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STATEMENT OF
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RESOURCES, COMMUNITY, AND ECONOMIC DEVELOPMENT DIVISION
BEFORE THE
SENATE COMMITTEE ON AGRICULTURE, NUTRITION, AND FORESTRY
ON THE
FINANCIAL CONDITION
OF THE FARMERS HOME ADMINISTRATION'S
LOAN PORTFOLIO AND ITS BORROWERS

Mr. Chairman and Members of the Committee:

We are here today at your invitation to discuss two reports issued to you earlier this month on work we did at your request at the U.S. Department of Agriculture's (USDA) Farmers Home Administration (FmHA).

As you know, Mr. Chairman, your letter of September 6, 1985, to us expressed concern over the American farmers' growing reliance on the resources of FmHA. You noted that FmHA's outstanding farm loan portfolio had increased from about $6 billion in 1978 to almost $28 billion in 1985. With the Congress addressing the issue of financial stress in U.S. agriculture, including FmHA's future role in assisting farmers, you asked us to provide this Committee with both national and state information on

--total farm debt and FmHA's portion of that total,

--total number of loans and borrowers and loan amounts for each of FmHA's major farmer programs, and

--delinquencies and loan losses occurring in these programs.

You also asked us to provide certain financial and general characteristics such as debt load, cash flow, assets, liabilities, income, the type and size of farm operations, and demographic data on FmHA borrowers.

Mr. Chairman, as you might suspect, the financial condition of FmHA's loan portfolio and its borrowers is not a very pretty picture. Individual debt load is high. A typical FmHA farmer is seeing shrinking equity, annual operating-cash shortfalls, and high debt-to-asset ratios, making many farmers technically insolvent. FmHA as an agency is experiencing loan delinquencies in the billions of dollars. Loan losses are increasing, as evidenced by the almost doubling of losses from 1984 to 1985. FmHA at the same time has responded to credit requests by substantially increasing its loan portfolio and trying to "walk the extra mile" with its problem borrowers. New loans have been made to already technically insolvent borrowers who, in some cases, were seriously delinquent and might not be able to work their way out of these financial problems. The result is an FmHA farm loan portfolio that contains a large number of loans that are highly susceptible to default. FmHA estimates that about $14 billion, or about half of its $28 billion farm loan portfolio, is in jeopardy of default.

The information contained in our reports comes from our analyses of FmHA automated data bases and other FmHA and USDA records. Attached to my testimony is a summary of the scope and methodology applied in our reviews.

The remainder of my testimony discusses our two reports in more detail, followed by some observations. The first report I will discuss provides an overview of FmHA's loan portfolio.

AN OVERVIEW OF FARMER PROGRAM DEBT, DELINQUENCIES, AND LOAN LOSSES (GAO/RCED-86-57BR)

FmHA is a credit agency of USDA. FmHA makes direct loans (government-funded) and guarantees loans made by private lenders primarily to family farmers who are unable to obtain credit from other lenders at reasonable rates and terms. Our report provides information on FmHA's five major farmer loan programs: farm ownership, operating, emergency disaster, economic emergency, and soil and water.

The financial condition of farmers and their lenders has deteriorated rapidly since 1980. As a result, increasing numbers of farmers have been turned down for financing by their private lenders and have come to FmHA for credit assistance. FmHA has responded to these credit requests by substantially increasing its loan portfolio.

Total farm debt from all lenders more than doubled over the 10 years prior to 1985, growing from about $91 billion to over $212 billion. Over this same period, FmHA's farm debt increased over 400 percent.

As of June 30, 1985, FmHA's direct farm loan portfolio was almost $28 billion--consisting of approximately 270,000 borrowers with 757,000 loans. The three largest loan programs are emergency disaster ($9.9 billion, 289,000 loans, and 122,000 borrowers), farm ownership ($7.4 billion, 162,000 loans, and 125,000 borrowers), and operating ($6.0 billion, 207,000 loans, and 124,000 borrowers).

FmHA's growing farm loan portfolio is increasingly at risk because delinquencies are on the rise and loan losses are mounting.

Delinquent payments on FmHA direct farm loans have risen from $164 million in June 1976 to $823 million in June 1980 to $6.4 billion in June 1985. Almost $4 billion of the 1985 delinquencies are in one loan program--emergency disaster.

The $6.4 billion direct loan delinquent amount represents nonpayment of principal and interest due on over 97,000 borrowers' loans with outstanding principal of $13.4 billion--almost half the total direct loan portfolio. In addition, delinquent amounts would be much higher if FmHA had not made about 45,000 borrowers current during fiscal year 1985 without requiring full loan payments. FmHA accomplished this through servicing actions such as rescheduling/reamortization and the setting-aside of debt for later payment.

About $4.8 billion--or 75 percent of the June 1985 $6.4 billion direct loan delinquent amount--is owed by about 37,000 borrowers who have not made a loan payment in over 3-years. According to FmHA officials, borrowers over 3 years delinquent probably will not be able to catch up on their payments and most likely will fail. Over $3 billion of this $4.8 billion is in the emergency disaster program.

For the past 10 fiscal years, annual FmHA farm loan losses (net of proceeds from sales of loan collateral) have grown from $24 million in 1976 to over $335 million in 1985 for direct loans and from $963,000 to over $19 million for guaranteed loans. Total annual farm loan losses increased over 400 percent between 1982 and 1985, growing from $82.6 million to $354.5 million, with the losses almost doubling between 1984 and 1985. Cumulative loan losses for the past 10 years have been greatest in the emergency disaster ($492 million) and economic emergency ($238 million) programs.

Mr. Chairman, this report contains a great deal of statistical information not only on the amounts of FmHA farm debt, delinquencies, and loan losses but also where this activity is located. Included in the report are a series of maps, tables, and graphs, which display the nationwide distribution of the statistics, and detailed state-by-state listings of loan activity.

FINANCIAL AND GENERAL CHARACTERISTICS OF FARMER LOAN PROGRAM BORROWERS (GAO/RCED-86-62BR)

I will now briefly discuss our second report, which analyzes the FmHA borrowers' financial condition.

FmHA acts as the federal government's "lender of last resort" and, as such, is expected to serve farmers under a high degree of financial stress. Our analysis of the financial condition of individual borrowers highlights the seriousness of this financial stress.

A primary source of financial information on the borrowers was FmHA's Farmer Program Information System, also known as the FARMS data base. FARMS was designed to capture certain financial and other characteristics of FmHA's farm borrowers. Although

FARMS does have some limitations, as discussed in the attachment, it is the most complete source of financial information available on FmHA borrowers. FmHA believes that this information is representative of all FmHA farmer program borrowers on a national basis.

In our report, we measured the financial condition of FmHA borrowers in the following ways:

--debt-to-asset ratio,

--equity position, and

--cash flow.

The debt-to-asset ratio, which compares the value of a farmer's assets to the amount of money owed to creditors, indicates the farmer's overall financial soundness and risk-bearing ability.

According to USDA's Economic Research Service, at current prices, farming costs, and asset values, most farmers start having difficulties meeting principal repayment commitments at debt-to-asset ratios of around 40 percent. Above 70 percent, farmers generally have problems meeting their interest and principal repayment commitments, and many start sliding toward insolvency. The final critical point is insolvency where the total debts of the farmer exceed the total value of owned assets. At this point, a farmer generally cannot meet either interest or principal payments; and the value of assets, if sold, would not be enough to retire the debts.

Our analysis showed that the average FARMS borrower has a debt-to-asset ratio of 83 percent. About 20 percent of the FARMS borrowers are technically insolvent, with debt-to-asset ratios of over 100 percent, as contrasted with about 3 percent of all U.S. farmers reported in this category by USDA in January 1985. An additional 31 percent of the FARMS borrowers are having extreme financial problems with debt-to-asset ratios of between 70 and 99 percent, while USDA classified 7 percent of all U.S. farmers in that category.

The FARMS borrowers we analyzed owed $8.1 billion or about 30 percent of the entire loan portfolio. Our analysis of these borrowers showed that those classified as technically insolvent owed over $2.2 billion on 61,000 loans. Other borrowers classified as having extreme financial problems owed an additional $2.9 billion on 81,000 loans. Thus, in June 1985 FmHA had over $5.1 billion outstanding on 142,000 loans to FARMS borrowers who were in extreme financial difficulty.

A farmer's equity represents the net worth of the farm operation; or, stated differently, equity is the value of property owned above the amount of debt associated with it. Our analysis showed that the average equity of FARMS borrowers is about $73,000. However, 20 percent of the borrowers have a negative equity, and an additional 8 percent have less than $10,000 equity.

A borrower's future equity position is greatly affected by the cash flow of his farming operations. A shortfall in cash flow can significantly erode a farmer's equity position.

Cash flow statements provide information on the source of cash income, both farm and nonfarm, and indicate the farm's overall ability to pay current production expenses, service principal and interest payments on farm debt, and provide for family living needs.

Our analysis showed that the average FARMS borrower has a net cash shortfall of $56,000. The major contributor to this cash shortfall is the amount of annual debt repayment ($83,000) required from the farmer's total income ($110,000). Eighty-five percent of the borrowers had a negative cash flow.

The report also provides general characteristics of the borrowers such as type of farm operation; type, size, and number of loans; and personal characteristics.

GAO OBSERVATIONS

As you can see, Mr. Chairman, these two reports paint a rather gloomy picture of the financial condition of FmHA loan programs. In these difficult times, FmHA is faced with the dilemma of providing credit to high-risk farmers while at the same time protecting the government's, and ultimately the taxpayer's, financial interests. The principal issue is: Where do you strike the balance? Where do you draw the line?

In February 1982, FmHA revised its servicing policy to assist farmers under extreme economic stress by allowing them to obtain additional farm loans without considering their ability to repay prior debts. This policy allowed many farmers to stay in business. However, it also resulted in FmHA's lending money to many farmers whose ability to repay was questionable.

For example, from the FARMS data we identified new loans totaling about $763 million made to 7,000 technically insolvent borrowers during the first 6 months of calendar year 1985. Additional new loans, for $1.2 billion, were made to 12,000 borrowers with extreme financial problems. These new loans include the servicing of existing debt and thus not all of the $1.9 billion is new money. In addition, although FARMS borrowers we analyzed represent onlv 30 percent of all borrowers, FARMS borrowers in extreme financial difficulty owed FmHA over $5.1 billion as of June 1985.

With more of its farm loan portfolio at risk, FmHA issued a policy directive in November 1985 that requires a borrower to be current on loan payments before additional credit will be provided. To help borrowers bring their loans into a current status, FmHA offers a variety of servicing alternatives, such as payment deferment and the consolidation, rescheduling, and reamortization of loans. Much concern has been expressed in the media and by Members of the Congress about the appropriateness of FmHA's actions.

As you can see, Mr. Chairman, FmHA does not have an easy task in finding an appropriate balance between acting as the lender of last resort for farmers who cannot get credit elsewhere while at the same time protecting the government's financial interests through sound loan-making practices.

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Mr. Chairman, I have attached to my testimony a series of maps, charts, and graphs from these two reports. This information highlights the results of our analyses. In addition, GAO has done a great deal of work recently that deals with the financial stress in agriculture. I have attached for your information a list of the reports that address various issues related to the financial and economic condition of the agricultural sector.

That concludes my statement. We will be glad to respond to any questions.

SCOPE AND METHODOLOGY

The information contained in our two reports comes from FmHA automated data bases and other FmHA and USDA records. We did not test the validity or reliability of this information. We obtained overall farm debt information from various reports issued by USDA's Economic Research Service. We developed FmHA farm debt information, including delinquencies, from FmHA's Master Borrower File and loan status reports. Loan loss data came from USDA budget records. We conducted our own computer analysis and developed programming and format methodologies to single out and specifically report on FmHA's five major farmer loan programs: farm ownership, operating, emergency disaster, economic emergency, and soil and water.

The primary source of financial information on the borrowers was FmHA's Farmer Program Information System, also known as the FARMS data base. FARMS was designed to capture certain financial and other characteristics of FmHA's farm borrowers. We obtained a July 1, 1985, copy of this data base, which was started by FmHA in 1983. We conducted our own computer analyses of the data and identified 66,000 individual borrowers who had received 117,000 FmHA farm loans during 1983 and 1984. We sorted, tabulated, arrayed, and averaged financial information on these borrowers using various production, sales, debt, asset, and personal characteristics. Although FARMS does have some limitations, it is the most complete source of financial information available on

FmHA borrowers. FmHA believes that this information is representative of all FmHA farmer program borrowers on a national basis.

We obtained agency comments on the results of our work, and the agency agreed with the information contained in the reports. The comments provided were incorporated in the reports where appropriate.

Figure I.1: Index of Farm Debt, December 31, 1975-1984

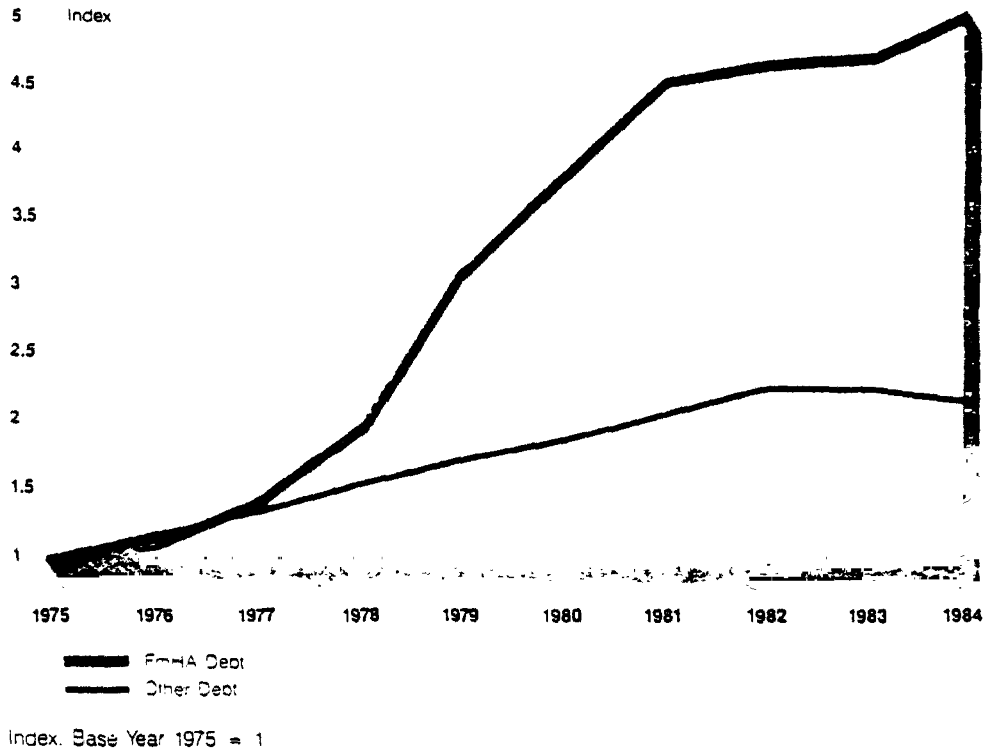


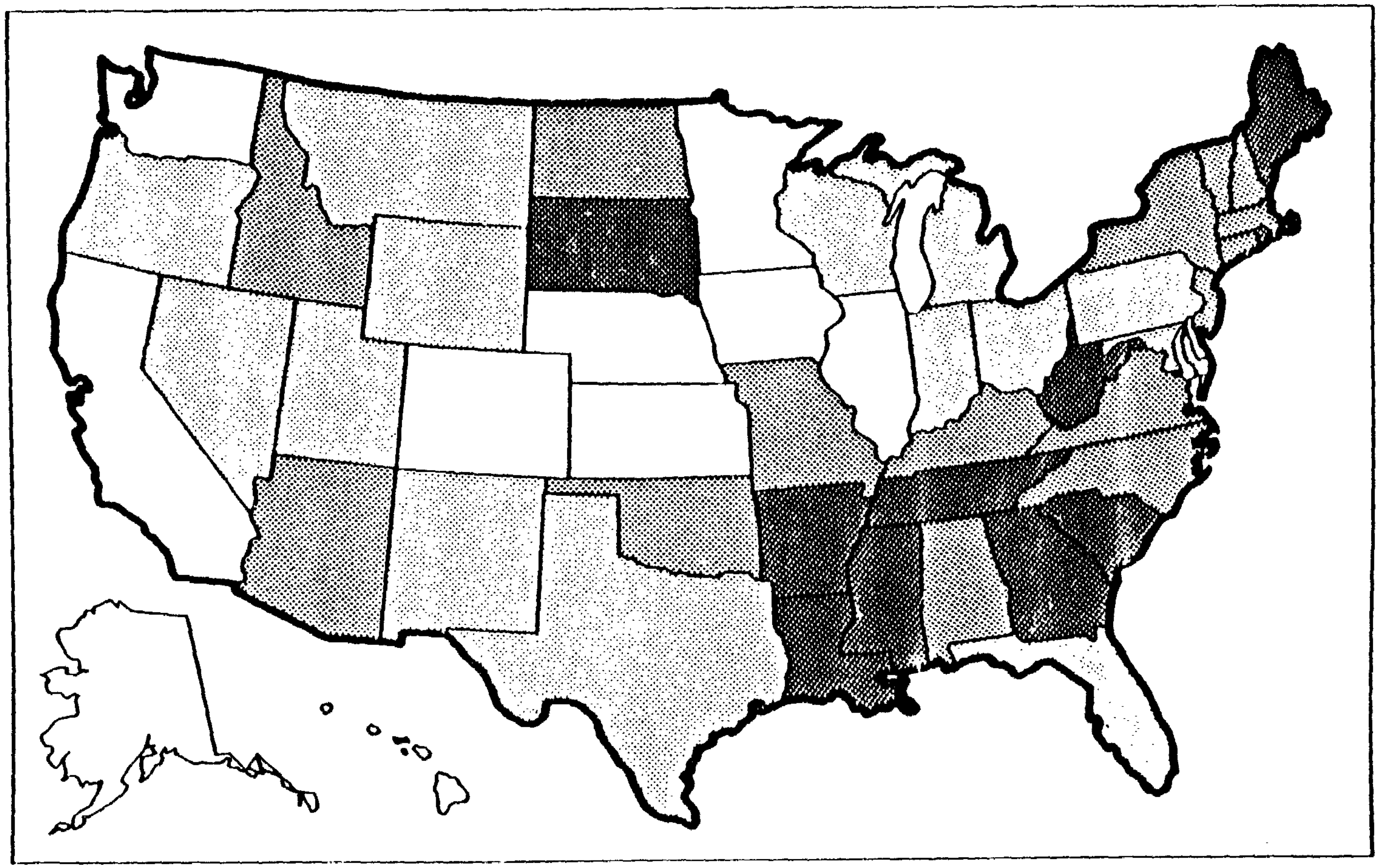
Table I.1
FmHA and All Other Farm Debt
(December 31, 1975-1984)

Year	FmHA farm debt (billions)	Index of annual change[a]	All other farm debt[b] (billions)	Index of annual change[a]	Total farm debt
1975	$ 5.1	1.00	$ 86.5	1.00	$ 91.6
1976	5.5	1.08	98.5	1.14	104.0
1977	7.1	1.39	115.9	1.34	123.0
1978	9.9	1.93	131.2	1.52	141.1
1979	16.1	3.13	150.0	1.73	166.1
1980	19.5	3.79	162.9	1.88	182.4
1981	23.2	4.51	178.9	2.07	202.1
1982	23.8	4.64	193.4	2.24	217.2
1983	24.1	4.69	192.1	2.21	216.2
1984	25.7	4.99	186.9	2.16	212.5

[a]Index: Base year 1975 = 1; index calculations based on whole numbers.

[b]Excludes FmHA farm debt.

Figure I.4: FmHA Farm Debt as Percent of Total Farm Debt--Nationwide Distribution, December 31, 1984



22.5-46.9 % (10 States)

14.0-22.5% (15 States)

8.5-14.0% (15 States)

Less Than 8.5% (10 States)

Figure II.1: FmHA Major Farmer Program Outstanding Principal--Direct Loans, June 30, 1976-1985

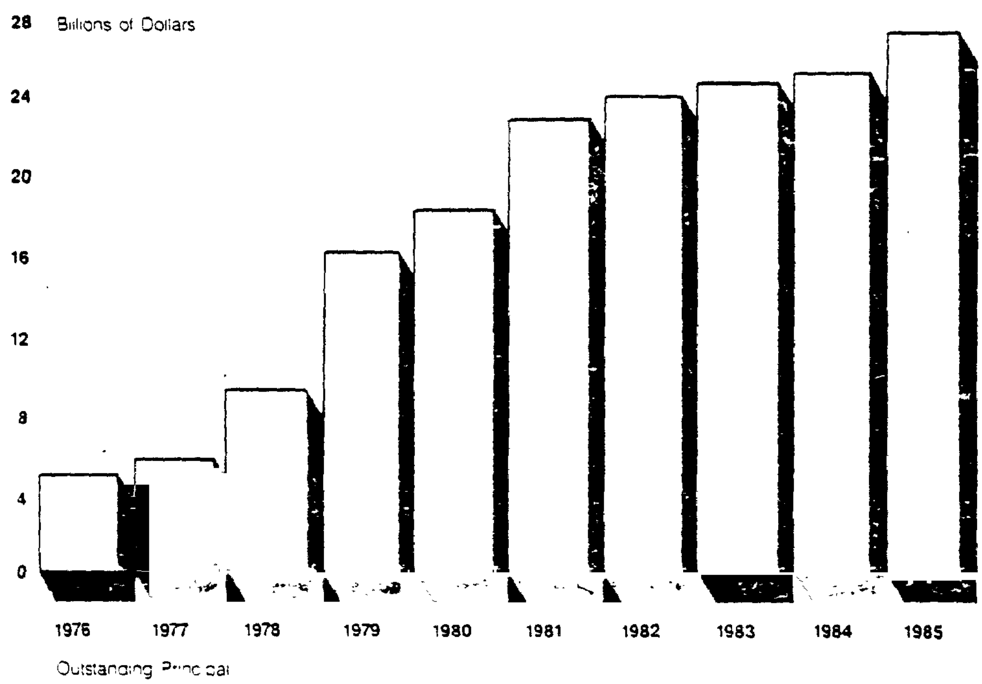


Figure II.6: Total FmHA Major Farmer Program Outstanding Principal, Direct Loans--Nationwide Distribution, June 30, 1985

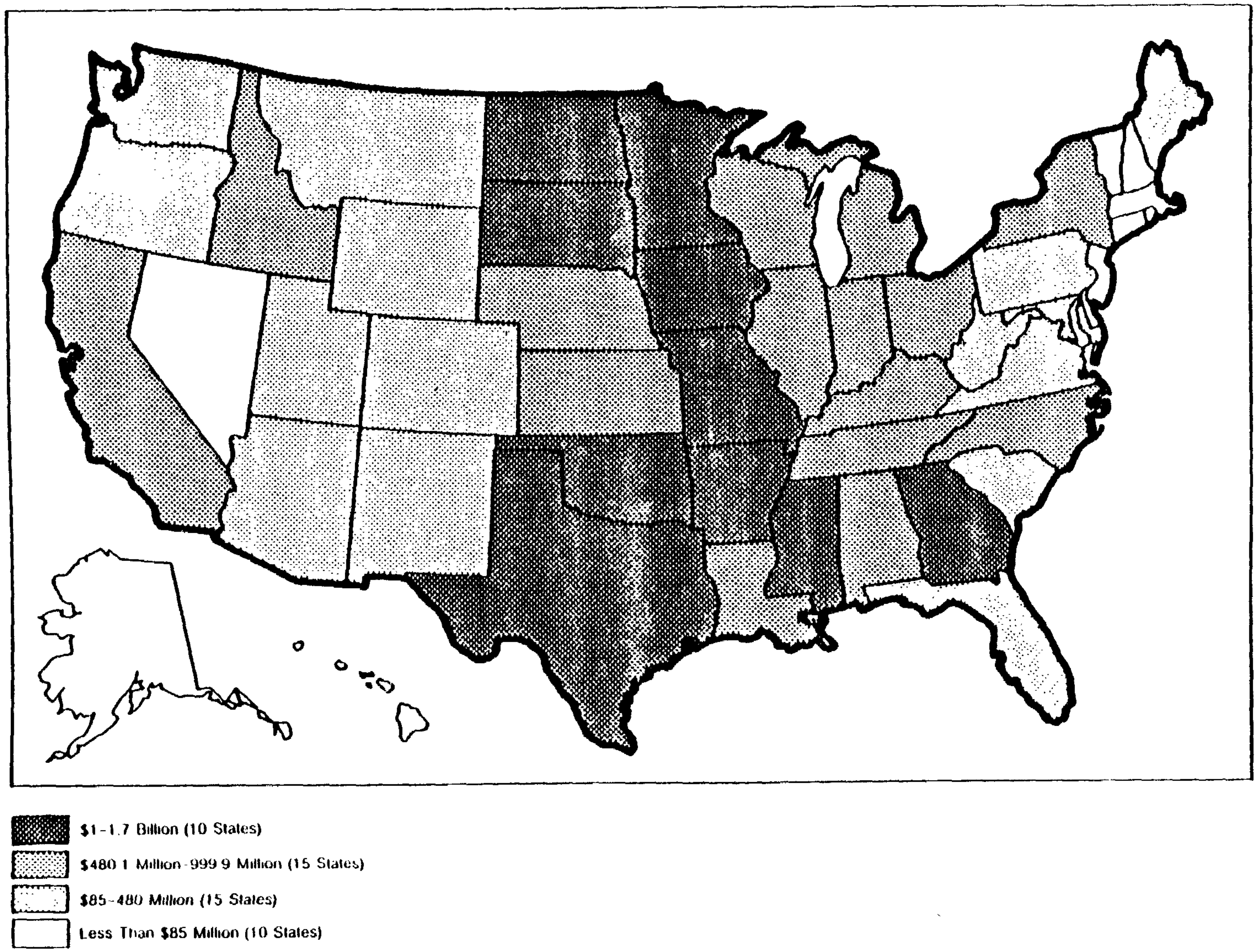


Figure III.1: FmHA Major Farmer Program Delinquencies as a Percentage of Outstanding Principal, June 30, 1976-1985

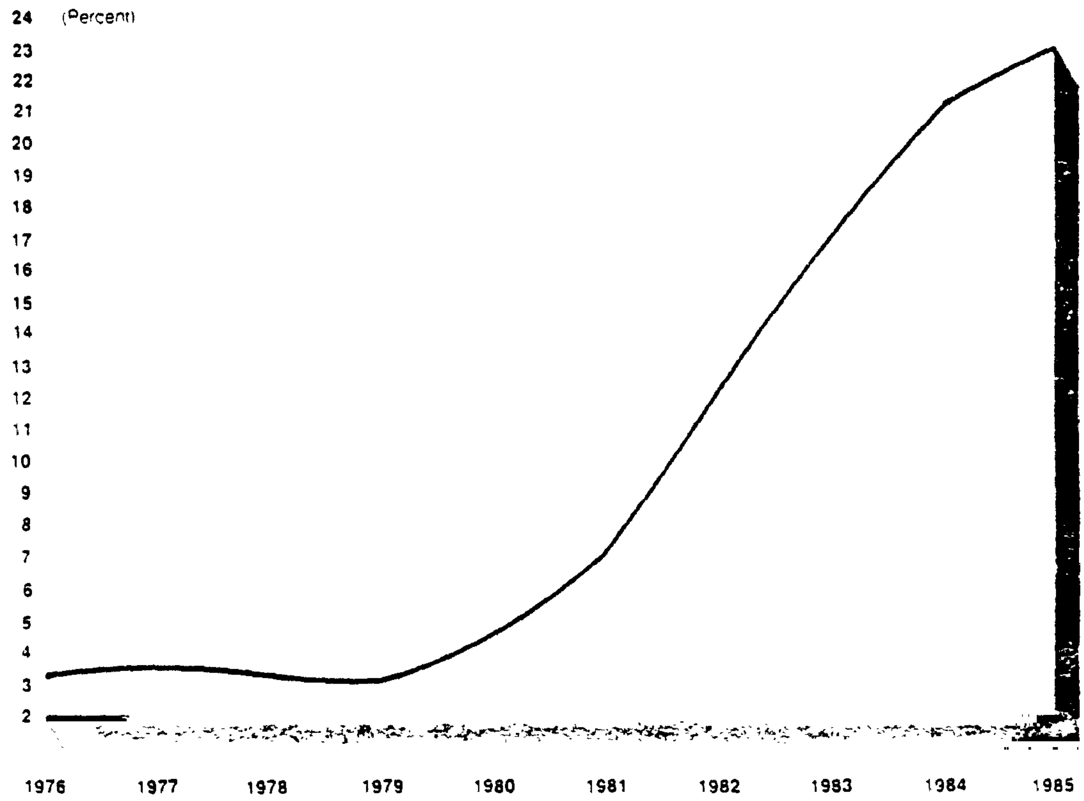


Figure III.2: FmHA Major Farmer Program Delinquent Dollars, June 30, 1976-1985

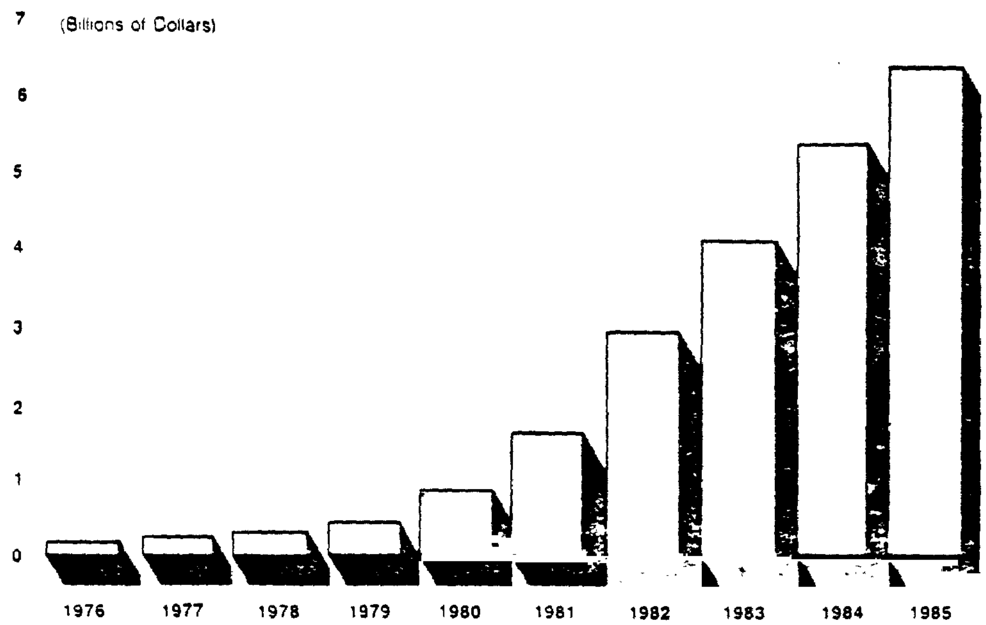


Figure III.3: FmHA Major Farmer Program Outstanding Principal on Delinquent Loans, June 30, 1976-1985

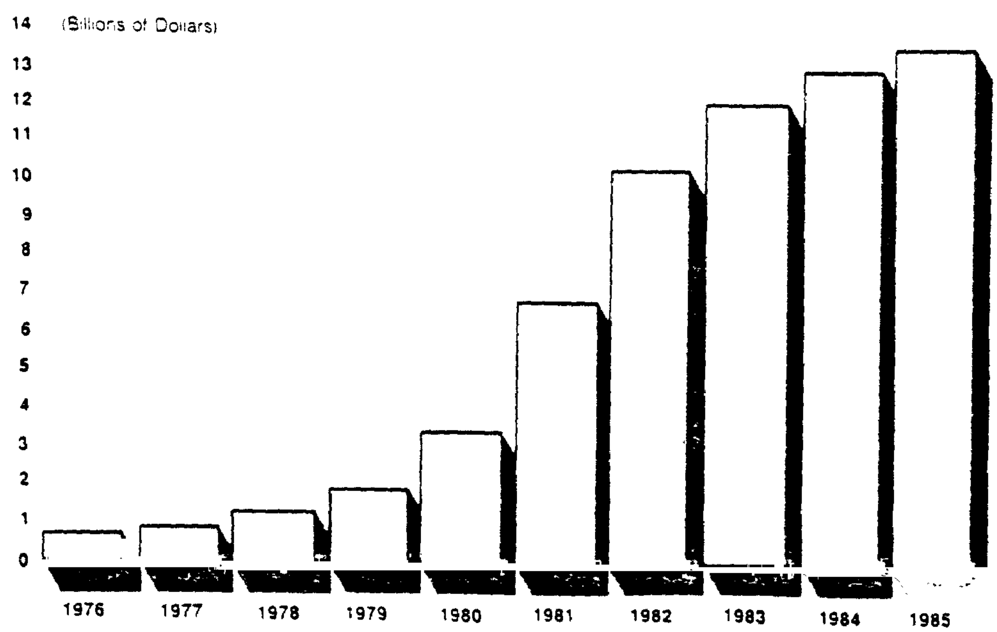


Figure III.4: Percent of FmHA Major Farmer Program Dollars Delinquent Over 3 Years to Total Delinquent Dollars, June 30, 1976-1985

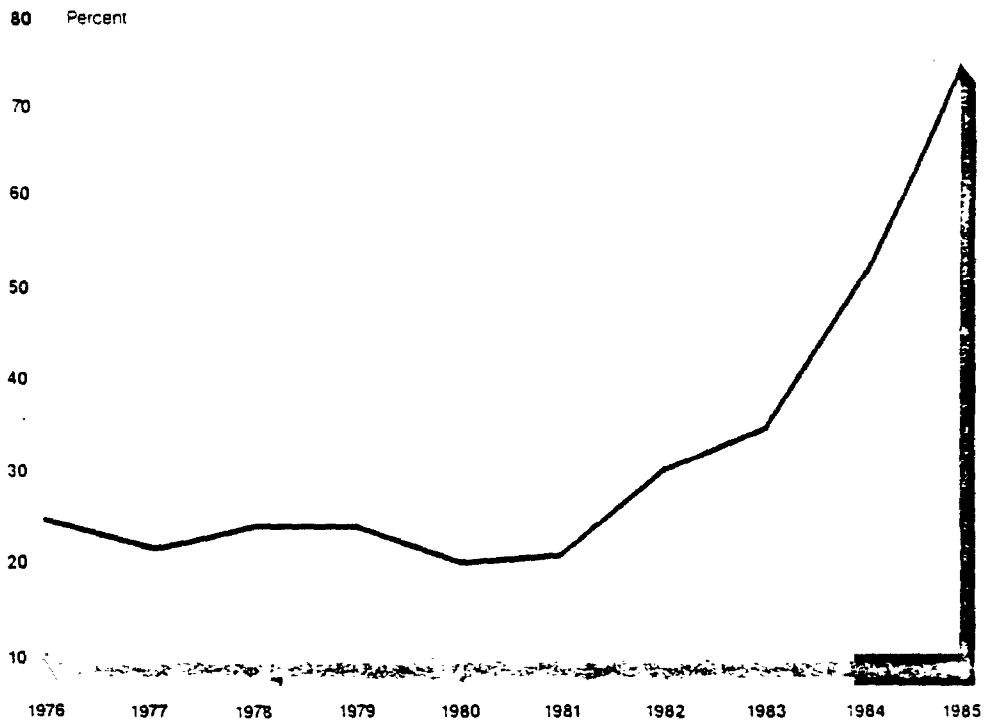
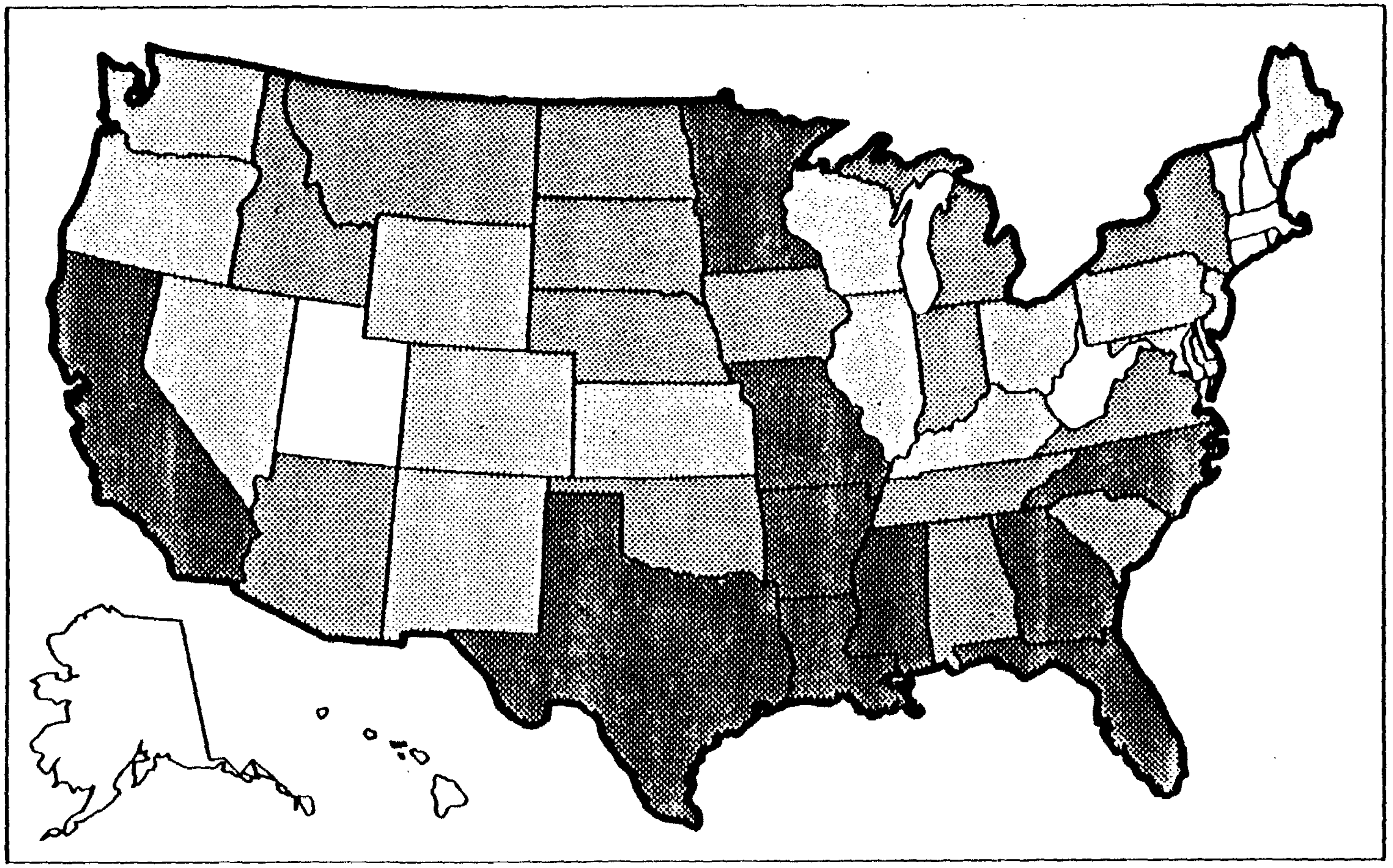


Figure III.13: FmHA Major Farmer Program Dollars Delinquent Over 3 Years--Nationwide Distribution, June 30, 1985



$120-659 Million (10 States)

$60.1-120 Million (15 States)

$4-60 Million (15 States)

Less Than $4 Million (10 States)

Table 1.1

Statement of Assets and Liabilities for FARMS Borrowers[a]

	Average	Median	Number of borrowers
Property owned/assets			
Real estate	$181,900	$135,000	52,109
Livestock	39,400	25,000	44,928
Machinery and equipment	58,000	40,000	63,033
Personal property	33,600	20,000	63,432
Total	$262,700	$190,000	64,869
Debts owed/liabilities			
Liens on real estate	$125,400	$ 85,000	48,664
Liens on chattel and crops	88,800	60,000	59,681
Judgments	21,300	100	9,149
Taxes	2,300	600	18,676
Other debt	14,000	5,000	46,015
Total	$193,700	$135,000	63,406
Equity	$73,400	$40,000	63,288[b]
Debt-to-asset ratio	83%	70%	63,288[b]

[a]The totals are not equal to the sum of their parts because figures were rounded and not all data elements applied to all borrowers.

[b]Of the 65,893 FARMS borrowers analyzed, 63,288 reported sufficient data to compute a debt-to-asset ratio and equity position.

Source: GAO analysis of 1983 and 1984 FARMS data.

Table 1.4

Total Loan Amount Outstanding on All FmHA Farm Loans Owed by FARMS Borrowers as of June 30, 1985

Financial status of borrower	Debt/asset ratio (percent)	Number of borrowers	Number of loans	Loan amount outstanding (millions)
Technically insolvent	100 and over	11,658	61,082	$2,214
Extreme financial problems	70 to 99	18,488	81,521	2,910
Serious financial problems	40 to 69	18,723	68,796	2,143
No apparent financial problems	under 40	9,998	30,394	870
Total		58,867	241,793	$8,137

Source: GAO analysis of 1983 and 1984 FARMS data and FmHA's Master Borrower File as of June 30, 1985.

Table 2.1

Cash Flow Statement for FARMS Borrowers[a]

	Average	Median	Number of borrowers
Crop income	$67,300	$45,000	55,899
+ Livestock income	53,500	30,000	44,235
+ Conservation payments & other farm income	9,000	5,000	23,536
= Total cash farm income	$98,300	$75,000	64,530
- Cash farm operating expenses	72,900	60,000	64,321
= Net cash farm income	$25,700	$20,000	64,298
+ Nonfarm income	12,000	10,000	46,833
= Total net cash income	$34,200	$25,000	64,692
- Cash family living expenses	11,000	15,000	63,130
= Net cash income	$23,500	$15,000	64,728
- Debt repayment due this year	83,300	55,000	61,932
= Cash surplus/ shortfall	-$56,000	-$30,000	64,930[b]

[a]The totals and subtotals are not equal to the sum of their parts because figures were rounded and not all data elements applied to all borrowers.

[b]Of the 65,893 FARMS borrowers analyzed, 64,930 reported sufficient data to compute a cash flow statement.

Source: GAO analysis of 1983 and 1984 FARMS data.

Table 2.2

FARMS Borrowers With a Cash Surplus or Cash Shortfall

	Cash surplus or shortfall	Number of borrowers	Percent of borrowers
Negative Cash Flow	-$100,001 or more	11,740	18
	-$ 50,001 to -$100,000	11,883	18
	-$ 10,001 to -$ 50,000	22,578	35
	-$ 1 to -$ 10,000	8,885	14
Total			85
Positive Cash Flow	$ 0 to $ 10,000	4,752	7
	$ 10,001 to $ 50,000	3,618	6
	$ 50,001 to $100,000	788	1
	$100,001 or more	686	1
Total			15
Total		64,930	100

Source: GAO analysis of 1983 and 1984 FARMS data.

GAO REPORTS ADDRESSING VARIOUS ISSUES RELATED TO THE FINANCIAL AND ECONOMIC CONDITION OF AGRICULTURE

1. Information on Delinquent Borrowers in Farmers Home Administration Major Farmer Loan Programs (GAO/RCED-85-71, Feb. 6, 1985).

2. Report on the Implementation of the Farm Credit Act Amendments of 1980 (GAO/GGD-85-32, Apr. 8, 1985).

3. Processing Time for Farmers Home Administration Operating Loans in Minnesota During Fiscal Year 1984 (GAO/RCED-85-142, Aug. 26. 1985).

4. Preliminary Analysis of the Financial Condition of the Farm Credit System (GAO/GGD-86-13BR, Oct. 4, 1985).

5. Financial Condition of American Agriculture (GAO/RCED-86-9, Oct. 10, 1985).

6. Farm Credit Administration's Liquidation of Production Credit Associations (GAO/GGD-86-35BR, Dec. 1985).

7. Agriculture Overview: U.S. Food/Agriculture in a Volatile World Economy (GAO/RCED-86-3BR, Nov. 1985).

8. Farm Credit System: GAO's Analysis of the System's Third Quarter Financial Condition (GAO/GGD-86-35BR, Dec. 1985).

9. Farmers Home Administration: An Overview of Farmer Program Debt, Delinquencies, and Loan Losses (GAO/RCED-86-57BR, Jan. 1986).

10. Farmers Home Administration: Financial and General Characteristics of Farmer Loan Program Borrowers (GAO/RCED-86-62BR, Jan. 1986).