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COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

MARCH 3, 1980

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The Honorable Norman D. Shumway
House of Representatives

Dear Mr. Shumway:

Subject: Farmers Home Administration: Emergency Loan Processing Procedures in Stanislaus County, California (CED-80-64)

Your letters of September 10 and 24, 1979, regarding the Emergency Loan Program administered by the Farmers Home Administration (FmHA), Department of Agriculture, asked us to determine whether the loan processing regulations governing the awarding of loans under the program contain deficiencies which permit abuses or inappropriate use of taxpayers' dollars. As later agreed, we limited our audit of the emergency loan processing regulations to loans the Stanislaus County, California, FmHA office made.

Our objective was to determine if the emergency loan applicants were given consistent treatment in accordance with FmHA regulations governing the program and to note any deficiencies in the regulations or procedures used by the Stanislaus County FmHA office.

We reviewed all emergency loan applications received at the Stanislaus County office in fiscal year 1979 and discussed the loan processing procedures with the FmHA County Supervisor and FmHA officials at the State and national offices. We also talked with two of the three private citizens who served on the FmHA county committee in Stanislaus County during the time the loan applications were processed.

BACKGROUND

The FmHA Emergency Loan Program is administered by FmHA county offices located throughout the United States. The program's basic objective is to provide financial assistance

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to farmers after they have sustained severe losses as a result of a disaster. For disasters occurring before October 1, 1978, the FmHA State Director could declare a county a disaster area when it was estimated that less than 25 farmers were affected. In those cases where it was estimated that 25 or more farmers were affected, a disaster declaration by the Secretary of Agriculture was required.

The disasters in Stanislaus County occurred before October 1, 1978, and it was estimated that more than 25 farmers were involved; therefore, a Secretary of Agriculture declaration was necessary. Starting in fiscal year 1979, however, the County Supervisor was authorized to make emergency loan funds available for disasters occurring after September 30, 1978, when at least one farmer sustained losses. This eliminated the need to obtain a Secretary of Agriculture disaster declaration.

To be eligible for an emergency crop production loss loan, the applicant must have suffered a loss of at least 20 percent in a crop considered essential to the success of the total farming operation. Additional eligibility criteria are listed on pages 9 and 10.

Once an applicant qualifies for a crop production loss loan, FmHA can make additional emergency loans to cover annual operating expenses during the disaster year and for 5 successive years 1/ following the disaster. Further, emergency major adjustment loans can be made for several purposes, including amounts necessary to reorganize the farm without substantially increasing the size of the predisaster operation. These loans are often used to refinance existing debts. The interest rates and repayment periods vary by type of loan. The rates shown on the next page were in effect during the time emergency loan applications were being processed in Stanislaus County.

1/In November 1979 FmHA proposed legislation which will limit to 2 the number of successive years a borrower can obtain emergency annual operating loans.

Types of emergency loans	Interest rates	Customary repayment period
	(percent)	(years)
Crop production loss	5	7
Annual operating (note a)	9	1
Major adjustment (note b)		
Real estate purposes	9	40
Operating purposes	9-1/2	40

a/Effective November 1, 1979, the interest rate for annual operating loans increased to 10-1/2 percent.

b/Effective November 1, 1979, the interest rate for major adjustment loans for real estate purposes increased to 10 percent and for operating purposes the rate increased to 10-1/2 percent.

The County Supervisor is authorized to approve emergency loans for amounts up to $400,000; however, loans in excess of this amount but less than $1.5 million must be approved by the FmHA State Director. Loans above $1.5 million must be approved by the FmHA Administrator.

In December 1978 the Secretary of Agriculture authorized the processing of emergency loans in Stanislaus County by issuing a disaster declaration. The declaration authorized FmHA to make emergency loans for qualifying crop losses suffered during periods of excessive rains in February, March, April, and September 1978. According to the County Supervisor, there are about 4,000 farming operations in Stanislaus County.

In fiscal year 1979 the FmHA county office processed 27 emergency loan applications for this disaster. Three applicants were ineligible and four withdrew their applications. Twenty farmers received loans totaling $4.7 million. Of this total, $1.2 million was for emergency crop production loss loans, $200,000 was for emergency annual operating loans, and $3.3 million was for emergency major adjustment loans. In Stanislaus County the largest loan was for $1.5 million, while the average loan size excluding the above loan was about $171,000.

STRONGER EMERGENCY LOAN PROCESSING PROCEDURES NEEDED

Emergency loan files at the Stanislaus County FmHA office showed that the applications were processed without giving preferential treatment to any applicant. However, we noted four areas where stronger loan processing procedures are needed. The areas involve major adjustment loans, crop loss calculations, crop loss documentation, and loan applications.

In November 1979 FmHA proposed a number of regulation changes designed to strengthen the Emergency Loan Program. As a result, the loan processing procedures are being revised. Further, in December 1979 a House and Senate Conference Committee approved legislation to phase out emergency loans for major adjustment purposes. Our comments on the proposed revisions are included where they relate to the issues discussed in this report.

Major adjustment loans made for nondisaster-related purposes

Although emergency loans are not limited to the amount of the actual loss sustained as a result of a disaster, they are limited to the amount the borrower needs to overcome financial difficulties caused by the disaster. (See H.R. Rep. No. 94-211, p. 12 (1975).) Also, the FmHA regulation states that emergency major adjustment loans may be made to sustain the operation and to overcome the financial difficulties caused by the disaster. To be consistent with the law this must mean loans may not be made for amounts greater than what is needed to recover from the damage caused by the disaster. However, the amount of the major adjustment loans has not always reflected this. The loans sometimes include amounts necessary to solve problems that existed prior to the disaster.

In Stanislaus County about 70 percent of the emergency funds were for major adjustment loans. Thirteen of the 20 emergency loan recipients received major adjustment loans. The interest rate for these loans was either 9 or 9-1/2 percent and all the loans were made for 40 years. The loans were used almost entirely to refinance existing debts. The debt refinancing loans are made when private lenders are unwilling to extend additional credit at rates and terms the applicant can meet.

In some cases a small crop production loss provides the basis for obtaining a large emergency major adjustment loan. In nine cases the amount of the major adjustment loan was several times larger than the production loss loan. Four examples are shown below.

Crop production loss loan	Major adjustment loan
$ 4,000	$ 26,000
23,000	417,000
46,000	1,415,000
54,000	371,000

In these examples the disaster created an environment in which the farmer was able to obtain the funds to solve a number of financial problems, not just those resulting from the disaster. The Stanislaus County Supervisor and the Director of the Emergency Loan Division at the national office believe this is a common practice not limited to Stanislaus County and is an appropriate use of emergency funds when it is determined the farmer has a reasonable chance to succeed if given assistance. According to the Stanislaus County Supervisor several farm operations may have failed if this approach had not been taken.

Applying the above FmHA reasoning dilutes the requirement in the law that the borrowers have the "experience and resources necessary to assure a reasonable prospect for successful operation with the assistance of such loan." If FmHA makes emergency loans large enough to assure successful operation, then anyone with some experience would meet the above test. In effect FmHA is ensuring that applicants meet the test instead of using the test to determine their eligibility. If applicants do not have resources necessary to assure successful operations with the assistance of a loan based on financial difficulties caused by the disaster, they should not be eligible to receive an emergency loan.

FmHA makes available a number of loan programs designed to provide assistance to farmers who are experiencing financial problems resulting from a variety of causes. These programs should be used when applicable. The applicants' eligibility should be determined based on the criteria for the individual program, rather than using the emergency loan program as a vehicle through which to provide assistance to overcome financial difficulties resulting from a variety of nondisaster-related causes.

We therefore believe that making emergency major adjustment loans to help alleviate problems that existed before the disaster, and thus not caused by the disaster, is an improper use of emergency loan funds. It involves an overly broad interpretation of the law and FmHA's own regulation which states that major adjustment loans may be made to overcome financial difficulties caused by the disaster.

In December 1979, a House and Senate Conference Committee approved legislation that will phase out the emergency major adjustment loans by fiscal year 1983. A ceiling of $1.5 million per loan has been proposed for 1980, and this will be reduced by $500,000 each year until it drops to zero by 1983.

Procedures for determining qualifying crop losses need to be strengthened

The FmHA procedures for calculating qualifying crop losses reward the less efficient farmers. Farmers may determine normal year yields either by using established county averages for each crop or by using their own records for prior year yields. The farmers can use the method that is most advantageous to them--that is, the method that gives the higher normal year yield.

The percentage of disaster year crop loss is the difference between the yield per acre harvested during a normal year and the yield per acre during the disaster year. Therefore, the higher the normal year yield the farmer can report, the higher will be the percentage of loss for the disaster year.

When a farmer's actual yield per acre in prior years is less than the county average, the county figures are used. This results in a higher percent loss for the disaster year and permits the farmer to obtain a larger loan than otherwise.

We noted several loans that were made based on county averages even though available data showed that the farmer had not achieved the county averages in the past. For emergency loan purposes this procedure rewards the less efficient farmers who do not produce the average yields by putting them on an equal basis with the more efficient farmers who achieve the averages. The impact of this procedure is that FmHA is making loans to farmers who possibly would not qualify if they were required to use their actual yield figures. Further, those farmers who would qualify by using their actual yield figures can use the county figures to achieve an even higher percentage loss. The net result in both cases is that the Government can make crop production loss loans for amounts exceeding the losses suffered by the farmers.

According to the FmHA County Supervisor and the Director of the Emergency Loan Division at the national office, the use of county averages simplifies loan processing procedures by eliminating the need to go back and recreate actual crop production figures for prior years. They believed this would be time consuming for both county office personnel and farmers since few farmers keep good records. Further, it would be unfair to deny a loan because the applicant did not have adequate records. However, when it is common knowledge that certain farmers in the community are less efficient and consistently produce below the county average yields, the FmHA County Supervisor in Stanislaus County believes he, together with the county committee, should have the option of establishing a normal yield figure for the farmer which realistically reflects actual crop yield.

One of the actions proposed by FmHA in November 1979 could possibly affect this issue in a positive manner. Specifically, the proposal would require that crop production loss loans be limited to the amount of the loss or the amount <u>needed</u> to continue normal operations, <u>whichever is less</u>. This will not change the procedures for determining crop losses, and thus will not affect the applicant's ability to meet the qualifying loss standard or to show a higher percentage loss. It will, however, permit FmHA to reduce the crop production loss loan amount to that which it determines the applicant <u>needs</u> rather than making a loan for the entire amount of the calculated crop loss.

<u>More documentation is needed to support crop losses</u>

We found little documentation in the loan files to support the claimed amount of disaster year crop loss. The regulations require only that the applicant certify that the accuracy and completeness of the information provided can be supported by written records. Fifteen of the 20 farmers who received loans were unable to provide written documentation in support of their crop loss; therefore, FmHA accepted the farmers word about the size of the loss.

Without a requirement for supporting documentation the farmers can report an inflated crop loss figure and receive a federally subsidized 5-percent crop-production-loss loan for more than the loss suffered. This review did not include a detailed examination to determine if and how frequently this occurs; however, based on the results of a previous audit in five other States, we reported (CED-79-111, Aug. 6, 1979) cases of farmers inflating disaster loss figures to increase the size of the loan for which they qualified. According to the FmHA County Supervisor he would know if a farmers' reported loss was "out of line" with the losses suffered in the rest of the county, and if so, the county staff would take the necessary steps to verify the figures.

The proposed action discussed in the prior section could influence this issue since a properly implemented test to determine the applicants actual <u>needs</u> could reduce the reliance which must be placed on the crop loss estimates provided by the applicant.

More complete financial data needed with some applications

Lack of complete financial data on one loan applicant resulted in the FmHA county office staff spending several hundred hours attempting to accumulate and verify basic financial data which should have been provided with the initial application. This situation could have been avoided had the County Supervisor required the applicant to provide complete financial information, and in this case, an audited financial statement before processing the loan application further.

FmHA regulations permit County Supervisors to obtain information adequate to process the loan application which can include an audited financial statement. A requirement for a financial statement would be time consuming and unreasonable for the vast majority of applicants who are small farmers. However, when the applicant is an individual with a large farming operation and other nonfarm interests, FmHA should be aware of the total financial status of the applicant before approving the loan. Commercial banks already require similar statements.

In the above case, a total picture of the applicants' financial status was not available for nearly 6 months following receipt of the initial application. Although incomplete and unaudited statements were provided, at no time during this period did the applicant submit an audited financial statement or information adequate for FmHA purposes. During this time, county office personnel spent many hours attempting to obtain an accurate understanding of the applicants financial situation. County office personnel estimate that in this case it took nearly seven times the typical 42 staff hours to process the application, much of which was due to incomplete financial data.

Although this was an isolated case, it points out the time-consuming problems that occur when an application is not properly documented. We believe that early identification of such cases and subsequently requiring complete financial data would assist in the timely processing of applications.

Role of the county committee in reviewing emergency loan applications

The FmHA County Supervisors are periodically reassigned to new counties and therefore may not be entirely familiar with local farming practices, crops, financial institutions, and agriculture-related business in the county. This was the case with the County Supervisor in Stanislaus County. County committees consisting of three members who reside in the community and who are familiar with these matters are available to provide advice to the County Supervisor on these matters. Committee members are selected by the FmHA State Director from a group of three candidates recommended by the County Supervisor and local citizens and organizations interested in the FmHA programs.

The committee is responsible for reviewing all emergency loan applications to determine if an applicant can be certified eligible for a loan. To certify that an applicant is eligible the county committee determines that the applicant

--is unable to obtain credit elsewhere;

--is a U.S. citizen;

--is an established farmer doing business as an individual, partnership, cooperative, or corporation;

--operates in an area determined to be eligible for emergency loans for actual losses;

--has sustained qualifying production losses;

--possesses the legal capacity to contract for the loan; and

--possesses the training and/or experience, character, managerial competence, ability, and industry necessary to carry out the farming operation to assure a reasonable prospect of success.

When applicants are certified eligible by the county committee, the applicants are notified by the County Supervisor, and loan processing continues. In those cases where the committee is unable to certify an applicant, the applicant is notified by the County Supervisor and given an explanation why certification is not possible. The applicant is also informed of the procedures available for appealing the decision.

During fiscal year 1979, the Stanislaus County committee was unable to certify four applicants eligible for emergency loans. Three of the applicants were determined ineligible because of their ability to obtain credit from commercial sources. These applicants did not appeal the decision. The county committee determined that the fourth applicant was ineligible due to a lack of managerial control over the farming operations. The applicant appealed this decision to the FmHA State Director who recommended the loan be approved because the committee was unable to provide adequate evidence that the applicant lacked managerial control of the farming operation. The State Director did acknowledge that a number of poor management decisions had been made, but that it was not unusual in such a large operation. Prior to loan closing, however, the applicant withdrew the loan application.

According to FmHA the county committee is an important and necessary element in the loan review process. The officials also noted that it is unusual for a county committee decision to be overruled, and it is not a desirable action as it tends to detract from the important role of the county committee.

CONCLUSIONS

The Stanislaus County FmHA office processed emergency loan applications in a consistent manner and without giving preference to any applicant. However, certain loan processing procedures need to be strengthened to ensure that the amount loaned accurately reflects the amount of the loss resulting from the disaster.

In Stanislaus County emergency major adjustment loans did not always reflect just the funds needed to recover from the damage caused by the disaster. They also included amounts to help alleviate problems that existed before the disaster. The FmHA County Supervisor and the Director in the Emergency Loan Division, FmHA, believe this is a common practice and not limited to the Stanislaus County office. Furthermore, they believe it is an appropriate use of emergency funds if the farmer has a reasonable chance to overcome the financial problems because of the assistance. We disagree and believe that using emergency loan funds to assist in solving financial problems not caused by the disaster is improper and that loans should be made to overcome only the financial difficulties caused by the disaster. In December 1979 a Senate and House Conference Committee approved legislation which will phase out the emergency major adjustment loans entirely by fiscal year 1983.

The procedures for calculating normal year crop production reward the less efficient farmers by permitting them to use county average figures to achieve a higher percentage loss even when available data shows the farmer has not in the past achieved the county averages. In addition, applicants are not required to provide documented support for the claimed amount of disaster year crop loss. This can result in inflated crop loss figures being reported. As a result of these two factors, loans are sometimes made for production losses which exceed the amount of the actual crop loss. However, an administrative action proposed by FmHA would limit crop loss loans to the actual dollar loss or the amount needed to sustain normal operations, whichever is less. This will reduce the reliance which is placed on the estimates used to determine the amount of crop loss.

Incomplete information on the financial status of an applicant can result in the FmHA staff spending a great deal of additional time processing an application. FmHA regulations permit the County Supervisor to obtain all financial information needed to process the loan application. On one application we reviewed, the staff needed nearly 6 months to develop the total picture of the applicants' financial status. The FmHA County Supervisor said that this situation could have been avoided if he had required the applicant to submit an audited financial statement before processing the loan application.

RECOMMENDATION TO THE
SECRETARY OF AGRICULTURE

Although the Congress is taking steps to phase out the emergency major adjustment loans, they will still be available at some level until 1983. Further, since the practice of making major adjustment loans for amounts in excess of the loss caused by the disaster is improper and not limited to Stanislaus County, we recommend that the Secretary direct the FmHA Administrator to inform County Supervisors that emergency major adjustment loans are to be limited to the amounts needed to overcome difficulties caused by the declared disaster. We also recommend that the County Supervisors be directed to obtain information adequate to support loan applications.

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At your request, we did not obtain written agency comments on the matters discussed in this report. As arranged with your office, unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days from the date of the report. At that time we will make copies available to others upon request.

Sincerely yours,

Henry Eschwege

Henry Eschwege
Director