

**SBA-SERVICED LIQUIDATION OF  
CERTIFIED DEVELOPMENT COMPANY  
LOANS**

*Report Number 9-11  
Date Issued: March 30, 2009*

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



U.S. Small Business Administration  
Office Inspector General

# Memorandum

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To: John A. Miller  
Director, Office of Financial Program Operations

Date: March 30, 2009

From: /s/ **original signed**  
Debra S. Ritt  
Assistant Inspector General for Auditing

Subject: Report on SBA-Serviced Liquidations of Certified Development Company Loans  
Report No. 9-11

This report presents the results of our audit of the liquidation process of Certified Development Company (CDC) loans by the Small Business Administration (SBA). CDC loans are placed into liquidation when SBA purchases the debentures that guarantee these loans. Currently SBA does most of the liquidations, but some are done by Premier Certified Lenders (PCL) and Authorized CDC Liquidators (ACL). In February 2007, SBA centralized CDC liquidations by shifting liquidation responsibilities from the district offices to the two commercial loan service centers in Fresno, California and Little Rock, Arkansas.

The audit objectives were to determine (1) whether SBA's liquidation efforts maximized recoveries of outstanding balances on purchased CDC loans, and (2) whether centralization improved the liquidation process. To address the audit objectives, we reviewed a sample of 95 of 1,427 loans in liquidation as of July 29, 2007 that had recorded purchase dates. Another 2,458 loans were in liquidation, but because their purchase dates could not be determined, they were excluded from our sample.<sup>1</sup> The 95 sampled loans had an outstanding loan balance of \$29.3 million and consisted of 54 that were in the process of being liquidated, 22 that had been charged off, 18 that had been paid-in-full, and 1 that became current after purchase. Of the 95 loans, 52 had been purchased before centralization and 43 were purchased after centralization. A listing of the sampled loans is presented in Appendix I, and our sampling methodology is provided in Appendix II.

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<sup>1</sup> Without purchase date information, we could not calculate the length of time these loans were in liquidation and/or the timeliness of specific liquidation actions. Furthermore, purchase dates were required in order to evaluate improvements in liquidation activities before and after centralization.

To determine whether SBA maximized recoveries on loans in liquidation, we compared actions taken on the sampled loans to requirements established in the Agency's standard operating procedure (SOP) 50 51(2). Our analysis focused on whether SBA pursued all collateral and other available assets, made reasonable compromise decisions, and properly charged off loans and referred them to the United States Treasury Department.

To determine whether centralization had improved liquidation efforts, we compared the timeliness and completeness of liquidation actions taken on loans processed by the district offices with those of the service centers. We reviewed SBA loan files, interviewed SBA and CDC personnel, and analyzed related financial and chronological postings from SBA's databases. We conducted our audit between October 2007 and October 2008, in accordance with *Government Auditing Standards* prescribed by the Comptroller General of the United States.

## **BACKGROUND**

SBA's 504 Loan Program provides small businesses with long-term, fixed-rate financing for the purchase of land, buildings, machinery, or other fixed assets in the form of government-guaranteed loans. These loans are issued through a partnership with CDCs and private sector third-party lenders and are funded through the issuance of government guaranteed debentures. CDCs are non-profit corporations that are certified and regulated by SBA to package, process, close, and service CDC loans. There are currently 271 active CDCs, of which 30 PCLs and ACLs have liquidation authority.

CDCs notify SBA when a loan is in default and not expected to return to current status, or when a loan is subject to legal action, such as a foreclosure notice or a bankruptcy filing. Upon such notice, SBA purchases the debenture and places it into liquidation. With the exception of PCL-approved loans, SBA incurs all of the associated losses. PCLs pay SBA 10 percent of the loss on purchased loans approved under the PCL program. As of November 30, 2008, SBA had 844 loans totaling \$418.3 million in liquidation.

Historically, SBA's 74 district offices processed all CDC liquidations. In February 2007, SBA transferred liquidation responsibility to the Fresno and Little Rock Commercial Loan Service Centers. During the audit period, these centers reported to the Office of Financial Assistance (OFA). The transfer of responsibility was intended to reduce staffing and unit costs to liquidate the loans, and to substantially improve consistency in applying SBA's liquidation policies and procedures, among other reasons. Recently, responsibility for the centers has been transferred to the Office of Program Operations (OFPO).

After centralization of the liquidation process, SBA granted CDCs a greater role in the liquidation process. In May 2007, 13 CFR 120 was revised to require that CDCs designated as PCLs liquidate and handle debt-collection litigation for their entire loan portfolios. In addition, SBA authorized non-PCL CDCs that were designated as ACLs to perform liquidation and debt-collection actions. Finally, for SBA-serviced liquidations, the Agency can request that CDCs assist in the liquidation process. This assistance includes communicating with borrowers, assisting with litigation actions, and liquidating collateral, among other things.

## **RESULTS IN BRIEF**

SBA did not maximize opportunities to recover \$12.7 million in outstanding loan balances on 30 of the 95 CDC loans we examined. Ten of the 95 loans were in liquidation for over 18 months, of which 6 were in liquidation in excess of 3 years. Based on the sample results, we estimate that SBA missed opportunities to collect at least \$106 million on the 1,427 loans with recorded purchase dates that were in liquidation status as of July 29, 2007.

SBA missed collection opportunities because it did not fully execute actions in all of the key areas of the liquidation process. Specifically, SBA did not adequately or timely:

- conduct protective bid analyses;
- obtain current appraisals;
- perfect liens;
- identify and pursue all available assets;
- attempt or reach compromises reflective of obligors' repayment ability;
- properly charge off loans; or
- refer charged-off loans to Treasury.

In the first 6 months after centralization, there was no measurable improvement in the percentage of loans with fully completed liquidation actions at the service centers. Specifically, the service centers completed actions on 71 percent of the loans, compared to 72 percent of the loans that the district offices had completed actions on prior to centralization. After centralization, increases occurred in the percentage of loans with inadequate collateral liquidation, insufficient negotiated compromises, or improper referrals to Treasury. However, some improvement occurred in two of the five liquidation activities—pursuing guarantors and all available assets, and charging off loan balances.

More significant improvements were not observed in the loans we sampled because the two centers inherited a large number of incomplete loan files and focused resources on reducing a backlog of older loans awaiting charge-off that had been transferred from the district offices. Prior to centralization, the backlog of loans that were 24 months or older was as high as 509. This number was reduced to 153 by April 2008.

Since April 2008, SBA has re-engineered the liquidation process and increased staffing at the two centers. It implemented a loan tracking system allowing the centers to better monitor the status of loans and established a triage unit that distributes loans to different loan liquidation specialists based on required actions to expedite loan liquidation. These process improvements are expected to expedite referral of loans to Treasury for further debt collection and, by September 30, 2008, had resulted in a reduction of loans that were older than 24 months to 137, even as new purchases increased.

We recommended that the Director of OFPO evaluate whether staffing and process improvements, introduced after the audit was completed, have enabled the centers to complete all required liquidation actions, and, if not, make appropriate staffing and process adjustments as necessary to ensure that loans are properly liquidated. Management agreed with our recommendation and stated that it would monitor the 504 liquidation process to ensure that all liquidation actions material to recovery are taking place and that loans are properly liquidated.

## RESULTS

### **SBA Liquidation Actions Did Not Maximize Recoveries on Purchased CDC Loans**

SBA did not complete all of the five key areas of the liquidation process on 30 of the 95 loans reviewed, missing opportunities to collect \$12.7 million on the loans in liquidation. SOP 50 51 (2) identifies the following five key liquidation activities that must be completed prior to charging off any unpaid balances:

- **Identifying, evaluating and disposing of collateral.** To maximize collection of collateral, SBA must ensure all collateral is accounted for and assessed so that SBA can determine the best course of action in disposing of the collateral. Once a CDC loan is purchased, SBA assesses the liquidation value of the collateral using 75 percent of the current appraisal or broker opinion, less the amount owed to prior lien holders and anticipated acquisition and disposal costs to SBA.
- **Pursuing guarantors and other available assets.** To further reduce the outstanding balance of a loan, SBA must evaluate all other assets and the

future earning potential of all responsible parties. Current credit reports, assets searches, and the obligors' financial condition are used to assist in identifying resources that can be used to pay down the loan debt. The responsibility for collecting this information rests with SBA.

- **Negotiating compromise agreements.** After recovery from collateral and other assets has been maximized, SBA can compromise the debt to get additional recovery on the loan. Compromises are not recommended when it is clear that SBA can collect fully without protracted litigation. To make informed decisions that maximize recovery when negotiating compromises, SBA must have an adequate evaluation of the obligors' financial capabilities.
- **Charging off loans.** When SBA has exhausted the prior three steps, it charges off the remaining loan balance. This action signifies the end of SBA's collection efforts on the loan. If continued collection actions against the debt are not legally prohibited, the loan is identified for transfer to the Treasury Department.
- **Referring loans to the Treasury Department for further collection actions.** Once a loan is transferred, the Treasury Department continues collection actions against the outstanding loan balance through tax offsets and traditional collection techniques to collect on SBA's outstanding debt.

However, despite these requirements, SBA did not:

- **Perform protective bid analyses, obtain current appraisals, or perfect liens to liquidate collateral on 8 loans.** SBA missed opportunities to properly appraise and pursue its share of up to \$5.7 million in collateral. For example, on one loan, SBA abandoned about \$212,000 of potential equity on the identified collateral because it did not obtain a current appraisal of the property. On another loan, a deed of trust on a second piece of collateral that was not properly filed caused SBA to lose entitlement to any of the proceeds when the collateral, which was valued at \$987,000, was sold.
- **Identify and pursue all available assets and guarantors on 16 loans.** SBA did not obtain current financial information on loans with potential assets of up to \$12.6 million that was critical for identifying and pursuing all other available assets. For example, on one loan SBA lost a potential recovery from 15 pieces of real estate because it did not identify and pursue the assets. After more than 20 months without action, all of the assets dissipated and/or were diverted, and were no longer available for collection. On two other loans, SBA did not pursue identified guarantors, who had other available assets, including outside incomes totaling up to \$6.1 million, collectively.

- **Attempt or reach compromises that fully reflected the obligors' repayment ability on 14 loans.** SBA did not appropriately negotiate compromises on 14 loans with outstanding balances that ranged from \$58,500 to \$1.2 million. On two loans, SBA did not negotiate a compromise for the full amount that the obligor could have paid. For example, SBA accepted \$2,000 on one loan with an outstanding balance of \$401,600, despite the obligor's young age and annual earnings of \$109,000.
- **Properly charge off 10 loans.** SBA improperly charged off 10 loans without fully assessing the potential for recovery on \$2.6 million in estimated assets and taking all possible collection actions. On one loan, which remained in liquidation for over 3 years, SBA did not liquidate collateral, pursue all available assets, and reach a fair compromise prior to its charge off.
- **Properly refer 10 charged-off loans to Treasury.** SBA failed to include the appropriate obligors or guarantors on 8 loans with \$4.9 million in outstanding balances in its referral to Treasury for offset or collection actions. On two loans, SBA assigned the wrong transmittal code which delayed Treasury's ability to take appropriate action. As a result of this audit, one of the miscodings has been corrected.

Based on our sample results, we estimate that SBA did not maximize collections on up to 339 of the 1,427 loans in liquidation status as of July 29, 2007 that had recorded purchase dates. These loans had outstanding balances of \$106 million. Our results reflected the findings for only two-fifths of the CDC loans in liquidation because SBA lacked purchase dates on the other 2,458 loans in liquidation.

### **SBA Completed a Slightly Lower Percentage of Liquidation Actions After Centralization and Reduced Backlogs of Older Loans, Even as New Purchases Increased**

In the first 6 months after centralization, the two centers fully completed required liquidation actions on 71 percent of the loans sampled compared to 72 percent that were completed by the district offices prior to centralization. As shown in Table 1, some improvement occurred in two of the five liquidations stages: pursuing guarantors and all available assets and charging off loan balances. For example, not all guarantors and assets were pursued on 40 percent of the loans after centralization, compared with 42 percent of the loans prior to centralization. Also, the centers improperly charged off loan balances in 29 percent of loans after centralization, compared with 35 percent of the loans charged off by the district offices prior to centralization.

**Table 1. Percentage of Loans with Incomplete Liquidation Actions**

<b>Liquidation Stage</b>	<b>Percentage Before Centralization</b>	<b>Percentage After Centralization</b>
Liquidate Collateral	8	13
Pursue Guarantors and All Available Assets	42	40
Negotiate a Compromise	38	44
Charge-off the Loan Balance	35	29
Refer Loan to Treasury	40	44

Source: SBA loan files

However, the percentage of loans with incomplete liquidation actions increased after centralization for three liquidation stages—liquidating collateral, negotiating a compromise, and referring loans to Treasury. For example, collateral was inadequately liquidated in 13 percent of the loans after consolidation, compared with 8 percent before consolidation. Specifically, SBA did not conduct protective bid analyses on three loans to determine whether collateral liquidation actions were in SBA’s best interest and made no assessment of collateral value on one loan, choosing instead to defer action until the first lien holder acted. On another loan, no collateral assessments were made to ensure SBA’s interests were protected when collateral was sold at public auction.

Further, SBA did not attempt to negotiate compromises on outstanding loan balances on a higher percentage of loans after consolidation. On many of these loans, the centers simply did not pursue compromise subsequent to collateral liquidation. Finally, the percentage of loans that were improperly or not referred to Treasury after charge-off increased from 40 percent prior to consolidation to 44 percent after consolidation. These loans were either miscoded or did not properly assign obligors.

More significant improvements were not observed in the loans we sampled because the two centers inherited a large number of incomplete loan files and focused resources on reducing a backlog of loans older than 24 months that had been transferred from the district offices and were awaiting charge-off. Prior to centralization the backlog of loans that were 24 months or older was as high as 509. This number was reduced to 153 by April 2008. Staff at the service centers focused on expediting loan charge-offs, which impacted their ability to complete all liquidation actions required at each liquidation stage.

SBA reduced its backlog of older loans even though the number of new purchases nearly doubled between April 2006 and April 2008. This dramatic increase underscores the continued need for SBA to ensure its liquidation actions are conducted in a timely manner as assets are subject to dissipation, devaluation, or diversion the longer they are allowed to sit in inventory.



## **Recent Re-engineering of the Liquidation Process Should Further Improve SBA's Ability to Manage Increasing Volumes and Expedite Referral of Loans to Treasury**

In April 2008, SBA introduced process improvements and implemented new practices in order to manage the increased number of newly purchased CDC loans. The new management processes included:

- Implementation of an automated tracking system where each loan is logged in as an open item, allowing SBA to monitor the status of loans. SBA anticipates this system will reduce delays in processing loans and allow improved loan monitoring.
- Establishment of a triage unit to expedite loan liquidation by evaluating required actions and distributing loans to the appropriate staff based on needed actions.
- Increased use of Treasury as a debt collection tool. Following collateral liquidation, SBA plans to transfer to Treasury all loans where the cost of further collection exceeds the potential recovery from available assets or offers in compromise.

In addition, SBA increased its planned liquidation staff at the two service centers from 8 to 13 and eliminated its use of SBA contractors for liquidation support. These changes, which occurred after the completion of audit field work, should further improve the centers' ability to timely liquidate loans in order to maximize collections. However, SBA will need to evaluate if such process and staffing changes have enabled the centers to complete a higher percentage of required liquidation actions.

## **RECOMMENDATION**

We recommend that the Director of OFPO:

1. Evaluate whether staffing and process improvements, introduced after the audit was completed, have enabled the centers to complete all required liquidation actions, and, if not, make appropriate staffing and process adjustments as necessary to ensure that loans are properly liquidated.

## **AGENCY COMMENTS AND OFFICE OF INSPECTOR GENERAL RESPONSE**

On February 19, 2009, we provided a draft of this report to SBA for comment. On March 23, 2009, SBA submitted its formal comments which are contained in their

entirety in Appendix III. Specific management comments on the report findings and recommendation, and our evaluation of them, are summarized below.

### *Management Comments*

SBA management concurred with the recommendation. Management noted that it is currently rewriting the liquidation procedures under SOP 50 51 to implement improvements to the 504 liquidation process. SBA's approach in its process improvements efforts is to focus resources on those liquidation actions that represent material sources of recovery and eliminating loans where additional liquidation actions are not cost effective for SBA to pursue through charge-off and referral to the U.S. Department of Treasury. According to SBA management, this will provide a more effective and efficient allocation of scarce Agency resources and fully utilize the Treasury service that is mandated in the Debt Collection Improvement Act of 1996. By focusing on liquidation actions that are deemed material to recovery, SBA will seek to improve recoveries and reduce risk. In its commitment to fully address all required liquidation actions in the loan files, SBA will document actions where liquidation actions are not pursued, providing the basis for its decision and the accelerated referral of the loan to Treasury.

### *OIG Comments*

Management's proposed actions are responsive to the recommendation. SBA stated they would monitor the 504 loan liquidation process to ensure that all liquidation actions material to recovery are taking place and that loans are properly liquidated. Furthermore, SBA will monitor performance and quality measures on a monthly basis, measuring areas such as liquidation case resolution rates, timeliness of review turnaround times, cash recovery rates, and the quality of liquidation decisions.

We will review center activities in the future to determine whether SBA planned actions and review processes have resulted in increased efficiencies and effectiveness in 504 loan liquidations.

We appreciate the courtesies and cooperation of the Office of Financial Program Operations and its commercial loan service centers during this audit. If you have any questions concerning this report, please call me at (202) 205-[FOIA ex. 2] or Debra Mayer, Director, Credit Programs Group at (202) 205-[FOIA ex. 2].

## APPENDIX I. SAMPLED LOANS

<b>Loan Number</b>	<b>Gross Loan Balance</b>
<i>Before Consolidation</i>	
[FOIA ex. 2]	\$854,105
[FOIA ex. 2]	\$612,120
[FOIA ex. 2]	\$230,458
[FOIA ex. 2]	\$0
[FOIA ex. 2]	\$0
[FOIA ex. 2]	\$129,907
[FOIA ex. 2]	\$0
[FOIA ex. 2]	\$0
[FOIA ex. 2]	\$157,785
[FOIA ex. 2]	\$329,963
[FOIA ex. 2]	\$197,200
[FOIA ex. 2]	\$0
[FOIA ex. 2]	\$0
[FOIA ex. 2]	\$0
[FOIA ex. 2]	\$452,497
[FOIA ex. 2]	\$243,992
[FOIA ex. 2]	\$0
[FOIA ex. 2]	\$462,942
[FOIA ex. 2]	\$208,885
[FOIA ex. 2]	\$0
[FOIA ex. 2]	\$0
[FOIA ex. 2]	\$180,985
[FOIA ex. 2]	\$552,828
[FOIA ex. 2]	\$0
[FOIA ex. 2]	\$22,746
[FOIA ex. 2]	\$231,925
[FOIA ex. 2]	\$269,107
[FOIA ex. 2]	\$0
[FOIA ex. 2]	\$150,586
[FOIA ex. 2]	\$555,900
[FOIA ex. 2]	\$198,209
[FOIA ex. 2]	\$0
[FOIA ex. 2]	\$466,289
[FOIA ex. 2]	\$128,344
[FOIA ex. 2]	\$202,669
[FOIA ex. 2]	\$89,641
[FOIA ex. 2]	\$0
[FOIA ex. 2]	\$57,644
[FOIA ex. 2]	\$940,974
[FOIA ex. 2]	\$189,836
[FOIA ex. 2]	\$285,811
[FOIA ex. 2]	\$0
[FOIA ex. 2]	\$197,284
[FOIA ex. 2]	\$1,268,386
[FOIA ex. 2]	\$211,612
[FOIA ex. 2]	\$0
[FOIA ex. 2]	\$0
[FOIA ex. 2]	\$0

<b>Loan Number</b>	<b>Gross Loan Balance</b>
[FOIA ex. 2]	\$328,167
[FOIA ex. 2]	\$552,947
[FOIA ex. 2]	\$635,963
[FOIA ex. 2]	\$18,586
<i>After Consolidation</i>	
[FOIA ex. 2]	\$1,173,550
[FOIA ex. 2]	\$153,075
[FOIA ex. 2]	\$144,844
[FOIA ex. 2]	\$353,629
[FOIA ex. 2]	\$910,467
[FOIA ex. 2]	\$460,888
[FOIA ex. 2]	\$154,681
[FOIA ex. 2]	\$698,517
[FOIA ex. 2]	\$165,660
[FOIA ex. 2]	\$593,909
[FOIA ex. 2]	\$156,444
[FOIA ex. 2]	\$0
[FOIA ex. 2]	\$0
[FOIA ex. 2]	\$868,400
[FOIA ex. 2]	\$248,482
[FOIA ex. 2]	\$239,754
[FOIA ex. 2]	\$1,208,925
[FOIA ex. 2]	\$726,838
[FOIA ex. 2]	\$179,997
[FOIA ex. 2]	\$602,194
[FOIA ex. 2]	\$273,507
[FOIA ex. 2]	\$207,070
[FOIA ex. 2]	\$136,859
[FOIA ex. 2]	\$275,294
[FOIA ex. 2]	\$1,205,589
[FOIA ex. 2]	\$1,057,196
[FOIA ex. 2]	\$197,514
[FOIA ex. 2]	\$255,276
[FOIA ex. 2]	\$0
[FOIA ex. 2]	\$603,813
[FOIA ex. 2]	\$284,059
[FOIA ex. 2]	\$181,489
[FOIA ex. 2]	\$631,423
[FOIA ex. 2]	\$218,309
[FOIA ex. 2]	\$525,546
[FOIA ex. 2]	\$0
[FOIA ex. 2]	\$114,534
[FOIA ex. 2]	\$14,733
[FOIA ex. 2]	\$189,945
[FOIA ex. 2]	\$971,510
[FOIA ex. 2]	\$401,580
[FOIA ex. 2]	\$405,321
[FOIA ex. 2]	\$542,102
<b>Total</b>	<b>\$29,349,216</b>

## **APPENDIX II. SCOPE AND METHODOLOGY**

Our audit objectives were to determine (1) whether SBA's liquidation efforts maximized recoveries of outstanding balances on purchased CDC loans, and (2) whether centralization improved the liquidation process. To determine whether SBA's liquidation efforts maximized recoveries on purchased CDC loans, we reviewed a sample of the 1,427 loans that were in liquidation as of July 29, 2007 that had recorded purchase dates. The universe of purchased CDC loans with purchase dates from SBA's Loan Accounting System included 1,234 loans purchased prior to January 31, 2007, and 193 loans purchased between February 1, 2007 and July 29, 2007. Using the Defense Contract Audit Agency's EZ Quant software program, we determined that a sample 95 loans were necessary to be able to project the audit findings to the universe of 1,427 purchased CDC loans with a 95 percent confidence level. Of the 95 sampled loans, 52, totaling approximately \$9.3 million, were purchased prior to centralization, and 43 loans, totaling approximately \$17.7 million, were purchased after centralization.

We also reviewed SBA and CDC liquidation actions. Specifically, we reviewed actions taken in attempting workouts with non-paying borrowers, sending default/demand letters, liquidating of loan collateral, identifying and pursuing other available assets, attempting compromises on outstanding balances, charging off outstanding loan balances, and referring loans to Treasury. These steps are performed to ensure SBA receives the best opportunity to collect on the outstanding balance on purchased CDC loans. We also assessed the working relationship between SBA and the CDCs and changes in liquidation proficiency due to the reorganization.

To determine whether centralization improved the liquidation process, we identified and compared the number and type of deficiencies in the 52 loans purchased before and the 43 loans purchased after centralization.

We also interviewed SBA personnel in Headquarters, the Fresno and Little Rock Commercial Loan Servicing Centers, District Offices, as well as management and staff at the Community Development Centers. In addition, we analyzed related financial and chronological postings from SBA's databases.

## APPENDIX III. MANAGEMENT COMMENTS

DATE: March 23, 2009

TO: Debra Ritt  
Assistant Inspector General for Auditing

FROM: Eric Zarnikow, Associate Administrator for the Office of Capital Access [FOIA ex. 6]  
John Miller, Acting Director, Office of Financial Program Operations [FOIA ex. 6]

SUBJECT: Response to OIG's Audit Report Titled "SBA-Serviced Liquidation of Certified Development Company Loans"

The Office of Capital Access (OCA) offers the following responses to the Office of Inspector General liquidation audit:

OIG conducted its audit on loans between October, 2007 and October, 2008, based upon a sample drawn July 29, 2007, six months after centralization of the 504 liquidation function. OIG compared liquidation actions that occurred prior to February, 2007 with those that occurred after that date. OIG indicates in its audit the sample was drawn very early in the centralization process, prior to the realization of centralization process improvements and elimination of a large backlog of cases inherited from district offices.

As the basis for its audit findings, OIG provided a list of what its auditors determined were liquidation deficiencies identified on sampled loans, but did not identify whether the deficiencies occurred prior to or after centralization, nor did OIG provide a loan by loan detail of the deficiencies. The deficiencies were identified under the context of liquidation procedures that were put in place prior to centralization. We are currently rewriting the liquidation procedures under the SOP 50 51 liquidation.

OIG correctly states that the centers received a large number of incomplete files from district offices. OIG further states that the centers focused resources on the review of old cases for charge-off at the expense of administering liquidation actions, materially impacting the Agency. We agree that files inherited from district offices were in varying condition and required an exceptional amount of due diligence to determine their true market condition; however, this function was subordinated to the handling of material liquidation actions on the portfolio for loans acquired from district offices and new defaults occurring after centralization. The charge off of older cases was conducted with additional resources in the form of overtime and a team of experienced finance and legal professionals in the SBA's Dallas/Fort Worth office.

We commend the OIG for recognizing the 504 liquidation process improvements the centers have implemented and continue to improve. The process is designed to move the market analysis of newly defaulted 504 loans as early in the process as possible, and focus resources on those liquidation actions that represent material sources of recovery, while eliminating loans through charge-off and referral to the U.S. Department of

Treasury for cross servicing where additional liquidation actions are not cost effective for SBA to pursue. This provides a more effective and efficient allocation of scarce Agency resources and fully utilizes the Treasury service that is mandated in the Debt Collection Improvement Act of 1996.

Through continuous process improvements, SBA is focused on improving recoveries and reducing risk by focusing on liquidation actions that are deemed material to recovery. Consequently the number of liquidation actions completed on loans in the portfolio will not always increase or decrease in direct proportion to changes in the size of the portfolio. Fluctuating real estate values and economic conditions will affect the materiality of liquidation actions, and the associated percentage of material liquidation actions completed on the loan portfolio will follow. SBA continues to be committed to fully address all required liquidation actions in the loan files, and SBA will document actions where liquidation is not pursued. Examples of where liquidation actions may not be pursued are cases where recent information in the file indicates that guarantors have little or no net worth or income to support a compromise of the loan balance, or cases where a recent real estate collateral valuation indicates that SBA's equity position is insufficient to warrant foreclosure. In such cases, SBA will document the loan file as to the basis of the decision and accelerate referral of the loan to Treasury for cross servicing.

OIG Recommendation 1: Evaluate whether staffing and process improvements, introduced after the audit was completed, have enabled the centers to complete all required liquidation actions, and, if not, make appropriate staffing and process improvements as necessary to ensure that loans are properly liquidated.

SBA will monitor the centralized 504 loan liquidation process to ensure that all liquidation actions material to recovery are taking place and that loans are properly liquidated. This ongoing monitoring will take place on a monthly basis through performance and quality measures, such as liquidation case resolution rates, case triage review turnaround times, cash recovery rates, and quality of case completion decisions. SBA will provide OIG a report of its performance and quality measures by August 31, 2009, that will demonstrate loans are properly liquidated.