SBA 'Bailed Out' Banks, Panel Told

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The Small Business Administration's top auditor told a House subcommittee yesterday that his agency in recent years has been running a "bail-out operation" for banks stuck with bad loans that will eventually cost taxpayers millions of dollars.

Under the complex scheme described yesterday, banks unable to collect on loans they had made to businesses could, in effect, convert those loans into federally insured SBA loans. This meant that the government and ultimately the taxpayers, would absorb the loss in place of the banks.

The description of lax lending practices by the SBA was given to the House Small Business Subcommittee by Frank Nicholas, chief internal auditor for the agency, in a closed committee session. The Post obtained a copy of some of his statements after they were distributed to committee members.

The subcommittee is investigating alleged mismanagement of SBA lending programs and allegations of criminal violations in connection with the agency's loans. It has voted unanimously to withhold a $2.3 billion increase in SBA lending authority until it concludes its investigation.

The SBA is close to its present $4.3 billion ceiling on outstanding loans and the agency has said that it will be forced to cut its loan volume by two-thirds by the end of the month unless it gets the ceiling increase.

In his first day of testimony yesterday, Nicholas described two types of complex financial transactions that he said are being encouraged by the SBA at a potential cost of millions of dollars to the government.

The first involves the shift-

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ing of deliquent debts by one bank to a second bank, which in turn helps the small business borrower obtain an SBA guarantee that 90 per cent of the loan will be repaid by the government if the business is unable to pay it off.

The second type of transaction involves lease guarantees by the SBA. Under this program, the agency promises to pay the rent under long term leases of offices and manufacturing facilities if the small business being aided is unable to make the payments.

Nicholas told the committee that he has found a "worsening nationwide trend" of failure by small businesses to make lease payments guaranteed by the government.

Nicholas told the committee that one small business, the Cannon Aeronautical School of Cheyenne, Wyo., obtained lease guarantees from SBA totaling $2.3 million, and is now unable to pay the rent.

Nicholas said that Cannon also obtained another $1 million in guaranteed SBA loans and is now unable to repay them. He said that the proceeds from the SBA loans were used by Cannon owners to pay off personal bank debts.

The two kinds of transactions described by Nicholas that permit banks to unload bad loans on the government apparently have been responsible for a huge increase in private bank participation in SBA programs in the last three years.

SBA Administrator Thomas Kleppe said in a press conference yesterday that when he took over the agency less than three years ago, only 8 per cent of the nation's banks would make SBA guaranteed loans. Today, he said, 67 per cent of the country's private banks are participating in the program.

Kleppe called the conference to deny reports that corruption in his agency is widespread. He said that increased bank participation has come as a result of simplified paperwork required of banks making SBA guaranteed loans and a speedup in loan approvals.

He said that none of these changes has reduced safeguards against bad loans.

Kleppe said prevention of bank abuses of SBA guarantees should be left to the agency's administrators, but Rep. Robert G. Stephens Jr. (D-Ga.), chairman of the Small Business Subcommittee, said that legislation may be needed to stop the bad loan transfers.

Stephens said in answer to questions after a closed committee session that evidence of possible criminal violations have been found in "seven or eight" of SBA's 62 lending offices. He said a similarity of mismanagement or criminal activity has been found in "two or three offices."

It has been publicly acknowledged by government officials that the SBA's Philadelphia and Richmond offices are the subject of criminal investigations. Stephens refused to name the other offices under study by the committee.

In another development yesterday, the SBA confirmed that Thomas F. Regan, the deposed former director of the SBA's Richmond office, approved a $2.3 million lease guarantee to a Georgia firm whose executive vice president is his brother-in-law. The brother-in-law, Joseph C. Palumbo resigned his vice presidency within the last two weeks and SBA has invalidated the lease guarantee, the firm said.

The Associated Press quoted Russell Hamilton, the former head of SBA's regional office in Philadelphia, as saying that Regan approved the lease guarantee 11 days after he married Terri Palumbo, whose brother is Joseph C. Palumbo. The Georgia firm is Dunn International Corp. in Atlanta.

The SBA said it did not know the date of the wedding or the date of Regan's approval of the lease, although an SBA press release announced it on Sept. 11.

In a companion action, the SBA also said that Regan approved a $350,000 loan last April 12 to the Trans-Ocean Steel Corp. of Florida in Hialeah. The Trans-Ocean firm, according to the SBA, was planning to occupy a 44,240-square-foot building built by Dunn in Portsmouth, Va. Dunn president Jack Dempsey said the project is now dead.

The loan gave Trans-Ocean money for operating what the SBA called "a unique steel distribution center," including the manufacture of odd-sized pieces of steel. The lease guarantee to Dunn would have insured Trans-Ocean's rental payments for 20 years.

Regan, 45, first joined the

SBA as a trainee loan examiner in 1955 and steadily worked his way up the Richmond office ladder to chief of the investment division in 1964, chief of the finance division in 1966 and district director since July, 1967. He is currently a GS-15 and paid $32,071 a year.

Under Regan's directorship, the SBA said the Richmond office has gradually increased the volume of its loans throughout Virginia to a current total of $100.7 million, about 65 per cent to businesses and 35 per cent for aid to natural disaster victims.

The SBA said that currently 83 of the Richmond office's 1,462 business loans are 60 days or more overdue and the delinquent amount totals $234,300. The agency said that 226 of 7,173 disaster loans are overdue and the delinquency amounts to $127,000.

The Richmond office also said that it currently has 70 loans totaling $4.3 million in one stage or another of being written off as bad loans.

A spokesman said that eventually, if the SBA's experience is an accurate indicator, about 60 per cent of this amount, or $2.58 million, would be collected through negotiations, sale of collateral for loans or court action.