United States General Accounting Office

GAO

Testimony

Before the Subcommittee on Conservation, Credit, and Rural Development, Committee on Agriculture
House of Representatives

144994

For Release
on Delivery
Expected at
10:00 a.m. EDT
Tuesday
October 8, 1991

FARMERS HOME ADMINISTRATION

Farmer Program Assistance to Beginning Farmers

Statement of
John W. Harman, Director of Food and Agriculture Issues,
Resources, Community, and Economic Development Division

GAO/T-RCED-92-4

GAO Form 160 (12/87)

Mr. Chairman and Members of the Subcommittee:

We are pleased to be here today to discuss the Farmers Home Administration's (FmHA) assistance to individuals who want to start farming operations. Our testimony is based primarily on two reports we issued that have implications for beginning farmers.[1] In summary, these reports indicated that:

-- Most FmHA loans did not go to beginning farmers. We estimate that 81 percent of the $2.2 billion that FmHA loaned or guaranteed in fiscal year 1988 went to individuals who already held FmHA loans and who were not likely to be just starting farming operations. Only 19 percent went to new customers who may or may not have been beginning farmers.

-- The impact of the 1990 Farm Bill's changes that add beginning farmers to those given preference in purchasing FmHA farm properties may be limited because, among other things, (1) such properties are not always appropriate for them and (2) others, such as former owners, have preference in purchasing such properties.

Neither report had specific recommendations to increase assistance for beginning farmers. However, we believe that, in deliberating on measures to assist beginning farmers the Congress needs to consider not only how to help people start farming but also how to help them successfully graduate to commercial credit sources. In the past, we identified problems with FmHA's assistance in improving the financial condition of borrowers and with transitioning borrowers from federal to private credit (attachment I lists selected GAO reports covering FmHA farm loan programs). Without addressing such problems, beginning farmers are likely to fall into the same loan-making and loan-servicing treadmill that many of FmHA's clients have been on for many years. The Congress also needs to consider the implications of how a beginning farmer is defined from a federal assistance standpoint. This will determine the number of individuals qualifying for such targeted federal assistance. FmHA has proposed a definition allowing individuals who have farmed for up to 10 years to be considered beginning farmers.

We recently started work for the Chairman, Subcommittee on Agricultural Credit, Senate Committee on Agriculture, Nutrition, and Forestry, covering such issues as FmHA's efforts to implement

---

[1] Farmers Home Administration: Use of Loan Funds by Farmer Program Borrowers (GAO/RCED-90-95BR, Feb. 8, 1990) and Farmers Home Administration: Sales of Farm Inventory Properties (GAO/RCED-91-98, Apr. 9, 1991).

the 1990 Farm Bill's beginning farmer provisions and barriers beginning farmers face in starting operations. This work should be useful to the Congress as it continues to deliberate on beginning farmer issues.

In the remainder of my statement I will discuss our past work in more detail. Let me begin by providing a brief background on FmHA's farm loan programs.

BACKGROUND

FmHA, an agency of the U.S. Department of Agriculture (USDA), provides loans to farmers who are unable to obtain credit elsewhere at reasonable rates and terms. FmHA credit is supposed to be temporary assistance until the farmer is able to obtain commercial credit and, in general, is not targeted to any specific category of borrower. FmHA credit assistance is provided through either direct government-funded loans or through guarantees of commercial lenders' loans to farmers. Both direct loans and guaranteed loans are used in FmHA's farm ownership and farm operating loan programs. The former provides funds for buying and improving farmland and for constructing, repairing, and improving farm buildings. The latter provides funds for buying feed, seed, fertilizer, livestock, and farm equipment, and for family living expenses. Refinancing borrowers' existing debts is an authorized use of funds in the farm ownership and farm operating loan programs.

When borrowers are unable to repay their direct loans, FmHA may acquire the property that was pledged as security for the loans and subsequently sell that property. FmHA has two categories of farm inventory property: (1) suitable property is farmland that can be used for general farming purposes and can produce agricultural commodities in a quantity that causes it to be recognized in the community as a farm or part of a farm and (2) surplus property is land that is not recognized in the community as farmland, that cannot be used for general farming purposes, or that was suitable property that did not sell within a specified time frame.

FmHA records indicated that on September 30, 1990, the agency had 3,411 farm properties in inventory that were valued at about $456 million. About 86 percent of these properties were classified as suitable, and 14 percent were classified as surplus. FmHA classified fewer properties as surplus because properties with even 1 acre of cropland or pasture are considered suitable for farming purposes.

Prior to the 1990 Farm Bill, FmHA gave priority in selling suitable property in the following order to: (1) the previous borrower-owner of the property, (2) members of that person's family who were engaged in farming, (3) the previous farm operator of the property, and (4) other family-size farm operators. The 1990 Farm

Bill adds beginning farmers to this list and gives them preference over other family-size farm operators in purchasing such properties.

Our February 1990 report used the terms "new customers" and "new borrowers" in reference to individuals who did not have outstanding FmHA debts. Our April 1991 report used the term "beginning farmers" in reference to individuals who were generally starting their own farming operations for the first time. Subsequent to our reports, FmHA proposed defining a beginning farmer as, among other things, an individual who has operated a farm or ranch for not more than 10 years. It is important to recognize that our references to new customers, new borrowers, and beginning farmers may be more restrictive than FmHA's current definition. (See attachment II for FmHA's proposed definition of a beginning farmer.)

MOST LOANS ARE TO EXISTING BORROWERS

Our February 1990 report examining the use of FmHA loan funds was based on a random sample of 1,800 farm loans made or guaranteed by FmHA in fiscal year 1988. As shown in table 1, we estimate that most (81 percent) of the $2.2 billion that FmHA loaned or guaranteed that year went to borrowers who already held farmer program loans and were unlikely to be beginning farmers. The remaining 19 percent went to new customers. Our work was not designed to determine whether the new customers were beginning farmers or established farmers who did not have outstanding FmHA debts.

Loans to new customers accounted for 21 percent or less of loan funds within three of the four loan types--guaranteed farm ownership, direct farm operating, and guaranteed farm operating. Although loans to new customers accounted for 44 percent of the direct farm ownership funds, about half were used for refinancing existing commercial debt, indicating that the borrowers who received these funds were not beginning farmers.

Table 1: Amount and Percent of FmHA Farmer Program Loan Funds Used by Existing Borrowers and New Customers, Fiscal Year 1988

Dollars in Millions

	Total loan funds used by			
	Existing borrowers		New customers	
Loan type	Amount	Percent	Amount	Percent
Direct farm ownership	$ 64	56	$ 50	44
Guaranteed farm ownership	289	80	74	20
Direct farm operating	767	88	103	12
Guaranteed farm operating	691	79	188	21
Total	$1,811	81	$415	19

Source: GAO estimated amounts based on a random sample of loans.

FARM INVENTORY PROPERTIES WERE OFTEN NOT APPROPRIATE FOR BEGINNING FARMERS

For our April 1991 report, we reviewed a total of 72 judgmentally selected farm properties that were in inventory or that were sold from inventory between January 1989 through May 1990 at seven FmHA county offices (one each in seven different states). FmHA sold 37 of the 72 properties during this period. Only 5 of the 37 properties were purchased by persons starting their own farming operations, which we considered to be beginning farmers. Of the remaining 32 properties, 14 were purchased by the properties' previous owners, and 18 were purchased by established farmers who used them as additions to their operations and not as independent farm units.

Many factors could help explain why so few beginning farmers purchased FmHA properties, including past FmHA sale practices that gave previous owners a preference over beginning farmers and the possibility that few beginning farmers are entering the market. Another reason, however, relates to the appropriateness of FmHA's inventory property for beginning farmers. FmHA county officials told us they considered only 11 of the 72 properties we reviewed as appropriate for beginning farmers. The remaining properties were not appropriate for a variety of reasons, including poor soil conditions and/or deteriorated farm buildings, high initial investment and/or operating costs, conservation easements that restricted the agricultural use of major portions of the land, or limited acreage. (See table 2.)

Table 2: Reasons Why 61 FmHA Inventory Properties Were Inappropriate for Beginning Farmers

Primary reason why property was inappropriate	Number of properties
Poor soil conditions and/or deteriorated farm buildings	24
Costs to purchase and/or operate	17
Conservation easements	15
Limited acreage	5
Total	61

Source: GAO discussions with FmHA county supervisors and review of county office records.

The following illustrates an inventory property that is of questionable value for beginning farmers. An Arizona property had facilities for and previously had been operated as a 200-cow dairy operation. However, according to the appraiser, the University of Arizona had estimated that an Arizona dairy farm needs about 350 cows to operate successfully. The most recent appraisal stated that the highest and best use of the property was as a rural residence. However, the farm house had been vandalized. Also, the FmHA county supervisor had removed and sold the farm's stainless steel bulk milk tank, which was essential for the dairy operation, to prevent further vandalization or theft. Overall, the difficulties in turning this particular property into a viable ongoing operation were illustrated by the fact that three different FmHA borrowers in succession had failed to successfully operate the farm because they could not generate a positive cash flow.

The few FmHA farm inventory properties that are appropriate for beginning farmers may limit the potential impact of the 1990 Farm Bill changes that give beginning farmers preference over other family farmers in purchasing suitable FmHA inventory properties. Furthermore, former owners, among others, still have priority over beginning farmers in purchasing suitable FmHA farm inventory property.

\- - - - - -

Mr. Chairman, this completes my prepared statement. I would be happy to respond to any questions.

SELECTED GENERAL ACCOUNTING OFFICE REPORTS ON FmHA PROGRAMS AND ACTIVITIES

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

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

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

Farmers Home Administration: Loan-Servicing Efforts Focus on Continually Delinquent Borrowers (GAO/RCED-87-13BR; Nov. 12, 1986)

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

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

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

Farmers Home Administration: Implications of the Shift From Direct to Guaranteed Farm Loans (GAO/RCED-89-86; Sept. 11, 1989)

Financial Audit: Farmers Home Administration's Financial Statements for 1988 and 1987 (GAO/AFMD-90-37; Jan. 25, 1990)

Farmers Home Administration: Use of Loan Funds by Farmer Program Borrowers (GAO/RCED-90-95BR; Feb. 8, 1990)

Farmers Home Administration: Farm Program Debt, Delinquencies, and Loan Losses as of June 30, 1989 (GAO/RCED-90-158BR; June 26, 1990)

Farmers Home Administration: Changes Needed in Loan Servicing Under the Agricultural Credit Act (GAO/RCED-90-169, Aug. 2, 1990)

Farmers Home Administration: Sales of Farm Inventory Properties (GAO/RCED-91-98; Apr. 9, 1991)

Farmers Home Administration: Information on Appeals of Farm and Housing Loan Decisions (GAO/RCED-91-106; Apr. 9, 1991)

Financial Audit: Farmers Home Administration's Financial Statements for 1989 and 1988 (GAO/AFMD-91-36; May 6, 1991)

 ATTACHMENT II

FmHA PROPOSED DEFINITION OF A BEGINNING FARMER

The 1990 Farm Bill requires, among other things, that USDA develop a definition of exactly who is a beginning farmer or rancher. In response to this requirement, on May 29, 1991, FmHA proposed regulations in the Federal Register defining a beginning farmer as one who meets its basic farm ownership loan eligibility criteria, has operated a farm or ranch for not more than 10 years, and does not own a farm or ranch, or owns such property but it is less than 15 percent of the median farm or ranch acreage in the county where the person will purchase land. Also, other conditions are that the person will materially and substantially participate in the farm or ranch operation, provide a majority of the day-to-day labor and management of the farm or ranch individually or along with the immediate family, demonstrate that the available resources of the person's family are not sufficient to enable the person to enter or continue farming or ranching on a viable scale, and participate in FmHA's loan assessment and borrower training programs. If the applicant is an entity, all members of the entity must meet the requirements. Further, FmHA stated that a person who previously farmed or ranched his/her own property may be considered a beginning farmer or rancher if the person operated the farm or ranch for not more than 10 years and meets all the other conditions of FmHA's definition.

(150317)