United States General Accounting Office

GAO

Briefing Report to the Honorable Leon E. Panetta, House of Representatives

June 1989

FARMERS HOME ADMINISTRATION

Status of Participation in the Interest Rate Reduction Program

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

Resources, Community, and
Economic Development Division

B-235192

June 15, 1989

The Honorable Leon E. Panetta
House of Representatives

Dear Mr. Panetta:

As requested, this briefing report provides information on the interest rate reduction (IRR) program for guaranteed farm loans administered by the U.S. Department of Agriculture's (USDA) Farmers Home Administration (FmHA). Specifically, this briefing report provides information on (1) the extent of program use, (2) reasons why activity is at its present level and the likelihood of expansion, (3) the potential impact of FmHA guaranteed farm loans with IRR on the U.S. budget compared with FmHA direct loans, and (4) compliance issues identified by USDA's Office of Inspector General (OIG).

Through the end of fiscal year 1988, FmHA had obligated about 10 percent of the $490 million authorized for the IRR program. FmHA and banking officials cited a wide variety of reasons why program participation has not been greater, including the high risk of financial failure of borrowers unable to project a positive cash flow without the IRR loan. The potential budgetary impact of FmHA guaranteed farm loans versus direct loans depends on numerous factors, such as when government disbursements occur, what interest is charged on the loan, and whether the loan is repaid. In addition, work completed by USDA's OIG in October 1987 and our review showed that FmHA has not ensured compliance with IRR program requirements.

BACKGROUND

Section 1320 of the Food Security Act of 1985 (P.L. 99-198, Dec. 23, 1985) provided for an IRR program for FmHA guaranteed farm loans. In guaranteeing loans, FmHA agrees to reimburse the lending institution for up to 90 percent of lost principal and interest if the borrower defaults on the loan. The IRR program, administered by FmHA, helps private lenders provide credit to family farmers who are temporarily unable to project a positive cash flow on all income and expenses without a reduced interest rate. When lenders reduce interest rates up to a maximum of 4 percentage points, they receive payments from FmHA in amounts equal to not more

than 50 percent of the reduction. In addition, these payments cannot be provided past the outstanding term of the loan, or 3 years, whichever is less.

The Food Security Act authorized the program through September 30, 1988, with funding not to exceed $490 million. FmHA issued regulations implementing the program on February 25, 1986. Section 613 of the Agricultural Credit Act of 1987 (P.L. 100-233, Jan. 6, 1988) extended the program through September 30, 1993, and added two provisions discussed below that could result in increased participation.

IRR PROGRAM USE AND ACTIVITY LEVELS

Of the $490 million authorized for the IRR program, FmHA had obligated about $49 million on 7,306 guaranteed farm loans through the end of fiscal year 1988. These loans totaled about $841 million and involved 5,287 different borrowers. Total IRR obligations more than doubled between fiscal years 1986 and 1987 but declined in fiscal year 1988. According to the FmHA and private lender officials we contacted, program participation has not been greater for a variety of reasons, such as the high risk of financial failure of borrowers unable to project a positive cash flow without the IRR loan and the volume of paperwork required to process the loans.

The Agricultural Credit Act of 1987 added two provisions, however, that could result in increased participation. The first was an FmHA demonstration project in which eligible FmHA borrowers could obtain guaranteed farm ownership loans to purchase acquired properties owned by certain Farm Credit System institutions. Under the second provision, lenders must consider an interest rate reduction for a borrower in default on an FmHA guaranteed loan prior to initiating foreclosure action. (FmHA published an interim rule on March 14, 1988, to implement this provision.) Because FmHA published final regulations implementing both provisions on January 13, 1989--as we were completing our audit work--we were unable to estimate the extent to which they may increase participation.

FmHA officials told us that other requirements added in the January 1989 regulations could increase participation in the IRR program. Under these regulations, a borrower must show cash flow of 110 percent to gain approval for a guaranteed farm loan. The regulations allow IRR to be used on guaranteed loans where the cash flow ranges between 100 and 110 percent. FmHA officials also told us that paperwork associated with the program has been simplified.

On the other hand, according to FmHA's Assistant Administrator for Farmer Programs, participation may not increase significantly under the current IRR program structure because most of the lenders who were willing to participate have already done so. In addition, our work and that of the OIG have shown that FmHA guaranteed loans, with or without IRR, are being made primarily to borrowers who are already private lender clients; whereas FmHA direct loans are being made primarily to existing FmHA borrowers who cannot obtain private credit, even with a loan guarantee, because of their poor financial condition.

FmHA and banking officials stated that program changes that would increase the return lenders could expect to receive from granting an IRR might provide the incentive to increase lender participation. However, these officials were hesitant to make such a prediction because they believed lenders should bear a sufficient share of the interest reduction to be more equitable from a financial institution and taxpayer viewpoint--each shares one-half of the IRR cost. (Section 1 contains more information on participation in the IRR program. App. I contains IRR program obligation statistics by state.)

BUDGETARY IMPACT

Many factors determine the impact on the U.S. budget of FmHA guaranteed farm loans with IRR compared with FmHA direct farm loans. According to budget officials of FmHA and the Congressional Budget Office, the budgetary impact of loans varies depending on whether the loans are made by the government directly, by a private lender with a government guarantee, or by a private lender with a government guarantee and a portion of the interest on the loan paid by the government through IRR. This impact also depends on when government disbursements occur, what interest is charged on the loan, and whether the loan is repaid.

IRR loans are guaranteed loans that require no outlays other than for IRR payments to lenders. The IRR outlays are not recovered through future repayments. Direct loans, on the other hand, require more initial outlays but do have offsetting repayment in the future, which will vary depending on actual repayments made. Direct loans can also include an interest subsidy if the government charges the borrower an interest rate less than its cost of money. The interest subsidy is not recovered in the future. Apart from the interest subsidy, FmHA direct loan borrowers also have a

financial advantage over other farmers because FmHA borrowers generally pay a lower interest rate than farmers who must obtain credit from other lenders.

As a result, the budgetary impact of direct loans is immediate in that outlays occur in the year the loan is made but are offset to the extent that loan repayments are made in future years, whereas the impact of guaranteed loans--beyond the IRR payments to lenders--takes place only if a loss occurs causing the government to honor its guarantee. Over time, differences in budgetary impact between guaranteed and direct loans depend on (1) the extent of IRR payments to lenders, (2) interest subsidies on direct loans, (3) repayments made by direct loan borrowers, and (4) the loan losses experienced under the guarantee program. (Section 2 contains more detailed information on the budgetary impact issue.)

PROGRAM COMPLIANCE

FmHA has approved guaranteed loans with IRR to borrowers who do not meet IRR program requirements. An October 1987 report by USDA's OIG revealed that in many cases program benefits had gone to borrowers who did not qualify on the basis of FmHA's regulations. The OIG found that 48 of 94 borrowers (51 percent) examined in three states did not meet program requirements. For example, some borrowers were able to demonstrate that they could generate enough income to meet or exceed expenses (a positive cash flow) without IRR assistance and others could not demonstrate a positive cash flow after the IRR assistance. We also found examples of similar noncompliance during our review, and county supervisors in two states attributed such noncompliance to carelessness or confusion over program regulations.

The OIG's October 1987 report and our review indicate that participation statistics would probably have been much lower had the FmHA county offices adhered to the regulations when approving IRR requests. The OIG made several recommendations to strengthen administrative controls over the IRR program. FmHA generally agreed with the conditions the OIG reported and the need for corrective action. On the basis of the examples of noncompliance we found, the Assistant Administrator for Farmer Programs also stated that FmHA needs to pay continued attention to ensuring program compliance. (Section 3 contains more detailed information on the compliance issue.)

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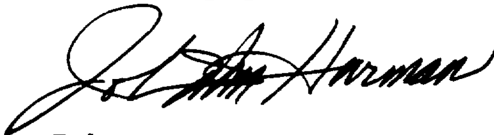
In responding to your request, we obtained FmHA statistics on IRR program use and discussed the program with FmHA officials, private lenders, representatives of bankers' associations, and Congressional Budget Office staff. We also used information from the OIG's October 1987 report on IRR program compliance issues. We provided a draft of this report to USDA officials, who generally agreed with the information contained in the report. Their comments have been incorporated where appropriate. Our work was performed between January 1988 and January 1989 in accordance with generally accepted government auditing standards. Section 4 contains more detailed information on our objectives, scope, and methodology.

As arranged with your office, we are sending copies of this briefing report to appropriate House and Senate Committees; interested members of 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.

Should you have questions or need additional information, please contact me on (202) 275-5138. Major contributors to this briefing report are included in appendix II.

Sincerely yours,



John W. Harman
Director, Food and
Agriculture Issues

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ABBREVIATIONS

FmHA	Farmers Home Administration
GAO	General Accounting Office
IRR	interest rate reduction
OIG	Office of Inspector General
USDA	U.S. Department of Agriculture

SECTION 1

PARTICIPATION IN FmHA'S GUARANTEED FARM LOAN INTEREST RATE REDUCTION PROGRAM IS SMALL

Section 1320 of the Food Security Act of 1985 (P.L. 99-198, Dec. 23, 1985) provided for an interest rate reduction (IRR) program for Farmers Home Administration (FmHA) guaranteed farm loans. In guaranteeing loans, FmHA agrees to reimburse the lending institution for up to 90 percent of lost principal and interest if the borrower defaults on the loan. Administered by FmHA, the IRR program helps lenders provide credit to family farmers who are temporarily unable to project a positive cash flow on all income and expenses without a reduced interest rate. When lenders reduce interest rates up to a maximum of 4 percentage points, they receive payments from FmHA in amounts equal to not more than 50 percent of the reduction. In addition, these payments cannot be provided past the outstanding term of the loan, or 3 years, whichever is less. The Food Security Act of 1985 authorized the program through September 30, 1988, with funding not to exceed $490 million. FmHA issued regulations implementing the program on February 25, 1986. Section 613 of the Agricultural Credit Act of 1987 (P.L. 100-233, Jan. 6, 1988) extended the program through September 30, 1993.

STATUS OF PARTICIPATION

Of the $490 million authorized for the IRR program, FmHA had obligated about $49 million on guaranteed farm loans that totaled about $841 million from when FmHA implemented the program in February 1986 through the end of fiscal year 1988. As shown in table 1.1, total IRR obligations more than doubled between fiscal years 1986 and 1987 but declined in fiscal year 1988. Utilization varied by FmHA loan program, with IRR obligations for farm ownership loans increasing each year and obligations for operating loans increasing between 1986 and 1987 but decreasing in 1988. The use of IRR for soil and water loans has been negligible. (App. I presents obligation statistics by state for fiscal years 1986-88.)

Table 1.1: FmHA Farm Loan Interest Rate Reduction Activity for Fiscal Years 1986-88

Dollars in thousands

Fiscal year	Borrowers	Loans	Loan amounts	Interest rate reduction obligations[a]	Interest rate reduction payments[b]
1986					
Farm ownership	262	294	$ 46,931	$ 2,776	$ 0
Operating	881	1,350	128,537	7,248	0
Soil and water	1	1	35	2	0
Total	1,144	1,645	175,503	10,026	0
1987					
Farm ownership	667	740	118,109	6,969	316
Operating	1,743	2,596	265,086	15,453	957
Soil and water	0	0	0	0	0
Total	2,410	3,336	383,195	22,422	1,273
1988					
Farm ownership	666	742	121,599	7,175	1,704
Operating	1,066	1,582	160,483	9,274	5,112
Soil and water	1	1	10	1	0
Total	1,733	2,325	282,092	16,450	6,816
1986-88					
Farm ownership	1,595	1,776	286,639	16,920	2,020
Operating	3,690	5,528	554,106	31,975	6,069
Soil and water	2	2	45	3	0
Total	5,287	7,306	$840,791[c]	$48,896[c]	$8,089

Note: During fiscal years 1986-88 the IRR program was used almost exclusively for farm ownership and farm operating loans. Farm ownership loans are made to buy and improve farm land and to construct, repair, and improve buildings. Farm operating loans are made for feed, seed, fertilizer, livestock, farm and home equipment, living expenses, and seasonal hired labor. There were also two soil and water loans during the period. Soil and water loans are made to help farmers and ranchers develop, conserve, and properly use land and water resources.

[a]Upon approval, FmHA obligates IRR funds to cover the interest payments it expects to pay to the lender over the life of the IRR loan. Since most IRR loans cover the full 3-year loan period at the maximum 2 percent FmHA participation rate authorized by the Food Security Act of 1985, IRR obligations in any fiscal year will be approximately 6 percent of the IRR loan amounts for that year (2 percent times 3 years).

[b]Actual IRR payments (funds expended) to lenders.

[c]Figures do not add because of rounding.

Source: FmHA's Guaranteed Loan Interest Rate Reduction Report as of January 27, 1989, (FmHA Report Code 220) and FmHA's Budget Explanatory Notes for Fiscal Years 1988-90.

REASONS WHY PARTICIPATION HAS NOT BEEN GREATER

To determine why IRR program participation has not been greater, we obtained views on this issue from officials at

-- FmHA's national office,

-- 10 FmHA state offices,

-- 3 FmHA county offices,

-- the American Bankers Association,

-- 2 state bankers associations, and

-- 5 banks in 2 states.

According to these officials, a wide variety of reasons exist regarding why program participation has not been greater, but the high risk of financial failure of borrowers unable to project a positive cash flow without the IRR loan and the paperwork required to obtain the IRR were the most frequently cited factors. Other less frequent comments were that lenders

-- limit participation to loans for their existing borrowers rather than using the program to extend financing to FmHA direct loan borrowers or new borrowers who are in a weak financial position,

-- resist sacrificing interest earnings and primarily use the IRR program to minimize loss exposure by continuing financing where foreclosure is the only alternative, and

-- receive complaints from borrowers who are not eligible for IRR program benefits about borrowers obtaining reduced interest rates on their loans through the IRR program.

Other work performed by USDA's OIG and by us provides further reasons for the existing participation rate. For example, in a September 1988 report on FmHA's guaranteed loan program,[1] USDA's OIG reported that FmHA guaranteed loans were being made primarily to borrowers who are already private lender clients rather than to FmHA direct loan borrowers. In addition, in a November 1988 report, we stated that few of FmHA's 263,000 direct loan borrowers are graduating to other sources of credit because they are not financially capable and because non-FmHA lenders are reluctant to

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[1] Farmers Home Administration Management of Farmer Program Guaranteed Loans Needs Improvement (USDA/OIG Audit Report 04665-2-Te, Sept. 29, 1988).

finance them.[2] If private lenders were willing to finance direct loan borrowers with guaranteed loans and IRR, participation could increase. However, according to FmHA's Assistant Administrator for Farmer Programs, lenders are reluctant to finance direct loan borrowers, with or without IRR, because of these borrowers' poor financial conditions.

OUTLOOK FOR THE FUTURE

According to FmHA's Assistant Administrator for Farmer Programs, participation may not increase significantly because under the current IRR program structure, most of the lenders who were willing to participate have already done so. In addition, FmHA state officials we interviewed saw little chance of increased participation or of meeting participation levels FmHA had estimated in its budget requests for fiscal years 1988 and 1989. IRR program obligation estimates were $100 million for each fiscal year. However, FmHA budget officials stated that these estimates reflected the balance remaining of the $490 million authorized through fiscal year 1993 rather than expected use of the IRR program. FmHA national office and state officials we contacted doubted that these estimates could be achieved. Their prediction was correct for fiscal year 1988--only $16.5 million of the estimated $100 million was obligated. Further, the fiscal year 1988 obligations were about $5.4 million less than those for fiscal year 1987.

FmHA allocated the annual $100 million IRR program obligation estimate to the various FmHA state offices on the basis of past IRR program use, with each state being allocated a minimum of $200,000. Again, these allocations were based more on a distribution of the remaining authorized funding than on the expectation that the various state offices would obligate the funds allocated to them. None of the 10 FmHA state chiefs of farmer programs we contacted predicted reaching the obligation goals for their individual states. For example, annual obligations of $200,000 were estimated for fiscal years 1988 and 1989 in Arizona, a state that had no interest rate reductions through the end of fiscal year 1988. The Arizona FmHA Chief of Farmer Programs told us that he had no reason to anticipate future program usage in a state where banks are generally very large and not interested in high-risk agricultural loans. Further, the Iowa FmHA Chief of Farmer Programs told us that he expected IRR program obligations to decline from the $3.4 million for fiscal year 1987 rather than increase to FmHA's estimated $18.4 million annually for fiscal years 1988 and 1989.

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[2] Farmers Home Administration: Farm Loan Programs Have Become a Continuous Source of Subsidized Credit (GAO/RCED-89-3, Nov. 22, 1988).

Iowa's fiscal year 1988 IRR obligations did in fact decline to about $1.6 million.

FmHA and banking officials stated that program changes that would increase the return that lenders could expect to receive from granting an IRR might provide the incentive to increase lender participation. These officials added that an increase in FmHA's share of interest payments might stimulate additional program participation, but they were hesitant to make such a prediction. For example, a Georgia bank official stated that the IRR program could be made more attractive if FmHA absorbed 100 percent of the cost of interest rate reductions and further subsidized the interest rate down to FmHA's direct loan limited resource rate, which ranged from 4.5 to 5.75 percent for operating loans in fiscal year 1987. He added, however, that the current 50-percent matching arrangement is more equitable from a financial institution and taxpayer viewpoint--each shares one-half of the IRR cost. The Iowa FmHA Chief of Farmer Programs speculated that program participation would increase if FmHA assumed a larger portion of the interest rate reductions. FmHA national office officials pointed out that FmHA's share of interest rate reductions is set by legislation and to change this share would require a change in legislation.

In addition to extending the IRR program an additional 5 years to 1993, the Agricultural Credit Act of 1987 contained two provisions that could result in increased participation. The first authorized FmHA to establish a demonstration project in which eligible FmHA borrowers could obtain guaranteed farm ownership loans to purchase acquired properties owned by certain Farm Credit System institutions. FmHA would then make annual interest rate reduction payments of 4 percent to the lender for the term of the loan or 5 years, whichever is less. The second requires a lender to consider an interest rate reduction for a borrower who is in default on an FmHA guaranteed loan if liquidation of the loan is imminent. The lender cannot initiate foreclosure action on the loan until 60 days after a determination of the borrower's eligibility to participate in the IRR program. (As mentioned earlier, FmHA published an interim rule on March 14, 1988, to implement this provision.) Because FmHA published final regulations implementing these two provisions on January 13, 1989--as we were completing our audit work--we were unable to estimate the extent to which they may increase participation.

FmHA officials told us that other requirements added in the January 1989 regulations could increase participation in the IRR program. Under these regulations, a borrower must show cash flow of 110 percent to gain approval for a guaranteed farm loan. The regulations allow IRR to be used on guaranteed loans where the cash flow ranges between 100 percent and 110 percent. FmHA officials also told us that paperwork associated with the program has been simplified.

SECTION 2

BUDGETARY IMPACT OF FmHA GUARANTEED FARM LOANS WITH IRR AND DIRECT LOANS DEPENDS ON MANY FACTORS

Under current budgetary policy, disbursements of funds for direct loans are treated as outlays and repayments on loans are treated as offsetting collections.[1] Most farm loans are multiyear transactions (even a 1-year loan is usually disbursed in 1 fiscal year and repaid in another). According to budget officials of FmHA and the Congressional Budget Office, the budgetary impact of loans varies depending on whether the loans are made by the government directly, by a private lender with a government guarantee, or by a private lender with a government guarantee and a portion of the interest on the loan paid by the government through IRR. The impact of loans on the budget also depends on when government disbursements occur, what interest is charged on the loan, and whether the loan is repaid.

A guaranteed loan that the borrower repays in full or that otherwise does not result in a loss claim to the government has the least budgetary impact because no government outlays are required. A loan made directly by the government would require an outlay in the year the loan is made, would generate offsetting collections in the form of principal repayments with interest during the years in which the loan is repaid, and would have no net budgetary impact over the life of the loan if the loan is repaid in full and the interest rate is at least equal to the government's cost of money (a nonsubsidized interest rate). A direct loan on which the government charges the borrower an interest rate less than its cost of money--an interest subsidy--or a guaranteed loan with IRR would have a budgetary impact over the life of the loan because the outlays made for the interest subsidies and interest payments would not be recovered.

The budgetary impact of direct loans is immediate in that outlays occur in the year the loan is made but are offset to the extent that loan repayments are made in future years, whereas the impact of guaranteed loans--beyond the IRR payments to lenders--

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[1]Our report, Budget Issues: Budgetary Treatment of Federal Credit Programs (GAO/AFMD-89-42, Apr. 10, 1989), provides further information on this topic. The report explains how we would measure the subsidy costs of credit programs, using hypothetical examples, and how the method of calculation we favor would affect the budget authority, outlay, and deficit totals under the various credit reform proposals.

takes place only if a loss occurs causing the government to honor its guarantee. Over time, differences in budgetary impact between guaranteed and direct loans depend on (1) the extent of IRR payments to lenders, (2) interest subsidies on direct loans, (3) repayments made by direct loan borrowers, and (4) the loan losses experienced under the guarantee program.

Interest subsidies for FmHA direct farm loans and the more recent IRR for FmHA guaranteed farm loans have had a budgetary impact, although both types of interest support help borrowers who are having difficulty in making loan payments at regular interest rates. In a November 1988 report, we estimated that in 1986 about 263,000 FmHA direct loan borrowers with about 770,000 outstanding direct loans received a government interest subsidy between $612 million and $1.6 billion.[2] These interest subsidies are continuing. In fiscal year 1988, about 63 percent of FmHA's $1 billion in new direct farm operating and ownership loans were made at interest rates below FmHA's regular interest rates for farm loan programs.[3] Apart from the interest subsidy, FmHA direct loan borrowers also have a financial advantage over other farmers because FmHA borrowers generally pay a lower interest rate than farmers who must obtain credit from other lenders. In our November 1988 report, we estimated that in 1986 the financial advantage gained by FmHA borrowers over other farmers was between $1.2 billion and $2.2 billion. On a smaller scale compared with the direct loan programs, the $49 million obligated for IRR during fiscal years 1986-88 have had, and will continue to have, a budgetary impact because the annual outlays made for each IRR are not recovered.

Both the outstanding principal and losses[4] on FmHA's direct

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[2]Farmers Home Administration: Farm Loan Programs Have Become a Continuous Source of Subsidized Credit (GAO/RCED-89-3, Nov. 22, 1988).

[3]FmHA's regular interest rates for farm loans are set at a level not to exceed the government's cost of money plus 1 percent. Interest subsidies occur when FmHA charges a limited resource interest rate rather than FmHA's prevailing regular interest rate for its various farm loan programs. For example, the current limited resource interest rate for an FmHA direct farm operating loan is 3 percentage points below the regular interest rate.

[4]According to an FmHA budget official, annual loss amounts are determined when FmHA actually writes off the loans from its accounting system. Prior to the write-off, FmHA may have established an allowance for loan losses.

and guaranteed farm loans have increased substantially in recent years. Between fiscal years 1984 and 1987, direct loan outstanding principal grew from $25.6 billion to $27.5 billion while losses on direct loans increased from $168 million to $1.2 billion. During this same period, guaranteed loan outstanding principal grew from $484 million to $2.1 billion while losses on guaranteed loans increased from $10 million to $78 million. In addition to actual loss experience, FmHA has established large allowances for future losses in both its direct and guaranteed loan programs. In an examination of FmHA's financial statements for the year ended September 30, 1987, we reported that FmHA had established allowances for losses of (1) $12.2 billion, or 44 percent, of the outstanding principal of $27.5 billion for direct farm loans and (2) $644 million, or 31 percent, of the outstanding principal of $2.1 billion for guaranteed farm loans.[5] The allowances for loan losses reflect FmHA's estimate of the ultimate collectibility of delinquent direct and guaranteed loans.

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[5]Financial Audit: Farmers Home Administration's Losses Have Increased Significantly (GAO/AFMD-89-20, Dec. 20, 1988).

SECTION 3

COMPLIANCE WITH PROGRAM REQUIREMENTS

IS FREQUENTLY ABSENT

A review by USDA's OIG and our review revealed that in many cases IRR program benefits had gone to borrowers who did not qualify on the basis of program regulations. To qualify for the IRR program, a borrower must be temporarily unable to project a positive cash flow (cash income equals or exceeds cash expenses) without IRR assistance and must be able to demonstrate a positive cash flow with IRR benefits. On the basis of the OIG's work and our review, participation statistics would probably have been much lower had the FmHA county offices adhered to the regulations when approving IRR requests.

The OIG reviewed the IRR program in FmHA's national office and in Illinois, Iowa, and Missouri. In October 1987 the OIG reported that 48 of 94 borrowers (51 percent) examined did not meet program requirements.[1] For example, the OIG found 42 cases in which borrowers' financial statements or operating plans included sufficient liquid or nonessential assets and income to project a positive cash flow without IRR assistance and 6 cases in which borrowers could not demonstrate a post-IRR positive cash flow when crop yields, expense overstatements, and debt repayment were corrected. Examples of the questioned IRR payments included

- -- $11,370 in IRR subsidies on loans totaling $189,500 to an Iowa borrower with $34,000 of certificates of deposit that could have been used to pay existing debts, thus creating a positive cash flow without the IRR and

- -- $20,964 in IRR obligations on loans totaling $349,400 to a Missouri borrower whose post-IRR financial statement would have shown a negative cash flow of $26,328 if crop yields, expenses, and debt repayment had been correctly stated.

We visited FmHA county offices in Texas and Iowa to further test compliance with IRR program requirements. In Texas, where $89,280 in IRR subsidies were obligated on 12 loans totaling about $1.4 million to 9 borrowers through fiscal year 1988, we reviewed records in one county office where IRR was applied on 3 loans to 3 borrowers. Financial statements for two of the three borrowers projected positive cash flows without the interest rate reductions

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[1]Farmers Home Administration's Guaranteed Loan Interest Rate Reduction Program (USDA/OIG Audit Report 04666-1-At, Oct. 22, 1987).

and should have disqualified the applicants for IRR. Instead, FmHA obligated $12,329 in IRR subsidies on two loans totaling $205,490 for these two applicants. The FmHA county supervisor attributed these ineligible obligations to carelessness within his office.

In Iowa, where FmHA has obligated about $8 million in IRR subsidies on 1,325 loans totaling $139.2 million to 1,041 borrowers through fiscal year 1988, we visited an FmHA county office responsible for subsidy obligations of $179,847 on 26 loans totaling $3.5 million to 11 borrowers. We did not review individual loan files, but one banker who had used the IRR program on loans to at least five borrowers said that none would have qualified for IRR loans if the bank had excluded noncash depreciation expense from the initial cash flow computations as specified in program regulations. The FmHA county supervisor confirmed that many of the borrowers who received IRR loans should have been disqualified because their pre-loan financial statements would have projected positive cash flows if noncash depreciation expenses were excluded. However, the county supervisor said that confusion over program regulations allowed depreciation expenses to be included to demonstrate negative cash flows.[2]

The OIG made several recommendations to strengthen administrative controls over the IRR program and to increase participation. For example, the OIG recommended that the FmHA Administrator provide (1) specific guidance to FmHA field personnel concerning their responsibilities for reviewing lender assessments of applicant repayment abilities and ensuring proper treatment of crop yield determinations, nonessential assets, and depreciation and (2) additional training to FmHA field personnel and lenders on the preparation and processing of IRR documents to ensure compliance with applicable policies and procedures.

FmHA's response was positive and generally agreed with the conditions the OIG reported and the need for corrective actions to comply with program requirements. FmHA stated, however, that although it would continue to stress the importance of IRR, individual lenders did not appear to have a lot of interest in IRR because they either do not care to make high-risk agricultural loans or their high-risk agricultural customers have been eliminated from their portfolios. In commenting on the examples of noncompliance we found, the FmHA Assistant Administrator for Farmer Programs stated that FmHA needs to pay continued attention to ensuring program compliance.

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[2]In our report, Farmers Home Administration: Sounder Loans Would Require Revised Loan-Making Criteria (GAO/RCED-89-9, Feb. 14, 1989), we recommended that FmHA improve the cash flow analysis used in loan-making decisions by incorporating an allowance to cover contingencies and equipment replacement.

SECTION 4

OBJECTIVES, SCOPE, AND METHODOLOGY

In response to Representative Leon E. Panetta's December 2, 1987, request and subsequent discussions with his office, our objectives were to examine the IRR program and report on the (1) extent of program use, (2) reasons why activity is at its present level and the likelihood of expansion, (3) potential impact of FmHA guaranteed farm loans with IRR on the U.S. budget versus that of FmHA direct loans, and (4) compliance issues identified by the OIG.

To provide information on program use, participation, and compliance issues, we (1) collected FmHA program statistics, (2) interviewed and made telephone contacts with FmHA officials in Washington, D.C., and 10 states, (3) interviewed officials from 5 banks in 2 states, the American Bankers Association, and the Iowa and Georgia bankers' associations, (4) used compliance information from the OIG's 1987 review of the IRR program, which tested program compliance in Illinois, Iowa, and Missouri, and (5) visited a county office in Texas and Iowa to further test compliance with IRR program requirements. In addition, we developed information on the budgetary impact of direct loans and guaranteed loans with and without interest rate reductions and discussed budgetary impact issues with budget officials of FmHA and the Congressional Budget Office. We did not independently verify the accuracy of FmHA computerized files or test the quality of the OIG's work.

We conducted our review in Washington, D.C., Georgia, Iowa, and Texas. Washington, D.C. is the location of FmHA's national office, the Congressional Budget Office, and the American Bankers Association. Georgia and Texas are states with limited IRR program utilization, while Iowa is the leading state in program participation. We also (1) made telephone contacts with FmHA officials in Arizona, California, Louisiana, Minnesota, Mississippi, North Dakota, and Wisconsin, which, as appendix I illustrates, provides a mixture of program activity levels and (2) contacted the OIG staff who reviewed the IRR program in 1987.

We conducted our review from January 1988 through January 1989 in accordance with generally accepted government auditing standards.

We provided a draft of this briefing report to USDA to obtain agency comments. USDA officials, including the Assistant Administrator for Farmer Programs, generally agreed with the reported information. The comments provided have been incorporated where appropriate.

FmHA FARM LOAN INTEREST RATE REDUCTION PROGRAM

OBLIGATION STATISTICS, BY STATE, FISCAL YEARS 1986-88

State[a]	Borrowers	Loans	Loan amounts	IRR obligation
Arkansas				
Farm ownership	5	7	$ 1,706,200	$ 78,972
Operating	2	4	341,500	13,610
Total	7	11	2,047,700	92,582
California				
Farm ownership	11	11	2,470,004	148,200
Operating	16	19	3,537,755	189,851
Total	27	30	6,007,759	338,051
Colorado				
Farm ownership	19	21	4,107,160	246,430
Operating	28	41	6,136,534	360,752
Total	47	62	10,243,694	607,182
Connecticut				
Farm ownership	1	1	286,000	17,160
Operating	1	1	35,000	2,100
Total	2	2	321,000	19,260
Georgia				
Farm ownership	0	0	0	0
Operating	4	7	659,500	24,750
Total	4	7	659,500	24,750
Idaho				
Farm ownership	4	5	798,810	47,929
Operating	6	7	1,291,580	64,242
Total	10	12	2,090,390	112,171
Illinois				
Farm ownership	183	198	32,655,235	1,956,414
Operating	255	389	34,618,587	1,989,263
Total	438	587	67,273,822	3,945,677
Indiana				
Farm ownership	9	9	1,617,289	97,037
Operating	19	36	3,420,600	196,536
Total	28	45	5,037,889	293,573

(continued)

State[a]	Borrowers	Loans	Loan amounts	IRR obligation
Iowa				
Farm ownership	224	239	$ 34,325,562	$ 2,037,569
Operating	817	1,086	104,888,316	6,011,189
Total	1,041	1,325	139,213,878	8,048,758
Kansas				
Farm ownership	60	67	9,385,860	563,152
Operating	164	264	26,261,889	1,521,738
Soil and water	1	1	35,000	2,100
Total	225	332	35,682,749	2,086,990
Kentucky				
Farm ownership	23	26	3,508,950	209,537
Operating	30	45	3,293,790	180,187
Total	53	71	6,802,740	389,724
Louisiana				
Farm ownership	3	3	721,690	35,234
Operating	4	5	825,880	44,996
Total	7	8	1,547,570	80,230
Maine				
Farm ownership	2	2	289,000	17,340
Operating	2	2	306,000	18,360
Total	4	4	595,000	35,700
Michigan				
Farm ownership	106	140	25,937,737	1,521,033
Operating	217	350	49,026,159	2,748,714
Total	323	490	74,963,896	4,269,747
Minnesota				
Farm ownership	197	206	27,496,265	1,623,955
Operating	532	820	72,154,298	4,137,871
Total	729	1,026	99,650,563	5,761,826
Mississippi				
Farm ownership	7	7	1,488,000	58,720
Operating	4	6	864,500	45,940
Total	11	13	2,352,500	104,660
Missouri				
Farm ownership	80	88	15,153,020	899,181
Operating	182	304	24,719,434	1,419,351
Total	262	392	39,872,454	2,318,532

(continued)

State[a]	Borrowers	Loans	Loan amounts	IRR obligation
Montana				
Farm ownership	19	20	$ 3,901,430	$ 234,086
Operating	47	77	11,163,076	653,813
Total	66	97	15,064,506	887,899
Nebraska				
Farm ownership	27	28	5,932,900	355,974
Operating	86	120	16,016,233	944,684
Total	113	148	21,949,133	1,300,658
New Jersey				
Farm ownership	1	1	100,000	2,000
Operating	1	1	100,000	2,000
Total	2	2	200,000	4,000
New Mexico				
Farm ownership	4	4	998,830	59,930
Operating	4	5	1,041,700	62,502
Total	8	9	2,040,530	122,432
New York				
Farm ownership	17	19	2,093,300	95,258
Operating	35	45	3,219,860	164,668
Total	52	64	5,313,160	259,926
North Carolina				
Farm ownership	1	3	449,180	26,951
Operating	2	3	180,667	9,720
Total	3	6	629,847	36,671
North Dakota				
Farm ownership	201	214	31,039,884	1,862,393
Operating	455	781	64,811,969	3,849,362
Total	656	995	95,851,853	5,711,755
Ohio				
Farm ownership	14	14	3,409,600	204,576
Operating	5	5	1,037,210	58,233
Total	19	19	4,446,810	262,809
Oklahoma				
Farm ownership	15	16	3,750,140	223,059
Operating	25	38	7,091,130	412,799
Total	40	54	10,841,270	635,858

(continued)

State[a]	Borrowers	Loans	Loan amounts	IRR obligation
Oregon				
Farm ownership	1	3	$ 527,820	$ 20,629
Operating	3	3	620,325	27,219
Total	4	6	1,148,145	47,848
Pennsylvania				
Farm ownership	23	23	3,725,910	220,554
Operating	12	16	1,456,550	78,593
Total	35	39	5,182,460	299,147
South Dakota				
Farm ownership	9	10	1,300,700	78,042
Operating	93	126	12,041,637	698,648
Total	102	136	13,342,337	776,690
Tennessee				
Farm ownership	3	4	930,700	52,028
Operating	4	4	499,850	23,451
Total	7	8	1,430,550	75,479
Texas				
Farm ownership	1	1	62,400	3,744
Operating	8	11	1,425,600	85,536
Total	9	12	1,488,000	89,280
Utah				
Farm ownership	1	3	671,560	40,294
Operating	4	7	1,024,480	61,469
Total	5	10	1,696,040	101,763
Vermont				
Farm ownership	6	8	1,010,700	60,642
Operating	5	7	652,000	32,920
Total	11	15	1,662,700	93,562
Virginia				
Farm ownership	2	2	485,000	29,100
Operating	5	6	967,000	33,020
Total	7	8	1,452,000	62,120
Washington				
Farm ownership	2	2	522,000	31,320
Operating	4	4	547,210	27,233
Total	6	6	1,069,210	58,553

(continued)

State[a]	Borrowers	Loans	Loan amounts	IRR obligation
West Virginia				
Farm ownership	1	1	$ 135,000	$ 8,100
Operating	1	1	190,000	11,400
Total	2	2	325,000	19,500
Wisconsin				
Farm ownership	316	369	63,345,606	3,735,036
Operating	598	860	94,649,966	5,589,987
Soil and water	1	1	10,000	600
Total	915	1,230	158,005,572	9,325,623
Wyoming				
Farm ownership	1	1	300,000	18,000
Operating	12	22	2,988,746	177,505
Total	13	23	3,288,746	195,505
U.S. total[a]				
Farm ownership	1,599	1,776	$286,639,442	$16,919,579
Operating	3,692	5,528	554,106,531	31,974,212
Soil and water	2	2	45,000	2,700
Total	5,293	7,306	$840,790,973	$48,896,491

[a]The sums of the individual states' categories may differ slightly from the U.S. totals shown in table 1.1 because of rounding and incomplete FmHA reconciliation of state and national data. Also, the following states and territories had no IRR activity through fiscal year 1988--Alabama, Alaska, Arizona, Delaware, Florida, Guam, Hawaii, Maryland, Massachusetts, Nevada, New Hampshire, Rhode Island, South Carolina, Puerto Rico, Virgin Islands, and West Pacific Territories.

Source: GAO analysis of FmHA's Guaranteed Loan Interest Rate Reduction Report as of January 27, 1989, (FmHA Report Code 220).

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