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SHORT- TERM AGRICULTURAL LENDING OF SELECTED MINNESOTA COUNTRY BANKS

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Introduction

The short-term debt of Minnesota agriculture continues to increase. The non-real estate debt of Minnesota farmers owed to principal lending institutions was $181,250,000 July 1, 1952. This was 16 per cent higher than on July 1, 1951. For the postwar period as a whole - January 1, 1946 to January 1, 1952 - the short-term farm debt has increased 230 per cent. This expansion of credit has resulted from rising production costs and increased expenditures on machinery, equipment, and improvements for both farm and home.

Commercial banks are the leading suppliers of short-term loans to Minnesota farmers. Furthermore, their share of these loans increased in recent years. On January 1, 1946, commercial banks held 68 per cent of the non-real estate farm debt owed to principal lending institutions in the state while on January 1, 1952, commercial banks held 84 per cent of this debt (Table 1).

In view of the increased use of short-term farm credit and the importance of commercial banks as suppliers of this credit the Department of Agricultural Economics of the University of Minnesota has conducted a survey of the short-term agricultural lending activity of 32 country banks in the state in the last two years. During the summer of 1951 sixteen banks were surveyed and two reports were issued covering the major findings. In an endeavor to obtain a more complete picture of short-term agricultural bank credit sixteen additional banks were surveyed in the summer of 1952. The objectives were as follows: To determine the characteristics, volume, and quality of short-term agricultural loans; to note differences in lending policies and practices of banks in different type-of-farming areas; to determine the importance of farm production loans in the country banks' portfolio of loans and discounts; and to obtain bankers' comments on farm credit trends and the current credit situation in their respective areas.

The survey consisted of two main phases. In the first place, information on bank lending practices and loan policies was obtained from interviews with the participating bankers. Bankers also made available their call reports from which figures on their investment in short-term agricultural loans and total loans and discounts were transcribed. Secondly, from the records of each of eight banks a random sample of 30 farm production loan borrowers was obtained for detailed study.

This report is a summary of the information collected by interviews with participating bankers on their lending practices and loan policies

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1/ The authors acknowledge with appreciation the assistance of E. Fred Koller who was the leader of this project. Appreciation is also expressed to the rural bankers for their generous cooperation in supplying the basic data and to the Minnesota State Banking Division and others for their suggestions in the development of this study.

Table 1. Non-Real Estate Loans to Farmers; Amounts and Proportions Held by Principal Lending Institutions, Minnesota, 1940-52. 1/

Year		Commercial Banks	Production Credit Associations	Farmers' Home Administration	Other 2/	Total
			(Thousands of Dollars)			
1940-45 ave.		66,975	6,177	19,370	1,602	94,123
1948:	Jan. 1	61,432	7,964	13,322	1,413	84,131
1949:	Jan. 1	81,470	10,252	11,159	1,578	104,459
1950:	Jan. 1	95,656	11,234	12,401	1,546	120,837
1951:	Jan. 1	121,202	13,542	11,157	1,662	147,563
	July 1	129,545	14,761	10,420	1,684	156,410
1952:	Jan. 1	147,052	16,960	9,528	1,806	175,346
	July 1	150,069	18,028	11,243	1,910	181,250
			(Per Cent)			
1940-45 ave.		71.2	6.6	20.5	1.7	100.0
1948:	Jan. 1	73.0	9.5	15.8	1.7	100.0
1949:	Jan. 1	78.0	9.8	10.7	1.5	100.0
1950:	Jan. 1	79.2	9.3	10.2	1.3	100.0
1951:	Jan. 1	82.1	9.2	7.6	1.1	100.0
	July 1	82.8	9.4	6.7	1.1	100.0
1952:	Jan. 1	83.9	9.7	5.4	1.0	100.0
	July 1	82.8	9.9	6.2	1.1	100.0

1/ Excludes loans guaranteed by Commodity Credit Corporation.

2/ Loans of livestock companies and agricultural credit corporations discounted at Federal Intermediate Credit Bank.

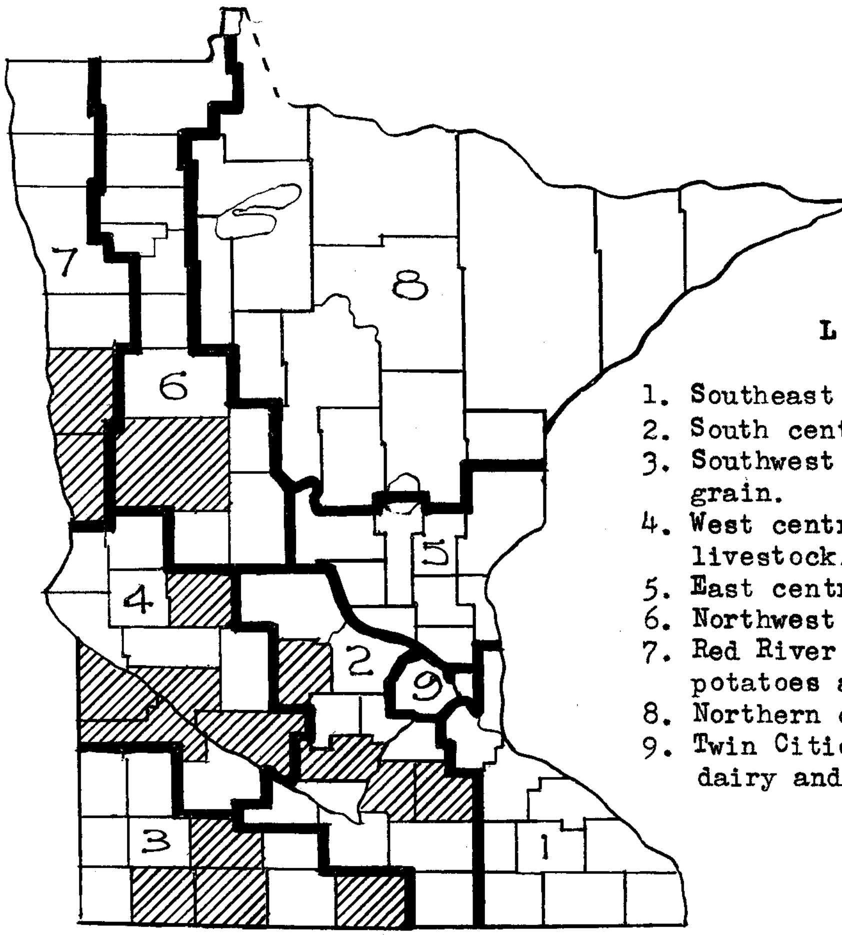
Source: Agricultural Finance Review.

with respect to credit files and methods of loan analysis, loan charges, and security requirements. In addition the importance of farm production loans to country banks will be considered together with a summarization of bankers' comments on farm credit trends and the credit situation in their respective areas. A later report will cover that phase of the study dealing with the characteristics of the sample borrowers' loan accounts and the promissory notes which make up those accounts.

Scope of the Study

The counties and type-of-farming areas in which the sample banks are located are shown in figure 1. The endeavor was to include country banks representative of the short-term agricultural lending activity of commercial banks in various type-of-farming areas. The largest bank in the study had total assets approximating six million dollars while the

Figure 1. Type-of-Farming Areas in Minnesota and the Counties in Which the Country Banks Participating in this Study are Located.



LEGEND

1. Southeast dairy and livestock.
2. South central dairy
3. Southwest livestock and cash grain.
4. West central cash grain and livestock.
5. East central dairy
6. Northwest dairy and livestock.
7. Red River Valley small grain, potatoes and livestock.
8. Northern cut over dairy
9. Twin Cities suburban truck, dairy and fruit.

smallest bank had total assets of about one and one-half million dollars. The average bank in the study had total footings amounting to $2,985,462 of which $950,918 were loans and discounts as of June 30, 1952 (Table 2).

Generalizations with respect to commercial bank lending policies and practices are difficult. They are affected by local circumstances and the attitude and business acumen of management. Each bank is an entity in itself. Although operating within an institutional and statutory framework the individual banker has considerable latitude in conducting the business, selecting borrowers, deciding on the extent of loan analysis and the like.

Table 2. Average Balance Sheet, Sixteen Minnesota State Banks, June 30, 1951, December 31, 1951 and June 30, 1952.

	June 30, 1951 (Dollars)	Dec. 31, 1951 (Dollars)	June 30, 1952 (Dollars)
Assets			
Loans and discounts			
Farm production loans	353,486	402,129	397,636
C.C.C. loans	7,463	27,848	1,838
Farm real estate loans	74,481	72,610	72,924
Other loans	483,630	492,275	478,520
Total loans and discounts	919,060	994,862	950,918
U. S. Government obligations	1,231,235	1,134,713	1,164,578
Other assets	781,747	928,440	869,966
Total assets	2,932,042	3,058,015	2,985,462
Liabilities			
Deposits	2,720,710	2,833,661	2,756,124
Other liabilities	4,083	6,065	5,797
Total liabilities	2,724,793	2,839,726	2,762,921
Net Worth			
Capital	49,375	49,375	49,687
Surplus	86,718	89,531	94,375
Undivided profits	55,966	59,674	60,040
Reserves	15,190	19,709	19,439
Total net worth	207,249	218,289	223,541
Total liabilities and net worth	2,932,042	3,058,015	2,985,462

The Importance of Short-Term Farm Loans in the Loan Portfolio

Information on total investment in short-term farm loans was transcribed from the three latest call reports of each of the sixteen banks in the study. The figures revealed that short-term agricultural loans occupied an important place in the loan portfolio of these country banks. As of June 30, 1952, the weighted average for all sixteen banks indicated that 41.8 per cent of the total loans and discounts consisted of short-term farm loans (Table 2). However, considerable variation existed among the banks (Table 3). Eleven of the banks in the study had farm production loans which amounted to over 40 per cent of their loans and discounts. The range was from 15 per cent to 65 per cent. This wide variation is due to

Table 3. Farm Production Loans as a Percentage of Total Loans and Discounts, Sixteen Minnesota State Banks, June 30, 1952

Percentage	Number of Banks
Under 20	2
20 - 29.9	0
30 - 39.9	3
40 - 49.9	6
50 - 59.9	2
60 - 69.9	3
Total	16

several factors. In the first place, size of the village or city in which the bank is located is important. Banks located in larger villages and cities may have a large volume of urban business so that farm business is a smaller percentage of the total. Secondly, the variation is due in part to the attitude of the bankers toward this type of investment. Another factor having a bearing on the extent to which country banks invest in short-term agricultural loans is the competition from other lenders operating in a bank's area.

Bankers were asked to estimate the per cent of their deposits which belong to farmers. On the average, 56 per cent of the deposits of the 16 banks under study were owned by farmers. The percentages varied from 25 per cent to 80 per cent with most of them falling in the vicinity of 60 per cent. If in a given bank the per cent of deposits belonging to farmers is high and the farm loans are only a small percentage of total loans then it can be concluded that the bank is not seeking agricultural loan business.

The attitude of the banker toward loans in general is indicated by the ratio of loans and discounts to deposits. The weighted average for all sixteen banks indicated that loans and discounts amounted to 34.5 per cent of deposits on June 30, 1952. Again, considerable variation existed among banks (Table 4). The range was from 12 per cent to 60 per cent.

Table 4. Loans and Discounts as a Percentage of Deposits, Sixteen Minnesota State Banks, June 30, 1952.

Percentage	Number of Banks
Under 20	2
20 - 29.9	3
30 - 39.9	3
40 - 49.9	5
50 - 59.9	3
Total	16

Short-term agricultural loans equaled about 13 per cent of the combined total assets of the sixteen banks.

Most Banks Expand Short-Term Farm Loans Over the Year

There was a pronounced expansion in the average volume of short-term farm loans for the sixteen banks during the latter half of 1951. On June 30, 1951, these loans averaged $353,486 and increased to $402,129 on December 31, 1951 - an increase of 13.8 per cent (Table 2). Some reduction in the average volume of the short-term farm loans took place during the first half of 1952, but the over-all increase was 12.5 per cent from June 30, 1951 to June 30, 1952. During the same period the sixteen banks, on the average, decreased their holdings of other loans.

An important factor accounting for this expansion of short-term farm loans during this period was the poor corn crop in 1951. The abundance of soft corn created a heavy demand for feeder cattle and many loans for their purchase. The four banks in the southwest livestock area expanded their short-term farm loans by an average of 42 per cent from June 30, 1951 to December 31, 1951. Some of these loans were evidently repaid during the first six months of 1952, as the outstanding loans of these four banks were lower on June 30, 1952 than six months earlier. However, the average volume of such loans outstanding was appreciably greater on June 30, 1952 than one year earlier.

Only five banks decreased their holdings of short-term agricultural loans during the year June 1, 1951 to June 1, 1952, these decreases averaging 5 per cent. On the other hand, the average increase in such loans by the remaining eleven banks was 21 per cent.

Bankers' Comments on Farm Credit Trends and the Financial Condition of Farmers.

The survey banks were asked to indicate the general trend in the demand for short-term agricultural loans in their respective areas during the year June 30, 1951 to June 30, 1952. Three banks reported that the demand for these loans had decreased during this period. Two of these were located in the south central dairy area and the other in the Red River Valley. The Red River Valley banker said that the average farmer had become more conservative in borrowing. His borrowers were alert to the fact that our economy is "riding high" and hesitated to borrow in such a period. One of the banks in the south central dairy area indicated that farmers had become well equipped, their margin had become thinner and they were more cautious about incurring new debts. Another banker in this area had experienced a marked decline in the demand for larger loans because farmers were not expanding as much as before. However, he also pointed out that more farmers were borrowing money to pay high operation costs because of the poor crops of corn and oats in the fall of 1951.

Of the remaining thirteen banks, one reported that the aggregate demand for farm production loans was about the same, while twelve reported that the demand had definitely increased. For the most part, these bankers ascribed the increased demand for this type of credit to the poor corn crops in the years 1950 and 1951, to the increased cost of farm operation, and to the increased purchases of modern machinery. The expansionary effect of poor corn crops on the short-term farm debt has been two-fold. In the first place, the demand for feeder loans has increased. Secondly, more farmers have found it necessary to borrow for such operating expenses as feed, seed, and gas.

The survey bankers were asked whether farmers were better or worse off financially in 1952 than a year earlier. Five bankers reported that farmers had strengthened their financial position (Table 5). Three of these banks were located in the northwest - in Clay, Wilken and Otter Tail Counties. These bankers attributed the financial progress to a good crop in 1951. The LeSueur and Rice County bankers also felt that, in general, farmers were better off financially in 1952.

Table 5. Bankers' Opinions Concerning the Financial Condition of Farmers in 1952 as Compared with 1951, Sixteen Minnesota Country Banks, June 30, 1952

Financial Condition in 1952 as Compared to 1951	Number of Banks	Location of Banks (County)
Better	5	Wilken, Clay, Otter Tail, Rice, LeSueur
About the same	5	Sibley, Faribault, Pope, Yellow Medicine, LacQuiParle
Somewhat poorer to much worse	6	Meeker, Cottonwood, Jackson, Renville, Chippewa, Nobles

Five bankers reported the financial condition of farmers to be about the same as in 1951. On the other hand, five bankers indicated that the financial condition of farmers was somewhat poorer than a year earlier and one banker felt that farmers were much worse off financially. It should be noted that, in general, the banks reporting the financial condition of farmers to be the same or poorer are located in the southwest and west central areas of the state. Corn and livestock feeding are very important in these areas. Bankers pointed out that two poor corn crops were the major reasons for the lack of financial progress on the part of farmers. Other factors mentioned were the increased costs of farm operation and the leveling off of farm prices. One banker in the southwest said that the poor farm manager had been hit the hardest and such farmers were the worst off since 1932.

The bumper corn crop in 1952 provided relief for many southwestern Minnesota farmers. However, on the other side there has been a decrease in the prices received by farmers.

The Chicago Federal Reserve Bank reports that credit requirements of

Corn Belt farmers in the Chicago Federal Reserve District eased in the fall of 1952. This is attributed to the sharp break in feeder cattle prices in mid-1952 and their continued gradual decline last fall. Additional contributing factors were the lesser decline in price of the better grades of slaughter cattle and the large harvests of good quality corn and soybeans. It is probable that these same factors have had similar effects on the volume of short-term agricultural loans in southwestern Minnesota.

More Renewals, Bankers More Cautious in Lending

Ten of the sixteen banks reported an increase in loan delinquency over the previous year. These bankers pointed out, however, that such loan cases were not delinquent in the sense of being uncollectible. Rather, renewals were required because loans could not be paid in full at maturity due to the fact that "profits from farming just were not there." In other words they were confident that the loans would be repaid, but a longer time period would be required for repayment in full.

During the past year farmers have been faced with a so-called cost-price squeeze. In fact in December of 1952 the parity ratio (the ratio of prices received by farmers to prices paid by them) stood at 96, the lowest level since June 1950. Has this situation following poor corn crops in 1950 and 1951 affected the credit policy of country banks? In other words, have banks tightened their lending policies? Fourteen of the sixteen banks reported that they had become more cautious in their lending operations. Indications were that, in general, bankers were screening new loan applicants more closely. Loans on feeder cattle, especially, were getting closer scrutiny. This undoubtedly stems from the unsatisfactory experience of farmers with feeding operations in 1951-52. Prices of feeder stock soared to new heights in the fall of 1951 because of the increased demand brought on by soft corn. Cattle prices broke in mid-1952 - with the result that profit margins were slim or non-existent. One banker reported that he was requiring his borrowers to take out insurance on the feeder cattle as well as requiring the borrower to pay at least one-third the purchase price of the cattle. Several bankers also were being more cautious on machinery loans. Some bankers reported that they did not want to get too much tied up with one borrower.

While the survey banks had become more cautious in their lending policies, there was little evidence to indicate that many farmer borrowers were being sent to other credit agencies. There were two banks where six borrowers from each bank had been sent to the Farmers Home Administration. Eight banks had no such loan cases, others had from one to four.

In general the survey indicated that bankers were conscious of the fact that credit analysis is extremely important in a period when farm income is declining. In such a period it is often times relatively easy for a particular farmer to get over-extended in credit. Farmers will continue to require large amounts of credit to finance their farm business. However, the interest of both the lender and the borrower can best be served when such credit is geared to the income-earning capacity of the enterprise being financed.

Re-Financing Short-Term Debt into Long-Term Debt

Of considerable interest at the present time when the short-term farm debt is at an all time high is the extent to which short-term debts are being re-financed into long-term obligations secured by real estate. Five of the sixteen survey banks reported no such loan cases in the past year. Information on the total number and amount of re-financed short-term farm loans was obtained from seven of the eleven banks reporting such re-financing. On the average, these banks had seven such loan cases with each loan averaging $6,000. The average number of these loans per bank was raised somewhat by reason of the fact that one bank reported twenty of these re-financed loans totaling $150,000.

Borrowing on a short-term basis implies that the loan is to be paid from current farm production. It is important that both the lender and the borrower keep this fact in mind. A chattel loan that has become "top-heavy" and of necessity requires repeated renewal often becomes a loan for fixed capital needs rather than a loan for purely current production. It is advantageous for both the lender and the borrower to have such loans on a longer term, serial repayment basis with real estate as collateral.

In recent years there appears to have been a tendency for farmers to use non-real estate credit not only for production expenses, but also for major farm improvements. In a period of rising farm prices farmers have been able to repay these loans in a relatively short period. When farm income is less favorable, it may well be worth the additional time and expense of obtaining a farm real estate loan to finance such improvements.

Credit Files and Methods of Loan Analysis

One of the most important problems in the lending field is that of determining a borrower's character, capacity to pay, and collateral. Information used in the measurements of these credit "C's" is collected and kept in a credit file that is maintained by the lender.

What items should be included in a credit file? The minimum credit file for country banks published by the Minnesota Bankers Association is of interest in this connection. The following forms are included in this credit file: a credit file memo, a financial statement, a comparison statement and a comment sheet. While it is considered that the above forms will provide information needed to make sound loans, certain supplementary forms may be included for more complete information. These include loan applications, farm inspection appraisal sheets, cream and other produce assignment forms, chattel abstracts, and copies of the chattel mortgage.

One banker who was impressed with the importance of the credit file pointed out that "chattel mortgage loans require careful supervision. The supervision can be no better than the credit file. The time and effort consumed in setting up and maintaining a good credit file are the best investment of time and labor that can be made by lending institutions. The file will not only be of great help in keeping losses at a minimum, but will also be a source of satisfaction and pleasure, and will ease the hard business of making loans."

Although the contents of the credit files varied among the survey banks, all sixteen banks reported that credit files were maintained on most of their farmer borrowers.

Financial Statements

A well prepared financial statement of a borrower can be useful in credit analysis. Liabilities in the balance sheet reveal the extent and nature of prior claims to a farmer's income. A consideration of these liabilities is essential in appraising the farmer's capacity to assume further obligations.

The majority of bankers reported that for loans of $500 or over a financial statement was required. This practice follows the recommendation of the Minnesota State Banking Division. In many instances, of course, particularly if a new client was involved or the banker was not familiar with the farmer's operations, the banker would recognize the importance of getting a financial statement from a borrower requesting a much smaller loan.

The retention of the financial statements of a borrower for a period of years makes it possible to follow the financial progress and changes in net worth over time. Indications were that bankers recognize this important use of financial statements. Most of the survey bankers sought to obtain a new financial statement from each borrower yearly. Old statements were retained in the credit file. A convenient method of maintaining a financial history of the borrower and his operations with the bank is through the use of a comparison statement. Several of the survey banks were using such statements.

Financial statements aid memory and give concise, accurate information for judging the desirability of granting a farmer continued or further credit.

Comment Sheets

Seven of the survey banks maintained comment sheets as a permanent part of their credit files. One of the most important of the many items of credit information that can be recorded on the comment sheet is the purpose and repayment plan of each loan. The bankers invariably discuss this information with the farmer borrower at the time the loan is made. If such information is recorded together with comments on the credit worthiness of the individual, misunderstandings frequently can be avoided. In addition the banker is in a better position to decide the advisability of granting further credit to an individual with such information at hand.

One banker followed the practice of recording all pertinent information pertaining to a loan with the aid of a dictaphone after the loan was made. At the end of each day this information was typed on the comment sheets. Information recorded included loan purpose, repayment plan, borrower financial progress and the bank's position with regard to further credit.

Obviously, it may not be practicable or necessary to record all this information for the small, so-called convenience loans. For larger loans, however, this information is very helpful in credit analysis.

Income and Expense Statements

The extension of credit over and above the borrower's capacity to repay is undesirable for both the lender and the borrower. Therefore, a consideration of a borrower's repayment ability is mandatory before a loan is closed. It is well to remember that short-term farm loans must be paid out of farm income which is subject to the hazards of fluctuating farm prices, adverse weather conditions and other risk elements inherent in farming. While short-term farm loans may be renewed at maturity, sound lending policy requires that these loans be regarded as a fixed commitment to be repaid within their stated maturity. Loans can be repaid within the maturity period only to the extent the original terms are geared to the farm income stream and the over-all income capacity of the farm enterprise.

In a period when farm prices are falling and farm costs are remaining at high levels, bankers will need to put increased emphasis on income analysis in the making of short-term farm loans.

None of the banks in this survey obtained income and expense statements from farmer borrowers. This does not mean that the banker had no knowledge of the earning capacity of the farmer-borrower. When asked how the repayment ability of a borrower was determined, most bankers indicated that they relied on personal knowledge of the borrower and his enterprise. They took account of the livestock and crops a borrower had in prospect for market the proceeds of which could be used to repay the loan.

The attitude of country bankers toward borrower income and expense summaries is undoubtedly influenced by the fact that a typical rural bank serves a limited area. The astute rural banker is acquainted with the farmer borrowers in his locality and usually knows what type of farm enterprise a particular farmer has. In addition, the farmers who obtain credit at a bank bring other business to the bank, such as checking and savings accounts. By observing borrowers' checking accounts the country banker can get some idea of the expense and receipts for the over-all business of the farmer. Notwithstanding, all these facts considered, it is well for the banker to keep in mind that conditions are constantly in the process of change. Consequently, to "keep track" of all borrowers by relying merely on personal acquaintance is no small task. For this reason, recorded information may be a helpful supplement.

Loan Administration

Budgeting of Loan Advances and Repayments

The preparation of a schedule of advances to cover a season's operation of a borrower was an uncommon practice among the survey banks. However, several banks reported that in the case of certain loans secured by chattel mortgages, such budgeting was achieved in part through the use of the advance clause in the chattel mortgage. This practice appeared to be the most common in the case of feeder loans.

For the most part, the banks did not prepare a schedule of repayments to cover a borrower's entire season's financing. Several banks followed the practice of setting up a loan on two or more promissory notes if the borrower intended to repay out of income of different periods. The individual notes carried terms approximating the length of time the farmer would need that portion of the loan. This procedure seeks to adjust the term of the loan to the anticipated receipts of farm income.

Bankers may find it profitable to give more attention to repayment schedules in the future, especially in the case of large loans or where the collateral is thin. Such a schedule is of considerable help in keeping a record of the crops and livestock the borrower is preparing for market, the approximate dates when these products will be ready for market and about what he may receive from their sale. Finally, provision is made for the payment of the loan out of estimated receipts from marketings. As was pointed out previously, such a repayment plan may be recorded on the comment sheet when a special form is not used.

Advantages accrue to both the lender and the borrower when a specific repayment schedule is worked out with the borrower in advance of the loan and the term is geared to fit the borrower's income flow. The borrower will not have to rely on a renewal or renewals of the loan before he receives income to pay it off. On the other hand, the lender is not faced with the costly operation of making renewals. In addition the bank will have a truer picture of the real liquidity of its loans.

Inspection of Collateral

In the case of new borrowers the survey banks reported that an inspection of collateral invariably was made. Collateral inspections also were common in the case of "thin loans" and for large loans. Most of the bankers felt that their close acquaintance with their old borrowers made formal inspections unnecessary. However, several banks made collateral inspections of their old chattel lines at least once a year.

The majority of the bankers tried to keep in touch with the farming operations of their borrowers through informal visits. Such visits were often made in connection with hail insurance or on an evening drive in the country.

Security Requirements

The survey reveals that banks employ both objective and subjective evaluations of the borrower in determining whether or not a chattel mortgage is required. One of the objective measurements commonly used is the borrower's balance sheet. Farmers having a strong net worth position and a well established credit standing were generally granted unsecured loans. Chattel mortgages were required more generally from tenants than farm owners.

Nearly every banker mentioned that such factors as a borrower's abilities as a farmer, his past record with the bank, and his general credit standing in the community affect the security requirement. Consequently, in a subjective evaluation of a borrower, the banker attempts to appraise the borrower as to his character and capacity. As one banker so aptly put it, "No two loans are the same, each loan is an entity in itself because no two borrowers are precisely alike". For this reason, subjective criteria are important when arriving at a decision as to whether to lend on a secured or unsecured basis to a particular farmer borrower.

The survey bankers indicated that size of loan is another important factor affecting the chattel mortgage requirement. Generally, chattels are required for a higher proportion of large loans than for small loans.

One type of security that has come into play, especially during the "tooling-up" period of our farms since the war, is the conditional sales contract. It is a common practice for farmers to purchase farm machinery on contract from dealers. The dealers in turn sell these contracts to the bank. Banks commonly require machinery dealers to endorse these contracts "with recourse". Consequently, the dealer is liable if the farmer does not meet his payments on the contract. Several banks purchased conditional sales contracts from certain dealers "without recourse". Conditional sales contracts enable farmers to purchase farm machinery with a low down payment, however, farmers should understand their relationship to the lender when a contract is involved. The lender has the privilege of possessing the machine without going through the lengthy process of foreclosure in the event payments on the contract are not met.

As was previously pointed out, most of the survey banks had become more cautious in their lending operations in the past year. In line with this general credit tightening, eight banks reported that they had increased their security requirements.

Loan Charges

Interest Rates

Generalizations on interest rates and other loan charges are difficult because of wide variations. The most common interest rate of the four survey banks located in the south central dairy area was six per cent with seven per cent charged on small, unsecured loans. However, one bank in this area charged eight per cent on all loans of less than $2,000 and seven per cent on loans over $2,000. This bank reported only a few sizable loans in the $4,000 - $5,000 range which carried interest rates of six per cent.

The six per cent rate also predominated in the southwest livestock area. In fact, one bank in this area made all short-term farm loans at this rate. Another bank charged seven per cent on the "general-run" of its chattel loans and six per cent on the "choice loans" and on feeder loans. Another bank charged five per cent on a few large loans and on feeder loans, six per cent on the regular "barnyard" loans, and seven per cent on the small $200 to $300 convenience loans. The other bank charged six per cent on the "general-run" of its farm production loans, seven per cent on the "thin loans" and eight per cent on small loans.

Interest rates tended to run slightly higher in the west central livestock and cash grain area. In fact, four of the five banks in this area reported that the "general-run" of farm production loans carried the seven per cent rate. These four banks also charged six per cent on feeder loans and eight per cent on small loans. One bank, however, reported that most of its chattel loans were made at six per cent.

The seven per cent rate also predominated in the three banks in the northwestern part of the state. All three of the banks in this area reported that most of their farm production loans were made at seven per cent. Some of the choice larger loans carried the six per cent rate and small loans went at eight per cent.

Although considerable variation exists in interest rate charges among banks in a given type-of-farming area, it is apparent from the preceding discussion that bank interest rates on short-term agricultural loans tend to be higher in the west central and northwest areas than in the south central and southwest areas of the state. Somewhat higher risks may be an explanation for higher rates in the former areas.

All but one of the survey banks charged different interest rates to different borrowers. Size of loan, collateral security, and the ability to repay were the most important factors affecting the interest rate which the banks charged farmer borrowers. Higher interest rates were charged on smaller loans. One reason for higher rates on smaller loans is that certain costs incurred by the bank in making and servicing a loan do not vary with loan size.

Interest rates generally have tended to increase over the last two years. However, only four of the sixteen survey banks reported that they had increased interest rates on short-term farm loans. One bank had raised its rates on feeder loans from five to six per cent. Another bank had raised its rates one per cent across the board while two banks reported increases of one half of one per cent. Interestingly enough, two banks reported decreases in interest rate charges. These banks wanted to meet the competition afforded by the production credit associations.

The contract interest rate is not an exact measure of the effective rate in that there are minimum interest charges, service charges, or filing and abstracting fees.

<u>Minimum Interest Charges and Chattel Mortgage Fees</u>

All the banks in the survey followed the policy of placing minimum interest charges on short-term loans. For all practical purposes, these minimum charges are not too significant because they were small. Twelve banks had minimum interest charges of fifty cents. Three banks had minimums of one dollar and one bank had a minimum of twenty five cents. The purpose of minimum charges is to cover service costs on small loans or loans that may be outstanding for short periods.

In most of the survey banks, the borrower was charged a fee to cover the costs connected with the chattel mortgage, that is, abstracting, filing, releasing and drawing up the mortgage itself. The size of this fee varied from bank to bank with most of them falling in the $1.00 to $2.00 bracket.

Loan charges other than minimum interest charges and chattel mortgage charges were uncommon among the survey banks. It can be concluded, that while banks have charges in addition to the contract rate of interest, these charges are in most cases nominal and raise the contract rate appreciably only on the small loans.

Summary

In the upswing of farm short-term borrowing since the war, loans to Minnesota farmers by commercial banks have increased in amounts and relative to other lending agencies.

This study of the short-term agricultural lending activity of sixteen Minnesota Country banks revealed that 42 per cent of the combined loans and discounts of these banks consisted of short-term farm loans. On the average, these banks expanded their investment in these loans by 12 per cent from June 30, 1951 to June 30, 1952. Bankers ascribed the increased demand for these loans to increased costs of farm operation, purchases of modern machinery, and poor corn crops in both 1950 and 1951. The latter factor was particularly important in the southwest and west central areas of the state.

Ten banks reported an increase in renewals over the previous year. All but two of the banks had become more cautious in their lending operations. However, there was little indication of borrowers being sent to other credit agencies.

Eleven banks reported cases of re-financing short-term loans into long-term obligations secured by real estate. Both lender and borrower may find it advantageous to consider long-term financing in the event that the loan is for fixed capital needs.

All the banks maintained credit files on most of their farmer borrowers. Most of the banks obtained a financial statement when a loan amounted to $500 or more. Old statements were retained for comparison purposes. Seven banks maintained comment sheets in the credit file. Borrower income and expense statements were not obtained.

In a period when farm prices are falling and farm costs are remaining at high levels, increased emphasis should be placed on income analysis in the making of short-term farm loans. Likewise, increased attention should be given to repayment schedules with the terms of the loan geared to fit the income flow of the operation being financed.

Bankers varied their security requirements with their knowledge of the borrower's character and capacity, his financial position, and the size of loan.

Although interest rates varied among banks in a given type-of-farming area, the 6 per cent rate was the most common in the southern areas. Interest rates of 7 and 8 per cent were more common in the west central and northwest areas. Only four banks reported increases in interest rates.

Loan charges in addition to the contract interest were nominal. Such loan charges make the effective interest rate appreciably higher than the contract rate only on small loans.

Farmers will continue to call on banks for large amounts of short-term credit because of technological changes which have taken place and are taking place in agriculture. These loans must be repaid out of current farm income, therefore, the interests of both the lender and the borrower can be served best when credit is geared to the earning capacity of the farm enterprise being financed.