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Report to the Chairman, Committee on the Budget, House of Representatives

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FARM SERVICE AGENCY

Information on Farm Loans and Losses

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GAO

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

Resources, Community, and
Economic Development Division

B-281178

November 27, 1998

The Honorable John R. Kasich
Chairman, Committee on the Budget
House of Representatives

Dear Mr. Chairman:

The Farm Service Agency (FSA), a lending agency within the U.S. Department of Agriculture (USDA), provides financial assistance to farmers and ranchers who are unable to obtain commercial credit at reasonable rates and terms. When a borrower does not repay his or her loans, FSA has various tools to resolve the delinquency, which may include forgiving—writing off—debt. The Federal Agriculture Improvement and Reform Act of 1996[1] generally prohibits FSA from making loans to borrowers who have previously had debts forgiven.

This report responds to your request for selected information on FSA's farm loans. In particular, as you requested, we are providing information on (1) the financial condition of FSA's active direct farm loan portfolio at the end of fiscal years 1995 through 1997; (2) the amount and number of losses incurred by FSA on direct farm loans from fiscal year 1989 through fiscal year 1997; and (3) new farm operating loans[2] that FSA has made on an exception basis, since the 1996 Farm Bill, to borrowers who had debts forgiven when their loans were restructured.[3]

Results in Brief

The unpaid principal on the Farm Service Agency's active direct farm loan portfolio totaled about $9.7 billion at the end of fiscal year 1997. Delinquent borrowers (those who are at least 30 days past due on loan repayment) held about $2.7 billion, or 28.2 percent, of this amount. The size of the agency's portfolio, as well as the percentage of the portfolio held by delinquent borrowers, has decreased since 1995, when the portfolio totaled $11.4 billion, of which 40.7 percent was held by delinquent borrowers. In fiscal years 1996 and 1997, about $1.9 billion of principal and interest owed on farm loans was written off by the agency.

[1]This act (P.L. 104-127, Apr. 4, 1996) is referred to as the 1996 Farm Bill.

[2]Farm operating loans are generally made to pay the expenses that farmers and ranchers incur in operating their farms and ranches, to refinance existing debts, and to pay family living expenses.

[3]Restructured loans had the original loan agreements altered by writing down unpaid principal and accumulated interest. The making of farm operating loans to such borrowers is an exception to the general prohibition on making loans to borrowers who have previously had debts forgiven.

For the 9-year period fiscal years 1989 through 1997, the Farm Service Agency wrote off $15.2 billion of direct farm loans for almost 80,000 borrowers through its various processes for resolving delinquencies, which provide for (1) restructuring loans, (2) allowing a borrower who does not qualify for restructuring to make a payment based on the value of loan-security property (this payment is referred to as a buyout payment), or (3) reaching a final resolution of the debt that may or may not include a payment by the borrower (this is referred to as debt settlement). About $1.7 billion of the agency's losses resulted from reducing the debts of borrowers whose loans were restructured, and about $2.4 billion resulted from forgiving the debts of those who made buyout payments. Most of the write-off—about $11.1 billion—occurred through debt settlement.

Since the enactment date of the 1996 Farm Bill through June 30, 1998, the Farm Service Agency made or guaranteed $54.2 million in new farm operating loans to 690 borrowers whose debts had been reduced when their prior farm loans were restructured. Most of the 690 borrowers who received loans—about 77 percent—obtained direct farm operating loans, and about 23 percent obtained guaranteed farm operating loans.

Background

FSA, established by the Federal Crop Insurance Reform and Department of Agriculture Reorganization Act of 1994 (P.L. 103-354, Oct. 13, 1994), provides, among other things, direct government-funded loans to farmers and ranchers who are unable to obtain financing elsewhere at reasonable rates and terms.[4] FSA also provides repayment guarantees on farm loans made by commercial lenders. For a guaranteed loan, a commercial lender must certify that it will not make the loan unless it receives an FSA guarantee. The Consolidated Farm and Rural Development Act, as amended (P.L. 87-128, Aug. 8, 1961), is the basic authority for the farm loan programs.

Farm ownership loans—both direct and guaranteed—are made for purposes such as buying farm real estate and making capital improvements. Farm operating loans—both direct and guaranteed—are made for purposes such as buying feed, seed, fertilizer, livestock, and farm equipment; refinancing existing debts; and paying family living expenses. Additionally, emergency disaster direct loans are made to farmers and ranchers whose operations have been substantially damaged by adverse weather or other natural disasters.

[4]FSA administers the farm loan programs that historically were operated by USDA's Farmers Home Administration. In this report, we refer to these loan programs as FSA's programs.

To obtain a direct farm loan, an applicant must, among other things, pledge property as security for the loan and have a projected cash flow that demonstrates the ability to repay the loan. The cash flow test requires showing projected income that must be at least equal to but not necessarily more than projected expenses, which include the principal and interest that will be due on the loan; this standard does not require an income cushion in anticipation of unforeseen circumstances. The 1996 Farm Bill required that a delinquent borrower demonstrate up to a 10-percent cash flow margin for a loan or loans to be restructured. However, this requirement was removed by the Omnibus Consolidated and Emergency Supplemental Appropriations Act, 1999 (P.L. 105-277, Oct. 21, 1998).

When a borrower does not repay his or her loans, FSA has various tools to resolve the delinquency, such as (1) restructuring loans, which may include reducing debt; (2) allowing a borrower who does not qualify for restructuring to make a buyout payment based on the value of loan-security property for less than the amount owed, which results in FSA's forgiving the balance; and (3) reaching a final resolution of the debt that may or may not include a payment by the borrower, which also results in debt forgiveness.

The 1996 Farm Bill generally prohibits new loans to borrowers who caused FSA to incur loan losses. However, the act contains an exception allowing borrowers whose debts were reduced through restructuring to obtain new farm operating loans—direct and guaranteed—for annual operating purposes, such as buying feed, seed, and fertilizer. In addition, P.L. 104-134 (Apr. 26, 1996), which provided supplemental appropriations for USDA for fiscal year 1996, allows further exceptions. Specifically, FSA can make a farm operating loan, or an emergency disaster loan, to any borrower who had a loan application in process at the time the Farm Bill was enacted, provided that the borrower was less than 90 days delinquent at that time. A farm operating loan under this exception provision can be for any purpose for which such loans are authorized. P.L. 105-277, which was enacted in October 1998, allows additional exceptions to the general prohibition of new loans to borrowers who caused FSA to incur loan losses.

Outstanding and Delinquent Loans Have Declined in Recent Years

The outstanding principal owed on FSA's active direct farm loans declined from about $11.4 billion in September 1995 to $10.5 billion in September 1996 and to $9.7 billion in September 1997.[5] The portion of the portfolio held by delinquent borrowers also declined over this period. Specifically, as table 1 shows, delinquent borrowers held $4.6 billion, or 40.7 percent, of the outstanding principal in September 1995 and $2.7 billion, or 28.2 percent, of the outstanding principal in September 1997.[6]

Table 1: Amount and Percentage of Outstanding Direct Farm Loans Owed by Delinquent Borrowers, September 30, 1995, Through September 30, 1997

Dollars in billions

	Outstanding principal		Owed by delinquent borrowers		Percentage owed by delinquent borrowers[a]	
Fiscal year	Amount	Number of borrowers	Amount	Number of borrowers	Percentage of debt	Percentage of borrowers
1997	$9.7	110,119	$2.7	18,558	28.2%	16.9%
1996	$10.5	115,714	$3.6	24,316	34.2%	21.0%
1995	$11.4	121,711	$4.6	29,669	40.7%	24.4%

[a]Percentages are based on whole numbers.

Source: GAO's analysis of records from FSA's Finance Office.

More Than $15 Billion of Direct Farm Loans Has Been Written Off

From fiscal year 1989 through 1997, $15.2 billion in principal and interest was lost by reducing or forgiving the delinquent debt of FSA's direct farm loan borrowers.[7] Of these losses, about $1.7 billion was debt written down when FSA restructured delinquent borrowers' loans, and another $2.4 billion was debt written off when delinquent borrowers, who did not qualify for restructuring, made buyout payments. Most of the losses during this 9-year period, however—about $11.1 billion, or 73 percent—were write-offs that resulted from debt settlements. As we previously reported,

[5]The information presented in this section of the report covers the outstanding principal owed on active direct farm loans and excludes inactive loans, such as those involved in bankruptcy or foreclosure proceedings. Also, while collateral property reduces FSA's risk on outstanding loans, we did not determine the extent to which the government's investment in outstanding loans is protected by such property.

[6]If a borrower was delinquent (at least 30 days past due on loan repayment) on any farm loan, the principal on all farm loans held by the borrower was totaled to calculate the amount owed by the delinquent borrower. We do so because FSA considers all loans held by borrowers when attempting to resolve delinquencies through its various servicing tools.

[7]The $15.2 billion of losses equals $17.4 billion in constant 1997 dollars.

debt settlements generally occur after loan-security property has been liquidated and frequently result in no payments being made to the agency by the borrowers at the time of settlement.[8] For example, we reported in May 1998 that 81.5 percent of the more than $2 billion written off during a recent 3-year period was done with no payments at the time of settlement.

Table 2 summarizes the amount of debt written off during the fiscal year 1989-97 period through each of the three tools available to FSA for resolving delinquent loans. (App. I provides annual information on write-offs by the type of loan-servicing action.)

Table 2: Direct Farm Loan Losses, by Type of Loan Servicing, Fiscal Years 1989 Through 1997

Dollars in billions

Type servicing	Amount	Number of borrowers[a]
Restructured with write-down	$1.7	10,994
Buyout with write-off	2.4	11,638
Debt settled with write-off	11.1	57,196
Total	**$15.2[b]**	**79,828**

[a]The number of borrowers represents discrete borrowers—that is, if servicing occurred for a borrower in more than 1 fiscal year over the 9-year period, the borrower is counted only once.

[b]The $15.2 billion of losses equals $17.4 billion in constant 1997 dollars.

Source: GAO's analysis of records from FSA's Finance Office.

FSA has incurred losses on all types of direct farm loans. The highest losses, however, occurred with the agency's emergency disaster loans, on which $7.5 billion was written off from 1989 through 1997. Table 3, which summarizes the amount of debt written off by the type of loan during this 9-year period, also shows that a total of $4.9 billion was written off on the agency's farm ownership and operating loans. (App. I provides annual information on write-offs by the type of loan.)

[8]See, for example, Farm Service Agency: Status of the Farm Loan Portfolio and the Use of Three Contracting Provisions for Loan Servicing (GAO/RCED-98-141, May 5, 1998) and Debt Settlements: FmHA Can Do More to Collect on Loans and Avoid Losses (GAO/RCED-95-11, Oct. 18, 1994).

Table 3: Direct Farm Loan Losses, by Loan Type, Fiscal Years 1989 Through 1997

Dollars in billions

Loan type	Amount	Number of borrowers[a]
Farm ownership	$1.9	23,970
Farm operating	3.0	48,124
Emergency disaster	7.5	41,225
Other[b]	2.8	23,441
Total	**$15.2**[c]	**136,760**

[a]The number of borrowers includes some borrowers who are counted more than once because they had more than one type of direct loan for which losses were incurred.

[b]"Other" covers economic emergency, soil and water, and recreation loans.

[c]The $15.2 billion of losses equals $17.4 billion in constant 1997 dollars.

Source: GAO's analysis of records from FSA's Finance Office.

A large part of FSA's losses on farm loans occurred during the early years of the fiscal year 1989-97 period. Specifically, more than half the losses—$7.9 billion, or about 52 percent of the total losses—occurred during the first 3 fiscal years of this 9-year period. Another $4.4 billion, or about 29 percent, occurred in fiscal years 1992 through 1994. The balance, $2.8 billion, or about 19 percent, occurred in fiscal years 1995 through 1997. (App. I provides annual information on write-offs.)

New Farm Operating Loans Were Made to Certain Borrowers Who Caused Prior Losses

Since enactment of the 1996 Farm Bill on April 4, 1996, through the first three quarters of fiscal year 1998, FSA made or guaranteed $54.2 million in new farm operating loans to borrowers whose prior debts had been reduced when their loans were restructured. A total of 690 borrowers whose loans had been restructured with write-downs obtained new farm operating loans since the passage of the 1996 Farm Bill. (We did not determine whether the loans received by these borrowers were for annual operating purposes or for other authorized purposes, such as acquiring livestock or farm equipment, refinancing existing debts, or paying family living expenses.) Most of these borrowers—77.4 percent—obtained direct farm operating loans, and the other 22.6 percent obtained guaranteed loans. Furthermore, as table 4 shows, almost twice as many direct farm operating loans were made in the first three quarters of fiscal year 1998 as were made in fiscal 1997.

Table 4: Direct and Guaranteed Farm Operating Loans Made From April 4, 1996, Through June 30, 1998, to Borrowers Who Previously Had Loans Restructured With Debt Forgiveness

Dollars in millions

	Direct loans		Guaranteed loans		Total loans	
Fiscal year[a]	Number of borrowers	Amount of new loans	Number of borrowers	Amount of new loans	Number of borrowers	Amount of new loans[b]
1996	103	$5.1	45	$6.2	**148**	**$11.3**
1997	180	8.3	83	10.9	**263**	**19.2**
1998	354	18.6	40	5.2	**394**	**23.7**
Total[b]	**534**	**$32.0**	**156**	**$22.2**	**690**	**$54.2**

[a]The time period covered in each fiscal year is as follows: April 4, 1996, through September 30, 1996, for fiscal 1996; October 1, 1996, through September 30, 1997, for fiscal 1997; and, October 1, 1997, through June 30, 1998, for fiscal 1998.

[b]Figures may not add to the total amounts because of rounding. Also, the number of borrowers does not add to the total; rather, the total represents discrete borrowers who received farm operating loans—that is, if a borrower received a loan in more than 1 fiscal year, the borrower is counted only once in the total.

Source: GAO's analysis of records from FSA's Finance Office.

Agency Comments

We provided a draft of this report to USDA for review and comment. We met with Farm Service Agency officials, including the Deputy Administrator for Farm Credit Programs, the Director of the Loan Servicing and Property Management Division, and the Deputy Director of the Loan Making Division. The agency generally agreed with the material contained in the report and offered technical changes and suggestions for clarifying the report. We made these changes and incorporated these suggestions as appropriate.

Scope and Methodology

To provide information on the portfolio, losses, and new farm operating loans, we obtained and analyzed information from the computerized databases in FSA's St. Louis Finance Office, where financial and statistical data on farm loans are maintained. We did not verify the accuracy of the information contained in these databases. In addressing the losses incurred by FSA on direct farm loans and the new farm operating loans to borrowers who previously received debt forgiveness when their loans were restructured, we reviewed the basic statutory authority for the farm loan programs, which is contained in the Consolidated Farm and Rural Development Act, as amended, and our prior reports. In addition, we reviewed the farm loan provisions in the 1996 Farm Bill and in the act that provided supplemental appropriations for USDA for fiscal year 1996. We performed our work from September through October 1998 in accordance with generally accepted government auditing standards.

As agreed, unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days from the date of this letter. At that time, we will send copies of this report to the appropriate Senate and House committees; interested Members of Congress; the Secretary of Agriculture; the Administrator of FSA; the Director, Office of Management and Budget; and other interested parties. We will also make copies available to others upon request.

Please call me at (202) 512-5138 if you or your staff have any questions. Major contributors to this report are listed in appendix II.

Sincerely yours,

Robert E. Robertson
Associate Director, Food
and Agriculture Issues

Contents

Abbreviations

FSA	Farm Service Agency
GAO	General Accounting Office
USDA	U.S. Department of Agriculture

Yearly Information on Write-Offs of Farm Loans

This appendix contains information on the farm loans written off by the Farm Service Agency (FSA) in each year from fiscal year 1989 through fiscal year 1997.[9] For example, table I.1 shows that more than $1 billion was written off through debt settlements in 6 different years during this 9-year period. Table I.2 shows that far more borrowers had loans written off through the debt settlement process each year than through the other two processes combined. Table I.3 shows that a larger amount was written off each year for emergency disaster loans than for any other type of loan. However, table I.4 shows that more borrowers had farm operating loans written off each year than any other type of loan.

Table I.1: Total Dollar Amount of Direct Farm Loan Losses, by Type of Loan Servicing, Fiscal Years 1989 Through 1997

Dollars in millions

Fiscal year	Restructured with write-down	Buyout with write-off	Debt settled with write-off[a]	Total[b]
1989	$762	$913	$1,649	**$3,323**
1990	353	643	1,830	**2,825**
1991	94	255	1,404	**1,753**
1992	63	178	1,440	**1,681**
1993	213	182	1,171	**1,566**
1994	96	116	964	**1,176**
1995	52	45	847	**944**
1996	30	74	1,146	**1,250**
1997	17	9	612	**638**
Total[b]	**$1,679**	**$2,413**	**$11,063**	**$15,155[c]**

[a]Debt settled with write-off includes borrowers whose accounts were resolved through bankruptcy.

[b]Figures may not add to the total amounts because of rounding.

[c]The $15.2 billion of losses equals $17.4 billion in constant 1997 dollars.

Source: GAO's analysis of records from FSA's Finance Office.

[9]The information in this appendix covers debt relief provided on farm loans by FSA, which currently operates the U.S. Department of Agriculture's (USDA) farm loan programs, or by a predecessor USDA agency or office. The information may differ somewhat from previously published figures for direct farm loan losses as a result of database adjustments.

Table I.2: Number of Borrowers Whose Direct Farm Loans Were Reduced or Forgiven, by Type of Loan Servicing, Fiscal Years 1989 Through 1997

Fiscal year	Restructured with write-down	Buyout with write-off	Debt settled with write-off[a]	Total
1989	4,601	4,376	11,900	**20,877**
1990	2,486	2,788	12,323	**17,597**
1991	646	1,207	7,786	**9,639**
1992	344	707	7,346	**8,397**
1993	1,855	1,244	6,177	**9,276**
1994	847	681	4,675	**6,203**
1995	451	295	3,950	**4,696**
1996	275	281	3,486	**4,042**
1997	160	59	2,948	**3,167**
Total[b]	**10,994**	**11,638**	**57,196**	**79,828**

[a]Debt settled with write-off includes borrowers whose accounts were resolved through bankruptcy.

[b]The number of borrowers does not add to the total; rather, the total represents discrete direct loan borrowers over the 9-year period—that is, if loan servicing occurred for a borrower in more than 1 fiscal year, the borrower is counted only once in the total.

Source: GAO's analysis of records from FSA's Finance Office.

Table I.3: Total Dollar Amount of Direct Farm Loan Losses, by Type of Loan, Fiscal Years 1989 Through 1997

Dollars in millions

Fiscal year	Farm ownership	Farm operating	Emergency disaster	Other[a]	Total[b]
1989	$406	$651	$1,591	$676	**$3,323**
1990	372	566	1,318	570	**2,825**
1991	236	333	841	343	**1,753**
1992	217	314	824	326	**1,681**
1993	221	353	708	283	**1,566**
1994	154	246	570	205	**1,176**
1995	128	201	461	154	**944**
1996	106	182	812	149	**1,250**
1997	76	134	332	95	**638**
Total[b]	**$1,917**	**$2,979**	**$7,458**	**$2,802**	**$15,155[c]**

[a]"Other" covers economic emergency, soil and water, and recreation loans.

[b]Figures may not add to the total amounts because of rounding.

[c]The $15.2 billion of losses equals $17.4 billion in constant 1997 dollars.

Source: GAO's analysis of records from FSA's Finance Office.

Table I.4: Number of Borrowers Whose Direct Farm Loans Were Reduced or Forgiven, by Type of Loan, Fiscal Years 1989 Through 1997

Fiscal year	Farm ownership	Farm operating	Emergency disaster	Other[a]	Total
1989	5,222	11,643	11,156	6,309	**34,330**
1990	4,657	9,902	8,622	5,082	**28,263**
1991	2,913	5,432	4,709	2,818	**15,872**
1992	2,579	4,812	4,235	2,434	**14,060**
1993	2,990	5,506	4,357	2,463	**15,316**
1994	1,953	3,598	2,909	1,609	**10,069**
1995	1,537	2,863	2,086	1,107	**7,593**
1996	1,193	2,449	1,871	918	**6,431**
1997	926	1,919	1,280	701	**4,826**
Total[b]	**23,970**	**48,124**	**41,225**	**23,441**	**136,760**

[a]"Other" covers economic emergency, soil and water, and recreation loans.

[b]The total number of borrowers includes some borrowers who are counted more than once because they had more than one type of direct loan for which losses were incurred.

Source: GAO's analysis of records from FSA's Finance Office.

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