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FARMERS HOME ADMINISTRATION

The Guaranteed Farm Loan Program Could Be Managed More Effectively

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Resources, Community, and
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The Honorable Patrick J. Leahy
Chairman
The Honorable Richard G. Lugar
Ranking Minority Member
Committee on Agriculture,
Nutrition, and Forestry
United States Senate

The Honorable E (Kika) de la Garza
Chairman
The Honorable Pat Roberts
Ranking Minority Member
Committee on Agriculture
House of Representatives

As part of our continuing review of the farm loan programs of the U.S. Department of Agriculture's (USDA) Farmers Home Administration (FmHA), this report presents information on the guaranteed farm loan program and its use as a tool for graduating FmHA's direct loan borrowers to commercial credit. We are recommending that USDA take actions to strengthen the process for graduating borrowers from direct loans.

We are sending copies of this report to other appropriate Senate and House committees; the Secretary of Agriculture; the Administrator, FmHA; the Director, Office of Management and Budget; and other interested parties. We will make copies available to others upon request.

This work was performed under the direction of John W. Harman, Director, Food and Agriculture Issues, who can be reached on (202) 512-5138 if you or your staff have any questions. Major contributors to this report are listed in appendix IX.

Keith O. Fultz

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Executive Summary

Purpose

The Farmers Home Administration (FmHA)—the government's lender of last resort to the nation's agricultural sector—has guaranteed $12 billion of lenders' farm loans to almost 86,000 farmers since 1976. Most of these loans, which are made by banks and other commercial lenders, were made since the mid-1980s. At that time, the government's emphasis in farm lending shifted from providing direct loans to farmers who could not qualify for commercial credit to guaranteeing loans for those who could qualify with government backing. This shift in lending was intended to, among other things, encourage farm lending from commercial lenders and reduce budget outlays for FmHA's direct loans.

Concerned about the high losses in FmHA's direct loan program and the potential for similar losses in FmHA's guaranteed loan program, GAO examined (1) the extent of losses under the guaranteed farm loan program compared with those under the direct loan program, (2) the extent to which the guaranteed farm loan program has graduated FmHA's direct loan borrowers to commercial credit, and (3) ways to make the guaranteed farm loan program more of a source for funding direct loan borrowers.

Background

Until the early 1970s, FmHA, an agency of the U.S. Department of Agriculture, provided credit to farmers exclusively through direct government-funded loans. However, in 1972, the Congress authorized FmHA to guarantee farm loans made by commercial lenders. In guaranteeing a farm loan, FmHA agrees, in the event of a borrower's default, to reimburse a commercial lender for up to 90 percent of the lost principal plus accrued interest and liquidation costs. Direct loans are made to riskier farmers, have lower interest rates, and are for longer repayment periods than guaranteed loans. FmHA's assistance is intended to be temporary; as soon as farmers become financially viable, they are to graduate from FmHA to commercial lenders for their financial needs. In recent years, FmHA has made an average of about $1.5 billion annually in new guaranteed loans and, as of September 30, 1993, had about $5 billion in outstanding guaranteed farm loan debt.

Results in Brief

Because it assists farmers who present less financial risk than direct loan borrowers, FmHA's guaranteed farm loan program has substantially lower rates of delinquency and loan losses than its direct loan program. Nonetheless, FmHA has hundreds of millions of dollars in guaranteed loans that are at risk, in part, because FmHA's lending policies allow borrowers who defaulted on past loans to obtain new guaranteed loans. Also, FmHA's field office officials have not always followed the agency's standards for servicing guaranteed loans, which are designed to protect the federal government's financial interest.

The guaranteed loan program has not been effectively used as a tool for graduating direct loan borrowers to commercial credit. During fiscal years 1991 through 1993, only 4 percent of the direct loan borrowers obtained guaranteed farm loans. Consequently, some borrowers may have direct loans longer than justified, taking advantage of the more favorable terms. One reason for this, which FmHA is developing a process to correct, is that FmHA has not systematically used the guaranteed loan program as an interim step to graduate borrowers. Another contributing factor is that the agency's processes for identifying and graduating qualified direct loan borrowers have often not been fully implemented.

Commercial lenders told GAO that changes to FmHA's farm loan programs are needed in order for lenders to consider taking on more direct loan borrowers as clients. Their suggestions center on changing the direct loan program to provide incentives for borrowers to seek commercial credit and changing the guaranteed loan program to make it more attractive to lenders.

Principal Findings

While Less Risky Than the Direct Loan Program, FmHA's Operation of the Guaranteed Loan Program Adds to the Government's Risk

In terms of its loss and delinquency performance, the guaranteed farm loan program has been much more successful than the direct loan program. From 1976 through 1993, FmHA guaranteed $12 billion of lenders' farm loans and made almost $56 billion in direct loans. Overall losses—actual losses through 1993 plus estimates of future losses—on guaranteed loans will be about 9 percent compared with losses on direct loans of about 40 percent. Also, FmHA's existing guaranteed portfolio is in much better financial condition than its direct loan portfolio. GAO estimates that 13.4 percent of the outstanding guaranteed loan debt in June 1993 was held by problem borrowers—those who were delinquent or who had their debts rescheduled because of past repayment difficulties. Previously, GAO estimated that 70 percent of the outstanding direct loan debt in September 1990 was in a similar condition.

However, some of FmHA's loan-making policies contribute to the government's exposure to risk with guaranteed loans. Specifically, borrowers who had defaulted on their previous guaranteed and direct loans and who had caused the agency to incur losses can obtain new guaranteed loans. During fiscal years 1991 through 1993, FmHA made guaranteed loans totaling about $60 million to borrowers who had previously caused the agency to incur about $67 million in losses. Added risk also exists because FmHA's field office officials have not always properly implemented loan-servicing standards, such as monitoring lenders' servicing of guaranteed loans. In April 1992, GAO made a recommendation to the Congress to strengthen FmHA's policies for making guaranteed loans, which has not yet been implemented. At the same time, GAO recommended that the Secretary of Agriculture increase compliance with standards for servicing guaranteed loans. FmHA's fiscal year 1994 reviews indicate improvement in this area.

The Guaranteed Loan Program Has Generally Not Helped to Graduate Direct Loan Borrowers to Commercial Credit

Only 4 percent of the borrowers who had direct loans during fiscal years 1991 through 1993 obtained guaranteed loans. Historically, FmHA has not attempted to use the guaranteed loan program as a stepping stone for direct loan borrowers to graduate to commercial credit. However, as directed by the Congress, FmHA has proposed regulations to accomplish this transition. These proposed regulations, which are expected to become effective in November 1994, could ultimately help the agency to graduate more direct loan borrowers to commercial credit.

Currently, FmHA's process for identifying direct loan borrowers to consider for graduation to commercial credit allows potential candidates to be easily eliminated. As a result, borrowers who qualify for guaranteed loans may continue with direct loans longer than justified. Over 500 of 1,160 borrowers reviewed, whom FmHA should have reviewed for graduation potential during fiscal years 1991 and 1992, either were not reviewed or were removed from consideration without explanation. Recently, at the direction of the Congress, FmHA proposed to use its loan classification system to identify potential candidates for graduation. However, FmHA's classifications are often incorrect. Of 171 borrowers who were classified as "commercial quality" borrowers, GAO found that about 66 percent were misclassified because they could not meet minimum commercial credit standards.

Suggestions for Using the Guaranteed Loan Program for Funding More Direct Loan Borrowers

Commercial lenders, banking industry representatives, and FmHA officials suggested changes for increasing the use of the guaranteed loan program as a source of credit for direct loan borrowers. These suggestions included changing the direct loan program to stimulate borrowers' efforts to seek guaranteed loans. Such changes could include gradually increasing the interest rate charged over the life of a new direct loan until it matches the rates charged by commercial lenders. Also, they suggested changes to the guaranteed loan program to stimulate lenders' participation, such as increasing the guarantee percentage when the loan is made to refinance outstanding direct loan debt. However, in the opinion of some FmHA officials and commercial lenders, if the suggested changes were made, few direct loan borrowers would be financially able to meet the lenders' requirements for loans even with guarantees.

Recommendations

To strengthen the graduation process, GAO is recommending that the Secretary of Agriculture direct the FmHA Administrator to (1) accurately assign and promptly update borrowers' loan classifications and (2) adequately evaluate direct loan borrowers for graduation to guaranteed loans or commercial credit and graduate those who qualify.

Agency Comments

In commenting on a draft of this report, FmHA stated that it shares GAO's concerns that the guaranteed loan program avoid the high losses that the direct loan program has had. Moreover, FmHA said that it has been aware of the issues raised by GAO, and FmHA believes that its ongoing and planned actions address GAO's concerns. FmHA indicated that it agreed with GAO's recommendations and cited planned actions to require that borrowers' loan classifications be updated at least every 2 years and that borrowers who are classified as potential commercial credit candidates be referred to commercial lenders every 2 years. However, FmHA did not provide specifics on how it plans to ensure that county office officials perform the required review of borrowers' loan classifications and potential for graduation or to graduate those borrowers who qualify. FmHA also said that it agreed that additional changes can be made to the guaranteed loan program to help graduate direct loan borrowers to commercial credit. FmHA cited various actions to make the guaranteed loan program more attractive to commercial lenders and said that it will consider the other suggestions for using guaranteed loans to fund more borrowers who have direct loans. FmHA's specific comments and GAO's evaluation are discussed in chapters 2, 3, and 4.

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Abbreviations

ABA	American Banking Association
CAR	Coordinated Assessment Review
Con Act	Consolidated Farm and Rural Development Act
FmHA	Farmers Home Administration
GAO	General Accounting Office
USDA	U.S. Department of Agriculture

Introduction

The Farmers Home Administration (FmHA), a lending agency within the U.S. Department of Agriculture (USDA), provides assistance to financially troubled farmers through direct government-funded loans and guarantees on loans made by other agricultural lenders.[1] Until the early 1970s, FmHA provided direct loans only. The Rural Development Act of 1972 (P.L. 92-419, Aug. 30, 1972) provided FmHA with discretionary authority to guarantee farm loans made by other agricultural lenders, such as commercial banks and the Farm Credit System. In guaranteeing a farm loan, FmHA agrees, in the event that a borrower defaults, to reimburse a commercial lender for up to 90 percent of lost principal plus accrued interest and liquidation costs.

Hierarchy of Farm Credit

American farmers have a hierarchy of credit available. Farmers who need to borrow funds to finance their operations or purchase farm property have three basic sources of credit. First, farmers in the best financial position can obtain credit from lenders such as commercial banks, the Farm Credit System, life insurance companies, or individuals. Second, if farmers' security or ability to meet repayment terms is somewhat marginal, they can obtain credit from commercial lenders through FmHA's guaranteed farm loan program. Third, if farmers are unable to obtain financing elsewhere, they can obtain a direct loan from FmHA. Table 1.1 shows that FmHA was responsible for about 12.5 percent of the total farm debt on December 31, 1992—guaranteed loans (3.4 percent) plus direct loans (9.1 percent). Data from December 31, 1992, were the latest available.

Table 1.1: Sources of Outstanding Farm Credit, as of December 31, 1992

Dollars in billions

Source of credit	Amount	Percentage of debt
Commercial lenders and individuals	$129.9	87.5
FmHA's guaranteed loans	5.0	3.4
FmHA's direct loans	13.5	9.1
Total	**$148.4**	**100.0**

Source: USDA's Economic Research Service.

[1]FmHA's basic authority for making farm loans is the Consolidated Farm and Rural Development Act of 1961, referred to as the Con Act, as amended (P.L. 87-128, Aug. 8, 1961).

Overview of FmHA's Farm Loan Programs

FmHA's mission is to be a temporary lender of last resort. For farmers who are unable to obtain credit elsewhere, FmHA can provide financing through either a direct or a guaranteed loan. To be eligible for a direct loan, a borrower must be unable to obtain commercial credit at reasonable rates and terms. To obtain a guaranteed loan, a lender must certify that it is unwilling to make the loan without a government-backed guarantee. Direct loans are made at lower interest rates and for longer repayment periods than guaranteed loans. When direct loan borrowers demonstrate financial progress, they are to graduate to commercial credit. If properly implemented, this process enforces FmHA's mission to supply temporary credit and makes direct loan funds available for other high-risk farmers needing financial assistance.

Although FmHA has traditionally provided more direct loans than guaranteed loans, it began to use more guaranteed loans in the mid-1980s. The Congress has since supported this changed emphasis with increased authorizations for guaranteed loans.

FmHA provides loan services through a highly decentralized organization consisting of a national program office in Washington, D.C.; a finance office in St. Louis, Missouri; and a field office structure comprising 47 state offices, about 250 district offices, and about 1,700 county offices located throughout the nation. FmHA's county supervisors, who manage the county offices, have extensive responsibility and authority for administering the agency's farm loan programs, including approving and servicing loans. FmHA's district directors are to provide guidance and supervision to county supervisors within designated geographic areas in the making and servicing of farm loans, and state directors are to administer and oversee operations within one or more states. Also, district and state directors have approval authority for certain loans. During 1993, the Secretary of Agriculture proposed to the Congress a plan to restructure USDA. In early October 1994, the Congress approved a restructuring plan for USDA. This action could change the way that farm loans are administered by the Department.

Direct and Guaranteed Loans Have Specific Authorized Uses

FmHA provides direct and guaranteed loans for both farm operating and farm ownership purposes. Farm operating loans are authorized for purposes such as buying equipment items, livestock, and poultry; paying annual operating and/or family living expenses; and refinancing debts. Direct operating loans may not exceed $200,000, including any outstanding principal on other direct farm operating loans. Guaranteed operating loans may not exceed $400,000 in total outstanding loan principal. When a farm operating loan is made, collateral must be provided as security.

Farm ownership loans, whether direct or guaranteed, are authorized for purposes such as buying real estate, refinancing existing debt, and making improvements to the farm. Direct and guaranteed farm ownership loans may not exceed $200,000 and $300,000, respectively, including any outstanding principal on other farm ownership loans, soil and water loans, and recreation loans. When a farm ownership loan is made, real estate or a combination of real estate and chattel property must be provided as security.[2]

Terms for repaying FmHA's loans vary according to the loan's type, the loan's purpose, and the nature of the security. The payment period for farm operating loans may range from 1 to 7 years, while the payment period for farm ownership loans can be as long as 40 years.

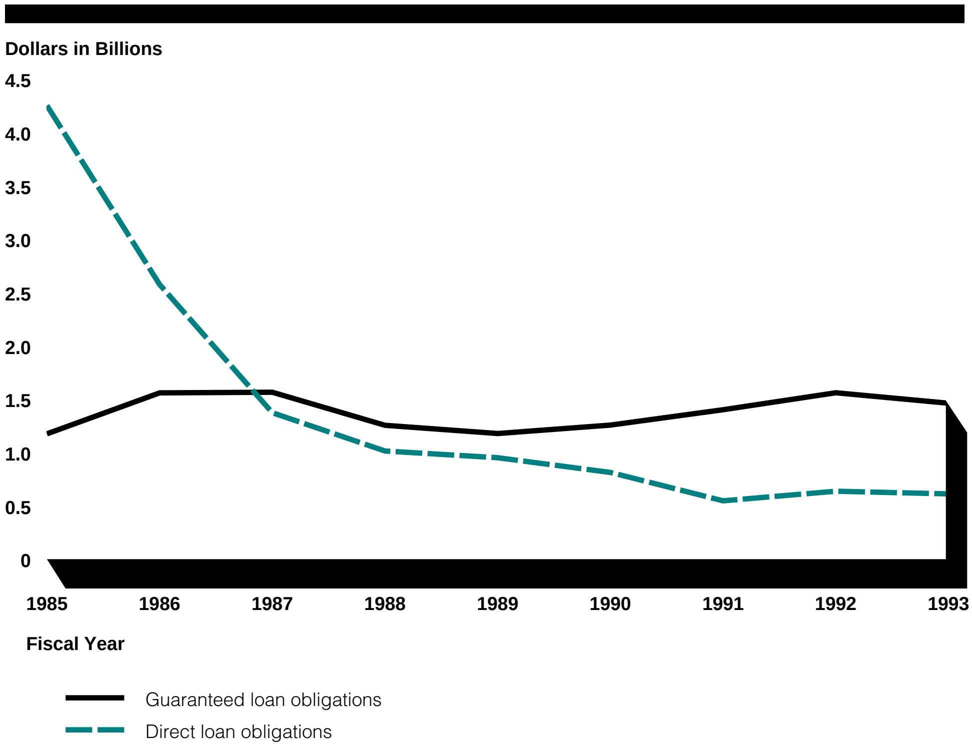
FmHA also makes other types of direct farm loans not evaluated in this report, such as emergency disaster loans that are made to farmers whose operations have been substantially damaged by adverse weather or by other natural disasters. These loans are intended to assist farmers in covering actual losses incurred so that they can return to normal farming operations.

Emphasis Has Been Changing to Guaranteed Loans

In the 1980s, FmHA began using more guaranteed loans and fewer direct loans in order to encourage farm lending by commercial lenders, reduce budget outlays on direct loans, and devote more effort to servicing its growing number of direct loans and increasingly delinquent direct accounts. Under the Food Security Act of 1985 (P.L. 99-198, Dec. 23, 1985)—referred to as the 1985 Farm Bill—and again in the Omnibus Budget Reconciliation Act of 1990 (P.L. 101-508, Nov. 5, 1990), the Congress supported this shift in emphasis by decreasing authorizations for direct loans and increasing authorizations for guaranteed loans. In each year since fiscal year 1987, FmHA's new guaranteed loans have exceeded new direct loans. (See fig. 1.1.)

[2]Chattel property, as opposed to real estate, is personal property used in farming operations for the production of income, including such property as trucks, tractors, and other major equipment.

Figure 1.1: FmHA's Guaranteed and Direct Farm Loan Obligations, Fiscal Years 1985-93



Source: FmHA.

However, the Agricultural Credit Improvement Act of 1992 (P.L. 102-554, Oct. 28, 1992) could change some of this emphasis back to direct loans. Under the act, FmHA must transfer 75 percent of its unobligated guaranteed operating loan authority at the end of the third quarter of a fiscal year to a new agency program that uses direct ownership loans to fund beginning farmers. In fiscal year 1993, FmHA transferred about $650 million under this authority but obligated very little of these transferred funds.

Profile of Borrowers Who Obtained Guaranteed Farm Loans During Fiscal Year 1992

During fiscal year 1992, FmHA guaranteed almost $1.6 billion on slightly less than 14,000 farm ownership and operating loans. On the basis of our random sample of these loans,[3] we estimate that 91 percent of the loans went to borrowers who already had farm loans (whether commercial or FmHA credit) when they obtained an FmHA guaranteed loan and that 9 percent went to first-time farm loan borrowers. In addition, as shown in table 1.2, about 68 percent of the loans went to borrowers who had more than 10 years' farm experience, 64 percent went to feed grain producers, 69 percent went to borrowers who had sales of between $100,000 and $500,000 annually, and the loans were made to borrowers whose farms averaged over 800 acres.

[3]This report presents loan estimates on the number of recipients of guaranteed loans and the use of such loans on the basis of sampling. Appendix I discusses our sampling procedures in detail and provides the sampling errors for our estimates.

Table 1.2: Borrowers' Characteristics for Guaranteed Loans Made During Fiscal Year 1992

Years of farming/ranch experience	Percent
Over 10 years	67.9
5-10 years	18.1
Less than 5 years	14.0
Total	**100.0**
Type of operation	**Percent**
Feed grains (e.g., corn and grain sorghum)	63.5
Meat animals	47.1
Oil-bearing crops (e.g., soybeans)	33.8
Wheat	33.1
Cotton	15.8
Dairy products	12.4
Vegetables, melons, fruits, and/or tree nuts	9.1
Rice	7.0
Poultry and/or eggs	6.1
Other crops	15.2
Total	**100.0**[a]
Farm sales	**Percent**
Less than $40,000	4.5
$40,000 to $99,999	20.8
$100,000 to $249,999	46.2
$250,000 to $499,999	22.7
$500,000 and more	5.8
Total	**100.0**
Size of operation	**Amount**
Acres (average)	828
Minimum (from sample)	2
Maximum (from sample)	13,618
Average number of livestock for those who had livestock	399

Note: The information in this table is based on the estimated percentage of loans that were made to borrowers in fiscal year 1992.

[a]Amount totals more than 100 percent because respondents placed borrowers in more than one category.

Source: GAO estimate based on a sample of FmHA's guaranteed loans.

Furthermore, we estimate that about 54 percent of the loan funds were used for paying operating expenses, various purchases, or other expenses. Another 6 percent was used for farm real estate purchases, as shown in table 1.3, and the remaining 40 percent was used for refinancing existing debt. Also, commercial banks provided the majority of the loans.

Table 1.3: Planned Use of Funds and Source for Guaranteed Loans Made During Fiscal Year 1992

Planned use of loan funds	Percent of loan funds
Refinance existing debt	39.5
Pay farm operating expenses	38.4
Purchase livestock, machinery, or equipment	7.5
Purchase farm dwelling or farmland	5.6
Capital and real estate improvements	6.3
Family living expenses	1.6
Other	1.0
Total	**100.0**[a]
Source of loans	**Percent of loans**
Commercial banks	83.4
Farm Credit System	14.7
Other commercial lenders[b]	1.9
Total	**100.0**

[a]Amount does not total 100 percent because of rounding.

[b]Includes mortgage corporations, credit unions, and life insurance companies.

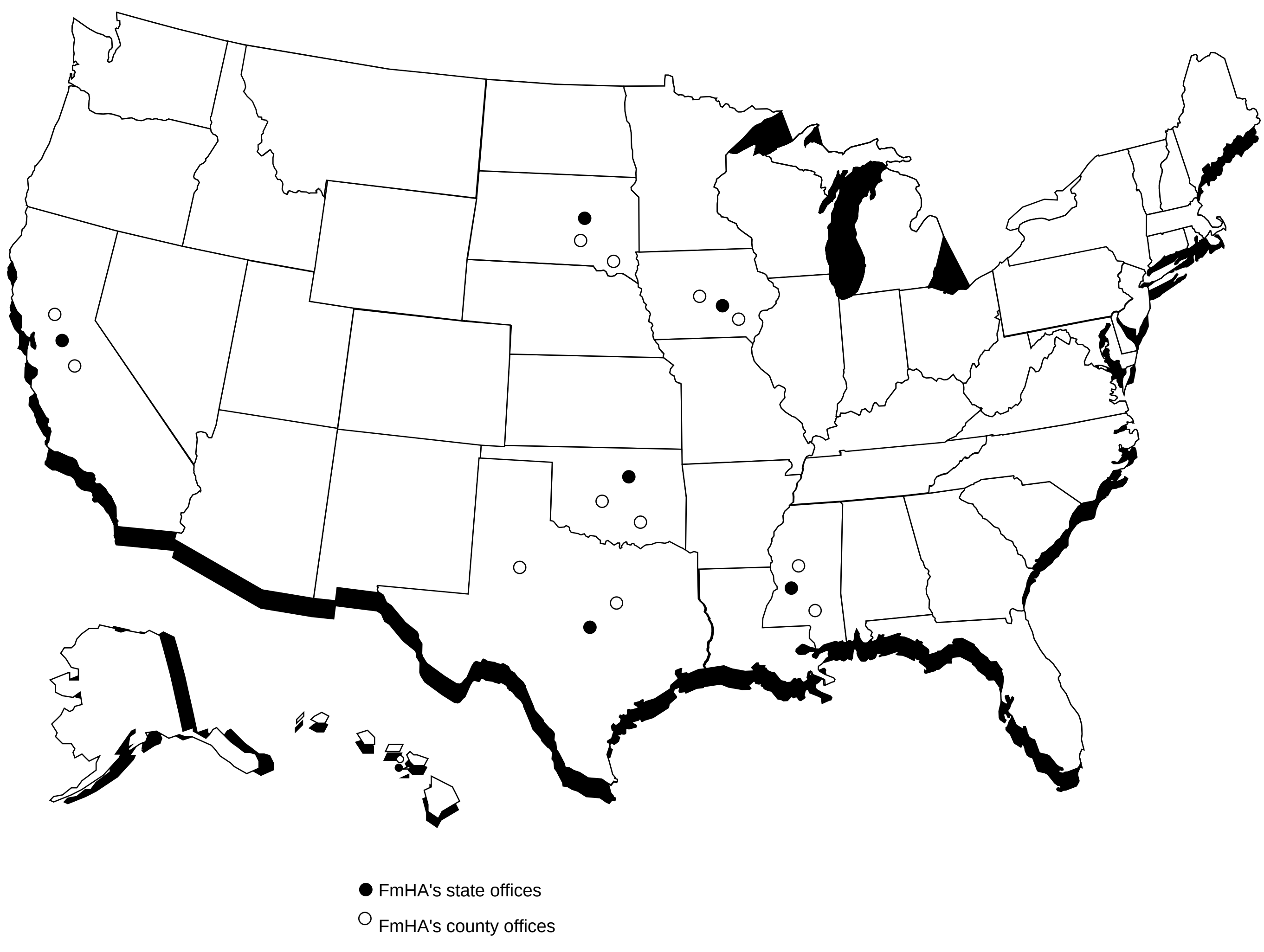
Source: GAO estimate based on a sample of FmHA's guaranteed loans.

Objectives, Scope, and Methodology

Our work was part of a special GAO governmentwide audit effort to help ensure that areas potentially vulnerable to fraud, waste, mismanagement, and abuse are identified and that appropriate corrective actions are taken. Concerned about FmHA's high losses in its direct loan program and the potential for similar losses in its guaranteed loan program, we reviewed the guaranteed loan program to determine (1) the extent of losses under the guaranteed farm loan program compared with those under the direct loan program, (2) the extent to which the guaranteed farm loan program has graduated FmHA's direct loan borrowers to commercial credit, and (3) ways to make the guaranteed farm loan program more of a source for funding direct loan borrowers.

In addressing these objectives, we conducted work at 6 FmHA state offices, 12 FmHA county offices, FmHA's St. Louis Finance Office, and FmHA headquarters. Figure 1.2 shows the location of the state and county offices that we reviewed.

Figure 1.2: FmHA's Field Offices Reviewed by GAO



Additionally, we reviewed and analyzed our reports issued since the 1985 Farm Bill was passed,[4] reports issued by USDA's Office of Inspector General since fiscal year 1988, the results of FmHA's internal control reviews, and the annual reports from the Secretary of Agriculture to the President required by the Federal Managers' Financial Integrity Act of 1982 (P.L. 97-255, Sept. 8, 1982). Appendix I provides more detail on our scope and methodology.

To obtain information on the characteristics of FmHA's guaranteed loan borrowers and the planned use of loan funds, we sent two questionnaires—one on farm ownership loans and another on farm operating loans—to county office officials requesting information about a randomly selected sample of loans that were made to borrowers who obtained loans in fiscal year 1992. Appendix II discusses our survey methodology and contains our estimates and sampling errors. Appendixes III and IV contain copies of the questionnaires used. Additionally, to evaluate the quality of the guaranteed loan portfolio, we sent another questionnaire to county office officials requesting information about the payment record of a randomly selected sample of borrowers who had outstanding loans as of June 30, 1993. Appendix V discusses our survey methodology for this aspect of our work and contains our estimates and sampling errors, and appendix VI contains a copy of the questionnaire.

To determine whether the guaranteed loan program is a viable funding source for more of FmHA's direct loan borrowers, we conducted a structured interview with 53 commercial lenders in eight states—34 of these lenders had outstanding guaranteed loans, and 19 did not. Also, we interviewed representatives of the American Bankers Association and the Independent Bankers Association of America.

We started our work in February 1993 and used September 30, 1993, as a cut-off date for most of the financial information about FmHA's farm loan portfolio. This date allowed us to have relatively recent and comparable data on the financial status of FmHA's direct and guaranteed farm loan portfolios. In addition, we conducted detailed field work through October 1993, updating selected information through July 1994. We performed our work in accordance with generally accepted government auditing standards. FmHA's written comments on the results of our work appear in appendix VIII.

[4]These reports include Farmers Home Administration: Billions of Dollars in Farm Loans Are at Risk (GAO/RCED-92-86, Apr. 3, 1992); Farmers Home Administration: Use of Loan Funds by Farmer Program Borrowers (GAO/RCED-90-95BR, Feb. 8, 1990); and Farmers Home Administration: Implications of the Shift From Direct to Guaranteed Farm Loans (GAO/RCED-89-86, Sept. 11, 1989).

Guaranteed Loans Have Resulted in Less Losses Than Direct Loans, but FmHA's Actions Increase Potential for Loss

FmHA's guaranteed loan program has been more successful than the direct loan program from a financial standpoint. From 1976 through 1993, FmHA guaranteed $12 billion of lenders' loans and made $55.6 billion in direct loans. Overall losses—actual losses through 1993 plus estimates of future losses—on FmHA's guaranteed loans are expected to be about 9 percent compared with direct loan losses of about 40 percent. A key reason for the differences in losses is that guaranteed loan borrowers are lower credit risks than direct loan borrowers are; that is, to obtain a direct loan, a borrower must show that a commercial lender would not make the loan at reasonable interest rates. Another contributing factor is that a greater proportion of the direct loans was made just prior to the farm financial crisis in the mid-1980s, when farm lenders experienced higher-than-normal loss rates.

Although more successful than the direct loan program, the guaranteed loan program is experiencing programmatic problems that contribute to increased financial risk to the government. Specifically, FmHA allows guaranteed or direct loan borrowers who have defaulted on previous loans to obtain new guaranteed loans. Also, FmHA's internal control reviews have reported that field office officials have not always followed the agency's standards for servicing guaranteed loans.

The Guaranteed Loan Program Is Not as Financially Stressed as the Direct Loan Program

Borrowers who receive FmHA's guaranteed loans are more creditworthy than FmHA's direct loan borrowers. As a result, FmHA has experienced and estimates it will experience lower losses from guaranteed loans. Also, as of September 30, 1993, about 5 percent of the outstanding guaranteed loan debt was held by delinquent borrowers compared with about 38 percent that was held by direct loan borrowers.

Actual and Potential Losses From Guaranteed Loans Are Less Than Those From Direct Loans

FmHA's actual and estimated losses from guaranteed loans are substantially less than those from its direct loans. From 1976 through 1993, FmHA guaranteed about $12 billion in lenders' loans—almost 135,000 farm loans to approximately 86,000 borrowers—and expects to incur losses of about $1.1 billion, or 9.2 percent. These losses are much lower than those expected for the direct loan program, which total about $22.3 billion on $56 billion of loans for the same period, or about 40 percent. (See table 2.1.)

Table 2.1: Comparison of FmHA's Actual and Estimated Loan Losses for Direct and Guaranteed Loans

Dollars in billions

FmHA's loans and losses	Direct loans that FmHA made	Loans that FmHA guaranteed
Total loans, 1976-93	$55.6	$12.0[a]
Total losses, 1976-93[b]	14.8[c]	0.6
FmHA's estimate of future losses (allowance for losses)	7.5	0.5
Total actual and estimated losses	$22.3	$1.1
Percentage of actual and estimated losses	40.1	9.2

Note: All dollars are nominal.

[a]Adjusted to reflect FmHA's risk, which is based on $13.5 billion in guaranteed loans made over the fiscal year 1976-93 period and an estimated average guarantee of about 89 percent.

[b]Although we attempted to compare the performance of the two loan programs by the year of loan origination, we could not do so because FmHA does not retain the information needed for direct loans.

[c]FmHA reported $16.2 billion in actual direct loan losses over the fiscal year 1976-93 period. However, because some of these losses relate to loans made prior to fiscal year 1976, we adjusted the losses and report here an estimate of the losses that relate to loans made during and after fiscal year 1976.

Source: GAO's analysis of FmHA's data.

Guaranteed loan losses would be expected to be less because guaranteed loan borrowers are less of a credit risk than direct loan borrowers are. Another contributing factor to the lower guaranteed loan losses is that a greater proportion of the direct loans was made in the late 1970s and early 1980s, just prior to the start of a period when farm lenders, overall, experienced higher-than-normal losses. Prior to 1987, the majority of FmHA's farm loans were direct loans. However, beginning with 1987 and through 1993, the majority of FmHA's farm loans were guaranteed loans.

Guaranteed Loan Portfolio Is Not as Vulnerable to Future Losses as the Direct Loan Portfolio

Consistent with FmHA's estimate of future losses, two other measures of future performance each indicate that the outstanding guaranteed loans are less vulnerable to future losses than direct loans. These indicators consist of our assessment of the outstanding guaranteed loans and recent delinquencies.

According to our estimates, 13.4 percent of the 1993 guaranteed loan portfolio is at risk: 7.5 percent is held by delinquent borrowers, and 5.9 percent is held by borrowers whose loans have been rescheduled to keep their accounts current. (See table 2.2.)[1] In comparison, as shown in our prior report, we estimated that 70 percent of the direct loans that were outstanding in 1990 were similarly at risk.[2]

Table 2.2: Estimated Number of Borrowers and Amount of Outstanding Debt That Was and Was Not Current on Guaranteed Loan Payments, as of June 30, 1993

Dollars in billions

	Estimated borrowers		Estimated outstanding debt	
Loan category	**Number**	**Percent**	**Amount**	**Percent**
Original loans				
Paid current	22,747	64.6	$3.0	64.5
First payment not due	4,257	12.1	0.8	16.4
Subtotal	27,003[a]	76.7	3.7[a]	80.9
Rescheduled loans[b]				
To be kept current	2,505	7.1	0.3	5.9
Other reasons[c]	1,665	4.7	0.3	5.6
Subtotal	4,170	11.8	0.5[a]	11.5
Loans not paid current				
Original	1,764	5.0	0.3	6.4
Rescheduled	355	1.0	0.1	1.2
Subtotal	2,119	6.0	0.3[a]	7.5[a]
Total	**35,210[d]**	**100.0[d]**	**$4.6[a]**	**100.0[a]**

Note: We obtained the figures for the total number of borrowers (35,210) and the total outstanding debt ($4.6 billion) from the records of FmHA's Finance Office and used these figures as a basis for sampling and calculating a resulting estimate.

[a]Items do not add to total because of rounding.

[b]Loans that were paid current or the first payment was not due.

[c]Includes loans that were rescheduled to obtain a lower interest rate or to consolidate debt.

[d]Items do not add to total because an estimated 5.4 percent of the borrowers who had paid off their loans were included in FmHA's database. (See app. V.)

Source: GAO estimate based on a sample of FmHA's borrowers.

Another indicator of the extent that guaranteed loans are less risky than direct loans is the difference in delinquencies. FmHA reports show that as of

[1]The data on the outstanding debt presented in this part of the chapter are based on our estimates from a dollar-unit sample of loans to 1,000 borrowers. Appendix V discusses our sampling procedures in detail and provides the sampling errors for our estimates.

[2]In Farmers Home Administration: Billions of Dollars in Farm Loans Are at Risk (GAO/RCED-92-86, Apr. 3, 1992), we estimated that about 40 percent of the 1990 direct loan debt was held by delinquent borrowers and another 30 percent was held by borrowers whose loans had been rescheduled (sampling errors of 5.4 percent and 4.0 percent, respectively).

September 30, 1993, delinquent borrowers held 4.8 percent of the outstanding guaranteed loan debt compared with 37.6 percent of the direct loan debt.

Current Lending Policies and Practices Expose FmHA to Increased Financial Risk

Despite the fact that the guaranteed farm loan program is in better financial condition than the direct loan program, FmHA has hundreds of millions of dollars in guaranteed loans that are at risk, in part, because some of its policies and practices do not protect the government's interest. Specifically, FmHA does not prohibit borrowers with poor repayment histories from obtaining new loans. Furthermore, FmHA's field office officials have not always properly implemented loan-servicing standards, which are designed to protect the federal government's financial interest.

Guaranteed Loan-Making Policies Add to FmHA's Risk

FmHA's loan-making policies do not prohibit borrowers who defaulted on a guaranteed or direct loan from obtaining new guaranteed loans. As we reported in February 1994,[3] 408 borrowers who received new guaranteed loans totaling almost $60 million during fiscal years 1991-93 had cost FmHA $67 million in losses on their previous loans. (See table 2.3.)

Table 2.3: Borrowers Who Received New Guaranteed Loans During Fiscal Years 1991-93 After Defaulting on Previous Guaranteed and Direct Loans

Dollars in millions

Action on borrower's previous loan	Number of borrowers	Amount of new guaranteed loans	Amount of FmHA's loss on previous loans[a]
Loss on previous guaranteed loans	36	$6.7	$2.9
Loss on previous direct loans[b]	372	52.9	64.2
Total	**408**	**$59.6**	**$67.1**

[a]These losses resulted from payments to commercial lenders on guaranteed loans or debt relief provided on direct loans.

[b]Covers borrowers whose delinquent debts were restructured with debt write-down or satisfied through a payment that resulted in debt write-off.

Although the loans are relatively new—from 1 to 3-years old—16 borrowers, or about 4 percent of the 408, were delinquent on their new loans as of September 30, 1993. For example, one borrower received a guaranteed loan for $80,000 in 1991 after receiving about $317,000 in direct loan debt relief in 1989; by 1993, this borrower was delinquent on the

[3]Farmers Home Administration: Farm Loans to Delinquent Borrowers (GAO/RCED-94-94FS, Feb. 8, 1994).

guaranteed loan. Similarly, FmHA guaranteed a $400,000 loan in 1991 for a borrower who had defaulted on an earlier guaranteed loan, thereby causing FmHA to pay a loss claim of $254,000; by 1993, this borrower was delinquent on the new guaranteed loan.

In our April 1992 report, we recommended that to strengthen FmHA's loan-making standards, the Congress amend the Con Act to prohibit loan guarantees for borrowers (1) whose defaulting on previous guaranteed loans caused FmHA to pay commercial lenders' loan loss claims and (2) whose defaulting on previous direct loans resulted in debt being written off or written down. The Congress has not implemented these recommendations.

FmHA's Field Offices' Noncompliance With Loan-Servicing Standards Adds to FmHA's Financial Risk

In recent years, FmHA's field offices have improved their compliance with the agency's standards for making guaranteed loans but, through fiscal year 1993, had not improved in complying with the standards for servicing such loans. FmHA requires its field offices to follow specific credit standards in approving guaranteed loans. These standards include determining an applicant's eligibility and repayment ability and the adequacy of collateral. FmHA also requires its field offices to follow specific loan-servicing standards in overseeing the lender's servicing of loans. This servicing includes (1) inspecting collateral to ensure that the borrower possesses and is maintaining security property, (2) providing the same servicing for FmHA guaranteed loans as for other loans, and (3) ensuring that loan funds are used properly.

To evaluate the extent that FmHA's field offices comply with the agency's policies, procedures, and standards, FmHA established the Coordinated Assessment Review (CAR) as a part of its internal control review. The CAR consists of examining a random sample of direct and guaranteed loans each year in selected states. Generally, loans made in about 15 states are sampled and reviewed each year so that each state is reviewed every 3 years. FmHA's target for an acceptable compliance rate is 85 percent—or no more than a 15-percent noncompliance rate.

According to the CARs, FmHA's field offices improved their oversight of lenders' guaranteed loan-making process. Since our April 1992 report, recent CARs have shown that the field offices had less than a 15-percent noncompliance rate for all standards that put the government at risk.

Conversely, through fiscal year 1993, the CARs showed that FmHA's field offices had not improved their oversight of lenders' servicing. In our April 1992 report, for example, we reported that in 25 percent of the cases reviewed, field office officials had not, as required, effectively monitored lenders' compliance with standards for inspecting collateral and for ensuring the proper use of loan funds. The CARs for fiscal year 1993 showed that the field offices continue to have a high rate of noncompliance in several areas. Of the 15 loan-servicing standards, the field offices exceeded a noncompliance rate of 15 percent for 12 of the standards. For example, the following three cases relate to potential loss claims and demonstrate the noncompliance areas found:

- There was a 36.8-percent noncompliance rate for the standard that FmHA officials concur with the lender that a delinquency was beyond a borrower's control before allowing the lender to reschedule or reamortize a loan. The failure to follow this standard can lead to the increased risk of paying higher loss claims because of accrued interest and deteriorated collateral.
- There was a 36.2-percent noncompliance rate for the standard that FmHA officials review lenders' loan files within 90 days of closing a loan. Not following this standard can lead to the increased risk of paying higher loss claims because of errors in the value of collateral and the position of the lien.
- There was a 21-percent noncompliance rate for the standard that FmHA officials approve cash flow values prior to advances for the 2nd and 3rd years on line-of-credit operating loans. Such deficiencies can lead to the increased risk of paying higher loss claims because of credit advances to borrowers (1) whose operations had changed to the point where the advances were not in accordance with the terms of the loan or (2) whose financial conditions had deteriorated to the point where repayment would be questionable.

In our April 1992 report, we recommended that FmHA develop and implement a system that ensures that its field office officials adhere to its standards for making and servicing guaranteed loans. In response, FmHA informed us about various actions it had developed for ensuring compliance, such as monitoring through its internal reviews and using the results of reviews to evaluate lending officials' performance. However, as discussed above, while FmHA's compliance with loan-making standards has improved, compliance with loan-servicing standards, through fiscal year 1993, had not.

Conclusions

Although the guaranteed loan program has incurred much less losses than the direct loan program, some of FmHA's lending policies and practices continue to place the government at a higher-than-necessary financial risk. These risks exist because (1) certain loan-making policies allow FmHA to guarantee loans whose potential for loss is high and (2) FmHA's field office officials have not always followed the agency's credit standards for servicing guaranteed loans. This risk could be reduced if, for example, the Congress implemented recommendations that we made in our April 1992 report.

Agency Comments and Our Evaluation

In commenting on a draft of this report (see app. VIII), FmHA agreed that a borrower's past record of debt repayment often reflects a willingness to repay debt. However, FmHA stated that our statistics do not support the position that losses caused by events beyond the control of borrowers should prevent them from receiving additional credit. FmHA also stated that there is no correlation between past failures and a probability of future losses. We share FmHA's concerns and recognize that there are cases in which borrowers may default for reasons that are beyond their control. Nonetheless, we are concerned that past failures are a strong indicator of not only the willingness but the priority of debt repayment by borrowers—i.e., the forgiveness of debt followed by the making of additional loans sends a signal (1) that could encourage borrowers to default and (2) that there will be little if any impact on obtaining additional loans.

As a beginning of a renewed emphasis on monitoring lenders, FmHA cited several actions that it has initiated and planned. FmHA added that its emphasis has resulted in improved monitoring, as evidenced by a significant improvement in the rate of compliance with the three key standards for servicing guaranteed loans discussed in this chapter. We are encouraged by the results of FmHA's fiscal year 1994 CAR reviews, which were not complete at the time of our review, and hope that the pattern of compliance with the servicing standards continues to follow the path of compliance with the agency's loan-making standards.

Furthermore, FmHA stated that its loss rate on guaranteed loans, which it calculated by comparing the total amount of losses incurred with the total amount of loans made over the life of the program, is 4 percent. We disagree with FmHA's methodology for making this calculation because it fails to take into account the losses estimated on outstanding loans. A more accurate presentation is to compare total loans made with the total of losses already incurred and those estimated to occur on loans that are outstanding. As shown in table 2.1, this results in a 9.2-percent loss rate.

Guaranteed Loans Have Not Been Systematically Used as an Interim Step to Graduate Direct Loan Borrowers to Commercial Credit

Few direct loan borrowers have moved to guaranteed loans as a step toward graduating to commercial—nongovernment supported—credit. A contributing factor has been the lack of an FmHA policy that would encourage the use of the guaranteed loan program as an interim step in graduating direct loan borrowers to commercial credit. At the direction of the Congress, FmHA initiated action in late 1993 to include moving to guaranteed loans as an interim step in the graduation process. Furthermore, FmHA field office staff often fail to follow through on the required processes for identifying direct loan borrowers with the potential for graduation and graduating those who have shown sufficient financial progress to qualify for commercial credit. As a result, some borrowers may remain in the direct loan program longer than justified, taking advantage of the agency's subsidized interest rates and long repayment terms. Although FmHA officials and commercial lenders believe that few direct loan borrowers can meet the requirements for a guaranteed loan, FmHA does not know how many can qualify.

FmHA Has Not Routinely Used the Guaranteed Loan Program to Help Viable Direct Loan Borrowers Progress to Commercial Credit

A logical step in graduating borrowers from direct loans to commercial credit would be to promptly replace their direct loans with guaranteed loans when a borrower qualifies. However, most direct loan borrowers are not getting guaranteed loans. Furthermore, FmHA has not had a policy to use the guaranteed loan program as a means of encouraging direct loan borrowers to graduate to commercial credit.

Few Direct Loan Borrowers Obtain Guaranteed Loans

According to FmHA's data on borrowers who have outstanding loans and who receive new loan obligations, most direct loan borrowers do not obtain guaranteed loans. As table 3.1 shows, only about 7,300 FmHA direct loan borrowers, or 4 percent of the total number during fiscal years 1991-93, obtained guaranteed loans. These borrowers held direct loans for varying lengths of time—some for more than 20 years.

Table 3.1: Direct Loan Borrowers Who Obtained Guaranteed Loans During Fiscal Years 1991-93

Fiscal year	Borrowers in direct loan portfolio	Borrowers who obtained guaranteed loans	Percentage of direct loan borrowers who got guaranteed loans
1991	169,782	7,049	4.2
1992	154,505	4,240	2.7
1993	140,297	1,892	1.3
Total[a]	**181,156**	**7,323**	**4.0**

[a]The total shows the number of discrete borrowers over this period —i.e., if a borrower was in the portfolio for more than 1 year, the person is counted once in the total.

Source: GAO's analysis of the records at FmHA's St. Louis Finance Office.

FmHA Is Developing a Policy to Use Guaranteed Loans as a Transition From Direct Government Assistance

FmHA has not historically used the guaranteed loan program as a stepping stone in helping direct loan borrowers progress to commercial credit. According to its own policies, FmHA, as a temporary source of credit, should graduate a borrower from direct loans to commercial credit at the earliest possible time. Because qualifying for commercial credit without a government guarantee is more stringent than qualifying with a guarantee, moving from a direct loan to a guaranteed loan is a logical progression for borrowers whose financial condition has improved but not sufficiently to qualify for commercial credit.

FmHA has not used the guaranteed program in this way because its criteria for graduation from direct loans to commercial credit have not included any interim steps. FmHA considers a direct loan borrower to graduate from government support when that borrower (1) pays in full, before the expiration of the loan, all farm program loans or all of one type of farm program loan by refinancing with other credit sources and (2) continues farming. FmHA does not consider graduation to cover a borrower who pays off the debt under normal terms, and the agency specifically excludes borrowers who move from direct to guaranteed loans.

However, FmHA recently initiated action to include moving to guaranteed loans as an interim step in the graduation process. In December 1993, 14 months after enactment of the Agricultural Credit Improvement Act of 1992, which required such action, FmHA published a proposed regulation in the Federal Register to incorporate the use of guaranteed loans as an interim step in graduating direct loan borrowers to commercial credit without a guarantee. In late October 1994, FmHA officials told us that the agency anticipates publishing the revised regulations to graduate direct loan borrowers to guaranteed loans in November 1994.

FmHA Has Not Effectively Administered Its Established Processes for Graduating Direct Loan Borrowers

FmHA requires that its field offices annually review direct loan borrowers for graduation to commercial credit. However, the field office lending officials often do not adhere to the process. As a result, some borrowers with graduation potential are not identified as likely candidates, and other borrowers who are identified are not made to graduate. In addition, its classification of borrowers according to their repayment ability is not reliable. Thus, FmHA does not know how many direct loan borrowers qualify for guaranteed loans. Nonetheless, FmHA officials and commercial lenders believe that few FmHA direct loan borrowers can meet the requirements for a guaranteed loan.

FmHA's Field Office Officials Often Do Not Comply With Requirements to Identify and Graduate Qualified Direct Loan Borrowers

FmHA's primary tool for identifying and graduating qualified direct loan borrowers is its annual graduation review process. This process is intended to target borrowers who have displayed sufficient financial progress to graduate from the direct loan program to commercial credit. Annually, FmHA's St. Louis Finance Office provides each county office with a list of borrowers who have had outstanding loans for 3 years or more. County office officials initially review and remove borrowers from the list who are clearly unable to graduate by using available knowledge of local lenders' criteria or other information that the officials may have on borrowers' financial status. County office officials may also add to the list borrowers whose financial condition has substantially improved since obtaining their loans. Borrowers who are not initially removed or who are added to the list are considered potential candidates for graduation. County office officials are to thoroughly evaluate these borrowers' financial position by considering their financial strengths, income capabilities, and other characteristics that relate to meeting local lenders' criteria. For those identified as candidates for commercial credit through this process, FmHA requires that they be requested to graduate or to provide information documenting why they cannot graduate.

However, FmHA's field office officials do not always conduct the reviews to identify which borrowers are potential candidates for graduation. Almost 200 borrowers, or about 17 percent, of the approximately 1,160 borrowers who FmHA should have reviewed for graduation potential during fiscal years 1991 and 1992 at the 12 county offices we visited were not reviewed. County office supervisors said they did not review the borrowers because they believed other pressing work was more important, such as servicing delinquent borrowers. In addition, another 310 borrowers, or about 27 percent, at these 12 offices were removed from consideration without any reasons annotated in the county offices' records for their removal. County office supervisors could not explain why the borrowers were removed from consideration.

Of 115 direct loan borrowers identified for graduation to commercial credit at these county offices, the FmHA supervisors did not take the additional steps required to graduate 54 borrowers or to conclude that they could not graduate. For 32 borrowers, the county office supervisors said they did not try to graduate them because they believed the borrowers could not meet local lenders' credit standards. For the remaining 22 borrowers, the county office loan files showed that the borrowers had not responded to the county offices' request to graduate and that the county office supervisors had not taken any further action. If a borrower fails to respond, the county office supervisor may consider the borrower to be in default as provided for in the loan agreement. A county office supervisor may then initiate action to accelerate repayment of the loan or legal action to foreclose on the loan. In taking such actions, the county office supervisor must obtain the concurrence of the FmHA district and state office officials and, if legal action is involved, USDA's Office of General Counsel. However, some county office supervisors said they did not pursue more forceful action with borrowers who did not provide the requested financial information because they did not believe that higher-level officials would support their efforts.

Our review indicates that some of the borrowers who did not graduate to commercial credit had financial circumstances indicating that they could have moved from the direct loan program if the county office supervisors would have followed through as required. For example, a borrower obtained a $28,000, 40-year soil and water loan in 1987 and paid off $1,300 by June 1993. According to June 1989 financial information in his FmHA loan file, the borrower had a net worth of over $400,000 and liabilities of about $116,000. The borrower did not comply with the county office's request for financial information during the 1991 graduation review. In early 1993, the borrower was again asked to provide updated financial information, but no response had been received as of August 1993. The county office's supervisor acknowledged that FmHA should have taken further action to force this borrower to graduate. Other examples are described in appendix VII.

FmHA's Field Offices Have Not Accurately Classified Borrowers' Repayment Ability

Another tool, which the Congress has directed FmHA to use in identifying direct loan borrowers for graduation, is FmHA's loan classification system. The loan classification system is designed to record FmHA's current judgment of all borrowers' ability to repay their loans. The objectives of the system are to assess the overall quality of FmHA's loan portfolio, estimate loan losses to the government, assess the need for any special loan servicing, and improve the management of the loan program. Classifications are to be assigned when loans are made and updated whenever a borrower's financial condition changes significantly. As shown in table 3.2, borrowers are classified on a 1-to 5-scale, with the highest-quality loans described as "commercial" (category 1) and the lowest quality described as a "loss" (category 5).

Table 3.2: FmHA's Loan Classifications

Classification category	Description	Definition
1	Commercial	Highest-quality loans; borrower has ample security and is viewed as profitable.
2	Standard	Fully acceptable accounts; risks and servicing costs are higher than acceptable to other lenders; and loans are adequately secured.
3	Substandard	Special counseling and servicing required; borrower's repayment ability marginal and payments are sometimes delinquent; and borrower's loan security is adequate but marginal.
4	Doubtful	Inadequate repayment ability; a loss will occur if liquidated; and at least one of the borrower's FmHA loans is undersecured.
5	Loss	Repayment is unlikely; liquidation is imminent; and security for all loans is inadequate.

Source: FmHA instruction 2006-W.

However, in many cases, FmHA's county offices did not assign a correct classification, and in other cases they did not keep the classifications current, as required. As of September 30, 1993, FmHA's records showed that about 27,000, or about 20 percent, of FmHA's approximately 140,000 direct loan borrowers were classified in the two highest loan categories, indicating that they should be candidates for graduation. Of these, 4,856 were classified as commercial, and 22,331 were classified as standard. In reviewing 171 borrowers who were classified as commercial quality borrowers at the 12 county offices we reviewed, county office officials told us that 112 borrowers, or about 66 percent, were improperly classified because they had insufficient income or inadequate loan security to meet minimum commercial credit standards.

County office supervisors explained that many borrowers were simply categorized incorrectly when originally classified. They stated that when the system was implemented in 1988, they had only a limited time to classify all borrowers. In their haste to meet the deadline to classify each borrower, county office supervisors relied on personal knowledge in lieu of supporting financial documents. Moreover, they said that in some cases, they did not update the borrowers' classifications because they do not view the information as useful to them.

In accordance with congressional requirements, FmHA is developing a plan to improve its graduation process. In December 1993, 8 months after the date established in the Agricultural Credit Improvement Act of 1992 for implementing such action, FmHA published a proposal in the Federal Register to improve the graduation process and plans to implement it in November 1994. The principal change in the proposed regulations strengthens the process by identifying potential graduation candidates on the basis of their financial condition as recorded in FmHA's loan classification system. Specifically, borrowers classified in the top two categories—i.e., commercial and standard quality—are to be reviewed each year for graduation. However, FmHA's proposed plan does not contain any new initiative to ensure that FmHA staff accurately assign and update the loan classifications of their borrowers—an overriding weakness in the existing program.

FmHA Officials and Lenders Believe That Few Direct Loan Borrowers Qualify for Guaranteed Loans

FmHA's headquarters and field office officials believe that few direct loan borrowers can meet the credit standards required by commercial lenders to qualify for guaranteed loans. For example, all 6 FmHA state officials and 9 of the 12 county office supervisors we interviewed said that many direct loan borrowers will never be able to qualify for guaranteed loans unless there is a major turnaround in their production and finances, which they believed would not occur. These officials' beliefs are based upon perceptions that some direct loan borrowers either (1) do not have sufficient farm management skills or financial education or (2) have farm operations or financial needs that are too small to be of interest to commercial lenders.

Furthermore, some lenders in the eight states we reviewed[1] also believed that FmHA's guaranteed loan program—as currently designed and operated—is not a viable funding source for some direct loan borrowers. These lenders stated that most direct loan borrowers simply cannot qualify for guaranteed loans. On the other hand, they also told us that it is viable for those individuals who have made progress in overcoming the financial difficulties that led to their becoming direct loan borrowers.

Conclusions

Most direct loan borrowers do not receive guaranteed loans even though obtaining such loans would seem to be a natural progression in improving their creditworthiness and ultimately qualifying them for commercial credit without a guarantee. While FmHA officials and lenders contend that few direct loan borrowers can qualify for a guaranteed loan, FmHA cannot verify this because its county offices have often failed to identify and graduate direct loan borrowers who qualify for commercial credit. As a result, some borrowers remain in the direct loan program and receive government assistance from the program longer than justified.

Congress's required changes to the graduation process, directed in 1992 legislation, have the potential to bring improvement when FmHA implements them—which are planned for November 1994. Requiring that FmHA's guaranteed loan program be routinely used as an interim step for direct loan borrowers in their progression to commercial credit without a guarantee and using the loan classification system as the basis for identifying candidates for graduation can bring improvement. However, given the past failure of FmHA field offices to comply with existing graduation and loan classification requirements, FmHA needs to address county supervisors' views that graduation is not a high priority and their skepticism about whether superiors will support them in graduating borrowers.

Recommendations to the Secretary of Agriculture

To ensure that FmHA effectively implements the congressionally directed plan for using guaranteed loans as an interim step in moving direct loan borrowers to commercial credit without a guarantee, we recommend that the Secretary of Agriculture direct the FmHA Administrator to develop and implement a plan to ensure that county office supervisors

- assign accurate loan classifications to all new direct loan borrowers,

[1]We contacted 53 lenders in eight states—34 lenders with guaranteed loans and 19 with farm loans but with no guaranteed loans—to obtain their comments about the guaranteed program.

- promptly update loan classifications as borrowers' financial conditions change, and
- adequately evaluate each direct loan borrower listed annually for graduation potential to identify and graduate those borrowers who qualify for guaranteed loans or commercial credit.

Agency Comments and Our Evaluation

In commenting on a draft of this report (see app. VIII), FmHA agreed that it has not emphasized the graduation of direct loan borrowers to commercial credit through the use of the guaranteed loan program. FmHA stated that it will soon implement various changes to its loan programs, some of which are designed to assist borrowers in graduating from direct loans. For example, FmHA plans to issue regulations requiring that borrowers' loan classifications be updated at least every 2 years and that borrowers who are classified as commercial or standard grade borrowers be referred to commercial lenders every 2 years. However, FmHA did not provide specifics on how it plans to ensure that county office officials perform the required review of borrowers' loan classifications and their potential for graduation or graduating those borrowers who qualify. In the past, county office officials have not fully complied with FmHA's requirements in these areas.

FmHA questioned our report's analyses of the agency's loan classification system, which indicated that many borrowers were incorrectly classified as commercial grade borrowers—the highest quality level. FmHA stated that the loan classification system was designed to provide a basis for assessing the quality of its loan portfolio by using the agency's rates and terms. FmHA contended that even though a borrower may be accurately classified as a commercial grade borrower, the person still may not qualify for a bank loan when a commercial lender's rates, terms, and security standards are considered. The implication of FmHA's comment is that the agency's definition of commercial grade may be different from an individual bank's definition. However, FmHA's definition of "commercial" clearly indicates that a borrower so classified should be a prime candidate for graduation from a direct loan to a guaranteed loan or to commercial credit. Specifically, FmHA describes commercial grade borrowers as follows:

"These are FmHA's highest quality Farmer Program accounts. The financial condition of the borrowers is strong enough to enable them to absorb the normal adversities of agricultural production and marketing. There is ample security for all loans, there is sufficient cash flow to meet the expenses of the agricultural enterprise and the financial needs of the family, and to service debts. The account is of such quality that commercial lenders would view the loans as a profitable investment." (Underscoring added.)

Therefore, our point remains unchanged—i.e., according to the county supervisors we spoke with, many borrowers (66 percent of the 171 direct loan borrowers reviewed who were classified as commercial) were misclassified using FmHA's own definition and were not candidates for graduation because of problems with cash flow, high debt, or a marginal repayment record.

Lenders' and FmHA's Suggestions for Making the Guaranteed Program a More Viable Funding Source for Direct Loan Borrowers

Commercial lenders[1] and FmHA officials believe that to get lenders to take on a greater portion of FmHA's approximately 140,000 direct loan borrowers as their own clients, changes would be required in (1) direct loan provisions to more effectively encourage borrowers to move from such loans and (2) the guaranteed loan program to make it more attractive to lenders. Moving borrowers from direct loans would reduce FmHA's outstanding direct loan debt and the government's risk exposure that exists with such loans, allow the agency's field staff to more effectively administer the direct loan program, and reinforce the agency's role as a temporary credit source. However, even if the suggested changes are made, many borrowers would still not be able to obtain guaranteed loans because they could not meet commercial lenders' credit standards.

Suggestions Have Been Made to Increase the Use of Guaranteed Loans

Commercial lenders and FmHA field office lending officials that we interviewed suggested changes to FmHA's direct loan program that they believe would cause existing direct loan borrowers to seek commercial credit with a guarantee as soon as they qualify. These suggestions involve

- gradually increasing the interest rate charged on direct loans until it equals the rate charged on commercial loans,
- making direct ownership loans for the purchase of farm land for 10 to 15 years with a balloon payment at the end of the term instead of payments over 40 years, and
- writing off the amount of the outstanding direct loan debt that exceeds the market value of the security property for the loan (collateral).

Regarding gradually increasing the interest rate charged on direct loans, some commercial lenders we interviewed and a 1991 American Bankers Association (ABA) Task Force report[2] said that interest rates on direct loans, which are lower than commercial rates, should be periodically increased. Specifically, eight commercial lenders suggested that the interest rate that FmHA charges should be increased over time so that the rates eventually match commercial rates. Such increases could cause borrowers to start looking elsewhere for financing as the advantage of below-market rates is eliminated. According to 64 percent of the 53 lenders that we interviewed, borrowers do not have an incentive to move

[1]We contacted 34 lenders who had guaranteed loans and 19 who had farm loans without guarantees to obtain their suggestions about ways to increase the use of the guaranteed loan program for funding direct loan borrowers.

[2]Agricultural Credit for the 1990's and Beyond, American Bankers Association's Agricultural Credit Task Force (Feb. 1991).

from direct to guaranteed loans because of the low interest rates on direct loans.

The ABA Task Force recommended that all of FmHA's direct loans have a graduated interest rate clause so that borrowers understand that interest rates will change on specific dates. According to the ABA, because there is no interest rate adjustment mechanism in place for FmHA's direct loans, borrowers are encouraged to remain in the program, particularly when the rates remain low in relation to commercial rates. For example, while interest rates on guaranteed operating loans made in 1992 averaged 9.8 percent, FmHA's direct loans were often made at 7 percent.

On the other hand, implementing a proposal that routinely causes interest rates to increase without considering the borrowers' financial condition could adversely affect some borrowers' abilities to repay their loans on schedule and thus result in defaults.

With respect to the suggestion for shortening FmHA's farm ownership loan terms, which typically run 40 years, some of the commercial lenders we interviewed and the ABA Task Force agreed with the need for shorter terms. The ABA emphasized that having a maturity date preceding the amortization date of the loan would enforce FmHA's purpose of being a temporary lender. Likewise, 10 of the lenders we interviewed told us that longer repayment terms act as a disincentive to get borrowers to move from the direct loan program. As an alternative, one commercial lender suggested that in lieu of making loans with a 40-year repayment, FmHA should make shorter-term loans—e.g., loans with a 15-year maximum term—and require a balloon payment at the end of the term.

On the other hand, implementing a proposal that causes a loan's maturity date to be shortened and that increases payments could result in repayment difficulties for those borrowers who acquire additional farm real estate to expand their operations or who made capital improvements to their existing operations.

Concerning the third suggestion—that FmHA reduce direct loan debt to the value of the loan security[3]—many lenders believe that some FmHA borrowers have outstanding direct loan debt that exceeds the value of their security. Some of the commercial lenders we interviewed told us that they would not make a loan to repay a borrower's outstanding direct loan

[3]The value of the security used as collateral that has depreciated or been devalued to the point where it no longer is worth the amount recorded in the loan agreement.

debt if the loan could not be adequately secured by collateral property. Specifically, most of the 53 lenders we interviewed said that FmHA would need to reduce the debt to at least the value of the security if the borrowers could not pay the debt down to that value. Implementing such a suggestion could provide lenders with a greater incentive to provide credit to direct loan borrowers.

On the other hand, implementing a proposal that causes FmHA to reduce outstanding debt would result in the agency's incurring losses on loans to borrowers who have remained current on their agreed-upon loan payments.

Suggestions Have Been Made to Make the Guaranteed Loan Program More Attractive to Commercial Lenders

Many of the commercial lenders that we interviewed told us about problems they have had in participating in the guaranteed farm loan program and suggested changes. For example, many of the lenders stated that FmHA's paperwork requirements are excessive. Some also said that FmHA has been slow in processing their guaranteed loan applications. Even though the lenders have had problems, many of them are still interested in participating in the guaranteed loan program. They, as well as the FmHA field office officials we interviewed, provided us with suggested changes that they said could increase the willingness of lenders to take on more direct loan borrowers as clients. These suggestions cover both administrative and programmatic aspects of making guaranteed farm loans.

Problems That Lenders Have Had With the Guaranteed Loan Program

Of the 34 lenders with guaranteed farm loans that we interviewed, 28 told us that FmHA's paperwork requirements are excessive. Seventy-five percent of these 28 lenders said it was the most significant problem they have had in participating in the guaranteed program. Another problem area frequently cited by the 34 lenders was that FmHA's field offices have been slow in processing applications. Table 4.1 shows the major problems that lenders identified.

Table 4.1: Comments From 34 Commercial Lenders on Problems They Have Had in Participating in the Guaranteed Farm Loan Program

Problems that lenders cited with the guaranteed farm loan program	Number of lenders[a]	Percentage of lenders
FmHA requires excessive paperwork	28	82.4
FmHA has been slow in processing applications	18	52.9
FmHA's county committees have been slow in deciding on applicants' eligibility	6	17.6
FmHA has been slow in making guaranteed payments when losses occurred	5	14.7

[a]Lenders sometimes stated more than one problem area. Furthermore, in some cases, lenders stated a problem not shown in this table. As a result, the responses do not add to the total number of lenders (34).

Source: GAO's analysis of commercial lenders' comments.

Generally, lenders with guaranteed loans told us that FmHA's paperwork requirements increase a bank's workload and the time spent in processing a loan application. This occurs because FmHA requires more information in a guaranteed loan application than a bank requires in an application for a loan not involving a guarantee.

Administrative Changes That May Make the Guaranteed Loan Program More Viable

The commercial lending officials we interviewed suggested changes to administrative aspects of the guaranteed loan program as a means of increasing their participation. These suggestions include

- reducing the paperwork required for guaranteed loans,
- eliminating the requirement that lenders submit financial and production history data on existing direct loan borrowers who seek guaranteed loans to repay outstanding direct loan debt, and
- allowing lenders to certify borrowers' eligibility to participate in the guaranteed loan program.

As discussed earlier, problems with FmHA's paperwork requirements were cited by lenders as a significant issue affecting their participation in the guaranteed loan program. Among other things, they told us that because FmHA's paperwork requirements differ from those normally used in the banking industry, they had to prepare two sets of loan application documents—one for reviews by their internal credit committee and a second containing the same information but in a different format on FmHA's forms. Also, according to ABA officials, lenders have to submit paperwork in the application package that does not directly relate to the loan, such as a certification that loan funds will not be used for lobbying activities.

According to the lenders, requirements such as these add to their cost of doing business and make them reluctant to participate—particularly, in regard to funding low-valued loans because of their low-profit potential.

In response to previous reports that have criticized FmHA's paperwork requirements and as required by the Agricultural Credit Improvement Act of 1992, on June 24, 1993, FmHA published interim regulations in the Federal Register revising FmHA's loan application paperwork requirements for loans of $50,000 or less and for lenders who participate in FmHA's certified lender program.[4] While these revisions should result in a lessening of the paperwork required for some lenders, many of the lenders that we interviewed did not know that FmHA was attempting to streamline the loan application process.

On the related suggestion that FmHA should stop requiring lenders to obtain and submit financial and production history data for borrowers when applying for guaranteed loans to repay existing direct loan debts, ABA officials and some of the lenders we interviewed questioned the need to submit such data, which the county offices should already have. Also, the lenders said that while FmHA requires 5 years of historical data, some lenders usually consider only the past 3 years in deciding on an application. ABA officials further recommended that if a commercial lender was willing to repay a borrower's outstanding direct loan debt with a guaranteed loan, then FmHA should simply "pass through" the person's outstanding debt to the bank without the need to submit any new or additional paperwork. In such cases, the ABA officials said that there is no need for an entire application package as with a new applicant/borrower. Fifty-eight percent of the 53 lenders we interviewed told us that eliminating this requirement could result in an increase in the use of the guaranteed farm loan program to repay applicants' outstanding direct loan debts.

The third change suggested by lenders was that they, rather than FmHA's county committees, should be allowed to certify applicants' eligibility to receive guaranteed loans. Specifically, county committees, which consist of two members elected by local farmers and one designated by FmHA, decide on the eligibility of applicants to participate in FmHA's farm loan programs. Among other things, two of the lenders who had guaranteed loans said they have encountered personal bias by some county committee members against their loan applicants, and six others said that county

[4]The certified lender program will make it possible for high-volume lenders having a proven record of success with FmHA to be rewarded with reduced application requirements, faster approval time, and reduced cost and paperwork.

committees have been slow in making decisions on guaranteed loan applications. One lender illustrated the situation as follows: The bank makes lending decisions on a daily basis, but it is delayed in making guaranteed loans if the applications do not arrive in time for a county committee meeting or if the committee requests additional information. Nineteen of the 53 lenders we interviewed stated that participation in the guaranteed loan program could increase if lenders were permitted to certify applicants' eligibility.

Suggested Programmatic Changes to the Guaranteed Loan Program

The commercial lenders and the FmHA field office officials we interviewed also cited various changes to the program that could result in increased use of guaranteed loans. These include

- increasing the guarantee percentage above 90 percent when the loan is being used to refinance outstanding direct loan debt,
- removing the guaranteed loan fee for borrowers whose direct loan debts are being refinanced with guaranteed loans, and
- increasing the authority for making subsidized loans under the Interest Assistance Program.

The first proposal applies to increasing the guarantee percentage above 90 percent when the loan is being used to refinance outstanding direct loan debt owed to FmHA. The Con Act currently limits the guarantee to 90 percent for all loan-use purposes. Forty of the 53 lenders we interviewed said that such a change would increase their use of the guaranteed loan program to repay an applicant's outstanding direct loan debt. Twenty-seven of these lenders suggested a 100-percent guarantee, and 12 others suggested a 95-percent guarantee (one did not suggest a specific percentage above 90 percent). Furthermore, one lender said that FmHA's guarantee percentage should be reduced over time, after a borrower demonstrates a record of loan repayment. FmHA has a 100-percent exposure with direct loans. If a 95-percent guarantee was provided on a loan for repaying outstanding direct loan debt, then the government's risk exposure would be reduced by 5 percent. If a 100-percent guarantee was provided on a loan for that purpose, then FmHA would only have the additional risk for any accrued interest and liquidation costs over what those costs would be to the agency.

Another proposed change was for FmHA to remove the guaranteed loan fee for borrowers whose direct loan debts were being refinanced with guaranteed loans. FmHA charges lenders a 1-percent loan origination fee for the federal guarantee, which lenders usually pass on to borrowers. For example, if a loan is for $200,000 and the guarantee is for 90 percent, then the guaranteed amount is $180,000, and the fee is $1,800. Removing this fee when any part of a guaranteed loan is being used to repay direct loan debt could be an added inducement for borrowers to seek guaranteed loans. Five lenders suggested removing the fee on loans involving the repayment of direct loan debt in order to make the guaranteed program more viable. For example, one lender said that the fee adds to a borrower's cost, and another said that borrowers can use the added cost as an excuse for not seeking to move from their direct loans. Although FmHA requires county supervisors to waive this fee when more than half of the guaranteed loan funds are being used for refinancing direct loan debt, two county office supervisors we interviewed said they do not waive the fee on any guaranteed loan.

The third change that some commercial lenders and county supervisors suggested was that FmHA's authority for making subsidized loans under the Interest Assistance Program should be increased. Under this program, which is an interest subsidy program, a lender is reimbursed by FmHA for charging a borrower an interest rate that is less than the lender's regular rate. Some lenders and county supervisors told us that this program has helped some direct loan borrowers obtain guaranteed farm operating loans. However, the agency has not been authorized to use the program for farm ownership loans. Four commercial lenders and five state and county office officials said that if FmHA's interest assist authority was expanded, they believe that some direct loan borrowers could move their outstanding farm ownership debt to guaranteed loans.

Many Borrowers May Have No Alternative to FmHA's Direct Loans

In order for borrowers to obtain commercial loans, they must be able to meet the credit standards of the lenders who make the loans. Because direct loan borrowers may not be able to fully meet standards in areas such as cash flow, security, and equity, lenders may need to lower their standards. However, even if the lenders relaxed their standards, there are, in the opinion of some lenders and banking industry representatives we interviewed, direct loan borrowers who would not be able to obtain commercial credit even with guarantees because of their inability to qualify for such credit. For example, the 30,806 borrowers who were delinquent on $5.2 billion in direct loans, as of September 30, 1993, would not be candidates for commercial credit.

Ten lenders with guaranteed loans told us that the guaranteed program cannot replace the direct loan program for some borrowers. Four lenders without guaranteed loans said that some direct loan borrowers simply are unable to qualify for commercial credit. Furthermore, some lenders, notably those without guaranteed loans, said that (1) they are not looking for risky customers, which FmHA's direct loan borrowers are by definition, or for clients who cannot meet their minimum credit standards and (2) they will not make a loan that is not financially sound. Three lenders, who did not have outstanding FmHA guaranteed loans, specifically said that they perceived borrowers who needed a guaranteed loan to be financially weak and that they would not lower their lending standards in order to fund an applicant with a guaranteed loan.

Likewise, officials from ABA and from the Independent Bankers Association of America said that even if changes are made to FmHA's farm loan programs, the guaranteed program would not be a viable funding source for some direct loan borrowers. For example, ABA officials said that commercial banks would be unwilling to fund some direct loan borrowers because their financial histories reflect a long-term pattern of failing to meet their debt obligations.

Conclusions

To stimulate the movement of borrowers from direct loans, lenders have made a variety of suggestions. If some or all of the proposals are implemented, some existing FmHA direct loan borrowers would likely move to guaranteed loans, which could lessen the agency's risk exposure, reinforce its role as a temporary source of credit, and reduce its workload. The exact number, while unknown, probably would not be a high percentage of FmHA's approximately 140,000 direct loan borrowers because many have marginal production and financial histories. Nonetheless, moving any portion of the outstanding direct loan borrowers to the commercial sector is desirable if the government's risk exposure can be adequately protected. Therefore, deciding whether suggested changes should be made ultimately requires balancing FmHA's risk exposure against the concessions that would have to be made to lenders.

Implementing some of the suggestions in this chapter may not have much impact on FmHA's risk exposure. For example, there would be no cost impact if FmHA stopped requiring lenders to submit financial and production data for guaranteed loans to refinance existing direct loan borrowers' debt owed to FmHA. Also, since FmHA has a 100-percent risk exposure with direct loans, allowing a greater-than-90-percent guarantee for loans to repay outstanding direct loan debt may actually lessen FmHA's risk if the rate was, for example, 95 percent, and may add only slightly to its risk if the rate was 100 percent. To ensure that lenders had some stake in the loan, a guarantee of something less than 100 percent would be needed. However, some proposals, such as reducing outstanding direct loan debt to the value of security would result in immediate losses to FmHA—i.e., forgiveness of some portion of existing debts—although some of the losses may ultimately occur anyway.

We realize that commercial lenders' support for many of these suggestions is influenced largely by their desire to expand their clientele and generate profit. Even so, we believe that the overall implications of the suggestions presented in this chapter are worthy of further discussion and consideration. For example, if FmHA offered to write off the part of borrowers' direct loan debts that exceeded the market value of their loan security property, what impact would that have on the agency's overall losses and on borrowers' receiving commercial credit, with or without a guarantee? Likewise, if the guarantee percentage for loans to pay off existing direct loans was increased above 90 percent, what impact would the lender's lessened exposure have on its incentive to properly service the loan and what would be the implications for other government guaranteed loan programs?

Agency Comments and Our Evaluation

In commenting on a draft of this report (see app. VIII), FmHA agreed that additional changes can be made to the guaranteed loan program to assist in moving direct loan borrowers to commercial credit. FmHA cited various actions it has initiated or plans to take to make the guaranteed loan program more attractive to commercial lenders, such as reducing the paperwork required for a guaranteed loan of less than $50,000 and having county office officials assist lenders in completing a guaranteed loan application. FmHA also said that it will consider the other suggestions in this chapter and that it shares our concern about making the guaranteed program vulnerable to the large losses that have been experienced by the direct loan program.

Objectives, Scope, and Methodology

Our review focused on (1) the extent of losses under the guaranteed farm loan program compared with those under the direct loan program, (2) the extent to which the guaranteed farm loan program has graduated the Farmers Home Administration's (FmHA) direct loan borrowers to commercial credit, and (3) ways to make the guaranteed farm loan program more of a source for funding direct loan borrowers.

To gain an understanding of the legislative requirements for FmHA's farm loan programs, we reviewed laws and legislative histories, including the Con Act and the Agricultural Credit Improvement Act of 1992. To determine FmHA's policies for making guaranteed farm loans and for graduating borrowers to nonsubsidized credit, we reviewed FmHA's regulations, operating instructions, and guidance to field offices; our prior reports and the U.S. Department of Agriculture's Office of Inspector General reports; and FmHA's annual guidance and plans for graduating borrowers to nonsubsidized credit. We also interviewed FmHA officials in the Office of Farmer Programs in Washington, D.C., to determine the status of FmHA's implementation of its graduation regulations and policies. Furthermore, to compile information on the extent to which direct loan borrowers obtain guaranteed loans and how the loan funds are used, we conducted two nationwide mail surveys of randomly selected guaranteed loans that were made in fiscal year 1992. Appendix II discusses our sampling and data analysis methodology, selection criteria, and sampling error. Appendixes III and IV contain copies of the questionnaires we used.

To determine how well the guaranteed farm loan program is working, we assessed and analyzed information from computerized databases in FmHA's St. Louis Finance Office, from the Secretary of Agriculture's annual Federal Managers' Financial Integrity Act reports to the President, and from various FmHA financial reports covering outstanding and delinquent loans and actual and projected losses. Also, to estimate the quality of the guaranteed loan portfolio, we developed another survey instrument that we used to collect information on a randomly selected sample of borrowers who had outstanding guaranteed loans on June 30, 1993. Appendix V discusses our sampling and data analysis methodology, selection criteria, and sampling error. Appendix VI contains a copy of the questionnaire we used.

Additionally, we used our past reports that highlighted financial risks with FmHA's guaranteed farm loan policies and practices. For example, our February 1994 report was used to show that FmHA's loan-making policies do not prohibit borrowers who defaulted on direct or guaranteed loans from obtaining new guaranteed loans. Our April 1992 report was used to show that the financial risk with FmHA's farm loan programs has been previously identified and that, among other things, the agency's field office officials often do not comply with established credit standards. Also, we reviewed the results of FmHA's fiscal year 1992 and 1993 internal control Coordinated Assessment Review process to determine whether noncompliance with guaranteed loan standards continues.

To determine FmHA's actions to identify and graduate direct loan borrowers and whether it uses guaranteed loans as a tool to assist borrowers to graduate, we conducted audit work at FmHA's Office of Farmer Programs in Washington, D.C., 6 of FmHA's state offices, and 12 of FmHA's county offices. Specifically, we judgmentally selected the six states to review on the basis of their having large numbers of guaranteed loans and dollar amounts of guaranteed loans obligated in fiscal year 1992 and for geographic spread; the states were California, Iowa, Mississippi, Oklahoma, South Dakota, and Texas. Using computerized databases from FmHA's St. Louis Finance Office, we judgmentally selected two county offices in each state for detailed audit work. The county offices were selected on the basis of their having direct loan borrowers classified as being commercial quality borrowers and having guaranteed operating and ownership loans outstanding. We interviewed the state director and/or the chief of farmer programs at each state office and the supervisor at each county office to determine their goals for graduating borrowers and their procedures for selecting and graduating borrowers. We also discussed the incentives and disincentives for county officials to promote graduation, for borrowers to seek commercial credit with or without a guarantee, and for lenders to fund direct loan borrowers. At each county office, we analyzed the graduation review process for fiscal years 1991 and 1992 to determine field office officials' adherence to FmHA's procedures and to determine if direct loan borrowers are graduating to commercial credit when they are able. We also reviewed the loan classification process—designed to record FmHA's judgment of a borrower's ability to repay the loan—to determine if it could be a reliable tool for identifying graduation candidates.

Since the involvement of commercial lenders is key to the use of guaranteed loans to fund direct loan borrowers, we conducted structured interviews with 53 commercial lenders in eight states— California, Iowa, Maryland, Mississippi, Oklahoma, Pennsylvania, South Dakota, and Texas. Since most of FmHA's guaranteed loans are made by commercial banks, 48 of the lenders we interviewed were commercial bankers, and the other 5 were Farm Credit System lenders. We selected lenders who were in the vicinity of the FmHA county offices where we conducted our work. To select the commercial banks, we used a database maintained by federal banking regulators to identify those with farm loans and then matched that listing with FmHA's guaranteed loan database to identify those that had and those that did not have FmHA guaranteed loans. We selected the local Farm Credit System lenders to interview at those locations where they, rather than commercial banks, were more heavily involved in guaranteed loans.

Specifically, we interviewed officials from 34 lenders with guaranteed loans to discuss how they use the program and the problems they have had in participating in it. We also interviewed 19 lenders with farm loans who did not have guaranteed loans to determine the reasons why they do not participate in the program. At each of the 53 lending institutions, we discussed various options and alternatives on how to increase their participation in the program and their use of the program to fund direct loan borrowers.

We also interviewed representatives from the American Bankers Association (ABA) and the Independent Bankers Association of America in Washington, D.C., to gain their views on FmHA's guaranteed farm loan program and how to assist FmHA's borrowers in moving from direct loans. Furthermore, we reviewed FmHA and independent reports, such as those of ABA, on the guaranteed loan program and on graduation.

The results of our work at FmHA's field offices and at the commercial lending institutions cannot be projected to the states we reviewed or to the nation overall.

Sampling and Data Analysis Methodology for Guaranteed Loan Surveys

To obtain data on recipients of guaranteed loans and the purposes for the loans, we obtained from FmHA a computerized record of the 13,896 farm operating and ownership loans obligated during fiscal year 1992. Actual total obligations for all guaranteed farm loans during that fiscal year was $1.6 billion. The source for these data was the automated tape that produced the FmHA Status of Loan and Grant Obligations Allotments or Distribution report (FmHA report code 205) as of September 30, 1992. From this universe, we then selected a probability sample of 1,000 guaranteed loans—550 operating loans and 450 ownership loans. We conducted two nationwide mail surveys: one of farm operating loans and a second of farm ownership loans. The survey questionnaires were mailed on May 25, 1993, to FmHA's county office officials responsible for the loans. Appendixes III and IV contain copies of the questionnaires. The response rate to our mailing was 100 percent.

We used the responses to the survey to make estimates for the universe of 13,768 loans (sampling error of 86 loans) whose data, we believe, would have provided useable information had we attempted to survey all loans that FmHA made in fiscal year 1992. In addition, respondents also supplied documentation supporting some of the critical facts in their responses to the survey questionnaire. We used the documents to verify the consistency of certain responses. When there were inconsistencies and data were not available to determine the correct answer, we made telephone calls to the county offices to obtain correct information.

Since we used a probability sample of guaranteed loan obligations to develop our estimates, each estimate has a measurable precision, or sampling error, which may be expressed as a plus/minus figure. A sampling error indicates how closely we can reproduce from a sample the results that we would obtain if we used the same measurement methods to take a complete count of the universe. By adding the sampling error to and subtracting it from the estimate, we can develop upper and lower bounds for each estimate. This is called a confidence interval. Sampling errors and confidence intervals are stated at a certain confidence level—in this case, 95 percent. For example, a confidence interval of 95-percent means that in 95 out of 100 instances, the sampling procedure we used would produce a confidence interval containing the universe value that we are estimating. As shown in table II.1, our estimates have relatively small sampling errors of less than 5 percentage points.

Table II.1: Sampling Errors at the 95-Percent Confidence Level for Estimates of Borrowers' Characteristics and How the Guaranteed Loan Funds Were Used

Description of estimate	Estimate	Sampling error	95-percent confidence interval[a]
Borrowers' credit history			
Already had farm loan	91.3%	1.7%	89.6% to 93.0%
First-time farm loan borrowers	8.7%	1.7%	7.0% to 10.4%
Borrowers' years of experience			
Over 10 years	67.9%	3.1%	64.8% to 71.0%
5-10 years	18.1%	2.6%	15.5% to 20.7%
Less than 5 years	14.0%	2.3%	11.7% to 16.3%
Borrowers' type of farming operation[b]			
Feed grain (e.g., corn & grain sorghum)	63.5%	3.2%	60.3% to 66.8%
Meat animals	47.1%	3.4%	43.8% to 50.5%
Oil-bearing crops	33.8%	3.2%	30.5% to 37.0%
Wheat	33.1%	3.2%	30.0% to 36.4%
Cotton	15.8%	2.5%	13.3% to 18.3%
Dairy products	12.4%	2.1%	10.3% to 14.5%
Vegetables, melons, fruits, and/or tree nuts	9.1%	2.0%	7.1% to 11.1%
Rice	7.0%	1.8%	5.2% to 8.9%
Poultry and/or eggs	6.1%	1.1%	5.0% to 7.2%
Other crops	15.2%	2.4%	12.8% to 17.6%
Borrowers' gross sales			
Less than $40,000	4.5%	1.4%	3.1% to 5.8%
$40,000 to $99,999	20.8%	2.5%	18.2% to 23.3%
$100,000 to $249,999	46.2%	3.4%	42.9% to 49.6%
$250,000 to $499,999	22.7%	2.7%	20.0% to 25.4%
$500,000 or more	5.8%	1.5%	4.4% to 7.3%
Size of borrowers' farming operation			

(continued)

Description of estimate	Estimate	Sampling error	95-percent confidence interval[a]
Average number of acres[c]	828.3	67.5	760.8 to 895.9
Average number of livestock[d]	398.7	55.6	343.1 to 454.2
Borrowers' planned use of funds			
Refinance existing debt	39.5%	3.4%	36.2% to 42.9%
Pay farm-operating expenses	38.4%	3.2%	35.1% to 41.6%
Purchase livestock, machinery, or equipment	7.5%	1.8%	5.7% to 9.3%
Purchase farm dwelling or farmland	5.6%	1.0%	4.6% to 6.7%
Capital and real estate improvements	6.3%	1.1%	5.2% to 7.3%
Family living expenses	1.6%	0.3%	1.3% to 2.0%
Other uses of funds	1.0%	0.3%	0.7% to 1.3%
Borrowers' source of loans			
Commercial bank	83.4%	2.4%	81.0% to 85.8%
Farm Credit System	14.7%	2.3%	12.4% to 17.0%
Other commercial lenders[e]	1.9%	0.8%	1.1% to 2.7%
Borrowers' credit situation[b]			
Existing customers of lenders making the loans	9,898	413	9,485 to 10,311
	71.9%	3.0%	68.9% to 74.9%
Existing direct loan borrowers	4,197	432	3,765 to 4,629
	30.5%	3.1%	27.4% to 33.6%
First-time farm loan borrowers	1,201	237	964 to 1,438
	8.7%	1.7%	7.0% to 10.4%
Other borrowers	1,018	240	778 to 1,258
	7.4%	1.7%	5.6% to 9.1%

(Table notes on next page)

Note: The estimates presented in this table are based on the percentage of loans, except for the loan-use estimate that is based on the percentage of dollars loaned.

[a]The estimates plus or minus the sampling error may not equal the upper and lower limits because of rounding.

[b]Items add to more than 100 percent because of responses in more than one category.

[c]Average based on an estimate of 11,769 loans involving acreage, with a sampling error of 300 loans.

[d]Average based on an estimate of 7,558 loans involving livestock, with a sampling error of 463 loans.

[e]Other commercial lenders include mortgage corporations, credit unions, and life insurance companies.

Guaranteed Farm Operating Loan Survey

United States General Accounting Office

GAO

Survey on Farmers Home Administration (FmHA) Guaranteed Farm Operating Loans

INTRODUCTION

The U.S. General Accounting Office (GAO) is an agency that assists Congress in evaluating federal programs. The purpose of this survey is to identify the use of Farmers Home Administration (FmHA) guaranteed farm operating loans. This questionnaire is being sent to a sample of FmHA county offices, through which a loan guarantee was made.

Your cooperation in completing this questionnaire is vital to our study. The information collected through this survey along with other information will be summarized in our report to the Congress.

Please complete the survey and return it to us within 10 days after receipt. We have provided a postage-paid business reply envelope to facilitate the return of your questionnaire. In the event that the return envelope is misplaced, please send the completed survey to:

U.S. General Accounting Office
Attn: Sy Mitchell
1445 Ross Avenue, Suite 1500
Dallas, TX 75202

If you have any questions, please call Sy Mitchell or Billy Bowles toll free at 1-800-388-3289

SECTION I: LOAN IDENTIFICATION DATA

Please answer all questions in this questionnaire in terms of ***Guaranteed Farm Operating Loans for the specific borrower identified on the borrower label below.***

Note: The information requested can be obtained from FmHA Form 410-1 (Application for FmHA Assistance), FmHA Form 1980-25 (Request for Guarantee), FmHA Form 449-23 (Guaranteed Loan Evaluation), FmHA Form 1940-3 (Request for Obligation of Funds-Guaranteed Loans), or FmHA Form 431-2 (Farm and Home Plan). Other sources of information include the loan note guarantee, running record, correspondence, etc.

SECTION II: INFORMATION ON LENDER

1. Which of the following best describes the classification of this lender? *(Check one.)*

   1. ☐ Element of the Farm Credit System
   2. ☐ Commercial bank
   3. ☐ Other commercial lender (e.g., mortgage corporation, credit union, life insurance company, etc.)
   4. ☐ Other (specify):

   ____

SECTION III: BACKGROUND INFORMATION ON BORROWER

2. Is this borrower classified as a member of a socially disadvantaged group, which the Con Act defines as a group that has been subjected to racial, ethnic, or gender prejudice? *(Check one.)*

   1. ☐ Yes
   2. ☐ No

3. Which of the following best describes the borrower? *(Check all that apply.)*

   1. ☐ A first-time farm loan borrower
   2. ☐ An existing FmHA direct farm loan borrower
   3. ☐ An existing farm loan borrower with the lender
   4. ☐ An existing guaranteed loan borrower with the lender making this loan
   5. ☐ An existing guaranteed loan borrower with a lender other than the one making this guaranteed loan
   6. ☐ Other (specify):

   ____

   ____

4. Did the borrower initially apply for, or express an interest to the county office in applying for a ***direct operating loan*** rather than this guaranteed operating loan? *(Check one.)*

   1. ☐ Yes
   2. ☐ No

5. How long has the borrower been operating through lease or ownership his or her farm? *(Check one.)*

   1. ☐ Less than 5 years
   2. ☐ 5 to 10 years
   3. ☐ Over 10 years

6. Which of the following best describes the primary type of farming the borrower is engaged in?

Farming Operation	Check All That Apply: Yes (1)	No (2)
Crops		
1. ASCS defined feed grains (e.g., corn & grain sorghum)		
2. Wheat		
3. Rice		
4. Cotton		
5. Oil-bearing crops		
6. Vegetables and/or melons		
7. Fruits and/or tree nuts		
8. Other (specify)		
Livestock and Products		
9. Meat animals		
10. Dairy products		
11. Poultry and/or eggs		
12. Other (specify)		

2

7. How large is the borrower's farming operation? If the farming operation is crops, indicate the number of acres. On the other hand, if the farming operation is livestock or poultry, indicate the number of head and/or poultry houses. (Complete for all that apply.)

   Number of acres__________

   Number of head__________

   Number of poultry houses__________

8. What was the borrower's projected level of gross sales of farm products during fiscal year 1992? *(Check one.)*

   1. ☐ Less than $40,000
   2. ☐ $40,000 to $99,999
   3. ☐ $100,000 to $249,999
   4. ☐ $250,000 to $499,999
   5. ☐ $500,000 or more

FmHA Direct Farm Loans

9. Has the borrower defaulted on a previous ***FmHA direct farm loan***? *(Check one.)*

   1. ☐ Yes ——→ ***If yes, continue to questions 10, 11 & 12***
   2. ☐ No ——→ ***If no, skip to question 13***
   3. ☐ Don't know ——→ ***If don't know, skip to question 13***

10. How many FmHA direct farm loans did this borrower default?

    ____

11. What was the month and year of the most recent FmHA direct farm loan default?

    ____

12. Which of the following best describes the status of the ***most recent*** defaulted FmHA direct farm loan?

    1. ☐ Loan was restructured (rescheduled or reamortized) but has not been paid off
    2. ☐ Loan was paid off with debt relief (write down or write off)
    3. ☐ Loan was paid off with no debt relief
    4. ☐ Loan was foreclosed
    5. ☐ Loan was not paid off because of bankruptcy
    6. ☐ Other (specify):

       ____

       ____

FmHA Guaranteed Farm Loans

13. Has the borrower defaulted on a previous ***FmHA guaranteed farm loan***? *(Check one.)*

    1. ☐ Yes ——→ ***If yes, continue to questions 14, 15 & 16***
    2. ☐ No ——→ ***If no, skip to question 17***
    3. ☐ Don't know ——→ ***If don't know, skip to question 17***

14. How many FmHA guaranteed farm loans did this borrower default?

    ____

15. What was the month and year of the most recent FmHA guaranteed farm loan default?

    ____

3

16. Which of the following best describes the status of the *most recent* defaulted FmHA guaranteed farm loan?

1. ☐ Loan was restructured (rescheduled or reamortized) but has not been paid off
2. ☐ Loan was paid off with debt relief (write down)
3. ☐ Loan was paid off with no debt relief
4. ☐ Loan was foreclosed
5. ☐ Loan was not paid off because of bankruptcy
6. ☐ Other (specify):

____

____

17. Did the borrower receive ASCS deficiency program payments during fiscal year 1992? If yes, please specify the amount in the space below. ***Note: Please specify actual payments only. If this information is not in your files, it can be obtained from the local ASCS office.***

1. ☐ Yes

Amount($)______________________

2. ☐ No
3. ☐ Don't know

SECTION IV: LOAN TERMS AND PURPOSE

18. Did this borrower receive a ***loan note*** or a ***line of credit***? *(Check one.)*

1. ☐ Loan note ——→***If yes, continue to question 19***
2. ☐ Line of credit——→***If yes, continue to question 20***

19. What is the term (in years) of the loan note?

____

20. What is the term (in years) of the borrower's line of credit? *(Check one.)*

1. ☐ Not applicable
2. ☐ 1 year
3. ☐ 2 years
4. ☐ 3 years

21. Did the loan involve an interest rate reduction? *(Check one.)*

1. ☐ Yes ——→***If yes, continue to question 22***
2. ☐ No ——→***If no, skip to question 23***

22. What was the reduction percentage? ***Note: Please round to the nearest whole percent.*** *(Check one.)*

1. ☐ 1%
2. ☐ 2%
3. ☐ 3%
4. ☐ 4%

4

23. In the table below, indicate whether or not any of the listed factors were cited as a purpose for the loan by checking the 'yes' or 'no' box. And, for those factors that were cited 'yes', indicate the dollar amount allocated for that specific purpose, as well as the total amount of the loan.

Purpose For Loan	Yes (1)	No (2)	Dollar Amount (3)
1. Farm operating expenses			$
2. Purchase of livestock			$
3. Purchase of machinery and/or equipment			$
4. Refinancing existing debt			$
5. Real estate improvements			$
6. Family living expenses			$
7. Other (specify)			$
8. Other (specify)			$
9. TOTAL AMOUNT OF LOAN			$

24. If this loan was used for refinancing, which of the following best describes the reason for the refinancing? *(Check all that apply.)*

1. ☐ Not applicable ——→ ***skip to question 26***
2. ☐ Consolidation of debt
3. ☐ Change in lender
4. ☐ Better interest rates and terms
5. ☐ Reschedule or reamortize delinquent debt
6. ☐ Other (specify)________________

25. If this loan was used for refinancing, please list the amount(s) that was refinanced by lender.

Farm Credit System($)____________

Commercial bank ($)____________

Other commercial lender (e.g., mortgage corporation, credit union, life insurance company, etc.)($)____________

Trade creditor (e.g., equipment dealer, veterinarian, supplier, etc.)($)____________

Other (specify)____________

($)____________

TOTAL REFINANCING AMOUNT

($)____________

Note: Total refinancing amount should equal the amount listed in question 23, line 4.

5

26. If the loan was used for real estate improvements, please indicate improvement type and dollar amount (e.g., silo construction for $10,000).

Type___________

Amount($)___________

STOP! Please provide copies of all documents used to complete this questionnaire. Attach all copies to the back of this questionnaire.

SECTION V: CONCLUDING INFORMATION

Please provide the following information about the person who completed this questionnaire. This information will assist us if clarification of answers is necessary.

Name/Title/Telephone:

____

____

Reminder! please review your responses to make sure that all appropriate questions have been answered and you have included all requested documents. Thank you for your cooperation and assistance! This concludes the questionnaire.

6

Guaranteed Farm Ownership Loan Survey

United States General Accounting Office

GAO

Survey on Farmers Home Administration (FmHA) Guaranteed Farm Ownership Loans

INTRODUCTION

The U.S. General Accounting Office (GAO) is an agency that assists Congress in evaluating federal programs. The purpose of this survey is to identify the use of Farmers Home Administration (FmHA) guaranteed farm ownership loans. This questionnaire is being sent to a sample of FmHA county offices, through which a loan guarantee was made.

Your cooperation in completing this questionnaire is vital to our study. The information collected through this survey along with other information will be summarized in our report to the Congress.

Please complete the survey and return it to us within 10 days after receipt. We have provided a postage-paid business reply envelope to facilitate the return of your questionnaire. In the event that the return envelope is misplaced, please send the completed survey to:

U.S. General Accounting Office
Attn: Sy Mitchell
1445 Ross Avenue, Suite 1500
Dallas, TX 75202

If you have any questions, please call Sy Mitchell or Billy Bowles toll free at 1-800-388-3289

SECTION I: LOAN IDENTIFICATION DATA

Please answer all questions in this questionnaire in terms of ***Guaranteed Farm Ownership Loans for the specific borrower identified on the borrower label below.***

Note: The information requested can be obtained from FmHA Form 410-1 (Application for FmHA Assistance), FmHA Form 1980-25 (Request for Guarantee), FmHA Form 449-23 (Guaranteed Loan Evaluation), FmHA Form 1940-3 (Request for Obligation of Funds-Guaranteed Loans), or FmHA Form 431-2 (Farm and Home Plan). Other sources of information include the loan note guarantee, running record, correspondence, etc.

SECTION II: INFORMATION ON LENDER

1. Which of the following best describes the classification of this lender? *(Check one.)*

   1. ☐ Element of the Farm Credit System
   2. ☐ Commercial bank
   3. ☐ Other commercial lender (e.g., mortgage corporation, credit union, life insurance company, etc.)
   4. ☐ Other (specify):

   ____

SECTION III: BACKGROUND INFORMATION ON BORROWER

2. Is this borrower classified as a member of a socially disadvantaged group, which the Con Act defines as a group that has been subjected to racial, ethnic, or gender prejudice? *(Check one.)*

   1. ☐ Yes
   2. ☐ No

3. Which of the following best describes the borrower? *(Check all that apply.)*

   1. ☐ A first-time farm loan borrower
   2. ☐ An existing FmHA direct farm loan borrower
   3. ☐ An existing farm loan borrower with the lender
   4. ☐ An existing guaranteed loan borrower with the lender making this loan
   5. ☐ An existing guaranteed loan borrower with a lender other than the one making this guaranteed loan
   6. ☐ Other (specify):

   ____

   ____

4. Did the borrower initially apply for, or express an interest to the county office in applying for a ***direct ownership loan*** rather than this guaranteed ownership loan? *(Check one.)*

   1. ☐ Yes
   2. ☐ No

5. How long has the borrower been operating through lease or ownership his or her farm? *(Check one.)*

   1. ☐ Less than 5 years
   2. ☐ 5 to 10 years
   3. ☐ Over 10 years

6. Which of the following best describes the primary type of farming the borrower is engaged in?

Farming Operation	Check All That Apply: Yes (1)	No (2)
Crops		
1. ASCS defined feed grains (e.g., corn & grain sorghum)		
2. Wheat		
3. Rice		
4. Cotton		
5. Oil-bearing crops		
6. Vegetables and/or melons		
7. Fruits and/or tree nuts		
8. Other (specify)		
Livestock and Products		
9. Meat animals		
10. Dairy products		
11. Poultry and/or eggs		
12. Other (specify)		

2

7. How large is the borrower's farming operation? If the farming operation is crops, indicate the number of acres. On the other hand, if the farming operation is livestock or poultry, indicate the number of head and/or poultry houses. (Complete for all that apply.)

   Number of acres____________________

   Number of head____________________

   Number of poultry houses____________________

8. What was the borrower's projected level of gross sales of farm products during fiscal year 1992? *(Check one.)*

   1. ☐ Less than $40,000
   2. ☐ $40,000 to $99,999
   3. ☐ $100,000 to $249,999
   4. ☐ $250,000 to $499,999
   5. ☐ $500,000 or more

FmHA Direct Farm Loans

9. Has the borrower defaulted on a previous ***FmHA direct farm loan***? *(Check one.)*

   1. ☐ Yes ——→***If yes, continue to questions 10, 11 & 12***
   2. ☐ No ——→***If no, skip to question 13***
   3. ☐ Don't know——→***If don't know, skip to question 13***

10. How many FmHA direct farm loans did this borrower default?

    ____

11. What was the month and year of the most recent FmHA direct farm loan default?

    ____

12. Which of the following best describes the status of the ***most recent*** defaulted FmHA direct farm loan?

    1. ☐ Loan was restructured (rescheduled or reamortized) but has not been paid off
    2. ☐ Loan was paid off with debt relief (write down or write off)
    3. ☐ Loan was paid off with no debt relief
    4. ☐ Loan was foreclosed
    5. ☐ Loan was not paid off because of bankruptcy
    6. ☐ Other (specify):

       ____

       ____

FmHA Guaranteed Farm Loans

13. Has the borrower defaulted on a previous ***FmHA guaranteed farm loan***? *(Check one.)*

    1. ☐ Yes ——→***If yes, continue to questions 14, 15 & 16***
    2. ☐ No ——→***If no, skip to question 17***
    3. ☐ Don't know——→***If don't know, skip to question 17***

14. How many FmHA guaranteed farm loans did this borrower default?

    ____

15. What was the month and year of the most recent FmHA guaranteed farm loan default?

    ____

3

16. Which of the following best describes the status of the ***most recent*** defaulted FmHA guaranteed farm loan?

   1. ☐ Loan was restructured (rescheduled or reamortized) but has not been paid off
   2. ☐ Loan was paid off with debt relief (write down)
   3. ☐ Loan was paid off with no debt relief
   4. ☐ Loan was foreclosed
   5. ☐ Loan was not paid off because of bankruptcy
   6. ☐ Other (specify):

   ____

   ____

17. Did the borrower receive ASCS deficiency program payments during fiscal year 1992? If yes, please specify the amount in the space below. ***Note: Please specify actual payments only. If this information is not in your files, it can be obtained from the local ASCS office.***

   1. ☐ Yes

   Amount($)______________________

   2. ☐ No
   3. ☐ Don't know

SECTION IV: LOAN TERMS AND PURPOSE

18. What is the term (in years) of the loan note?

   ____

19. Did the loan involve an interest rate reduction? *(Check one.)*

   1. ☐ Yes ——→***If yes, continue to question 20***
   2. ☐ No ——→***If no, skip to question 21***

20. What was the reduction percentage? ***Note: Please round to the nearest whole percent.*** *(Check one.)*

   1. ☐ 1%
   2. ☐ 2%
   3. ☐ 3%
   4. ☐ 4%

4

21. In the table below, indicate whether or not any of the listed factors were cited as a purpose for the loan by checking the 'yes' or 'no' box. And, for those factors that were cited 'yes', indicate the dollar amount allocated for that specific purpose, as well as the total amount of the loan.

Purpose For Loan	Yes (1)	No (2)	Dollar Amount (3)
1. Purchase of farm dwelling and/or farmland			$
2. Refinancing existing debt			$
3. Capital improvements			$
4. Other (specify)			$
5. Other (specify)			$
6. TOTAL AMOUNT OF LOAN			$

22. If this loan was used for refinancing, which of the following best describes the reason for the refinancing? *(Check all that apply.)*

1. ☐ Not applicable ——→***skip to section V***
2. ☐ Consolidation of debt
3. ☐ Change in lender
4. ☐ Better interest rates and terms
5. ☐ Reschedule or reamortize delinquent debt
6. ☐ Other (specify)____________________

23. If this loan was used for refinancing, please list the amount(s) that was refinanced by lender.

Farm Credit System($)________________

Commercial bank ($)________________

Other commercial lender (e.g., mortgage corporation, credit union, life insurance company, etc.)($)________________

Trade creditor (e.g., equipment dealer, veterinarian, supplier, etc.)($)________________

Other (specify)________________

($)________________

TOTAL REFINANCING AMOUNT

($)________________

Note: Total refinancing amount should equal the amount listed in question 21, line 2.

5

STOP! Please provide copies of all documents used to complete this questionnaire. Attach all copies to the back of this questionnaire.

SECTION V: CONCLUDING INFORMATION

Please provide the following information about the person who completed this questionnaire. This information will assist us if clarification of answers is necessary.

Name/Title/Telephone:

____

____

Reminder! please review your responses to make sure that all appropriate questions have been answered and you have included all requested documents. Thank you for your cooperation and assistance! This concludes the questionnaire.

6

Sampling and Data Analysis Methodology for Guaranteed Loan Portfolio Quality Survey

To estimate the proportion of FmHA's active guaranteed farm loan portfolio that is held by borrowers who have kept the payments on their original loans current and by other borrowers who have not kept current, we reviewed, through FmHA's St. Louis Finance Office, a dollar-unit sample of loans to 1,000 of the 35,210 borrowers who were identified as having outstanding loans in the agency's computerized records as of June 30, 1993. The source for these data was the automated tape that produced the FmHA Guaranteed Loan Master File. The probability that borrowers would be selected was proportional to the dollar value of their unpaid loan principal. Thus, borrowers with higher unpaid principal balances were more likely to be sampled.

We mailed questionnaires to FmHA's county office officials responsible for handling the loans on July 30, 1993. Appendix VI contains a copy of the questionnaire. We received a 100-percent response rate to our mailing. We obtained information on the outstanding loan balances as of June 30, 1993, and classified borrowers according to whether their loans were original loans or rescheduled loans and whether the loans were paid current, the first loan payments were not due, or the loans were not paid current. We classified borrowers whose loans fell into more than one of these categories into the category that had the largest outstanding balance.

As discussed in appendix II, since we used a probability sample of 1,000 borrowers to develop our estimates, each estimate has a measurable precision, or sampling error, which may be expressed as a plus/minus figure. Table V.1 shows our estimates, the sampling errors, and the upper and lower confidence interval limits for our estimates of borrowers who kept current and did not keep current on their loan payments. Table V.2 shows our estimates, the sampling errors, and the upper and lower confidence interval limits for our estimates for the FmHA debt that was kept current and not kept current by borrowers.

In the tables, the figures for the total number of borrowers (35,210) and the total outstanding debt ($4.6 billion) are the actual figures we obtained from FmHA's St. Louis Finance Office and were used as a basis for sampling and making the resulting projections. As a result of our sampling, we estimate that 1,918 of the 35,210 borrowers did not have outstanding loans as of June 30, 1993. This discrepancy resulted from timing differences between the time when loans are repaid and recorded as paid-in-full in the agency's database.

Table V.1: Sampling Errors and Confidence Intervals for Estimated Number of Borrowers Who Did and Did Not Keep Loan Payments Current

Description of estimate	Estimate	Sampling error	95-percent confidence interval
Estimated number of borrowers			
Original loans			
Paid current	22,747	1,459	21,288 to 24,206
First payment not due	4,257	887	3,370 to 5,144
Subtotal	27,003[a]	1,239	25,764 to 28,242
Rescheduled loans[b]			
To be kept current	2,505	771	1,734 to 3,276
Other reasons	1,665	535	1,130 to 2,200
Subtotal	4,170	924	3,246 to 5,094
Loans not paid current			
Original	1,764	513	1,251 to 2,277
Rescheduled	355	190	165 to 545
Subtotal	2,119	549	1,570 to 2,668
Total outstanding	33,292		
Did not make loans outstanding as of June 30, 1993	1,918[c]	721	1,197 to 2,639
Total in FmHA's database	**35,210**		
Percentage of estimated borrowers			
Original loans			
Paid current	64.6	4.1	60.5 to 68.7
First payment not due	12.1	2.5	9.6 to 14.6
Subtotal	76.7	3.5	73.2 to 80.2
Rescheduled loans[b]			
To be kept current	7.1	2.2	4.9 to 9.3
Other reasons	4.7	1.5	3.2 to 6.2
Subtotal	11.8	2.6	9.2 to 14.5
Loans not paid current			
Original loan	5.0	1.5	3.5 to 6.5
Rescheduled loan	1.0	0.5	0.5 to 1.5
Subtotal	6.0	1.6	4.4 to 7.6
Total outstanding	94.5		
Did not have loans outstanding as of June 30, 1993	5.4[c]	2.0	3.4 to 7.4
Total in FmHA's database	**100.0[a]**		

[a]Does not add because of rounding.

[b]Loans that were either paid current or for which the first payment was not due.

[c]Due to timing differences between when loans were repaid and recorded in the agency's database.

Table V.2: Sampling Errors and Confidence Intervals for Estimated Debt That Was and Was Not Kept Current

Dollars in millions

Description of estimate	Estimate	Sampling error	95-percent confidence interval
Estimated outstanding debt			
Original loans			
Paid current	$2,965	$154	$2,811 to $3,119
First payment not due	756	115	641 to 871
Subtotal	3,721	146	3,575 to 3,867
Rescheduled loans[a]			
To be kept current	271	63	208 to 334
Other reasons	259	62	197 to 321
Subtotal	531[b]	86	445 to 617
Loans not paid current			
Original	294	71	223 to 365
Rescheduled	53	28	25 to 81
Subtotal	347	75	272 to 422
Total	$4,599		
Combined rescheduled loans to be kept current and loans not paid current	$618	$94	$524 to $712
Percentage of estimated debt			
Original loans			
Paid current	64.5	3.0	61.5 to 67.5
First payment not due	16.4	2.4	14.0 to 19.0
Subtotal	80.9	2.4	78.5 to 83.3
Rescheduled loans[a]			
To be kept current	5.9	1.4	4.5 to 7.3
Other reasons	5.6	1.4	4.2 to 7.0
Subtotal	11.5	1.9	9.6 to 13.4
Loans not paid current			
Original	6.4	1.5	4.9 to 7.9
Rescheduled	1.2	0.6	0.6 to 1.8
Subtotal	7.5[b]	1.6	5.9 to 9.1
Total	100.0[b]		
Combined rescheduled loans to be kept current and loans not paid current	13.4	2.1	11.3 to 15.5

[a]Loans that were either paid current or for which the first payment was not due.

[b]Does not add because of rounding.

Guaranteed Farm Loan Portfolio Quality Survey

United States General Accounting Office

GAO

Survey on Outstanding Farmers Home Administration (FmHA) Guaranteed Farm Loans

The U.S. General Accounting Office (GAO) is an agency that assists Congress in evaluating federal programs. The purpose of this survey is to gather information on guaranteed farm operating and ownership loans that were ***outstanding on June 30, 1993***. This survey is being sent to county supervisors who had one or more guaranteed farm operating or ownership loans.

Please complete the survey and return it to us within 10 days after receipt. We have provided a postage-paid business reply envelope to facilitate the return of your questionnaire. In the event that the return envelope is misplaced, please send the completed survey to:

U.S. General Accounting Office
Attn: Larry Van Sickle
5799 Broadmoor, Suite 600
Mission, KS 66202-2400

If you have any questions, please call Larry Van Sickle or John Smith at 1-913-384-7400

Please answer all questions in this questionnaire in terms of the specific borrower identified on the borrower label below. The borrower has a loan (or loans) that was guaranteed through your office. Please provide the following information for each loan, as of June 30, 1993.

DEFINITIONS

Original Loan: A loan that does not involve debt previously guaranteed by FmHA and would include, for example, a loan for a new credit purchase or a loan for refinancing existing debt that was not under an FmHA guarantee.

Rescheduled Loan: A loan that involves debt that was previously guaranteed by FmHA.

Place label here

1. Is this loan outstanding as of June 30, 1993? *(Check one.)*

   1. ☐ Yes———→***If yes, continue to next question***
   2. ☐ No———→***If no, skip to the next borrower label (if applicable)***

2. Is this loan an original or a rescheduled loan? *(Check one.)*

   1. ☐ Original loan
   2. ☐ Rescheduled loan to keep a borrower current or to bring a delinquent borrower current
   3. ☐ Rescheduled loan for all other reasons (e.g., lower interest rate, consolidation of debt, etc.)

3. If this loan is a rescheduled loan, has there been debt write down? If yes, please specify the amount in the space below. *(Check one.)*

   1. ☐ Not applicable, loan is not a rescheduled loan
   2. ☐ Yes Amount($)____________________
   3. ☐ No

4. What is the loan status as of June 30, 1993? *(Check one.)*

   1. ☐ Paid current
   2. ☐ Not paid current
   3. ☐ First payment not yet due

5. What is the outstanding principal balance on this loan, as of June 30, 1993? (Please enter the dollar amount)

   Amount($)______________________________

PLEASE TURN OVER ———→

Please provide the following information about the person who completed this questionnaire. This information will assist us if clarification of answers is necessary.

Name/Title: ____________________________

Address: ____________________________

____

____

Phone: ____________________________

Examples of Borrowers Whose Financial Conditions Indicates That They Could Have Graduated

Case A. A borrower producing grain and livestock on a 400-acre farm had paid $5,000 of his $17,000, 40-year farm ownership loan over 20 years. A July 1992 financial statement showed that the borrower had a net worth of almost $300,000 and total assets of about $360,000, indicating that he could graduate. However, county officials did not refer the borrower to a lender to determine whether he could qualify for commercial financing. The borrower was not asked to graduate in 1992, according to the county office officials, because his cash flow (comparison of projected income to expenses) did not appear to meet minimum local lending standards.

Case B. A borrower producing grain and livestock on 720 acres reported gross sales of $46,000 annually. Over a 28-year period, $14,900 of the borrower's $20,800 direct farm ownership loan had been paid off. During this time, he had obtained and repaid another farm ownership loan with a Farm Credit System bank. In 1986, the borrower informed FmHA that he had transferred all his assets and liabilities to a living trust. In 1990, county office officials pursued graduation by asking for updated financial information, but the borrower failed to respond. At that time, the borrower had about $208,000 of assets and $5,900 in liabilities. In 1992, the borrower was again asked for updated financial information as part of the graduation review. In response, he provided incomplete information and did not provide, as requested, any letters from commercial lenders denying him credit. The county office officials told us they planned to request a legal decision concerning the borrower's transfer of his farm without FmHA's approval.

Case C. A borrower with a 500-acre cattle operation paid off $15,500 of his $40,000, 40-year farm ownership loan over the past 25 years. In August 1992, in response to the county office's request, the borrower submitted updated financial information. Although this borrower was on the 1992 graduation review list, there was no evidence in the county office's files indicating that the financial information was reviewed. Upon our questioning, the county office's supervisor added the borrower to the 1993 graduation review list for follow-up and evaluation.

Comments From the Farmers Home Administration

Note: GAO comments supplementing those in the report text appear at the end of this appendix.

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

SEP 1 5 1994

SUBJECT: GAO Draft Report RCED-94-245, "FARMERS HOME ADMINISTRATION: The Guaranteed Farm Loan Program Could Be Managed More Effectively"

TO: John W. Harman
Director
Food and Agriculture Issues
Resources, Community, and Economic
Development Division
General Accounting Office

Thank you for giving us an opportunity to address the draft GAO report. Attached are FmHA's comments to the report.

Michael V. Dunn
MICHAEL V. DUNN
Administrator

Attachment

CONCUR:

Stephen L. Babcock
Office of the General Counsel

Stephen B. Dewhurst
Director
Office of Budget and Program Analysis

Under Secretary
for Small Community
and Rural Development

FmHA Farmers Home Administration is an Equal Opportunity Lender.
Complaints of discrimination should be sent to:
Secretary of Agriculture, Washington, D.C. 20250

See comment 1.

See comment 2.

See comment 3.

See comment 3.

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

SEP 15 1994

SUBJECT: GAO Audit RCED-94-245
Farmers Home Administration: The Guaranteed Farm Loan Program Could Be Managed More Effectively

TO: John S. Cassell
Acting Director
Planning and Analysis Staff

In response to the subject General Accounting Office's (GAO) draft report dated August 19, 1994, we are providing comments as requested.

EXECUTIVE SUMMARY

In order to strengthen the graduation process, FmHA will be issuing new regulations in October of 1994 which will ensure that all direct loan borrowers' loan classification are updated at least every 2 years. Those classified as commercial or standard will be referred to commercial credit sources every 2 years. This change should enhance the graduation process.

GUARANTEED LOANS HAVE RESULTED IN LESS LOSSES THAN DIRECT LOANS, BUT FmHA's ACTIONS INCREASE POTENTIAL FOR LOSS

We agree that a borrower's past record of debt repayment often reflects willingness to repay debt. However, statistics do not support the opinion that losses which were beyond the control of the borrower should prevent him or her from receiving additional credit. Section 353 (k) of the Consolidated Farm and Rural Development Act (CONACT) states that the creditworthiness of any borrower whose loan obligations have been previously restructured will be determined without regard to the restructuring.

In addition, when evaluating the impact of providing guaranteed loans to those borrowers who have previously defaulted on a guaranteed loan and resulted in a loss payment or had debt written down on a direct loan, the audit fails to demonstrate any correlation between these past failures and a higher probability of future losses. GAO recommended to Congress in their 1992 report, to amend the CONACT to prevent previous borrowers who have failed, from getting additional credit. To date, the statute has not changed.

FmHA concurs that lender monitoring can be improved as indicated by the Coordinated Assessment Review (CAR) scores. However, we did provide National training on lender

FmHA Farmers Home Administration is an Equal Opportunity Lender. Complaints of discrimination should be sent to: Secretary of Agriculture, Washington, D.C. 20250 monitoring in connection with the Certified Lender Program (CLP) as a beginning of a renewed emphasis on lender monitoring. As part of our Coordinated Assessment Review (CAR) process we have also established a Guaranteed loan loss review in which several additional loan servicing related issues are reviewed. The results provide the states with information to use in their training sessions concerning guaranteed loan servicing. A summary of the 1994 CAR results indicates significant improvement in loan servicing. The noncompliance rate for fiscal year 1994 for FmHA officials concurring with a lender that a delinquency was beyond the control of the borrower was 4.8 percent compared to the 36.8 percent noncompliance of the previous year. The noncompliance rate for fiscal year 1994 for the requirement that FmHA officials approve cash flows prior to advances being made for the second and third year on line of credit operating loans was 10 percent compared to the 21 percent noncompliance of the previous year. The guarantee program is continuing to expand into new areas. This requires training of lenders and training of FmHA personnel in order that they become familiar with the program. We also point out that our personnel have tremendous demands placed upon them to carry out several loan programs in addition to the guaranteed program. Monitoring this program will become more difficult in the future with limited resources. FmHA's loan loss rate for all guaranteed loans since the inception of the program is 4 percent. In addition, loss rates in our two largest guaranteed programs are 2.7 percent for Farm Ownership loans (FO) and 3.3 percent for Operating loans (OL). The FO and OL programs make up 89.6 percent of all guaranteed loans ever made. FmHA's loss rates are a percentage of the guaranteed amount of the loan, if taken as a percentage of the whole loan the loss rate would be less. We note that if the guarantee fee of 1 percent is subtracted from the loss rate, we have a rate that is so low it prompts lenders to criticize us for much of our oversight activity.

See comment 1.

See comment 3.

The proposed audit indicates that FmHA is too lenient with lender monitoring. However, lenders say we do too much monitoring and oversight. Many lenders wonder why FmHA has a guaranteed program if these loans are going to be monitored like direct FmHA loans. FmHA's guaranteed program continues to grow utilizing all available funding and with limited losses this program compares favorably with all other Federal Guaranteed loan programs.

FmHA continues to work on improving servicing actions on guaranteed loans in all areas. Regulation changes have been made requiring semi-annual reviews of at least 20 percent of Certified Lender Program (CLP) loans and 40 percent of non

CLP loans. Lender monitoring requirements have been set forth by the National Office as well as each individual State Office. FmHA continues to emphasize the importance of lender monitoring through training, reviews, regulation changes and the issuance of Administrative Notices in an effort to improve the servicing of guaranteed loans.

GUARANTEED LOANS HAVE NOT BEEN SYSTEMATICALLY USED AS AN INTERIM STEP TO MOVE DIRECT LOAN BORROWERS TO COMMERCIAL CREDIT

See comment 4.

FmHA concurs that in the past it has not emphasized the graduation of Direct borrowers to commercial credit through the use of the Guaranteed program. However, the soon to be implemented Farm Assessment, Market Placement, and Graduation of Seasoned Direct Borrowers regulations are designed specifically to address this issue. In addition, a live video conference is scheduled this month to emphasize and focus the field offices on the new processes. These regulations will provide the tools necessary for the County Office to accomplish this task.

Through Farm Assessment and Supervised Credit requirements we will improve borrower operations so that borrowers can begin to move towards commercial credit. FmHA will perform an assessment of all aspects of the farm business when considering the loan application. Appropriate oversight and recommendations will be derived from this assessment. Farm business planning will then include assessment recommendations. Operations will be closely supervised to assure that recommendations are followed. Supervision will include in depth analysis, biennial financial statements, farm visits, recommendations on recordkeeping systems and semi-annual reviews of the borrower assessment to determine if there will be any difficulty in meeting goals and agreements reached as part of the assessment.

See comment 4.

We do question the analysis of the classification system described in the report. The report cited a County Supervisor who stated 66 percent of the borrowers were improperly classified because they had insufficient income or inadequate loan security to meet minimum commercial credit standards. The classification system was designed to provide the Agency with a basis for assessing the quality of its own loan portfolio, using FmHA rates and terms. A borrower may be accurately classified as "Commercial" using FmHA rates and terms, but still not qualify for a loan from a commercial bank when the rates, terms, and unique security standards are considered.

FmHA currently requires each new direct loan borrower to be classified immediately after the loan is closed. New regulations to be implemented in October 1994, will require updated financial information and classifications for each direct borrower every 2 years. This same regulation package will substantially modify the current graduation process by requiring each borrower classified "commercial" or "standard" to be referred to lenders for graduation every 2 years.

LENDERS' AND FmHA's SUGGESTIONS FOR MAKING THE GUARANTEED PROGRAM A MORE VIABLE FUNDING SOURCE FOR DIRECT LOAN BORROWERS.

See comment 5.

FmHA concurs that additional changes can be made to the Guaranteed program regulations which will facilitate the movement of direct borrowers to commercial credit. We have already substantially reduced the paperwork burden with a streamlined application and CLP. Additional reductions are planned for loans under $50,000. Also, the soon to be implemented Market Placement Program will eliminate most all of the loan origination work for the lender when refinancing Direct borrowers. In addition, no fee is required on Guaranteed loans when over half of the loan funds are used to refinance Direct FmHA credit. FmHA will consider the other recommendations, and shares GAO's concern about making the Guaranteed program vunerable to the large losses experienced by the Direct program.

GENERAL COMMENTS:

FmHA believes that all of GAO's concerns outlined in this audit are currently being addressed. FmHA has been aware of these concerns, which is why changes in many cases have been or are about to be implemented.

Lou Anne Kling

LOU ANNE KLING
Assistant Administrator
Farmer Programs

Attachment

The following are GAO's comments on the September 15, 1994, letter from the Farmers Home Administration.

GAO's Comments

1. We revised the report to recognize the updated information that FmHA provided us with in its comments. Also, in late October 1994, FmHA officials told us that the agency anticipates publishing the revised regulations in November 1994.

2. We addressed FmHA's comment in the discussion of agency comments in the executive summary.

3. We addressed FmHA's comment in the discussion of agency comments and our evaluation in chapter 2.

4. We addressed FmHA's comment in the discussion of agency comments and our evaluation in chapter 3.

5. We addressed FmHA's comment in the discussion of agency comments and our evaluation in chapter 4.

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