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UNITED STATES GENERAL ACCOUNTING OFFICE

WASHINGTON, D.C. 20548

CIVIL DIVISION

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MAR 15 1971

Dear Mr. Smith:

The General Accounting Office has reviewed the procedures and practices of the Farmers Home Administration (FHA), Department of Agriculture, for making recreational loans to individuals under FHA's farm operating, farm ownership, and farm recreational loan programs. The review was undertaken in conjunction with our review of FHA's procedures and practices for making loans to public and nonprofit organizations for the development of rural recreational projects. A draft of our proposed report to the Congress on the results of that review was furnished to you for review and comments on February 18, 1971.

Our review of loans to individuals included an examination of the authorizing legislation, related FHA policies and procedures and selected loan files, and discussions with FHA State and county officials and borrowers. We included in our review loans totaling $705,000 made to 16 individuals located in Arkansas, Delaware, Georgia, Missouri, New Mexico, North Carolina, and Virginia. FHA did not adequately follow its instructions in approving loans for nine of the 16 individuals receiving recreational loans totaling $374,470. Approval of recreational loans for certain of the nine individuals was questionable on more than one basis.

On the basis of our review, we concluded that there is a need for FHA to:

--prepare more realistic farm and home plans in determining the financial soundness of recreational loans to individuals;

--require borrowers to meet loan approval conditions before Government funds are disbursed; and

--take steps to assure that only eligible borrowers are approved for recreational loans.

Specific comments on each of these above areas and our recommendations are presented under the following captions.

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NEED TO PREPARE MORE
REALISTIC FARM AND HOME PLANS

FHA instructions require county supervisors to develop annual farm and home plans with loan recipients, as a basis for determining (1) the adequacy of the borrower's resources and the suitability of his proposed operations, (2) the probable income, expenses and net returns from the proposed operations, and (3) the financial feasibility of the loan requested. The instructions state that particular attention should be given to borrowers who have both major production and financial management problems. Various FHA bulletins reinforcing these instructions state that field staffs must be realistic in estimating income and expenses when developing annual farm and home plans with loan recipients.

In the case of six individual borrowers, FHA made loans on the basis of farm and home plans which did not realistically present the potential of the borrowers' operations for developing the recreational projects to be financed by the loans. An example follows where the borrower received loans which were apparently considered to be feasible on the basis of unrealistic income and expense goals.

A borrower in New Mexico received 11 FHA farm operating and ownership loans from 1960 through 1967 amounting to $83,270, for both farming and recreational purposes. Since 1962, the borrower received seven loans totaling $54,650 to develop a recreational facility consisting primarily of fishing ponds, cabins, and picnic-camping areas.

Prior to making the recreational loans to the borrower, FHA's development plan for the recreational project showed that the project's typical year operation would have an annual gross income of $35,000, operating costs of $13,000, and a net income of $22,000, before depreciation, repayment of the loans, and profit.

The following table compares the planned and actual income and expenses for the recreational enterprise as shown on the borrower's annual farm and home plans for 1963 through 1968.

	Planned			Actual		
Year	Gross income	Expenses	Net income (loss)	Gross income	Expenses	Net income (loss)
1963	$ 1,400	$ 1,976	$ (576)	$ 194	$1,115	$(921)
1964	8,800	4,860	3,940	195	1,053	(858)
1965	7,600	2,980	4,620	974	1,621	(647)
1966	9,630	3,255	6,375	1,228	1,646	(418)
1967	11,775	5,175	6,600	866	3,475	(2,609)
1968	27,750	16,120	11,630	2,226	a/	a/

a/Actual recreational expenses and net income for 1968 were not available in the FHA files.

Although the borrower's financial statements for 1963 through 1966 showed he was losing money from his recreational enterprise, FHA's farm and home plans, as indicated above, continued to show an increase in the planned net income. FHA records also showed that from 1963 through 1966, the borrower had a net loss from farming operations.

By 1967, the borrower was delinquent on 5 loans which he received to develop the recreational project. Nevertheless, FHA made two additional loans totaling $27,780 of which $25,460 was for the recreational project. In December 1968, the county supervisor advised the borrower by letter that "***It appears that nothing we have planned has improved the recreation income. Each year the delinquencies keep increasing. It now appears that you should be on the lookout for a buyer for your property.***" FHA records showed that the recreational project was not suitably located to attract tourists and State residents and that this was one of the major causes why the project was not a financial success.

At the time of our fieldwork, the borrower was delinquent on all eight of his FHA loans outstanding--seven were for the recreational project. As of September 26, 1969, unpaid principal and interest on the eight loans totaled about $85,000.

NEED TO REQUIRE BORROWERS TO MEET LOAN APPROVAL CONDITIONS BEFORE RECEIVING GOVERNMENT FUNDS

FHA instructions require that loans not be closed until the loan applicant has met all loan closing conditions. Contrary to this requirement, FHA made recreational loans to three individuals who did not meet certain of FHA's loan closing conditions. One example follows.

A borrower in New Mexico received an FHA loan totaling $54,500 in January 1968 to finance the development of a girls summer camp. As a condition to closing the loan, FHA required the borrower to sell 25 horses. The county supervisor established this condition after making an analysis of the borrower's financial records. The analysis indicated that the large number of horses maintained by the borrower was the cause of the borrower having an adverse financial position. The FHA State office and county office determined that the sale of 25 horses was necessary to ensure the financial feasibility of the recreational project and repayment of the loan.

At the time FHA closed the loan, the borrower had not sold the horses and at the time of our fieldwork, the borrower had increased the size of the herd. He was also delinquent on two annual loan installment payments to FHA.

LOANS MADE TO BORROWERS WHO APPEARED INELIGIBLE FOR FHA LOANS

The Consolidated Farmers Home Administration Act of 1961 (7 U.S.C. 1921) provides that loans be made only when FHA determines that a loan applicant is unable to obtain sufficient credit elsewhere to finance his actual needs at reasonable rates and terms. FHA instructions provide that such determinations be made by the county supervisor before a loan applicant is considered eligible for FHA assistance.

FHA instructions provide also that a loan applicant must, after receiving a farm operating and/or farm ownership loan, become an operator or owner-operator of an adequate or less than adequate family farm. An adequate family farm is defined by FHA as a farm of sufficient size and productivity to enable a farm family to have a reasonable standard of living. The farm must be managed by the family and the labor must be primarily furnished by the family.

On the basis of these instructions, it appears that four of the borrowers included in our review were ineligible for recreational loans. Two examples follow where loans were made under two different situations even though the borrowers' eligibility appeared questionable.

Example 1

In May 1969, FHA made a $30,000 recreational loan to a borrower in the State of Arkansas. The borrower's application showed that he owned property valued at $97,175, had total debts of $23,400 and a net worth of $73,775. In view of this borrower's substantial net worth, it appears that he should have been able to obtain financing from other sources.

The only documentation in the FHA loan file indicating that the borrower was unable to obtain financing from another source was a letter from the Federal Land Bank stating that it did not make loans to finance recreational projects.

Example 2

FHA made farm operating and farm ownership loans totaling $175,640 to two brothers for farming purposes and to finance the development of a recreational project in the State of Virginia. Of the $175,640, FHA records show that $135,000 was used for the recreational project, which consisted of cabins, campsites, and hiking and horseback trails.

At the time both brothers requested FHA loan assistance in April 1965, they owned adjacent farm land in the State of Virginia but only one of the brothers was farming his land. The other brother, who was not farming his land, resided and worked in the State of Delaware.

In September 1965, the Administrator, FHA, authorized the FHA State Director in Virginia to approve the loans subject to the State office assuring itself that the loans be made to eligible applicants who would continue to farm as well as operate the recreational project. FHA records did not include any information, however, to show that the State Director had assured himself that the one brother, who resided and worked in the State of Delaware, would operate his farm and the recreational project jointly with his brother in Virginia after the FHA loans were made.

At the time we completed our fieldwork in 1970, the one brother was still residing and working in Delaware. FHA records show the brothers received a total of $175,640 of loan funds as follow.

Loans	Date	Amounts Brother (Delaware)	Brother (Virginia)	Total
Operating	12/13/65	$17,500	$17,500	$ 35,000
Ownership	4/13/66	60,000	58,000	118,000
Operating	5/ 5/67		3,640	3,640
Operating	7/28/67	8,500	8,500	17,000
Ownership	1/ 8/69		2,000	2,000
Totals		$86,000	$89,640	$175,640

CONCLUSION AND RECOMMENDATION

Conclusion

We believe that there is a need for closer adherence to existing FHA instructions by county and district supervisors in making recreational loans to individuals. FHA instructions for the making of recreational loans appear to be adequate regarding the procedures for (1) preparing annual farm and home plans, (2) closing loans, and (3) determining the eligibility of applicants for FHA assistance. The procedures should be followed and loans should not be closed until determinations have been made that recreational loans are financially feasible, credit is not available elsewhere, and applicants are eligible for the loans.

Recommendation

We recommend that the State office officials be required to take necessary action to see that (1) realistic farm and home plans are prepared, (2) loan closing conditions are met before Federal funds are disbursed, and (3) adequate determinations are made regarding the eligibility of loan applicants.

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We wish to acknowledge the cooperation your field staffs have extended to our representatives. We would appreciate being advised of the action you plan to take on our recommendation.

Copies of this report are being furnished to the Inspector General, Department of Agriculture.

Sincerely yours,

G. W. Berry for
Bernard Sacks
Assistant Director

Mr. James V. Smith, Administrator
Farmers Home Administration
Department of Agriculture