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## What is the Loss Experience for FSA's Guaranteed Farm Loans?

by:

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The Farm Service Agency's (FSA) guaranteed farm loans are the primary mechanism for providing federal farm credit assistance, with \$7.6 billion in outstanding loans at mid-2000. FSA guaranteed an average of \$1.7 billion in farm loans per year, or 68 percent of the agency's total annual farm lending volume, during the 1990s. FSA has operated guaranteed farm ownership (FO) and guaranteed operating loan (OL) programs since 1974, but the programs received little funding until the mid-

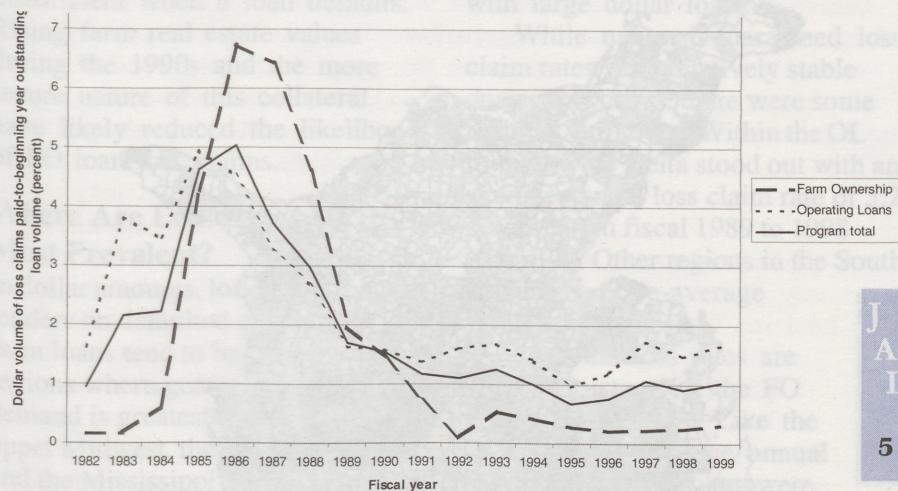
1980s; earlier the agency emphasized its direct loan programs.

While annual guaranteed farm loan volume has increased, loan defaults and loan losses have been modest during the 1990s, especially when compared to FSA's direct lending programs. From fiscal 1982 through fiscal 1999, FSA guaranteed \$24.3 billion in farm loans made by commercial banks, the Farm Credit System and other lenders. Guaranteed farm loan loss payments made to lenders totaled \$745 million during this period. This level of loss claims or "settlement" payments translates into an overall loss rate of about 3 percent on the \$24 billion in gross lending volume.

### Annual Loss Rates Up Slightly

Annual loss claims paid to lenders as a percentage of outstanding beginning year guarantee volume has risen only slightly in recent years, despite a weaker farm economy (figure 1). During the 10 fiscal years beginning in 1990, guaranteed loss settlements with lenders averaged \$53 million per year, which translates into an average annual loss rate of under 1 percent. In fiscal 1999, loss

Figure 1. Annual FSA Guaranteed Loan Loss Rates, Fiscal 1982-99



claims paid to lenders rose to \$67.8 million, a level slightly above the decade average.

The financial performance of many guaranteed loan program borrowers, especially those raising crops, has been bolstered by record levels of government farm payments. Government support is helping to keep farm loan defaults from rising dramatically. Guaranteed farm loan borrowers are generally less creditworthy and hence more vulnerable during economic downturns than other farm borrowers (Dodson and Koenig).

There is a substantial difference in the annual loss claim rates between the guaranteed OL and FO programs. OL loans, which cover short-term financing needs and chattel financing, had higher loss claim rates, averaging 1.4 percent per year during the 1990s. FO loans, which must be secured with

farm real estate and have long repayment periods, had an average annual loss rate of just 0.3 percent during the decade. Loss settlements with lenders on FO loans averaged just \$8 million per year during the 1990s.

The difference in loan loss rates between the two loan programs is consistent with the higher delinquency rates for the OL program. Delinquent loan volume at fiscal year-end averaged 1.2 percent for FO and 2.1 percent for OL loans during the 1990s. Loan delinquency rates have been creeping up in the OL program since 1995, suggesting that the loss rate for this program may continue to rise. The difference between loan program delinquency and loss rates is likely attributed in large part to the fact the guaranteed FO loans must be secured with farm real estate, while OL loans are generally secured with crops and chattel. Greater variability in crop

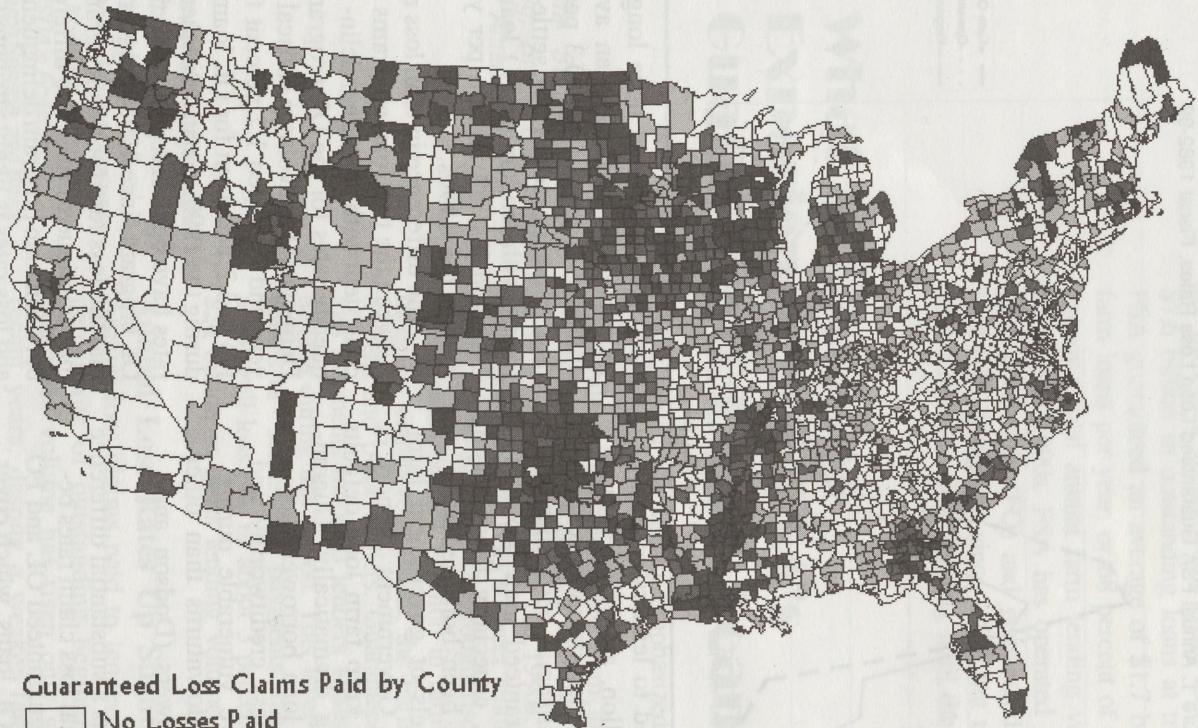


Figure 2

and chattel values coupled with losses in production means OL loan collateral is more likely to be insufficient when a loan defaults. Rising farm real estate values during the 1990s and the more secure nature of this collateral have likely reduced the likelihood of FO loan loss claims.

## Where Are Losses Most Prevalent?

In dollar amounts, loss claims paid to lenders on defaulted guaranteed farm loans tend to be concentrated in regions where guaranteed loan demand is greatest (figure 2). The upper Midwest, the Southern Plains and the Mississippi River Delta have the greatest concentrations of counties with high guaranteed loan loss claims, but high loss counties are also scattered elsewhere. Many counties in major farming regions have had few or no loss claims paid

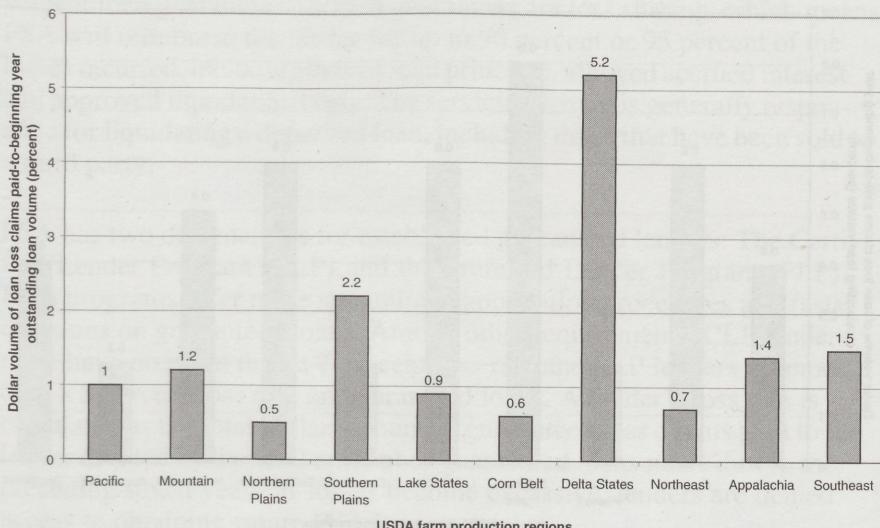
since 1989. Often large losses on a few loans within the county explain the presence of counties with large dollar losses.

While national guaranteed loss claim rates were relatively stable during the 1990s, there were some regional variations. Within the OL program, the Delta stood out with an average annual loss claim rate of 5.2 percent from fiscal 1989 to 1998 (figure 3). Other regions in the South also had above-average annual loss rates.

Regional loss rates are more consistent for the FO program (figure 4). Like the OL program, average annual loss rates for FO loans were the lowest in the Corn Belt and Northern Plains. These regions account for a large share of total farm debt as well as total guaranteed FSA debt.

Congress provides a certain

Figure 3. Average Annual Guaranteed Operating Loan Loss Rates, Fiscal 1989-98

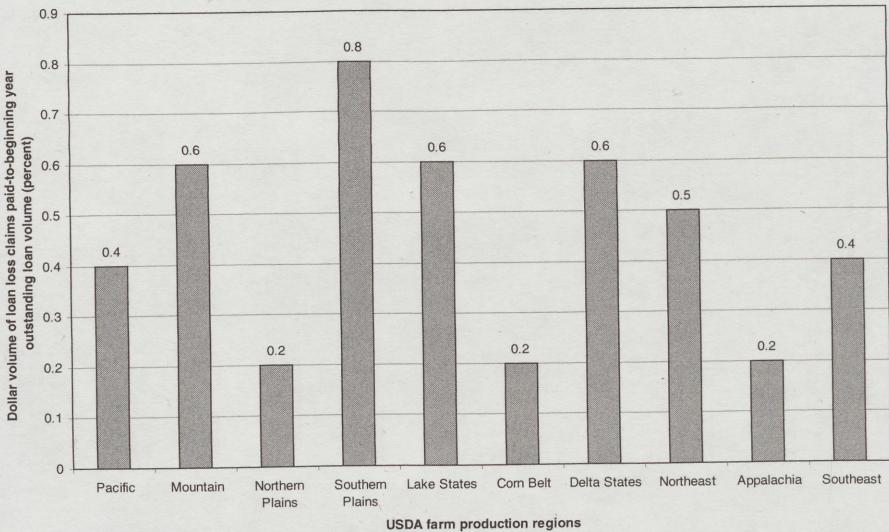


amount of money, or budget authority, for FSA loan programs each year. The amount of lending that a given level of budget authority will support is determined by the budget subsidy rate, or the cost of lending \$1 under the program (Koenig and Dodson). For example, a budget authority of \$1 will support \$20 of lending at a 5 percent total subsidy rate, but \$100 of lending at a 1 percent subsidy rate.

For the guaranteed FO loan program, the rate of loss claim payments made to lenders is the primary factor in determining the budgetary subsidy rate. For the guaranteed OL loan program, the amount of interest rate assistance provided is the other primary factor determining the budgetary subsidy rate. Administrative costs are treated as a separate budget item and are not included in the subsidy rate calculation. In addition, FSA collects a 1 percent fee on loans guaranteed, which helps to offset costs associated with loss claim payments to lenders and interest rate assistance to borrowers. In fiscal 1999, FSA collected \$16.2 million in guarantee fees from lenders.

Because FO loss rates have been very low

Figure 4. Average Annual Guaranteed Farm Ownership Loss Rates, Fiscal 1989-98



in recent years, the subsidy rate for this program has also been kept low. The subsidy rate fell from 1.59 percent in fiscal 1999 to 0.56 percent for the fiscal 2000 budget, allowing lawmakers to provide more guaranteed FO lending authority in fiscal 2000 for less budget cost. An uptick in loss claims paid is having the opposite effect for the OL program. The guaranteed OL subsidy rate increased from 1.16 percent to 1.41 percent from fiscal 1999 to fiscal 2000, thereby increasing the budget cost for each dollar of lending in fiscal 2000.

For OL loans made with 4 percent interest rate assistance, the subsidy rate rose to 8.81 percent for fiscal 2000. The much higher subsidy rate for OL loans made with interest rate assistance means that signifi-

cantly fewer borrowers can be served for a given dollar amount of budget authority. Therefore, when interest rate assistance is provided on guaranteed loans, there is a trade-off between the number of borrowers helped by the programs and the amount of financial help provided per borrower.

### Summary

Despite low farm commodity prices in recent years, Farm Service Agency guaranteed farm loan default rates and loss claim rates have increased only slightly. Record levels of government farm program payments have helped many indebted farmers avoid defaulting on their FSA guaranteed loans thus far. In fiscal 1999, loss claims paid to lenders did rise to \$67.8 million,

### How Do FSA Farm Loan Guarantees Work?

Under a loan guarantee, FSA guarantees repayment of 90 percent of a loan made by the participating lender. For loans to certain beginning farmers and loans to refinance direct FO loans, FSA provides a 95 percent loan guarantee. All loan guarantees are loss sharing, which means FSA will reimburse the lender for up to 90 percent or 95 percent of the losses incurred, including loss of loan principal, allowed accrued interest and approved liquidation costs. The servicing lender is generally responsible for liquidating a defaulted loan, including those that have been sold to a third party.

FSA has two designations for established guaranteed lenders: The Certified Lender Program (CLP) and the Preferred Lender Program (PLP). Both programs offer more streamlined application procedures and faster decisions on guaranteed loans. Among other requirements, CLP lenders must have no more than a 7 percent loss rate and PLP lenders no more than a 3 percent loss rate on guaranteed loans. A lender's loss rate is calculated as the total dollar amount of guaranteed loss claims paid to the lender divided by the total amount of guaranteed loans made during the preceding seven years. If losses become excessive, lenders are denied access to obtaining future FSA loan guarantees.

but the rate of loss claims remained close to the decade average of 1 percent. Loss claim rates are greater for the guaranteed Operating Loan program, and rising delinquency rates on these loans suggest that loss claim payments to lenders could rise again in fiscal 2000. Loss payments made to lenders under the guaranteed farm ownership program remain very low, perhaps reflecting continued strength in farm-land values across most major farm production regions. jal

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