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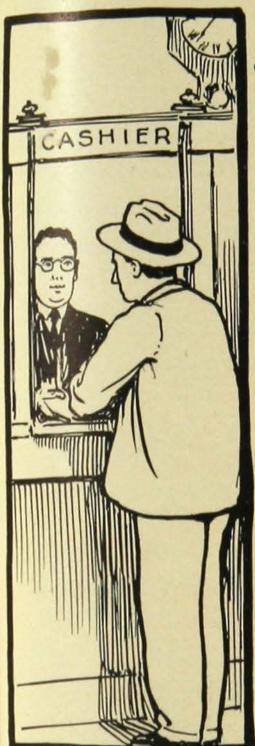

AGRICULTURAL CREDIT IN MINNESOTA

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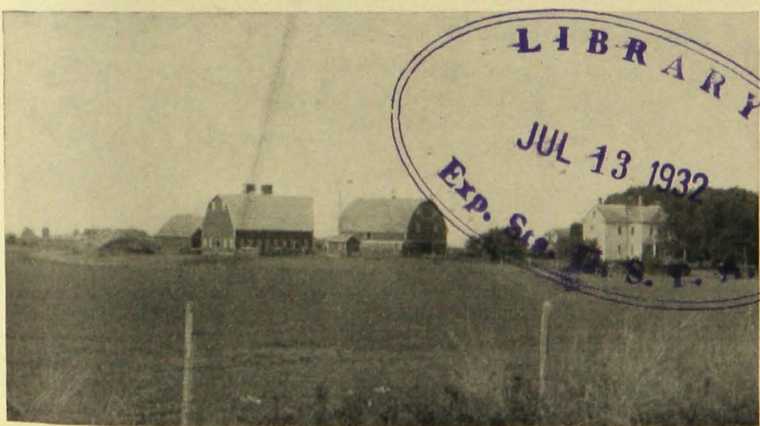

UNIVERSITY OF MINNESOTA
AGRICULTURAL EXTENSION DIVISION

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MINNESOTA farmers are dependent upon credit for part of the funds necessary to own and operate farms, and interest payments are important items of expense. During periods of prosperity, most farmers find little difficulty in meeting interest payments when due and increased borrowing usually follows. In periods of depression, however, incomes decline and many farmers find it very difficult to meet financial obligations. Also during periods of depression, many farmers feel that they can not get the credit they need, and credit in agriculture becomes an issue of great importance. Because of the importance of the credit problems at the present time, it was thought advisable to obtain facts relative to the credit situation by sending inquiries to farmers asking for information in regard to their use of credit. The questionnaire was mailed in June, 1931, to representative Minnesota farmers and 502 usable reports were received.

Of the 502 farmers, 431 were owners of farms and 71 were tenants. Of all farmers replying only 20 per cent were free from debts. In Table 1 the farmers are classified according to districts and the percentage having debts.

Table 1

Number of Minnesota Farmers, Number Reporting Debts, and Percentage Reporting Debts

District	Number of farmers	Number reporting debts	Per cent reporting debts
Northwestern	53	39	74
Southwestern	305	256	84
Southeastern	144	107	74
All farmers	502	402	80

The farmers were asked whether they had requested credit during the last year. Forty-four per cent reported that they had asked for credit and that 77 per cent of the total amount asked for had been granted. Only 19 per cent of those asking for credit were refused all credit; 72 per cent received all and 9 per cent a part of the amount requested. (See Tables 2 and 3.)

Table 2

Percentage of Minnesota Farmers Requesting Credit in the Last Year and Percentage of Total Amount Granted

District	Per cent requesting credit	Per cent of amount requested, granted
Northwestern	32	66
Southwestern	45	78
Southeastern	46	75
All farmers	44	77

Table 3

Percentage of Minnesota Farmers Refused All, Refused Part, or Received All of the Credit Requested

District	Refused all	Refused part	Received all
Northwestern	31	19	50
Southwestern	20	10	70
Southeastern	13	6	81
All farmers	19	9	72

Nearly one-fifth of all the farmers reporting were refused all the credit requested. This may not seem to indicate that a large share of the farmers are unable to obtain credit, but examination of Tables 2 and 3 shows that conditions are not the same throughout the state. In northwestern Minnesota only one-half of the farmers received all the credit requested and one-third were refused all requested. On the other hand, in southeastern Minnesota only one-eighth of the farmers were refused all the credit for which they asked. In other words, conditions are different in the various communities. In some regions, under present conditions, the farmer can obtain additional credit without much difficulty but in others the credit available to farmers is restricted.

The purpose for which loans are sought is an important factor in determining whether or not credit asked for will be granted. If the loan is for productive purposes, that is, if the funds will be used in an enterprise that is likely to yield enough income to pay the interest and principal of the note when due, the lender is more likely to make the loan than if it is for the purchase of consumptive goods or payment of debts, interest, and taxes. Fifty-five per cent of the farmers that were refused credit said they wanted the funds to pay debts, interest, and taxes. Others were refused credit that they felt was needed for operating. Twelve per cent of the farmers refused credit wanted funds for feed and seed; 15 per cent, for machinery and equipment, and 6 per cent for purchasing cattle. Farmers that were refused credit indicated that the main reasons advanced by credit agencies for refusing to make loans were depression in agriculture, insufficient security for the loan, and lack of available funds.

MORTGAGE CREDIT

Generally speaking, loans to farmers can be divided into two main classes according to security: (1) Loans secured by a mortgage on real estate and (2) loans secured by personal note and chattel mortgage. Of the farm owners reporting, 67 per cent said their farms were mortgaged. In northwestern and southeastern Minnesota, 57 per cent reported mortgages; in southwestern Minnesota 74 per cent had mortgages. Approximately 13 per cent of all the farmers had second mortgages. The average amount of second mortgages for farms reporting was $3,695 as compared to $8,214 for first mortgages. The average amount of all mortgage indebtedness per farm was $8,874. (See Table 4.)

Table 4

Percentage of Minnesota Farms Operated by Owners Reporting Farm Mortgages and Average Amount of Mortgage Indebtedness

District	Per cent reporting mortgages	Per cent reporting first and second mortgages	Average amount of mortgage debt for farms reporting mortgages
Northwestern	58	9	$6,387
Southwestern	74	15	9,718
Southeastern	57	9	7,621
All farms	67	13	$8,874

Many of the mortgages on farms in Minnesota are the result of borrowing during the period of inflation, 1917-20. At that time, prices were high and income on farms was much larger than at present and it was not so difficult to pay interest on the mortgage. In recent years, the mortgage debt on most farms has not decreased but the farmer's income, because of falling prices, has declined materially, with the result that interest payments are a much greater burden than formerly. If we figure interest at 5½ per cent on $8,874, the average debt per mortgaged farm, we arrive at an annual interest payment of $488. When wheat was $1.50 per bushel it took only 325 bushels to pay this amount of interest, but when wheat was 50 cents it took 976 bushels. Similarly, when butterfat was 50 cents a pound it required 976 pounds, or the production of about 5 average cows, but when butterfat was 25 cents it took twice that amount, or the product from 10 cows, to pay this interest. This is a typical example of the difficulties that grow out of a declining general price level. The farmer who mortgaged the farm during the period of inflation received dollars of comparatively low purchasing power and now he is paying to the creditors dollars of comparatively high purchasing power. Periods of rising prices call for conservatism in the use of credit by farmers because they are usually followed by declining prices making it difficult to meet heavy financial obligations.

SHORT-TERM CREDIT

While the mortgage loans comprise the largest amount of indebtedness, other debts also are important. These other debts generally are secured by chattel mortgages or by personal notes without specific security. Usually they are of comparatively short term, most of them less than one year. Table 5 gives the percentage of all farms reporting different kinds of debts and the average amount per farm reporting each type.

Table 5

Percentage of Minnesota Farms Reporting Personal and Collateral Loans and the Average Amount for Farms Reporting

Type of loan	Per cent of farms reporting	Average amount per farm reporting
Notes to local banks	54	$1,330
Notes to livestock loan companies	4	1,127
Implement notes (not to banks)	14	270
Auto notes (not to banks)	7	238
Truck and tractor notes (not to banks)	10	561
Notes to merchants	5	273
Store accounts	18	127
Life insurance notes	16	861
Other notes	23	1,482

Still another type of indebtedness found on some farms is delinquent taxes and interest. While not in the nature of contract loans, they are nevertheless financial obligations of the farmer. Farmers reporting delinquent taxes represented 9.4 per cent of all farmers reporting and the average delinquency per farm was $276. Similarly, 8.6 per cent reported delinquent interest averaging $347 per farm.

The total of all debts, incuding mortgage debts, averaged $9,165 for farms operated by owners, and $1,759 for rented farms. The average amounted to about 43 per cent of the total assets of these farmers. (See Table 6.)

Table 6

Average Total Debts per Minnesota Farm for Owners and Tenants Reporting Debts

District	Average debt per farm		Percentage liabilities are of assets	
	Owners*	Tenants	Owners	Tenants
Northwestern	$ 7,043	$1,025	40	34
Southwestern	10,335	1,799	46	45
Southeastern	7,327	2,167	36	42
All farms	$ 9,165	$1,759	43	43

* This includes 350 owners reporting debts. Not all had farm mortgage debts. The average farm mortgage debt for the group was $7,364.

Costs of credit include interest and other charges, such as commission fees paid in obtaining the loan. Many farmers reported the interest rates on various loans. This made it possible to calculate the average rate of interest paid by farmers on different types of credit. No information is available on commissions and other charges that farmers often pay in obtaining loans, particularly farm mortgage loans. A summary of rates is shown in Table 7. Interest costs for notes involving installment payments undoubtedly are higher in many cases than the rates indicated because the farmers did not take account of the fact that interest was charged for the full period of the contract, while the principal was reduced by regular installment payments.

Table 7

Summary of Interest Rates Paid by Minnesota Farmers. Rates Given Are Weighted Averages for All Farmers Reporting

Type of loan	North-western	South-western	South-eastern	All farms
	per cent	per cent	per cent	per cent
First mortgage	5.8	5.3	5.2	5.3
Second mortgage	5.7	5.7	5.8	5.7
Notes to local banks	7.8	7.9	7.0	7.7
Notes to livestock loan companies	6.3	6.8	7.0	6.7
Implement notes	7.5	7.7	7.1	7.5
Tractor and truck notes	7.9	7.3	6.7	7.3
Auto notes	...	7.9	7.5	7.8
Notes to merchants	7.3	6.5	6.0	6.5
Life insurance loans	6.7	5.8	5.8	5.9
Other notes	6.4	5.6	5.1	5.4

The local commercial bank is the most important agency providing short-term loans to farmers. The farmer has looked to the bank in his community for short-term loans and many farmers have also obtained long-term farm mortgage loans. In spite of the importance of local banks, however, they do not hold the position in agricultural finance that they did some years ago. Since 1920 some communities have been left without a local bank. Economic conditions have changed to some extent the position of the local bank in financing the farmer.

The bank's first responsibility is to its depositors. When depositors demand funds the bank must pay, and it is this responsibility that determines the type of loan the bank can make. From the standpoint of the local banker, the most desirable type of loan is a short-term loan that is likely to be paid when due, or investments that can be readily turned into cash, thus enabling the banker to pay depositors when they demand funds. The banker must exercise great care in making loans so that he will be in a position to meet demands by depositors. This has been the condition in recent years.

In an effort to maintain a liquid condition, commercial banks in rural communities now specialize more in short-term loans and other institutions take care of less liquid loans. The Federal Land Bank and Minnesota Rural Credits Bureau, for example, specialize in long-term farm mortgage loans, and local banks make fewer farm mortgage loans, which, as a rule, are considered non-liquid loans. Agricultural credit corporations have been organized in some communities in Minnesota for the purpose of handling livestock loans by rediscounting the farmers' notes at the Federal Intermediate Credit Bank, in St. Paul. Implement manufacturers are extending credit for periods up to three years to farmers purchasing machinery. In other words, there is a tendency to develop specialized institutions to handle certain types of loans and the commercial bank in agricultural communities is becoming more and more an institution that serves the farmer by granting short-term credit for farm operating expenses.

In June, 1931, forty banks in northwestern and southwestern Minnesota were visited, and information was obtained in regard to their loans to farmers. The average amount of loans and discounts per bank was $355,833, of which $241,974, was loans to farmers. Table 8 classifies the agricultural loans of these banks according to security and gives interest rates prevailing.

Table 8

Agricultural Loans of Local Banks Classified According to Security

Security	Average amount per bank June, 1931	Prevailing rate of interest
		per cent
First mortgages	$ 45,914	6
Second mortgages	953	8
Personal notes, not endorsed or secured	68,545	8
Personal notes, endorsed	3,885	8
Chattel mortgages	116,027	8
Other security	6,650	8

The farmer who can present a strong financial statement and who is a good moral risk, in most cases can borrow from banks for farm operating purposes on personal notes without security, but if a farmer is not in this fortunate condition, banks usually demand specific security or make no loan. The usual security is a chattel mortgage. Farmers heavily in debt, who can not give security, find it impossible to borrow from banks under present conditions. The ruling interest rate on all loans except first mortgages is 8 per cent, altho a few banks indicated that some farmers who were good risks could borrow at 7 per cent.

Agricultural credit corporations, either as subsidiary organizations to local banks or independent corporations, merit consideration as a means of improving the credit facilities for farmers, particularly for the purpose of financing livestock operations. These corporations rediscount farmers' notes at the intermediate credit banks, which were established by Act of Congress in 1923. There is one bank in each of the twelve federal land bank districts, the state of Minnesota being served by the Federal Intermediate Credit Bank, in St. Paul. Intermediate credit banks do not make loans direct to farmers, but discount farmers' notes to local banks, credit corporations, or livestock loan companies.[1] The amount of rediscounts by local banks has been very small and, with the exception of direct loans to co-operative marketing associations, the activities of federal intermediate credit banks have been confined largely to rediscounts for agricultural credit corporations and livestock loan companies. On June 30, 1931, the Federal Inter-

[1] In discounting a note the interest is collected in advance, that is the amount of the principal is advanced less interest for the time of the note.

mediate Credit Bank in St. Paul, reported loans to co-operative marketing associations of $2,960,608 and discounts of financing institutions of $7,281,505, or total loans and discounts of $10,242,113. The capital stock of the bank, amounting to $5,000,000, was subscribed by the United States Treasury of which $2,000,000 has been paid and $3,000,000 is callable. Additional funds for loans are obtained by the sale of debentures (short-term bonds of the intermediate credit banks), the maximum amount of debentures being limited to 10 times the paid-up capital and surplus. With a sufficient demand for loans and discounts on approved security, such loans and discounts could be expanded to approximately $60,000,000 for each of the twelve banks. There is, in other words, unused lending capacity in the Federal Intermediate Credit Banks which, with proper organization of credit corporations, could be used to advantage by farmers.

Agricultural credit corporations are incorporated under state laws and must have a minimum paid-up capital stock of $10,000 to be eligible for rediscounting with the intermediate credit bank. This stock is purchased usually by stockholders of the bank if it is a subsidiary to a bank, or by local business men and farmers if it is independent. Rediscounts can not exceed 10 times the capital of the credit corporation and are usually less than that amount. Loans to farmers are secured by chattel mortgages and in applying for a loan the farmer must submit a detailed financial statement. In some communities of Minnesota it seems likely that the formation of credit corporations would aid the farmers by relieving local credit stringency due to commercial banks being unable to provide the credit needed. Besides meeting an emergency, the corporations would have a permanent place in financing livestock production.

SUGGESTIONS ON USE OF CREDIT BY FARMERS

Mortgage Credit

It is now difficult to secure mortgage credit unless land is purchased. Those who have land to sell usually are willing to take a mortgage on a farm in order to make a sale. Institutions that hold farm mortgages usually are willing to renew mortgages if there is a prospect that they will be paid eventually.

In obtaining a new loan, it is desirable to have it on the "amortization" plan such as the Federal Land Bank and Minnesota Rural Credits mortgages. For example, a loan for 5½ per cent may be paid off in 34 years by paying 6½ per cent per year on the original face value of the mortgage. This plan does away with commissions and other expenses that go with renewals. It also does away with the possibility of a forced sale due to inability to renew the loan. The following table illustrates how a $1,000 loan at 5½ per cent interest may be paid in 69 semi-annual payments of $32.50. Table 9 shows how such a plan gradually reduces the amount of the unpaid principal.

The first payment of $32.50 consists of $27.50 to meet interest for the first six months and $5.00 to be applied on the principal. Each payment on principal reduces the amount to be applied on interest so that in the later years of the contract a large proportion is applied on principal. Thus, the sixty-eighth payment consists of only $1.71 for interest and $30.79 to apply on principal. This table illustrates the power of small regular payments to extinguish a debt.

Table 9
Amortization Plan for $1,000 Loan; Interest 5½ Per Cent; Semi-Annual Payments $32.50

Payment	Interest	Principal	Balance
1	$27.50	$ 5.00	$995.00
2	27.36	5.14	989.86
3	27.22	5.28	984.58
4	27.08	5.42	979.16
5	26.93	5.57	973.59
6	26.77	5.73	967.86
7	26.62	5.88	961.98
8	26.45	6.05	955.93
9	26.29	6.21	949.72
10	26.12	6.38	943.34
20	24.13	8.37	869.02
30	21.52	10.98	771.54
40	18.10	14.40	643.68
50	13.61	18.89	475.96
60	7.72	24.78	255.97
68	1.71	30.79	31.56
69	0.87	31.56	......

Every effort should be made to meet all financial obligations when due but if it is impossible to do so the creditor should be so informed in advance and be advised when payments can be expected. The borrower should always realize his responsibility to creditors and make plans for meeting financial obligations promptly whenever possible. The mortgaging of execution-exempt property, however, in order to pay interest and taxes may be unwise from the standpoint of the borrower. The law provides that a man is entitled to keep a certain amount of the most necessary property. In Minnesota the law specifies that creditors can not take certain items if they are kept free of mortgage.

Instances have come to our attention where as a result of mortgaging execution-exempt property in order to pay interest, farmers have lost not only the farm but all their personal property. If they had saved their execution-exempt property, they would have been in a position to start again as tenants in a modest way.[2]

If the farmer finds himself drifting into financial difficulties he will find competent legal advice helpful in ascertaining what his rights are under the law in matters of this kind. Important legal papers should be examined by his lawyer in advance of signing by the farmer.

While land is selling at a low figure at the present time, a tenant usually will find it wise to defer the purchase of a farm until he has a good outfit of personal property free of debt, and money for a substantial down payment. In addition, he should have an adequate cash reserve for operating expenses. In buying a farm whose buildings need repairs, or needs wells or other urgent improvements, the buyer sometimes can get the seller to make the improvements and include the cost in the purchase price. In this way, long-term mortgage credit is secured for the improvements, otherwise it would be necessary to make short-term loans at high rates or, perhaps, be unable to get the money.

Short-Term Loans

In making short-term loans, figure carefully—first, as to whether the loan will add to the profits of the farm business; second, if the loan is to be made, are the terms the best obtainable. In figuring the possible profit from a loan, it is well to remember that breeding stock deteriorates with age and that machinery wears out. One farmer recently told us: "In the spring of 1931, I was considering the purchase of a tractor, but after figuring the interest on the investment, depreciation, and operating expenses I decided that I could run my farm with the present equipment by hiring a neighbor to do some tractor work for a few days during the peak loads. An additional advantage of this method was that I had my resources left for other urgent needs."

If a farmer decides to purchase machinery or livestock, it is important to get the best possible deal. Usually the cash customer can make a better deal than the one who asks for credit. This may appear in the form of a discount for cash or it may be covered by a more gen-

[2] The following is the principal execution-exempt property allowed by Minnesota law: a dwelling house with eighty acres of land provided the land is not located in an incorporated city or village, 3 cows, 10 swine, a pair of horses or mules, 100 chickens, 50 turkeys, 20 sheep and the wool therefrom, either in raw material or manufactured form, in yarn or cloth, food for all the stock previously mentioned for one year, one wagon, two plows, one drag and other farm utensils, including tackle for horses, not exceeding $300 in value, provisions for the debtor and his family necessary for one year's support, either provided or growing or both and fuel for one year; necessary seed for the actual personal use of the debtor for one season, not to exceed in any case 100 bushels of each of wheat, rye, barley, potatoes, oats, flax, corn, and binding material sufficient for use in harvesting the crops raised from such seed; family pictures, school books, or library, and musical instruments for the use of the family, all wearing apparel of the debtor and his family, all beds, bed sheets and bedding, all stoves, cooking utensils and other household furniture not exceeding $500 in value; and the earnings of the minor children of any debtor except for debts contracted for the benefit of the child.

erous trade-in allowance for second-hand implements. In computing the interest actually paid, not only should the interest charge be considered, but to this should be added any discount for cash or extra trade-in allowances and financial service charges. Figured on this basis the purchaser may find that he is paying 12 to 17 per cent, while the rate mentioned in the contract is only 7 or 8 per cent.

Farmers replying to our inquiry reported that on the average there was a saving of 8.4 per cent by purchasing tractors, trucks, and automobiles for cash; 7.8 per cent on other implements; 4.4 per cent on groceries; 5.1 per cent on clothing; 4.3 per cent on purchasing feeds and seed for cash. With a nominal interest rate of 8 per cent, this would figure out a total interest rate of 12 to 16 per cent. If these people had realized that they were paying these rates, they likely would have decided to do without some items rather than to buy on credit.

In the case of installment purchases with monthly payments, one should keep in mind that the money is borrowed on the average for only half the period of the contract. In one typical case that came to our attention, the unpaid balance was to be paid in twelve monthly installments of $37 each, or a total of $444. A cash payment of $410 at the time of delivery would have settled the bill. This makes a payment of $34 for a loan of $410 for an average period of six months or a rate of over 16 per cent. Sometimes such a loan is spoken of as a loan for one year, but after the first month, one is no longer borrowing the first payment of $37. After the eleventh payment he is only borrowing $37. On the average he is borrowing about one-half of the loan.

A person lacking funds to pay cash often can effect savings by borrowing the money from local banks or credit agencies for purchase rather than to buy on credit. In this way he gets the benefits of cash prices and avoids service charges and other methods of getting more than the legal rate of interest. If he can not pay cash or borrow from the regular financial agencies, he should make every effort to defer purchases until he can.

Borrow Only for Productive Purposes

It is, perhaps, unnecessary to add that a farmer ordinarily is headed for trouble if he borrows for other than productive purposes, that is, for the purchase of needed land, seed, feed, or equipment. He will get much more enjoyment out of non-necessities, if their purchase is deferred until he has the ready money.

Sickness, floods, drought, and hail may at times make it necessary to borrow for living expenses, but the less he uses his credit for such purposes the better will be his opportunity to obtain such loans if dire circumstances should make it necessary to borrow for such items.