United States Government Accountability Office
Washington, DC 20548

June 28, 2006

The Honorable Saxby Chambliss
Chairman
Committee on Agriculture, Nutrition and Forestry
United States Senate

Subject: *Farm Loan Programs: GAO Reports on USDA Lending Practices*

Dear Mr. Chairman:

This report responds to your request for information relating to the committee's June 13, 2006, hearing on the U.S. Department of Agriculture's (USDA) farm loan programs. In particular, your May 16, 2006 letter requested that we summarize our findings from the 1990s through 2002 on USDA's farm loan programs. You also requested that we provide any GAO opinions on the current management and status of the loan programs and identify any matters that the committee should consider.

The USDA Farm Service Agency's (FSA) farm loan programs are intended to provide temporary financial assistance for the nation's farmers and ranchers who are unable to obtain commercial credit at reasonable rates and terms. FSA provides various types of both direct and guaranteed farm loans. *Direct farm ownership loans* can be used to buy farm real estate and make capital improvements. *Guaranteed farm ownership loans* are made for the same purposes and for refinancing existing debts. Also, *direct farm operating loans* can be used to buy feed, seed, fertilizer, livestock, and farm equipment; pay family living expenses; and, subject to certain restrictions, refinance existing debts. *Guaranteed farm operating loans* are made for the same purposes, but without restriction on refinancing existing debts. Additionally, direct loans include *emergency disaster loans*, which are made to farmers and ranchers whose operations have been substantially damaged by adverse weather or other natural disasters. In operating the farm loan programs, USDA faces the conflicting tasks of providing temporary credit to high-risk borrowers so that they can stay in farming until they are able to secure commercial credit and ensuring that the taxpayers' investment is protected.

Our reports from the mid-1980s through 2001 highlighted significant financial and policy shortcomings in USDA's farm loan programs. In particular, we reported that billions of dollars of losses had occurred on USDA's farm loan programs because of weaknesses in USDA's lending practices and management of the program. In 1990, we placed USDA's farm loan programs on our "high-risk" list because delinquent farm loan borrowers held $11.1 billion of the agency's outstanding loans. In 1992, we reported that because of defaults in recent preceding years the Farmers Home Administration (FmHA) had reduced or forgiven delinquent debt of $7.6 billion. However, starting in the mid-1990s, the Congress passed key legislation, such as the 1996 Farm Bill, that addressed many of the weaknesses in USDA’s farm loan programs. USDA also initiated program management improvements in response to our recommendations. In January 2001, we removed these programs from our high-risk list because actions taken by the Congress and USDA had a significant positive impact on the operations and financial condition of USDA's farm loan programs. In our January 2001 report,[1] we noted that borrowers who were delinquent on their farm loans owed $1.8 billion on direct loans (about 21 percent of the outstanding principle on direct loans)—a significant decrease in delinquent debt. Moreover, we reported that USDA’s direct loan losses of $427 million in fiscal year 2000 were the lowest in over 10 years. Summaries of selected GAO reports from 1988 through 2001 that outline our prior findings on USDA’s farm loan programs are enclosed.

Concerning USDA’s more recent farm loan program performance, we have not performed work that would allow us to comment on the current management and status of the loan programs, or identify matters that the committee should consider at this time. We would, of course, be pleased to discuss further work in this area should it be of interest to the committee. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. Please contact me at (202) 512-5988 or bertonid@gao.gov if you or your staff have any questions about this report.

Sincerely yours,

Daniel Bertoni
Acting Director, Natural Resources
and Environment

Enclosure

[1]GAO, *Major Management Challenges and Program Risks: Department of Agriculture*, GAO-01-242 (Washington D.C.: January 2001).

Summaries of Selected GAO Reports on USDA's Farm Loan Programs, 1988 - 2000

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

We reported that the Farmers Home Administration (FmHA), which was FSA's predecessor agency, faced the dilemma of finding the appropriate balance between acting as the lender of last resort for family farmers who could not get credit elsewhere while at the same time fulfilling its congressional mandate to serve as a temporary source of credit. Between 1976 and 1987, the amount of delinquent loan payments increased from $164 million to about $7 billion, and the total outstanding principal owed by delinquent borrowers increased from $723 million to over $12.8 billion. FmHA was originally established as a temporary source of credit for farmers, and it was expected that FmHA's borrowers would graduate to commercial sources of credit once they could do so at affordable rates and terms. However, the farm loan programs were not operating in that manner--many FmHA borrowers remained in the farm loan program for extended periods. We found that about 42 percent of FmHA's borrowers had borrowed from FmHA for 7 or more years, including about 57,600 borrowers who had had borrowed from FmHA for 10 or more years. We suggested that the Congress reevaluate the role of FmHA in farm lending by considering, among other things, at what point the costs of providing long-term credit assistance to farmers in financially marginal situations outweigh the benefits to the government, rural communities, and the farmer. We also recommended that FmHA develop an operational definition of "graduation" and monitor compliance with that definition.

***Government Financial Vulnerability: 14 Areas Needing Special Review*, OCG-90-1 (Jan. 23, 1990)**

This report identified federal programs that we considered to be plagued by serious breakdowns in their internal controls and financial management systems and, as a result, vulnerable to major losses of federal funds. We included the FmHA's loan programs because delinquent farm loan borrowers held $11.1 billion, or 48 percent, of the agency's $23.3 billion in outstanding loans as of September 30, 1989. We stated that the potential for controlling loan losses warranted additional review and oversight.

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

We reported that the multibillion-dollar federal investment in farmer loan programs was not adequately protected: about 70 percent of USDA's direct farm loans of almost $20 billion were held by borrowers who might not meet some or all their obligation to repay their loans. In the direct loan program, field lending officials had not complied with agency loan-making and loan-servicing standards established to safeguard federal financial interests. By allowing delinquent borrowers to obtain additional credit, FmHA had also reinforced its lending to poor credit risks, and by providing debt relief to borrowers who had defaulted on their loans, it had created incentives for farmers to avoid repaying their debts. Furthermore, the FmHA's mission--to help keep high-risk farmers on their farms—often conflicted with normal fiscal controls and policies designed to minimize risk and financial losses. As a result, there were no clear guidelines that would have enabled FmHA to balance its responsibilities as the lender of last resort for the nation's farmers with its responsibilities as a fiscally prudent lender. We made numerous recommendations to USDA and the Congress aimed at (1) improving compliance with loan and property management standards, (2) strengthening farm loan policies and programs design, and (3) clarifying USDA's farm lending role and mission.

***Farm Service Agency: Information on Farm Loans and Losses* (GAO/RCED-99-18, Nov. 27, 1998)**

We reported that the value of direct farm loans held by delinquent borrowers had decreased from $4.6 billion in 1995--about 41 percent of USDA's total outstanding direct farm loan principal--to $2.7 billion by 1997. However, in fiscal years 1996 and 1997, about $1.9 billion of principal and interest owed on farm loans was written off by USDA. For the 9-year period, fiscal years 1989 through 1997, FSA wrote off $15 billion of direct farm loans for almost 80,000 borrowers through its various processes for resolving delinquencies.

***Farm Service Agency: Updated Status of the Multibillion-Dollar Farm Loan Portfolio*, GAO-01-202 (Jan 10, 2001)**

We provided an updated overview of the changing financial condition of FSA's farm loan portfolio as of September 30, 2000. FSA had more than $16.6 billion in outstanding farm loans at the time. Of that amount, about $2.1 billion was owed by delinquent borrowers, and most of this amount (87 percent) was owed on direct loans. Overall, this financial position reflected improvement in FSA's direct farm loan portfolio as well as a continuation of a relatively healthy guaranteed farm loan portfolio. Also, farm loan losses incurred by FSA during fiscal year 2000 totaled about $486 million, considerably less than in each of fiscal years 1995 through 1999, when USDA's direct farm loan losses averaged $778 million per year.

***Farm Loan Programs: Improvements in the Loan Portfolio But Continued Monitoring Needed,* GAO-01-732T (May 16, 2001)**

We testified that the overall financial condition of the farm loan portfolio had improved and that USDA's direct loan losses in fiscal year 2000 were the lowest in over 10 years. We also noted that the continued improvements in the farm loan portfolio in recent years had resulted from legislative and management actions. In particular, the 1996 Farm Bill included provisions that (1) prohibited borrowers who are delinquent on direct or guaranteed farm loans from obtaining additional direct farm operating loans, (2) generally prohibited borrowers whose past defaults resulted in loan losses from obtaining new direct or guaranteed farm loans, and (3) limited borrowers to one instance of debt forgiveness on direct loans. The 1996 Farm Bill also required borrowers to have or to agree to obtain hazard insurance on the property that they acquire with farm ownership and operating loans, and required applicants, as a condition for obtaining an emergency disaster loan, to have had hazard insurance on property that was damaged or destroyed. Further, the 1996 Farm Bill limited the length of time that direct loan assistance is available and enhanced the potential for direct loan borrowers to obtain conventional credit by allowing a 95-percent guarantee on loans made by commercial lenders. Also, since the mid-1990s, USDA had addressed several loan management problems, such as the quality controls over loan-making and loan-servicing, thereby reducing some of the risks associated with the farm loan programs.

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