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GAO

Report to Congressional Requesters

June 1986

# FARMERS HOME ADMINISTRATION

# Federally Acquired Farm Property Presents a Management Challenge

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GAO

**United States**
**General Accounting Office**
**Washington, D.C. 20548**

**Resources, Community, and**
**Economic Development Division**

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June 13, 1986

The Honorable Thad Cochran
Chairman, Subcommittee on
Agriculture and Related Agencies
Committee on Appropriations
United States Senate

The Honorable Edward Zorinsky
United States Senate

The Honorable Thomas F. Eagleton
United States Senate

The Honorable David L. Boren
United States Senate

The Honorable Alan J. Dixon
United States Senate

Your April 26, 1984, joint letter expressed concern about the large number of farms that the Farmers Home Administration (FmHA) had acquired as a result of loan foreclosures and other actions. You requested that we examine FmHA's management of this farm property and the procedures used to sell or lease the property. This report summarizes our findings on these issues and provides several recommendations to the Secretary of Agriculture for improving FmHA's management and sale of farm properties in inventory.

As arranged with your office, we are sending copies of this report to appropriate House and Senate Committees; interested members of Congress; the Secretary of Agriculture; and the Director, Office of Management and Budget. Copies will also be made available to other interested parties who request them.

J. Dexter Peach

J. Dexter Peach
Director

# Executive Summary

## Purpose

The Department of Agriculture's (USDA) Farmers Home Administration (FmHA) has become one of the largest farm landlords in the United States. The estimated number of farm properties in FmHA's inventory increased from less than 300 in December 1979 to about 4,000—valued at almost $700 million—in October 1985. The combined acreage of these properties is greater than the land area of Rhode Island. The Chairman, Subcommittee on Agriculture and Related Agencies, Senate Committee on Appropriations, and five other Senators asked GAO to review this situation. Specifically, GAO addressed the following questions:

- Why has this dramatic increase occurred?
- What is the financial impact on the government?
- How well is FmHA managing these properties?

To answer these questions, GAO reviewed 206 FmHA farm inventory properties in six states (including 77 that had been sold) and projected the results to a universe of 1,270 properties in those states.

## Background

FmHA serves as a "lender of last resort" to farmers and is the federal government's primary provider of farm credit. When a farmer receives an FmHA loan, he/she must sign a note promising loan repayment and provide collateral, such as farm property, as security. If the farmer is unable to make loan payments, FmHA must take some action to protect the government's financial interest. This action may include acquiring the borrower's loan collateral and selling it to recover the unpaid debt. FmHA policies provide that once acquired, collateral should be managed to preserve its value and sold promptly.

## Results in Brief

A number of interrelated factors have led to the dramatic increase in FmHA's property inventory. They include continued farm failures, a depressed farm real estate market, and FmHA policies that include a moratorium on the sale of some inventory properties and restrained selling efforts on other properties.

GAO projects that FmHA will lose about $190 million on the 1,270 properties in the six states reviewed. These losses will occur primarily because the value of the acquired properties will be less than the defaulted-borrowers' unpaid indebtedness and the cost of acquiring, managing, and selling the properties.

Until recently, FmHA has made minimal efforts to manage its farm properties. In addition, while in inventory, most properties GAO reviewed were leased and used to grow price-supported commodities that are in over-supply.

## Principal Findings

### Increase in FmHA Inventory

Farmers fail financially—leading to FmHA acquisition of their farm properties—for a variety of reasons. Pinpointing a particular cause for failure is difficult and oftentimes judgmental. Although a poor agricultural economy has contributed to farm failures, FmHA records and county office personnel indicated that for 57 percent of the properties acquired, borrowers failed because of poor farming/financial practices or personal problems—not low crop prices or other economic factors such as high interest, inflation, and the decline in farm real estate values. This situation could change, however. GAO has noted in other reviews that as much as half of FmHA's farm loan portfolio is in danger of default, and future failures may be increasingly related to economic factors rather than poor farming/financial practices. (See ch. 2.)

FmHA initiated sales moratoriums on inventory properties in various states aimed at reducing the effect FmHA property sales could have on an already depressed farm real estate market. The moratoriums have contributed to the increased inventory by reducing property sales. In addition, FmHA reserves farm properties up to 3 years for purchase only by farmers eligible to participate in FmHA loan programs even though most sales of reserved properties occur within 1 year. Lengthy reservation of inventory properties limits their sales potential and increases government management costs.

Sales potential was also limited by minimal FmHA efforts to sell inventory properties. Unsold properties averaged 16 months in inventory as of January 1985 yet were advertised an average of 6 days or less. Less than one quarter of the properties were listed with realtors. (See ch. 4.)

### Inventory's Financial Impact

The 1,270 inventory properties in the six states reviewed cost FmHA about $374.3 million to acquire and maintain while providing a projected $184.6 million in revenue, mainly from property sales. Most of this projected loss of about $190 million is due to (1) undersecured loans that resulted in part from a nationwide decline in the value of farm assets and (2) FmHA loan-servicing policies that allow the agency to place its lien in a secondary position to obtain other lenders' financing for its borrowers. (See ch. 3.)

## FmHA Property Management

FmHA regulations state that the value of properties in inventory should be preserved to protect the government's financial interest. For the six states in GAO's review, estimated annual property management expenditures totaled $790,000—a minimal amount relative to the total value of the properties. FmHA recognized that this level of funding was inadequate to preserve a property's value and in June 1985 revised its property management regulations, which will likely increase management expenditures to maintain property values and also result in higher sales income.

FmHA frequently leases its properties while in inventory. GAO projects that FmHA, in awarding these leases, allowed about 70 percent of the leased properties to be used to grow crops subject to federal price-support and/or reduced-production programs. Although various USDA programs attempt to reduce the oversupply of certain crops, FmHA policy does not prohibit growing these crops on its leased land. (See ch. 5.)

## Recommendations

GAO makes several recommendations to the Secretary of Agriculture aimed at improving FmHA's selling efforts for inventory property, reducing the time that reserved properties are held for sale to only FmHA-eligible farmers, and prohibiting farmers from growing surplus crops on FmHA-leased properties. (See chs. 4 and 5.)

## Agency Comments

USDA agreed with the intent of GAO's recommendations and said the report's observations will assist FmHA to better manage its farm inventory properties. However, USDA said it plans no immediate action on prohibiting farmers from growing surplus crops on FmHA-leased lands, citing the relatively small impact such a restriction would have on the surplus production problem. Instead, the Department plans to assess the possible economic effects of a restriction should the amount of FmHA inventory property increase substantially in the future. GAO realizes that the total farmland currently in FmHA inventory is relatively small when compared with all U.S. farmland. However, in GAO's opinion, this does not diminish the fact that current FmHA leasing practices directly conflict with other USDA programs aimed at reducing the production of surplus crops. (See ch. 5.)

# Contents

## Chapter 5
## FmHA Has Taken Steps to Improve Its Property Management



## Appendixes



## Tables

## Figures



### Abbreviations

| | |
|---|---|
| DCI | data collection instrument |
| ERS | Economic Research Service |
| FmHA | Farmers Home Administration |
| GAO | General Accounting Office |
| OIG | Office of Inspector General |
| RCED | Resources, Community, and Economic Development Division |
| USDA | U.S. Department of Agriculture |

# Introduction

American farmers have been experiencing the worst financial pressure they have encountered since the Depression. In March 1985 the U.S. Department of Agriculture (USDA) estimated that 7 percent of all farms were technically insolvent or had extreme financial problems, following a farm-income decline of 44 percent[1] from the 1970's. Factors causing this income decline included a worldwide recession, a strong U.S. dollar value, a rise in real interest rates, and an abundant supply of agricultural commodities in foreign and domestic markets. As their incomes have declined, many farmers have been unable to make payments on farm loans from lenders, including USDA's Farmers Home Administration (FmHA).

FmHA makes direct loans (government-funded) and guarantees some loans made by private lenders primarily to family farmers[2] who are unable to obtain credit from other lenders at reasonable rates and terms. As such, FmHA serves as a "lender of last resort" to farmers and is the federal government's primary provider of farm credit. The Consolidated Farm and Rural Development Act (7 U.S.C. 1921-1996) authorizes FmHA to provide credit through several farmer loan programs. These programs provide or guarantee loans for farm ownership, operating expenses, and soil and water resource improvements. FmHA loans are also provided for emergency expenses incurred as a result of natural disasters. In addition, from August 1978 through September 1984, FmHA was authorized to provide economic emergency loans to farmers experiencing a credit shortage or reduced income in a time of increased costs.

As of June 30, 1985, FmHA's farmer loan portfolio included over 270,000 borrowers with more than 750,000 outstanding loans valued at more than $27.7 billion. Primary responsibility for delivering FmHA financial services to these farmers rests with FmHA's approximately 1,900 county offices.

FmHA, along with other agricultural lenders, has been negatively affected by the decline in farmers' financial status. One major negative impact is a significant increase in the number of farm properties FmHA has acquired because borrowers' farm operations failed. Section 335 of

[1] This calculation is based on data contained in The Current Financial Condition of Farmers and Farm Lenders, USDA-ERS, Agricultural Information Bulletin, No. 490, March 1985. The percentage reflects a change in annual average net farm income between the two base periods of 1970-1979 and 1980-1983 for constant 1967 dollars.

[2] A family farm is one that can be operated and managed by one family, which performs a substantial portion of the labor. The farm may be operated by an individual, partnership, corporation, or cooperative.

the Consolidated Farm and Rural Development Act (7 U.S.C. 1985) authorizes and empowers FmHA to acquire, preserve, manage, and dispose of property securing FmHA loans. FmHA estimates that its inventory increased from 288 properties in December 1979 to 2,095 properties in March 1984 and 3,969 properties in October 1985. The October 1985 inventory (see app. III) was valued at almost $700 million and represented about 1.1 million acres, or more than the land area of Rhode Island. FmHA's ownership of farm property ties up a significant amount of government funds and results in increased government management expenses. It also enhances a public perception that many farmers are losing their land and homes to the government.

## Why FmHA Acquires Farm Property

When borrowers' farm operations fail, FmHA acquires and then attempts to sell farm property to recover all or some of the loan funds it is owed. The acquisition and sale of a borrower's farm property is intended to minimize FmHA's losses and protect the government's interest. FmHA regulations for acquiring property require that the revenue FmHA expects to receive from the sale of an acquired property should, at a minimum, exceed the costs FmHA incurs in acquiring, managing, and selling the property. If acquired property costs exceed revenue, FmHA would incur additional expense without reducing unpaid loan funds and thus add to its losses.

FmHA has the legal right to acquire farm property because a farmer who receives an FmHA loan must sign a note promising loan repayment and provide collateral, such as farm property, for security. Farmers who receive farm ownership and emergency loans often provide real estate as collateral; those receiving operating loans often provide livestock or crops as collateral.

The borrower's promissory note specifies repayment terms. If the borrower does not make payments according to the note's terms, FmHA considers the loan delinquent. The dollar amount of delinquent FmHA farmer loans increased dramatically from June 30, 1980, to June 30, 1985, growing from $0.8 billion, or 5 percent of FmHA's outstanding farmer loans, to about $6.4 billion, or 23 percent of the $27.7 billion in outstanding farmer loans. As of June 30, 1985, about 97,500, or 36 percent, of FmHA's approximately 270,000 farmer program borrowers had delinquent loans. Farm ownership and operating loans accounted for 6 and 15 percent, respectively, of the $6.4 billion delinquent loan amount, while natural disaster emergency and economic emergency loans accounted for 61 and 17 percent, respectively. Soil and water loans accounted for the remaining 1 percent of the delinquent loan amount.

When a borrower becomes delinquent, FmHA will eventually take some action to protect the government's interest. Such action may lead to acquiring the collateral. However, before acquiring collateral, FmHA attempts to help farmers pay their loans by offering such services as additional loans, payment adjustments, and financial counseling. During fiscal year 1985, the agency provided these services to over 29,000 farmers. FmHA further assisted about 16,000 farmers through a debt set-aside program initiated during fiscal year 1985. When such services cannot keep a borrower in operation, FmHA may choose to minimize its losses by acquiring and selling the borrower's property.

## How FmHA Acquires Farm Property

FmHA acquires properties primarily through (1) voluntary conveyance and (2) foreclosure, or forced liquidation, usually by other lenders. FmHA estimated that of the 3,969 farm properties in its inventory in October 1985, 2,064, or 52 percent, had been acquired by voluntary conveyance; and 1,548, or 39 percent, had been foreclosed on by other lenders. FmHA had foreclosed on the remaining 9 percent, or 357 properties.

In acquiring property through voluntary conveyance and foreclosure, FmHA pays other creditors to remove their claims or liens against the borrower's property title. A property title free of liens is usually needed for FmHA to sell the property. Creditors paid by FmHA to remove liens may include banks, for unpaid borrower loans; county governments, for unpaid property taxes; and individuals, for unpaid property purchase contracts (contracts for deed). FmHA considers the amounts of these liens in its decision as to whether revenue from acquired property will exceed costs. If FmHA decides not to acquire the property, other creditors may foreclose, acquire, and sell the property. If a foreclosing lender's lien is primary, or prior, to FmHA's, that lender is not obligated to pay any portion of FmHA's lien on the property.

### Voluntary Conveyance

In voluntary conveyance, FmHA accepts the borrower's voluntary transfer of the property title. If the borrower's debt to FmHA is more than the property's value, the borrower continues to be indebted to FmHA for the difference. However, FmHA may, and often does, release the borrower from further liability for the unpaid debt. In bankruptcy proceedings, FmHA may also accept the conveyance of property from a borrower's bankruptcy trustee.

When property is voluntarily conveyed, FmHA normally pays other creditors having unpaid loans secured by the property to remove their liens and allow clear title transfer to FmHA. FmHA prefers voluntary conveyance as an acquisition method because it avoids some costs, such as additional legal fees, and additional time-consuming procedures involved with forced liquidation.

## Forced Liquidation

While FmHA generally does not force the liquidation of borrowers' property, other lenders, such as commercial banks, often initiate foreclosure to satisfy unpaid loans the FmHA borrowers owe them. Foreclosure results in the forced sale of the property used as security, with the proceeds being applied to the debts owed secured creditors in lien position order. FmHA may determine that it is financially advantageous to bid for the property at the foreclosure sale. If it is the successful bidder, FmHA pays prior secured creditors to obtain a clear property title.

FmHA initiates foreclosure after all other possibilities—loan servicing, other lender liquidation, or voluntary conveyance—have been exhausted. It forecloses when it believes that the revenue generated by the property's sale will help offset FmHA losses or when failure to foreclose would adversely affect the FmHA loan program as an example of nonenforcement of obligations. If the proceeds from the forced sale do not fully satisfy the borrower's debt to FmHA, FmHA may take legal or administrative collection actions to recover the balance. However, as with voluntarily conveyed property, FmHA may, and often does, relieve the borrower from further liability for the unpaid loan balance.

# Objectives, Scope, and Methodology

In April 1984 the Chairman and Ranking Minority Member of the Subcommittee on Agriculture and Related Agencies, Senate Committee on Appropriations, and the Ranking Minority Member and three other members of the Senate Committee on Agriculture, Nutrition, and Forestry asked us to examine FmHA's management of farm inventory property and the procedures FmHA used to sell or lease this property. The senators, who said they were concerned about the increased number of FmHA inventory properties, said that they believed that the Congress never intended that FmHA become a big farm landlord. They asked us to review the inventory situation and provide them with recommendations on management improvements or policy revisions to protect the taxpayers' and FmHA borrowers' interests. (See app. I.) We focused our work on obtaining information on

- why FmHA borrowers' operations failed, causing their properties to come into FmHA inventory;
- why the FmHA farm property inventory had grown;
- what the federal fiscal impact had been of FmHA's inventory property activities;
- what FmHA does to sell inventory property; and
- how FmHA manages and leases inventory property.

Nationwide summary information on FmHA's farm property inventory was generally limited to FmHA tabulations of properties acquired, sold, and in inventory. Thus, to answer the above questions, we reviewed individual properties and borrower files at the county level. In deciding which properties to review, we selected six states—Kansas, Missouri, Minnesota, Wisconsin, Tennessee, and Georgia—which, at the start of our review, had 33 percent of all FmHA farm properties in inventory. As of October 1985 this percentage had not changed.

In selecting individual properties for review, we used a two-stage cluster sample methodology. Cluster sampling involves defining items in sample groups such as FmHA county offices. Using this methodology we initially selected six FmHA county offices per state on a random basis and with a selection probability proportionate to the number of inventory properties per county. Therefore, county offices with a larger number of properties had a greater selection probability than those with fewer properties.

For the second stage, we selected for detailed review those properties either in inventory or sold as of a specific date during the period May through August 1984. Because FmHA inventory data were not available as of a common date at the state level, the specific dates were June 18 for Kansas, July 20 for Missouri, August 31 for Minnesota, June 1 for Wisconsin, May 9 for Tennessee, and June 30 for Georgia. At each county office, we categorized the properties as either "sold," "in inventory," or "partially sold" (a parcel of the property had been sold). We reviewed up to five properties in each category. If a category had more than five properties, we randomly selected five for review. This resulted in our reviewing a total of 206 properties from a universe of 255 in the selected county offices. Of the 206 properties, 77 had been sold, 115 were in inventory, and 14 had been partially sold at the time of our review. Appendix IV lists the county offices sampled and the number of properties reviewed.

We developed a standardized data collection instrument (DCI) to gather information on FmHA's acquisition, management, and sale of our sampled inventory properties. We filled out the DCIs during reviews of borrowers' files and discussions with county officials. To help ensure the accuracy of information gathered, we reviewed completed DCIs with an FmHA county official, usually the county supervisor. Our use of DCIs allowed us to gather uniform information for the 206 sampled properties. Using appropriate statistical formulas, we summarized, weighted, and projected results from the DCIs to the 1,270 FmHA property universe in the six states we reviewed. The projected results, calculated at the 95-percent confidence level, are used in the following chapters. We also calculated the sampling error for the statistical estimates that are relevant to the main issues of this report. These estimates and their associated sampling errors are contained in appendix VII.

To determine the general primary and secondary reasons why borrowers' operations had failed and their properties had come into inventory, we reviewed FmHA borrower files for the 206 sampled properties and interviewed county officials. A general reason, such as personal problems, may have included specific problems, such as divorce or poor health. Since FmHA county officials were usually familiar with the borrowers' operations, we obtained their concurrence on the designations of the primary and secondary reasons for failures. Borrower problems were often complex and had several interrelated aspects that, in our opinion, made the designation of a primary and secondary reason difficult and somewhat judgmental.

To compute FmHA's actual or potential gain or loss for each of the 206 properties, we used financial data in the borrower files and an imputed interest cost that we computed. Imputed interest represents the government's cost for borrowing funds that would otherwise be available if FmHA inventory properties were sold for cash immediately after acquisition. We computed this cost by multiplying the acquired property's appraised value by an interest rate for the time the property was in inventory. We based the interest rate on the government's cost of borrowing as reflected in the monthly average yields for constant maturity, 1-year Treasury notes during the time period individual properties were in inventory. The inventory time period we used was the number of days from FmHA acquisition until (1) the property was sold or (2) January 1, 1985, a uniform ending date. (See app. V.)

To develop information on FmHA's acquisition, management, and disposition of farm properties, we interviewed FmHA officials at the national office in Washington, D.C., and at FmHA state and county offices in the states reviewed. During the interviews at the county and state offices, we also obtained additional specific information on properties in inventory. In addition, we visited 111, or about 54 percent, of the 206 properties to observe property conditions.

Our work also included a review of documents relating to FmHA's legal authority and the exercise of that authority. These documents related to FmHA's property acquisition, management, and disposal and included public laws, federal regulations, legislative history, and FmHA instructions, announcements, and directives. In addition, we gathered information on how property was managed by the Department of Housing and Urban Development and the Veterans Administration. Although this information increased our understanding of property management, the policies and procedures followed by these agencies were not applicable to FmHA's management of farm properties. We coordinated our review work with USDA's Office of Inspector General (OIG) and reviewed OIG audit reports on FmHA farmer programs.

We made our review from August 1984 to December 1985 and in accordance with generally accepted government auditing standards. To the extent practical, we obtained updated or supplemental information through April 1986.

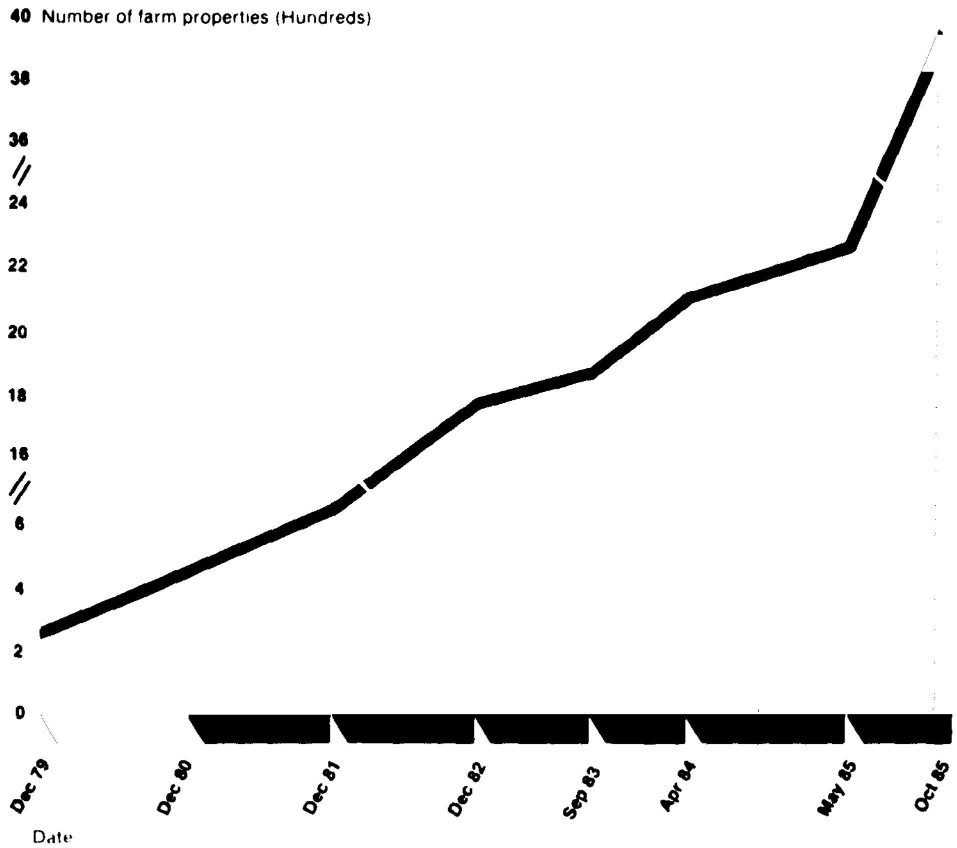
# Increased Property Inventory Caused by Farm Failures, Market Factors, and FmHA Policies

FmHA's farm property inventory has increased dramatically as a result of an increased number of farm failures, a depressed farm real estate market, and FmHA property sales moratoriums declared in response to declining land values. Because of these conditions, FmHA's farm property inventory increased almost fourteenfold from an estimated 288 in December 1979 to an estimated 3,969 in October 1985. (See fig. 2.1.)

FmHA's October 1985 inventory would likely have been greater, except that FmHA has exercised restraint in liquidating borrower accounts and has provided delinquent borrowers additional financing, financial counseling, and payment adjustments to keep them operating. In addition, borrower legal actions taken against FmHA have slowed property acquisition, particularly by FmHA foreclosure. In the six states we reviewed, borrowers whose operations had failed and whose properties had been acquired by FmHA usually failed financially because of poor farming practices, poor financial practices, or personal problems.

FmHA's farm inventory properties may increase significantly during 1986 and 1987 because on November 1, 1985, FmHA announced a delinquent borrower servicing policy that is less liberal than the previous policy. The policy was changed because of the deteriorating condition of FmHA's farm loan portfolio. FmHA also issued regulations that set forth new procedures for the supervision of delinquent and problem-case farm borrowers that could increase FmHA-initiated foreclosures. FmHA has estimated that if agricultural economic conditions do not improve, its farm property inventory could double in 1986 and again in 1987. FmHA's Assistant Administrator for Farmer Programs told us that by the end of that 2-year period, the agency may be the largest single holder of farm property in the United States with an inventory of over 20,000 farm properties.

Figure 2.1: FmHA-Estimated Number of Farm Properties in Inventory




## Most Farm Operation Failures Caused by Poor Management and Personal Problems

The financial failure of an FmHA borrower's farm operation is the prelude to a property's coming into FmHA inventory. Such failure can result from one or more of a number of reasons. Of the 1,270 farm properties in the six review states, we project that over half were acquired by FmHA when poor management (poor farming or financial practices) or personal problems caused farm operation failure, according to FmHA records and county office personnel. Although a poor agricultural economy caused a decline in farmers' income and contributed to farm failures, poor economy was not the primary reason that most of the borrowers' farm operations failed, according to the FmHA records and officials. Low commodity prices and other economic factors (high interest rates, decline in land values) were projected as the primary reasons for borrower failure in only 7 and 9 percent of the 1,270 properties, respectively.

On average in the six states, borrowers who failed had been financed by FmHA for a projected 5.5 years before their properties were acquired. FmHA initially financed about 78 percent of the failed borrowers in the six states between 1975 and 1980 when a large number of farmers were expanding operations and farm incomes were relatively high. When the agricultural economy turned downward in the 1980's, many FmHA borrowers with poor financial practices, poor farming practices, personal problems, or heavy indebtedness went out of business, resulting in FmHA's acquisition of their properties. FmHA acquired about 96 percent of the 1,270 properties in the six states from 1982 through 1984. Because FmHA is the lender of last resort, its borrowers' operations represent a greater risk and have a higher failure probability than farm operations financed solely by private lenders.

Figures 2.2 and 2.3 summarize the primary and secondary reasons for borrowers' farm operation failures as projected to our universe of 1,270 properties. Because borrower problems were often complex and interrelated, we relied on documentation in FmHA borrower files and judgments of county office personnel to designate primary and secondary reasons. The reasons are stated in general terms, some of which cover more specific reasons. For example, poor farming practices include inadequate care of livestock or crops; poor financial practices include excessive personal debt or improper use of loan funds; personal problems include poor health or divorce; other economic factors include high interest rates, inflation, or decline in land values; and other reasons include diverse reasons such as borrower's death or poor cropland.

Figure 2.2: Primary Reasons Borrowers Failed

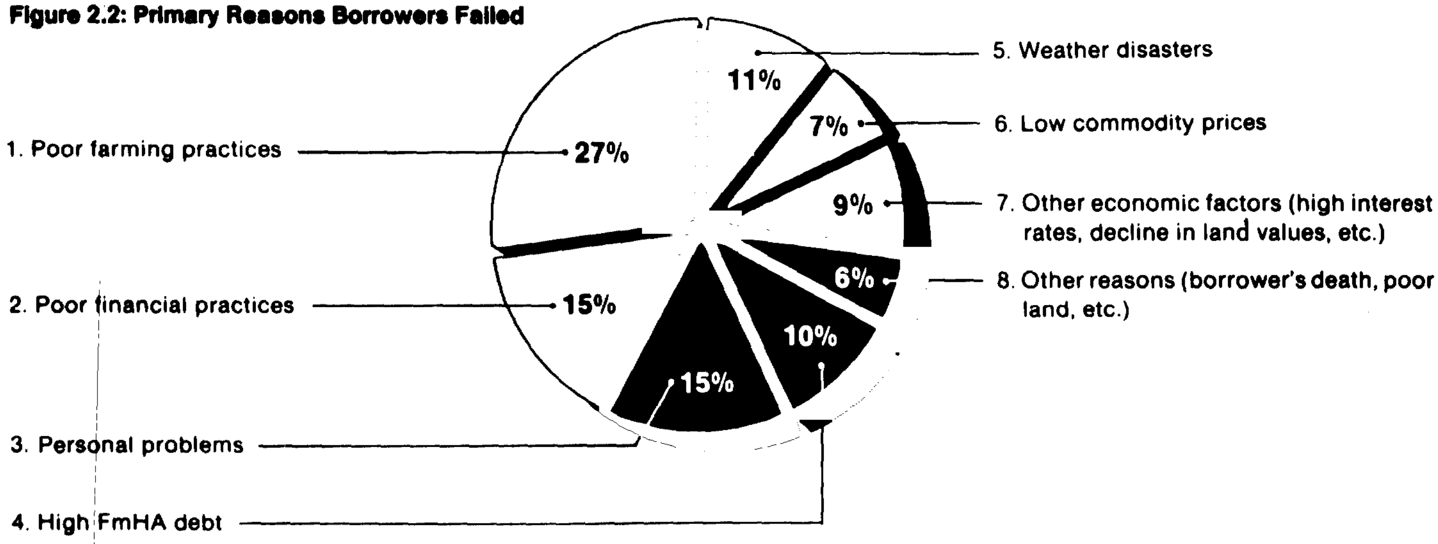
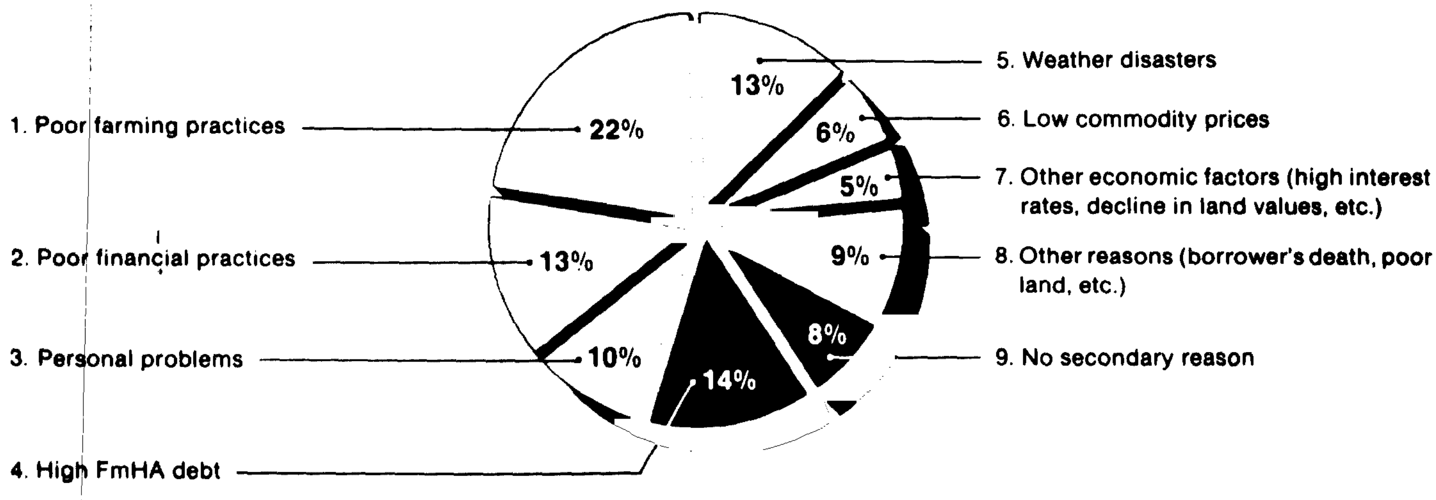



Figure 2.3: Secondary Reasons Borrowers Failed




## Poor Farming Practices

FmHA county officials and FmHA records indicated that poor farming practices, such as inadequate care of livestock or crops, were the most frequent primary and secondary reasons for borrower failure—347 of 1,270 cases, or a projected 27 percent, and 285 of 1,270 cases, or a projected 22 percent, respectively. Poor farming practices often result in decreased farm income. Two instances in which FmHA determined that poor farming practices led to borrower failure follow:

- FmHA provided a $42,310 farm ownership loan for a Wisconsin borrower's 160-acre, 40-cow dairy operation in 1977. Using additional FmHA financing, in 1980 the borrower expanded his operation with additional land and livestock but then began having problems managing the operation. FmHA file documents indicate the borrower was not completing necessary farm work and not properly caring for the dairy cows. Many cows died and milk production dropped. During the period 1980 through 1982, the borrower became delinquent on FmHA and other loans. The borrower filed for bankruptcy in April 1982, and FmHA acquired the property through voluntary conveyance by a bankruptcy trustee in August 1983.
- In 1980 FmHA provided a $113,000 economic emergency loan for a 1,135-acre livestock partnership operation in Missouri. A farm visit by FmHA in 1981 disclosed that the borrowers were not operating as planned when the loan was approved, causing an inadequate cash flow. Crops had not been planted and livestock not marketed as set forth in the borrowers' operating plan provided to FmHA. Actual acreage planted was 55 percent of that planned. In 1981 the borrowers listed the farm for sale. After reviewing the operation in early 1982, FmHA concluded that the farm operation should be liquidated because sufficient income could not be generated to make loan payments and pay the interest. FmHA acquired the property in May 1983 after a bank foreclosed.

## Poor Financial Practices

Poor financial practices were cited in 194 (15 percent) and 166 (13 percent) of the projected cases as the primary and secondary reasons, respectively, for farm operation failure. Instances of poor financial practices included excessive personal debt, improper use of loan funds, and improper sale of loan collateral. A case in which loan collateral was sold without FmHA approval follows:

- In 1975 FmHA provided a $17,000 farm ownership loan and a $41,000 operating loan for a borrower's 160-acre dairy operation in Minnesota. During the period 1980 through 1983, the borrower sold, without FmHA authorization, about half his dairy cattle that were collateral for FmHA loans. The borrower obtained private financing to obtain new cattle to replace the sold cattle, but the financers repossessed the new cattle in 1982. As a result, the dairy farm had only half its former production capacity. The borrower stopped farming in late 1982 and voluntarily conveyed the property to FmHA in August 1983.

## Personal Problems

Personal problems were also a frequent cause of FmHA borrower failure and were projected in 15 percent of the cases as a primary reason (192 cases) and 10 percent as a secondary reason (127 cases). Circumstances categorized as personal problems included poor health, divorce, or medical problems. An instance in which a personal problem was the primary reason for failure follows:

- FmHA financed a Georgia borrower's 258-acre poultry and egg operation in March 1980 with a $141,000 farm ownership loan and an $8,790 disaster emergency loan. During 1981 the borrower moved to North Carolina for treatment of alcoholism. Since the borrower was maritally separated from his wife, no one was left to manage the farm. The borrower's mother hired an individual to manage the farm, but it was not well run. The firm contracting to purchase the borrower's eggs notified FmHA in 1982 that it could not continue with the egg contract because of the poor situation caused by the borrower's absence. In September 1983 FmHA obtained title to the property after a bank foreclosed.

## Excessive FmHA Debt

Another reason frequently provided for borrower failure was excessive FmHA debt. FmHA officials and records indicated this was a primary reason for failure in 124, or a projected 10 percent, of the 1,270 cases, and a secondary reason in 179, or a projected 14 percent, of the cases. In these cases, borrowers became too indebted to repay loan funds provided by FmHA. FmHA's loan policies are discussed further in this chapter and in chapter 3. Often FmHA provided these loans under the economic emergency and emergency disaster programs. The case of a borrower whose farm operation failure was primarily attributed to excessive FmHA debt follows:

- In 1975 FmHA provided a $60,000 disaster emergency loan to a Tennessee farmer for production of soybeans and wheat. The farmer owned 28 acres and rented additional acreage. FmHA provided additional disaster emergency loans from 1976 to 1979 and in 1982, resulting in a total outstanding principal amount of $618,160. At the beginning of 1982, the yearly payment due on these loans was $110,705. However, the farmer's operating plan showed he expected a $3,667 cash loss from his farm operations for that year. FmHA viewed the borrower's situation as hopeless and acquired the property in April 1983 through foreclosure.

## Weather Disasters

Weather disasters, such as drought, hail, or excessive rain, constituted another prominent cause of failure, being the primary and secondary reasons in 146, or 11 percent, and 161, or 13 percent, of the projected cases, respectively. Adverse weather can reduce crop production and farm income. A case in which weather was the primary cause for failure follows:

- In 1979 FmHA provided a $98,000 economic emergency loan to a Kansas farmer to finance operation of a 305-acre farm where livestock (beef cattle and hogs) and crops (corn, soybeans, and hay) were raised. In the summer and fall of 1980, severe drought reduced crop yields, and the borrower suffered an estimated $34,000 loss. In 1981 he received two emergency disaster loans, totaling about $80,000, for operating funds and a bank debt reduction. When a 1982 crop failure also adversely affected the borrower, other lenders would not continue the financing. The borrower voluntarily conveyed the property to FmHA in May 1984.

## Low Commodity Prices and Other Economic Factors

Low commodity prices and other economic factors combined were given as the primary failure cause for 195, or about 16 percent, of the projected cases and the secondary failure cause for 143, or 11 percent, of the cases. Low commodity prices include low prices for crops and livestock and other economic factors include high interest rates, inflation, and declining land values. A case in which low livestock prices were cited as the primary failure reason follows:

- In 1980 FmHA provided a Missouri farmer with an $84,000 farm ownership loan and the farmer also assumed FmHA farm ownership loans having a total principal amount of $53,000. The borrower's farm consisted of 318 acres on which he raised several types of crops (soybeans, corn, and wheat) and hogs. Low hog prices were responsible for the borrower's delinquency on his farm ownership loan in 1983, according to FmHA. The borrower decided to sell part of his hog herd in 1983 and in early 1984 decided to quit farming and voluntarily convey his farm to FmHA.

# Farm Real Estate Market Conditions Have Been Depressed

FmHA's inventory of farm properties has been increasing while the agricultural economy and the average value of farmland have been decreasing. Across the nation, many farms have been offered for sale while the demand for farm properties has been limited. FmHA has been in the unenviable position of obtaining properties with falling values and few buyers. These poor real estate market conditions have contributed to keeping FmHA properties in inventory and prompted FmHA sales moratoriums.

During the period February 1981 to April 1984, the USDA index of average value per acre of land and buildings in 48 states (1977 = 100) dropped about 8 percent (from 158 to 146).[1] This decline continued, and in June 1985 USDA reported that from April 1984 to April 1985 the index dropped from 146 to 128, or another 12 percent. This 1-year decline was more than the aggregate decline from February 1981 to April 1984. The largest yearly index decline, 19 percent, occurred in 1933 during the great economic depression. The national averages, however, do not reveal the significantly greater property-value declines in certain states. From February 1981 to April 1985, the indexed average per acre value of farm real estate dropped from 150 to 77, or 49 percent, in Iowa; from 151 to 82, or 46 percent, in Nebraska; and from 160 to 90, or 44 percent, in Ohio.

In the six states we reviewed, the indexes of property values declined sharply from February 1981 to April 1985. (See table 2.1.)

**Table 2.1: Indexed Property-Value Declines in Six Review States**

| State | Farm real estate value index[a] Feb. 1981 | April 1985 | Percent of decline |
|---|---|---|---|
| Georgia | 139 | 116 | 17 |
| Tennessee | 146 | 127 | 13 |
| Missouri | 165 | 102 | 38 |
| Kansas | 137 | 98 | 28 |
| Wisconsin | 179 | 126 | 30 |
| Minnesota | 179 | 109 | 39 |

[a]Index based on USDA surveys of average value per acre. The 1977 base year equals 100.

The value of the FmHA inventory properties either sold or projected to be sold in the six states we reviewed had dropped 16 percent from an average acquisition price of about $143,000 to an average selling price of about $120,000 after being in inventory about 1 year.

[1] Agricultural Land Values, Outlook and Situation Summary, USDA-ERS, June 7, 1985.

## FmHA Has Placed Moratoriums on Inventory Property Sales

Since August 1984 FmHA has placed two moratoriums on the sale of farm property in inventory. The moratoriums, which varied in duration and geographical coverage, were to minimize any depressing effect FmHA property sales might have on already rapidly declining farm property values. These moratoriums contributed to FmHA's increased farm property inventory by suspending property sales while additional properties were being acquired.

FmHA's Administrator announced a temporary nationwide moratorium on inventory property sales on August 15, 1984, in response to the Secretary of Agriculture's directive to carefully review the handling of farm inventory properties. The specific directed actions included

- suspension of sales efforts where offers had not been accepted in writing,
- notification of real estate brokers having listing agreements with FmHA that property sales would be suspended until an analysis of farm real estate market conditions was completed, and
- an analysis of farm real estate markets by FmHA district directors to determine whether property sales would put downward pressure on farm real estate values in their districts.

After the FmHA district directors completed their evaluations of market conditions, the states were notified by the FmHA National Office during late October and early November 1984 if sales should be resumed. Most of the evaluations showed that sales of FmHA property would not devalue surrounding farm property. However, resumption of sales was prohibited in 79 counties in 20 states where FmHA officials believed that FmHA property sales would depress farm real estate values. (See app. VI.)

About 2 months later, a December 18, 1984, FmHA directive suspended all sales of farm inventory properties in nine states—Iowa, Minnesota, Missouri, Kansas, Illinois, Nebraska, North Dakota, South Dakota, and Wisconsin. The action was taken "to minimize any adverse effects that sales of farm inventory property, by FmHA, could have on farm real estate values." Forty-three counties in 6 of the 9 states had been among the 79 counties still subject to the previous sales suspension. The three states without such counties were Illinois, North Dakota, and Wisconsin. According to FmHA officials, the second moratorium was required because of severely stressed agricultural conditions, including several bank failures, in those states. In December 1985 the Secretary of Agriculture was directed by the Food Security Act of 1985 (Public Law

99-198) not to offer for sale or sell any farmland that will have a detrimental effect on the value of area farmland. The December 1984 moratorium was still in force as of April 1986. According to FmHA officials, they plan to review the further need for the moratorium at various times during 1986.

In the six states we reviewed, FmHA county officials told us that the sales moratoriums were the reason that 510 inventory properties had not been sold. In the nine moratorium states, the number of farm properties in inventory increased at a rate that was 55 percent greater than the increase in all other states. Inventory properties in states with a sales moratorium increased from an estimated 649 in December 1984 to an estimated 1,555 in October 1985 as compared with an estimated increase of 1,301 properties to 2,414 properties over the same period for the rest of the nation.

## Two Factors Slowed Increase in Farm Property Inventory

Two factors—legal actions taken against FmHA and FmHA's liberal loan-servicing policy—have worked to slow the increase in FmHA's farm property inventory. A May 1983 federal district court decision, Coleman v. Block, 562 F. Supp. 1353, halted FmHA's ability to foreclose until final regulations on borrower appeal alternatives were issued. These regulations were issued November 1, 1985. In addition, FmHA avoided foreclosure on many delinquent borrowers through adoption of a policy from February 1982 through November 1, 1985, that allowed FmHA to provide additional operating financing without a borrower's showing the ability to repay prior debt. FmHA adopted this continuation policy to assist farmers in dealing with existing farm credit conditions, believing that the policy was representative of the agency's mission to sustain agricultural production and provide credit to farmers who are unable to finance their operations through commercial and private credit sources.

### Legal Actions Against FmHA Slowed Property Acquisition

Between November 1981 and May 1983, FmHA borrowers filed several lawsuits challenging, among other things, FmHA's implementation of foreclosure actions. The most significant of these lawsuits, in terms of FmHA's property inventory, was Coleman v. Block, which caused FmHA foreclosure actions to be suspended and slowed FmHA's acquisition of farm property after November 1983.

The Coleman v. Block suit was initiated by nine North Dakota farmers in May 1983 as a class action. The suit originally affected FmHA borrowers in all but six states where similar suits were already pending.

One of the main issues raised in Coleman v. Block was that FmHA's appeals process for delinquent borrowers was inadequate because the borrowers were frequently unaware of their rights. In November 1983 the judge hearing the case issued a preliminary injunction that precluded FmHA from foreclosing or requesting voluntary conveyance of property until borrowers were informed of their right to apply for a loan deferral and provided an opportunity for an appeals hearing as called for in FmHA regulations. In February 1984 the court ordered the preliminary injunction to be made permanent.

In December 1983 FmHA issued temporary instructions to comply with the injunction. These instructions postponed acquisition actions until borrowers had been notified of various available appeal alternatives. Borrowers were notified of these alternatives by a pretermination notice sent by FmHA. In a December 1984 directive, FmHA retroactively suspended the use of pretermination notices, effective October 1984, because of complaints about the "temporary" regulations' extended use. The suspension stopped FmHA foreclosure action on borrowers not previously notified under the temporary regulations. In November 1984 FmHA published proposed regulations in the Federal Register (49 Fed. Reg. 47007), setting forth procedures that were substantially the same as the temporary regulations using the pretermination notice. These regulations were published in final form on November 1, 1985, (50 Fed. Reg. 45739) and subsequently challenged in court by a group of farmers. In March 1986 the judge that heard Coleman v. Block and the challenge to the November regulations refused to overturn the regulations but did order FmHA to provide borrowers additional appeal options.

Under the new regulations and FmHA directives issued February 3, 1986, FmHA is expected to send loan-servicing notices to about 65,000 borrowers who were over $100 delinquent on December 31, 1985. Borrowers who have not made any payments on a loan or loans within the past 3 years will be sent a "Notice Of Intent To Take Adverse Action." This notice advises the borrower that if the listed violation(s) is not corrected, FmHA intends to require immediate full payment of the account or foreclose. Borrowers have 30 days to respond to the notice. An accompanying servicing action notice, however, allows borrowers to request various appeal or servicing actions such as modifying or deferring loan payments or selling loan security to bring the loan account current. For borrowers that are less seriously delinquent, FmHA will also send a servicing option notice but not an adverse action notice. Borrowers receiving these notices are asked to contact FmHA within 30 days for loan-servicing advice.

## FmHA's Liberal Loan-Servicing Policy Slowed Inventory Increase

FmHA had avoided the forced liquidation of many delinquent borrowers' operations as a result of the liberal loan-servicing, or "continuation," policy it adopted in a February 3, 1982, directive. The purpose of this policy was to continue lending money to the majority of FmHA borrowers and slow the number of cases requiring forced liquidation, ultimately slowing the number of properties being placed in inventory. However, as we pointed out in a January 1986 report,[2] the policy also resulted in over half of FmHA's $28 billion farm loan portfolio being owed by borrowers in jeopardy of default. On November 1, 1985, FmHA announced the continuation policy had expired and it would service delinquent accounts in accordance with the new loan-servicing regulations published on that date. The policy was changed because of the deteriorating financial condition of FmHA's farm borrower loan portfolio. However, if agricultural economic conditions do not improve, this change could also result in an increasing number of farm failures due primarily to economic conditions rather than poor farming/financial practices that were indicated during our review.

The February 1982 continuation policy allowed FmHA to provide additional financing to an existing borrower without the borrower's showing the ability to repay prior loans. The policy directive stated that FmHA would continue to work with existing borrowers who, among other things, had "a reasonable chance to repay any new loan for 1982 production purposes plus the interest accruing on that loan." Borrowers were not required to show repayment ability for principal and interest on other existing loans.

In March 1983 USDA's Office of Inspector General issued an audit report[3] stating that FmHA loan-making policies had resulted in additional loans to borrowers who could not repay prior indebtedness and had little or no chance of repaying existing production (operating and emergency) loans.

In responding to that report, FmHA's Administrator justified this policy by stating

> "The Agency's objective in adopting the 1982 policy, and it continues to be the Agency's objective, was to continue with the vast majority of our borrowers and to spread out the number of cases requiring legal action or forced liquidation over a

[2]Farmers Home Administration: Financial and General Characteristics of Farmer Loan Program Borrowers (GAO/RCED-86-62BR, Jan. 2, 1986).

[3]Farmers Home Administration, Emergency Loan Program, Debt Management for Delinquent Borrowers (Washington, D.C.: Audit Report 04-638-2-At, Mar. 31, 1983).

period of several years, taking action first on the most seriously delinquent and hopeless problem case borrowers. If the Agency had taken a firm stand against all of its delinquent borrowers and had forced a large number of those borrowers out of business over a relatively short period of time, it would have driven down the value of real estate and chattel security for FmHA as well as other agricultural lenders. This would not only have caused a further downturn in the agricultural economy, but would also have aroused political concerns which might very well have resulted in legislation mandating the Agency to temporarily cease all foreclosure actions, provide moratoriums on loan payments, forgive principal and interest or mandate other unsound credit management policies.... We agree with OIG that the February 1982 policy has resulted in FmHA continuing with borrowers, in some cases, who are seriously delinquent and may not be able to work their way out of their financial problems. However, we believe the policy is within the legislative intent of the Consolidated Farm and Rural Development Act, and is representative of the Agency's mission to sustain agricultural production and provide credit to farmers who are unable to finance their operations through commercial and private credit sources."

FmHA has continued to finance borrowers who are severely delinquent. In a January 1986 report,[4] we noted that as of June 1985, about 97,500, or about 36 percent, of FmHA's 270,000 farmer program borrowers were delinquent and $4.8 billion, or about 75 percent, of the total delinquent outstanding principal and interest had been delinquent for over 3 years. According to FmHA, borrowers who have not made loan payments for over 3 years are extremely high risk and will probably fail. FmHA estimated that it had 17,000 borrowers in this delinquency category who had loans secured by real estate. FmHA expected these properties to end up in the agency's inventory.

## Conclusions

FmHA's inventory of farm properties has increased for a variety of interrelated reasons, including the general poor economic condition of agriculture. However, the majority of FmHA borrower farm failures and subsequent acquisitions of property occurred because of borrowers' poor farming and financial practices as well as personal problems, according to FmHA records and officials. Had it not been for legal actions that prohibited FmHA from foreclosing on farm property and the agency's efforts to help struggling farmers by implementing a liberal loan servicing policy, the inventory would likely be much higher.

[4]Farmers Home Administration: An Overview of Farmer Program Debt, Delinquencies, and Loan Losses (GAO/RCED-86-57BR, Jan. 2, 1986).

Unfortunately, the financial condition of the agricultural sector in general and farmers who are financed with FmHA loans in particular continues to deteriorate. The expiration of the liberal loan-servicing policy that helped farmers to continue over the past several years has resulted in a backlog of severely delinquent borrowers and a large number of farm loans that are highly susceptible to default. These borrowers' properties may dramatically increase FmHA's inventory as the agency implements a more stringent loan-servicing policy. This policy will likely curtail financing of some delinquent borrowers thereby increasing the rate of FmHA foreclosure actions. According to agency estimates, its farm property inventory could exceed 20,000 properties by the end of 1987.

# Large Financial Losses Are Projected From FmHA Inventory Property Sales

Although FmHA usually has recovered some of the defaulted borrowers' unpaid principal and interest by acquiring and selling their properties, we estimate that FmHA will lose about $190 million on the 1,270 inventory farm properties in the six states we reviewed. This amount includes actual losses from sold properties and projected losses on properties still in inventory as of January 1, 1985. The losses were due mainly to (1) the difference between the unpaid principal and interest of $260.0 million and the $171.8 million aggregate value—either the sold price or the most recent appraised value—of the 1,270 properties, (2) FmHA payments of $83.9 million to other lenders with prior liens on inventory properties, and (3) imputed interest costs[1] of $24.9 million. Also included in the estimate are $5.5 million in other costs, such as taxes, legal fees, and management and maintenance costs, and $12.8 million in lease and other income, such as payments from sale of crops or other assets.

For an estimated 9 percent, or 119, of the 1,270 properties, the revenue from selling the property was less than the estimated costs of acquiring and managing the property as well as payments to prior lienholders and imputed interest. Because these costs were greater than revenues, no funds are available to reduce the borrower's unpaid loan balances owed to FmHA. Thus, FmHA incurred or likely will incur additional losses by acquiring the property.

To help prevent the acquisition of properties for which costs exceed revenues, FmHA instructed state office personnel in an August 1, 1985, directive and in October and November 1985 training classes to consider additional factors in their property acquisition decisions. Two of these additional factors are (1) imputed interest and (2) expected changes in property value. Consideration of these factors should help reduce the acquisition of properties whose expected property costs exceed expected revenues.

## Projected Financial Losses Result From Several Factors

FmHA acquires and attempts to sell farm properties to recover unpaid principal and interest owed by borrowers who default on loans. However, even when a defaulted borrower's property is acquired and sold, FmHA losses can be substantial. As of January 1, 1985, we estimate that FmHA's total revenue from the 1,270 projected properties in the six review states will be about $184.6 million while total costs will be about

[1] Imputed interest cost is the government's cost to borrow funds. See app. V for detailed definition and calculation methodology.

$374.3 million—resulting in estimated losses of $189.7 million, or an average of $150,000 per property. In other words, FmHA will not recover about one half, or an estimated 51 cents on every dollar, of unpaid loans and property costs.

## Property Revenue Will Not Equal Property Costs

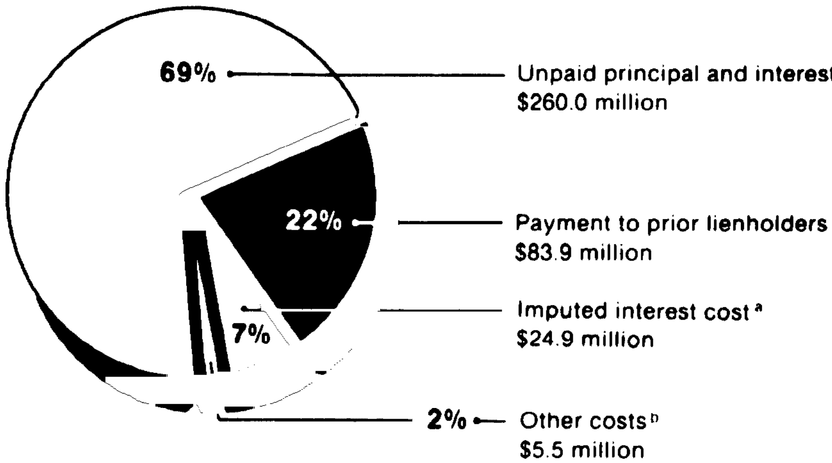
FmHA will obtain an estimated $184.6 million in revenues from the 1,270 projected farm properties in inventory. This revenue consists of $171.8 million obtained from the selling of the properties and $12.8 million in lease and other income such as the sale of farm machinery. However, when the revenues are compared with the total projected costs of $374.3 million, FmHA will recover only about 49 cents on every dollar expended on a failed borrower. These losses occur primarily from the large unpaid loan balances, payments to prior lienholders, and the government's cost of borrowing money to acquire and hold properties (imputed interest costs). These losses also indicate that, on average, the FmHA loans were extensively undersecured by the farm properties at the time FmHA acquired them.

## Unpaid and Undersecured Principal and Interest Represent Major Source of Projected Losses

The largest component of FmHA's projected losses on the 1,270 properties was the cost associated with defaulted borrowers' unpaid FmHA loan principal and interest, which we estimate at $260 million. (See fig. 3.1.) That amount exceeded the properties' projected $171.8 million selling price by $88.2 million, or 51 percent. The $260 million projection includes total unpaid principal and interest on all of a borrower's unpaid FmHA loans, whether secured by real estate or other collateral, at the time FmHA acquired the 1,270 properties. The $171.8 million projected selling price consists of actual selling prices or FmHA's most current appraised value of the property at the time of our review.

**Figure 3.1: Projected Costs for 1,270 Reviewed FmHA Farm Inventory Properties**

Total Projected Costs $374.3 Million




[a] App. V contains an explanation of our method of calculating imputed interest.

[b] Taxes, judgments, legal fees, and management and maintenance costs.

According to the USDA OIG's March 1983 report,[2] FmHA borrower indebtedness was exceeding property value or other security for the loans the OIG audited. This report summarized the audit results on 202 delinquent emergency disaster loans in 31 states. The audit, which focused on borrowers who had received loans in 1982 under FmHA's continuation lending policy (see ch. 2), showed that over half the emergency disaster loans sampled were undersecured by a total of at least $35.8 million. In response to the audit report, the FmHA Administrator stated that "The FmHA was cognizant of the effect the February 1982 policy could have on the soundness of new loans..." and "We now know some unsound loans have been made...."

## Payments to Prior Lienholders Account for Part of FmHA's Projected Losses

Payments to prior lienholders, augmented by FmHA's loan-servicing policy that allows the agency to make its liens secondary to those of other creditors, also contributed heavily to FmHA's projected losses. Prior lienholder payments were made on 924 of the 1,270 properties, totaling an estimated $83.9 million, or 22 percent of FmHA's total projected costs. (See fig. 3.1.) FmHA pays prior lienholders to obtain clear

[2](Washington, D.C.: Audit Report 04-638-2-At, Mar. 31, 1983).

title to a property when the agency is the successful bidder at a foreclosure auction or when FmHA acquires a property by voluntary conveyance.

When prior liens—typically held by commercial banks, federal land banks, or individual contract-for-deed lenders—are satisfied, FmHA obtains clear title and tries to sell the property to recoup the unpaid principal and interest and other costs. If a prior lienholder obtains title through foreclosure, FmHA may not receive any payment on its subordinated lien. The number of lenders holding prior liens on FmHA borrowers' security collateral increased after FmHA implemented a loan-servicing policy that encouraged subordination of FmHA's lien position.

In November 1981 FmHA issued a directive encouraging the subordination of FmHA's liens against the borrower's security to assist farmers in obtaining private lender loans. When FmHA subordinates its lien to that of a private lender, it obtains a secondary claim or lien on the borrower's real estate that is provided as security for both the private lender and FmHA loans. If the borrower's real estate is sold, the private lender's primary lien must be satisfied first before FmHA's second, or subordinate, lien.

The 1981 FmHA subordination directive stated that unfavorable economic conditions would lead to a demand for FmHA farm loans that would exceed the funds authorized for fiscal year 1982. The directive further stated that by subordinating its security interest, FmHA would reduce the impact of government lending on the economy and allow use of other credit sources to meet borrowers' needs for the 1982 crop year. As a result of the directive, the number of borrowers who had loans on which FmHA subordinated its security interest increased from about 5,000 in fiscal year 1981 to 30,000 in 1982 and stayed above 30,000 in each of fiscal years 1983 and 1984. As of September 30, 1985, FmHA had subordinated its security interest on loans for almost 28,000 borrowers during the first 11 months of fiscal year 1985. This policy has substantially increased FmHA's real or potential payments to prior lien holders. The following case illustrates the effect of the need to make payments to prior lienholders as well as the impact of declining land values.

- In 1981 an FmHA borrower decided to quit farming and voluntarily conveyed his Wisconsin dairy farm to FmHA. A commercial bank, however, had the first lien on the property with $24,554 owed on the borrower's mortgage. The borrower's unpaid FmHA principal and interest at that time totaled $224,419 while the property was appraised at $225,000.

FmHA decided to pay the $24,554 unpaid mortgage amount to the prior lienholder in order to obtain title to the property for liquidation. From FmHA's viewpoint, it was in its best interest to acquire the $225,000 property. At that time, FmHA's computation showed that after payment of the bank's $24,554 mortgage and sale of the property for $225,000, FmHA could recoup $200,446 to apply against the $224,419 outstanding indebtedness.

In the above case, the property value dropped in subsequent appraisals; and at the time of our review, the property was still in inventory, valued at $150,000. If the property is liquidated at the $150,000 price, $125,446 rather than $200,446 would be applied to the $224,419 indebtedness.

### Imputed Interest Costs Add to FmHA Projected Losses

Imputed interest—representing the government's cost to borrow funds needed to perform an action—also contributes to FmHA's total projected loss. We estimate that FmHA's imputed interest costs from acquisition until sale or until January 1, 1985, totaled $24.9 million for the 1,270 farm properties in the six states we reviewed. (See fig. 3.1.) We calculated these costs for each property, using the yield on 1-year Treasury notes during the period that FmHA held the property. In calculating the interest cost, we multiplied the property acquisition value by the then-existing Treasury note rate for the period the property was in inventory. We made adjustments for FmHA reappraisal of the property; and if the property was not sold, we used January 1, 1985, as a uniform date to end the interest calculation. (See app. V for a detailed explanation of these calculations.)

## FmHA Will Consider Additional Property Acquisition Criteria to Minimize Losses

In an August 1, 1985, directive and in October and November 1985 training classes, FmHA instructed its state office personnel to consider additional costs and expected changes in property value in their property acquisition decisions. Implementation of the directive and instructions, which were initiated in part as a result of our review work, should help FmHA avoid acquiring properties that are not expected to produce revenue for reducing unpaid loan balances.

### Incomplete Cost Criteria Were Used for Property Acquisition

At the time of our review, FmHA used two basic criteria for acquiring property and paying prior lienholders to obtain clear title. The first criterion applied when property was acquired by voluntary conveyance. For this acquisition method, FmHA regulations directed that prior liens would be paid in full if the government's secured indebtedness would be substantially recovered after payment of the liens.[3] Substantial recovery, however, was not specifically defined in the regulations or further specified by FmHA for use by state and county office personnel.

The second criterion applied when FmHA or another lender foreclosed on a property. In the foreclosure process, FmHA calculated a property bid to be placed at a foreclosure sale. The payment of prior lienholders was a cost factor in determining FmHA's bid. The maximum amount FmHA would bid was the property's current market value or FmHA's gross investment, whichever was less. According to FmHA regulations, gross investment was to include the borrower's secured indebtedness; payment for prior liens; and other costs, such as legal fees and taxes, that must be paid from the foreclosure sale proceeds.[4] This criterion was designed to minimize FmHA's bid at the time of sale, but it did not consider either estimated costs or revenues that would accrue after the property was acquired or any expected change in property value.

FmHA discussed the consideration of additional future property costs in an August 1982 FmHA headquarters memorandum to its field offices on farmer program management and goals. This memorandum, which was effective for about 1 year, suggested that in preparing foreclosure bids, field staff might consider how long the property would be in inventory, the investment cost while in inventory, vandalism, and taxes. This memorandum was not part of FmHA regulations; but on June 7, 1985, FmHA issued revised property acquisition regulations that expanded the cost considerations in decisions to acquire property and pay prior lienholders. FmHA will now accept voluntary conveyance of a borrower's property and pay prior liens only if there will be a substantial recovery on the government's total investment versus recovery on only secured indebtedness.

On August 1, 1985, FmHA issued a directive supplementing its revised property management regulations that stated "with the continued decline in farm real estate values you should use extreme caution in taking farms into FmHA inventory which are subject to prior lien(s)." FmHA state employees were told that before approving the acquisition of property, they should consider the property's current market value; local farmland price trends; prior lien amounts and associated interest;

[3] 7 C.F.R 1955.10(c), (1985).

[4] 7 C.F.R 1955.15(d)(9)(iii), (1985).

and direct costs associated with acquisition, management, and sale of the property.

During FmHA training courses for state office employees held in October and November 1985, these criteria were expanded to include interest accrual (imputed interest). The employees were also told to apply the criteria for acquisitions by both voluntary conveyance and foreclosure. Substantial recovery was not specifically defined during the training course; however, training material directed that

"A thorough, realistic analysis of the cost and income factors related to the acquisition, management and sale of security property must be documented to support a decision [to acquire the property]...."

## Previously Unconsidered Costs

Previous FmHA property acquisition directives did not require that imputed interest costs and expected changes in property value be considered in acquisition decisions even though these factors can affect the revenue available to reduce unpaid indebtedness. For the 1,270 properties in our review states, the estimated annual imputed interest rate averaged 12 percent. On a per property basis, the projected average imputed interest costs were $14,000 per year for sold properties and $17,000 per year for inventory properties (which had a higher average property value than sold properties).

FmHA also incurred certain administrative costs that were not considered in acquisition decisions. These costs, such as caretaker fees and general repair and maintenance costs, are relatively minor because FmHA county office personnel perform most management and selling activities. (See chs. 4 and 5.) Nevertheless, such costs add to the costs against which projected revenues must be compared in acquisition decisions.

Another factor that was not considered in FmHA acquisition decisions was the expected change in property values. As stated in chapter 2, the value of farm real estate dropped a total of 20 percent nationally from February 1981 to April 1985. For our review states, sold properties were in inventory about 1 year, and their FmHA selling price was about 16 percent below their acquisition value. For unsold properties in inventory for a longer time, the projected drop in value will likely be greater when they are eventually sold, if the farm real estate market continues in its depressed state.

When FmHA acquires and sells inventory property, the revenue obtained should exceed any additional incurred costs in order to reduce the defaulted borrower's unpaid principal and interest. On most of the 1,270 properties, FmHA had reduced or can be expected to reduce borrowers' unpaid principal and interest. However, for about 9 percent, or 119, of the properties, the projected costs associated with acquiring and managing the property exceeded the expected or actual property revenues, thus the borrower's unpaid principal and interest would not be reduced. (To determine the revenue amount for each property, we added the property's latest appraised value or selling price and any other revenue obtained, such as lease payments. From this total, we deducted all the costs associated with each property, including imputed interest.)

For another 4 percent, or 46 properties, the estimated amount of money available after the sale of the property to reduce the unpaid principal and interest averaged $1,700 per property as of January 1, 1985. Depending on how long these properties are held, this amount could be less at the time of sale if land values continue to drop and additional imputed interest and management costs are incurred. In each of these 165 cases, FmHA had paid a prior lienholder in order to acquire the property. Since FmHA regulations require a substantial recovery of the government's indebtedness, in hindsight, it would have been better if FmHA had not acquired these properties given the minimal recovery versus the risk of acquiring properties when farmland values were rapidly decreasing.

The following acquisition example illustrates a case where we believe, in retrospect, it would have been better if FmHA had not acquired the property.

- In February 1983 a Minnesota dairy farmer decided to quit farming and offered to voluntarily convey his 365-acre dairy farm to FmHA. The borrower owed about $114,000 to FmHA and about $104,000 to a land contract holder with a lien prior to FmHA's. The property's appraised value was $150,000 in February 1983. FmHA accepted the voluntary conveyance offer in April 1983 and, to obtain clear title, paid the land contract holder about $104,000. The difference between the property's $150,000 value and the $104,000 land contract holder payment at that time was $46,000, compared with the borrower's $114,000 outstanding FmHA debt. In April 1984 the property was reappraised—downward $25,000—to a new value of $125,000. During property acquisition and management, FmHA also incurred about $3,000 in expenses for taxes, judgments, legal fees, and advertising. As a result, the potential amount to apply to the borrower's indebtedness, before considering imputed interest, was reduced from $46,000 to $18,000. The property remained unsold, however, and imputed interest cost calculated for the property totaled about $24,000 as of January 1985. When this cost is considered, the $18,000 available to reduce the indebtedness is eliminated, and FmHA will not benefit from acquiring the property. In fact, FmHA has added to its losses.

## Conclusions

FmHA's losses on its inventory properties have been significant. The continuing decline in farm real estate values, combined with FmHA's liberal loan-servicing policy, has led to unpaid loan balances that were undersecured by the farm real estate that was provided as collateral. To protect its financial interest in acquiring the property, FmHA must make significant payments to prior lienholders to obtain a clear title. These payments, which result from FmHA's subordination of its security interest in the property, have significantly added to FmHA's losses.

Although FmHA has generally reduced its loan losses by acquiring, managing, and selling defaulted borrowers' properties, it previously did not consider expected changes in property values and all prospective management, selling, and imputed interest costs associated with a property in its acquisition decisions. As a result, FmHA acquired some properties that did not or will not return enough revenue to reduce the defaulted borrower's indebtedness or will likely result in a relatively small reduction in the unpaid principal or interest. In retrospect, such properties were not or may not have been worth acquiring given declining farmland values. The number of properties in FmHA's inventory whose sales will not reduce unpaid indebtedness will likely increase if land values continue to drop and additional imputed interest and management costs are incurred.

Under FmHA's revised property acquisition directive and instructions, additional costs associated with inventory properties are to be considered in acquisition decisions. Implementation of the directive and instructions should result in acquisition of fewer properties that do not return enough revenue to reduce defaulted borrowers' unpaid indebtedness.

# FmHA's Restrained Property Selling Efforts Limit Sales Opportunities

Although FmHA regulations require that inventory properties be sold as soon as possible after acquisition, some properties had been kept off the market and the market for others had been limited to certain buyers. Federal law (7 U.S.C. 1985(c)) allows FmHA to reserve properties for sale for up to 3 years if FmHA determines that they are suitable for purchase by persons eligible for FmHA farm loan programs. This limits sales opportunities for those properties. In addition, FmHA's recent moratoriums on selling inventory properties have halted or delayed sales in an already depressed farm real estate market.

For sales efforts that were made, FmHA primarily relied on county office personnel who were also responsible for, and gave priority to, loan processing and servicing. As a result, in the six states we reviewed, only the minimum sales efforts required by statute had usually been made. The county offices had used realtors and property advertising only sparingly in their sales efforts. In some cases FmHA had also allowed defaulted borrowers about 1 year to sell their property before FmHA acquired it, which further delayed FmHA's own sales efforts. The average dollar amount FmHA spent on sales efforts had been minimal in comparison with property values, further reflecting FmHA's restrained selling efforts.

## Some Properties' Market Potential Is Limited by "Suitable" Classification

The sales opportunities for some FmHA properties are limited by reserving them as "suitable" for sale to farmers eligible for FmHA loan programs. Although authorized by 7 U.S.C. 1985(c), reserving properties for up to 3 years limits sales opportunities when eligible borrowers cannot be found to purchase the properties. When FmHA acquires a farm property, the county supervisor recommends whether it should be classified "suitable"—appropriate for purchase by only an eligible FmHA borrower—or "surplus"—not suitable for participation in FmHA farmer programs and available for sale to anyone for farming or other uses. If a property is classified suitable, the law directs FmHA to sell the property expeditiously to an eligible person. If the property is not purchased by an eligible person within 3 years from FmHA's acquisition date, it can be sold to the general public.

The legislative history of 7 U.S.C. 1985(c), enacted August 8, 1961, does not reveal a clear rationale for allowing this reserve period. FmHA officials told us that they believed the purpose of the reserve period was to provide, during times when agricultural real estate conditions were more favorable and properties sold quickly, an adequate supply of suitable properties for family farmers who could not obtain financing elsewhere. We project that about 57 percent of the 1,270 inventory properties in our six review states will be initially classified as suitable.

According to FmHA regulations,[1] properties need not remain classified as suitable for the entire 3 years. At any time during the 3-year period, FmHA may reclassify a property if it sustains physical damage or if a change in economic conditions makes reserving the property for FmHA programs unfeasible. However, FmHA state officials in the six states we reviewed told us that they usually do not reclassify suitable properties as surplus if they do not sell before the end of the 3-year period. In three of the six states, officials usually waited the entire 3 years before reclassifying property. Officials in the other three states said they would reclassify a property only if property conditions change.

In the six states, FmHA initially classified 57 percent, or 729, of the 1,270 projected inventory properties as suitable. Of these 729, 126 had been sold, 400 were unsold, and 203 had been reclassified as surplus as of January 1985. The sold properties averaged 12 months in inventory. The 400 unsold suitable properties had been in inventory over 1 year, with 46 of them in inventory more than 2 years.

The value of classifying property as suitable or surplus was questioned by half the county supervisors we interviewed in 36 FmHA county offices. These 18 supervisors told us that the classifications were not beneficial—they caused delays and restricted flexibility in selling the property. The other half were either in favor of the property classification—16—or neutral—2. The favorable opinions were based primarily on the belief that the suitable designation reserves good properties for eligible buyers.

FmHA's Acting Assistant Administrator for Farmer Programs and FmHA personnel responsible for property management told us that reserving suitable properties allows FmHA to provide farm ownership loan applicants with quality properties. However, they also said that the time allotted to reserve properties for eligible buyers should be reduced to 1 year. In our opinion, reserving properties for 3 years restricts the potential sales market for the properties, and their remaining unsold is expensive considering the imputed interest costs for FmHA inventory properties.

[1] 7 C.F.R. 1955.116(b), (1985).

## Moratoriums Have Delayed Some Sales

FmHA's two sales moratoriums have delayed or postponed sales efforts and have been partially responsible for the increased property inventory. (See ch. 2.) The first moratorium initially halted sales in all states in August 1984, but sales were resumed in October and November 1984 except in 79 counties in 20 states.

The second moratorium declared in December 1984 has virtually stopped sales of inventory properties in nine states, as discussed in chapter 2. During the first 5 full months of the nine-state moratorium, January through May 1985, FmHA acquired an estimated 373 farm properties in the affected states. However, because of the moratorium, FmHA could sell only 44 properties during this period; and these sales occurred only because the sale was in process before the moratorium was imposed or an exception to the moratorium was granted. These 44 farm properties represented about 11 percent of the 391 total FmHA inventory sales made in the nation during the 5 months. These nine states, however, contained 925 farm inventory properties, or about 40 percent of the total FmHA inventory, at the end of May 1985.

## Selling Efforts Were Frequently Minimal and Sometimes Delayed

The efforts FmHA made, through its county office personnel, to sell inventory properties were frequently minimal in the six states reviewed. When FmHA attempted to sell acquired properties, it usually made only the minimum sales efforts required by law. FmHA made little use of realtors and advertising to increase the number of potential buyers for properties, and it spent little on the sales efforts it undertook, especially considering the value of many of the properties and the cost of carrying and maintaining them.

FmHA also delayed its sales efforts for a projected 68 percent, or 867, of the 1,270 properties by allowing delinquent borrowers 1 year to sell their properties before initiating liquidation. We believe many borrowers in the six states reviewed had no incentive to sell because they usually had no equity in the property. These delays may have cost FmHA lost opportunities to sell the property.

### FmHA Sales Efforts Usually Have Not Exceeded Legal Requirements

When FmHA attempted to sell inventory properties in the six states, it usually did little more than required by law. According to 7 U.S.C. 1985(c), real property in FmHA's surplus category is to be offered for public sale by sealed bid or auction as soon as possible; and if no acceptable bid is received, FmHA may sell the property at the best price obtainable by negotiating with interested parties. A public sale is not required for property classified as suitable, but it is to be sold expeditiously to a person eligible for FmHA loan programs. FmHA may use other methods—such as realtors or advertising—to sell surplus or suitable properties, but these are not required by statute. The state director may also authorize the use of other selling methods.

At the time of our reviews in the six states, FmHA had solicited bids, as required by statute, for 80 percent, or 612, of the 766 projected surplus inventory properties on hand. It had not yet solicited bids on the remaining 20 percent because of FmHA's sales moratoriums or other reasons. FmHA had incurred advertising expenses soliciting bids for 458, or 75 percent, of the 612 properties. For 189 of the 766 surplus properties, the FmHA county supervisor had tried to negotiate a sale after a sealed bid or auction failed to sell the property. The following additional sales efforts were made for the 766 surplus properties:

- 22 percent were listed with a realtor;
- 21 percent were advertised in other FmHA county offices;
- 17 percent were advertised for sale (in newspapers, etc.); and
- 13 percent were posted for sale (sign on the property).

For the 392 surplus properties that were sold or that we projected will be sold in the six states, the selling methods that most frequently resulted in sales, according to FmHA county officials, were sealed bid—29 percent, or 115 properties; newspaper advertisements—25 percent, or 99 properties; negotiated sale—23 percent, or 92 properties; and realtors—12 percent, or 49 properties. Once sold, 71 percent, or 279, of these surplus properties were used for the same type of farm operation that they had been used for before FmHA acquisition.

FmHA creates an incentive for buyers to purchase surplus property by providing financing at favorable terms. This financing is available to buyers who are not eligible for FmHA farm loan programs. During the period we reviewed, FmHA could finance the purchase of surplus property at terms of a 5-percent down payment, an interest rate one half of 1 percent above the FmHA operating loan rate, and a repayment period of up to 25 years. No limit existed on the amount financed. In June 1985 FmHA raised the minimum down payment to 10 percent. At the time of our review, the applicable interest rate was the same as that for a standard FmHA farm ownership loan, 10.75 percent. Of the 392 surplus properties sold or projected to be sold, 78 percent, or 305, had been financed by FmHA.

When FmHA tried to sell suitable property, it searched for a buyer that was both eligible for and would be financed through one of FmHA's farm loan programs. Suitable property does not have to be publicly advertised for bids, which was FmHA's most successful sales technique for surplus properties, but it is supposed to be sold, whenever practicable, expeditiously, according to 7 U.S.C. 1985(c). For 60 percent, or 434 of the 729 inventory properties that had been initially classified as suitable, FmHA sales efforts had consisted primarily of contacting eligible borrowers. The other efforts to sell the suitable properties were as follows:

- 38 percent were included on state office listings,
- 34 percent were advertised in the FmHA county office,
- 32 percent had a record or file search made for eligible borrowers,
- 27 percent were advertised in other FmHA county offices,
- 16 percent were posted for sale (sign on the property), and
- 9 percent were listed with a realtor.

According to FmHA county office personnel, the two most successful methods for selling an estimated 126 suitable properties were personal contact of eligible applicants by the county supervisor—39 percent, or 50 properties—and FmHA's being contacted by the buyer—27 percent, or 34 properties. In all cases, buyers of suitable property used the property for the same type of farm operation for which it had been used before FmHA acquisition.

## Limited Use of Advertising and Realtors

Real estate market exposure of FmHA farm properties is important for generating buyer interest and sales. Property advertising by FmHA and listing properties with realtors help provide this market exposure. However, FmHA's advertising efforts fell short of agency requirements. FmHA regulations (7 C.F.R. 1955.122, Jan. 1, 1984) stated that properties not sold after required sales efforts should be readvertised in other publications "to get larger coverage." However, FmHA had incurred advertising costs on only 51 percent of the 1,270 projected inventory properties. Most of these costs were for advertising surplus properties for bid as required by statute. In general, surplus properties were advertised for an average of 6 days and suitable properties for an average of 3 days, whereas all unsold properties had been in inventory an average of 16 months as of January 1, 1985. Thus FmHA was advertising its properties on a very limited basis relative to the amount of time they had been in inventory.

Listing properties with realtors provides additional market exposure, but the extent to which realtors had been used varied by state and reflected the opinions of FmHA state officials who had to approve county offices' use of realtors. County offices had used realtors to try to sell an estimated 22 percent of the surplus properties and 9 percent of the suitable properties in our review states. Officials in four states—Wisconsin, Missouri, Kansas, and Georgia—said that they favored using real estate agents to some extent, because the agents gave properties greater market exposure and relieved the county supervisor of showing properties. In two states—Minnesota and Tennessee—officials were generally opposed to using realtors. They said that realtors are reluctant to search for eligible applicants for suitable properties, that FmHA should not have to pay real estate commissions, and that having properties listed with several realtors through what is termed an "open listing" is of questionable value because such a listing offers little incentive for an individual realtor to advertise the property.

The costs that FmHA had incurred using advertising and realtors to help sell properties were not significant compared with the average property selling price or the yearly imputed interest cost. For the estimated 748 properties sold or in inventory on which FmHA had incurred selling costs (advertising and/or realtor fees), the costs averaged $756 per year per property, compared with the average selling price of about $135,000 and yearly imputed interest costs of about $14,000 for sold properties and $17,000 for inventory properties. (See ch. 3.) FmHA had incurred no selling costs on an estimated 522, or 41 percent, of the 1,270 properties. Of these 522, 395 were suitable properties, which the county supervisors primarily relied on personal contacts to sell.

When we asked FmHA county supervisors about the reasons for the limited inventory sales, they did not include a lack of property exposure—by advertising or realtor—as a main reason. Instead they gave the following reasons why 843 of the 1,270 projected properties remained unsold at the time of our review: (1) FmHA's holding property off the market, 60 percent, or 510 properties; (2) lack of demand for property, 58 percent, or 486 properties; (3) poor property condition, 17 percent, or 143 properties; (4) high interest rates, 13 percent, or 109 properties; and (5) too highly priced, 12 percent, or 100 properties.

## FmHA Sometimes Delayed Sales Efforts by Giving Borrowers Time to Sell

FmHA has not been anxious to acquire farm property and has usually encouraged delinquent borrowers to sell their property, giving them about 1 year, before taking action to acquire the property. FmHA followed this pattern, which serves to delay its sales efforts, for about 68 percent, or 867, of the 1,270 projected properties in our review states. For the remaining properties, either FmHA had not encouraged borrowers to sell (326 properties) or it was unclear if they were encouraged (77 properties). According to FmHA records or officials, about 52 percent of the borrowers (660 of the 1,270 properties) had tried to sell, usually through realtors (387 properties) and personal contacts (222 properties). FmHA ultimately acquired all these properties because the borrowers' selling efforts were unsuccessful.

For about two thirds (840) of the 1,270 properties, the borrowers' debts exceeded their properties' values. Thus, the borrowers had no economic incentive to sell since they would not have received any of the sale proceeds and would still have had to relinquish the property. An example of this situation follows:

- A Kansas FmHA borrower, heavily indebted to FmHA, was told by the county supervisor in August 1982 that obtaining FmHA financing the following year was unlikely. In March 1983 FmHA denied additional financing because the borrower's projected income was inadequate for the expenses. The farm was valued at $240,000, while the unpaid indebtedness to FmHA and another lender totaled over $270,000. Therefore, all sales proceeds would have been applied to the indebtedness. The borrower would not have realized a net financial gain and would have had to give up the property. FmHA encouraged the borrower to try to sell the farm. During an 8-month period, the borrower's selling efforts consisted of contacting his neighbors about buying the farm. FmHA acquired the property by voluntary conveyance in May 1984, about 1 year after the borrower was denied financing.

In situations where borrowers likely will not realize any net financial gain and therefore have little economic incentive to sell, FmHA may have lost opportunities to sell the properties by allowing borrowers to attempt to sell the properties first. FmHA's revised final regulations (50 Fed. Reg. 45739) issued November 1, 1985, direct that borrowers be allowed only 120 days to sell their properties before liquidation action begins.

## Conclusions

A general decline in the demand for farm real estate and FmHA's sales moratoriums imposed in response to declining farmland values have hampered its efforts to sell inventory properties. In addition, FmHA has not actively attempted to sell many of the properties in its inventory. Actions such as allowing delinquent borrowers a year to sell their properties before acquiring them, infrequent use of advertising and realtors, and reserving suitable properties up to 3 years when a shorter period seems more appropriate have all limited the market exposure of these properties. As a result, these actions have contributed to an increase in the inventory.

FmHA has taken action to limit the amount of time allowed delinquent borrowers to sell their properties before liquidation action begins, but further actions are needed. Although FmHA cannot improve farm real estate market conditions, it can increase the sales potential of its properties (in those areas where the sales will not have a detrimental effect on the value of area farmland) by increased advertising of unsold properties as required by its regulations. Increased advertising would also increase FmHA selling costs, but these costs would likely be offset by reduced management and imputed interest expenses that could be avoided if sales occurred sooner. Quicker sales may also be achieved by reclassifying unsold suitable properties to surplus after individuals eligible for FmHA loan programs have been given ample time, perhaps the 1 year suggested by FmHA officials (see ch. 2), to purchase the property. This action would expand the sales market to include all potential buyers—not just those that are eligible for FmHA loan programs.

## Recommendations to the Secretary of Agriculture

We recommend that the Secretary of Agriculture direct the FmHA Administrator to intensify the selling efforts for inventory property through more extensive use of advertising.

We also recommend that the Secretary direct the Administrator to issue a policy directive to FmHA state personnel stating that, when suitable property is not sold within a specified time, perhaps 1 year, because of a lack of eligible buyers or economic conditions, it should be reclassified as surplus property.

## Agency Comments

In commenting on a draft of this report, USDA agreed with these recommendations.

On intensifying selling efforts through more extensive use of advertising, USDA said that FmHA will issue a directive to that effect. However, USDA added that in accordance with Section 1314 of the Food Security Act of 1985, all selling efforts must cease whenever it is determined that the sale of FmHA farms will have a detrimental effect on the value of farmland in the area.

USDA also agreed that FmHA should reclassify unsold suitable farm property sooner if it does not sell because of a lack of eligible buyers or economic conditions. USDA said FmHA will issue such a policy directive to all its field offices.

# FmHA Has Taken Steps to Improve Its Property Management

FmHA's past efforts to manage and lease farms in its inventory did not fully achieve the agency's policy goal of preserving the properties' value and protecting the government's financial interest. Agency regulations in effect at the time of our review had restricted maintenance expenditures on some inventory properties; and in many cases, other FmHA county supervisor work priorities resulted in property management activities receiving little attention. Without adequate repair and maintenance, properties usually deteriorate while in FmHA inventory, decreasing both their selling price and the amount FmHA recovers on unpaid indebtedness of the properties' former owners. In June 1985 FmHA issued revised property management regulations that, if properly implemented, should improve its property management activities. As of August 1985 FmHA was studying the possibility of hiring more contractors to manage inventory properties.

FmHA had refrained from advertising most properties for lease and, as a result, may have settled for lower leasing payments than necessary. In August 1984, after we began our review, the agency directed that properties be advertised for lease. FmHA also allows lessees to grow government price-supported crops on FmHA property, a practice that conflicts with the purpose of federal agricultural price-support and acreage limitation programs.

## FmHA Maintenance Requirements Are to Ensure Property Value Preservation

The objectives of FmHA's property management policy are to preserve the property's value and protect FmHA's financial interest. FmHA assigns county supervisors the responsibility for managing inventory properties, requiring them to first inspect all acquired property to make sure it is secured and protected. When managing properties county supervisors may lease properties or have them maintained or protected under a caretaker's agreement. At the time of our review, however, if properties were adequately secured or did not contain any buildings, the county supervisor was not required to take further actions for property protection.[1]

For properties that FmHA classified as suitable—reserved for sale to FmHA-eligible borrowers—the county supervisor had specific authority to pay for securing, protecting, maintaining, repairing, and renovating the property. The county supervisor was authorized to spend up to $500 for securing and protecting a suitable property, another $500 for maintenance, and up to $2,000 for repair and renovation. Requests for

[1] 7 C.F.R. 1955.63(a), (1985).

repairs costing more than $2,000 were to be forwarded to FmHA headquarters for contract approval. Surplus properties were to be sold in the acquired condition, unless the property could not be sold in that condition, in which case improvements needed to sell the property could be made. Expenditures could be made to secure and protect all properties, including surplus properties.

On June 7, 1985, FmHA issued revised final property management regulations that further specify what repairs or renovations should be made to inventory properties. This revised policy states that essential farm service buildings will be repaired, renovated, or improved as necessary to put them in saleable condition. The new policy makes no distinction between surplus properties and those suitable for sale to an FmHA borrower; both are to be repaired and maintained. The purpose of this policy change was to place properties in saleable condition and prevent property deterioration while in inventory. Deteriorating FmHA properties may reduce surrounding property values and may not comply with local government property safety and maintenance requirements.

The revised policy also states that property will not be allowed to stand unsecured and unmanaged, and it increases county supervisor authority to approve maintenance and security expenditures totaling up to $15,000 per property. Implementation of the revised policy can be expected to substantially change the focus of and expenditures for FmHA property management and should eliminate past practices of limited spending on renovations and repairs as discussed in the following section.

## Repair, Maintenance, and Renovation Expenditures Were Minimal for Inventory Properties

Previously, FmHA had not spent any money to manage over half the projected properties in our review states, and the management costs it did incur were minimal relative to the properties' value. FmHA had not incurred any management expenditures on a projected 56 percent of 1,270 properties in inventory. The total amount FmHA spent on farm property management, including hiring caretakers and performing renovations, was minimal, totaling an estimated $790,000 annually on the 1,270 properties in our six review states.

Some inventory properties needed substantial repair or renovation such as extensive barn repairs to be viable farming operations. In the opinion of FmHA county supervisors, about 30 percent, or 384, of the projected inventory properties in our review states would need extensive repairs or renovations to be viable operations. However, these repairs or renovations had not been made. The average estimated cost for these repairs or renovations was $13,900 per property. These needed repairs or renovations will be or were likely reflected in the property's selling price. For suitable property, FmHA will provide buyers financing for repairs and renovations.

The following example describes a farm that needed renovations and, at the time of our review, had been in inventory for over a year:

- In October 1983 FmHA acquired a 159-acre Wisconsin dairy farm. The farm was valued at $120,000 in March 1983 and, when acquired, was considered suitable for FmHA borrower financing. In the county supervisor's opinion, the property, when acquired, needed about $28,000 worth of repairs and renovations to be a viable operation. The barn needed repair; and to be operational, the farm needed a mechanical barn cleaner, milking equipment, and silo unloaders, most of which had reportedly been taken by the former owner or stolen by other individuals. The property also needed additional storage for machinery and livestock. The county supervisor reappraised the property's value at $90,000 in July 1984. This appraisal report cited the need for the extensive renovations and said that if the improvements were made, the appraised value would be $115,000. Because of the needed work, the supervisor also requested the FmHA state office's permission to change the property's classification to surplus. This request was denied. As of November 1984 the property was still in inventory and the renovations had not been made.

Adverse weather or inadequate maintenance, repair, and security can cause the deterioration of farm buildings on inventory properties, which may lower the value and ultimate selling price. However, determining the extent to which property selling prices are lower because of building or other property deterioration is difficult. Some farm buildings will have deteriorated to a valueless condition at the time FmHA acquires them and further deterioration will not decrease property values.

Figures 5.1 and 5.2 illustrate deteriorated buildings on two FmHA inventory properties that have likely decreased the properties' value. Figures 5.3 and 5.4 illustrate deteriorated buildings that have not likely decreased the properties' value.

Figure 5.1: Wind-Damaged Hog Facility on 75-Acre Inventory Property

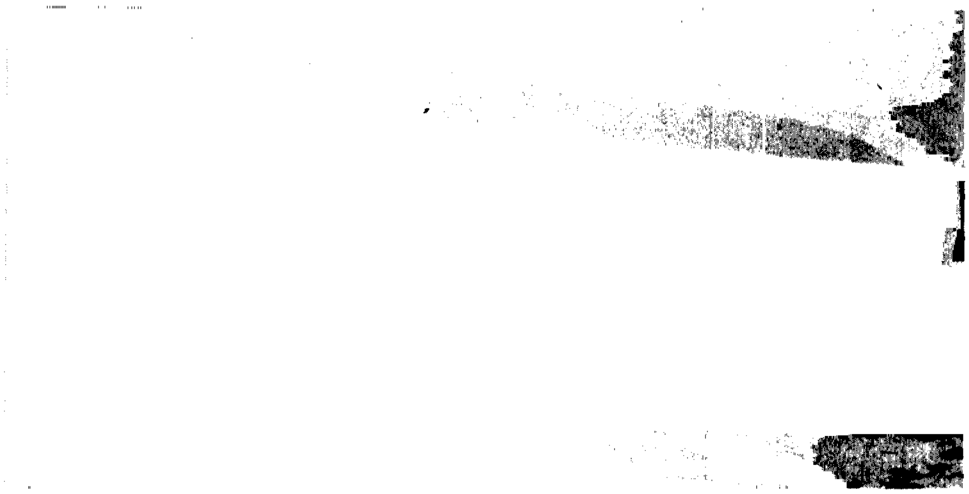
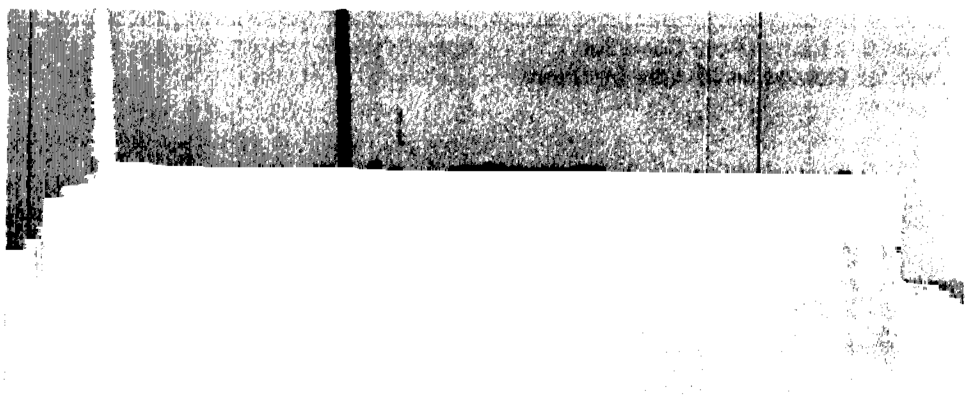


Figure 5.2: Remains of Dairy Barn, on 101-Acre Property, That Was Struck by Lightning and Burned While in Inventory



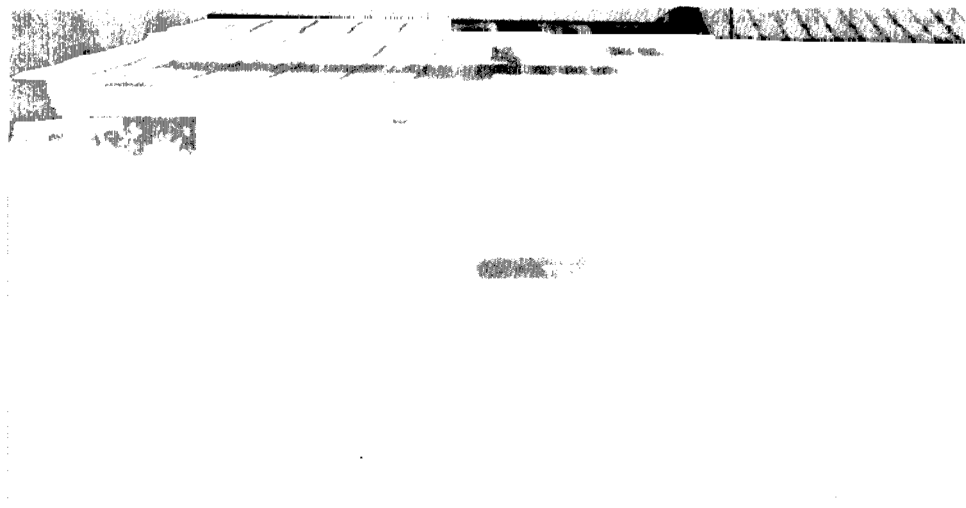


**Figure 5.3: Barn Having No Appraised Value on 1,088-Acre Inventory Property**

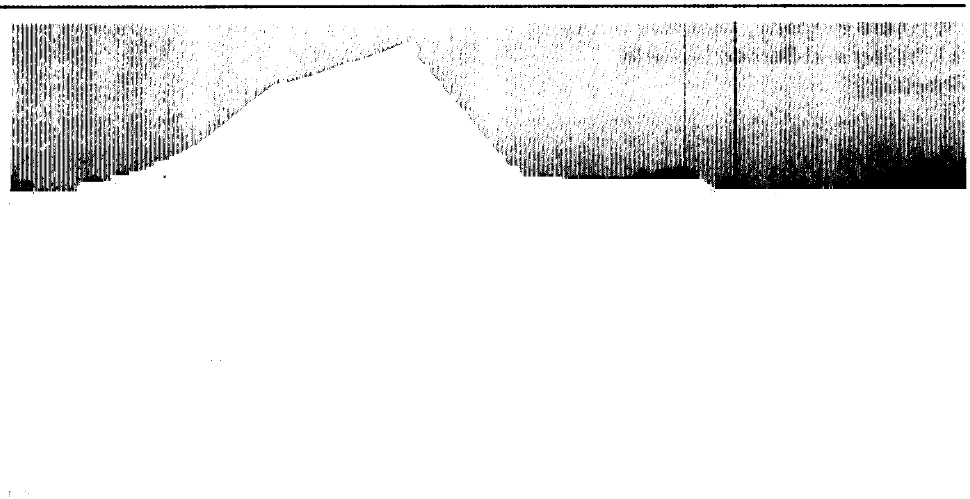


**Figure 5.4: Barn in Poor Condition, Used for Storage on 48-Acre Inventory Property**

## County Supervisors' Workloads Restrain Property Management

Many FmHA properties had received limited care and maintenance because the property managers—county supervisors—had been busy performing other higher priority FmHA duties and FmHA staff resources have been limited. On a national basis, FmHA staff resources have not kept up with the increasing agency workload, according to FmHA testimony provided in March 1985 before the House Appropriations Committee, Subcommittee on Agriculture. For fiscal year 1984 FmHA estimated that 14,665 staff years were required for the agency's workload but actual staff years were 12,658, or 2,007 less. A 1983 OIG audit report[2] also disclosed that FmHA faced serious problems in loan making and servicing with existing staffing levels. To help with the increasing workload, FmHA announced in February 1985 that it was hiring an additional 1,284 temporary employees to help process farm loan applications.

As the federal government's major farm credit agency, FmHA gives priority to loan activities, including processing and approving new farm loans and servicing existing farm loans. With agricultural financial conditions worsening, FmHA's farmer program loan portfolio increased 53 percent in the 5 years that ended June 30, 1985. FmHA's farm loan portfolio as of June 30, 1985, consisted of about $28 billion for over 270,000 borrowers with over 757,000 loans. At the same time that FmHA's lending activities escalated, so did the number of properties in inventory. From December 1979 to October 1985, the number of properties dramatically increased from an estimated 288 to an estimated 3,969. Prior to this increase, property management was not a problem because of the low number of properties in inventory. However, this expanded inventory caused a new dilemma for county supervisors in determining how to manage these properties.

State FmHA officials in four of our review states—Kansas, Missouri, Tennessee, and Wisconsin—said that management of farm properties placed an undue burden on county supervisors. State officials in Georgia and Minnesota said they did not believe property management was an undue burden but noted that the overall workload of county supervisors in selected counties had increased because of property management.

State officials and most county supervisors said they expected the inventory property workload to increase. Each of the six state FmHA officials expected the state's inventory of farm properties to increase during fiscal year 1985. Of the 36 county officials, 26 said they expected farm properties to increase by the end of fiscal year 1985. FmHA headquarters officials said that after issuance of the agency's revised regulations for servicing delinquent borrowers (see ch. 2), FmHA could become the largest holder of farmland in America, with inventory properties doubling during 1986 and 1987 to a total of 20,000 farms. Such action would have a tremendous impact on the FmHA county supervisors' ability to fulfill their property management responsibilities.

[2](Washington, D.C.: Audit Report 04-638-2-At, Mar. 31, 1983).

## Limited Use of Outside Assistance for Property Management

County supervisors have the authority to hire a firm or an individual to assist in the care or management of inventory properties but had seldom done so, even though such services are relatively inexpensive. Firms or individuals were hired for a projected 27 percent, or 338, of the 1,270 properties in the six states. When FmHA contracted for property management assistance, such help was usually for general caretaker duties, such as inspecting the property, reporting vandalism, cutting grass, and showing the property to prospective buyers. The average annual caretaker fee totaled $488 per property for inventory properties that had an average value of $135,000.

To determine whether property management should be contracted for on a larger scale, FmHA conducted a pilot program in Missouri, hiring 2 firms to manage 21 farms for the 1984 crop year. The results of this initial pilot program appear inconclusive. According to FmHA, the management firms were proficient at leasing property and providing property management expertise for FmHA. In addition, most county supervisors in the project expressed relief that someone else was managing the properties. An FmHA cost analysis of the program, however, determined that it was more cost-effective for FmHA employees to handle the leasing of property. The pilot program was continued for the 1985 crop year and expanded to involve more than 100 farms, in order to obtain more contractor property management information and a better cost-benefit analysis.

State officials we interviewed in five states—Kansas, Missouri, Georgia, Wisconsin, and Minnesota—said they could see value in using property managers to assist county supervisors in some situations—during a time when the number of inventory properties were increasing, for example. Only in Missouri, however, was FmHA using property management firms to assist county supervisors. FmHA headquarters officials said they believed that if FmHA's farm property inventory increases as expected, the only way to resolve the property management problem will be through the extensive use of property management firms.

## FmHA's Practices in Leasing Inventory Properties May Not Have Protected the Federal Government's Interests

While in inventory, most FmHA properties are leased, but few properties we reviewed had been publicly advertised for lease. Leasing land without advertising could lead to inequitable treatment of interested parties because potential lessees may not be aware FmHA land is available for lease, precluding them from making an offer to lease the land. As a result, FmHA may not maximize lease revenue. During our review, FmHA modified its leasing policy by issuing a directive that stated that FmHA farm inventory properties should be publicly advertised for lease.

Most leased farmland in FmHA inventory was used to grow crops that receive federal price supports or for which acreage limitation programs existed. Such practices are not in the federal government's best interests. FmHA does not have a policy prohibiting these practices, but its June 1985 revised regulations stated that FmHA could prohibit them if it desires.

### Most FmHA Properties Are Leased While in Inventory

When a farm property in FmHA inventory cannot be promptly sold, it may be leased to protect the government's interests.[3] Leasing generates revenue from the property and can also contribute to property maintenance. Because of poor farm real estate market conditions and FmHA moratoriums on sales, properties are being held in inventory for longer periods and leasing has become increasingly important.

FmHA had leased a projected 60 percent, or 762, of the 1,270 inventory properties in our review states. From each leased property, FmHA averaged $4,700 in annual lease payments. The remaining 508 properties were not leased because (1) a sale of the property was in process, 28 percent; (2) the land was not suitable for leasing, 13 percent; (3) the owner still occupied the property, 11 percent; (4) the property was acquired too late in the growing season to lease, 9 percent; and/or (5) the property was not leased for other reasons, 24 percent.[4] For 15 percent, or 77 properties, we could not determine why the property was not leased.

[3] 7 C.F.R. 1955.63(a), (1985); 50 Fed. Reg. 23917.

[4] Other reasons for not leasing included allowing a caretaker to live on the property, borrower trying to sell property, and legal actions.

## Few Properties Were Advertised for Lease

The leasing of inventory properties, like other property management duties, is usually handled by the FmHA county supervisor. Since FmHA regulations did not require advertising or competitive bidding for lease, supervisors usually relied on personal contacts to lease properties. A projected 13 percent, or 159, of the 1,270 properties were publicly advertised for lease. For 40 percent, or 506 properties, leases were made either to someone the supervisor had initially known was interested in leasing the property or to someone who had initially contacted the supervisor. According to FmHA regulations, supervisors were to select lessees on the basis of the following criteria: "potential as an eligible applicant, ability to preserve the property, effect on future sales value of property, and rental income." The county supervisor and the lessee negotiate the lease terms.

Because leasing through personal contact rather than competitive bid gives only a limited number of people a chance to express interest in leasing a property, FmHA did not have assurance that the leasing procedures county supervisors used were equitable for all potential lessees and ensured that FmHA received the highest lease payments possible.

During our review, as we discussed our concerns about not advertising for lease, FmHA modified its leasing policy. An August 1984 directive stated that FmHA farm inventory properties should be publicly advertised for lease to "assure fair and equitable treatment to all interested parties." FmHA officials told us that although FmHA's June 1985 revised property management regulations do not require that FmHA advertise property for lease, the August 1984 directive was still in effect and county supervisor training on implementing these regulations will include the advertising requirement. We believe this advertising policy will increase FmHA's exposure to potential lessees and provide assurance that FmHA receives a competitive lease payment for the property.

## Most Leased Properties Are Used to Grow Price-Supported Crops

Through various programs USDA has tried to stabilize farm commodity supplies and enhance prices and incomes. For some crops—wheat, rice, cotton, and feed grains (including corn and grain sorghum)—price- and income-support programs and related acreage limitation programs have been used by USDA as authorized by periodic farm legislation, such as the Agriculture and Food Act of 1981 (Public Law 97-98, Dec. 22, 1981). The recently enacted Food Security Act of 1985 continues to authorize such programs. In addition, in 1983 USDA tried to further reduce supplies of five commodities (corn, grain sorghum, wheat, rice, and cotton) by announcing a Payment-In-Kind program by idling cropland for these commodities. The acreage limitation programs are intended to reduce crop supplies by taking cropland out of production. Programs also exist to enhance producer incomes or control production of peanuts, tobacco, and milk. In fiscal year 1985 USDA spent about $17.7 billion on these and other agricultural programs that directly affect the prices and incomes farmers receive.

In apparent contradiction of these programs' purposes, FmHA, a USDA agency, has allowed farmers who lease inventory properties to grow crops subject to these programs and contribute to an oversupply situation. This was done on about 70 percent, or 531, of the 762 projected leased properties in our review states. Lessees grew one of these price-supported commodities—corn—on about 24 percent, or 181, of the 762 projected properties while in FmHA inventory. In 1983 and 1984 USDA programs supported the price of corn, and in 1983 two USDA programs paid farmers about $6.5 billion to reduce corn acreage. An example of this apparent contradiction follows:

- In 1983 a Missouri farmer leased an inventory property from FmHA on which he earned more from participating in USDA acreage limitation programs than he paid for leasing the property. For his participation, he received $387 cash and 620 bushels of corn, valued at about $2.70 a bushel, or a total of $1,674, as a payment-in-kind. The total value of these payments—$2,061—was greater than his $1,200 annual lease payment to FmHA. In addition to receiving his program participation payments, he used the property to plant 17 acres of corn and 19 acres of soybeans.

FmHA has no policy prohibiting the planting of price-supported crops on FmHA property. FmHA officials agreed that allowing such growth appears contradictory but stated that they believed FmHA's policy of maintaining the family farm and its production potential justified the practice. FmHA views the leasing of property primarily as a way to offset carrying costs and minimize program costs, and FmHA state officials in the six states we reviewed were not concerned with the apparent contradiction. They said that lessees should be allowed to grow whatever crop they desired.

FmHA has not always allowed lessees to grow any crop they choose. In 1956, when commodity surpluses also existed, President Eisenhower by executive memorandum set forth a general lease prohibition. This memorandum directed that "leases of farm lands made by the Federal Government...shall prohibit the cultivation of price-supported crops in surplus supply." The memorandum was effective for all federal departments and agencies and was promulgated

"In order that the leasing of farm lands owned by the Federal Government shall be consistent with the Administration's determined effort to reduce price-depressing surpluses and to bring agricultural production into line with markets,...."

Since this policy was contained in an executive memorandum, it was effective only during that administration and currently is not in effect or legally binding.

The House version of the Food Security Act of 1985 (H.R. 2100) contained a provision that any farm real estate acquired by the Secretary of Agriculture may not be leased or operated for the production of surplus agricultural commodities. However, the Senate amendment, which did not include the provision, was ultimately adopted by the Congress in December 1985.

FmHA's June 1985 revised property management regulations state that the FmHA Administrator can issue directives "restricting the leasing of property which could be used to produce agricultural products determined to be in surplus supply." This revision was provided in part to respond to our review inquiries and because of FmHA's prior concern that agency actions may contribute to surplus commodity production. As of January 1986 FmHA had not taken any action to implement this authority, and according to FmHA officials, no action is planned.

## Conclusions

FmHA has been expending a minimal amount of funds and effort to care for farm properties in its inventory. While we could not specifically determine whether and to what extent FmHA's level of management contributed to a decline in inventory property values, the minimal care that was provided may not have been enough to protect the government's interest. FmHA has since revised its regulations, which will likely change the focus and expenditure level of FmHA property management activities. Implementing these regulations along with FmHA's intention to increase the use of property managers should improve overall property management.

FmHA has also improved its efforts to lease property in its inventory by requiring that properties be advertised for the best lease price obtainable rather than relying primarily on personal contacts between the county supervisor and potential lessees.

FmHA, however, is allowing farmers who lease its properties to grow crops that are subject to USDA agricultural price-support or acreage limitation programs. This policy conflicts directly with USDA programs aimed at reducing the production of such crops as corn, wheat, rice, grain sorghum, and cotton. On the one hand, FmHA is leasing land to farmers that is being used to grow crops that are in oversupply. On the other hand, USDA is paying these same farmers under other programs not to produce these crops.

The Congress, in passing the Food Security Act of 1985, recognized the problem of oversupply as a major cause of depressed farm prices and included several provisions in the act to control production. Although we did not determine the amount of farm payments related to FmHA-leased land, we do not believe it is good policy for one agency of USDA (FmHA) to carry out programs that conflict with the objectives of other USDA programs and their authorizing legislation. Not only does it send the wrong message to the farmers who are leasing the property, but, more importantly, it undermines the purpose of the basic farm programs, i.e., to reduce production thereby increasing prices. The FmHA Administrator should exercise his authority to restrict farmers from growing surplus crops on properties leased from FmHA.

## Recommendation to the Secretary of Agriculture

We recommend that the Secretary of Agriculture direct the FmHA Administrator to issue a policy directive to FmHA state personnel stating that farm real estate in inventory should neither be leased nor operated for the production of surplus agricultural commodities.

## Agency Comments and Our Evaluation

In commenting on a draft of this report, USDA agreed with the intent of our recommendation that farm real estate in inventory should neither be leased nor operated for the production of surplus agricultural commodities. USDA noted, however, that the total number of acres of farmland in FmHA inventory represents approximately one tenth of 1 percent of all U.S. farmland and, as such, currently does not significantly affect the surplus production problem. USDA said that should the amount of FmHA inventory property increase substantially in the future, the impact of the potential surplus production from inventory farms will be weighed against the adverse economic effects associated with the implementation of such restrictions.

We realize that the total amount of farmland currently in FmHA's inventory is relatively small compared with total U.S. farmland. We agree that prohibiting the growth of surplus crops on government-owned land would have little impact on the total surplus production problem. However, we believe the issue of whether USDA should allow surplus agricultural commodities to be grown on FmHA-leased land does not rest on the quantity of surplus commodities produced. Rather, it involves a policy decision on whether USDA should be spending billions of dollars (over $17 billion in fiscal year 1985 alone) to stabilize farm commodity supplies through acreage limitation programs and income- and price-support programs while, at the same time, allowing farmers to produce those same crops on land it owns.

FmHA itself has recognized this policy issue. For example, when FmHA revised its property management regulations in June 1985, the Administrator was authorized to issue directives restricting the leasing of farm property in inventory because of FmHA's concern that agency actions may contribute to surplus commodity production.

In our opinion, the limited amount of farmland in FmHA inventory does not justify current FmHA leasing policy that directly conflicts with other USDA programs aimed at reducing the production of surplus crops.

# Request Letter From Members of the Senate Agriculture and Appropriations Committees

WALTER D. HUDDLESTON
KENTUCKY

COMMITTEES:
AGRICULTURE, NUTRITION, AND FORESTRY
APPROPRIATIONS
SELECT COMMITTEE ON INTELLIGENCE
SELECT COMMITTEE ON SMALL BUSINESS

United States Senate
WASHINGTON, D.C. 20510

April 26, 1984

Honorable Charles A. Bowsher
Comptroller General of the United States
General Accounting Office
441 G Street, N.W.
Washington, D.C. 20548

Dear Mr. Bowsher:

We are very concerned about the large number of farms that the Farmers Home Administration has taken possession of during the last three years as the result of loan foreclosures or other actions. We believe that the General Accounting Office should examine the agency's management of farm property that is in inventory and the procedures used to sell or lease that property.

Prior to 1981, the agency never held more than 260 farms in inventory at any time. It is our understanding that the Farmers Home Administration is currently in possession of over 2,200 farms valued at over $400 million dollars.

Congress never intended the Farmers Home Administration to be one of our Nation's biggest farm landlords. Further, the agency was created to assist family farmers with their credit problems and is poorly equipped to act as a real estate agent or manage hundreds of thousands of acres of farmland.

We request that you review this situation and provide us with your recommendations on any management improvements or revisions of policy needed to protect the substantial interests of the taxpayers and Farmers Home Administration borrowers.

Sincerely,

Thad Cochran
THAD COCHRAN
Chairman, Subcommittee on Agriculture and Related Agencies, Committee on Appropriations

Walter D. Huddleston
WALTER D. HUDDLESTON
Ranking Member, Committee on Agriculture, Nutrition, and Forestry

- 2 -

EDWARD ZORINSKY
Ranking Minority Member,
Subcommittee on Agricultural
Credit and Rural Electrification

THOMAS F. EAGLETON
Ranking Minority Member,
Subcommittee on Agriculture
and Related Agencies,
Committee on Appropriations

DAVID L. BOREN
Member, Committee on
Agriculture, Nutrition, and
Forestry

ALAN J. DIXON
Member, Committee on
Agriculture, Nutrition, and
Forestry

# Advance Comments From the Under Secretary for Small Community and Rural Development, Department of Agriculture

DEPARTMENT OF AGRICULTURE
OFFICE OF THE SECRETARY
WASHINGTON, D.C. 20250

APR 10 1986

Mr. J. Dexter Peach
Director
United States General Accounting Office
Washington, D.C. 20548

Dear Mr. Peach:

A review has been made on the proposed GAO report entitled "Farmers Home Administration: Farm Property Acquired by the Federal Government Presents a Management Challenge." Our response to your recommendations are as follows:

1. GAO Recommendation:

   We recommend that the Secretary of Agriculture direct the Farmers Home Administration (FmHA) Administrator to intensify the selling efforts for inventory property through more extensive use of advertising.

   Response: We agree with your recommendation. The FmHA will issue a directive to all of its field offices to intensify their efforts to sell inventory property through more extensive advertising. However, all selling efforts must cease whenever it is determined that the sale of FmHA farms will have a detrimental effect on the value of farmland in the area in accordance with the provision of Section 1314 of the Food and Security Act of 1985.

2. GAO Recommendation:

   We also recommend that the Secretary direct the Administrator to issue a policy directive to FmHA State personnel stating that, when suitable property is not sold within a specified time, perhaps 1 year, because of a lack of eligible buyers or economic conditions, it should be reclassified as surplus property.

   Response: We agree with your recommendation. The FmHA will issue such a policy directive to all of its field offices.

3. GAO Recommendation:

   We recommend that the Secretary of Agriculture direct the FmHA Administrator to issue a policy directive to FmHA State personnel stating that farm real estate in inventory should not be leased nor operated for the production of surplus agricultural commodities.

Response: FmHA Instruction 1955-B, "Management of Property," authorizes the FmHA Administrator to restrict the leasing of farm inventory property which could be used to produce agricultural products determined to be in surplus supply. The FmHA has 3,977 farms and 1.1 million acres of farmland in its inventory. The total number of acres of farmland in FmHA inventory represents approximately one-tenth of 1 percent of all U.S. farmland and currently does not significantly impact on the surplus production problem. However, should the amount of FmHA farm inventory property increase substantially in the future, the impact of the potential surplus production from inventory farms will be weighted against the adverse economic effects associated with the implementation of such restrictions. Such adverse effects include, but are not limited to:

1. Causing an overproduction of alternative crops that are not in surplus supply.

2. When no alternative farming enterprise exists, farms remain idle and rapidly decrease in value. Also, idle farms require greater monetary investment to maintain, and usually bring a lower sale price than active, producing farms.

3. Section 1314 of the Food Security Act of 1985 provides that the previous owner or operator of FmHA farm inventory property shall be given special consideration in the leasing of such land. A restriction on the type of enterprise that can be carried out could prevent the previous owner or operator from leasing their farm back.

4. Such restrictions will require monitoring to ensure compliance, and would place an additional demand and burden upon FmHA employee time and budget resources.

We believe your recommendations and observations will assist the FmHA to better manage its farm inventory properties.

Sincerely,

FRANK W. NAYLOR, JR.
Under Secretary
for Small Community
and Rural Development

# FmHA Farm Inventory Properties by FmHA State Offices as of October 31, 1985

| FmHA state office | Number of farm inventory properties |
|---|---|
| Alabama | 26 |
| Arizona | 17 |
| Arkansas | 107 |
| California | 78 |
| Colorado | 87 |
| Delaware | 1 |
| Maryland | 11 |
| Florida | 87 |
| Georgia | 122 |
| Idaho | 139 |
| Illinois | 95 |
| Indiana | 170 |
| Iowa | 193 |
| Kansas | 207 |
| Kentucky | 76 |
| Louisiana | 72 |
| Maine | 42 |
| Massachusetts | 7 |
| Connecticut | 3 |
| Rhode Island | 1 |
| Michigan | 145 |
| Minnesota | 133 |
| Mississippi | 162 |
| Missouri | 492 |
| Montana | 20 |
| Nebraska | 71 |
| New Jersey | 3 |
| New Mexico | 27 |
| New York | 129 |
| Virgin Islands | 0 |
| North Carolina | 171 |
| North Dakota | 74 |
| Ohio | 63 |
| Oklahoma | 140 |
| Oregon | 54 |
| Pennsylvania | 39 |
| South Carolina | 38 |
| South Dakota | 125 |
| Tennessee | 199 |

| FmHA state office | Number of farm inventory properties |
|---|---|
| Texas | 48 |
| Utah | 5 |
| Nevada | 3 |
| Vermont | 5 |
| New Hampshire | 1 |
| Virginia | 21 |
| Washington | 44 |
| West Virginia | 14 |
| Wisconsin | 165 |
| Wyoming | 18 |
| Alaska | 0 |
| Hawaii-Am. Samoa | 0 |
| West Pacific Terr. | 0 |
| Puerto Rico | 19 |
| **Total** | **3,969** |

# FmHA County Offices Sampled and Number of Properties Reviewed

| State[a] | County office location | Number of properties |
|---|---|---|
| **Georgia** | Ashburn | 4 |
| | Lyons | 6 |
| | Swainsboro | 8 |
| | Sylvester | 9 |
| | Valdosta | 5 |
| | Waynesboro | 8 |
| **Kansas** | Garden City/Scott City | 2 |
| | Girard | 11 |
| | Hutchinson | 5 |
| | Manhattan | 7 |
| | Marysville | 4 |
| | Pratt | 4 |
| **Minnesota** | Glenwood | 2 |
| | Litchfield | 3 |
| | Little Falls | 5 |
| | Pine City | 8 |
| | Preston | 4 |
| | Willmar | 2 |
| **Missouri** | Bethany | 5 |
| | Bloomfield | 5 |
| | Fayette | 9 |
| | Keytesville | 6 |
| | Marble Hill | 9 |
| | Trenton | 8 |
| **Tennessee** | Bolivar | 10 |
| | Huntingdon | 5 |
| | Kingston | 3 |
| | Lafayette | 5 |
| | Memphis | 3 |
| | Trenton | 10 |
| **Wisconsin** | Black River Falls | 6 |
| | Juneau | 1 |
| | Portage | 3 |
| | Shawano | 5 |
| | Wausau | 8 |
| | Whitehall | 8 |
| **Total** | | **206** |

[a]GAO visited 6 FmHA county offices in each of 6 states for a total of 36 county offices.

# GAO's Method of Calculating Imputed Interest Costs

When FmHA acquires a farm property through a forced sale or voluntary conveyance, the federal government incurs an interest cost on the funds that would otherwise be available if the property were sold for cash immediately after acquisition. This interest cost continues to be incurred until the property is sold. The imputed interest cost of FmHA's purchase or investment should be estimated and included in FmHA's acquisition decision as part of the government's total cost to acquire a farm property.

To calculate the imputed interest cost for each of the 206 inventory properties reviewed, we multiplied the property's FmHA assessed value at acquisition by a 1-year interest rate by the length of time a property was in inventory. For rate of interest, we used the average yield on 1-year U.S. Treasury notes as of the date of property acquisition. For length of time in inventory, we began our calculation with FmHA's acquisition date and ended it when the property was sold or through January 1, 1985, if the property was still in inventory. Time periods were expressed in years by dividing the number of days by 365.25, which considered leap years. If FmHA reappraised the property after acquisition, we computed the interest cost to the reappraisal date and then adjusted the imputed interest calculation by changing the property value to the reappraised value and the interest rate to the rate in effect at reappraisal. The calculation was then continued using these new values, and the products were summed for the total imputed interest cost.

For example, one property in Missouri, acquired on September 16, 1982, had an appraised value of $137,500. At the time the 1-year U.S. Treasury note rate was 10.85 percent. The property was reappraised about 1.5 years later on March 15, 1984, at $100,000. The rate for 1-year U.S. Treasury notes was then 10.59 percent. The property was then sold 19 days later on April 3, 1984, for $100,000. We calculated a total imputed interest cost of $22,852.42 for this property. This consisted in part of $22,301.54, which we computed by multiplying 0.1085 (Treasury rate) times $137,500 (initial appraised value) times 1.4948665 years (length of time property was appraised at $137,500). To this $22,301.54 product, we added a second $550.88 product that resulted from multiplying 0.1059 (Treasury rate at reappraisal) times $100,000 (reappraised value) times 0.052019 years (length of time property was valued at $100,000 until sold). The sum of these two products totaled to the $22,852.42 imputed interest cost.

Using this methodology, imputed interest costs were projected to be $24.9 million for the 1,270 farm inventory properties in the six states reviewed.

# States and Counties Affected by FmHA Moratorium on the Sale of Farm Properties in Inventory as of October 24, 1984

| State | Number of counties |
|---|---|
| Arkansas | 2 |
| Colorado | 3 |
| Georgia | 2 |
| Idaho | 4 |
| Indiana | 3 |
| Iowa | 1 |
| Kansas | 6 |
| Kentucky | 1 |
| Louisiana | 2 |
| Michigan | 3 |
| Minnesota | 2 |
| Mississippi | 1 |
| Missouri | 9 |
| Nebraska | 24 |
| New Mexico | 1 |
| New York | 4 |
| North Carolina | 3 |
| Oklahoma | 5 |
| South Dakota | 1 |
| Tennessee | 2 |
| **Total** | **79** |

# Statistical Estimates and Associated Sampling Errors

This appendix provides the sampling errors associated with our statistical sample of FmHA farm property in inventory for six states. A description of the methodology used to select this sample is provided in chapter 1 of this report.

Because we reviewed a statistical sample of farm properties in FmHA's inventory, each estimate developed from the sample has a measurable precision, or sampling error. The sampling error is the maximum amount by which the estimate obtained from a statistical sample can be expected to differ from the characteristics of the true universe. Sampling errors are usually stated at a certain confidence level—in this sample, 95 percent. This means the chances are 19 out of 20 that if we reviewed all the farm properties in FmHA's inventory for the 6 states, the results would not differ from the estimates obtained from our sample by more than the sampling error of such estimates.

We calculated the sampling error for those statistical estimates that are relevant to the main issues of this report. These estimates and their associated sampling errors at the lower and upper boundary limits for the 95-percent confidence level are shown on the following pages.

**Table VII.1: Statistical Estimates Relevant to the Reasons for Farmer Failure**

Percent

| Reason for failure | Estimate | Lower limit | Upper limit |
|---|---|---|---|
| **Primary reason** | | | |
| Poor farming practices | 27.3 | 26.6 | 28.0 |
| Poor financial practices | 15.2 | 14.6 | 15.8 |
| Personal problems | 15.1 | 14.6 | 15.6 |
| High FmHA debt | 9.8 | 9.4 | 10.2 |
| Weather disasters | 11.4 | 11.0 | 11.8 |
| Low commodity prices | 7.0 | 6.7 | 7.3 |
| Other economic factors | 9.0 | 8.2 | 9.8 |
| **Secondary reason** | | | |
| Poor farming practices | 22.4 | 21.8 | 23.0 |
| Poor financial practices | 13.1 | 12.6 | 13.6 |
| Personal problems | 10.0 | 9.5 | 10.5 |
| High FmHA debt | 14.1 | 13.6 | 14.6 |
| Weather disasters | 12.6 | 12.1 | 13.1 |
| Low commodity prices | 6.2 | 5.8 | 6.6 |
| Other economic factors | 4.6 | 4.2 | 5.0 |
| No secondary reason | 7.7 | 7.3 | 8.1 |

**Table VII.2: Statistical Estimates Relevant to FmHA's Property Inventory**

Dollars in millions

| Estimated items | Estimate | Lower limit | Upper limit |
|---|---|---|---|
| **Revenue, costs, and losses** | | | |
| Total property revenue | $184.6 | $175.5 | $193.7 |
| Property selling price | 171.8 | 163.5 | 180.1 |
| Other income | 12.8 | 10.9 | 14.7 |
| Total property costs | $374.4 | $353.1 | $395.7 |
| Unpaid principal and interest | 260.0 | 239.2 | 280.8 |
| Payments to prior lienholders | 83.9 | 78.9 | 88.9 |
| Imputed interest | 24.9 | 23.0 | 26.8 |
| Other costs | 5.5 | 5.0 | 6.0 |
| Total losses on property | $189.7 | $173.9 | $205.5 |

Percent

| Estimated items | Estimate | Lower limit | Upper limit |
|---|---|---|---|
| **Properties resulting in loss or little revenue** | | | |
| Properties where total costs exceed total revenue at acquisition | 9.3 | 8.8 | 9.8 |
| Properties where total revenue will exceed total costs by less than $1,700 | 3.6 | 3.3 | 3.9 |
| **Suitable properties** | | | |
| Properties classified as suitable | 57.4 | 56.7 | 58.1 |
| Suitable properties sold | 17.2 | 16.4 | 18.0 |
| Suitable properties unsold after 1 year in inventory | 54.9 | 53.4 | 56.4 |
| **Properties with advertising costs** | | | |
| Total properties for which FmHA incurred advertising costs | 51.0 | 50.1 | 51.9 |
| **Leased properties** | | | |
| Total properties leased while in inventory | 60.0 | 59.1 | [illegible]0.9 |
| Leased properties receiving price supports | 69.6 | 68.2 | 71.0 |

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