United States General Accounting Office

GAO

Testimony

Before the Subcommittee on Forestry, Resource Conservation, and Research, Committee on Agriculture, House of Representatives

For Release on Delivery Expected at 9 a.m. CST Friday February 21, 1997

FARM LOANS

Information on the Status of USDA's Portfolio

Statement for the Record by
Robert A. Robinson, Director,
Food and Agriculture Issues,
Resources, Community, and Economic
Development Division

Mr. Chairman and Members of the Subcommittee:

Thank you for inviting us to provide this statement for the record as part of the Subcommittee's oversight hearing on the farm loan programs administered by the U.S. Department of Agriculture's (USDA) Farm Service Agency (FSA). You asked us to (1) summarize our January 1997 report,[1] which updated prior reports on the financial condition of FSA's farm loan portfolio, and (2) discuss changes to the farm loan programs that were mandated by the Federal Agriculture Improvement and Reform (FAIR) Act of 1996 (P.L. 104-127, Apr. 4, 1996).

In summary, our January report shows that a significant portion of FSA's direct farm loan portfolio continues to be at risk because it is held by delinquent borrowers. As might be expected, a much smaller percentage of FSA's guaranteed loan portfolio is held by delinquent borrowers. Specifically:

- As of September 30, 1996, $3.6 billion, or about 34 percent of the total outstanding principal on direct loans ($10.5 billion), was held by delinquent borrowers. This level of delinquency is an improvement over the $4.6 billion, or about 41 percent of the total outstanding principal ($11.4 billion), that was held by delinquent borrowers at the end of fiscal year 1995.
- During fiscal year 1996, FSA lost $1.1 billion of principal and interest by reducing or forgiving the debt of delinquent direct loan borrowers.
- As of September 30, 1996, about $280 million, or 4.4 percent of the total outstanding principal on guaranteed loans ($6.4 billion), was held by delinquent borrowers. In comparison, at the end of fiscal year 1995, delinquent borrowers held about $218 million, or 3.7 percent of the total outstanding principal ($5.9 billion).
- Much of the increase in guaranteed loan delinquencies is concentrated in a few states.

The FAIR Act made significant changes to FSA's lending programs. These changes were aimed at strengthening the financial condition of the farm loan portfolio and improving the operation of the programs. They include modifying or eliminating lending policies that added to FSA's risk and clarifying FSA's fundamental lending role and mission. Because USDA is in the process of implementing these changes, their impact will not be known for some time. However, we believe that they should go a long way

[1]Farm Service Agency: Update on the Farm Loan Portfolio (GAO/RCED-97-35, Jan. 3, 1997).

to reducing the risk associated with the farm loan programs and to improving their operations.

Background

FSA provides credit to farmers and ranchers who are unable to obtain funds elsewhere at reasonable rates and terms. The agency provides credit assistance through direct loans, which are funded by the government, and through guaranteed loans, which are made by commercial lenders and guaranteed by the government. Generally, the maximum guarantee is 90 percent; however, the FAIR Act allows the guarantee to be higher in certain instances. FSA's assistance is intended to be temporary; once farmers and ranchers have become financially viable, they are to graduate to commercial sources of credit.

FSA incurs losses in the direct loan program through various types of debt relief assistance offered to borrowers who have trouble repaying their loans. Two such debt relief options are (1) reducing a borrower's debt so that the borrower continues farming or ranching and remains an FSA client—referred to as restructuring with write-down—and (2) forgiving debt by allowing a borrower who does not qualify for restructuring to make a payment to FSA that is based on the value of collateral security and that is less than the outstanding debt—referred to as recovery value buy-out with write-off. FSA has a third option when one of these two approaches does not resolve a borrower's delinquency—debt settlement. Typically, this option involves writing off part or all of the unpaid loans for borrowers who are no longer farming.

FSA also incurs losses as a result of guaranteeing farm loans. If a borrower defaults, FSA reimburses the commercial lender for the guaranteed portion of lost principal, accrued interest, and liquidation costs.

Status of Farm Loan Portfolio, as of September 30, 1996

As of September 30, 1996, the outstanding principal on FSA's farm loans—direct and guaranteed—totaled about $17 billion. Of this amount, delinquent borrowers held about $4 billion. Table 1 shows that direct loan delinquencies decreased while guaranteed loan delinquencies increased between the end of fiscal years 1995 and 1996.

Table 1: Outstanding Principal and Amount Owed by Delinquent Borrowers, by Loan Type, as of September 30, 1996, and September 30, 1995

Dollars in millions

	Outstanding principal		Owed by delinquent borrowers		Percentage owed by delinquent borrowers	
Loan type and year	**Amount**	**Number of borrowers**	**Amount**	**Number of borrowers**	**Percentage of debt**	**Percentage of borrowers**
Sept. 1996						
Direct	$10,457.8	115,743	$3,578.1	24,326	34.2	21.0
Guaranteed	6,360.3	39,653	279.9	1,957	4.4	4.9
Total	$16,818.1	155,396[a]	$3,858.0	26,283[a]	22.9	16.9
Sept. 1995						
Direct	$11,379.7	121,732	$4,627.5	29,676	40.7	24.4
Guaranteed	5,932.6	38,671	217.7	1,567	3.7	4.1
Total	**$17,312.3**	**160,403[a]**	**$4,845.2**	**31,243[a]**	28.0	19.5

[a]The total number of borrowers may include some borrowers who are counted twice because they have both direct and guaranteed loans.

Source: GAO/RCED-97-35.

The amount of direct loans owed by delinquent borrowers varied by state. As of September 30, 1996, nine states had borrowers who held at least $100 million in delinquent loans. Collectively, these states had about 51 percent of the total $3.6 billion held by delinquent borrowers. Specifically, delinquent borrowers in Texas owed $483 million, those in Mississippi owed $255 million, and those in California owed $223 million. Delinquent borrowers in Oklahoma, North Dakota, New York, Louisiana, Minnesota, and South Dakota owed more than $100 million but less than $200 million.

On guaranteed loans, borrowers in nine states accounted for about 64 percent of the delinquency. Specifically, as of September 30, 1996, delinquent borrowers in Oklahoma owed $43 million, and those in Texas owed $38 million. Delinquent borrowers in Nebraska, Louisiana, Minnesota, Wisconsin, Kansas, South Dakota, and Iowa owed more than $10 million but less than $20 million. Additionally, much of the increase in delinquencies on guaranteed loans in fiscal year 1996 involved borrowers in three states—Texas, Oklahoma, and Louisiana.

Table 2 shows that during fiscal year 1996, FSA incurred losses of about $1.1 billion on direct loans (principal and interest) and about $42 million on guaranteed loans.

Table 2: FSA's Direct and Guaranteed Loan Losses, Fiscal Year 1996

Dollars in millions

Loan type	Amount of loss	Number of borrowers
Direct		
Restructured with write-down	$26.8	254
Recovery value buy-out with write-off	50.9	253
Debt settled with write-off	1,020.9	2,887
Subtotal	**$1,098.6**	**3,394**
Guaranteed		
Payments on loss claims	41.9	545
Total	**$1,140.5**	**3,939**

Source: GAO/RCED-97-35.

Borrowers in four states accounted for slightly more than half of the total losses on FSA's direct loans. Specifically, during fiscal year 1996, FSA reduced or forgave $224 million on direct loans for borrowers in California, $135 million for those in Mississippi, $103 million for those in Texas, and $101 million for those in Louisiana.

On guaranteed loans, the highest amount of loss payments involved borrowers in two states—$6.8 million in Louisiana and $5.5 million in Oklahoma.

FAIR Act's Changes to the Farm Loan Programs

Title VI of the FAIR Act contains fundamental reforms to the farm loan programs that are intended to reduce the risks associated with the programs and clarify FSA's basic lending mission. In particular, the act modifies or eliminates certain lending and servicing policies that had, in the past, increased the risk of loss. Specifically, the act, among other things, does the following:

- Prohibits borrowers who are delinquent on FSA direct or guaranteed farm loans from obtaining direct farm operating loans.
- Generally prohibits borrowers whose past default resulted in loan losses from obtaining new direct or guaranteed farm loans. Specifically, FSA may not make a new loan to a borrower if the borrower's prior direct loans were reduced or forgiven or if a payment had to be made to a commercial lender on the borrower's prior guaranteed loan. One exception to this prohibition is allowed: A direct or guaranteed farm operating loan for paying annual farm or ranch operating expenses—that is, for purchasing

seed, feed, fertilizer, insecticide, and farm or ranch supplies, and for meeting other essential farm or ranch operating expenses, including cash rent—may be made to a borrower whose restructuring resulted in debt forgiveness.

- Limits borrowers to one instance of debt forgiveness on direct loans.
- Requires borrowers, as a measure of protection on loans made by FSA, to have, or agree to obtain, hazard insurance on the property that they acquire with farm ownership and operating loans. In addition, as a condition for getting disaster emergency loans, applicants are required to have had hazard insurance on property that was damaged or destroyed. The Secretary of Agriculture is to establish the levels of insurance that borrowers need to obtain on property acquired with farm loans and the level of insurance that borrowers needed to have had as a condition for obtaining an emergency loan.
- Establishes a maximum indebtedness level of $500,000 for disaster emergency loans.
- Allows FSA to (1) contract with commercial lenders to service the farm loan portfolio (2) use private collection agencies to assist in collecting delinquent amounts.
- Requires borrowers to pay at least a portion of the interest on their loans as a condition for having the terms of their loans rescheduled or reamortized. In particular, borrowers who are unable to make their farm loan payments, but who are not 90 days past due, can have the terms of their farm loans rescheduled or reamortized if they pay a portion of the interest that is due on the loans. The Secretary of Agriculture is to establish the level of interest payments that borrowers need to make.

The FAIR Act also clarifies FSA's basic lending mission by, among other things, emphasizing that its assistance is to be temporary. Additionally, the act builds upon other legislation enacted earlier in the 1990s that emphasized helping beginning farmers and ranchers get started and progress in farming or ranching. The act also reinforces past congressional emphasis on shifting farm lending from direct loans to guaranteed loans. More specifically, the act, among other things, does the following:

- Sets term limits for the receipt of direct farm ownership and operating loans. A person must have operated a farm or ranch for at least 3 years to be eligible to obtain a direct farm ownership loan. A borrower can obtain direct farm ownership loans during a 10-year period that starts when the person first obtains a farm ownership loan. A borrower can obtain direct farm operating loans during 7 years; these may be consecutive,

nonconsecutive, or a combination of consecutive and nonconsecutive years.

- Encourages the graduation of direct loan borrowers to conventional credit by allowing a 95-percent guarantee on loans made by commercial lenders to refinance the existing direct loans that borrowers have.
- Increases the guarantee percentage allowed on loans made by commercial lenders to beginning farmers and ranchers who participate in a farm ownership loan program that is targeted to them.
- Targets farm properties that are in FSA's inventory for sale to beginning farmers and ranchers. If a beginning farmer or rancher does not offer to acquire the property at current market value within 75 days of FSA's acquisition, then the properties are to be disposed of competitively.

The changes in the FAIR Act address many of the problems that we have reported on in the past. While it is too early to gauge their impact on the financial condition of the portfolio, we believe that, if properly implemented, they will reduce the financial risk associated with the farm lending programs. We plan to continue to monitor and report on the USDA's progress in implementing the FAIR Act's credit provisions.

This concludes our prepared statement.

Ordering Information

The first copy of each GAO report and testimony is free. Additional copies are $2 each. Orders should be sent to the following address, accompanied by a check or money order made out to the Superintendent of Documents, when necessary. VISA and MasterCard credit cards are accepted, also. Orders for 100 or more copies to be mailed to a single address are discounted 25 percent.

Orders by mail:

U.S. General Accounting Office
P.O. Box 6015
Gaithersburg, MD 20884-6015

or visit:

Room 1100
700 4th St. NW (corner of 4th and G Sts. NW)
U.S. General Accounting Office
Washington, DC

Orders may also be placed by calling (202) 512-6000
or by using fax number (301) 258-4066, or TDD (301) 413-0006.

Each day, GAO issues a list of newly available reports and testimony. To receive facsimile copies of the daily list or any list from the past 30 days, please call (202) 512-6000 using a touchtone phone. A recorded menu will provide information on how to obtain these lists.

For information on how to access GAO reports on the INTERNET, send an e-mail message with "info" in the body to:

info@www.gao.gov

or visit GAO's World Wide Web Home Page at:

http://www.gao.gov

PRINTED ON RECYCLED PAPER

United States
General Accounting Office
Washington, D.C. 20548-0001

Bulk Rate
Postage & Fees Paid
GAO
Permit No. G100

Official Business
Penalty for Private Use $300

Address Correction Requested