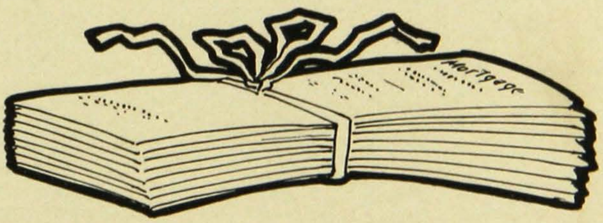
Special Bulletin 157 December 1932

ADJUSTING FARM DEBTS

Suggestions for Creditors and Debtors

by
E. C. Johnson
Division of Agricultural Economics

W. L. Cavert
Division of Agricultural Extension



UNIVERSITY OF MINNESOTA
AGRICULTURAL EXTENSION DIVISION

Published in furtherance of Agricultural Extension, Act of May 8, 1914. F. W. Peck, Director Agricultural Extension Division, Department of Agriculture, University of Minnesota, co-operating with U. S. Department of Agriculture.

FARMERS as a class have suffered a great deal because of the inflation in prices as a result of the World War. During the World War, prices of farm products increased greatly, resulting in a rise in farm land values and great increases in farm indebtedness. Since the war, and particularly since 1929, there have been sharp declines in farm prices and land values and many farmers have been unable to meet financial obligations. The result has been numerous foreclosures of farm mortgages and much delinquency in interest and taxes.

The relative changes in the average prices received for products sold by farmers in Minnesota since 1910 are shown in Figure 1. In the years 1916 to 1920 there was a great inflation in prices and farmers went heavily into debt. The total farm mortgage debt in Minnesota more than doubled during these years and continued to increase until 1928. The borrowers at that time received dollars of comparatively low purchasing power but in paying their debts under present conditions of very low prices are forced to give up dollars of much higher purchasing power. Heavy borrowing during the period of inflation was a grave mistake but it was not farmers alone who made the mistake. People in every line of business and also governments made the same mistake. Under present prices, many of the debts in all lines represent a crushing burden.

MORE PRODUCTS REQUIRED TO PAY DEBTS

The burden of farm debts today as compared to former years might be illustrated in terms of the average mortgage debt per mortgaged farm in Minnesota, which according to the U. S. Census of 1930 was \$4,734. Figuring interest at 5½ per cent, the annual interest payment on this average debt per farm is \$260. On the basis of the average

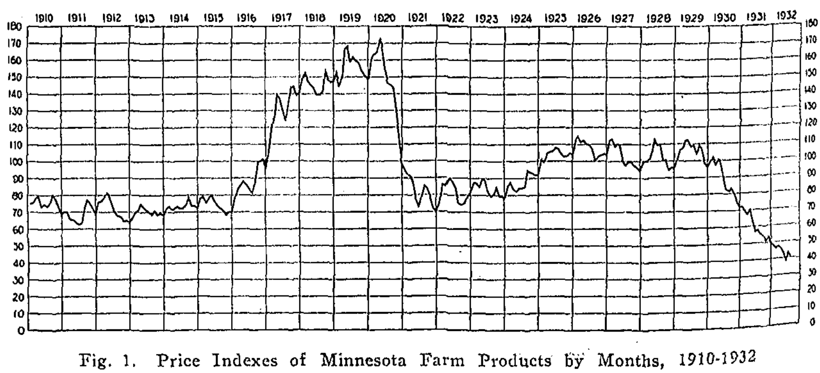


Fig. 1. Price Indexes of Minnesota Farm Products by Months, 1910-1932
(Average of corresponding months of 1924-25-26 = 100)

farm price of wheat in Minnesota in 1919, it required only 116 bushels of wheat to pay this interest; in 1925 it required 173 bushels and at the present farm price of 35 cents a bushel, 743 bushels are necessary. Similarly, in terms of hogs, to pay the $260 in 1919 the farmer had to sell only seven 250-pound hogs; in 1925 it required about ten head, and at the present price of $3.00 per hundredweight the farmer must sell 33 hogs. The farmer selling butterfat could pay this interest with 433 pounds in 1919; with 591 pounds in 1925; but at the price of 22 cents that has prevailed recently, it required 1,182 pounds, or the total production of about six average cows.

THREE CLASSES OF FARMERS

From the standpoint of the farm mortgage problem, the farmers may be divided into three groups: (1) Those free from mortgage debts, (2) those with small debts, and (3) those having large debts. The first class, which includes over 40 per cent of the farm owners in Minnesota, presents no particular problem. Their income is lower but they are in no danger of losing their farms and in many respects are in a more favorable sitution than some other groups of the population. The second consists of farmers who have only comparatively small debts and on the whole are able to meet financial obligations. They are finding interest payments difficult under present prices and have been forced to sacrifice and lower their standard of living in order to pay interest and taxes, but they have equities in their farms and any increase in farm prices will greatly improve their position, making it possible for them to pay interest and perhaps principal on their loans without much difficulty. The third group presents a serious problem. This group consists of farmers who are so heavily in debt that with present prices of farm products they find it impossible to meet interest payments. Because of low incomes, brought about in most cases by forces over which they had no direct control, they are unable to pay. Many of these are efficient farmers, capable and useful citizens in their communities. To force them off their farms or to change them from a status of owners to tenants would be unfortunate for the community as a whole. Only a sharp recovery in farm prices will enable these farmers to pay their obligations in full.

CREDITORS HAVE SERIOUS PROBLEMS

Farmers should make every effort to pay their obligations. They obtained their capital from creditors who, in many cases, have only a modest amount of wealth. These creditors include individuals, the large group of people in all walks of life paying on life insurance policies and depositors in banks, and large and small investors of the bonds of Federal Land Banks and Joint Stock Land Banks. If the farmer does not pay, the creditors lose and many of them are persons of only modest means to whom the loss of income is a serious matter. In the case of the Minnesota Rural Credits, any losses will eventually be borne by the taxpayers of the state.

ADJUSTMENTS OF DEBTS

As a group, farmers have incurred debts with no other intention than to pay and this attitude must be maintained. Farmers can not afford to lose a high credit standing by defaulting on loans or demanding adjustments when they are able to pay. Adjustments in debts can not be made generally. It is a matter of individual cases and each case must be treated separately on the basis of what the debtor is reasonably able to pay, and handled quietly, without publicity. Furthermore, it must be recognized that not all credit agencies can make adjustments. Legal provisions make it impossible for some to adjust interest or principal and all they can do is to carry a mortgagor delinquent if they do not foreclose or refinance him. Some creditors find it difficult to make adjustments because they obtained the funds they loaned to farmers from the sale of bonds to investors. These agencies must pay interest on the bonds. If the farmers do not pay interest on their mortgages these credit agencies will be unable to pay interest on the bonds and will become insolvent.

SOME POSSIBLE ADJUSTMENTS

If we assume that no sharp recovery will occur in the prices of farm products, the farmers very heavily in debt in most cases will be unable to meet payments due creditors and will lose their farms unless adjustments are made. If a creditor forecloses and takes the farm, he is usually faced with the problem of operating the farm with a tenant and receiving but little income or selling the farm at a loss. It is likely that if the mortgagor is an able man the creditor in the long run will take less loss by making adjustments in interest payments and the principal, thereby enabling the farmer to keep his farm and giving him a chance to work out of a difficult situation. Such adjustments also will encourage many debtors to do a better job of farming and the creditor will be more sure of some income than if the farm is foreclosed and rented to a tenant not familiar with it.

While general adjustments in debts are out of the question, it must be recognized that in certain cases adjustments can and will be made to the advantage of both creditor and debtor. Many debtors and creditors today are getting together and effecting some settlement in cases of delinquency. For the purpose of aiding debtors and creditors who wish to make adjustments in debts, the following points are offered as possible financial adjustments to meet the present difficult situation. They are not offered as a means by which debtors who are able to pay can avoid debts, but as a solution for necessary adjustments.

POSSIBLE ADJUSTMENTS IN REAL ESTATE MORTGAGE DEBTS

1. Put the Debtor on Basis Where Payments are the Same as on a Rental Contract.

Under this plan the debtor would give the mortgage holder the usual share of the crop—one-fourth, one-third, or two-fifths—that customarily goes to the landlord in the locality when the tenant furnishes all the seed and equipment. In addition, the landlord should receive the amount of cash that the hay, corn fodder, and pasture land would ordinarily rent for in the locality. Out of this income the mortgage holder will pay taxes and have the rest for interest. This arrangement under present prices will bring the mortgage holder much less than if the debtor were able to keep his loan in good standing. However, it is likely to bring more income and keep the property in better condition than if the mortgage were foreclosed and a tenant put on the place who was not acquainted with the farm. Furthermore, the creditor may not know just the kind of farmer a new tenant is, while he is usually well acquainted with the ability of the debtor. Under this plan, the mortgage holder would ordinarily desire and could reasonably expect a mortgage on the share of the crop that he is to receive, the same as is ordinarily taken in connection with rental contracts. Any necessary adjustments of this plan can be made after it appears that conditions have become somewhat stabilized.

2. Extend Mortgage for a Period of Years, with Possibly a Reduction of the Interest Rate.

In some cases financial institutions would much rather reduce the interest rate to a low figure than to reduce the principal, as it saves writing off a loss.

On a debt that is to run for only a year or two, reducing the interest rate has comparatively little effect in reducing the total payment. For example, if a $1,000 note runs for a year at 6 per cent, reducing the interest to 3 per cent only reduces the total payment from $1,060 to $1,030, but if the note is amortized over a 10-year period, the necessary annual payment to pay interest and retire principal is reduced from $135.87 to $117.23. In this case, there is a saving over the 10-year period of $186.40. For a 20-year period, the annual payment is reduced from $87.18 to $67.22, and the saving is $399.24.

3. Credit Interest as Payments on Principal During a Specified Period of Time.

Under this plan all payments of interest or any larger sum would be applied to the reduction of the principal. This method has the great merit for both debtor and creditor that it gives encouragement to making the largest possible payments while the interest payments are suspended.

4. Shift Mortgages to Others.

In occasional cases, the debtor has relatives who can be induced to purchase the mortgage, if the creditor will discount the amount of the principal to a figure that is in line with present and prospective conditions.

5. Accept Deed to Farm from Debtor and Rent It Back to Him.

This may be done with the understanding that the previous owner will have an opportunity to repurchase the farm provided he is in a position to do so when the loan company may have an opportunity to sell the farm.

6. Accept Deed to Farm from the Debtor and Sell It Back at Once on Some Crop Payment Plan.

Ordinarily, a certain portion of the crop would be set aside each year to apply on taxes, interest, and principal.

7. Accept Deed to Farm from the Debtor and Sell It Back for So Much Produce.

For example, one quarter-section in North Dakota has recently been sold for 5,000 bushels of No. 1 hard wheat to be paid in 10 annual payments of 500 bushels each. In this case, there was no interest on deferred payments. Probably corporate creditors will not, in most cases, look with favor on such an arrangement as it is difficult to know how to value on their books a contract that calls for a certain amount of wheat or other produce.

POSSIBLE ADJUSTMENTS OF SHORT TERM DEBTS

1. Refinance Through the Regional Agricultural Credit Corporation.

Credit from this source is available only where local credit is not available and where the debtor is solvent. If the debtor is insolvent on the basis of present assets and debts, he may be able to borrow from the Regional Credit Corporation, if he can get his creditors to scale down their obligations in consideration of getting cash. If desired, county agricultural agents will assist farmers in preparing applications to the Reconstruction Finance Corporation.

2. Scale Down the Debts and Start Regular Payments on Principal.

Where debts can not be paid, sometimes if they are scaled down it is possible for the debtor to start making monthly or other periodical payments, thus eventually wiping out the debt.

3. Get Creditor to Take the Mortgaged Property and Cancel the Debt.

From the debtor's standpoint, this is an especially desirable arrangement if the mortgaged property is of such character that it is not vital to the operation of the farm. In some cases, it might be a good bargain for the debtor to pay a small cash consideration in addition to turning over the mortgaged property in order to clean up a debt.

4. In the Case of Debts Owed for Cash Rent, Give the Landlord the Same Share of the Crop That He Would Receive Under a Share Lease.

Under present prices, this gives the landlord much less than the cash rent, but it will be better business to keep a good tenant under an arrangement in which he sees some prospect for the future than to take his personal property for the debt.

5. Give the Creditor the Property and Step Out.

In some cases where the debts represent an impossible burden and where the creditor or creditors are unwilling to make adjustments, the only feasible solution may be to turn the property over to the creditor. In such cases the execution exempt property[1] may be retained by the debtor if it has been kept free from mortgage.

[1] 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 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, 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.