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Report to the Ranking Minority Member, Subcommittee on Agriculture, Rural Development, and Related Agencies, Committee on Appropriations, U.S. Senate

November 1987

FARMERS HOME ADMINISTRATION

Problems and Issues Facing the Emergency Loan Program

GAO/RCED-88-4

GAO United States
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Resources, Community, and
Economic Development Division

B-227691

November 30, 1987

The Honorable Thad Cochran
Ranking Minority Member
Subcommittee on Agriculture,
Rural Development, and Related Agencies
Committee on Appropriations
United States Senate

Dear Senator Cochran:

In response to your March 27, 1986, letter, this report discusses how the Farmers Home Administration's (FmHA) emergency loan program has evolved over the past several years, why its delinquency rate is so high, what alternatives are available to deal with debt that may be uncollectible, and any changes needed in legislation and or program regulations to make it function more effectively. This report contains no recommendations for legislative or program changes, in large part, because of recent changes in legislation and FmHA loan policies that should resolve many of the program's past problems. The report does include issues for congressional consideration and raises questions about whether credit, particularly liberal credit, is the proper vehicle for providing disaster relief to farmers.

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

This work was performed under the direction of Brian P. Crowley, Senior Associate Director. Other major contributors are listed in appendix VII

Sincerely yours,

J. Dexter Peach

J. Dexter Peach
Assistant Comptroller General

the basis of its analysis of FmHA data, that FmHA could lose about $7.8 billion on existing, undersecured farm program loans. FmHA and the Congress have made changes to the emergency loan program that GAO believes will not only help farmers recover from disaster losses but also reduce future costs, delinquencies, and losses. Because of these changes, GAO did not develop new alternative proposals for dealing with debt that may be uncollectible and is making no suggestions for additional changes to legislation for the emergency loan program. GAO raises questions, however, on whether credit, particularly liberal credit, is the proper vehicle to provide disaster assistance and offers issues for congressional consideration

Principal Findings

Program Expansion Increased Loans

From 1949 to 1969 emergency loans were available only to borrowers who could not obtain credit elsewhere. Program changes initiated in 1970, and extended to additional borrowers in 1972, contributed to a dramatic increase in the number and dollar amount of emergency loans. Further, in 1975 Public Law 94-68 expanded the program to include two new loan types—emergency annual production and major adjustment loans. Borrowers who had received emergency loans could, under the annual production loan authority, receive five subsequent emergency annual production loans without experiencing another disaster or loss. Borrowers could also obtain major adjustment loans to modify or expand their farming operations. Consequently, the amount of emergency loans made each year increased from $735 million in 1975 to $5.1 billion in 1981.

Since 1981 the amount of delinquent loan payments has increased steadily from $937 million in June 1981 to $4.1 billion in June 1986. As of June 30, 1986, about 50,000 borrowers were $4.1 billion behind in payments on about 157,000 loans, and these delinquent borrowers owed about $6.5 billion of the $9.5 billion emergency loan portfolio.

Reasons for High Delinquencies

GAO grouped the reasons for sampled borrowers' delinquencies into three broad categories—external elements such as adverse weather or a poor economy, borrowers' unsound farming and financial practices, and program features. External elements and borrower practices were the major reasons why borrowers became delinquent, and these are some of year 1987 (P.L. 100-71, July 11, 1987), the Congress included a provision that reinstituted the continuation policy. Reestablishment of the continuation policy will likely result in increased loan losses if it remains in effect for an extended period of time.

Issues for Congressional Consideration

GAO offers two issues for congressional consideration in deliberating future policy on disaster assistance to farmers—who should provide disaster relief and how should it be provided? Striking a proper balance between the risks to be taken by the farmer or by the government is a difficult task. Given the current range of programs available to help farmers recover from a disaster—emergency loans at subsidized interest rates, disaster payments, federal crop insurance—the Congress may wish to consider whether a proper balance is being struck between the farmer and the government in protecting against disaster losses. The Congress may also wish to consider whether credit is the proper vehicle for providing disaster relief and, if so, what role it should play. The financial conditions of FmHA's emergency loan program and of the borrowers with emergency loans demonstrate the difficulty of using credit, particularly liberal credit, to help farmers recover from disaster losses.

The history of the emergency program shows that it best fulfills its objective of providing credit to help farmers recover from disaster losses when coverage is limited to actual losses and borrowers can demonstrate repayment ability. GAO believes that FmHA's efforts to return to a more sound, prudent lending program is a step in the right direction for a viable emergency loan program that will strike a proper balance between helping farmers recover from disaster losses and protecting the government's and the taxpayers' financial interests.

Agency Comments

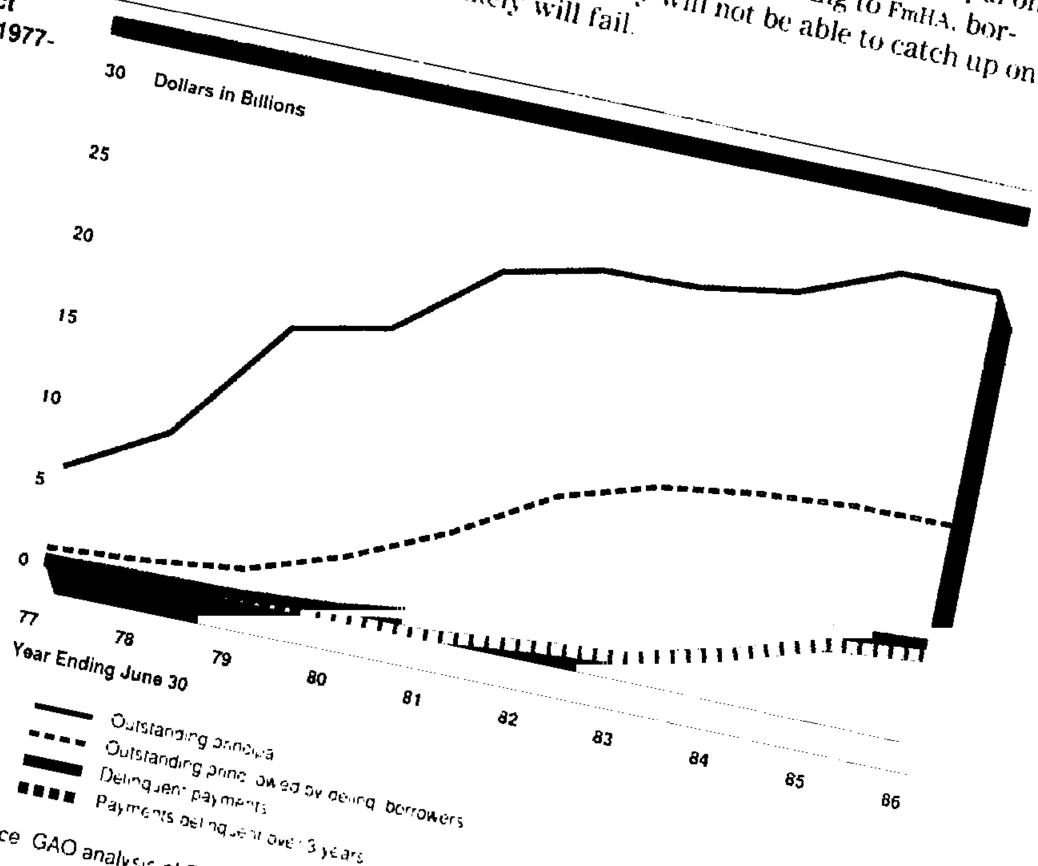
In its official comments, USDA agreed with the information contained in the report

Appendixes

Tables

$5.4 billion (over 1,000 percent). This group's outstanding principal on June 30, 1986, was $6.9 billion. (See fig. 1.1.) According to FmHA, borrowers over 3 years delinquent probably will not be able to catch up on their payments and most likely will fail.

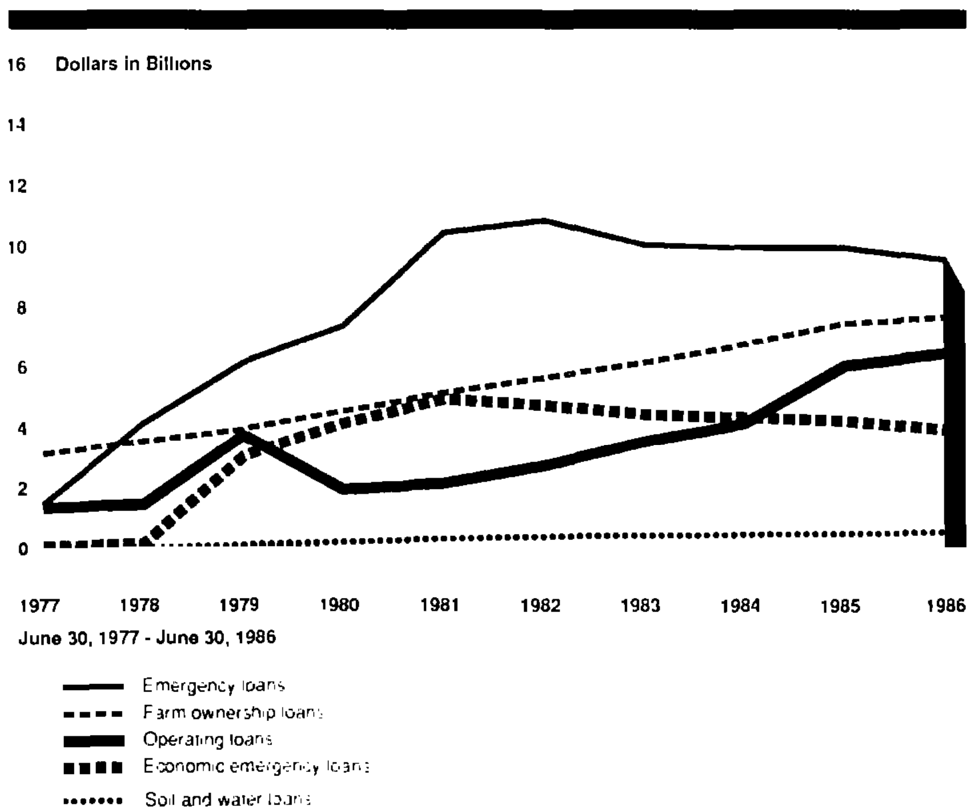
Figure 1.1: Status of FmHA's Direct Major Farmer Programs, June 30, 1977-86



Source GAO analysis of FmHA Active Borrowers Delinquent Report data (FmHA report code 616)

For the past 10 fiscal years, annual FmHA direct major farmer program loan losses (net of proceeds from sales of loan collateral) grew from $26 million in 1977 to $490 million in 1986. These losses increased about 275 percent between 1984 and 1986, growing from $178 million to $490 million. (See fig. 1.2.) FmHA estimates that it will write off as losses another $2 billion in the near future.

Figure 1.3: Unpaid Principal Outstanding on FmHA Major Farmer Program Loans, June 30, 1977-86



Source: GAO analysis of FmHA Active Borrowers Delinquent Report data (FmHA report code 616)

Table 1.1: Status of FmHA's Major Farmer Programs and Emergency Loan Program as of June 30, 1986[a]

Dollars in billions

	Major farmer programs	Emergency program	Percent of emergency program to major farmer programs
Total portfolio			
Borrowers	260,969	115,266	44
Loans	738,737	271,538	37
Outstanding principal	$27.8	$9.5	34
Delinquent portfolio			
Borrowers	92,914	50,139	54
Loans	331,369	156,879	47
Delinquent payments	$6.8	$4.1	60
Outstanding principal owed by delinquent borrowers	$13.5	$6.5	48
Loan losses[a]	$.5	$.2	40

[a]Loan loss data as of Sept. 30, 1986.

Source: GAO analysis of Active Borrowers Delinquent Report data (FmHA report code 616) and USDA budget data.

Emergency Loan Program

FmHA makes emergency loans available to farmers, ranchers, and aquaculture operators when their operations have been substantially damaged by unusual and adverse weather conditions or other natural phenomena. These loans are made available in specific areas declared as disaster areas by either the President, the Secretary of Agriculture, or the FmHA Administrator. The primary initial and current purpose of emergency loans is to provide farmers direct assistance to cover actual losses so they can return to normal farming operations. However, from 1975 through 1985, the emergency loan program was expanded to include loans for purposes other than actual losses, such as expanding farm operations.

Program Administration and Qualification

Primary responsibility for providing emergency loans to affected farmers rests with FmHA's approximately 1,900 county offices. The county supervisors, in coordination with district and state officials, serve as local contact persons for application processing, loan-making, and loan-servicing activities.

what alternatives are available to deal with debt that may be uncollectible, and (4) if any changes are needed in the legislation or regulations governing the program (See app. I.)

Emergency Program Evolution

To determine emergency program evolution, we traced the history of the program by reviewing legislation and regulations governing the program from its inception through the Food Security Act of 1985 (P.L. 99-198, Dec. 23, 1985). We also developed historical data on loan volume, delinquencies, and loan losses to show how the size and condition of the emergency loan portfolio relate to key program provisions since the program's inception. We reviewed only direct emergency loans because of the relatively small number and dollar amount of guaranteed emergency loans. On June 30, 1986, FmHA had only 30 active guaranteed emergency loans totaling about $1 million in unpaid principal but had about 272,000 direct loans with unpaid principal of $9.5 billion

High Delinquency Rate

To determine the reasons for the high delinquency rate in the emergency loan program, we first obtained the opinions of the Assistant Administrator for Farmer Programs and the Director of the Emergency Division. We then selected for review the three states having the highest delinquent emergency loan debt—Georgia, Mississippi, and Texas As of June 30, 1986, these states accounted for about $1.5 billion of the $4 1 billion delinquent payments on emergency loans and $1.8 billion, or 28 percent, of the $6.5 billion in unpaid principal outstanding owed by delinquent emergency loan borrowers To assess the delinquency situation in these states, we discussed the reasons for delinquencies with FmHA State Directors or Assistant Directors and the Chiefs of Farmer Programs. Detailed information on reasons why individual borrowers became delinquent came from a random sample of delinquent borrowers from 13 case-study FmHA county offices in these 3 states.

Uncollectible Debt

FmHA and the Congress have taken action over the past several years to deal with delinquent and uncollectible debt. Chapter 3 discusses the amount of loss that FmHA may incur on delinquent farm loan borrowers, including borrowers delinquent on emergency loans. Chapter 4 discusses the actions FmHA has taken on its own or as directed by legislation to deal with its delinquent farm loans. Because of these recent actions, we did not develop suggestions or recommendations for legislative or program changes, although we present issues for congressional consideration in chapter 5.

territories. Additionally, chapter 2 contains information on emergency loan losses that we obtained from USDA budget records.

Detailed information on individual borrowers came from a random sample of delinquent emergency loan borrowers in 13 case-study county offices—4 in Georgia, 4 in Mississippi, and 5 in Texas. We judgmentally selected these county offices because of their high and low delinquency rates and locations in different parts of the states, which provided good geographic coverage and/or diverse farming operations. The information on these borrowers was projected to the 13 case-study county office universe and was obtained and used in this report for illustrative purposes. The information is not projectable nationally.

Using FmHA county office Status Reports of Farmer Program Accounts, which showed borrowers' loan status, we determined a universe of 1,388 borrowers within the 13 county offices who were delinquent on one or more emergency loans as of December 31, 1985. We then selected a sample of the delinquent emergency loan borrowers from each state. We stratified the sample universe, randomly selecting 253 borrowers who were less than $1 million delinquent and all 28 borrowers who were $1 million or more delinquent on emergency loans. In reviewing borrowers' loan files, we found that 3 of the 253 borrowers were only temporarily delinquent because of local FmHA actions. Thus, we reduced the number of sample borrowers from 281 to 278, proportionately reducing the universe to 1,372, which we use in projections in chapters 3 and 4. In addition, from among these sample borrowers, we developed six case studies that illustrate the various factors contributing to their delinquencies. (See ch. 3 and app. VI.) Appendix IV contains information on sample sizes for each state and county office visited.

To ensure consistency in gathering and reporting information on sample borrowers, we developed and used a standard data collection instrument to interview and record information from county supervisors and staff. We primarily relied on the county supervisors' and staffs' knowledge, or information we or they obtained from loan files, to document each borrower's financial and farming operations, reasons for delinquencies, and amounts of uncollectible debt. Officials in the 13 county offices also provided opinions on whether FmHA could assist the sample borrowers to restructure their debt or retain their homes and/or land through use of provisions contained in the Food Security Act of 1985.

We obtained comments from FmHA national, state, and county office officials about the emergency loan program and the reasons for delinquencies. In addition, the information recorded on the data collection instruments for delinquent borrowers was obtained from county office supervisors and their staffs. On the basis of our knowledge of the emergency loan program and a limited review of loan files at the county offices, we believe that the FmHA officials generally provided reliable information on the program and on individual borrowers' problems, operations, and financial conditions emergency loans totaling about $1.6 billion, an average of about $67.4 million each year. FmHA had no ceilings on emergency loan amounts, minimum qualifying loss, or restrictions on the size of farm operation that could receive an emergency loan, as long as the operator was unable to obtain sufficient operating credit elsewhere to finance actual farming needs. According to FmHA officials, borrowers repaid 94 percent of all emergency loans during this period.

Program Benefits Increased and Debt Cancellation Allowed Between 1970 and 1973

Program changes introduced in 1970 and extended to additional borrowers in 1972 contributed to dramatic increases in the number of emergency loans made, the total dollar value of those loans, and the government's cost for the loans.

The Disaster Relief Act of 1970 (P.L. 91-606) introduced many major changes in the emergency loan program that led to dramatic temporary program increases following the enactment of Public Law 92-385 in 1972. The 1970 act and implementing regulations (1) suspended the statutory eligibility requirement for showing inability to obtain credit elsewhere, (2) included an automatic principal debt cancellation of up to $2,500 for that part of an emergency loan in excess of $500 for a major disaster declared by the President and not compensated for by insurance or otherwise, (3) authorized deferring interest and principal payments during the first 3 years of a loan, and (4) extended these benefits to victims of disasters declared by the Secretary of Agriculture, as well as by the President. The 1972 act expanded these program benefits by increasing the cancellation feature up to $5,000, dropping the previous $500 front-end payment requirement, and lowering the interest rate to 1 percent. The 1972 act also restricted the benefits added in 1970 to damage incurred between June 30, 1971, and July 1, 1973.

The impact of these program changes, particularly the 1972 changes, can be seen in the dramatic increase in loans between fiscal years 1972 and 1973 and later debt cancellations. In fiscal year 1972 FmHA made 12,979 emergency loans totaling about $108.9 million. The following fiscal year FmHA made 128,667 loans totaling about $557.8 million. In addition, the cost of debt cancellations increased from about $7.4 million in response to the limited forgiveness in fiscal years 1966 and 1967 for Hurricane Betsy (1965) loans to about $519.5 million for fiscal years 1973 through 1976. These costs do not factor in additional costs to the federal government for subsidized low-interest rates or eventual loan defaults.

repayment within 1 year or when the financed crops or livestock were marketed.

The second new loan type established a purpose for emergency loans that had been specifically excluded since 1967—major adjustments to the borrower's farming operation. Borrowers could use major adjustment loans, among other things, to purchase additional real estate, modify operations, refinance debts, improve buildings, purchase production inputs, or develop land and water resources. Interest rates for major adjustment loans, like those for annual production loans, were at higher rates than for actual loss loans. FmHA generally scheduled major adjustment loans for repayment within 7 years, but repayment could be scheduled over 40 years if the borrower used real estate as security.

Changes Made Between 1980 and 1985 to Restrict Program Coverage Hampered by Agency and Borrower Actions

In response to increased program costs, delinquencies, and losses, FmHA and the Congress took steps in 1980, 1981, and again in the Food Security Act of 1985 to tighten emergency loan program features. However, a liberal FmHA loan policy and borrower actions hampered efforts to tighten the program until 1985. Some statutory and administrative changes made in 1980 and 1981 included

- limiting loan amounts to $500,000 or the amount of actual loss (whichever is less) for each disaster,
- setting termination dates for phasing out annual production and major adjustment loans,
- reducing the period authorized for receiving subsequent annual production loans from 6 to 3 years,
- establishing a maximum combined principal indebtedness of $1.5 million per borrower for emergency annual production and major adjustment loans for fiscal year 1980 to be phased down to $0.5 million during fiscal year 1982 and no such assistance be made in fiscal year 1983 and succeeding years,
- limiting eligibility to applicants who are unable to obtain credit elsewhere (this requirement had been briefly dropped),
- increasing the minimum production loss from 20 percent to 30 percent as the eligibility entrance level for applicants,
- reducing the maximum amount of an actual production loss loan from 90 percent to 80 percent of the total calculated production loss, and
- prohibiting use of emergency loan funds for any expansion beyond the predisaster "normal" farming operation.

and implementing regulations, restricted emergency loans to borrowers (1) who operate family-type farms and (2) for whom federal crop insurance was not available. The last feature became effective in January 1987.

Financial Status of the Emergency Loan Program

The emergency loan program experienced large increases in outstanding principal and delinquencies over the 10-year period between June 30, 1977, and June 30, 1986. Outstanding principal grew from about $1.4 billion to about $9.5 billion, and principal owed by delinquent borrowers increased from about $217 million to about $6.5 billion. Delinquent payments increased from $58 million to $4.1 billion, while payments over 3 years in arrears grew from $8 million to $3.1 billion. (See fig. 2.1.) Loan losses also increased from about $14 million to about $205 million between fiscal years 1977 and 1986. In addition, borrowers with emergency loans are in poorer financial condition than other FmHA farm loan borrowers, and borrowers with delinquent emergency loans are, on average, technically insolvent with debts exceeding assets. (See table 2.4.)

Outstanding Principal Increased

The total emergency loan outstanding principal increased substantially between June 30, 1977, and June 30, 1986. The emergency loan portfolio grew rapidly between 1977 and 1981 as a result of natural disasters occurring in 1978 and 1980 and expansions in the program. The portfolio then remained at about $10 billion each year from 1983 to 1985 before decreasing to about $9.5 billion on June 30, 1986. (See fig. 2.1.)

During the 10-year period between 1977 and 1986, the dollars loaned increased dramatically to over $1 billion in each fiscal year from 1977 through 1984, except for 1983 when the Payment-in-Kind program was in effect. Beginning in fiscal year 1985 and continuing through fiscal year 1986, the dollars loaned dropped dramatically as FmHA phased out its annual production loans, terminated its continuation policy, and implemented features of the Food Security Act of 1985. (See table 2.1.)

Table 2.1: Emergency Loans (1949-86)

Dollars in millions

Fiscal Year	Number	Amount
1949	302	$1 0
1950	25 418	31 6
1951	13 291	20 3
1952	21 304	34 4
1953	35 348	44 0
1954	46 361	93 5
1955	56 472	89 2
1956	45 847	87 0
1957	28 440	66 2
1958	24 260	63 5
1959	11 405	39 9
1960	9 203	23 0
1961	7 941	26 6
1962	20 861	63 3
1963	19 344	62 5
1964	15 302	50 2
1965	22 290	78 4
1966	24,371	100 5
1967	22,174	94 6
1968	22,228	108 2
1969	20 686	114 7
1970	12 778	89 4
1971	19 804	127 6
1972	12 979	108 9
1973	128 667	557 8
1974	22 434	128 3
1975	43 675	735 0
1976	18,453	519 2
1977	35,769	1 178 4
1978	89 119	3 411 8
1979	62 913	2 871 6
1980	54 394	2 226 9
1981	138 990	5,112 3
1982	42 863	2 173 4
1983	8 771	565 9
1984	34,997	1 052 0
1985	14,060	490 9
1986	5,584	217 8

Source FmHA Emergency Division data

payments and most likely will fail. From 1981 to 1986 the percentage of emergency program payments delinquent over 3 years has increased from 21 percent to 77 percent. As of June 30, 1986, almost 70,000, or about 47 percent, of the 149,471 emergency loans were more than 3 years delinquent. (See table 2.3.)

Table 2.3: Number and Amount of Emergency Program Delinquent Loans by Age as of June 30, 1986[a]

	1 year or less	1-2 years	2-3 years	3-4 years	Over 4 years	Total	Percent delinquent over 3 years
Loans	47 423	18 878	13 498	19 485	50 187	149 471	47
Dollars (millions)	$288	$288	$354	$734	$2,414	$4 079	77

[a]Data sorted by delinquent borrowers

Source: GAO analysis of FmHA Active Borrowers Delinquent Report data (FmHA report code 616)

Emergency Loan Borrowers in Worse Financial Condition Than Other Program Borrowers

One way to measure a borrower's financial condition is to contrast the amount of money the borrower has invested (assets) with the amount owed (liabilities). A low debt-to-asset ratio indicates overall financial soundness and risk-bearing ability. Real estate usually comprises the major portion of the farmer's assets, and liens on real estate usually comprise the major portion of liabilities.

USDA's Economic Research Service classifies borrowers' financial conditions using four categories of debt-to-asset ratios:

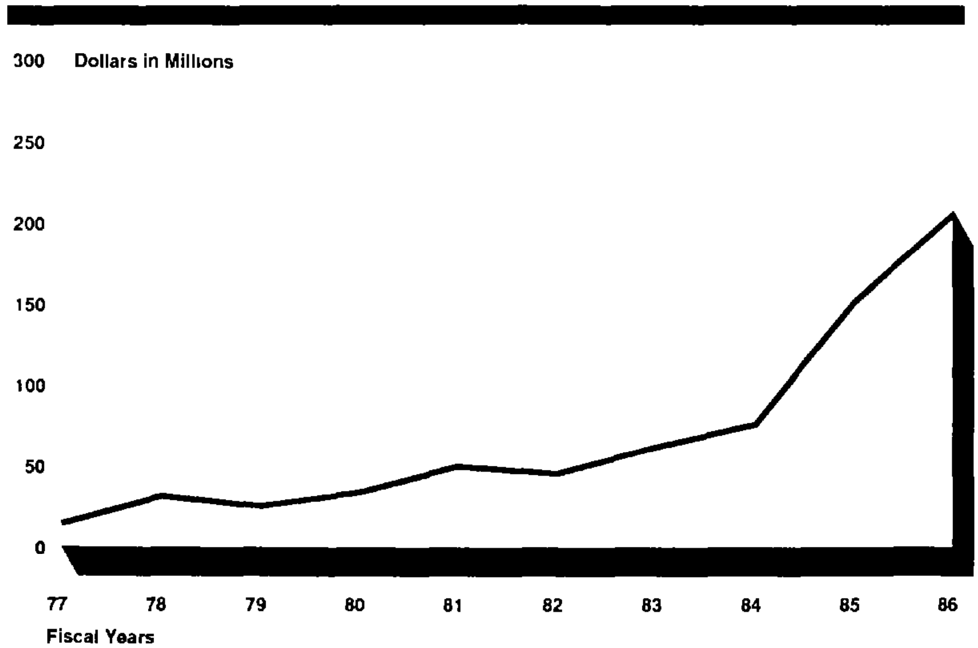
Under 40 percent. Borrowers generally have few financial problems and very strong net worth (no apparent financial problems).

40 to 69 percent. Borrowers have problems meeting principal payments but have adequate net worth (serious financial problems).

70 to 99 percent. Borrowers have problems meeting principal payments and current interest due and have declining net worth (extreme financial problems).

100 percent or more. Borrowers have severe problems meeting principal payments and interest commitments (technically insolvent).

Figure 2.2: FmHA Direct Emergency Loan Losses, Fiscal Years 1977-86



Source USDA budget records

personal problems. An additional 42 percent of the farm operation failures were attributed to borrowers' unsound farming and financial practices, and 10 percent of the failures were attributed to high FmHA debt. In addition, a March 1983 Office of Inspector General report[2] stated that FmHA had made emergency loans to borrowers who had not (1) made honest efforts to pay, (2) applied successful production and management practices, and (3) maintained and accounted for security property.

Table 3.1 shows the county supervisors' responses regarding the 278 sample borrowers, grouped into three broad categories—external elements, borrower practices, and program features—and projected to a universe of 1,372 delinquent emergency loan borrowers in the 13 county offices. Because we were counting borrowers, not factors, an individual was counted only once in each category even though more than one factor included in that category may have affected the delinquency. For example, a borrower who experienced weather disasters and personal problems and demonstrated unsound farming practices would be counted once under external elements and once under borrower practices.

Table 3.1: Projected Results of Major Factors Contributing to Emergency Loan Delinquencies in Case-Study County Offices

	Borrowers			Total[a]	
Categories	Georgia	Mississippi	Texas	Number	Percent
External elements	248	152	480	879[b]	64
Borrower practices	139	209	158	506	37
Program features	40	107	142	289	21

[a]The total number of borrowers does not add to 1,372, and the percent of universe will add to more than 100 because many delinquencies were attributed to more than one major factor. For 27 delinquencies no major factor could be identified.

[b]Total does not add because of rounding.

Source: GAO analysis of data obtained on sample borrowers.

External elements are primarily uncontrollable, but borrowers' unsound farming and financial practices and program features can be controlled by either the borrowers, FmHA servicing actions, or changes in program legislation.

In the county offices we visited, county supervisors told us that certain unsound farming and financial practices of borrowers contributed to loan delinquencies. These practices would appear to be generic and

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

Table 3.2: Unpaid Principal and Delinquent Payments by Type of Emergency Loan, June 30, 1986

Dollars in billions

	Unpaid principal		Delinquent payments	
Loan type	**Amount**	**Percent of total**	**Amount**	**Percent of total**
Total actual loss	$4.0	43.2	$1.1	29.4
Expanded coverage				
Major adjustment	3.7	39.4	1.2	31.6
Annual production	1.6	17.4	1.5	39.0
Total	**5.3**	**56.8**	**2.7**	**70.6**
Total	**$9.3**	**100.0**	**$3.8**	**100.0**

Source: GAO analysis of Status Report of Farmer Program Accounts (FmHA report code 540)

High-Risk Nature of Emergency Loans

Emergency loans are more risky than FmHA's other farm loans because they are made to help farmers recover from losses rather than generate new income. This fact was emphasized in January 1986 hearings before the Senate Committee on Agriculture, Nutrition, and Forestry, when USDA's Under Secretary for Small Community and Rural Development testified that

"In our basic Real Estate and Farm Operating Loan Program, we are making loans to produce a product which we expect to earn income and provide repayment ability. In the case of disaster loans, however, we are attempting to replace lost income with lent money that has to be repaid and for which there is no expectation of income in effect, to really provide that repayment capability. And so the Disaster Program, in and of itself, has a built in high risk of not being able to effectively repay those loans."

The "Continuation Policy"

As stated earlier FmHA initiated a continuation policy in 1982 that allowed borrowers to obtain additional emergency annual production and regular operating loans without their showing the ability to repay principal and interest on existing loans. Although this continuation policy allowed FmHA to avoid liquidating many delinquent borrowers, it also increased emergency loan debt and, to some extent, delinquencies.

In 1983 the USDA Office of Inspector General reported[1] that liberal FmHA loan policies allowed additional loans to borrowers who had not repaid prior indebtedness. Specifically, the report described FmHA's credit policies and loan-servicing activities as follows:

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

delinquencies increased about $2.1 billion. FmHA officials at the state offices in Georgia and Texas, and one county supervisor in Georgia, mentioned the lawsuits as a major factor that increased the emergency loan delinquencies.

The suspension on foreclosures was reestablished on June 2, 1987, when the same federal district court enjoined FmHA from accelerating certain delinquent loans or initiating foreclosure action on delinquent borrowers until FmHA provides corrected adverse action notices to these borrowers. These notices directed the borrowers to contact FmHA within 30 days to attempt to resolve their delinquencies. The notices also provided that liquidation procedures would be instituted if the borrowers either did not contact FmHA within the required time frame or could not resolve their delinquent status through a variety of servicing actions such as rescheduling or deferring loan payments. The court ruled that the challenged notice procedure violated due process guarantees contained in the Constitution because it did not give farmers enough information or an adequate opportunity to apply for the FmHA programs available to prevent foreclosure The government has appealed the ruling. Since the previous suspension of foreclosure action for about 3 years contributed to the accumulation of large amounts of delinquent debt, another long suspension could further increase delinquencies and loan losses.

Large Loan Losses Expected

Delinquent loans eventually lead to loan losses if the accounts are not made current and, in the case of liquidation, if the proceeds of the sale of loan collateral are not sufficient to recover the debt. Regardless of why delinquencies occurred or the reasons why borrowers accumulated large amounts of delinquent debt, the longer the delinquencies remain unresolved the larger the loan losses will be. This increased loss will occur primarily because interest will have continued to accrue and the value of the loan collateral (land and equipment) will likely have declined.

The potential losses in FmHA's farm loan programs, including its emergency program, are far greater than what has been experienced thus far. On the basis of our analysis of an FmHA internal study conducted in July and August 1985 we estimate that FmHA could lose as much as $7.8 billion of its $27.8 billion farm loan portfolio, including about $5.2 billion from farm loans to borrowers delinquent on emergency loans as of June 30, 1985.

In 1978 this cotton and soybean producer, who owned 1,157 acres and leased about 740 acres of farm land, obtained four emergency loans totaling $615,870. The loans included $253,860 to cover losses resulting from a 1977 drought and, under the 1975 expanded program provisions, a $130,710 annual production loan and a $231,300 major adjustment loan to assist in repaying existing loans The borrower reported a net worth of about $208,000 on his 1978 loan application.

As shown in table 3.3, the borrower received actual loss loans each year from 1978 through 1981 and emergency production loans annually from 1978 through 1983, despite rapidly declining net worth and increasing delinquency.

Table 3.3: Summary of Borrower A's Emergency Loan Debt

	Emergency loans				
Year	Actual loss	Annual production	Total	Cumulative delinquency	Net Worth
1978	$253,860	$130 710	$615 870[a]		+$207 560
1979	122 500	127 500	250 000	$105 800	+ 255 477
1980	39 480	225 520	265 000	243 000	+ 79 937
1981	134,680	153 640	288 320	465 000	- 215 577
1982	0	200 000	200 000	400 000	- 379 544
1983	0	70 000	70 000	700 000	- 576 104
Total	**$550,520**	**$907,370**	**$1,689,190[a]**		

[a]This total includes a $231 300 major adjustment loan

Source: Borrower's FmHA loan file

An entry in the borrower's record from a November 1982 county supervisor's visit to the borrower's farm stated that the borrower would not meet 1982 farm operating expenses and had no excuse for not doing so, considering the number of acres planted and the loans received. The entry also revealed that this borrower had demonstrated poor management practices, which resulted in the lowest yields in a good farming area. The county supervisor's entry concluded by stating, "don't believe borrower can succeed taking under consideration debts and management ability." Despite the borrower's high delinquency and poor farming record, however, he received a $70,000 emergency annual production loan in 1983 because of the automatic eligibility for this type loan at that time.

Table 3.4: Summary of Borrower B's Emergency Loan Debt

Emergency loan type	Original loan amount	Percent of total	Delinquent principal and interest	Percent of total
Actual loss	$806 110	10 2	$583,447	7 1
Annual production	6,255,000	79 4	7 144 207	86 4
Major adjustment	815 000	10 3	535 704	6 5
Total	**$7,876,110**	**99.9**[a]	**$8,263,358**	**100.0**

[a]Total does not add to 100 percent because of rounding

Source Borrower's FmHA loan file

The county supervisor attributed this borrower's delinquency to both the high-risk nature of emergency loans and program expansion to include annual production loans. FmHA expects to lose about $8 million in uncollectible debt when the borrower's security is liquidated.

During calendar year 1986, FmHA classified 54,100 delinquent farm borrowers as being in monetary default and initiated action to resolve these defaults. As of December 31, 1986, 20,910 defaulted borrowers had made their accounts current through various ways, such as restructuring debt and catching up on their payments. (See table 4.1.) Of the remaining 33,190 defaulted borrowers, 18,500 borrowers' defaults had not been resolved, 4,860 had filed bankruptcy, and 9,830 had received acceleration notices from FmHA that liquidation of their accounts was imminent.

Table 4.1: Methods of Making Delinquent Borrowers' Accounts Current During Calendar Year 1986

	Frequency of application[a]	
Method	**Number**	**Percent**
Borrowers paid delinquent debt	3,850	17
Another lender refinanced FmHA debts	315	1
Borrower restructured farm operation and debt by selling portion of assets	222	1
FmHA restructured debt	12,624	55
FmHA deferred debt	724	3
FmHA subordinated lien to another lender	385	2
Borrower liquidated security property	2,825	12
Other (unspecified)	1,981	9
Total	**22,926[a]**	**100**

[a]The methods of resolving defaults total more than the 20,910 borrowers who used them to make their accounts current because some defaults were resolved by a combination of methods.

Source: FmHA's Servicing Activity Report as of January 31, 1987.

Loan-Servicing Options Not Always Successful

Despite FmHA's attempts to help borrowers make their accounts current, many borrowers will not be able to resolve their financial problems and will leave farming either voluntarily or through liquidation. For example, from our 13-county office sample of delinquent emergency loan borrowers, we project that about 48 percent were no longer actively farming. During calendar year 1986, 4,303 FmHA borrowers nationwide liquidated their accounts by various means, the most prevalent method being the selling of security property and applying the proceeds to FmHA loans. (See table 4.2.)

Table 4.3: Projected Results of FmHA Servicing Actions in Case-Study County Offices as of September 30, 1986

Method	Number of borrowers	Percent of borrowers
Borrowers current		
Borrowers paid delinquent debt	41	3.6
FmHA restructured debt	325	28.6
Total	**366**	**32.2**
Borrowers liquidated		
FmHA foreclosed	117	10.3
Voluntary conveyance to FmHA	248	21.8
Other lenders foreclosed	4	0.3
Borrowers filed bankruptcy	95	8.4
Total	**464**	**40.8**
Action pending		
No action taken	118	10.4
Options exhausted but no acceleration of debt	116	10.2
Borrowers appealed rejection of servicing action	53	4.7
Total	**287**	**25.2**
Other	21	1.8
Total[b]	**1,137[a]**	**100.0**

[a]Details do not add to total

[b]An additional 235 borrowers were delinquent but no servicing actions were taken

Source: Results of servicing actions were based on FmHA county supervisors' opinions and were projected from a sample of borrowers with delinquent emergency loans from 13 county offices in Georgia, Mississippi, and Texas. (See apps. I and II.)

Few Borrowers Will Qualify for New Servicing Options

The Food Security Act of 1985 made available two additional servicing options, the conservation easement program and softwood timber production, for which implementing regulations were proposed in January 1987. On the basis of opinions of FmHA officials in the national office and in our 13 case-study county offices, few borrowers will be able to take advantage of these servicing options because of their inability to demonstrate repayment ability on their remaining debt.

The conservation easement program provides for the acquisition of easements in wetland, upland, or highly erodible land belonging to delinquent FmHA borrowers. Easements, which will be obtained from FmHA borrowers by cancelling a portion of their debt, must be for a period of at least 50 years and used for conservation, recreational, and/or wildlife purposes. To qualify for this option under the proposed regulations, the borrower must opinions on the likelihood that our sample of delinquent emergency loan borrowers could qualify for these two options Table 4.4 shows that county supervisors believed that about 3 percent of the applicable delinquent borrowers in the sample county offices would qualify for the conservation easement or softwood timber options

Table 4.4: Likelihood of Delinquent Emergency Loan Borrowers in Case-Study County Offices Qualifying for Conservation Easement or Softwood Timber Production

	Conservation easement		Softwood timber production	
Likelihood	Number	Percent	Number	Percent
Would qualify	26	2.4	5	0.5
Would not qualify	1,008	93.7	1,036	96.3
No opinion	42	3.9	36	3.4
Total[b]	**1,076**	**100.0**	**1,076[a]**	**100.0[a]**

[a]Details do not add to total

[b]These options were not applicable to an additional 296 delinquent borrowers because FmHA expected them to become current either (1) making their delinquent payments or (2) FmHA restructuring their debt

Source: The number of borrowers was projected from a sample of delinquent emergency loan borrowers in 13 county offices in Georgia, Mississippi, and Texas (See apps. I and II.)

Few Borrowers Will Qualify for Assistance After Accounts Are Liquidated

If delinquent borrower accounts cannot be made current through loan servicing, FmHA plans to liquidate the accounts—sell borrower assets to recover FmHA loan funds Short of debt forgiveness, FmHA has limited options available to assist borrowers unable to repay their loans after extensive loan servicing FmHA does not consider debt forgiveness to be a viable option to help delinquent borrowers because forgiveness would (1) be inequitable to borrowers who are repaying their loans and (2) make it increasingly difficult to obtain loan payments from borrowers in the future.

The Food Security Act of 1985 contained two provisions designed to assist qualified FmHA borrowers whose loan accounts have been liquidated through foreclosure, voluntary conveyance, or bankruptcy proceedings. The first provision gives the previous owner or operator of the farm property the first opportunity to lease the property, with or without an option to purchase The second provision creates a program to help farmers retain their dwellings. Of the 54,100 borrowers in monetary default as of December 31, 1986, 4,303 were liquidated and thus eligible for these two options. As of March 31, 1987, only about 200 borrowers have been approved for these options, with over 250 more having applications pending, since the regulations were published in March and April 1986 According to FmHA's Assistant Administrator for Farmer

- more liquidated farmers may qualify for dwelling retention, but the farmer would have to pay market-rate rent for the dwelling and would most likely not have enough land or equipment to continue farming; and
- those borrowers who will be able to qualify for dwelling retention will most likely do so on the basis of nonfarm income, which means that they will probably no longer engage in farming.

The national statistics, which demonstrate that thousands of borrowers are in financial trouble, and our work in Georgia, Mississippi, and Texas supported the Assistant Administrator's opinions. As of March 31, 1987, FmHA had approved only 57 dwelling retentions and 145 leases with options to purchase farm property since the regulations were issued in March and April 1986, respectively. As shown in table 4.5, county supervisors in the 13 case-study county offices indicated that only about 5 and 15 percent of delinquent emergency loan borrowers likely would qualify for the lease purchase and dwelling retention options, respectively.

Table 4.5: Likelihood of Delinquent Emergency Loan Borrowers in Case-Study County Offices Qualifying for Lease With or Without Option to Purchase or Dwelling Retention

	Lease with option to purchase		Dwelling retention	
Likelihood	Number	Percent	Number	Percent
Would qualify	57	5.3	157	14.6
Would not qualify	1,013	94.1	920	85.5
No opinion	7	0.6	0	0.0
Total[b]	**1,076[a]**	**100.0[a]**	**1,076[a]**	**100.0[a]**

[a]Details do not add to total.

[b]These options were not applicable to an additional 296 delinquent borrowers because FmHA expected them to become current either by making their delinquent payments or by FmHA restructuring their debt.

Source: The number of borrowers was projected from a sample of emergency loan borrowers in 13 county offices in Georgia, Mississippi, and Texas. (See app. [illegible] and [illegible])

FmHA and the Congress Have Taken Actions to Limit Future Emergency Loan Debt

FmHA and the Congress have taken actions to eliminate the factors that contributed to the high dollar amount of delinquencies and loan losses in the emergency loan program. These actions, however, will limit both the number of farmers who will qualify for future emergency loan assistance and the size of loans provided. The emergency loan program now covers only actual losses—as it did from 1949 to 1975. FmHA has also reemphasized the requirement that borrowers have both adequate security and repayment ability before approving emergency loans. In

Issues for Consideration by the Congress

While the Congress and FmHA have taken a number of actions to help resolve the high rate of delinquencies and loan losses in the emergency loan program, the Congress may wish to consider two issues in deliberating future policy on disaster assistance to farmers.

- What should be the government's responsibility in providing disaster relief to farmers?
- What policies would best help farmers recover from disasters while protecting the government's financial interests?

Who Should Provide Disaster Relief?

FmHA can point to record levels of loan-making activity as indicators of how well it responded to farmers' needs; however, credit cannot serve as a substitute for income over time. Farming is a business and, like all businesses, has certain risks. The question is: How much risk should the farmer assume versus the government and ultimately the taxpayer? Prudent business managers make decisions to minimize risk and to protect the business from events beyond their control. Although disasters can be considered farming risks beyond farmers' control, farmers can protect themselves from disaster-related losses. Various types of insurance—crop, hazard, flood, etc.—are available to cover the likelihood that disasters will affect their farming operations.

Notwithstanding the means by which farmers could protect themselves from disaster losses the government has traditionally borne a good deal of the risk by making available low-interest loans and, for a period, debt cancellation features for some loans. With the passage of the Food Security Act of 1985, the Congress shifted the burden of protecting against disaster losses more to the farmer. Features, such as requiring crop insurance as a condition of eligibility for emergency loans, restricting loans to family farmers, and limiting emergency loans to those who are unable to obtain credit elsewhere, will limit the amount of assistance that family farmers will be able to obtain Thus, family farmers will have to take steps to control disaster risks, not only for their own protection but also to remain eligible for government credit assistance.

The Congress has since temporarily shifted part of the burden of protecting against disaster losses which occurred during 1986 back to the government with the passage of FmHA's fiscal year 1987 appropriation (P.L. 99-500; P L. 99-591). Section 633(B) of this law provided for disaster payments to eligible producers for production losses due to drought, excessive heat, hail, or excessive moisture in 1986. The payments would not be direct cash payments or loans but would be in the form of farmers who could have repaid actual loss loans incurred additional debt that they could not repay. Those farmers now face financial ruin, and both they and the taxpayers will lose.

The consequences of expanded benefits and liberal loan policies are expressed not only in terms of increased cost and losses to the government but also in human terms. Loan losses result from liquidated loan accounts where the proceeds of collateral sales do not equal the value of the liquidated loans. This literally means that the affected farmers not only lose their property but also incur a liability for the balance of the debt. This may affect their future earnings potential whether in or out of farming. Large debt loads, whether delinquent or current, also affect farmers' ability to obtain financing for normal operations and especially to help recover from future disasters.

Currently, the emergency program restricts loans to farmers who have suffered actual losses, and FmHA has tightened its credit policy. These changes should make for a more viable emergency loan program that may be more beneficial to farmers in the future. However, should future occasions arise to broaden eligibility and expand benefits when disasters are widespread, as in the case of the 1986 drought in the Southeast, the Congress and FmHA should look to the lessons learned from past excesses and resist making policy decisions that could create additional problems for farmers already overly burdened with excessive debt.

We believe that FmHA's return to more sound, prudent lending practices and the tightened eligibility requirements for the emergency loan program are steps in the right direction for a viable emergency loan program that will strike a proper balance between helping farmers recover from disaster losses and protecting the government's and the taxpayers' financial interests

The Honorable Charles A. Bowsher 2

The Farmers Home Administration clearly has a problem on its hands with the emergency disaster program, and I believe that both the Congress and FmHA can benefit from an analysis of this program by the GAO. Consequently, I request that GAO review the emergency disaster program to determine why the delinquency rate is so high and what alternatives are available to deal with the debt that may be uncollectible. I would also like GAO to review how the emergency disaster program has evolved over the past several years, including the changes mandated by the Food Security Act of 1985, and provide suggestions for changes in legislation and/or program regulations and operations to make the program function more effectively.

With kindest regards.

Sincerely,

Thad Cochran

THAD COCHRAN
Chairman
Subcommittee on Agriculture,
Rural Development, and
Related Agencies

State/territory	Total delinquent borrowers	Total delinquent loans	Total delinquent payments[a]	Total outstanding principal owed by delinquent borrowers[a]
Ohio	2 946	5,336	100 8	265 7
Oklahoma	5 661	10 997	211 3	538 7
Oregon	1 435	2 673	61 5	145 7
Pennsylvania	1 192	2 171	34 1	85 7
Puerto Rico	1 343	1 742	19 9	59 3
Rhode Island	18	23	0 6	1 4
South Carolina	3 082	7 040	128 9	250 6
South Dakota	6 654	14 080	168 2	538 7
Tennessee	4 764	8 877	151 6	347 5
Texas	9 504	23 914	656 6	875 9
Utah	445	709	8 3	34 1
Vermont	111	209	2 1	7 5
Virgin Islands	36	43	0 7	2 0
Virginia	2 637	5 544	84 7	163 9
Washington	1 235	2 469	56 1	136 0
West Virginia	446	693	7 4	22 0
Wisconsin	3 981	6 990	88 8	269 7
Wyoming	602	1 069	26 6	63 1
Total	**155,402**	**331,369**	**$6,833.2**	**$13,453.4**

[a]The total for delinquent payments and outstanding principal may be slightly different from the individual state and territory amounts because of rounding

Source FmHA Report Code 616

State/territory	Total delinquent borrowers	Total delinquent loans	Total delinquent payments[a]	Total outstanding principal owed by delinquent borrowers[a]
Ohio	916	2 141	41 4	101 7
Oklahoma	1 474	4 251	107 5	226 4
Oregon	281	703	23 4	47 4
Pennsylvania	185	437	8 4	17 0
Puerto Rico	135	168	1 4	2 8
Rhode Island	2	3	0 0[c]	0 1
South Carolina	1 305	4 181	89 3	158 4
South Dakota	2 573	7 483	92 0	274 4
Tennessee	1 405	3 387	65 9	132 2
Texas	3 548	12 775	430 3	480 5
Utah	59	97	2 0	4 7
Vermont	5	5	0 0[c]	0 1
Virgin Islands	4	5	0 0[c]	0 1
Virginia	1 147	3 147	52 2	89 9
Washington	170	453	18 8	33 9
West Virginia	19	35	0 8	1 1
Wisconsin	751	1 559	21 5	49 2
Wyoming	144	307	11 2	21 0
Total	**50,139**	**156,879**	**$4,065.0**	**$6,462.5**

[a]The total for delinquent payments and outstanding principal may be slightly different from the individual state and territory amounts because of rounding

[b]No emergency loans reported for Alaska

[c]The figure is less than $0.05 million

Source FmHA Report Code 616

Statistical Estimates and Associated Sampling Errors

This appendix lists the statistical estimates for the attributes examined in our random sample of delinquent emergency loan borrowers in 13 county offices in Georgia, Mississippi, and Texas. (See app. IV.)

Because we reviewed a statistical sample of borrowers, each estimate developed from the sample has a measurable precision, or sampling error. The sampling error is the maximum amount by which an estimate obtained from a sample can be expected to differ from the characteristics of the universe. Combining the estimates with their respective sampling errors yields confidence intervals, the lower and upper limits of which are listed on the following pages. Confidence intervals are usually stated at a certain confidence level—in this sample, 90 percent. This means that 9 out of 10 of all possible random samples of the same size would yield confidence intervals that would include the results obtained if the entire universe of all delinquent emergency loan borrowers in the sampled county offices were reviewed.

DCI[a] question or attribute	Estimate[b] Number	Estimate[b] Percent	Lower limit Number	Lower limit Percent	Upper limit Number	Upper limit Percent
Do you expect this borrower to have an uncollectible debt after liquidation and collection efforts have been exhausted?						
Not applicable	297	21.7	243	17.7	352	25.6
No	126	9.2	91	6.6	161	11.7
Yes	950	69.2	889	64.8	1 010	73.6
Total	**1,372[c]**	**100.0**				
In your opinion would this delinquent borrower qualify for any of the following servicing options?						
Options not applicable because borrower is now or will be current and is expected to remain so	296	21.5	241	17.6	350	25.5
Homestead provision for retention of principal residence and reasonable amount of adjoining land						
No opinion—not knowledgeable about option[d]	0	0.0				
Yes	157	11.5	118	8.6	197	14.3
No	920	67.0	858	62.5	981	71.5
Total	**1,077**	**78.5**				
Reamortization and/or rescheduling of loan payments with the use of future revenues produced from softwood timber crops planted on marginal land						
No opinion—not knowledgeable about option[d]	36	2.6				
Yes[e]	5	0.4				
No	1 036	75.4	978	71.3	1 093	79.6
Total	**1,077**	**78.5[c]**				
Special consideration (first priority) for leasing or leasing with the option to purchase from FmHA land that borrower owned prior to liquidation						
No opinion—not knowledgeable about option[d]	7	0.5				
Yes	57	4.2				
No	1 013	73.8	955	69.6	1 072	78.1
Total	**1,077**	**78.5**				

Case Studies on Delinquent Emergency Loan Borrowers

Chapter 3 provides two case studies (A and B) of delinquent emergency loan borrowers illustrating why borrowers became delinquent on emergency loans and how they accumulated large amounts of debt that they likely will be unable to repay. This appendix presents four additional case studies of delinquent emergency loan borrowers.

Case Study C

A soybean and grain producer, who owned 3,138 acres and leased up to 1,650 acres, owed $4.7 million in outstanding principal and $2 million in interest and was $4.8 million delinquent on emergency loans as of December 31, 1985. The borrower had received $4.9 million from 18 emergency loans between May 28, 1976, and May 14, 1985. The borrower filed chapter 11 bankruptcy in September 1985. According to documents in the loan file, the borrower's debts ($7.3 million) exceeded assets ($1.4 million) by $5.9 million as of December 6, 1985.

The county supervisor estimated that FmHA will lose about $5 million in uncollectible debt from these loans and attributed this borrower's delinquency and failure partially to unsound farming and financial practices. As an example of the latter, the county supervisor indicated that the borrower had used some emergency loan money for expensive automobiles and vacations. The county supervisor added that liberal FmHA credit allowed the borrower to obtain additional loans and accumulate excessive debt, even though the borrower was already seriously delinquent on existing loans and could not show repayment ability. According to notes in this borrower's loan file, state FmHA officials had encouraged carrying the accounts as delinquent and making additional loans to keep from foreclosing on the borrower.

Case Study D

In 1979 a corn, peanut, and soybean producer, who owned 127 acres and leased about 153 acres, obtained three emergency loans totaling $71,200. The loans were obtained to cover losses resulting from a 1978 drought and to pay other debts. In 1979 the borrower owed other lenders about $166,000 and had a net worth of about $41,000. The borrower received five more emergency loans totaling $173,100 in 1980 and 1981. Only $40,000 of this amount was for actual losses; $133,100 was for annual operating and major adjustment loans.

By 1982 the borrower was about $73,000 delinquent on FmHA loans and had a negative net worth of about $9,000. However, pursuant to the 1982 FmHA continuation directive, the borrower received additional

The county supervisor said all servicing actions have been exhausted on this borrower, but FmHA had not started foreclosure action. The county supervisor estimated that after all assets have been liquidated and applied to the borrower's debt, FmHA would probably have uncollectible debt of about $400,000. The county supervisor attributed this borrower's delinquency to adverse weather, economic factors, and the high-risk nature of emergency loans. However, on the basis of information in the loan file, we believe that this borrower received additional loans because of the continuation policy. This policy, plus the borrower's decision to give priority to paying other creditors, contributed to the delinquency. Further, this borrower had never qualified for an emergency actual loss loan by suffering a production loss of 30 percent or more but had assumed another borrower's emergency loan, which is permissible under FmHA's regulations

Case Study F

In 1976 a borrower who was in the grocery and service station business, as well as row-crop farming, received a regular annual operating loan from FmHA totaling $7,500. At this time, the borrower reported a net worth of $87,109. The borrower received another operating loan for $16,000 and two emergency loans totaling $217,500 in 1977. The borrower used the emergency loan funds to pay annual installments on prior FmHA loans ($18,526), private lender loans ($106,286), and unsecured debts ($92,664). In 1978 the borrower received a $34,200 operating loan from FmHA and a $74,000 loan from a private lender.

In 1979 this borrower received four more FmHA emergency loans totaling $159,640 and used the funds to pay FmHA ($67,884) and private lenders' loan installments and to operate the farm in 1979. In August 1980 this borrower received two economic emergency loans from FmHA totaling $259,480 and $250,000 from the Federal Land Bank to change the major farming enterprise to a dairy operation

This borrower received three emergency loans totaling $221,860 in 1981 and one emergency annual production loan for $70,000 in 1982, but FmHA rejected an application for a loan of $275,000 in 1983 because the farming operation exceeded the family-farm criteria In 1984 FmHA restructured—rescheduled and reamortized—the borrower's debt on the basis of the borrower's confidence in winning a pending legal suit and meeting a new total installment payment of $24,444 by January 1, 1985. As of October 1985, the borrower had not made any payments on the loans restructured in 1984, and the county supervisor recommended foreclosure proceedings, as well as civil and criminal action against the

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borrower because of apparent conversion and misuse of government security.

As of January 16, 1986, this borrower owed FmHA about $897,000 in principal and $127,000 in accrued interest on loans totaling almost $1 million during a 7-year period. In February 1986 FmHA was informed that the borrower had filed for bankruptcy. The county supervisor attributed this borrower's delinquency to unsound farming and financial practices and expects that FmHA will have uncollectible debt of about $600,000 after liquidating this borrower's assets.

operating loans in 1982, 1983, and 1984, totaling $114,000. The borrower's application for a 1985 operating loan was rejected because payment had not been made on the 1984 operating loan and the borrower had not followed the 1984 Farm and Home Plan. At that time, the borrower was about $190,000 delinquent on FmHA loans and had a negative net worth of about $140,000

In summary, the borrower was delinquent on FmHA farm loans for 3 of the 6 years. As of September 1986, the borrower owed FmHA about $285,000 in emergency loans and was $242,000 delinquent. The county supervisor expects FmHA will lose about $240,000 in uncollectible debt from the emergency loans when the borrower liquidates and attributes the borrower's delinquency primarily to poor farming practices and the high-risk nature of emergency loans.

Case Study E

As of June 1986, a cotton farmer, who owned 200 acres and leased about 863 acres, was delinquent $370,851 on a portfolio of farm program loans that included one emergency loan, five operating loans, and one economic emergency loan. The original amount of all these loans totaled $506,660.

From 1982 through 1985, this borrower's gross farm income ranged from about $68,000 to $142,000, with an annual average of $113,549. The borrower's farm operating expenses ranged from about $96,000 to $215,000, with an annual average of $172,822, or about $60,000 more than the average gross income. The borrower paid other creditors $433,440, or 76 percent, of $570,776 due but paid FmHA only $39,201, or 11 percent, of $359,686 due. During this same time period, the borrower's net worth decreased from a negative $3,988 to a negative $59,808.

In 1985 the continuation policy allowed FmHA to make this borrower a new $61,500 operating loan despite the Farm and Home Plan's showing repayment of only $61,935 of the approximately $360,000 in existing FmHA debt due that year The borrower actually paid only $2,745 of the $61,935 scheduled payment for 1985. In 1986 the borrower's negative net worth increased to $313,499, and the Farm and Home Plan would not show cash flow, even when all restructuring options had been considered. Consequently, FmHA would not approve the borrower's loan request.

	Estimate[b]		Lower limit		Upper limit	
DCI[a] question or attribute	**Number**	**Percent**	**Number**	**Percent**	**Number**	**Percent**
Cancellation of a portion of borrower's FmHA debt in exchange for a conservation, recreational, or wildlife easement on wetland, upland, or highly erodible land						
No opinion—not knowledgeable about option[e]	42	3.1				
Yes[e]	26	1.9				
No	1,008	73.5	950	69.2	1,067	77.7
Total	**1,077[c]**	**78.5**				
Write off (forgive) sufficient delinquent debt to produce a positive cash flow that will allow FmHA to continue financing the borrower's operation						
Yes	61	4.4	32	2.4	89	6.5
No	1,016	74.0	958	69.8	1,074	78.3
Total	**1,077**	**78.5[c]**				
Total	**1,372[c]**	**100.0**				

[a]DCI (data collection instrument)

[b]Where the estimate for any count in sample is zero, the confidence interval may be understated because of the nature of the computation

[c]Details do not add to total because of rounding

[d]Estimate was not totaled because more than one action or reason applied to some borrowers. Data were as of September 30, 1986

[e]The rates of occurrence in the sample are not sufficient to accurately estimate confidence intervals. Point estimates are provided only to show that the rate of occurrence is probably relatively small

Source: GAO projections of sample attributes

Table V.1: Statistical Estimates and Confidence Intervals for Attributes of Delinquent Emergency Loan Borrowers in Case-Study County Offices

DCI[a] question or attribute	Estimate[b] Number	Estimate[b] Percent	Lower limit Number	Lower limit Percent	Upper limit Number	Upper limit Percent
Is this borrower actively farming in 1986?						
Yes	720	52.4	655	47.7	785	57.2
No	653	47.6	588	42.8	718	52.3
Total	**1,373[c]**	**100.0**				
If this borrower received a notice of servicing action letter, what, if any, servicing actions did FmHA take?[d]						
Restructured debt (rescheduled, reamortized, consolidated, etc.)	325	23.7	270	19.7	380	27.7
Above servicing actions could not be taken and FmHA initiated foreclosure action	117	8.5	83	6.1	151	11.0
Borrower voluntarily liquidated assets	248	18.0	200	14.5	296	21.5
Borrower filed bankruptcy	95	6.9	62	4.5	128	9.3
None—borrower responded to letter, but FmHA has taken no further action	118	8.6	84	6.1	152	11.0
All options exhausted, but FmHA has not accelerated collection efforts	116	8.5	80	5.8	152	11.1
Borrower has appealed FmHA rejection of servicing options or appeal is pending[e]	53	3.9				
Borrower paid current[e]	41	3.0				
Servicing options exhausted—prior lien holder foreclosure[e]	4	0.3				
Other[e]	21	1.5				
Not applicable—no servicing letter sent	235	17.1	186	13.6	283	20.6
Major reasons for delinquency?[d]						
Weather, economy, illness, or family problems	879	64.0	822	59.9	937	68.2
Unsound farm or financial practices, available income not applied, or payment application factors	506	36.9	446	32.5	566	41.2
Program factors	289	21.1	238	17.3	341	24.8
Can you categorize this borrower's future potential for repaying the delinquent emergency loan debt?						
Borrower has been or will be rescheduled and will likely remain current	244	17.8	194	14.1	295	21.5
Borrower has been or will be rescheduled but will likely return to delinquency	84	6.1	52	3.8	117	8.5
Borrower will likely pay current within 1 year	13	0.9				
Borrower will likely pay current after 1 year	4	0.3				
Borrower will likely make some payments but never will become current	196	14.3	153	11.1	238	17.3
Borrower will likely never make additional loan payments	759	55.3	695	50.6	824	60.0
Other	72	5.2	44	3.2	100	7.3
Total	**1,372[c]**	**100.0**				

(continued)

State and FmHA County Offices Visited and Number of Delinquent Emergency Loan Borrowers Reviewed

State and FmHA county office location	Number of counties in jurisdiction	Randomly selected borrowers delinquent less than $1 million	All borrowers delinquent $1 million or more	Total sample size
Georgia				
Athens	4	8	0	8
Camilla	1	27	2	29
Macon	6	23	9	32
Waynesboro	2	21	8	29
Total	**13**	**79**	**19**	**98**
Mississippi				
Booneville	1	15	0	15
Clarksdale	1	31	3	34
Louisville	1	5	0	5
Poplarville	1	32	1	33
Total	**4**	**83**	**4**	**87**
Texas				
Crosbyton	1	23	0	23
El Paso	3	4	4	8
Levelland	1	42	1	43
Nacogdoches	1	6	0	6
Sweetwater	2	13	0	13
Total	**8**	**88**	**5**	**93**
Total	**25**	**250**	**28**	**278**

Delinquent Emergency Program Direct Loan Activity, June 30, 1986

Dollars in millions

State/territory	Total delinquent borrowers	Total delinquent loans	Total delinquent payments[a]	Total outstanding principal owed by delinquent borrowers[a]
Alabama	1,215	4,281	$95.0	$137.2
Alaska	[b]	[b]	[b]	[b]
Arizona	289	1,253	107.8	135.2
Arkansas	2,608	8,388	200.2	316.0
California	687	2,166	334.6	488.0
Colorado	279	684	19.2	40.1
Connecticut	6	11	0.7	7.6
Delaware	23	51	0.8	1.5
Florida	824	3,053	127.9	150.7
Georgia	3,441	17,299	614.6	675.2
Guam	3	7	0.1	0.1
Hawaii	9	10	0.2	1.0
Idaho	374	1,033	44.1	71.8
Illinois	1,611	3,349	45.1	91.9
Indiana	957	2,170	49.0	97.8
Iowa	1,995	4,198	48.3	124.1
Kansas	1,152	2,390	28.1	71.7
Kentucky	1,199	2,918	22.7	93.0
Louisiana	2,336	9,392	238.1	350.3
Maine	228	866	26.8	35.6
Maryland	127	244	4.2	8.1
Massachusetts	9	47	0.5	2.0
Michigan	904	2,513	58.5	119.1
Minnesota	2,001	5,358	92.1	182.7
Mississippi	3,834	16,722	493.1	683.0
Missouri	2,934	7,515	95.0	216.1
Montana	662	2,062	51.9	112.8
Nebraska	1,478	3,231	50.2	120.1
Nevada	15	29	1.0	2.4
New Hampshire	1	2	0.0[c]	0.0[c]
New Jersey	182	451	9.4	15.3
New Mexico	170	471	15.4	27.5
New York	959	2,684	52.8	90.9
North Carolina	1,793	5,603	92.6	153.1
North Dakota	1,[illegible]1	5,292	79.0	199.3

(continued)

Delinquent FmHA Major Farmer Program Direct Loan Activity, June 30, 1986

Dollars in millions

State/territory	Total delinquent borrowers	Total delinquent loans	Total delinquent payments[a]	Total outstanding principal owed by delinquent borrowers[a]
Alabama	2,864	7,063	$133.2	$216.6
Alaska	4	8	0.1	0.2
Arizona	967	2,368	140.0	204.2
Arkansas	6,878	15,028	296.1	538.9
California	2,472	5,046	419.9	675.8
Colorado	1,498	2,718	63.4	145.8
Connecticut	60	86	2.1	12.2
Delaware	85	136	2.8	5.9
Florida	2,438	5,986	199.7	258.6
Georgia	7,178	23,659	747.9	890.0
Guam	6	11	0.1	0.1
Hawaii	98	117	1.0	10.7
Idaho	3,107	5,703	136.0	288.7
Illinois	4,590	7,984	116.3	291.0
Indiana	4,097	7,356	164.2	371.3
Iowa	7,173	13,055	164.5	519.9
Kansas	3,979	6,414	80.2	250.9
Kentucky	4,217	7,465	65.0	269.7
Louisiana	6,104	16,874	360.6	575.0
Maine	1,027	2,530	44.1	80.3
Maryland	448	766	12.7	28.3
Massachusetts	103	195	2.3	8.6
Michigan	3,393	6,782	122.7	302.7
Minnesota	7,339	13,897	214.6	533.7
Mississippi	8,641	24,658	631.8	931.1
Missouri	8,624	16,495	195.6	522.6
Montana	1,971	4,557	89.4	232.9
Nebraska	5,300	8,808	139.2	405.0
Nevada	213	377	8.4	21.1
New Hampshire	17	39	0.2	1.0
New Jersey	526	1,016	17.2	32.0
New Mexico	861	1,583	37.3	85.3
New York	3,087	6,156	99.0	202.2
North Carolina	5,193	11,537	176.9	330.5
North Dakota	4,752	10,318	140.5	403.0

(continued)

Request Letter From the Chairman, Subcommittee on Agriculture, Rural Development, and Related Agencies, Senate Committee on Appropriations

United States Senate

COMMITTEE ON APPROPRIATIONS
WASHINGTON, DC 20510

March 27, 1986

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

Dear Mr. Bowsher:

In January 1986, the General Accounting Office issued two reports on the financial condition of the Farmers Home Administration's (FmHA) loan portfolio and its borrowers and testified on these reports before the Senate Committee on Agriculture, Nutrition, and Forestry, of which I am also a member. These reports showed that a large portion of the FmHA loan portfolio and its borrowers were in severe financial difficulty. FmHA is taking a closer look at long-term delinquencies under its revised loan servicing regulations, and many FmHA borrowers may now find themselves in financial jeopardy. I am greatly concerned about the ramifications of the continuing credit crunch in agriculture, particularly in states where FmHA provides a high percentage of total farm credit and where delinquency rates are highest.

The FmHA loan program that seems to be having the most difficulty is the emergency disaster program which is FmHA's largest farmer loan program and has the highest delinquency rate. Your office reported that as of June 30, 1985, almost $4 billion of the $6.4 billion delinquent payments on major farmer program loans was in that program, and about $3 billion of the delinquent amount was delinquent for more than 3 years. In addition, the states with the largest delinquent amounts are located primarily in the southern region of the country where FmHA provides the largest percentage of total farm credit.

generic, negotiable commodity credit certificates redeemable from stocks of commodities held by USDA's Commodity Credit Corporation. The law provided for the transfer of $400 million from FmHA's fiscal year 1987 emergency loan program to the Commodity Credit Corporation.

Striking a proper balance between what risks the farmer will assume and those that the government will assume is a difficult task. Given the current range of programs available to help farmers recover from a disaster—emergency loans at subsidized interest rates, disaster payments, federal crop insurance—the Congress may wish to consider whether a proper balance is being struck between the farmer and the government in protecting against disaster losses. Is the government assuming risks that farmers can, but are unwilling, to assume? Are further steps needed to refine policies defining when the government will step in?

How Should Disaster Relief Be Provided?

In answering the questions on who should provide disaster relief and how, the Congress may wish to consider whether credit is the proper vehicle for providing disaster relief and, if so, what role it should play. The financial conditions of FmHA's emergency loan program and of the borrowers with emergency loans go far in demonstrating the difficulty that farmers face in incurring a heavy debt load to recover from disaster losses. Furthermore, FmHA's Assistant Administrator for Farmer Programs stated that many Southeastern U.S. farmers who suffered losses as a result of the 1986 drought will not be able to qualify for disaster loans because they are already overburdened with debt. The Congress, in passing Section 633(B) of the 1987 appropriation, recognized that credit does not always help farmers recover from disaster losses.

Between 1949 and 1972 FmHA's loan policies provided assistance only to borrowers who suffered actual losses. During this 24-year period, annual loan activity did not exceed $128 million and exceeded $100 million only 5 times. With the expansion of program benefits in the early 1970s and 1980s to cover more than actual losses, annual loan outlays grew dramatically to over $1 billion between the late 1970s and mid-1980s, with more than $5 billion loaned in fiscal year 1981.

The history of the emergency loan program shows that when credit is used to help farmers recover from disaster losses, FmHA's credit policies need to be sound to enable borrowers to survive financially over the long run. While some farmers may have benefited from expanded program coverage, others did not. Under past liberal loan policies, some addition, the Food Security Act of 1985 limited emergency loan eligibility to family-size farms and restricted loan eligibility, starting in 1987, to persons for whom federal crop insurance was unavailable.

Program Features Contributing to Large Emergency Loan Debt Eliminated

With the phaseout of major adjustment loans and annual production loans under the emergency loan program, FmHA now provides assistance to help farmers recover only from actual losses. On the basis of past experience, the delinquent debt should go down if loans are provided only for actual losses. For example, from 1949 to 1972, the emergency program covered primarily actual losses and had a repayment rate of about 94 percent. Additionally, FmHA's rescinding of the continuation policy should have contributed to improved portfolio performance, as well as reduced the amount of outstanding debt that would be at risk for FmHA's marginal borrowers. However, the July 1987 congressional action to reinstitute this policy may have the effect of reversing FmHA's progress in improving the deteriorated financial condition of its farm loan portfolio, including the emergency loan program.

Other Program Changes Will Reduce Participation and the Size of Future Loans

Additional changes in the emergency loan program in 1985 and 1986 will reduce both the number of borrowers eligible for emergency loans and the size of future emergency loans. First, the Food Security Act of 1985 restricted eligibility for emergency loans to family farms. Before that time the emergency program, unlike other FmHA farmer loan programs, had no farm-size restrictions, and loans were made to operators of larger than family farms. FmHA defines a family farm as one that can be operated and managed by the borrower's family, or by the members of borrowers' families if the farm is operated by a partnership, corporation, or cooperative. A reasonable amount of hired labor may be employed on family farms during peak load periods.

The Food Security Act of 1985 also specified that applicants will not be eligible for emergency loans to cover damages and losses to any crops planted or harvested after December 31, 1986, that could have been, but were not, insured with Federal Crop Insurance Corporation crop insurance. This restriction does not apply if crops could not be planted because of a disaster. The crop insurance requirement should reduce the size of loans and the amount needed to fund the emergency loan program.

Programs, few delinquent borrowers would qualify for these provisions In addition, the 13 county supervisors we contacted estimated that about 5 and 15 percent of the delinquent emergency loan borrowers likely would qualify for the lease purchase and dwelling retention options, respectively (See table 4.5.)

Before approving a lease of the farm property with or without an option to purchase, FmHA's regulations require that FmHA determine that the previous owner or operator has sufficient experience, management skills, and financial resources to ensure a reasonable prospect of success in the farming operation In making this determination, FmHA will evaluate the previous owner's or operator's financial and production records and determine whether the failure was caused by factors beyond the farmer's control, such as natural disasters, inflated farm operating costs, high interest rates, and low crop prices.

The dwelling retention program provides that a borrower meeting the eligibility requirements may apply to lease, with an option to purchase, for a period of not less than 3 years or more than 5 years, the residence and a reasonable amount of adjoining land—normally not more than 5 acres To qualify for this program borrowers, among other things,

- must have possessed and occupied the dwelling and engaged in farming or ranching operations during the 5-year period ending December 31, 1985, and still remain in possession of the property;
- must have sufficient income to make rental payments based upon equivalent rents charged for similar residential properties in the area, maintain the property in good condition, and agree to all terms and conditions specified by FmHA; and
- will personally occupy the dwelling as a personal residence and must not own other suitable housing

FmHA's Assistant Administrator for Farmer Programs stated that many farmers would not qualify for either leasing the farm property with an option to purchase or retaining the dwelling because

- the liquidated farmers would most likely have difficulty obtaining the necessary financing to operate a farm because of their deteriorated financial condition·
- the property lease option applies only to real estate, and the farmer would have to acquire the equipment and other essentials to operate the farm;

- own real estate that secures an FmHA farmer program loan that was made before December 23, 1985;
- be unable to repay FmHA loans without the cancellation of debt associated with the easement;
- demonstrate repayment ability on the FmHA debt remaining after the easement is established; and
- have row cropped, with the exception of wetland, the proposed easement land each year during the 3-year period ending December 23, 1985.

The second servicing option provides for deferring and reamortizing distressed FmHA farmer program loans with the use of future revenue produced from softwood timber planted on marginal land. This new feature is intended to help financially stressed FmHA borrowers to develop a positive cash flow for their farming operation, increase the future production of softwood timber, take marginal land out of agricultural production, and assist in the control of soil erosion. In accordance with Section 1254 of the Food Security Act of 1985, payments on the reamortized loans may be deferred for up to 45 years, but repayment must be completed within 50 years after reamortization. The marginal land must previously have produced agricultural commodities or been used as pasture and may not have any lien against it other than the FmHA loans to be reamortized. The total amount of loans secured by the marginal land cannot exceed $1,000 per acre. The Food Security Act of 1985 also effectively limited the number of borrowers who can qualify for this option to no more than 1,000, because the provision limits the total program to 50,000 acres and requires each participant to set aside at least 50 acres of marginal land for softwood timber production. Under FmHA's proposed regulations, the borrower must also show debt repayment ability, reliability, and managerial ability to carry out the proposed operation.

FmHA's Assistant Administrator for Farmer Programs stated that many FmHA borrowers may not be able to take advantage of the conservation easement or softwood timber options to reschedule debt and defer FmHA loan payments because they may be unable to demonstrate repayment ability on their remaining debt. The Assistant Administrator also said the softwood timber option had two impediments to extensive use: (1) the Food Security Act of 1985 limits participation to no more than 1,000 borrowers and (2) most borrowers will be unable to demonstrate repayment ability after the 45-year deferral period because of the interest accrual over this period

Our work in Georgia, Mississippi, and Texas supported the Assistant Administrator's opinions We asked 13 county supervisors for their

Table 4.2: Methods of Liquidating Borrowers' Accounts During Calendar Year 1986

	Frequency of application[a]	
Method	**Number**	**Percent**
Borrower transferred security property and debt to someone else	213	5
Borrower conveyed security property to FmHA	712	15
Borrowers sold security property and applied proceeds to FmHA loans	2,713	59
Another lender foreclosed	495	11
FmHA foreclosed	205	4
Bankruptcy liquidation	255	6
Total	**4,593[a]**	**100**

[a]The methods of liquidation total more than the 4,303 liquidated borrowers because some liquidations involved a combination of methods.

Source: FmHA's Servicing Activity Report as of January 31, 1987.

Our work in the 13 FmHA county offices further demonstrated that loan-servicing options are not always successful. As of September 30, 1986, we project that about 41 percent of the delinquent emergency loan borrowers in these county offices had liquidated assets through either voluntary conveyance and bankruptcy or FmHA and other lenders' foreclosure actions. (See table 4.3.)

Recent Program Changes Should Help Resolve Some Past Problems but Will Limit Future Participation

FmHA has developed guidelines for servicing delinquent loan accounts and implemented new servicing options to help liquidated borrowers lease back their farms with an option to purchase or retain their dwellings. Unfortunately, many farmers are so deeply in debt that FmHA will be unable to (1) resolve their delinquencies through servicing actions, (2) assist them after liquidation, or (3) lend them money in the future.

Since 1980 the Congress and FmHA have taken steps to eliminate program features that contributed to the high delinquent emergency loan debt. FmHA has also changed its loan-making and servicing policies, which should help minimize future delinquencies. These changes will probably limit the size of future emergency loans and make them available to fewer farmers

FmHA Actions to Deal With Delinquent Emergency Loan Debt

FmHA farm loan-servicing regulations apply generally to delinquent borrowers with major farm program loans. Consequently, FmHA actions related to delinquent emergency loan debt are part of the overall effort to deal with its delinquent farm loans. FmHA has three separate approaches for dealing with delinquent borrowers who cannot or will not make their accounts current: (1) restructure debt to help borrowers become current on their accounts, (2) liquidate delinquent borrowers' accounts through foreclosure or voluntary conveyance when delinquencies cannot be resolved through restructuring actions, and (3) help qualified borrowers to retain their homesteads and or continue in farming after liquidation through various provisions of the Food Security Act of 1985

Loan-Servicing Options Helped Make Delinquent Accounts Current

FmHA expects all its borrowers to repay their loans according to planned repayment schedules. FmHA recognizes, however, that borrowers sometimes will not be able to pay as scheduled and has established regulations offering a variety of loan-servicing options to help delinquent borrowers to make their accounts current. In November 1985 FmHA revised its loan-servicing regulations to offer borrowers an opportunity to restructure their debt using a variety of options, such as (1) consolidating, rescheduling, or deferring payments; (2) providing loans at reduced interest rates to borrowers with limited resources; (3) reamortizing loans; (4) subordinating FmHA's lien to that of another creditor; and (5) restructuring the farming operation and debt by selling a portion of the assets.

During 1984 and 1985 the borrower financed his farming operations from income provided by relatives, a nonfarming operation, and suppliers' credit. In August 1985, the borrower filed chapter 11 bankruptcy. His bankruptcy plan was subsequently confirmed in April 1986.

Although information in the borrower's loan file indicated that adverse weather conditions and the poor farm economy had adversely affected this borrower, the county supervisor said the borrower's poor farming practices—inadequate fertilization and weed and insect control—were a major reason for delinquency. He stated that poor financial management, including the purchases of unnecessary farm equipment and an expensive car, also contributed to the delinquency. We believe FmHA's liberal credit policy, which allowed additional loans to this borrower while he was delinquent on other loans also contributed to the large amount of delinquent payments.

Case Study B

This borrower received seven emergency loans totaling about $7.9 million from 1979 through 1981. The borrower's last cash payment on these loans was in September 1983. As of June 1986, he was delinquent about $8.3 million in principal and interest and was accruing additional interest at a rate of $1,821 per day. Three of the seven loans were for actual production losses, but they represented only about 10 percent, or $806,110, of the total original emergency loan debt. About 86 percent of the debt was from emergency annual production loans.

This borrower had a farming and ranching operation of 18,574 acres. His agricultural production consisted of cattle grazing and crops, such as milo, wheat, barley, cotton, and soybeans. In 1982 the first lien holder, who had a lien of $7.6 million against the land, foreclosed on the loan; and FmHA, which was in a subordinate lien position on the land, chose not to protect its investment by paying off the first lien holder because the total cost, including rapidly accruing interest, could exceed the property's estimated maximum value of about $9 million. Because of FmHA's subordinated lien position and the first lien holder's large lien against the land, FmHA was virtually unsecured on this borrower's emergency loan debt. Table 3.4 provides details on the borrower's emergency loans.

Projections Based on FmHA Study Show Large Farm Program Loan Losses

In July and August 1985, FmHA conducted an internal loan classification study of 4,258 farm program borrowers for budgeting, servicing, and credit assistance purposes. The study included a statistically valid random sample of 4,146 borrowers selected from all farm program borrowers nationwide who had FmHA debt of less than $3 million each and all 112 farm program borrowers who each had FmHA debt of $3 million or more. The sample was designed to result in a sampling error of no more than 2 percent, with a 95-percent confidence level. On the basis of the sample results, FmHA projected a possible loss of $7.73 billion on all farm loans.

To verify FmHA's projection we used FmHA's sample information and made a projection to the universes of both borrowers who have farm loans and borrowers who have delinquent emergency loans. Our projection showed that FmHA could lose about $7.8 billion, slightly more than FmHA's projection—$7.5 billion on loans made to borrowers who each had FmHA debt of less than $3 million and $347 million from borrowers who had debt of $3 million or more. We also projected that, of the $7.8 billion, FmHA could lose about $5.2 billion from farm loans to borrowers who were delinquent on one or more emergency loans as of June 30, 1985.

Case Studies Illustrating How Various Factors Contributed to Delinquencies

During our visits to the 13 FmHA county offices, we developed case studies to demonstrate how various factors can contribute to a borrower's delinquency. These case studies may not be typical, but we believe they illustrate how the factors described can contribute to why borrowers become delinquent and/or increase emergency loan delinquent payments. They also show how delinquent and sometimes technically insolvent borrowers obtained additional funding under FmHA's continuation policy. The following case studies include both a borrower with less than $1 million in delinquent emergency loan payments (case A) and one with over $1 million in delinquent emergency loan payments (case B). Additional case studies are included in appendix VI

Case Study A

This borrower received emergency loans totaling about $1.7 million over a 6-year period and was delinquent on FmHA loans for 5 of these 6 years. As of January 1, 1986, the borrower had outstanding principal and interest of about $1.1 million on all farm program loans. FmHA expects that about $1 million of the outstanding debt will be uncollectible.

"FmHA's liberal credit policies and program management have resulted in continued financing of unsound farming operations . . . From the mid 1970's until the present, FmHA's liberal credit policies for the Emergency Loan (EM) Program, as well as other farm loan programs, have allowed marginal farmers to borrow more than they can possibly repay, resulting in delinquent loan accounts."

In regard to the continuation policy, the report stated,

"It is reasonable to assume that delinquencies will continue to increase under this liberalized policy that was designed to postpone and spread out imminent foreclosures and liquidations."

In responding to the report, the FmHA Administrator justified the continuation policy as a way to continue with the vast majority of FmHA borrowers and to spread out the number of cases requiring legal actions or forced liquidations over a period of several years.

Four of our case studies (A, C, D, and E) discussed later in this chapter and in appendix VI illustrate how some emergency loan borrowers' delinquent payments increased because of this liberal credit policy. In large part because of GAO's work, FmHA rescinded the continuation policy in November 1985, about 4 years after its inception, and stopped making loans to delinquent borrowers. However, in making supplemental appropriations for fiscal year 1987 (P.L. 100-71, July 11, 1987), the Congress included a provision that reinstituted the continuation policy. Reestablishment of this policy will likely result in increased loan delinquencies and losses if it remains in effect for an extended period of time.

Emergency Loan Delinquencies Increased During Period of Lawsuits

Between November 1981 and May 1983, FmHA borrowers filed several lawsuits challenging, among other things, FmHA's implementation of certain foreclosure actions. Coleman v. Block, initiated by several North Dakota farmers in May 1983 as a national class action lawsuit, resulted in injunctions suspending a number of FmHA foreclosure actions until certain notices and other procedures were provided to borrowers.

To conform to the order of the federal district court of North Dakota, on November 1, 1985, FmHA issued revised regulations (50 Fed. Reg. 45739) establishing procedures for the systematic servicing of delinquent borrower accounts, which is required for foreclosure action. However, during the approximately 3-year period before FmHA issued the revised regulations, from 1982 to 1985, FmHA loan foreclosures decreased from 844 to 89, and delinquent farm program debt increased by about $3.5 billion. Most of this increase was in the emergency loan program, where affect not only borrowers with emergency loans but also borrowers with other types of loans. Examples of these practices included

- spending more to produce a crop than its yield can return in revenue or spending less than is necessary to produce good yields,
- selling loan security without FmHA authorization,
- planting crops on land too poor for good production,
- failing to sell crops at a good market price,
- failing to apply available income to emergency loan payments,
- using emergency loan funds for expensive automobiles and vacations, and
- delaying scheduled loan payments during a period when an injunction prevented FmHA from foreclosing on delinquent borrowers.

High Dollar Amount of Delinquent Emergency Loan Payments Attributable to Program Features

Delinquent emergency loan payments have increased dramatically over the past 5 years, from $937 million in June 1981 to $4.1 billion in June 1986. At least 67 percent of the delinquent payments are attributable to loans that were made under program features providing for other than actual losses. In addition, the inherent risk of loaning money for disaster relief, the continuation policy that allowed new loans to delinquent borrowers, and borrower lawsuits that delayed FmHA foreclosures have added to delinquent payments, although we were unable to quantify these contributions

Expansion of Emergency Loan Coverage

As of June 30, 1986, at least $5.3 billion (56 percent) of the unpaid emergency loan principal and at least $2.7 billion (67 percent) of the delinquent payments can be attributed to expanded loan coverage through the major adjustment and annual production loans. We were able to segregate by loan type $9.3 billion of the $9.5 billion in unpaid principal on emergency loans and $3.8 billion of the $4.1 billion in delinquent payments. Table 3.2 shows that more money has been loaned under the expanded program coverage and that these type loans are more delinquent than those made for actual losses.

Many Factors Contribute to Emergency Loan Delinquencies and Losses

Because many interrelated factors can be involved, isolating a particular cause for an individual borrower's emergency loan delinquency is difficult. On the basis of our work in 13 county offices in Georgia, Mississippi, and Texas, adverse weather, a poor farm economy, and unsound farming and financial practices were major contributing factors in why most of our sample borrowers became delinquent. However, major factors contributing to the large amount of the borrowers' delinquent payments were (1) the inherent risk of loaning money for disaster relief; (2) expanded emergency program features, which accounted for at least 67 percent of the $4.1 billion in delinquent payments as of June 30, 1986; (3) liberal loan policies, and (4) a court-ordered suspension of foreclosure actions. These elements also contributed to delinquent borrowers accumulating large debt loads that they now find difficult to repay, but we were unable to quantify those contributions. On the basis of our analysis of an FmHA study conducted in July and August 1985, we estimate that FmHA could lose as much as $7.8 billion from all farm program loans, of which about $5.2 billion would be attributable to borrowers who were delinquent on one or more emergency loans as of June 30, 1985.

Why Borrowers Become Delinquent on Emergency Loans

FmHA officials in the national office, 3 state offices, and 13 county offices told us that borrowers become delinquent on FmHA farm loans because of a number of interrelated factors. Using responses from FmHA county supervisors from our 13 case-study county offices, we grouped the reasons for sampled borrowers' delinquencies into three broad categories—external elements, borrower practices, and program features. These supervisors cited external elements—such as adverse weather; a poor economy; and borrowers' illness, death, or family problems—as major factors contributing to about 64 percent of the delinquencies. They also cited borrowers' unsound farming and financial practices as major reasons for 37 percent of the delinquencies and program features as major reasons for 21 percent of the delinquencies. (See table 3.1.)

Our findings were similar to previous GAO and USDA Office of Inspector General reports that explained how many of these same factors have contributed to FmHA loan delinquencies and farm failures. For example, in June 1986 we reported[1] that 48 percent of 1,270 farm operation failures in 6 states were primarily attributable to external elements, such as weather disasters, economic factors, borrowers' deaths, and borrowers'

[1] Farmers Home Administration: Federally Acquired Farm Property Presents a Management Challenge (GAO/RCED-86-88, June 13, 1986).

Borrowers with emergency loans have, on average, the most outstanding debt and higher debt-to-asset ratios than borrowers who have no emergency loans. Borrowers with delinquent emergency loans are, on average, above the 100-percent debt-to-asset ratio, which classifies them as technically insolvent. (See table 2.4.) While most FmHA borrowers are experiencing financial problems, borrowers who have emergency loans are in the worst financial condition. (See table 2.5.)

Table 2.4: Average and Median Debt and Debt-To-Asset Ratios of Borrowers as of June 30, 1986

Debt-to-asset ratios in percent

Loan mix	Average debt	Average debt-to-asset ratio	Median debt	Median debt-to-asset ratio
All farm program borrowers	$203 864	87	$145 000	70
Borrowers with no emergency loans	161 482	77	110 000	70
Borrowers with emergency loans	245 501	96	180 000	75
Borrowers with one or more delinquent emergency loans	296 385	110	225 000	85

Source: The average and median debt and debt-to-asset ratios were based on data from borrowers 1983, 1984, 1985, and 1986 Farm and Home Plans contained in FmHA's Farmer Program Management Information System (FARMS) as of June 30, 1986. We used the latest data reported for each borrower and our analysis involved only borrowers who reported sufficient data to compute the debts and debt-to-asset ratios.

Table 2.5: Financial Status of Borrowers With Various Loan Mixes as of June 30, 1986

	Percentage of borrowers			
Financial status	All farm program borrowers	Borrowers with no emergency loans	Borrowers with emergency loans	Borrowers with delinquent emergency loans
Technically insolvent	21	17	24	36
Extreme financial problems	31	33	31	32
Serious financial problems	31	32	31	23
No apparent financial problems	17	18	14	9
Total	**100**	**100**	**100**	**100**

Source: GAO analysis of 1986 FARMS data.

Loan Losses

As delinquent dollars increased, so did loan losses for the emergency loan program. Direct loan losses in the emergency loan program (net of proceeds from sales of loan collateral) increased from about $14 million in fiscal year 1977 to about $205 million in fiscal year 1986. (See fig. 2.2.) Potential loan losses are in the billions, as discussed in chapter 3.

Emergency Loan Program Delinquent Debt Increased Sharply

Delinquent payments on FmHA's emergency program loans increased about $4 billion during the 10-year period from June 30, 1977, to June 30, 1986. In addition, the outstanding principal owed by delinquent emergency loan borrowers increased over $8 billion. (See fig. 2.1.) According to FmHA regulations, borrowers are to be considered delinquent if they have unpaid scheduled payments and the delinquent amount is greater than $100. In calculating the delinquent amount, FmHA offsets payments made ahead of schedule on other loans. Figure 2.1 shows that the amount of delinquent payments continues to increase even though total outstanding principal and outstanding principal on delinquent loans have leveled off since 1982.

Nationwide Distribution of Emergency Loan Delinquencies

The 10 states having the largest delinquent emergency loan debt are shown in table 2.2. The three states with the largest dollar amounts in delinquent emergency loan payments are Georgia, Mississippi, and Texas. Appendix III provides statistics on emergency loan delinquencies in all states and territories as of June 30, 1986.

Table 2.2: Ten States With Largest Delinquent Emergency Loan Debt as of June 30, 1986

Dollars in thousands

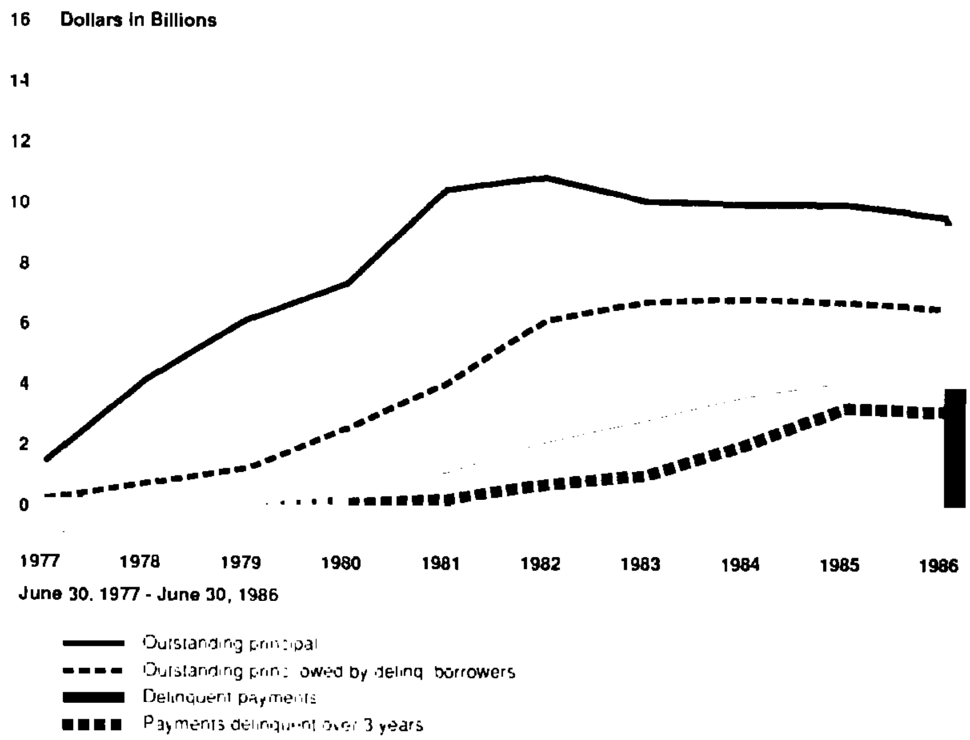
State	Number of loans	Delinquent loans	Percent of loans delinquent	Outstanding principal owed by delinquent borrowers	Delinquent payments
Georgia	20 743	17 299	83	$675 233	$614,633
Mississippi	23 060	16,729	73	683,045	493,060
Texas	19 906	12,775	64	480,502	430,294
California	2 934	2,166	74	488,011	334,629
Louisiana	13 266	9 392	71	350 250	238 102
Arkansas	13 835	8 388	61	316 041	200 171
Florida	3 801	3 053	80	150 669	127,890
Arizona	1 586	1 253	79	135,212	107,803
Oklahoma	7 866	4,251	54	226,392	107,549
Missouri	14 183	7 515	53	216,138	95,046
Total	**121,180**	**82,814**	**68**	**$3,721,493**	**$2,749,177**
National total	271 538	156,879	58	$6 462 475	$4,064,980

Source: GAO analysis of FmHA Active Borrowers Delinquent Report data (FmHA report code 616)

Age of Delinquent Emergency Loans

Borrowers may be delinquent on more than one loan within a loan program and by varying amounts of time. According to FmHA, borrowers over 3 years delinquent have little chance of becoming current on their

Figure 2.1: Emergency Loan Outstanding Principal and Delinquent Payments, June 30, 1977-86



Source GAO analysis of FmHA Active Borrowers Delinquent Report data (FmHA report code 616)

As we stated in a June 1986 report,[1] the worsening farm economy of the early 1980s prompted increased requests for FmHA loans from farmers who had limited ability to repay their loans. In an effort to assist farmers who were dealing with difficult farm credit conditions, FmHA revised its loan-servicing policy in February 1982 to allow delinquent borrowers to reschedule or defer outstanding indebtedness to FmHA and to obtain additional loans without proving their ability to repay prior loans. This revision, which became known as the "continuation policy," allowed FmHA personnel to make loans to borrowers who were delinquent on prior loans and/or were technically insolvent (their debts exceeded their assets). In large part because of GAO's work, FmHA rescinded the continuation policy in November 1985 and stopped making loans to delinquent borrowers. However, in making supplemental appropriations for fiscal year 1987 (P.L. 100-71, July 11, 1987), the Congress included a provision that reinstituted the continuation policy.

Efforts to tighten program features were hampered by lawsuits challenging, among other things, FmHA's implementation of foreclosure actions against borrowers. Several North Dakota farmers initiated what resulted in a national class action lawsuit against FmHA in May 1983. Subsequently, 1983 and 1984 federal district court decisions in this case, Coleman v. Block, 562 F. Supp. 1353 (D.N.D. 1983); 580 F. Supp. 194 (D.N.D. 1984), enjoined FmHA from proceeding in certain foreclosure actions until appropriate administrative procedures were provided to borrowers. FmHA did not resume foreclosure on delinquent borrowers' loans until the agency issued final regulations on administrative procedure matters in November 1985. On June 2, 1987, the same federal district court in Coleman v. Lyng, 663 F. Supp. 1315, 1339 (D.N.D. 1987), again enjoined FmHA from accelerating delinquent loans or instituting foreclosure action on delinquent borrowers until FmHA provided further procedural protections related to adverse actions notices. These notices directed the borrowers to contact FmHA within 30 days to attempt to resolve their delinquencies. The notices also provided that liquidation procedures would be instituted if the borrowers either did not contact FmHA within the required time frame or could not resolve their delinquent status through a variety of FmHA servicing actions such as rescheduling or deferring loan payments.

The Food Security Act of 1985 also included features designed to help curb emergency loan program costs, delinquencies, and losses. This act,

[1] Farmers Home Administration: Federally Acquired Farm Property Presents a Management Challenge (GAO/RCED-86-88, June 13, 1986).

Expanded Program Benefits Curtailed Between 1973 and 1974

Administrative and legislative actions taken in late 1972 and early 1973 curtailed the emergency loan program's expanded benefits. On December 27, 1972, the emergency loan program was administratively terminated. This action immediately cut off benefits to disaster areas designated by the Secretary of Agriculture and authorized a January 15, 1973, cutoff date for benefits to disaster areas designated by the President. This led to applicant confusion and charges of inequity. Public Law 93-24, enacted on April 20, 1973, repealed the benefits provided in 1970 and 1972 for disasters occurring between July 1, 1971, and June 30, 1973. The law extended the benefits provided under the 1972 statutes only to disaster areas designated during 1972, including the debt forgiveness provisions and the 1-percent interest rate for some applicants. Public Law 93-237, enacted on January 2, 1974, further extended disaster relief provided by emergency loan statutes in 1972 to disasters occurring after December 26, 1972, and before April 20, 1973.

Program Coverage Expanded Through Two New Loan Types Introduced in 1975

In 1975 Public Law 94-68, an amendment to the Consolidated Farm and Rural Development Act, reintroduced the requirement that borrowers under the program be unable to obtain sufficient credit elsewhere and broadened the emergency loan program by introducing two new loan types, annual production loans and major adjustment loans. This amendment contributed to another dramatic increase in the amounts loaned under the emergency loan program in fiscal years 1977 through 1984. This 1975 law also (1) required loan applicants to show that they sustained a minimum production loss of 20 percent (continuing FmHA policy in effect since 1972) and (2) allowed the use of new loans to refinance FmHA debt, a use first permitted under a 1975 amendment to Public Law 93-237. More significantly, FmHA had previously restricted the purpose for emergency loans to actual losses only, but the two new loan types made financing available for purposes other than actual losses.

Under these new emergency loan provisions, borrowers who had received emergency loss loans for annual operating purposes could be considered eligible for five subsequent annual emergency production loans without experiencing another disaster or loss. The subsequent production loans had to be made within 6 crop years after the disaster and were intended to permit borrowers additional time to return to their normal credit sources. Annual production loans could be used, among other things, to purchase production inputs and for family living expenses. These loans were (1) made at higher interest rates than the subsidized rates charged for actual loss loans and (2) generally scheduled for

Development and Financial Status of the Emergency Loan Program

Since its inception in 1949, the emergency loan program has gone through several cycles of broadened and tightened eligibility and benefits. Inevitably, when eligibility requirements were relaxed and program benefits were expanded, the government's cost for providing disaster relief grew through increased delinquencies, loan losses, and for a period, loan forgiveness. Each time, the increased cost led to policy and legislative changes to narrow the program, which lasted for a time before the program was expanded again

The emergency program history shows that the financial impact of relaxed eligibility and expanded benefits can be substantial. This is illustrated by the poor financial condition of the emergency loan program as of June 30, 1986 About 68 percent of its outstanding principal ($6.5 billion of $9.5 billion) was owed by delinquent borrowers; and delinquent payments amounted to $4.1 billion, of which $3.1 billion was more than 3 years in arrears and most likely will not be repaid. FmHA borrowers with emergency loans are in the worst financial condition of all FmHA farm borrowers, and those borrowers with delinquent emergency loans are, on average, technically insolvent. The poor financial condition of the emergency loan program is also reflected in increasing loan losses—with losses more than tripling to $204.5 million between fiscal years 1984 and 1986

Development of the Emergency Loan Program

Stability and gradual expansion of coverage and benefits characterized FmHA's emergency loan program from 1949 to 1972. Although periodic broadening and tightening of program coverage began in 1970, loan activity did not increase sharply until after 1972 when benefits previously available only for presidentially declared disasters became available for disasters designated by the Secretary of Agriculture The program was expanded in the 1970s and early 1980s to achieve objectives other than recovery from actual disaster losses, such as helping farmers survive during periods of financial stress or make major adjustments in their farming operations. The program has evolved back to providing coverage for actual losses, and legislative and policy changes made in the past few years have further tightened the program.

Program Coverage Generally Stable From 1949 to 1972

Although emergency loan benefits and coverage gradually expanded between 1949 and 1972, in comparison with later years the emergency loan program remained generally stable in terms of the number of loans made, the amount loaned and the amount repaid. From 1949 through the end of fiscal year 1972, FmHA records show it made over 538,000

Using appropriate statistical formulas, we weighted and projected the sample responses to the universe of 1,372 borrowers who had delinquent emergency loans in the 13 county offices. Chapters 3 and 4 summarize these results, and appendix V contains the 90-percent confidence intervals for the statistical estimates.

We coordinated our review with USDA's Office of Inspector General and reviewed its reports on FmHA's emergency loan program. We conducted our review from April 1986 through March 1987 and performed our work in accordance with generally accepted government auditing standards, although some of the data used had limitations as discussed below.

We obtained USDA comments on the results of our work, and the agency agreed with the information contained in the report.

Data Limitations

This report contains information from FmHA's automated data sources. We made limited tests of the validity and reliability of these automated data sources to determine whether the data were sufficient for the purposes of our review. Since we had performed limited testing of data in the Active Borrowers Delinquent Report file previously and our analysis and characterization of FmHA's borrower data and status were reasonably accurate for the two county offices where data were examined, we accepted the data for our review.

As part of our county office visits, we performed a limited test of the reported loan information in the Status Report of Farmer Program Accounts (FmHA 540 reports) and found the information to be reasonably accurate. However, this testing was insufficient to render an opinion on the overall reliability of this automated data file.

As stated in a previous GAO report,[2] the FARMS data file information is not projectable either nationally or to the individual state and county levels, because not all county offices have reported on all borrowers. In addition, one of the major data sources for the FARMS system is the Farm and Home Plan, a planning document that farmers use to develop a farm budget that projects production, commodity prices, and family living and production expenses. Our previous report stated that such data may be an optimistic projection of a borrower's financial condition.

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

In addition to providing information on what FmHA has done to deal with delinquent and uncollectible debt, we attempted to develop other alternatives for dealing with emergency loan debt that may be uncollectible. We identified one alternative not currently being used by FmHA—write-off or forgiveness of debt prior to liquidating the borrower's accounts To assess the costs and impacts of this alternative, we planned to perform computer analysis of delinquent emergency loan borrowers' accounts to determine if the borrowers could achieve a positive cash flow with varying levels of debt write-off. We were unable to perform this analysis, however because sufficient national data were not available.

Sources of Data Obtained

National statistics on (1) the number of emergency and other farm program delinquencies, (2) the amount of borrowers' assets and debts, (3) the status of farm loan accounts, and (4) FmHA servicing actions came from the following four FmHA data sources.

- The June 30, 1986, Active Borrowers Delinquent Report file (FmHA report code 616), which contains selected information on all active borrowers and loans in FmHA's farm loan portfolio. (See figs. 1.1, 1.3, 1.4, and 2.1 and tables 1.1 and 2.2.)
- The December 31, 1985, and June 30, 1986, Status Report of Farmer Program Accounts (FmHA report code 540), which reports borrower loan information, such as date of last loan payment and pending bankruptcies. (See table 2.3.)
- The June 30, 1986, Farmer Program Management Information System file, also called the FARMS data file, which contains financial and other information on borrowers' farm operations not available from the other files. (See tables 2.4 and 2.5.)
- The Servicing and Guaranteed Activity Report (national) ending December 31, 1986, which reported the number of borrowers in loan default as of December 31, 1985, and the status of actions to resolve those defaults, including specific methods of resolution.

We sorted, tabulated, and arrayed the information from these sources on borrowers and farm loan programs, including unpaid loan principal outstanding, delinquent debt, age of loan delinquencies, average and median debt and debt-to-asset ratios of borrowers, and methods of resolving loan defaults Much of this information is presented in chapter 2, and information on resolution of loan defaults is presented in chapter 4. Appendixes II and III contain data on delinquencies for all states and

FmHA now makes emergency loans for two types of actual losses: production and physical. Emergency loans are limited to a maximum of 80 percent of the actual production losses but may be made up to 100 percent of market value at the time of loss for physical losses. Currently, to qualify for an emergency production loss loan, an applicant must sustain a loss of at least 30 percent of a normal year's production in any single enterprise, such as all cash field crops, all feed crops, or one or more livestock operations. These enterprises must normally generate sufficient income to be considered essential to the success of the total farming operation. To qualify for a physical loss loan, a farmer must have sustained damage to or destruction of physical property that is essential to the successful operation of the farm, that is, if such property is not repaired or replaced, the farmer will be unable to continue reasonably sound operations.

Loan Amount, Interest Rates, and Repayment Terms

The maximum emergency loan amount available to any farmer is limited to the amount necessary to restore the farm to its pre-disaster condition, not to exceed the sum of the maximum production and physical loss or $500,000, whichever is less. Farmers can, however, receive subsequent emergency loans not to exceed their actual losses or $500,000, whichever is less, for each additional disaster.

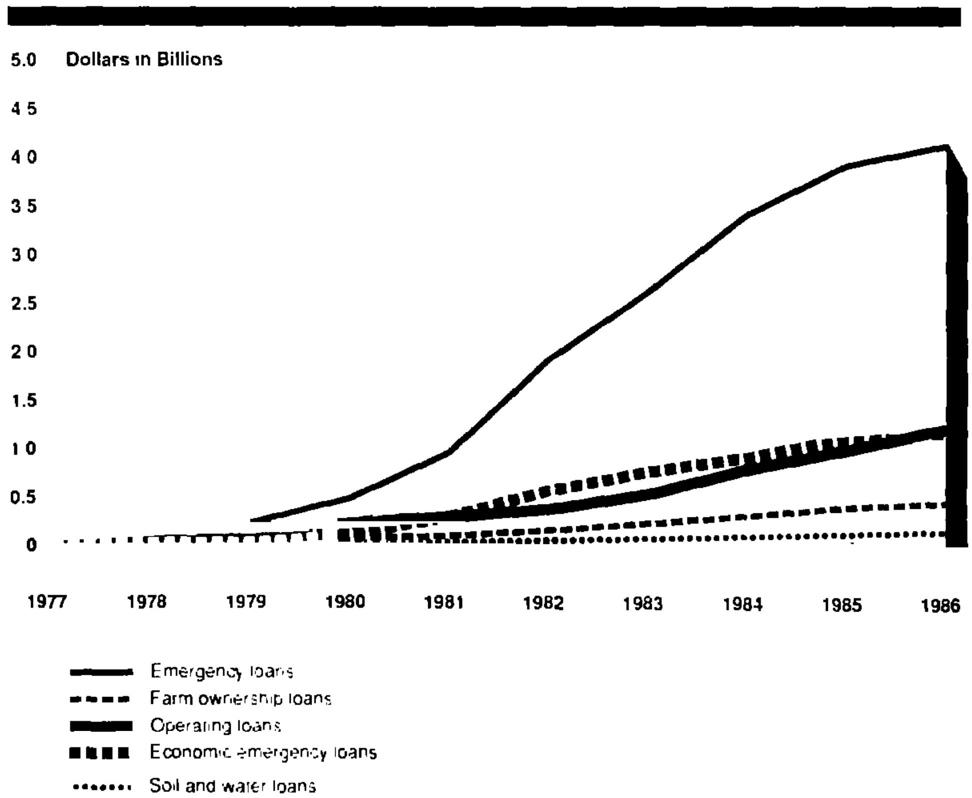
Loans to cover actual losses are made at subsidized interest rates. For loans made through November 18, 1986, the interest rate was 5 percent for loan amounts of up to $100,000, and 8 percent for loan amounts exceeding $100,000 up to $500,000. Loans made after November 18, 1986, are at a single interest rate of 4.5 percent.

Repayment terms for emergency loans vary according to the type of loss, use of loan funds, available collateral, and borrower's repayment ability. Loans made for production losses are generally scheduled for repayment over a period not to exceed 7 years, but a period of up to 20 years may be approved if real estate is used as security. For real estate physical loss loans, the repayment period is usually 30 years but cannot exceed 40 years.

Objectives, Scope, and Methodology

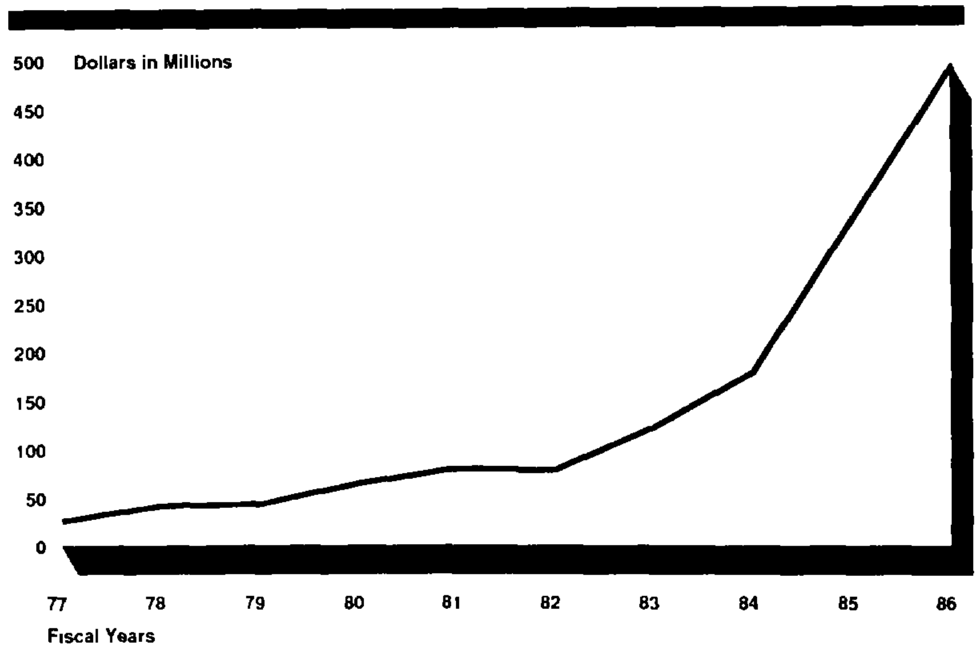
In March 1986 the former Chairman, now Ranking Minority Member of the Subcommittee on Agriculture, Rural Development, and Related Agencies, Senate Committee on Appropriations, asked us to determine (1) how the emergency program has evolved over the past several years, (2) why the emergency loan program delinquency rate is so high, (3)

Figure 1.4: Delinquent Payments on FmHA Major Farmer Program Loans, June 30, 1977-86



Source GAO analysis of FmHA Active Borrowers Delinquent Report data (FmHA report code 616)

Figure 1.2: Losses on FmHA's Direct Major Farmer Program Loans, Fiscal Years 1977-86



Source USDA budget data

FmHA's largest farm loan program and the one experiencing the highest delinquent payments and largest losses is the emergency loan program. (See figs. 1.3 and 1.4 and table 1.1) This loan program helps farmers recover from losses inflicted by natural disasters, such as drought, floods, and hailstorms. Emergency loans, in essence, generate income to replace losses from a disaster rather than generate new income as do other loans, such as those for operating expenses. Consequently, emergency loans are high-risk loans that are difficult to repay, especially while the agricultural economy is depressed.

Introduction

The U.S. Department of Agriculture's (USDA) Farmers Home Administration (FmHA) provides financial assistance to about 14 percent of the nation's farmers through direct loans (government-funded) and guarantees on loans made by other lenders for purchasing, expanding, and operating farms. FmHA serves primarily family farmers who are unable to obtain credit elsewhere at reasonable rates and terms and is commonly referred to as the lender of last resort for farmers. Many FmHA borrowers have one or more loans under different farm loan programs. FmHA's five major farm loan programs include (1) farm ownership, (2) farm operating, (3) emergency, (4) economic emergency,[1] and (5) soil and water. The Consolidated Farm and Rural Development Act (P.L. 87-128, Aug. 8, 1961, as amended) provides statutory authority for FmHA's major farm loan programs.

When receiving an FmHA loan, a farmer 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 interest. This action may eventually include acquiring the borrower's loan collateral and selling it to recover the unpaid debt.

The Financial Condition of FmHA's Farm Loan Portfolio

The financial condition of farmers has deteriorated rapidly between 1977 and 1986. As a result, increasing numbers of farmers have been turned down for financing by their private lenders and have come to FmHA for credit assistance. FmHA has responded to these credit requests by substantially increasing its loan portfolio. Over the 10-year period from June 30, 1977 to June 30, 1986, the outstanding principal in FmHA's major farmer programs increased about 370 percent, from about $6 billion to about $28 billion. (See fig. 1.1.)

As outstanding principal increased for FmHA's major farm programs, so did delinquent payments and the amount of unpaid principal owed by delinquent borrowers. Between June 30, 1977, and June 30, 1986, the amount of delinquent payments rose from about $213 million to about $6.8 billion, while outstanding principal owed by delinquent borrowers grew from about $859 million to about $13.5 billion. Appendix II contains a breakdown by state of delinquent FmHA major farmer program direct loan activity. Over this same 10-year period, the delinquent amount owed by severely delinquent borrowers, those over 3 years delinquent on one or more loans, increased from about $46 million to

[1] Economic emergency loan program authority expired in September 1984

Figures

Abbreviations

FARMS	Farmer Program Management Information System
FmHA	Farmers Home Administration
GAO	General Accounting Office
RCED	Resources, Community, and Economic Development Division
USDA	U.S. Department of Agriculture

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the same reasons why borrowers become delinquent on other types of farm loans. However, other factors enabling borrowers to accumulate large amounts of delinquent debt were (1) program features, such as expanded program coverage; (2) a liberal "continuation policy" that permitted additional loans to delinquent borrowers; and (3) borrowers' lawsuits that virtually suspended FmHA loan foreclosures for about 3 years.

Large Losses Are Expected on Farm Program Loans

On the basis of its analysis of an FmHA internal loan classification study, GAO projects that FmHA could lose about $7.8 billion of its $28 billion farm loan portfolio. The projection took into account the estimated sales proceeds of loan collateral. About $5.2 billion of this loss could be on FmHA farm loans held by borrowers who were delinquent on one or more emergency loans as of June 30, 1985

Recent Emergency Loan Program Changes Should Help

FmHA and the Congress have made several changes to the emergency loan program that GAO believes will reduce future costs, delinquencies, and losses. For example, FmHA phased out emergency annual production and major adjustment loans and terminated the continuation policy. FmHA also issued new loan servicing regulations and is attempting to bring all delinquent accounts current through borrowers' payments or debt restructuring. FmHA plans liquidation action if loan accounts cannot be made current through various servicing alternatives.

Additionally, the Food Security Act of 1985 (P.L. 99-198, Dec. 23, 1985) restricts emergency loans to owners operators of family-type farms and, starting in January 1987, restricts emergency loan eligibility to borrowers for whom federal crop insurance was not available. This act also contains some options that FmHA may use to restructure the existing debt for qualified borrowers or allow them to remain on the farm after liquidation. However, nationwide statistics, as well as GAO's work in 13 county offices, indicate that few borrowers will qualify because of their deteriorated financial condition.

The changes FmHA and the Congress made in the program will probably limit the size and availability of future emergency loans. These changes should also reduce program costs, eventually reduce loan delinquencies, and help achieve the program's objective of helping farmers recover from disasters. On the other hand, recent judicial and legislative actions may reverse FmHA's progress in improving the deteriorated financial condition of its farm loan portfolio, including the emergency loan program. For example in making supplemental appropriations for fiscal

Executive Summary

Purpose

The Farmers Home Administration (FmHA) provides direct loans through its emergency loan program to farmers who have sustained losses as a result of natural disasters. The emergency program at $9.5 billion in outstanding loans is FmHA's largest farm loan program, and borrowers are having difficulty repaying these loans.

In March 1986 the former Chairman, Subcommittee on Agriculture, Rural Development, and Related Agencies, Senate Committee on Appropriations, asked GAO to review the emergency loan program to

- document program changes that occurred over the past several years,
- determine why the program's delinquency rate is so high,
- identify the potential loss that FmHA may incur and the available alternatives to deal with debt that may be uncollectible, and
- provide suggestions for changes in legislation and or program regulations and operations to make the program function more effectively.

Background

FmHA, a credit agency of the U.S. Department of Agriculture (USDA), provides emergency loans to eligible farmers who have sustained actual losses as a result of natural disasters, such as droughts, floods, windstorms, and hailstorms. As of June 30, 1986, the emergency loan program, with about 115,000 borrowers and 272,000 loans, comprised about $9.5 billion of the $28 billion outstanding principal on FmHA's major farm loan programs. Emergency loans are inherently more risky than other types of farm loans because they are made to help farmers recover from losses rather than generate new income.

Results in Brief

Since its inception in 1949, the emergency loan program has gone through several cycles of broadened and tightened eligibility and benefits. The program is currently in a phase of tightened eligibility and benefits following a period of expansion in the 1970s and early 1980s that resulted in a severely delinquent loan portfolio with potential losses in the billions of dollars.

FmHA borrowers became delinquent on their emergency loans for many of the same reasons as do borrowers on other farm loans—external elements such as the weather, a poor farm economy, and unsound farming and financial practices. In addition, expanded emergency loan program features and a liberal "continuation policy" that permitted additional loans to already delinquent borrowers enabled borrowers to accumulate large debt loads that they now find difficult to repay. GAO projects, on