TWENTY-FIVE YEARS OF FARM-MORTGAGE FINANCE IN THE UNITED STATES WITH SPECIAL REFERENCE TO THE STATE OF KANSAS

by

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DEDICATION

This study is dedicated
to my parents. The indomitable
and courageous spirit exemplified by them
as they live and toil on their Kansas farm
has been a source of inspiration
throughout the preparation
of this thesis.

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CHAPTER I

AN INSIGHT INTO FARM MORTGAGE FINANCE

Since the dawn of history land has been of primary importance as a source of livelihood for mankind. The history of the development and utilization of land serves well in describing the development of civilization itself. Its importance in the total economy of past and present generations has been universally recognized by economists, and consequently, a vast number of chapters and volumes have been devoted to the science of land economics. However, in spite of the attention which the agriculturalist has received in the realm of economic studies, the problems connected with land are far from having been solved. And, although for many years the United States has been developing into a highly industrialized nation, the products of agriculture continue to hold a key position in our national economy. Moreover, the influence which the congressional representatives of the farming industry exert upon the nation as a whole is so great that we can ill afford to neglect making a continual honest effort to solve the problems of agriculture in the best interests of our total economy.

History has recorded and is still recording administrative and legislative actions vital to the agricultural industry. Of primary importance are those affecting farm-mortgage finance. It is the purpose of this study to analyze the activities and policies of each of the various agencies which has provided long-term credit to farmers subsequent to 1916, and to note the far-reaching effect which any or all of these activities and policies may have upon the American farmer in general and the Kansas farmer in particular. The year 1916 has been selected advisedly as a starting point for this study. It was on July 17, 1916, that the Federal Farm Loan Act was enacted which marked the beginning of a new era for the farmer--an era in which it was hoped that the crying needs for adequate long-term credit facilities would be provided.

It is quite obvious that, in making a study of any industry, its financial status, so far as monetary values and financial policies are concerned, cannot be intelligently considered without a knowledge of the economic peculiarities and characteristics of that industry.

The farming industry directly employed approximately 30,475,000 persons or a little less than one-fourth of the total population of the country in 1940. More than one-third of the Kansas population obtained its livelihood from

agriculture during the same year.[1] It should be recognized that although the population figures mentioned above constitute the number directly engaged in agriculture, another large group of Americans are engaged in non-agricultural pursuits which are so closely allied with farming that their welfare is dependent upon the welfare of the farmer. According to the United States Bureau of Census, approximately forty per cent of the entire population was "rural" in 1930, and 1,151,165 Kansans, constituting more than sixty per cent of its total population, were classed as "rural" in the same year.[2] It is therefore evident that this study is concerned with an industry which relates itself in a vital way to the masses.

Undoubtedly one of the most outstanding characteristics of agriculture, as contrasted with industry at large, is the fact that the farm operator can not definitely control nor predict the volume of the farm's annual production. In the first place the farmer is engaged in a "partnership" with the elements of nature; and, although the efficiency and skill of the farmer has an influence upon the product of the land which he cultivates, the forces of nature are paramount

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[1]Conrad Taeuber, "Changes in Farm Population," The Agricultural Situation, Vol. XXV (April 1941) pp. 16-19.

[2]United States Department of Commerce, Bureau of Census, Census of Agriculture, 1930.

in determining the farm's produce. Unlike the industrialist, who through his ability and power to guage his production to the fraction of a unit, the farmer has no assurance that his production for any period of time will be any certain amount. It is true that while the total annual production may be fairly constant, the individual farmer is not assured of a uniform yearly output. This is certainly true of the Kansas wheat farmer who is often the victim of drouth, hail, rust or insects.

The fact that the farmer has no direct control over his output would not in itself be so serious if it were not for some other important economic characteristics of agriculture which affect the economic welfare of the farmer to no small degree. One of these, as Seligman points out, is that the proportion of constant to variable costs seems to be greater in agriculture than it is in industry.[1] The industrialist, anticipating a fall in the demand for his product and probably a fall in price, is quite generally able to decrease, immediately, the variable capital costs of his industry in proportion to his decrease in production. The farmer is not able to do that to any considerable extent. Since the farmer's fixed costs constitute

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[1]E. R. A. Seligman, Economics of Farm Relief, (New York: Columbia University Press, 1929), p. 47.

the greater proportion of his total costs, the cost of producing 160 acres of wheat may be very little higher than the cost of producing 80 acres. Moreover, the cost of producing 5,000 bushels of wheat may be very little, if any, higher than the cost of producing 1,000 bushels in another year even though the price levels are the same for both years. Furthermore it is interesting to note that it is quite common for farmers to produce more during years of low prices than during years of high prices, for an extra output is necessary when prices are low to meet the costs of production which, for the most part, are relatively fixed. Such a policy, of course, tends to aggravate the market of agricultural commodities by increasing the supply at a time when a decrease in supply would be more effective in raising the price of farm products to a higher level.

Still another characteristic of land which causes it to be a rigid factor of production is that it cannot be shifted from one type of production to another with any degree of success. Again, to a considerable extent, it is unlike industrial capital which can be shifted quite easily and quickly. A wheat farmer of Kansas, for instance, can ill-afford to plant tobacco even though the price of tobacco is relatively higher than the price of wheat. Not only is his soil better adapted to the growing of wheat but the

machinery which the wheat farmer owns can hardly be used for the cultivation and harvest of any other crop. It also follows that the farm is not only a productive enterprise, but it is a home as well; and, consequently, it is quite improbable that anticipated low prices will drive the farmer into another line of endeavor so long as he can hold out financially.

Of vital importance to the study of the needs for long-term farm finance are the characteristics: slow turnover, few laborers, and increasing costs. While the industrialist sees his stock turn many times within a month or a year, the farmer raises one crop of wheat, barley, or corn per year. Nature forbids a more rapid turnover. The hiring of three times the number of workers required to produce one wheat crop in an effort to produce two additional crops will only be done in vain. The operation of the laws of increasing costs and diminishing returns limit the amount of labor and machinery which can be profitably used on a farm to a relatively small amount. Again we see the rigidity of the farm as compared to industry in general.

The foregoing discussion of the major economic characteristics of land should serve to make any statement regarding the peculiarities of farm mortgage finance more intelligible. It is clearly evident that some of the char-

acteristics discussed above have a more direct bearing upon short-term and intermediate farm finance than they have upon long-term credit. However, each characteristic bears a direct relationship to every other characteristic, and it is only through a thorough understanding of them all that solutions to the problems of farm mortgage finance can be effected.

Two major points stand out as being of paramount importance to this particular study. First, it has been stated that high fixed costs in relation to variable costs is a characteristic of agriculture. And, since land constitutes the major portion of a farmer's capital outlay, it is clearly evident that the farmer, at least when making his initial investment, is ordinarily in need of a large amount of credit in relation to his total investment. Secondly, it has been stated that farming is characterized by a slow turnover and uncertainty of output. The problems associated therewith quite naturally call for a long-term type of credit.

The following chapter will serve to show in a somewhat statistical manner the important trends of farm-mortgage credit during the past quarter-century.

CHAPTER II

FARM-MORTGAGE TRENDS

Before an analysis of the functions performed and policies followed by each of the various lending agencies is attempted, it would be well to briefly examine the trends in farm-mortgage holdings during the period under study. These trends are not only the results of the changing economic order which has characterized the past twenty-five years, but they, in themselves, have had a dynamic impact upon the course of American history. Myers describes the importance of these trends by stating that "the history of farm credit marches along with the story of the Western migrations as if tied to the wheels of prairie schooners."[1]

During the era in which land could be purchased for $1.25 an acre from the government, any extensive use of farm credit was quite unnecessary. However, by the end of the 19th century, the land which could be purchased in

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[1]W. I. Myers, Cooperative Farm Mortgage Credit, 1916-1936, Farm Credit Administration (Washington: Government Printing Office) p. 1.

this manner had become exhausted.[1] This meant rising costs of farm properties, more intensive labor, increased fertilization, more machinery--in short, it meant that land had become an economic scarcity and that the provision of farm credit would be an ultimate necessity.[2] Again Myers explains the situation:

> So the farm mortgage, which had first been a rare, then a casual feature of farm life since the days of the colonists--and once accepted almost as a stigma upon the social and financial integrity of the farmer utilizing it--rapidly became a pressing economic issue.[3]

Throughout the course of the development of farm credit there have been periods of wild speculative fervor in agriculture which have produced maladjustments so serious that they are still affecting the farmer in no small way. It is quite obvious that, while at times the farmers were in need of a greater volume of credit, many times their successful cries for credit extensions proved to be their financial undoing. To say that the farmers have constituted the only class of people who have sometimes followed unwise courses of expansion would be far from the

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[1]*Ibid*., p. 1.

[2]R. T. Ely, and E. W. Morehouse, *Elements of Land Economics*, (New York: Macmillan Company, 1924), p. 19.

[3]Myers, *op*. *cit*., p. 2.

truth. Economic history proves the contrary. The following table reveals in a statistical manner the broad trends in farm-mortgage holdings for the period under study. An analysis of the data presented here, as well as in the other tables of this chapter, should serve to develop a better understanding of the entire field of farm finance.

Table I

ESTIMATED FARM-MORTGAGE DEBT*

Year	United States	Kansas
1910	$3,207,863,000	$163,359,000
1915	4,990,785,000	180,875,000
1920	8,448,772,000	344,597,000
1925	9,912,650,000	505,041,000
1930	9,630,768,000	411,747,000
1935	7,785,971,000	357,123,000
1939	7,070,896,000	319,404,000
1940**	6,910,000,000	309,602,000

*D. C. Horton, Fluctuations in Outstanding Farm-Mortgage Debt, 1910-1939, (U. S. Department of Agriculture: 1939), pp. 90-92.

**U. S. Department of Agriculture, "Farm Mortgage Debt at Lowest Level in 22 years", (Reprint from Agricultural Finance Review, Vol. III, No. 2), p. 5.

The foregoing table rather interestingly reveals that the volume of mortgage credit, for both the state of Kansas and the United States at large, expanded considerably from 1910 to 1925. The rate of increase during this period was 209 per cent--the same rate of increase applying to both state and nation. It is clearly evident that the increase from 1910 to 1915 was nominal and followed, rather closely, the normal expansion of agriculture during those years. The major portion of this phenomenal increase, particularly from 1915-1920, occurred during the agricultural "boom" days of World War I. The effect which this era of wild farm prices and increased mortgage load has had upon agriculture in general cannot be overstated. The consideration of such effects will be left for another chapter; however, in the consideration of trends, these figures represent a radical departure from the normal upward trend which was a natural result of the expansion of the industry. In fact, a large amount of the increase in the mortgage debt load, as indicated by the 1920 figures, was due to excessive personal and collateral loans by commercial banks during the war period which were later funded into real-estate-secured debt.[1]

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[1]D. C. Horton, Fluctuations in Outstanding Farm-Mortgage Debt, 1910-1939, (Washington: U. S. Department of Agriculture, 1939), p. 16.

Even in the study of trends, however, it must be kept in mind that changes in the volume of farm-mortgage debt are not, necessarily, indicators of the general financial position of agriculture. An increase in the volume of farm-mortgage debts does not, in itself, indicate that agriculture is in a less favorable financial condition. Neither does a decrease in the debt load of the farmer necessarily indicate that he has been placed in a better financial condition. D. C. Horton presents an illuminating discussion of the factors which are involved in determining the effect of the mortgage-debt load on the financial condition of agriculture:

> On the one hand, a rise of mortgage debt may accompany a general expansion of agriculture and may be associated with rising agricultural income and general improvement in the financial position of farm owners. On the other hand, a rise of mortgage debt may be associated with depressed agricultural conditions in which many farm owners have to borrow to tide over temporary periods of low income or give real estate security as added protection for non-real-estate loans. Likewise, a drop in outstanding farm-mortgage debt may be associated either with an improvement of the financial position of agriculture, which enables farm owners to repay debts, or with depressed agricultural conditions, which force many heavily indebted farmers to give up their farms in satisfaction of their debts. Changes in outstanding farm-mortgage debt usually involve a combination of these several factors. To understand the significance of mortgage-debt trends it is necessary to analyze the many other related movements which have a bearing on the fi-

nancial position of agriculture.[1]

Another trend of great importance as indicated in Table I is the somewhat steady decline in the amount of mortgage debt outstanding from the years 1925 to 1940. There is included in this period the great financial "boom" of the years leading up to 1929. The movement of mortgage debt following the 1929 collapse had some elements in common with that following the 1920 collapse, but in most respects it was markedly different. The sharp decline in mortgage debt came in 1932 and 1933, whereas the break in farm prices came much earlier. In this respect the post-1929 mortgage movement was similar to that following 1920. However, Table I indicates that mortgages increased tremendously following the 1920 collapse for reasons which have been mentioned, while mortgage holdings were considerably decreased following the 1929 collapse. "In fact, the rate of decline was greater in 1930 and 1931 than for the years immediately preceding the 1929 collapse."[2] The factors which contributed to the increase in mortgages following 1920 were of much less importance in this later period. For, although prices in

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[1]Horton, _op_. _cit_., p. 13.

[2]_Ibid_., p. 18.

general were soaring during the years leading up to 1929, land values had been declining for the country as a whole during the 1920's, and the volume of transfers which had been effected during this period and which were to be effected after the collapse were relatively small. Hansen points out that in spite of the 20's being prosperous years as indicated by the business cycle "there is, however, the undoubted fact, of which cognizance must be taken, that the decade of the 20's was preponderantly a period of hard times for agriculture."[1] Moreover, the volume of non-real-estate credit which was extended during the years immediately subsequent to the 1929 collapse was very small in comparison to that extended in 1921 and 1922 as indicated above. One reason for this is that, since land values had been steadily declining for the country as a whole, the farmers were left with very little equity on which to borrow. Furthermore, the national financial system was less able to lend money to farmers in the way of "distress borrowing" during 1930 and 1931 than it was after the 1920 crisis. Hence, there was not such a large amount of this "emergency" borrowing to be funded into farm mortgages later on, as was the case in the period follow-

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[1]A. H. Hansen, Fiscal Policy and Business Cycles, (New York: W. W. Norton Company, 1931), p. 31.

ing 1920.

The general pattern of the movement of mortgage debt since 1931 has been similar in some respects to that from 1923 to 1930. As is indicated by the foregoing table, debt liquidation between 1930 and 1935 was very rapid. This period was characterized by a large number of foreclosure proceedings and bankruptcies which were finally halted to a considerable extent in 1934 when the Farm Credit Administration began its extensive program of refinancing. Emergency debtor-relief laws which were enacted during 1933 and 1934 placed temporary obstacles in the way of foreclosure actions and constituted an important factor in halting the sharp decline in mortgage holdings. Since 1934, the gradual decline in mortgage holdings has been due to continued foreclosures of farms that were unfortunately, and in many instances unwisely, financed; to refinancing procedures which have involved the scaling down of the debt by placing it more in line with farm values; and, also, to an increased volume of principal payments, especially on loans placed on an amortization basis in the period of large-scale refinancing.[1]

Throughout the entire period from 1910 to 1942 the

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[1]Horton, _op_. _cit_., p. 18.

general movements in the farm-mortgage structure of the state of Kansas were quite similar to those for the nation as a whole. It has been indicated previously that the per cent of increase in mortgage debt from 1910 to 1925 was 209 per cent for state and nation alike. During the five-year period from 1925 to 1930, however, the 18.4 per cent rate of decrease in Kansas mortgages was much greater than that for the United States, which was 3.8 per cent. This marked difference was due, primarily, to the large number of foreclosures on Kansas farms which were victims of the wild Mid-West speculative era of World War and immediate post-war days. The gradual decrease in holdings subsequent to 1930 show that a 28 per cent decrease is recorded for the nation, while a 24 per cent decrease is recorded for Kansas.[1]

Another valuable approach to the study of general trends, so far as the dollar value of mortgage holdings is concerned, is through the mortgage load per acre of land under production. Table II, on page 17, shows the same general movements of long-term debts as was indicated by the data in Table I.

As was stated earlier in this chapter, an analysis of

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[1]These percentages were computed from the data supplied in Table I.

Table II

FARM-MORTGAGE DEBT PER ACRE OF LAND*

Year	United States	Kansas
1910	$3.65	$3.74
1920	8.83	7.58
1930	9.76	8.76
1940	6.51	6.42

*The data in Table II are obtained from computations based upon figures given on page 534, Agricultural Statistics, 1941, (U. S. Department of Agriculture), and figures given in Table I.

the effects of "shifting" equities in land holdings will be made more complete in chapters five and six; however, a few statistics at this point revealing the relation of mortgage debt to the value of the security back of the loan should be of value in furthering the outlining of trends and general movements. Table III, page 18, gives such information.

The data as presented in Table III is uniquely important to the welfare of the farming industry. It shows rather clearly that, whereas farm-mortgage debt recordings

Table III

RATIO OF FARM-MORTGAGE DEBT TO TOTAL VALUE
OF FARM LAND AND BUILDINGS*

Year	United States	Kansas
1910	9.2	9.4
1920	12.6	12.1
1930	20.1	18.0
1940	20.5	21.7

*Computations based upon data provided in sources used for Table II.

were consistently rising until 1923,[1] the farmers' equities were constantly diminishing. Just as important, however, is the fact that, while Table I shows a decrease in mortgage holdings subsequent to 1930, Table III indicates a continued decline in the equity of the farmer for this same period. It must be remembered that the welfare of the farmer depends, in a very vital sense, upon the equity he holds in his property.

Table IV on the following page serves to indicate the

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[1]Mortgage debt reached an all-time high in 1923--$10,784,621. For the purpose of showing general trends the 1930 figure has been used.

Table IV*

TOTAL FARM MORTGAGE DEBT AND AMOUNTS HELD BY SELECTED LENDER GROUPS

(1,000 dollars)

Year	Total Debt	L. Bank & L. Bank Comm.	Joint Stock L. Bank[1]	Life Insurance Co's	Banks[2]	State Credit Agencies[3]	Others[4]
1910	3,207,863	....	....	386,961	406,248	....	2,414,654
1915	4,990,785	....	....	669,984	746,111	....	3,574,690
1920	8,448,772	296,386	60,038	974,826	1,204,383	(5)	5,913,139
1925	9,912,650	923,007	446,429	1,942,624	1,200,456	(5)	5,400,064
1930	9,630,768	1,185,765	626,980	2,105,477	997,468	93,274	4,621,804
1935	7,785,971	2,501,824	255,931	1,258,900	498,842	62,286	3,208,188
1936	7,638,867	2,853,966	175,677	1,054,770	487,505	48,091	3,018,858
1937	7,389,797	2,888,912	133,499	936,454	487,434	32,657	2,910,741
1938	7,214,138	2,835,962	104,163	895,470	501,450	24,657	2,852,436
1939	7,070,896	2,723,022	87,362	887,336	519,276	17,281	2,836,619
1940	6,909,794	2,583,901	65,719	883,414	534,170	14,823	2,827,767

[1]Including banks in receivership.

[2]1935-40 insured commercial banks; prior to 1935 open State and national banks.

[3]Rural Credit Board of South Dakota, Bank of North Dakota, and Department of Rural Credit of Minnesota.

[4]Including loans of individuals, Farm Security Administration, mortgage companies, and other miscellaneous lenders.

[5]Unavailable.

*Bureau of Agricultural Economics, The Agricultural Situation, (Washington: U. S. Department of Agriculture, May 1941), p. 12.

trends of mortgage holdings in relation to the various classes of agencies making such loans. This information not only rounds out the study of the general movements in the field of farm-mortgage finance, but it serves as a basis for the analysis of the functions performed by each of the major lending groups which will be made in the following three chapters.

CHAPTER III

THE ROLE OF FEDERAL ACTIVITY

The development of a federal system of farm-mortgage credit has had a long and interesting history. The Farm Credit Administration, as it exists today, is not the product of the efforts of any one generation, but, rather, the product of continuous agitation on the part of the farmer since the days of the Colonial period. Many efforts were made in Colonial and Early State periods to establish land banks and loan associations; however, it was not until a few years before the World War that a general and determined agitation grew for a national system of rural credits. This is clearly understood in view of the fact that people generally regarded it the business of the state, rather than the business of the federal government, to participate in the business affairs of the people. Therefore, it is not surprising that the first institutions inaugurated for the purpose of supplementing private sources of agricultural credit were state or state controlled institutions. Various types of farm-credit institutions prior to 1916 were significant in marking the development of a federal system such as exists today. It

should be of value to briefly consider some of these institutions by way of an historical introduction.

During the Colonial period several Public Loan Offices or Public Land Banks were established to meet the credit demands of farmers. In fact, all the original thirteen colonies, save Virginia, created loan offices or public land banks in the form of paper money issues of "batches of paper" which were loaned on the security of real estate. It was contended by the land-owning class that no security for money issues could be more stable than land; however, excessive issues of these "batches of paper" resulted in an artificial redistribution of the goods of society in terms of an inflated, or cheaper currency, and in a manner which subsidized one industry at the expense of others. The security of the paper issues was over-valued, bad loans were made, favoritism of various kinds arose, and when the borrowers failed to pay, new legislation was often forthcoming to allow easier terms to the borrowers.[1]

A multitude of evils accompanied the poorly regulated administration of the loan offices. However, the inherent weakness of the system lay at its very foundation. As

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[1]E. S. Sparks, History and Theory of Agricultural Credit in the United States, (New York: Thomas Y. Crowell Company, 1932), pp. 77-81.

Professor Sparks has stated:

> It was argued that real estate security would automatically limit the currency issued on loans so as to provide a stable medium, but the only limit was the capricious will of the governmental assemblies. The natural result was a heterogeneous paper currency with various degrees of depreciation in the several colonies, and with all the familiar evils of an inflated currency.[1]

Thus, it was demonstrated that the first attempt to establish a governmentally owned and controlled system of farm-mortgage credit was a dismal failure. It should be recognized, however, that the failure of the colonial land banks did not prove that land banks, per se, are bad, but rather that the policies adopted by their administrators were unwise and economically unsound.

From 1800 to 1860 the "Property" and the great "State Banks" were the outstanding types of farm-mortgage credit institutions. The property banks resembled the present-day Federal Land Banks more closely than any agency established prior to their existence had done. The majority of the property banks were located in Louisiana, Florida, Arkansas, and Mississippi--thus, they were developed almost exclusively in the South. It was the policy of the property banks to attract foreign capital into agriculture by the issue and sale of bonds secured by real estate mort-

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[1] *Ibid.*, p. 80.

gage. But in addition to being purely land banks, these banks also performed the functions of commercial banks which included the issuance of notes. It was this policy of performing a double service, that of a mortgage bank and that of a commercial bank issuing notes, which caused the downfall of these institutions. "It must be admitted, however, that the policies of these banks marked a great step forward from the early paper money land banks."[1] The policies of the property banks were more conservative in that the securities which they issued were upon the basis of mortgages representing a safe margin of value. But in spite of a more conservative policy these banks failed because of their inherent weakness of performing the double function as indicated above. The nature of their loans drained the banks of specie, leaving but little to serve as a basis for any further note issue.

> Had note issue been guarded carefully and loans granted wisely, all might have gone well, but there was always a great demand for long time loans in the newly settled districts; hence there were irresistible temptations to employ the printing press as a bountiful source of available funds. The natural consequence was insolvency when the notes were presented in large quantities for redemption.[2]

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[1] *Ibid.*, p. 97.

[2] *Ibid.*, p. 97.

The history of the development of any institution usually reveals that each new establishment profits by the mistakes of the past. That has been true in the development of a federal farm-mortgage system, and it can be said that the early-day property banks were instrumental in pointing the way toward the establishment of the federal land banks in 1916.

During the same period that the property banks were operating, "state" banks were chartered in several of the Southern states, whose chief purpose was that of lending to farmers upon the basis of real estate. Unwise lending and inflationary policies, which were so very common as a result of the bank officials being elected annually, soon caused the downfall of this type of institution.

The only institutions established for the purpose of financing agriculture during the first half of the 19th century, and which survived, were the farm-mortgage companies. The functions performed by these companies were entirely divorced from the commercial bank policies of issuing notes. The history of these institutions reveal, however, that even though they did survive, they did not expand to wide usefulness.[1]

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[1]W. J. Shultz and M. R. Caine, Financial Development of the United States, (New York: Prentice-Hall, Inc., 1937), p. 513.

The period from 1860 to the date of the establishment of the federal farm loan system was characterized by various movements on the part of the farmers for cheap money. These movements were marked by the same basic thinking and policies which caused the collapse of the various farm lending institutions which have been mentioned previously. From the standpoint of an historical approach to the Federal Farm Loan Act of 1916, these "movements", on the part of the farmer for better credit facilities, are very significant and are worthy of mention at this point.

The plea of the farmer has always been for cheaper money, for an inflated currency relieves the debtor from the "sting" of his mortgage load when the result of the inflated money is rising prices for the products he offers for sale. The Granger movement was one of the first effective movements through which the farmers, first, expressed their disapproval of depreciating greenbacks to fifty cents on the dollar. Their demand was for cheaper money, and, also, the abandonment of the policy of taxing state bank notes. The Granger movement reached its height in 1873 and 1874.

The same philosophy which was back of the Granger movement was responsible for the National Greenback Party which was organized in 1874 and whose platform in the 1876 presi-

dential campaign included a demand for a national paper currency, redeemable in interest-bearing bonds. Although the party was defeated, the results of the election revealed that the movement was very strong, especially in the states of the upper Mississippi Valley and Pennsylvania.[1] Beyond doubt, the Granger movement was effective in expressing itself through the National Greenback Party, but in spite of this strong sentiment, specie payment was resumed in 1879.

This same decade saw those who were disappointed with not being successful with the National Greenback Party sponsor a "free silver" movement in Congress. As silver at that time was exchanging in the market at a ratio of over seventeen to one, the free coinage of silver at the mint ratio would have led to silver displacing gold. A compromise measure was passed in the Bland-Allison Act of 1878, which provided for the purchase of at least $2,000,000 worth of silver a month. This compromise measure pacified the farmers temporarily, and it was not until a few years later that agitation grew strong again. Professor Eliot explains why the cheap money issue subsided for a considerable period of time.

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[1]C. Eliot, The Farmer's Campaign for Credit, (New York: D. Appleton and Company, 1927), p. 19.

For the decade of the eighties, the money issue lay somewhat dormant. The crops of corn, wheat and oats in 1880 passed all previous records, and the price of corn maintained itself so well in spite of the increased supply that the crop was worth 50 per cent more than in 1878. Under such conditions the farmer temporarily lost interest in inflation.[1]

After a few years of stability, however; farm prices began to decline and farmers began to reassert themselves in terms similar to those of the days of cheap money movements. The Farmers' Alliance, which reached the peak of its power in 1888-89, demanded the abolition of national banks, substitution of greenbacks for bank notes, free coinage of silver, equal taxation and reduction of public expenditure, and government ownership and operation of the railroads, who, the farmers contended were charging exhorbitant freight rates on agricultural commodities. In addition to these and other measures of much less importance, the Alliance called for the establishment of a government land-loan bureau to loan legal tender currency on land mortgages up to 50 per cent of the value of the land, for periods of twenty years, at 2 per cent interest.

Further effects of hard times for the farmer brought about other movements such as the Populist Party and the bimetallic controversy, which were strongly supported by

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[1] Ibid., p. 2o.

the farming regions of the upper Mississippi Valley. Among other things, the Populist Party was vitally interested in bringing about a free and unlimited coinage of silver and gold at the legal ratio of 16 to 1. It can be said that both movements had as their chief aim the obtaining of a great supply of cheaper money in the hope that the burden of the farmers would, thereby, be lifted.[1]

From the foregoing discussion of the restlessness of the farmer during times of adversity it would appear that many of their efforts were in vain. And, it is true that, from the standpoint of winning elections and the establishing of institutions providing more lenient credit facilities, they were not always immediately successful. Nevertheless, continuous agitation, year after year, did accomplish great results in the way of influencing various administrations to the extent that investigations into the credit needs of agriculture were carried on. It was quite evident that commercial banks, limited as they were by the Federal Reserve Act, were not suited to meet the needs for long-term credit. Shultz and Caine have stated that:

> Savings banks and insurance companies could and did place part of their funds in farm mortgages, but their resources could not begin to cover a

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[1]*Ibid.*, pp. 22-25.

> continent-wide demand for agricultural capital. A scattered horde of private investors took up three-fifths of farm mortgages.[1]

Moreover, agriculture was becoming industrialized. And, unlike big business which had developed a system of credit commensurate with its needs, agricultural credit problems remained unsolved.

Recognizing that the farmer was faced with a problem of not having access to sufficient capital in the nature of long-term loans, President Theodore Roosevelt, in 1908, appointed a Country Life Commission to study the agricultural situation. This commission reported that there was a need but made no recommendations. Soon afterwards the National Monetary Commission issued a report regarding the farm-mortgage system in Germany. As public interest grew, the European systems were studied by business organizations and representatives abroad. Finally, the United States Commission, appointed by Wilson in 1913 to cooperate with the American Commission which had been appointed by the Southern Commercial Congress to study the European systems, made specific recommendations which led to the introduction of a farm-loan bill into Congress in 1914. After two years of consideration, the Federal Farm Loan Act was

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[1]Shultz and Caine, _op_. _cit_., p. 514.

passed on July 17, 1916.

It is of special significance that the Federal Farm Loan Act was the result of the various movements which had been traced throughout the course of more than a century. The act was not a product of hasty procedures on the part of Congress, and, consequently, it seems only plausible that the credit system provided by this act should be free from many of the defects which were inherent in systems called for and provided heretofore.

The Federal Farm Loan Act provided for the establishment of two types of long-term credit institutions, namely, the Federal Land Banks and the Joint-Stock Land Banks. The Federal Land Bank system was patterened after the Federal Reserve system, in that the United States was divided into twelve districts according to agricultural needs and a land bank was provided for each district. Initial capital for each land bank was fixed at $750,000 and was to be raised by open subscription. It was the hope of those who were responsible for writing the bill, which provided for the creation of these banks, that a more cooperative spirit could be created among the farmers.[1] To this end, provision was made whereby ten farmers seeking loans, the aggregate value of which totaled not less than $20,000, could

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[1]Sparks, op. cit., p. 127.

organize a national farm loan association. It was the business of these associations to lend money in exchange for mortgages based upon not more than fifty per cent of the value of the land, or twenty per cent of the value of the improvements. Each mortgagor was required to purchase stock in the loan association which granted the loan amounting to five per cent of his loan, and upon payment of the mortgage this stock was to be forfeited. The loan associations would get their lending capital by discounting with the land banks, the mortgages they accepted from the farmers. They, in turn, were required to purchase stock in the land bank through which each was operating. The amount of stock was to equal five per cent of the value of the mortgages discounted. In this way, it was hoped that the initial capital stock held by the government could be retired and that the banks would soon become the property of the farm loan associations. Since the farm loan associations were required to be owned by the farmers who held stock in them, the farmers, therefore, were to become the indirect stockholders of the land banks. All requests for loans were to be passed upon by the loan committee of the association, the directors of the association, and the appraiser representing the land bank which would discount the mortgage for the farm loan association. The land banks were to

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acquire their capital by selling bonds secured by the mortgages acquired from the loan associations.

The mortgages, all of which were to be first mortgages based on a very safe margin, were to be standardized, thereby creating an attractive security which would put farm mortgages on par with the industrial securities offered on the open market. It was hoped that this procedure would correct the prevailing situation in the farm-mortgage field as expressed by T. N. Carver of Harvard:

> The market for farm mortgages is a notoriously poor one. The principle is very simple. Farm mortgages cannot be standardized and sold on grade or brand. The first buyer of a mortgage must inspect very closely, not only the property which is mortgaged, but the character of the mortgagors and even the administration of justice where the property lies. In general, anything which has to sell on inspection does not sell so readily as a standardized article which can be sold on grade.[1]

It was hoped that the land bank system would help to standardize farm-mortgage securities, to the end that sufficient capital might be attracted to the country from the city to meet the needs of the farmer. It is significant that the land banks, provided for in the Federal Farm Loan Act of 1916, were a distinct departure from the earlier land bank schemes of this country. In the first place,

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[1]E. S. Sparks, History and Theory of Agricultural Credit in the United States, (New York: Thomas Y. Crowell Company, 1932), Foreword by T. N. Carver, p. xii.

they were entirely divorced from commercial banking and currency schemes. In the second place, they were purely investment banks attracting loaning funds by the sale of tax-exempt debenture bonds based on first mortgages on land to the extent of twenty times the paid-in capital.[1] Moreover, the loans to the farmers were to be paid back on an amortized basis and they were to bear interest at a rate not to exceed one per cent more than the interest which the last sale of debenture bonds bore.

The Federal Farm Loan Act of 1916 also provided for the establishment of joint-stock land banks. These banks were designed to give service very similar to the federal land banks but without the cooperative features and without capital from the federal treasury. It was intended that these institutions were to afford private capital an opportunity to enter the mortgage banking field. Each bank was to have a publicly subscribed initial capital of not less than $250,000 "formed by any number of natural persons not less than ten."[2] The joint-stock land banks were permitted to issue bonds up to fifteen times the amount of their capital

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[1]Shultz and Caine, op. cit., p. 515.

[2]Farm Credit Administration, Laws Administered by the Farm Credit Administration as Amended to July 1, 1938, Circular No. 20, (Washington: Government Printing Office, July 1938) p. 61.

and surplus. Mortgages were to be made on the same basis as those made by the farm loan associations. Due to reasons connected with the depressive condition of agriculture during the 30's and which will be discussed later, the joint-stock land banks were ordered to cease operations with the passage of the Emergency Farm Relief Act of May 12, 1933.

The foregoing discussion has outlined in a somewhat brief fashion the two banking systems that were provided for in the Federal Farm Loan Act of 1916. It will be next in order to make an investigation into the activities of the federal farm-mortgage institutions throughout the quarter century of time elapsing since provision for this establishment was made. It will, also be within the scope of this chapter to consider any other governmental agency established for mortgage lending purposes by later legislative enactments, as well as, any changes that have been made affecting them.

The lending activities of the federal land banks have proven to be quite extensive during the first twenty-five years of their existence. In fact, according to H. W. Torgerson, one-third of the total number of farms of the country were mortgaged in 1939, and of these one-third,

forty per cent were held by federal agencies.[1] At first, however, the land banks did not enjoy a very satisfactory business. Applications for loans were numerous, but the financial operations of the banks were limited by the fact that federal war loans absorbed investment funds that might otherwise have been invested in federal land bank bonds. An attack upon the constitutionality of the Federal Farm Loan Act, which was not settled until 1921, also hampered the financial growth of the agency. The middle of the 20's, however, saw a remarkable increase in the expansion of land bank loans, and a natural result was the retirement of capital stock held by the federal government in lieu of the stock subscriptions of the farm loan associations. Table IV, on page 19, reveals that it was not until during the years 1920 and 1925 that any significant amount of farm-mortgage debt was held by the land banks. The total holdings for these years was $296,386,000 and $923,077,000 respectively. It is significant that federal land bank loans were not popular in Kansas until 1933.[2] In 1917

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[1]H. W. Torgerson, "Agricultural Finance in the United States", Journal of Land and Public Utility Economics, Vol. XVI (May 1940) p. 198.

[2]Bureau of Agricultural Economics, Farm-Mortgage Recordings--Kansas (Washington: U. S. Department of Agriculture, January 1939) mimeographed, p. 2.

loans made by the federal agency comprised only 3 per cent of the total loans closed in Kansas for that year, whereas, 4 per cent was the figure in 1932. The percentages for the years 1922, 1923, and 1924 were 9, 7, 6, respectively--these being the highest percentages for the entire 15-year period. It was during these years that a large amount of personal and collateral loans were refunded into real estate loans. The federal land banks refunded a relatively large share of these loans during this period.

Non-federal agencies continued to make their share of farm mortgage loans until 1933. On January 1, 1928 the federal land banks held only 12.1 per cent[1] of the total farm mortgage holdings of the country, and even in May, 1933 the per cent remained approximately the same. 1933, however, marked the beginning of a new era for the federal agencies.

The collapse of business in 1929, together with the effect it had upon the money market, made agricultural economists aware of the fact that farmers were soon going to be in need of large amounts of capital with which to refinance existing loans that would soon come due. Private

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[1]Donald C. Horton, Long-Term Debts in the United States, U. S. Department of Commerce, (Washington: Government Printing Office, 1937) p. 110.

funds were being withdrawn from the money market as rapidly as possible, and, consequently, the government began to take steps to relieve the disastrous real estate situation which seemed to be the inevitable result.

In 1931, Congress proceeded to increase the capital of the federal land banks by authorizing the Secretary of the Treasury to subscribe for additional capital stock of the land banks to the amount of $125,000,000. At the end of 1935, treasury holdings amounted to $123,097,895 or 52.2 per cent of the total capitalization of the banks.[1] As stock held by the government is retired, the funds used for its retirement are held in the federal treasury as a revolving fund which may again be used by the government for the purchase of stock.

In addition to increasing the capitalization of the federal land banks, Congress, in 1933, took further measures in meeting the credit needs of the farmers by passing the Emergency Farm Mortgage Act to become effective on May 12, 1933. The Treasury was authorized to subscribe to the surpluses of the various banks, and "the money was to be

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[1]Chamber of Commerce of the United States, Agricultural Credit Under the Federal Government, (Washington D. C., November, 1936), p. 9.

used, in part, in making extensions to deserving farmers so that they might be carried along for a period of years against a return to normal prices."[1] The Reconstruction Finance Corporation was authorized to make available to the Land Bank Commissioner $200,000,000[2] to be used for first and second mortgage loans secured by real estate or personal property. These loans were to supplement the loans made available by the federal land banks. By law, the land banks were unable to lend more than 50 per cent of the appraised value of the land offered for security and 20 per cent of the permanent, insurable improvements; and, since it was believed that that would not provide many deserving farmers with enough funds, the Land Bank Commissioner loans could be made up to a maximum of 75 per cent of the "normal" value of farm property, real or personal, including crops. This emergency act also lowered the rate of interest on federal land bank loans, and any loss suffered, thereby, was to be assumed by the government.

There was also an endeavor made to increase the attrac-

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[1]W. I. Myers, Cooperative Farm Mortgage Credit, 1916-1936, Farm Credit Administration (Washington Government Printing Office) p. 12.

[2]In 1934 this amount was increased to $800,000,000. In 1935 it was raised to a possible maximum of $2,000,000,000.

tiveness of federal land bank bonds by adding a government guarantee of the interest payments to the tax-exemption features which they already possessed. Bonds having this additional feature were still unsaleable to the public and were used solely as collateral for advances from other farm credit institutions and the Reconstruction Finance Corporation.[1]

On January 31, 1934 a further step was taken to provide funds. The Federal Farm Mortgage Corporation was created to issue its own bonds secured by the bonds of the federal land banks. The bonds of this new corporation were not only tax exempt but carried the government guarantee of the principal as well as interest payments. "These bonds proved saleable and at the end of 1935 this corporation held as security for its own bonds almost 40 per cent of the land bank bonds then outstanding." [2]

In addition to the legislation affecting the lending facilities, the President reorganized the entire farm credit set-up into one coordinated system which was called the Farm Credit Administration.

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[1]Chamber of Commerce of the United States, op. cit., p. 11.

[2]Ibid., p. 11.

Brief mention should be made at this point of the Bankhead--Jones Farm Tenant Act of 1937 which provided that the Farm Security Administration should enter upon a program of financing the purchase of farms by tenants. Although the number of such purchases are small it is hoped that the continuation of such a program will act in the direction of supporting farm real estate values and increasing the volume of voluntary transfers.

In view of what has been stated, relative to the government providing for an abundance of mortgage credit on liberal terms for the farmers, it is not surprising that the federal agencies began doing an exceedingly large business in 1933. It was stated above that in the early part of 1933, the federal land bank held but 12.1 per cent of the total farm-mortgage holdings of the country. Statistics show, however, that, by the end of 1936, federal agencies were holding 33 per cent of the total, and, as has already been mentioned, the figure stood at approximately 40 per cent by the end of 1939.

This enormous increase in holdings by federal agencies has been due, for the most part, to the refinancing of loans formerly held by other types of lending agencies. Table V, page 42, gives evidence of that fact. The monthly report of the Farm Credit Administration of November, 1936

Table V*

PERCENTAGE OF FEDERAL LAND BANK LOAN PROCEEDS

USED FOR VARIOUS PURPOSES

Purpose	1927-1929	May 1, 1933 to Sept. 30, 1934
Refinancing Indebtedness	77.2	88.0
National Farm Loan Assn. Stock	5.0	5.0
Loan Fees, etc.	----	1.3
Purchase of Land	10.0	3.3
General Agricultural Uses	----	1.1
Buildings and Improvements	4.9	.9
Equipment, fertilizer, livestock, irrigation	2.9	.4
Total	100.0	100.0

*Ibid., p. 14.

reveals that federal land bank and Land Bank Commissioner loans were 85 per cent less for that month than they were for the same period of 1934. It is quite evident that the federal agencies have reached a peak in granting farm-mortgage loans and that they are now sharing the field more equally with other agencies. The changes in the loan activities of the federal agencies for the country as a whole are quite comparable to those for the state of Kansas.

Of particular importance in a study of mortgage loans is that phase which deals with the terms of the loans and the costs connected therewith. It has been suggested that

the terms made by the federal lending agencies were extremely lenient, that is, they were lenient in comparison to loans extended by other agencies.

In the first place, it can be said that practically all of the loans of the federal agencies are made for a period of over thirty years. Up to 1924 all such loans had been made on the basis of thirty years or more.[1] Since that time, however, a few of the banks have made loans for ten and twenty years.[2] The farm loan act restricts loans to a term of not less than three nor more than forty years.

Service fees to meet costs of operation are charged by both the national farm loan associations and the federal land banks when the loan is made. Associations are permitted to charge up to 1 per cent of the amount of the loan. The land bank fee is based on the actual cost of appraisal, examination of title and recording. If the loan is not closed the costs are nominal. The most important advantage of the federal farm loan system in the matter of costs of loans is the fact that there are no frequent renewals with their recurring costs.

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[1] Evans Clark, The Internal Debts of the United States, (New York: The Macmillan Company, 1933), p. 37.

[2] Chamber of Commerce of the United States, op. cit., p. 18.

So far as interest charges are concerned, under normal conditions the rate of interest to be charged farmers by the land banks is governed by the rate which they find it is necessary to pay on the bonds, since the primary source of loanable funds is the receipts from bond sales. The official rate of interest, however, differs somewhat from the actual rate which the borrower must pay since he is obliged to subscribe for an amount of stock equivalent to 5 per cent of the loan, and the association through which he borrows may deduct an additional 1 per cent from the loan. As the interest is computed on the full amount of the loan, the real rate will be above the official rate, unless the dividends on the bank stock are sufficient to compensate for this difference.

A policy of regulating the interest rates of the federal land banks was adopted by Congress when the Act of 1916 was passed. This act provides that the rates charged on loans may not exceed by more than 1 per cent the rate on the last issue of bonds of the bank making the loan. A second limiting provision requires that the rate of interest charged farmers may not exceed 6 per cent. As was indicated previously in this chapter, during the more severe stages of the depression this restriction operated to render the banks unable to obtain, through the usual channels,

sufficient capital with which to perform their functions.

The Emergency Farm Mortgage Act of 1933 lowered the rate of interest that could be charged by the federal land banks to 4½ per cent. Later amendments reduced the rate to 3½ per cent. Table VI shows the amount of loans that the federal land banks had outstanding in 1938 in relation to the rates of interest charged.

Table VI*

FEDERAL LAND BANK LOANS OUTSTANDING AS OF DEC. 31, 1938, CLASSIFIED BY RATES OF INTEREST

Rate	Amount
4 per cent	$ 277,058,000
4 1/4	57,103,000
4 1/2	12,871,000
4 3/4	1,320,000
5	1,007,448,000
5 1/4	44,275,000
5 1/2	506,402,000
5 3/4	56,000
6	74,092,000
6 1/2	789,000
Total	$1,982,224,000

*Torgerson, op. cit., p. 322.

The contract rate of 5 per cent on Land Bank Commissioner loans was established. This rate was not out of line with the lower rates set for the land banks when it is consid-

ered that the larger proportion of the Commissioner loans were secured by second mortgages.

Another very important element in making farm loans is the appraisal of the property to be mortgaged. This is especially important since it affects the amount which the farmer may borrow as well as the safety of the lender's principal. Accurate appraisals of farm properties have constituted one of the major problems of any farm loan agency.

The original Farm Loan Act required that loans should be based on the value of the farm for agricultural purposes and that income should be the principal element in the value. However, it was soon recognized by the Federal Farm Loan Board that farm income is very unstable and unpredictable over a period of years. Consequently, in view of the inflated farm values of 1919, the Board set $100 per acre as a maximum, regardless of the current selling price. It was the policy of the Board to require the land banks to protect themselves against possible future depreciation of the security of the loans and also to prevent to some extent the development of land speculation which might result in excessive land values.

The decline in farm income in 1930 and 1932 lowered current farm values to such an extent that in many instan-

ces these values were inadequate to support loans of a sufficient size to be of practical use. Therefore, in order to meet more adequately the needs of the industry for credit, the "normal" farm income was adopted as a basis of value. Exhaustive studies of the movements of farm prices over a period of years resulted in a conclusion that the prices of farm products were likely to be stabilized at a level approximating the average for the five years, 1910-1914. Appraisals are therefore now made as nearly as possible on the basis of the probable earning power of the farm in the hands of the ordinary farmer with prices at the 1910-1914 level. In appraising the property, however, consideration is given to other factors which may influence the income, such as possible changes in economic and physical conditions in the particular region, shifts of population, changes in types of farming, in the demand for agriculture, etc. It is apparent that there are no specific and "clear cut" criteria whereby the value of a farm can be judged.

Throughout this chapter the role of federal activity in the business of farm-mortgage lending has been under consideration. A presentation of the history of events which led up to the Farm Loan Act of 1916 has been made. It has been shown that this act created an agency in the federal land bank, which has become the world's largest co-

operative.[1] It can be truly stated that the federal land banks, along with the lending capacity of the Federal Farm Mortgage Corporation, have provided a sufficient supply of credit to meet the needs of the farmers in all parts of the United States. Whether or not the federal lending agencies have at all times worked for the greatest possible good for all farmers is within the scope of another chapter, but it can be said in all fairness that these agencies have answered the call of the farmer for a sufficient supply of credit on lenient terms.

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[1] Myers, _op_. _cit_., p. 1.

CHAPTER IV

LIFE INSURANCE COMPANIES: A VITAL SOURCE OF FARM MORTGAGE CREDIT

The nature of the financial structure of life insurance companies has made it possible for them to play a major role in the field of farm-mortgage lending activities. The fact that the major portion of the funds held by life insurance companies is derived from premium payments, which are made a long time before disbursements are necessary, places them in a unique position capable of meeting the long-term credit needs of the farmer. With the exception of periods of prolonged depression, during which it often becomes necessary for life insurance companies to liquidate their holdings, it is possible for them to maintain a large per cent of their capital in the form of fixed holdings such as farm mortgages. Before the establishment of farm-lending agencies by the government in 1916, life insurance companies had been active in granting mortgage loans to agriculturalists, and although their relative importance decreased to a considerable extent during the depression of the 30's, they continue to serve the farming industry in that capacity in no small way. It

is because of their unique ability to invest in farm mortgages that they merit special attention in any study of farm-mortgage finance.

In 1910, life insurance companies held 12.1 per cent of the total farm-mortgage holdings of the country. By 1928, this amount increased to 22.3 per cent; and, although the depression of the 30's caused them to liquidate a great amount of their holdings in real estate, they still held 12.6 per cent in 1939. Their 1939 holdings, relatively small as they were, exceeded those held by the Land Bank Commissioner or the commercial banks.[1] They were, however, smaller than the holdings of individuals and the federal land banks.

Before any detailed facts, relative to the extent of the activity of the life insurance companies in the farm mortgage field, are presented, it would be well to consider the organizational facilities through which loans to the farmers were negotiated. It should be remembered that the majority of the companies that were interested in real estate mortgages were located in the Eastern part of the

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[1]Temporary National Economic Committee, "Study of Legal Reserve Life Insurance Companies", Investigation of Concentration of Economic Power, Monograph No. 28, (Washington: Government Printing Office, 1940) p. 345.

United States. Consequently, it was necessary for these companies to create some kind of mediary agencies through which the loans to the farmers could be closed. Four general methods were developed by which farmers were able to secure loans from life companies: (1) Through a branch office organization maintained by the life company; (2) the loan correspondent system which was the most popular method; (3) the check letter method which was a variant on the correspondent system; and (4) purchase of blocks of loans without specific consideration of individual items.[1]

The branch office system, although it was not used by many of the life companies, proved to be very successful between 1919 and 1930. The companies using this system maintained a salaried representative in each region in which they desired to solicit business. This officer established an office and handled all applications which came in from those who had been designated as loan brokers for the company. Those who were designated as agents for the companies were local men who were not only thoroughly acquainted with farmers but were familiar with the farms of his particular territority as well. The agents were,

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[1]A. M. Woodruff, Jr., Farm Mortgage Loans of Life Insurance Companies, (New Haven: Yale University Press, 1937), p. 7.

for the most part, bankers and fire insurance representatives. It seemed obvious that men acting in these capacities were well fitted to perform the duties of farm-loan brokers.

The brokers or agents received a commission from the borrower on the loans which were closed by them. In each case the agent interviewed the applicant for the loan, made a personal inspection of the property to be mortgaged, appraised it, and then forwarded the application to the branch office. The branch office checked the application and in turn sent it to the head office of the company where it was either approved or rejected after having been checked again.

If the risk was acceptable to the head office of the company the mortgage papers were then drawn.

> The papers, together with a check for the amount of the loan, were then sent to the branch office. The branch office arranged for the execution of the papers. The money seldom went directly to the farmer; usually the branch manager paid the farmer's debts for him. Those payments frequently involved the liquidation of existing mortgages and other debts and a commission to the local agent. The balance, if any, went to the farmer.[1]

This method of closing loans offered distinct advantages to both the borrower and the lender. The borrower

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[1] Ibid., p. 8.

profited by the fact that there was only one "middle man" involved in negotiating the loan, and consequently, there was only one commission charged. Furthermore, by reason of the fact that the branch office was a part of the company, itself, and did not depend upon commissions for its existence, it was possible for it to pay the agents well. Agents who were well paid did not find it necessary to accept applications for loans in which the risk was great. Consequently, the mortgage portfolios of the insurance companies using the branch office method could be filled with a high grade of mortgages.

The loan correspondent system has been the most popular method used by life companies in closing farm-mortgage loans. These correspondents were the successors to the mortgage loan companies which had been doing business prior to 1893 as intermediaries between eastern lenders and western borrowers. Shortly after 1893 the insurance companies held large cash reserves and were looking for new investment opportunities. The western mortgage companies or "correspondents", while they also transacted business for banks and private investors, found that life companies were very eager to increase their farm-mortgage investments, and, consequently, most of their business was done for them. During the peak of farm-

mortgage investment activity for the life companies in 1929, 91.3 per cent of the loans closed by loan correspondents in the seven West North Central states, ultimately, came into the possession of the life insurance companies.[1] The figure for Kansas was 70.4 per cent, which was the lowest figure recorded for any state in the West North Central area. Private investors took a relatively high per cent of the loans closed in Kansas by the loan correspondents. This accounted for the fact that the per cent recorded for life companies was relatively low.

In all cases the correspondent got its applications for new business from local agents who were paid a commission on all new business produced. The correspondent then culled these applications and sent the best ones to the home office of the life company. Here they were inspected, usually by a finance committee[2] as required by law in many states, and the correspondent was notified that the company was or was not disposed to consider the loan. If the life company replied that it would consider making the loan, the correspondent proceeded to draw up the mortgage

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[1] A. M. Woodruff, Jr., Farm Mortgage Loans of Life Insurance Companies, (New Haven: Yale University Press, 1937) cited from a preliminary table issued by the Bureau of Agricultural Economics, United States Department of Agriculture, 1931. Mimeographed. p. 9.

[2] Sparks, op. cit., p. 194.

papers and then lent the money to the farmer out of its own funds. This was all done, however, before the correspondent was assured that the life company would accept the mortgage. In most cases the insurance company would purchase the mortgage from the correspondent, but if it refused to do so, the correspondent would have to either place it in its own portfolio or sell it to a less discriminating investor. Some correspondents went so far as to personally guarantee the safety of the mortgages they sold, by promising to buy them back at any time. This policy was responsible for the insolvency of many of the correspondents during the 30's when the insurance companies were eager to decrease their farm-mortgage holdings.

The income of the correspondents was derived from commissions, service charges, and sometimes a percentage of the gross interest. The commission was collected by the correspondent by withholding part of the proceeds of the loan received from the life company. The remainder was remitted to the borrower. The commission usually amounted to fifteen to twenty-five dollars per thousand.[1] Service charges constituted a very small source of income and were collected from the borrower at the time the application was made. A percentage of the gross interest was collected

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[1] Ibid., p. 194.

by the correspondent by one of two methods. Sometimes the correspondent would collect the gross interest from the borrower and would remit all but a certain per cent to the company. In other instances, the company would collect the interest directly from the borrower and would then remit a certain per cent, usually ranging from one-half to 1 per cent, to the correspondent. The loan correspondent method was very successful up until 1918; however, in the period which followed, there was a mad competetive scramble for sources of investment, and the natural consequence was the lowering of standards upon which loans were based. Lower standards resulted in larger loans in proportion to the value of the security--this in turn led to an undesirable foreclosure record during the course of the great depression. Since the correspondents' income was derived from commissions, their primary concern was that of quantity rather than quality.

It is interesting to note that "the one company which made all of its loans through its own branch offices had a substantially better foreclosure record than those which made loans through correspondents."[1] This speaks well for the branch office system although it was not used so extensively.

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[1]Woodruff, _op_. _cit_., p. 13.

Two other methods by which the life companies made farm-mortgage loans, and which were named above, were the "check letter" method and the purchase of block loans. Neither of these methods were used extensively but a brief explanation of each should be made at this point.

The check letter method was used, primarily, when the loan correspondent was sending in a small volume of business or when the life company did not have a complete confidence in it. Woodruff presents a succinct explanation of this method.

> In check letter cases, the correspondent made his inspection of the property and forwarded the information to the home office. The correspondent did not close the loan, but waited for definite word that the company had approved the application. The correspondent then drew the papers and sent them to the home office. The insurance company inspected the papers and, if they were satisfactory, sent them back to the correspondent together with a check to the order of the borrower. The correspondent had the borrower execute the papers and gave him the check. After this was done, the correspondent had to collect his commission from the farmer. The system got its name from the fact that the check went out in the letter in lieu of a deposit to the credit in an eastern bank.[1]

Only one large company made loans by purchasing large blocks of mortgages. Under this system the Western mortgage companies would make a large number of mortgage loans and would sell them to the life company in a block. Some-

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[1] *Ibid.*, p. 14.

times a block would amount to several million dollars. No inspection of the security was made by the life company, and consequently, these blocks often included some very poor risks. The most successful operation of this system occurred when European mortgage companies, who had extensive holdings in farm mortgages in the United States, were anxious to liquidate their holdings in 1914. This gave the life insurance company a chance to buy large blocks of sound mortgages. The system, as a whole, however, was not successful, nor was it widely used.

The four principal methods which the life insurance companies used in investing in farm mortgages have been considered above. It should now be worthwhile to consider the length of the duration of the loans granted, interest rates charged, and the volume of mortgages held throughout the period under study.

According to data supplied by Evans Clark,[1] the average term for loans closed by life companies, as of January 1, 1924, was for 5.6 years. The per cent of the loans closed for a one year term was 4.4; 13.3 per cent were closed for a period of two to four years; 64.8 per cent were closed for five years; and, 17.1 per cent were closed

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[1]Evans Clark, The Internal Debts of the United States, (New York: The Macmillan Company, 1933), p. 37.

for a period of ten to thirty years, no loans being made for a longer period by that date. Following that date, however, a few loans have been made by life companies for a longer period. Some companies make thirty-four and one-half year amortized loans. These loans are repaid by adding about 1 per cent of the principal to the regular interest rate each year.[1] The amortization plan was not popular with life companies until after the recent depression of the 30's. A report of 177 companies in 1921 revealed that only 6 were granting loans on an amortization payment basis.[2] The companies did not, however, deny the mortgagor the privilege of paying part of the principal on specified dates, for as early as 1914, many of the companies made loans in Kansas with a provision that the mortgagor could reduce the principal by $100 or any multiple thereof on interest paying dates.[3]

Due to the fact that the cost of closing a loan is an appreciable item, the life insurance companies have avoided

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[1]Sparks, *op. cit.*, p. 194.

[2]V. N. Valgren and E. E. Engelbert, *Farm Mortgage Loans by Banks, Insurance Companies, and Other Agencies*, United States Department of Agriculture Bulletin 1047 (Washington: Government Printing Office, 1921) p. 21.

[3]Geo. E. Putnam, "Farm Credit in Kansas", *The American Economic Review*, Vol. V (March, 1915) pp. 27-28.

making loans on farms of low value. Consequently, the average size of farm loans which have been closed by them is relatively large. It should be stated that, for the most part, life insurance company loans were made for not more than approximately 50 per cent of the value of the farm land and buildings. However, the loan policies have changed considerably in recent years, so that they now base their loans on the earning power of the farms that are mortgaged.

The rate of interest charged by the mortgagee on farm loans is always of vital importance to the farmer, for it is the principal item in the cost of borrowing money. Table VII, on page 61, indicates the average rates of interest charged on farm-mortgage loans in the United States by life companies over a period of twenty-five years. The data given can be supplemented with information from the Temporary National Economic Committee of the Senate which found that only three of the twenty-six leading insurance companies made new farm mortgages at contract rates averaging more than 5 per cent in 1938, and slightly less than one-half the companies reported average rates exceeding 5 per cent on all mortgages owned by them in that year.[1]

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[1]Farm Credit Administration, _Farm Credit Quarterly_, _op. cit._, (March 31, 1940) p. 5.

Table VII*

AVERAGE RATES OF INTEREST CHARGED BY LIFE INSURANCE COMPANIES ON FARM-MORTGAGE LOANS IN THE U. S., 1910-1935

Year	Rate
1910	5.6
1915	6.1
1920	6.1
1925	5.5
1930	5.8
1935	5.5

*Computations based on data given by Donald C. Horton, Regional Trends of Farm-Mortgage Interest Rates, 1910-1939, Bureau of Agricultural Economics (Washington: U. S. Department of Agriculture, May 1940) Mimeographed. p. 5; reprinted from Agricultural Finance Review (May 1940).

These data indicate decided reductions since 1932, when no company reported an average rate less than 5 per cent on either new mortgages, purchase money mortgages, or all mortgages.

In addition to the usual interest charges on the life company loans, there are the costs of closing the loans as was indicated earlier in this chapter. Often times this cost is overlooked in determining the comparative advantage in loans made by various classes of lenders, but one can scarcely afford to do that when the cost is as significant as it is. Usually on a five-year loan there has been a 5 per cent commission to the agent, which increases

the rate of interest by 1 per cent. Sometimes this increase was 2 per cent but never higher.[1]

It has been indicated by Table IV on page 19, that life insurance companies made rapid strides forward in building up their farm-mortgage investments during the first two decades of the present century. It is interesting to note that by far the largest per cent of the loans closed by the life companies were on farm mortgages in the middle-western states. According to Woodruff, in 1930, 79.41 per cent of the total farm mortgages held by the life companies were located in twelve middle-western states; 13.85 per cent were held in seven south-central states; 3.42 per cent in five south-eastern states; and, 3.38 per cent were held in five states of the far west. Of the total amount held in the middle-western group of states in 1930, Kansas ranked fourth with 6.94 per cent of the total held for that group. Iowa ranked first having the high per cent of 26.70, followed by Illinois with 10.03 per cent, and Minnesota with 7.15 per cent.[2] Of the total loans outstanding in Kansas in 1916, more than

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[1]Putnam, op. cit., p. 28.

[2]Woodruff, op. cit., p. 45.

one-third were held by life insurance companies.[1]

Of the total loans outstanding in the United States in 1914, life insurance loans represented 37.48[2] per cent of the total, and fourteen years later (1928) they still held 34.9[3] per cent of the total, thus almost retaining their same relative importance as a lending agency for farmers. Even though their relative importance declined somewhat during this period, it has been indicated that their total holdings increased. By 1928, the life companies reached their peak in volume of loans outstanding.

The farm mortgage accounts of the companies as a whole have been steadily contracting since 1929. Reduction has resulted to a considerable extent from foreclosures. Real estate holdings increased from $220,000,000 to $713,000,000 between 1932-1937, and this accounted for about one-half of the decrease in loans held.[4]

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[1] H. G. Moulton, Principles of Money and Banking, (Chicago: University of Chicago Press, 1916), p. 381.

[2] R. L. Cox, "Life Insurance Investments with Special Reference to Farm Mortgages", (Report submitted December 9, 1915 at the 9th Annual Meeting of the Association of Life Insurance Presidents), p. 7.

[3] Temporary National Economic Committee, op. cit., p. 345.

[4] H. W. Torgerson, "Agricultural Financing in the United States", Journal of Land and Public Utility Economics, Vol. XVI (May, 1940), p. 201.

A considerable portion of the reduction has, also, been due to refinancing. Approximately 15 per cent of all refinancing money of the federal land bank and the Land Bank Commissioner went to life insurance companies. This, incidentally, permits an interesting comparison between life company and other farm loans. The life companies held in 1928 about 26 per cent of the total farm-mortgage debt eligible for federal refinancing.[1] Thus the life companies accepted less assistance from the Farm Credit Administration than their proportional holding of loans would have indicated, and the other investors proportionally more.

The steady contraction of loans since 1928, on the part of the life companies, decreased their per cent of total holdings from the high per cent given above for 1928 to 13 per cent in 1939.[2] These figures, however, should not be interpreted to mean that the life companies have lost all interest in making farm-mortgage loans. On the contrary, they have continued to be active in the field. Percentage changes in the amount of farm mortgages recorded

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[1]Woodruff, _op_. _cit_., p. 165.

[2]Farm Credit Administration, _Farm Credit Quarterly_, U. S. Department of Agriculture (Washington: Government Printing Office, May 1941) Vol. VI, p. 5.

reveal that the life companies increased their lending activity by 162 per cent from 1934 to 1936,[1] and the recordings for 1938 were estimated at three times the volume recorded for 1934.[2] Thus, the life insurance companies not only played a very important part in the agricultural development of the Middle West, in particular, but they are continuing to play an active role in the field of farm-mortgage activity.

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[1]Farm Credit Administration, Monthly Report on Farm Mortgages Recorded and Foreclosure Sales, November 1936, Mimeographed, p. 1.

[2]M. M. Regan, Farm Real Estate Situation 1936-1939, U. S. Department of Agriculture, Circular 548 (Washington: Government Printing Office, October 1939) p. 23.

CHAPTER V

THE IMPORTANT ROLE OF MINOR AGENCIES

In any study of farm mortgages the federal agencies and the life insurance companies demand special attention as farm-mortgage lending institutions; however, no study would be complete if it ended with the consideration of those agencies alone. It is true that they represent the largest single lending agencies which have been active in the farm-mortgage field, nevertheless, it is significant that they hold but approximately 50 per cent of the total farm mortgages in the United States today. The other one-half of the total mortgage loans outstanding have been made by joint stock land banks, commercial banks, state credit agencies, private individuals, Farm Security Administration,[1] mortgage companies, and other miscellaneous lenders. This group of lending agencies shall be the object of consideration in this chapter.

The joint stock land banks are privately organized

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[1]Although the Farm Security Administration is a federal agency, its farm-mortgage lending activities are merely of secondary importance--hence, it is classified with the group of "other" lenders.

institutions chartered under provisions of the Federal Farm Loan Act of 1916. As was stated in Chapter III, the stock of these banks was subscribed by the investing public, none being owned by the United States Government.

For the purpose of obtaining funds with which to make loans, joint stock land banks were empowered under the provisions of the Farm Loan Act to issue bonds in an amount not to exceed fifteen times their capital and surplus. These bonds were exempt from taxation.

The directors of each joint stock land bank are elected by the stockholders, and the directors in turn elect the officers of the bank and control its policies. The Farm Credit Administration has general supervisory authority over the joint stock land banks, however, and appoints receivers and directs the conduct of joint stock land bank receiverships. Limitations and terms of mortgage loans by joint stock land banks were the same as those for federal land bank loans.

The joint stock land banks experienced many problems in their early days of existence similar to those experienced by the federal land banks. Of primary importance was the fact that their initial bond issues came at a time when they competed with the government war bond issues during the first world war. Consequently, the banks were unable to enjoy a very extensive volume of business for

some time. Moreover, since they were required to loan money at a relatively low rate of interest, their profits depended upon a large volume of business. Therefore, many of the banks experienced financial difficulty, and the complete failure of two of the banks had a bad effect upon the sale of the joint stock land bank bonds on the open market. It was soon made clear, however, that the banks were not jointly liable to one another and that the failure of one bank did not necessarily affect the status of the others.

A total of eighty-eight charters were granted to joint stock land banks by the Federal Farm Loan Board. Fifty-six was the maximum number in operation at any one time. The total mortgage holdings of the joint stock banks reached their peak in 1927, when the figure stood at $667,314,000.[1] The most significant increase in the loans extended by the joint stock banks occurred between 1920 and 1926.

The depression of the 30's and the plight of the farmer during this period placed many of the joint stock land banks in a precarious condition. Excessive loans, based on inflated valuations, which of course were inten-

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[1]Chamber of Commerce of the United States, _op. cit._, pp. 22-23.

ded to increase the profits of the banks, became such a burden to the farmers that they were unable to pay either the installment on the principal or the interest charges. As a result of these conditions three of the banks went into receivership in 1932, and "the others were more interested in foreclosing on their loans and buying in their bonds at a discount than in assisting their farmer-debtors."[1]

The Emergency Farm Mortgage Act of 1933 provided for the liquidation of the joint stock land banks, for it seemed obvious that they were not in a condition to continue business. No further loans were to be made by these banks; however, in some cases they were empowered to renew existing mortgages coming due in an effort to prevent an excessive number of foreclosures.

In 1941, twenty-six joint stock land banks were in operation, eight were in voluntary liquidation, and six were in the process of liquidation through receiverships. Forty-eight of the eighty-eight joint stock land banks chartered had been liquidated by 1941.[2] The total joint stock land bank loans outstanding in 1940 amounted to

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[1]W. J. Schultz and M. R. Caine, op. cit., p. 699.

[2]Farm Credit Administration, "Joint Stock Land Banks--Progress in Liquidation Including Statements of Condition," United States Department of Agriculture, (1941) p. 4.

$65,719,000 as compared to the peak of their holdings in 1927 which was $667,314,000 as given above.

It should be stated at this point that, although the federal land banks survived the depression of the 30's and the joint stock banks did not, it was through the benevolent intervention of the federal government that the federal land banks were saved from apparent disaster. The joint stock land banks were not given any of the benefits conferred by Congress upon the federal land banks in an effort to keep them in existence.

The discussion in Chapter III of the movements which led up to the farm loan act of 1916 indicated that the extent to which commercial banks can prudently extend farm-mortgage credit is rather limited. Nevertheless, commercial banks have played an important part in this field during the period under study. Not only is the total amount of farm-mortgages held by the banks significant, but the service they perform in making their loans is rather unique.

Loans made by commercial banks are usually based upon the personal element, and much of the "red tape" of getting a loan through federal land banks or insurance companies is avoided. The unit cost of extending a loan is, consequently, lower than that of other agencies. The banker is usually, personally acquainted with the borrower and has a personal knowledge of his ability to repay the loan as well as

knowing the value of the security back of the loan. That the personal element plays an important part in commercial bank loans is reflected by the fact that 20 per cent of all farm-mortgages held by commercial banks in 1934 were held by banks in cities having less than 1,000 population; 65 per cent were held by banks in cities with less than 15,000; and 82 per cent by banks in cities having fewer than 500,000.[1]

Farm-Mortgage loans extended by commercial banks are usually made for a relatively short term. Since most of the funds, of a commercial bank are derived from demand deposits, it is evident that a bank cannot lend for long periods of time and that the volume of such loans must be relatively small. In 1920, the average size of farm-mortgage loans recorded for commercial banks was $3,840 as compared with $8,100 for insurance companies, $3,740 for federal land banks and Land Bank Commissioner, and $11,670 for joint stock land banks.[2] The figures for 1935 were

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[1]Norman J. Wall, "Outstanding Farm-Mortgage Loans of Leading Lending Agencies", Bureau of Agricultural Economics, United States Department of Agriculture, (1937) p. 31.

[2]Bureau of Agricultural Economics, "Average Size of Farm-Mortgage Recordings of Selected Lender Groups", United States Department of Agriculture (1940) p. 3.

$2,380, $5,710, $3,020, and $4,370 respectively.[1] Of particular significance is the fact that in 1920 the average loan by commercial banks in Kansas was for $4,450 while in 1935 it had decreased in size to $1,980.[2] This wide variation in the size of Kansas loans is accounted for by the fact that commercial banks were also "victims" of the wild inflationary land values following the first World War. Recent policies of the Federal Reserve System, however, make it impossible for the member banks to invest heavily in real estate mortgages.

As was stated above, commercial banks cannot extend long-term loans. The average term of farm-mortgages held by commercial banks in 1924 was 2.6 years. Further statistics reveal that 52.1 per cent of commercial bank real estate loans were made for not more than one year; 19.9 per cent were made for two to four years; and 26.7 per cent were made for five years.[3]

An important phase of the farm-mortgage lending activities of commercial banks is the purposes for which their loans have been made. In 1923, over one-half of their real estate loans were made for the purpose of re-

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[1]Ibid., p. 3.

[2]Ibid., p. 33.

[3]Evans Clark, The Internal Debts of the United States, (New York: The Macmillan Company, 1933), p. 37.

funding mortgages and other debts. Only 18.2 per cent were used in that same year for the purchase of land. The per cent of loans granted by the banks for the purchase of land continues to be small--the major portion is granted for the refunding of existing mortgages and other debts for which real estate mortgages are taken as security.

The official interest rates charged by commercial banks on farm-mortgage loans have been consistently higher than the rates charged by most of the other lenders. Average rates charged by the banks on Kansas loans rose constantly from 6.3 per cent in 1917 to 7.8 per cent in 1921, which was the highest average rate recorded for the period under study. Since 1921 there has been a steady decrease in the interest rates charged--6.3 is recorded for 1935.[1] Records show that the interest rates as charged in Kansas were very much the same for the United States as a whole. In both 1920 and 1921, the average interest rates charged by commercial banks in Kansas were .2 per cent higher, for each year, than for the United States at large. Since

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[1]Bureau of Agricultural Economics, "Farm-Mortgage Recordings--Kansas," United States Department of Agriculture (1939) p. 6.

1925 the rates have been practically identical.[1]

It was explained in the preceding chapters that the money rate of interest often differs from the official rate charged by various agencies. This results from the fact that other costs involved in closing the loan must be paid by the borrower. During the early years of the period under study, these "other" costs, charged by commercial banks, were sometimes quite excessive and, in many instances, raised the money rate from 1 to 2.5 per cent above the official rate.

Total farm-mortgage recordings for commercial banks reached a high point during the early 1920's when the figure rose to $1,447,000,000. From that date farm-mortgage holdings of the banks decreased constantly until the figure stood at the low point of $487,505,000. Since 1935, however, the banks' mortgage holdings have been steadily rising--the figure for 1939 was $530,628,000.[2] Further information relative to the recent lending activity of the commercial banks is available:

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[1]Donald C. Horton, "Regional Trends of Farm-Mortgage Interest Rates, 1910-39", Bureau of Economics, United States Department of Agriculture, p. 5, reprint from Agricultural Finance Review (May 1940).

[2]H. W. Torgerson, "Agricultural Finance in the United States", Journal of Land and Public Utility Economics, Vol. XVI (May 1940) p. 201.

> Recordings by commercial banks increased from $110,900,000 in 1934 to $219,800,000 in 1940; during the same period outstanding farm-mortgage loans of insured commercial banks increased approximately 9 per cent. Recordings by commercial banks during 1940 were equivalent to 41 per cent of the farm-mortgage debt held by insured banks at the beginning of the year, indicating the relatively rapid turnover of the mortgage debt held by banks. The high ratio of recordings to amounts outstanding arises in part from the use of relatively short-term contracts. . . . . At the end of 1940 insured commercial banks held approximately 8 per cent of the total farm-mortgage credit outstanding.[1]

A large per cent of the total farm-mortgage holdings of the commercial banks continue to arise out of loans granted for production purposes for which real estate mortgages are taken as security. Consequently, the nature of farm-mortgage loans made by banks varies, somewhat, from those made by the federal agencies and insurance companies.

Another source of farm-mortgage credit is represented by the state credit agencies. A number of the states have permanent endowment funds for the purpose of farm-mortgage lending; three states, namely, South Dakota, North Dakota, and Minnesota, have special rural credit systems; however, these systems constitute a very minor source of farm-mortgage credit and do not merit extensive discussion.

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[1]Farm Credit Administration, Farm Credit Quarterly (March 31, 1940) p. 4.

The volume of holdings of the three state rural credit systems amounted to $93,274,000 in 1930 and decreased to $14,823,000 by 1940.[1] The permanent endowment funds held by many of the states and which are used for agricultural purposes, are handled in a number of ways. It is common for the earnings of these funds to be used for educational purposes and in some instances the loans are made directly through the State Departments of Public Instruction.[2] The volume of such loans are relatively small and should, for all practical purposes, be included in the classification of "other" lenders which will be discussed later in the chapter.

In view of the fact that mortgage companies were discussed at length in connection with life insurance loans in Chapter IV, it will not be necessary to elaborate on them here. They have constituted a very important group engaged in farm-mortgage lending, however; and it should be profitable to make a few additional statements concerning them. Quite naturally, the terms of the loans made by this group have been comparable to the terms made by life insurance companies, since the majority of the loans closed by mort-

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[1]See Table IV.

[2]Earl Sylvester Sparks, History and Theory of Agricultural Credit in the United States, (New York: Thomas Y. Crowell Company, 1932), pp. 198-206.

gage companies came into the possession of life companies later. In 1928, $988,000,000, or 10.4 per cent of the total mortgage holdings recorded for that date, were held by mortgage companies.[1] This was almost the same per cent as was recorded for the commercial banks in the same year. In that same year the mortgage companies held but 4 per cent of the total mortgage holdings in Kansas, and their percentage has been constantly decreasing since that time.

It was stated in Chapter III that although the Farm Security Administration was a governmental agency, it seemed advisable to classify it with "other" lending agencies in view of the fact that its farm-mortgage business is small. Under the Bankhead-Jones Act of 1937, the Farm Security Administration has entered upon a program of financing the purchase of farms by tenants. Loans are granted for the full value of the farm and the machinery necessary to operate the farm. They are made for a period of forty years, bearing interest at 3 per cent.

During the first year of the program, loans were made for a total of $9,199,000 in 322 counties; during 1939, 4,341 loans in 732 counties amounting to $24,140,675 were closed; and $38,000,000 were made available for such loans

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[1]Donald C. Horton, Long-Term Debts in the United States, United States Department of Commerce, Washington, D. C., 1937.

in the year ending June 30, 1940.[1]

Of noteworthy importance throughout the quarter-century covered by this study, were private individuals who accounted for a great portion of the farm-mortgage loans granted to farmers. In many cases the mortgagor was the former owner of the farm which was sold. He often accepted part of the sale price in cash and a mortgage on the farm for the balance. This practice was very common during the upward swing of land values following the first world war.

From 1917 to 1920, individuals closed from 37 per cent to 41 per cent of the total mortgage-loans which were made in Kansas during that period. From 1921 to 1928, individuals withdrew from the field to a considerable extent, during which time the insurance companies were doing a big business. From 1928 to 1932, however, individuals came back into the lending field and closed from 39 to 45 per cent of all farm-mortgage loans closed during that period. During the great refinancing year of 1934, in which the federal agencies played the leading role, individuals decreased their business to 9 per cent of the total. By 1935, however, it again reached 18.0 per cent and has very

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[1]H. W. Torgerson, _op_. _cit_., pp. 200-201.

nearly maintained that level since then.[1]

The average interest rates charged on Kansas loans by individual lenders were very nearly the same as the rates charged by them for the entire United States. In 1920 the rate was 6.5 per cent; 1921, 7.0 per cent; 1935, 6.2 per cent; and in 1935, 5.5 per cent.

Mortgage loans extended by individuals have usually been for a relatively short period ranging from one to five years in length. Very few were made for a longer period.

Other sources of farm-mortgage loans which are usually classed as "other" lenders include building and loan associations, school funds, real estate companies, and a host of other minor sources which do not merit special consideration in a study of this kind.

The importance of the minor lending agencies in the field of farm-mortgage finance has been revealed by this chapter, and it is evident that any study of the farm mortgage situation would be incomplete without giving due consideration to them. Together, they represent a large per cent of the total mortgage holdings of the nation.

This chapter concludes the consideration of the machinery through which farm-mortgage credit is extended to

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[1]Bureau of Agricultural Economics, *op. cit.*, p. 2.

farmers, and, also, the trends in the volume of loans outstanding. It will now be of interest to delve into an analysis of the effects which the mortgage load has had upon the agricultural industry during the period which is being studied. Only by making such an analysis, can any reasonable evaluation of the entire farm-mortgage system be made.

CHAPTER VI

THE RELATIVITY OF FARM-MORTGAGE DEBTS

Any analysis of farm-mortgage finance must be concerned, primarily, with the relationship that one set of statistics describing the farm-mortgage finance situation bears to another set. Absolute data are important only in so far as their relationship to other absolute data can be determined. For instance, to say that a nation is worse off financially because it carries a larger volume of debt than it did at some other time might be far from the truth, for the productive capacity or the income of that nation might have increased four-fold while the debt load might have only doubled. Thus, the absolute volume of debt loses much of its significance when it is considered in terms of its relationship to the debt paying capacity of the nation.

It shall be the purpose of this chapter, and of those that follow, to reveal the relative significance of the long-term debt load of the farmers as it has been built up through the functioning of the various lending agencies which have been discussed in the foregoing chapters. Chief emphasis will be placed upon the relation which the debt load of the farmer bears to the value of the security back

of the mortgage and to the earning capacity of that security.

In Chapter II, "Farm-Mortgage Trends", a few statistics were presented indicating the relationship between the total value of land and buildings and the total mortgage debt. More complete information of similar nature is presented in Table VIII on the following page.

Upon the basis of data given in this table, computations reveal that a 12.8 per cent increase in the total farm-mortgage debt of the nation, between 1920 and 1930, was not the only factor which contributed to the change in the ratio of debt to the total value of land and buildings within that area.[1] The ratio of the debt load to the value of the security rose from 12.6 per cent to 20.1 per cent during those years. The fact that the value of the security back of the debt declined 27.8 per cent is of major importance as a contributing factor to the decrease in the farmers' equities and, of course, it follows that, to the extent that the value of land and buildings reflects their earning power, the decrease in the farmers' equities means an immediate increase in the burden of the debt.

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[1]"Security" and "value of land and buildings" includes, here, the total value for the state or nation--not just the value of the real estate actually mortgaged.

Table VIII

FARM MORTGAGE DEBT, VALUE OF LAND AND BUILDINGS, AND RATIO OF DEBT TO LAND AND BUILDINGS FOR UNITED STATES AND KANSAS

Date	Farm Mortgage Debt[1]		Value of Land and Buildings[2]		Ratio of Debt to Land and Buildings	
	U. S.	Kans.	U. S.	Kans.	U. S.	Kans.
	($1,000)	($1,000)	($1,000,000)	($1,000,000)	(per cent)	(per cent)
1910	3,207,863	163,359	34,801	1,738	9.2	9.4
1920	8,448,772	344,597	66,316	2,830	12.6	12.1
1930	9,630,768	411,747	47,880	2,281	20.1	18.0
1935	7,785,971	357,123	32,859[3]	1,478[3]	23.0	24.1
1940	6,909,794	309,602	33,642	1,421	20.5	21.7

[1]See Table IV.

[2]United States Department of Agriculture, Agricultural Statistics, 1941 (Washington: Government Printing Office, 1941) pp. 534-535.

[3]*Ibid.*, 1940, p. 584.

The years 1930-1935 marked another period during which the farmer's equity in his land diminished markedly. However, during the same period the total amount of farm-mortgage debt decreased considerably, the figure being 13 per cent for Kansas. But, in spite of this decrease in total debt recordings, the ratio of debt to the value of land and buildings increased from 18.0 per cent to 24.1 per cent in Kansas, and this was caused by the precipitous 35 per cent decline in the value of the security back of the farm-mortgage debts of the Kansas farmers. The decline in total farm mortgage holdings during the 1930-1935 period, as was stated in a previous chapter, was due principally to the large number of foreclosures and bankruptcies recorded during those years. Distress transfers of land holdings continued to be an important factor in the decline of total debt subsequent to 1935; however, the last two years have marked a turning point in which foreclosures have declined markedly and payments of principal installments have increased. Table VIII indicates that the farmer's equity in his farm has increased somewhat in recent years; however, his equity, for the country as a whole, is still smaller than in 1930--and even to a greater extent is that true for the Kansas farmer. It is significant that the value of land and buildings for the country as a whole was a trifle higher in 1940 than in 1935, and

this, together with the fact that principal payments on loans have been increasing, is reason for the more favorable debt situation. Increased land and building values for Kansas have not kept pace with the average for the country as a whole.

The foregoing discussion was based upon the relationship between the total farm-mortgage debt and the total value of all land and buildings within a given area. Such an analysis serves to indicate the total burden which rests upon the people of a state or nation without regard for the direct burden which is borne by the group who owns the property which is mortgaged. A consideration of the mortgage status of all farms operated by full owners will serve to give that information concerning a particular group of farmers who must bear the direct brunt of a mortgage debt.

The data which is presented in Table IX on the following page serves to indicate, clearly, the mortgage status of the farmers who were classed as the full owners and operators of their farms. Thus, an examination of these data will reveal the actual burden of debts as carried by this particular group.

In the first place, an examination of the table gives evidence to the fact that the ratio of debt to the value of the security back of the debt has been increasing quite

Table IX

STATUS OF FARMERS' EQUITIES ON FARMS OPERATED BY FULL OWNERS

United States:[1]	1910	1920	1925	1930	1940
Average Value Per Farm	6,289	11,546	9,564	8,997	6,241
Average Equity Per Farm	4,574	8,190	5,560	5,436	3,584
Average Debt Per Farm	1,715	3,356	4,004	3,561	2,657
Ratio Of Debt To Value	27.3	29.1	41.9	39.6	42.6
Kansas:[2]					
Average Value Per Farm	9,430	15,766	13,198	12,604	8,273
Average Equity Per Farm	7,104	11,683	8,044	8,144	4,651
Average Debt Per Farm	2,326	4,083	5,154	4,460	3,622
Ratio Of Debt To Value	24.7	25.9	39.0	35.4	43.8

[1] U. S. Bureau of Census, Sixteenth Census of the United States, 1940, "Agriculture--U. S. Summary", (2nd series; Washington: Government Printing Office, 1941) p. 7.

[2] Ibid., "Agriculture--Kansas", p. 7.

generally throughout the past thirty years. The figure for 1930 is the only exception to the general increase.

It is of vital significance in considering the farm mortgage structure, that cognizance be taken of each and every item as listed in the table--not just the ratio of the debt to the value of the property. If one would only look at the ratio of debt to the value of the property for 1920, on first thought he might conclude that there was little change in the debt situation during the ten years following 1910. It is true that the ratio increased only 1.8 per cent. However, it should be noted that the average value per farm for the United States was $11,546 in 1920 as compared with $6,289 for 1910; for Kansas the averages were $15,766 and $9,430 respectively. This enormous increase in the value of the farm was not in itself bad since the farmer's equity remained about the same. The crux of the whole situation is understood, however, when the "average value per farm" in 1920 is compared with the average for 1940. This comparison is especially significant when the fact is recognized that farm mortgages usually run for a period of several years after which time they are often renewed. It was possible for a farmer holding a $6,000 equity in his Kansas farm in 1920 to have his equity completely wiped out by 1940 as a result of the falling value of his real estate property. Of the many

factors contributing to the plight of the farmer during the past two decades, one of the most important is that a large volume of long-term debt was contracted during the land boom days of the post-war period, which was based on the immediate value of the security rather than upon the normal earning power of that security over a period of years comparable to the life of the mortgage. It is quite evident that false appraisals of farm real estate property were quite largely responsible for the enormous debt burdens of farmers following the land boom era.

The "average debt per farm" decreased considerably during 1925-1940; however, as was suggested previously, this decrease was offset by falling values, so that the farmers' equities were likewise decreased. It should be stated, however, that decreases in the amount of debt is to the advantage of the farmer even though real estate values do fall in a greater proportion, for he is then in a more favorable situation when farm values begin to rise. That is being experienced by farmers at the present time due to the fact that farm income and real estate values are rising.[1]

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[1]Bureau of Agricultural Economics, Farm Real Estate Values Show General Rise During Past Year (Washington: U. S. Department of Agriculture, Release for April 13, 1942) Mimeographed. p. 1.

It should be stated here again that the decrease in the "average debt per farm" has resulted from mortgagees scaling down the amount of the mortgages for those farmers who were deserving and who could probably handle the "scaled down" load satisfactorily; from foreclosures of those farms which were most heavily indebted; and, from payments on the principal, which have increased since 1939, but which were very small prior to that time.

Fortunately, there has developed, out of the costly experience of borrowing and lending upon the basis of false appraisals of land values, a new method of determining the value of farm land and buildings. It became recognized that loans should not be based upon land values which were determined by the capitalized income of any one year. That was the economically unsound method used in 1919 and 1920 which caused the inflation of farm values.

It has become the common practice of lending agencies to base their loans on "the normal agricultural value" of a farm.[1] This normal agricultural value is based upon the "normal" farm income. The average farm income for the years 1910-1914 were considered normal--that is, farm

[1]F. F. Hill, "Finding Normal Farm Values", The Agricultural Situation (Washington: Government Printing Office, February 1939) p. 21.

prices of those years were regarded as normal. Furthermore, the normal agricultural value of a farm is considered as the amount a purchaser, who is representative of the area, would be willing to pay and would be justified in paying for the property for agricultural purposes, including farm home advantages, assuming average production and normal prices for farm products. Involved in such an appraisal should be a careful estimate of long-term factors, such as, possible economic and physical changes of the farm, shifts of population, changes in types of farming, and changes in the demand for agricultural products.[1] Moreover, the appraisal consists of a careful inventory of both land and buildings. The land is classified in accordance with its productivity and its utilization by a typical owner of the particular unit. The buildings are examined for material, construction, and design to determine their durability and their suitability to community standards, as well as to the needs of the farm.

With full consideration to its productivity, the property is then valued, first, by assigning acre values to the different classes of land, insurable value and farm value to each of the buildings, and then by assigning a value to the property as a whole. The latter is referred to as "the

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[1]Chamber of Commerce of the U. S., op. cit., pp. 14-15.

normal agricultural value."

The Farm Credit Administration does not use the so-called "capitalization method" which is based upon the capitalized income of a farm. The Farm Credit Administration believes that, "this method is full of possibilities of error, and invites the manipulation of figures . . . . (and that) it is likely either to cause the appraiser to get the wrong answer or to lead him to change his figures to get what his common sense tells him is the answer."[1] It is apparent that the "capitalization method" does have its weaknesses; however, it must be admitted that the "normal agricultural method" is also based to a considerable extent upon methods of appraisal that are not wholly "objective" in nature. The personal "subjective" element is always present in appraising land values, and consequently, the most consistent and dependable conclusions have resulted when an experienced appraiser takes all the various facts into consideration and sets a price "as determined by the applying of a schedule of reasonable acre values which are justified by normal sales, reasonable yields of principal crops, and the average acre net income."[2] In other words it can be said that the prudent application of the "normal

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[1]Hill, _op_. _cit_., p. 21.

[2]_Ibid_., p. 22.

agricultural value" method of appraisal will probably yield the best results for both the mortgagor and the mortgagee.

The fact that an appraisal of real estate, which is based upon the capitalized income of a farm for (say) a particular year or two, is unwise and unsound is further analyzed by M. M. Regan:

> Changes in the value of farm real estate during the period from 1924-1939 have been rather closely associated with differences in farm income. This has been the case for the country as a whole as well as for the principal agricultural regions and for the individual states.[1]

These facts are rather clearly summarized in Table X, on page 93, which gives the index value per acre of farm real estate and index of income from farm production for the United States and for the wheat region including the states of North Dakota, Montana, and Kansas. Exact correspondence in any area between the two series is not to be expected, nor do logical considerations warrant such a close relationship. Nevertheless the data supplied in Table X indicate, as Mr. Regan points out, that there is a close relationship between real estate values and farm incomes. Moreover, statistics showing this same relationship for years prior to 1925 would reveal even a closer connec-

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[1]M. M. Regan, The Farm Real Estate Situation, 1936-1939, U. S. Department of Agriculture, Circular 548 (Washington: Government Printing Office, October 1939) p. 12.

Table X

INDEX OF VALUE PER ACRE OF FARM REAL ESTATE AND INDEX OF INCOME FROM FARM PRODUCTION, 1924-39[1]

(Index of value per acre of farm real estate: 1925-1929--100. Index of Income: 1924-1928--100)

Year	Wheat Region		United States	
	Income	Real Estate	Income	Real Estate
1924	106	108	98	107
1925	95	103	103	105
1926	95	101	99	103
1927	101	99	100	99
1928	104	99	101	97
1929	94	98	102	96
1930	69	98	82	95
1931	45	90	57	88
1932	30	77	42	73
1933	34	63	50	60
1934	49	65	62	63
1935	53	66	69	65
1936	54	68	77	68
1937	58	69	83	70
1938	47	68	74	70
1939	---	67	---	70

[1]M. M. Regan, op. cit., p. 17.

tion between the two series of indexes.

In summary, this chapter has served to point out that "real" debt is the important concern of the farmer; and that drastic declines in real estate values can seriously affect the farmer's equity in his farm. A debt based upon inflated land values can become extremely burdensome, especially, in view of the fact that, as was pointed out in Chapter I, farmers' fixed costs are relatively great. Scientific real estate appraisals based upon the earning power of farms over a long period of time should go a long way to remedy the ills which were present in the schemes of lending and borrowing during the period of the first World War. Long-term farm credit has its peculiarities, and, unless they are recognized and handled realistically, they may result in lending practices during a short period of time which will create burdens that may become increasingly great for many years to follow.

CHAPTER VII

FORECLOSURES AND RELATED PROBLEMS

The use of farm-mortgage credit can be justified only in so far as it enhances the productive capacity of the individual or the enterprise to which it is applied. Unfortunately, the history of agriculture for the past decade, in particular, presents evidence to the fact that farm mortgage credit has not always worked for the best interests of the farmer. That, however, does not indicate that farm-mortgage credit is inherently bad. It does suggest, however, that there are grave dangers connected with its use that may place an enormous hardship upon the farmer under certain conditions. Some of those conditions were discussed in the preceding chapter, chief of which were declining real estate values and decreasing farm income during the life of a mortgage. Attention will now be given to the problem of foreclosures and bankruptcies--a problem which is far-reaching in its effects, and which presents an extremely unfortunate situation so far as the farming industry is concerned.

Prior to 1926 foreclosures did not present problems that were acute in nature or broad in scope. Naturally,

as could be expected in any business, there were always a scattered few who lost their farms through foreclosures prior to that date. However, the effects of the land speculation era of the World War period began to be felt in 1926 as declining farm prices began to exert their influence on the financial status of the farmer. Foreclosures for the period of 1926-1931 accounted for a considerable proportion of the total transfers in farm ownership, although the acuteness of the situation did not assume major proportions until 1932, 1933, and 1934. It was during these years that the foreclosure situation proved to be disastrous for a great number of farmers--not only those who had purchased their farms in 1919 and 1920, but those who had purchased them at lower prices in the subsequent period as well. The precipitous decline in farm income during the depression years made it extremely difficult for a farmer to finance any loan of considerable size. In many instances farm income would scarcely pay for the general operating expenses of a farm, not including taxes and interest on the mortgage debt. Large tax delinquencies, and defaults in interest and principal payments were the inevitable results of such operations, and became the first indications of more serious farm mortgage investment difficulties which were to follow.

In Table XI, page 97, is presented data relative to

methods of farm transfers during the period 1926-1939 for which figures are available.

Table XI*

NUMBER OF FARMS CHANGING OWNERSHIP BY VARIOUS METHODS PER 1,000 OF ALL FARMS, 1926-1939

Year	Voluntary Sales and Trades	Forced Sales and Related Defaults	
		Delinquent Taxes	Foreclosure of Mtgs., Bankruptcy etc.
1926	29.6	4.1	17.3
1927	28.3	5.1	18.2
1928	26.3	5.2	17.6
1929	23.5	4.7	14.8
1930	23.7	5.1	15.7
1931	19.0	7.4	18.7
1932	16.2	13.3	28.4
1933	16.8	15.3	38.8
1934	17.8	11.1	28.0
1935	19.4	7.3	21.0
1936	24.8	5.9	20.3
1937	31.5	4.3	18.1
1938	29.9	3.1	14.3
1939	28.2	3.4	13.4

*1926-1935 figures were taken from: Horton, op. cit., p. 121; and 1936-1939 figures were taken from Regan, op. cit., pp. 32-33.

It is interesting to note the inverse relationship which "voluntary sales and trades" bear to transfers by "delinquent taxes" and "foreclosures of mortgages, bankruptcies, etc." It can be noted that the foreclosure record reached

an all-time high in 1933 after which it declined to a point in 1939, which was lower than any year subsequent to 1926. This drop in the number of foreclosures recorded does not necessarily indicate an improved financial condition for the farmer, however. Much of the decline recorded for 1934, 1935, and 1936 was due to the large-scale refinancing of delinquent mortgages by the federal agencies. This action prevented a large number of foreclosures which otherwise would have normally occurred. Except to the extent that loans were "scaled down" from their original figure, refinancing did not lessen the debt load of the farmer, although it did cause foreclosure figures to decline. In addition to the refinancing program of the federal land banks and the Land Bank Commissioner, legislation providing for a moratorium upon foreclosures accounted for a considerable part of the decline following 1933.

Moratorium legislation came as an emergency measure due to the violent uprising of the farmers against their creditors who began a "wholesale" business of foreclosing mortgages in 1933, as the foregoing table indicates. Under recent legislation in most states, all foreclosures must be made by court action. The debtor is usually given a period during which time he may redeem his property--in Kansas the redemption period is eighteen months. Moratorium legislation was designed to extend the period of redemption. One

of the first moratorium laws was passed in Minnesota which provided for an extension of the redemption period without any payment being made to the creditor. This act was declared unconstitutional by the United States Supreme Court, after which, another act providing for the payment of rent to the creditor during the period of extension was provided. This act was held constitutional by the Supreme Court and served as a pattern for the Kansas moratorium legislation. The original moratorium legislation in Kansas, however, did not protect the interests of the creditors in any way and was held unconstitutional in three different cases.[1] The Kansas law of March 2, 1935 was then patterned after the Minnesota law and was upheld by the courts.

Foreclosures in the ninth district, which includes New Mexico, Colorado, Oklahoma, and Kansas were considerably above the average in number during the years following 1933. In 1934, when the average number of foreclosures per one-thousand farms mortgaged in the United States was 28, the figure for the ninth federal land bank district was 40.6. Even in 1940 when the average for the United States was 8.9, it was 15 for the ninth district. Moreover, the number of foreclosures in Kansas has been well above the average for the four states. 1940 figures indicate a sig-

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[1]Woodruff, op. cit., p. 175.

nificant decline in the rate of foreclosure proceedings, and this fact can be attributed to the increase in farm income during that year.

Table XII on the following page, gives the estimated number of foreclosure sales of farm real estate per 1,000 farms mortgaged January 1, 1935 according to the class of creditor. Life insurance companies appear to have foreclosed the largest per cent, followed, in order, by commercial banks, individuals, and the federal agencies.

The large volume of life company foreclosures is not surprising in view of their comparatively reckless appraisal methods as discussed previously. Moreover, most of their loans were concentrated in the North Central States which were so greatly affected by declining real estate values.

Commercial bank loans were more widely scattered than life company loans, and were usually smaller in amount. Furthermore, the farmer usually had more personal contact with his banker than with the insurance company, and, consequently, kept his interest and principal paid if at all possible, for he wanted to maintain his credit rating so that he could get short-time loans when needed.

Individual lenders were, as a rule, more cautious in making loans than either of the agencies mentioned above. As a rule, the individual creditor and debtor knew each

Table XII*

ESTIMATED NUMBER OF FORECLOSURE SALES OF FARM REAL ESTATE, 1934-40

PER 1,000 FARMS MORTGAGED JANUARY 1, 1935, BY CLASS OF CREDITOR

Year	Fed. L. Banks and L. B. Comm.	Individuals	Commercial Banks	Insurance Companies
1934	4.7	34.3	36.9	92.5
1935	11.8	28.5	36.9	67.7
1936	15.7	24.5	34.5	49.7
1937	13.1	20.0	30.4	34.2
1938	13.4	17.3	25.9	29.2
1939	15.3	13.8	21.5	25.3
1940	6.4	11.0	14.4	13.9

*Farm Credit Administration, Number of Foreclosure Sales of Farm Real Estate, July 1941, multographed. Table I.

other well. Of special importance is the fact that, as in the case of commercial banks, individual loans were spread over the entire United States, and, consequently, they were not affected by any unfortunate situations in any one particular area. Individual loans were comparatively small in size and were based on a fairly wide margin of security which also accounted for the fact that their foreclosure record excels that of the commercial banks and insurance companies.

The record of the federal land banks excelled the records of all of the above named agencies with the exception of the record of individual lenders in 1939. In all fairness, however, it must be stated that no logical comparison can be made between the record of the federal agencies and the record of any other lender group. This is true because of the tremendous amount of assistance which the federal agencies received from the government by way of direct subsidies and subscription to capital stock. Mortgages that normally would have been closed because of delinquencies were reinstated by the federal agencies and any loss resulting from such action was made good by the government. It is clear that lender groups operating under such an advantage can hardly be compared with those agencies who had to operate according to the principles of an ordinary business enterprise.

During the past ten years vast quantities of real estate holdings have been acquired by lending agencies through foreclosure proceedings. In 1938 the real estate holdings of four lending groups (Federal agencies, life companies, joint-stock land banks, and three state agencies) amounted to $971,315,000.[1] Of this total 72 per cent was held by life insurance companies. It is interesting to note that in 1929 about 96 per cent of the total farm investment of life companies was in mortgages, but by 1939 such mortgages accounted for only 55.8 per cent of their interest in farm properties.[2] Federal Land Bank and Federal Farm Mortgage Corporation[3] real estate holdings amounted to only approximately 4 per cent of the total of their farm investments in 1938--96 per cent was in the form of farm mortgages.

Here, again, absolute data does not reveal the entire situation. In the case of the life companies it is reasonable to believe that their portfolios are now filled with a much higher grade of mortgages than the federal agencies now possess, and that their foreclosures from now on will

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[1]Regan, op. cit., p. 27.

[2]Temporary National Economic Committee, Monograph. 28, op. cit., p. 348.

[3]Formerly referred to as the Land Bank Commissioner.

be at a very small rate. In contrast, it is evident that the federal agencies possess a comparatively low grade of mortgages and that their foreclosures will continue rather extensively over a long period of time. As was pointed out in a previous chapter, a large per cent of the loans extended by the federal agencies were for the purpose of refinancing mortgages held by other agencies. A large per cent of these mortgages were subject to foreclosure and the federal agency loans usually took care of all delinquent payments in addition to the amount of the mortgage proper. Moreover, the loans granted by the federal lender groups have been, largely, to farmers on the poorer grade of farms, whereas, the life companies' mortgages were on the better grade farms. A period of rising prices for farmers may result in a continuous favorable foreclosure record for the federal agencies--that seems to be the case during the present time. However, should prices fall again for a considerable period of time it would not be unreasonable to expect the federal agencies to acquire vast holdings through foreclosure proceedings against those farms that were mortgaged for 75 per cent (or more) of their value. Whether they will or will not depends upon the income of the farmer during the years that lie ahead, as well as the action of the federal government in determining the policies of the land banks.

During the crisis of 1932 and 1933, a great deal of fallacious reasoning prevailed among the farmers of the country, the Mid-West in particular, in regard to the lending agencies' action of foreclosing those mortgages that apparently could not be handled by the mortgagor. Open violence in many cases prevented the normal procedure of foreclosure actions, and the farmers came to regard those agencies which were seeking foreclosure judgments as being "Shylocks" and malefactors". Without upholding or condemning the action of the farmers in preventing foreclosure proceedings, it can be stated that their attitude toward their creditors was not based upon facts. In fact, in the case of the insurance companies which did a large part of the foreclosing in the Mid-West, Woodruff states that, "in general, foreclosure was instituted only when it was evident that no other course was available."[1] They were always interested in having the mortgagor retain his land if there was a reasonable chance of his being able to handle his debt load, and preference was given to the owner operated farms.

There is sufficient evidence in the fact, that foreclosed real estate is not a profitable investment for most corporate lending agencies, to warrant the statement that

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[1]Woodruff, _op_. _cit_., p. 76.

they avoided foreclosure whenever possible. For instance, in 1938, the real estate holdings of the twenty-six insurance companies, holding most of the real estate held by that class of lenders, returned an average annual income of less than one per cent of mean admitted asset value without taking depreciation into consideration. Two companies have lost money, before depreciation, in the operations of their farm real estate accounts, and in no instance has the farm real estate been sufficient to return income adequate to meet the amount guaranteed under insurance policy contracts.[1] Hence, life companies have not been anxious to acquire real estate holdings, especially, since the market for land has been very poor, making it difficult for the companies to dispose of it at a reasonable price.

The land which the life companies have been able to sell, however, has been sold for a price adequate to recover the principal sum invested in a very substantial majority of cases.[2] The experience of the life companies has been more pleasant in that respect than the experience of the federal land banks, which is largely accounted for by the difference in the quality of the mortgages held by each.

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[1]Temporary National Economic Committee, _op_. _cit_., p. 348.

[2]Woodruff, _op_. _cit_., p. 75.

Up to 1939, the federal land banks had suffered losses of approximately 25 per cent of their investment on farms foreclosed or deeded to them.[1] A record of recoveries from real estate holdings of the land banks as of 1935 has been given by the United States Chamber of Commerce:

> From the date of organization of the federal land banks to the end of 1929, they disposed of 7,327 pieces of property on which there was a net loss of $3,804,477. For the period between 1929 and 1935, the gains and losses are not reported. In 1935 property representing an investment of $35,150,000 and a carrying value of $28,079,000 was disposed of for $28,138,000. This was a slight increase over the carrying value but the loss of investment of over $8,000,000 was absorbed by the individual profits of the banks.[2]

Due to the fact that the land banks are not equipped to operate farm property it is their policy to dispose of it as soon as possible. Since their foreclosures are, as a rule, on the very poorest type of farm, it is not strange that the selling value of this land is about the minimum.

A study of the foreclosure situation of the past ten years, in particular, cannot help but impress one with the fact that foreclosures of farm mortgages are not only disastrous to the mortgagor but burdensome to the mortgagee as well. Foreclosures are not to be only reckoned in terms

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[1]Farm Credit Administration, The Profitable Use of Farm Credit, (Washington: Government Printing Office, 1939) p. 42.

[2]Chamber of Commerce of the U. S., op. cit., p. 21.

of dollars and cents but also in terms of loss of homes and broken and discouraged individuals who often become a problem to society at large. Moreover, as this study brings out, the mortgagee is quite often a loser as well. In short, foreclosures indicate a great social loss so far-reaching in effect that every effort to encourage "good business" on the part of farm lenders and borrowers will not only benefit the parties to the loan but society as a whole.

CHAPTER VIII

EVALUATION AND CONCLUSION

A farm mortgage may be a means of promoting the welfare of a farmer or it may be a means of causing the collapse of the enterprise he seeks to establish. A mortgage may assist an individual possessing limited capital to become a farm owner, and thereby increase the productive capacity of himself, his farm, and society in general; or it may work toward the destruction of the soil, the impoverishment of capital, and most serious of all, the break-down of the morale of the enterpriser. It should be obvious that no system of farm mortgage finance can be justified which does not better the status of the farmer. Furthermore, it must be recognized that "in the successful financing of farming cognizance should be taken of the same economic and business laws which affect industry."[1] The foregoing statement is basic to any valid analysis or evaluation of a farm credit system.

Of foremost importance during the period under study has been the problem of interest rates on agricultural

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[1]Sparks, *op. cit.*, p. 196.

loans. One of the major grievances which the farmer has had is the contention that capitalists deliberately shunned farm investments solely because they were farm investments, and that whenever capital was offered exorbitant and unreasonable rates of interest were charged. Such contentions probably were not valid. Capital, quite naturally tends to flow toward those investments which are most profitable, and any variation in interest rates is usually accounted for by the risks involved and the cost of the movement of the capital.

It should be recognized that farm-mortgage credit, as well as other types of credit, is based upon the three C's of credit; namely, character, capacity, and capital. It is quite obvious that, other things being equal, capital will flow more easily and quickly into the hands of the Eastern Kansas farmer who is reasonably certain of a crop each year, than it will into the hands of the Western Kansas farmer who experiences frequent crop failures. And, since interest rates are largely determined by the laws of supply and demand, it follows that the Western Kansas farmer will have to pay a higher interest rate in order to call forth a given amount of capital than what the Eastern Kansas farmer will have to pay for the same quantity. It is, of course, possible that the volume of loans extended

to farmers in the Western part of the state might exceed the volume extended to the farmers in Eastern Kansas. This, however, would be the result of higher interest rates being paid in the West, as well as a greater aggregate demand.

This same principle can be applied to farm areas which are equally productive but which are owned by farmers possessing character and capacity in varying degrees. For example, let it be supposed that farms in areas A and B are equally productive; however, the farmers in area A are extremely honest, thrifty, and efficient, whereas farmers in area B are quite the opposite. Again presuming other things to be equal, it is natural that the farmers in area A will be able to borrow capital at a lower rate of interest than the farmers in area B.

It is quite evident, then, that interest rates are not determined arbitrarily but that they are determined by the supply and demand of capital. Moreover, as it was pointed out above the "quality" of the farmers themselves, as well as the quality of the land they farm, have a direct effect upon the interest rates they are permitted to enjoy on the capital they borrow. Wright states that "other things being equal, the states in which up-to-date enterprising farming leads to good buildings, well-stocked farms, and good crops are those which attract capital and secure low

interest rates."[1] There is an abundance of evidence to support the foregoing discussion, and it seems that farmers would be fair to themselves as well as to the agencies they have criticized to recognize that variations in the rates of interest charged on farm-mortgage loans are just as natural as variations in the price of land in various farming regions.

To the extent that farms increase in productivity and become stable enterprises, and, thereby, attract capital at lower interest rates than before, decreases in interest charges can be justified. However, it should be apparent that any "unnatural" decrease in the interest rates may cause complications in agriculture that are much more disastrous to the farmer than high interest rates. It must be recognized that "just as an investment is valued according to its earnings, farm land is worth what the income will pay interest on."[2] Consequently, if the net return per acre is $3 and the interest rate on loans is 6 per cent, the farmer can afford to pay $50 per acre for the land. If the interest rate is 3 per cent, the buyer can afford to

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[1]Ivan Wright, Farm Mortgage Financing, (New York: McGraw Hill Book Company, 1923), p. 113.

[2]U. S. Department of Agriculture, Soils and Men, Yearbook of Agriculture, (Washington: Government Printing Office, 1938), pp. 161-162.

pay $100 per acre for the same land, since $3 of income will pay carrying costs on a debt twice as large as when the interest rate was 6 per cent. The result, then, of loaning money at rates below the normal market rate will be speculation which would boost farm land prices so that the land would yield an income amounting to only a very small per cent of the investment.[1] Complications such as were discussed in the foregoing chapters dealing with shifting land equities and foreclosures would be the inevitable result of such loaning practices. If a farmer follows good business principles, as he certainly should do, he will recognize that in absolute costs the amount of the borrowed principal is just as important as the rate of interest he pays on his loan. According to the Yearbook of Agriculture of 1938,

> the least danger to ownership on account of interest rates is likely to occur where there is a fairly uniform interest rate of such amount as will cover the cost of funds and the risk involved in the loan, which may be expected to continue over a long period of time, and which will permit the financing of a debt if necessary on a basis not greatly different from one period to another.[2]

It should be more specifically pointed out, however, that

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[1]Moulton, _op_. _cit_., p. 393.

[2]U. S. Department of Agriculture, _op_. _cit_., p. 162.

the interest rate which has been referred to in the above quotation should be the rate which agriculture is permitted to enjoy by competition on an equal basis with commerce and industry, i. e., the market rate of interest. If the rate is below the market rate funds will be misdirected from other enterprises into agriculture, which, as has been indicated, means speculation in land with all of its dangerous consequences. The history of the past twenty years, in particular, presents evidence that the greatest need of the farmer has been for facilities which would help him to get out of debt; however, it appears that many of his demands have literally been for facilities which would get him into debt. The importance of interest rates on farm indebtedness has been over emphasized as compared with the importance of sound farm valuations.[1]

Earlier in this study it was pointed out that the establishment of the federal farm loan system in 1916 was the result of a long series of movements on the part of agriculture for better credit facilities. An appraisal of the services which these institutions render, and occasional references to the non-federal agencies, should prove to be of value at this point.

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[1]Sparks, op. cit., p. 445.

Of great importance is the fact that the framers of the Farm Loan Act of 1916 provided for a uniform rate on the theory that money is worth no more in Western Kansas than in Wisconsin, provided the risks are the same. It was contended that with joint liability and standardized methods of appraisal and supervision, the risks could be made uniform throughout the country, and, consequently, the interest rate on farm mortgages should be the same. This theory sounds plausible but in practice many weaknesses appear. Sparks deals with this theory in an interesting manner:

> In the first place, it is hard to calculate values in new districts which have not had sufficient experience in long time earnings. Secondly, the valuations are generally more likely to be overestimated than understimated in such districts, which are often featured with low earning periods. Thirdly, there is something to be said for the claim that each section of the country should accumulate part of its own capital savings in order to evaluate correctly sound investments. Finally, a sudden shift from high prevailing interest rates in the sparsely settled districts to low rates is likely to result in over capitalization of land which more than offsets any advantage which might otherwise accrue.[1]

Much of the speculation in land during the first world war days, in particular, was undoubtedly a result, in part at least, of this policy of the federal land banks.

Another problem relative to the lending policies of

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[1] Sparks, op. cit., pp. 157-158.

the federal land banks is the problem of governmental intervention. For almost a decade the government has forced interest rates charged by the banks below the level which the sale of bonds would warrant. The loss accruing from such transactions is made good by the federal government in the form of subsidy. If what has been said in the foregoing discussion about "unnatural" interest rates is true, then such a policy, at least if made permanent, will inevitably injure the farming industry as a whole. Likewise, the exemption from taxation of bonds sold by the land banks tends to direct an undue quantity of funds into agricultural channels which otherwise would not be possible. This would particularly be true if land bank bonds were especially favored with the tax exempt feature over the various types of industrial securities; it would be less true if such privileges served to put land bank bonds on par with other securities. Again, it must be emphasized that if farm credit is to benefit the farmer, permanently, he must be willing to pay a rate of interest merited by agriculture upon the basis of competition with other forms of industry.

Another phase of lending activity to which the student of farm mortgage finance must give some attention is the quantity of credit extended relative to the value of the farm. The results of "over-lending" were revealed in the two preceding chapters. There, it was indicated that prac-

tically all private lenders were able to recoup their loans through foreclosure. Federal lending groups, however, have suffered enormous losses. The question arises, "Who really suffers these losses?" Obviously, society does, for most of the losses are suffered by the Federal Farm Mortgage Corporation which loans a large per cent of its funds in exchange for second mortgages. Even to a greater extreme the Farm Security Administration under the authority of the Bankhead-Jones Act extends loans to tenants who desire to purchase land for the full value of the land purchased. This is being done in spite of the fact that the Farm Credit Administration has found during the past fifteen years that unless a farmer is able to make a down payment of 25 per cent of the farm and have operating capital in addition he usually fails to pay for the farm.[1]

It is conceivable that some farmers could handle a loan for the full value of their farm; however, upon the basis of past experience it is a dangerous and radical departure from good business procedures. Such lending practices if made very extensive will obviously tend to raise land values beyond their natural level. Moreover, past experience has shown that heavy indebtedness very often leads

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[1]J. L. Robinson, The Profitable Use of Farm Credit, Farm Credit Administration, Circular No. E-4, (Washington: Government Printing Office, 1939), p. 42.

to the general exploitation of the soil and deterioration of the security. There is also sufficient evidence to assume that heavy indebtedness often breaks the morale of a farmer, thereby decreasing his efficiency as a producer. Many good farmers who were proud of being farm owners and operators have become disheartened by debt loads that were unreasonably heavy and have literally lost all of their ambition to make their farm a genuine successful business enterprise. It must be recognized that there can be too much credit extended to the farmers, and any policy such as demonstrated by the Federal Farm Mortgage Corporation and the Farm Security Administration in lending upon the full value of the security is fraught with great danger. Those who support the policies of these agencies contend that they have acted in an emergency, and that, from the long-run standpoint, such loans will help the farmers to become land owners; whereas, otherwise they would remain tenants or would lose the farms they did have an equity in. It remains to be seen what the future holds, but from the standpoint of good business practice, it seems altogether possible that such excessive loans may only serve to postpone the "evil" day of farm foreclosures without having helped the farmer permanently.

Closely allied with the problem discussed above is that of the length of the period for which the loan is made

and the manner in which it is to be repaid. It is well recognized that farm-mortgage loans should be for comparatively long periods on an amortization basis. The amortization feature is certainly sound and feasible in every respect; however, the long-term feature should be carefully considered. It is very probable that extremely long periods of payment may act to induce speculation. Professor Sparks states:

> Some convincing reasons tend to prove that a period of about twenty years would be better for loan amortization purposes than the longer period now allowed. The 20-year period would give the farmer ample time to complete his economic program, and would not give the added stimulus to unwise speculative credits.[1]

Practically all of the loans made by the federal agencies, including the federal land banks, are made for more than thirty years--some are made for as long as forty years. While the soundness or unsoundness of thirty-and forty-year loans may be a debatable point, it should be recognized that there is a limit to the conditions of leniency beyond which there may be grave danger of going. Even if it is accepted that there was need for mortgage relief during the perilous days of the 30's, it should not be denied that the continuation of some of these "lenient" policies may injure agriculture permanently.

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[1]Sparks, op. cit., p. 454.

In many references to governmental agencies throughout this study, the federal land banks have been classed as such. It has seemed logical and necessary to refer to them as governmental agencies in view of the fact that their policies have been determined by the federal government throughout the major part of their lending history. It should be recalled that they were not created as governmental institutions--it was the intention of the framers of the farm loan act that these banks should be owned and controlled by the farm loan associations, or, in other words, by the farmers themselves. However, the fixing of interest rates at a certain level, instead of letting them be determined by the rates for which bonds can be sold in the open market, represents a radical departure from the principles on which at the beginning it was expected that the banks would operate. As a result "the banks to a certain degree ceased to be self-governing institutions, the policies of which are determined by economic considerations."[1]

It has been repeatedly pointed out in this study that economic principles should be the guiding factor in farm-mortgage lending. Hence the recommendations of the United States Chamber of Commerce:

1. The committee recommends adherence to the

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[1]Chamber of Commerce of the United States, <u>op</u>. <u>cit</u>., p. 17.

> original policy which provided for borrower control of the federal land banks.
>
> 2. The committee favors the adherence of the federal land banks to those appraisal and lending policies which will tend to keep the risks involved commensurate with the rates charged to borrowers.
>
> 3. The committee disapproves the incorporation into the permanent farm credit system of the government of any loan policies which place a major portion of the risk directly or indirectly on the government.[1]

It also appears to be evident that if the federal land banks are to be run according to economic considerations they should be taken out from under the control of the Department of Agriculture where it was placed in 1933.[2] By so doing, it will remove the banks from other governmental agencies which make grants and benefit payments--not necessarily on a business like basis. If the federal agencies function according to sound business principles, private lenders will be able to compete for their share of the farm-mortgage investments and a much more stable agricultural economy will be the result.

So far as getting a plentiful supply of long-term credit at low rates of interest is concerned, the farmers have certainly been successful. However, those who are

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[1] Ibid., pp. 12-17.

[2] H. W. Torgerson, "Agricultural Finance in the United States," Journal of Land and Public Utility Economics, (August 1940) pp. 318-319.

interested in having the farm population of America consist of farmers who own their own farms, rather than consisting of a huge class of tenants, will serve agriculture best by recognizing that sound lending principles must be employed in every area of agricultural activity--if they are not, the farmer suffers in the long run. It cannot be denied that the farmer has great power, and it can be hoped that he uses it wisely.

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