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# WHY NOT FINANCE FARMLAND WITH EQUITY INSTEAD OF DEBT?

— by Harold D. Guither  
and H. Joseph Bourn —

In the midst of the farm financial crisis, Neil Harl proposed an Agricultural Financing Corporation (AFC). It would be an institution to acquire the farmland assets of farmers who were unable to develop a feasible cash flow reorganization plan short of asset liquidation. The proposed AFC would acquire land from lenders holding land in inventory, or, as an alternative to foreclosure or bankruptcy, from farmers unable to service the real estate debt.

Harl's idea called for a federally chartered corporation with a governing board composed of representatives from production agriculture, public and private sector lending, agribusiness firms, and consumers. Under the plan, the AFC would acquire farmland, take over existing secured indebtedness, and rent the land back to farmers (with a preference for prior owners) at a fair rate.

Harl intended the AFC as a temporary entity, simply holding land until either the prior owners or another farmer could get adequate financing to buy it back. Several funding sources were suggested in the proposal, including direct congressional appropriations, industrial development-type bonds and the combination of private investment and federal, state, and local funds. We agree with Harl on all but one point: the AFC need not be temporary but could be institutionalized into a permanent cooperative equity investment system.

The major difference between the proposed Agricultural Financing Corporation and the Farm Credit System as it has operated through the years would be emphasis on equity ownership and professional management rather than debt financing of farmland.

## Getting Started

The AFC would be involved in acquisition of farmland, leasing and professional management, and disposal of property that did not fit into the system's goals or is not profitable to operate. It could acquire farmland by giving the Farmers Home Administration (FHA), the Farm Credit System (FCS) and private lenders equity shares in exchange for land, purchasing land from retiring farmers or other landowners and accepting farmland debt of farm owner-operators in exchange for an equity share of farm property and a lease requiring annual rent payments to AFC by the farmer involved in the exchanges.

There is no shortage of land for AFC to acquire. By March 31, 1987, the FCS had acquired 8,082 properties totaling 2,770,000 acres; the FHA, 5,276 properties totaling 1,577,683 acres. As of December 31, 1986, life insurance companies had acquired 2,731 properties totaling 2,424,000 acres and commercial banks, 1,212,000 acres. All told, 7,984,183 acres were acquired as a result of foreclosures (deeds in lieu of fore-

closures) and bankruptcy. Although some of these lands have been sold, those remaining could provide the cornerstone for an AFC.

The capital for the AFC could be both public and private monies. Public monies might be arranged in a way similar to the procedure used to establish the original federal land bank and production credit associations. The federal government could provide start-up capital and receive bonds in the Agricultural Financing Corporation just as they did in the beginning with the Farm Credit System, or by acquiring an equity interest through the purchase of stock shares. Shares of AFC could also be sold to private individuals and institutions. As private investors purchased AFC stock shares, AFC could pay off bonds or repurchase the federal government's equity shares so that eventually the system would be owned entirely by private investors.

The eventual financial independence of the AFC would rest on its ability to produce a return sufficiently attractive to draw in and hold private capital investment. Professional management of the farm properties would help secure favorable income returns. Appreciation and stability of the values of stock shares, as well as current dividends, would surely be a consideration for investors, just as these conditions influence investors selecting stocks of major corporations.

Harl pointed out that since federal funds would be involved in its establishment, the AFC would require not only a federal charter and initial capitalization, but also authority to operate as a private land holding and leasing corporation. The formal type of business organization could be a federally chartered corporation, a partnership with general and limited partners, a real estate investment trust or a cooperative owned by tenant operators who are also stockholders. Professional managers would provide farm management, appraisal, and financial services as direct employees or under contract.

## Potential Benefits

- The benefits from the proposed new institution would be:
- It would help keep individual farm operators with limited capital on the farm.
  - It would reduce the risks of foreclosure and liquidation which have hurt so many farmers in the 1980s because of the debt burden of major farmland purchases.
  - It would provide the chance for private investors to own farmland through the purchase of equity shares with a much smaller investment than is required to buy an entire farm.
  - It could provide farmers with the opportunity for equity ownership in farmland without the debt burden of buying the whole farm.
  - The federal government could share in stabilizing the farm real estate market and also achieve its long-range goal of redistributing land acquired from foreclosed FmHA loans.
  - The Farm Credit System could also rid itself of acquired farm properties by exchanging farmland titles for equity shares in the AFC; the move would relieve it of land management, leasing, and sales operations. The Farm Credit System could take a leadership role in organizing and establishing the AFC, or it could encourage others to do so.
  - By leasing land from the AFC, competent young farmers lacking capital to purchase land would be provided the opportunity to be in farming. Though some farm operators undoubtedly prefer to own their land, part-owners comprised nearly 30 percent of all operators in 1982.

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## Do We Really Need It?


The idea of a AFC-type institution is not new.

The American Farm Bureau in its 1987 resolutions called for a plan that would help recapitalize production agriculture through an equity investment program using both public and private funds.

Fiske and associates at the 1986 American Agricultural Economics Association meeting noted the weakened financial state of financial intermediaries. They then suggested that the development of an efficient equity market for agriculture is the next step in an evolutionary process. They suggested that such a market would provide farmers the means and flexibility to attain a desirable capital structure.

The proposal is consistent with the basic tenet of American farm policy—maintaining a sector of family-size owner-operated farms. For this philosophy to work, there must be a means by which large numbers of farmers can obtain title or long-term control of farmland.

The AFC proposal addresses one of the major financial problems of farmers—the high cost of financing ownership of land, buying out heirs, or buying land from other sellers. The Agricultural Financing Corporation would be an alternative method for maintaining family operation and control of U.S. farms. In this way the proposed AFC is consistent with the point that Boehlje and Pederson made in the Third Quarter 1988 issue of CHOICES. In that article they cited the need for more and different people and institutions to become equity owners of farm real estate. The AFC would supplement but certainly not replace individual ownership as it now exists.

Establishing an Agricultural Financing Corporation System also would not eliminate capital losses when farmland values decline. As land assets were revalued, losses would still fall on those people and institutions who owned the land. And foreclosures would involve losses for lenders who acquired the properties and upon farm landowners (operators and non-operators) who were foreclosed. But the AFC would prevent substantial losses by farm operators and lenders in the future, provide leasing opportunities for beginning farmers, and help maintain a system of family-operated farming units. 

## HAVE YOU READ...

*The Role of State Government In Agriculture*, edited by Enrique Ospina and Cami S. Sims, and published by the Winrock International Institute for Agricultural Development? Drawing on information gathered from 43 states the book examines the agriculturally related roles of state governments. Officials and those who aspire to influence state governments will find the comparisons among states and the concepts developed by the authors useful in defining appropriate future roles for their state governments. The address of the Winrock International Institute for Agricultural Development is Petit Jean Mountain, Morrilton, AR 72110.