United States General Accounting Office

Report to the Chairman, Committee on Agriculture, Nutrition, and Forestry, U.S. Senate

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FARMERS HOME ADMINISTRATION

Implications of the Shift From Direct to Guaranteed Farm Loans

GAO/RCED-89-86

GAO United States
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Resources, Community, and
Economic Development Division

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September 11, 1989

The Honorable Patrick J. Leahy
Chairman, Committee on Agriculture,
Nutrition, and Forestry
United States Senate

Dear Mr. Chairman:

In response to your request, this report discusses the Farmers Home Administration's (FmHA) progress in shifting from direct to guaranteed farm loans and the financial condition of the guaranteed loan borrowers; the impact of this shift on borrowers, private lenders, and the government; and program problems that contributed to losses on guaranteed loans. We recommend that the Secretary of Agriculture direct the FmHA Administrator to make program changes that will help minimize losses and improve management of the guaranteed farm loan program. We make no recommendations for legislative changes.

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 done under the direction of John W. Harman, Director, Food and Agriculture Issues, (202) 275-5138. Other major contributors are listed in appendix VII.

Sincerely yours,

J. Dexter Peach
Assistant Comptroller General

Executive Summary

Purpose

The Farmers Home Administration (FmHA) is shifting from making direct farm loans to guaranteeing loans of private lenders to reduce the government's role in supplying credit and its budget outlays. This shift has created uncertain effects on borrowers, lenders, and the government.

At the request of the Chairman of the Senate Committee on Agriculture, Nutrition, and Forestry, GAO determined (1) FmHA's progress in shifting from direct to guaranteed farm loans and the financial condition of guaranteed loan borrowers; (2) the impact of this shift on borrowers, private lenders, and the government; and (3) whether program problems contributed to losses on guaranteed loans.

Background

Until the early 1970s FmHA, an agency of the U.S. Department of Agriculture (USDA), provided credit directly to farmers through government-funded (direct) loans. The Rural Development Act of 1972 authorized FmHA to guarantee farm loans made by private lenders. In guaranteeing farm loans FmHA agrees to reimburse the private lender for up to 90 percent of lost principal and interest if the borrower defaults.

In fiscal year 1984 FmHA began emphasizing guaranteed farm operating and ownership loans to help keep lending in the private sector, reduce budget outlays, and better service a growing but deteriorating direct loan portfolio. The Food Security Act of 1985 and subsequent appropriations legislation supported FmHA's shift to guaranteed farm loans.

Results in Brief

Although FmHA's farm lending is shifting to guaranteed loans, the increase in guaranteed lending—from about $71 million to $1.3 billion between fiscal years 1983 and 1988—has resulted primarily from private lenders obtaining loan guarantees for their existing customers who had become financially stressed. Few FmHA direct loan borrowers have switched to guaranteed loans with private lenders, or are likely to, because their poor financial conditions make private lenders reluctant to finance them even with loan guarantees. The decrease in FmHA direct lending—from about $2.4 billion to $1.0 billion between fiscal years 1983 and 1988—is the result of several factors including increased use of government farm program payments instead of credit to finance farm operations and the reduced authorizations for farm ownership loans.

Although guaranteed loans help high-risk borrowers obtain private credit, such borrowers have higher costs of money, stricter loan terms, and, at the time of GAO's review, greater likelihood of liquidation because of private lender policies than do FmHA direct loan borrowers. Thus, direct loan borrowers have little incentive to seek guaranteed loans. Because few direct loan borrowers are obtaining guaranteed loans and recent congressional actions have extended their direct loan eligibility, direct loan requests may not decline further. Thus, these borrowers likely will need continued direct loan financing, and further decreases in direct loan funding may restrict availability of credit for them.

Guaranteed loans benefit private lenders by reducing financial risk and loan losses, improving liquidity and profitability from selling the guaranteed portion of loans in the secondary market, and upgrading bank regulators' classifications of their loan portfolios. The increase in guaranteed lending has helped the government keep some farm lending in the private sector and reduce budgetary outlays needed to make new direct loans. However, because the increase in outstanding principal for guaranteed loans has outpaced the decrease in that for direct loans, the government's overall financial exposure has increased.

FmHA's inadequate assessment of borrowers' financial conditions prior to loan guarantee approval and insufficient oversight of approved loan guarantees have contributed to guaranteed loan losses, which have increased at a faster rate since 1984 than has guaranteed loan activity. The more guaranteed loan losses increase, the greater will be the impact on budget outlays. Thus, correcting the problems causing the increasing losses grows in importance as the shift continues.

Principal Findings

Guarantees Increased; Few Direct Borrowers Obtained Guarantees

In fiscal years 1983-89, total annual authorizations for guaranteed farm operating and ownership loans increased from $175 million to $3.3 billion. Total annual obligations for these loans grew from about $71 million in fiscal year 1983 to about $1.3 billion in fiscal year 1988, peaking at about $1.6 billion in fiscal year 1987. Total annual authorizations for direct farm operating and ownership loans increased from about $2.4 billion in fiscal year 1983 to about $4.3 billion in fiscal year 1985 and then declined to $995 million for fiscal year 1989. In fiscal years 1983-88, FmHA obligated virtually all of its authorized funding for direct farm operating and ownership loans.

The increase in guaranteed lending resulted primarily from private lenders obtaining guarantees for their financially stressed clients. GAO's analysis of FmHA loan data showed that only 2 percent of the borrowers with direct farm operating and/or ownership loans between 1985 and 1987 also obtained the same type of guaranteed farm loans. Direct lending declined primarily because of earlier availability of government farm program payments, fewer borrowers, reduced farm operating expenses, and reduced farm ownership lending authorizations.

Shift's Impact on Borrowers, Lenders, and Government

Guaranteed loans help risky borrowers obtain private credit; however, guaranteed loan borrowers pay higher interest rates and loan fees and, at the time of GAO's review, faced a greater chance of liquidation if they defaulted on their loans than FmHA direct loan borrowers. Thus, direct loan borrowers have little, if any, incentive to seek guaranteed loans.

In July 1987 the Congress reinstated a "continuation policy" allowing delinquent borrowers to defer FmHA debt and obtain new loans without showing the ability to repay old loans. This action and the Agricultural Credit Act of 1987, which requires FmHA to write down a borrower's debt if it is less costly to the government than liquidation, allow delinquent and previously ineligible borrowers to obtain direct loans. Since few of these borrowers are obtaining guaranteed loans and direct loan requests may not decline further because of these actions, additional funding decreases may restrict credit availability for them.

Although lenders have to submit financial data and other paperwork on borrowers to receive guarantees, such guarantees help lenders finance borrowers who are poor credit risks and protect lenders against potential losses. Lenders can also sell the guaranteed portion of loans in the secondary market, thereby improving their liquidity and increasing their profitability. Additionally, the guaranteed portion of the loan does not count against a bank's legal lending limit, which allows the bank to make more loans; and regulators generally do not classify an FmHA-guaranteed loan as a weak loan if the lender properly services it.

Increased guaranteed lending has helped the government keep some farm lending in the private sector and, assuming that some guaranteed loan borrowers would have qualified for direct loans, has helped reduce budget outlays for new direct loans. However, because few direct loan borrowers have switched to guaranteed loans, and most likely will not because of their poor financial conditions, continued substantial budget outlays will probably be needed to provide financing to help them stay in business. In addition, the increase in the outstanding principal of guaranteed loans has outpaced the decrease in that of direct loans by about $570 million for fiscal years 1986-88, resulting in an overall increase in the government's financial exposure.

Program Problems Contribute to Loan Losses

Since 1984, losses on guaranteed loans have grown at a faster rate than guaranteed loan activity. FmHA has estimated that losses on these loans could exceed $115 million in fiscal year 1989 and, in its fiscal year 1987 financial statements, anticipated future losses of $644 million of the $2.1 billion in outstanding guaranteed farm loan principal at that time. Although loan losses may be caused by such uncontrollable factors as adverse weather, losses can also be attributed to problems in FmHA's assessment of borrowers' financial conditions prior to loan guarantee approval and in FmHA's oversight of approved loan guarantees. The problems included FmHA's (1) inadequate assessment of borrower finances and collateral for guaranteed loans, (2) unclear guidance for determining the percentage of guarantee prior to loan guarantee approval, (3) not obtaining timely default notices and/or liquidation plans, and (4) not requiring action to recover from borrowers losses paid to lenders.

Recommendations

To help control losses and improve management of FmHA's guaranteed farm loan program, GAO recommends that the Secretary of Agriculture, among other things, develop more comprehensive criteria for approval of guaranteed loans, establish a range of loan guarantee percentages based on loan risk, enforce requirements for lender servicing of guaranteed loans, and establish procedures for recovering from borrowers amounts the government paid to lenders for guaranteed loan losses.

Agency Comments

USDA generally agreed with most of GAO's findings and recommendations. However, some of its actions planned or underway may not fully resolve some of the problems that led to the recommendations. In one instance where USDA disagreed on the need to establish procedures for recovering government losses from defaulted borrowers, it agreed to further study the issue. GAO continues to believe that recovery action should be pursued against borrowers who may have assets available to reimburse the government's losses. USDA stated that a contracted study of the program's loan approval and borrower selection criteria will consider most of GAO's recommendations, including the recovery of loan losses. USDA's comments and GAO's evaluation are discussed in chapter 3.

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Abbreviations

ASCS	Agricultural Stabilization and Conservation Service
FmHA	Farmers Home Administration
GAO	General Accounting Office
OIG	Office of Inspector General
OMB	Office of Management and Budget
RCED	Resources, Community, and Economic Development Division
USDA	U.S. Department of Agriculture

Chapter 1

Introduction

The Farmers Home Administration (FmHA) is the credit agency for agriculture and rural development in the U.S. Department of Agriculture (USDA). FmHA provides direct (government-funded) loans and guarantees loans private lenders make. Until the early 1970s FmHA's only vehicle for providing credit to farmers was its insured, now commonly referred to as direct, loan programs. The Rural Development Act of 1972 (P.L. 92-419), which amended the Consolidated Farmers Home Administration Act of 1961 (P.L. 87-128), provided FmHA with discretionary authority to guarantee farm loans made by other agricultural lenders. This amendment authorizes the Secretary of Agriculture to provide financial assistance to borrowers by guaranteeing farm loans made by any federal or state-chartered bank, savings and loan association, cooperative lending agency, or other legally organized lending agency.

Background

Although FmHA has made several types of guaranteed farm loans since 1974, its two principal types of guaranteed farm loans are (1) farm operating loans for feed, seed, fertilizer, livestock, farm and home equipment, living expenses, and seasonal hired labor and (2) farm ownership loans to buy and improve farm land and construct, repair, and improve buildings. Between fiscal years 1974 and 1983, FmHA placed little emphasis on guaranteed loans, and annual guaranteed farm operating and farm ownership loan obligations[1] did not exceed $100 million.

In fiscal year 1984 FmHA began placing greater emphasis on guaranteed loans to help keep farm lending in the private sector, reduce budgetary outlays for direct loans, and devote more effort to servicing its growing and increasingly delinquent direct loans. From June 30, 1978, to June 30, 1983, outstanding principal on FmHA's major direct farm loan programs increased from $9.2 billion to $24.3 billion as increasing numbers of farmers were turned down for financing by private lenders and came to FmHA for credit assistance. By 1981 this direct loan portfolio had begun to show stress, and the stress continued to increase. From June 30, 1981, to June 30, 1983, delinquent payments on direct loans grew from $1.6 billion to $4.1 billion—an increase from 7 percent to 17 percent of outstanding principal—and loan losses increased from $77 million in fiscal year 1981 to $113 million in fiscal year 1983.

[1] According to an FmHA budget official, when a conditional commitment is issued for a guaranteed farm loan, it is reflected in FmHA's accounting records as an obligation, in order to maintain control over the individual program-authorized loan level. This is somewhat different from an obligation for a direct farm loan or for a payment of loss claim on a guaranteed farm loan, both of which lead to an expenditure of funds from a different account.

FmHA's increased emphasis on guaranteeing loans, as well as the willingness of private lenders to use loan guarantees instead of referring customers to FmHA for direct loans, resulted in a growth in guaranteed loan activity. As shown in table 1.1, guaranteed operating loan obligations increased from about $50 million in fiscal year 1983 to about $1.1 billion in fiscal year 1985, and obligations for guaranteed farm ownership loans increased from $20 million to $68 million over the same period.

Table 1.1: Amounts Authorized and Obligated for FmHA Guaranteed Farm Operating and Ownership Loans for Fiscal Years 1983 Through 1985

Dollars in Thousands

	Farm Operating		Farm ownership	
Fiscal year	Authorized	Obligated	Authorized	Obligated
1983	$100,000	$50,547	$75,000	$20,032
1984	200,000	111,444	50,000	41,504
1985	1,172,000	1,106,850	68,000	67,927

Source: Summaries of FmHA budget history

The Food Security Act of 1985 (P.L. 99-198, Dec. 23, 1985), which authorized FmHA farm lending levels for fiscal years 1986 through 1988, supported the shift from direct farm loans to loan guarantees by decreasing authorizations for direct loans and increasing authorizations for guaranteed loans. Although the act authorized a total of $4 billion for direct and guaranteed farm operating and ownership loans in each fiscal year, the amount authorized for direct and guaranteed loans changed from $2 billion each in fiscal year 1986 to $1.5 billion for direct and $2.5 billion for guaranteed loans in fiscal year 1987 and $1 billion for direct and $3 billion for guaranteed loans in fiscal year 1988. Over 80 percent of the amount for guaranteed loans was targeted for farm operating loan guarantees. Table 1.2 demonstrates the funding shift by fiscal year from direct to guaranteed lending as authorized by the Food Security Act of 1985.

Table 1.2: Guaranteed and Direct Operating and Ownership Loan Authorizations for Fiscal Years 1986 Through 1988 as Allocated by the Food Security Act of 1985

Dollars in Millions

	Guaranteed			Direct		
Fiscal year	Operating	Ownership	Total	Operating	Ownership	Total
1986	$1,740	$260	**$2,000**	$1,740	$260	**$2,000**
1987	2,175	325	**2,500**	1,305	195	**1,500**
1988	2,610	390	**3,000**	870	130	**1,000**

Source: The Food Security Act of 1985

As discussed further in chapter 2, the shift continued in fiscal year 1989 in which authorized lending levels are about $3.3 billion for guaranteed loans and $995 million for direct loans. Of these totals, $2.8 billion and $474 million are for guaranteed operating and ownership loans while $900 million and $95 million are for direct operating and ownership loans, respectively.

FmHA has emphasized shifting from direct farm loans to guaranteeing loans made by other lenders as a means of transferring most loan-making and -servicing responsibilities to private lenders, as well as to facilitate graduations of borrowers from FmHA to private lender credit. Because private lenders provide the actual funds for guaranteed loans, no government outlays are required unless borrowers default on their loans and FmHA has to fulfill its obligation to cover lenders' losses.

Purpose of Guaranteed Loans

The guaranteed loan program is designed to make credit available to family farm owners or operators who are unable to qualify for adequate credit from commercial agricultural lenders without a loan guarantee. Their financial conditions are normally slightly better than FmHA's direct loan program eligibility criteria, which stipulate that borrowers must not be able to obtain private financing at reasonable rates and terms. In guaranteeing loans, FmHA agrees to reimburse the lending institution for a specified percentage (up to 90 percent) of any loss—principal, interest, and liquidation costs—it may incur if the borrower defaults on the loan. Lenders may sell loans with guarantees, in whole or in part, to secondary market investors. FmHA insures loans sold to secondary market investors against loss of principal and interest at the original guarantee percentage.

Types of Loan Guarantees and Qualification Requirements

Two types of operating loan guarantees are available depending on the use of funds. These include the loan note guarantee (term loan) and the contract of guarantee (line of credit). Loan note guarantees cover loans made to (1) purchase such items as equipment, livestock, and poultry; (2) pay annual operating and/or family living expenses; (3) refinance debts; and (4) pay other creditors. Basically, line-of-credit guarantees allow borrowers to obtain loan funds, as needed, up to a predetermined amount for more limited operating purposes, such as purchasing foundation livestock replacements and paying annual operating expenses. Farm ownership loan guarantees are loan note guarantees (term loans) and, as stated previously, basically cover real estate purchases, refinancing of real estate debt, or improvements to the farming enterprise.

To obtain an FmHA farm operating and/or ownership loan guarantee, a private lending institution must certify that it will not provide credit to or continue with a borrower without a loan guarantee. Additionally, the lender must provide information showing that the borrower has income that equals or exceeds expenses and adequate security to ensure repayment of the loan or line of credit. FmHA charges lenders a fee of 1 percent—based on the principal loan amount or on the line of credit ceiling amount, multiplied by the percent of guarantee—to obtain a farm loan guarantee. Lenders may and usually do pass this fee on to the borrowers.

Guaranteed Loan Interest Rates, Limits, and Servicing Requirements

FmHA's guaranteed loan requirements are similar to those of direct loans in regard to borrower eligibility criteria, loan purposes, loan repayment periods, and adequate security to protect the government's interest. Guaranteed loans differ, however, in that (1) the interest rate charged is generally higher (see ch. 2), (2) the loan limits are higher, and (3) lenders are responsible for servicing the loans.

The interest rate on a guaranteed loan is negotiated between the lender and borrower. In 1988, FmHA regulations (1) allowed lenders to charge a variable interest rate that fluctuated with changes in market interest rates and (2) stipulated that the interest rate on a guaranteed loan could not be more than 1 percent higher than the rate the lender charged its average farm customer. On January 13, 1989, FmHA published revised regulations that now limit lenders' guaranteed loan interest rates to no more than the rates that the lenders charge to their average farm customers.

The lending limit and maximum principal indebtedness for direct operating and farm ownership loans is $200,000 each, per borrower. These limits are $400,000 for guaranteed operating loans and $300,000 for guaranteed farm ownership loans. Additionally, when a borrower has or will have FmHA direct loans and guaranteed loans of the same type, the combined principal indebtedness cannot exceed the guaranteed loan limit for the two types of loans ($400,000 for operating loans and $300,000 for farm ownership loans).

Although lenders are responsible for servicing a guaranteed loan and protecting loan collateral, FmHA county supervisors are responsible for monitoring the loan to ensure that the required servicing takes place. Also, county supervisors have authority to approve or concur in (1) any alterations in the loan approval conditions; (2) any replacement of loan collateral; (3) all lien coverage and lien priorities on the collateral; (4) any deferral, rescheduling, or reamortization of the loan; and (5) use of proceeds from the disposition of collateral. In contrast, FmHA services its direct loans.

Changes in Guaranteed Farm Loan Regulations

On January 13, 1989, FmHA published in the Federal Register general revisions of its guaranteed farm loan regulations to (1) implement provisions of the Agricultural Credit Act of 1987, (2) make revisions that will encourage increased lender participation in the guaranteed loan program, and (3) clarify the processing and servicing requirements of guaranteed operating and farm ownership loans. These changes involved

- requiring a borrower's income to equal or exceed all anticipated cash outflows plus a planned reserve of at least 10 percent (110 percent positive cash flow) to allow for new investments and uncertainties associated with the farming operation;
- requiring lenders to charge a guaranteed loan borrower an interest rate that is no greater than what is charged to the lender's average farm customer rather than allowing the lender to charge 1 percent above that rate;
- allowing lenders to write down the principal indebtedness of a borrower's account, with an accompanying loss payment by FmHA in accordance with the debt restructuring provisions of the Agricultural Credit Act; and
- clarifying lien priorities and the application of proceeds from the sale of collateral when the lender holds guaranteed and nonguaranteed loans on the same borrower.

FmHA proposed in the June 17, 1988, Federal Register that all farm loans be guaranteed at 90 percent, rather than "up to 90 percent." However, because of Office of Management and Budget (OMB), USDA's Office of Inspector General (OIG), and our concerns, this provision was withdrawn from the final regulations.

Objectives, Scope, and Methodology

We performed this review in response to a March 30, 1987, request from the Chairman of the Senate Committee on Agriculture, Nutrition, and Forestry. He requested that we review FmHA's farm loan guarantee program and determine how well FmHA is implementing its congressionally authorized shift from direct to guaranteed farm loans and the overall impact of this shift on farm credit availability (see app. I). On the basis of this request and subsequent discussions with committee staff, we agreed to determine

- the progress FmHA is making in shifting from direct to guaranteed farm loans (see ch. 2);
- the impact of this shift on borrowers, private lenders, and the government (see ch. 2);
- the financial condition of borrowers who are receiving loan guarantees (see ch. 2 and 3 and app. V); and
- whether program problems have contributed to losses on guaranteed loans (see ch. 3).

We limited our scope to operating and farm ownership loans because of the negligible guaranteed loan activity in other loan programs. Guarantees for recreation loans have not been funded since 1981, guarantees for emergency loans have been under suspension for a number of years, and guarantees for soil and water loans were less than $500,000 annually in fiscal years 1986-88.

Progress Made in Shifting to Guaranteed Loans and Impact of the Shift

To determine the progress FmHA is making in its shift from direct to guaranteed farm loans and the impact of this shift on borrowers, lenders, and the government, we obtained FmHA national reports and computer tapes of direct and guaranteed loan data bases and documented the extent of guaranteed farm operating and ownership loan activity nationally and by state. We also used information from these data bases to determine the extent to which FmHA direct farm loan borrowers are receiving loan guarantees. In addition, from the guaranteed loan data base, we obtained information on the amount, outstanding balance, status, and type of loans guaranteed, and the closing, maturity, and loss payment dates on loan defaults. Further, we obtained, through interviews with FmHA and private lenders, information on the impact of the shift on borrowers, lenders, and the government.

Detailed Information on Financial Condition of Borrowers, Available Credit, and Program Problems

To develop detailed information on the financial condition of borrowers who are receiving farm loan guarantees, the amount of credit available to direct and guaranteed loan borrowers, and credit needs of borrowers in general and to determine whether program problems have contributed to losses on guaranteed loans, we judgmentally selected for review eight states that among them had high, medium, and low levels of guaranteed loan activity. The states selected were Iowa, Minnesota, Wisconsin, Texas, Louisiana, Arkansas, Florida, and South Carolina. We also obtained additional information on borrowers' financial conditions and credit availability from interviews with private lenders and FmHA officials in five other states—Ohio, Tennessee, Indiana, Oklahoma, and California. The results of our work in the selected states are not projectable. Additionally, we reviewed FmHA's own internal assessments to develop information on how the guaranteed loan program is functioning.

Within each of the eight states, we first selected the district with the highest number of guaranteed loans. We then chose the county office within that district having the highest and, except for one district, the lowest guaranteed loan activity, considering both operating and ownership loans. The one exception was a county office located in a district that we believed was not representative because of urban sprawl. In total, we included 16 county offices in our review. In addition, at the county offices where loan guarantees had been made, we randomly selected and reviewed loan files of at least five borrowers who had obtained guaranteed loans. In county offices that had guaranteed fewer than five farm loans, we reviewed all guaranteed loan files. Two of the county offices we visited had not made any farm loan guarantees.

We reviewed loan files of 67 borrowers who had 74 guaranteed loans—69 operating and 5 farm ownership. Three of these borrowers had received both an operating and ownership loan. From these borrowers' loan files, we documented (1) information on their financial conditions and credit needs, (2) why the guaranteed loan was needed, (3) how many existing FmHA direct loans each borrower had in addition to their loan guarantees, and (4) how well FmHA administered the application and approval process for these loans.

In addition to our review of 67 borrowers' loan files, we judgmentally selected and reviewed 12 loan files of borrowers who had defaulted on their guaranteed loans to document how program problems contributed to guaranteed loan losses. We reviewed these files to determine why the defaults occurred; whether program problems contributed to loan losses; the amount of loss payments FmHA provided lenders to cover guarantees; and the adequacy of FmHA's oversight of the default, liquidation, and collection processes.

To ensure consistency in gathering and reporting data, we developed a standard data collection instrument to record information on sample borrowers at the county office level. We also developed specific interview questions as an aid to obtaining relevant information from FmHA and private lending institution officials on the guaranteed farm loan program. In addition to obtaining information from FmHA and private lending officials and borrowers' loan files, we used FmHA's guaranteed loan data base to determine the status of outstanding loans.

Program Obstacles Limiting Participation, Implementation Problems, and Farm Credit Needs

The interview questions for FmHA and lenders were designed to add insight into how the guaranteed loan program is functioning, to identify obstacles limiting program participation, and to determine factors affecting farm credit needs. We interviewed FmHA Farmer Program officials in Washington, D.C., and state directors, farmer program chiefs, district directors, and county supervisors in 8 states, 6 districts, and 16 county offices. Additionally, we interviewed officials—presidents, chief executive officers, vice presidents, agricultural loan officers, and credit directors—of 38 local banking and Farm Credit System lending institutions in these 8 states. We also interviewed officials from the American Bankers Association, the Independent Bankers Association of America, and the American Farm Bureau Federation in Washington, D.C. At the state level, we interviewed officials of four state farm bureaus and an agricultural loan counseling group. As previously mentioned, we also obtained information on credit availability from FmHA and private lender officials in five additional states.

Appendixes II, III, and IV contain fiscal years 1987 and 1988 data on FmHA guaranteed loan activity, delinquencies, and losses for all states and U.S. territories. Appendix V contains financial condition and other data on the guaranteed loan borrowers randomly selected from the county offices we visited.

Data Sources

We obtained national and state statistics on (1) the number and dollar amount of guaranteed loans, (2) the number and dollar amount of guaranteed loan delinquencies, and (3) the number and dollar amount of guaranteed loan losses from the following FmHA data sources.

- The fiscal year 1984 through 1988 Status of Loan and Grant Obligations Allotments or Distributions reports (FmHA report code 205), which contain obligation information on the number and amount of direct and guaranteed loans by loan type and by state.
- The fiscal year 1986 through 1988 Analysis of Delinquencies reports (FmHA guaranteed loan report 4067), which contain analyses of delinquencies by loan type and by state for guaranteed farm loans.

- The fiscal year 1984 through 1988 Summary Loss Listing reports (FmHA guaranteed loan report 4131), which contain the number of loss claims and loss amounts by loan type and by state for guaranteed farm loans.
- FmHA Finance Office's General Ledger Accounts 5323, 5324,5325, and 5326, which list guaranteed farm operating and ownership loan losses by fiscal year.

We also obtained information on FmHA borrowers with direct farm loan activity who were receiving guaranteed loans, losses on guaranteed loans, the guarantee percentages offered on guaranteed loans, and interest rates that lenders charged borrowers for guaranteed loans from the following data sources.

- The June 30, 1985, 1986, and 1987, Active Borrowers Delinquent Report files (FmHA report code 616), which contain selected information on all active direct loan borrowers and loans in FmHA's farm loan portfolio.
- The September 30, 1987, and September 30, 1988, Guaranteed Loan Program data base tapes, which are used to generate such reports as the 4067 analysis of delinquencies, 4110 loan caseload, and 4130 detail loss listing.

Data Limitations

This report contains information from FmHA automated data bases on the direct and guaranteed farm loan programs. The data base used for direct loan borrowers was the Active Borrowers Delinquent Report files (FmHA report code 616) for June 30, 1985, 1986, and 1987, which contain selected information on all active direct borrowers and loans in FmHA's farm loan portfolio. We have conducted limited tests of the validity and reliability of certain farm loan data in the Active Borrowers Delinquent Report files for previous reviews; consequently, we accepted the data as sufficient for this review. We used these data to determine (1) how many FmHA direct loan borrowers received guaranteed loans during 1985, 1986, and 1987 and (2) the total dollar amount of operating loans these borrowers had outstanding.

We also used information from the guaranteed farm loan data bases because FmHA officials stated that these data bases were the best and most complete source of data available on borrowers who had received FmHA guaranteed loans. However, as part of our county office visits, we performed a limited test of certain loan information from these data bases and found that some of the data were incomplete or inaccurate. We also performed limited testing of the guaranteed farm loan data base tapes FmHA provided for our review and found incomplete records, duplicate records, and what appeared to be either erroneous data or typographical errors. Our testing was insufficient, however, to render an opinion on the overall reliability of information from this automated data file.

Another problem with FmHA's guaranteed loan data base is that not all guaranteed loans are being recorded in the system. This was cited as an internal accounting control weakness in a recently issued report expressing our opinion on FmHA's financial statements for the year ended September 30, 1987, and the reports on internal accounting controls and compliance with laws and regulations.[2]

FmHA personnel acknowledged that the guaranteed loan data bases are incomplete because not all loan data have been recorded in the system. Also, they indicated that duplications or errors may exist in certain data records. However, since FmHA officials stated that these data bases were the best and most complete sources of information, we used them for our review.

Coordination and Compliance With Auditing Standards

We coordinated our review with USDA's OIG and reviewed its reports on FmHA's guaranteed farm loan program. The OIG issued a report on the guaranteed farm loan program in September 1988.[3] We discussed review objectives and closely coordinated our review efforts with OIG personnel to maximize audit coverage and minimize duplication of effort. We have included findings from the OIG's work in appropriate sections of our report.

We conducted our review from April 1987 through March 1989 and performed our work in accordance with generally accepted government auditing standards. The review included segments of the audit elements of compliance, economy and efficiency, and program results. We also reviewed all the Secretary of Agriculture's annual statements and reports as required by the Federal Managers' Financial Integrity Act of 1982 to identify internal control weaknesses and actions taken or planned to resolve them.

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

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

We obtained written USDA comments on the results of our work, which are contained in appendix VI.

Shift to Guaranteed Lending Occurring but Impact Varies

As emphasized by FmHA since 1984 and as authorized by the Food Security Act of 1985 and subsequent appropriations, FmHA is shifting its farm lending from direct to guaranteed loans. However, the increase in guaranteed lending has resulted from private lenders obtaining loan guarantees for their existing customers who became financially stressed rather than from FmHA's direct loan borrowers shifting to guaranteed loans. Few direct loan borrowers have shifted to guaranteed loans, and large numbers are unlikely to shift in the future, because their poor financial conditions make private lenders reluctant to finance them even with loan guarantees. The decrease in direct lending has resulted less from a shift to guaranteed lending than from such factors as increased and, in some cases, earlier availability of government farm program payments that farmers used instead of credit to finance their operations; reduced numbers of FmHA direct loan borrowers and direct loan applications; decreased farm operating expenses; and reduced authorizations for farm ownership loans.

The shift to guaranteed lending may not continue at the pace of previous years and as anticipated by lending authorizations. Despite increased lending authorizations, guaranteed operating loan obligations have decreased each year since fiscal year 1986, with the gap between authorizations and obligations growing to about $1.3 billion in fiscal year 1988. On the other hand, with the exception of fiscal year 1988, guaranteed farm ownership obligations have essentially kept pace with the increased lending authorizations over the past few years. In addition, the decline in direct lending may not continue as anticipated by lending authorizations because of 1987 and 1988 congressional actions that made previously ineligible delinquent borrowers eligible for continued direct loan assistance.

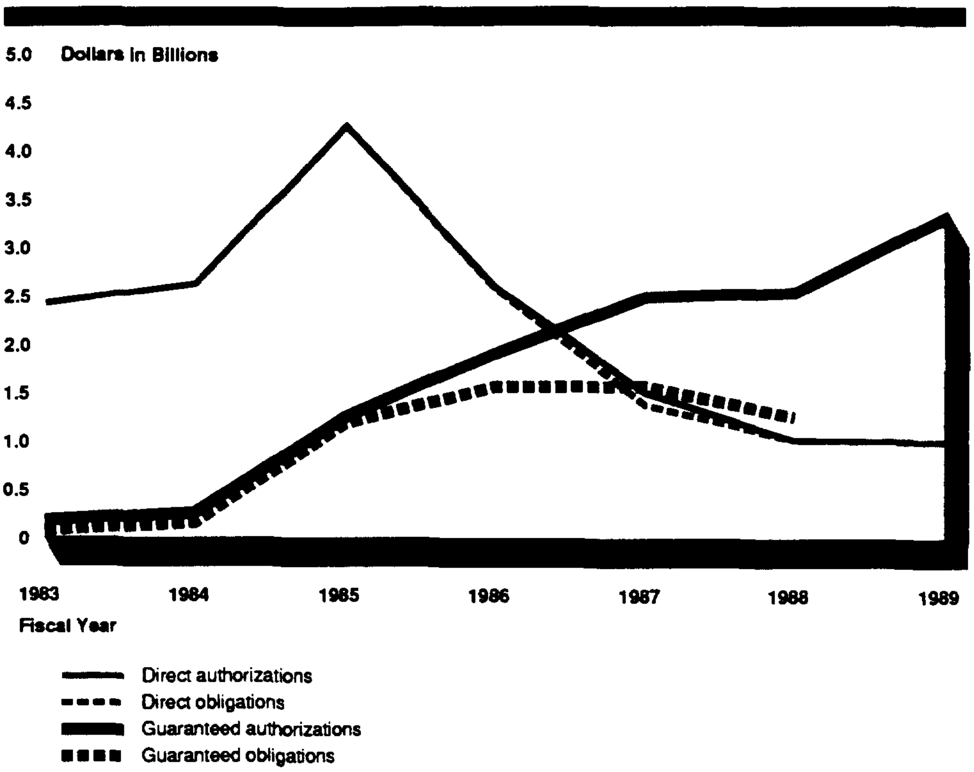
The impact of the shift to guaranteed lending varies among borrowers, lenders, and the government and cannot be easily measured. Although guaranteed loans help high-risk borrowers obtain credit from private lenders on better loan terms, these borrowers have higher costs of money, stricter loan terms, and, at the time of our review, greater likelihood of liquidation because of lender policies than do direct loan borrowers. These factors are disincentives for direct loan borrowers to seek guaranteed loans. Since few direct loan borrowers are shifting to guaranteed loans and direct lending may not decline as anticipated, further shifts in authorized funding may restrict credit availability for direct loan borrowers in fiscal year 1989 and future years. Guaranteed loans benefit lenders by reducing financial risk and loan losses, improving liquidity and profitability from selling the guaranteed portion of loans in the secondary market, and upgrading the classification of their loan portfolios with bank regulators.

The impact of the shift on the government is mixed. The increase in guaranteed lending has helped keep some farm lending in the private sector and reduce budgetary outlays needed to make new direct loans. However, the increase in outstanding principal for guaranteed loans has outpaced the decrease in that for direct loans by about $570 million between fiscal years 1986 and 1988 primarily because few direct loan borrowers are switching to guaranteed loans. Consequently, despite the progress in shifting from direct to guaranteed lending, the government's overall financial exposure has increased. Continued substantial budgetary outlays for direct loans will probably be needed for the foreseeable future, if the government intends to continue helping these borrowers stay in business.

Lending Is Shifting From Direct to Guaranteed Loans

As emphasized by FmHA since 1984 and as authorized by the Food Security Act of 1985, FmHA is shifting its farm lending toward guaranteed loans and away from direct loans, although not to the extent anticipated by the act or by annual appropriations establishing lending authorizations. From fiscal year 1983 through fiscal year 1989, total annual authorizations for guaranteed farm operating and ownership loans increased from $175 million to about $3.3 billion (almost 1,800 percent), while total annual obligations for these loans grew from about $71 million in fiscal year 1983 to about $1.6 billion in fiscal year 1987 and then declined to about $1.3 billion in fiscal year 1988. Total annual authorizations for direct farm operating and ownership loans increased from about $2.4 billion in fiscal year 1983 to about $4.3 billion in fiscal year 1985 and then declined to $995 million for fiscal year 1989. During these years FmHA obligated virtually all of the total authorized lending levels for direct farm operating and ownership loans. (See fig. 2.1.)

Figure 2.1: Total Authorizations and Obligations for Farm Operating and Ownership Guaranteed and Direct Loans, Fiscal Years 1983-89

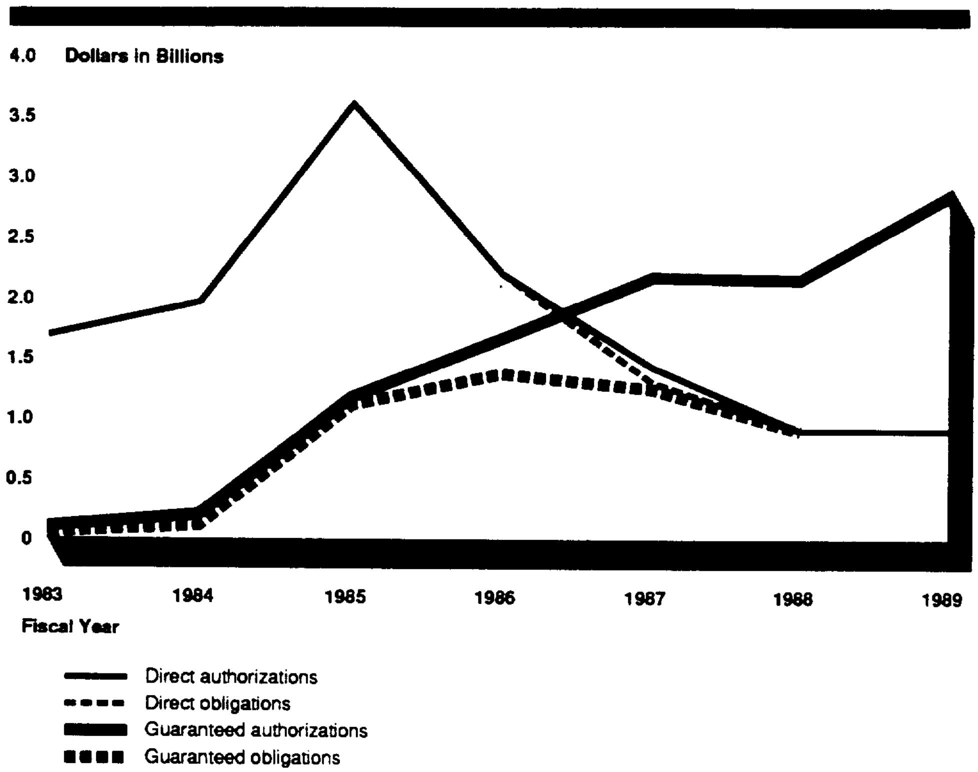


Note: Fiscal year 1988 guaranteed farm ownership authorizations exclude $250 million for purchasing Farm Credit System inventory property as authorized by the Agricultural Credit Act of 1987 because the provision was not implemented during 1988.

Source: Summaries of FmHA budget history

Annual guaranteed operating loan authorizations grew from $100 million in fiscal year 1983 to about $2.8 billion in fiscal year 1989. Obligations for these type loans surged in fiscal years 1985 and 1986, but have declined since then. Obligations have been increasingly less than the lending authorizations since fiscal year 1986, with the gap between authorizations and obligations growing to about $1.3 billion in fiscal year 1988. If, as some lenders we interviewed indicated, guaranteed operating lending further declines, the shift to guaranteed loans may not continue at the pace of previous years and as anticipated by lending authorizations. FmHA obligated virtually all of its authorized direct operating lending from fiscal year 1983 through 1988. Annual direct operating loan obligations grew from about $1.7 billion in fiscal year 1983 to about $3.6 billion in fiscal year 1985 before declining sharply to about $900 million in fiscal year 1988, which is the amount authorized for fiscal year 1989. Despite the increase in guaranteed loans, direct operating loans still exceeded guaranteed operating loans in each fiscal year. (See fig. 2.2.)

Figure 2.2: Authorizations and Obligations for Farm Operating Guaranteed and Direct Loans, Fiscal Years 1983-89

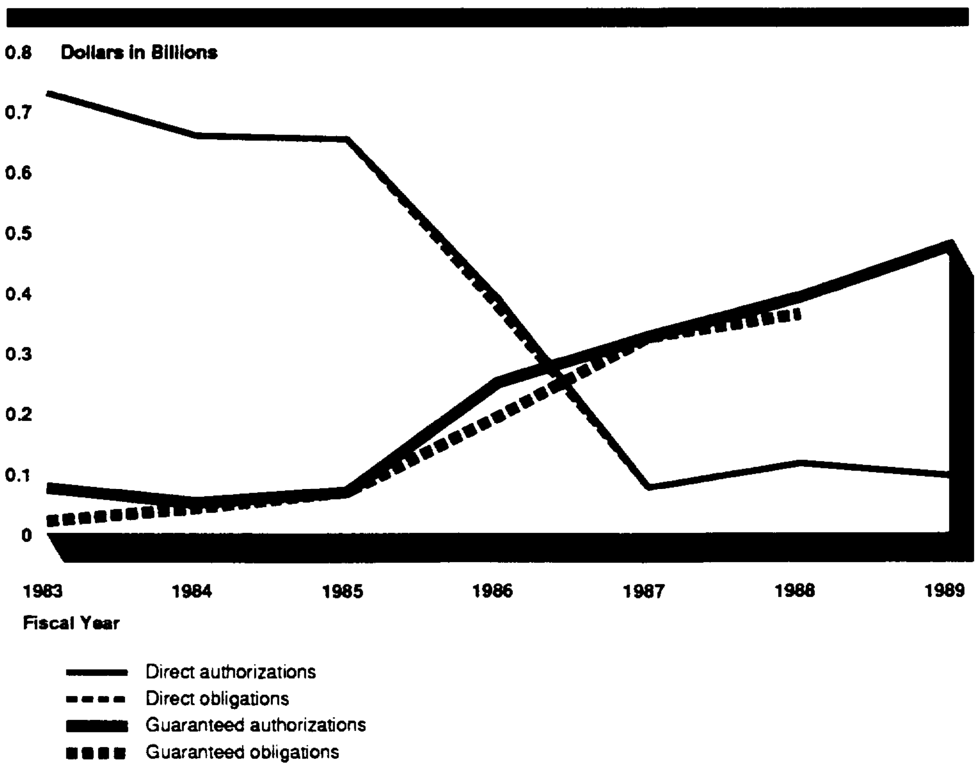


Source Summaries of FmHA budget history

Annual guaranteed ownership loan authorizations grew from $75 million in fiscal year 1983 to $640 million in fiscal year 1988 and declined to $474 million for fiscal year 1989. However, authorizations for guaranteed ownership loans actually increased to about $390 million in fiscal year 1988 because $250 million of the $640 million was authorized to cover purchases of Farm Credit System inventory property as authorized by the Agricultural Credit Act of 1987. Because the regulations implementing this provision were not finalized before the end of fiscal year 1988, none of the $250 million set aside for this program was obligated in fiscal year 1988. Annual obligations for guaranteed ownership loans grew from about $20 million in fiscal year 1983 to about $362 million in fiscal year 1988, roughly the same pace as authorizations, with the exception of the fiscal year 1988 anomaly previously discussed.

FmHA obligated virtually all of its authorized direct ownership loan funds from fiscal year 1983 through fiscal year 1988. FmHA could possibly have made more direct ownership loans during this period because in some years it had unfulfilled loan requests that exceeded authorized lending levels, which declined sharply to emphasize guaranteed ownership loans and to make more direct loan funds available for higher priority operating loans. Annual direct ownership obligations decreased substantially from about $730 million in fiscal year 1983 to about $75 million in fiscal year 1987. Obligations increased to $115 million in fiscal year 1988 but will decline again in fiscal year 1989 because only $95 million has been authorized for this type of loan. Despite the increase in guaranteed lending and the decrease in direct lending, it was not until fiscal year 1987 that guaranteed farm ownership loans exceeded direct loans. (See fig. 2.3.)

Figure 2.3: Authorizations and Obligations for Farm Ownership Guaranteed and Direct Loans, Fiscal Years 1983-89



Note: Fiscal year 1988 guaranteed farm ownership authorizations exclude $250 million for purchasing Farm Credit System inventory property as authorized by the Agricultural Credit Act of 1987 because the provision was not implemented during 1988.

Source: Summaries of FmHA budget history

Although Lending Has Shifted, Direct Loan Borrowers Are Not Obtaining Guaranteed Loans

The increase in guaranteed loan obligations was not a result of FmHA direct loan borrowers obtaining guaranteed loans. Rather, the increase occurred primarily because private lenders obtained guaranteed loans for their existing commercial customers who were experiencing financial problems. Direct operating loan obligations declined primarily because other forms of government financial assistance were available; therefore, borrowers needed less FmHA credit. Reduced lending authorizations contributed to the decline in direct farm ownership lending.

Loan Guarantees Not Going to Direct Loan Borrowers

Our analysis of FmHA data disclosed that of 107,232 borrowers with direct farm operating and/or ownership loans in 1985 through 1987, only 2,195 (about 2 percent) obtained a guaranteed loan of the same type during the same period. This analysis was further supported by the USDA OIG September 1988 report that projected that about 1 percent of the 15,585 guaranteed farm loans totaling $1.5 billion in its sample universe were used to finance FmHA direct loan borrowers. Our analysis further showed that the 2,195 direct loan borrowers who obtained guaranteed loans in 1985 through 1987 represented about 11 percent of the 20,868 total borrowers who received guaranteed loans during this period.

FmHA direct loan borrowers are not obtaining loan guarantees primarily because most are in worse financial condition than private lender borrowers and cannot qualify for private lender credit. About 40 percent (15 of 38) of the private lending officials we interviewed said their institutions were not willing to extend credit to FmHA direct loan borrowers even with an FmHA loan guarantee. Of the 23 lending institutions willing to provide financing to FmHA direct loan borrowers, 21 would require the borrowers to meet more stringent loan eligibility criteria than required by FmHA. Two of the lending institution officials did not cite any specific loan eligibility criteria.

Currently, in order to receive an FmHA direct loan, a borrower's income must be at least equal to expenses and the borrower must have adequate security to ensure loan repayment, which in the case of a farm ownership loan is defined as security equal to or greater than the value of the loan. In contrast, the private lenders we interviewed typically would require borrowers to have higher cash flow margins,[1] security valued at

[1] Amount by which borrowers' income exceed their expenses.

more than the loan amount, and lower debt-to-asset ratios.[2] Our findings were similar to findings in another report that we issued in November 1988.[3] This report stated that few FmHA borrowers are graduating to other sources of credit because they are not financially capable and because non-FmHA lenders are reluctant to refinance them.

Private Lenders Request Loan Guarantees for Their Financially Stressed Customers

According to the FmHA state and county and private lending officials we interviewed, private lenders are primarily obtaining loan guarantees to cover loans made to their financially stressed customers who have either marginal loan security, marginal cash flow, or poor debt-to-asset ratios and insufficient net worth. The OIG confirmed this situation in its September 1988 report that projected that 99 percent of the 15,585 guaranteed loans in its sample universe were used to finance lender clients. In addition, we found that some lenders obtain guarantees to avoid having bank examiners classify the loans as substandard.

We developed financial statistics on a sample of 67 borrowers randomly selected from 14 of the 16 FmHA county offices that had guaranteed farm operating and ownership loans (2 counties had no borrowers who had guaranteed loans). On average, these 67 borrowers had current liabilities that exceeded their current assets,[4] and their average total debts represented 76 percent of their total assets. (According to the USDA's Economic Research Service, the debt-to-asset ratio compares the value of assets to the amount of debt and is one indicator of financial soundness. Borrowers with ratios of over 70 percent are less likely to be able to offset negative cash flows through borrowing.) In addition, eight of the borrowers were technically insolvent (total debts exceeded total assets). Appendix V contains additional information on the general financial condition of the guaranteed loan borrowers in our sample.

[2]The debt-to-asset ratio compares the value of assets to the amount of debt and is one indicator of financial soundness.

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

[4]Current liabilities are those payable within a 12-month period. Current assets are those that could normally be disposed of within a 12-month period, such as cash, marketable bonds, and receivables.

Farm Lending Declined Primarily Because of Reduced Credit Need

Farm credit, including FmHA direct farm operating loans, has been decreasing since fiscal year 1985. Total farm debt declined about $21 billion from the end of 1985 through 1986[5] and another $18 billion from the end of 1986 through 1987.[6] This decline can be attributed primarily to increased and, in some cases, earlier availability of government farm program payments that farmers used instead of credit to finance their operations. Other factors include a reduced number of active farmers and decreased farm operating expenses. FmHA has also experienced a decline in farm operating credit as obligations decreased 24 percent in fiscal year 1986 and about 29 percent in fiscal years 1987 and 1988. The decline in farm ownership lending can be attributed in large part to decreased authorizations for these loans, which decreased from over $650 million in fiscal year 1985 to $115 million in fiscal year 1988. In some years requests for farm ownership loans have exceeded authorized funding. FmHA officials have indicated that farm ownership loan requests denied because of funding limitations would be carried forward to the next fiscal year.

Government Farm Program Payments Reduced Credit Need

FmHA and private lender officials we interviewed said that the availability and use of government farm program payments, which increased from about $8 billion in 1985 to over $20 billion in 1987, have contributed to the reduction in total farm debt. These officials said the three programs listed in table 2.1 were the primary reason farm credit has been decreasing. Farmers used advanced deficiency payments instead of credit to finance their crop planting, the conservation reserve program to reduce the need for credit by providing them income in exchange for taking highly erodible land out of crop production, and the dairy termination program to reduce the need for credit by eliminating dairy operations.

Table 2.1: Government Farm Programs Cited by FmHA and Private Lender Officials as Factors Reducing Farm Credit

Factors reducing farm credit	Percent of FmHA officials	Percent of lenders
Advanced deficiency payments	82	70
Conservation reserve program	32	32
Dairy termination program	32	27
Combination of the above programs	73	64

Source Opinions of surveyed FmHA and private lender officials in eight states

[5] Farm Finance: Financial Condition of American Agriculture as of December 31, 1986 (GAO/RCED-88-26BR, Oct. 20, 1987).

[6] Farm Finance: Financial Condition of American Agriculture as of December 31, 1987 (GAO/RCED-89-33BR, Oct. 18, 1988).

USDA's Agricultural Stabilization and Conservation Service (ASCS) makes deficiency payments to farmers to supplement their incomes when a commodity's market price is lower than a set or target price established by law. Formerly paid in full the year after the farmer signed up for the program, farmers growing wheat, feed grains, upland cotton, and rice in fiscal years 1986 and 1987 received from 30 to 50 percent of the estimated deficiency payment for their crops in advance when they registered for the ASCS deficiency payment program. Deficiency payments help improve farmers' overall financial conditions, and advanced deficiency payments can be used instead of credit to finance farmers' operations such as crop planting rather than recovering these costs, including the cost of credit, after the harvest. In fiscal year 1987, farmers received $2.48 billion in advanced deficiency payments.

According to the FmHA Deputy Assistant Administrator for Farmer Programs, and officials from the American Bankers Association, the Independent Bankers Association of America, and the American Farm Bureau Federation, the use of advanced deficiency payments has had the greatest effect on reducing total farm credit. Further, 10 of the private lending officials we interviewed estimated that they had reduced the amount of funds lent to farm customers by 10 to 25 percent because these borrowers used the advanced deficiency payments in lieu of credit.

The conservation reserve program and the dairy termination program were other programs cited by FmHA and private lending officials as reducing total farm credit. These programs reduced the size of farming operations by taking land out of production and eliminating dairy operations. The conservation reserve program, established to help control critical soil erosion and to decrease production of surplus agricultural commodities, provides for paying farmers to enroll highly erodible cropland into a reserve for 10 years. Nationally, about 23 million acres of farm land have been enrolled in the conservation reserve program through fiscal year 1987, and farmers received about $655 million for participating in the program in fiscal year 1987. Under the dairy termination program, farmers received payments for agreeing to discontinue milk production for 5 years. Nationally, farmers received $587 million through this program in fiscal year 1987.

These programs had a greater effect in some states than others. For example, Texas had about 2.8 million acres enrolled in the conservation reserve program but Louisiana had only 59,396 acres enrolled through fiscal year 1987. Also, while 32 percent of all FmHA respondents and 27 percent of all lender respondents believed the dairy termination program was responsible for reducing credit in their areas, the percentages were much higher in Minnesota, Wisconsin, and Iowa, where about 67 percent of FmHA respondents and 53 percent of all respondents, respectively, believed this program reduced credit demands in these states that have substantial dairy production.

Declining Number of Farmers Reduced Farm Credit

USDA's Economic Research Service reported that the number of farms has declined every year since 1981, falling over 9 percent from 1981 through 1986. The FmHA Deputy Assistant Administrator for Farmer Programs said that, in his opinion, the overall decrease in the number of farmers was the second largest factor reducing farm sector credit. The American Bankers Association and Independent Bankers Association of America officials we interviewed also believed that the decreasing number of farmers has reduced farm credit. FmHA reported that the number of active FmHA farm borrowers decreased about 17,600, or 6.3 percent, from fiscal year 1985 through fiscal year 1987. FmHA further reported that its farm loan applications declined from 121,985 in fiscal year 1986 to 80,249 in fiscal year 1987. Although a number of reasons existed for this decline in applications, the decreasing number of farmers was one factor.

Decreasing Farm Operating Expenses Reduced Farm Credit Need

Overall decreases in farm operating expenses have also reduced the need for farm credit. Production expenses decreased about 4 percent in 1985,[7] and another 8.7 percent in 1986,[8] and, although about 1 percent higher in 1987,[9] were still below 1985 expenses on such items as feed grain prices, fertilizer costs, rent, repair expenses, and interest charges. The decline reported in 1986 was the largest since 1953.

[7]Farm Finance: Financial Condition of American Agriculture as of December 31, 1985 (GAO/RCED-86-191BR, Sept. 3, 1986).

[8]GAO/RCED-88-26BR, Oct. 20, 1987

[9]GAO/RCED-89-33BR, Oct. 18, 1988.

Guaranteed Loans Help Borrowers Obtain Private Credit but Are Costlier and Riskier to Borrowers Than Direct Loans

Guaranteed loans help borrowers obtain private credit on better terms and when such credit may otherwise be unavailable from private lenders. However, guaranteed loan borrowers pay higher interest rates and loan fees than FmHA direct loan borrowers. Because of these increased credit costs and generally a greater risk of liquidation, direct loan borrowers have little, if any, incentive to seek guaranteed loans.

Guaranteed Loans Provide Borrowers Better Loan Terms and Increased Private Credit Availability

Private lenders normally charge higher interest rates for higher-risk borrowers, periodically ration credit to their more creditworthy borrowers during liquidity shortages, and restrict credit when borrowers' collateral values decline. Guaranteed loans help borrowers overcome these obstacles to obtaining private credit. Under FmHA's existing regulations published in January 1989, a guaranteed loan borrower pays interest at rates no more than rates the lenders charge their average farm customers. Thus, interest rates charged to a guaranteed loan borrower can be several percentage points less than what the lender would normally charge a high-risk farm borrower. In addition, because the guaranteed portion of guaranteed loans can be sold in the secondary market and provide an additional source of loan funds to the lender, the lender may be able to finance more high-risk borrowers during periodic liquidity shortages when credit may otherwise need to be rationed to better-risk borrowers. Further, during periods of economic stress that may cause collateral values to decline, borrowers who can demonstrate repayment ability may obtain credit from their private lenders with FmHA guarantees because the guarantees support the collateral.

Guaranteed Loan Interest Rates Higher Than for Direct Loans

Although guaranteed loans enable borrowers to obtain credit at interest rates lower than what they would normally have to pay because of their being high-risk borrowers, the interest rates on guaranteed loans can range from about 3 to 7 percent higher than FmHA direct loan interest rates. To illustrate, the median interest rate private lenders charged on the guaranteed operating loans to the 67 borrowers in our sample was 11.9 percent. In contrast, during fiscal year 1987 the FmHA regular direct loan interest rates ranged from 7.5 to 9.25 percent; and the limited resource interest rate, which is a government subsidized rate, ranged from 4.5 to 5.75 percent. FmHA provides the limited resource rate to those borrowers who cannot make loan payments at its regular interest rates. According to FmHA's September 30, 1987 and 1988, Status of Loan and Grant Obligations Allotments or Distributions reports, FmHA made about 64 percent of its direct farm operating and ownership loans at its limited resource interest rates.

Additional Charges Assessed on Guaranteed Loans

Borrowers obtaining guaranteed loans may incur additional loan fees from private lenders. FmHA charges private lenders a guaranteed loan origination fee, which is 1 percent of the loan amount guaranteed. Lenders generally pass this fee on to the borrowers as part of the loan amount. FmHA does not charge a loan origination fee for its direct loans. In addition, borrowers obtaining a loan from a Federal Land Bank or Production Credit Association with an FmHA guarantee were typically required to buy stock in the organization equal to 5 to 10 percent of the amount borrowed. Further, four of the lenders we interviewed in one state were charging an additional 1 percent of the loan amount only to borrowers receiving credit with an FmHA guarantee. These additional costs represent disincentives for FmHA direct loan borrowers to obtain guaranteed loans.

Private Lenders More Likely to Liquidate Borrowers' Loans Than FmHA

At the time of our review, guaranteed loan borrowers faced a greater chance of loan liquidation if they defaulted on a guaranteed private lender loan than borrowers who received FmHA direct loans. One of the reasons for this is that FmHA was under a court-ordered moratorium on foreclosures for about 3 years until November 1985 and was under another moratorium on foreclosures from June 1987 to December 1988. Private lenders do not have such restrictions and generally follow policies that call for liquidation if a loan is in serious default. Comparison of a 1986 American Bankers Association survey of commercial banks and FmHA foreclosure data illustrates the increased risk of liquidation for borrowers receiving credit from private lenders. According to the survey, which included responses from 939 commercial banks, an average of 6.2 percent of the farmers in the banks' lending areas went out of business in the year ending June 1986—26.3 percent of these through foreclosures. Whereas, during fiscal year 1986, 5,317 (2 percent) of the 274,145 FmHA direct loan borrowers went out of business. Of the 5,317 total, 111 borrowers (2 percent) went out of business through FmHA foreclosure.

Further Shift to Guaranteed Lending Could Affect Credit Available to Direct Loan Borrowers

Over the past several years, FmHA direct operating loan credit has generally been made available to direct loan borrowers, and large numbers of these borrowers were not denied operating credit because of FmHA's lack of funds. When operating loan funding availability became a problem, the Secretary of Agriculture made additional funds available through his authority to transfer funds between loan programs. (See table 2.2.) In addition, because of limited available funding, FmHA helped some direct loan borrowers obtain private operating credit by subordinating its security or lien position to that of private lenders on collateral backing direct loans to these borrowers. For example, in fiscal year 1988 FmHA helped about 23,400 borrowers obtain $769 million operating credit from private lenders through subordinations. However, since current direct loan borrowers are not shifting to guaranteed loans and the request for loans may not decline as anticipated because of 1987 and 1988 congressional actions making more borrowers eligible for direct loans, further shifts from direct to guaranteed authorized operating lending may restrict credit availability for direct loan borrowers in fiscal year 1989 and future years.

Table 2.2: FmHA Budget History for Direct and Guaranteed Operating Loan Programs, Fiscal Years 1983-88

Dollars in Thousands

Fiscal year	Initial congressional authorization	Supplemental appropriations	Sequestration reductions	Program transfers	Net authorized available	Obligations
Direct operating loans						
1983	$1,460,000	$0	$0	$225,000	$1,685,000	$1,685,000
1984	1,810,000	0	0	150,000	1,960,000	1,959,710
1985	1,920,000	0	0	1,680,000	3,600,000	3,599,968
1986	1,740,000	0	(74,820)	538,000	2,203,180	2,203,165
1987	1,425,000	0	0	0	1,425,000	1,298,281
1988	900,000	0	0	0	900,000	899,501
Guaranteed operating loans						
1983	50,000	50,000	0	0	100,000	50,547
1984	100,000	0	0	100,000	200,000	111,444
1985	500,000	150,000	0	522,000	1,172,000	1,106,850
1986	1,740,000	0	(73,100)	(6,000)	1,660,900	1,367,287
1987	2,170,000	0	0	0	2,170,000	1,240,738
1988	2,400,000	0	0	(250,000)	2,150,000	892,578

Source: FmHA budget histories

FmHA direct farm ownership loan funding has not been adequate in some years to meet loan requests. As was the case with operating loans, the

Secretary of Agriculture transferred additional funds to the farm ownership loan program in some years, and the Congress also provided supplemental appropriations for farm ownership loans in fiscal years 1983 and 1984. FmHA has also assisted some direct loan borrowers to obtain private farm ownership credit through subordinations. For example, in fiscal year 1988 FmHA helped about 3,400 borrowers obtain about $90 million in private farm ownership credit through subordinations.

In recent years, however, FmHA has attempted to curtail its direct farm ownership lending to make more direct loan funds available for what it considered to be higher priority operating loans and to emphasize guaranteed ownership loans. For example, the President's budget submissions for fiscal years 1986-89 proposed no funding for direct farm ownership loans. The Congress authorized funding for these loans in those years but at levels considerably less than in previous fiscal years. (See table 2.3.) With direct farm ownership loan funding inadequate to fulfill loan requests in previous years, further shifts from direct to guaranteed authorized farm ownership lending may further restrict credit availability for borrowers requesting direct farm ownership loans in fiscal year 1989 and future years.

Table 2.3: FmHA Budget History for Direct and Guaranteed Farm Ownership Loan Programs, Fiscal Years 1983-88

Dollars in Thousands

Fiscal year	Initial congressional authorization	Supplemental appropriations	Sequestration reductions	Program transfers	Net authorized available	Obligations
Direct farm ownership loans						
1983	$700,000	$25,000	$0	$4,550	$729,550	$729,547
1984	625,000	25,000	0	9,230	659,230	659,192
1985	650,000	0	0	2,594	652,594	652,592
1986	260,000	0	(11,180)	140,000	388,820	371,389
1987	75,000	0	0	0	75,000	74,999
1988	115,000	0	0	0	115,000	114,979
Guaranteed farm ownership loans						
1983	75,000	0	0	0	75,000	20,032
1984	50,000	0	0	0	50,000	41,504
1985	50,000	0	0	18,000	68,000	67,927
1986	260,000	0	(10,750)	0	249,250	192,018
1987	325,000	0	0	0	325,000	324,419
1988	390,000	0	0	250,000	640,000	362,087

Source: FmHA budget histories

Two congressional initiatives to help keep FmHA borrowers in business will affect future credit availability for direct loan borrowers. Both these initiatives will make direct loan credit available from declining direct loan funds to borrowers who, without these initiatives, would not be eligible for direct loans. Further, these actions force direct loan borrowers who are current on existing loans to compete for funding with delinquent borrowers who were previously ineligible for continued financing.

In passing fiscal year 1987 supplemental appropriations (P.L. 100-71, July 11, 1987), the Congress reinstituted the "continuation policy" that FmHA had in place from February 1982 to November 1985. This policy allows delinquent borrowers to reschedule or defer outstanding indebtedness to FmHA and to obtain additional operating loans without proving their ability to repay prior loans. Although it is still too early to estimate the overall impact of this action, FmHA estimated the reinstitution of the continuation policy would require $540 million in fiscal year 1988 to provide operating credit to 12,000 borrowers. Because of the delay in issuing regulations, FmHA actually obligated only $11.7 million in fiscal year 1988 for these type loans.

The Agricultural Credit Act of 1987 (P.L. 100-233, Jan. 6, 1988), under its debt restructuring provisions, provides for substantial revisions in FmHA's loan-servicing policies including debt write-down. FmHA will be required to write down debt if it is less costly to the government than foreclosure for those borrowers who cannot make scheduled loan payments. FmHA borrowers may be eligible for such loan restructuring including write-down of debt and possible additional financing. In November 1988 FmHA sent notices to over 66,000 delinquent borrowers to notify them of the debt-restructuring options available under the act.

Guaranteed Loans Benefit Lenders

FmHA's guaranteed farm loan program benefits lenders in several ways. Loan guarantees enable lenders to continue financing borrowers who are poor credit risks because the guarantees protect lenders against potential loan losses. Further, the guaranteed portion of loans can be sold in the secondary market thereby improving a lender's liquidity, enabling a lender to make long-term loans, and increasing a lender's profitability by charging the holder loan-servicing fees on the sold portion of the loan. Variable interest rates may be charged on guaranteed loans, thus shifting the risk of sharp changes in the lender's cost of funds. Also, for banking institutions, the guaranteed portion of the loan does not count against the lender's legal lending limit, which enables the lender to make more loans. In addition, bank regulators generally will not classify an FmHA-guaranteed loan as a weak loan if the banks properly service the loans.

To obtain loan guarantees and the benefits of those guarantees, lenders have to spend additional time and effort and agree to meet certain responsibilities. Additional paperwork and loan-processing time are required. FmHA's regulations have to be followed from the initial application to final approval of the guarantee to servicing the loan after the guaranteed loan is made. FmHA must approve any changes in the terms of the original loan—such as rescheduling or changing interest rates—and the loan must be serviced properly. Negligence or failure to meet these responsibilities can result in a reduction of the amount guaranteed by FmHA in the event of a loss. Although the private lending officials we interviewed were concerned about confusing program regulations and the amount of time and paperwork necessary to obtain an FmHA farm loan guarantee, 52 percent of the officials responding said such problems had little or no effect on their willingness to request guarantees.

Shift to Guaranteed Lending Has Mixed Impact on the Government

The shift to guaranteed lending has advantages and disadvantages for the government. The increase in guaranteed lending has helped keep some farm lending in the private sector and, assuming a number of guaranteed loan borrowers would have qualified for direct loans, has helped reduce budgetary outlays needed to make new direct loans. However, because current direct loan borrowers have not shifted to guaranteed loans and most likely will not because of their poor financial conditions, substantial budgetary outlays will probably be needed to finance these borrowers for the foreseeable future—if the government continues to help them stay in business as intended by 1987 and 1988 congressional actions. In addition, because few direct loan borrowers have shifted to guaranteed loans, the increase in outstanding principal on guaranteed farm ownership and operating loans has outpaced a corresponding decrease in such direct loans by about $570 million between fiscal years 1986 and 1988. (See table 2.4.) Consequently, despite the progress in shifting from direct to guaranteed lending, the government's overall financial exposure has increased.

Table 2.4: Outstanding Principal for Direct and Guaranteed Farm Ownership and Operating Loans, Fiscal Years 1986-88

Dollars in Millions

	Outstanding principal		
Fiscal year	**Direct loans**	**Guaranteed loans**	**Total**
1986			
Ownership	$7,697	$195	**$7,892**
Operating	6,340	1,242	**7,582**
Total	**14,037**	**1,437**	**15,474**
1987			
Ownership	7,451	325	**7,776**
Operating	5,879	1,880	**7,759**
Total	**13,330**	**2,205**	**15,535**
1988			
Ownership	7,302	611	**7,913**
Operating	5,698	2,433	**8,131**
Total	**13,000**	**3,044**	**16,044**
1986-88 Increase (Decrease)			
Ownership	(395)	416	**21**
Operating	(642)	1,191	**549**
Total	**(1,037)**	**1,607**	**570**

Source FmHA budget explanatory notes and FmHA report code 4067

Conclusions

The administration and the Congress began placing increased emphasis on guaranteed farm loans in 1984 and 1985 for various reasons—a principal one being to reduce budgetary outlays for direct farm loans. To drastically reduce outlays for direct loans, two conditions would have to exist. First, private lenders would have to provide financing, if necessary with FmHA loan guarantees, to those customers who in the past would have been denied private financing and thus become eligible for FmHA direct loans. Second, FmHA direct loan borrowers would have to shift to private financing, with or without loan guarantees. The results of our work, as well as that of the USDA OIG, show that the first condition is occurring, but the second is not. Private lenders have increased the use of loan guarantees for their existing customers; however, few direct loan borrowers have shifted to guaranteed loans. In addition, the increase in guaranteed lending has outpaced the decrease in direct lending. Consequently, the government's overall financial exposure has increased, and continued substantial budgetary outlays will probably be needed for direct loans for the foreseeable future, if the government intends to continue helping these borrowers stay in business.

The administration and the Congress should recognize that with the increased credit costs and the greater risk of liquidation associated with guaranteed loans, coupled with direct loan borrowers' poor financial conditions, it is unlikely that significant numbers of these borrowers will shift to guaranteed loans in the future. The administration and the Congress should also recognize that if direct loan funding continues to decline and delinquent direct loan borrowers continue to request direct loan financing under recent congressional initiatives, funding may not be sufficient to meet future credit needs of all direct loan borrowers.

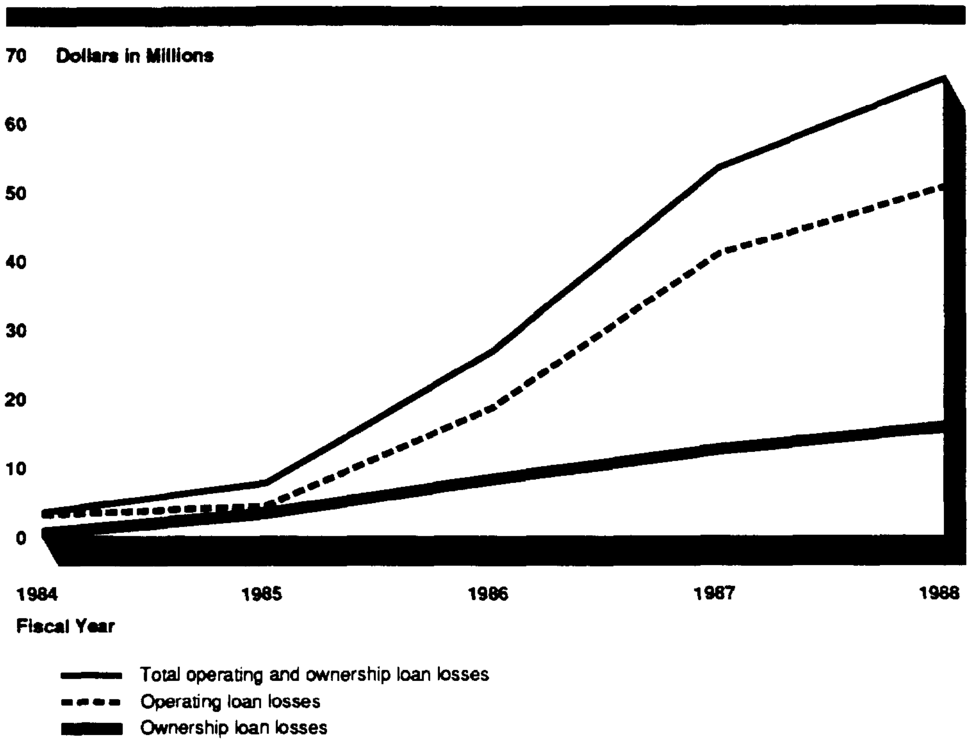
Program Problems Contribute to Guaranteed Loan Losses

While FmHA's guaranteed farm operating and ownership loan activity has significantly increased since 1984, losses on these loans have grown at a faster rate. Loan delinquencies are also growing, and FmHA projects that losses on guaranteed loans will increase in the future. Because lenders generally obtain guaranteed loans for financially stressed farmers, losses on such loans can be expected. Although some loan losses may be attributable to uncontrollable factors such as adverse weather conditions and a poor farm economy, problems in FmHA's assessment of borrowers' financial conditions prior to loan guarantee approval and in FmHA's oversight of lenders' servicing of loan guarantees after approval have also contributed to guaranteed loan losses. These problems are similar to those FmHA has with its direct farm loans, on which FmHA expects to eventually lose about 44 percent of its $27.5 billion portfolio. As the shift continues from direct to guaranteed farm loans, correcting the problems with the guaranteed loan program grows in importance to control the mounting losses, prevent the loss of the shift's budgetary advantage, and avoid the experience with the direct loan program.

Guaranteed Farm Loan Losses Increasing

From fiscal years 1984 through 1988, total annual losses on guaranteed farm operating and ownership loans increased from $3.4 million to $66.2 million. (See fig. 3.1.) As shown in table 3.1, those loan losses increased at a greater rate than did obligations and outstanding principal over this same period, with the ratio of losses to obligations increasing from 2.2 to 5.3 percent and the ratio of losses to outstanding principal growing from 2.0 to 2.2 percent. Appendix IV contains information on guaranteed loan losses in individual states and territories.

Figure 3.1: Losses on Guaranteed Farm Operating and Ownership Loans, Fiscal Years 1984-88



Note: Losses do not include General Ledger Account 4412 Guaranteed Loss Recoveries. FmHA does not record recoveries by loan type. However, the total amount recovered for all farm loan programs during the 1984-88 period was $829,021.

Source: FmHA Finance Office's General Ledger Accounts 5323, 5324, 5325, and 5326

Table 3.1: Comparison of Loan Losses to Obligations and Outstanding Principal for Total Guaranteed Farm Operating and Ownership Loans for Fiscal Years 1984 and 1988

Dollars in Millions

Fiscal year	Loan losses	Obligations	Outstanding principal	Ratio of losses to obligations, in percent	Ratio of losses to outstanding principal, in percent
1984	$3.4	$153	$166	2.2	2.0
1988	66.2	1,255	3,044	5.3	2.2
Percent increase	1,847	720	1,734	140.9	10.0

Source: GAO analysis of FmHA Finance Office's General Ledger Accounts 5323-5326 (losses), FmHA report code 205 (obligations), and FmHA report code 4067 (outstanding principal)

Guaranteed loan losses are likely to increase even more in the future. On the basis of previous loan loss experience in both guaranteed and comparable direct loan programs and current market conditions, FmHA estimates that guaranteed farm loan losses could exceed $115 million in fiscal year 1989—a 75-percent increase over fiscal year 1988. Additionally, in its fiscal year 1987 financial statement, FmHA anticipated that guaranteed loan losses could ultimately amount to $644 million, or about 31 percent of the $2.1 billion in guaranteed farm loan principal outstanding at that time. Guaranteed farm loan delinquencies further indicate that losses may increase. For example, at the end of fiscal year 1988, borrowers were delinquent on guaranteed farm operating and ownership loans of about $134 million, a 46-percent increase over the $92 million in delinquent loan principal at the end of fiscal year 1987. These delinquencies could result in loan losses when lenders foreclose on delinquent borrowers. Appendix III contains delinquency information on FmHA's guaranteed farm loans in individual states and territories.

Problems in Assessing Borrowers' Financial Conditions Prior to Loan Guarantee Approval

Our review, as well as the September 1988 USDA OIG report, disclosed three basic problems that FmHA has in assessing borrowers' financial conditions prior to loan guarantee approval. These problems are (1) poor assessment of borrowers' repayment ability, (2) insufficient determination of collateral securing guaranteed loans, and (3) unclear guidance on determining the percentage of guarantee.

Prior to approving a lender's request for a loan guarantee, FmHA county supervisors are required to perform a credit analysis of the loan application to determine whether the borrower has the financial ability to repay the loan and sufficient collateral backing the loan to enable the lender to recover the loan amount in the event of nonpayment. When borrowers' repayment ability and/or loan security are insufficient, FmHA faces increased risk of paying loss claims to lenders who liquidate defaulted borrowers' loan accounts.

Poor Assessment of Borrowers' Repayment Ability

FmHA regulations require that county supervisors review guaranteed loan applications to determine whether there is reasonable assurance of repayment. At the time of our review, FmHA's regulations required that a borrower's projected income must equal or exceed projected expenses, including payment on the guaranteed loan as well as other debts (a break-even or positive cash flow). Our work, the OIG's report, and FmHA's own internal reviews disclosed problems with FmHA's assessment of lenders' evaluation of borrowers' repayment ability. The primary problems identified were understatements and/or overstatements of expense and income amounts on the borrowers' applications and insufficient lender verification of applicants' nonfarm income and debts. In January 1989, FmHA revised its regulations to require that a borrower must have at least a 10-percent reserve beyond a break-even cash flow (110-percent positive cash flow) to allow for new investments and uncertainties associated with the farming operations. According to the Assistant Administrator for Farmer Programs, the 10-percent reserve requirement should strengthen the quality of future guaranteed loans.

Insufficient Assessment of Borrowers' Expenses and Income

Realistic and accurate projections of an applicant's expenses and income are necessary for an adequate assessment of repayment ability. When income and/or expense amounts are understated and/or overstated and unrealistically projected beyond what has been the farmer's past performance, a poor loan approval decision can result. At the time of our review, FmHA regulations required any readily obtainable financial information for the past 3 years. The regulations also required production history (up to 5 years) and forecasts that included projected production, income and expenses, and a credit repayment plan.

In our review, we found that 13 of the 74 guaranteed loans made to our sample borrowers contained inaccurate expenses and/or income amounts on the financial statements. These inaccuracies, which ranged from a low of $475 to a high of $11,593, included an understatement of the expected interest to be paid on the guaranteed loan and other nonguaranteed loans. If the correct expense and/or income amounts that were available in the loan files had been included on the financial statements, 5 of these 13 loans would not have shown a positive cash flow and should not have been approved.

In addition, of the 13 loans we reviewed on which FmHA had paid loss claims, 10 loans to 9 borrowers contained inaccurate expenses and/or income in the application package. These inaccuracies, which ranged from $1,865 to $46,132, included an understatement of interest to be paid on the guaranteed loans and an overestimate of expected ASCS deficiency payments. If correct expenses and/or income amounts that were available in the loan files had been used, 4 of these 9 borrowers would not have shown positive cash flows, and their loans should not have been approved. These 4 loans resulted in FmHA's approving payments of about $300,000 to settle loss claims.

In its September 1988 report on FmHA's guaranteed farm loan program, the USDA OIG found similar problems concerning income and expense projections. The OIG projected that of the 15,585 loans in its sample universe, 9,448 loans had been approved when projected income was based on lenders' estimates of prices and yields rather than on forecasts that considered several sources of price and yield information. Since the sources of price and yield information were not standardized, the OIG reported that projected incomes could be overstated to the extent that it could adversely affect repayment ability. In addition, the OIG found that lenders did not always use prior year or historical data to project borrowers' operating expenses; consequently, the OIG projected that 2,152 loans, or 14 percent of the 15,585 guaranteed loans in its sample universe, had been approved in which projected operating expenses could be significantly understated or overstated. Of the 69 guaranteed operating loan files we reviewed, 57 did not contain 5-year production yield information and 8 did not have documented income or price data.

In coordinated assessment reviews conducted in fiscal years 1986 and 1987, FmHA national and state officials reported several deficiencies regarding the use of unrealistic production, income, and expense projections. For example, our review of FmHA assessments of guaranteed loan files in 13 states revealed that in 8 states some lenders had not documented production yield and income and expense histories. Additionally, in four of the eight states, over 50 percent of the loan files did not contain 5-year yield and expense documentation, a general FmHA requirement.

Insufficient Verification of Nonfarm Income and Debt

FmHA regulations require lenders to verify an applicant's nonfarm income and debts and, in reviewing guaranteed loan applications, FmHA county supervisors are responsible for ensuring that this is done. Without such verification, FmHA has no reasonable assurance that the cash flow analysis is sufficient to determine repayment ability. The OIG projected that of the 15,585 guaranteed loans in the sample universe, lenders did not make background credit checks on 12,137 loans. In addition, the OIG projected that 1,972 loans were approved in which unverified nonfarm income had been used to estimate total income of the applicants and that 1,725 loans were approved without verifying applicants' existing debts. FmHA's own internal assessments disclosed similar problems. For example, FmHA reported that in 1 state review of 242 borrowers, lenders had not verified borrowers' debts in 62 cases. This review also disclosed that the borrowers' farm budgets did not consider all debt payments and/or show a positive cash flow in seven cases.

The Deputy Assistant Administrator for Farmer Programs confirmed that FmHA county supervisors are doing very little verification or monitoring of information in financial statements and loan applications. The Director of the Farmer Programs Loan Making Division said that the majority of FmHA county supervisors, while knowledgeable about farming, are poorly trained in financial credit analysis. These FmHA officials said that county supervisors need more training in assessing borrowers' loan applications. Further, these officials believe staffing levels in the county offices are not sufficient to manage both direct and guaranteed loan activity, and county supervisors tend to devote more time to managing the direct loan program.

Insufficient Determination and Documentation of Collateral

FmHA regulations on loan security basically require that the equity value of collateral be sufficient to recover the loan amount and that the collateral be adequately documented. However, the regulations are unclear as to what constitutes proper and adequate security for a guaranteed loan. FmHA regulations state that the lender must believe the security is adequate to ensure repayment of the loan, that the security be maintained, and that the county supervisor is responsible for determining whether collateral and equity are sufficient for the loan. Thus, the determination of the adequacy of security is generally subjective, allowing for inconsistencies among county offices. Our review as well as the OIG's found problems in FmHA's determination of collateral securing guaranteed loans. The basic problems were (1) determining the adequacy of collateral and (2) ensuring that the specific security backing the guaranteed loan was documented.

Adequacy of Collateral Not Always Determined

One means of determining whether a borrower has sufficient assets to use as collateral for a guaranteed loan is to measure the borrower's debt-to-asset ratio. The debt-to-asset ratio compares the value of assets to the amount of debt and is one indicator of financial soundness. According to USDA's Economic Research Service, farmers with ratios of 40 percent or less are in the best position to withstand financial adversity. They can likely offset negative cash flows from farming operations by borrowing against or selling assets. Farmers in the 41- to 70-percent category may be able to offset negative cash flows and meet all expenses. Farmers in the 71- to 100-percent category are less likely to be able to offset negative cash flows through borrowing. Farmers with a ratio over 100 percent have severe problems meeting principal and interest commitments and have a negative net worth. Farmers in this category are technically insolvent and the sale of farm assets would be insufficient to retire their debts.

We and the OIG found that FmHA had approved loan guarantees for many borrowers whose debt-to-asset ratios indicated that they would have difficulty offsetting negative cash flows through borrowing or were technically insolvent. With debt-to-asset ratios in this range, borrowers have little likelihood of having sufficient collateral to back guaranteed loans, and the risk is increased for FmHA to pay loss claims on defaulted guaranteed loans. Of the 67 borrowers in our sample, 26 had debt-to-asset ratios between 70 and 99 percent and 8 were technically insolvent. The average debt-to-asset ratio for our sample was 76 percent. (See app. V for additional information on our sample borrowers.) The OIG projected that of the 15,585 guaranteed loans in its sample universe, 916 loans totaling $132.7 million had been made to borrowers who were technically insolvent.

One of the major problem areas regarding adequacy of collateral is whether crops are sufficient as the only security to back a guaranteed loan. Crops are questionable as adequate security because of the unpredictability of yields, prices, weather, and other factors. FmHA guidance is unclear on accepting crops as the only security backing a guaranteed loan. The regulations do not prohibit taking crops as the only security nor do they require crop insurance on unharvested crops when used as loan collateral. However, FmHA's revised regulations published in January 1989 do permit, but not require, an FmHA loan approval official to require crop insurance, in individual cases, when crops serve as security for a loan. According to the Director, Farmer Programs Loan Making Division, since FmHA takes crops as the only security on direct loans for which the government bears 100 percent of the risk, it is reasonable to accept crops as the only security on guaranteed loans on which the government is not bearing all the risk. The Director also stated that crop insurance should be obtained if feasible when crops are the only security for the loan.

Although 16 of the 69 guaranteed operating loans we reviewed were secured with only crops and/or deficiency payments tied to crops, private lenders generally appear reluctant to make loans on which crops are the only security. According to officials from the American Bankers Association and the Independent Bankers Association of America, crops alone should not be considered as adequate security for a farm operating loan; and if crops were the only available collateral, they should be covered by crop insurance. In addition, 16 of the 31 lenders, who responded to our question about crops being adequate security for a loan, said that they would not generally make a loan with crops as the only security. Two lenders said that they would not accept unharvested crops as loan collateral.

Collateral Not Always Documented

In our review, we did not specifically analyze loan files for documentation of security; however, the OIG reported that documentation of the specific loan security for guaranteed loans is a problem. The OIG report indicated that lenders did not always document loan collateral; consequently, the guaranteed loans did not always have a stated lien position (first, second, or third lien) for the loan security. Lenders therefore were able to apply borrowers' payments to different loans at their discretion. In addition, without adequate documentation of the security, accounting for security upon loan liquidation would be difficult and could result in FmHA's paying higher loss claims than necessary. The OIG projected that of the 15,585 guaranteed loans in its sample universe, 6,367 loans had been approved without documenting the specific loan security. For example, the OIG found that loan files did not always contain

- documentation that the lender perfected (properly recorded) the liens against the security,
- evidence that other liens had not been filed against the security between the loan approval and loan obligation dates,
- assurance that the borrower had marketable title to the security,
- documentation that the lender remained secured party of record, and/or
- an indication that taxes on the security had been paid.

Unclear Guidance on Determining the Percentage of Guarantee

FmHA regulations allow for guaranteeing a maximum of 90 percent of the loan principal and interest. At the time of our review, the regulations also described various credit factors to consider in determining the percentage. However, the regulations did not address and FmHA's National Office had not provided guidance on whether the guarantee percentage should be increased or decreased on the basis of the status of the credit factors.

FmHA Guidance and General Practice

To determine the percentage of guarantee, the county supervisor should review each individual application and consider the following credit factors identified in FmHA's regulations. FmHA will determine the percentage of guarantee after considering all credit factors involved, including but not limited to (1) applicant's management, (2) collateral, (3) financial condition, (4) lender's exposure, and (5) trends and conditions.

At the time of our review, over 70 percent of the FmHA farm operating loans guaranteed during fiscal years 1984 through 1988 were at the 90-percent rate, with about 80 percent of the 1987 loans and 86 percent of the 1988 loans being guaranteed at the maximum rate. Also, in our review of 67 borrowers who had received 74 guaranteed loans (69 operating and 5 ownership), 64, or 86 percent, of the loans had been guaranteed at 90 percent.

The higher the percentage of guarantee, the greater the risk exposure is for FmHA. In an internal FmHA study based on fiscal year 1986 obligations, FmHA estimated that each percentage point reduction in the guarantee resulted in FmHA's risk exposure being reduced by $13.7 million. Consequently, relating risk to the percentage of guarantee can have a major effect on the amount of potential losses that FmHA could incur on guaranteed loans.

Unclear Guidance Led to Inconsistencies

Unclear FmHA guidance on how to determine the percentage of guarantee has led to inconsistencies among the states. In five of the eight states we visited, county supervisors and/or state office personnel were generally guaranteeing the least risky farm loans at 90 percent and offering lower guarantee percentages on the more risky loans. Two states were guaranteeing all loans at 90 percent because, according to the state directors, lenders would not accept a lower guarantee. The other state was offering 90-percent guarantees as an incentive for lender participation. In this state, the most risky loans were generally guaranteed at 90 percent, and lower guarantee percentages were offered when loan risk decreased.

FmHA has recognized that the unclear guidance has led to inconsistencies in determining the percentage of guarantee. In reviews of state operations, the National Office staff have maintained that the percentage of guarantee should generally increase as the government's risk is decreased—the stronger the loan, the greater the guarantee percentage. According to the Deputy Assistant Administrator for Farmer Programs, however, because of the lack of clarity in the regulations, FmHA had not been totally successful in persuading some states to lower the percentage of guarantee to compensate for increased risk exposure.

FmHA's Proposal to Guarantee All Loans at 90 Percent

In an attempt to clarify its regulations, FmHA proposed in June 1988 to amend its regulations to guarantee all farm loans at the maximum of 90 percent. However, in its final regulations published in January 1989, FmHA withdrew the proposal because of OMB, OIG, and our concerns that, if all loans were guaranteed at 90 percent, lenders' varying risks would not be adequately considered, and lenders may have reduced incentive to properly process and service guaranteed loans. As a result of the provision's withdrawal, FmHA's policy on establishing the percentage of guarantee remains unclear.

One of the reasons cited for FmHA's proposed change was that most guarantees were issued at 90 percent anyway. Another reason was that lender participation should increase if all guarantees were issued at the maximum percentage. The attempt to increase lender participation was one means of following the emphasis placed on loan guarantees in the Agricultural Credit Act of 1987. The act states that the Secretary of Agriculture should issue guarantees to the maximum extent practicable to assist eligible borrowers whose loans are being restructured by lenders. To compensate for the increased risk associated with guaranteeing all loans at 90 percent, FmHA proposed to raise the cash flow requirement to 110 percent (projected income must exceed estimated expenses by 10 percent) except in cases where FmHA's interest rate reduction program[1] would be applicable. The credit factors previously mentioned would no longer be considered in determining the guarantee percentage.

In its review of FmHA's farm loan guarantee program, the OIG considered the unclear policy guidelines on negotiating guarantee percentages to be a problem. The OIG stated in its September 1988 report that this lack of specificity would likely continue to result in the maximum guarantee percentage for guaranteed loans. The OIG further stated that lower guarantee percentages would reduce FmHA's loss risk and provide lenders additional incentive to better process and service guaranteed loans. The OIG recommended that FmHA should (1) issue specific policies and procedures for consistency in negotiating guaranteed loan percentages with lenders, giving primary consideration to the lenders' risk exposure for the loans and (2) establish controls, such as district director review of county office guaranteed loan approvals, to help ensure that guaranteed loan percentages are proper.

In responding to the OIG's recommendation, FmHA cited the emphasis in the Agricultural Credit Act of 1987 on increasing the use of loan guarantees. FmHA stated that it was not only the sense of the Congress but also the spirit of the law that the Secretary should issue farm loan guarantees to the maximum extent practicable; accordingly, it appeared to FmHA that the Congress intended for FmHA to issue 90-percent guarantees on its guaranteed farm loans, as it proposed in June 1988. The OIG agreed that FmHA should issue guarantees to the maximum extent practicable but did not believe that it was the intent of the Congress to establish the government's financial responsibility at 90 percent for all guaranteed loans since the legislation uses the terminology "a maximum

[1] FmHA's interest rate reduction program was authorized by the Food Security Act of 1985 and helps lenders to 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.

of 90 percent." Consequently, the OIG requested that FmHA reconsider its position regarding recommendations for establishing guarantee percentages.

In discussions with the Assistant Administrator for Farmer Programs, he agreed that guaranteeing all loans at 90 percent would not adequately consider lenders' varying risks and may reduce lenders' incentive to properly process and service guaranteed loans. He said that because of OMB, OIG, and our concerns, FmHA reconsidered its position on this point and withdrew the provision in its final regulations published in January 1989. As a result of the provision's withdrawal, FmHA's policy on establishing the percentage of guarantee remains as previously stated in its regulations and, as previously discussed, is still unclear.

Problems in Overseeing Loan Guarantees After Approval

Lenders are responsible for servicing guaranteed loans and protecting loan collateral, and FmHA is responsible for overseeing lenders' servicing activities. We and the OIG found problems with FmHA's oversight of loan guarantees after approval. The oversight problems involved lender and/or FmHA (1) not always obtaining periodic financial statements from borrowers nor always performing the required collateral inspections during the life of the loan, (2) making unauthorized loan advances to borrowers and including them under the guarantee, (3) not submitting timely default notices and/or liquidation plans, and (4) not pursuing recovery of losses after liquidation and FmHA's guaranteed loan loss payment to the lender. These problems have hindered FmHA's ability to identify problem loans early and to efficiently manage the liquidation process to minimize guaranteed loan losses.

Under FmHA's regulations and the lender's agreement, lenders are responsible for servicing guaranteed loans and protecting loan collateral. Servicing includes, among other things, (1) obtaining borrower compliance with loan agreements and security instruments, (2) collecting loan payments as they fall due, (3) inspecting and protecting collateral, (4) obtaining periodic financial statements from the borrower, (5) reporting to FmHA when a borrower is in default, (6) working with FmHA and the borrower to cure the default, (7) obtaining FmHA's concurrence on a decision to liquidate a loan account if the default cannot be cured, (8) obtaining FmHA's concurrence in a liquidation plan, (9) conducting the liquidation, (10) submitting a loss claim, where applicable, to FmHA if the proceeds from collateral disposition do not cover the loan amount, and (11) prorating any funds that may be recovered after liquidation between FmHA and the lender in proportion to the guarantee percentage.

Under FmHA's regulations, FmHA is responsible for monitoring the lender's servicing activities primarily through (1) periodic review of the lender's guaranteed loan files and (2) FmHA and lender contacts with the borrower to observe the farming operation and inspect collateral. FmHA is also responsible for working with the lender to resolve a borrower's default and to monitor and concur in the liquidation process. Under the lender's agreement executed by FmHA and the lender, if FmHA determines that a loss occurred because of a lender's negligent servicing, FmHA can refuse to honor the guarantee. The lender's agreement executed by FmHA and the lender defines negligent servicing as the failure to perform those services that a reasonably prudent lender would perform in servicing its own portfolio of loans that are not guaranteed. The term includes not only the concept of a failure to act but also not acting in a timely manner or acting in a manner contrary to how a reasonably prudent lender would act up to the time of loan maturity or until a final loss is paid. The Assistant Administrator, Farmer Programs, informed us that district directors are to review, as a part of FmHA's servicing goals, 15 percent of each county office's guaranteed loans and report on problems identified. He said that in fiscal year 1988, only three states were able to meet these servicing goals.

Lenders Not Obtaining Financial Statements Nor Inspecting Loan Collateral

FmHA's regulations require the lender to obtain from the borrower periodic financial statements, analyze the financial statements, take any servicing actions needed, and provide copies of the statements and record of actions to the FmHA county supervisor. The lender is also required to inspect the loan collateral as often as necessary to service the loan properly. The periodic financial statements and collateral inspections enable both the lender and FmHA to monitor the financial condition of the borrower and ensure that the loan remains adequately secured.

Although our review did not concentrate on determining whether lenders were obtaining financial statements or inspecting loan collateral, the FmHA Assistant Administrator, Farmer Programs, acknowledged that FmHA should monitor these aspects more closely. In its review, the OIG projected that of the 15,585 loans in the sample universe, 3,513 loans had been serviced without annual financial statements from the borrowers, 7,416 chattel-secured loans had been serviced without required semiannual financial statements from borrowers, and 1,511 loans had not received collateral inspections by lenders. The OIG recommended that FmHA should instruct state and county offices to closely monitor lender servicing actions to ensure that lenders meet FmHA servicing requirements. FmHA responded that its regulations require this monitoring and that a proposed regulation revision will require county supervisors to review at least 20 percent of the loan guarantees each year and report problems to the appropriate district director.

Lenders Are Making Unauthorized and Improper Loan Advances

FmHA regulations authorize lenders to advance additional funds not included in the original guaranteed amounts, providing FmHA approves the advances. These advances, which constitute an indebtedness of the borrower to the lender, may be made for property taxes, ground rent, annual assessments, and other expenses necessary to preserve or protect the guaranteed loan security. However, in our review of borrowers' loan files, we found that lenders were advancing funds without FmHA approval and sometimes including such funds under the original guarantee. We also determined that some county supervisors were allowing lenders to collect the additional advances prior to paying off the guarantees, thus increasing the possible loan loss for FmHA.

FmHA regulations state,

"The Lender will not make additional expenditures or new lines of credit or loans to any borrower which has financial assistance guaranteed by FmHA without first obtaining the written approval of FmHA even though such expenditures or lines of credit or loans will not be guaranteed."

In one state, our review of loan files disclosed that a lender had made unapproved advances and had included such advances in the loss claims submitted to FmHA. These unapproved advances were not deducted from the loss claims because the FmHA county supervisor and state farmer program chief considered this advance as a normal practice that they approved with the direct loan borrowers. FmHA reviews also indicated that lenders sometimes advance additional funds or make additional loans to borrowers without FmHA approval and include these advances under the guarantee. FmHA national farmer program officials acknowledged that lenders are making advances without FmHA approval; however, they said that FmHA would likely reimburse the lenders for such advances included in a loss claim if they were for purposes that FmHA would have previously approved.

Our review of loan files for 67 borrowers also disclosed that in two instances a county supervisor approved additional advances of funds and advised the lender to have the borrower repay the advance before repaying the guaranteed loan. In addition, 1 of the 12 loan loss files we reviewed showed that the county supervisor had approved a $70,000 advance of funds and advised the lender to have the borrower repay the advance before any payment on the guaranteed loan. The repayment of the advance was to come from crop proceeds, which were also used to secure the guarantee. As a result of this action, when the borrower defaulted on the guaranteed loan, the lender submitted a loss claim that was about $50,000 greater than it would have been had the guaranteed loan amount been paid first. In yet another case, a county supervisor authorized an additional advance and advised the lender that the advance would be included under the guarantee; however, the supervisor did not collect any additional fee or have the lender submit additional documents as regulations require.

Lenders Not Submitting Timely Default Notices and/or Liquidation Plans

FmHA regulations require a lender to notify FmHA in a timely manner when a borrower is in default and to work with FmHA and the borrower to attempt to cure the default. The regulations also require (1) timely notification if a lender decides liquidation of a loan account is necessary and (2) FmHA's concurrence in the liquidation decision. In addition, timely submission of a liquidation plan to FmHA is required as is FmHA's concurrence in such a plan. Timely submission of default notices, liquidation intentions, and liquidation plans is necessary to resolve problems early to help borrowers stay in business if possible or, if not, to minimize loan losses. Increased loan losses can result from unnecessary interest accrual if a liquidation decision is delayed and from inadequate accounting for collateral disposition if a faulty—or no—liquidation plan is submitted.

Contrary to regulations, FmHA county and state offices we reviewed were generally not requiring private lenders to submit proper default notices and liquidation plans, or to make a full accounting of all security upon liquidation of guaranteed loans. Consequently, lenders are not (1) submitting default notices and/or liquidation plans in a timely manner or at all in some cases and (2) adequately documenting disposition of loan security.

FmHA regulations require a lender to notify FmHA when a borrower is 30 days past due on a payment and is unlikely to bring the account current within 60 days or if the borrower has not met the responsibilities of providing the required financial statements to the lender or is otherwise in default. The lender is required to arrange with the FmHA county supervisor to meet with the borrower to resolve the problem and to negotiate in good faith to attempt, where reasonable, to permit the borrower to cure the default. Also as required by the Agricultural Credit

Act of 1987, the lender is to consider interest rate reduction as an alternative to foreclosure action and must wait at least 60 days before foreclosing. If the lender concludes that liquidation of the loan account is necessary, the lender is required to notify the FmHA county office in writing within 10 days after the decision to liquidate. The lender and FmHA then meet and reach agreement that liquidation is necessary.

Within 30 days after the lender's decision to liquidate, the lender is required to provide FmHA a written proposal detailing the method of liquidation—a liquidation plan. The plan will include proof of the lender's ownership of the loan guarantee and related security instruments, list of the borrower's assets identifying those assets serving as collateral for the guaranteed loan, and a proposed method of making the maximum collection possible on the indebtedness. Within 30 days after receipt of the liquidation plan, FmHA is required to inform the lender in writing whether it concurs with the plan or to advise the lender that additional time is needed to respond. After agreement is reached on the liquidation plan, the lender will ordinarily conduct the liquidation, although under certain circumstance FmHA may conduct the liquidation.

The default/liquidation process as set forth in the regulations seems to be a reasonable approach to resolving problem loan accounts. However, our review as well as FmHA's own internal assessments found several instances in which the process was not followed and increased loan losses resulted.

We reviewed loan files of 12 borrowers who had defaulted on 13 guaranteed loans and found that only 6 of the loan files contained evidence that a default notice had been submitted. Also, four of the six default notices submitted were not submitted within the required time period. These four default notices were received from 13 to 52 days after the required time period. Further, 9 of the 13 loans contained no liquidation plans; and in 1 of these cases, we believe the lender did not make the maximum effort possible to reduce the loss claim amount. In this case, the borrower had about $215,000 in unencumbered assets that could have been used to pay off the loan. However, there was no information in the loan file showing that the lender tried to collect the unpaid loan balance from these assets. The lender filed a loss claim on the loan, and FmHA paid the lender over $38,000 to honor the guarantee.

The Deputy Assistant Administrator, Farmer Programs, other national farmer program officials, and two state farmer program chiefs acknowledged that lenders are not notifying FmHA on a timely basis when a borrower's loan is in default. According to the Deputy Assistant Administrator, although FmHA was unable to provide the exact number of occurrences, the problem is likely widespread. These officials also said that FmHA is not doing a good job of requiring and obtaining liquidation plans from lenders. The Deputy Assistant Administrator further stated that county supervisors are not adequately trained to review and approve liquidation plans. In addition, a report on a review of lenders' files conducted by one FmHA state office showed that for 41 of 242 (17 percent) liquidation records reviewed, the lenders had not documented the disposition of security. Further, FmHA National Office officials reported in their reviews that in many liquidations lenders were not adequately documenting the disposition of security property or the release of proceeds from sales of such property.

Limited Pursuit of Recovery of Loss Claims Paid by FmHA

FmHA's current regulations do not require either lenders or FmHA to pursue recovery from borrowers of loss claims paid by FmHA to lenders. An FmHA regulation requires, however, that once liquidation has occurred and FmHA has paid a final loss payment, any funds recovered in the future by the lender must be prorated between FmHA and the lender on the basis of the percentage of guarantee. FmHA does not consider guaranteed loan loss claims paid to a lender to be an indebtedness owed FmHA by the borrower. FmHA considers the guarantee satisfied when it settles with the lender. Because lenders only liquidate security property and are paid a percentage of any loss by FmHA in accordance with the guarantee, lenders have no real incentive—and FmHA does not require them—to pursue future recovery of loan losses from borrowers that would be shared on a prorated basis with FmHA. In addition, because FmHA does not establish a paid loss claim as an indebtedness owed the government by the borrower, losses that might possibly be recovered to some degree are not, and borrowers could continue to operate using assets not liquidated under the guaranteed loan without repaying the losses incurred by the lender and FmHA.

In its September 1988 report on FmHA's guaranteed farm loan program, the OIG pointed out that because FmHA did not consider losses paid to lenders to be a debt owed the government by the borrowers, no attempt had been made to collect about $140 million in losses paid to lenders in fiscal years 1986 and 1987. The OIG took the position that this lack of a collection effort was contrary to the May 1985 OMB Circular A-129, Managing Federal Credit Programs, which sets standards for, among other things, collecting loans and other receivables under both direct and guaranteed loan programs. The OIG recommended that FmHA establish and implement policies and procedures in accordance with OMB Circular A-129 to initiate collection action against borrowers immediately after final settlement of loan guarantees with lenders.

In its response to the OIG's recommendation, FmHA stated that it continues to look to the lender to collect guaranteed loans after the lender receives a loss payment from FmHA. FmHA stated that (1) only when FmHA repurchases a guaranteed loan from the lender does the loan become a debt owed to FmHA, (2) FmHA's contract is with the lender and the borrower's obligations are owed to the lender, not FmHA, and (3) the lender has the responsibility of servicing the loan and making post-liquidation recovery on the loan. FmHA also stated that it planned to develop regulations that will require county office staffs to monitor collection efforts on defaulted loans for 5 years after the loss payment is made.

In analyzing FmHA's response, the OIG commented that lender agreements with FmHA do not require lenders to attempt collection from borrowers after receiving the final loss claim payment from FmHA, and lenders have little incentive to pursue such recovery. The OIG pointed out that when FmHA reimburses a lender to the extent of the guarantee, a gain in the form of forgiveness accrues to the borrower and FmHA incurs a loss. The OIG maintained that borrowers may have current or future assets in addition to the collateral for the specific loan that went bad, and FmHA has ample leeway to seek and obtain recovery of its losses. Consequently, the OIG's recommendation remained unchanged in the report. On March 23, 1989, FmHA informed the OIG that, as a result of an agreement with OMB, FmHA would further study this area. On March 27, 1989, the OIG informed FmHA that this recommendation had been resolved and could be closed upon completion of the study, analysis of the issue, and subsequent modification of the rules.

Our review of guaranteed loans to 12 borrowers on which FmHA paid loss claims disclosed that at least 1 borrower, and possibly others, had assets that could have been used to repay the losses that FmHA paid. After our discussion with FmHA officials about one particular case, FmHA state farmer program officials and the county supervisor requested the lender to try to collect the loan loss amount from the borrower. We also found that farmers who received guaranteed loans with crops as the only security could have defaulted on their loans and still be farming. Such farmers may have assets that could be used to repay losses suffered by lenders and FmHA.

Case Studies Illustrating Guaranteed Loan Program Problems

During our visits to the 16 county offices, we developed case studies on borrowers who had defaulted on FmHA-guaranteed loans. Although these case studies may not be typical, they illustrate many of the problems we identified.

Case Study A

A borrower received an operating loan in April 1986 for about $118,000, which FmHA guaranteed at 90 percent. This loan was for production purposes and to make payments to other creditors for the borrower's son. The borrower listed no debts and total assets of $215,000. The assets consisted of $10,000 in cash, $145,000 in savings, and $60,000 in real estate. It appeared that the borrower had sufficient collateral to obtain a loan without the FmHA guarantee. However, the guaranteed loan was secured only by a crop lien and assignment of ASCS payments on 600 acres of cotton and soybeans. The borrower had no crop insurance and leased land from his son for farming purposes.

The county supervisor indicated on the guaranteed loan evaluation form that the security offered (crops) appeared adequate and that the borrower had been unable to obtain necessary credit without a guarantee. The county supervisor's evaluation of the borrower's inability to obtain credit without a loan guarantee appeared questionable because (1) a letter from the private lender accompanying the loan application did not state that credit would be denied without the guarantee and (2) the borrower had not signed the Conditional Commitment for Guarantee certifying that credit was not available at reasonable rates and terms.

The borrower's repayment estimate showed projected income from crop production of $112,750, government payments of $19,000. and other income of $5,900 for a total projected income of $137,650. Loan records showed the borrower was actually loaned $106,200 of the $118,000 approved and repaid only $72,781. Of this amount, $64,600 was applied to loan principal and $8,181 was for interest on the loan. In March 1987 the lender filed a loss claim with FmHA for $42,286, and in May 1987 FmHA paid the lender $38,409, including accrued interest until date of payment, to honor its 90-percent guarantee.

We identified several problems with this guaranteed loan. First, the loan guarantee request probably should not have been approved because sufficient assets, including cash and savings, were available to finance the farming operation without a loan guarantee. Second, one of the loan's purposes—payment of the borrower's son's debts—is not a permissible loan purpose under FmHA's regulations. Third, accepting crops as the only collateral without crop insurance and when over $200,000 in unencumbered security was available proved to be a costly mistake because FmHA paid the lender a loss claim of over $38,000. Finally, until our inquiry there was no evidence that either FmHA or the lender pursued recovery of this $38,000 from the borrower despite the apparent existence of ample assets on which to base a recovery.

Case Study B

In April and May 1985 a lender obtained two guaranteed loans for an existing borrower, a 1-year operating loan for $95,000 and a farm ownership loan for $275,000. The operating loan, secured by 1985 crops and guaranteed at 50 percent, was to be used for rent, crop production expenses, and the purchase of feeder pigs. The farm ownership loan, guaranteed at 90 percent, was to cover refinancing of past operating losses and capital expenditures. The farm ownership loan was secured by a third lien position on 400 acres of land and machinery. The lender agreed to write off $30,000 of the borrower's debt to help ensure survival and obtain the farm ownership loan guarantee. The farm ownership loan guarantee was approved by the FmHA state office because the loan amount exceeded the county supervisor's approval authority.

In September 1985 the lender sold the farm ownership loan on the secondary market. By January 1986 the borrower was in default on both loans, and the lender gave FmHA notice of default and proposed liquidation action. FmHA approved the liquidation of the loan accounts in April 1986. In June 1986 the lender advised FmHA that other lenders had claims of $778,000 against the 400 acres of land and that it was unlikely there would be any equity to protect on their lien. The lender obtained sufficient funds from the borrower to pay the balance due on the operating loan but filed a loss claim for the outstanding balance of $234,290 on the guaranteed farm ownership loan. The guaranteed loss amount was $210,861.

In reviewing the case file, the county supervisor found several problems that resulted in a recommendation against loss payment because of lender misrepresentation. Among these problems were the following:

- The borrower made a major change in his farming operation between the time of loan application and loan closing that was not reported to FmHA, nor was revised financial data submitted to reflect the new operation.
- An after-the-fact June 1986 lender submission of financial information on the revised farm operation, according to the county supervisor, overstated the projected income and the farmer's capacity to operate at the level indicated.
- The lender omitted from the loan application a Federal Land Bank debt of $51,000 against the land, resulting in significantly overstating the collateral available to secure the third lien position on the farm ownership loan guarantee.
- The land value shown in the borrower's January 1985 financial statement was significantly higher than that shown just prior to the liquidation decision in December 1985 ($936,600 versus $550,000), causing the county supervisor to question the reliability of the lender's appraisal submitted with the loan guarantee request.

In countering the county supervisor's recommendation, the lender maintained that the change in operation had been discussed with an FmHA state official, and this state official said that no new cash flow projection or amendment to the application was needed. The state official, however, could not recall such a conversation. The county supervisor maintained that, had he been informed of the change in operation and aware of the additional $51,000 lien against the farm, the loan guarantee request may have been denied.

The dispute over the loss claim continued for about 2 years during which time interest continued to accrue on the outstanding balance of the farm ownership loan. Another complicating factor was that the farm ownership loan note had been sold in the secondary market, and the holder was demanding the payments that the lender was supposed to collect and forward under the servicing agreement. On June 23, 1987, the lender acting on behalf of FmHA notified the holder to surrender to FmHA the guaranteed part of the loan and advised the holder to contact the FmHA county office to arrange for loss payment. On June 25, 1987, the holder demanded that the lender repurchase the unpaid guaranteed portion of the loan. The lender refused this request and again advised the holder to demand payment of the guarantee from FmHA.

According to a state official, FmHA submitted the required paperwork for payment of a loss claim of about $245,200 on May 13, 1988. However, FmHA apparently still has a dispute with the lender over $6,000 that it believes the lender should pay FmHA. On June 2, 1988, FmHA finally paid the holder $247,735 to settle the loss claim.

This case study illustrates several program problems, including questionable loan approval, possible misrepresentation, questionable collection efforts, and an untimely loan loss payment. The questionable loan approval and other subsequent events resulted in a loss to FmHA of over $200,000, and, in not settling this loss claim promptly, FmHA incurred additional losses of about $40,000 because of interest accrual.

Case Study C

This borrower received two operating loans that FmHA guaranteed at 90 percent in May and June 1986—a $267,580 line of credit for production expenses and a $78,900 loan note guarantee to refinance three pieces of equipment. The line of credit was secured by a crop lien on soybeans, milo, and cotton to be planted on 2,756 acres. The loan note was secured by five pieces of equipment, which had an estimated value of $63,600 according to the borrower's financial statement. The maturity date on the line of credit was December 1, 1986.

The borrower's financial statement showed total assets of $335,200 and total liabilities of $754,667, for a negative net worth of $419,467. At the time of loan application, the borrower had nine outstanding direct loans from FmHA with a total loan amount of about $345,000. Four of the loans were delinquent but were rescheduled and brought current in order to approve the loan guarantees.

In August 1987 the lender requested in a letter to the county supervisor that FmHA pay its 90-percent guarantee on the line-of-credit production loan. The lender advised FmHA that the borrower had paid a total of $208,423 of the $267,272 advanced under the line of credit, but the lender had advanced the borrower an additional $12,674 to cover certain harvesting expenses, resulting in a principal balance shown by FmHA of $71,431 (although the net amount would appear to be $71,523). With accrued interest on the outstanding principal remaining, the amount of loss claim on the line of credit was $74,090, and FmHA paid the lender $66,681 to honor the guarantee.

From the borrower's loan file, the lender's letters to FmHA, and discussions with the loan officer and FmHA officials, we identified the following problems with this case.

- The loan file contained no county committee certification of loan eligibility and no loan evaluation form.
- The borrower was technically insolvent with a negative net worth of over $400,000 and had a series of FmHA direct loans, some of which required rescheduling prior to approval of the loan guarantees, indicating that approving an operating loan guarantee with crops as the only security at 90 percent was highly risky.
- The lender released $12,674 of crop proceeds to the borrower to cover certain harvesting expenses without obtaining the required FmHA approval for making the advance and, contrary to FmHA regulations, included this advance in the loss claim. FmHA included the advance in settlement of the loss claim, which resulted in FmHA's paying a loss that exceeded 90 percent of the unpaid balance of the loan.
- The lender did not provide FmHA a notice of default or a liquidation plan prior to submitting a loss claim about 8 months after the maturity date of the line-of-credit guarantee.

According to the lender and FmHA officials, the borrower continued to farm in 1987 despite the liquidation of the line-of-credit guarantee and FmHA's payment of a loss claim to the lender. The borrower still experienced financial problems, however, as demonstrated by the fact the he made no payments on his FmHA direct loans or on the guaranteed portion of the line-of-credit loan. In view of the borrower's past and continuing financial problems, we asked FmHA state officials of their rationale for guaranteeing loans at 90 percent to this borrower. Their response follows.

> "Our policy is to allow the maximum guarantee in cases involving financial statements such as that produced by the borrower provided the security value and repayment ability are realistically projected as adequate. Cases in this category are often salvable and lenders would not make loans to this type client without a guarantee as additional security. However, in cases projecting more than adequate security and other unencumbered assets with very marginal repayment ability, our policy is to grant less than a maximum guarantee because the lender's exposure is less and the government's protection from losses are needed to a much lesser degree."

This case study illustrates how loan losses can result from inadequate (1) evaluation of a borrower's financial condition prior to approving a loan guarantee request, particularly the assessment of collateral backing the loan and the determination of the percentage of guarantee and (2) monitoring of a lender's servicing activities, particularly approving lender advances to borrowers and requiring proper and timely submission of default notices and liquidation plans.

Similar Problems Exist in Both Guaranteed and Direct Loan Programs

The problems identified with FmHA's guaranteed farm loan program are similar to those that exist with its direct loan program. In a February 1989 report addressing the loan-making criteria for FmHA's direct farm loan program, we stated that FmHA's cash flow analysis overstates repayment ability, which results in frequent loan servicing, and that declining net worth and asset values jeopardize loan security.[2] These problems are similar to those identified in this report regarding FmHA's assessment of borrowers' financial conditions prior to loan guarantee approval and in FmHA's oversight of loan guarantees after approval.

The problems that exist in both the direct and guaranteed loan programs have contributed to increasing loan losses. FmHA's recorded direct farm ownership and operating loan losses increased from $57.5 million in fiscal year 1984 to $384.8 million in fiscal year 1987.[3] Further, we reported that, in its financial statements for the period ended September 30, 1987, FmHA recognized that losses on both direct and guaranteed loans had not been fully recognized until fiscal year 1987.[4] FmHA established allowances for future losses of $12.2 billion, or about 44 percent of the $27.5 billion outstanding principal on direct loans, and $644 million, or about 31 percent of the $2.1 billion outstanding principal on guaranteed loans.

To stem the increasing direct loan losses and to provide direct loan borrowers with a more realistic assessment of their ability to recover financially, we recommended in our February 1989 report that the FmHA Administrator develop, in consultation with the Congress, more comprehensive loan-making criteria that assess an applicant's financial solvency, profitability, liquidity, and repayment ability prior to making new loans. On the basis of our guaranteed loan work, the OIG's work, and FmHA's own internal assessments, we believe that such a comprehensive approach is also needed for guaranteed loans.

Conclusions

As guaranteed loan activity has increased so have guaranteed loan losses, and FmHA expects such losses to increase in the future. Contributing factors to the increasing losses on guaranteed loans are problems in

[2] Farmers Home Administration: Sounder Loans Would Require Revised Loan-Making Criteria (GAO/RCED-89-9, Feb. 14, 1989).

[3] Farmers Home Administration: Farm Program Debt, Delinquencies, and Loan Losses as of June 30, 1987 (GAO/RCED-88-134BR, May 20, 1988).

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

FmHA's assessment of a borrower's financial condition prior to approving the guarantee and in FmHA's oversight of the loan guarantee after approval. Problems such as poor assessment of a borrower's repayment ability, insufficient determination of collateral securing a guaranteed loan, inadequate credit analysis training for FmHA county supervisors, and unclear guidance for determining the percentage of guarantee demonstrate that FmHA needs to take a more comprehensive approach to reviewing and approving lenders' loan guarantee requests. In addition, problems such as lenders' not obtaining financial statements, not inspecting loan collateral during the life of the loan, making unauthorized and improper loan advances, not submitting timely default notices and/or liquidation plans, and rarely pursuing recovery of loss claims paid by FmHA illustrate that FmHA needs to exercise greater oversight of lenders' servicing of loan guarantees after approval.

One of the problem areas deserving particular attention is whether crops are sufficient as the only security to back a guaranteed loan. When FmHA guarantees a loan with crops as the only collateral, the lender essentially converts the collateral from "weak" to "firm" because the lender is protected from loss not by the adequacy of collateral but by the government's guarantee. The absence of crop insurance for such a loan further increases the government's exposure. The private lenders we contacted generally do not consider crops alone as adequate collateral for a loan, especially without crop insurance and/or a loan guarantee.

Another problem area deserving attention is FmHA's guidance on determining the percentage of guarantee. The higher the percentage of guarantee, the greater the risk exposure is for FmHA. Conversely, the higher the guarantee loan percentage, the lesser the risk is for the lender. FmHA's current regulations are unclear on how the percentage of guarantee should be determined in relation to risk exposure, and this has led to inconsistencies. As FmHA proposed in June 1988, one solution to this problem is to guarantee all farm loans at 90 percent and, to compensate for this increased risk, to raise the cash flow requirement from 100 to 110 percent. In its January 1989 regulations, FmHA withdrew the 90-percent proposal based on OMB, OIG, and our concerns that FmHA would bear too much of the risk of the guaranteed loan program and lenders would have reduced incentive to properly process and service their guaranteed loans. Consequently, the unclear guidance on establishing the percentage of guarantee remains in effect.

Regarding the recovery of losses, we agree with the OIG's September 1988 report that under the current postrecovery process, lenders have little or no incentive to initiate collection action on borrowers whose guaranteed loan accounts have been liquidated. The government's financial interest is not well served when neither lenders nor FmHA are required under existing regulations to take action to recover amounts the government paid to lenders for guaranteed loan losses from borrowers who may have assets currently or in the future that could offset these losses.

FmHA's increasing losses and financial risk from a growing guaranteed farm loan portfolio require good management of its guaranteed farm loan program from the initial application stage through the recovery of losses from borrowers. However, because many of the problems contributing to loan losses can be traced back to lenders not meeting their servicing responsibilities, FmHA can and should refuse to fully honor its guarantee in those instances where lenders' negligent servicing caused the losses. Although guaranteed loans are essentially private lender loans, the problems with the guaranteed loan program demonstrate that FmHA cannot assume that private lenders will manage the program for FmHA. Lenders and borrowers have ample incentive to hedge on meeting FmHA's requirements for making and servicing guaranteed loans because up to 90 percent of the risk is transferred to the government. Insufficient attention to guaranteed loan applications and inadequate oversight of the guaranteed loans after they are made have contributed to guaranteed loan losses and will continue to do so unless changes are made.

The guaranteed loan program offers an opportunity to avoid problems experienced in the direct loan program. However, if problems with the guaranteed loan program continue, losses will increase, thus overcoming the budgetary advantage of shifting to guaranteed loans. As the shift continues from direct to guaranteed loans, correcting these problems grows in importance to control the mounting losses and to avoid the experience with the direct loan program.

Recommendations to the Secretary of Agriculture

To help control losses and improve management of the guaranteed farm loan program, we recommend that the Secretary of Agriculture direct the Administrator, FmHA, to

- develop, in consultation with the Congress, and implement more comprehensive guaranteed loan-approval criteria that assess an applicant's financial solvency, profitability, liquidity, and repayment ability prior to approving loan guarantees;

- establish in regulations the type and amount of security required for a guarantee and, if crops are accepted as the only security, require that crop insurance be obtained;
- establish a range of loan guarantee percentages based on loan risk, with the higher guarantee percentages going to lower risk loans;
- enforce FmHA requirements for lender servicing of guaranteed loans and place greater emphasis on establishing the extent to which lenders' negligent servicing caused loan losses before determining the amounts to be paid as loss claims; and
- establish in regulations procedures for recovering from defaulted borrowers amounts the government paid to lenders for guaranteed loan losses.

We also recommend that the Secretary of Agriculture direct the Administrator, FmHA, to provide (1) county supervisors with training in credit analysis to better acquaint them with what constitutes adequate financial data on which to base a guaranteed loan-approval decision and (2) guidance and training to state, district, and county officials that would enhance the monitoring of lenders' guaranteed loan-servicing activities, especially guaranteed loan liquidations.

Agency Comments and Our Evaluation

USDA generally agreed with most of our findings and recommendations. However, some of its actions planned or underway may not fully resolve the problems that led to our recommendations. USDA stated that it is contracting for a study of loan approval and borrower selection criteria and that most of our recommendations will be considered in the study. USDA's comments and our evaluation are discussed below.

Regarding our first recommendation to develop and implement more comprehensive loan approval criteria, USDA stated that the OIG's September 1988 report was also critical of this area. In response to concerns that we raised and the OIG's report, FmHA met with officials from OMB and agreed to contract for a study of loan approval and borrower selection criteria. USDA stated that once this study is completed, FmHA will (1) have an outside opinion of documented, reliable financial criteria necessary to make loan approval decisions and (2) evaluate the results and revise its regulations as appropriate. The projected contract award date is September 30, 1989. USDA also stated that increasing the cash flow requirement in its January 1989 revised regulations to allow for a 10-percent cash reserve will help borrowers better cope with unforeseen events and reduce the likelihood of failure. In addition, USDA commented that changing the requirements for borrowers' financial history from 3 to 5 years and production history from "up to 5 years" to 5 years will result in more accurate financial projections and improved loan quality. USDA further stated that the recent and continuing monitoring efforts of FmHA National Office program managers should strengthen loan quality.

A study of loan approval and borrower selection criteria is an essential first step in meeting the intent of our first recommendation. The statement of work for the study contract also specifies that this aspect of the direct loan program will be studied as well, which meets the intent of a similar recommendation contained in our February 1989 report on FmHA's direct loan program.[7] We encourage FmHA to consult with the Congress early and often on this study to obtain congressional support for the necessary changes in loan approval criteria. As for USDA's comments on improved loan quality resulting from revised regulations and FmHA's National Office monitoring efforts, we also believe that these are steps in the right direction. Our report points out, however, that many of the loan-quality problems resulted from FmHA's county supervisors' not complying with previous FmHA regulations on assessing borrowers' repayment ability and collateral securing guaranteed loans. Closer supervision of county office loan-approval activities by district, state, and national offices will likely be needed to ensure that the strengthened regulations will actually result in improved guaranteed loan quality.

In commenting on our second recommendation to establish in regulations the type and amount of security required for a guarantee and, if crops are accepted as the only security, require that crop insurance be obtained, USDA responded that security requirements had been strengthened by the January 1989 revised regulations, which clearly state FmHA security requirements for loan guarantees. In addition, USDA commented that the revised regulations permit the loan approval official to require crop insurance, in individual cases, when crops are the only security for a loan. USDA also indicated that the revised regulations and an April 1989 administrative notice providing loan-processing check lists would improve the documentation of loan collateral. USDA further stated that FmHA will evaluate the results of the study on loan approval and borrower selection criteria to determine if additional security requirements are warranted.

[7]GAO/RCED-89-9, Feb. 14, 1989.

While the revised regulations and the loan-processing check lists provide more specificity in loan collateral requirements, particularly in the types of security (such as real estate, chattel, and lien position), the amount of collateral required for a guaranteed loan remains generally subjective and will likely continue to cause inconsistencies among county offices. Terminology such as "the security must be adequate in the opinion of the lender and FmHA to assure repayment" and "if security alone is inadequate, then the applicant's repayment ability will also be considered by the lender and FmHA" falls short of meeting the intent of our recommendation. We believe that collateral requirements would be strengthened, better loan quality would result, and the intent of our recommendation would be better met if FmHA more clearly specified that security value must be equal to or greater than loan value and that, if security value does not meet this test, a higher percentage of borrower positive cash flow would be required to compensate for the increased risk associated with inadequate loan security.

Similarly, USDA's comments on crop insurance go part way in meeting the intent of our recommendation. We believe, however, that our report demonstrates the need for requiring crop insurance when crops are the only security for a loan rather than, as specified in the January 1989 revised regulations, permitting a loan approval official to require crop insurance, in individual cases, when crops serve as security for a guaranteed loan. We encourage FmHA to consider this recommendation further and provide more specific instructions to county offices on this issue.

Regarding our third recommendation to establish a range of loan guarantee percentages based on loan risk, USDA agreed with our findings that the current regulations do not give clear guidance to field personnel on establishing the loan guarantee percentage and stated that, implicitly, the guarantee percentage should decrease with the increased risk of failure. USDA stated that this issue will also be addressed under the contract to study loan approval and borrower selection criteria, and FmHA will establish defined criteria for determining the guarantee percentage on the basis of the study results. This planned action is an essential first step in meeting the intent of our recommendation. Again, we encourage FmHA to consult with the Congress on this issue.

In its written comments, USDA did not fully respond to our draft report's fourth proposal to enforce FmHA requirements for lender servicing of guaranteed loans, particularly when default reports and liquidation plans are not submitted in a timely manner, and refuse to pay loss claims when lenders do not fulfill their obligations. USDA's response generally described FmHA's servicing procedures and some of the actions being taken to make FmHA county supervisors and lenders more aware of their servicing responsibilities. These actions are commendable and could lead to better lender servicing; however, the USDA response did not address the enforcement point of our proposal. Our report demonstrates that many of the problems contributing to guaranteed loan losses can be traced back to lenders not meeting their responsibilities and that lenders have ample incentive to hedge on meeting FmHA requirements because up to 90 percent of the risk is transferred to the government.

After discussions with USDA Office of General Counsel and FmHA officials subsequent to receipt of the written USDA comments, we modified our proposal and direct our recommendation more toward lenders' negligent loan servicing as opposed to the broader language contained in the draft submitted to USDA for comment.

While lenders' better understanding of their servicing responsibilities and FmHA's increased oversight could improve lender servicing, we continue to believe that FmHA can and should refuse to fully honor its guarantee in those instances where lenders' negligent servicing caused guaranteed loan losses. Although some lenders may use FmHA's refusal to fully honor the guarantee in settling a loss claim as a reason to not participate in the program, we believe that lenders receive substantial benefits from the program (transfer of risk, increased liquidity and profitability from participating in the secondary market, and improving the quality of their total loan portfolios in the eyes of regulators) that provide a sound business basis to participate within the existing regulations. With guaranteed loan losses increasing, we believe that FmHA needs to take additional steps to control these losses. If lenders knew that FmHA would place a greater emphasis on establishing the extent to which lenders' negligent servicing caused losses before determining the amounts to be paid as loss claims, lenders would have greater incentive to meet their servicing responsibilities, which should in turn help control future guaranteed loan losses.

In its written comments, USDA did not agree with our draft report's fifth proposal to implement policies and procedures to establish loss claims paid to lenders as debts owed the government by the borrowers and to initiate collection action in coordination with lenders immediately after final settlement of loan guarantees with lenders. USDA commented that establishing loss claims as government debts would create many problems, such as reducing or eliminating the lender's incentive to pursue collection after liquidation and causing a significant increase in administrative costs of the program. USDA also stated that such a policy could possibly trigger FmHA "borrower rights" as established by the Agricultural Credit Act of 1987, which would further increase program costs.

USDA stated that FmHA believes that the January 1989 revised regulations allow for both proper collection of debt after a final loss claim is paid and adequate monitoring of lender collection efforts by (1) requiring a lender to submit a liquidation plan within 30 days after the decision to liquidate, (2) specifying that the lender's liquidation plan provide for maximum collection of the debt and identify other borrower resources or income for potential future collection, (3) reaching agreement with FmHA on the liquidation plan, and (4) FmHA exercising its option to liquidate the account if agreement cannot be reached with the lender on the liquidation plan. USDA further stated that the regulations now require FmHA county supervisors to contact lenders in writing for 5 years after the final loss claim is paid to monitor collection of debt on which FmHA has paid a loss. In addition, USDA commented that FmHA has agreed to include this issue in the previously mentioned study on loan approval and borrower selection criteria.

We agree that establishing losses paid to lenders as debts owed the government by the borrowers will likely create additional administrative burden and cost. With FmHA estimating that guaranteed loan losses could exceed $115 million in fiscal year 1989, however, we believe some additional burden is justified. Collections on these losses could help offset administrative costs associated with the collection effort.

As for USDA's comment on reducing or eliminating the lender's incentive to pursue collection after liquidation, both our report and the OIG's report point out that lenders already have little or no incentive to initiate collection action on borrowers whose guaranteed loan accounts have been liquidated. First, lenders would have to remit to FmHA the pro rata share of the collection (90 percent if the loan were guaranteed at 90 percent). Thus, the portion of the collection that the lender could legitimately retain may not offset the lender's time and administrative costs to pursue the collection. In addition, since many of these borrowers are existing clients of the lenders and may have other loan accounts with the lenders that remain active after the guaranteed loan liquidation, collection of debt from the borrower after the loss claim is paid may affect the borrower's ability to meet payment obligations on the other debt held by the lender. Consequently, we believe that, under such conditions, lenders may have more incentive to not pursue collection of debt from borrowers after the loss claims are paid, and FmHA's policy of looking to the lender to pursue collection may not result in recovery from borrowers who may have assets that could offset the losses.

While the revised regulations may improve lender compliance with the requirement to submit better and more timely liquidation plans prior to liquidation of the loan account, the regulations do not require lenders to pursue collection action after liquidation. Consequently, requiring FmHA county supervisors to contact lenders in writing for 5 years after the loss claim is paid to monitor collection of debt on which FmHA has paid a loss will likely yield little results because, as discussed previously, lenders are not required and have little or no incentive to pursue collection. Furthermore, if lenders knew FmHA might pursue collection from borrowers of loss claims paid to lenders, which could jeopardize other loan accounts lenders may have with the borrowers, lenders may (1) better service guaranteed loans to help prevent them from going into default or liquidation and (2) submit better liquidation plans if liquidation is the only alternative.

USDA's comments on the possibility of triggering FmHA "borrower rights" suggest that by FmHA's establishing losses paid to lenders as debts owed the government by the borrowers, FmHA would essentially convert a guaranteed loan into a direct loan. If this is the case, the conversion may afford the guaranteed loan borrower the full range of servicing options available to direct loan borrowers under the Food Security Act of 1985 and the Agricultural Credit Act of 1987, which would create additional administrative burden and program costs. Among these servicing options are (1) homestead protection, which allows borrowers who have lost or are losing their farms to FmHA through foreclosure or voluntary conveyance to retain possession and occupancy of their principal residence, and a reasonable amount of land, through a lease with an option to purchase; (2) lease/buy-back, which allows borrowers to lease with an option to purchase the farmland they had already lost or are losing to FmHA through foreclosure or voluntary conveyance; (3) debt restructuring, which requires FmHA to write down debt if it is less costly to the government than foreclosure for those borrowers who cannot make scheduled loan payments; (4) net recovery buyout, which allows borrowers to purchase the collateral securing the FmHA debt at an amount computed as the current appraised value of the loan collateral minus the estimated administrative, legal, and other expenses associated with liquidating the loan and disposing of the collateral; (5) the "continuation policy," which allows delinquent borrowers to reschedule or defer outstanding indebtedness to FmHA and to obtain additional operating loans without proving their ability to repay prior loans; and (6) appeal rights against adverse FmHA loan decisions.

We believe that another, perhaps more appropriate, comparison would be with that of a direct loan borrower who has a balance remaining on the debt after the loan account has been liquidated. In this case, FmHA would establish a collection-only account on the borrower and perhaps obtain a deficiency judgment against the borrower. FmHA would continue to hold the borrower liable for the debt and could pursue collection action against other assets held by or which may come into possession of the borrower until the entire debt is settled.

After discussions with USDA Office of General Counsel and FmHA officials subsequent to receipt of the written USDA comments, we modified our proposal and direct our recommendation more toward establishing procedures to require that recovery action be taken as opposed to FmHA establishing the loss claim paid to lenders as debts owed the government by the borrowers and to initiate collection action itself. We believe that, in view of the lack of incentive for lenders to pursue collection after loan liquidation and FmHA's payment of a loss claim, FmHA should revise its regulations, lenders' agreements, and other pertinent documents to (1) require lenders to determine within a specified period of time whether to take action to recover losses from borrowers and (2) reserve the right to pursue recovery itself when it may be in the government's interest to do so. In determining whether to exercise this right to pursue recovery action itself, FmHA would have to consider the extent to which "borrower rights" issues are involved.

Although USDA disagreed with our proposal, it said it will include this issue in the contract to study loan approval and borrower selection criteria. A decision to revise its regulations in line with our recommendation could be made without a study, but we agree that further study could determine how best to revise the regulations. We continue to believe that FmHA should establish procedures to require lenders and/or FmHA to determine whether to take action to pursue recovery from defaulted borrowers amounts the government paid to lenders for guaranteed loan losses.

USDA responded to our sixth recommendation to provide guidance and training to field staff in its comments on our other recommendations. USDA commented that FmHA conducted a training program for all Farmer Program chiefs and one Farmer Program specialist from each state in

June 1989. USDA stated that the focus of this training was on credit quality and loan servicing and that the trainees would in turn provide similar training to field staff in their states. In addition, USDA commented that FmHA National Office personnel also periodically visit states to monitor program implementation and provide guidance and assistance in loan making and servicing. USDA further stated that FmHA holds informational and training meetings with the American Bankers Association, the Independent Bankers Association of America, and Farm Credit System members; and FmHA state offices provide training to lenders on state, district, and in some cases at county levels.

USDA's response meets the intent of our recommendation on training. However, in view of the many changes in legislation, regulations, and policy that have taken place recently and are continuing, we encourage FmHA to continue the emphasis on providing guidance and training to help its field staff better fulfill their guaranteed loan responsibilities.

Request Letter From the Chairman of the Senate Committee on Agriculture, Nutrition, and Forestry

United States Senate

COMMITTEE ON
AGRICULTURE, NUTRITION, AND FORESTRY
WASHINGTON, DC 20510-6000

March 30, 1987

The Honorable Charles A. Bowsher
Comptroller General of the United States
United States General Accounting Office
Washington, DC 20548

Dear Mr. Bowsher:

The Farmers Home Administration (FmHA) provides direct loans (government funded) and guarantees some loans made by private lenders to family farmers who are unable to obtain credit elsewhere at reasonable rates and terms. Historically, FmHA's farm credit assistance has been primarily through direct loans, but the past few years have seen a dramatic increase in loan activity. Guaranteed loans not only help private lenders stay with borrowers longer, but also reduce the need for direct government assistance.

Through the Food Security Act of 1985, the Congress supported a shift in emphasis from direct to guaranteed loans. Between fiscal years 1986 and 1988, the Food Security Act authorized $4 billion annually for FmHA farm loans. However, the percentage allocated to guaranteed versus direct loans changes from an even split in fiscal year 1986 to 25 percent direct/75 percent guaranteed loan mix by fiscal year 1988. FmHA has suggested a quicker movement to guaranteed loans than mandated in the Act and termination of ownership loans in all forms.

This Committee has an interest in determining how well FmHA is implementing its Congressionally mandated shift in lending and the overall impact of this shift on farm credit availability. We are concerned whether FmHA can fulfill its mandate of being a lender of last resort if it becomes primarily a guarantor rather than a provider of farm credit. Toward this end, I would like to request that the General Accounting Office review FmHA's farm loan guarantee program. I believe this Committee and the Congress could benefit from such a GAO assessment in its future deliberations on the role of FmHA as a lender of last resort to the nation's farmers.

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We look forward to discussing this issue with your staff in the near future.

With kindest regards,

Sincerely,

Patrick Leahy

Patrick J. Leahy
Chairman

Obligations for FmHA Guaranteed Farm Operating and Ownership Loans, Fiscal Years 1987-88

Table II.1: Obligations for FmHA Guaranteed Farm Operating and Ownership Loans, Fiscal Year 1987

State/territory	Operating loans	Operating loan obligations	Percent of national operating loan obligations	Farm ownership loans	Farm ownership loan obligations	Percent of national farm ownership loan obligations
Alabama	89	$11,992,900	0.97	25	$3,961,050	1.22
Alaska	0	0	0	0	0	0
Arizona	2	186,000	0.01	0	0	0
Arkansas	328	34,339,150	2.77	59	9,824,510	3.03
California	166	25,806,140	2.08	25	4,250,230	1.31
Colorado	96	13,108,420	1.06	22	4,729,910	1.46
Connecticut	12	686,050	0.06	6	515,000	0.16
Delaware	9	755,500	0.06	26	4,436,840	1.37
Florida	45	5,583,090	0.45	7	599,360	0.18
Georgia	340	34,531,160	2.78	17	2,416,400	0.74
Hawaii	0	0	0	0	0	0
Idaho	151	22,088,710	1.78	20	3,680,680	1.13
Illinois	821	56,878,890	4.58	126	18,076,320	5.57
Indiana	188	14,296,030	1.15	41	7,197,780	2.22
Iowa	1,468	99,484,390	8.02	266	35,970,520	11.09
Kansas	788	60,230,250	4.85	125	15,775,860	4.86
Kentucky	165	12,152,650	0.98	78	9,806,860	3.02
Louisiana	1,113	98,548,610	7.94	50	8,460,820	2.61
Maine	14	1,658,120	0.13	4	667,010	0.21
Maryland	25	1,809,300	0.15	12	2,158,000	0.67
Massachusetts	7	447,550	0.04	1	300,000	0.09
Michigan	442	43,771,310	3.53	75	13,671,670	4.21
Minnesota	917	63,254,960	5.10	157	19,029,690	5.87
Mississippi	180	31,192,840	2.51	38	7,595,510	2.34
Missouri	491	35,796,590	2.89	80	11,743,370	3.62
Montana	272	33,730,970	2.72	29	6,593,560	2.03
Nebraska	896	79,903,830	6.44	72	10,206,380	3.15
Nevada	1	150,540	0.01	0	0	0
New Hampshire	0	0	0	0	0	0
New Jersey	15	1,585,870	0.13	2	425,000	0.13
New Mexico	47	9,341,970	0.75	6	1,169,200	0.36
New York	131	9,286,160	0.75	23	2,758,280	0.85
North Carolina	218	13,180,780	1.06	43	6,644,790	2.05
North Dakota	628	51,312,860	4.14	132	17,598,360	5.42
Ohio	209	19,820,040	1.60	34	6,611,580	2.04
Oklahoma	566	73,405,140	5.92	86	13,482,620	4.16
Oregon	65	9,749,750	0.79	9	1,750,990	0.54

(continued)

State/territory	Operating loans	Operating loan obligations	Percent of national operating loan obligations	Farm ownership loans	Farm ownership loan obligations	Percent of national farm ownership loan obligations
Pennsylvania	63	4,258,640	0.34	40	6,064,340	1.87
Rhode Island	3	394,000	0.03	0	0	0
South Carolina	53	5,127,260	0.41	6	715,230	0.22
South Dakota	313	25,692,580	2.07	11	1,273,500	0.39
Tennessee	98	8,029,960	0.65	20	2,915,150	0.90
Texas	779	88,920,930	7.17	36	5,568,270	1.72
Utah	16	2,088,820	0.17	5	863,000	0.27
Vermont	28	1,829,800	0.15	19	2,911,000	0.90
Virginia	52	5,181,960	0.42	12	1,992,710	0.61
Washington	170	20,955,160	1.69	31	6,161,020	1.90
West Virginia	29	1,306,390	0.11	14	1,757,000	0.54
Wisconsin	946	86,535,170	6.97	224	38,810,580	11.96
Wyoming	151	19,227,750	1.55	18	2,693,500	0.83
Puerto Rico	8	1,123,500	0.09	5	586,000	0.18
Virgin Islands	0	0	0	0	0	0
West Pacific Territory	0	0	0	0	0	0
U.S. total	**13,614**	**$1,240,738,440**	**100[a]**	**2,137**	**$324,419,450**	**100[a]**

[a]Percentages do not add to 100 because of rounding

Source: FmHA Report Code 205

Table II.2: Obligations for FmHA Guaranteed Farm Operating and Ownership Loans, Fiscal Year 1988

State/territory	Operating loans	Operating loan obligations	Percent of national operating loan obligations	Farm ownership loans	Farm ownership loan obligations	Percent of national farm ownership loan obligations
Alabama	87	$11.418.160	1.28	31	$4.334.830	1.20
Alaska	0	0	0	0	0	0
Arizona	10	1.856.210	0.21	3	675,000	0.19
Arkansas	360	37.567.010	4.21	79	13,385.440	3.70
California	186	31,770.220	3.56	25	5,104,990	1.41
Colorado	84	10,409.490	1.17	28	5,195,940	1.43
Connecticut	6	258.400	0.03	1	286.000	0.08
Delaware	7	855,370	0.10	11	2.059,600	0.57
Florida	42	3.860.730	0.43	13	1,194,530	0.33
Georgia	358	35.575,510	3.99	22	3,239,780	0.89
Hawaii	0	0	0	0	0	0
Idaho	169	24,323,740	2.73	24	3,820,660	1.06
Illinois	578	39.928,380	4.47	158	24,626,300	6.80
Indiana	94	6.171.120	0.69	41	6,442,510	1.78
Iowa	590	36.688,910	4.11	246	32,038,040	8.85
Kansas	457	33.909.580	3.80	140	19,172,180	5.29
Kentucky	260	13.699.580	1.53	90	11,348,150	3.13
Louisiana	1.172	107.175.160	12.01	58	8,089,040	2.23
Maine	16	1.634.000	0.18	6	869,800	0.24
Maryland	51	4.396.330	0.49	12	2.387,700	0.66
Massachusetts	7	390.000	0.04	2	360,000	0.10
Michigan	394	36.324.630	4.07	84	14,519,550	4.01
Minnesota	484	30.743.980	3.44	153	17.374.880	4.80
Mississippi	194	31.201.440	3.50	42	7.653,080	2.11
Missouri	227	16.812.950	1.88	54	7,359,440	2.03
Montana	124	16.275.790	1.82	28	4.562,110	1.26
Nebraska	461	36.793.220	4.12	125	17,934,200	4.95
Nevada	2	66.000	0.01	3	358.000	0.10
New Hampshire	1	114.000	0.01	3	316,700	0.09
New Jersey	9	530.000	0.06	2	320.000	0.09
New Mexico	34	5.076.420	0.57	9	1.562.100	0.43
New York	78	5.304.770	0.59	32	3,986.240	1.10
North Carolina	297	19.191.130	2.15	71	8.820.360	2.44
North Dakota	400	33.216.020	3.72	122	17.419.430	4.81
Ohio	185	15.290.620	1.71	47	8.055.920	2.22
Oklahoma	321	43.044.430	4.82	116	19.934.130	5.51

(continued)

State/territory	Operating loans	Operating loan obligations	Percent of national operating loan obligations	Farm ownership loans	Farm ownership loan obligations	Percent of national farm ownership loan obligations
Oregon	57	8,572,430	0.96	17	2,820,120	0.78
Pennsylvania	66	4,136,290	0.46	47	6,915,570	1.91
Rhode Island	0	0	0	1	158,000	0.04
South Carolina	172	16,040,940	1.80	18	2,493,800	0.69
South Dakota	171	10,031,020	1.12	35	3,410,370	0.94
Tennessee	125	9,682,410	1.08	27	3,680,490	1.02
Texas	463	53,342,240	5.98	25	3,813,280	1.05
Utah	14	2,900,050	0.32	18	3,065,040	0.85
Vermont	44	3,630,680	0.41	20	2,611,700	0.72
Virginia	49	3,766,340	0.42	22	3,160,060	0.87
Washington	136	17,209,060	1.93	35	6,841,840	1.89
West Virginia	45	1,380,180	0.15	25	3,731,500	1.03
Wisconsin	672	60,085,790	6.73	250	42,355,190	11.70
Wyoming	71	7,242,010	0.81	11	1,255,000	0.35
Puerto Rico	23	2,685,500	0.30	7	1,326,000	0.37
Virgin Islands	0	0	0	0	0	0
West Pacific Territory	0	0	0	0	0	0
U.S. total	**9,853**	**$892,578,330**	**100[a]**	**2,436**	**$362,086,590**	**100[a]**

[a]Percentages do not add to 100 because of rounding

Source: FmHA Report Code 205.

Delinquent FmHA Guaranteed Farm Operating and Ownership Loans, Fiscal Years 1987-88

Table III.1: Delinquent FmHA Guaranteed Farm Operating and Ownership Loans, Fiscal Year 1987

State/territory	Active borrowers	Delinquent borrowers	Outstanding principal owed by active borrowers[a]	Outstanding principal owed by delinquent borrowers[a]	Percent of outstanding principal owed by delinquent borrowers	Delinquent payments[a]
Alabama						
Operating	51	4	$5,265,498	$370,692	7.04	$82,977
Ownership	33	1	3,384,917	259,767	7.67	19,620
Total	**84**	**5**	**8,650,415**	**630,459**	**7.29**	**102,597**
Alaska						
Operating	0	0	0	0	0	0
Ownership	1	0	290,714	0	0	0
Total	**1**	**0**	**290,714**	**0**	**0**	**0**
Arizona						
Operating	2	0	527,630	0	0	0
Ownership	0	0	0	0	0	0
Total	**2**	**0**	**527,630**	**0**	**0**	**0**
Arkansas						
Operating	140	15	16,379,150	2,022,116	12.35	603,859
Ownership	57	3	7,834,516	258,666	3.30	47,415
Total	**197**	**18**	**24,213,666**	**2,280,782**	**9.42**	**651,274**
California						
Operating	84	1	15,361,803	95,054	0	1,130
Ownership	12	0	1,934,988	0	0.62	0
Total	**96**	**1**	**17,296,791**	**95,054**	**0.55**	**1,130**
Colorado						
Operating	63	8	8,449,788	681,478	8.06	185,322
Ownership	25	1	4,054,490	244,425	6.03	59,050
Total	**88**	**9**	**12,504,278**	**925,903**	**7.40**	**244,372**
Connecticut						
Operating	10	1	1,089,583	198,149	18.19	803
Ownership	8	1	1,361,093	288,424	21.19	11,141
Total	**18**	**2**	**2,450,676**	**486,573**	**19.85**	**11,944**
Delaware						
Operating	3	0	157,500	0	0	0
Ownership	4	0	627,300	0	0	0
Total	**7**	**0**	**784,800**	**0**	**0**	**0**

(continued)

State/territory	Active borrowers	Delinquent borrowers	Outstanding principal owed by active borrowers[a]	Outstanding principal owed by delinquent borrowers[a]	Percent of outstanding principal owed by delinquent borrowers	Delinquent payments[a]
Florida						
Operating	18	2	2,454,070	354,366	14.44	18,929
Ownership	8	1	1,106,699	100,000	9.04	94,439
Total	**26**	**3**	**3,560,769**	**454,366**	**12.76**	**113,368**
Georgia						
Operating	124	4	14,476,963	446,098	3.08	40,116
Ownership	12	0	1,662,200	0	0	0
Total	**136**	**4**	**16,139,163**	**446,098**	**2.76**	**40,116**
Hawaii						
Operating	0	0	0	0	0	0
Ownership	0	0	0	0	0	0
Total	**0**	**0**	**0**	**0**	**0**	**0**
Idaho						
Operating	91	2	12,023,504	135,759	1.13	117,210
Ownership	24	1	3,474,240	145,000	4.17	177,234
Total	**115**	**3**	**15,497,744**	**280,759**	**1.81**	**294,444**
Illinois						
Operating	452	11	38,924,403	699,502	1.80	260,805
Ownership	89	9	11,988,953	1,585,412	13.22	265,971
Total	**541**	**20**	**50,913,356**	**2,284,914**	**4.49**	**526,776**
Indiana						
Operating	189	3	22,675,591	184,572	0.81	2,825
Ownership	48	0	7,158,567	0	0	0
Total	**237**	**3**	**29,834,158**	**184,572**	**0.62**	**2,825**
Iowa						
Operating	3,197	90	336,451,727	11,480,962	3.41	1,727,833
Ownership	217	13	31,828,281	2,263,897	7.11	400,284
Total	**3,414**	**103**	**368,280,008**	**13,744,859**	**3.73**	**2,128,117**
Kansas						
Operating	673	15	81,712,813	1,176,488	1.44	379,490
Ownership	80	3	10,379,928	714,411	6.88	94,692
Total	**753**	**18**	**92,092,741**	**1,890,899**	**2.05**	**474,182**
Kentucky						
Operating	117	4	10,585,351	391,219	3.70	29,213
Ownership	73	3	9,795,436	368,153	3.76	39,438
Total	**190**	**7**	**20,380,787**	**759,372**	**3.73**	**68,651**

(continued)

State/territory	Active borrowers	Delinquent borrowers	Outstanding principal owed by active borrowers[a]	Outstanding principal owed by delinquent borrowers[a]	Percent of outstanding principal owed by delinquent borrowers	Delinquent payments[a]
Louisiana						
Operating	618	18	69,909,136	1,618,560	2.32	192,848
Ownership	79	14	12,997,233	2,344,489	18.04	931,461
Total	**697**	**32**	**82,906,369**	**3,963,049**	**4.78**	**1,124,309**
Maine						
Operating	14	0	2,508,423	0	0	0
Ownership	1	0	49,617	0	0	0
Total	**15**	**0**	**2,558,040**	**0**	**0**	**0**
Maryland						
Operating	5	0	203,367	0	0	0
Ownership	5	0	725,848	0	0	0
Total	**10**	**0**	**929,215**	**0**	**0**	**0**
Massachusetts						
Operating	4	0	396,370	0	0	0
Ownership	5	0	916,461	0	0	0
Total	**9**	**0**	**1,312,831**	**0**	**0**	**0**
Michigan						
Operating	395	13	59,201,071	1,643,326	2.78	289,875
Ownership	68	2	10,572,503	345,447	3.27	54,525
Total	**463**	**15**	**69,773,574**	**1,988,773**	**2.85**	**344,400**
Minnesota						
Operating	1,753	67	188,123,823	6,068,439	3.23	2,769,699
Ownership	144	11	17,504,830	1,305,552	7.46	557,123
Total	**1,897**	**78**	**205,629,653**	**7,373,991**	**3.59**	**3,326,822**
Mississippi						
Operating	129	6	24,076,029	334,360	1.39	157,080
Ownership	40	2	7,447,215	235,252	3.16	33,018
Total	**169**	**8**	**31,523,244**	**569,612**	**1.81**	**190,098**
Missouri						
Operating	280	1	26,726,617	125,000	0.47	17,693
Ownership	131	11	16,060,636	1,245,317	7.75	235,474
Total	**411**	**12**	**42,787,253**	**1,370,317**	**3.20**	**253,167**
Montana						
Operating	241	5	41,760,159	340,368	0.81	64,406
Ownership	45	0	8,648,811	0	0	0
Total	**286**	**5**	**50,408,970**	**340,368**	**0.68**	**64,406**

(continued)

State/territory	Active borrowers	Delinquent borrowers	Outstanding principal owed by active borrowers[a]	Outstanding principal owed by delinquent borrowers[a]	Percent of outstanding principal owed by delinquent borrowers	Delinquent payments[a]
Nebraska						
Operating	2,055	106	266,449,903	12,104,045	4.54	4,066,904
Ownership	185	15	28,094,368	2,627,461	9.35	578,985
Total	**2,240**	**121**	**294,544,271**	**14,731,506**	**5.00**	**4,645,889**
Nevada						
Operating	2	0	476,599	0	0	0
Ownership	0	0	0	0	0	0
Total	**2**	**0**	**476,599**	**0**	**0**	**0**
New Hampshire						
Operating	1	0	116,270	0	0	0
Ownership	1	0	117,045	0	0	0
Total	**2**	**0**	**233,315**	**0**	**0**	**0**
New Jersey						
Operating	4	0	402,000	0	0	0
Ownership	2	0	167,500	0	0	0
Total	**6**	**0**	**569,500**	**0**	**0**	**0**
New Mexico						
Operating	39	2	7,159,757	535,405	7.48	326,448
Ownership	12	0	2,526,439	0	0	0
Total	**51**	**2**	**9,686,196**	**535,405**	**5.53**	**326,448**
New York						
Operating	135	2	13,146,691	53,833	0.41	69,413
Ownership	40	3	4,273,674	346,565	8.11	200,331
Total	**175**	**5**	**17,420,365**	**400,398**	**2.30**	**269,744**
North Carolina						
Operating	163	3	11,841,862	166,651	1.41	60,487
Ownership	47	0	7,054,476	0	0	0
Total	**210**	**3**	**18,896,338**	**166,651**	**0.88**	**60,487**
North Dakota						
Operating	308	7	38,031,590	625,516	1.64	67,921
Ownership	76	7	9,328,811	1,149,400	12.32	507,854
Total	**384**	**14**	**47,360,401**	**1,774,916**	**3.75**	**575,775**
Ohio						
Operating	174	9	22,869,648	1,317,677	5.76	376,431
Ownership	45	5	7,005,888	9,111,390	13.01	83,282
Total	**219**	**14**	**29,875,536**	**2,229,067**	**7.46**	**459,713**

(continued)

State/territory	Active borrowers	Delinquent borrowers	Outstanding principal owed by active borrowers[a]	Outstanding principal owed by delinquent borrowers[a]	Percent of outstanding principal owed by delinquent borrowers	Delinquent payments[a]
Oklahoma						
Operating	666	24	130.030.720	3.161.280	2.43	722.058
Ownership	177	13	27.342.582	1,802.412	6.59	331.596
Total	**843**	**37**	**157,373,302**	**4,963,692**	**3.15**	**1,053,654**
Oregon						
Operating	61	4	10.699 154	755.506	7.06	129.841
Ownership	18	1	2.678.447	114.934	4.29	12.084
Total	**79**	**5**	**13,377,601**	**870,440**	**6.51**	**141,925**
Pennsylvania						
Operating	32	1	2.783.246	36.814	1.32	26.332
Ownership	27	1	3.849.635	224.008	5.82	3,954
Total	**59**	**2**	**6,632,881**	**260,822**	**3.93**	**30,286**
Rhode Island						
Operating	1	0	5.589	0	0	0
Ownership	0	0	0	0	0	0
Total	**1**	**0**	**5,589**	**0**	**0**	**0**
South Carolina						
Operating	64	2	5.664.852	204.290	3.61	107,450
Ownership	5	1	272.410	31.000	11.38	2.872
Total	**69**	**3**	**5,937,262**	**235,290**	**3.96**	**110,322**
South Dakota						
Operating	980	78	116.312.109	9.404.105	8.12	1.940.164
Ownership	75	19	9.969.254	3 022.304	30.32	821,157
Total	**1,055**	**97**	**126,281,363**	**12,462,409**	**9.87**	**2,761,321**
Tennessee						
Operating	94	8	9.359.245	713.492	7.62	225,365
Ownership	[illegible]	1	4.029.840	47.464	1.18	21.609
Total	**124**	**9**	**13,389,085**	**760,956**	**5.68**	**246,974**
Texas						
Operating	690	14	113.462.440	1.798.883	1.59	511.082
Ownership	50	1	7.736.597	85.500	1.11	14.911
Total	**740**	**15**	**121,199,037**	**1,884,383**	**1.55**	**525,993**
Utah						
Operating	20	0	3.476.822	0	0	0
Ownership	7	1	1.158.690	120.535	10.40	8.387
Total	**27**	**1**	**4,635,512**	**120,535**	**2.60**	**8,387**

(continued)

State/territory	Active borrowers	Delinquent borrowers	Outstanding principal owed by active borrowers[a]	Outstanding principal owed by delinquent borrowers[a]	Percent of outstanding principal owed by delinquent borrowers	Delinquent payments[a]
Vermont						
Operating	29	0	1,998,305	0	0	0
Ownership	25	0	3,803,166	0	0	0
Total	**54**	**0**	**5,801,471**	**0**	**0**	**0**
Virginia						
Operating	58	2	7,174,774	275,639	3.84	87,519
Ownership	24	0	3,360,102	0	0	0
Total	**82**	**2**	**10,534,876**	**275,639**	**2.62**	**87,519**
Washington						
Operating	88	3	14,353,280	335,436	2.34	144,244
Ownership	21	1	3,521,177	40,000	1.14	42,150
Total	**109**	**4**	**17,874,457**	**375,436**	**2.10**	**186,394**
West Virginia						
Operating	10	0	455,781	0	0	0
Ownership	8	0	1,004,183	0	0	0
Total	**18**	**0**	**1,459,964**	**0**	**0**	**0**
Wisconsin						
Operating	748	42	91,783,800	4,880,115	5.32	898,637
Ownership	180	32	23,997,012	4,124,878	17.19	1,141,193
Total	**928**	**74**	**115,780,812**	**9,004,993**	**7.78**	**2,039,830**
Wyoming						
Operating	170	10	29,670,644	908,722	3.06	230,692
Ownership	10	0	1,554,278	0	0	0
Total	**180**	**10**	**31,214,922**	**908,722**	**2.91**	**230,692**
Puerto Rico						
Operating	25	0	3,160,043	0	0	0
Ownership	3	0	149,500	0	0	0
Total	**28**	**0**	**3,309,543**	**0**	**0**	**0**
Virgin Islands						
Operating	0	0	0	0	0	0
Ownership	0	0	0	0	0	0
Total	**0**	**0**	**0**	**0**	**0**	**0**

(continued)

State/territory	Active borrowers	Delinquent borrowers	Outstanding principal owed by active borrowers[a]	Outstanding principal owed by delinquent borrowers[a]	Percent of outstanding principal owed by delinquent borrowers	Delinquent payments[a]
West Pacific Territory						
Operating	0	0	0	0	0	0
Ownership	0	0	0	0	0	0
Total	**0**	**0**	**0**	**0**	**0**	**0**
U.S. total						
operating	15,270	587	1,880,326,489	65,679,920	3.49	16,933,100
Ownership	2,277	177	324,800,547	26,352,062	8.11	6,791,253
Total	**17,547**	**764**	**$2,205,127,036**	**$92,031,982**	**4.17**	**$23,724,353**

[a]The totals for outstanding principal owed by both active and delinquent borrowers and for delinquent payments may be slightly different from the sums of the individual state/territory amounts because of rounding.

Source: FmHA Report Code 4067

Table III.2: Delinquent FmHA Guaranteed Farm Operating and Ownership Loans, Fiscal Year 1988

State/territory	Active borrowers	Delinquent borrowers	Outstanding principal owed by active borrowers[a]	Outstanding principal owed by delinquent borrowers[a]	Percent of outstanding principal owed by delinquent borrowers	Delinquent payments[a]
Alabama						
Operating	138	3	$20,674,899	$228,420	1.10	$72,598
Ownership	66	0	8,703,324	0	0	0
Total	**204**	**3**	**29,378,223**	**228,420**	**0.78**	**72,598**
Alaska						
Operating	0	0	0	0	0	0
Ownership	1	0	281,815	0	0	0
Total	**1**	**0**	**281,815**	**0**	**0**	**0**
Arizona						
Operating	9	0	1,831,099	0	0	0
Ownership	2	0	375,000	0	0	0
Total	**11**	**0**	**2,206,099**	**0**	**0**	**0**
Arkansas						
Operating	381	12	50,085,380	1,165,480	2.33	398,593
Ownership	146	4	22,379,285	505,943	2.26	259,024
Total	**527**	**16**	**72,464,665**	**1,671,423**	**2.31**	**657,617**
California						
Operating	200	0	40,116,561	0	0	0
Ownership	31	1	4,986,305	300,000	6.02	19,283
Total	**231**	**1**	**45,102,866**	**300,000**	**0.67**	**19,283**

(continued)

State/territory	Active borrowers	Delinquent borrowers	Outstanding principal owed by active borrowers[a]	Outstanding principal owed by delinquent borrowers[a]	Percent of outstanding principal owed by delinquent borrowers	Delinquent payments[a]
North Carolina						
Operating	313	2	23,267,688	32,051	0.14	56,014
Ownership	106	0	15,137,827	0	0	0
Total	**419**	**2**	**38,405,515**	**32,051**	**0.08**	**56,014**
North Dakota						
Operating	411	7	42,637,054	653,643	1.53	189,386
Ownership	101	8	11,910,687	1,162,727	9.76	301,265
Total	**512**	**15**	**54,547,741**	**1,816,370**	**3.33**	**490,651**
Ohio						
Operating	286	9	32,893,474	1,211,660	3.68	713,601
Ownership	84	5	13,833,357	785,810	5.68	124,484
Total	**370**	**14**	**46,726,831**	**1,997,470**	**4.27**	**838,085**
Oklahoma						
Operating	830	44	149,226,608	6,834,019	4.58	2,335,923
Ownership	235	24	36,236,090	3,296,264	9.10	754,189
Total	**1,065**	**68**	**185,462,698**	**10,130,283**	**5.46**	**3,090,112**
Oregon						
Operating	97	8	16,209,575	1,220,410	7.53	611,882
Ownership	30	1	4,217,770	250,000	5.93	48,822
Total	**127**	**9**	**20,427,345**	**1,470,410**	**7.20**	**660,704**
Pennsylvania						
Operating	75	1	5,855,393	8,000	0.14	3,500
Ownership	71	1	10,215,616	214,901	2.10	4,012
Total	**146**	**2**	**16,071,009**	**222,901**	**1.39**	**7,512**
Rhode Island						
Operating	2	0	344,867	0	0	0
Ownership	1	0	158,000	0	0	0
Total	**3**	**0**	**502,867**	**0**	**0**	**0**
South Carolina						
Operating	205	2	20,068,283	171,084	0.85	107,273
Ownership	19	1	1,959,208	30,485	1.56	164
Total	**224**	**3**	**22,027,491**	**201,569**	**0.92**	**107,437**
South Dakota						
Operating	1,120	131	120,078,582	16,339,705	13.61	3,655,203
Ownership	92	18	11,382,016	2,919,928	25.65	935,034
Total	**1,212**	**149**	**131,460,598**	**19,259,633**	**14.65**	**4,590,237**

(continued)

tate/territory	Active borrowers	Delinquent borrowers	Outstanding principal owed by active borrowers[a]	Outstanding principal owed by delinquent borrowers[a]	Percent of outstanding principal owed by delinquent borrowers	Delinquent payments[a]
ennessee						
Operating	177	7	15,762,793	786,553	4.99	172,517
Ownership	55	2	7,790,412	144,418	1.85	13,276
otal	**232**	**9**	**23,553,205**	**930,971**	**3.95**	**185,793**
exas						
Operating	1,062	21	155,925,622	2,268,704	1.45	527,446
Ownership	85	3	13,225,804	497,196	3.76	76,583
otal	**1,147**	**24**	**169,151,426**	**2,765,900**	**1.64**	**604,029**
tah						
Operating	36	1	5,358,559	44,000	0.82	9,104
Ownership	20	2	3,294,242	222,000	6.74	15,922
otal	**56**	**3**	**8,652,801**	**266,000**	**3.07**	**25,026**
ermont						
Operating	64	0	4,777,723	0	0	0
Ownership	43	0	6,158,632	0	0	0
otal	**107**	**0**	**10,936,355**	**0**	**0**	**0**
rginia						
Operating	88	1	10,144,850	340,000	3.35	2,964
Ownership	43	1	6,188,345	172,114	2.78	0
otal	**131**	**2**	**16,333,195**	**512,114**	**3.14**	**2,964**
ashington						
Operating	194	6	32,474,032	616,013	1.90	307,824
Ownership	63	0	12,047,441	0	0	0
otal	**257**	**6**	**44,521,473**	**616,013**	**1.38**	**307,824**
est Virginia						
Operating	52	0	2,360,786	0	0	0
Ownership	31	0	4,381,345	0	0	0
otal	**83**	**0**	**6,742,131**	**0**	**0**	**0**
isconsin						
Operating	1,101	48	120,933,312	6,479,034	5.36	1,022,213
Ownership	244	34	34,412,456	4,642,346	13.49	1,408,338
otal	**1,345**	**82**	**155,345,768**	**11,121,380**	**7.16**	**2,430,551**
yoming						
Operating	229	16	35,048,213	2,293,281	6.54	1,370,650
Ownership	27	1	3,461,607	50,000	1.44	8,480
otal	**256**	**17**	**38,509,820**	**2,343,281**	**6.08**	**1,379,130**

(continued)

State/territory	Active borrowers	Delinquent borrowers	Outstanding principal owed by active borrowers[a]	Outstanding principal owed by delinquent borrowers[a]	Percent of outstanding principal owed by delinquent borrowers	Delinquent payments[a]
Puerto Rico						
Operating	29	0	4,078,915	0	0	0
Ownership	8	0	1,032,000	0	0	0
Total	**37**	**0**	**5,110,915**	**0**	**0**	**0**
Virgin Islands						
Operating	0	0	0	0	0	0
Ownership	0	0	0	0	0	0
Total	**0**	**0**	**0**	**0**	**0**	**0**
West Pacific Territory						
Operating	0	0	0	0	0	0
Ownership	0	0	0	0	0	0
Total	**0**	**0**	**0**	**0**	**0**	**0**
U.S. total operating	22,191	811	2,432,712,524	97,314,617	4.00	26,602,841
Ownership	4,296	235	610,823,016	37,016,283	6.06	10,861,328
Total	**26,487**	**1,046**	**$3,043,535,540**	**$134,330,900**	**4.41**	**$37,464,169**

[a]The totals for outstanding principal owed by both active and delinquent borrowers and for delinquent payments may be slightly different from the sums of the individual state/territory amounts because of rounding.

Source: FmHA Report Code 4067

osses for FmHA Guaranteed Farm Operating and Ownership Loans, Fiscal Years 1987-88

able IV.1: Losses for FmHA Guaranteed Farm Operating and Ownership Loans, Fiscal Year 1987

	Operating loan losses		Ownership loan losses		Total operating and ownership loan losses	
tate/territory	Loss claims	Loss amounts[a]	Loss claims	Loss amounts[a]	Loss claims	Loss amounts[a]
labama	1	$(22,435)	0	$0	1	$(22,435)
laska	0	0	0	0	0	0
rizona	0	0	0	0	0	0
rkansas	11	709,423	1	120,185	12	829,608
alifornia	2	249,836	0	0	2	249,836
olorado	6	658,693	3	256,844	9	915,537
onnecticut	1	32,000	0	0	1	32,000
elaware	0	0	0	0	0	0
orida	2	252,642	0	0	2	252,642
eorgia	4	93,675	1	78,949	5	172,624
awaii	0	0	0	0	0	0
daho	2	64,393	0	0	2	64,393
nois	14	961,936	2	196,720	16	1,158,656
diana	5	360,063	0	0	5	360,063
wa	105	6,064,555	19	3,603,382	124	9,667,937
ansas	18	677,331	4	459,489	22	1,136,820
entucky	7	206,498	1	53,652	8	260,150
uisiana	28	1,527,072	1	98,355	29	1,625,427
aine	0	0	0	0	0	0
aryland	0	0	0	0	0	0
assachusetts	0	0	0	0	0	0
chigan	30	2,513,110	4	480,259	34	2,993,369
nnesota	148	7,228,668	12	1,344,671	160	8,573,339
ssissippi	10	642,330	3	501,454	13	1,143,784
ssouri	7	495,627	9	446,131	16	941,758
ontana	7	681,331	0	0	7	681,331
ebraska	25	1,231,565	6	648,166	31	1,879,731
evada	0	0	0	0	0	0
ew Hampshire	0	0	0	0	0	0
ew Jersey	0	0	0	0	0	0
ew Mexico	2	201,881	0	0	2	201,881
ew York	2	40,564	1	73,861	3	114,425
orth Carolina	3	165,888	1	96,801	4	262,689
orth Dakota	12	560,288	8	554,436	20	1,114,724
[illegible]	10	692,619	5	637,091	15	1,329,710
lahoma	12	1,208,530	0	0	12	1,208,530

(continued)

State/territory	Operating loan losses: Loss claims	Operating loan losses: Loss amounts[a]	Ownership loan losses: Loss claims	Ownership loan losses: Loss amounts[a]	Total operating and ownership loan losses: Loss claims	Total operating and ownership loan losses: Loss amounts[a]
Oregon	1	265,545	1	32,949	2	298.494
Pennsylvania	1	23,734	0	0	1	23.734
Rhode Island	0	0	0	0	0	0
South Carolina	2	10,889	1	30,485	3	41.374
South Dakota	33	2,207.658	12	1,354,112	45	3.561 770
Tennessee	4	302.435	0	0	4	302.435
Texas	21	1,685.660	0	0	21	1.685.660
Utah	0	0	0	0	0	0
Vermont	0	0	0	0	0	0
Virginia	2	266,380	1	128,611	3	394.991
Washington	2	55.120	0	0	2	55.120
West Virginia	0	0	0	0	0	0
Wisconsin	32	1,877,097	14	1,123.274	46	3.000.371
Wyoming	6	356.646	0	0	6	356.646
Puerto Rico	0	0	0	0	0	0
Virgin Islands	0	0	0	0	0	0
West Pacific Territory	0	0	0	0	0	0
U.S. total	**578**	**$34,549,250[b]**	**110**	**$12,319,875[b]**	**688**	**$46,869,125[b]**

[a]Amounts shown in parentheses represent recoveries through settlement with lenders of loss claims paid in previous years

[b]The totals for loss amounts may be slightly different from the sums of the individual state/territory amounts because of rounding

Source FmHA Report Code 4131

Table IV.2: Losses for FmHA Guaranteed Farm Operating and Ownership Loans, Fiscal Year 1988

	Operating loan losses		Ownership loan losses		Total operating and ownership loan losses	
State/territory	Loss claims	Loss amounts[a]	Loss claims	Loss amounts[a]	Loss claims	Loss amounts[a]
Alabama	4	$248,287	2	$293,909	6	$542,196
Alaska	0	0	0	0	0	0
Arizona	1	125,914	0	0	1	125,914
Arkansas	11	690,131	0	0	11	690,131
California	0	(4,375)	0	0	0	(4,375)
Colorado	7	468,405	2	239,577	9	707,982
Connecticut	1	179,318	0	0	1	179,318
Delaware	0	0	0	0	0	0
Florida	3	476,451	1	24,040	4	500,491
Georgia	4	186,501	0	0	4	186,501
Hawaii	0	0	0	0	0	0
Idaho	3	310,955	0	0	3	310,955
Illinois	17	424,414	8	728,856	25	1,153,270
Indiana	17	834,138	2	101,406	19	935,544
Iowa	135	10,381,627	16	2,307,605	151	12,689,232
Kansas	42	2,580,142	0	38,572	42	2,618,714
Kentucky	11	462,317	2	89,587	13	551,904
Louisiana	74	3,411,319	8	1,213,755	82	4,625,074
Maine	1	16,249	0	0	1	16,249
Maryland	0	0	0	0	0	0
Massachusetts	0	0	0	0	0	0
Michigan	26	2,013,349	3	219,535	29	2,232,884
Minnesota	97	6,097,009	12	1,226,695	109	7,323,704
Mississippi	17	1,172,559	2	231,019	19	1,403,578
Missouri	12	391,324	6	762,734	18	1,154,058
Montana	10	762,713	3	485,894	13	1,248,607
Nebraska	76	4,776,060	7	575,322	83	5,351,382
Nevada	1	14,089	0	0	1	14,089
New Hampshire	0	0	0	0	0	0
New Jersey	0	0	0	0	0	0
New Mexico	2	454,926	1	128,377	3	583,303
New York	2	113,652	1	81,196	3	194,848
North Carolina	4	94,692	0	0	4	94,692
North Dakota	12	909,340	7	620,795	19	1,530,135
Ohio	11	669,642	2	250,564	13	920,206
Oklahoma	53	5,133,918	15	1,712,999	68	6,846,917

(continued)

State/territory	Operating loan losses: Loss claims	Operating loan losses: Loss amounts[a]	Ownership loan losses: Loss claims	Ownership loan losses: Loss amounts[a]	Total operating and ownership loan losses: Loss claims	Total operating and ownership loan losses: Loss amounts[a]
Oregon	2	281,901	3	401,321	5	683,222
Pennsylvania	0	(274)	0	0	0	(274)
Rhode Island	0	0	0	0	0	0
South Carolina	2	87,699	0	0	2	87,699
South Dakota	71	4,799,414	17	1,294,135	88	6,093,549
Tennessee	10	267,806	2	118,321	12	386,127
Texas	48	2,998,453	0	0	48	2,998,453
Utah	0	0	1	117,390	1	117,390
Vermont	0	0	0	0	0	0
Virginia	2	65,079	1	172,115	3	237,194
Washington	4	246,766	2	77,915	6	324,681
West Virginia	1	11,091	0	0	1	11,091
Wisconsin	43	2,877,972	21	2,111,834	64	4,989,806
Wyoming	8	449,497	0	0	8	449,497
Puerto Rico	0	0	0	0	0	0
Virgin Islands	0	0	0	0	0	0
West Pacific Territory	0	0	0	0	0	0
U.S. total	**845**	**$55,480,470[b]**	**147**	**$15,625,468[b]**	**992**	**$71,105,938[b]**

[a]Amounts shown in parentheses represent recoveries through settlement with lenders of loss claims in previous years

[b]The totals for loss amounts may be slightly different from the sums of the individual state/territory amounts because of rounding

Source: FmHA Report Code 4131

Table IV.3: Cumulative Losses for FmHA Guaranteed Farm Operating and Ownership Loans Through Fiscal Year 1988

	Operating loan losses		Ownership loan losses		Total operating and ownership loan losses	
State/territory	Loss claims	Loss amounts	Loss claims	Loss amounts	Loss claims	Loss amounts
Alabama	10	$388,697	3	$303,532	13	$692,229
Alaska	0	0	0	0	0	0
Arizona	1	125,914	0	0	1	125,914
Arkansas	27	1,609,178	1	120,185	28	1,729,363
California	3	294,581	0	0	3	294,581
Colorado	28	1,635,408	7	588,328	35	2,223,736
Connecticut	3	326,273	0	0	3	326,273
Delaware	1	106,951	0	0	1	106,951
Florida	7	993,058	1	24,040	8	1,017,098
Georgia	13	350,843	1	78,949	14	429,792
Hawaii	0	0	0	0	0	0
Idaho	10	724,511	0	0	10	724,511
Illinois	39	1,654,554	12	1,233,628	51	2,888,182
Indiana	26	1,407,190	4	274,471	30	1,681,661
Iowa	301	20,036,991	54	8,842,526	355	28,879,517
Kansas	81	3,786,912	6	613,161	87	4,400,073
Kentucky	20	735,577	6	332,044	26	1,067,621
Louisiana	133	6,950,652	9	1,312,110	142	8,262,762
Maine	4	107,970	0	0	4	107,970
Maryland	1	92,403	0	0	1	92,403
Massachusetts	2	87,664	0	0	2	87,664
Michigan	79	5,886,908	11	1,367,158	90	7,254,066
Minnesota	346	17,402,977	31	3,733,098	377	21,136,075
Mississippi	52	3,391,297	11	1,377,633	63	4,768,930
Missouri	27	1,086,919	28	1,985,411	55	3,072,330
Montana	21	1,807,203	3	485,894	24	2,293,097
Nebraska	127	7,180,725	16	1,440,557	143	8,621,282
Nevada	1	14,089	0	0	1	14,089
New Hampshire	0	0	0	0	0	0
New Jersey	1	206,696	0	0	1	206,696
New Mexico	6	688,831	1	128,377	7	817,208
New York	12	451,612	3	254,252	15	705,864
North Carolina	11	405,561	3	206,528	14	612,089
North Dakota	55	2,542,208	17	1,540,538	72	4,082,746
Ohio	37	1,990,928	10	1,537,055	47	3,527,983
Oklahoma	81	7,207,772	17	$1,830,853	98	9,038,625

(continued)

State/territory	Operating loan losses: Loss claims	Operating loan losses: Loss amounts	Ownership loan losses: Loss claims	Ownership loan losses: Loss amounts	Total operating and ownership loan losses: Loss claims	Total operating and ownership loan losses: Loss amounts
Oregon	12	944,550	6	573,754	18	1,518,304
Pennsylvania	4	87,847	0	0	4	87,847
Rhode Island	0	0	0	0	0	0
South Carolina	6	232,966	1	30,485	7	263,451
South Dakota	134	8,178,015	40	3,699,747	174	11,877,762
Tennessee	16	624,757	3	285,535	19	910,292
Texas	107	6,464,490	0	0	107	6,464,490
Utah	0	0	1	117,390	1	117,390
Vermont	1	64,328	0	0	1	64,328
Virginia	4	331,459	2	300,726	6	632,185
Washington	8	463,046	2	77,915	10	540,961
West Virginia	2	171,361	0	0	2	171,361
Wisconsin	122	6,702,879	44	3,779,939	166	10,482,818
Wyoming	18	931,198	0	0	18	931,198
Puerto Rico	1	177,486	0	0	1	177,486
Virgin Islands	0	0	0	0	0	0
West Pacific Territory	0	0	0	0	0	0
U.S. total	**2,001**	**$117,053,435**[a]	**354**	**$38,475,819**[a]	**2,355**	**$155,529,254**[a]

[a]The totals for loss amounts may be slightly different from the sums of the individual state/territory amounts because of rounding.

Source: FmHA Report Code 4131

Information on GAO's Sample of Borrowers With Guaranteed Loans

This appendix contains financial condition and other data on the 67 guaranteed loan borrowers randomly selected from the 16 county offices visited during our review. The information presented in this appendix relates only to the borrowers randomly selected for review and is not projectable.

Table V.1: Borrowers and Guaranteed Farm Loans in Sample

Operating loans	Ownership loans	Total number of loans	Total number of borrowers
69	5	74	67

Table V.2: Types of Guaranteed Loans in Sample

Loan note	Line of credit	Total number of loans
58	16	74

Table V.3: Terms of Guaranteed Loans in Sample

Loan term in years	Number of loans	Percent of total loans
1	21	28
3	16	22
4	3	4
5	1	1
7	28	38
10	1	1
20	2	3
30	2	3
Total	**74**	**100**

Table V.4: Percentage of Guarantee for Sample Loans

Guarantee percentage	Number of loans	Percent of total loans
90	64	86
85	1	1
80	5	7
70	3	4
50	1	1
Total	**74**	**100[a]**

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

Table V.5: Interest Rates by Guaranteed Loan Type in Sample

Loan type	Lowest rate	Highest rate	Average rate	Median rate
Operating	8.9	14.5	11.79	11.9
Ownership	7.0	11.5	9.85	10.0

Table V.6: Range of Interest Rates for Sample Guaranteed Loans

Interest rates on loans, in percent	Number of loans	Percent of total loans	Cumulative percent of loans
Less than 10	5	7	7
10 to 10.99	12	16	23
11 to 11.99	26	35	58
12 to 12.99	20	27	85
13 to 13.99	9	12	97
14 to 14.99	2	3	100
Total	**74**	**100**	

Table V.7: Range of Sample Guaranteed Loan Amounts

Smallest loan	Largest loan	Average loan
$14,570	$400,000	$125,122

Table V.8: Farming Experience of Sample Guaranteed Loan Borrowers

Years of farming experience	Number of borrowers	Percent of borrowers with known experience	Cumulative percent of borrowers with known experience
Less than 10	7	13	13
10 to 20	24	43	56
20 to 30	14	25	81
30 to 40	8	14	95
More than 40	3	5	100
Total	**56**	**100**	
Amount of experience unknown	11		
Total number of borrowers	**67**		

Table V.9: Current Assets and Liabilities of Sample Guaranteed Loan Borrowers

	Smallest amount	Largest amount	Average amount
Current assets[a]	$500	$678,500	$63,854
Current liabilities[a]	800	683,500	79,246
Current ratio[b]	0.01	5.96	1.27

[a]Current assets are the most liquid assets, such as cash and marketable securities. Current liabilities are those debts payable within 1 year.

[b]Current assets divided by current liabilities.

Table V.10: Total Assets and Liabilities of Sample Guaranteed Loan Borrowers

	Smallest amount	Largest amount	Average amount
Total assets	$22,500	$1,567,935	$404,594
Total liabilities	15,689	1,950,000	308,215
Debt-to-asset ratio,[a] as percent	21	342	76

[a]The debt-to-asset ratio compares the value of assets to the amount of debt and is one indicator of financial soundness

Table V.11: Range of Debt-to-Asset Ratios for Sample Guaranteed Loan Borrowers

Debt-to-asset ratios,[a] as percent	Number of borrowers	Percent of total borrowers	Cumulative percent of borrowers
Less than 40	7	10	10
40 to 69	26	39	49
70 to 99	26	39	88
More than 100	8	12	100
Total	**67**	**100**	

[a]According to USDA's Economic Research Service, farmers with ratios of 40 percent or less are in the best position to withstand financial adversity. They can likely offset negative cash flows from farming operations by borrowing against or selling assets. Farmers in the 41- to 70- percent category may be able to borrow to offset negative cash flows and meet all expenses. Farmers in the 71- to 100-percent category are less likely to be able to offset negative cash flows through borrowing. Farmers with a ratio over 100 percent have severe problems meeting principal and interest commitments and have a negative net worth. Farmers in this category are technically insolvent, and the sale of farm assets would be insufficient to retire their debts.

Table V.12: Net Worth of Sample Guaranteed Loan Borrowers

Smallest net worth[a]	Largest net worth[a]	Average net worth[a]
$(1,379,000)[b]	$583,000	$96,379

[a]Borrowers' total debts subtracted from their total assets yield their net worth.

[b]Figure shown in parenthesis indicates negative net worth (debts exceed assets).

Table V.13: Number of Sample Guaranteed Loan Borrowers With Positive and Negative Net Worth

Number of borrowers with positive net worth[a]	Number of borrowers with negative net worth[b]	Total number of borrowers
59	8	67

[a]Positive net worth occurs when assets exceed debts

[b]Negative net worth occurs when debts exceed assets

Comments From the Under Secretary for Small Community and Rural Development, USDA

United States Department of Agriculture | Farmers Home Administration | Washington D.C. 20250

JUN 1 5 1989

SUBJECT: GAO Draft Report (RCED-89-86) - FmHA: Implications of the Shift From Direct to Guaranteed Farm Loans

TO: John W. Harman
Director
Food and Agriculture Issues
General Accounting Office

THROUGH: Roland R. Vautour
Under Secretary
Small Community and Rural Development

6/15/89

Neal Sox Johnson
Acting Administrator

6-19-89

Attached is a copy of the response from the Deputy Administrator for Program Operations referencing the subject draft report.

If we can be of further assistance, please contact Doris Morgan of my staff at FTS 475-5318.

LEONARD HARDY, JR.
Director
Planning and Analysis Staff

Attachment

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Complaints of discrimination should be sent to
Secretary of Agriculture, Washington, D.C. 20250

United States Department of Agriculture | Farmers Home Administration | Washington D.C. 20250

JUN 1 1989

SUBJECT: GAO Report - FmHA: Implications of the Shift From Direct to Guaranteed Farm Loans (RCED-89-86)

TO: Leonard Hardy, Jr.
Director
Planning and Analysis Staff

The following will provide Farmers Home Administration's (FmHA) response to recommendations made in the subject General Accounting Office's (GAO) audit dated May 17, 1989.

Recommendation 1):

Develop, in consultation with the Congress, and implement more comprehensive guaranteed loan approval criteria that assesses an applicant's financial solvency, profitability, liquidity, and repayment ability prior to approving loan guarantees.

Response: The Office of Inspector General's (OIG) audit report of September 1988 was also critical of this area. FmHA officials have met with the Office of Management and Budget (OMB) and OIG on this issue. FmHA has agreed to conduct a study of loan approval and borrower selection criteria. The study will be performed by contract. The projected award date of this contract is September 30, 1989. When this study is completed, FmHA will evaluate its results and revise its regulations as appropriate.

FmHA published revisions to its Guaranteed loan regulations on January 13, 1989. In addition to many changes required by the Agricultural Credit Act of 1987, FmHA increased the cash flow requirements necessary to receive a loan guarantee. Positive cash flow was redefined to require at least a 10 percent cash reserve after payment of all loan installments due. This reserve will allow for new investments, risk, and uncertainties. FmHA's risk will be reduced, since borrowers will better be able to cope with unforeseen events and thus, less likely to fail. The agency is continuing to review the issue of cash flow margin and its impact on the guaranteed loan program. The new regulations also strengthen FmHA's requirements for the financial and production history of the borrower. Projected cash flows must now be supported by the 5-year financial and production history of the borrower. Previously, regulations required only a 3-year financial history and up to a 5-year production history. This change will result in more accurate financial projections, improving loan quality.

FmHA conducted a training program for all Farmer Program Chiefs and one FP Specialist from each state on June 13 - 15, 1989. The focus of this training was credit quality. The trainees will in turn provide similar training for field staff.

The FmHA Farmer Programs Loan Making Division has completed and released a Guaranteed Loan Processing Checklist to all field staff in Administrative Notice (AN) No. 1896. This provides a step-by-step processing guide for both FmHA and the lender. A copy of this AN is enclosed for your review.

FmHA National Office Program Managers are closely monitoring loan quality. FmHA's recent and continuing efforts in this area should strengthen loan quality. The study required by OMB, once completed, will provide FmHA with an outside opinion of documented, reliable financial criteria necessary to make loan approval decisions.

<u>Recommendation 2)</u>:

Establish, in regulations, the type and amount of security required for a guarantee and, if crops are accepted as the only security, require that crop insurance be obtained.

<u>Response</u>: FmHA Instruction 1980.114 requires the County Supervisor to complete Form FmHA 449-23, "Guaranteed Loan Evaluation". This form, in part, requires the County Supervisor to examine the net worth of the applicant and evaluate the security offered as collateral. The appraised value of the collateral and value of existing liens are considered.

Security requirements were also strengthened by the January 13, 1989, regulation change. Revised FmHA Instruction 1980-B, Paragraphs 1980.175(g), 1980.175(h), 1980.175(i); 1980.180(f), and 1980.185.(f) clearly state FmHA security requirements for loan guarantees.

FmHA Instruction 1980-B, Paragraph 1980.175(i) was revised to outline the agency's position on insurance. This instruction, in part, permits the loan approval official to require crop insurance, in individual cases, when crops are the only security for a loan.

FmHA Instruction 1980-B, Paragraph 1980.115, Administrative (B)(2) requires the County Supervisor to include all security requirements on the Conditional Commitment for guarantee. FmHA AN 1896, "Guaranteed Loan Processing Checklist" (enclosed), states that the Conditional Commitment must cover the required security and lien position. With the revised FmHA Instructions and FmHA AN 1896, FmHA believes security requirements for guaranteed loans have been significantly strengthened and are now adequate. FmHA will evaluate the results of the study referred to in the response to recommendation 1 to determine if additional security requirements are warranted.

Recommendation 5):

Implement policies and procedures to establish loss claims paid to lenders as debts owed the government by the borrowers and to initiate collection action in coordination with lenders immediately after final settlement of loan guarantees with lenders.

Response: FmHA disagrees with this recommendation. Establishing the loss claims as a government debt would create many problems. This policy would reduce or eliminate the lender's incentive to pursue collection after liquidation, and cause a significant increase in administrative costs of the program. Such a policy could possibly trigger FmHA "borrower rights" as established by the Agricultural Credit Act of 1987, which would further increase program costs.

FmHA believes that current regulations (revised January 13, 1989) allow for proper collection of debt after a final loss claim is paid and adequate monitoring of lender collection efforts. Lenders are required to submit a liquidation plan to FmHA within 30 days after their decision to liquidate. This plan should provide for maximum collection of the debt. If the borrower has other resources or income for potential future collection, this should be addressed in the plan. If FmHA and the lender disagree with the liquidation plan, FmHA has the option to liquidate the account. FmHA Instruction 1980-B, Paragraph 1980.146, Administrative (F), has been added to the regulations to require County Supervisors to contact lenders in writing for five years after the final loss claim is paid to monitor collection of debt on which FmHA has paid a loss. FmHA has also agreed to include alternatives for improving loss recoveries in the study previously mentioned.

We hope that the above information will allow the subject audit to close. If you need additional information, please contact Randy Tingler at FTS 475-4022.

for Ronnie L. Thompson MCW 6-19-89

MICHAEL C. WILKINSON
Deputy Administrator
Program Operations

Attachment

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