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Farm Loan Programs

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The President of the Senate
The Speaker of the House of Representatives

In 1990, the General Accounting Office began a special effort to review and report on the federal program areas we considered high-risk because they were especially vulnerable to waste, fraud, abuse, and mismanagement. This effort, which has been strongly supported by the Senate Committee on Governmental Affairs and the House Committee on Government Reform and Oversight, brought much needed focus to problems that were costing the government billions of dollars.

In December 1992, we issued a series of reports on the fundamental causes of problems in areas designated as high-risk. We are updating the status of our high-risk program in this second series. Our Overview report (GAO/HR-95-1) discusses progress made in many areas, stresses the need for further action to address remaining critical problems, and introduces newly designated high-risk areas. This report series also includes a Quick Reference Guide (GAO/HR-95-2) that covers all 18 high-risk areas we have tracked over the past few years, and separate reports that detail continuing significant problems and resolution actions needed in 10 areas.

This report summarizes our findings and the progress made in correcting problems with the federal government's direct and guaranteed farm loan programs and the management of farm properties obtained as a result of defaults on federal loans. Within the U.S. Department of Agriculture, farm loans have been historically administered by the Farmers Home Administration. In October 1994, the responsibility was transferred to the newly created Consolidated Farm Service Agency. Because of the general familiarity with the agency's earlier name, we refer to the Farmers Home Administration throughout this report.

Copies of this report series are being sent to the President, the Republican and Democratic leadership of the Congress, congressional committee and subcommittee chairs and ranking minority members, the Director of the Office of Management and Budget, and the Secretary of Agriculture.

Charles A. Bowsher
Comptroller General
of the United States

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Overview

The Farmers Home Administration (FmHA), an agency of the U.S. Department of Agriculture (USDA), provides temporary financial assistance to farmers who are unable to obtain commercial loans at reasonable rates and terms. FmHA has two principal and often conflicting roles: (1) to provide high-risk borrowers with temporary credit to enable them to stay in farming until they are able to secure commercial credit and (2) to do so in a way that protects the taxpayers' investment.

The Problem

FmHA has evolved into a continuous source of credit for many of its borrowers, and it has had a high rate of loan defaults, which have resulted in the loss of over $6 billion of taxpayers' money in recent years.

As we have previously reported, FmHA field office lending officials have not always implemented loan-making and loan-servicing standards intended to safeguard federal financial interests or prudently managed farm property that the agency has acquired. Also, some loan-making, loan-servicing, and property management policies do not adequately protect the taxpayers' interests. Furthermore, because legislation has not yet established clear priorities for FmHA's fundamental role and mission, losses can be expected to continue.

Progress

FmHA has taken steps to correct some problems with its farm loan programs. For example, FmHA has provided its field office lending officials with extensive training in credit and financial analysis to improve the quality of the loans being made. FmHA reviews show that most new direct and guaranteed loans meet the agency's lending standards. Also, FmHA's field office officials recently improved their compliance with the agency's standards for servicing guaranteed loans.

However, little progress has been made in correcting other basic problems in FmHA's farm loan programs. FmHA field officials still do not always follow established procedures for servicing outstanding direct loans. Also, neither USDA nor the Congress have addressed problems involving the agency's loan and property management policies. As a result, the agency continues to, for example, make loans to borrowers who either are behind on repaying their current debts or did not repay their previous debts; reduce and forgive the debts of borrowers who do not repay their loans; and sell farm properties at fixed prices to targeted purchasers, which limits returns and increases holding costs.

The Congress has clarified FmHA's fundamental role and mission in one area. Specifically, in late 1992, it required FmHA to establish programs for beginning farmers and target a certain portion of its loan funds to them. The Congress, however, has not yet provided FmHA with clear direction on being a fiscally prudent lender nor on handling those borrowers who have come to rely on FmHA as a continuous source of credit.

Outlook for the Future

FmHA's farm loan portfolio continues to contain a high level of delinquent debt, even though billions of dollars in unpaid loans has been forgiven. As of September 1994, FmHA's outstanding loans to the nation's farmers totaled $18 billion. Of that amount, almost 27 percent—about $4.8 billion—was held by borrowers who were behind on their loan payments. This condition exists even though FmHA lost more than $6 billion during fiscal years 1991-94.

In view of the very tight fiscal constraints that the federal government is facing, action is needed to bring FmHA's losses under control. Our April 1992 report presented a strategy for such action through a series of recommendations covering, for example, policies and program design in the direct loan, guaranteed loan, and farm inventory property areas, and matters for congressional consideration covering FmHA's fundamental role and mission. As we reported in December 1992, we believe that the Congress needs to recognize that not all financially stressed farms can be saved and that not all farm families can benefit from a government assistance program intended to keep them in farming. With this in mind, we suggested that the Congress consider, among other things, giving FmHA firm guidance on the following: (1) the level of loan losses that the Congress is willing to accept, (2) the length of time over which borrowers should be allowed to receive FmHA assistance, and (3) the kind of assistance, if any, that should be made available to unsuccessful borrowers who want to leave farming.

FmHA's Farm Loan Programs Continue to Be Very Risky

Under the authority of the Consolidated Farm and Rural Development Act, as amended, FmHA provides financial assistance to farmers through federally funded direct loans and through guaranteed loans, which are made by commercial lenders and guaranteed up to 90 percent by the federal government. FmHA's assistance is intended to be temporary; once farmers have become financially viable, they are expected to move to commercial sources of credit.

FmHA incurs a loss on a direct or a guaranteed farm loan when a borrower defaults and the proceeds from selling the collateral do not equal the outstanding loan amount plus the costs of acquiring and disposing of the collateral. In some cases, FmHA may acquire the property that was pledged as security for the loan and subsequently try to sell that property to recover some or all of the unpaid debt.

Billions of Dollars Have Been Lost and Billions More Are at Risk

Because of loan defaults, FmHA lost about $6.3 billion on its farm loan programs during fiscal years 1991-94. Of this amount, about $6.1 billion was forgiven debt on unpaid direct loans and about $200 million was payments to lenders on guaranteed loans.

Despite relief of this magnitude, as of September 30, 1994, another $4.8 billion in direct and guaranteed loans was held by borrowers who were unlikely to meet some or all of their obligations. Specifically, borrowers were delinquent on almost 27 percent of the $18 billion in outstanding loans—about $4.6 billion of the $12.6 billion direct and about $200 million of the $5.4 billion guaranteed loan debt.

As we reported in December 1992, FmHA and the Congress share responsibility for many of the problems with FmHA's farm loan programs. Although some contributing factors—such as the general decline of the agricultural economy in the 1980s—have been beyond the control of FmHA or the Congress, other factors do lie within their authority. First, FmHA's field office lending officials have not always followed the agency's own standards for making loans, servicing loans, and managing property. Second, FmHA loan and property management policies—some of which are congressionally directed—do not protect the taxpayers' interests. For example, these policies allow FmHA to make new loans to borrowers who either are behind on repaying their current debts or did not repay their previous debts; reduce and forgive the debts of borrowers who do not repay their loans; and sell farm properties at fixed prices to targeted purchasers, which limits returns and increases holding costs.

The Congress has the ability to influence the direction of FmHA's farm loan programs. However, it has given FmHA two broad, often conflicting, responsibilities—(1) to provide high-risk borrowers with temporary credit to keep them in farming until they secure commercial credit and (2) to operate as a fiscally prudent lender. Congressional actions emphasizing assistance over prudence are perhaps a greater cause of FmHA's farm loan problems than program management. For example, a previous attempt by FmHA to make loan standards more stringent was not implemented because of, among other things, congressional concern about the adverse impact that the proposed changes might have on farmers. Similarly, FmHA has also been directed by the Congress to allow delinquent borrowers to obtain additional loans and relief from existing debts.

Limited Progress Made Correcting Basic Problems

FmHA has taken steps to correct some problems with its farm loan programs. However, these actions do not fully address the root causes of problems in these programs. As a result, the taxpayers' investment continues to be at substantial risk.

Compliance With Loan-Making Standards Is Improving

On the positive side, in the past few years FmHA has provided its field office lending officials with extensive training in credit and financial analysis and has emphasized the importance of ensuring that new loans meet the agency's loan-making standards. Recent FmHA reviews show that the vast majority of direct and guaranteed loans now being made meet the agency's basic lending criteria, which cover such credit standards as applicants' demonstrating an ability to repay and providing adequate collateral. For example, while FmHA's internal reviews during fiscal years 1988 through 1991 showed that 13.5 percent of the sampled direct loans did not meet the agency's cash flow standard used to test a borrower's repayment ability, reviews during fiscal years 1993 and 1994 showed that about 7 percent of the sampled loans failed to meet this standard.[1] Reviews during the same periods also showed that the failure to verify borrowers' debts has decreased from about 31 percent of the sampled direct loans to about 11 percent.

The approval of guaranteed loans shows similar improvement. For example, FmHA's internal reviews during fiscal years 1988 through 1991 showed that 13 percent of the sampled guaranteed loans did not meet the cash flow standard for guaranteed loans and 20 percent did not have adequate collateral; reviews during fiscal years 1993 and 1994 showed that only about 3 percent of the sampled loans failed to meet these two key loan-making standards.

Progress in Complying With Loan-Servicing Standards Is Mixed

FmHA's field office officials recently improved their compliance with the agency's standards for servicing guaranteed loans, but the officials still frequently fail to implement standards for servicing direct loans. For example, FmHA requires field office officials to approve a lender's plan to reschedule or reamortize a delinquent guaranteed loan and to concur with cash flow estimates (income

[1]The numbers presented in this and the following section on the results of FmHA reviews are taken directly from FmHA reports. We did not attempt to verify their accuracy or the methodology used to generate these numbers.

and expenses) before approving advances for the second and third years on a line-of-credit operating loan. FmHA's fiscal year 1993 reviews showed 37-percent and 21-percent noncompliance rates with these two standards, respectively; reviews during fiscal year 1994 showed improvement—5-percent and 10-percent noncompliance rates with these standards, respectively.

In servicing direct loans, however, the story is not the same. For example, FmHA requires field office officials to annually (1) inspect property offered as collateral, (2) analyze borrowers' operations and assist them in planning for future farming, and (3) conduct supervisory visits with borrowers. FmHA's internal reviews during fiscal year 1991 disclosed that collateral had not been inspected for 12.5 percent of the sampled direct loans; the rates of noncompliance with this key standard increased to 19 percent in fiscal year 1993 and then decreased to 10 percent in fiscal year 1994. FmHA's reviews showed a somewhat different pattern with the analysis and planning requirement—a noncompliance rate of 20 percent in both 1991 and 1993 that declined to 16 percent in 1994. Noncompliance with the supervisory visit requirement, however, has continued rising, from 11 percent in 1991 to 19 percent in 1993 and to 21 percent in 1994.

Furthermore, as we reported in November 1994, field office officials do not always take action to identify direct loan borrowers who have the potential to move to commercial credit. And, when they do identify potential candidates, they often fail to take actions to move them to commercial credit. They did not do so because they perceived other work, such as resolving delinquent debts, to be more important. Likewise, as we reported in October 1994, when field officials were resolving unpaid direct loans, they frequently did not develop a complete inventory of borrowers' financial resources and were not aware of assets or income that could have been used to reduce loan losses. Even when they had a complete inventory of borrowers' financial resources, these officials did not always use those resources to offset losses. They did not do so because the agency's managers have placed little emphasis on minimizing losses and maximizing recoveries and because competing work priorities create incentives to use the debt settlement process to "clean up" the loan portfolio by writing off delinquent debt rather than to pursue recoveries.

FmHA has published in the Federal Register proposed and interim changes to its operation of the farm loan programs. For example, FmHA is in the process of developing regulations that would implement congressional requirements to assess the farming operation and financial condition of its borrowers, assist borrowers to obtain credit through guaranteed rather than direct loans, and attempt to move direct loan borrowers to commercial credit. Furthermore, in October 1994, a nationwide USDA task force was established to concentrate on resolving many of the agency's delinquent loan accounts.

Problems With FmHA's Farm Loan Policies Remain Unchanged

Neither USDA nor the Congress has addressed policies involving whether the agency should continue, for example, to

- make additional loans to borrowers whose previous delinquent debts were forgiven and to borrowers who are delinquent on their existing loans;
- allow lenders to use guaranteed loans to refinance existing customers' debts and to guarantee most loans at the maximum rate (90 percent) regardless of risk;
- rewrite loan terms and conditions, without requiring borrowers to make payments;

- forgive borrowers' delinquent debts; and
- dispose of farm inventory properties in ways that prevent FmHA from increasing recoveries and lessening losses.

Limited Progress in Clarifying FmHA's Role and Mission

The Congress somewhat clarified FmHA's fundamental role and mission in the Agricultural Credit Improvement Act of 1992, which directed the agency to establish programs for, and target a certain portion of its loan funds to, beginning farmers. Specifically, the Congress required FmHA to establish a farm ownership loan program that is aimed at enhancing the financial viability of new farmers by putting them in a position to build equity in their farming operations. The Congress also required FmHA to establish a farm operating loan program that is aimed at putting beginning farmers in a financially viable position, independent of the need for further FmHA financial assistance, within a set period of time. For example, the Congress directed that financial assistance in the operating loan program be available for up to 10 years to borrowers who develop and meet operating plans that provide for their progression to private credit and who participate in loan assessment, borrower training, and financial management programs.

The Congress, however, has not yet provided FmHA with clear direction on being a fiscally prudent lender nor on handling those borrowers who have come to rely on it as a continuous source of credit.

Further Action Needed to Protect Taxpayers' Investment

As we reported in April and December 1992, FmHA has neither acted as a prudent lender nor enhanced the creditworthiness of the nation's financially stressed farmers. As the lender of last resort to borrowers whom commercial lenders do not consider creditworthy, FmHA would be expected to incur some losses through defaults on loans. However, the massive amount of money that FmHA has lost, and the amount that is vulnerable to loss, far exceed the losses that might be anticipated, even for a lender of last resort.

In April 1992, we made numerous recommendations to the Secretary of Agriculture and to the Congress to improve compliance with loan and property management standards and to strengthen policies and program design in the direct loan, guaranteed loan, and farm inventory property areas. However, only limited action has been taken on those recommendations. In October and November 1994, we made additional recommendations aimed at strengthening the farm loan programs and presented various suggestions aimed at helping the agency to move borrowers from direct loans.

Many of our recommendations have been directed toward improving FmHA's program management. However, as we previously reported, if the losses in FmHA's programs are to be brought under control, the Congress needs to make clear that it expects FmHA to act as a prudent lender. In our opinion, not all marginal, financially stressed farms can be saved and not all farm families can benefit from attempts to keep them in farming. To communicate this recognition to FmHA and its managers, the Congress should, among other things, establish guidance concerning (1) the level of loan losses that it is willing to accept, (2) the length of time that borrowers may receive financial assistance from FmHA, and (3) the type of assistance, if any, that should be made available to help unsuccessful borrowers who want to leave farming. The Congress took a step in this direction when it directed FmHA to establish programs for beginning farmers in which loan funds are targeted on the basis of farming experience and are available for a set period of time, and which emphasize the developing of plans covering farm operations, progression to private credit, borrower training, and close FmHA supervision.

Related GAO Products

Farmers Home Administration: The Guaranteed Farm Loan Program Could Be Managed More Effectively (GAO/RCED-95-9, Nov. 16, 1994).

Debt Settlements: FmHA Can Do More to Collect on Loans and Avoid Losses (GAO/RCED-95-11, Oct. 18, 1994).

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

High-Risk Series: Farmers Home Administration's Farm Loan Programs (GAO/HR-93-1, Dec. 1992).

Farmers Home Administration: Billions of Dollars in Farm Loans Are at Risk(> (GAO/RCED-92-86, Apr. 3, 1992).

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