



**U.S. Department of Agriculture**  
**Office of Inspector General**  
**Southwest Region**

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# **Audit Report**

## **Rural Utilities Service Broadband Loan and Loan Guarantee Program**

**Report No. 09601-8-Te**  
**March 2009**

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UNITED STATES DEPARTMENT OF AGRICULTURE

OFFICE OF INSPECTOR GENERAL

Washington, D.C. 20250



March 31, 2009

REPLY TO

ATTN OF: 09601-8-Te

TO: Jim Newby  
Acting Administrator  
Rural Utilities Service

THROUGH: John Purcell  
Director  
Financial Management Division

FROM: Robert W. Young /s/  
Assistant Inspector General  
for Audit

SUBJECT: RUS Broadband Loan and Loan Guarantee Program

This report presents the results of the subject audit. The Rural Utilities Service (RUS) written response to the draft report, dated March 25, 2009, is included as exhibit D with excerpts and the Office of Inspector General's (OIG) position incorporated into the Recommendation section of the report.

Since 2001, RUS has offered loans to help provide broadband service to rural communities, first as part of a pilot program, then later under the 2002 Farm Bill. In total, RUS has lent approximately \$1.35 billion in loans<sup>1</sup> intended to help foster economic growth by delivering broadband service to rural communities that might otherwise go without service. In September 2005, however, the Office of Inspector General (OIG) issued a report that disclosed irregularities in how RUS approved and serviced these loans.<sup>2</sup>

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<sup>1</sup> The \$1.35 billion is for the Broadband Loan and Loan Guarantee Program; however, at the time of our review no loan guarantees were applied for or approved.

<sup>2</sup> "RUS Broadband Grant and Loan Program," dated September 2005.

In 2007, Congress requested that we determine if RUS had taken sufficient corrective actions in response to the issues disclosed in our report.<sup>3</sup> In particular, members of the Appropriations Committee expressed concerns that RUS, “instead of focusing on rural areas that have no broadband service,” continues “to grant loans to areas where broadband service is already being offered by private providers. Such practices penalize private providers that have already built broadband systems in the area. Such practices also do nothing to further the goal of bringing broadband to unserved areas.” Given these concerns, Congress requested that OIG answer the following questions:

- How many unserved households were included in approved RUS broadband loan program applications?
- How many applications were granted to applicants who proposed to serve areas where one or more private broadband providers already offered service?
- How many approved loans (and their total amount) have defaulted since the program’s inception?
- How many applicants who have been approved for loans have subsequently withdrawn from the program due to the eventually discovered infeasibility of the approved project?

We found that RUS has not fully implemented corrective action in response to 8 of the 14 recommendations from our September 2005 audit report. RUS had written a proposed change to the regulation which would have affected 2 of the 8 recommendations (Recommendations 2 and 5); however, they chose to wait for passage of the Food, Conservation, and Energy Act of 2008 (2008 Farm Bill) to ensure that their proposed rule met the new requirements. While waiting on the enactment of the Act, RUS continued to make loans to providers in areas with preexisting service, sometimes in close proximity to large urban areas. We detail each of these outstanding recommendations, and answer the questions asked by Congress in the report.

Based on the agency’s written response dated March 25, 2009, they agreed to take action in response to the one recommendation in the report. However, RUS did not believe that our current report was an accurate portrayal of the performance of the Broadband program. RUS stated that they followed the statutory requirements that they were bound to administer. However, RUS agreed to implement changes recommended in our September 2005 report within certain timeframes. Its decision to wait for the release of the 2008 Farm Bill meant that the corrective actions had not been completed at the time of our review.

We remain concerned with RUS’ current direction of the Broadband program, particularly as they receive greater funding under the American Recovery and Reinvestment Act of 2009 (Recovery Act), including its provisions for transparency and accountability. As structured, RUS’ Broadband program may not meet the Recovery Act’s objective of awarding funds to projects that provide service to the most rural residents that do not have access to broadband service.

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<sup>3</sup> Agriculture, Rural Development, Food and Drug Administration, and Related Agencies Appropriations Bill, 2008, Committee on Appropriations Report, Report 110-258, dated July 24, 2007.

## **BACKGROUND:**

RUS has been responsible for administering two distinct broadband loan programs. In 2002, an amendment to the Distance Learning and Telemedicine Program authorized the Broadband Pilot Loan Program.<sup>4</sup> Later, the Farm Security and Rural Investment Act of 2002 authorized the Rural Broadband Access Loan and Loan Guarantee Program.<sup>5</sup> Exhibit A illustrates the lending level and the obligations for this program.

From 2003 to 2008, RUS was to provide broadband loans to borrowers who proposed to provide service to rural communities, which Congress defined as communities with fewer than 20,000 inhabitants.<sup>6</sup> Regulations also provided that RUS would prioritize borrowers who would serve communities lacking preexisting access to broadband.<sup>7</sup>

In 2005, based on a review of 28 of the 64 judgmentally selected loans that had been funded, OIG found that RUS had not maintained its focus on rural communities and had instead funded communities near large metropolitan cities. We also questioned the agency's decision to issue loans to providers who were intending to service communities that already had preexisting, private providers, since this could disadvantage providers operating without Government assistance. We concluded that RUS needed to return the programs' focus to rural communities that cannot obtain broadband from the private market. In total, OIG made 14 recommendations relating to RUS' administration of the broadband grant and loan programs.

RUS issued a proposed rule change on May 11, 2007, for the Broadband Access Loan and Loan Guarantee Program with a comment period ending on July 10, 2007. In this proposed rule RUS recommended changes on: (1) funding in competitive markets and new eligibility survey requirements; (2) new equity and market survey requirements; and (3) new legal notice requirements to increase transparency. RUS proposed to prohibit funding urban areas, regardless of population, where a significant share of the market was already served by incumbent providers. In addition, they planned to prohibit funding to communities where four or more providers already existed. We acknowledge the proposed rule change as action to address some of the prior audit concerns; however, this rule was never implemented due to the pending changes in the 2008 Farm Bill.

## **OBJECTIVES:**

At the request of Congress, OIG initiated this audit to determine if RUS had made sufficient corrective actions in response to our September 2005 report. Additionally, we sought to answer four questions posed by the House and Senate Committees on Appropriations.

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<sup>4</sup> Public Law (P.L.) 106-387, dated October 28, 2000.

<sup>5</sup> P.L. 107-171, dated May 13, 2002.

<sup>6</sup> P.L. 107-171, dated May 13, 2002.

<sup>7</sup> Title 7, *Code of Federal Regulations*, section 1738.11, dated January 30, 2003.

## SCOPE AND METHODOLOGY:

We performed fieldwork for our audit at the RUS National Office in Washington, D.C., and also gathered financial information from RUS' Fiscal Control Branch/Financial Accounting Division in St Louis, Missouri. We reviewed loans approved during the pilot phase (fiscal years 2001 and 2002) and the 2002 Farm Bill (fiscal year 2003) through June 10, 2008, totaling \$1,346,768,170. For our review of the number of unserved households and number of providers, we limited our scope to the period beginning with the end of our prior audit (September 30, 2005) to June 10, 2008. In reviewing the number of defaulted loans and the number of projects that were deemed infeasible, our scope was from October 1, 2000 through June 3, 2008. In addition, we reviewed RUS' corrective action taken in response to the prior OIG audit report issued in September 2005.

Specifically, we (1) reviewed the prior 2005 audit report as well as RUS' current processes; (2) interviewed RUS officials responsible for broadband loans and grants; (3) reviewed information maintained in RUS' Broadband Application Information Log and borrower applications approved since September 2005; (4) reviewed all loans in default; (5) reviewed loans approved and later withdrawn from the program since fiscal year 2001 to June 3, 2008; (6) interviewed borrowers that withdrew from the program; and (7) analyzed financial data maintained by RUS' fiscal branch. We conducted our fieldwork from April 2008 through October 2008.

We conducted this performance audit in accordance with generally accepted Government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

## RESULTS:

Of the 14 recommendations from the September 2005 OIG audit, we found that RUS had not implemented 8 of the previous recommendations (Recommendations 2, 4, 5, 6, 7, 10, 12, and 14). RUS officials explained that they had not taken more expeditious action on these recommendations because they were awaiting the release of the 2008 Farm Bill, and believed that the new legislation would require them to revise any guidelines they produced in response to Recommendations 2, 4, 5, 6, 7, and 12. For Recommendation 10, we believe that RUS is making a good faith effort to recover or restructure the \$30 million in delinquent pilot broadband loans. These officials also stated that they lacked the resources to complete the comprehensive management information system to create a database including all grant and loan information so that the agency could capture critical information across the entire range of broadband programs, as specified by Recommendation 14.

**Recommendation 2** concerned developing a definition of "rural area" that would prevent communities in close proximity to large cities from receiving broadband funds intended

for truly rural communities.<sup>8</sup> RUS issued a proposed rule changing the community eligibility requirements from being just 20,000 inhabitants to the 20,000 inhabitants and not located within an urban area. The passage of the 2008 Farm Bill provided RUS with a definition of rural area which negated the need for RUS to develop its own definition.<sup>9</sup> However, in the period between the publication of our 2005 report and the 2008 Farm Bill, RUS' regulation and statute allowed RUS to continue to serve exurban and suburban communities. We determined that RUS Broadband borrowers, providing services in 148 communities, were within 30 miles of cities with 200,000 inhabitants, including communities near very large urban areas such as Chicago and Las Vegas. Of these 148 communities, 89 belonged to a single company. This company received a loan totaling \$267 million to serve 546 communities.

**Recommendations 4 and 5** criticized RUS' practice of making loans to providers intending to service areas that already had broadband service through preexisting, private providers.<sup>10,11</sup> In 2005, OIG was concerned that these loans did not follow the intent of the program (which was to provide service to rural areas that would not otherwise have access), and might cause legal problems, since USDA was subsidizing some broadband competitors in a given market, but not others. RUS' proposed rule change would have limited providing loans to borrowers servicing areas with less than four existing providers. However, the 2008 Farm Bill began to address these concerns because it specified that RUS should provide loans to projects where broadband services are not provided by three or more providers.<sup>12</sup>

*Congress requested that we determine how many applications RUS granted to applicants proposing to serve areas where one or more private broadband providers already offered service.* Since the publication of our 2005 report, RUS has continued providing loans to providers in markets where there is already competing service. Of the 37 applications approved by RUS since September 2005, 34 were granted to applicants in areas where one or more private broadband providers already offered service. These 34 borrowers received \$873 million to service 1,448 communities (see exhibit C).

Only 3 borrowers were providing service to totally unserved areas, which represented \$40 million in loans to service 20 communities.<sup>13</sup> However, one of the borrowers was providing services to "greenfield"<sup>14</sup> communities within the city limits of a community of

<sup>8</sup> Recommendation 2: "If the Office of the General Counsel concludes that RUS may restrict the law's definition of an eligible rural area, then RUS should develop and implement a definition of an eligible rural area that includes, as part of its criteria, a community's population density and distance from metropolitan areas. If the Office of the General Counsel concludes that RUS may not, on its own authority, restrict the definition, then RUS should seek legislation to clarify the program's definition of an eligible rural area."

<sup>9</sup> P.L. 110-234, section 6110, dated May 22, 2008. Rural Area was defined as being a city, town, or incorporated area with less than 20,000 inhabitants, that is not in an urbanized area contiguous and adjacent to a city or town greater than 50,000 inhabitants. In addition, the Secretary, by regulation, may identify areas as not being rural if they are a collection of census blocks that are contiguous to each other.

<sup>10</sup> Recommendation 4: "Cease providing loans to competing broadband providers until RUS has reviewed past loans made in competitive environments. That review should determine if these loans have given funded providers an unfair financial advantage over those without RUS funds, or have otherwise adversely and materially affected the success of these loans."

<sup>11</sup> Recommendation 5: "Based on the results of this review, RUS should determine if its practice of issuing loans to competing broadband providers should continue and take appropriate action."

<sup>12</sup> P.L. 110-234, dated May 22, 2008.

<sup>13</sup> Three borrowers are FL 1102, NV 1101, and VT 1101(see exhibit C).

<sup>14</sup> A piece of usually semirural property that is undeveloped except for agricultural use, especially one considered as a site for expanding urban development.

more than 88,000 residents. Ordinarily, this loan would not have been approved, but RUS approved it because Congress had directed, through law, that the agency grant loan eligibility for fiber-to-premises broadband facilities in St. Lucie County, Florida, and the City of Port St. Lucie.<sup>15</sup> Thus, only two borrowers, with an aggregated loan amount of \$25.8 million, were truly providing services to a total of five unserved communities.

If these 37 applications totaling \$913 million were reprocessed according to the 2008 Farm Bill, 6 applications totaling \$138 million would have been ineligible since they proposed funding communities with 3 or more providers. An additional 21 applications totaling \$724 million would not have been completely funded because a portion of the loan funds would have been used to provide services to communities with 3 or more providers.

While RUS' practice of making loans in markets where preexisting service exists does not contradict the 2008 Farm Bill, OIG remains concerned because the overwhelming majority of communities (77 percent)<sup>16</sup> receiving service through the broadband program already have access to the technology, without RUS' loan program. Moreover, the legal ramifications of subsidizing some providers in a given area, but not others, have proved problematic.

**Recommendations 6, 7, and 12** required RUS to develop and implement written internal guidelines for the broadband grant and loan programs.<sup>17,18,19</sup> Although RUS agreed to develop and implement these changes by March 3, 2006, we determined that RUS did not contract with an outside company to develop and write final guidelines until September 26, 2007, and are still using previous ineffective draft, or expired guidelines. Agency officials stated that they had not developed new internal guidelines because they were waiting for the passage of the 2008 Farm Bill—they believed that the new legislation might force them to revise administrative guidelines they drafted. In fact, RUS notified the Office of the Chief Financial Officer that the agency was waiting on the passage of new legislation before implementing the agreed upon corrective action. However, OIG contends that RUS did not need to wait for the new bill's passage in order to implement internal guidelines necessary to strengthen its processing, oversight, and servicing of the programs. By not implementing these procedures for more than 2 years, RUS allowed problems in its broadband loan and grant application and service processes to continue.

<sup>15</sup> P.L. 108-447, section 727, dated December 8, 2004.

<sup>16</sup> See exhibit C for numbers (264 + 467 + 403) divided by 1468 = 77 percent.

<sup>17</sup> Recommendation 6: "Develop and implement written guidance for the Community Connect Grant Program including the following: application review and rating; training for reviewers; general field representative (GFR) requirements for project visits; monitoring project activity and completion (including compliance reviews); and suspension or termination in accordance with regulation."

<sup>18</sup> Recommendation 7: "Develop and implement written guidance for the Broadband Loan Program including the following: applications to be reviewed and approved; GFRs to perform periodic reviews to ensure the proper use of funds and the viability of projects; independent annual audit reports to be obtained and reviewed; quarterly financial reports to be obtained and reviewed; recommendations from GFR reports and compliance reviews to be analyzed and acted upon; and applications and supporting documents to be complete before the applicant is approved."

<sup>19</sup> Recommendation 12: "Establish and implement procedures to ensure cancellation and reobligation of unused grant and loan funds within the time periods specified by Congress."

**Recommendation 10** required RUS to recover the funds for six defaulted pilot loans totaling \$30 million, but we found that the agency was still working to recover funds for three of the six loans.<sup>20</sup> For the three loans that had been resolved, RUS was able to collect \$3.6 million and wrote off \$9.5 million of the remaining balance.<sup>21</sup>

*As part of its request for additional information, Congress asked OIG to determine how many approved loans (and their total amount) have defaulted since the programs' inception. Including the 6 pilot loans mentioned in our 2005 report, we determined that 11 broadband loans, totaling \$48 million,<sup>22</sup> were in default as of June 3, 2008.<sup>23</sup> These loans have each been referred to RUS' internal collection agency, the Policy Analysis and Risk Management Division, which is attempting to recoup the Government's potential losses without depriving customers of their broadband service.*

When we initially approached RUS with this question, agency officials told us that they did not have a definition of "default," and therefore could not provide a definitive total number of approved loans that have defaulted since the programs' inception. Instead of declaring delinquent loans as defaulted, RUS sends loans that are 60 days or more delinquent to its Policy Analysis and Risk Management Division where specialists work with the borrower to bring the loan current. This can include loan restructuring, sale of assets, or debt settlement. For purposes of our review, we used the definition of default provided by the Federal Accounting Standards Advisory Board, which states that an account is in default if it is more than 90 days delinquent on any of its terms of agreement.<sup>24</sup>

For reporting purposes, RUS needs to develop a definition of default that corresponds to Federal Accounting Standards. This definition should be applied to all future requests for the number and amount of loans in default.

**Recommendation 14** required RUS to create a database including all grant and loan information so that the agency could capture critical information across the entire range of broadband programs.<sup>25</sup> Although RUS agreed to complete this database by September 30, 2006, we found that RUS' Broadband Application Information Log—an automated information system that RUS uses to capture borrowers' application data—does not meet the recommendation's requirements since it contains information related only to farm bill loan applications (but not grants or information from the pilot programs), nor does it include servicing information.<sup>26</sup> OIG concluded that RUS has yet

<sup>20</sup> Recommendation 10: "Recover the \$30,377,069 for the six defaulted pilot loans." KS 1302, MN 1301, PA 1301, CO 1301, CA 1301, and OH 1301.

<sup>21</sup> See exhibit B, table 2.

<sup>22</sup> See exhibit B for this calculation  $\$32,018,199 + 3,157,342 + 13,071,888 = \$48,247,429$ .

<sup>23</sup> A 12<sup>th</sup> loan (NE 1301), totaling \$1.5 million, did default, but RUS was able to work with the borrower, restructure the loan, and now considers the loan current.

<sup>24</sup> Statements of Federal Financial Accounting Concepts and Standards, dated June 30, 2007.

<sup>25</sup> Recommendation 14: "Develop and implement an integrated management information system that will track all loan and grant information from the date the application is submitted through servicing and project completion. The system also should include (a) all pilot loan and grant information, (b) identification of specific communities or locations for each loan or grant, and (c) dates and results of servicing activities."

<sup>26</sup> The previous report noted significant problems with how RUS serviced grants and loans, and proposed that the agency develop a database to track servicing actions. At present, no automated system at RUS tracks servicing actions related to grants.

to complete a management information system as recommended. Officials explained that they have not created a complete management information system because they lack the financial resources needed to do so. Without a comprehensive system, however, RUS has continued to issue duplicate funding for at least two communities. For example, one community, with 555 inhabitants, received both a grant and a loan for different companies providing broadband service. Although this is not prohibited or addressed by regulation, this does not appear to be an effective use of broadband funding since RUS is subsidizing competition between two providers in areas where there is extremely limited demand. Such duplicate funding could result in one, or both, companies failing to become commercially viable. Furthermore, without a comprehensive management tracking system, RUS still cannot effectively determine whether: (1) required site visits are conducted, (2) projects are on schedule, (3) funds are used properly, and (4) performance reports are accurate.

For five of the remaining six recommendations, we found that RUS has implemented the agreed upon corrective action:

In response to **Recommendation 3**, RUS established and implemented a process to ensure that unserved areas received priority over other applications.<sup>27</sup> OIG notes that this new process has not, in fact, been tested because the agency continues to have more funds than it can spend in a given year due to applications not meeting qualification requirements. RUS has never spent all of its funds and has often "carried over" to subsequent years hundreds of millions of dollars. Of the \$5.7 billion RUS could have loaned since 2001, the agency has loaned only \$1.35 billion. However, since 2004, Congress has decreased funding to RUS for the broadband loan program, which makes it increasingly important that RUS have an effective mechanism in place for prioritizing communities that, without Government subsidy, will lack access to broadband.

In response to **Recommendations 8 and 9**, RUS stated that it was waiting on the results of an OIG audit of a grant recipient.<sup>28,29,30</sup> On July 3, 2008, that audit was completed, and found that the grantee needs to return \$429,159 to the Government. RUS has established an accounts receivable for this amount and a demand letter has been sent to the grantee.

In response to **Recommendation 11**, RUS reviewed loans and grants that have not drawn down funds and deobligated the funds for those projects that were no longer viable.<sup>31</sup>

In response to **Recommendation 13**, RUS aligned both the broadband grant and loan programs under its Broadband Division.<sup>32</sup>

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<sup>27</sup> Recommendation 3: "Establish and implement cutoff dates to ensure that applications are evaluated for priority at least every quarter."

<sup>28</sup> "RUS Texas Community Connect Grantee Close-Out Audit" (Report No. 09601-4-Te), dated July 2008.

<sup>29</sup> Recommendation 8: "Recover advanced grant funds of \$1,936,046 from company B."

<sup>30</sup> Recommendation 9: "Deobligate the remaining grant funds of \$762,226 from company B."

<sup>31</sup> Recommendation 11: "Review all loans and grants that have not drawn down funds and determine whether proposed projects are still viable. If the projects are not viable, deobligate the funds."

<sup>32</sup> Recommendation 13: "Align both the Broadband Loan Program and the Broadband Grant Program under the Broadband Division to promote accuracy in eligibility determinations when processing broadband loan and grant applications."

For **Recommendation 1**, no action was needed since RUS agreed to follow Federal rule making procedures to change the definition of rural area; however, this was not necessary because Congress redefined “rural area” in the 2008 Farm Bill.<sup>33</sup>

**Answers to Additional Questions Posed by the House and Senate Appropriations Committee**

*How many unserved households were included in approved RUS broadband loan program applications?*

According to agency officials, prior to the 2008 Farm Bill, RUS tracked (and reported on) the number of households served by its programs, but it did not record how many of these households were unserved prior to issuing a broadband loan. In other words, a provider could enter a community and state that it was serving 1,000 households, but some portion of those households could have had prior service with another provider. RUS officials explained that they did not track the number of unserved households that would receive service from any given loan, since that information was not required by statute. Thus, they did not have this information to prioritize loans. OIG noted that such information is relevant to determining the programs’ success, and without it, we could not answer this Congressional inquiry. Since the 2008 Farm Bill requires this information, RUS now requests that applicants state the number of unserved households that a project will serve, and has updated its Broadband Application Information Log accordingly.

*How many applicants who have been approved for loans have subsequently withdrawn from the program due to the eventually discovered infeasibility of the approved project?*

Of the 113 applicants who received RUS’ approval for broadband loans since 2001, 13 did not proceed with the loan because the company decided that it could not complete the project as it was initially conceived:

- Four companies decided to change the planned technology, which would require a new application.
- Three companies did not proceed with projects because they were unable to meet the credit support requirement.<sup>34</sup>
- Six companies did not proceed with projects because of increased competition, business plan changes, and their inability to meet market penetration goals.

In conclusion, OIG notes that the key problems identified in our 2005 report—loans being issued to suburban and exurban communities and loans being issued where other providers already provide access—have not been resolved. The 2008 Farm Bill has redefined the term “rural area”

<sup>33</sup> Recommendation 1: “RUS should obtain an Office of the General Counsel opinion concerning its availability to restrict the law’s definition of an eligible rural area.”

<sup>34</sup> Title 7, *Code of Federal Regulations*, section 1738.2, dated January 1, 2004. This regulation requires that the applicant must have credit support in an amount equal to 20 percent of the requested loan amount. The 20 percent credit support includes cash, cash equivalent (State and local government) or cash equivalents in the amount equal to first year operating expenses. This requirement has been changed under the 2008 Farm Bill, and now states that applicants are required to have credit support “not to exceed 10 percent of the amount of the loan or loan guarantee.”

and has specified when loans may be issued to areas with preexisting service, but sufficient time has not passed for OIG to evaluate the impact of this new legislation. We remain concerned that the majority of RUS' program funds have not been utilized in expanding broadband service to rural areas where no prior service exists.

Congress has recently passed a law requiring the Federal Communications Commission to complete a map of the United States, identifying areas lacking broadband access.<sup>35</sup> OIG believes that such a map would be a useful tool for RUS to design broadband programs that focus exclusively on rural areas that, without the Government's intervention, will not have access to broadband.

**RECOMMENDATION 1:**

Define a "loan default" for reporting purposes. That definition should correspond to the definitions of the Federal Accounting Standards Advisory Board.

**RUS RESPONSE:**

They agreed to include a definition of "loan default" in its operating instructions that implement the 2008 Farm Bill and to publish the regulations and accompanying instructions as an interim rule within the next 90 days.

**OIG POSITION:**

We accept RUS' management decision.

We appreciate the courtesies and cooperation extended to us by members of your staff during this audit.

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<sup>35</sup> P.L. 110-385, dated October 10, 2008.

# Exhibit A - Broadband Loan Funding

Exhibit A - Page 1 of 1

Fiscal Year	Lending Level/Total Allotment	Deobligated Funding	Unobligated Funding	Total Obligation
2001	\$ 100,000,000	\$23,575,988	\$ 0	\$76,424,012
2002	80,000,000	19,894,800	0	60,105,200
2003	56,263,000	0	0	56,263,000
2004	602,946,931	271,707,973	0	331,238,958
2005*	2,078,975,023	7,939,000	1,967,553,023	103,483,000
2006*	1,035,620,404	127,798,000	706,411,404	201,411,000
2007*	990,000,000	65,767,000	739,041,000	185,192,000
2008* †	792,900,000	0	460,249,000	332,651,000
<b>Total Loan Funding</b>	<b>\$5,736,705,358</b>	<b>\$516,682,761</b>	<b>\$3,873,254,427</b>	<b>\$1,346,768,170</b>

\* Includes funds carried over from the prior year or rescinded from a prior year obligation. In FY 2006, Congress limited the carry over to \$495 million per fiscal year.

† FY 2008 unobligated funding as of June 3, 2008. RUS had obligated an additional \$70,325,000 by September 20, 2008; it is therefore carrying over \$389,924,000 (\$460,249,000 - \$70,325,000) into FY 2009.

# Exhibit B – Loans in Default

Exhibit B - Page 1 of 1

## Loans in Default

**Table 1**

Company	Loan Amount	Total Advanced	Principle Balance	Unpaid Principle	Unpaid Interest & Fees	Unpaid Balance
<b>Farm Bill Loans</b>						
GA 1102	\$ 362,000	\$ 318,980	\$ 280,091	\$ 14,236	\$ 5,631	\$ 19,866
MI 1101	1,985,000	1,883,707	1,882,956	242,382	85,752	328,134
OK 1104	2,880,000	2,880,000	3,078,563	168,118	127,583	295,702
VA 1101	11,716,000	8,132,907	8,404,320	753,685	406,913	1,160,598
<b>Subtotal</b>	<b>16,943,000</b>	<b>13,215,594</b>	<b>13,645,930</b>	<b>1,178,421</b>	<b>625,879</b>	<b>1,804,300</b>
<b>Pilot Loans</b>						
CA 1301	9,248,820	4,249,396	3,991,475	1,306,275	667,238	1,973,513
CO 1301	12,914,000	11,714,401	10,909,940	4,695,575	1,324,871	6,020,446
MI 1301	298,000	298,000	118,457	44,048	753	44,801
NE 1301	1,446,200	1,079,131	144,999	0	0	0
OH 1301	3,295,000	3,292,691	3,207,398	1,217,546	538,601	1,756,147
<b>Subtotal</b>	<b>27,202,020</b>	<b>20,633,619</b>	<b>18,372,269</b>	<b>7,263,444</b>	<b>2,531,463</b>	<b>9,794,907</b>
<b>Total</b>	<b>\$44,145,020</b>	<b>\$33,849,213</b>	<b>\$32,018,199*</b>	<b>\$8,441,865</b>	<b>\$3,157,342*</b>	<b>\$11,599,207</b>

## Pilot Loans Written-Off

**Table 2**

Company	Loan Amount	Advanced	Unpaid Balance	Asset Purchase/ Bankruptcy Settlement	Written-Off
KS 1302	\$6,755,000	\$ 6,755,000	\$ 6,658,162	\$1,270,275	\$5,387,887
MN 1301	4,252,000	4,252,000	4,064,991	2,105,435	1,959,556
PA 1301	5,012,000	2,148,675	2,348,735	209,200	2,139,535
<b>Total</b>	<b>\$16,019,000</b>	<b>\$13,155,675</b>	<b>\$13,071,888*</b>	<b>\$3,584,910</b>	<b>\$9,486,978</b>

\*Total broadband loan amount in default (\$32,018,199 + 3,157,342 + 13,071,888 = \$48,247,429)

# Exhibit C – Listing of the Number of Providers for Approved Loans<sup>36</sup>

Exhibit C - Page 1 of 1

Borrower	Loan Amount	Total number of Communities	Number of Communities with			
			0 Providers	1 Provider	2 Providers	3 or More Providers
AL 1103	\$ 9,796,000	11	2	6	3	0
AZ 1106	8,002,000	7	1	1	3	2
AZ 1107	10,329,000	27	0	10	15	2
CO 1103	267,298,000	546	32	65	220	229
CT 1102	12,478,000	17	1	12	3	1
FL 1102 <sup>37</sup>	14,479,000	15	15	0	0	0
FL 1103 <sup>38</sup>	8,136,000	1	1	0	0	0
GA 1104	33,809,000	146	61	32	49	4
IA 1105	9,475,000	1	0	0	1	0
IA 1107	15,902,000	5	0	1	0	4
IA 1108	10,000,000	1	0	0	0	1
IA 1109	2,082,000	3	0	0	0	3
IL 1101	127,798,000	75	14	11	16	34
KS 1101	4,973,000	53	38	12	2	1
KY 1102	7,599,000	2	0	2	0	0
LA 1101	38,219,000	5	0	3	2	0
LA 1103	3,847,000	11	0	2	9	0
MD 1102	3,211,000	11	0	2	8	1
MI 1102	1,028,000	57	30	17	10	0
MI 1105	4,724,000	1	0	0	1	0
MN 1101	38,000,000	15	11	1	3	0
MN 1102 <sup>39</sup>	21,994,000	159	93	24	24	18
MO 1102	9,299,000	7	5	0	1	1
NC 1102	15,543,000	4	0	0	0	4
NJ 1103	12,444,000	26	0	4	3	19
NV 1101	23,538,000	2	2	0	0	0
NY 1102 <sup>38</sup>	10,989,000	23	3	19	1	0
OH 1103	6,167,000	1	0	0	0	1
OK 1107	35,499,000	55	0	10	25	20
OR 1103	24,583,000	133	8	27	64	34
SD 1106	3,382,000	21	14	2	3	2
TX 1112	11,828,000	2	0	1	1	0
UT 1101	66,166,000	6	0	0	0	6
VT 1101	2,229,000	3	3	0	0	0
WV 1101	37,973,000	16	0	0	0	16
<b>Total</b>	<b>\$912,819,000</b>	<b>1,468</b>	<b>334</b>	<b>264</b>	<b>467</b>	<b>403</b>

<sup>36</sup> Source of information – Director, RUS Broadband Division

<sup>37</sup> Borrower that was not eligible for a loan based on the regulation governing the Broadband Loan and Loan Guarantee program. Borrower was funded based on congressional mandate.

<sup>38</sup> This borrower indicated that it was providing service to a community that had service, but RUS mistakenly characterized this application as providing service to an area without preexisting providers.

<sup>39</sup> Company received more than one loan. This figure represents the total.

# Exhibit D – RUS Response

Exhibit D - Page 1 of 5



United States Department of Agriculture  
Rural Development

TO: Robert W. Young  
Assistant Inspector General for Audit  
Office of Inspector General

MAR 25 2009

FROM: David J. Villano  
Assistant Administrator  
Telecommunications Program

THROUGH: James R. Newby  
Acting Administrator  
Utilities Programs

William F. Hagy, III  
Acting Deputy Under Secretary  
Rural Development

SUBJECT: Office of Inspector General (OIG)  
Report # 09601-8-Te  
Broadband Loan and Loan Guarantee Program

Thank you for the opportunity to comment on OIG's recent Audit of Rural Development's Broadband Loan program. Rural Development appreciates Inspector General's input into ensuring that our Broadband program meets its statutory and regulatory missions.

As noted by OIG, Rural Development began providing broadband loans in 2001 under a pilot program authorized by Congress and then later under the 2002 Farm Bills. Loans made under these programs were the subject of OIG's work plan. While we appreciate OIG's recent Report, Rural Development feels it does not accurately portray the performance of the program.

The loans and grants provided during the period in question were provided in a way entirely consistent with the statutory requirements of the underlying legislation governing administration of the program, the regulations and guidance issued by the Department to implement the statute, and the intent of Congress.

Many of the comments that appear in the OIG report are a reflection of the statutory requirements which Rural Development was bound to administer. For example, OIG noted the statutory definition of "rural" (Public Law 107-171, as amended), as communities with fewer than 20,000 inhabitants. There were no

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additional statutory restrictions or qualifiers, such as proximity to larger towns. Rural Development codified this definition at 7 CFR 1738.1. As such, in accordance with the statute and published regulations, Rural Development could not arbitrarily declare communities that met the statutory definition of "rural" to be "ineligible" for financing in favor of other communities considered to be 'more rural.'

Rural Development offers the following:

**1. All loans made under Rural Development's Broadband Loan program have been provided in eligible rural areas defined by law and regulation.**

In the subject Report, OIG highlights that certain loans were made in close proximity to suburban areas, and that one loan was made in a community with a population of 88,000 residents. All of these communities were eligible for assistance under the law and published regulations; the later receiving special legislative authority in 2004.

OIG furthers this statement in its current Report that if loans approved under the 2002 Farm Bill, were reprocessed under the 2008 Farm Bill, many would have been ineligible. The 2008 Farm Bill was not in effect when the subject applicants applied for assistance making this a moot point.

**2. All loans made under Rural Development's Broadband Loan program have been provided in eligible communities based on published regulations at the time loans were made, notwithstanding their level of existing service providers.**

In the subject Report, OIG continues to highlight that some loans were made in communities with existing service providers. Again, the 2002 Farm Bill upon which the subject loans were approved, did not exclude certain communities from participation in the program by virtue of the fact that an entity may be providing some level of broadband service within all or a portion of an eligible community. Rather, it established "priority" for those applications where there was no residential access. The Managers' Report accompanying the 2002 Farm Bill stated:

*The Managers expect the Agency to determine the priority status of applications on hand at least once every quarter. In general, all other applications [those where there is some level of residential service] should be evaluated and awarded on a first come first serve basis. (Bracketed language added.)*

As such, the Managers clearly contemplated that funding would be provided to areas where some level of residential service was available. In fact, the original enabling legislation provided a definition of "rural" that originally excluded areas

within what was then referred to as "Standard Metropolitan Statistical Areas." These areas contained not only some relatively low population areas as well as more suburban areas adjacent to larger towns. This exclusion would have prevented funding in some of the areas referenced in the OIG audit. However, Congress specifically removed this restriction in 2004, indicating its intent to make those areas eligible for funding under the statute, leaving the only limitation to the size of the communities being served: specifically, towns with population of less than 20,000 inhabitants and their outlying areas. Rural Development implemented this definition and has adhered to this definition as required by law.

Again, all Rural Development broadband loans were approved in accordance with the statute and published regulations in effect at the time. The issue of "competition" was addressed in Rural Development Proposed Rulemaking in 2007. This issue was not formally resolved until enactment of the 2008 Farm Bill which included specific language that precludes Rural Development from providing broadband loans in areas with 3 or more service providers.

Rural Development fully supports financing of broadband service in rural areas that lacks any broadband service. Regrettably, many applicants are unable to develop a viable business plan to serve unserved areas.

***3. OIG's conclusion that the key problems identified in the 2005 report have not been resolved is inaccurate.***

In the subject Report, OIG states that:

*"In conclusion, OIG notes that the key problems identified in our 2005 report – loans being issued to suburban and exurban communities and loans being issued where other service providers already provide access – have not been resolved."*

We disagree with this statement. Enactment of the 2008 Farm Bill addressed many of OIG's criticisms of the way Rural Development implemented the 2002 Farm Bill. These changes have been reflected in the proposed interim final rule, but more importantly, Rural Development is now able to receive and act upon loan applications in a way that is responsive to the concerns raised by OIG.

Lastly, Rural Development has not approved any requests for loan assistance received since enactment of the 2008 Farm Bill.

***4. Rural Development did develop internal regulations for its broadband loan and grant programs.***

In the subject Report, OIG states that Rural Development has not implemented its recommendations to develop internal Agency operating instructions. Rural Development respectfully disagrees with this finding.

Rural Development's internal Agency operating procedures were issued between March 2005 and January 2007. In January 2007, these procedures were incorporated into a 170 page guide, entitled "Broadband Loan Applications – Review Process" and have been used within Rural Development's broadband division. OIG is correct that Rural Development recently contracted with an outside vendor to assist Rural Development with updating these internal instructions consistent with the 2008 Farm Bill and our interim final rule which should be published within the next 90 days.

A copy of the subject document was provided to your OIG Investigator during the Audit and another copy is attached to this response.

**5. Rural Development does understand the term "default."**

In the subject Report OIG contends that Rural Development could not provide a list of defaulted loans. In the subject instance, the OIG Auditor requested a list of loans in "default" from our staff. Since "default" has many meanings, Rural Development asked the OIG investigator to define "default" so we could provide the investigator with the specific and relative information requested. The inference portrayed in the subject Audit is that Rural Development does not understand the term "default."

The term "default" is multi-faceted. Rural Development loan and security agreements contain many provisions to adequately secure the debt. Any violations thereof, either monetary or non-monetary, have the potential to be considered a "default" and are often specific to the individual broadband project being financed. A uniform tracking system, containing every possible permutation of "default," would be impracticable. For example, a borrower is required to submit an annual operating report. If a borrower fails to submit same, the loan is technically in default; however, the loan could be current and performing above expectations. Rural Development, like most lenders, relies upon the terms and conditions of its security agreement to determine when a default has occurred. OIG's recommendation that loans which are 90 days delinquent be considered in "default," is just one standard upon which a lender can evaluate its portfolio.

Using OIG's proposed definition of default (90-days or more delinquent), Rural Development is proud of the Telecommunications default rate. As of January 31, 2009, only 17 accounts – or 1.25 percent of the portfolio were more than 90 days delinquent. If you removed broadband loans made under the 2001 pilot program and 2002 Farm Bill, the 90-day delinquency rate lowers to .5 percent.

**6. Rural Development has acted prudently in responding to OIG concerns.**

Rural Development is bound by the law and its published regulations. To respond, in part, to the recommendations provided by the last OIG Report, Rural Development, published a proposed rule in 2007. Shortly thereafter, reauthorization of the 2002 Farm Bill ensued. Rural Development was fortunate to have received comments to many of the issues being debated in the Farm Bill and was able to share these public comments with policymakers. These comments, along with the OIG's Audit were instrumental in the final enactment of the 2008 Farm Bill.

With proposed changes to the program being discussed during the Farm Bill debate, Rural Development determined that it was not a prudent use of taxpayer resources to further promulgate its 2007 proposed rule. Obviously, the rule would need to be changed as a result of the 2008 Farm Bill. In addition, the cost and staff resources needed throughout USDA and other government agencies to approve the subject regulation would have been an inefficient use of taxpayer dollars. Further, with on-going debate of terminology in the Farm Bill, publishing a final rule at the same time would have been confusing to the public. Rural Development prudently chose to wait until enactment of the 2008 Farm Bill. These regulations are in final USDA clearance and should be published as an interim final rule within the next 90 days.

Despite OIG's conclusion that the key problems identified in the 2005 report have not been resolved, it provided only one Recommendation to Rural Development.

**Recommendation 1** – Define a "loan default" for reporting purposes. That definition should correspond to the definitions of the Federal Accounting Standards Advisory Board.

**Rural Development Response.** – Rural Development will include a definition of "loan default" in its operating instructions that implement the 2008 Farm Bill. The regulation and accompanying instructions should be published as an interim final rule within the next 90 days.