GAO

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

April 1991

FARMERS HOME ADMINISTRATION

Sales of Farm Inventory Properties

GAO/RCED-91-98

GAO

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

Resources, Community, and
Economic Development Division

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April 9, 1991

The Honorable Kent Conrad
Chairman, Subcommittee on
Agricultural Credit
Committee on Agriculture,
Nutrition, and Forestry
United States Senate

Dear Mr. Chairman:

The Farmers Home Administration (FmHA) has over 3,400 farm properties in its inventory that were acquired from borrowers who were unable to repay FmHA loans. This report responds to your November 17, 1989, request for information on (1) the price at which farm inventory properties have been sold or offered for sale, (2) the extent to which beginning farmers acquired these properties and whether such properties are appropriate for them, and (3) the effect that conservation easements have on the agricultural uses of FmHA properties. As you know, we testified on the preliminary results of our work before your Subcommittee in March 1990 in order for our information to be considered in the development of the 1990 Farm Bill.[1] In general, this report updates that testimony and, as requested, also provides information on how the 1990 Farm Bill affected each of the areas we reviewed.

Results in Brief

Prior to the 1990 Farm Bill's passage, FmHA sold, or offered to sell, most farm inventory properties to qualified buyers at the lower of two values—either market or capitalization value—on the basis of guidance contained in the Food Security Act of 1985 (P.L. 99-198, Dec. 23, 1985) and the Agricultural Credit Act of 1987 (P.L. 100-233, Jan. 6, 1988). The market value was based on comparable property sales, income generated from the property, and the value of land and buildings while the capitalization value reflected the net income (gross income less expenses) that might be generated from farming the property. We compared the two values for 72 judgmentally selected farm properties, of which 37 were inventory properties that FmHA sold from January 1989 through May 1990 and 35 were properties that remained in FmHA's inventory at the time of our review. We found that, although the market and capitalization values for 62 of the 72 farm inventory properties

[1]The Food, Agriculture, Conservation, and Trade Act of 1990 (referred to as the 1990 Farm Bill) passed the Congress in October 1990 and was signed by the President in November (P.L. 101-624, Nov. 28, 1990).

varied on average by less than 5 percent, the values for the remaining 10 properties varied significantly because the capitalization values were zero or negative. In order to avoid selling properties at unrealistically low prices, the 1990 Farm Bill prohibits FmHA from selling property at the capitalization value.

Of the 37 properties that FmHA sold, all but 5 were sold to farmers with ongoing operations or to former owners of the properties as opposed to beginning farmers. While many factors may account for the relatively few property purchases by beginning farmers, FmHA officials noted that only 11 of the 72 properties we reviewed were appropriate for beginning farmers. The appropriateness of the remaining properties was questionable for a variety of reasons, including poor soil, run-down buildings, and large conservation easements that restricted the extent to which land could be farmed. The appropriateness of farm properties may limit the impact of changes in the 1990 Farm Bill that are intended to assist beginning farmers to purchase FmHA farm properties.

Conservation easements, which are placed on some farm properties after they enter FmHA's inventory, protect and enhance certain natural resources, such as wetlands and wildlife habitats. However, easements restrict the agricultural uses of FmHA farm inventory properties that are leased while in inventory and that are sold from inventory. As a result, these easements reduce the agricultural productivity of FmHA properties and, thus, their agricultural value. About 40 percent of the properties we examined had conservation easements that restricted the use of about 30 percent of the combined properties' acreage. In an effort to reduce the adverse agricultural impacts of conservation easements, the 1990 Farm Bill set caps on the amount of land that can be placed under easement.

Background

FmHA, an agency of the U.S. Department of Agriculture, is the lender of last resort to financially troubled farmers who cannot get credit elsewhere at reasonable rates and terms. When borrowers are unable to repay their 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, or 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.

At the time of our review, suitable farm properties had been held in inventory about 40 months on average, while the surplus farm properties had been held 42 months on average. The 72 properties that we reviewed averaged slightly over 3 years in inventory. The range of time in inventory for the 37 sold properties was from 9 months to almost 7 years, and the range for the 35 unsold properties was from 6 months to almost 8 years at the time of our review.

During fiscal year 1990, FmHA sold 1,195 farm properties from inventory. Prior to the 1990 Farm Bill's passage, FmHA would generally use the lower of two values in determining a property's actual selling price—either market or capitalization value—on the basis of guidance contained in the Food Security Act of 1985 and the Agricultural Credit Act of 1987. The market value was based on comparable property sales, income generated from the property, and the value of the land and buildings. The capitalization value indicated the agricultural income that might be generated from the property and was calculated by first determining a capitalization rate for a comparable property—the property's net income (gross income less expenses) divided by its sales price. This capitalization rate was then divided into the projected net income of the property being appraised. The result of the calculation was the capitalization value for the appraised property. The 1990 Farm Bill prohibits FmHA from selling property at the capitalization value to avoid selling properties at unrealistically low prices.

Market and Capitalization Values Generally Did Not Vary Significantly

For 62 of the 72 properties we reviewed, the market and capitalization values varied on average by less than 5 percent. However, the 10 remaining properties, which had not been sold at the time of our review, had much higher market values because the capitalization values were zero or negative. The low capitalization values for these properties reflected the fact that they could not generate sufficient income to cover expenses either as an independent farming unit or an extension of an existing unit. While having no capitalization value, these properties had value for nonagricultural uses, such as speculation for housing projects in urban expansion areas or for water rights. These 10 cases, located in Arizona, presented opportunities for windfall profits if potential buyers were allowed to purchase the properties at their capitalization values. However, the FmHA Arizona State Director said that these properties would not be sold at a zero capitalization value.

Appendix I shows a comparison of the market and capitalization values for each of the properties that we examined. For the 62 properties with an average difference of less than 5 percent, 27 had a market value greater than the capitalization value, 26 had a capitalization value greater than the market value, and 9 had equal values. All 37 properties we reviewed that FmHA sold were suitable properties. Of these, 15 had a market value lower than the capitalization value, 17 had a capitalization value lower than the market value, and 5 had equal values.

The 1990 Farm Bill changed FmHA's sales of inventory properties to require that suitable properties be sold at appraised market value. Pricing property at the capitalization value was eliminated because of FmHA's concerns that properties could be sold at unrealistically low prices and purchasers could subsequently resell the properties for other uses and realize windfall profits. While suitable property is now sold at a price based on appraised market value, surplus property continues to be sold to the general public at auction, negotiated sales, sealed bids, or through real estate brokers. Also, the 1990 Farm Bill changed the time period that property remains classified as suitable from 3 years after the date of FmHA acquisition to 1 year after the date FmHA publicly advertised it for sale.

Inventory Farms Reviewed Were Often Not Appropriate for Beginning Farmers

Very few of the 72 properties we examined were sold to or appropriate for beginning farmers. Specifically, only 5 of the 37 sold properties we reviewed were purchased by beginning farmers.[2] Of the remaining 32 properties, 18 were purchased by established farmers who used them as additions to their operations and not as independent farm units, and 14 were purchased by the properties' previous owners.

[2] As you also requested, we reviewed inventory property purchases by members of socially disadvantaged groups. Only 1 of the 37 properties FmHA sold was purchased by a member of a socially disadvantaged group. The property was purchased by a husband and wife of American Indian heritage who were beginning farmers and who planned to grow crops while continuing full-time, off-farm employment.

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, deteriorated farm buildings, conservation easements that restricted the agricultural use of major portions of the land, or limited acreage.

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.

Another factor that may limit the appropriateness of some inventory properties for beginning farmers is high initial investment and/or operating costs. More specifically, the value of some properties and/or the cost of operations exceeded the maximum amounts that FmHA will loan farmers. For example, FmHA direct and guaranteed ownership loans are limited to a maximum amount of $200,000 and $300,000, respectively. However, 13 properties, or 18 percent of the 72 properties we reviewed, had a market value of more than $300,000. For example, a 1,240-acre Arizona property was valued at $2.1 million. Reduction in the availability of FmHA direct loans may further exacerbate the beginning farmers' ability to finance inventory property purchases. These reductions occurred in large part as a result of congressional efforts to shift lending emphasis from using direct loans to using guaranteed loans—commercial loans guaranteed by FmHA. Even with guarantees, however, commercial lenders may be hesitant to lend funds to beginning farmers, who are generally perceived as very high-risk borrowers.

Table 1 summarizes the types and frequency of problems associated with the 61 properties that were of questionable value to beginning farmers.

Table 1: 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 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 few FmHA farm inventory properties that are appropriate for beginning farmers may limit the potential impact of the 1990 Farm Bill changes that are intended to provide beginning farmers with advantages in purchasing inventory properties. Prior to the 1990 Farm Bill's passage, 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.

Conservation Easements Restrict the Use of Inventory Properties and Reduce Their Agricultural Value

Conservation easements restrict the agricultural uses of FmHA properties and therefore reduce their agricultural value. Of the 72 properties we reviewed, 28 had conservation easements; many of these significantly limited the uses of large portions of the properties. For example, 14 of the properties had at least 50 percent of the acreage under easement, including 4 properties that had 100 percent of the acreage under easement. The 1990 Farm Bill attempts to minimize the effects that easements have on agricultural properties by limiting the amount of acreage that can be placed under easement.

Purpose and Impact of Conservation Easements

Conservation easements, which are placed on some farm properties after they enter FmHA's inventory, protect and enhance certain natural resources, such as wetlands, floodplains, and endangered or threatened wildlife species' habitats. Easements generally preclude active farming of the easement area and are granted in perpetuity by FmHA to the government, with the U.S. Department of the Interior's Fish and Wildlife Service (FWS) or another organization, such as a state department of natural resources, designated as the easement manager. FWS provides technical advice to FmHA for identifying easement areas and defining easement restrictions. Once an easement is placed on a property, the agency or organization designated as easement manager is responsible for ensuring compliance with the easement restrictions.

Table 2 summarizes the extent to which conservation easements affected the 72 properties we reviewed. It shows that the 28 properties had easements that affected 32 percent of the combined acreage.

Table 2: Acreage Placed Under Easement for 72 FmHA Inventory Properties

			For properties with easements		
FmHA county office location	**Number of properties**	**Properties with easements**	**Total acres**	**Total easement acres**	**Easement acres as a percent of total acres**
Kansas	7	1	484	273	56.4
Minnesota	8	7	1,190	614	51.6
South Dakota	12	5	1,617	657	40.6
Mississippi	14	10	2,845	1,059	37.2
North Dakota	7	5	3,706	590	15.9
Arizona	17	0	0	0	0.0
Iowa	7	0	0	0	0.0
Total	**72**	**28**	**9,842**	**3,193**	32.4

Source: GAO review of FmHA county office records.

Land use restrictions resulting from conservation easements can have significant impacts on the agricultural value of properties. For example, an 80-acre Minnesota property that we examined was placed entirely under easement. This former dairy farm, which included 52 acres of cropland and 23 acres of pasture, is located in a floodplain with a river flowing through the tract. While this property could have been used as an add-on parcel for another farming operation, the appraisal noted that the property is now, with the addition of the conservation easement, only appropriate for hunting or other recreational purposes. The perpetual conservation easement prohibits growing crops or grazing livestock on the property, but its owners may reside and hunt on the property. The property, which was valued at $30,000 when acquired by FmHA, was held in inventory for about 19 months before being sold for $12,160 to the former owner, who intended to use it as a rural residence.

Affects of Farm Bill on Easements

The 1990 Farm Bill made several changes that limit the amount of inventory property acreage that can be placed under easement. These changes are intended to moderate some of the negative agricultural impacts resulting from conservation easements for properties still in FmHA's inventory. Specifically, the act directs FmHA to limit conservation easements on each property to 10 percent of existing cropland that had been converted from wetlands prior to December 1985, 20 percent of wetlands that had been routinely used for growing crops, and 50 percent of wetlands that had been used for growing hay or grazing livestock. Also, buffer areas around wetlands generally cannot be more than 100 feet wide and provision must be made for access to other portions of the property. Further, the maximum percentages subject to easement may be reduced for property to be sold to former owners or beginning farmers if necessary to preserve the property as a marketable farm unit. Prior to the 1990 Farm Bill's passage, there were no limits on the amount of farmland that could be placed under easement. We did not determine how the recently enacted 1990 Farm Bill's easement provisions could have potentially affected the 28 properties.

Conclusions

The 1990 Farm Bill made significant changes affecting FmHA's sales of inventory property, including giving beginning farmers preference over other family farmers in purchasing suitable FmHA inventory properties. However, many of these properties may not be appropriate for beginning farmers or for independent farm units. Most of the 72 FmHA farm inventory properties in the seven states we reviewed have value only for existing operators who want to expand their operations, speculators, or those who want a rural residence. It is unclear whether giving priority to beginning farmers will increase sales to this group of potential purchasers.

The Farm Bill also contains provisions intended to minimize the adverse impact that conservation easements have on the agricultural value of FmHA property. These provisions may make FmHA inventory property more attractive to potential purchasers since restrictions on land use are reduced. On the other hand, certain wetlands and wildlife habitats will receive less protection. Whether beginning farmers will purchase more FmHA inventory properties because easement restrictions are eased is unclear since a variety of other factors also influence their decisions to purchase such properties.

FmHA officials reviewed a draft of this report for technical accuracy, and changes were made where appropriate. However, as requested by your office, we did not obtain official agency comments.

Our objectives, scope, and methodology in conducting this review and preparing this report are discussed in appendix II.

As arranged with your office, we are sending copies of this report to appropriate Senate and House committees; interested Members of Congress; the Secretary of Agriculture; the Secretary of the Interior; the Administrator, FmHA; the Director, FWS; the Director, Office of Management and Budget; and other interested parties. We will also make copies available to others upon request.

If we can be of further assistance, please contact me at (202) 275-5138. Major contributors are listed in appendix III.

Sincerely yours,

John W. Harman
Director, Food and
Agriculture Issues

Contents

Abbreviations

FmHA	Farmers Home Administration
FWS	Fish and Wildlife Service
GAO	General Accounting Office

Market and Capitalization Values for 72 FmHA Inventory Properties

Property number	Market value	Capitalization value	Percentage of difference when Market exceeded capitalization	Capitalization exceeded market
Sold				
1	$325,000	$307,000	5.9	
2	119,000	114,000	4.4	
3	114,000	111,600	2.2	
4	113,650	113,488	0.1	
5	101,000	100,350	0.6	
6	86,800	85,700	1.3	
7	79,000	76,116	3.8	
8	68,300	68,200	0.1	
9	56,700	54,234	4.5	
10	52,800	52,480	0.6	
11	49,500	48,300	2.5	
12	48,500	48,300	0.4	
13	42,500	42,100	1.0	
14	41,300	41,000	0.7	
15	38,750	38,053	1.8	
16	38,400	37,500	2.4	
17	13,500	12,160	11.0	
18	125,400	129,800		3.5
19	109,000	109,307		0.3
20	105,600	106,500		0.9
21	92,400	92,700		0.3
22	81,600	82,900		1.6
23	76,000	77,404		1.8
24	63,600	67,270		5.8
25	55,000	55,160		0.3
26	44,000	45,380		3.1
27	42,600	43,580		2.3
28	40,000	41,650		4.1
29	35,000	35,625		1.8
30	34,000	35,000		2.9
31	33,200	33,580		1.1
32	18,000	18,100		0.6
33	19,500	19,500		
34	102,000	102,000		
35	100,000	100,000		
36	50,000	50,000		
37	41,000	41,000		

(continued)

Property number	Market value	Capitalization value	Percentage of difference when: Market exceeded capitalization	Percentage of difference when: Capitalization exceeded market
Unsold				
38	2,102,000	2,100,000	0.1	
39	1,752,000	1,453,000	20.6	
40	1,046,000	1,038,000	0.8	
41	695,000	614,923	13.0	
42	442,500	420,442	5.2	
43	422,000	418,000	1.0	
44	142,000	138,735	2.4	
45	94,000	90,875	3.4	
46	46,000	32,640	40.9	
47	36,000	35,029	2.8	
48[a]	1,188,000	0		
49[a]	628,000	0		
50[a]	313,000	0		
51[a]	232,000	0		
52[a]	225,000	0		
53[a]	128,000	0		
54[a]	78,200	0		
55[a]	75,000	0		
56[a]	55,600	0		
57[a]	20,800	0		
58	1,500,000	1,529,228		1.9
59	468,500	492,825		5.2
60	429,000	433,600		1.1
61	227,000	231,500		2.0
62	190,000	198,800		4.6
63	192,900	195,375		1.3
64	168,036	171,798		2.2
65	162,500	163,540		0.6
66	112,000	116,875		4.4
67	77,500	81,900		5.7
68	13,000	13,800		6.2
69	258,000	258,000		
70	37,500	37,500		
71	15,000	15,000		
72	2,400	2,400		

[a]These 10 properties, which had not sold, had zero or negative capitalization values that reflected the fact that they could not generate sufficient income to cover expenses. A zero capitalization value is listed for each of these properties. The percentage of differences is not included for these properties because of the infinite percentage that results when a zero value is used in the denominator in a mathematical calculation.

Objectives, Scope, and Methodology

On November 17, 1989, the Chairman, Subcommittee on Agricultural Credit, Senate Committee on Agriculture, Nutrition, and Forestry, requested that we review the Farmers Home Administration's (FmHA) sales of farm inventory properties. On the basis of the Chairman's request and subsequent discussions with the Subcommittee staff, we focused our work on

- the price at which farm inventory properties have been sold or are offered for sale,
- the extent to which beginning farmers acquired these properties and whether such properties are appropriate for them, and
- the effect that conservation easements have on the agricultural uses of FmHA properties.

In March 1990, we testified before the Subcommittee on Agricultural Credit on the preliminary results of our work on this review.[1]

To compile general information on FmHA farm inventory properties, we gathered and analyzed FmHA statistical data on the number, location, and status of all properties in inventory as of September 30, 1990. We also reviewed statutes and proposed legislation, executive orders, FmHA regulations, operating instructions, and other documents related to FmHA inventory properties, and interviewed FmHA headquarters and state office officials.

To compile specific information on each of the 72 properties in our review, we examined inventory property files at FmHA county offices and interviewed FmHA state officials and county supervisors. In selecting county offices to review, we first judgmentally selected states that had a high number of properties in inventory or that had sold from inventory. The states selected were Iowa, Kansas, Minnesota, Mississippi, North Dakota, and South Dakota.

In addition to these six states, we selected Arizona for review because some FmHA inventory properties there were appraised at a zero or negative capitalization value. In testifying in March 1990 before the Senate Subcommittee on Agricultural Credit, the Under Secretary for Small Community and Rural Development, U.S. Department of Agriculture, had used an Arizona inventory property as an example in proposing

[1] Farmers Home Administration's Implementation of the Agricultural Credit Act of 1987 and Sales of Farm Inventory Property (GAO/T-RCED-90-38, Mar. 5, 1990).

that capitalization value be eliminated as a method in pricing inventory property.

In each state, we judgmentally selected one FmHA county office that had more than five properties in inventory or that sold from inventory between January 1989 and May 1990. At each county office, we reviewed property files and compiled and analyzed information on property prices, easements, and other factors, such as time in inventory, for all properties in inventory. Also, we interviewed FmHA county supervisors to obtain information about the purchasers of the properties, such as their farming experience, and the appropriateness of the properties for beginning farmers.

We visited selected properties in Arizona, Mississippi, and North Dakota to observe the condition of the property and conservation easement areas. To gather additional information on conservation easements, we interviewed selected FWS regional and headquarters officials and reviewed FWS documents. Also, we interviewed FmHA officials at selected state and county offices regarding easement issues.

The results of our work cannot be projected to the states we reviewed or the nation overall. We conducted our review from January through September 1990 in accordance with generally accepted government auditing standards.

FmHA officials reviewed a draft of this report for technical accuracy, and changes were made where appropriate.

Major Contributors to This Report

Resources, Community, and Economic Development Division, Washington, D.C.

John P. Hunt, Jr., Assistant Director
Robert E. Robertson, Assistant Director
Patrick J. Sweeney, Assignment Manager

Chicago Regional Office

John A. Wanska, Evaluator-in-Charge
Sheldon H. Wood, Jr., Site Senior

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