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FARM BUSINESS NOTES

Prepared by the Divisions of Agricultural Economics and Agricultural Extension
Paul E. Miller, Director Agricultural Extension

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Factors Involved in the Difficulties of Rural Banks, 1918 to 1938¹

G. L. PETERSON

The Division of Agricultural Economics has recently completed a study of reports of 116 state banks for the period 1918 to 1938. The banks included are located in villages and smaller cities in various parts of the state so their loans are largely to farmers. The results throw light on some of the conditions which gave rise to difficulties of country banks during this period and suggest ways in which banks may be of greater service to farmers and at the same time improve their own earnings.

Considerable difficulty during the period covered by the study originated with real estate loans, both on first and second mortgages. A large volume of real estate was acquired by these banks as a result of their lending operations. The real estate owned by them exceeded 20 per cent of their capital and surplus during the period 1924 through 1932. Had banks instituted foreclosure proceedings during the late 1920's and early 1930's as readily as they did earlier, the real estate held by them would have increased considerably. The loans were allowed to remain delinquent in the hope of ultimate repayment. Like many other lenders, banks during this period were not eager to take possession of mortgaged real estate which could be disposed of only at considerable loss. Declining land values also made it necessary to write down the value of real estate owned by the banks. The preponderance of agricultural loans by these banks is indicated by the fact that until 1933 over 80 per cent of the real estate owned by them was farm land. After that date, other real estate increased somewhat in importance.

Country banks in Minnesota made a considerable number of loans on second mortgages until the state adopted restrictions against such loans by state banks. That second mortgages tend to be inferior security is borne out by the fact that from 20 to 36 per cent of the farm acreage owned by these banks from 1921 to 1932 was acquired through foreclosure of such mortgages.

During the 1920's country banks extended considerable credit to borrowers in outside areas. This was done by rediscounting loans for banks located in these areas, largely North Dakota and Montana. Many of these loans resulted in losses.

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A large share of the loans of commercial banks are outside the real estate mortgage field. That the banks studied experienced considerable difficulties with these loans as well is evidenced by the large number of loans which were overdue both in principal and interest. For the period covered by the study more than 1½ per cent of the total loan volume were loans on which

neither interest nor principal had been paid for more than one year after becoming due. The proportion was much higher for some years, as for instance 1934 when 7.4 per cent of the loans were overdue more than one year.

These banks found it necessary to make substantial charge-offs from year to year because of loans on which collections could not be made. In every year but one after 1923 the losses on loans were equal to or above ½ per cent of the total loan volume.

The losses incurred on real estate owned were very substantial in amount for many of the years included. From 1925 to 1932, when the real estate holdings were largest, these assets were written down an average of 5.5 per cent annually. Altogether the losses incurred on loans, real estate, and bonds were equivalent to 0.7 per cent of the deposits and to 7 per cent of the capital and surplus. In six out of ten years the losses were greater than the profits remaining. In other words, more than half of the earnings from business operations for these years had to be used to absorb charge-offs on loans and real estate and losses on bonds. With the exception of the latter years of this period more than 80 per cent of the losses were on loans and real estate. If losses could have been reduced by 50 per cent, profits would have been increased correspondingly. The average dividend payments for this ten-year period were less than 5 per cent in all but one year.

Following the bank holiday in 1933, considerable reorganization of banks took place. While the situation improved somewhat after that year, some unprofitable loans and investments remained. Annual losses on such loans and investments for the years 1934 to 1938 averaged 0.6 per cent of deposits and 4.5 per cent of the capital and surplus. More than half of the earnings in both 1934 and 1938 were needed to defray losses. The same would have been true in 1936 had it not been for the rise in bond values that year.

¹ Assistance in assembling and analyzing the data for this study was furnished by the personnel of the Works Progress Administration, Official Project No. 165-1-71-124, Subproject 420.

The period from 1920 to 1933 was one in which many banks were closed. A comparison of the assets held by the 116 banks referred to above and 77 banks which closed did not reveal any appreciable difference in the types of assets held. The assets of the closed banks, however, tended to be lower in quality. This suggests that the difference was due largely to differences in the quality of management. The better bankers succeeded while some of the poorer failed. The latter did not use sufficient discretion in selecting their assets.

The foregoing suggests some weaknesses in the banking practices which have been followed in the past and it is apparent that bankers need to be on the alert to avoid losses from similar causes in the future. Second mortgage loans and loans to outside areas have been entirely or largely eliminated so they will not be an important cause of loss in the future. However, first mortgage loans on farm land may continue to give rise to some difficulties in the future. If there is a speculative boom in land as a result of inflation or war prices for farm products, the danger of overexpansion of credit will increase. Such conditions call for conservative appraisal and lending policies by banks and all other agencies and individuals who are making loans on farm lands. Loans which may appear to be on a sound basis in periods of satisfactory farm prices and income may easily prove otherwise in a subsequent period when farm prices may be less attractive. The greater the rise in prices which may occur in the present period, the more need there will be for caution in making mortgage loans. No one foresaw in 1915 the levels which land prices would attain by 1920 because of war prices. Likewise, it was not foreseen in 1920 that there would be a drastic fall in land prices and that the prices of land by 1940 in many cases actually would be less than they were in 1910. While there is reason to believe that any rise in land prices which may occur will not compare with the rapid rise which characterized the last war period, it is important for both borrowers and lenders to be on their guard against a speculative boom in land. They should keep in mind that land values are based upon longer-run returns rather than on temporarily high prices.

The results of this survey suggest that bankers should make careful analysis of the loans which they are asked to make. The volume of overdue loans, the amount of loans which were criticized from year to year by bank examiners, and the annual charge-offs necessary to cover losses give testimony to this effect. Without ignoring the security offered, more attention needs to be given to the productivity of the loan. The banker expects to get his return from the loan and not from acquiring the property. It is therefore important for him to consider the use which the borrower expects to make of the proceeds of the loan and the prospects of income from such use under existing and prospective circumstances. Unless a banker is prepared to carry out a hard-boiled foreclosure policy, too much emphasis on security in property may give him a false sense of protection. Furthermore, the risks to the borrower in the case of loans based on collateral in property should not be overlooked. If he is granted loans in excess of his ability to repay, he faces the prospect of losing his accumulated capital and part of his means of earning an

income. He is as much interested as the lender in having only sound loans made.

The productivity of a loan is determined by the purpose for which it is made, the circumstances surrounding the use of the funds, and the methods employed. This suggests the desirability of lenders "following up" the loans which they make more closely than they have in the past. If extended time is required for all or part of the loan, it is desirable that this be foreseen and arrangements made before the loan falls due. The large volume of overdue loans in the banks studied indicates that some of the loans had been allowed to get out of hand with the result that greater losses occurred than would have been the case if more care had been taken to keep the loans in good standing.

Bankers whose principal function is that of making loans to farmers in many cases would profit from a better understanding of farming problems and of factors affecting the prospects of the undertakings in the financing of which they have a part. The suggestion is not that the banker should do this with the object of telling the farmer how to manage his business but rather that he be better equipped to render the financing services needed.

War and Farm Mortgage Debts

E. FRED KOLLER and O. R. SHELLEY

Major wars have generally been accompanied by violent price fluctuations which ultimately have created serious agricultural credit problems. In World War I the sustained rise in the price of agricultural commodities soon found expression in higher land prices and an increasing volume of debts.

As shown in figure 1 the indexes of Minnesota farm prices, land values, and farm mortgage debts skyrocketed in the years 1915 to 1919. While farm prices started to decline in 1920, farm mortgage debts continued to rise at a more rapid rate than in any of the preceding years. The all time high of these debts was reached in 1924. The continued rise in mortgage debts for several years after land values started downward was due, at least in part, to the conversion of many unsecured loans to mortgage loans as lenders sought added protection. Greater availability of mortgage credit from insurance companies, and from the Federal Land Banks and Joint Stock Land Banks after certain constitutional issues had been clarified in 1921, made it easier for many farmers to finance their needs by means of a mortgage loan and therefore explains some of the increase.

At the 1924 peak Minnesota's farm mortgage indebtedness was \$609,013,000 or more than three times the average debt in the pre-war period, 1910-1914. In thousands of cases this increased mortgage debt was more than the farm could carry and an avalanche of foreclosures followed in the 1920's and 1930's. Much of the decline in the volume of mortgage debt after 1924 was due to these foreclosures although debt adjustments and repayments of principal account for some of the change. Also as land values declined, farms changed hands at lower prices and thus also reduced the credit required. As a result of these factors the mortgage debt on Minnesota farms reached a post-war low of \$343,512,000 in 1940. Although the total

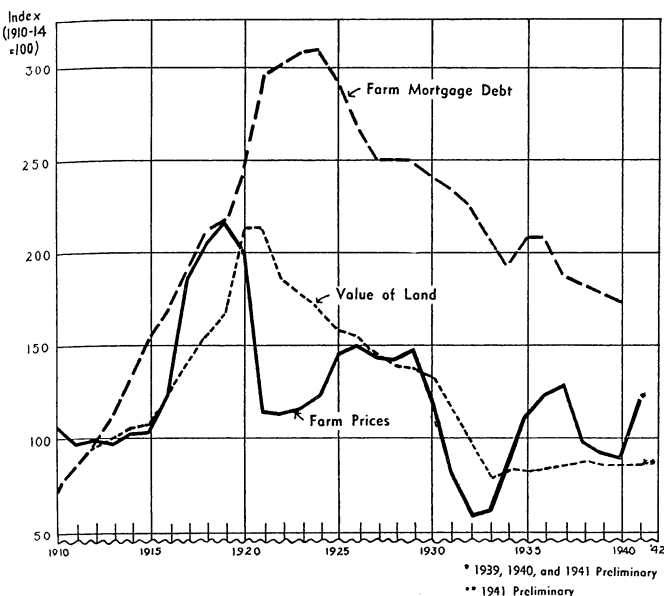


FIG. 1. INDEXES OF FARM PRICES, ESTIMATED VALUES OF LAND PER ACRE, AND ESTIMATED FARM MORTGAGE DEBT IN MINNESOTA, 1910-41 (Index numbers 1910-14=100. For land values 1912-14=100.)

mortgage debt has been reduced significantly since 1924, the 1940 total is still 74 per cent above the pre-war average while land values are 14 per cent below.

As World War II progresses, the question arises: "Will the processes of inflation, speculation, excessive debt, and foreclosure repeat themselves?" Although the prices of Minnesota farm commodities have advanced sharply in recent months (see figure 1), there is as yet no evidence of a marked boom in land values. However, the danger that prices, land values, and debts may follow a similar pattern to that of 1915-1920 is becoming more and more real. As farm incomes improve credit agencies report that application for loans to purchase land are increasing and supply of farms available for sale is rapidly declining.

To avoid a repetition of World War I conditions farmers should use the higher incomes now available to reduce their debts rather than increase them. Individuals planning to buy a farm should consider prospects for prices over a long period of time in deciding what the farm is worth. Farm creditors, private and public, can also render agriculture a service by adopting stricter credit policies now. In the past, many creditors have encouraged speculative expansion by liberal lending and lax collection in periods of high farm income. If farmers can reduce their debt and interest burden during the present period of inflation, they will be in a better position to meet the depression which is likely to follow this emergency.

Zoning Minnesota Farm Lands

S. H. RUTFORD

The Minnesota Legislature enacted the law authorizing rural zoning in April, 1939. The act authorizes "county boards of commissioners in certain counties, in conjunction with town boards, to enact ordinances establishing districts and regulating the location and use of structures and the use and occupancy of lands therein." The object sought

is primarily to direct and control the settlement and occupancy of land rather than to control its use, and the law and proposed ordinances are so drawn.

Since the enactment of this law four counties have taken advantage of the authority granted, namely, Carlton, Koochiching, Lake of the Woods, and Beltrami. Carlton was the first to adopt an ordinance. Because of opposition in certain townships the ordinance covers only those townships where town boards were ready to cooperate with the county board. In Koochiching County the ordinance covers the whole county. The Lake of the Woods County ordinance covers only the Northwest Angle and the relocation area in the Beltrami Island Forest and Game Preserve. However, at the time of the enactment of this ordinance the Lake of the Woods County Board indicated that it considered this a first step rather than a complete job. The recently enacted Beltrami ordinance covers all townships. In other counties land use planning committees, after carefully considering the problems arising out of past unplanned settlement, have recommended that a zoning ordinance be enacted. Several county boards are studying the idea, and indications are that additional ordinances will be enacted in the near future.

The idea of regulation of settlement and land use is new, and, as might be expected, county and town boards have been very conservative in using the authority given them. For the most part only those lands have been placed in restricted zones that are of very low quality or that are entirely without such public services as roads and schools. Occupied lands usually have been placed in unrestricted zones, the boards feeling that injustice might be done in placing restrictions upon such lands. Only where occupants of farms are obviously unable to make a living from the land, or where the cost of public services far exceeds any possible present or future tax revenue, have occupied farms been "zoned out." Inasmuch as zoning is new in Minnesota and neither officials nor the public have accumulated experience in its use, this is probably as it should be. However, as one views the maps of the zoned counties showing the restricted and unrestricted zones, it is obvious that much remains to be done as experience accumulates. From time to time ordinances will have to be re-examined as to their effectiveness in preventing further scattered settlement. Areas where a large proportion of farmers fail to get along, as reflected by high tax delinquency and a high percentage of families on relief, will need to be studied with the idea of restricting further settlement through zoning. Opportunities for relocation of isolated settlers will have to be further developed. The law providing for the exchange of public for private lands is one possibility. The submarginal land purchase program of the Soil Conservation Service is now being tried out and may be expanded if funds are available. When county and town boards feel that adequate machinery has been provided to offer some alternative to families living on farms placed in restricted zones they will be ready to draw the lines closer.

An excellent start on zoning has been made. Officials and the public are cooperating in the use of the authority provided to restrict further unwise settlement. As experience is gained and understanding increases, it is reasonable to expect that developments in this field will become increasingly effective.

Minnesota Farm Prices for October, 1941

Prepared by W. C. WAITE and H. W. HALVORSON

The index number of Minnesota farm prices for the month of October, 1941, was 86. When the average of farm prices of the three Octobers, 1924-25-26, is represented by 100, the indexes for October of each year from 1924 to date are as follows:

1924— 93	1929—107	1934— 67	1939— 68*
1925—104	1930— 82	1935— 74	1940— 63*
1926—103	1931— 52	1936— 94	1941— 86*
1927— 98	1932— 38	1937— 82	
1928— 95	1933— 50	1938— 62	

* Preliminary.

The price index of 86 for the past month is the net result of increases and decreases in the prices of farm products in October, 1941, over the average of October, 1924-25-26, weighted according to their relative importance.

Average Farm Prices Used in Computing the Minnesota Farm Price Index, October 15, 1941, with Comparisons*

	Oct. 15, 1941	Sept. 15, 1941	Oct. 15, 1940		Oct. 15, 1941	Sept. 15, 1941	Oct. 15, 1940
Wheat	\$0.87	\$0.98	\$0.69	Cattle	\$9.00	\$9.10	\$7.60
Corn .....	.54	.60	.49	Calves	11.20	11.40	8.80
Oats .....	.34	.36	.22	Lambs-Sheep	9.39	9.89	7.68
Barley .....	.49	.53	.34	Chickens .....	.13	.14	.11
Rye .....	.48	.56	.33	Eggs .....	.28	.27	.19
Flax	1.63	1.86	1.27	Butterfat .....	.39	.39	.30
Potatoes .....	.50	.50	.32	Hay	5.03	5.08	4.62
Hogs	10.10	11.20	5.70	Milk	2.20	2.00	1.60
				Wool† .....	.37	.38	.29

* These are the average prices for Minnesota as reported by the United States Department of Agriculture.

† Not included in the price index number.

Prices of all commodities included in the index except potatoes, eggs, butterfat, and milk declined from September 15. In the grains all declines except corn were by more than the usual seasonal amounts. Similarly, hogs and lambs-sheep declined more than seasonally. Eggs and butterfat failed to show their usual seasonal increase while the advance in milk was more than is usual at this time of the year.

The U. S. average turkey price on October 15 was 18.8 cents per pound or 4.1 cents per pound above the October 15, 1940 price.

Indexes and Ratios of Minnesota Agriculture*

	Oct. 1941	Sept. 1941	Oct. 1940	Average Oct. 1924-26
U. S. farm price index.....	100.7	101.5	71.7	100
Minnesota farm price index.....	86.0	92.0	62.7	100
U. S. purchasing power of farm products	112.5	116.0	89.4	100
Minn. purchasing power of farm products	96.4	105.4	78.2	100
Minn. farmers' share of consumers' food dollar		53.8	44.2	54.6
U. S. hog-corn ratio	15.5	15.7	9.8	12.8
Minnesota hog-corn ratio	18.7	18.7	11.6	14.6
Minnesota beef-corn ratio	16.7	15.2	15.5	8.1
Minnesota egg-grain ratio	23.7	20.7	20.3	21.7
Minnesota butterfat-farm-grain ratio	38.0	35.3	40.6	38.3

* Explanation of the computation of these data may be had upon request.

Distribution of Income from Farm Products in Minnesota, 1939

The number of farms in Minnesota having specified values of farm products sold, traded, or used by the farm households in 1939 is provided by the last Census. The data are shown in the table below:

Value of Farm Products Sold, Traded, or Used by the Farm Households, 1939

Value Group	Number of Farms Reporting	Value of Farm Products
Under \$400	30,881	\$ 6,041,262
400 to 599	14,053	6,998,724
600 to 999	29,096	23,244,533
1,000 to 1,499	32,736	40,621,054
1,500 to 2,499	44,928	87,284,107
2,500 to 3,999	27,571	85,472,114
4,000 to 5,999	10,271	48,924,094
6,000 and over	4,541	45,490,015
All groups	194,077	344,075,858

The average value of farm products sold and consumed per farm in Minnesota in 1939 was \$1,773 of which \$212 or 12.5 per cent were consumed on the farm. This average value of \$1,773 was 12 per cent smaller than that shown for 1929, due partly to a price decline of 51 points between the two years and partly to an increase in the number of farms of smaller acreages.

Examination of the distribution of farms classified by value of products reveals that half of Minnesota farmers sold and consumed products in 1939 valued at between \$650 and \$2,300 and that this half of the farm group sold and consumed 58 per cent of the total value of products. The fourth of the farms reporting sales and consumption valued at \$2,300 or more sold and consumed 30 per cent of the total value of Minnesota farm products in 1939. The fourth of the farms reporting sales and consumption of farm products valued at \$650 or less sold and consumed only 12 per cent of the total value of Minnesota farm products.

A considerable number of the farms in Minnesota are evidently of relatively small scale in their operations since 38 per cent of the farms reported sales and consumption of farm products valued at less than \$1,000.

UNIVERSITY OF MINNESOTA
Department of Agriculture
Agricultural Extension
University Farm, St. Paul, Minn.

PAUL E. MILLER, Director

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