each level of subsidy among various community income categories. This procedure is not a perfect measure of agency targeting by income and financial need, but it provides useful insights into program patterns and the policies reflected in those patterns.

As Table 5 shows, there has been some change in the utilization of the different forms of assistance between 1985 and 1988, although the shift is dramatic in only one case.

Grants made up a consistent 26 percent of total program funds, a reflection of congressional appropriations decisions rather than FmHA policy. Interest rate distributions displayed interesting patterns during the evaluation period.

1. Interest rates

Loans at the five-percent interest rate grew consistently over the four years, rising from nine percent of all funds in FY '85 to 19 percent in FY '88. Loans at the intermediate rate grew from 29 percent of all funds in FY '85 to 37 percent the following year, and declined to 34 percent of all assistance by 1988, replacing market rate loans as the most common level

Table 4 Geographic Distribution Compared with Indicators of Need

STATE/REGION	Share of Total Funding (FY 85-8)	FmHA Initial Allocation Formula	Units w/o Public Water: All Nonmetro Areas	Units w/o Public Water: Small Towns (2,500-to 10,000)
Pennsylvania	4.8%	5.6%	4.2%	3.6%
Rest of Region	12.6%	10.5%	10.6%	18.2%
NORTHEAST	17.4%	16.0%	14.8%	21.8%
Ohio	3.6%	4.4%	3.7%	3.6%
Rest of Region	16.6%	22.2%	28.1%	21.9%
NORTH CENTRAL	20.3%	26.6%	31.8%	25.5%
North Carolina	5.8%	5.4%	7.4%	3.2%
Virginia	4.1%	2.9%	4.3%	2.2%
South Carolina	3.3%	2.7%	2.3%	2.4%
Rest of Region	10.3%	10.2%	10.2%	20.0%
SOUTH ATLANTIC	23.7%	21.2%	24.3%	27.8%
Kentucky	5.5%	3.6%	3.9%	1.0%
Texas	5.2%	5.2%	3.4%	3.3%
Arkansas	4.7%	2.3%	2.4%	1.3%
Louisiana	4.0%	2.7%	1.6%	1.5%
Mississippi	3.7%	3.2%	1.7%	0.5%
Rest of Region	8.2%	8.3%	6.7%	4.6%
SOUTH CENTRAL	31.3%	25.2%	19.7%	12.1%
California	2.5%	3.2%	1.6%	4.3%
Rest of Region	4.9%	7.7%	7.8%	8.5%
WEST	7.3%	11.0%	9.4%	12.8%
U. S. TOTAL	100.0%	100.0%	100.0%	100.0%

Source: Funding from 205C Reports; Initial Allocation from Instruction 1940–1; Other data from 1980 Census of Housing.

of subsidized loan. In contrast, both the proportion of FmHA loan funds lent at the market level interest rate and their numbers declined significantly, from 36 percent of all program funds in FY '85 to 22 percent in FY '88.

Two factors could account for this decline. Program changes during the four-year period expanded the range of communities eligible for more heavily subsidized assistance. In addition, the prime interest rate fell by nearly two percentage points between FY '85 and FY '86, decreasing the differential between private market borrowing costs and those of FmHA borrowers.

Table 5 Distribution of All Funds by Type of Assistance

	FY 85	FY 86	FY 87	FY 88
ASSISTANCE PROVIDED:				
Grant Funds	26.2%	26.1%	25.6%	25.6%
5% Rate Loans	9.0%	11.1%	15.7%	18.9%
Intermediate Rate Loans	28.8%	37.1%	35.6%	33.9%
Market Rate Loans	36.0%	25.7%	23.1%	21.6%
TOTAL	100.0%	100.0%	100.0%	100.0%

Source: Unpublished data from FmHA Management Information Systems.

2. Number of projects

Table 6 below shows the number of grant and loan projects reported in each of the four years by the community income levels. The same information is summarized visually in Figures 1 and 2. While overall funding levels had stabilized by 1985 after a period of serious budget cuts, the number of projects funded by the Water and Waste Loan and Grant programs declined overall and within each category of community income, except that of communities between 80 percent and 100 percent of statewide nonmetro median income. The number of loan and grant projects in communities with these incomes increased from 422 in 1985 to 461 in 1988.

The community income category hit hardest by the decrease in the number of funded projects was that of communities with incomes above the statewide nonmetro average. Most of this change occurred between FY '85 and FY '86 and may be related to the exhaustion of funds provided through the special FY

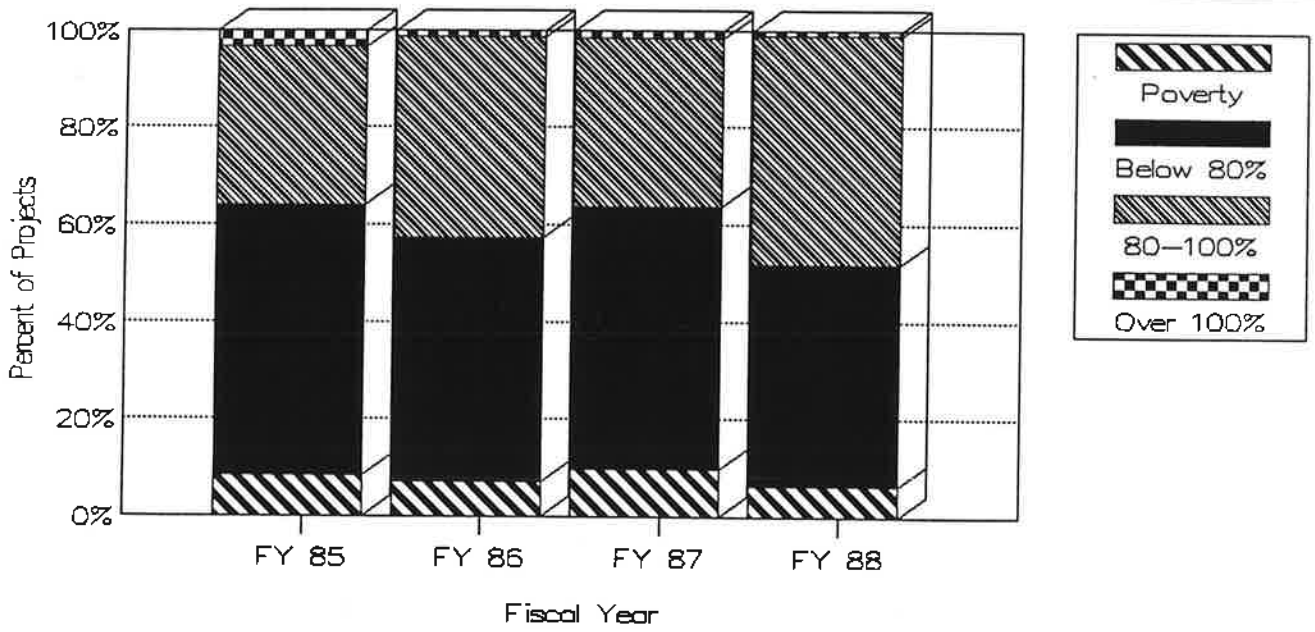
Table 6 Distribution of Water-Sewer Grant and Loan Projects by Community Income

	FY 1985		FY 1986		FY 1987		FY 1988	
	No.	Percent	No.	Percent	No.	Percent	No.	Percent
COMMUNITIES RECEIVING GRANTS:								
Income Below Poverty ($7,412)	35	8.4%	27	7.1%	34	9.9%	21	6.4%
Above Poverty-Below 80% NMHI	231	55.5%	192	50.4%	185	53.8%	148	45.3%
Between 80% and 100% NMHI	136	32.7%	157	41.2%	120	34.9%	155	47.4%
Above Statewide NMHI	14	3.4%	5	1.3%	5	1.5%	3	0.9%
TOTAL	416	100.0%	381	100.0%	344	100.0%	327	100.0%
COMMUNITIES RECEIVING LOANS:								
Income Below Poverty ($7,412)	44	4.9%	37	4.6%	43	5.8%	32	4.7%
Above Poverty-Below 80% NMHI	299	33.0%	250	31.4%	223	30.0%	179	26.3%
Between 80% and 100% NMHI	286	31.6%	310	38.9%	294	39.6%	306	44.9%
Above Statewide NMHI	277	30.6%	200	25.1%	183	24.6%	164	24.1%
TOTAL	906	100.0%	797	100.0%	743	100.0%	681	100.0%

"NMHI" means statewide Nonmetro Median Household Income (as of 1979).

Source: Unpublished data from FmHA Management Information Systems.

Figure 1 Distribution of FmHA Grant Projects by Community Median Income Level



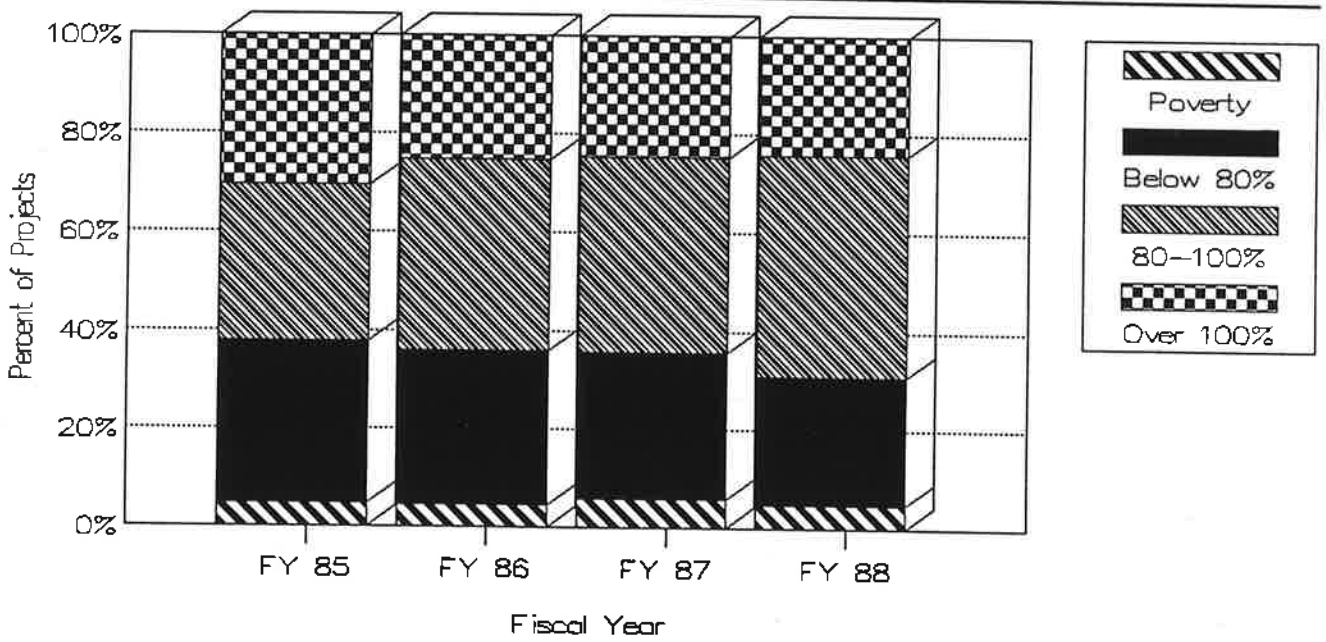
Source: Unpublished data from FmHA Management Information Systems.

'83 "Jobs Bill" appropriation. These funds did not carry the same targeting requirements imposed on the traditional Water and Waste loan and grant programs.

3. Dollars Provided

Table 7 and Figures 3 and 4 display the patterns of assistance in terms of total dollars provided, rather than the number of projects. The table confirms that not only did the program serve fewer communities each year with incomes above the statewide nonmetro median, but that the share of total funding going to such communities also declined modestly—from 29 percent in FY '85 to 22 percent in FY '88.

Figure 2 Distribution of FmHA Loan Projects by Community Median Income Level



Source: Unpublished data from FmHA Management Information Systems.

Table 7 Distribution of Water-Sewer Grant and Loan Funds by Community Income

	FY 1985		FY 1986		FY 1987		FY 1988	
	$ 000s	Share	$ 000s	Share	$ 000s	Share	$ 000s	Share
COMMUNITIES RECEIVING GRANTS:								
Income Below Poverty	$6,144	5.1%	$4,252	3.7%	$6,988	6.2%	$3,367	2.9%
Above Poverty-Below 80% NMHI	$66,924	55.9%	$60,248	52.8%	$59,046	52.2%	$49,119	42.9%
Between 80% and 100% NMHI	$43,884	36.7%	$48,472	42.5%	$46,037	40.7%	$61,199	53.4%
Above Statewide NMHI	$2,739	2.3%	$1,149	1.0%	$964	0.9%	$835	0.7%
TOTAL	$119,691	100.0%	$114,120	100.0%	$113,035	100.0%	$114,519	100.0%
COMMUNITIES RECEIVING LOANS:								
Income Below Poverty	$5,718	1.7%	$3,507	1.1%	$5,289	1.6%	$3,677	1.1%
Above Poverty-Below 80% NMHI	$85,087	25.2%	$81,953	25.4%	$76,883	23.4%	$79,833	23.9%
Between 80% and 100% NMHI	$118,033	34.9%	$137,281	42.5%	$146,547	44.6%	$152,082	45.6%
Above Statewide NMHI	$128,962	38.2%	$100,524	31.1%	$99,700	30.4%	$97,924	29.4%
TOTAL	$337,799	100.0%	$323,265	100.0%	$328,419	100.0%	$333,515	100.0%
RECEIVING LOANS AT 5% INTEREST:								
Income Below Poverty	$2,092	5.1%	$1,430	2.9%	$2,208	3.2%	$1,302	1.5%
Above Poverty-Below 80% NMHI	$23,642	57.3%	$33,155	68.1%	$42,880	61.8%	$58,097	68.5%
Between 80% and 100% NMHI	$15,531	37.6%	$14,076	28.9%	$24,256	35.0%	$24,600	29.0%
Above Statewide NMHI	$0	0.0%	$0	0.0%	$0	0.0%	$793	0.9%
TOTAL	$41,265	100.0%	$48,662	100.0%	$69,344	100.0%	$84,791	100.0%
RECEIVING LOANS AT INTERMEDIATE INTEREST RATE:								
Income Below Poverty	$2,797	2.1%	$1,814	1.1%	$2,763	1.8%	$1,842	1.2%
Above Poverty-Below 80% NMHI	$60,435	45.9%	$47,523	29.3%	$30,114	19.2%	$21,736	14.3%
Between 80% and 100% NMHI	$68,562	52.0%	$111,823	68.9%	$118,651	75.5%	$125,779	82.9%
Above Statewide NMHI	$0	0.0%	$1,072	0.7%	$5,651	3.6%	$2,371	1.6%
TOTAL	$131,793	100.0%	$162,231	100.0%	$157,179	100.0%	$151,728	100.0%

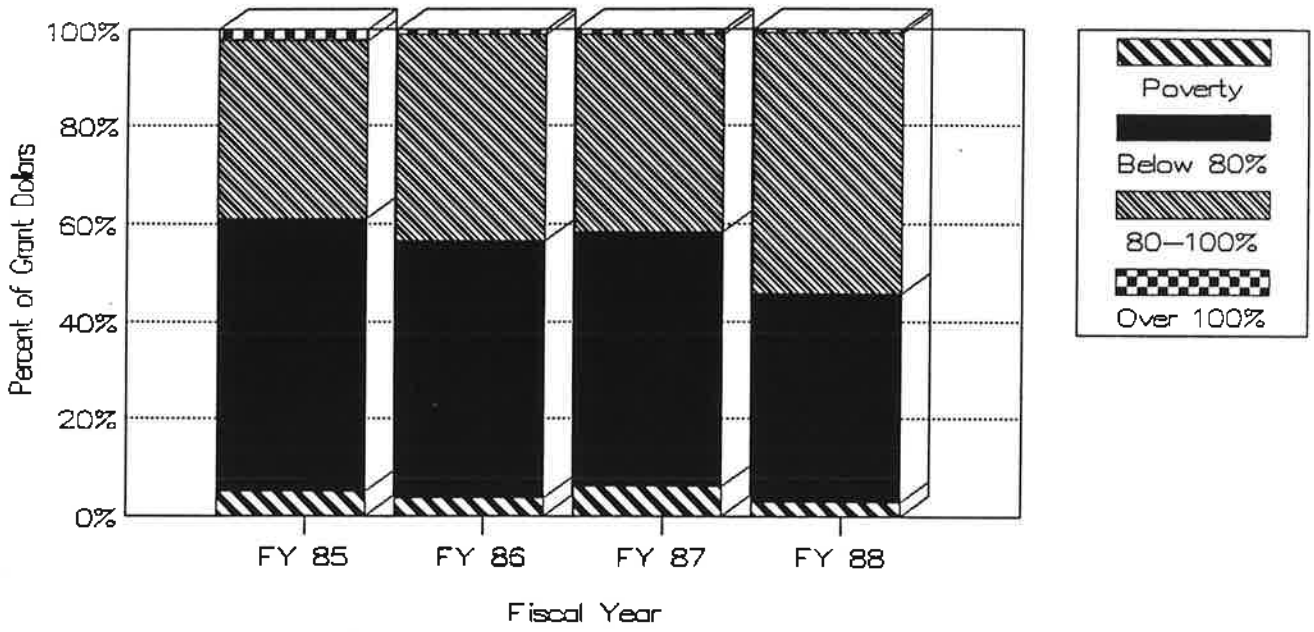
"NMHI" means statewide Nonmetro Median Household Income (as of 1979).

Source: Unpublished data from FmHA Management Information Systems.

At the same time that the share of funding going to above-median income communities was declining, program funds targeted to projects in communities with incomes below 80 percent of the statewide nonmetro median or the poverty level also declined: from 36 percent in FY '85 to 30 percent in FY '88. These communities received an increasing proportion of loan funds at the five-percent rate over the period, from 62 percent to 70 percent of these loans. But these same communities suffered cuts in the proportion of intermediate rate loans available to them. In 1985, 48 percent of all intermediate-rate loans flowed to communities below the poverty line or below 80 percent of statewide nonmetro median. By 1988, the figure had declined to 15 percent of all intermediate rate loans.

In contrast, program spending has increased among communities with incomes between 80 percent and 100 percent of the statewide nonmetro median. These communities represented 35 percent of all spending in 1985, but 48 percent of funding by 1988. Moreover, these communities accounted for an increasing amount of intermediate-rate financing during the period. In 1985, 52 percent of communities borrowing at the intermediate rate were at that income level; by 1988, 83 percent of intermediate-rate borrowers had incomes between 80 percent and 100 percent of the statewide nonmetro median. Clearly, the market for

Figure 3 Distribution of FmHA Grant Dollars by Community Median Income Level

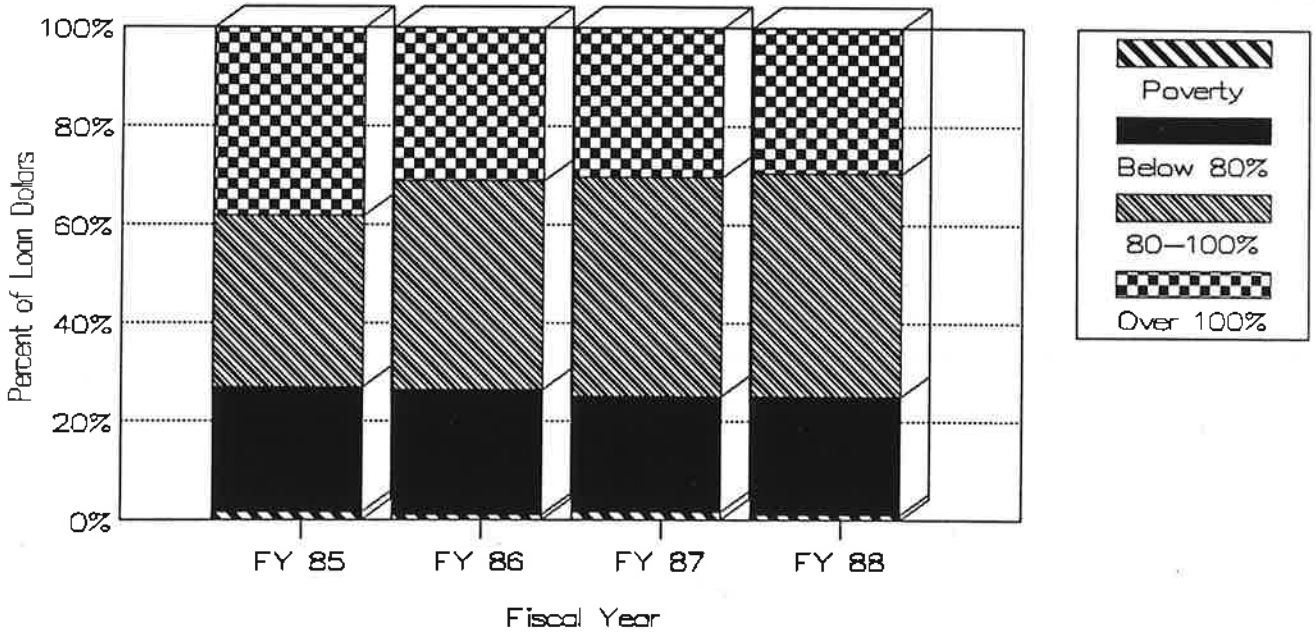


Source: Unpublished data from FmHA Management Information Systems.

intermediate-rate loans had shifted from poor communities to moderate-income communities, without a corresponding increase in more heavily subsidized assistance to the poorer communities.

Table 7 indicates that a very small number of projects are constructed in communities with incomes below the poverty level, and an even smaller proportion of these poorest communities receive either outright grants or loans at the five-percent rate. In fact, in 1988, poverty-income communities accounted for 1.5 percent of borrowers at the five-percent rate, but a similar proportion of communities borrowing at intermediate rates had incomes below the poverty rate.

Figure 4 Distribution of FmHA Loan Dollars by Community Median Income Level



Source: Unpublished data from FmHA Management Information Systems.

Table 8 Water-Sewer Funding In Poverty-Level Communities

	FY 1985		FY 1986		FY 1987		FY 1988	
	No.	Percent	No.	Percent	No.	Percent	No.	Percent
Total Projects	47	5%	41	5%	51	6%	36	5%
Loan Projects:								
At 5% Rate	24	54.5%	22	59.5%	18	41.9%	16	50.0%
At Intermediate Rate	19	43.2%	14	37.8%	22	51.2%	15	46.9%
At Market Rate	1	2.3%	1	2.7%	3	7.0%	1	3.1%
TOTAL	44	100.0%	37	100.0%	43	100.0%	32	100.0%
Grant Projects:	35	74%	27	66%	34	67%	21	58%
Average Share in Grant:		62.2%		65.5%		64.8%		68.6%
Projects with NO Grant	12	26%	14	34%	17	33%	15	42%
Projects with NEITHER Grant NOR 5% Rate Loan:	6	13%	7	17%	11	22%	6	17%

Notes: The percentage figures in the Total Projects row represent the percentage of all FmHA projects funded that year which served poverty-level communities

The percentage figures in the Grant Projects row represent the percentage of projects in poverty-level communities which received grant funds. The figures are the inverse of the percentages in the Projects with NO Grant row.

The percentages in the Average Share in Grant row represent the percentage of all FmHA funds provided to grant-loan combination projects in poverty-level communities which were provided in grant form.

Source: Unpublished data from FmHA Management Information Systems.

Meanwhile, program resources are increasingly funnelled to projects in communities with incomes between 80 and 100 percent of the statewide non-metro median. More than one-fifth of all assistance continues to flow to communities with above-average incomes, mostly in the form of market-rate loans.

A Look at Assistance to Poverty-level Communities

Table 8 indicates that the percentage of FmHA Water and Waste projects (grant, loan and grant-loan combination) funded in poverty-level communities never exceeded six percent of all projects between FY '85 and FY '88. The percentage of total loan and grant funds made available to these communities peaked at 2.8 percent in FY '87.

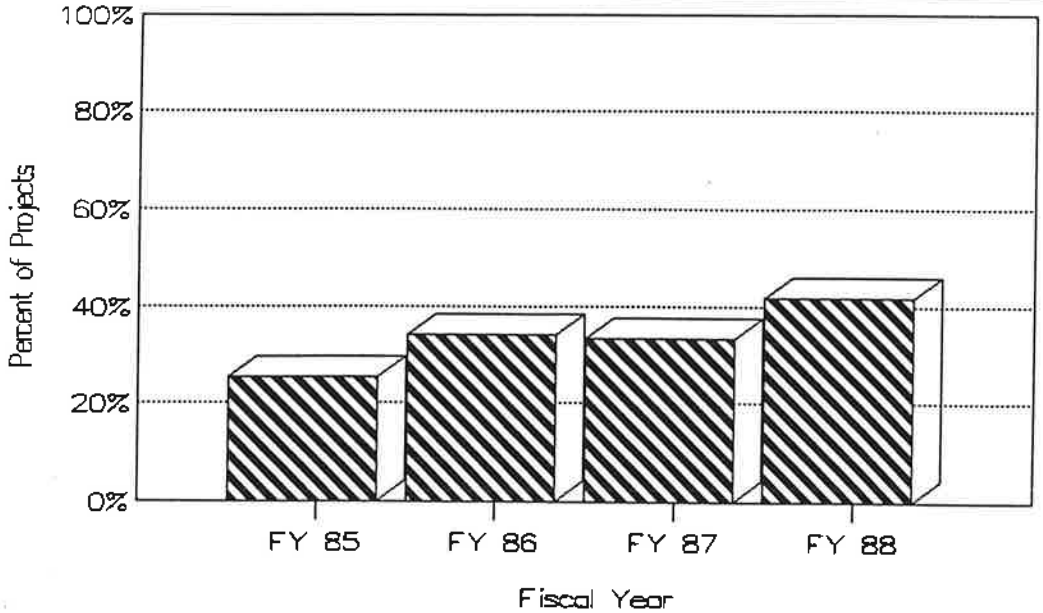
Only six percent of all projects receiving grant funds in 1988 were located in poverty communities, and these projects accounted for only 2.9 percent of total grant funds. The average grant share of a poverty-community project funded with FmHA grant funds increased between 1985 and 1988, however. If a low-income community were to receive grant funding, the average proportion of assistance in grant form increased from 62 percent to 70 percent of the FmHA financial contribution.[4]

Nevertheless, 42 percent of projects funded in poor communities in FY '88 received no grant assistance at all as shown by Figure 5. This figure has risen significantly since FY '85, when fully 25 percent of all projects in poverty-income communities received no grant assistance.

Figures for loan assistance are more disconcerting. Poor communities received only 1.1 percent of the total loan funds provided in FY '88 and FY '86. As Table 8 indicates, this figure was only slightly higher in the other two years.

Low-income communities were also underserved in the distribution of the most deeply subsidized loans. Their share of the loan dollars provided at the five-percent interest rate was only 5.1 percent in FY

Figure 5 Projects in Poverty-Level Communities Not Receiving Any Grant Support



Source: Unpublished data from FmHA Management Information Systems.

'85, and shrank to 1.5 percent by 1988. Indeed, as Table 9 indicates, only 60 percent of utility system borrowers serving poverty-level communities received loans at the lowest interest rate in the most "generous" year. In FY '87, only 42 percent of the poverty communities that borrowed from FmHA's program obtained that rate.

Finally, roughly a fifth of poverty-level communities served by the program each year received *neither* a grant nor a five-percent interest rate loan.

State-to-State Variations in Targeting

Just as the various FmHA state offices differ in their levels of utilization of the Water and Waste programs, they also differ in the forms of assistance provided and the degree to which these are a function of community income levels. Table 9 compares the income targeting records between 1985 and 1988 of five states that are major users of the program.

California, the western state with the largest program, shows considerably more evidence of income targeting than any of the other four states in the table. Not only is California the only one of the five states in which the average income in a program-assisted community is less than 80 percent of the statewide median figure, but its average community income is lower than that of three of the four southern states with which it is compared. Less than 15 percent of its assistance goes to communities with incomes above the statewide nonmetro median and more than 40 percent of its funding goes to those not exceeding the 80 percent mark. Moreover, California is by far the most generous of the five states with grant assistance.

At the other extreme is South Carolina, where 45 percent of all funding flows to communities with above-average incomes and only 15 percent flows to communities with incomes at the 80-percent level or below. In both North and South Carolina, loan funds are in most cases lent at market interest rates. In South Carolina, almost no use is made of five-percent loans. Those few loans made at that rate received no grant assistance between 1985 and 1988, while intermediate rate borrowers, on average, received a grant covering 73 percent of the FmHA contribution to the project in 1988.

This example demonstrates the effect of the interest-rate write-down function. Assume that two South Carolina communities planned projects whose costs totalled $500,000. One community had a median income below the poverty level, while the other community's residents had more moderate incomes between 80 percent and 100 percent of the statewide nonmetro median. The poverty community received a five-percent loan on the full $500,000 cost, and no grant subsidy, for an effective interest rate of five percent. In contrast, the more moderate-income community received an intermediate-rate loan at 7 per-

Table 9 Targeting of Water-Sewer Funds, Selected States, FY 85 to FY 88

	California	Texas	Arkansas	North Carolina	South Carolina
Number of Projects:	57	164	243	125	107
Statewide NMHI:	$14,904	$12,974	$11,115	$12,933	$13,071
Average Project Income:	$11,289	$12,399	$9,776	$12,417	$12,418
Relationship:	75.7%	95.6%	88.0%	96.0%	95.0%
Share of All Projects With Income Above Statewide NMHI:	18%	38%	16%	46%	41%
Share of Funds to Them:	14%	25%	20%	41%	45%
Share of Projects With Income Not Exceeding 80% NMHI:	53%	39%	30%	30%	27%
Share of Funds to Them:	42%	47%	19%	24%	15%
Average Share of Funding in Grant Form - Overall:	43.9%	17.1%	27.7%	19.4%	18.7%
With 5% Loans:	73.2%	48.7%	44.3%	55.9%	0.0%
With Intermediate Loans:	62.1%	50.6%	53.3%	58.3%	72.8%

"NMHI" means statewide Nonmetro Median Household Income (as of 1979).

Source: Unpublished data from FmHA Management Information Systems.

cent, but 73 percent, or $365,000, of its total project costs were covered by an FmHA grant. Its effective interest rate on the entire project is only 1.7 percent, nearly two-thirds less than the rate paid by the poverty-level community. While the more moderate-income community is not eligible for the five-percent loan, the total federal subsidy for its project is much more generous than for that of the poverty-level community.

The administrative flexibility embodied in this write-down function is magnified in the EPA program for wastewater facilities, which is essentially run by each of the states. That program is described in some detail in Chapter Seven.

1 Among other things, this results in a category of grant-only actions which includes projects that cannot be linked with their associated loans. It should also be noted that a few entries from the tracking system lacked essential information (either population or income data) and had to be excluded from the analysis. None of these factors was of sufficient magnitude to affect the validity of the analysis.

2 Those ten states are North Carolina, Kentucky, Texas, Pennsylvania, Arkansas, Virginia, Louisiana, Mississippi, Ohio, and South Carolina.

3 In this case the Census Bureau definition of "rural"—outside urbanized areas and places of 2,500 or more people—is used.

4 No information is available on the proportion of grant funds from other sources that help reduce overall project costs, as FmHA does not keep statistics on complementary sources of financing in jointly funded projects.

CHAPTER SEVEN

Environmental Protection Agency Waste Construction Grants

Farmers Home Administration Water and Waste funds are frequently used in conjunction with Environmental Protection Agency funds in financing community waste disposal systems. This chapter describes EPA program operations, and experiences that communities have had with both the Construction Grant Program and its successor, the State Revolving Fund program, in North Carolina. The program, which operates essentially as a block grant, offers an opportunity to compare and contrast the effectiveness of the two approaches to meeting waste water needs.

Authorized under the Federal Water Pollution Control Act of 1972,[1] the EPA construction grant program provides funds to states which they in turn give to established communities for waste treatment works construction that will "prevent discharge of untreated or inadequately treated sewerage or waste." Since its inception, the program has funded over $40 billion in projects throughout the country.

Eligible activities include planning, engineering studies, design, architectural, legal and financial studies, acquisition, remodeling or new construction, inspection and supervision. States, municipalities, or regional agencies can apply for funds. Unincorporated areas cannot apply, a serious obstacle for many rural communities inasmuch as approximately 40 percent of all rural communities are unincorporated.

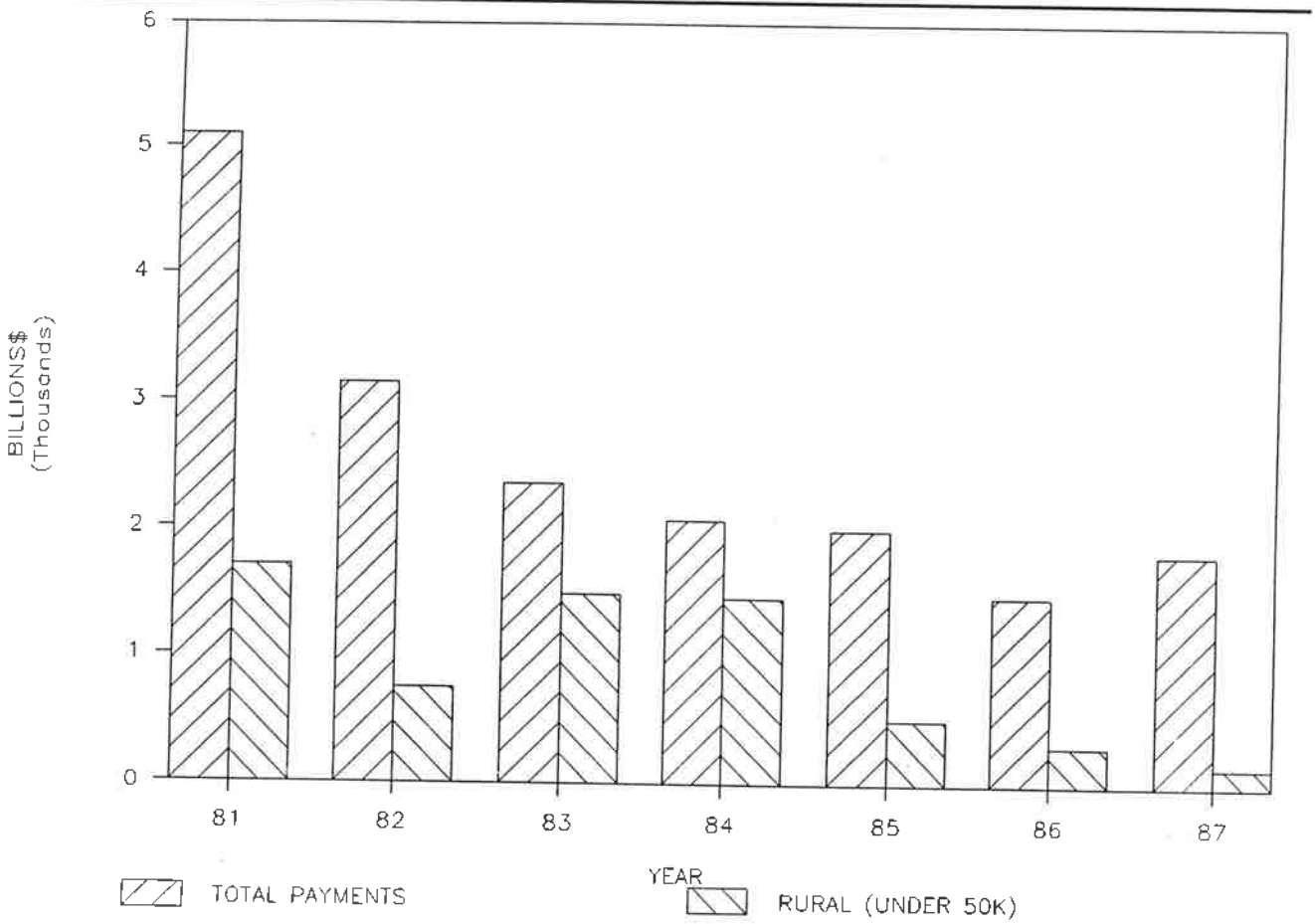
Under the program, EPA delegates significant administrative control to the states, through their state water pollution control agencies. Each state develops its own construction grant program and signs an agreement with the EPA regional administrator concerning standards and implementation. Provided that each individual proposal complies with the criteria outlined below, the state water pollution control agency has the authority to approve a grant out of its annual allocation, with the concurrence of the regional administrator.

Each state must conduct a needs survey, and design a funding process and criteria which include: the severity of the pollution problem (taking into consideration its impact on watersheds), the size of the affected population, and the need for preservation of high-quality waters. The state can determine the weight given to each of these and any additional criteria it considers appropriate. (For instance, states have flexibility to establish a rural set-aside or increase priority for rural projects, although very few actually do so.) States can further classify and fund applications by project type, for instance collecting all secondary treatment proposals and funding the highest priority of these projects, and treating all sewer replacement projects similarly.

Although proposed projects are ranked using the criteria above, they are evaluated by the water pollution control agency and the EPA regional administrator on additional criteria: appropriateness of scale and maintenance costs, effectiveness of water pollution control technique, public health necessity, financial burden on the community, prospects for prompt construction and level of current compliance (or lack thereof) with water pollution standards. Moreover, the regional administrator must certify that a project is consistent with the state's water pollution control plan and priorities, and meets certain baseline technical requirements. Generally, the regional administrator rubber-stamps projects that have been approved at the state level. (Proposals denied by the state can be appealed to the administrator.)

The vast majority of rural America's water and wastewater systems do not meet federal standards. The EPA's 1986 National Needs Survey found that 70 percent of the nation's substandard wastewater facilities are in small towns and rural areas. Moreover, numerous rural communities are without treatment facilities of any sort. The agency's 1984 study of water quality found that two-thirds of rural water supplies violated EPA drinking water standards. Faulty septic systems and waste disposal facilities are key contributors to unsafe drinking water.

Figure 6 EPA Construction Grants: Real Obligations, 1981–1987



Source: Municipal Construction Division, Environmental Protection Agency.

Despite this severe documented need, EPA spends a very small and diminishing amount of funds on wastewater projects located in rural communities. As Figure 6 indicates, EPA Construction Grant expenditures in rural communities declined by 91 percent in real terms between 1981 and 1987. Total program funding declined by 56 percent during the period. Only 8.3 percent of program expenditures in 1987 were made in communities with populations under 50,000.

Until 1988, states were allocated funds based on a simple formula somewhat comparable to that used by the FmHA Water and Wastewater program. The first $100 million of the EPA appropriation was distributed giving equal weight to population and per-capita income, as a proportion of national population and income. Funds beyond that amount were distributed based solely on population, weakening the income-based factor. Unused funds were repooled based on the same formula, although states which had used no funds during the year were not eligible for additional allocations.

Congress dramatically altered the construction program as part of the 1986 amendments to the Clean Water Act, and for FY 1989 cut funding by 15 percent. Beginning in FY 1989, an increasing portion of federal contributions to waste treatment are in the form of grants to states for relending purposes. As in past years, states will be allocated funds based on a formula, but will then create an Intended Use Plan (comparable to past state plans) and apply to the EPA for a grant with a 20 percent state match. Although states can offer grants out of their own funds, EPA State Revolving Funds must be disbursed in loan or guarantee form rather than grant form.

The grant portion of the program will be phased out by 1991, and the revised revolving loan program is authorized through 1994. Through that year, the legislation intended that Congress will continue to inject the State Revolving Funds with new capital.

Over time, however, it is anticipated that the funds will be self-sustaining.

Before 1982, the Construction Grant program funded 75 percent of the proposed cost of a project; at that time, the local match was increased from 25 percent to 45 percent, and EPA's share declined to 55 percent of costs. The non-EPA portion is secured through grants or loans from FmHA, state programs, or through conventional bonding authority. Proposals are generally submitted and paid for in phases, however, so EPA might fund 55 percent of the planning and engineering costs, then 55 percent of construction. This requirement poses problems for lower-income communities which often have difficulty funding 45 percent of the cost of a planning project out of operating funds.

In fact, some state administrators of the program suggest that the funding hump for rural communities apparent during 1983–4 in Figure 6 might represent a concerted effort on their part to sign agreements with lower-income, predominantly rural, communities before the new rules increasing the match went into effect. (Funds authorized in 1982 would have been expended in the following years.)

In exchange for their efforts, states receive great flexibility in funding waste systems. EPA contributes two percent of the total allocation for states' administrative costs. The regional administrator oversees the program's operation, but the authorizing legislation and regulations indicate that the federal government is committed to delegating as much authority as possible to states.

The program contains little in the way of targeting to rural areas. In those states in which 25 percent of the population lives in communities of under 3,500, four percent of a state's funds are set aside for those communities. This small set-aside has rarely shifted new funds to small communities because demand for systems is disproportionately higher in small communities than in large communities; the small communities would have received at least four percent of the funding anyway in a state with the requisite population profile.

State needs surveys do not classify rural community needs separately. This area deserves additional research. In fact, questions about rural funding patterns from staff of the Rural Development Policy Project in 1988 prompted EPA's needs survey team at the national level to generate data on funding trends in rural areas for the first time.

North Carolina's Program

North Carolina's water and waste programs are heavily politicized and weighted toward high-density communities. For instance, the state legislature recently appropriated $10 million for the state match portion of its Revolving Loan Fund program.[2] In exchange for passage, the legislative leadership required that $6.5 million of these funds be earmarked for their communities; only $3.5 million will be available competitively to the rest of the state.

Rural advocates were able to include a 15-percent rural set-aside in the state authorizing legislation. But all loans will carry a flat four-percent interest rate or half the Bond Buyer's 20-Bond Index, rather than a sliding-scale rate based on ability to pay. As a result, many communities, particularly lower-income rural communities with high per-capita project costs, may be unable to afford the program. Ten percent of the state funds are available in grant form to "High Unit Cost" communities—those whose per-capita water or wastewater rates, as determined by the funding formulae, would consume more than 1.5 percent of the community median income. These grants are capped at $500,000 per year. Terms on state-sponsored loans extend up to 20 years. During the course of any year, a community can borrow up to $3 million.

As mentioned above, the funding criteria for water and wastewater projects in the North Carolina program tend to favor high-population communities and systems serving four or more cities or towns. In addition, communities with existing systems are favored over communities with no water or waste service; communities intending to "significantly increase" their service area are favored over communities intending to "increase the source of raw water to meet existing . . . needs or to alleviate water shortage problems"; and communities building systems to serve growth expected over a 20-year period are favored over communities trying to meet immediate or shorter-term needs.

1 Regulations appear at 40 CFR 35.800–880.

2 The Waste Water program is funded through a ½ cent increase in the state sales tax.

CHAPTER EIGHT

Enterprise Development Loan and Grant Programs

As noted at the outset of this report, infrastructure assistance and business development assistance are very different in character, and should be targeted differently. Successful economic development efforts are extremely difficult to predict. Factors largely beyond the manager's control, such as market shifts, protectionist policy changes, or personnel problems, can mean success or failure. Despite these risks, and in part because the risks are so great, the federal government has regularly played a role in business development efforts, including those in rural areas.

Business and Industrial Loans

While the loan programs in support of physical and social infrastructure outlined in the previous chapters involve direct government loans, business development loans are generally extended by private banks at market rates, with guarantees provided by the federal government.

The Business and Industrial Guaranteed Loan program (B&I) was authorized under the Rural Development Act of 1972.[1] Its purpose is: ". . . to improve, develop or finance business, industry and employment and improve the economic and environmental climate in rural communities, including pollution abatement and control, [by] bolstering the existing private credit structure through guarantee of quality loans which will provide lasting community benefits."

Since its inception, the program has guaranteed $5.8 billion to over 7,000 borrowers. In FY 1987, 67 businesses borrowed $95.7 million.

Although the regulations allow for insured government loans to public bodies and to private borrowers in cases where no guarantee lender is available, that authority has rarely been used by program administrators. Instead, local businesses solicit the participation of private banks in financing deals that aim to save jobs, create jobs, improve existing businesses, or stabilize the local economy. Depending on the size of the loan and other factors, the federal government guarantees between 70 percent and 90 percent of the debt; the average 1988 B&I loan carried a 78 percent guarantee.

The Business and Industrial Loan program appears to have been developed in response to a perceived lack of credit (or credit on appropriate terms) in rural areas for credit-worthy projects rather than to provide credit for projects too risky for the balance sheets of local financial institutions. Unlike many other government-sponsored loan programs, the B&I program does not include a "credit elsewhere" provision; applicants are not required to prove that local financial institutions consider their applications too risky for lending purposes. In fact, the regulations explicitly prohibit guarantees for marginal or substandard loans.

Under the B&I approach, the government hopes that guaranteed loans will "graduate" to the private market after a period of public support, thereby removing the loan (and the accompanying risk) from the government's books entirely. Moreover, while the regulations support the "bolstering" of the private credit market, they also emphasize that the B&I program is not intended to bolster rural banks' balance sheets or to shift the financial risks of problem loans from banks to the government.

Responsibility for servicing loans once they are extended under the program falls on the participating bank. Since the bank stands to lose only 10-20 percent of the loan amount should the borrower default (because the federal government guarantees the rest), the bank has little incentive to track financial statements, intervene at appropriate times or move to protect collateral. In fact, a recent FmHA Administrative Notice described a program audit conducted by the Office of the Inspector General which concluded that,

> . . . lenders have continued to provide inadequate service on B&I loans. . . . (L)enders had (1) not

protected the collateral prior to and during liquidation, (2) not accounted for or directly allowed the misuse of loan funds and liquidation proceeds, (3) been involved in conflicts of interest with borrowers, and (4) submitted inadequate liquidation plans and final loss claims.

In many cases, the participating bank is able to sell the guaranteed portion of the loan on the secondary market soon after approval (while retaining servicing responsibilities), further removing its interests from those of FmHA.

Because of this issue and the fact that business development lending is intrinsically more risky than lending to communities with tax bases behind them, the B&I program has had a history of high default rates. In 1987, for instance, while the Water and Waste Disposal and Community Facilities Loan program default rate fell below three percent, the B&I program default rate was 24 percent.

Funding for the Business and Industrial Loan program has been cut more dramatically than any other FmHA rural development loan program over the past eight years—from $741 million in 1981 to $95.7 million in 1987. FmHA administrative staff claim that programmatic excesses during the Carter administration led to high default rates and politicization of the funding process, leaving the Reagan administration no choice but to rein in the program.

1. Administration

The Business and Industrial Loan process loosely parallels the administrative procedure of the Community Facility Loan program. According to the regulations, the focal point for administration of the Business and Industrial Loan program, however, is the FmHA state director. Applications and pre-applications (in cases in which a lender is already committed) may be submitted by the would-be borrower to the county supervisor or to the district director, but are then forwarded to the state director for evaluation. Funding criteria are not laid out in the regulations as they are for Community Facility Loans, but criteria developed by the national office include factors relating to community income, unemployment, and anticipated job creation. (See Figure C in the Appendix.)

The state director evaluates the proposal for eligibility, environmental impact, equal employment opportunity, conflicts of interest between lender and borrower, and for sufficiency of collateral. If the proposal is eligible for Small Business Administration assistance, the state director must refer the borrower to the SBA. Businesses looking for assistance in an expansion must hold a minimum ten-percent equity stake in the endeavor; new businesses must put up 25 percent of the project. Moreover, new businesses are required to submit a detailed feasibility study.

Although the interest rate is negotiated privately between lender and borrower, other loan terms vary, depending on the type of project. Loans to buy land or buildings have a 30-year term while working capital loans are paid off over seven years and machinery and equipment are paid off over 15 years (or less, based on the usable life of the equipment). Interest payments begin immediately, although principal payments can be deferred for three years or longer, if the project begins operation beyond the three-year point. These terms are generally much more favorable than the private market would offer without a federal guarantee.

After consultation with district level staff, the state director convenes a meeting of the State Loan Review Board. The state director chairs the group, which is composed of the B&I chief, the rural housing chief, the farms program chief, and if appropriate, the county supervisor or district director for the area in which the project is located. The regulations state that the state director, with the advice of this group, can authorize a loan for up to $5 million.

A complex series of Administrative Notices and other guidelines have effected changes over the years that in many ways disregard these program regulations. Almost all loan approval authority has been reserved for the national office. The state director evaluates the loan proposals, assigns points and distributes discretionary points, and passes the docket, along with a recommendation, to the national office. The national office, through a National Office Executive Loan (NOEL) Committee not authorized in regulations nor by law, then makes a final decision, rarely disagreeing with the state director's recommendation, and passes the docket back to the state level for issuance of a Conditional Commitment for Guarantee.

The national office has further contravened its own informal process in certain circumstances. At this time, for instance, nine states with healthy loan portfolios and experienced staff have been authorized by the national office to process and approve loans under $750,000.

Program regulations address concerns about sufficiency of collateral at several points: FmHA loan officers must assure that the life of the collateral is comparable to the term of the loan; real estate is valued at 80 percent for collateral purposes; and property valued at over $350,000 must be appraised before the loan can close. Although servicing responsibility falls on the lender, FmHA can play a significant role if default and liquidation should occur.

In a bankruptcy situation, the lender must submit to FmHA its plans for liquidation of assets. If the state director is concerned about the plan (and about potential excess losses to FmHA as a result of its implementation), he/she can forward the plan to the national office with a recommendation that the office refuse to accept it. At that point, FmHA can step in and liquidate. In recent years, FmHA has successfully persuaded the courts to relieve FmHA of its guarantee commitments in cases where a lender did not properly fulfill its servicing obligations.

2. Funding Formula

Regulations indicate that funds are allocated to the states in a manner similar to that of the Water and Waste and Community Facility programs. Two adjustments are made, however.

While the state factors for the community programs are derived from poverty and rural population statistics, the Business and Industrial Loan program includes measures of unemployment. The State Factor formula is weighted as follows:

- 33.3 percent— State percentage of U.S. rural population
- 33.4 percent— State percentage of U.S. nonmetro unemployment
- 33.3 percent— State percentage of nonmetro communities below poverty line.

In addition, the regulations require that ten percent of total funds be set aside for a reserve account, although in practice the administrator sets aside 15 percent of the appropriation.

Interestingly, FmHA has found that projects requiring smaller loans have been more successful at generating new jobs. The agency figures that a $1.1 million loan typically generates one job per $11,000 in federal investment. Smaller loans generate one job for each $8,500 invested.

Other FmHA Enterprise Development Programs

There are two other FmHA rural development programs—the Intermediary Relending Program (IRP), formerly administered by the Community Services Administration and then by the Department of Health and Human Services as the Rural Development Loan Fund (RDLF), and the Industrial Development (ID) Grants program. Both programs convey funds to public or private nonprofit organizations, Indian tribes, or cooperatives for relending to local businesses and for the provision of technical assistance. These programs are very flexible in both purpose and form of assistance.

IRP funding comes to intermediaries in the form of a low interest loan.[2] At present, IRP money is lent to intermediaries at one-percent interest over 30 years, with repayments of principal generally delayed for up to three years. Intermediaries in turn lend funds at negotiated rates to new or expanding businesses. As loan payments are returned by the businesses to the intermediary's loan fund, they lose their federal character and can be re-lent without federal limitations.

Loan funds cannot be used for agricultural projects, administrative costs, recreation, tourism projects, or charitable institutions. Moreover, a maximum of 75 percent (capped at $150,000) of a project's total cost can be financed through the IRP, and FmHA must sign off on all intermediary loans to recipients.

An integral component of the Intermediary Relending Program is its job-creation aspects: The program is specifically intended to fund businesses which in turn will employ low-income workers and displaced farm families. The ID Grant program incorporates this policy objective to some extent by basing funding criteria in part on area unemployment rates, but the program does not require that the funded business itself hire low-income (or previously unemployed) workers.

The Industrial Development Grant program is very similar to the IRP in that funds are provided to a local or regional intermediary which, in turn, lends funds in a flexible and responsive manner to local businesses.[3] Rather than borrow funds through a long-term arrangement with FmHA, however, ID grantees receive funds in grant form. In both cases, administrative costs and the costs of providing technical assistance to businesses are intended to be covered by the spread between the intermediary's cost of funds and the rate at which it lends funds to businesses.

Of 15 ID grants awarded in the 1988 FmHA funding cycle, 12 went to public bodies and three were awarded to nonprofit organizations. This funding record reflects the history of the program: For 20 years, during many of which the program was unfunded, ID grants were available only to public bodies, and generally for the purpose of constructing industrial parks. In 1987, nonprofit organizations became eligible to participate in the $6.5 million program, and the range of eligible projects was widened.

In contrast, 50 percent of FY 1989 IRP loan awards were obligated for lending by nonprofit organizations. The program's history, as noted previously, dates back to the Community Services Administration, which, of course, had close ties to the nonprofit world. Although the program has shifted from CSA to HHS to FmHA, it still retains remnants of its original constituency.

1. Administration

Industrial Development Grants The Industrial Development grants program is coordinated by the state director, although funding decisions are made by the national office. Applications, which must include detailed if tentative work plans, are submitted to the state director, who assures that proposals meet eligibility guidelines and pass environmental review and other federal requirements.

Recipient organizations have great flexibility in spending ID funds. Provided they are used to "support the development of small and emerging private business enterprises in rural areas," funds can be used by the intermediary to build facilities itself, to provide technical assistance to businesses, or to loan or grant funds to businesses for eligible purposes. If funds are re-lent, a revolving loan fund is, in essence, created with repayments not subject to federal control in any way.

Grantee funds can be used for land acquisition and development, construction of facilities, purchase of equipment, development of utilities, start-up costs and working capital, technical assistance, or loan packaging services. Funds cannot be used for agricultural projects, planning, refinancing (except in a few circumstances), or for projects requiring more than $500,000 in ID grant funds.

Proposals are scored at the state level, based on criteria including the proposed service area's proportion of rural population, unemployment rate, median household income, and the organization's level of nonfederal funding and track record (see Figure D, Appendix). Contrary to other programs, in which the director has discretion over approximately 20 percent of total points, the state director may assign an ID grant proposal up to 50 discretionary points (out of a total of 170).

During FY 1988, FmHA published regulations covering the program, including funding criteria, in the *Federal Register*. The *Register* notice did not establish a timetable or mention the dollar amount available for distribution. The administering staff simply set an informal deadline in-house, set aside $3 million of the funds for projects in Oklahoma as required by the congressional conference report, asked state directors to prioritize proposals from their states, and funded those with the highest rankings. Only organizations with a relationship with the agency were aware of the process.

The *Register* notice reserved assignation of the 50 discretionary points for the administrator. Those proposals that were not funded were either denied (in which case a detailed denial letter was mailed from the state director's office), or held over for further consideration.

Intermediary Relending Program Although the IRP program is administered at the National Office by the director of the Business and Industrial Loan Division, the program operates in a manner very similar to the ID Grant program: Identical projects are eligible for assistance through the intermediaries, financial arrangements with recipient businesses are negotiated on a case-by-case basis, administrative expenses are funded out of loan spreads, and adequate collateral is required both for the FmHA-intermediary loans and for the intermediary-recipient loans. Both programs require environmental evaluation for the initial grant or loan and for individual projects proposed by third-party loan recipients. States can elect to review projects funded by both ID grant and IRP intermediaries.

Intermediaries apply directly to the FmHA National Office for funding under the IRP. The application must include information on the intermediary's track record as a relender, a detailed work plan (including proposed projects and selection criteria) and description of the organization and staff, indications of nonfederal funds that will be utilized in support of the IRP, plans for collateralization of the loan, and *pro formas* covering three years of operation.

Although an objective rating system is not laid out in the regulations, intermediaries are evaluated based on their intended level of assistance to projects benefiting low-income people, and their ability to leverage private funds.

During the last funding round, the process proceeded differently, however. The national office brought the B&I chiefs from each applicant's state to Washington to receive training and evaluate the proposals. Each B&I chief then made a recommendation to the National Office Executive Loan Committee regarding funding. The national office intends that decisions concerning the IRP will be made by state directors once state staff are trained in Washington.

2. Funding

Congress has authorized both the IRP and the ID Grant programs for many years. Nevertheless, neither has been consistently funded. IRP was unfunded for nearly 20 years. In FY 1988 and 1989, IRP was funded at $14 million and ID Grant at $6.5 million (although significant portions of the latter were set aside for specific projects in the report language in FY 1988). Fiscal Year 1990 levels are higher: $19.5 million for IRP and $16.5 million for ID Grant.

Although the programs were appropriated very small amounts of money, FmHA initially intended to replicate its traditional funding mechanism and allocate the funds on a state-by-state basis for distribution by state directors. Only intervention in early 1988 on the part of Senators Leahy and Burdick, chairs of the Senate Agriculture Committee and Agriculture Subcommittee of the Senate Appropriations Committee respectively, led to establishment of nationally competitive criteria for the programs and ensured that recipient organizations would have sufficient funds to make a difference in encouraging enterprise development.

The experience of Northern Community Investment Corporation (NCIC) of St. Johnsbury, Vermont, and a number of area businesses, illustrates the operation of several of FmHA's business development programs.

Case Study: Northern Community Investment Corporation

Northern Community Investment Corporation (NCIC) was started in 1975 with a $150,000 grant under Title VII of the Economic Opportunity Act (Revolving Loan Guarantee Fund). A community action agency covering northern Vermont and northern New Hampshire was instrumental in putting together the proposal. Since its inception, NCIC has lent $20.3 million of its own funds, and leveraged an additional $88 million.

The organization has a 15-member board and a 1,300-member base (each member pays one dollar). One board member is elected from among members in each county, two are elected within each state, and then those ten members appoint an additional five members with professional qualifications.

The bylaws of the organization indicate that NCIC was established to:

- Stimulate the general economic condition and development of the northern counties of New Hampshire and Vermont;
- Support specific economic ventures by investment, acquisition initiations or continuations, working in conjunction with commercial banking interests; and
- Increase job opportunities for low-income people in the public and private sectors, both profit and nonprofit.

The organization's service area includes the Northeast Kingdom of Vermont (three northernmost counties) and the North Country of New Hampshire (three northernmost counties). Seventy-five percent of the Northeast Kingdom and 80 percent of the North Country is covered by forest. Agriculture, logging, and woodmilling formerly were the primary occupations; now service jobs predominate.

Beyond a network of mostly secondary hard-surface roads, there is little transportation infrastructure and no local public transportation in the area. Resource-based and manufacturing industries are on the decline, wage scales are low, outmigration is a significant problem, and there is a history of high unemployment in the area. In fact, the areas within NCIC's service territory have historically had some of the highest unemployment and poverty rates in the New England.

At the moment, the economic picture is comparatively bright. The booming economy in southern New England has rippled up into the northern areas, and unemployment rates are below five percent. Moreover, Interstate 93 was recently extended into northern

New Hampshire, opening up the area for second-home development and short-term construction jobs, which have further decreased the unemployment rate in the North Country and neighboring Northeast Kingdom. Wages have risen in reaction to labor shortages. Nevertheless, average family incomes in the area are 20 percent below the state averages and 30 percent below the national average.

The total area population is 190,000, spread out among 137 municipalities, of which 120 have populations under 2,500. The area has a population density one-half to one-third the national average. Statistics for 1983 indicate that durable manufacturing comprised 15.3 percent of the work force, nondurable manufacturing 16.6 percent, construction 10.7 percent, and agriculture, forestry, and fishing 8.2 percent.

Project staff looked at two financing packages in which NCIC participated: Conner Footwear, a B&I project, and Tender Corporation, financed through the Rural Development Loan Fund during the time it was administered by the Community Services Administration.

1. Conner Footwear

Several shoemaking factories in NCIC's service area closed during the late 1970s. One of them, Rosita Footwear, was bought by a group of former factory managers. In early 1980, after negotiating for six months, the principals secured a B&I loan guaranteed by FmHA. In concert with other funds, they were able to buy and reopen the plant, hiring 200 local workers to produce generic women's casual shoes that are sold under various brand names. Many of the workers had been left unemployed by the shoe plant closings that swept New England in the late 1970s. The reopening of the plant generated a one-percent increase in employment in NCIC's service area; the plant is now one of the major employers in northern New Hampshire.

The original Conner Footwear financing package, signed in April 1980, was structured as follows:

First Mortgage:
Term: 20 years
Rate: 10.25 percent
Source: Lafayette National Bank
Principal: $100,000
Guarantee and source: 20 percent, NCIC, seven years
Collateral: Real estate

Second Mortgage:
Term: ten years
Rate: 14 percent with one year principal holiday
Source: Lafayette National Bank
Principal: $175,000
Guarantee and source: 90 percent, SBA
Collateral: Real estate and machinery; personal guarantees on the part of the four principals.

Revolving Line of Credit:
Rate: Prime plus three percent
Source: New England Merchants Bank
Principal: Maximum $1.5 million
Guarantee and source: 90 percent, FmHA B&I program
Collateral: Inventory and receivables as collateral. Formula is 80 percent of accounts receivable under 60 days, and 35 percent of value of inventory.

Equity investment:
Source: NCIC
Amount: $200,000 in common stock, $500,000 in 15 percent subordinated ten-year convertible debentures and $100,000 in 15 percent cumulative preferred stock, with varying call provisions and repurchase terms.

Source: Principals
Amount: $330,000 in common stock (60 percent, with the balance controlled by NCIC).

Since the time the agreement was signed, financing for the firm has been restructured, but all payments have been met by Conner Footwear. In November 1982, Conner Footwear and NCIC agreed that Conner would repurchase 50 shares in December 1982 (with cash), 75 shares in December 1983 (with cash), and 75 shares in December 1984 ($40,000 in cash, and $206,000 financed at prime minus one percent over three years). The stock's value was figured according to a formula included in the original financing agreement in 1980. The $500,000 debenture was neither called nor converted.

This refinancing package was itself restructured: The initial 50 shares were purchased on schedule with cash; the first 75 shares were financed with a note for $149,000 at ten percent that continues to roll over. The payment for the final 75 shares was folded in with the remaining portion of the 15 percent debenture to form a new ten-year note (11 percent through 1992 and adjustable through 1997).

Finally, under a management incentive plan, NCIC's portion of the total common stock was reduced in the first year from 40 percent to 36 percent.

As in the case of Tender Corporation below, NCIC provided extensive technical assistance to Conner Footwear, including assistance with its business plan and in negotiations with private lenders.

2. *Tender Corporation*

Tender Corporation is a small family-run firm in northern New Hampshire which produces and markets AfterBite, a bug bite remedy. The principals had originally started as a business consulting firm, but saw promise in production of nonprescription products like AfterBite. In 1986, the company wanted to expand and acquire the right to produce Afterburn, a burn remedy, and Natrepel, an insect repellent free of DEET, a widely used chemical that is toxic at high levels. The firm went to NCIC for financing for the acquisition.

The TenderCorp deal was less complex than that of Conner Footwear:

First Mortgage:
Term: Five years
Rate: 12 percent
Source: NCIC's Rural Development Loan Fund
Principal: $100,000
Collateral: Inventory, machinery, equipment, contract rights, accounts receivable, etc.

Second Mortgage:
Term: Five years
Rate: 12 percent
Source: NCIC's Intermediary Relending Program fund
Principal: $50,000
Collateral: Same as above

NCIC had loaned $50,000 to a sister corporation of Tender Corporation, KDI, several years earlier. The original firm failed, and NCIC was still owed its principal. As part of the acquisition, Tender Corporation essentially shifted the original $50,000 loan onto its books (in the form of the new second mortgage), and agreed to pay NCIC back for the KDI losses. TenderCorp more recently secured an SBA guarantee on a long-term loan covering the construction of its production facility.

The financing agreement requires that TenderCorp provide "demonstrable benefits" to low-income people and low-income rural residents, and that the majority of new employees should be of low income. The agreement contains explicit provisions for action in the case of noncompliance. TenderCorp's original business plan estimated that nine new entry-level jobs would be created through the expansion; 15 additional staff were actually hired shortly after the expansion.

In addition to its financing assistance, NCIC brought TenderCorp significant technical assistance. In particular, management credits NCIC's involvement with easing its relationship with its conventional lender, and with bringing an experienced outside perspective to broaden the capabilities of a small, family-owned business.

Although the Tender Corporation management know in an intellectual sense that they are beneficiaries of a federally sponsored program, they do not perceive NCIC as an extension of the federal bureaucracy. They view NCIC staff as lenders, albeit more flexible than the local bank. When asked their view of FmHA, they immediately refer to its housing programs. They say that the only other government-sponsored technical assistance they have received was an exporting class sponsored by the Department of Commerce. (A significant portion of TenderCorp production is destined for northern European markets.)

Finally, when asked whether state administration of the Rural Development Loan Fund would improve the program, TenderCorp staff say emphatically that in New Hampshire, state administration would mean that funds would be earmarked for businesses in the southern part of the state. Northern New Hampshire has much in common with northern Vermont, and is traditionally the last section of the state to see the benefits of conventional economic initiatives.

3. *The view from CSA*

As noted, NCIC acted as an intermediary between the Community Services Administration, which administered the IRP at the time under the name Rural Development Loan Fund, and the ultimate borrower. The agency's agreement with NCIC required the organization to consider the social as well as financial benefits of proposed projects—the number of year-round jobs, impacts on earnings of low-income residents, improved prospects for natural resource development, leverage factors, opportunities for institution building, and geographic distribution of the projects. Each financing proposal was checked for eligibility, and then for financial strength. Any loans above

$250,000 required CSA approval before an agreement was signed. CSA expected its grantees to draw down its balance within two years, build up a revolving balance, and then maintain a fund balance of approximately $500,000 thereafter.

The RDLF monies were lent to NCIC at one-percent interest over 30 years with a five-year moratorium on principal repayments. In general, banks have a 4-5 percent spread between their cost of funds and lending rate to account for administrative costs and profit. NCIC's spread of approximately six percent reflects the extensive technical assistance provided to borrowers and the increased risk that those borrowers represent. The organization capitalizes a loss reserve of ten percent of outstanding loans.

4. The intermediary's perspective

NCIC President Stephen McConnell tells potential borrowers not to look at NCIC's funds as "cheap money." A low interest rate may provide breathing room, but McConnell maintains that if a project cannot meet a market rate, its prospects for long-term success are not good. Because the organization is traditionally in third or fourth position behind better collateralized lenders, and because the projects in which it invests are at the margin between conventionally financed success and failure, NCIC expects to lose a certain amount each year.

McConnell sees a vast difference between HHS and FmHA, although IRP regulations are nearly identical under the two administrating agencies. Most importantly, HHS staff were, he says, quite unfamiliar with business or financial matters. Consultants were often brought in to review applications for business development loans and grants. Since HHS staff did not learn the ropes, they did not become comfortable with the program, its complications or its successes. In contrast, FmHA business lending staff, who tend to have long tenure in their jobs, are much more comfortable with lending and credit analysis. They tend to be inflexible in implementing regulations, however, McConnell says.

Banks in NCIC's area are particularly attracted to deals involving SBA loan guarantees, McConnell says, because they can sell the guarantee through brokers and increase their liquidity. McConnell has heard some complaints about SBA application turnaround, although the certified lender program authorizes certain prequalified lenders to sign off on loans provided the guaranteed portion remains below 75 percent of the value of the loan. To be eligible for the program, borrowers must have a 3:1 ratio of debt to net worth, which eliminates many of the businesses most likely to apply for assistance through the RDLF or B&I programs.

There is little question that the projects financed with assistance from NCIC are located in communities with relatively high unemployment and poverty rates. Is this the case for the program in general? We examined the distribution of projects funded through the B&I program, and analyzed the manner in which they are targeted to communities of high unemployment and low income. Our findings appear in the next chapter.

1 Regulations at 7 CFR 1980.401–500.
2 Regulations at 7 CFR 1948.101–150.
3 Regulations at 7 CFR 1942.301–350.

CHAPTER NINE

Distribution of FmHA Business and Industrial Loans

This chapter analyzes the level of targeting evident in B&I loans guaranteed between 1986 and 1988.[1] The database from which the relevant data were selected was provided by the Farmers Home Administration in response to a Freedom of Information Act request.

The project-by-project data obtained from the agency included information on borrower, location, amount of loan, interest rate set by lender, and the four-digit Standard Industrial Classification (SIC) code for each approved project. Because of the diminished size of the program since the significant budget cuts of the early 1980s, data for all three years were pooled for evaluation.

Geographic Distribution

During the time covered by this analysis, 178 loans involving a total of nearly a quarter billion dollars were guaranteed. The number rose from 34 loans and $48.9 million in FY '86 to 65 loans and $105.7 million in FY '87 and 79 loans for $92.6 million in FY '88.

As with other FmHA programs, use of the B&I program varies considerably from state to state. A third of the states had no program activity in any of the three years covered by the analysis. On the other hand, two states (North Carolina and West Virginia) each reported more than a dozen loans. They accounted for more than 25 percent of the credit guaranteed under the program. When Mississippi, Ohio, and Texas are added, five states account for a majority of the loans and 45 percent of the total guarantee amount provided.

Sectoral Distribution

Our analysis divided the 178 loans into four groups on the basis of the SIC code provided for each project. These groups were: Manufacturing: Primary (which includes food, tobacco, textiles, lumber and furniture, paper and printing, chemicals and petroleum); Manufacturing: Other; Trade; and All Other SICs. Table 10 summarizes the data by SIC group.

Almost half of all loans and two-thirds of the loan funds guaranteed through the B&I program were devoted to manufacturing activities. Manufacturing

Table 10 Business and Industry Loans Guaranteed, FY '86 – FY '88

	Manufacturing: Primary (SIC: 20-29)	Manufacturing: Other (SIC: 30-39)	Trade (SIC: 50-59)	Other Industries	All Industries
Number of Loans	40	44	46	48	178
Amount of Loans ($ 000s)	$78,577.0	$83,699.0	$37,191.0	$47,628.8	$247,096
Avg. Loan Amount ($ 000s)	$1,964.4	$1,902.2	$808.5	$992.3	$1,388.2
Avg. County Income	$13,929	$15,065	$14,306	$14,078	$14,368
Avg. County/State Income	106%	114%	105%	100%	106%
Avg. County Unemployment	8.42%	8.13%	7.69%	8.77%	8.26%
Avg. County/State Unemp't	100%	98%	95%	102%	99%

Source: Program data provided by Farmers Home Administration; income and unemployment data from the Bureau of the Census and the Department of Labor.

of primary materials accounted for 32 percent of the loan funds while other manufacturing activities accounted for another 34 percent. Loans in manufacturing were typically larger—averaging more than $1.9 million each. Loans outside the manufacturing categories averaged less than $1 million each.

The median household income in the counties in which projects were located was $14,368, a figure 6 percent above the average statewide nonmetro figures for those counties.[2] Incomes were highest in the second manufacturing category, in which they averaged 14 percent above the relevant statewide nonmetro figures.

Unemployment in the project counties averaged 8.3 percent, a figure just under the statewide nonmetro average. The relative unemployment level was lowest in the counties where the assisted project involved the trade sector. However, it should be stressed that differences in median income or unemployment do not appear to be very large across sectors.

Loan Size and Interest Rate

As Table 10 shows, the mean loan guaranteed under the program in the last three years was $1.4 million. The median declined over the period examined, from $1.1 million in FY '86 to $680,000 in FY '88. The following chart shows the distribution of B&I loans during the three-year period as a whole.

	Number	*Amount ($000s)*
$ 500,000 or less	63	$ 17,234
$ 500,001 – $ 1,000,000	36	26,901
$ 1,000,001 – $ 1,500,000	24	29,756
$ 1,500,001 – $ 2,000,000	20	36,932
$ 2,000,001 or more	35	136,273
	178	$ 247,096

More than 40 percent of the loans guaranteed were larger than $1 million dollars, and 55 percent of the total dollar amount guaranteed resulted from loans of more than $2 million.

Interest rates under the program are set by agreement between the borrower and the lender. A relatively wide spectrum of rates has characterized the program over the last three years. The range varied from 7.5 percent for an FY '86 loan of $320,000 in Mississippi to 14 percent for a loan of $350,000 in Tennessee in that same year.

However, interest rates were heavily concentrated around the median rate of ten percent. In fact, 86 percent of program activity involved loans at interest rates within 1.5 percentage points of the median. There was some year-to-year shift in interest rates under the program, but no dramatic changes. The median rate for a project closed in FY '86 was 10.5 percent. In FY '87 the rate hovered around 9.5 percent; but by FY '88, the rate drifted back up to 10.5 percent. The average prime rate in each of those periods was 8.8 percent, 7.9 percent and 9.0 percent, respectively. Thus, the median rate on a B&I project was approximately 1.5 to 1.7 points above the prime rate.

Targeting by Income and Employment

While FmHA's loan guarantee program has few explicit targeting requirements, its goal is to foster development in areas in need of economic growth. The project scoring sheet gives greater weight to communities of small size and relatively high unemployment rates; communities in need of economic growth also tend to have somewhat lower incomes than more prosperous communities. Therefore, income and unemployment are used for this preliminary analysis of the degree to which the distribution of program assistance has actually been targeted to the areas most in need.

For each project, the relationship between county income in the project county and the appropriate statewide figure was determined. A similar calculation made for the unemployment level in the county.[3]

Loans were grouped according to whether the county income level was less than the statewide figure or was equal to or above the statewide figure, and whether the county unemployment figure was less than or equal to the statewide figure or was above it. Table 11 reflects the data for four groups of loans, by SIC category. The first grouping involves loans in which both income and employment were below average. At the other end of the continuum was a grouping for those in which both income and employment in the county appear to be above average. In between are those in which the two indicators diverged.

This analysis can only be regarded as a preliminary assessment of targeting in the B&I program. It indicates, however, that targeting of assistance to poorer rural communities is not strong.

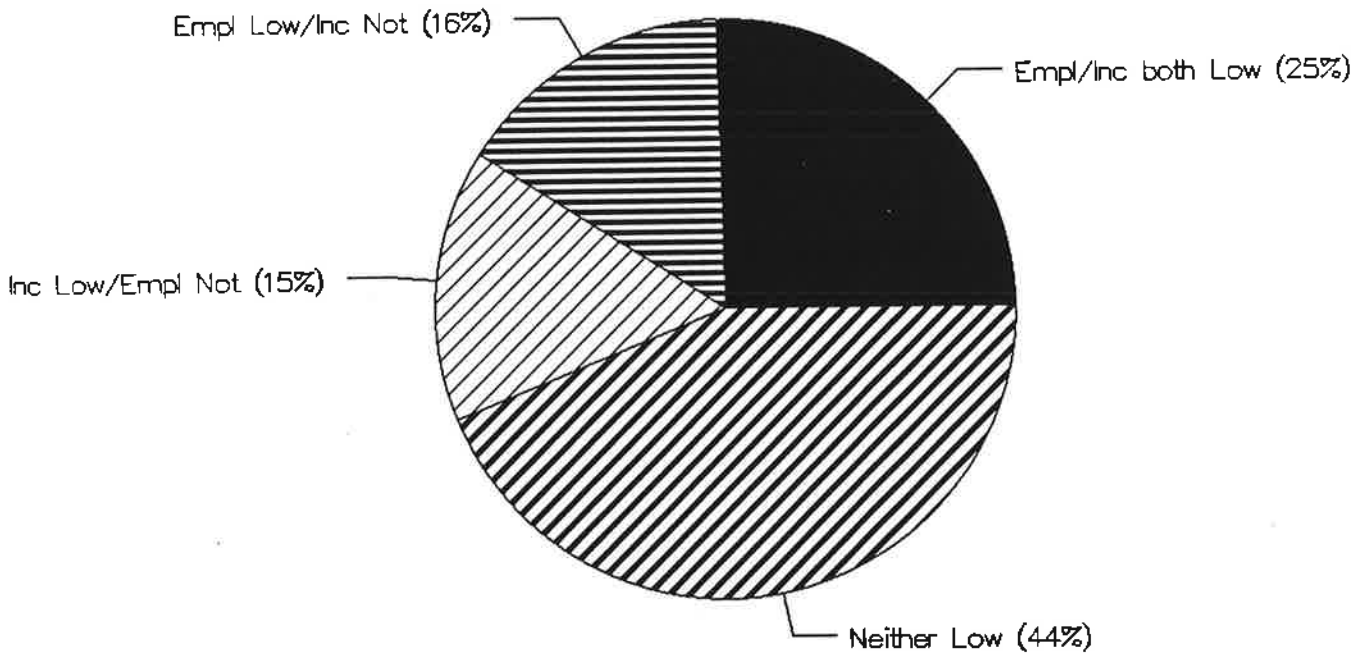
As Table 11 and Figures 7 and 8 indicate, less than one-fifth of all guarantees were attached to loans for

Table 11 B & I Loans by Relative Income and Employment

	Manufacturing Primary (SIC: 20-29)	Manufacturing Other (SIC: 30-39)	Trade (SIC: 50-59)	Other Indust's	All Industries
Income and Employment Both Low:					
Number	10	8	14	13	45
Amount ($ 000s)	$9,284.0	$12,240.0	$8,274.4	$12,140.0	$41,938
Percent of Total	11.8%	14.6%	22.2%	25.5%	17.0%
Employment Low, Income Not:					
Number	9	6	6	7	28
Amount ($ 000s)	$15,363.0	$23,367.0	$6,845.0	$9,132.8	$54,708
Percent of Total	19.6%	27.9%	18.4%	19.2%	22.1%
Income Low, Employment Not:					
Number	3	6	6	12	27
Amount ($ 000s)	$11,500.0	$12,053.0	$2,026.0	$11,659.1	$37,238
Percent of Total	14.6%	14.4%	5.4%	24.5%	15.1%
Neither Income Nor Employment Low:					
Number	18	24	20	16	78
Amount ($ 000s)	$42,430.0	$36,039.0	$20,045.6	$14,697.0	$113,212
Percent of Total	54.0%	43.1%	53.9%	30.9%	45.8%
All Loans Guaranteed:					
Number	40	44	46	48	178
Amount ($ 000s)	$78,577	$83,699	$37,191	$47,629	$247,096
Percent of Total	100.0%	100.0%	100.0%	100.0%	100.0%

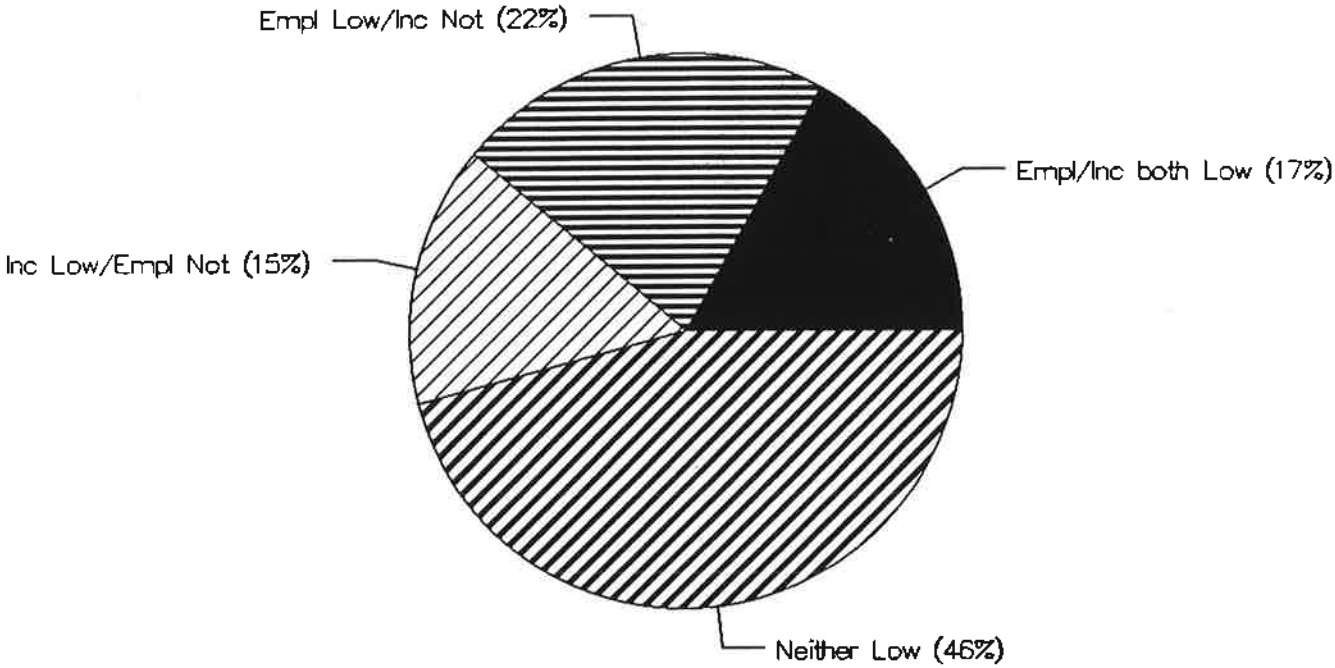
Source: Program data provided by FmHA; income data from the Bureau of the Census; unemployment data from the Bureau of Labor Statistics.

Figure 7 Distribution of B & I Projects by Economic Conditions



Source: Unpublished data from FmHA Management Information Systems.

Figure 8 Distribution of B & I Dollars by Economic Conditions



Source: Unpublished data from FmHA Management Information Systems.

projects in counties in which both income and employment were below the statewide average.

Some 46 percent of guaranteed funds went into counties in which both income and employment were equal to or above average. Moreover, six percent of all guaranteed loans financed projects in counties in which both income and employment were at least ten percent above average.

Loans at the other end of the spectrum (with both income and employment at least ten percent below average) accounted for only one percent of the B&I guarantees. Taking the indicators separately, less than 40 percent of the guarantees were devoted to projects in counties with below-average employment levels and less than one-third went into counties in which incomes were below average.

Small Cities CDBG funds can be used for infrastructure projects as well as business development. The chapter that follows describes the program in some detail, and offers a case study of a business development project funded through CDBG in North Carolina.

1 It should be noted that the annual program funding levels in the database obtained from FmHA differ slightly from those in the federal budget documents.

2 As is discussed further below, the median household income and the unemployment rate were determined for each county in which a loan was guaranteed. These were compared with the statewide median nonmetro household income and the statewide nonmetro unemployment figure as relative indicators of economic distress.

3 The income data used were median household income and state nonmetro household income, both figures for 1979 and obtained from the 1988 edition of *The County and City Data Book*. The unemployment figures used were county and statewide averages for 1987 and obtained from the Local Area Unemployment Statistics (LAUS) series maintained by the federal Bureau of Labor Statistics.

CHAPTER TEN

Community Development Block Grants—Small Cities

Authorized under the Housing and Community Development Act of 1974, the Small Cities Community Development Block Grant (CDBG) program[1] is what remains of a series of competitive community development programs that were "folded in" to form the block grant in 1975.

Seventy percent of total funding is earmarked for the CDBG Entitlement Program, which conveys funds, based on a formula, to metropolitan cities, other cities with populations greater than 50,000, and urban counties. The remaining funding, roughly $800 million a year, forms a block grant to the states, which in turn grant funds to development projects in eligible communities too small to receive entitlement funds under the HUD-administered program. A recent report by the Council of State Community Affairs Agencies indicates that roughly 30 percent of Small Cities CDBG funds are used for projects in metro areas, 20 percent for projects in towns between 50,000 and 20,000 in population, and the remaining 50 percent fund projects in conventionally "rural" communities under 20,000. Block grant monies can be used for a wide variety of purposes including housing, public facilities construction, and economic development projects.

Small Cities state-by-state allocations are based on a formula which includes the following factors: population, trends in population, population in poverty, proportion of overcrowded housing, and age of housing.

In turn, the states develop administrative procedures to program the money in support of three objectives. Projects must benefit low- and moderate-income people, eliminate slums and blight, or address urgent community development needs. Sixty percent of CDBG funds must benefit low- and moderate-income residents, although monitoring efforts coordinated by the Center for Community Change indicate that this goal is relatively easy to subvert.

Since the states took over administration of the Small Cities program, the use of funds at the local level has shifted from an emphasis on housing programs to an emphasis on public facilities construction and economic development efforts. This could mean several things: a shift to higher priority functions, a move away from projects that most directly serve low-income people, or an attempt to meet other state and local concerns, such as tax reduction.[2] But whatever the reasons behind it, the shift indicates that states perceive their community development needs differently than did the HUD administrators who ran the program before them.

It is difficult to describe the state administration of the Small Cities program in general terms, because each state has organized its own administrative procedure and monitoring mechanism. Most states develop a set of criteria, which might include low- and moderate-income benefits, levels of other community distress, local tax capacity and effort, leveraging of private or other public dollars, a project success indicator such as the number of jobs created or housing units rehabilitated, consistency with a local community development strategy or with state priorities, indicators of citizen participation, and quality of project design.

Communities, counties, or in some cases, multi-county districts apply for project funding, are evaluated by state staff or by independent evaluators, and generally are awarded funding based on a points system.

For example, the state of Virginia uses the following criteria in evaluating its Small Cities applications: community relative need criteria (income, unemployment, population change, and tax effort and ability), and project impact criteria (consistency with state, regional and local priorities, appropriateness of project cost, non-CDBG leverage, low- and moderate-income benefit, and alleviation of emergency conditions). Relative need criteria are assigned a 25 percent weight, while project impact criteria carry a 75 percent weight.

Standards of accountability vary across the country as well. Some states require that a multifaceted community development project benefit low- and moderate-income people in a general way, simply through the potential for job creation, while other states require that each component of the project directly benefit low- and moderate-income residents. Because many projects are completed over the course of three, five, or even ten years, monitoring the program at the state level can be very difficult.

States are required to submit monitoring information to the Department of Housing and Urban Development, but the reporting format is not consistent and terms are loosely defined. As a result, benefits and accomplishments are not readily comparable. In fact, for FY 1987 expenditures, HUD had received no program information concerning the anticipated use of ten percent of state projects representing seven percent of total funds. Complicating the federal oversight role is the fact that little program data is gathered on a national basis, so adequate evaluation over time is impossible.

State block grant funds have been used to capitalize revolving loan funds for investments in for-profit businesses. A study completed in 1986 by the Council of State Community Affairs Agencies (COSCAA) concluded that $76.6 million out of FY 1984 Small Cities CDBG funds were invested in this manner. Little could be concluded about the success of these programs, although the report indicates that CDBG investments generated a 6.5:1 non-CDBG leveraging ratio, and that, on average, $3,109 in CDBG funds were invested for each new job created.[3]

Most states operate their Small Cities CDBG program out of their departments of economic and community development. In some states, staff are responsible only for project evaluation, financial administration, and monitoring. In other states, staff take on technical assistance responsibilities as well. They travel throughout the state helping communities pull together applications and providing management assistance and leadership training.

At the federal level, HUD operates the Small Cities program out of the Office of Block Grant Assistance within the Office of Community Planning and Development. The Office of Program Analysis and Evaluation is responsible for monitoring.

Case Study: Owens-Illinois Glass Company

In late 1984, Owens-Illinois[4] received a Community Development Block Grant (CDBG) of $750,000 from the state of North Carolina through Warren County to help pay for a large piece of equipment central to the operation of its planned $19 million facility in rural north-central North Carolina. Altogether, the State of North Carolina contributed over $1.3 million to the corrugated container (cardboard box) manufacturing concern. In addition to the CDBG grant, the local state-funded community college invested approximately $600,000 in employment training and related costs.

1. The county

Warren County, North Carolina is among the poorest in the state. Nineteen percent of the county's housing is substandard, and just over 30 percent of its residents live in poverty. The county population, of which 63.7 percent is minority, grew only slightly between 1980 and 1985, in stark contrast to growth in the nearby Research Triangle area. The county's per-capita income in 1984 ranked 79th out of 100 counties in North Carolina and stood at only 65 percent of the national per-capita income. The county's median household income ranked 95th out of 100 in the state. At the time the Owens-Illinois plant was constructed in 1984, unemployment in the county stood at 8.8 percent.

Historically, Warren County has relied on an agricultural base, but in recent years most employment has been in manufacturing. Only eight percent of Warren County's population works in the agricultural sector; 20 percent in sales and service; 11 percent in administrative and secretarial support jobs; 15 percent in management and the professions; and the remainder labor in technical jobs and manufacturing.

Half of the employed men and women living in Warren County also work in the county. The rest commute, generally within about 30 miles, to jobs in southern Virginia, northern North Carolina, or in the Research Triangle area.

Seventy-six percent of the housing in Warren County is owner occupied and 24 percent is occupied by renters. The figures are lower for minority households, however. Only 64 percent of blacks own their homes. Eighty percent of those in poverty in the county are black. The average black family income is 76 percent of the county average. Fifty-two percent of black families earn less than $10,000.

Less than a mile from the Owens-Illinois site is Soul City, a predominantly black development built under the Johnson Administration's Model Cities Program. Only 60 or 70 homes were ever constructed. Today, they huddle on an expanse of rolling farmland, a testimonial to mid-'60s housing designs and social experiments. Although the project failed and was placed in receivership in the early 1980s, its large-scale water and sewer system is a major asset to the county. Nearly three-quarters of its two million gallon capacity is currently unutilized.

The county has a five-member board of commissioners, the chair of which is elected by the other commissioners and is executive officer for the county. The county also has an Economic Development Commission, with a nine-member board of directors.

Many Warren County residents have been active in soliciting new business for the county. A "Committee of 100" has been established; each member contributes $100 per year which in turn is offered to new or existing businesses for new construction or expansion in Warren County.

2. The Project

When Owens-Illinois first explored a Warren County site, it envisioned a $10-12 million plant which would eventually employ 65-120 employees. It hoped that the county would buy land, build a building, and then lease the building back to the plant at a favorable rate for two or three years. The company would guarantee to purchase the plant after that time.

The company's Forest Products Division had done poorly during the recession of the early '80s, and corporate staff argued that the firm should not build a new plant without a financial incentive. Interviewed in 1989, Owens-Illinois staff involved in the planning process said that the company's main concern was not where to locate but rather whether to expand the Forest Products Division and establish a new plant. It seems clear, however, that the company's decision hinged to some extent on the offers it could attract. According to notes taken at the time by Warren County Economic Development Commission Executive Director James Whitley, the southeastern U.S. location was competing against two alternative sites elsewhere in the country when corporate planners sat down to make a siting decision in late 1983.

Owens-Illinois staff initially expressed several concerns about the Warren County location. They feared that the public education system and other quality-of-life factors might not be attractive to senior management. In addition, the county's large minority population and the site's proximity to Soul City were perceived by corporate staff to be a drawback. The company was uncertain that the local work force could handle high technology processes. Its two most recently built plants continued to lose money because of personnel and training difficulties.

In late 1983, Owens-Illinois staff agreed that among the Virginia and North Carolina sites, they preferred the Warren County location. But the company was reluctant to commit to the new plant without firm assurances from the state and county that significant financial assistance would be forthcoming. Likewise, the Community Assistance Division of the Department of Natural Resources and Community Development (which administers the CDBG program) was reticent to commit to a CDBG grant or loan without assurances from Owens-Illinois that the project would go forward. Although all parties were interviewed, it is still unclear who jumped first.

Owens-Illinois coordinator Jerry Trevey pushed hard for a grant. When local officials were concerned that a loan would be more politically palatable and wanted to explore a range of interest rates and terms, Trevey wrote, "This will have a negative impact on the proposal." According to county staff notes, "In the words of an O-I [Owens-Illinois] official, the failure to commit these grant monies to the company has 'put a cloud over this project.'" On June 28th, 1983, at the suggestion of the Department, the county filed an incomplete CDBG application to hold its place in the funding line and assure that an impending change in regulations prohibiting grants to for-profit corporations would not apply to this project.

There were significant political overtones to the decision making surrounding this project. The State of North Carolina had recently selected Warren County as the site for a new PCB dump. According to several participants in the project, Governor Hunt felt that he had an obligation to compensate Warren County for the siting decision. In addition, Eva Clayton, a black woman who was then chair of the Economic Development Commission and is now chair of the Board of Commissioners in Warren County, had recently worked as Undersecretary in the Department.

Correspondence among Rick Carlisle (the state CDBG program director), Eva Clayton, Billy Ray Hall (an assistant to Hunt), the governor himself, and

Economic Development Commission Director Whitley indicates that there was a political push to get a manufacturing site, preferably the Owens-Illinois site, located in Warren County. The letters explained that if the project had difficulty gaining approval through the conventional CDBG process, funding would come out of the governor's CDBG discretionary fund. In a letter to county officials, Hall indicated that Carlisle and Department of Natural Resources and Community Development Secretary Grimsley both supported the Warren County project, and that this interest was shared "all the way up"—that is, by the governor.

Eva Clayton said in an interview that the project clearly was politically motivated, but that it brought "advantaged jobs" and high wages to a county with a large low-income population. She said that Owens-Illinois had been a good corporate citizen of Warren County. Clayton pointed out that the community development block grant program has become more rigid since this project was approved.

Warren County's economic development commissioners flew to the Owens-Illinois home office in Toledo and made a presentation to the Board on November 22, 1983. During the presentation, Governor Hunt called Bill Laimbeer, an Owens-Illinois vice president, to commit the state's resources and express support for the project. By the end of the meeting, the board had chosen the Warren County location over two others in the Midwest.

The county held two hastily called hearings concerning the CDBG proposal, as required by state CDBG regulations, in late January. There is no record of the testimony given at the hearings. Staff submitted the final proposal to the Community Assistance Division in Raleigh on February 1, 1984.

At a meeting on February 2, 1984, Owens-Illinois staff turned to specific infrastructure needs (a 12-inch water line to the site, a sewerage pump station) but also asked for a $30,000 limit on its annual tax payments to the county. Notes taken by Economic Development Commission Director Whitley indicate that, off the record, the commissioners agreed to support the company on the property tax issue. However, the State of North Carolina prohibits property tax abatements or incentives of any kind, and the limit, which would have cut the company's taxes by 75 percent, was never approved.

Under CDBG program regulations, Owens-Illinois was required to submit financial information which supported its contention that the Warren County plant was not financially viable without the CDBG grant. In accordance with an agreement among the state, county, and Owens-Illinois, this information was removed from the files after a funding decision was made, and was not available at the time of the site visit.[5]

Staff notes from the state's CDBG application review indicate that neither Owens-Illinois nor Warren County adequately quantified need, however. Although company officials argued at the time that Owens-Illinois's Forest Products Division had fared poorly during the recession and needed assistance, department staff pointed out that financial statements were presented in a consolidated format, and no conclusions could be drawn concerning the finances of the division. Staff notes indicate that Owens-Illinois, a company "worth billions," did not identify a specific financing problem, and did not explore alternative financing mechanisms including a loan at market or below-market rates.

But did it matter? Current CDBG staff in Raleigh say that before 1987, staff rarely analyzed company financial information, even if it were available. If a company asserted that it needed grant funds and the applying county concurred, the department assumed that this was the case.

As indicated above, Owens-Illinois received assistance from the North Carolina Industrial Training Service (operated by the community college system) in addition to the CDBG grant. The service is available to any new or expanding industry in the state.

In the case of Owens-Illinois, the Vance-Granville Community College developed a training program and leased space for training sessions eight miles from the plant site. The community college paid 100 percent of salaries for Owens-Illinois' supervisors while they trained new employees; 50 percent of the trainees' pay was also funded by the state program during the training period. Moreover, the company was eligible for a federal tax credit of up to $3,000 per trainee.[6] While at the training site, the new employees (half of whom were minority) produced cardboard boxes which were then sold by the company. The community college reimbursed Owens-Illinois for a portion of the value of substandard boxes.

Finally, Owens-Illinois also received the benefit of lower financing costs through the sale of industrial revenue bonds. The county authorized up to a $1 million bond issue to be used for machinery and equipment bought by Owens-Illinois.

The groundbreaking took place on April 6, 1984.

3. Benefits

Direct Benefits Construction of the Owens-Illinois plant increased Warren County's tax base by approximately $15 million; the company pays $124,000 in taxes each year. When it was built, the Owens-Illinois plant added ten percent to the total county tax base. At present, the assessed value of the plant represents about three percent of the total county tax base.

In addition, the 214,000-square-foot facility employed 49 workers when it opened in 1984, 82 people by January 1987, and currently employs 115 workers—30 salaried employees and 85 hourly employees, each of whom makes on average about $8.00 per hour.

The plant operates on a shift schedule, causing some problems for local employees, many of whom are not comfortable with shift work. Turnover is relatively low, with about ten employees leaving during any one year. The most frequently cited reason for leaving is dissatisfaction with the shift schedule.

Secondary Benefits The Owens-Illinois project has generated some secondary benefits. Swing Transport, Inc., a transportation and trucking firm employing a dozen workers, has located a facility adjacent to the Owens-Illinois plant. Owens-Illinois also relies, in part, on local hardware stores for spare parts for its machinery. The local Southern States Cooperative provides lawn and garden supplies, fuel oil has been procured locally from year to year, and some dyes and glue used in the manufacturing process are bought in North Carolina. In addition, the company contributes annually approximately $5,000 to local charities, including the area fire station.

County officials emphasize that the Owens-Illinois plant has brought more than financial benefits to the county. Of greatest importance is the credibility gained through successfully attracting a *Fortune 500* plant. Eva Clayton pointed to the construction of a Perdue poultry hatchery in the county to support the notion that success breeds success.

The county staff has become more sophisticated in pursuing industry and promoting the county. For instance, Warren County's Economic Development Commission has produced two thick publications which include information on labor force characteristics, livability, utilities and infrastructure, communications, industrial sites, employment training, transportation to markets, and other information.

Finally, the jobs offered by Owens-Illinois are seen as significantly better than jobs available in other manufacturing plants in the county. In 1985, the average wages earned by manufacturing employees in Warren County were $5.85 an hour. Trainees hired by Owens-Illinois in late 1983 earned approximately $7.50 per hour.

Benefits to Low and Moderate Income Residents On June 30, 1985, the company reported that 60 percent of its work force was white and 40 percent was black. Seven percent were females heading households. Of the 62 workers employed at the time, 32 (52 percent) were of low and moderate income, of which 16 were of low income. This ratio generated a "low to moderate benefit" of $390,000 of the total $750,000 grant.

Whitley indicated to Owens-Illinois staff that "once the facility is completed [and the CDBG grant expended], there would not be any restrictions placed on your operating procedures." In other words, the CDBG low-moderate benefit requirements would no longer hold. Neither county nor Owens-Illinois officials could estimate the proportion of current plant workers that had been of low and moderate income before employment, although they pointed out that a majority of the recruitment pool resides in the county, which has a significant low-income population. The proportion of black workers has remained stable through the years, at approximately 40 percent.

The North Carolina CDBG Program

The North Carolina program has seen many changes over the years, is quite politicized, and generally has been loose in its reporting requirements. Contrary to priorities in the remainder of the country, the program heavily emphasizes housing programs, and the CDBG office sees its principal constituency as housing officials, developers, and consultants. Twenty percent of the annual CDBG allocation (currently totalling $38 million per year) is set aside for economic development, a small amount is set aside for housing demonstration programs and for contingency/discretionary projects, and the remainder is devoted to housing. (Roughly 2.5 percent of the allocation is used to administer the program.)

The Division of Community Assistance within the Department of Natural Resources and Community Development is responsible for administering the Small Cities CDBG program. The state took over administration of the program from the federal gov-

ernment in Fiscal Year 1982. As required by HUD, North Carolina now requires that at least 60 percent of CDBG funds be used to benefit low- and moderate-income people.

The objectives of the economic development program are:

1) to create or retain jobs for low- and moderate-income persons;
2) to increase the skill levels of low- and moderate-income workers through training;
3) to provide opportunities for increased earnings for low- and moderate-income workers;
4) to respond to local economic development and community development needs;
5) to provide the maximum benefits for each CDBG dollar while leveraging the maximum amount of other funds.

Proposals under the economic development component first are evaluated according to quantitative selection criteria outlined below:

1) Extent to which the project exceeds required standards, benefits low- and moderate-income persons, generates jobs with a minimum of CDBG funds per job, leverages private investment, and addresses local obstacles to development;
2) Demonstrated need for funding;
3) Feasibility of the project;
4) Evidence of local economic distress.

Projects can qualify for funding by addressing all four criteria in a minimal manner, or three of the four criteria in a moderate manner, or two of the criteria in a very stringent manner. For instance, a project could provide benefits to 60 percent low- or moderate-income residents (the minimum acceptable under the state guidelines), generate jobs at a high cost of $25,000 in CDBG funds per job, leverage nonpublic funds on a meager one-to-one basis, and have only a moderate impact on the local economy, and still receive funding. On the other hand, a project that provided benefits to 80 percent low- or moderate-income people and cost only $2,000 in CDBG funding per job would qualify even though it leveraged few nonpublic funds and had a minimal impact on the local economy. Each project is given a rating which reflects the degree to which it meets all the quantifiable criteria.

The projects are then compared to each other on a qualitative basis. The qualitative criteria (which are quite subjective) include:

1) the demonstrated need for and appropriateness of CDBG assistance;
2) the probability of success, and
3) local economic conditions.

These three criteria, along with the quantitative criterion, are each given 25 percent weight in the final evaluation of the project.

State office staff said that proposals are rarely rejected, and then, only if they clearly do not meet the minimum state requirements (for instance, 60 percent low- and moderate-income benefit). The project sponsor is required to file monitoring reports on a quarterly basis while the project is "active"—while the loan is being repaid, or in the case of Owens-Illinois, until the equipment for which the grant was made is bought.

Because most of North Carolina's housing problems are located in the eastern part of the state, the private CDBG proposal-writing consultants who play a significant role in the program have strong contacts there, and the bulk of the CDBG housing program's funding is spent there. In turn, the consultants tend to suggest nonhousing projects to their eastern North Carolina clients, and the economic development component of the program maintains a heavy eastern emphasis as well.

The program has hired two outreach workers—one in the east and one in the west. The western worker has generated additional proposals from communities near her base in the Asheville area, but officials in communities further west continue to complain about lack of access to the program. State-sponsored Lead Regional Organizations or LROs also provide technical assistance in assembling proposals.

Housing proposals must be submitted by May of each year, while economic development proposals are approved on a rolling basis. This approach reflects concerns that economic development projects often involve a "decision window" and require a quick response. The housing program has a significant backlog of eligible but unfunded projects (only 43 out of 143 applicants were funded in FY '88), while the state has never had more demand for economic development funds than funds available. Each project meeting minimum guidelines has been funded. When funds are left over, they are quickly transferred to the higher-profile housing program and disbursed.

State CDBG officials admit that the economic development proposals they review are not necessarily of the highest quality, and proposals are not competing against each other for funding. In order to prevent oversubscription of the program and avoid the complexity of a competitive program run on a first-come first-served basis, the CDBG office simply downplays the program. Little program information is made available, and the office has no apparent interest in changing the procedure—or the outcome.

The state CDBG office has received pressure from the HUD area office concerning HUD's requirement that for-profit businesses prove that CDBG assistance is necessary to bring about development, and that assistance is provided in amounts just sufficient to adequately meet the need. The state office requires localities to submit a five-year financial projection and three years of historic data on each company proposed for assistance, but until this year the office had little capacity to evaluate the accuracy or significance of that information. Often, staff members say, they would receive a proposal and would simply decrease the amount requested by some arbitrary figure. A CDBG staff person maintains that until recently "the state gave away money" through its CDBG program.

The economic development program has shifted from a reliance on grants to loans, whether the assistance is provided directly to a county or municipality, or indirectly to a business. Terms and interest rates vary, up to market levels. In the past, the state often reduced the level of assistance by decreasing the principal of the loan rather than increasing the interest rate or adjusting the term. Of course, this practice, if applied to a company that truly was short of up-front cash, would support undercapitalization, one of the most significant reasons for business failure.

The program staff prefer not to finance working capital, and thus exclude many of the smaller seasonal businesses in small rural communities (such as sewing operations) that rely heavily on lines of credit and working capital. In any case, economic development assistance is capped at $600,000 per project.

North Carolina's CDBG program established a small business loan program in April 1989. Up to $1 million out of the $7 million in economic development funds is available to assist small businesses employing fewer than 20 full-time employees and generating less than $750,000 in annual gross sales. Each business is eligible to receive up to $60,000 in loan funds.

Of course, the Small Business Administration also offers loan guarantees to small businesses in both urban and rural parts of the country. Generally, the businesses it helps finance are larger than those targeted by the North Carolina program, and relatively few small businesses of that size in rural areas are served. SBA is described in Chapter Eleven.

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1 With regulations at 24 CFR 570.420–438.

2 A public financing technique relatively common to CDBG administrators is to free up local tax revenues by paying for local capital projects with other federally generated sources of funds such as CDBG monies. Savings can be used to reduce tax bills or cover costs of other pressing needs, thereby averting a tax increase.

3 COSCAA is preparing an analysis of Small Cities CDBG economic development efforts for The Aspen Institute and The Ford Foundation. The report should be available in the spring of 1990.

4 Since the time Owens-Illinois received the CDBG grant, it was taken over by Nekoosa Packaging, Inc., a subsidiary of Burlington Northern Nekoosa Corporation.

5 Such confidentiality agreements are quite common in business development programs.

6 Company executives could not ascertain whether the credit was claimed on company tax returns.

CHAPTER ELEVEN

THE SMALL BUSINESS ADMINISTRATION

Although the Small Business Administration has no programs targeted specifically to rural areas, it covers rural as well as urban parts of the country. Its purpose is to "aid, counsel, assist and protect the interests of small business concerns and to help victims of disasters." SBA is not involved in development approaches other than enterprise development.

Authorized under the Small Business Act of 1953 and the Small Business Investment Act of 1958,[1] Small Business Administration programs promote government procurement from small businesses, provide management and technical assistance, and lend financial support and surety bond guarantees through a decentralized administration.

The agency also works with public and private institutions under the auspices of SBA-supported development organizations to lend debt and equity capital to emerging businesses. Small Business Investment Companies (SBICs) and Minority Enterprise Small Business Investment Companies (MESBICs) are authorized to offer loans, guarantees and equity investments, with private sector participation. Certified Development Companies (CDCs) are organized by financial institutions and are restricted to SBA-supported long-term fixed asset financing. State Development Companies (SDCs) and Local Development Companies (LDCs) are organized by state or local governments, but are composed of local lending institutions. The development companies can borrow from the SBA at low interest rates and relend those funds, in conjunction with private funds, to small businesses.

These development organizations generally offer a spectrum of financial services and management support. Small Business Administration participation usually comes through a complicated series of transactions. Typically, SBA issues a guaranteed debenture to a development company; the company sells the debenture to the Federal Financing Bank or on the open market in exchange for cash, it then lends those funds, along with private sector funds, to the small business at a rate lower than the business would have paid (had the financing been available at all, given the risk). The development company takes back a second mortgage, which it passes on to SBA.

In essence, the development companies "retail" SBA funds, but only for deals in which there is sufficient private sector confidence that private financial institutions are also willing to lend. Generally, loan servicing is provided by the development company.

In contrast, SBA also offers direct and insured loans to small businesses under the 7(a) program. If credit is not available elsewhere, a small business and its prospective lender can apply directly to SBA for a guarantee (up to 90 percent) for private-sector financing at a privately negotiated rate. If no lender can be found to participate, SBA can lend up to $150,000 directly to the business, at a rate based on the Treasury rate for a bond of comparable life. Ninety percent of SBA's 7(a) loans involve a guarantee rather than a direct loan.

SBA is sometimes criticized, especially in rural areas, for focusing on the large end of the small-business market. Although loan standards vary among programs, SBIC standards for business size are typical: borrowers must have a net worth not exceeding $6 million, net income must be under $2 million per year, receipts must total less than $13.5 million dollars, and wholesale businesses can employ no more than 500 workers. In most rural areas, businesses at the upper end of this range would be regional-level employers. Thus many rural small businesses believe that they are too small to interest the Small Business Administration.

In fact, SBA's 7(a) loan portfolio includes very few loans under $25,000 or $10,000, and almost no loans of these sizes in rural communities. In 1988, SBA made 500 loans under $25,000 and 50 loans under $10,000 throughout the nation. In rural areas, the figures are even more bleak. In 1987, the SBA made no loans of less than $10,000 in rural areas. By 1988, the total dollar value of loans of this size had increased to $27,000.

Small rural loan activity is concentrated in relatively few states, particularly in the urban Midwest. Thirty-six states, many of which are highly rural in character, received no loans under $25,000 in their rural areas during 1988. Two loans, totalling $29,000, were made in the entire rural South in 1988; the rural Southwest (including California) received no small loans. Similarly, of roughly 400 SBICs approved by SBA, only four are located in rural communities.

SBA is an independent federal agency headed by an Administrator appointed by the President to a ten-year term. The agency employs approximately 4,000 staff members, 3,000 of whom work in the field. SBA's field operation is composed of 10 regional offices (patterned after the 10 federal regions), each of which has between six and 16 district, branch, or post-of-duty offices for a total of 100 subregional offices.

With the exception of Delaware, each state has at least one full service district office, which administers the three program areas: business development (Small Business Development Centers, other training), finance and investment (loan processing), and minority small business. A typical office might have a district director and deputy director, staff in the three program areas, an Advocate for Small Business, staff counsel, an information center, a loan servicing section, SCORE volunteers, and administrative staff for a total of 30 employees.

Larger states have additional branch offices, which are supervised by the district director, but which offer the same services as a district office. Eight small "post-of-duty" stations, each with three or four employees, operate in relatively isolated areas and focus on loan and financing programs. These are also under the control of the district director. District or branch office education and training staff circuit ride through the district from time to time, but loan processing takes place at the field office.

SBA follows a decentralized administrative process: all loan-making decisions are made at the district level. If a borrower goes into liquidation, the regional office takes responsibility for workouts. The national headquarters is responsible primarily for national policy making and administrative functions.

In some rural parts of the country, the SBA program is utilized heavily. The Wichita district office is one of the busiest in the nation. A case study follows which examines SBA's relationship with a western Kansas bank served by the Wichita district office.

Case Study: First National Bank of Liberal, Kansas

The First National Bank of Liberal serves the extreme southwest corner of Kansas and neighboring portions of Oklahoma and Colorado. With $90 million in assets and $53 million in outstanding loans, the bank plays a significant financing role in southwest Kansas. The bank's Chief Executive Officer, Deryl Schuster, spent several years during the Reagan Administration as SBA's District Director in Wichita, covering the western three-quarters of Kansas. Although Schuster now spends most of his time at the bank's holding-company offices in Wichita, his SBA experience is much in evidence at the Liberal. The First National Bank of Liberal markets itself as an SBA intermediary, and recently became the only bank in the town to gain SBA certified lender status.

1. Seward County, Kansas

Unemployment is relatively low (5.2 percent) in this county heavily dependent on wheat, cattle ranching, meat packing, and oil and gas production. In 1984, four percent of the county work force was employed on farms. Between May 1984, and May 1987, oil and gas production in the county (centered on the Hugoton gas field) dropped 41.2 percent. Nevertheless, the county remained the 15th largest producer of oil and the seventh largest producer of natural gas in the state of Kansas.

Throughout this period, the National Beef Packing Company, the county's largest employer, continued to employ approximately 2,000 workers. De Kalb Swine Breeders recently opened a high-tech livestock production facility nearby, with 180 employees, most of whom have college degrees. In 1986, the county raised $51 million worth of livestock, making it the fourth largest producer among 14 counties in the southwest portion of the state. On the other hand, Beech Aircraft recently closed its general-aviation manufacturing facility in Liberal, laying off 425 workers. Generally, employment is somewhat cyclical, with employment highest in June and lowest in January of each year.

Wages in the county appear to be quite low, with a significant portion of workers earning near the minimum wage. The county is very transient, with a median age of 27—very low by national standards and among the lowest in the state. The population of Seward County has stabilized somewhat in recent

years at 19,000, with 17,000 of those residing in Liberal. Seward was one of only nine counties in the state not to lose population between 1980 and 1986.

Approximately a third of the population is non-white—roughly 12 percent is southeast Asian, 17 percent of the population is latino, and five percent black. These figures have changed significantly since the 1980 census, when only ten percent of the population was latino and 111 individuals were reported to be southeast Asian. According to census statistics, the northeast portion of Liberal is almost exclusively black, and two-thirds of the town's black population lives in that area. Nevertheless, city council and school board members are elected on an at-large basis. Each year, the local high school graduates about 200 students; approximately 50 students drop out of school during the year. This dropout rate is high compared to schools throughout Kansas.

2. The economic development landscape

Local observers cite several obstacles to economic development in Seward County. Jerry Lindberg of the Chamber of Commerce points to a shortage of venture capital. Carol McDaniel of the Job Service Center argues that Liberal's geographic isolation is its biggest drawback. "Dillard's [a large regional department store] passed up a location here because we're not on the way to anywhere," she says. Cliff Swirczynski, an SBA borrower, thinks that many local business owners lack "business maturity." Tom Scott, another borrower, says his employees, several of whom had been in business for themselves, are "too scared—they lack that entrepreneurial spirit."

The state and local governments have developed several programs to address the slowdown in economic development. State economic development grant making more than doubled between 1985 and 1987. Liberal's City Council will offer tax concessions to nonretail businesses proposing to hire 50-100 additional employees. A local Vocational Technical Center uses Joint Training Partnership Act (JTPA) funds to offer businesses free employee training sessions. The city loaned Community Development Block Grant funds to a local business for a planned expansion in anticipation of a federal contract to produce large mail carts.[2]

Over the past eight years, the Chamber of Commerce has sponsored a capacity-building program called Leadership Liberal, patterned on similar programs at the local and state level throughout the country. Twenty participants meet all day once every two weeks over a 12-week period for the program. They also travel to the statehouse in Topeka, and learn about government, styles of leadership, and voluntarism.

The program has had mixed results. Lindberg says that approximately one-third of the program's participants have moved away from Liberal in the last eight years, while several have run for local office. Participants apply for the program, and pay $120 in tuition, which is usually covered by their employers, although scholarships are available. In recent years, roughly 40 percent of participants have been women; over the eight-year term, only three or four minority-group members have participated.

According to the SBA Annual Report for 1987, eight Liberal businesses received SBA-guaranteed loans: two laundries, two restaurants, an athletic equipment store, a video vendor, a vacuum cleaner distributorship, and an electrical company. The loans ranged between $5,000 and $133,000; they totalled $594,000 for an average of $74,000 each. In contrast, Topeka businesses borrowed $1.86 million and borrowings in Kansas City, Kansas totalled $2.6 million.

SBA's western Kansas district (excluding Topeka, Kansas City and the easternmost two tiers of counties) has a reputation for heavy use of the SBA program. Despite the relatively low utilization rates in the eastern portion of the state, Kansas still ranks eighth in the country, on a per capita basis, in SBA guarantee usage.

Arden Webb, a senior loan officer at the First National Bank, identified three borrowers whose loans carried SBA 7(a) guarantees: Sam's Packer and Supply, owned by Sam Belleau; C-R, Inc., owned by Cliff Swirczynski and Roy Gant; and Scott Power and Machine, owned by Tom and Ann Scott.

3. The borrowing companies

Sam's Packer and Supply Sam Belleau began working in the oil field service business, which is generally controlled by large firms. In 1981, at the age of 23, he went independent. He borrowed $4,000 from another local bank to buy a pickup truck and a packer, a piece of oilfield equipment used in diagnosing leakages, sources of water and other problems in oil and gas wells. Shortly afterward, as business in the oil fields picked up significantly, he returned to the bank for a second, larger loan for additional equipment. The banker refused to lend him additional funds, but was willing to invest in the firm and take an equity position. Instead, Belleau moved to First National, paid off

the original loan, and borrowed $32,000 for bridge plugs, float equipment, and guide shoes.

Under conventional banking terms, Belleau's anticipated cash flows could not have supported his loan payments at the floating rate over a term consistent with the rapidly declining value of the collateral—in this case, the equipment he was buying. By adding a 90 percent SBA guarantee to the deal, however, the term was stretched to five years, and the monthly payments were correspondingly lowered to manageable levels.[3] After four years, the loan was paid off.

Sam's Packer and Supply has been able to weather tough times in the oil patch for several reasons. Webb says Belleau is a very hard worker. In addition, he has made several strategic decisions that paid off: Although he and his five co-workers service oil and gas wells themselves, the firm has expanded into the equipment reconditioning business. After each use, a piece of equipment must be cleaned up and outfitted with new gaskets and O-rings. Generally, distributors will recondition only their own equipment. Sam's Packer and Supply reconditions all brands. If a field crew is uncertain of the brand of equipment in a "hole," they are more likely to bring the work to Belleau than make the rounds of local distributors, looking for the one that will do the work. In addition, Belleau has begun selling equipment himself, in conjunction with Arrow Oil Tools, Inc. A local distributorship of a national oil field tool company closed, leaving owners of the company's equipment without reconditioning service. Sam's has picked up that business as well.

Since the initial SBA loan, Belleau's finances have allowed him to acquire new equipment and $100,000 in inventory on a cash basis.

C & R, Inc. Cliff Swirczynski sold fertilizer throughout the midwest for national firms until, at the age of 55, he decided he was tired of the salesman's life. He moved to Liberal in 1975 to work with Ingall, Inc., a fertilizer and fuel distributor in the area. The owner of the firm was ready to retire, and his son was not interested in the business. Swirczynski and the owner agreed that if the relationship worked out, Swirczynski would buy the firm. Roy Gant had worked with Swirczynski in Colorado, and moved to Liberal to work at Ingall, Inc. Swirczynski and Gant eventually became equal partners and bought the fertilizer operation, including land, a building, and equipment.

In late 1981, the two, operating as C & R, Inc., borrowed $160,000 over 15 years at the "Bank Four" plus one percent rate with a 90 percent SBA guarantee. Bank Four is a large regional bank, and local banks in Kansas frequently peg their rates to those of Bank Four. Unfortunately, the prime rate hit 19.5 percent on the day the business opened.

As Swirczynski explains, he had plenty of experience but little equity. At the time, he sat on the local Extension Service Council, along with a (now retired) loan officer from First National. The two became friends, and although Swirczynski had been turned down for a personal loan at about the same time, the SBA loan was approved through First National only six weeks after he applied.

In 1986, C&R, Inc. borrowed an additional $200,000 to buy out a fertilizer operation located just over the Oklahoma line. First National offered a 75-percent SBA guarantee, and the seven-year loan carries an interest rate based on the New York rate plus 2 ½ percent. The firm has also borrowed to build a new building, buy new equipment and larger capacity tank trailers. Meanwhile, some of the land bought from Ingall, Inc. has been sold. These later loans have been made without an SBA guarantee. Although SBA paperwork is "onerous," says Swirczynski, he maintains that it is worth the trouble. He has no patience with people who want federal benefits but are unwilling to deal with the paperwork.

The fertilizer business is extremely seasonal, and thus, is heavily dependent on credit. Fertilizer is produced between September and January each year, and shipped to distributors. In the past, distributors could pay the producer in April, but now payment is expected within 15 days of delivery. Although some farmers prefer to pay in advance (to lock in prices or for tax reasons), most pay for their fertilizer after delivery in the spring, and conditions in the farm economy are directly correlated to accounts receivable levels. When payments are delayed, the fertilizer distributor is caught in the middle. C&R, Inc. has access to a $300,000 operating line of credit, and taps additional resources, in $100,000 increments, when seasonal circumstances require.

Swirczynski says he felt particularly caught in a bind when the federal government initiated the Payment in Kind (PIK) program. The program encouraged farmers to take land out of production, and demand for fertilizer declined correspondingly. Eighteen months after the program started, C&R, Inc.

received a letter from FmHA indicating that if the firm had been adversely impacted by the PIK program, it could apply for low-interest loans. Swirczynski, frustrated with the capriciousness of government action, argues that any fertilizer firm severely impacted by the program would have been out of business in six months; the offer of a low-interest loan two years later was anything but timely.

With the help of his existing credit arrangements, Swirczynski has prospered despite the vagaries of the fertilizer business. Employment has increased from three to 12 at the firm, which sees $3 million in sales annually.

Scott Power and Machine, Inc. Over the past twenty years, a major innovation in technology has generated significant economic development in western Kansas. In times past, farmers irrigated land with gravity: a well was dug at the highest point on a field, and irrigation water was pumped out and simply flowed downhill. This was a relatively cheap way to irrigate, but it did not work well with large, relatively flat fields.

More recently, farmers have leveled land and set up rotating irrigation systems that pivot around a central point. Well water is piped to this point, and the system is either powered with an engine (a fuel tank generally sits nearby), or in some cases the pressure of the water is used to rotate the system.

The new irrigation system has allowed western Kansas farmers to grow feed crops, which in turn has improved prospects for efficient, relatively intensive, locally supported cattle operations and resulting meat packing plants. Central to this process is the irrigation equipment itself. Scott Power and Machine sells and rebuilds irrigation engines and other farm equipment.

Tom and Ann Scott both grew up familiar with farming and irrigation systems. In the late '70s, after living in Colorado, they moved back to Elkhart, Kansas, just yards north of the Oklahoma line. In 1978, they were leasing space for their machine shop, financed initially with $20,000 in equity. Deryl Schuster suggested that they consider an SBA loan to finance construction of a building.

In late 1980, they took his advice and borrowed $95,000 over 20 years, with a 90-percent SBA guarantee. In 1981, they borrowed to finance equipment. A seasonal line of credit was authorized in 1983 at $300,000, originally with an 80-percent guarantee which has since been dropped. In 1985, they moved into a new field, buying out a Case-International Harvester dealership. First National financed the purchase with an $80,000 loan over ten years at New York prime plus 2 ½ percent, with a 90-percent guarantee.

In recent years, the company has operated simultaneously out of three different shops within Elkhart. In 1988, construction began on a new facility, just over the line in Oklahoma, financed with a $400,000 loan from First National with a 21-year term at prime plus 2.75 percent, with an 85 percent SBA guarantee. Over the years, turnaround time on the SBA-guaranteed loans has dropped from about six weeks to seven to ten days, according to Tom Scott.

The Scotts say that the biggest obstacle to expansion has been a lack of qualified workers. In the past, when the general aviation industry was strong in Kansas, skilled men and women were readily available. Many have since left the area. Workers from other areas are not much interested in moving to southwest Kansas, the Scotts say. During the worst of the farm crisis, the company ran employment advertisements in neighboring states. The initiative paid off, as several good workers moved to Kansas, but when the farm economy improved, they moved back to Iowa. The Scotts figure they have hired approximately 80 people over the years (current employment is 21), and while the SBA program is not intended to serve low-income residents, they estimate that perhaps 25 percent would have been low income but for the job.

Tom Scott thinks that rural businesses in general most need capital, owners with entrepreneurial spirit, and technical assistance to help with the expansion process. He would have particularly appreciated assistance with personnel issues. He considers most management training programs useless—too general to be of help or too focused primarily on issues of importance to retailers. However, he speaks highly of a management school at International Harvester that he attended. It is tailored directly to the needs of dealers, he says.

4. The view from First National

First National Bank of Liberal integrates the SBA program into its marketing strategy and planning process. For instance, the bank has recently received certified-lender status, which means it is authorized to make decisions on SBA-guaranteed loans (with a 75-percent guarantee cap) and is entitled to faster turnaround on SBA paperwork. The bank moved in this direction for another reason as well: It expects SBA, as a deficit-reducing measure, to reduce its guarantee

from a 90 percent maximum to something closer to the certified-lender maximum of 75 percent. If First National operates on that basis for several years before the anticipated change, it should be at the front of the pack when the shift goes into effect.

The bank's auditor, Bob Immell, has developed a computer program (called SBA Pro) which the bank hopes to market in 1990. The program prompts a loan officer to ask a series of questions of a potential borrower. In as few as 20 or 25 minutes, the officer can compile a profile, at which point the information is organized and a completed SBA application form is automatically printed. Alternatively, the borrower can take the disk home, respond to the questions, and bring the file containing the answers back to the bank.

5. What is SBA's role in rural Kansas?

Although First National loan officer Arden Webb's instinct is that the bank's SBA guarantee covers a relatively small portion of its nonagricultural portfolio, his figures indicate otherwise. The bank has an SBA portfolio of approximately $9 million in outstanding loans. Of its $48 million in non-real estate loans, Webb estimates that approximately 40 percent are commercial loans, potentially eligible for an SBA guarantee. Thus, $9 million out of $18.5 million in commercial loans—nearly 50 percent—carry an SBA guarantee.

Clayton Hunter, SBA District Director for western Kansas, is based in Wichita. He and his staff say that in many rural communities, *all* of the relatively little commercial lending that goes on carries an SBA guarantee. Kansas is a non-branch-banking state, with exceptions for communities adversely impacted by a bank closure. As a result, many small town bankers have extremely limited experience with commercial lending. Their bread and butter for generations has been agricultural lending. They feel comfortable extending the loan only if the SBA checks the numbers and gives its imprimatur. And, according to Hunter, 90 percent of Kansas banks have issued an SBA loan at some point.

This process seems more akin to technical assistance provision than issuance of a guarantee. Do these small town Kansas bankers and their rural borrowers need the SBA guarantee? Or do they need a training course in commercial lending? Or do they need both?

Project staff asked Webb how he decides if a loan requires an SBA guarantee. Generally, he says, a guarantee is used to lengthen the term of a loan—otherwise, collateral with a short useful life would require a shorter-term loan than the business could cover with its cash flow. There seems to be no statistical measure or rule of thumb that indicates whether a guarantee is necessary. District Director Hunter also refers to longer terms as the primary benefit of an SBA guarantee. But is all collateral in some rural Kansas towns substandard? Or are small rural banks simply unwilling to venture into unfamiliar terrain? When asked whether SBA applications are ever turned down because the district office perceives that a conventional loan could be supported by the financials, Hunter indicated that he had turned down one loan in 17 years of service—and that application was simply ineligible under SBA regulations.

6. The SBA-FmHA relationship

Clayton Hunter argues that SBA and FmHA approach lending in fundamentally different ways. SBA has traditionally placed more emphasis on cash flow analysis, whereas FmHA emphasizes collateral, "the black acre." As a result, he argues (as do other Kansas-based SBA staffers and former staffers) that SBA should have jurisdiction over business lending in rural areas, taking over the B&I market, and FmHA should "stick to ag lending." At various points in the past decade, however, each agency has been authorized and encouraged to enter into the other's market.

Hunter feels that he has less contact with the Farmers Home Administration than in years passed, particularly since the Memorandum of Understanding between the two agencies was signed. In contrasting the two agencies, he emphasized that in liquidation proceedings, SBA buys the loan from the bank and liquidates the collateral, whereas FmHA leaves that process to the banker-servicer. The two agencies have shared budget cuts, however. The Wichita SBA office has lost ten of 17 staff over the past eight years.

For its part, FmHA has been hit hard by staffing cuts, and particularly by budget cuts, over the past decade. These two issues are discussed at greater length in the next chapter.

1 Regulations at 13 CFR 101–144.11.

2 The business secured the one-year contract, but the Postal Service later discontinued use of the carts in its operations, and 100 workers hired to fulfill the contract were laid off.

3 Although the floating rate changes over time, the loan payments are fixed, in accordance with SBA regulations. Any unpaid balance, including amortized interest payments, forms a balloon payment at the end of the term.

CHAPTER TWELVE

FmHA Administration and Organization

The Farmers Home Administration operates within the Department of Agriculture, under the Undersecretary for Small Community and Rural Development (see USDA Organizational Chart, Figure 9). In addition to FmHA, the undersecretary is responsible for the Federal Crop Insurance Corporation (FCIC) and the Rural Electrification Administration (REA).

These three agencies employ 12,850 full time equivalent staff members (FTE), distributed in the following manner:

Agency	*Number of FTE('88)*
FmHA	11,421
FCIC	895
REA	500

Of the FmHA staff, 9,997 are employed in field offices at the state, district, or county level; 607 work at the Finance Office in St. Louis; and 817 work at the national level (with 232 of these based in St. Louis). Although 87 percent of total FmHA staff work is in the field, 93 percent of total personnel costs are expended there. Surprisingly, the mean salary for field workers is higher than for staff in the headquarters.

Between 1988 and 1989, FmHA cut its work force by 292 FTEs. Field offices lost 268 staff, the financial office lost 30, and the national office gained seven.[1]

Headquarters Level

As the FmHA organizational chart (Figure 10) indicates, policy, legal, financial, administrative and some loan-processing staff operate out of the Washington and St. Louis offices of FmHA. All offices are connected by a computer network, through which staff at various levels can file and analyze loan data, management statistics, personnel information, financial information, and overall agency trends.

Although 13,000 staff members are subordinate to the undersecretary, only about a dozen report directly to him/her. The vast majority of the remaining staff within the secretariat report to the FmHA administrator, who, in addition to this line authority, has significant budgetary control.

While the undersecretary is authorized under statute to ensure that federal rural development policy is coordinated, the FmHA administrator is authorized by statute to control all funding decisions, regulatory exemptions, development of regulations and administrative notices. This unusual arrangement of authority generates tension within the organization.

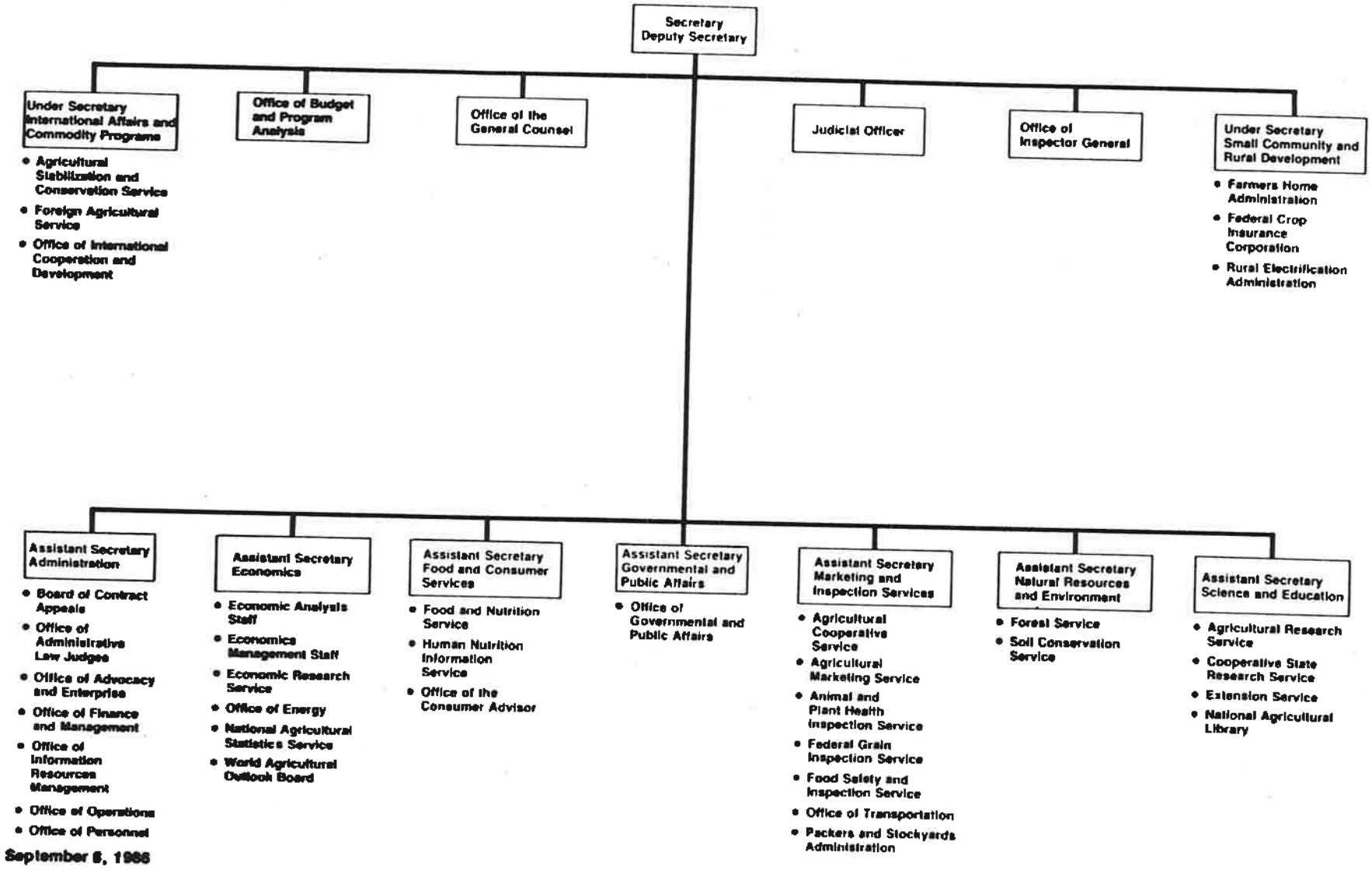
Another quirk complicates agency administration. The state directors report to the administrator, but as political appointees they are chosen, in effect, by the senior member of the state's congressional delegation of the party of the presidency. Thus, the state director has a power base outside the organization, which he/she can use to override the directives of the administrator as they affect FmHA activities within the state.

Funding decisions for many programs are delegated by the administrator to the state directors, and those that are reserved for the national office are often strongly influenced by the views of the state director. For instance, although funding decisions for the B&I and IRP programs are made at the national level, the state director can block a proposal by making sure that it is scored conservatively, or by erecting obstacles at the pre-application point.

As a result, state funding practices often reflect the subjective preferences of the state director—for farm programs over housing, for instance—rather than the objective needs of the state's target communities.

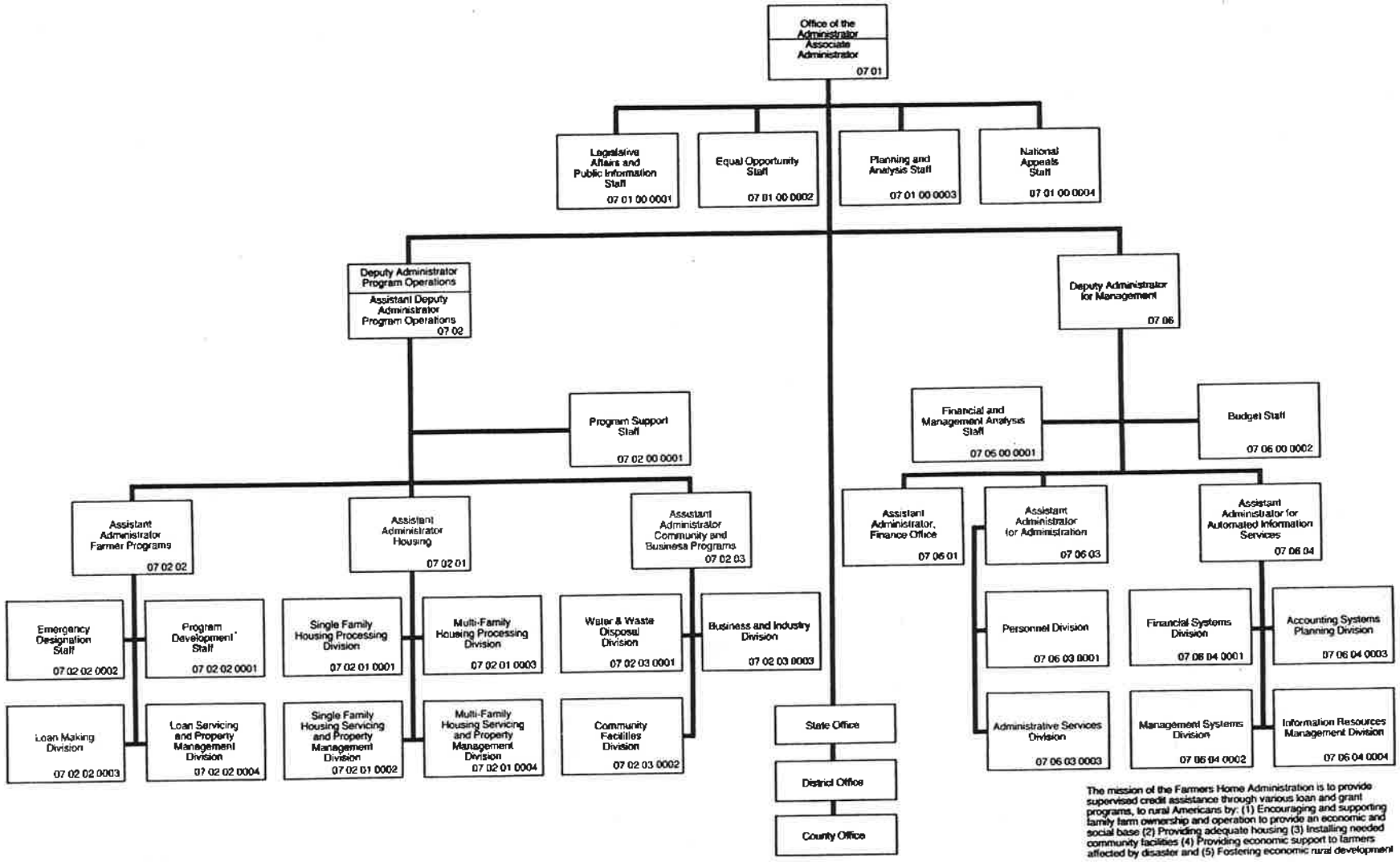
The agency effectively has no policy analysis arm. According to FmHA insiders, the Planning and Analysis staff emphasize policy evaluation (after the fact) rather than policy planning. If the Business and Industrial loan director wants to examine a policy option, he/she relies on administrative staff within the division, who in turn utilize simple anecdotal evi-

Figure 9 U.S. Department of Agriculture Organizational Chart



Source: U.S. Department of Agriculture, 1989.

Figure 10 USDA Farmers Home Administration Organizational Chart



Source: USDA Farmers Home Administration, 1989.

dence or the agency's computerized management information system (MIS), which unfortunately contains significant amounts of unreliable data generated by the field offices.

For instance, the agency has a clear sense of the amount of staff time, on average across the nation, needed to process a typical farm or B&I loan. It cannot, however, indicate the number of staff hours or FTEs devoted to farm programs compared with community programs in Wisconsin or across the nation. The agency's national figures on staff resources devoted to program areas are extrapolations, derived by multiplying the average loan processing time by the number of that classification of loan or grant processed during the year. If this method generates fewer FTEs than there are staff employed at FmHA, the numbers are "grossed" up or down to meet the actual staffing level.

These extrapolations say something about average processing times but next to nothing about staff resource allocation. As a result, little can be definitively said about the adequacy of resources given to program areas, or the comparative efficiency across states of staff processing similar types of loans.

From time to time, the administrator calls on outside contractors or the Economic Research Service of the Department of Agriculture to perform policy analysis. ERS has access to the FmHA financial database, which is considered more reliable than the MIS system. Of course, the financial database collects different information for a different purpose than does the MIS system, and often, good numbers upon which to base policy decisions are simply impossible to secure.

Legal support for FmHA is housed not within the agency, but rather at USDA's Office of General Counsel and its Community Development Division. The Department of Justice would intervene if a legal claim were filed against FmHA. According to OGC staff, FmHA does not have the legal capacity, as do some other agencies, to defend the government in court.

Finally, staff hired throughout the agency tend to have an agriculturally related educational background. In the early years, FmHA programs were predominantly agricultural in nature and an agriculture degree was consistent with the role of the agency. More recently, of course, the emphasis has shifted to include development programs.

A very informal survey of schools of agriculture indicates that few institutions appear to have adjusted their curricula to meet the relatively new need for project management and development expertise within the agency, and no other departments at these schools seem to have stepped forward to fill the gap. A high school senior interested in rural development would have to work hard to develop a suitable college curriculum.

Project staff wrote to ten of the strongest schools of agriculture in the nation and received information from six. All emphasized that positions with FmHA were among typical career paths chosen by graduating seniors. None had programs including a subspecialty in rural development. One offered an emphasis in agribusiness, but required only three courses outside the traditional agricultural schedule. One offered a work-study program over two years (in which students alternated between school and employment with the Extension Service), but participants could focus only on agricultural projects while at the Extension Service. One offered a program in "Agriculture and Extension Education," but required only one nonagricultural course—a choice between introductory finance and management. While all six schools offer conventional business administration degrees, none emphasizes the utility of a business degree in working in the public sector, or offers public administration classes within the business department.

Field Staff

Both official regulations and FmHA policy indicate that field staff are responsible not just for processing applications, but also for guiding loan or grant applicants and other citizens through the bureaucracy—providing technical assistance, help in filling out applications, and follow-up during application evaluation and project implementation. Field staff for farm housing and rural development programs are distributed in the following manner:

Field Office Characteristics

	State	*District*	*County*
Total Employees	1,625	1,273	7,099
Average (# of Emp.)/ Office	35.3	4.8	3.7
# of Offices	46	266	1,920

Date: July 1988

Average grade levels of FmHA staff dropped overall between 1981 and 1988. The average was GS-8.1 in 1981, and has stabilized at 7.8 in recent years.

1. State Level

According to FmHA personnel staff and agency records, a typical state office would employ a total of 31 staff: ten staff at the GS-12 level or higher, including the state director, program chiefs and specialists, two architect/engineers at the GS-12 level, one administrative officer and three program review assistants at GS-10/12, eight loan technicians at GS-7, and seven state clerks or clerk/typists at GS-4/5.

Six years ago, FmHA folded the state-level Community Facilities chief and Business and Industry chief positions into one slot. At this point, then, the state office operations are divided into housing programs, farm programs, and community programs, each with its own chief.

At about the same time, a controversy arose over the appointment of state directors. Under the Carter administration, state directors were not Schedule C but Schedule A appointees—although appointed by the President, candidates also were required to have skills and background appropriate for the job.

When the Reagan administration began making new appointments in 1981, several Carter appointees attempted to remain in their jobs, arguing that the competency requirements under Schedule A protected them. The Administration's position was that the state directors were political appointees, whose jobs ended with the defeat of their candidate. The suits dragged on, and were finally decided in favor of the Reagan administration. FmHA state directors are now appointed under Schedule C, making the slots purely political in nature.

The state director has discretion to hire FmHA staff up to the GS-12 level in county, district, and state offices. For more senior positions (a group which includes the district directors and program chiefs), staff are recruited from a national pool by the personnel office in Washington, and are hired with the state director's concurrence.

Whether staff are hired at the state or national level, all positions are advertised. The selecting official establishes a panel of agency employees familiar with the position to interview candidates and develop a "short list" of qualified candidates. The hiring official must choose someone on this list or reject the entire list (in which case the process begins again), but may not choose a candidate not recommended by the panel.

North Carolina and Texas have the largest state office staffs with 59 and 65 members each, while Alaska and Wyoming have small offices with ten and 17 members respectively. FmHA staff indicate that the size of a state office is based on its program volume, although they concede that intra-agency politics enters into the staffing size decisions.

Fourteen states or governmental units join together to form five "state" offices for administrative purposes. For instance, Massachusetts joins Connecticut and Rhode Island while Maryland, the District of Columbia and Delaware have a joint office in Dover.

2. District Level

At the District level, a typical office might have a district director (at GS-13), an assistant district director (GS-12), a district loan specialist (GS-12), a loan specialist trainee (GS-9/11), and a district office clerk (GS-4/6).

Interestingly, staffing variations among states are much more significant at the district level than at the state level. For instance, the district offices in Tennessee employed a total of 15 staff at the director or assistant director level, 13 at the district loan specialist level, and six construction inspectors, but no technical or clerical staff throughout the state in July 1988.

In contrast, the New York district offices, which employed one more person overall than did those in Tennessee and process roughly comparable loan volume, had on staff five directors or assistant directors, ten district loan specialists, five construction inspectors and 15 clerical staff. Twenty states employ no district construction inspectors, while one-third of Vermont's district office staff is composed of construction inspectors. While, on average, 30 percent of a state's district office staff were at the district director or assistant director level, four states had 50 percent of total staff at that level, and 60 percent of North Dakota's district staff were directors or assistant directors.

The size and composition of district offices may be attributable to several factors. There were few district offices in place before the Carter administration dramatically expanded the programs administered at that level, such as Water and Wastewater and Community Facilities loans, and shifted responsibility for the expanding multifamily housing program from the county offices to the district level. Thus, those states with large farm loan and homeownership programs would rely on the county level for administration, while states with a heavier emphasis on rural development or multifamily housing programs would have proportionally larger district level staffs.

Moreover, many of those hired 12 years ago during the Carter administration to administer the development and housing programs may have remained at FmHA, climbed the short district office seniority ladder, and could now be squeezed at the top with nowhere to go. FmHA staff in Washington explain that upward movement in the ranks tends to run from the county level to the state or national level, bypassing the district offices.

District level staffing and administrative patterns are further distorted by developments during the Reagan administration. The administration drastically cut funding for loan programs that happen to be administered at the district level, and, through asset sales, sold off loans that would have been serviced by district staff. As a result, points out Undersecretary for Small Community and Rural Development Roland Vautour, the district offices are operating at less than full workload.[2]

3. County Level

The Farmers Home Administration is proud of its tight network of field offices around the country. The agency argues that this decentralized structure is perfectly suited to rural development initiatives. For many FmHA programs, however, particularly the rural development programs, FmHA's 1900 county offices are currently irrelevant, inasmuch as the loans and grants are processed at the district, state, or national level rather than out of the county offices.

In general, a typical county office would have a supervisor at GS-11, one or two assistant county supervisors within the GS-5/7/9 range, a county program assistant or county loan technician at GS-7 and a clerk at GS-4/5. In particularly large counties (such as those in California), an office might have three or four assistant county supervisors. In addition to these permanent staff, temporary staff are hired from time to time to process emergency loans. FmHA staff in Washington say that orders authorizing the hiring of temporary staff have become an annual tradition, and that generally, former FmHA staff are employed to do the work.

A new Office of Personnel Management standard has recently been developed for county level FmHA workers. According to FmHA personnel office and OPM staff, most of the 1,900 county offices were administered by county supervisors at the GS-11 level. That standard was last reviewed in 1967. In the future, the organization will move to a point where a quarter of the county supervisors will shift upward to the GS-12 level, and approximately five percent will shift down to the GS-10 level (those whose primary workload is homeownership loans, which the OPM staff considers less complex than farm loans).

Mississippi, North Carolina, and Texas have the largest number of county offices in the country, with nearly 350 staff each, working in 80 to 120 county offices. As the number of county offices within a state might be determined by the amount of county level business—i.e., homeownership and farm loans—generated by that state, one would expect farm states to warrant disproportionately large numbers of county offices. Generally, this is true.

The county offices do not exhibit the variation in staffing patterns that the district offices do, with one exception. The Massachusetts, Connecticut, and Rhode Island county offices (all supervised by the Massachusetts state office) hire no mid-level program assistants or technicians; instead, county supervisors, assistant county supervisors, and clerical staff are employed.

Funding

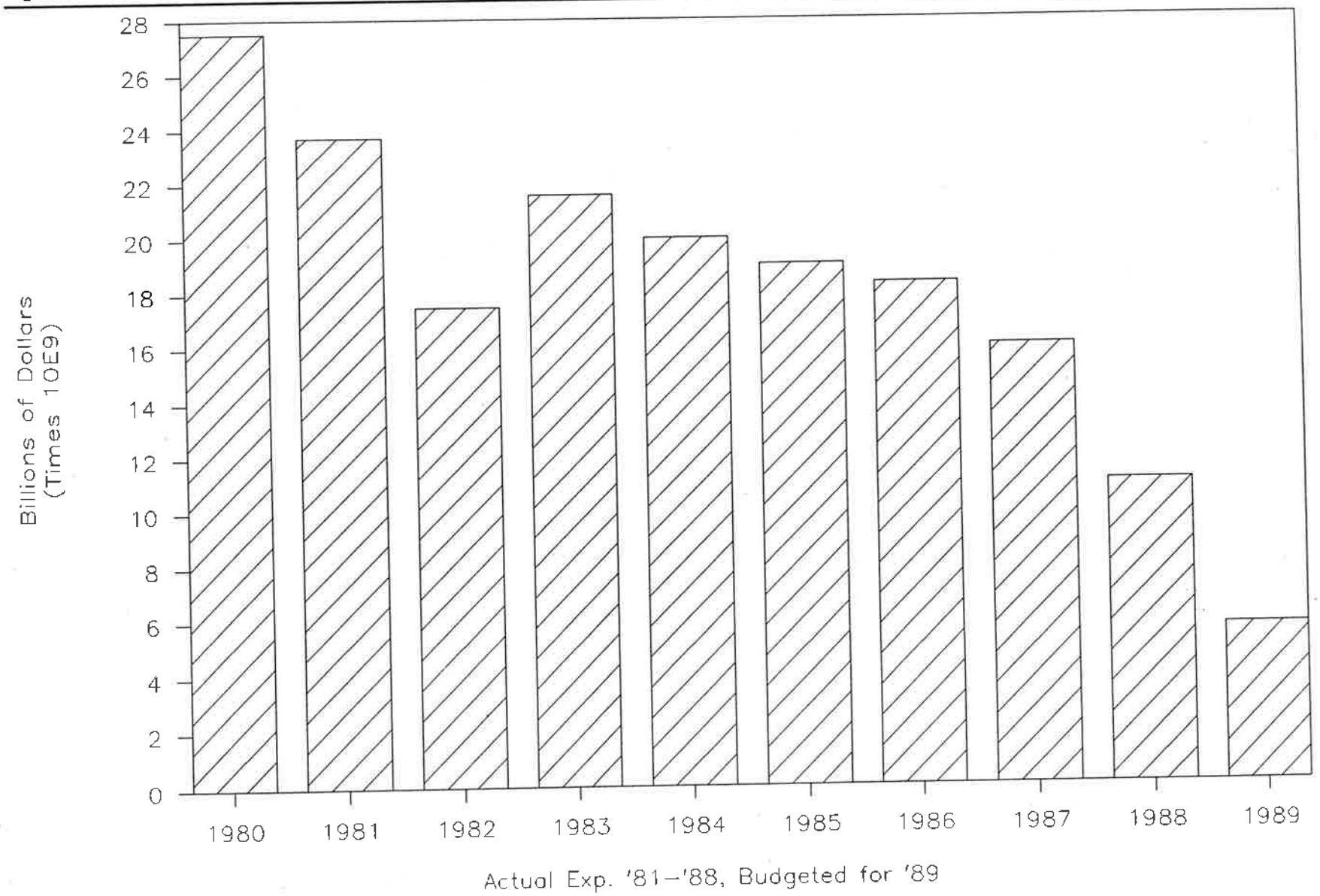
Any discussion of trends in rural development expenditures during the Reagan administration must focus on three things: cuts in funding; increased reliance on loans (and even more so on loan guarantees) rather than grants; and a shift in emphasis to fewer, smaller projects.

President Reagan repeatedly asked Congress to de-fund the majority of rural development loan, grant and technical assistance programs in place, whether administered by FmHA, EDA, SBA, or the ARC. Although Congress has refused to discontinue most programs, it has acquiesced in changing the programs dramatically, consistent with the three initiatives outlined above.

Total rural funding, including farm and rural housing programs, was cut nearly 60 percent in real terms between 1981 and 1987 (see Figure 11). But federal rural development funding alone has been even harder hit, declining nearly 70 percent over the same time period (Figure 12 and Table 12).

Farmers Home Administration rural development programs dropped 69 percent in real terms (including guaranteed loan obligations), from $1.67 billion in 1981 to $490 million in 1987 (see Table 12 and Figure 13). The FmHA's Business and Industrial loan and Community Facilities loan programs experienced the

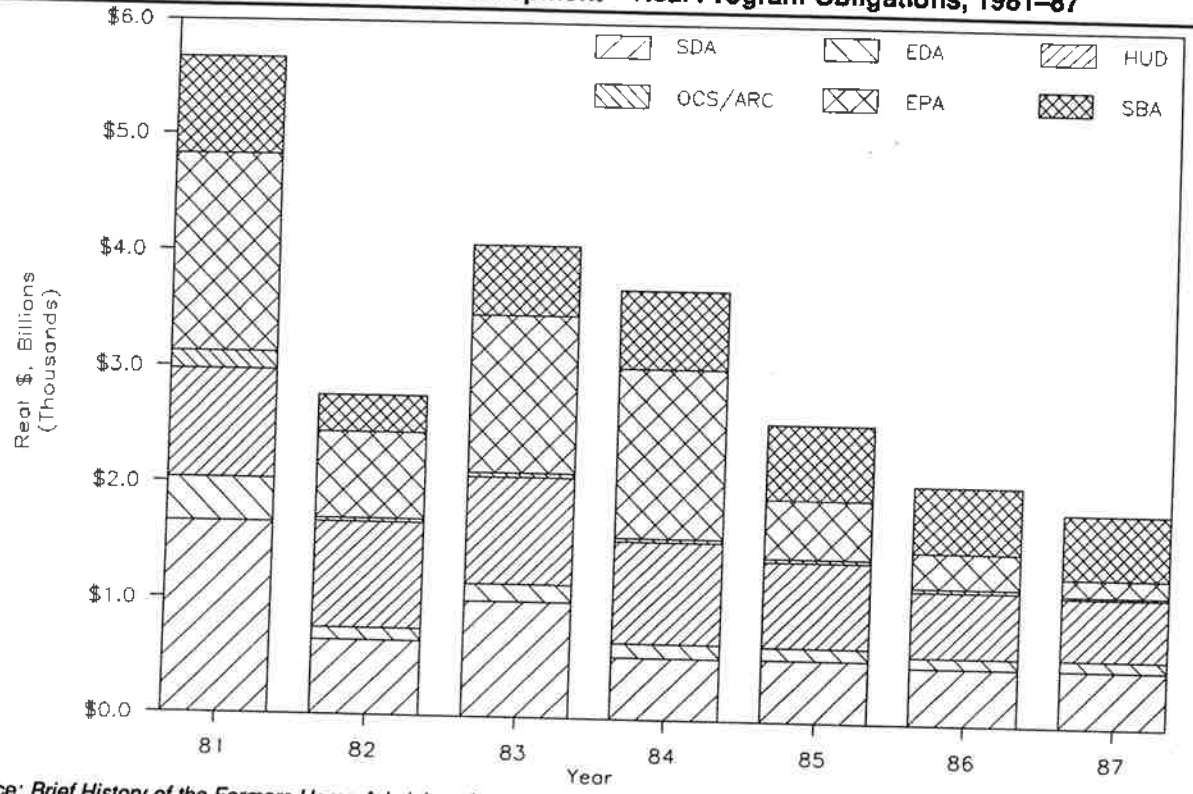
Figure 11 Funding Levels for Rural Program* (Inflation Adjusted)



* Includes loan limitations.

Source: Senate Budget Committee

Figure 12 Federal Rural Economic Development – Real Program Obligations, 1981–87



Source: *Brief History of the Farmers Home Administration*, '82–'87; Public Works, Economic Development Administration; Urban Development Action Grant Program, Department of Housing and Urban Development; CDBG, *Annual Report to Congress*, '83–'88; Office of Community Service, Department of Health and Human Services; Communications Unit, Appalachian Regional Commission; Office of Planning and Budget, Small Business Administration.

most severe cuts—B&I obligations declined by 85 percent during the period (see Figures 14, 15 and 16). While FmHA's farm and housing programs have suffered funding cuts as well (see Figure 13), neither has declined as significantly as have FmHA's rural development programs.

The cuts in FmHA and other programs were softened slightly in the early years of the Reagan administration by small increases in rural funding through HUD's Small Cities Community Development Block Grant program, whose administration shifted to the states in 1982, and stability in the EPA Construction Grants program. During President Reagan's second term, however, both the EPA and SCCDBG obligations declined at a faster rate than most other federally funded rural development programs.

The funding hump apparent on Figure 13 for 1983 is attributable to increased appropriations under the 1982 Jobs Bill. Although nearly $1 billion in additional funds were obligated in rural areas through the jobs initiative in 1983 compared to 1982, levels were still 25 percent below 1981 levels, and dropped back down again quickly.

Federal cash expenditures on rural development programs were cut more severely than the obligations graphs indicate. Those graphs treat loan guarantee programs as if the federal government were issuing a direct loan to the recipient. This is, of course, not the case. The participating bank issues the cash, and, except for administrative costs, the government expends funds only if the recipient defaults on the loan and, at that point, only up to the level of the guarantee.

Thus, if a recipient pays off 20 percent of the principal of a 90-percent guaranteed $100,000 loan and then defaults, the government expends cash for the first time (other than for administrative costs) by paying the bank $70,000—the difference between the $90,000 that was guaranteed and the $20,000 already paid by the borrower.[3]

As a result, the government cuts back its financial support and shifts additional costs onto recipients when it moves from grants to low-interest loans, and from low-interest loans to market-rate guaranteed loans. Between 1981 and 1987, the federal government eliminated EDA direct loans and marginally increased its guarantee program, reduced SBA direct

Table 12 Economic Development Obligations, by Program, 1982–87

Current Dollars in Millions

Program	1982	1983	1984	1985	1986	1987
USDA^						
B&I	$61.2	$81.9	$124.4	$61.3	$54.8	$95.7
Community Facilities	126.2	130.0	130.0	115.0	95.7	95.7
WWD Loans	375.0	600.0	270.0	340.0	325.4	330.4
WWD Grants	133.8	313.2	103.7	129.0	119.3	117.7
Subtotal	$696.2	$1,125.1	$628.1	$645.3	$595.2	$639.5
Ec. Dev. Administration#						
Public Works Grants	77.9	149.4	119.0	97.5	78.7	96.6
Title IX Ec. Adj. Asst.	19.8	21.6	24.9	24.7	20.1	26.0
Bus. Dev. Assistance						
Direct Loans	8.2	0.0	0.0	0.0	0.0	0.0
Guarantees	7.2	0.0	0.0	8.9	12.1	0.0
Subtotal	$113.1	$171.0	$143.9	$131.1	$110.9	$122.6
HUD*						
Small Cities CDBG	861.7	877.2	816.0	775.2	580.7	617.8
Small Cities UDAG	134.0	165.0	228.0	119.0	106.0	79.0
Subtotal	$995.7	$1,042.2	$1,044.0	$894.2	$686.7	$696.8
SBA'						
Direct Bus. Loans	24.6	37.7	45.4	43.3	21.5	21.5
Guaranteed Loans	318.3	646.4	753.9	733.0	662.9	700.0
Subtotal	$342.9	$684.1	$799.3	$776.3	$684.4	$721.5
HHS Office of Comm. Serv.%						
Discretionary Fund						
Rural Ec. Development	7.5	7.5	7.5	8.0	7.0	7.0
Rural Community Fac.	2.0	1.5	1.5	1.7	1.7	1.8
Subtotal	$9.5	$9.0	$9.0	$9.7	$8.7	$8.8
Appalachian Regional Comm.@ Community Development Programs (Water/Sewer)	23.6	32.9	27.4	28.8	26.4	19.4
EPA$ Water/Waste Const.	745.0	1478.0	1452.0	501.0	303.0	149.0
GRAND TOTAL	$2,926.0	$4,542.3	$4,103.7	$2,986.4	$2,415.3	$2,357.6

Sources:

^ USDA figures are from the *Brief History of the Farmers Home Administration, '82–'87.*

Obligations, from David McIlwain, EDA. Assumption that proportions of total obligations expended in rural areas: 60% in '82, 65% in '83, 70% in '84, 75% in '85, 79% in '86. The '83 and '84 Public Works figures include supplemental obligations under the Emergency Jobs Bill. EDA uses the Census Bureau definition of "rural." Excludes highway funding.

* UDAG figures from Darryl Bladen, CDBG figures from *Annual Report to Congress, '83–'88.* After the program was turned into a block grant in FY '82, the proportion of CDBG funds going to housing declined from 43% in '81 to 12% in '82, and has since slowly increased. The housing portion of annual obligations is excluded from these figures.

Governmental entities comprised of fewer than 50,000 people that are not within an MSA are eligible for Small Cities funding. Approximately 20% of funds is awarded to grantees with between 25,000 and 50,000 residents. While these figures indicate the amounts obligated to states each year, they do not reflect the time lag involved in getting funds to localities. In '85 and '86, 50% of funds were obligated at the local level within 15 months of federal award to the state.

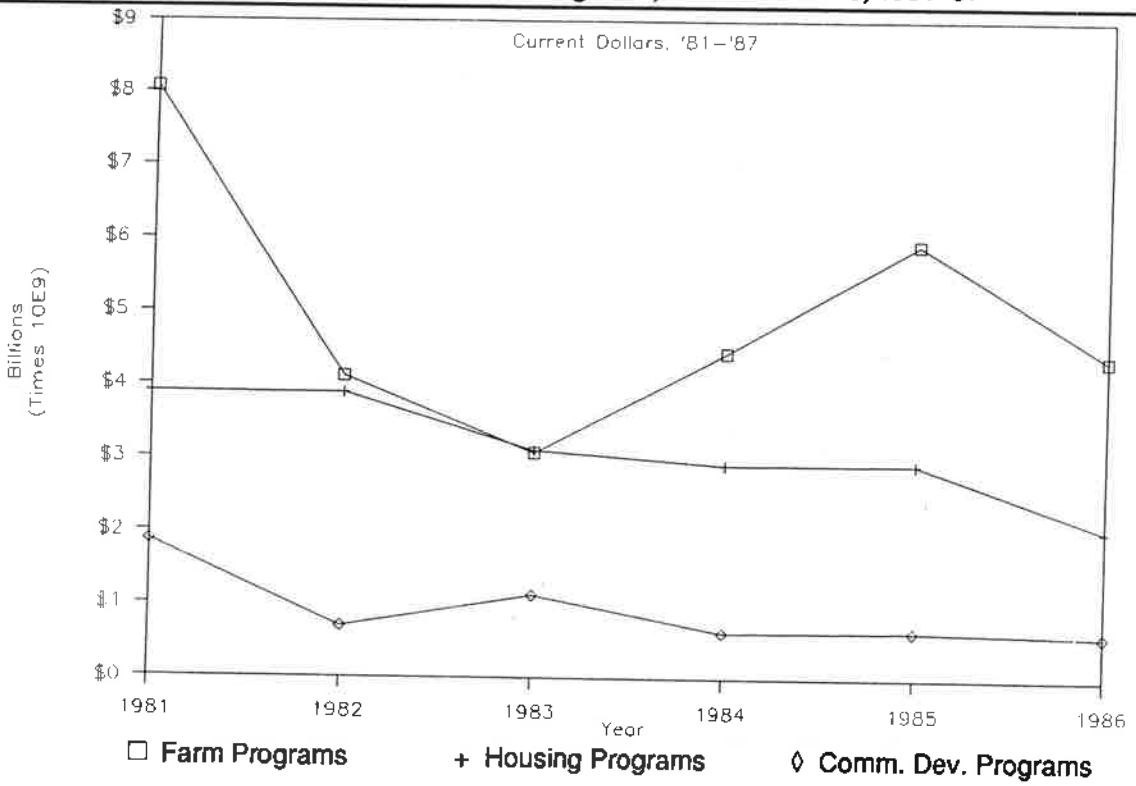
' Figures from Greg Walter. Unfortunately, SBA does not break out rural obligations. We multiplied total SBA obligations and commitments by .25, a figure that Judy Hacket, Special Assistant for Rural Development, proposed. Not included are 'Salaries and Expenses,' which funds Disaster Assistance, SCORE and the Business Development Centers.

% Figures from Jacqueline Lemire, OCS. CF figures are actual; Lemire said that OCS estimated several years ago that 40% of CED funds are expended in rural areas.

@ Figures from Ann Anderson. She indicates that almost these entire amounts are expended in rural areas.

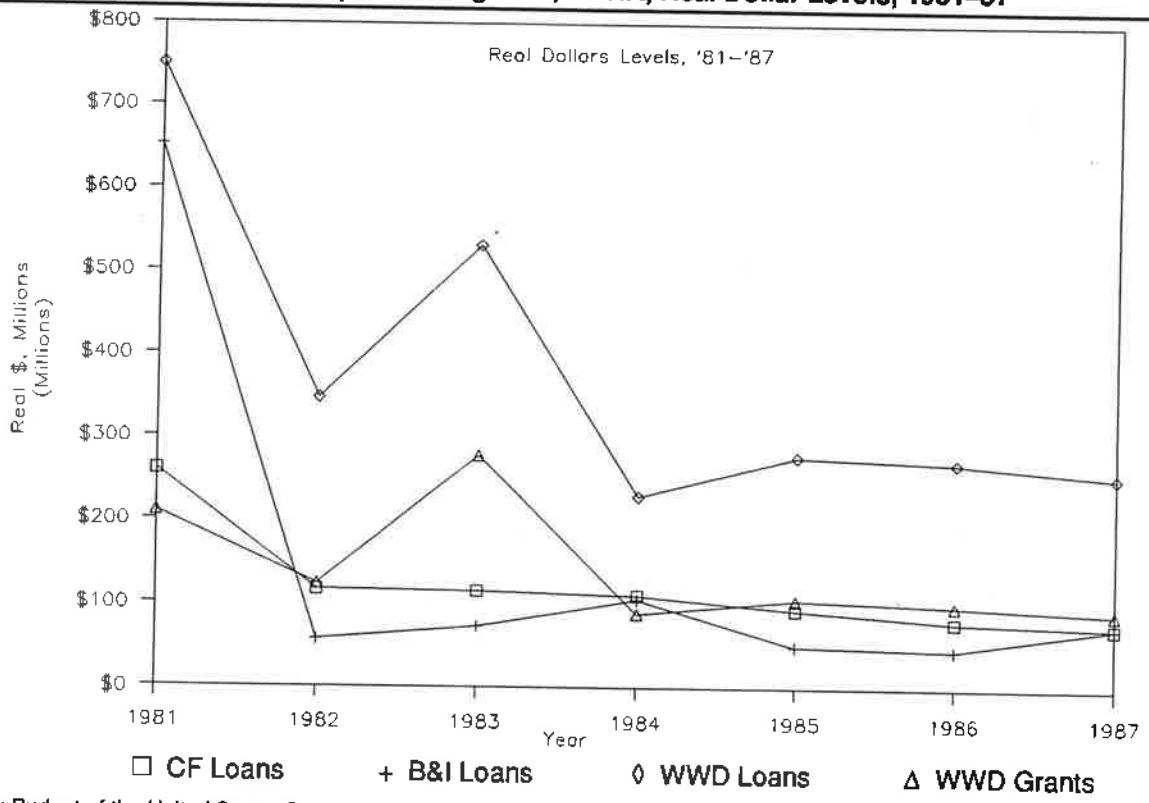
$ Municipal Construction Division, Environmental Protection Agency.

Figure 13 Comparison of Funding for FmHA Programs, Current Dollars, 1981–87



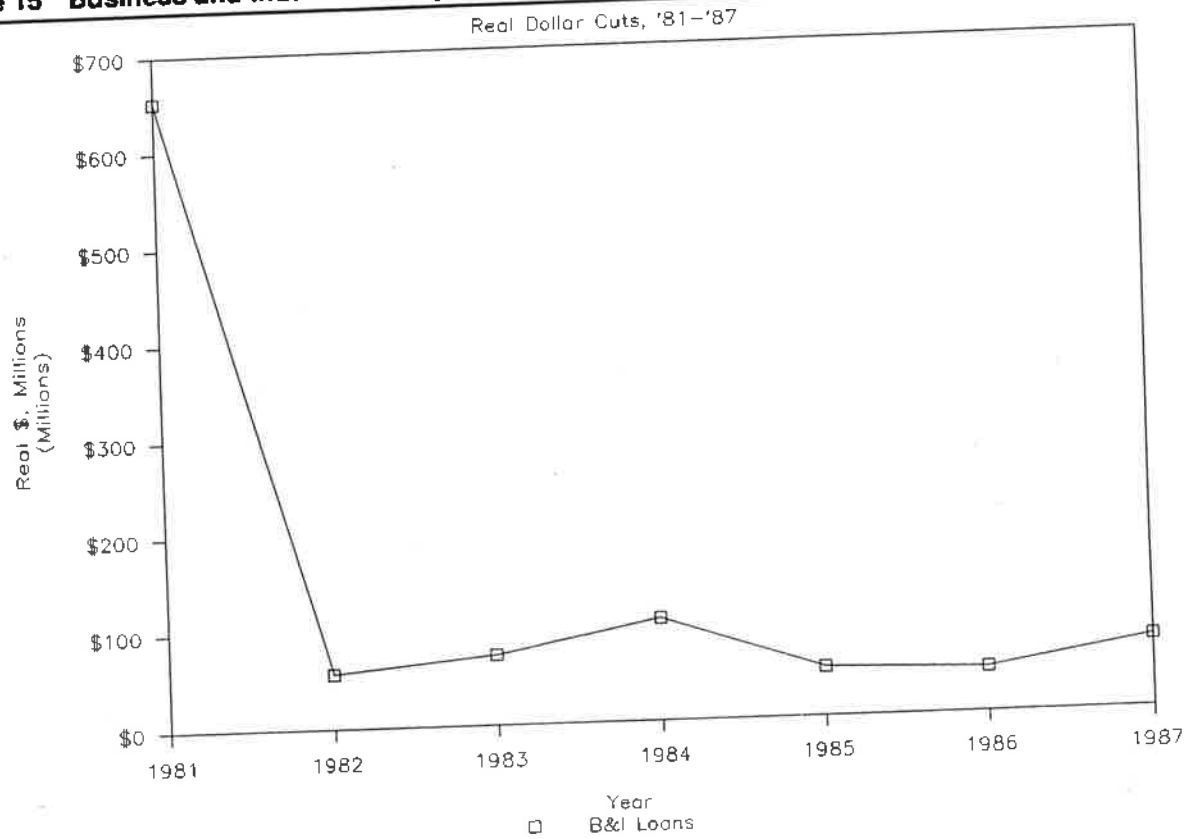
Source: Budget of the United States Government, 1987, obligations.

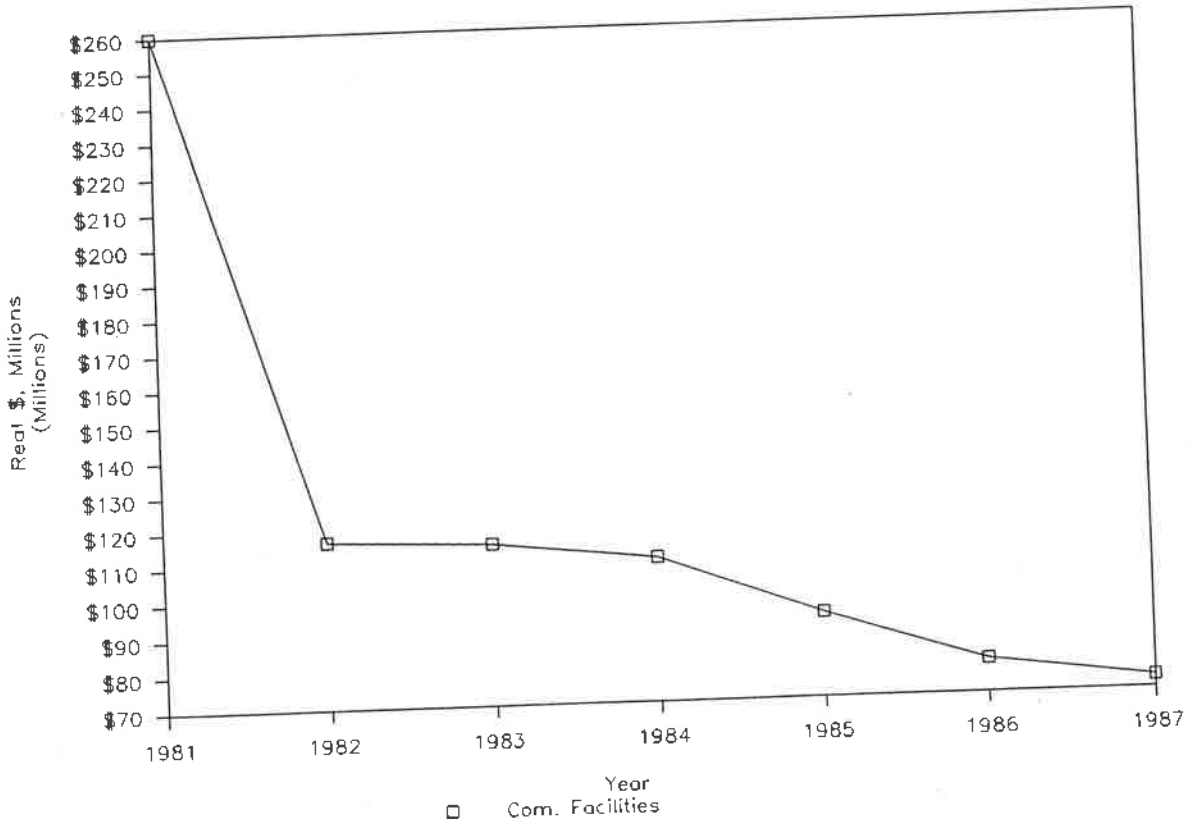
Figure 14 Community Development Programs, FmHA, Real Dollar Levels, 1981–87



Source: Budget of the United States Government, 1987, obligations, adjusted for inflation.

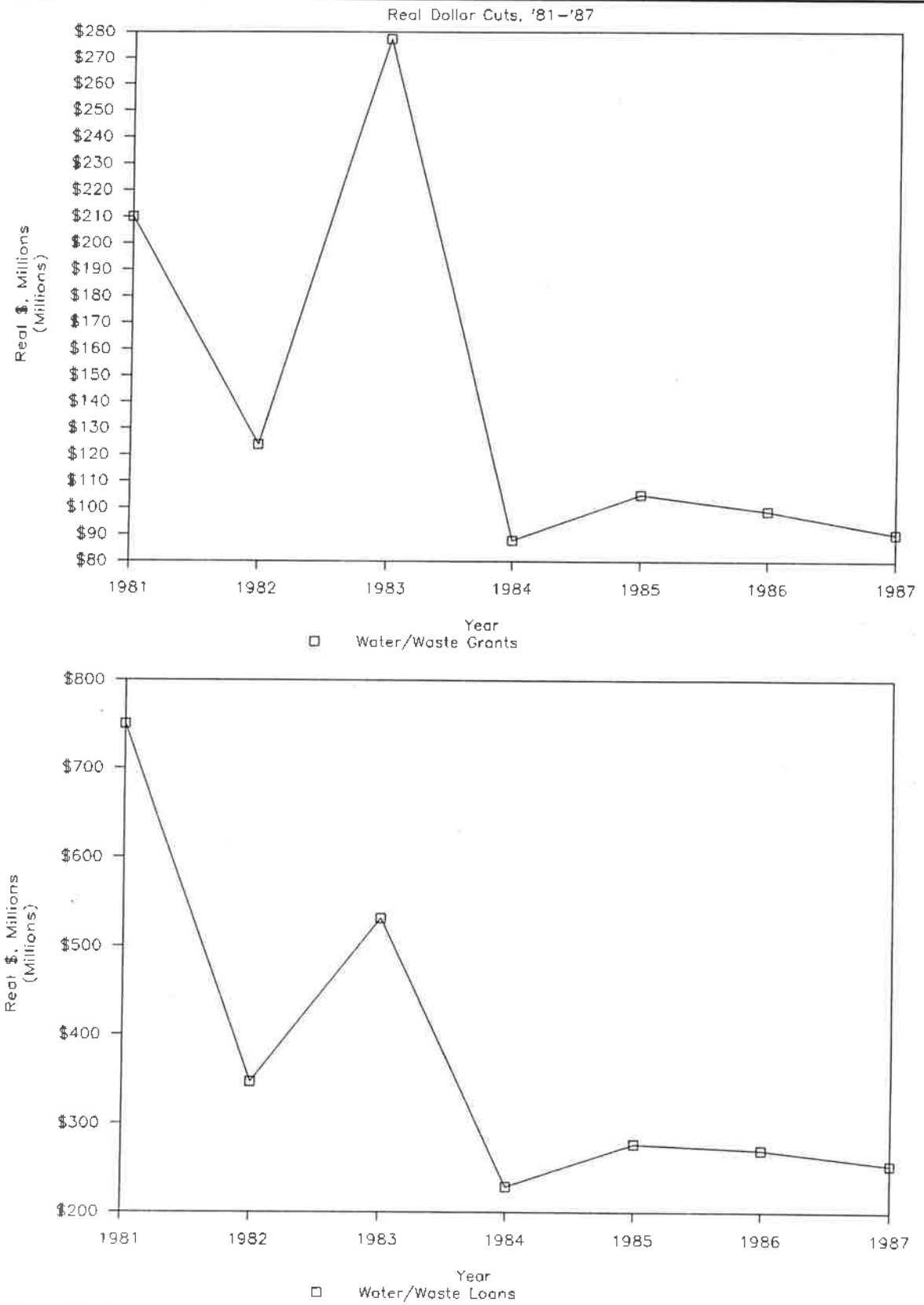
Figure 15 Business and Industrial Obligations — Community Facilities Obligations





Source: Budget of the United States Government, 1987.

Figure 16 Water and Waste Grant and Loan Program Obligations



Source: Budget of the United States Government, 1987.

loans somewhat while expanding its guarantee program by more than 100 percent, and cut FmHA's three direct community loan programs roughly in half. As mentioned above, FmHA's B&I guarantee program did not escape the budget knife.

Of course, these operating shifts not only result in fewer costs to the government: They also mean that government services are less flexible than they once were. Whereas a low-income community might have been eligible for a needed water and sewer grant in past years, the project is less likely to be funded with this year's scarce resources. Alternatively, the community might now be eligible for a market-rate loan which the local tax base cannot support.

Finally, budget cuts have led program managers to fund fewer, smaller projects than they might have under previous funding conditions. This shift was a conscious policy decision in the Business and Industrial loan program (which FmHA staff say had become politicized and bloated), but is also a natural phenomenon among programs with reduced resources and continuing high demand.

For instance, the average size of an FmHA Water and Wastewater loan declined by nearly 40 percent (excluding the effects of inflation) between 1981 and 1987 (see chart below).

With fewer resources available, program managers are likely to satisfy regional funding pressures by spreading limited financial resources more thinly than in the past, perhaps bypassing some expensive projects that address more serious needs.

Thus far, we have analyzed the Farmers Home Administration rural development programs, their history, current operation, funding levels, and staffing patterns. For comparison purposes, we also have described rural development programs administered in different manners through the SBA, EPA, and CDBG programs.

How effective are FmHA's programs compared to those administered through other delivery mechanisms?[4] To what degree do the FmHA programs meet the program effectiveness criteria identified in Chapter Three?[5] Might the use of other delivery mechanisms improve FmHA's delivery of rural development benefits? While specific recommendations will follow in the concluding chapter, this next portion of the report will evaluate the six FmHA rural development programs (Water and Waste loans and grants, Community Facilities loans, B&I guarantees, IDG grants and IRP loans) in the context of each of the criteria already outlined, and programmatic alternatives.

FmHA Water and Waste Disposal Loans
1981–1987

	1981	*1983*	*1987*
Number of Loans	1,768	1,184	769
Total Amt. Oblig. ($Millions)	$750	$600	$330
Average Loan Size	$775,000	$506,750	$486,000

1 Temporary staff are not included in these figures.

2 As pointed out in the case study in Chapter Five, some district offices with aggressive loan programs continue to operate at a full workload.

3 Many argue that an accurate cost accounting of these programs would include a subsidy equal to the difference between the interest rate paid by the borrower and the rate that the bank would have charged if the loan were not guaranteed, but these costs are extremely difficult to measure, and are disregarded by the government itself in its budget document.

4 The delivery mechanisms include: direct payments, services or standard setting; grant and loan assistance to communities through a centralized or decentralized federal system, state block grants, and intermediary contracts.

5 Those were: targeting, coverage, accessibility, efficiency, accountability, flexibility, capacity, performance, technical assistance, leveraging, political context, outreach, and program integration.

CHAPTER THIRTEEN

Applying the Evaluative Framework to FmHA—How Does it Rate?

The overall success of a program rests both on program design and program implementation. While our case study of the FmHA water and waste program indicates that it worked reasonably well in delivering water and waste facilities to a remote, low-income community in North Carolina, the program statistics explored in the targeting chapter indicate that, on the whole, the program does not serve communities similar to the one in North Carolina well. In 1989, FmHA staff in Maine were able to obligate four times their annual allocation of water and waste loan funds, while in Georgia, staff approved projects whose value totalled less than a third of that state's allocation. Although the case study of a business development project administered by the CDBG program in North Carolina was less than exemplary, anecdotal evidence indicates that CDBG business development efforts in some other states are well-conceived, successful, and relatively immune to political favoritism.

These widely differing records reflect differences in implementation,[1] since the delivery mechanisms in each case are identical. So while we may suggest wholesale changes or minor adjustments to FmHA programs, improvements in program outcomes remain dependent on a host of additional factors as well.

Targeting

As indicated in the targeting chapters, the FmHA Water and Waste loan and grant programs (a decentralized program) and its Business and Industrial loan guarantee program (a centralized program) are not well targeted to lower-income or more distressed communities as required by Congress. Although low-income communities receive assistance under the programs, higher-income communities (or in the case of the B&I program, communities with lower unemployment rates) are much more likely to be served, and assistance to low-income communities is often less subsidized than that given to higher-income communities.

The EPA Revolving Loan Fund program, which essentially operates as a block grant, is not intended to target rural or lower-income communities and does not do so. The CDBG program is somewhat targeted to a population comparable to that of the FmHA programs: Only half of Small Cities CDBG communities have populations under 20,000, although 51% of a CDBG-funded water or waste system's users must be of low income. Despite these requirements, the CDBG program is often criticized for its poor targeting record.

FmHA could easily promulgate regulations that would more appropriately distribute program benefits to eligible communities. Moreover, the national office could encourage state and district offices to properly implement those regulations. It appears that, in the case of the Water and Waste and B&I programs, the delivery mechanism itself is not responsible for the programs' poor targeting record.

Programs implemented through intermediaries tend to have better targeting records because they frequently have been established precisely to serve a particular niche or targeted group. Typically, when a program manager recognizes that an important market in need of specific program resources is not receiving them, an intermediary relationship will develop to fill the gap. Yet if the intermediary is not properly monitored, targeting records can lapse, as appears to be the case in the SBA loan guarantee program in western Kansas.

SBA uses private loan officers as intermediaries in implementing its program. When conceived, the agency undoubtedly perceived that these lenders were perfectly placed to identify targeted borrowers and ensure that federal resources were delivered to them. But in the Kansas case study, accountability efforts seem to have broken down, and the intermediary has lost its targeted focus.

Coverage

As indicated above, eligible communities in Georgia appear to have a significantly reduced chance of receiving water and waste assistance than do communities in Maine. This uneven record indicates that the targeted population is not evenly covered by the Water and Waste loan and grant program throughout the nation. A switch to a state block grant arrangement would introduce its own coverage problems because the records of state-run programs would be uneven—successful in some states and failures in others.

A move to a centralized federal program would probably improve program coverage, since administrative discretion is reduced somewhat, but would decrease program effectiveness in other areas such as accessibility and flexibility.

These three factors are intertwined in the B&I loan program, with the final effect of severely limiting coverage. In recent years, administration of the B&I program, in most instances, has been reserved for the national office. The program is administered by staff that understand the complexities of business finance, and administer the program in a consistent manner throughout the country. The target population would appear to be covered adequately. Yet because program administration is so far removed from the field, the B&I guarantee program is not accessible, and in most states, it is virtually unknown.[2] As a result, the program "covers" a small portion of its intended market.

In some cases, programs implemented through intermediary contracts have poor coverage records. Both the Intermediary Relending Program and the Industrial Development Grant program are so limited in size that businesses in most parts of the country are ineligible for assistance, simply because intermediaries are so thinly distributed. In other cases, such as that of the SBA guarantee program, intermediaries are widely dispersed and effectively cover eligible program users throughout the country.

Accessibility

The FmHA field structure offers its staff an unparalleled opportunity to work closely with communities to identify their development needs, and administer supervised credit programs to match those needs with specific business or infrastructure projects. Yet reports from the field indicate that FmHA staff generally are not accessible. Although they may work within a two-hour drive of most areas in rural America, the district staff apparently do not capitalize on that proximity to further the goals of their programs. As program administration moves to the state or national level, accessibility correspondingly declines.

Moreover, the FmHA rural development programs have never been structured to incorporate the perspectives of its "clients" into operation or design of the program. Administrative procedures are passed down from the state and national offices, and infrequently are new approaches developed that address regional variations. In contrast, the CDBG program regulations require annual hearings on program operations, to which the target population is invited, and programs based on an intermediary model are required to regularly demonstrate that their programs are accessible to the public and responsive to their needs.

There may be a logical explanation for the differences in program accessibility. Under both the block grant and intermediary approaches, the federal government transfers the implementation of a federal function to another entity. In exchange for loss of direct control over the program, the Congress attempts to maintain control over the programmatic outcome by insisting that these entities ensure accessibility and responsiveness, and by relying on the program users themselves to monitor the program. Only when the program passes out of federal hands does it appear that accessibility emerges as an important issue. Nevertheless, federally administered programs, particularly those administered on a substate basis, are not intrinsically less accessible than those administered through other means.

Efficiency

Most policy analysts examining the Water and Waste and Community Facilities programs would assume that the benefits of the programs (broadly defined) far outweigh the costs of administration and interest subsidies. But they would also argue that, given the information available in the agency's management information system, there is no way to determine those costs and benefits to the nation or to the community being served. More importantly, there is little opportunity to examine whether various program changes would generate improvements in effi-

ciency: The data simply are not available for this or for other FmHA programs.

These problems are endemic in bureaucracies at all levels. State block grant and intermediary officials are regularly asked by their federal supervisors to justify funding requests and quantify anticipated program benefits. But this information does not measure efficiency in program outcomes, merely *anticipated* outcomes.

Because block grant funds can be viewed by states as "free money," there may be a tendency to accept lower levels of efficiency in block grant programs than in other state programs. Again, it does not appear that a specific delivery mechanism is likely to be more efficient than another.

Accountability

By nearly all accounts, the Farmers Home Administration and its field staff are not appropriately accountable to the agency's rural constituents, to the Congress nor, in certain circumstances, to the administrator of FmHA in Washington. The most acute problems with accountability appear to center on the infrastructure programs, administered in the district and state offices, although all FmHA rural development programs may suffer in this regard.

As described above, there are no mechanisms to encourage constituent input into program design and implementation, nor mechanisms by which program constituents can evaluate the specific or general effectiveness of the programs.[3] A significant proportion of points used to rank projects at the state level are subjective, and if a project is rejected or assigned a low position on the priority list, there is little recourse. Communities often complain of waiting several years for a funding decision, during which FmHA staff slowly ask for a succession of of documents. They feel utterly powerless.

The fact that the state director is a political appointee further reduces programmatic accountability. In examining funding distribution data, one easily picks up patterns that indicate that the state directors are careful to fund projects in certain districts represented by powerful members of Congress. Needed projects in other members' districts may get short shrift.

Moreover, because the state directors are, in essence, appointed by the ranking member of the congressional delegation belonging to the party in the White House, former administrators report that the directors can frequently outmaneuver the administrator on implementation and policy issues. For instance, while demand for the Water and Waste programs is easily demonstrable in Georgia, the state director approved projects totalling only one-third of the state's 1989 Water and Waste loan program allocation. Federal policy supports full use of the money, yet the state director consistently refuses to do so. Finally, because so little useful program data is available, the agency has difficulty providing Congress with useful measures of program success and effectiveness.

Advocates of state implementation of federal responsibilities argue that states, because they are closer to the people and better understand their needs, are more accountable than the massive federal bureaucracy. This is undoubtedly the case in some states. The factor mitigating this argument is that in other states, the federal bureaucracy, with all its shortcomings, is more responsive to the development needs of poorer, more rural, and often minority communities targeted by FmHA than would be the state government. If these communities had high incomes and relatively few serious unmet development needs, one might not be concerned. But in fact, the communities most likely to be missed by their respective state governments are the very communities most in need of coverage by a federally implemented program.

Administration through intermediary contracts introduces yet another mechanism for improving accountability: If the intermediary does not perform, the contract can be terminated. As mentioned in the efficiency discussion, a program officer will generally be more demanding of a contractor regarding accountability issues, precisely because accountability is highly valued when program implementation is passed to another entity.

Flexibility

Almost by definition, federal programs administered at any level are less flexible and accomodating of local conditions than are programs administered through other delivery mechanisms. Federal regulations are written to encompass circumstances across the country, and rarely are they structured to accomodate local discretion or responsiveness, both of which, in measured doses, could greatly increase the effectiveness of federal programs. But there is a fine line between rigidity and irresponsible flexibility.

The history of the CDBG program under state control is haunted by descriptions of local mayors using federal funds to build swimming pools and driveways at private homes. Likewise, a poorly monitored intermediary contract can evolve into a program serving the needs of the program's administrator rather than those of its constituents or the federal agency providing the funding.

The case study describing the Community Facilities program in Vermont indicates that in some cases, administrators of decentralized programs, if motivated to do so, can work with program users to adjust or interpret national regulations to reflect local conditions. But this flexibility appears to hinge more on the creativity of the administrator than the delivery mechanism itself.

Capacity

Does FmHA have the capacity to adequately administer its programs? In many ways, the agency is better prepared to handle the more complex aspects of its loan and grant programs (such as credit evaluation, workouts, and design or construction review and inspections) than are its counterparts within the states or intermediary organizations. Because the bureaucracy is so large, individuals can specialize to some degree, and the organization can rely on those skills wherever they are needed.

Moreover, an FmHA staffer generally works full time on rural development loan or grant projects. In contrast, staff implementing a state block grant program or an intermediary program often divide their time among several functions, and never learn one program inside out. Or, as was the case in the North Carolina CDBG case study, staff are borrowed from other programs, and simply do not have the skills needed to properly administer the program.

Training and capacity building targeted to program administrators and staff is traditionally an underfunded, undervalued function, regardless of the delivery mechanism used to adminster a program. In times of tight budgets, training funds and general program administration are often first to feel the pinch. This is particularly the case for block grant programs and federally mandated programs, under which the federal government is increasingly transferring responsibility for implementation to the states, without corresponding administrative funds.

Performance

As noted above, FmHA generates very little reliable data by which program administrators, individual workers, members of Congress or others can evaluate its performance. Moreover, the data available—generally relating to the number and size of loans and grants closed each year and the delinquency rates of the various loan portfolios—paint an incomplete portrait of the programs and their effectiveness in meeting the development needs of rural Americans.

The record among state block grant administrators and intermediary program directors undoubtedly varies, based on the capabilities of the management. Both the COSCAA report cited earlier and the discussion of the CDBG program indicate that relatively little information is available through federal channels concerning the performance of Small Cities CDBG development efforts, although state governments probably have more complete information on program performance.[4]

Technical Assistance

Technical assistance, particularly for capacity building efforts, is extremely difficult to effect, but necessary to ensure that federal development resources reach small, poor, isolated communities that are often most in need. The process is long and labor intensive.

The Farmers Home Administration provides limited technical assistance to targeted communities, but in almost all instances, this assistance is provided through a series of contracts with intermediary organizations. In some states, CDBG administrators also rely on intermediaries for technical assistance efforts, while other states have developed aggressive technical assistance units in-house, and still others have no technical assistance resources available. Thus, it appears that intermediaries may be the delivery mechanism best able to provide targeted assistance that is flexible enough to meet the needs of a wide range of communities, and skilled enough to make a difference.

Leveraging

All FmHA rural development programs require that a project include leveraged assistance from a source other than FmHA. Small Cities CDBG programs vary across the country in leveraging require-

ments, as do intermediary programs. Clearly, leveraging requirements can be imposed on a program implemented through any of the delivery mechanisms under discussion in this report.

Political Pressures

The level of political support held by a program is often a measure of program performance. On this issue, the evidence with regard to FmHA delivery mechanisms is mixed, and the history of the rural development bill considered during the 101st Congress is illustrative.

The Senate passed a bill which essentially reaffirmed the federal role in rural development, although a heavier emphasis was given to intermediary organizations, including states, for establishing and implementing the revolving fund portion of the bill. The House bill, in contrast, turned decision making for FmHA-funded rural development programs over to a state-level review panel. While Senate members seemed generally satisfied with the FmHA record, some House members (on both sides of the aisle) argued that FmHA was not responsive to development needs in their districts, and thus favored the block grant approach.

Outreach

Clearly, effective outreach efforts are easier to perform when those conducting the efforts are in relatively close proximity to the target population. Generally, a decentralized mechanism, block grant mechanism, or intermediary mechanism will more successfully reach out to program users than will a centralized mechanism.

From the case studies and anecdotal evidence, it appears that FmHA does not place a high premium on outreach efforts, and as a result, program resources are allocated essentially on a first-come first-served basis, rather than on a needs basis. A low-income community with major water supply problems is unlikely to find out about FmHA water programs through agency efforts, and thus is less likely to utilize the program than a moderate-income community with a more sophisticated town manager who knows about the program. In this case, poor outreach efforts would lead to less-than-optimal distribution of program resources.

Perhaps more than for any other criterion, the success of outreach efforts hinges on commitment of program staff, and devotion of program resources to efforts that many administrators may consider secondary in importance to more direct program activities.

Rationalization

Administrators can more easily ensure that their program efforts are integrated with those of other federal, state, or local programs when they have a clear sense of these programs' operations. Workers operating within a centralized federal delivery mechanism (such as the B&I program) would have difficulty identifying related state and local programs, and working to mesh the two.

In contrast, staff of programs administered at a more local level can put themselves in the position of a program user and identify related programs or private resources at the local, state, or federal level. These staff, in practice, are more likely to initiate meetings with staff from other programs to encourage joint efforts or more efficient division of labor. For example, the staff of the Montpelier, Vermont Community Programs office of FmHA regularly met with potential program users and with staff from HHS and the Small Cities CDBG program to plot out potential Community Facilities projects. Staff of Intermediary Relending Program borrowers work regularly with SBA Small Business Development Center staff, bank loan officers and others to identify potential borrowers and develop financing packages.

These patterns may reflect, above all, financial necessity. In light of the decade's budget cuts, many projects can be funded only through a complicated patchwork of diverse funding sources, necessitating close working relationships and coordination.

A series of conclusions follow, resulting from the case studies, program descriptions, and from the analysis of this chapter.

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1 And in the case of the CDBG program, minor differences in program design.

2 As reported in Chapter Nine, one-third of the states received no B&I guarantees between 1986 and 1988.

3 If an intermediary program is run by an organization with a board representative of program users, accountability is clearly improved.

4 For the 1987 program year, HUD had received no information concerning CDBG projects accounting for nearly 10% of funds.

CHAPTER FOURTEEN

CONCLUSIONS

This report focused on several issues:

- Who are the federal players in rural development? Should the Farmers Home Administration retain its leading role in this area of policy making, or defer to another agency, perhaps one yet to be established?
- What delivery mechanisms should federal rural development agencies use in delivering assistance? Should the federal government increase its reliance on intermediaries to accomplish rural development objectives?
- Are limited federal rural development resources targeting the poorest rural communities?
- Is there any indication that certain types of assistance—loans, grants, or guarantees—are more effective than others in the delivery of rural development services?

The work embodied in the three sections of the report—the paper, the case studies and the analysis of program beneficiaries—addresses these questions, reframes them, and identifies new questions, answering some and leaving others for future research. The researchers were careful to give heavy weight to the perspectives of two groups in the rural development process: users of the programs (representatives of communities themselves, state rural development policy makers, nonprofits, REA coop staff) and lower-income communities and individuals who, particularly in times of scarce federal resources, should be targeted for benefits.

A series of conclusions follows that arises from the accompanying components of the project, as well as from meetings with other rural development policy makers (including agency officials, representatives from Capitol Hill, and other researchers in the field), the perspectives of the Advisory Panel (whose members may not agree with every conclusion), and some hard thinking. The focus remains on the Farmers Home Administration.[1] First, some amplification.

The Advisory Panel devised an approach to rural development that seems to reconcile the traditional conflict between promoting rural development by targeting the "poorest of the poor," and targeting higher income "growth center" communities that have the capacity to generate jobs and other benefits, with the hope that some of these benefits will trickle down to lower income citizens and those living in surrounding communities.

The group argued that development of infrastructure (water and waste, basic community facilities, etc.) should be considered a basic human need, and should be delivered by government on a needs basis. On the other hand, the success of business development efforts depends in large part on community strengths. The amenities already available in a community, such as good transportation links and a motivated work force, are critical to success. As a result, business development assistance should be allocated on an "opportunity" basis.

Communities that are well-prepared for business development may not be of high income, may not be "growth centers," and may not define success in a manner identical to federal or state bureaucrats. Yet they may offer the greatest "bang for the buck" in a field whose successes come few and far between.

As the project progressed, it became evident that in virtually every rural development program, and on every rural development project, some "intermediary" took the initiative, kept the process on track, and pushed for funding and implementation. Policy makers generally assume that such an intermediary is a non-profit technical assistance provider, supported specifically to help communities or businesses identify their development needs and reach them. Yet in practice, a range of entities fulfills this role: loan

officers in banks participating in the SBA guaranteed loan program, consulting architects and engineers, or agressive CDBG or REA coop staffers.

Agencywide Issues

1. Reorganization

Many lawmakers, policy analysts, and advocates argue that the federal government's rural development efforts should be reorganized; a half dozen legislative proposals have been put forth.[2] Some feel that a separate agency—a Rural Development Administration—should be established within the Department of Agriculture to administer all rural development programs. Such an entity could give rural development a higher profile within the department, leading to greater funding and more effective deployment of resources. Others argue that primary responsibility for the function should shift to (or be shared more equally with) other agencies, such as the Small Business Administration or Rural Electrification Administration, or even the states through a block grant arrangement. Many conclude that the FmHA field staff's rural development efforts are simply inadequate, especially given the heavy reliance on intermediaries to bring projects to fruition. Moreover, decision making by staff of its business development programs can be more cautious and conservative than that of a local rural bank.

Despite its serious shortcomings and the attraction that a new agency holds in theory, *an FmHA overhaul has significant drawbacks*. Congressional support for rural development within the Agriculture and Appropriations Committees is relatively weak, at least compared to more traditional farm programs. There is a very real danger that if rural development initiatives were extracted from the protective mantle of the FmHA and consolidated elsewhere, deep funding cuts would follow. This is particularly the case in the House of Representatives, where very few members represent rural districts without traditional farm-based constituencies.

Likewise, a shift to funding through block grants might have some appeal, but it would further remove members of Congress from the beneficiaries of the program and therefore could also lead to an erosion of financial support. State officials rather than federal legislators are likely to cut the ribbons on rural block grant projects. Block grant programs (and their categorical grant predecessors) have suffered significant cuts over the years in large part as a result of this phenomenon.

Moreover, federal policy makers have no assurance that a state will continue to offer a range of programs after consolidation. For instance, if FmHA were to "block grant" its business and infrastructure development programs, states, at their discretion, could drop infrastructure assistance and focus on business development. As we note, these programs are typically targeted at very different communities. Those that have traditionally formed the market for infrastructure programs could be left unserved through a state block grant focused on business development.

Surprisingly, many users of FmHA programs oppose a reorganization or consolidation, despite dissatisfaction they may have with the agency. In part, this may be because they are familiar with the players and the rules and have developed a tradition of playing one agency off another in assembling funding for projects. A major change in FmHA or its programs brings with it uncertainty and new, uncomfortable risks. Moreover, there is a strong fear that unless drastic measures are taken, a reorganization will be in name only. The reorganization itself will disrupt agency activities for a year or two, and thereafter, while boxes may be moved around in the organizational chart, the names will stay the same.

Any administrative overhaul should occur only when a strong rural development constituency has evolved to protect it, when disruptions can be kept to a minimum, and when benefits to communities as a result of the change clearly outweigh the costs of retaining the current structure. Nevertheless, there are many areas in which FmHA and other rural development agencies can improve their service; these are outlined below and in the body of the report.

2. Role of the Undersecretary

At present, the Undersecretary of Agriculture for Small Community and Rural Development faces a formidable task. He or she must oversee and coordinate the administration's rural development efforts and supervise the Rural Electrification Administration, the Farmers Home Administration and the Federal Crop Insurance Corporation. Nevertheless, the undersecretary has a dozen staff members compared to 13,000 spread among the three agency administrators. In addition to this line authority (which by statute includes control over development of regulations, administrative notices, and policy exemptions), the

administrators retain virtual control over budgets. In short, the undersecretary has considerable responsibility, but very little authority.

The office should either be abolished (in which case the administrators should be elevated to deputy undersecretary status), or should be bolstered with staff, resources, and greater de facto *control over the activities of the three agencies.* At present, rural development interests are not benefiting from the undersecretary's position within the department.

3. Capacity Building

Additional emphasis should be placed on capacity building in rural America. All participants in the field agree that capacity building—supporting the spark, the critical mass, the leadership which translates needs into action into success—is the key to rural development. Yet because capacity building programs are amorphous, relatively expensive, and quite risky, there is generally little funding to support them. *Support can be provided in two ways: through direct leadership training and support, or as a byproduct of a local rural development initiative.*

For instance, Chambers of Commerce around the country support Leadership America (or Leadership Kansas, or Leadership Liberal) programs that train residents in leadership skills, organizational issues, and building resources for development. The Virginia Water Project funds a peer-to-peer program in which leaders from low-income communities that have completed development projects confer with leaders from communities with needs but few resources.

On the other hand, many a leader has gained on-the-job training and leadership skills when a water emergency forced a resident to help guide the community to identify its needs, evaluate resources, push for funding, work with consultants and administrators and oversee implementation of the project.

FmHA should devote additional resources to both approaches to capacity building. Moreover, the agency should incorporate capacity building criteria into its management evaluation system. At present, a loan technician's work might be measured by the number of loans closed, the number of dollars lent, or the portfolio's default rate. As a result, that worker's focus centers on these issues. While the technician's job description may include work related to capacity building, he or she is much more likely to promote capacity if an end-of-the-year evaluation form specifically explores activity in this area.

4. Agency Resource Allocation

At present, agency staff dispute the notion that FmHA assistance should be targeted to communities that do not otherwise have access to those needed funds. In the early decades, the agency targeted its resources to rural dwellers of all incomes, and on the farm side, still does so. *But in these years of reduced federal resources, funds should be carefully targeted to communities that can demonstrate maximum gain to the community (and to the country) through FmHA funding.*

For instance, in the Water and Waste Disposal loan program, loan and grant dollars are increasingly going to communities with incomes between 80-100% of nonmetro median household income, while lower income communities with similar (or more pressing) needs are receiving fewer loan and grant monies. Staff argue that the program is set up to meet water and sewer needs of *all* communities, and generous financing (based on income) is offered to those projects already chosen. In contrast, a more appropriate program would first target low-income communities with serious health and safety violations, then wealthier communities with serious health and safety violations or lower income communities with somewhat less pressing needs, and only then, wealthier communities with a limited financing gap. In all cases, *effective* interest rate subsidies should be distributed on a sliding scale, based on income.[3]

The business development programs within FmHA, which are very demand driven, illustrate similar problems. If an eligible business and lender apply for a Business and Industrial loan program guarantee in Vermont, and funds remain from the state allocation, the project will generally be funded. A project in Mississippi that promises to generate greater benefits for lower income workers or displaced farmers will not receive funding if the state's allocation has already been exhausted. Likewise, the Intermediary Relending Program distributes funds to eligible borrowers on a first-come, first-served basis, without comparing anticipated project benefits. A year's expenditures are the same regardless of the projects chosen, but the total *value* of those projects could vary wildly, depending on the quality of proposals next in line. If the agency were to ensure that those projects funded offer FmHA the greatest benefits (however defined), it would maximize national benefits out of a limited pot of money.

Finally, the agency's tradition of state-by-state allocations based in large part on rural population generally skews benefits away from areas of higher need and fewer resources and toward states with large rural populations, regardless of resources or relative need. The water and waste disposal loan and grant program is further skewed as it presumes that relative rural populations in poverty are an adequate proxy for water and waste need. Results from the targeting study indicate that this is not necessarily the case. Moreover, FmHA may be able to work with EPA databases to generate statistics on water and sewer needs that would be more appropriate factors in a funding formula. These formulae should be adjusted to more accurately reflect need for FmHA resources.

5. Technical Assistance and Outreach

Two key criteria by which programs should be evaluated are the extent to which they are marketed and accessible to eligible recipients, and followup and technical assistance is provided. Program users repeatedly argue that FmHA rural development staff do not reach out to eligible communities, encourage them to use the resources available, work with them to develop fundable applications, and ensure implementation of quality projects. Staff perceive themselves to be loan processors rather than community development specialists, and, as noted above, capacity building is rarely considered an integral part of the job description. This tradition may be explained by FmHA staff backgrounds: Most continue to come from agriculture rather than from finance, community development, or other more applicable backgrounds, and relevant academic programs in undergraduate schools reinforce this focus.

The FmHA's position is generally that these tasks are indeed part of the job description, and if staff are not performing these functions, they should be pressured to do so. "Don't let us off the hook," agency officials say, by increasing reliance on independent technical assistance providers. On the other hand, one can develop an argument that a credit provider *ought* not also provide direct technical assistance. On the business development side, a fundamental conflict may exist when a federal agency develops a clear financial stake in a firm, and at the same time provides ongoing management assistance to those projects. An impartial business advisor might recommend a risky move to strengthen a flagging company, while the federal lender might be opposed to such an action.

Nevertheless, during nearly 20 years of rural development programming, there have been few if any attempts to more highly value technical assistance provision. The agency continues to do a poor job in this regard, and a host of technical assistance providers have sprung up (many with FmHA funding) to meet the demand for TA and plug the gap. *Rather than continuing to press an agency to provide critical assistance of which it seems incapable, the time has come to formalize the role of the intermediary and increase reliance on contracts for technical assistance.*

Contractors should include a range of entities (nonprofits, state governments, economic development districts, coops), but funding must be adequate to provide equitable coverage throughout the country. If one performs poorly, the contractor should be defunded. Above all, development projects should continue to be evaluated by and ranked by FmHA based on traditional criteria, so intermediaries facilitate rather than subvert the process.

6. Capacity Building Among TA Providers

Such increased reliance on technical assistance providers should be accompanied by efforts to increase their *capacity and quality, and to ensure that capable providers are in place throughout the country.* This is not the case at present, particularly on the business development side.

A limited number of nonprofit and state agencies provide this kind of technical assistance, and businesses in large parts of the country, particularly the plains and mountain states, do not have access to the programs. Such a poor record of program coverage threatens the overall success of these technical assistance efforts.

7. Agency Expertise

As noted above, the vast majority of FmHA staff implementing rural development programs come from agricultural backgrounds, despite the fact that these programs demand training in finance, civil engineering, and organizing. Unfortunately, agricultural schools around the country have yet to recognize this trend, and have not broadened their curricula to include skills necessary for today's rural communities. Although staff appear to adequately handle loan processing tasks in both business and infrastructure development programs, they have difficulty on the technical side—analyzing business loan *pro formas* and negotiating multimillion dollar deals with financial consult-

ants, or evaluating proposed water systems for adequacy, scale, and ease of operation and maintenance.

FmHA should strengthen its substantive training programs, but more importantly, the agency should focus its recruiting efforts on those with backgrounds appropriate to the changing needs of the agency. This initiative may be hampered by the discrepancy between salaries in the private and public sectors for personnel with these qualifications. *Another approach (which the agency appears to be following in the business and industrial loan program) is to funnel decision making on the agency's most complex deals to a small group of best-qualified staff.* Just as rural banks have difficulty becoming adept at SBA guarantees if they process one loan a year, an FmHA community programs chief will have difficulty developing the expertise to handle B&I loans if he or she sees one every three years.

8. Programmatic Flexibility

All administrators constantly walk a thin line between too much programmatic flexibility (leading to abuse) and too little flexibility (leading to irrelevance). FmHA program users, advocates and even some staff indicate that the agency record on this score is spotty. In some states, a community programs chief will take a broad, inclusive view of regulations and work to get a worthy water project off the ground, while in another state a chief will take a narrow, obstructive view, effectively blocking water service for certain communities.

Program staff should keep foremost in their minds the ultimate purposes of the rural development programs, and work to complete quality projects consistent with an inclusive view of program regulations.

9. Policy and Management Analysis

In effect, FmHA does not have adequate policy or management analysis capabilities, and should develop both as soon as possible. The agency's Management Information System (MIS) data is, according to agency staff, consistently inaccurate. In fact, staff rely on outside consultants with access to FmHA's financial database for management purposes. Of course, the financial database is intended for very different functions and does not include information fundamental to management decision making. An FmHA administrator cannot compare the actual efficiency of loan processing staff in Wisconsin to those in Nebraska, and can compare neither to the national average. Basic management information is frequently developed through extrapolation, or is generated based on complex (and often faulty) assumptions.

Prescriptive policy analysis is likewise hampered. A former FmHA administrator spent two years of his term waiting for information describing typical FmHA housing program borrowers, hoping to determine whether the program was targeting the appropriate population. The information was not available. Basic questions, such as "Are the poorest communities receiving the greatest proportional subsidies in the water and waste disposal program?" are not explored. There is no office specifically charged with this function; high ranking administrators sometimes recognize the need for policy analysis, but are forced to rely on their close subordinates (whose job descriptions and backgrounds are not well suited to the work) for policy analysis on an *ad hoc* basis.

10. State Block Grants

Although some members of the panel and others argued that state administration of infrastructure programs may be an improvement over current administration, case studies and interviews indicated that federally funded, state-administered infrastructure and business programs tend to be more politicized than federally administered programs, and thus should be avoided as a mechanism to deliver additional FmHA resources to rural areas. These funds are not state-raised revenues—they are often perceived by politicians as "free" in some respects and are subject to less locally based accountability. As a result, politicization can more easily follow.

If politicization only led to haphazard outcomes—some appropriate and some not—it might cause less concern. By its nature, however, politicization tends to funnel resources away from those entities most deserving, and towards those less deserving. If the project were deserving, it would be funded without political interference. This shift is counter to the premise upon which most FmHA programs are based. Federally administered programs can, of course, be operated out of offices at the state level.

Needs Based Development

1. Water and Waste Grant Funding

Congress should earmark additional funds for grant funding to water and wastewater projects.

Currently, the administration obligates approximately three times more loans than grants in this program. Unused loan funds are repooled two times a year; grant funds are always used completely. While there is a significant backlog for both forms of assistance, projects in lower-income communities are frequently rejected or delayed because of constraints on grant funding needed to complete the financial package. A low priority loan-only project in a higher-income community will frequently leap frog over a high priority low-income project that needs scarce grant funds before it can access loan monies. Finally, project analysis indicates that program resources are increasingly going to communities of somewhat higher incomes, in part because grant funds are less available. Clearly, the level of grant funds is not in proper balance.

As presently administered, the water and waste disposal grant and loan programs give short shrift to the need for safe and affordable drinking water and sanitary wastewater systems in poor communities. Only five percent of grant funds and six percent of loan funds are provided to communities whose median household incomes are below the poverty level (adjusted for consistency over time). The projects that are funded in these communities frequently receive less grant and subsidized interest rate loan support than projects in higher income areas.

Farmers Home should change its program regulations to conform to the mandate of the 1985 farm bill that it implement "a graduated scale of grant rates establishing higher rates for projects in communities that have lower community population and income levels."

Both the "1% rule" and the "reasonable rate" rule can present obstacles to the utilization of the programs by poor communities. Both rules should be replaced by a standard, easily calculated formula which sets the grant rate for every project and provides proportionally greater grant assistance to proportionally poorer, smaller communities.

In addition, the Congress and the agency should examine why fully half of the loan projects approved in poverty level communities do not receive the deepest level in interest subsidy available.

The extent to which the basic facility needs of poor communities receive FmHA assistance varies enormously from one state office to the next. *The national office should establish a set of guidelines for all state offices to ensure that targeting objectives are met in a more uniform way.*

As explained in the targeting chapter, FmHA uses median income figures from the census to determine community incomes, but uses a floating poverty rate figure to determine eligibility for low interest rate loans through the water and waste disposal loan program. A significant number of communities that were ineligible for sought-after assistance at the beginning of the decade become eligible as the poverty line increases to a point above their 1980 median income. These communities compete head-to-head with very low-income communities whose incomes would remain below the poverty level if adjusted for inflation. *FmHA should adjust either income levels or the poverty level so that the two are consistent, after inflation effects are taken into account.*

Business Development

1. Risk Levels

FmHA should decide whether business development credit programs (guarantees as well as supervised credit) should be targeted to market-risk businesses in communities without access to credit, or to businesses of greater-than-market risk in communities with adequate access to market-rate credit. Then the agency should adhere to that approach. The two approaches require radically different programs. But at present, FmHA attempts to live in both worlds, targeting resources to businesses that involve risks at a level somewhat above the market level, yet enjoying market-level default rates and underwriting loans from that perspective.

Clearly, defaults should be kept to a minimum. But if the goal is to reach above market risks, a more appropriate response might be to determine in advance an acceptable default rate (higher than that of the market) and work hard to limit defaults to that level. If the target group is market risk businesses in very isolated communities with very conservative financial institutions, the response might be to develop a program to encourage these banks to change their investment behavior, rather than supplant them. There is no reason to enter markets with adequate access to conventional credit, and invest only in market-rate risks.

2. Business and Industrial Loan Program

The Business and Industrial Loan program has lost support among FmHA staff and administrators, borrowers, intermediaries and the Small Business

Administration. Relatively few states utilize the program. Its default rate is unacceptably high, in large part based on bad decisions during the late '70s; its image has yet to recover. Several attempts have been made to revise or overhaul the program, to no avail. *The program should be abolished or significantly reduced, and the focus of FmHA business development efforts (along with financial resources) should shift to the IRP and IDG business loan programs.*

3. Private Sector Involvement

Many of FmHA's business development programs were established at a time when the perceived problem was availability of credit. With the emergence of interstate and branch banking, availability of credit appears to be more or less uniform, except in the most isolated of communities. A far more difficult problem faced by businesses is accessing the credit local banks have. *The project case studies and interviews indicate that a much more productive approach to business development would be to work with the private sector, in partnership, to address local credit needs.* A community institution steeped in agricultural banking may need help recognizing a good commercial deal. A conservative banker may need assistance in evaluating cash flows, may need a partial guarantee, or may need a public sector actor to take over the more risky portion of a deal.

In all cases, FmHA should ensure that the private sector receives the financial and other assistance it needs to participate in a deal, but only such assistance as is necessary to ensure participation. For instance, the case study that examined the SBA program in Kansas indicates that federal assistance to these projects may go beyond that line, and may be supplying guarantees when local banks indicate that they are most in need of technical assistance or a second opinion.

Technical Points

1. Five-Percent Funding for Health Clinic Facilities

At present, the majority of Community Facility loan funds are devoted to health clinics, which clearly are key to a community's well-being. In order to qualify for lowest interest rate (five percent) loan funds, however, eligible projects must be located in low income or poverty level communities, *and* must meet "applicable health and sanitary standards." Yet according to the FmHA, none of the health facilities meet the second test, and thus they are not eligible for five-percent funding. *The Congress should amend the Consolidated Act to authorize application of five-percent loans for health facilities in lower income communities.*

2. Proxies

As mentioned above, most FmHA funds are allocated on a state-by-state basis, according to formulae which include proportion of national rural population, proportion of national rural population in poverty and relative unemployment rates. Yet these funds are devoted to programs whose goals are to address needs for water and sewer, housing, and job creation or retention. *More appropriate proxies for these needs are available within the agency, or from the Census Bureau or EPA, and should be utilized in the formulae to improve program targeting.*

3. Decision making in the IRP and IDG Programs

Funding decisions in both the Intermediary Relending Program and the Industrial Development Grant Program should be tightened up. Fully 50 out of 170 points on the IDG score sheet are at the state director's[4] discretion. Moreover, in 1988, the *Federal Register* notice on program funding did not establish a timetable or mention the dollar amount for distribution. Administrators of the IRP dispense with an evaluation sheet, and simply fund eligible applications on a first-come first-served basis. A nationally competitive ranking system should be developed for the IRP, and discretionary points should be reduced in the IDG program.

4. One-Percent Waiver Rule in the Water and Waste Program

In some situations, a community applying for FmHA funds will not be eligible for grant funding (because the *debt service* on the project is less than one percent of the community median household income[5]), but will be rejected for overall funding because operating and maintenance costs are particularly high, and, in the opinion of FmHA, community incomes cannot support the monthly *rate*. In the past, the administrator could waive the "one-percent rule" and allow grant funding to effectively reduce monthly bills and generate a reasonable rate in these unusual circumstances. *The waiver provision was dropped several years ago, but should be reinstituted.*

5. Interdepartmental Coordination

The Undersecretary of Agriculture for Small Community and Rural Development is charged with ensuring interdepartmental cooperation and coordination on rural development policy. Over the years, this task has proved nearly impossible. Turf fights ensue and other departments have little incentive to cooperate. *Nevertheless, the Undersecretary (or a comparable replacement) should ensure that interdepartmental policies and regulations are not in direct conflict with long-term rural development goals.* For instance, state FmHA staff explained that the Department of Health and Human Services offers operating funds for health services to underserved communities. But if the community constructs a health facility, it is no longer eligible for the HHS assistance, and a consistent source of funds to cover debt service is lost. As a result, the state sometimes is forced to reject a proposal, simply because operating funds will be cut off. Resolution of these policy conflicts should be a priority for the undersecretary.

6. Microbusiness Lending

Microbusinesses offer an important opportunity for rural job creation. Particularly in rural areas, significant numbers of new jobs are created in businesses of fewer than ten employees. Yet the conventional small business assistance programs do not address this market. In 1987, the SBA lent no loans of less than $25,000 in the entire rural Southwest (including California), and only two in the rural South.[6] High transaction costs erect a virtual barrier to lending of this magnitude on the part of the private banks.

FmHA or SBA should develop a new program to meet the need for microbusiness lending. This program should be developed in close concert with the private sector, and may involve lifting certain regulatory requirements for microbusiness loans. The program should be built around an intermediary (either a financial institution or other intermediary) that is easily accessible throughout the country, and is familiar with small business lending.

7. Technical Assistance in Business Development Programs

FmHA should arrange to provide adequate follow-up and technical assistance to any business representing above-market-rate risks that receives financial assistance. While FmHA appears to adequately handle loan processing tasks (and has refused to reimburse financial institutions that inadequately service FmHA guaranteed loans), less emphasis has been placed on working with borrowers to help ensure that their businesses remain in the black. Banks do not ordinarily offer this somewhat intensive service, and cannot be expected to do so without compensation. As mentioned above, FmHA may have a conflict if it directly provides financing and management assistance to an entity. Yet the traditional FmHA business loan borrower is precisely the owner most likely to need this assistance.

8. Grants for Business and Infrastructure

Grant funding has traditionally been available in the water and wastewater program for needy communities, but has generally not been available for business development projects. Yet in limited instances, a small amount of grant funding would mean the difference between success and failure on a business development deal. *Both business and infrastructure programs should incorporate at least some grant funding, to increase program flexibility at the margins.*

9. Further Research on Technical Assistance Provision

Although various entities have provided technical assistance to business and infrastructure projects for years, very little research has been conducted to determine its effectiveness, or to identify "best practices" on either the business or infrastructure side. Since these functions are clearly so important to the rural development process, they should be examined more fully. *FmHA or another source should fund a limited research project to examine these issues.*

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1 Although the paper analyzes programs administered by other agencies, conclusions center on the traditional rural development agency.

2 These proposals and our analysis center on the Department of Agriculture, as it is responsible for coordination of all federal rural development initiatives.

3 Other constraints, such as the "1-percent rule" are addressed below.

4 In 1988, the Administrator reserved this discretion for himself.

5 0.5% in certain circumstances.

6 A recent study completed by the Council of State Policy and Planning Agencies and funded by The Aspen Institute and Ford Foundation found that more than half of new businesses started in rural North Dakota since 1980 required less than $24,000 in total start-up funds.

Appendix A Community Programs Project Selection Criteria Form

(Guide 26 - Part I) (Page 1) FmHA Instruction 1942-A

Community Programs
Project Selection Criteria

Project Score _____

Name of Applicant _____

Case Number: _____

Project Type ☐ Water and Waste Disposal (WWD) ☐ Community Facilities (CF)

State _____ County _____ Congressional District No._____

Loan $ _____ Grant $ _____ Initial or Subsequent _____

Amount of previous FmHA funding for this project: loan $ _____, grant $ ___.

Anticipated interest level: Poverty _____, Intermediate _____, Market _____.

Brief description of the proposed facility _____

_____

Priorities	Points
A. Population priorities. The priorities in this section apply to both Water and Waste Disposal and Community Facilities preapplications	
1. Proposed project is located in a rural community having a population not in excess of 2,500.	25
2. Proposed project is located in a rural community having a population not in excess of 5,500. (Do not award points under this priority if points were awarded under Priority A-1).	20
B. Health priorities.	
1. Water and Waste Disposal preapplication only -	
a. Proposed project is needed to alleviate the sudden unexpected diminution or deterioration of a water supply, or to meet health or sanitary standards which pertain to a community's water supply.	25

(10-19-88) SPECIAL PN

Priorities	Points
b. Proposed project is required to correct an inadequate waste disposal system due to unexcepted occurrences, or to meet health or sanitary standards which pertain to a community's waste disposal systems.	25
2. Community Facilities preapplication only- Proposed project is required either to correct a health or sanitary problem, or to meet a health or sanitary standard.	25
C. Income priorities. The priorities in this section apply to both Water and Waste Disposal and Community Facilities preapplications. The median income of the population to be served by the proposed facility is:	
1. Less than the poverty line for a family of four as defined in section 673(2) of the Community Services Block Grant Act (42 U.S.C. 9902(2), or less than 80% of the statewide nonmetropolitan median household income.	25
2. Equal to or more than the poverty line and between 80% and 100%, inclusive, of the State's nonmetropolitan median household income.	20
D. Other factors.	
1. Water and Waste Disposal preapplications only - The proposed project will: merge ownership, management, and operation of smaller facilities providing for more sufficient management and economical service; and/or enlarge, extend, or otherwise modify existing facilities to provide service to additional rural residents.	10
2. Community Facilities preapplication only - The purpose of the proposed project is to construct, enlarge, extend or otherwise improve the following types of facilities. (Select only the factor most applicable to the proposed project.)	
a. Public safety.	10

(Guide 26 - Part I) (Page 3) FmHA Instruction 1942-A

Priorities	Points
b. Health care. (Do not award points under this priority if points were awarded under priority B-2.)	5
3. Water and Waste Disposal and Community Facilities preapplications -	
a. Applicant is a public body or Indian tribe.	5
b. Project is located in a "truly rural area" as described in Section 1942.17(c)(1).	10
c. Amount of joint financing committed to the project is:	
i. 20% or more private, local or State funds.	10
ii. 5% - 19% private, local or State funds.	5
E. State Director's discretionary points. (Up to 15). Give written justification.	____

_____

_____

_____

_____ _____

Chief, Community (and Business) Programs Date

Directions: Complete the information requested on Page 1. In paragraphs A-D circle the points for those priorities which apply to and are met by the preapplication under consideration. Determine and justify the number of discretionary points, if any, to be awarded in paragraph E and add up the total number of points scored.

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(10-19-88) SPECIAL PN

(Guide 26 - Part II) (Page 1)

FmHA Instruction 1942-A

TO: Administrator, FmHA
Washington, DC 20250

Attention: _____ Water and Waste Disposal Division
_____ Community Facilities Division

State: _____

Name of Applicant: _____

A. Amount of additional funds requested: Loan $_____ Grant $_____

B. Are funds being requested for an approved project that has encountered cost overruns due to high bids or unexpected construction problems that cannot be reduced by negotiation, redesign or other means?
____ yes ____ no

C. State the priority of this project in relation to all others for which requests are pending in the National Office. (Attach a revised priority listing for previously submitted projects if necessary.) _____

D. Is this project ready for obligation? ____ yes ____ no.
If no, give estimated date project will be ready for obligation of funds. _____

E. Has the appropriate environmental review, including the public notice requirements for a Class II action, been completed for the project?
____ yes ____ no.

F. If other funds are involved in this project, have they been committed?
____ yes ____ no.

G. Has all of the State's fund allocation been obligated? ___ yes ____no.
If no, attach specific explanation of plans to use funds.
Include a list of projects and planned dates of obligation.

_____
State Director

_____
Date

Directions: To request an additional allocation of funds from the National Office Reserve, State Offices should complete this Part of Guide 26, attach it to the front of a completed copy of Part I and submit both to the National Office.

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(10-19-88) SPECIAL PN

Appendix B Water and Waste Disposal Grant Determination Form

USDA-FmHA
Form FmHA 1942-51
(Rev. 10-87)

WATER AND WASTE DISPOSAL GRANT DETERMINATION

Name of Applicant _____ State _____

TYPE OF SERVICE ☐ WATER ☐ SEWER ☐ SOLID WASTE ☐ STORM DRAINAGE

PART I. GENERAL DESCRIPTION

A. Median Household Income (MHI) of Service Area

1. Obtain MHI information from U.S. Bureau of the Census Publication or Bureau of the Census data for individual enumeration districts. _____ (Specify data source) . . . . . _____ (MHI)

OR

2. Explain the reasons the census data is not an accurate representation of the MHI of the service area. Attach documentation of any survey made or other data used to establish MHI. _____

$ _____ (MHI)

B. Number of Benefited Users *(All users must be actual users, not equivalent users)*. . . . . _____

C. FmHA Amortization Factor to be Used in Calculations. . . . . _____
_____ Interest Rate _____ Number of Years

D. Annual Debt Service per Benefited User Based on ____ % of MHI . . . . . $ _____

E. Applicable percentage of grant eligible project costs . . . . . _____

PART II. DETERMINING THE AMOUNT OF FmHA GRANT

A. Maximum FmHA Grant

1. Total Project Cost *(Benefited and Nonbenefited Portions)* . . . . . $ _____

2. Project Cost Attributable to Nonbenefited Users *(Include in Part V Calculations Used to Determine Amount)*. . . . . $ _____

3. Total Cost Attributable to Benefited Users *(1 minus 2)* . . . . . $ _____

4. Ineligible Project Cost Attributable to Benefited Users
   a. Interest . . . . . $ _____
   b. Initial Operation and Maintenance . . . . . $ _____
   c. Other *(Identify)*
   _____ . . . . . $ _____
   _____ . . . . . $ _____
   d. Total . . . . . $ _____

5. Grant Eligible Project Cost *(3 minus 4d)* . . . . . $ _____

6. Maximum Grant *(Part I E multiplied by 5)* . . . . . $ _____

PART II. *(Continued)*

B. FmHA Grant Based on Percentage of MHI

1. Amount of Part II A3 to be Funded by FmHA . . . . . $ _____

2. Annual Debt Repayment Attributable to Benefited Users
   a. Projected FmHA Debt Service *(Part II B1 multiplied by Part I C)* . $ _____
   b. Existing FmHA Debt Service . . . . . $ _____
   c. Proposed Other Debt Service . . . . . $ _____
   d. Existing Other Debt Service . . . . . $ _____
   e. Total . . . . . $ _____

3. Annual Debt Service Based on MHI *(Part I D, multiplied by Part I B)* . . . . . $ _____

4. Debt Service Reduction Based on Percent of MHI *(Part II B2e minus Part II B3)* . . . . . $ _____

5. FmHA Grant *(Divide Part II B4 by Part I C)*. . . . . $ _____

C. FmHA Grant Based on Similar Systems Average User Cost *(Complete this part when the grant amount is either limited or determined using similar system cost.)*

1.

Name of Communities or System Used as Comparison	Median Household Income	Average Annual Use Cost Per Benefited User
_____	_____	$ _____
_____	_____	$ _____
_____	_____	$ _____

2. Based on this comparison, it is our opinion that the average annual benefited user cost should be . . . . . $ _____

3. FmHA grant based on similar system cost *(Include calculations in Part V)*. . . . . $ _____

PART III. FmHA LOAN/GRANT FUNDING

A. FmHA GRANT *(Cannot exceed Part II A6)* . . . . . $ _____

B. FmHA Loan Attributable to Benefited Users *(Part II B1 minus Part III A)* . . . . . $ _____

C. Reasonable Average Annual Benefited User Cost for Similar Systems: $ _____

D. Average Annual Benefited User Cost Based on FmHA Grant Shown in Part III A *(Cannot be less than Part III C)*:

Debt Service . . .	$ _____
Reserve	$ _____
Operation & Maintenance . .	$ _____
Other	$ _____
Total	$ _____

E. Percent of Benefited Users MHI Required for Annual Debt Service . . . . . _____ %

PART IV. COMMENTS:

PART V. CALCULATIONS: *(Attach necessary sheets showing all calculations for grant determination with each sheet labeled at top with name of applicant, type of service and date).*

The above information prepared by:

Signature _____

Name _____

Title _____

Date _____

Reviewed and concurred in by FmHA Community Programs Chief or Community and Business Programs Chief:

Signature _____

Name _____

Title _____

Date _____

☆U.S. GOVERNMENT PRINTING OFFICE: 1987-554-052/60008-FmHA-88

Appendix C Business and Industry Application Priority Points Scoring Form

FmHA Instruction 1980-E
Appendix J

BUSINESS AND INDUSTRY
APPLICATION PRIORITY POINTS SCORING

Date:

Name _____

State _____

List the maximum points the applicant is eligible for under each category.

Jobs created____ Jobs saved____ Total jobs____
Loan amount $__,___,___ Index factor ____
State income $__,___ Indexed State income $__,___
National unemployment __.__% Area unemployment __.__%

1. Location:

   A. Located in city or area under 25,000. (10 points) ___

   B. Located in city or area under 25,000 population which is a high unemployment area. (20 points) ___

   C. Located in a high unemployment area and the borrower has certified that at least 25 percent of its employees will be displaced farmers. (35 points) ___

2. Jobs:

   A. Project will contribute to the overall economic stability of the area and generate employment beyond entrepreneur's household. (10 points) ___

   B. Project will contribute to the overall economic stability of the area and provide significant employment in the area. (20 points) ___

   C. Project will contribute to the overall economic stability of the area, provide significant full-time employment in the area, and retain a significant number of jobs in the area.(35 points) ___

3. Job cost: [See FmHA Instruction 1980-E, §1980.451 (d)(3)(iii), for calculation instructions]

   A. Job cost score greater than 1.5 but less than 2.0. (5 points) ___

   B. Job cost score from 1.0 to 1.5. (15 points) ___

   C. Job cost score less than 1.0. (25 points) ___

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Appendix J
Page 2

4. Additional points: [Give points for each criteria met]

   A. Loan is less than 50 percent of project cost. (5 points) ___

   B. Percentage of guarantee is 10 or more percentage points less than the maximum allowable. (5 points)___

   C. Project will create a significant number of part-time or seasonal jobs in addition to permanent full-time jobs. (10 points) ___

5. State Director's administrative points: (May be up to 20 points but documentation must support the number given)

   _____
   _____
   _____
   _____ ___

Total points ___

Is applicant eligible for veteran preference? ____

Date served: _____to_____

_____
State Director

THE FOLLOWING TO BE COMPLETED BY THE NATIONAL OFFICE ON APPLICATIONS SUBMITTED TO THE NATIONAL OFFICE:

Administrator's administrative points: (May be up to 20 points but documentation must support the number given)

_____
_____
_____
_____ ___

Total points ___

oOo

Appendix D Industrial Development Grant Program Project Selection Criteria

FmHA Instruction 1942-G
Attachment 1
Page 17

Section C

Industrial Development Grant Program
Project Selection Criteria

Project Score _____

Name of Applicant _____

State _____ County _____

Grant $ _____ Initial or Subsequent _____

Amount of previous FmHA funding for this project $ _____

Purpose: ____ Revolving Fund ____ Technical Assistance

____ Industrial Site ____ Other Business Development

Brief description of the proposed facility:

_____

_____

Priorities	Points
A. Population.	
Proposed project is located in a rural community having a population not in excess of 25,000.	10

(3-8-89) PN 104

FmHA Instruction 1942-G
Attachment 1
Page 18

B. Economic conditions.

1. Proposed project will be located in areas where the unemployment rate exceeds the State unemployment rate by:

a. 25 percent or more	20
b. less than 25 percent	10
c. equal to or less than state rate	0

2. Proposed project will be located in areas where the median household income of the population to be served by the proposed facility is:

a. Less than the poverty line for a family of four as prescribed by Section 673 (2) of the Community Services Block Grant Act (42 U.S.C. 9902 (2).	25
b. More than the poverty line and less than 85% of the State's median household income.	15
c. More than the poverty line and between 85% and 100% of the State's median household income.	10

C. Experience. Applicant has substantial experience in administering a rural economic development program. 15

For grants to establish a revolving fund points will be distributed if:

D. Grant request contains proposed loan/grant recipients. 25

E. Other.

1. Applicant has industry or business committed to locate on the sites.	25
2. Grant request contains evidence of substantial commitment of funds from nonfederal sources for proposed projects.	15

FmHA Instruction 1942-G
Attachment 1
Page 19

F. Discretionary points. (Up to 50). Give written justification.

_____

_____

_____

_____

_____ Chief, Community (and Business) Programs

_____ Date

Directions: Complete the information requested on Page 1. In paragraphs A-D, circle the points for those priorities which apply to and are met by the preapplication under consideration. In Sections A-C, only one selection can be made. Determine and justify the number of discretionary points, if any, to be awarded in paragraph E and add up the total number of points scored.

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Searching for "The Way That Works" takes a careful look at the implementation of rural development programs administered by the Farmers Home Administration (FmHA). The book examines both infrastructure and business development programs administered by the $8.5 billion agency, which is also responsible for the nation's farm and rural housing programs.

The agency's six rural assistance programs will provide $881 million in grants and loans during fiscal year 1990, but the authors found that only a small part of these funds go to the neediest rural communities—those to which the programs are targeted.

The policy recommendations that round out *The Way That Works* are based on extensive field work, an analysis of agency-generated project data, and interviews with current and former FmHA officials. The book paints a complex picture of an agency, which like its rural constituency, is in transition.

About the Rural Economic Policy Program of The Aspen Institute

The Rural Economic Policy Program (REPP) was created in 1985 as a collaborative program of The Aspen Institute, The Ford Foundation, and the Wye Institute. Working closely with The Ford Foundation's Rural Poverty and Resources Program, the REPP encourages greater attention to rural policy issues through a program of research grants, seminars, and public education. The Program is focused on rural concerns, including agricultural policy, community economic development, resource management and enhanced livelihoods for the rural poor. REPP is funded by a grant from The Ford Foundation.

The Rural Economic Policy Program is housed at The Aspen Institute in Washington, D.C. The Aspen Institute is an international nonprofit organization whose broad purpose is to seek consideration of human values in areas of leadership development and public policy formulation. Since its founding in 1949, the Institute has operated a program of Executive Seminars in which leaders of business, government, the arts, education, law and the media convene with distinguished scholars to reinforce the application of traditional humanistic values in their personal and professional deliberations. The Aspen Institute's Policy Programs seek to advance the formulation of public policy.

About the Center for Community Change

The Center for Community Change is a national nonprofit organization that provides technical assistance to minority and low-income community-based groups across the country. Founded in 1969 through the efforts of The Ford Foundation, Robert Kennedy and Walter Reuther, the Center's mission is to help grassroots organizations establish self-help community programs and participate more fully in the development of local and national policies that affect low-income people. The Center works with over 200 minority and low-income community groups annually and provides on-site comprehensive assistance to community groups on internal management issues. In addition, it helps groups finance, build and rehabilitate low-income housing; develop shopping centers and small businesses and other economic development projects, and conduct campaigns around issues such as crime and drugs, city services and voting rights.

SEARCHING FOR "THE WAY THAT WORKS"

An Analysis of FmHA Rural Development Policy and Implementation

By
The Center for Community Change

Prepared with support from
The Ford Foundation
and the
Rural Economic Policy Program
of The Aspen Institute