United States General Accounting Office

GAO

Report to Congressional Committees

March 1996

EMERGENCY DISASTER FARM LOANS

Government's Financial Risk Could Be Reduced

GAO/RCED-96-80

GAO

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

Resources, Community, and
Economic Development Division

B-271392

March 29, 1996

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

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

We have issued a series of reports highlighting the significant financial risk associated with the U.S. Department of Agriculture's (USDA) multibillion-dollar farm loan portfolio.[1] This report focuses on one component of the portfolio—emergency disaster loans. The emergency disaster loan program, administered by USDA's Farm Service Agency (FSA)[2] provides assistance to farmers who sustain losses resulting from adverse weather conditions or other natural disasters. The objectives of our work were to analyze the financial condition of the emergency loan portfolio and identify factors that contribute to the financial risk associated with these loans. We also examined the extent to which farmers attempted to minimize the need for this type of government loan by purchasing insurance to protect their farming operations.

We conducted our work at FSA headquarters and at state and county offices in California, Florida, Iowa, Michigan, and New York. Our work included analyzing information in FSA's centralized computer databases on the payment status of emergency loans. In addition, we mailed a survey to FSA county officials to obtain detailed information about a random sample of 600 loans made during fiscal years 1992-94 (see apps. II and III). This sample allowed us to make national estimates of certain characteristics of all emergency loans made during that period.

[1]See "Related GAO Products" at the end of this report.

[2]FSA consolidates and delivers services formerly provided by several predecessor agencies, including the farm loan programs administered by the Farmers Home Administration.

Results in Brief

Over the past 7 years, the Farm Service Agency (FSA), under its emergency disaster farm loan program, has forgiven over $6 billion in unpaid principal and interest. More losses can be expected because 80 percent of the $3 billion in outstanding loan principal is held by borrowers who are delinquent or who have previously had difficulty repaying emergency or other farm program loans.

Although emergency loans are inherently risky, several lending policies and practices have added to their risk. For example, current legislation does not prohibit borrowers who have received debt forgiveness on past loans from obtaining new emergency loans. Under another policy, borrowers with minimal projected cash flow margins are eligible to obtain loans—as long as their expected income equals their expected expenses, they qualify, and no cushion is required for unexpected difficulties. Besides having weak lending policies, the agency does not consistently implement lending requirements that are intended to safeguard federal financial interests. For example, the agency does not always verify the accuracy of the information in loan applications.

Although crop insurance was generally available, few recipients of emergency loans obtained coverage to protect their crops against the risk of natural disaster. Instead, they relied on the federal government for assistance. Recent legislation strengthens the requirement that emergency loan borrowers have crop insurance at the time of the disaster loss in order to qualify for loans. However, in most years, the Congress has waived this requirement.

Background

As the government's lender of last resort to the nation's farmers, FSA lends federal funds directly to farmers who are unable to obtain financing elsewhere at reasonable rates and terms. It also guarantees loans made by other agricultural lenders.

The emergency disaster loan program—in operation since 1949—is one of several FSA loan programs. Emergency disaster loans cover actual physical and production losses so that farmers can return to normal farming operations. The emergency loan program consists entirely of subsidized loans, offered at interest rates below those offered by other federal farm loan programs. As of January 1996, the emergency loan interest rate was 3.75 percent, while rates for other types of loans, such as operating and farm ownership loans, were 6.5 percent and 7.0 percent, respectively.

Emergency loans are made available in specific counties when disasters are declared by the President, the Secretary of Agriculture, or the FSA Administrator. Farmers may use loan funds for a variety of purposes, including land restoration, farm operating costs, family living expenses, and debt refinancing. Under the Food Security Act of 1985, applicants are ineligible for emergency loans for crop losses if they did not purchase insurance for crops planted or harvested after December 31, 1986, assuming it was available. However, in most years, the Congress has waived this requirement.

Currently, the maximum emergency loan assistance available to a farmer for any single disaster is the amount necessary to restore the farm to its condition preceding the disaster, not to exceed (1) the sum of 80 percent of the production losses plus 100 percent of the physical losses not reimbursed by other sources or (2) $500,000, whichever is less. Farmers can qualify for additional emergency loans following subsequent disasters. There is no limit on the total amount of emergency loan debt that a farmer may accrue.

Over the years, changes have occurred in the emergency disaster loan program. The program was expanded in the 1970s to achieve objectives other than the recovery from actual disaster losses, such as helping farmers survive during periods of financial stress or make major adjustments in their farming operations. However, during the 1980s, restrictions were placed on the availability of emergency loans, including the $500,000 limit for each disaster. As shown in table 1, the number and total value of emergency loans have varied greatly.

Table 1: Amount of Emergency Loan Obligations by Year, Fiscal Years 1975-95

Dollars in millions

Fiscal year	Number of loans	Amount of loan obligations
1975	43,675	$735.0
1976	18,453	$519.2
1977	35,769	$1,178.4
1978	89,119	$3,411.8
1979	62,913	$2,871.6
1980	54,394	$2,226.9
1981	138,990	$5,112.3
1982	42,863	$2,173.4
1983	8,771	$565.9
1984	34,997	$1,052.0
1985	14,060	$490.9
1986	5,584	$217.8
1987	2,548	$113.6
1988	554	$29.9
1989	2,806	$73.5
1990	2,609	$101.5
1991	1,181	$81.5
1992	1,602	$74.9
1993	885	$58.6
1994	3,815	$145.7
1995	1,526	$68.8

Source: FSA's obligation reports.

Our Previous Reports Have Highlighted the Risks in FSA's Farm Loan Programs

Problems with FSA's farm loan portfolio are not new. In 1990, we identified FSA's farm loan programs as one of 17 high-risk areas especially vulnerable to waste, fraud, abuse, and mismanagement. In 1992, we reported that the taxpayers' interests were not being protected in these programs, the agency had evolved into a source of continuous farm credit for many borrowers, and billions of dollars in debt were being written off.[3] Large losses continue to plague the programs.

We also issued two reports that focused specifically on emergency disaster loans. In November 1987, we reported that delinquencies in the emergency

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

disaster loan program were increasing, and we suggested that the Congress consider whether credit, particularly less restrictive credit, was the proper vehicle for providing disaster relief and whether a proper balance of risk existed between the farmer and the government.[4] In September 1989, we reported on the federal government's strategies for responding to natural disasters affecting agriculture—direct cash payments, subsidized loans, and subsidized insurance (crop insurance).[5] We concluded that crop insurance was the most effective of the three disaster assistance strategies in part because it could minimize the government's costs.

Large Losses in the Emergency Loan Program Are Likely to Continue

Although the amount of the outstanding emergency loan principal and the amount owed by delinquent borrowers have declined, FSA's emergency loan program continues to exhibit the problems that we first identified in 1987. From 1989 through 1995, the program has lost over $6.1 billion in debt forgiveness. Moreover, much of the remaining portfolio is at high risk of failure.

Billions of Dollars Have Been Lost

As shown in table 2, from fiscal years 1989 through 1995,[6] FSA forgave over $6.1 billion in principal and interest held by over 35,000 borrowers who did not meet their payment obligations.

[4]Farmers Home Administration: Problems and Issues Facing the Emergency Loan Program (GAO/RCED-88-4, Nov. 30, 1987).

[5]Disaster Assistance: Crop Insurance Can Provide Assistance More Effectively Than Other Programs (GAO/RCED-89-211, Sept. 20, 1989).

[6]We selected fiscal year 1989 as the starting point for our review because it was the first year for which computerized data were available.

Table 2: Amount of Emergency Loan Debt Forgiven, Fiscal Years 1989-95

Dollars in millions

Fiscal year[a]	Amount of emergency loan debt forgiven	Number of borrowers
1989	$1,617.3	11,102
1990	1,330.4	8,400
1991	815.0	4,525
1992	788.2	3,910
1993	647.8	4,032
1994	543.3	2,592
1995	403.5	1,769
Total	**$6,145.6[b]**	**35,439[c]**

Note: Judicial decisions in 1984 and 1987 prevented FSA's predecessor agency—the Farmers Home Administration—from foreclosing on delinquent borrowers. As a result, the losses since 1989 are probably higher than they would have been if the losses had been spread out over the previous years when the agency could not foreclose.

[a]Debt forgiven in any year may consist of loans made in previous years.

[b]The figures in the column do not add to the total because of rounding.

[c]The figures in the column do not add to the total because individual borrowers are counted only once and some borrowers received more than one loan over the 7 years.

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

In commenting on this report, agency officials noted that many of the past losses, as well as much of the risk in the current portfolio, are primarily attributable to past lending policies that have since been changed (see further discussion in the agency comments section). Also, they noted that the federal government's overall exposure to risk has decreased because the size of the program has declined.

Future Losses Could Be Significant

Although FSA has forgiven billions of dollars in emergency loans to borrowers who have had problems repaying their debt, the portfolio continues to present a high risk of substantial losses to the government. Much of the portfolio is held by borrowers who are delinquent or who have previously had difficulty repaying emergency or other types of FSA loans. Furthermore, borrowers have already had difficulty repaying recent loans, which reflect the most current changes to the agency's emergency lending policies and practices.

As of September 30, 1995, FSA had over $3 billion in outstanding emergency loan principal to 42,093 borrowers. Of that amount, about $1.8 billion, or 58.6 percent, was held by borrowers who were delinquent on emergency loans, a percentage that has been fairly consistent over the last several years, as shown in table 3.

Table 3: Outstanding Emergency Loan Principal and Amount Owed by Delinquent Emergency Loan Borrowers at Fiscal Year End, Fiscal Years 1985-95

Dollars in millions

Fiscal year end	Outstanding emergency loan principal	Principal owed by delinquent borrowers	Percentage owed by delinquent borrowers
1985	$9,862.2	$6,116.1	62.0
1986	$9,373.4	$5,928.3	63.2
1987	$8,639.6	$5,680.5	65.7
1988	$8,413.5	$5,932.2	70.5
1989	$7,682.6	$5,252.2	68.4
1990	$6,057.3	$3,802.0	62.8
1991	$5,296.2	$3.348.0	63.2
1992	$4,526.2	$2,847.7	62.9
1993	$3,876.1	$2,279.6	58.8
1994	$3,435.1	$1,914.9	55.7
1995	$3,046.3	$1,785.3	58.6

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

Payment status alone, however, does not provide a complete measure of the potential risk associated with the portfolio. This indicator excludes borrowers who may be current on emergency loan payments but who have previously had problems repaying emergency loans or other types of FSA farm loans. These problems required FSA to restructure payment schedules or forgive debt. As of September 30, 1995, such borrowers held approximately $665 million, or 21.8 percent, of the outstanding emergency loan principal. When this principal is combined with the principal owed by delinquent borrowers, about $2.5 billion, or 80.4 percent, of the outstanding emergency loan principal is held by borrowers who are at risk.

This overall picture of potential risk in the emergency loan portfolio reflects both past and present lending policies and practices. To better assess the risk associated with current loans, we examined the status of loans made during fiscal years 1992 through 1994.

FSA made 6,302 emergency loans totaling $279 million to 5,753 borrowers during this period. Although these loans are relatively new—from 1 to 4 years old—repayment problems have already surfaced. Through September 30, 1995, FSA had forgiven $1.2 million in uncollectible principal and interest on 41 of these loans. In addition, on the basis of our sample of 600 loans, we estimate that payments were delinquent on approximately 25 percent of the loans as of January 10, 1995.[7]

Weak Lending Policies and Practices Add to Inherent Risk of Emergency Loans

The likelihood that farmers will repay emergency loan debt is diminished by the nature of the loans. Emergency loans are inherently riskier than other types of farm loans because they are made to help farmers recover from losses rather than generate new income. This problem is compounded by weak lending policies and the agency's failure to implement existing lending requirements.

Lending Policies Are Weak

Three lending policies expose the government to potential losses by allowing borrowers who have poor credit histories or are in a very weak financial position to obtain loans. First, the provisions of the Consolidated Farm and Rural Development Act as amended (P.L. 87-128, Aug. 8, 1961) do not prohibit borrowers who received prior FSA debt forgiveness from obtaining additional farm loans, including emergency loans. We identified 293 borrowers who obtained $11.6 million in emergency loans during fiscal years 1992 through 1994 after having about $51 million in unpaid debt forgiven. As of September 30, 1995, 27 percent of these borrowers were already experiencing problems repaying the recent emergency loans. The following example illustrates this problem:

- A New York vineyard owner, an FSA farm loan borrower since 1978, received a 1993 emergency loan of $9,640 for crop losses resulting from a drought. FSA made this loan after having forgiven approximately $207,000 on five other farm loans in 1990. In January 1995, the borrower was delinquent on the 1993 emergency loan. FSA classified this borrower as being unlikely to repay the loan.

Second, FSA's method for determining an applicant's ability to repay a loan does not provide for contingencies. The current "cash flow" lending criterion requires only that an applicant have an estimated income equal to the estimated expenses in order to qualify for a loan. It does not provide a

[7]We chose Jan. 10 as a cutoff date to give the FSA county staff time to record payments at the beginning of the new year.

cushion for any unanticipated expense that may occur during the life of the loan.[8] On the basis of our sample of loans made during fiscal years 1992 through 1994, we estimate that FSA made about 62 percent of the emergency loans to borrowers whose anticipated income exceeded their expenses by less than 10 percent. Furthermore, about 17 percent of these borrowers attained these minimal cash flows only because FSA rescheduled or forgave debt on which the borrowers had failed to honor repayment schedules. As of September 30, 1995, approximately 37 percent of the borrowers with cash flow margins of less than 10 percent were behind on their loan payments or had required debt restructuring or forgiveness after receiving their emergency loans. For borrowers with cash flow margins of 10 percent or more, this percentage dropped to about 28 percent. The following example shows the kinds of problems that can arise when cash flow margins are minimal:

- A Michigan fruit producer applied for a 1992 emergency loan because of freeze damage. FSA approved the application, even though the applicant—an FSA borrower since 1985—had a poor payment history and a projected income exceeding his projected expenses by only $2. This borrower's cash flow margin was low even after FSA rescheduled existing loans on which he could not make payments. In 1993, the 1992 emergency loan was rescheduled because the borrower had not made payments; in 1994, the debt was forgiven; and, as of July 1995, the borrower was again delinquent on other FSA loan payments, and the county supervisor expected additional losses to the government.

Finally, there is no limit on the amount of emergency loan indebtedness an individual borrower may accumulate. Although assistance for a single disaster is limited to the amount necessary to restore a farm to its predisaster condition or $500,000, whichever is less, a farmer can obtain additional emergency loans for subsequent disasters. As of September 30, 1995, 696 borrowers had each accumulated emergency loan principal in excess of $500,000, with a cumulative total in excess of $800 million. These borrowers had a higher rate of delinquency than those with less outstanding emergency loan principal. Specifically, borrowers with more than $500,000 in emergency loan principal had a delinquency rate of 82 percent, while those with $500,000 or less in emergency loan principal had a delinquency rate of about 30 percent. The following example

[8]In 1987, FSA attempted to strengthen its loan-making criteria but withdrew its proposal in part because the Congress was concerned that more stringent lending criteria might limit the availability of farm loans. Similarly, in 1989, we recommended that USDA work with the Congress to improve the cash flow lending criteria (Farmers Home Administration: Sounder Loans Would Require Revised Loan-Making Criteria (GAO/RCED-89-9, Feb. 14, 1989)). However, the criteria remain unchanged.

illustrates the large emergency loan indebtedness that a borrower can accumulate and the types of repayment problems that can result:

- A Maryland farmer who operated a dairy and produced multiple crops had seven emergency loans with outstanding principal balances totaling approximately $850,000 as of September 30, 1995. According to an FSA county official, the borrower has been unable to repay the emergency loans on schedule, and FSA has deferred payments for 5 years. We noted that FSA compounded this problem in 1992 by providing an emergency loan that exceeded the borrower's eligibility level for the disaster by $101,000. FSA did not reduce the borrower's eligible losses, as required, by the amount of reimbursements received from the USDA's Federal Crop Insurance Corporation (FCIC).

The Congress is considering legislation that would strengthen two of the lending policies that expose the government to risk. In February 1996, the Senate passed a bill that generally would prohibit USDA from making farm program loans, including emergency loans, to borrowers whose debts have been forgiven—a proposal similar to one made by USDA. This bill would also restrict a borrower's outstanding emergency disaster loan principal to a maximum of $500,000.[9]

Lending Requirements Are Not Followed

Reviews by FSA and USDA's Office of Inspector General (OIG) noted weaknesses in FSA's emergency loan lending practices. Among other things, these reviews found that FSA field officials do not always receive accurate information in determining applicants' loan eligibility.

To determine whether its field offices are complying with its lending requirements, FSA conducts Coordinated Assessment Reviews (CAR).[10] For fiscal years 1992 through 1995, FSA completed CARs of 369 emergency loans. As shown in table 4, for at least 14 percent of the loans reviewed, FSA field offices had not verified information on the level of an applicant's disaster loss, debt, or income before approving the loan. While FSA considers noncompliance rates of more than 15 percent to be unacceptable, any noncompliance increases the government's financial risk. FSA officials noted, however, that in times of certain natural disasters, such as the Midwest flooding in 1993, the need to assist people quickly

[9]S. 1541, "Agricultural Reform and Improvement Act of 1996, 104th Cong., 2d Sess., secs. 641, 622 (1996).

[10]In the CARs, FSA reviews a random sample of loans in about 15 states annually. Each state is reviewed at least once every 3 years.

sometimes takes priority over following every detailed lending requirement.

Table 4: Noncompliance With Selected Lending Requirements on Emergency Loans, Fiscal Years 1992-95

Lending requirement	Number of loans tested	Rate of noncompliance
Disaster losses verified	261	18.4
Debts verified	367	16.1
Operating expenses deemed realistic	369	7.0
Nonfarm and other farm income verified and included in farm plan	305	14.4
Financial plan feasible	357	7.0

Note: Because the CARs of emergency loans covered only a relatively small number of cases, the results apply only to the sampled cases and cannot be projected to all emergency loans.

Source: FSA's CAR reports for fiscal years 1992-95.

The OIG also found problems with lending practices. According to December 1994 and March 1995 reports, six of seven emergency loans reviewed in Wisconsin and Illinois were overstated because they were not based on the most current and accurate information available at the time of the loan closings. Specifically, six borrowers received loans totaling about $100,000 more than they were entitled to receive because FSA approved the loans on the basis of information about the borrowers' eligibility that FSA believed to be accurate but later found to be in error. In commenting on a draft of this report, FSA officials told us that they verified the information when they approved the loans, but the information changed before they closed the loans. Furthermore, according to these officials, their current standards do not require them to reverify information that is provided by other USDA agencies, such as the Agricultural Stabilization and Conservation Service.

Few Borrowers Use Insurance to Protect Their Property

We have previously reported that subsidized crop insurance, compared to other forms of federal assistance such as loans and direct payments, is an efficient and equitable method of providing disaster assistance.[11] Although we did not perform a detailed analysis of why borrowers did not obtain insurance, FSA county officials reported that most borrowers who chose not to purchase insurance did so because they did not consider coverage to be cost-effective. Our sample of loans made during fiscal years 1992 through 1994, before recent crop insurance reform legislation provided

[11]Disaster Assistance: Crop Insurance Can Provide Assistance More Effectively Than Other Programs (GAO/RCED-89-211, Sept. 20, 1989).

coverage at minimal cost, indicates that very few borrowers obtained insurance to protect their crops against losses resulting from natural disasters, even though insurance was frequently available.

More specifically, we estimate that about 96 percent of the emergency loans made during fiscal years 1992 through 1994 covered crop losses, 4 percent covered real property losses, and 8 percent covered losses of other property, including livestock.[12] In most cases, crop insurance coverage was available to the borrowers either through FCIC or other sources. However, as shown in table 5, the borrowers frequently did not purchase coverage, even when both options were available. The table also shows that a smaller percentage of the borrowers rejected hazard insurance.

Table 5: Insurance Coverage on Emergency Disaster Loans Made During Fiscal Years 1992 Through 1994

Disaster loss		Insurance		
Type	Percentage of loans involved	Source/type of coverage	Percentage of loans for which coverage was available	Percentage of loans for which available coverage was not obtained
Crop	95.8	FCIC	96.7	51.6
		Other	69.9	77.1
		FCIC or other	98.2	44.5
		Both	68.4	91.6
Real property	4.1	Hazard	81.1	19.5
Other property[a]	8.1	Hazard	64.2	36.7

Note: Estimates of sampling errors appear in app. II.

[a]Includes items such as equipment and livestock.

Source: GAO's analysis of county supervisors' responses to GAO's questionnaire.

The following example illustrates a situation in which a borrower did not obtain crop insurance:

- An Iowa corn and soybean farmer, whose emergency loan application showed annual nonfarm income of $34,500 and about $8,000 in cash and certificates of deposits, did not obtain either FCIC or other crop insurance, even though both were available. The farmer lost $64,090 in crops as a result of flooding in 1993 and received approximately $21,000 in USDA

[12]The total of these percentages exceeds 100 percent because some loans covered more than one type of property loss.

disaster assistance, as well as an emergency loan for $34,480 in 1994. As of January 1995, this borrower was delinquent on the emergency loan payments. FCIC coverage would have cost $1,151 and paid the borrower about $15,200 for crop losses.

According to FSA county officials, most borrowers did not buy insurance because they did not consider coverage to be cost-effective.[13] The Food Security Act of 1985 makes applicants ineligible for emergency crop loss assistance if federal crop insurance was available to them and they did not purchase it for crops planted or harvested after December 31, 1986. This eligibility requirement has had little impact, however, because it has been waived in most years by subsequent disaster legislation enacted to minimize the economic hardships that some farmers might face in the absence of federal assistance. These waivers have not been targeted to grant relief to selected types of borrowers. Rather, the waivers have been made available to all who were interested in obtaining emergency loans in a particular year.

The crop insurance reform legislation enacted in 1994 may increase the use of crop insurance among those seeking USDA benefits, such as emergency loans, and decrease the availability of ad hoc disaster assistance for crop losses. The Federal Crop Insurance Reform Act of 1994, which became effective in 1995, generally conditions the receipt of USDA benefits, including emergency loans and price support benefits, upon an applicant's having obtained at least the minimum level of crop insurance available under the act, known as catastrophic risk protection, at a cost ranging from $50 to $600 for a borrower.[14] The 1994 act also made the passage of agricultural disaster assistance legislation more difficult.

Apart from crop loss insurance, the Congress is now considering legislation that may increase the use of hazard insurance by farmers. The agricultural credit legislation passed by the Senate in 1996[15] would prohibit

[13]In determining why insurance coverage was not obtained, we limited our review to asking FSA field officials why coverage was not obtained.

[14]Since the enactment of the 1994 crop insurance reform legislation, both Houses of Congress have passed proposed legislation which would give a person an alternative to obtaining the minimum level of crop insurance in order to be eligible for certain benefits, including emergency loans, with respect to spring planted 1996 and subsequent crops. Under this proposed legislation, a person could also remain eligible for these benefits by waiving, in writing, any eligibility for emergency crop loss assistance in connection with the crop.

[15]The February 1996 Senate bill would strike the 1985 law denying eligibility for emergency loans to those who had federal crop insurance available to them, apparently because the linkage between obtaining crop insurance and eligibility for emergency loans was addressed in the 1994 crop insurance reform legislation.

USDA from making emergency loans to farmers or ranchers unless the applicants had hazard insurance that insured their property at the time of the loss. The level of insurance needed to satisfy this requirement would be determined by the Secretary of Agriculture.

Conclusions

FSA's emergency loan program has lost billions of dollars in debt that has not been repaid, and it stands to lose billions more, given the characteristics of the borrowers currently holding emergency loans. The Congress is considering legislative changes whose implementation would help reduce the program's losses. However, these changes would not correct the weaknesses stemming from FSA's cash flow lending policy.

The 1994 insurance reform legislation strengthens the requirement that farmers have insurance in order to receive federal assistance, including emergency loans. In most years, the Congress has waived similar requirements for obtaining emergency loans, reflecting its desire to assist farmers suffering from the economic consequences of natural disasters. The Congress has, historically, granted waivers to all farmers who sought loans within a given year. Continued use of this blanket type of waiver may contribute to concerns about equity. For example, borrowers who, on a one-time basis, neglected to obtain insurance, would be treated in exactly the same way as borrowers who have repeatedly chosen not to obtain insurance and have relied, instead, on federal assistance to cover their losses.

Recommendation to the Secretary of Agriculture

We continue to believe that our 1989 recommendation to USDA to strengthen its cash flow lending policy has merit. More specifically, we recommend that the Secretary of Agriculture direct the FSA Administrator to develop regulations that improve the cash flow analyses used in loan-making decisions by incorporating an allowance to cover contingencies and the costs of replacing equipment.

Matters for Congressional Consideration

We recognize that recent legislation creates added incentives for borrowers to purchase crop insurance and that the Congress may consider many factors when deciding whether to waive the existing requirement for crop insurance. However, if the Congress decides to waive this requirement, it may wish to consider options that would more selectively target the applicants who would be eligible for the waiver and limit the amount of the loan that they could receive. These options could include

(1) prohibiting borrowers who have previously been granted insurance waivers from receiving additional waivers and/or (2) reducing the amount of an emergency loan to exclude the value of the proceeds that would have been available if the borrower had chosen to purchase the required insurance.

Agency Comments

We provided copies of a draft of this report to FSA for its review and comment. In a meeting to discuss FSA's comments, the Deputy Director for Farm Credit Programs and Farm Credit Program staff generally agreed with the report's conclusions and recommendations. However, they believed that several additional factors should be better recognized in discussions of the loan portfolio's risk.

FSA stated that its emergency loan obligations have decreased significantly in recent years; therefore, the government's exposure to risk has also decreased. We agree and show the decline in emergency loan obligations in table 1 of our report.

FSA also noted that the past losses and much of the risk associated with the current portfolio are due to policies that are no longer in effect. We agree that the current portfolio's problems can be linked to past policies; however, as noted in our report, not all of the policies that have contributed to these problems have been corrected. Consequently, there are still significant risks associated with the emergency loan program that could be reduced by further congressional or agency actions.

Finally, FSA stated that loan repayment statistics that we developed on recent loan making indicate acceptable performance, given the agency's role as a lender of last resort. In our view, the Congress is ultimately responsible for determining what constitutes acceptable levels of performance for these loans. Our report provides information that can help the Congress make this determination, noting, among other things, that these relatively recent loans have already shown signs of repayment problems.

We incorporated other technical corrections suggested by FSA officials as appropriate.

We performed our work between November 1994 and March 1996 in accordance with generally accepted government auditing standards. Our objectives, scope, and methodology are discussed in appendix I. Our

methodology for sampling and analyzing data is discussed in appendix II. The emergency disaster loan survey is presented in appendix III.

We are sending copies of this report to the appropriate congressional committees; interested Members of Congress; the Secretary of Agriculture; the FSA Administrator; the Director, Office of Management and Budget; and other interested parties. We will also make copies available on 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 IV.

Robert A. Robinson
Director, Food and
Agriculture Issues

Contents

Letter 1

Appendix I Objectives, Scope and Methodology 20

Appendix II Methodology for Survey of Emergency Disaster Loans 21

Appendix III Emergency Disaster Loan Survey 24

Appendix IV Major Contributors to This Report 32

Related GAO Products 36

Tables

Table 1: Amount of Emergency Loan Obligations by Year, Fiscal Years 1975-95 4

Table 2: Amount of Emergency Loan Debt Forgiven, Fiscal Years 1989-95 6

Table 3: Outstanding Emergency Loan Principal and Amount Owed by Delinquent Emergency Loan Borrowers at Fiscal Year End, Fiscal Years 1985-95 7

Table 4: Noncompliance With Selected Lending Requirements on Emergency Loans, Fiscal Years 1992-95 11

Table 5: Insurance Coverage on Emergency Disaster Loans Made During Fiscal Years 1992 Through 1994 12

Table II.1: GAO's Sample of Loans 21

Table II.2: Sampling Errors at the 95-Percent Confidence Level for Estimates of Loan Characteristics 23

Abbreviations

ASCS	Agricultural Stabilization and Conservation Service
CAR	Coordinated Assessment Review
FCIC	Federal Crop Insurance Corporation
FSA	Farm Service Agency
GAO	General Accounting Office
OIG	Office of Inspector General
USDA	U.S.Department of Agriculture

Objectives, Scope and Methodology

This review is part of a special GAO effort to address federal programs that pose a high risk of waste, abuse, and mismanagement. To gain a complete understanding of the Farm Service Agency's (FSA) emergency loan program, we reviewed FSA's regulations, operating instructions, and other guidance to field offices. We also interviewed officials at the agency's headquarters in Washington, D.C., and at state and county field offices. We analyzed computerized databases on the status of loans and loan obligations provided by FSA's Finance Office in St. Louis, Missouri.

Additionally, we reviewed and analyzed our prior reports addressing emergency loans, reports issued by the U.S. Department of Agriculture's (USDA) Office of Inspector General in December 1994 and March 1995, and the results of FSA's internal control reviews.

To obtain information on the characteristics of FSA's emergency loan borrowers and the planned use of loan funds, we mailed a survey to FSA county officials requesting information about a randomly selected stratified sample of the loans made from fiscal years 1992 through 1994. Appendix II discusses our survey's methodology and contains our estimates and sampling errors. Appendix III contains a copy of the survey used.

We started our field work in November 1994 and used September 30, 1995, as a cutoff date for the financial information about FSA's farm loan portfolio. This date allowed us to have relatively recent and comparable data on the financial status, including the losses, of FSA's emergency disaster loan portfolio. We present the loss information in nominal (versus constant) dollars. We performed our work in accordance with generally accepted government auditing standards.

Methodology for Survey of Emergency Disaster Loans

To obtain data on the emergency disaster loans that FSA made from fiscal years 1992 through 1994, we obtained computerized records from FSA of the 6,302 loans obligated during this period. The emergency loans obligated during this period totaled $279 million. FSA provided the automated data from its obligations database for each year. We divided this universe into two strata: one stratum consisted of loans whose obligation amount was less than $75,000, and the other stratum consisted of loans whose obligation amount was greater than or equal to $75,000.

We conducted a nationwide mail survey to obtain detailed data on the emergency disaster loans. The survey questionnaires were mailed on February 9, 1995, to the USDA county officials through whom the emergency loans were made. Of the 600 questionnaires mailed, 589 were returned with valid responses. These 589 valid responses represented an overall response rate of 100 percent because the remaining 11 files were either not available or the loans were never closed. The initial and adjusted universe and the number of responses by stratum are shown in table II.1. Our questionnaire appears in appendix III.

Table II.1: GAO's Sample of Loans

	Stratum		
	I	II	Total
Size of stratum	5,364	938	6,302
Size of initial sample	425	175	600
Size of adjusted sample[a]	421	168	589
Estimated size of stratum	5,314	900	6,214
Number of valid responses	421	168	589

[a]The sample size was adjusted to exclude 11 loans that either were never closed or had no available record.

We used the responses to the survey to project estimates for the universe of 6,302 loans. In addition, respondents supplied documentation supporting some of the critical facts in their responses to the survey. We used this documentation to verify the consistency of certain responses. When inconsistencies occurred and data were not available to determine the correct answer, we telephoned the county officials to obtain the correct information.

Since we used a sample of emergency disaster loans 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 the estimate. This range 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 procedures we used would produce a confidence interval containing the universe value that we are estimating. As table II.2 indicates, most of our estimates have relatively small sampling errors of fewer than 5 percentage points.

Table II.2: Sampling Errors at the 95-Percent Confidence Level for Estimates of Loan Characteristics

Description of estimate	Estimate[a]	Sampling error	95-percent confidence interval
Status of payment on loan			
Behind on payments	25.2	3.5	21.7 to 28.7
Crop			
Type of property loss covered	95.8	1.5	94.3 to 97.3
FCIC coverage available	96.7	1.4	95.3 to 98.1
FCIC coverage not obtained	51.6	4.4	47.2 to 56.0
Other coverage available	69.9	4.0	65.9 to 73.9
Other coverage not obtained	77.1	4.4	72.7 to 81.5
Either FCIC or other coverage available	98.2	1.0	97.2 to 99.2
Neither FCIC nor other coverage obtained	44.5	4.3	40.2 to 48.8
Both FCIC and other coverage available	68.4	4.0	64.4 to 72.4
Both FCIC and other coverage not obtained	91.6	2.5	89.1 to 94.1
Real property			
Type of property loss covered	4.1	1.4	2.7 to 5.5
Hazard coverage available	81.1	15.6[b]	65.5 to 96.7
Hazard coverage not obtained	19.5	16.8[b]	2.7 to 36.3
Livestock and other property (e.g., equipment)			
Type of property loss covered	8.1	2.1	6.0 to 10.2
Hazard coverage available	64.2	14.7[b]	49.5 to 78.9
Hazard coverage not obtained	36.7	18.7[b]	18.0 to 55.4

[a]The estimates presented in this table are based on the percentage of loans.

[b]The sampling errors are large in these cases because the sample was small.

Emergency Disaster Loan Survey

U. S. General Accounting Office
Survey of U.S. Department of Agriculture (USDA)
Emergency Disaster Farm 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 gather information on emergency disaster (EM) farm loans that were made during the fiscal year 1992 through 1994 period (October 1, 1991 - September 30, 1994) by USDA's Farmers Home Administration (FmHA). As you know, USDA recently abolished FmHA and established the Consolidated Farm Services Agency, which has been assigned the farm loan programs that FmHA had operated. We use FmHA in this questionnaire since it was responsible for EM loans during the fiscal year 1992-94 period.

This questionnaire is being sent to a sample of USDA county offices through which an EM loan 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.

INSTRUCTIONS

While some borrowers may have received more than one EM loan during the fiscal year 1992 through 1994 period, please answer all questions in this questionnaire in terms of the specific loan identified on the borrower label above. St. Louis Finance Office records indicate that the borrower had received this EM loan through your office.

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: Linda Libician
1445 Ross Avenue - Suite 1500
Dallas, TX 75202-2783

If you have any questions, please call Linda Libician or Reid Jones at 1-800-388-3289

BACKGROUND INFORMATION ON THE BORROWER AND THE DISASTER

1. Which of the following best describes the borrower's credit relationship with FmHA at the time this EM loan was made? (CHECK ONE.)

   1. [ ] An existing FmHA direct farm loan borrower-->(CONTINUE)

   2. [ ] A first-time FmHA direct farm loan borrower-->(GO TO QUESTION 3)

   3. [ ] A former FmHA direct farm loan borrower who did not have an outstanding direct loan at the time of this EM loan-->(GO TO QUESTION 3)

1

2. If an existing direct farm loan borrower, for how long had he or she received FmHA direct loan assistance at the time this EM loan was made? (CHECK ONE.)

   1. [ ] Less than 5 years
   2. [ ] 5 to less than 10 years
   3. [ ] 10 years or more

3. How long had the borrower been operating through lease or ownership his or her farm at the time the EM loan was made? (CHECK ONE.)

   1. [ ] Less than 5 years
   2. [ ] 5 to less than 10 years
   3. [ ] 10 years or more

4. In how many years of the last 5 fiscal years (Oct. 1, 1989, through Sept. 30, 1994) have disaster loans been available in the county where the borrower farms? (CHECK ONE.)

   1. [ ] One year
   2. [ ] Two years
   3. [ ] Three years
   4. [ ] Four years
   5. [ ] Five years

5. What was the disaster designation number and date--that is, the date of the Secretary of USDA's finding or presidential designation--for this EM loan? (ENTER NUMBER, AND MONTH, DAY, AND YEAR.)

   1. Number: _____
   2. Date: /___/___/___/
      Mo Da Yr

6. What type of natural disaster caused the loss that resulted in this EM loan? (CHECK ONE.)

   1. [ ] Drought
   2. [ ] Excessive rain or flood
   3. [ ] Frost or freeze
   4. [ ] Hail
   5. [ ] High wind
   6. [ ] Tornado
   7. [ ] Hurricane
   8. [ ] Other (SPECIFY):

   _____

7. In your opinion, could this disaster be considered a normal occurrence for your area, such as a reoccurring drought, or was it an unusual occurrence in your area, such as an out-of-the-ordinary flood? (CHECK ONE.)

   1. [ ] Normal occurrence
   2. [ ] Unusual occurrence

2

BORROWER'S FARMING OPERATION AND FINANCIAL POSITION

8. Which of the following best describes the primary type of farming--i.e., the one with the highest gross income--that the borrower was engaged in when the disaster occurred? (CHECK ONE.)

Crops

1. [ ] ASCS defined feed grains (e.g., corn and 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 crops (SPECIFY):

_____

Livestock and Products

9. [ ] Meat animals
10. [ ] Dairy products
11. [ ] Poultry and/or eggs
12. [ ] Other livestock and products (SPECIFY):

_____

9. What was the borrower's projected level of sales of farm products for the year in which the EM loan was made? (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

10. What was the borrower's total level of assets and liabilities (both farm and nonfarm) when he or she received the EM loan? (ENTER AMOUNT(S).)

1. Assets $_____
2. Liabilities $_____

11. What was the borrower's projected level of total income and expenses (both farm and nonfarm, including family living expenses) when he or she received the EM loan? (ENTER AMOUNT(S).)

1. Income $_____
2. Expenses $_____

BORROWER'S EM LOAN

12. Please enter the date that the borrower submitted a complete application for this EM loan and the date that the loan closed. (ENTER MONTH, DAY, AND YEAR FOR EACH.)

1. Loan application date: /___/___/___/ Mo Da Yr
2. Loan closing date: /___/___/___/ Mo Da Yr

3

13. What was the total gross dollar loss that the borrower had due to the disaster? (ENTER DOLLAR AMOUNT.)

    $_____

14. Which type property loss did this EM loan cover? (CHECK ONE FOR EACH.)

	Yes	No
1. Crops		
2. Livestock		
3. Real property (e.g., buildings)		
4. Other property (e.g., equipment)		
5. Other (SPECIFY) _____		

15. What property did the borrower pledge as security for this EM loan? (CHECK ALL THAT APPLY.)

    1. [ ] Real estate
    2. [ ] Chattel property
    3. [ ] Crops
    4. [ ] Livestock
    5. [ ] Other (SPECIFY):

    _____

16. In your opinion, what percentage of the outstanding loan amount would be recovered if your agency were forced to liquidate this loan and sell the loan security property? (ENTER PERCENTAGE.)

    _____ %

17. Was the EM loan that the borrower received equal to, more than, or less than the amount that he or she applied for? (CHECK ONE.)

    1. [ ] Loan amount equaled amount applied for-->(GO TO QUESTION 19)
    2. [ ] Loan amount was more than amount applied for-->(CONTINUE)
    3. [ ] Loan amount was less than amount applied for-->(CONTINUE)
    4. [ ] An actual amount was not specified in the loan application-->(GO TO QUESTION 19)

18. If the loan was for more or less than the amount applied for, what was the reason(s) for the difference? (BRIEFLY DESCRIBE THE REASON(S).)

4

19. Please indicate whether or not any of the listed factors were cited as a purpose for this EM loan by checking the 'yes' or 'no' box. And, for those factors that are cited 'yes', indicate the dollar amount allocated for that specific purpose, as well as the total amount of the loan. (CHECK ONE FOR EACH.)

	Yes	No	If yes, what was the amount?
1. Purchase farmland			$ _____
2 Repair or replace real estate capital items (e.g., buildings)			$ _____
3. Repair or replace machinery, equipment, or livestock			$ _____
4. Farm operating expenses			$ _____
5. Family living expenses			$ _____
6. Refinance existing debt			$ _____
7. Other (SPECIFY) _____			$ _____
8. TOTAL AMOUNT OF LOAN			$ _____

20. If this EM loan was for refinancing, which of the following lenders held the debt that was refinanced? (CHECK ONE FOR EACH.)

[ ] N/A - Loan was not for refinancing

	Yes	No
1. FmHA		
2. Commercial bank		
3. Farm Credit System		
4. Other commercial lender (e.g., mortgage corporation)		
5. Trade creditor (e.g., equipment dealer)		
6. Other (SPECIFY) _____		

21. What was the status of payments on this EM loan, as of Jan. 10, 1995? (CHECK ONE.)

1. [ ] Loan was repaid
2. [ ] First payment not yet due
3. [ ] Current on payments
4. [ ] Behind on payments
5. [ ] Other (SPECIFY): _____

22. If the first payment on this EM loan was not yet due, do you anticipate that the borrower will make the first payment on schedule? (CHECK ONE.)

1. [ ] Not applicable (first payment due date has occurred)
2. [ ] Yes
3. [ ] No

5

23. As of Jan. 10, 1995, how much principal and interest has been due on this EM loan and how much has been paid? (ENTER AMOUNT(S).)

Principal and interest due

1. Principal $_____

2. Interest $_____

Principal and interest paid

3. Principal $_____

4. Interest $_____

OTHER INFORMATION

24. What insurance coverage was available that could have protected the borrower from the loss experienced in this disaster? (CHECK ONE.)

1. [ ] All property could have been covered by insurance -->(CONTINUE)

2. [ ] Some but not all property could have been covered by insurance -->(CONTINUE)

3. [ ] No insurance coverage was available for the property-->(GO TO QUESTION 27)

25. If full or partial insurance coverage was available, was it obtained by the borrower? (CHECK ONE FOR EACH.)

	Yes	No	N/A
1. Federal Crop Insurance Corp. (FCIC)			
2. Non-FCIC crop insurance			
3. Hazard insurance on real property items			
4. Hazard insurance on machinery, equipment, or livestock			
5. Other (SPECIFY COVERAGE) _____			

26. If insurance coverage was available but the borrower had not obtained it, what was the reason(s) why not? (BRIEFLY DESCRIBE THE REASON(S).)

6

27. Did the borrower receive any other disaster assistance or compensation--for example, ASCS disaster payments or FCIC supported crop insurance payments--that involved or was related to the disaster that resulted in this EM loan? (CHECK ONE.)

    1. [ ] Yes-->(CONTINUE)

    2. [ ] No-->(GO TO QUESTION 29)

28. If yes, which of the following provided the assistance or compensation and, if so, how much was provided? (CHECK ONE FOR EACH AND ENTER DOLLAR AMOUNT.)

	Yes	No	If yes, how much was provided?
1. ASCS			$ _____
2. FCIC			$ _____
3. Other (SPECIFY) _____			$ _____
4. Other (SPECIFY) _____			$ _____

YOUR COMMENTS

29. Please provide below any comments you wish to make concerning this EM loan.

30. Please provide below any comments you wish to make concerning the use of EM loans to assist farmers.

(CONTINUE TO NEXT PAGE)

REMINDER: Please provide photocopies of three forms that were used in deciding to approve and fund this loan--the Farm and Home Plan, the Certification of Disaster Losses, and the Calculation of Actual Losses.

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: _____
(Please print)

Title: _____

Telephone number:_____

Thank you for your cooperation and assistance.

8

Major Contributors to This Report

Resources, Community, and Economic Development Division

Linda J. Libician, Assistant Director
Robert E. Robertson, Adviser
Reid H. Jones, Project Leader
Syrene D. Mitchell, Evaluator
Olin S. Thummel, Evaluator
LuAnn Moy, Social Science Analyst
Robert C. Sommer, Computer Analyst
Donna B. Svoboda, Computer Analyst

Related GAO Products

Consolidated Farm Service Agency: Update on the Farm Loan Portfolio (GAO/RCED-95-223FS, July 14, 1995).

High-Risk Series: Farm Loan Programs (GAO/HR-95-9, Feb. 1995).

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).

Disaster Assistance: Crop Insurance Can Provide Assistance More Effectively Than Other Programs (GAO/RCED-89-211, Sept. 20, 1989).

Farmers Home Administration: Sounder Loans Would Require Revised Loan-Making Criteria (GAO/RCED-89-9, Feb. 14, 1989).

Farmers Home Administration: Problems and Issues Facing the Emergency Loan Program (GAO/RCED-88-4, Nov. 30, 1987).

Federal Disaster Assistance: What Should the Policy Be? (PAD-80-39, June 16, 1980).

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

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