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A SOUND BASIS FOR FARM MORTGAGE CREDIT

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THE subject which I have the privilege to discuss is closely associated with other basic problems of agriculture, such as land tenure, marketing, and banking. These all strike at the base of any system of farm credit. I shall confine my discussion to that phase of farm credit which has the widest application, namely, financing the individual farmer towards home ownership. Corporate or large-scale farming is so scattered geographically and is so different in character that the same factors would not apply.

It is easy to develop a plausible theory on how to lend money on mortgages to farmers, but whether one's programme will stand the test of time, from both the investor's and borrower's standpoint, is another matter. It is quite as difficult as to attempt to tell how to operate several thousand individual farms of all types and conditions so that they will be successful and free of debt a generation hence. At best, therefore, all I can hope to do here is to review, briefly, the available farm mortgage experience, and draw such conclusions as may seem warranted.

Fortunately for me, I had the opportunity to spend ten years in farm management research with special study of those factors, both physical and economic, which seem to control profits in American farming. This was just prior to the time I became administrative head of the Federal Land Bank of Springfield, seventeen years ago. Since then I have had the privilege of serving under able bank directors and under seven different Land Bank Commissioners as national administrative officers. The conclusions I present are my own observations and, if in error, I must assume that responsibility.

The financial structure of an agency furnishing farm mortgage credit will vary, depending upon whether farm loans are its sole function or whether they constitute only a part of its lending activities. Most institutions that have entered the farm mortgage field have under-estimated the amount of capital and reserves needed to tide them over periods of depression. The pace of farming is so slow that it takes years for farmers who suffer reverses to recover. Particularly in times of low or falling prices, some of the lender's capital will become partly frozen in foreclosed real estate, delinquent interest, and in advances for taxes and insurance, so that the institution may find itself in a strained position unless it has adequate funds to carry it through the cycles. Again, operating expenses increase greatly during a troublesome period while earnings decline, adding to the burden.

The statutes governing farm mortgage banks usually allow them to issue from fifteen to twenty times their capital in bonds or other obligations secured by their mortgage loans. This ratio may be adequate in periods of stable or rising land values when troubles are few, but under such conditions as have existed in America in the past twenty years, such a ratio is altogether inadequate. Bonds or liabilities of not more than ten times the capital and reserves would be much better.

On June 30, 1936, the twelve Federal land banks in the United States had a combined capital, reserves, and undivided profits of $393,929,687 and outstanding bonds in the amount of $1,964,448,000, which is a ratio of one to five.

The Federal land banks have made their loans through local co-operative units known as national farm loan associations, of which there are over 5,000. Each serves a community, a county, or, in some cases, a larger area. They are modelled, in most respects, after the long-established local credit societies of central European countries. Each farm loan association has initial capital equal to one-twentieth of its loans, which capital is pledged with the land bank of the district as additional collateral for all the loans made through that association.

The amount of capital in the associations has proved wholly inadequate in the nineteen years' experience of the system. This may be due to any one or all of several factors—too high loans, too many loans in poor farming regions, too small returns as dividends on their capital, or failure to hold earnings as reserves against future losses. In any event, if the capital of these local associations had been supplemented by an equal amount of reserves or surplus, making a ratio of one to ten, more of the associations would be functioning to-day in spite of being a new undertaking in American farm credit and having operated through one of the most difficult periods in our history.

Where farm land values have remained fairly constant, the national farm loan associations are in very good financial condition. For instance, in the State of Connecticut—a state with very little fluctuation in land values—there are fifteen such associations which have operated since 1917–18. Eleven of these show no capital impairment, and only one has an impairment of over 5 per cent.

Institutions which lend on long-term farm mortgages are also confronted with the problem of obtaining funds through the sale of bonds on a basis that will not prove embarrassing during some period. The contract rate of interest carried by long-term mortgage loans may be lowered but cannot be raised and, with the form of amortisation generally used by the Federal land banks in the United States, twenty-four years elapse before a loan is half repaid. If the lending institution is fortunate enough to be able to refund its outstanding bonds at lower rates of interest, to increase the spread between the mortgage rate and the bond rate, all is well. If, however, the institution has maturing bonds which it must renew at higher rates, but yet cannot raise the rate of interest to its borrowers, the situation may become very embarrassing. The proper timing of bond and mortgage maturities, coupled with the best possible diagnosis of the long-term interest trend, is a most intricate and difficult problem.

If amortisation payments are reinvested in mortgages, bond issues may mature when investment funds are scarce and rates are high. If principal repayments on contracts are invested in government bonds or other readily salable securities, the yield may be less than the rate paid on the bank's own outstanding obligations. Since the earnings of mortgage institutions depend largely upon the spread between the loan rate and the bond rate, proper financing is a most important matter.

Experience has shown that life insurance companies must operate on a wide margin of reserve. Each year they collect huge sums in excess of expected needs, the companies returning the unused portion in the form of dividends to their policy-holders.

The mutual savings banks in the United States operate in a similar way. Most of these banks are located in the north-eastern States and have had a very successful experience, many of them being over a hundred years old. At the close of June this year they had over ten billions in deposits. Their deposits are on demand, or require reasonable notice, and the banks make no guarantee as to interest or dividend return. With no capital stock, but with large guaranty funds, the entire income from mortgage loans and investments is available, should occasion arise, for expenses or emergencies. Their financial position is flexible enough to meet almost any situation. With about half of their deposits invested in mortgages, rural and urban, I question whether they could have survived the numerous severe depressions through which they have passed if they had had fixed interest-bearing obligations instead of open deposits on which they paid only net earnings after expenses and adequate reserves were deducted. As a matter of experience, the records of a very successful mutual savings bank in Massachusetts show that over a 47-year period the spread actually needed between interest on loans and net interest paid to depositors was eighty-nine hundredths of 1 per cent.

In this fast-changing world it seems impossible to predict conditions that may arise, so only the most flexible and safest plan of operation should be followed.

An institution lending to farmers must be prepared to operate in good times and bad. It can do this only by building substantial reserves which will be available in periods of depression. Investment funds in the open market frequently are not available during periods of stress or may be obtained only at prohibitive rates. It is during such periods, when other credit sources are restricted, that farmers need help. The institution which can help them then is the one that serves best.

For these reasons, a capital structure and basis of earnings that will provide the maximum safeguards for continuing service best serve both the borrowing farmer and the man whose money is borrowed.

A review of farm mortgage experience indicates that the type of organization or type of institution making the loans has much to do with the success of the undertaking. Several different systems have been tried, but the oldest systems are those, mostly co-operative in character, which have operated successfully in Europe for a long period of years. Patterned somewhat after the farm mortgage banks of Germany is the Federal land bank system which, as mentioned before, has been in operation on a nation-wide basis in the United States since 1917. Owned in part by the farmers themselves and partly by the United States Government, the system may be called semi-governmental.

A third type is the State-wide, rural credit systems of which there are at least three examples in the United States. A fourth type is the private mortgage banks that operate under government supervision as represented by the joint-stock land banks in the United States. In the fifth group are insurance companies, local commercial banks, mutual savings banks, local credit unions, and wholly private mortgage companies.

It is not possible to analyse here the set-up of each of these different types or trace their methods of operation and experience. However, a brief summary of their most important features, with a view to reaching certain conclusions, is desirable.

I am most familiar with the Federal land bank system which was organized only after a special government commission had made a study of the set-up and experience of all types of rural credit then in existence.

The object of the American system was twofold: to furnish a form of sound mortgage credit that fitted the needs of agriculture, and to provide this credit in a manner which would attract the investment funds of the large banking centres. The aim was to provide not only an additional source of farm mortgage credit in regions already reasonably well supplied but, more particularly, new credit in parts of the country where interest rates were high and funds not abundant.

This system is primarily directed through the twelve Federal land banks which are so located as to serve adequately our entire forty-eight States. One of the functions of the banks is to organize the national farm loan associations. These associations are simply local groups of borrowers, conveniently located, who agree upon a certain limited liability for each member on the loans of all other members of the one association. Each local association is independent in action as to the officers it selects and the loans it approves or rejects. Moreover, no loan may be made by a Federal land bank until it is first offered and approved by an association under its jurisdiction.

In effect, the Federal land banks act as banks of rediscount. However, in actual practice the banks do not operate in the sense that reserve banks discount commercial paper, since the associations have no funds of their own with which to make loans in the first instance. The loans made through all the national farm loan associations in a given Federal land bank district constitute the basis of the collateral against which farm loan bonds are issued and sold to the investing public. Each Federal land bank, in turn, guarantees the bonds of the other banks, thus creating a national system.

Experience already gained by the Federal land banks indicates that the national farm loan associations or local units have an important part in the programme. The importance of local contact with individual borrowers is often not realized until collection and real estate troubles arise. The local agency must be thoroughly acquainted with the problems of agriculture in its particular area. It should also have a sense of local responsibility because operating expenses can be reduced materially if the local associations function efficiently.

Experience also indicates that two appraisals—one by the local association and the other by the Federal land bank, each bound by the lowest amount recommended in either case—is an additional safeguard.

While the American farm loan system was patterned closely after the farm mortgage credit system of central Europe, conditions in the United States were so altogether different and so varied among the States that the application of what was apparently a sound principle has not worked out in the same way throughout the nation.

As nearly as I can determine, the units of the European system, after which the American system was modelled, were strictly local co-operatives, functioning in given communities, with each member fully acquainted with the operations of his neighbours and willing to insure fully their success. These locals, for the most part, operated with little expense, the services of the officers being largely voluntary.

Perhaps one reason for the success of these European farm credit associations was that they were located in an area where the supply of farm land was limited and very intensive farming was necessary. Population was dense, and the production from each piece of land was fairly well known. The average farm was about twenty acres in area, and there was the further advantage that the credit or resources of an individual in the community were known to practically every one else in his section.

In organizing a similar system in the United States, it soon developed that only in certain regions were the farmers ready and educated to this type of credit system. Mutual institutions for financing were not common among the farmers in many areas, hence there was little experience to guide them. The result has been that in some regions where the associations have continued small in size and on a community basis, they have operated with little expense and have done creditably. In other regions, the associations developed so rapidly that they soon lost the community interest and salaried employees were needed if adequate supervision and efficient functioning were to continue. Where troubles have not been too severe, both types of associations have continued to grow and are functioning well to-day. The question remains, nevertheless, as to whether an association requiring the services of a salaried officer will be as effective in the long run and provide credit as cheaply as the form of organization originally intended, namely, the small local unit with little or no overhead expense.

I believe both types of local credit associations are justified, depending upon the volume of loans, the attitude towards co-operative finance, and the character of the borrowers. Of this I am convinced; whatever the type of central lending institution, some form of local borrower contact is needed. Personally, I favour the smaller association serving a local community with the borrowers having the same general interests, and with the unit operating with more or less voluntary service. I realize that in times of stress and trouble additional expense and service will be needed. However, farm mortgage credit under normal conditions should not require much field service with individual borrowers. All collections and book-keeping transactions, after the loans are placed, can be done through the central institution. Collections, in the few trouble cases, may be made by the local association officials.

This conclusion as to the need of these local contacts is supported by the experience of the farm loan societies in Europe, by the experience, in America, of local mutual fire insurance companies, some of which have operated over a hundred years in our eastern States, and by the experience of our mutual savings banks which have had a long history of success.

Several attempts have been made in the United States to organize and operate State-wide rural credit systems. These have been governmental in character, designed to furnish farm mortgage credit at low rates and for long terms to farmers of a given commonwealth. They operated from a central bank with no local groups. Loaning funds have been obtained through bond issues, in some cases based partly upon the security of the loans themselves and sometimes on the credit of the State. Of three such systems which I have reviewed, all are now in liquidation. A recent report on one such system with total resources of about $39 million showed that over 77 per cent. of its resources were in loans in process of foreclosure or in real estate owned.

The experience of private mortgage banks operating under governmental supervision has not been favourable, judging from the length of time they have operated, the number that have failed, and the service rendered. Eighty-eight joint-stock land banks were organized in the United States during the period from 1917 to 1931. Many failed and by mandate of legislation all are in liquidation. They provided serviceable loans to farmers on terms that fitted the farm business, but much of the service was done at the expense of the investors and stockholders.

The private farm mortgage companies are so varied in character that any conclusion regarding them would be inappropriate.

Some of our large life insurance companies have operated fairly successfully in the farm mortgage field, such loans making up only a part of their investment portfolios. Their interest rates have not been so low, or their repayment terms so favourable, as loans furnished by semi-governmental institutions, but unquestionably these companies have been a real benefit in furnishing credit to new areas. At the same time, their loans have been a sound basis of investment for the reserves of their policy-holders. Here again, the experience of the life insurance companies indicates the need for local organizations, especially in times of stress. Local agencies, paid by fees and commissions to make new loans, serve well in times of prosperity when there are no delinquencies or foreclosures, but their ability and responsibility often fade when the loans need servicing from a trouble standpoint.

The mutual savings banks as found in the north-eastern part of the United States offer an interesting chapter in mortgage credit. When confined to their own immediate localities, their loans, for the most part, have been safe and constructive. When they made loans outside of their own communities, they encountered a lot of trouble. Their supply of funds has depended entirely upon local savings, both rural and urban, and ability to make new loans has been subject to the volume of savings. These banks are wholly mutual in character, being organized by the citizens of a community as a depository for their savings, to receive therefrom the full interest return less the cost of operation and necessary reserves.

While some may not agree with me, my observation is that most farm mortgage loans made by these institutions have been satisfactory from the borrowers' standpoint. While the loans are practically demand in character, rarely have unreasonable or severe demands been made. Generally the banks are local enough in character to sense local conditions, to make sound appraisals, and to serve their borrowers at low cost. Their weakness is that in times of stress, when new funds are most urgently needed, their resources are limited. Moreover, their deposits are frequently drawn from urban communities and the banks gradually take on the complexion of the city rather than of the country. When that occurs the bank officials lose touch with agriculture and fail to appreciate the farmers' needs. I believe, however, that mutual savings banks or local co-operative credit unions, operating in regions that have a reasonable amount of funds for investment and having some kind of a central reserve fund available when needed, could be made eminently sound and serviceable in the field of farm mortgage credit.

We often forget that farmers are as much interested in savings as in loans. The latest available United States census indicates that 58 per cent. of owner-operated farms are free of mortgage debt. Not only farm owners but members of their families have savings to invest. If these savings can be kept in the local banks that operate under the most stringent regulations and restrictions, they are more likely to be invested judiciously and to be available when needed. Long-range investments are more apt to suffer losses unless very carefully guarded. Some of the saddest pages in the history of American agriculture tell of the losses of hard-earned, lifetime savings of farmers through poor investments. Some of our best agricultural States, where farm owners are now deeply involved financially, once possessed untold millions of bankable wealth.

Sound farm mortgage credit requires that the loans be made to fit the needs of the farm business. Farming is not only a long-term business but it is subject to wide variations, unforeseen hazards, and factors which cannot be controlled. Different types of farming require different kinds of financing. The repayment of a loan must necessarily be made from the productive income of the property. While the loan is made to the operator, the resources at his command determine his income-producing ability and his ability to pay.

We have three types of mortgage loans in general use to-day. Probably the most popular form is the amortised loan which requires interest plus regular payments on principal during a given period of years. The period varies from 10 to about 35 years, the majority of such loans being written for 20 or 33 years. The 20-year loan requires a payment of 5 per cent. principal per annum, while the 33-year loan requires 3 per cent. principal per annum with a slightly larger payment the last year.

The type in general use by commercial banks, mortgage companies, and insurance companies is written for three or five years with only interest payments required during that period. At maturity a loan may be renewed, it may be called in full, or a part payment may be demanded. Of late years, there is a tendency to change these loans to the amortised type.

The third type, characterized as a demand loan, has been generally used by mutual savings banks. Nearly all of these mortgages have been written for one year and are on demand thereafter. However, the practice has been to make no demand for payment as long as the interest is paid and the security is kept in good condition. While such a loan may place the borrower in a precarious position, it possesses many advantages from the standpoint of both borrower and lender. Perhaps the best criterion is that it has been used successfully over a long period of years.

Loan limits, in relation to appraised values, are provided by the statutes governing farm mortgage banks except those privately owned. The usual limit is about half of the property value. Restrictions are of no value, however, unless the appraisal itself is sound, and appraisals are hard to control by statutes. The integrity and loaning experience of the bank offer better safeguards than any arbitrary loan limits. Time does not permit a discussion of appraisal problems—soils, buildings, farm lay-out, water-supply, and other factors which should be considered. Loaning institutions have different appraisal methods and various appraisal report forms. It is my observation that the ability of the appraiser is far more important than the appraisal form. Perhaps the best form is a blank sheet of paper in the hands of a competent man. Each farm is an individual study and a keen appraiser will give the proper weight to the factors controlling its success. Another appraiser, provided with elaborate forms, may easily lose himself in a mass of detail and fail to point out the essential features upon which the loan should be considered.

Too great emphasis cannot be given to the ability of the appraiser, for, in the final analysis, it is the man who interviews the operator and examines the farm who really makes the loan. The executive officers must necessarily be guided very largely by the report of the investigator. Statistical information as to trends, production, markets, and the like, should be thoroughly understood by the investigator so that he may correctly interpret the future of the particular farm in the light of the best information available.

It is the experience of most farm mortgage institutions that they undervalue the higher grade farms and overvalue the poorer ones. In the same way, if properties have to be foreclosed and sold, there is a tendency to undersell the good farms and to endeavour to oversell the poorer ones. Local values seldom reflect the difference in worth between land which normally produces 30 bushels of wheat per acre and that which produces only 20. Good farms in a neighbourhood of poor ones are sometimes undervalued, but overvaluation of a poor farm in an area of good farms is a very frequent error. Many such farms are always on the market and form the stock in trade of some real estate operators. They have, however, very little debt-paying capacity.

In most regions there are many farms that are capable of producing a living for a farmer and his family, but which, even under reasonably good management, have little capacity for paying debts. In other words, the gross income from such properties is hardly more than sufficient to furnish the owner and his family with a moderate living, pay the taxes, and keep the property in repair. Such farms have an exchange or sale value and, if supplemented by outside income or if operated with unusually high efficiency, will provide the income to repay small loans. On great numbers of such properties, however, any mortgage debt is likely to prove a hardship as the payments must be made from funds which should go for living expenses. Farm mortgage institutions encounter many cases of this character.

In the United States the character of the community—the ideals of its people, its schools, churches, and its desirability as a place in which to live—has an important bearing upon farm values. It follows that changes in the characteristics of a community vitally affect property values. Generally a farm is a home as well as a place on which to earn a livelihood. There are districts, however, where the farm is regarded as strictly a place of business, the homes being centred in towns or cities. As a region grows older, there is usually more emphasis on the homes, and this emphasis is accompanied by better buildings, a more-established type of agriculture, and a stronger community life. The degree to which farmers are attached to their homes is a strong factor in determining the effort and sacrifice they will make to retain them under adverse conditions.

The chief security in short-term credit is the character of the individual. His promise is supported by his reputation for ability and his willingness to pay. The personal factor is of equal importance with farm mortgage loans. A loan is made to the man, and much will depend upon his character, intent, and ability. These should be investigated first, and, if found satisfactory, the farm which is offered as collateral security comes next.

It is true that farms may change ownership or the operators may die, but these changes affect only a part of the loans of an institution and are no excuse for lending to poor moral risks, even on good security.

In 1918, the first full year the Federal Land Bank of Springfield operated, it made 1,811 loans. Now, 18 years later, 675 or 37 per cent. have been paid in full; 251 or 14 per cent. have been foreclosed or deeded to the bank; and 885 or 49 per cent. are still in force. Of this last group, 615 or 70 per cent. are still in the hands of the original borrowers and the mortgages have been reduced 27 per cent. These figures in themselves are convincing evidence of the need to consider the personal factor when the loans are made.

While it may slightly restrict private sales or transfers of farms, there are good reasons why mortgage loans should become due and payable at the option of the lender upon change of ownership or death of the owners. If, upon investigation, the new owner of the farm proves to be a satisfactory risk, then there is no reason why the loan should not continue.

Experience with farm mortgage loans in some districts shows that gradual depreciation of the security is a frequent cause of trouble. As an illustration, a loan was made fifteen years ago to a successful farmer who was then 50 years old and operating a good farm. To-day at 65, with failing health and largely dependent upon hired labour, he finds himself gradually losing ground and unable to meet expenses. His intentions are good but, with waning strength and lessening resources, the need for repairs to his buildings increases, the land loses its fertility by reason of not being operated to capacity, and year by year the property depreciates. Presently, with delinquent interest and depreciation of the premises, the mortgagee may find these items pile up faster than the payments on principal will reduce the debt. If there is a ready sale for farms, such an owner may be able to save his equity by transferring the property to a new owner. Depreciation problems are much more acute towards the close of a depression cycle.

Dependability of farm income has an important bearing on loaning policies. If a farm is well diversified so that the operator has several sources of income and is well insured against extremely low prices for a particular product or against loss of one or more crops through weather hazards, fewer safeguards are needed on a long-term loan. If, however, the type of farming is hazardous, with too great possibilities of complete loss of income in certain years, then precautions must be taken.

One-crop farming, and to a certain extent a single type of livestock farming, must always be subject to extreme fluctuations in income. Crop failures and low prices are beyond the control of farm operators. To meet such conditions provision should be made for temporary deferment of principal payments and possibly interest also, with higher principal payments in good years.

I know of no system in America that provides for larger payments in good years to be used as reserve for subsequent bad years. This is needed, however, if the best results are to be obtained and the best service is to be rendered. The form of amortisation used by the Federal Land Bank of Springfield permits larger principal payments in favourable seasons as an offset against smaller payments or entire lack of them in unfavourable times, but the larger payments in good years are not compulsory.

The granting of farm mortgage credit requires the best possible analysis of long-term trends of agriculture in a given area. The net income from most types of farming is such that a long period of years is required to liquidate a loan that amounts to half the value of the property. Changes in markets due to competition from other areas and changes in methods of transportation cause major shifts in agriculture. Coupled with these long-term shifts, changes in methods of production due to new machinery and increasing problems of combating new insect pests and plant diseases make it extremely hard to forecast the future of a farming area which may seem perfectly sound to-day.

Experience has shown that it is not the mistakes of appraisers on individual farms which have caused trouble to lending institutions, but the lack of a proper diagnosis of the trends of agriculture over a period of years. Troubles arising from adverse trends are cumulative in effect. While the productive capacity of a farm must be carefully appraised, its markets for produce are of equal importance. Dependability of markets is on a par with dependability of production.

Added to all the uncertainties and changes in trends due to shifting markets, soil depletion, and weather hazards, are the effects brought about by changes in price levels. Such changes may be nation-wide or world-wide and wholly outside the control of the individual farmer or lender, and they wreak havoc with any farm mortgage programme. Such changes may bring inflation or deflation, the effects of which are equally serious to a long-time business like farming where one cannot hurry the forces of nature and where the favourable harvests are few, even during a man's lifetime.

Of far-reaching importance in farm mortgage financing is the possibility of unfavourable legislation such as moratoria of interest or principal, statutes forbidding foreclosure, and the like, which add enormously to the cost of operating a system. A still more important factor is the possibility of excessive taxes or legislation which prevents farmers from applying their income to their indebtedness. Local taxes in many farming districts become such a burden that they alone amount to a fair rental for the entire farm, leaving nothing for the owner to apply against interest and principal of his debts. The farmers in a community, however, may be in no way responsible for tax programmes which vitally affect them. Laws are often imposed by legislatures whose members are from cities and whose interests are not the interests of farmers. Nevertheless, property owners become the chief sufferers.

Certain types of agriculture require short-term financing for such production items as fertilizer, feed, and seed. The question frequently arises as to whether the payments on such production loans take precedence over payments due on the first mortgage. Obviously, a first mortgage when granted is based on the earning capacity of the farm, with the understanding that the first proceeds from sales will be used for mortgage payments. Only the living expenses of the farmer and his family and taxes are recognized as prior claims. Statutes governing mortgage loans provide that the mortgagee may hold the growing crops. Obviously, supplies for production are necessary, but rates of interest for short-term loans provide for the risks and hazards common to them. If their repayment is to precede the mortgage interest, then mortgage rates will greatly increase and the total cost to the farmer will be raised. I know of no region that has a good mortgage credit rating where crop liens are allowed to interfere with the instalments due on mortgages. Only in real emergencies or crop disasters can the basic mortgage lien on the proceeds of crops or live stock be subordinated to other creditors.

A continuing institution in the business of making mortgage loans to farmers must do a certain amount of educational work. Prospective borrowers need to be informed of the services which the bank or company is prepared to render; old borrowers need to be reminded of the services they receive; bondholders or those whose funds are being loaned need to be furnished with complete and accurate information on operations. It is not sufficient to carry an educational programme for a year and then feel that the job is done. It must continue. Conditions are constantly changing; new borrowers take the place of the old ones, and new investors come into the picture.

The bank, in effect, goes into partnership with every farmer it finances. It is essential, therefore, that the borrower should have complete confidence in the lending institution; that he should get a fair deal and realize it to the point where he will make every sacrifice to see that his interest and principal are paid when due. There is no substitute for integrity and willingness to pay.

Thus, we find many factors, besides the natural and physical resources of a farm or the qualifications of the operator himself, which enter into a well-balanced farm mortgage loaning policy. One must be on the look-out for long-term trends of distant forces, which may be difficult to foresee at the time a loan is made. One must keep in mind the possibilities of changes in price levels, adverse legislation, and the like, nearly all of which are wholly beyond the control of the farmer or the lender.

The requirements for sound mortgage credit may be summarized somewhat as follows:

(*a*) The institution or company should have capital, surplus, and reserves equal to at least 10 per cent., and preferably 15 per cent., of its volume of outstanding loans. Such capital is needed not only to provide earnings but to tide over the cycles of depression common in agriculture.

(*b*) The system should provide a spread between the loan rate and the cost of funds much larger than normally needed, preferably $1\frac{1}{2}$ to 2 per cent., with some provision for refunding surplus earnings to borrowers if not needed for emergencies or reserves.

(*c*) A dependable source of funds must be available, even in hard times, with rates low enough to permit loans that will attract the best farmers in the best regions.

(*d*) Loaning policy should provide: (1) a liberal attitude towards the most efficient farmers on the best lands; (2) a very conservative policy towards any loans on the poorer grades of land; (3) absolute rejection of all applicants of poor character or inferior ability as operators.

(*e*) A form of mortgage should be used that provides maturities and payments that fit the business of agriculture, with necessary variations for different types of farming.

(*f*) The system should adopt a consistent and continuing educational programme coupled with local associations or local units to keep in contact with both old and new borrowers. These local agencies must be agriculturally minded and operate with low overhead cost.

(*g*) Personnel must be trained in finance and in agriculture, capable of diagnosing farm problems, and so selected and employed that the individuals are free to exercise their best judgement. Particular emphasis should be given to the selection of the most capable men for appraisers.

(*h*) Provision should be made for safe investment of farm savings as well as provision for farm loans. Most farm communities have ample means to finance themselves if the savings are properly conserved.

(*i*) A straightforward policy of fair dealing must be accepted and carried out by providing both the farmers and the investors with full information on all operations.

(*j*) Above all, the bank officials must have confidence both in farmers and the business of agriculture, and recognize the fact that the rank and file of farmers are honest and will pay their debts.