

Selecting and Financing a Farm



FARM CREDIT ADMINISTRATION
Circular No. 14

W. T. Myers, Governor
and Economic Director

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Selecting and Financing a Farm

THE prospective purchaser of a farm faces at least two important jobs. One is the selection of the farm and the other is the financing of its purchase. The Farm Credit Administration is concerned with this second task, the financing of the purchase of farms.

FINANCING THE PURCHASE OF A FARM

COMMISSIONER loans as well as land bank loans are now available to tenants and other prospective farm owners for use in buying farms. It has been possible to use land bank loans for this purpose since the organization of the Federal land banks in 1917, but Commissioner loans were made available for the purchase of farms only recently.

Both loans are handled by the Federal land banks and are often made together. Land bank loans are made by the Federal land banks from their own loan funds, while Commissioner loans are made by the banks as agents of the Land Bank Commissioner from funds provided by the Federal Farm Mortgage Corporation. Land bank loans are made on first mortgage security; Commissioner loans are made on either first or second mortgage security.

Farmers or Prospective Farmers May Borrow

To be eligible for loans from the Federal land bank and Land Bank Commissioner, the applicant must be engaged in farming operations, or derive the principal part of his income from farming operations. Thus, prospective farm owners may qualify for these loans if they are shortly to become engaged in farming.

Interest Rates Are Low

The interest rate on Commissioner loans is fixed at 5 percent per year.

On land bank loans now being made through national farm loan associations, the interest maturing during the year ending June 30, 1936, will be at a rate of 3½ percent per year and that maturing thereafter will be at 4 percent. On direct loans now being made by the land banks, the interest maturing during the period ending June 30, 1936, will be at 4 percent and thereafter at 4½ percent.

Repayment Terms are Favorable

Both land bank and Commissioner loans are made on an amortized repayment basis. Land bank loans are made for periods usually ranging from 20 to 34½ years. Commissioner loans usually are made for shorter periods although they may be made for similar periods if the loan is secured entirely by first or second mortgages on farm real estate. If the loan is not secured wholly by real estate, its maturity cannot exceed 10 years. Payments on the principal of loans are made either annually or semiannually and are sufficient to retire the loan during the period for which the loan is made. Dates when installments come due usually are made to conform with the dates on which the farmers in the locality market their cash crops or products.

Two types of installment tables are used for land bank loans. One is the standard plan under which the total payment of principal and interest remain the same throughout the life of the loan. The other is the Springfield plan under which the principal payments remain the same during the life of the loan while the total payment of principal and interest declines. The Springfield plan alone is used for Commissioner loans.

Condensed tables showing semiannual payments required in connection with long-term land bank loans follow:

TABLE 1.—SELECTED SEMIANNUAL PAYMENTS ON A \$1,000 LOAN AT 4 PERCENT FOR 34½ YEARS, STANDARD PLAN OF INSTALLMENT PAYMENTS

Number of payment	Payment			Unpaid balance
	Interest	Principal	Total	
1-----	\$20.00	\$7.00	\$27.00	\$993.00
2-----	19.86	7.14	27.00	985.86
3-----	19.72	7.28	27.00	978.58
11-----	18.47	8.53	27.00	914.82
21-----	16.60	10.40	27.00	819.52
31-----	14.32	12.68	27.00	703.34
41-----	11.54	15.46	27.00	561.73
51-----	8.16	18.84	27.00	389.10
61-----	4.03	22.97	27.00	178.67
68-----	.62	26.38	27.00	4.51
69-----	.09	4.51	4.60	...

TABLE 2.—SELECTED SEMIANNUAL PAYMENTS ON A \$1,000 LOAN AT 4 PERCENT FOR 33 YEARS, SPRINGFIELD PLAN OF INSTALLMENT PAYMENTS

Number of payment	Payment			Unpaid balance
	Interest	Principal	Total	
1-----	\$20.00	\$15.00	\$35.00	\$985.00
2-----	19.70	15.00	34.70	970.00
3-----	19.40	15.00	34.40	955.00
11-----	17.00	15.00	32.00	835.00
21-----	14.00	15.00	29.00	685.00
31-----	11.00	15.00	26.00	535.00
41-----	8.00	15.00	23.00	385.00
51-----	5.00	15.00	20.00	235.00
61-----	2.00	15.00	17.00	85.00
65-----	.80	15.00	15.80	25.00
66-----	.50	25.00	25.50	...

Maximum Loan is 75% of Appraised Value

Under satisfactory conditions the prospective farm owner may borrow from the Federal land

bank and the Land Bank Commissioner as much as 75 percent of the normal value of the farm he wishes to buy. The land bank may make a loan on first mortgage security for an amount not exceeding 50 percent of the appraised normal value of the farm land and 20 percent of the appraised value of the insured buildings and other permanent improvements. In addition, the Land Bank Commissioner may make a second mortgage loan for an amount which together with the land bank loan will not exceed 75 percent of the appraised normal value of the property to be mortgaged. Commissioner loans may be made on first mortgage security in cases where a land bank loan is not made or on second mortgage security where first mortgage loans have been obtained from sources other than the Federal land bank.

Maximum Amounts Are Fixed

In addition to limitations with regard to appraised value, the loans are limited as to actual amounts. A Commissioner loan may not exceed \$7,500 to any one farmer. A land bank loan may be for as much as \$50,000, but preference is given to loans of \$10,000 or less. A loan for more than \$25,000 must be approved by the Land Bank Commissioner.

Appraised Value Is Not Sale Value

It must be remembered, however, that land bank and Land Bank Commissioner loans are made on the basis of the appraised normal value of the farm for agricultural purposes and not upon sales value. In some instances the sales value may be in excess of the appraised value and consequently the prospective farm owner would not be able to borrow 75 percent of the value of the farm he desires even if the other credit factors are entirely satisfactory. For example, a farm priced at \$6,000 may have a normal appraised value of only \$4,800. In this case the land bank and Commissioner could not lend more than \$3,600. Or the reverse might be true. The sales price might be less than the appraised value. The Farm

Credit Administration does not follow the "ups" and "downs" of sales prices in its appraisals. The basis upon which appraisals are made is discussed on page 8.

It must be remembered that the appraised value of a farm is not the only factor which determines the amount of a loan. Other factors affecting the size of a loan are described on page 8.

All Debts Must Be Included

Maximum Commissioner loans are made subject to the conditions that all other debts secured by the property mortgaged will be cleared up. Thus, if a farm already has a prior lien or debt on it which the prospective farm owner agrees to assume, the maximum Commissioner loan could not be for more than the difference between that debt and 75 percent of the normal appraised value of the property to be mortgaged.

Make First and Second Mortgage Loans

Land Bank Loans.—The security required for a Federal land bank loan is a complete farm unit of sufficient size and earning power to meet all annual expenses, including principal and interest on the loan, insurance, taxes, wages and other cash costs, in addition to providing a suitable living for the borrower and his family. Thus, in order to be eligible for a land bank loan the prospective farm owner must have in mind the purchase of a farm which will be a complete farm unit. The borrower must also have adequate equipment and livestock to operate the property.

Commissioner Loans.—A farm does not have to be a complete farm unit to be acceptable as security for a Land Bank Commissioner loan. One reason for this is that income from sources other than the farm may be considered in determining the farmer's ability to carry a Commissioner loan. Another is that the value of the farm for residential or business purposes, due to suburban location or other special factors, may be taken into consideration in the ap-

praisal, provided it does not exceed a prudent investment consistent with community standards and rentals.

In any event the income from the farm together with earnings received by the operator from other dependable sources ordinarily available in the community to a person operating such a farm, must be sufficient to support the borrower's family, pay operating expenses and fixed charges, and carry the installments on his loan. Commissioner loans may be made on the security of either a first or second mortgage on farm property. However, Commissioner loans ordinarily are not made on chattel property alone.

Farms Are Appraised

For both land bank and Commissioner loans, the value of the property is determined by a personal visit and appraisal by a land bank appraiser who is a public official appointed by the Farm Credit Administration at Washington and not by the Federal land bank.

The basis of appraisals in all cases is the normal value of the land when used for agricultural purposes, and its earning power measured in terms of farm production is the principal factor in determining its value. In determining the normal earning power of the farms, the average prices of farm commodities during the 5 years from 1909 to 1914 are used as a base, allowance being made, of course, for increased taxes and other costs and for changes in the economic position of the commodities produced. One appraisal serves as a basis for making both the land bank and the Commissioner loans.

Appraisals are discussed more fully in Farm Credit Administration Circular 13, entitled, "Appraising Farms for Farm Mortgage Loans", which may be obtained from the secretary-treasurer of your national farm loan association or by writing to the Federal land bank of your district or to the Farm Credit Administration, Washington, D. C.

Other Factors Are Considered

In determining whether an application for a loan will be approved or rejected, the Federal

land bank considers other factors in addition to the appraised value of the farm. Some of these factors are the past and prospective earnings of the farm, the credit standing of the applicant, his equity in the farm, his ability as a farmer, his financial standing, his moral character, and all other factors bearing upon the value of the farm and the ability of the farmer to meet the payments on his loan under normal conditions.

In connection with loans for the purchase of farms, it is essential that the tenant or prospective farm owner own sufficient equipment and livestock to operate the farm in a successful manner. Also, it is important that he have had satisfactory farming experience, preferably within the community in which he wishes to buy the farm.

Cost of Obtaining Loans Is Low

In addition to the interest, the banks charge fees which do not exceed the actual cost of the appraisal and determination of title in connection with the making of the loan. An initial payment covering a part of the cost is made at the time the farmer applies for a loan. Ordinarily this payment consists of a \$1 fee for writing or filing the application, plus a small deposit. If an appraisal is not made the deposit is returned to the applicant. If an appraisal is made, however, the deposit will be used to defray part of the cost of the appraisal and will not be returned.

Information concerning the initial deposit required in connection with applications for loans and loan costs in general may be obtained from the secretary-treasurer of the local national farm loan association, the local correspondent, or from the Federal land bank.

The borrower also pays the cost of preparing an abstract of title to his farm. In addition, the borrower pays fees for recording the mortgage or deed of trust, fees to the land bank for that part of the cost of appraisal and determination of title not included in the initial deposit, and any other costs incident to ob-

taining the loan. Furthermore, national farm loan associations make charges to meet their necessary expenses which may not exceed one percent of the amount of the loan. The land bank is permitted to make similar charges, not to exceed one percent, in connection with direct loans.

In view of the long period of years for which a loan is made, the foregoing costs constitute a very small item.

Most Loans Are Made Through National Farm Loan Associations

Federal land bank loans in the continental United States are made through, and with the endorsement of national farm loan associations, wherever associations are in existence through which applications may be received by the Federal land bank. These associations are cooperative credit corporations operated under the supervision and regulation of the Farm Credit Administration. The membership of each association is restricted to borrowers from the Federal land bank. Each member has at least one vote at the annual meeting of members. Any savings made by the association are returned to its members.

A borrower through a national farm loan association must purchase stock in the association in an amount equal to 5 percent of his loan. The amount necessary to pay for such stock may be included in the amount of the loan obtained from the Federal land bank. Prior to June 16, 1933, shareholders in national farm loan associations were individually responsible equally and ratably for all contracts, debts, and engagements of the association up to an amount equal to the par value of the stock they owned, in addition to the amount they paid for their shares. The Farm Credit Act of 1933 eliminated this liability with respect to contracts, debts, and engagements entered into by the association after June 16, 1933, but preserved the double liability of association shareholders for contracts, debts, and engagements entered into on or before that date.

Associations Endorse Notes

The national farm loan association endorses and becomes liable for each of the loans made to its members. The stock subscribed by each member is pledged with the association as collateral security to the loan endorsed by the association. The association, in turn, subscribes to an equal amount of stock in the Federal land bank. This stock is held by the bank as collateral.

When the borrower pays his loan in full, the bank retires its stock which was subscribed for by the association at the time the loan was made. If the association is not in debt to the bank, the bank remits the proceeds of this stock to the association in cash. If, on the other hand, the association is in debt to the bank as a result of losses sustained by the bank on loans endorsed by the association, it may be necessary for the bank to withhold all or any portion of the proceeds of its stock to apply as a credit on the association's indebtedness. In either event, the borrower's stock in the association is retired when he pays his loan in full, and if the association has the money with which to make the payment to him and has met, or can meet, all its debts, he receives payment for his stock at par.

Direct Loans by the Federal Land Bank

In localities where there are no national farm loan associations operating, through which the Federal land bank is able to accept applications, the bank may make direct loans to farmers. Borrowers obtaining direct loans must subscribe for capital stock in the bank in the amount of \$5 for each \$100 or fraction thereof borrowed. Upon the full payment of the loan, such stock, if still outstanding, will be canceled at par or, in the event that the stock has become impaired, at its estimated value as approved by the Land Bank Commissioner and the proceeds thereof will be paid to the borrower.

SELECTING THE FARM

UNDER this arrangement for financing the purchase of farms, the farmer or tenant buys a farm of his own selection. The choice of a farm is one of the most important decisions of a farmer's lifetime. There are a large number of factors which the prospective purchaser must consider. A few suggestions concerning the more important of these may be helpful to young men who are planning to buy farms.

Deciding the Type of Farming

The type of farming in a region which has been settled for many years is usually the result of experimentation by hundreds of farmers. The prospective farm owner should be guided by the experience of the best farmers in a community as to the types of farming which pay best in that community. If he wishes to buy a dairy farm the safest course to follow is to buy a farm in a community where dairy farmers are prosperous. If he wishes to grow wheat he is less likely to make a mistake if he buys in an area where wheat is commonly grown. Many failures are directly traceable to attempts to introduce untried farm practices on a large scale in areas where they are not suited.

Climate Should be Considered

Climate is an important factor in determining the kind of crops which can be grown in a region and in determining crop yields. It also determines to a large extent the kind of livestock which may be kept. Some of the climatic factors which should be considered are rainfall (annual amount and distribution throughout the year), length of the growing season, temperature, severity of the winters, and the frequency of natural hazards such as wind, hail, and drought.

One who is not thoroughly familiar with the area in which he is planning to buy a farm should study all the available climatic records. Ordinarily the most complete information will be obtained from the Weather Bureau, United States Department of Agriculture, Washington, D. C. Decisions should be based on accurate records of the past rather than on loose statements that "the climate has changed."

Good Soil is Essential for High Yields

Good soil is essential if high yields are to be obtained at a reasonable cost. It is difficult to overemphasize the importance of buying a farm with good soil. While high yields have always been important, they are more important now than formerly. Production costs of many farm products are high relative to the prices farmers receive for those products. Low yields will not pay high production costs.

Before buying, the prospective farm owner should always assure himself that the soil on the particular farm he is considering is adapted to the crops he plans to produce. Soil maps showing the location and extent of the different soil types are available for many of the counties in the United States. A list of the reports available for general distribution, together with a list of libraries where a complete file is kept, may be obtained by writing to the Bureau of Chemistry and Soils, United States Department of Agriculture, Washington, D. C.

A Home Being Selected as Well as a Business

The community in which a farm is located must be carefully considered, since a farm is a home as well as a business. Good schools, churches, community organizations and desirable neighbors will make a farm a better place to live. Farms in a good community also are easier to resell.

Good Roads Add to Value

Since this is an age of hard-surfaced roads with automobile and motor-truck transporta-

tion, a farmer whose farm is on a dirt road has a serious handicap. This is especially true in areas where market milk, eggs, fruits, vegetables, and other bulky and perishable products are produced.

Buildings Should be Suited to Needs of Farm

The buildings should be carefully inspected, particularly in areas where dairying or poultry farming is to be carried on. They should be in good condition and suited to the needs of the farm. Constructing new buildings, or making extensive repairs on buildings which have been allowed to run down is likely to cost more than is estimated at first. More or larger buildings than necessary for the successful operation of the farm should be avoided because that part of the purchase price paid for the excess is an unproductive investment. Also excessive improvements do not increase the appraised value of the farm upon which the amounts of the land bank and Commissioner loans largely depend.

Cleaning Up a Farm Is Costly

A farm which has been poorly operated may have a number of undesirable features. These usually are not given sufficient consideration and are often completely overlooked by prospective farm owners. Some common results of poor management and neglect are weeds, insects, and diseases in the fields; livestock diseases and parasites in buildings and yards; fences and buildings in poor condition, and tile drains or ditches closed up. "Cleaning up" a neglected farm is costly and the price of the farm should be sufficiently discounted to pay for this expense.

Size of Farm Is Important

The size of business which one family can handle is constantly increasing due to the expansion in the use of machinery. As a result many American farms, particularly in the older settled regions, are too small to keep a family

efficiently employed. Many farms which were large enough 50 years ago are too small now, and will be much too small 20 or 30 years hence. Farm management studies indicate that, over a period of years, moderately large family farms pay better than small ones, providing high rates of production are maintained.

Farming Poor Land Does Not Pay

In many parts of the country, particularly in the older settled regions, there are large areas of idle or abandoned lands. These farms have been abandoned because experienced farmers have found that it does not pay to work them. Where experienced farmers have failed, inexperienced persons have little chance of success. It is not safe to assume that farms have been abandoned because the previous owners did not know how to farm.



WHERE TO APPLY FOR A LOAN

FARMERS who need farm mortgage loans should apply through a local national farm loan association. Where the local association is not accepting applications the applicant may apply to the Federal land bank of the district directly. The cities in which the 12 banks are located and the territories which they serve are listed below.

Springfield, Mass.

Connecticut, Maine, Massachusetts, New Hampshire, New Jersey, New York, Rhode Island, and Vermont

Baltimore, Md.

Delaware, District of Columbia, Maryland, Pennsylvania, Virginia, and West Virginia

Columbia, S. C.

Florida, Georgia, North Carolina, and South Carolina

Louisville, Ky.

Indiana, Kentucky, Ohio, and Tennessee

New Orleans, La.

Alabama, Louisiana, and Mississippi

St. Louis, Mo.

Arkansas, Illinois, and Missouri

St. Paul, Minn.

Michigan, Minnesota, North Dakota, and Wisconsin

Omaha, Nebr.

Iowa, Nebraska, South Dakota, and Wyoming

Wichita, Kans.

Colorado, Kansas, New Mexico, and Oklahoma

Houston, Tex.

Texas

Oakland, Calif.

Arizona, California, Nevada, and Utah

Spokane, Wash.

Idaho, Montana, Oregon, and Washington



FARM CREDIT ADMINISTRATION

W. I. Myers, Governor

Circular No. 13

Appraising Farms for Mortgage Loans

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[2]

WHEN LOCAL investors, such as bankers, retired farmers, or doctors, consider the making of loans on farm mortgage security they usually are well acquainted with both the farm and farmer. In contrast to this, the committees and officers of the Federal land banks, of necessity, must consider loans on farms and to farmers often several hundred miles distant from the banks.

Since the law is designed to give each applicant a fair and impartial appraisal by an independent appraiser, the farm and farmer are brought to the bank by means of the detailed descriptive report of a land bank appraiser who is a public official appointed by the Land Bank Commissioner. Appraisers are therefore the "eyes and ears" of the Federal land banks. To submit a "word picture" to the bank through his report is one of the primary functions of the appraiser.

Objectives of an Appraisal

The fundamental objectives of an appraisal and appraisal report, therefore, are:

1. To determine the value of a farm or ranch for loan purposes, the maximum amount of a loan which may be made under the provisions of the laws and to suggest the term of years of the loan.
2. To obtain the facts regarding the applicant as a credit risk, his financial condition, and his management of the property which may have a bearing on the amount of the loan.
3. To determine the amount of loan, if any, that should be recommended under the particular circumstances.
4. To report the result of the appraisal and investigation in clear, concise language and consistent figures so that the loan com-



Farms are appraised on the basis of their normal value for agricultural uses.

mittee of the bank may give intelligent consideration to the loan application.

Farms Appraised on Normal Agricultural Value

The basis of appraisal is prescribed in the laws under which the Federal land banks operate. The Federal Farm Loan Act provides that in making appraisals of farms for Federal land bank loans "the value of the land for agricultural purposes shall be the basis of appraisal and the earning power of said land shall be a principal factor." Consequently, farms upon which Federal land bank loans are requested, are appraised on the basis of their value for producing agricultural income, and not on the basis of their expected use for suburban homes, their actual or expected production of oil or minerals, or their suitability for any other nonagricultural use, either actual or expected.

The Emergency Farm Mortgage Act of 1933 placed appraisals for loans by the Land Bank Commissioner upon the basis of normal values rather than upon values or prices existing at the time of the appraisal, which might be either depressed or inflated. The same basis of appraisal has been adopted for Federal land bank loans.

After making a detailed study of farm prices for the 135 years, 1798-1932, the Farm Credit Administration decided to use the commodity prices received by farmers during the 1909-14 period, with such adjustment as may be necessary because of the change in the economic position of certain products, as a basis for determining the earning power and, in turn, the normal agricultural value of farm land. These average prices are not as high as those of the



Appraisers check their estimates of land values in any community by obtaining opinions of substantial farmers.

war period or as low as those of the years 1931-33, but are believed to represent the approximate level of commodity prices which farmers generally can expect on the average over long periods of time.

Many Factors Affect Appraisals

The determination of the value of an individual farm presents a problem involving judgment because land appraisal is not an exact science. One of the first problems for consideration is the method by which values are to be established. Although the earning power of the land is a principal factor in its valuation, the appraiser must have in mind other factors such as location, the desirability of the farm as a home, and the hazards entering into the production and marketing of crops. The appraiser does not use a simple method of capitalizing the net returns from the farm in determining its value, as is sometimes supposed, as there are all grades of farms, many types of farmers, various methods of computing returns, different grades of home desirability and many other factors which enter into the determination of the value of a farm.

How Much Is Farm Worth to Farmer?

The problem of appraising an individual farm may be summed up in the questions "How much would a typical farmer for this area be willing to pay for this farm, and how much could he afford to pay, if he obtained normal prices for the products of the farm."

In answering these questions the appraiser would consider the type of the community as a whole and the rate of return that might be regarded by owners generally as a normal and satisfactory rate on investments under condi-

tions prevailing. Highly desirable farms, like Government bonds, usually sell at prices which pay a low rate of return, while less desirable properties in hazardous areas must return higher rates to attract ownership by well informed farmers. In a certain district of very durable land, good climatic conditions, and good farmers engaged in general farming, with regular returns and few hazards and with good home values, the appraiser would expect that an owner would be willing to accept a low rate of return, say 5 percent or less. In an area where conditions are less favorable, or farming more highly specialized with greater chances of loss, the appraiser would expect the investors generally would want to purchase land on such a basis as to return them higher rates, perhaps as much as 7, 8, or even 10 percent.

In appraising a farm the appraiser must consider, then, the normal use that would be made of it by an average farmer for the area and type of farm, the acreage of crops he would grow, the yields that could be expected under his management, the share that would customarily go to the owner of the land as a return on his investment, the normal prices he would receive for the products, and the rate of



New appraisers are trained carefully.

return he should expect on his investment, taking into consideration the attractiveness of the investment and the dependability of the earnings.

With these factors in mind the appraiser would have very definite ideas of the average earnings, desirability, and normal value of different types of land in various locations. His individual appraisal, therefore, would be largely a comparison of the particular farm with average farms or typical farms of the area. If the applicant is a better-than-average farmer, the appraiser attempts to determine the part of the earning capacity of the farm as now operated which is attributable to the exceptional ability of the present operator. This requires consideration of the personal element in order that the earning capacity of the farm will not be overestimated.

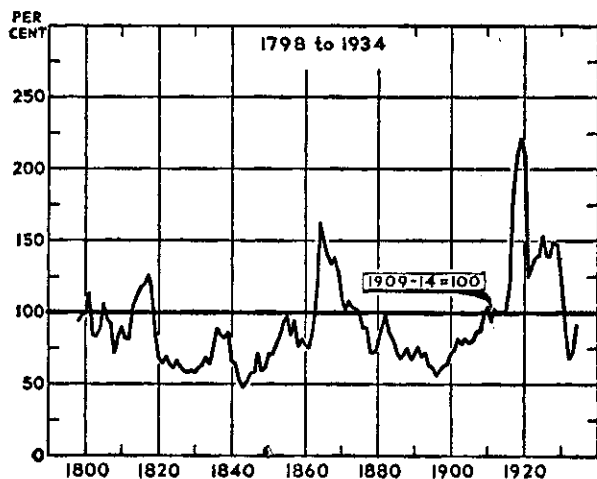
Training Appraisers

Proper training of appraisers to provide them with necessary information and a background for making comparisons is essential. This training consists largely of building, on the foundation of experience already possessed by the appraiser, a structure of appraisal experience consisting of (1) appraisal methods, (2) appraisal principles, and (3) practice appraisals of farms of various soil types and productive records.

In his early experience the appraiser encounters a considerable number of farms representing different locations, types of soil, types of farming and grades of desirability. He learns to balance the important factors entering into value and to arrive at a logical and sound conclusion. The conclusion, of an experienced and

WHOLESALE PRICES OF FARM COMMODITIES, FROM 1798 TO 1934

Average Prices for the Years, 1909-14 Are Used as the Basis for Figuring Normal Earning Power





The type of soil is an important factor in determining the value of a farm.

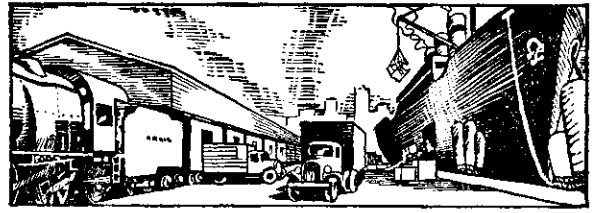
thoughtful appraiser, arrived at after giving consideration to all the factors entering into the values of a particular piece of land in comparison with known lands of varying quality in different locations and subject to different conditions, should be sound.

Appraisers Obtain Background Information

The appraisal of a farm properly begins with the setting. An experienced appraiser makes it his business to become well acquainted with the important features of the locality having a bearing on farm values.

In preparing to make appraisals in a particular territory an appraiser familiarizes himself with the climatic features of the area, the length of growing season, the amount and distribution of rainfall and, if in an irrigated country, the supply and dependability of irrigation water, as well as the hazards and expense of drainage. He studies the soils in order to learn the characteristics of each type common to the area, and checks them with soil maps if available. He notes the crops grown and their adaptation to both climate and soils. He studies the common cropping systems, the yields obtained by farmers on different types of soil and in different seasons, and the carrying capacity of the grassland in terms of livestock. He acquaints himself with the agricultural history of the area and the characteristics of the people of the community. He observes the methods of transportation available and the facilities for marketing the farm products. He notes the various conveniences in the community, such as electricity, mail delivery and telephone, and the local business, social, and religious organizations.

He familiarizes himself with the prices farmers have paid for land over a period of



Good transportation facilities increase the value of a farm.

years, as well as the customary terms of rental and the income received therefrom. He studies the record of land values during periods of fluctuating prices and attempts to determine the factors responsible for that record. He finds out, if possible, the amounts which other lending agencies have loaned on farms in the community and their experience with such loans. He observes the ability of farmers of the community generally to obtain short-term credit for financing their productive enterprises. He obtains the opinions of farmers as to the soundness of existing land values and as to the prices farmers can afford to pay for land if they receive normal prices for their products.

Appraising the Individual Farm

This basic information is essential for the satisfactory appraisal of a particular farm and with this knowledge the appraiser may begin his consideration of a particular application. Before going to the farm, however, the appraiser may obtain information concerning the personal qualities of the applicant from men whose judgment appears to be sound, preferably those who have had business dealings with the applicant, but who would not benefit from the proceeds of the loan.

After getting these preliminary facts he drives to the farm. Ordinarily he will take a route that will enable him to note the farms surrounding that of the applicant, the type of farming practiced, and the general condition of roads, buildings and fences. He also looks carefully for noxious weeds. Often he will talk with some of the neighboring farmers concerning crop yields and their ideas of land



Appraisers interview men with whom the applicant does business to ascertain his standing in the community.

values and other matters which will be helpful in making a sound appraisal.

When the appraiser reaches the farm he introduces himself and proceeds in a business-like manner to get the required information. Generally, he arranges to have the farmer accompany him over the farm. The appraiser takes complete notes, makes a plat of the farm and examines the soil at various points by means of a soil auger as he and the farmer or his representative walk along. He obtains the past history of the farmer, his experience in other areas, the number of years he has been on each farm he has operated and his success with each. He checks crop yields, the crop rotation practiced, the number, kind, and quality of livestock kept and other important facts. He also tries to determine the plans and objectives of the applicant and learns of his financial progress since his acquirement of the farm.

Value of Buildings Included

The maximum which may be loaned on a particular farm by a Federal land bank is an amount equal to 50 percent of the appraised normal agricultural value of the land and 20 percent of the appraised value of the permanent insured buildings.

The valuation of buildings by an appraiser is an extremely important part of his work, since Commissioner loans may be made for as much as 75 percent of the value of the property, including land, buildings, and personal farm property. Thus the appraiser's estimate of the value of buildings to a farm may have an important bearing on the soundness of a loan.



The community in which a farm is located has an important effect on the value of the farm.

After valuing the land, therefore, the appraiser carefully inspects the farm buildings and establishes their value on the basis of replacement less depreciation, which indicates the character of the buildings and the insurance requirements. Appraisers are furnished with cost data on buildings of different kinds and types of construction to assist them in this work. They also fix the value of the buildings to the farm on the basis of their utility to an average farmer who might be handling the property. The value of the permanent insured buildings to the farm viewed from the standpoint of a prudent investment for an average operator is used in determining the maximum amount which may be loaned on them in addition to the loan based on the land.

Placing values on buildings calls for good judgment by the appraiser in addition to the information mentioned. Arbitrary rules of establishing values are generally unsound because conditions vary from farm to farm and from one type of farming community to another.

Appraiser Checks Values with Earnings

By adding the value of land and the value of buildings to the farm, the appraiser arrives at the normal agricultural value of the property. He checks the values so obtained with the earnings of the farm, using normal prices for farm products and customary acreages and average yields obtained by an average farmer for the locality.

If the property being appraised is a livestock unit, the appraiser checks its carrying capacity



The most important factor in determining the value of buildings is their value to the farm.

in terms of milk cows, beef cattle, or sheep as the case may be, and determines whether his values established by methods of comparison are consistent with the carrying capacity of the unit. If the farm is located in an area where properties are ordinarily rented, he estimates the net rental returns to the landlord and determines whether the values established are consistent with these returns.

Appraisers Consider All Factors

The appraiser must, of course, consider all of the factors entering into land values in deciding what rate of return on the investment to the owner would be reasonable; that is, in deciding the rate of capitalization which should apply. The appraiser uses his judgment first in determining values through the comparison method of appraisal, and then checks with the earnings of the farm rather than first estimating the average net returns and then mechanically figuring the value of the farm by the capitalization method.

In areas where farms are not rented, but operated by owners the appraiser estimates the net returns to the owner-operator from average management, allows the owner a reasonable share of the net returns for his management and labor, consistent with the standard of living in the area and the size and importance of the unit, and checks his land value with the income allocated to the land. In areas where rental and owner operation are both common, the appraiser will ordinarily use both checks on his appraisal. Rates of return, therefore, should reflect all factors including the hazards of production and marketing.



The appraiser checks his valuation of a farm with its actual earnings.

Check Values with Sale Prices

The appraiser also checks his valuations with sale prices of land under various conditions and with the opinions of substantial farmers as to the price they could afford to pay for land of similar quality if they were assured of "normal prices" for their products.

Must Consider the Personal Element

When the appraiser has arrived at the value of the property, as above indicated, he then must consider the long-time paying ability of the applicant in order to determine what the loan recommendation should be. Briefly, in making a recommendation the appraiser will be guided by a comparison of the applicant with an average farmer, since the appraiser should not recommend a loan of an amount greater than that which he believes will be within the capacity of the applicant, or an average farmer, whichever is the lesser, to carry satisfactorily. He cannot safely exceed the recommendation for the average farmer when the owner-operator is above average, since it is not known how long the property will remain in the present owner's hands. On the other hand, if the applicant is a "below-average" farmer, the appraiser should not recommend a loan greater than this particular applicant can repay.

Although a farm may be capable of producing an income sufficient to repay a loan, the loan may not be granted because of an unfavorable personal element. The term "personal element", as used by land bank appraisers, includes the qualifications of the applicant not only as (1) a farmer and, (2) a manager, but



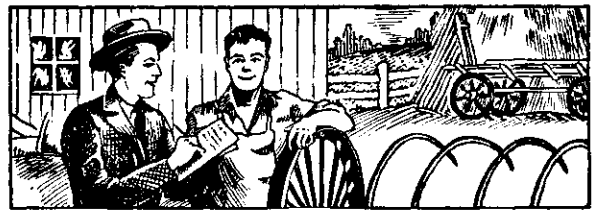
The home value of a farm is an important factor in appraising a farm.

also as (3) a moral risk, (4) a credit risk, (5) a citizen, and (6) a family man. Credit risk means both the ability of the applicant to earn an income and his ability and inclination to pay obligations. Moral risk applies to his uprightness of character and his attitude toward his obligations. Citizenship refers to a farmer's standing in the community. By "family man" is meant the relations of the applicant with the members of his family and the cooperation he receives from them in the farm enterprise.

Applicant Must Be a Good Credit Risk

A man may be a good farmer, raise good crops and keep livestock of high quality, but still be unsatisfactory from a credit standpoint. He may be a good moral risk, being honest and having a desire to pay, but a poor credit risk because he is a poor manager, lazy, or because he has so much other indebtedness in addition to the loan that he is unable to pay. He temporarily may be a good credit risk because he pays his bills promptly, but a poor moral risk because he is engaged in some unlawful business which gives him good paying ability, but may result in expensive litigation for him, or in some cases, his imprisonment with the consequent neglect of his farm.

Maximum loans are based upon a good moral and credit risk, average farming ability and management, good citizenship and family cooperation. It is not intended that loans will be made to men who are not honest and who do not intend to do their honest best. Loans may be made in reduced amounts to those who are below average as farm managers or whose manner of living, methods of operation, or lack of family cooperation, is such as to cast doubt



The adequacy of farm equipment is also considered in making loans on farms.

upon their ability to repay maximum loans, but not so unsatisfactory as to prevent them from carrying a more moderate debt.

The experienced appraiser makes a full investigation in each case, and will not be influenced by the opinions of prejudiced individuals. He will get all sides of the picture and report not only the opinion of persons interviewed but also give his opinion of the applicant, based on the information obtained. In order to learn about family cooperation, in the event there is a family, the appraiser usually regards it as essential to meet the members of the family and observe whether the applicant has their wholehearted cooperation in the operation of the farm.

Information Is Confidential

Information as to "personal element" is highly confidential and is treated as such. To treat this information otherwise would defeat the proper development of this important angle of appraisal work because the appraiser would be reluctant to give the complete story in unfavorable cases and, also, local persons whose confidence has been gained would no longer cooperate.

Appraisers Are Public Officials

Land bank appraisers are public officials and are selected upon the basis of their education, farm experience, and general adaptability to the work. They are expected to be entirely independent of any undue influence. The appraiser must not only be entirely free from outside influence, but must realize thoroughly the importance of his position. He should be judicial in his attitude, and therefore, should develop all of the information on an application



Good markets add to the value of good farms.

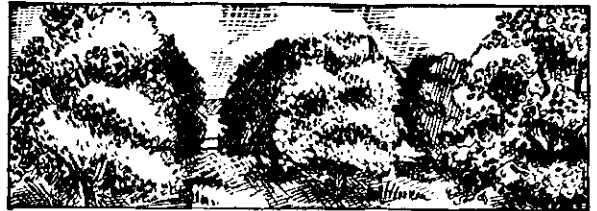
for a loan and weigh it carefully and impartially in order to reach a sound conclusion which will be equally fair to the applicant and to the investor who provides the money which the land banks lend.

Appraising Specialized Farms

In order that the Farm Credit Administration might constructively perform its function by providing a source of credit for all types of sound agricultural enterprises insofar as possible, appraisal policies for various types of specialized farming have been developed. Briefly stated, specialized farms to be eligible for loans must meet the following qualifications: (a) The specialty must be well established on a commercial basis in the locality. (b) The specialty must have proved profitable over a period of years and must have apparently stable market outlets. (c) The production, care, and marketing of the specialized product must be understood by others in the locality.

Specialized farms, of course, include commercial poultry raising, truck gardening, orchards and other types of fruit production. Some lands not adapted to produce general crops are well adapted for specialty crops, whereas other lands may have greater value for general crop production than for specialty crop production.

In the case of orchards the present policy is to value the farm as a fruit producing unit by determining the income which will be derived from its use for this purpose and relation of this income to value after giving due consideration to the locality as a proved fruit area and the extent of its development for fruit production.



In the case of orchards the farm is valued as a fruit-producing unit.

The appraisal subdivision of the Farm Credit Administration has made extensive investigations in connection with fruit properties under the direction of a specialist who is both an experienced orchard operator and appraiser. It also has extended its investigations into other specialized types of farming. In many instances these specialized types of farming have called for appraisers with special qualifications and training. Such appraisers are carefully selected and trained under experienced specialist appraisers furnished by the appraisal subdivision in Washington.

Special Loan Problems Arise in Some Areas

In addition to the problems presented by specialized types of farming, there are special loan problems in certain areas which must be given more than usual attention and consideration if loans are to be made on the proper basis. The banks must have reports from engineer appraisers on the economic, financial, and physical features of all drainage, levee, irrigation, or other type of special improvement districts in order to determine whether loans may be made therein on a sound basis. The banks must be informed regarding the fixed charges in the form of special taxes applicable in the district, as well as the efficiency of the physical system; for example, the adequacy of protection against excessive water in drainage areas or the supply of irrigation water available for crops.

In some territories, noxious weeds are a problem and, if proper measures are not taken to eradicate them, may greatly increase costs and lessen the productive capacity of land, thus seriously impairing its value for agricultural



Appraisers protect the interests of farmers and investors.

purposes. Often, not only the farm now infested with such weeds is endangered, but also adjacent farms are subject to the same damage. The banks and the appraisers familiarize themselves with the particular noxious weeds common to the territory in which they operate and the extent of damage such weeds may do to farms in the area. Appraisers give adequate attention to these and the various other loan problems which present themselves.

It can be seen then that appraisals are a major part of the making of farm loans and that appraisal work covers a wide range and is a field requiring broad knowledge. The responsibility upon the appraiser is great because of the need for proper decision to do justice to applicants for loans and contribute to the permanence of the Farm Credit Administration as a consistent unsubsidized cooperative source of all forms of credit to American agriculture.

Cost of Appraisals

Federal land banks are authorized by law to charge reasonable fees to cover their cost of appraisal, as well as their cost of passing upon the applicant's title to the property. In most cases, the fees collected do not fully reimburse the banks for these expenses. Appraisal cost includes not only the salary and expenses of the appraiser who inspects the farm, but also the salary and expenses of the chief appraiser and his assistants and certain other costs of operating the appraisal department of the bank.

The fees which are charged applicants and borrowers are based on the average actual cost of appraisals to the bank, and not on the cost of the individual appraisal. The fees are not

the same in all land bank districts, or even the same on all applications in a district. They are generally higher on applications for large loans or applications on large farms. Some banks collect their full appraisal and title determination fee at the time the application is filed, but others do not. Where the full fee is not collected with the application, the balance is deducted from the loan proceeds when the loan is closed. If an application is rejected after appraisal, the bank is entitled to retain the entire application fee or such portion of the fee as represents its appraisal charge.



Other Publications Available

THE CIRCULARS on farm credit and related subjects listed below are available from the district offices of the Farm Credit Administration located at Springfield, Mass.; Baltimore, Columbia, S. C.; Louisville, New Orleans, St. Louis, St. Paul, Omaha, Wichita, Houston, Oakland, and Spokane, or the central office at Washington, D. C.

Federal Land Bank Loans and Land Bank Commissioner's Loans, *Circular 1.*

Loans by Production Credit Associations, *Circular 3.*

Agricultural Financing through the Farm Credit Administration, *Circular 5.*

Loans to Farmers' Cooperatives, *Circular 6.*

Federal Farm Mortgage Corporation Bonds, *Circular 8.*

Helping the Farmer Pay His Debts, *Circular 12.*

Appraising Farms for Mortgage Loans, *Circular 13.*

Selecting and Financing a Farm, *Circular 14.*

Production Loans, *Circular C.*

Loans to Dairymen, *Circular D.*

Feeder Loans, *Circular E.*

Loans for Crop Production, *Circular F.*

PREVENTIVE MEDICINE for Cooperatives



**An address before
the Twin Cities
Milk Producers
Association.
Minneapolis Minn.
November 1935**

by **FRANK W. PECK**
Cooperative Bank Commissioner
FARM CREDIT ADMINISTRATION

“Preventive Medicine”

for Cooperatives

THERE WAS a time in our experience when the emphasis on human health was laid upon *curing* the diseases with which mankind was afflicted. In our own time, this emphasis has changed to the *prevention* of disease. It has long been known, as *Poor Richard* said, that an ounce of prevention is worth a pound of *cure*. Whether this ratio of values is accurate or not may be open to question—the important point is that guarding against sickness and ailments in the human family is one of the principal objectives of the medical profession.

Not only is this change noticeable in human medicine but likewise in veterinary science as applied to the animal kingdom. Hogs are now immunized against cholera, iodine is fed to prevent hairless pigs, poisonous plants are eradicated so that cattle cannot eat them, horses are properly fed so as to prevent azotemia—the examples of prevention are many in agricultural experience.

Farmers' business enterprises—cooperatives—are subject to many ailments. Many of these disorders, just as in humans and in animals, have proved fatal, largely because of the lack of proper “preventive medicine.” The simile does not end at this point for the only way in which effective preventive remedies have been discovered in human medicine and in veterinary medicine has been by diagnosis, post-mortem examinations, and countless experiments and tests. Similarly, sick and “dead” cooperatives have been analyzed, diagnosed, and examined in order to ascertain the causes of illness and of death. From these findings have come rather definite recommendations for prevention rather than cure, for the employment of safeguards rather than the undertaker, and for corrective injections and transfusions rather than final recourse to embalming fluid.

Now I am not a doctor, or veterinarian, or chiropractor, or a faith healer. I am, in this instance, a student observer, and a reporter of the

findings of those who have conducted these clinics and autopsies. It is true that I have attended several cooperative "funerals" and was a pall-bearer for two associations that passed on. One was born prematurely, was of uncertain parentage, was force-fed from the start with "promotion" milk and "price" baby food, and was cared for by a wet nurse called Mismanagement. The other developed a faulty bony structure, was pampered along on transfusions of easy money, but succumbed to rickets and never really stood on its own legs. But their demise was a great boon to those interests who "knew they couldn't live" and great capital was made of their passing.

I believe in preventive medicine and have found that eminent specialists in cooperative diseases have prescribed remedies to be taken in advance of sickness. I wonder if your association would be as strong and successful as it is today if those in charge had omitted some safeguards in your operations.

May I call to your attention some of the more common diseases of cooperatives. The preventive is usually obvious when the symptoms are recognized—in some instances the antidotes are indicated.

Faulty Organization

Although it is not always so realized, the organizational stages in the life of any cooperative constitute one of its most important opportunities to obtain a good start toward success. Among the ailments that may lead to unfortunate consequences are those of faulty organization. The first of these is premature birth. It is not always easy to decide when conditions are ripe for successfully bringing forth a cooperative enterprise.

Many experiences are of record that indicate premature attempts were made to get groups together quickly to meet what seemed to be emergency situations. This type of hasty action usually requires the overselling of the purposes and objectives of the organization with extravagant promises of performances that later on fail to materialize. The consequences of overconfidence inevitably follow—too little capital, lack of

complete understanding of the objectives to be obtained, poor and undeveloped market connections, and failure to fill a real need of producers.

This means that, in these instances, the cooperative program has been overpromoted and oversold and results have been overestimated. Operating problems and difficulties have been minimized in the organizational stages of the association. This is one of the reasons we have today a number of leaders' enterprises rather than bona fide members' cooperatives.

Failure to adhere to essential legal requirements in the formative stage of organization represents a second fault in the experience of many associations. A study of the charter and bylaws of many of the older cooperatives has brought to light a number of deficiencies that require amendment and adjustment to meet present-day needs not foreseen when the associations were started.

Maximum flexibility in business procedure may be obtained without sacrificing the members' beneficial interests by proper and adequate provisions in the charters and bylaws. Competent attorneys are available at reasonable compensation, and much subsequent difficulty would be avoided if their services were used in this phase of forming cooperative associations. Here again a dollar spent wisely may save much larger amounts later on.

A third common fault in organization is a tendency to overstimulation after the association has gotten away to a good start, resulting in abnormal growth—growing too big too fast. This results in heavy initial overhead expense, overcapitalization with frequent overborrowing, and a program larger than the capacity and the ability of the management will permit to be conducted economically and effectively. Business enterprises, just as humans, need to grow from relatively small beginnings into larger spheres of opportunity and service.

Admittedly this is a most difficult lesson to learn because costs are high in the beginning of any enterprise and the great urge is to expand rapidly. This expansion sometimes takes the form of a diversity of products under the assumption that the risk will be spread over the various commodities and that each will contribute to the payment of the

overhead expense. Another type of expansion entails the ambition to handle an extremely large percentage of the available commodity on the theory that a high percentage will give control over price and distribution into consuming markets. Normal growth leads to a normal expectancy of success; artificial stimulation may lead to disaster.

So much for the ailments that arise from faulty organization. There is also a group of diseases peculiar to the operations of cooperatives.

Operating Deficiencies

An analysis of the operations of a large number of cooperative associations discloses the presence of a number of weaknesses, the first of which I have termed "pernicious anemia." This refers to the weakened condition apparent in many cooperatives resulting from their inability to compete successfully with private concerns for a sufficient volume of business, at an operating cost that will permit satisfactory returns to be made to their members. There are a number of causes for this condition. One is lack of membership support, in which, for any number of reasons, members who have signed marketing or purchasing agreements find it advisable to do their business elsewhere.

A second weakness is mismanagement, which, in itself, covers a multitude of factors that have important relations to the operations of the enterprise.

A third is unwarranted emphasis upon price, the member being led to believe that price is the only consideration and that if his cooperative cannot raise prices, control surpluses, and dictate the terms of the market it is to be considered a failure.

A fourth weakening influence is the ineffective use of credit. This may mean credit either at a prohibitive cost or in an amount and under such terms as to be harmful rather than helpful in the cooperative's business transactions. Finally a lack of owned capital tends to place the enterprise in a vulnerable position contributing to its weakness in times of distress and serving often as a major

factor in curtailing its opportunity to serve its members effectively.

Whatever the cause for the anemic condition of a number of the cooperatives, the usual defense is to complain against outside competition and to accuse the private trade of overbidding the market and of spreading dissatisfaction among the membership, thereby undermining the farmers' business institution. The only effective preventive in instances of this kind is strong operating performance built upon a soundly formed organization, with business being conducted with greater efficiency than a private business can maintain. It is essential, too, that a satisfied membership understand the competition and be willing to stand by its cooperative enterprise.

It should be more generally recognized that the life of any cooperative represents a constant battle for the right to live and to serve the people for whom it exists. Those not able to "take it" in the competitive race for existence cannot depend upon Government subsidy, upon propaganda, or upon organized attacks on private business, for they will finally succumb after a period of weak and ineffective operation.

Malnutrition

A first cousin to the ailments that cause the weaknesses I have just described, but which deserves separate consideration in itself, is what I have termed "malnutrition." The common cause of this ailment is *neglect*. This means failure of responsible elements in a cooperative adequately to build its organization and support its operating program. What are the responsible elements in a cooperative business institution? I should say the first one is the interest of producers who desire to meet their needs by forming a cooperative association.

A second is the type of foundation that is laid, upon which will be erected the superstructure to service these needs. This foundation represents the legal structure, the provisions for acquiring capital subscriptions, and the methods used in forming the organization. The superstructure rep-

resents a series of elements, such as management financing, accounting, merchandising, advertising general business procedure in conducting every day operations, and membership relations.

In this building process, including operations, an important element is the board of directors. A great deal depends upon the type of men chosen to perform this responsible function of a business concern. The method of their selection is important. The vision they possess, the objectives they seek, and the responsibilities they feel to those who selected them are contributing factors that vitally affect the success of the association.

The enterprise will be no stronger than its weakest link. If "malnutrition" permeates the association in any of these responsible elements, the result will be failure with a consequent set-back in the progress of the cooperative movement.

I have said that the principal cause of this ailment is neglect. This neglect may be evidenced by a weak financial condition due to lack of initially subscribed capital, to inadequate credit facilities, or to failure to set aside reserves for losses and contingencies, or to insistence by members that surpluses and reserves be paid out in dividends, or that overadvances be made on delivered commodities. There are a number of very sad experiences due to this one element of overadvancing upon commodities; subsequent markets could not support the ideas some people had as to what prices would obtain when the products were sold. Speculation supplanted safe business operations, with consequent losses for which provision had not been made and with ensuing disastrous results.

Again, neglect is apparent through failure of members to patronize and support their own enterprises. The records indicate heavy member withdrawals from marketing contracts. Half-hearted, spasmodic support by the "in-and-outers" are indicated in the history of cooperatives. I have been told by managers that some of their members deliver their poorer grades of commodities to the cooperative after privately selling the best grades to dealers. This is in the nature of

"daring" cooperatives to succeed rather than actively boosting them at every opportunity. It is essential that members realize that they must be more than patrons if they are to build worthwhile enterprises. They cannot expect to be beneficiaries unless they support their own business institutions.

Still another type of neglect is noted in the record of the failure of boards of directors to assume their proper responsibilities. There is evidence to support the statement that boards do not always act on the basis of facts but on biased assumptions. They often fail to back up good management or to terminate bad management. There is a tendency to put self-interest first rather than to operate on the basis of the greatest good to the greatest number.

It is encouraging to note, however, that many boards actually control the steering wheel of their organization and operate on the basis of sound permanent principles instead of temporary expedencies. Unless this type of neglect can be speedily overcome, the movement will fail to make the progress that it should. The preventive measures to both "malnutrition" and "pernicious anemia" are quite self-evident.

"Poisoning" Influences

Authentic medical reports indicate that many people are particularly susceptible to different types of poisoning. The fact that fatalities from poisoning are extremely rare should not obscure the correlated fact that deleterious effects of poisoning in various degrees have been recognized by the medical profession for many years. Again, there is a great similarity between the effects of poisoning influences upon individuals and upon cooperative associations.

Ineffective Financing

Everyone recognizes a complete break-down of a business institution through a large overdose of some insidious poison. It is not this type of effect with which we are so concerned in this discussion. It is the indirect and more or less hidden influences

that operate without immediate tangible effects with which we are particularly concerned in the cooperative movement.

The first one that comes to mind is that of *ineffective financing*. Easy credit is poison to any sound business enterprise. That is to say, unlimited credit tends to permit looseness in operating practices and develops the assumption of undue risks, which often results in disastrous consequences. If this source of easy credit is the Government, it is all the worse, for we cannot escape entirely the fact that many people believe Government credit carries an entirely different obligation than that obtained from private lending institutions.

Resort to borrowing in place of subscription of capital by beneficiaries of cooperatives has led to credit poisoning in many instances. This is particularly true where the credit has been obtained under terms that were not adapted to the long-time needs of the business or at costs that could not be sustained by the association's operations. Hence, the lack of capital ownership, failure to operate on conservative budgets, and insufficient reserves for losses and contingencies combine to result in weak net worth positions and inadequate working capital.

The antidote is sound financing on a business basis with net worth a prime requisite. There is no substitute for a stake in the business by the membership of any association.

Price Consciousness

This poisoning influence works upon the minds of those who have been sold the "cooperative way" wholly upon the promise of immediate dollar returns through some method of price control. Even though we have outgrown many "promising" stages of cooperation, it is still apparent that members have been led to believe that their cooperative would be able to raise prices, peg the market, control the surplus, plus a patronage dividend that would be guaranteed with every delivery. Naturally, the overdoing of price emphasis means that the cooperative, in order to meet competition, must pay the last fraction of a cent, even though

this practice weakens its working capital position and tends to lead to an unsatisfactory balance sheet. On the other hand, it is important that cooperatives "deliver the goods" in the form of fair dollar returns and satisfactory service, together with the intangible values that are not always recognized immediately by cooperative members.

The antidote for overdoses of this poison is to keep price promises, costs of operation, and payment of dollar returns under reasonable control.

Propaganda

There are so many types of propaganda that it becomes difficult to classify those that properly belong in the poison class. It is conceivable that this term may be used to designate worthy attempts to publicize facts and objectives that may be entirely advantageous to any given association. One of the difficulties centers in the interpretation that may be made of any given statement under the peculiar conditions that may exist at any particular time. It is practically impossible, in most instances, to guard against misinterpretation and deliberate misrepresentation, which often result in direct attacks upon the association by its opponents.

As used in this discussion, the term implies the deliberate use of propaganda as an insidious poison, both within and without the field of cooperation. Usually, the opponents of the cooperative way of doing business resort to propaganda of one type or another to make their point. In some instances, cooperatives themselves have been known to resort to the same means to further their own interests, often at the expense of other cooperatives that may be in competition with them for the same market.

The essential elements of the vicious types of propaganda are half truths, distorted facts, unwarranted conclusions, unsound comparisons, deliberate misrepresentations, subtle insinuations, and outright open attacks upon the theory of cooperation and upon the practices of cooperative institutions. These attacks usually center upon the management practices of cooperatives, upon their sources of financing—particularly Government

sources—and upon the general support of cooperatives by public agencies.

Antidote: The only permanent effective answers to propaganda are—

- (1) Economical and effective performance with the rendering of recognized services to members;
- (2) Emphasis upon properly interpreted facts in all instances; and
- (3) Financial independence in the form of owned capital and surplus to provide strength and ability to survive “propaganda” attacks.

Competition

This poison is generated by unfair trade practices, deliberate price-cutting, effective use of propaganda, operation by expediency, and the seeking of immediate advantage at the cost of permanent success. This competition on the part of private business needs no discussion. Where this competition lies between cooperatives in the same market, however, the remedy is not so apparent.

In discussing the future success of the cooperative movement, I have said that there are too many small cooperative units serving a small number of patrons in a limited way. The future will show continued tendencies towards the survival of the most serviceable and the most economical, with a consequent decrease in the number of associations. Jealousies and personal antagonisms between cooperative leaders will tend to pass out, and harmony and close cooperative relations will gradually be the dominant note in this competitive situation. It should be found possible to convince cooperatively-minded members that fair outside competition can be met and that inside throat-cutting by the management of competing cooperatives can have only disastrous results for the cooperative movement.

INTERNAL DISORDERS

In every commercial undertaking involving problems of management, the formulation of policies, the administration of personnel, and varied types of relations, there are any number of opportunities

for things to go wrong. Ill health is probably more often caused by “internal disorders” than by any other series of ailments. The mechanism of a modern business enterprise is about as complicated and its parts as intricately correlated as that of the human body, and just about as many things can go wrong.

Mismanagement

This correlation of parts, which decides the proper functioning of each part or unit of the organization, may be called the management of the routine affairs of the enterprise. Mismanagement or poor management is one of the internal disorders with which some cooperatives have been or are now afflicted. Among all the factors that decide the success or failure of any business, the element of management carries the greatest relative load of responsibility. Ineffective operating policies in financing, accounting, merchandising, and in relationships, with consequent failure to obtain for its members those beneficial returns that efficient management would produce, are dangerous influences in any cooperative.

The job of operating a cooperative enterprise successfully is much more difficult, in my opinion, than that of managing a private business. The source of authority and the essential elements of control in a cooperative organization are not always easy to identify and trace. Likewise, the personal incentive for success is not always as definite or clear cut as in private business.

There is also involved the important relations that must be maintained by cooperative management. There must be relations with boards of directors who are not always businesslike in their attitude towards their business institution. There are also relations to the trade in which the commodity is marketed or with whom the management has business dealings. Most significant of all, there are member relations to develop, maintain, and protect that are not simple or easy of accomplishment. Therefore, great stress needs to be laid upon the character, experience, and training of managers of cooperative enterprises.

Forgotten Producers

A study of the turn-over in management in some cooperatives indicates a lack of appreciation of the earning worth of managers and the compensation that needs to be allowed for their services. Here again, cooperatives are in competition with private business, and, in many instances, there needs to be a reevaluation of management services and a greater appreciation of their importance to the success of cooperative enterprises.

There is also the ever-present danger of one-man control and one-man power in the management of the cooperative enterprise. If this one man is exceptionally strong and able, the cooperative may grow faster and perhaps prosper in greater degree while he is in control than where there is too active participation in routine affairs by "busy" boards of directors. The danger develops, however, where the one-man influence is so dominant as to create dissension in the directorate or where outside influences gradually sap the vitality and life-blood of the association. There is also the weakness of sudden changes in management without adequate experience in the particular cooperative concerned. It is only good business insurance for the management of larger cooperative enterprises to maintain a competent force of younger executives coming along prepared to assume major responsibilities.

Irresponsible Boards of Directors

The symptoms of this internal disorder are quite pronounced. Likewise, the effects have been recorded from time to time in the history of many cooperatives. The symptoms include political maneuvering on the part of individual members of a board; development of a job complex in which board members become hired employees of the association; employment of relatives and close friends of board members; severe clashes of personalities in which personal ambition is an important factor; assumption of the balance of power by one individual; failure of the board to make decisions on the basis of facts in the permanent interest of the membership; the seeking of special privileges and opportunities; and the granting of advantages to certain groups or individuals.

It is to the credit of cooperatives that this disease is becoming less prevalent.

Another type of disorder that carries a definite danger signal is that of inadequate and ineffective member relations in which the producer is often the forgotten man. In these cases the cooperatives become either close corporations operated for the benefit of a few individuals or quickly succumb because their members fail to support them. This tendency is particularly apparent among large-scale cooperatives in which the business operations are conducted at long distances from producing points. The members are not kept fully informed, the local associations are often weak in performing definite functions, and the lines of control from the members to the larger business units are not clearly traced and well-defined.

The evidence indicates that many times important facts are kept from members under the assumption that they will not be understood and that such information may stir up more trouble than it can contribute to the well-being of the business. It is quite obvious that there are types of business relations that cannot be explained to the membership at any certain time, but it should be recognized that, sooner or later, the membership of any association must have definite knowledge of the financial status and progress of their own enterprises.

Whether attempts to reach effectively the members of a given association is called service, education, management, or whatnot, ways and means should be found to maintain the confidence of individual members in their marketing and purchasing associations. Unless this is more generally done, they will continue to be open prey for the propaganda of the opponents of the cooperative movement.

Conclusion

While there are rather definite trends to indicate that the cooperative movement is making progress among rural producers, it remains to be seen whether farmers really want to act together for their best interests over long periods. I have sometimes thought that cooperation goes better

when times are tough and the going is hard, but that in fair weather the interest is less and regression rather than progression may be the order.

A prominent cooperative leader once defined cooperation as an opportunity for sacrifice by the individual for the greatest good to the greatest number. That is an excellent Sunday definition. On Monday morning, things look somewhat different, and my Monday definition of cooperation is that it presents an opportunity for people to promote their own selfish interests much more successfully together than they can be advanced by individual action. Economic necessity will prove to be one of the strongest forces in bringing people together for their own best individual advancement if the objectives are worthy and the efforts are soundly and conservatively administered. Then the greatest good for the greatest number will be the final achievement.

Circular A-3.



AGRICULTURAL FINANCING

through the
FARM CREDIT ADMINISTRATION

The Farm Credit Administration

THE FARM Credit Administration and the institutions operating under its supervision provide a coordinated credit system for agriculture. The permanent institutions operating under the supervision of the Farm Credit Administration are the Federal land banks, national farm loan associations, production credit corporations, production credit associations, Federal intermediate credit banks, and banks for cooperatives, including the Central Bank for Cooperatives.

The regional agricultural credit corporations and the emergency crop and feed loan offices are also under the jurisdiction of the Farm Credit Administration, but are of a relatively temporary character, established to meet a passing emergency. Acting on behalf of the Federal Farm Mortgage Corporation (created by the Federal Farm Mortgage Corporation Act and having its principal office at Washington, D. C.) the Land Bank Commissioner makes long-term loans to farmers on the security of either first or second mortgages on farm property, employing the Federal land banks as agents for that purpose. In addition, the Governor of the Farm Credit Administration makes direct loans to certain classes of agricultural cooperative associations with the revolving fund established by section 6 of the Agricultural Marketing Act, as amended. The above mentioned activities are more fully discussed in the following portions of this circular.

The continental United States is divided into 12 Federal land bank districts as indicated on the back page of this circular. In each district there is a Federal land bank, a Federal intermediate credit bank, a production credit corporation, and a bank for cooperatives, located in the same city and having the same board of directors. It is planned that they will eventually be housed in the same quarters; and this is now an accomplished fact in many districts. Further coordi-

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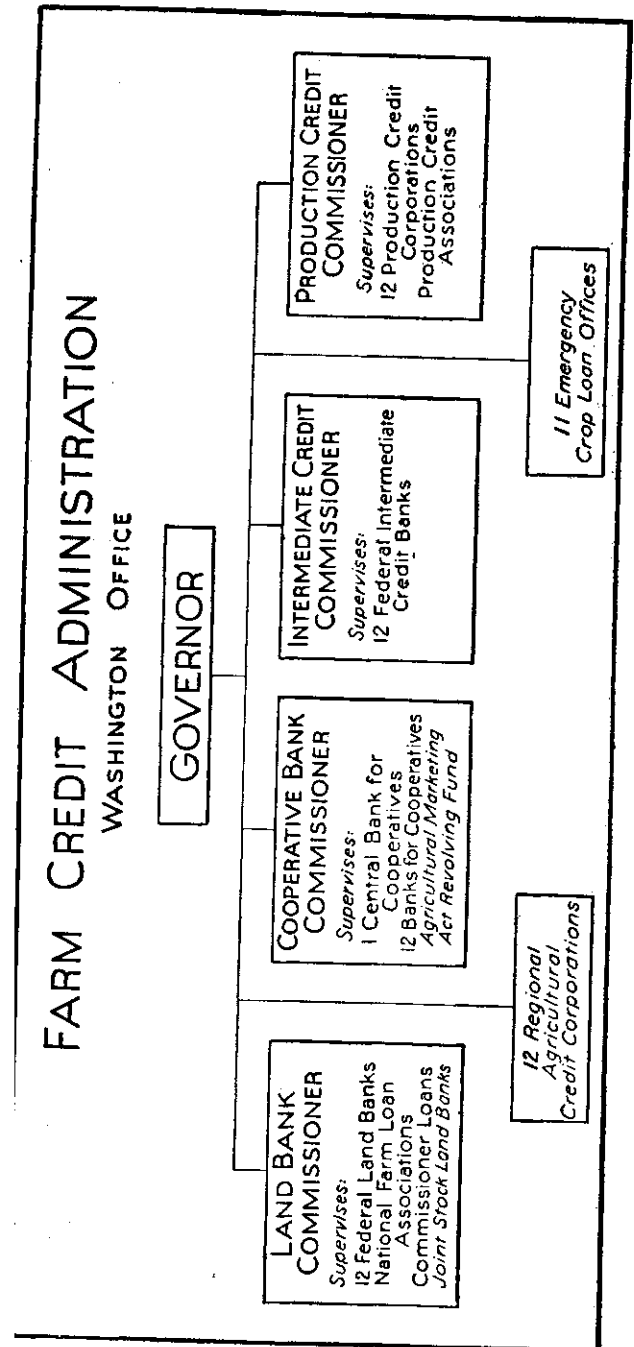
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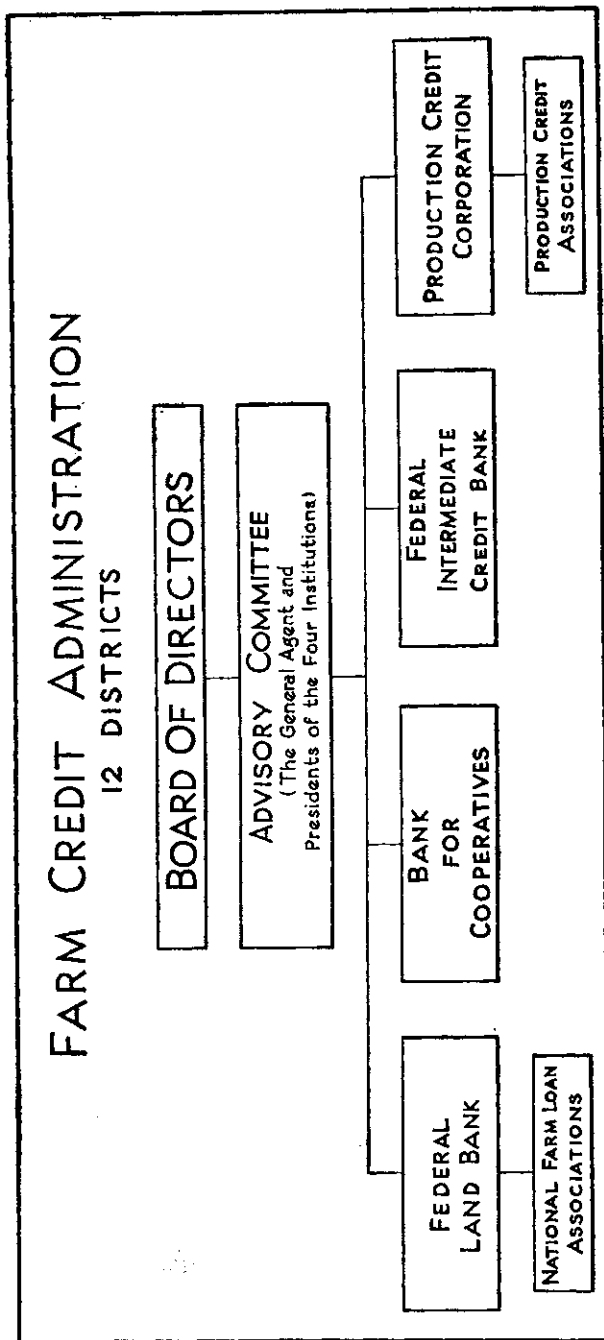


The Farm Credit Administration

nation of activities in each district is accomplished, and needless duplication of effort and service avoided, through a body known as the "Council of the Farm Credit Administration" of the district, composed of the directors of the four institutions, who meet and act in this collective capacity, and through a general agent elected by the Council, on nomination of the Governor of the Farm Credit Administration. By writing a single letter addressed to the Farm Credit Administration of the district in which his farm is located, a farmer can obtain full information on all types of agricultural credit extended by or through these institutions, including loans made by the Land Bank Commissioner on behalf of the Federal Farm Mortgage Corporation.

National Organization





Federal Land Bank Loans

THE FEDERAL land banks make loans only upon the security of first mortgages covering farm lands and the improvements thereon. To be eligible for such a loan an applicant must be engaged, or shortly to become engaged, in farming operations including livestock raising, or must derive the principal part of his income from such operations. Corporations are not eligible for land bank loans unless engaged in the raising of livestock. (See p. 13.)

How Much May Be Borrowed?

Federal land bank loans may be made for not less than \$100 nor more than \$50,000 to any one borrower; but preference is given to loans in the amount of \$10,000 or less. No Federal land bank loan in excess of \$25,000 may be made except with the approval of the Land Bank Commissioner. A loan may not exceed 50 percent of the appraised value of the land to be mortgaged as security therefor, and 20 percent of the appraised value of the permanent, insured improvements thereon.

Purposes of Loans

Federal land bank loans may be made for the following purposes: (a) To purchase land for agricultural uses; (b) to buy equipment, fertilizers, and livestock necessary for the proper and reasonable operation of the mortgaged farm; (c) to provide buildings and for the improvement of farm land; (d) to liquidate indebtedness of the owner of the mortgaged land incurred for agricultural purposes, or, other debts if incurred prior to January 1, 1933; and (e) to provide the owner of the mortgaged land with funds for general agricultural uses.

Loans Through National Farm Loan Associations

Federal land bank loans are made in the continental United States through, and with the endorsement of, national farm loan associations

Federal Land Bank Loans

wherever associations through which applications may be received by Federal land banks are in existence. At the present time there are more than 3,200 such associations serving nearly all agricultural communities in the United States. With the approval of the Land Bank Commissioner, the Federal land banks are authorized to make loans direct to borrowers in localities not served by national farm loan associations. These associations are cooperative credit corporations operating under the supervision and regulation of the Farm Credit Administration. The membership of each association is restricted to borrowers from the Federal land bank. No other persons are eligible as shareholders.

A borrower through a national farm loan association must purchase stock in the association in an amount equal to 5 percent of the amount of his loan. The amount necessary to pay for such stock may be included in the amount of the loan obtained from the Federal land bank. Prior to the enactment of the Farm Credit Act of 1933, approved June 16, 1933, shareholders in national farm loan associations were individually responsible, equally and ratably, for all contracts, debts, and engagements of the association up to an amount equal to the par value of the stock they owned, in addition to the amount paid in and represented by their shares. That act eliminated this liability with respect to contracts, debts, and engagements entered into by the association after June 16, 1933, but preserved the double liability of association shareholders for contracts, debts, and engagements entered into on or before that date.

Associations Endorse Notes

The National Farm Loan Association endorses and becomes liable for each of the loans made to its members. The stock subscribed by each member is pledged with the association as collateral security to the loan endorsed by the association. The association in turn subscribes

Federal Land Bank Loans

to an equal amount of stock in the Federal land bank. This stock is held by the bank as collateral to the loan.

When the borrower pays his loan in full, the bank retires its stock which was subscribed for by the association at the time the loan was made. If the association is not in debt to the bank, the bank remits the proceeds of this stock to the association in cash. If, on the other hand, the association is in debt to the bank as a result of losses sustained by the bank on other loans endorsed by the association, it may be necessary for the bank to withhold all or some part of the proceeds of its stock and apply it as a credit on the association's indebtedness. In either event, the borrower's stock in the association is retired when he pays his loan in full, and if the association has the money with which to make the payment to him and has paid, or can pay, all its debts to the bank or other creditors, he receives payment for his stock at par.

Direct Loans by Federal Land Banks

In localities where there are no local national farm loan associations through which the Federal land bank is able to accept applications, the bank may make direct loans to farmers. Borrowers obtaining direct loans must subscribe for capital stock in the bank in the amount of \$5 for each \$100 or fraction thereof borrowed. Upon the full payment of the loan such stock, if still outstanding, will be canceled at par, or, in the event that the stock has become impaired, at its estimated value as approved by the Land Bank Commissioner, and the proceeds thereof will be paid to the borrower.

A farmer who obtains a direct loan may agree in his mortgage that he will unite with other such borrowers to form an association when there are 10 or more borrowers, or applicants with acceptable applications, whose loans aggregate not less than \$20,000 and who reside in a locality which

Federal Land Bank Loans

may, in the opinion of the Land Bank Commissioner, be conveniently covered by the charter of, and served by, a national farm loan association.

After such an association is formed, the stock in the Federal land bank held by each of its members will be canceled at par and the bank will issue an equal amount of stock in the name of the association. This stock will be held by the bank as collateral security as in the case of stock subscribed by national farm loan associations in connection with new loans. The association, upon its formation, will issue to each member capital stock in an amount equal to the amount of stock which he previously owned in the bank.

Appraisals

Before the Federal land bank may make a loan, either through a national farm loan association or direct, the farm offered as security must be appraised by a land bank appraiser who is a public official appointed by the Farm Credit Administration of Washington, and not by the Federal land bank. The basis of appraisal in all cases is the normal value of the land when used for agricultural purposes and its earning power for agricultural purposes is a principal factor. In estimating the normal earning power of the farm, the average prices of farm commodities during the 5 years from 1909 to 1914 are used as a base, allowance being made, of course, for increased taxes and other costs and for any changes in the economic position of the commodities produced. An appraisal of the farm and any personal property offered as security for a Land Bank Commissioner's loan may be made at the same time that an appraisal is made for a land bank loan.

Interest Rates on Loans

The rate of interest charged on new loans made through national farm loan associations may not, except with the approval of the Governor of the Farm Credit Administration, exceed by more than

Federal Land Bank Loans

1 percent the rate of interest borne by the bonds last issued by the bank prior to the making of the loan. Since the last bonds issued by the banks bore an interest rate of 3 percent, land bank loans are now, September 1, 1936, made with an interest rate of 4 percent per year. Loans made prior to June 24, 1935, bear higher interest rates.

The rate of interest on direct loans made by a Federal land bank is one half of 1 percent greater than the rate of interest charged to borrowers on loans made through national farm loan associations. Thus, the direct loan rate is now, September 1, 1936, 4½ percent. If a borrower who has obtained a direct loan becomes a member of a national farm loan association, the interest rate on his loan, if in good standing, will be reduced one half of 1 percent.

Reduced Rates of Interest

By act of Congress the rate of interest on all Federal land bank loans has been temporarily reduced for a 2-year period ending June 30, 1937. Regardless of the contract rate or the date on which the loans were made, interest maturing from July 1, 1935, through June 30, 1937, on loans made through national farm loan associations is payable at a rate not exceeding 3½ percent. During the same period the interest chargeable on loans made by the banks directly may not exceed 4 percent a year. After June 30, 1937, all loans will carry interest at the rate written on the face of the mortgage.

Cost of Obtaining Loans

The banks charge fees which do not exceed the actual cost of appraisal and determination of title. An initial payment covering a part of this cost must be made at the time the loan application is filed. Ordinarily this payment consists of a \$1 fee for writing or filing the application plus a small deposit. If no appraisal is made the de-

Federal Land Bank Loans

posit is returned to the applicant. However, if an appraisal is made the deposit is not returned. The borrower also pays the cost of preparing an abstract of title to his farm, the legal fees for recording his mortgage or deed of trust, the bank's fees for that part of the cost of appraisal and determination of title which is not included in his initial deposit, and any other costs incidental to procuring the loan. In addition, national farm loan associations make charges to meet their necessary expenses, which may in no case exceed 1 percent of the amount of the loan, and the bank is permitted to make similar charges, not to exceed 1 percent, in connection with direct loans. Finally, the borrower purchases stock in the association through which he obtains his loan, or, in the case of a direct loan, stock in the Federal land bank, in an amount equal to 5 percent of the loan. Although not strictly a cost of obtaining the loan the price of the stock is deducted from the loan proceeds unless paid for by the borrower out of other funds. The retirement of this stock is discussed on page 9.

Information concerning the initial deposit required in connection with applications for loans and loan costs in general may be obtained from the secretary-treasurer of the local national farm loan association, the land bank, or its local correspondent.

In view of the long period of years for which Federal land bank loans are made, the foregoing costs constitute a very small item.

Repayment of the Loan

Federal land bank loans are usually repayable in semiannual installments although in some land bank districts loans are made on an annual payment basis. In addition to the interest due on the loan, a sum is added which, when applied to the principal, will amortize or pay off the loan and retire the debt of the borrower within the period specified in the mortgage. For example, a semi-

Federal Land Bank Loans

annual payment of \$27.00 will retire in 34½ years a \$1,000 loan bearing 4 percent interest under the amortization plan which has been used generally by the banks. These payments, aggregating \$54.00 annually, not only pay the interest on the loan, but also pay off the entire principal in 34½ years. Loans are made also in some instances for shorter periods, usually 20 years. Such loans, of course, require larger annual payments upon principal.

On all loans which were outstanding on June 3, 1935, the effective date of the Farm Credit Act of 1935, the borrower will be entitled to a deferment of any payment upon principal prior to July 11, 1938, if the borrower is not otherwise in default. Borrowers may, of course, pay regular installments of principal during that period if they so desire. If, however, principal payments are postponed during the period ending July 11, 1938, it will take that much longer to complete the payment of installments on the loan.

Loans to Livestock Corporations

Federal land bank loans may be made to corporations engaged in the raising of livestock on the same terms, in general, as to individual farmers. However, in order for such a corporation to be eligible, all its stock must be owned by persons actually engaged in the raising of livestock on the farm to be mortgaged unless the Land Bank Commissioner otherwise permits the loan. Such permission may be given if at least 75 percent in number and value of the shares of stock of the corporation is owned by persons engaged in raising livestock on the farm to be mortgaged. In all instances the owners of at least 75 percent in number and value of shares of stock of the corporation must assume personal liability for the loan.

Land Bank Commissioner's Loans

THE FEDERAL Farm Mortgage Corporation is authorized to issue bonds in an aggregate amount not exceeding \$2,000,000,000. These bonds and the proceeds thereof are used by the Land Bank Commissioner in making loans under the provisions of the Emergency Farm Mortgage Act of 1933.

Land Bank Commissioner's loans are made upon the security of first or second mortgages on farm property. The Commissioner uses the services of the Federal land banks in making these loans.

Who May Borrow

Any person who is engaged or shortly to become engaged in farming operations, including livestock raising, or the principal part of whose income is derived from farming operations, is eligible for loans.

Corporations engaged in the raising of livestock are also eligible. All the stock of the corporation must be owned by persons actively engaged in the raising of livestock on the farm to be mortgaged unless the Land Bank Commissioner otherwise permits the loan. His permission may be given if at least 75 percent of the corporation's stock, both in number and value of shares is owned by persons engaged in raising livestock on the farm to be mortgaged. In all instances the owners of at least 75 percent in number and value of the shares of stock in the corporation must assume personal liability for the loan.

The definition of eligible farmers also includes a personal representative of a deceased farmer.

Differences Between Loans

One important difference between a land bank and a Commissioner loan should be kept in

Land Bank Commissioner's Loans

mind. A land bank loan can be made only on the security of a first mortgage. A Commissioner's loan may be made on the security of either a first or a second mortgage.

Purposes of Loans

Loans to farmers may be made by the Land Bank Commissioner for the same purposes as land bank loans. However, the purposes for Commissioner loans are broader than for land bank loans in that Commissioner loans may be made to refinance any indebtedness of the farmer without regard to its purpose or the time it was made. Indebtedness for which the farmer is not personally liable, but which is secured by a lien on his farm property, may also be refinanced.

Commissioner loans may be made in connection with composition proceedings under the Bankruptcy Act.

The Amount of Loans

The total amount of Commissioner loans to any one farmer may not exceed \$7,500. The amount of the mortgage to the Land Bank Commissioner, together with all prior mortgages or other evidences of indebtedness secured by the farm property, may not exceed 75 percent of the appraised normal value thereof. One appraisal is made for both types of loans, and after the appraisal the farmer will be notified by the bank of any amount which may be granted by it or by the Commissioner.

If the borrower's debts, leaving out those adequately secured or offset by other assets, exceed 75 percent of the normal agricultural value of the farm property offered as security, the bank's commitment will be on condition that creditors agree to scale down their claims to the extent of the excess. Farmers in many cases find creditors are willing to accept a scale-down in order to obtain an immediate settlement of their claims.

Land Bank Commissioner's Loans

Appraisals

Before a loan may be made, the farm property offered as security must be appraised by an appraiser designated by the Farm Credit Administration.

In general the same considerations are used in determining the normal value of land and buildings as are used in making appraisals for Federal land bank loans, the basis of appraisal ordinarily being the normal value of the land for agricultural purposes. (See p. 10.) However, a farm does not have to be a complete farming unit to be acceptable security for a Land Bank Commissioner loan. Dependable income from sources other than the farm may be considered in determining the farmer's ability to carry a Commissioner loan if income from outside sources would ordinarily be available to persons operating the farm. This is often the case in suburban areas where farm owners work in town in addition to managing their farms. Where outside income is dependable, and would be available to an average operator, the value of the farm for residential purposes, due to suburban location or other special factors, may be taken into account in the appraisal, provided it does not exceed a prudent investment consistent with community standards and rentals.

In any event the income from the farm, together with earnings received by the operator from other dependable sources ordinarily available in the community to a person operating such a farm, must be sufficient to support the borrower's family, pay operating expenses and fixed charges, and carry the installments on his loan.

Security Requirements

A substantial percentage of Commissioner loans are made on second mortgages on farm real estate. In the case of second mortgages upon farm real estate, the Commissioner requires the holder of the first mortgage to limit his right to proceed

Land Bank Commissioner's Loans

against the farmer and the mortgaged property in accordance with regulations issued by the Commissioner.

Interest Rate

At the present time, September 1, 1936, the rate of interest charged on these loans is 5 percent per year.

Cost of Obtaining a Loan

Reasonable fees, not exceeding the actual cost of appraisal, determination of title, and recording, are charged. The initial payment covering part of this cost is made at the time the loan application is filed.

Ordinarily, this payment consists of a \$1 fee for writing or filing the application plus a small deposit. If no appraisal is made the deposit is returned to the applicant. However, if an appraisal is made the deposit is not returned.

Repayment of the Loan

Payments on the loans may be made annually or semiannually as determined by the Commissioner. Equal payments upon principal sufficiently large to repay the debt within an agreed period is made with each annual or semiannual interest payment. During the first 3 years after a Commissioner loan is made, the borrower will be entitled to a deferment of any payment upon the principal if he is not in default with respect to any other provision of his mortgage.

Commissioner loans secured wholly by real property may be made for the same number of years as land bank loans. However, they are not ordinarily made for terms longer than 20 years. If a loan is not secured wholly by a first or second mortgage on farm real estate, it cannot be made for more than 10 years.

Secretary-treasurers of national farm loan associations in most localities handle applications for both Federal land bank and Commissioner's

Land Bank Commissioner's Loans

loans. In other localities correspondents have been appointed who will handle applications for both loans.

The name of the correspondent or the secretary-treasurer in your community may be obtained from officers of local banks or the county agricultural agent. If unable to locate the secretary or the correspondent, write directly to the Federal land bank of your district for information. The locations of the Farm Credit Administration offices are given on the back cover of this circular. The Federal land banks are located in the same cities and serve the same territories.

The Banks for Cooperatives

THE BANKS for cooperatives—the Central Bank at Washington, D. C., and a district bank in each of the 12 Federal land bank districts—are designed exclusively to serve the credit needs of farmers' cooperative associations. All 13 banks make the same types of loans and have the same interest rates. In general, though, the district banks serve the local associations and those operating in a single land bank district, while the Central Bank serves the national associations and the larger regionals.

The original capital of the banks for cooperatives was subscribed by the Governor of the Farm Credit Administration from the revolving fund authorized by the Agricultural Marketing Act of 1929.

The amount of capital of any bank for cooperatives paid in by the Governor can be increased or decreased by him as the needs of the individual bank make necessary. Additional capital is supplied by the borrowers through the purchase of stock in proportion to the amount of their loans.

Classes of Loans to Cooperatives

The banks for cooperatives make loans to cooperative marketing, purchasing, and farm business service associations for the following purposes:

(1) **Operating loans.**—Such loans are made for operating purposes.

(2) **Facility loans.**—Such loans are made to finance or refinance the purchase, construction, or lease of a grain elevator, fruit-packing plant, cotton gin, creamery, or other facilities.

Facility loans to cooperative associations for the construction or acquisition of physical facilities by purchase or lease, or for refinancing the cost of the construction or acquisition of such facilities, are subject to the following conditions:

(a) No loan may be made in an amount in excess of 60 percent of the value of the security offered therefor.

The Banks For Cooperatives

(b) No loan for the purchase or lease of such facilities may be made unless the Governor of the Farm Credit Administration finds that the purchase price or rent to be paid is reasonable.

(3) **Commodity loans.**—Such loans are made to cooperative marketing associations for the purpose of enabling them to make advances to grower members on commodities delivered to the associations and to pay the cost of marketing such commodities. Commodity loans to cooperative purchasing associations are made principally to assist them in carrying their necessary inventories.

In addition to making loans to cooperative associations, the Central Bank for Cooperatives is authorized to make loans to the 12 district banks for cooperatives (see p. 21) under terms and conditions prescribed by the Cooperative Bank Commissioner who is also chairman of the board of directors of the Central Bank for Cooperatives.

Rates of Interest

By law the Governor fixes the rates of interest. The rates, however, shall not exceed 6 percent a year, and are subject to the following provisions:

(1) The rate of interest on operating loans, not secured by commodities, shall conform as nearly as practicable to a rate 1 percent in excess of the prevailing interest rate paid by production credit associations to the Federal intermediate credit bank of the district.

(2) The rate of interest on facility loans shall conform as nearly as practicable to the prevailing rate on farm mortgage loans to members of national farm loan associations.

(3) The rate of interest on commodity loans, insofar as practicable, shall conform to the prevailing interest rate on commodity loans charged borrowers from the Federal intermediate credit bank of the district.

The present interest rate, September 1, 1936, on operating loans is 3 percent, on facility loans is 4 percent, and on commodity loans is 2 percent.

The Banks For Cooperatives

Stock Ownership Privileges

Each cooperative association that borrows from a bank for cooperatives is required to own or purchase stock in that bank. The amount of stock is in proportion to the amount of the loan. In the case of operating loans (other than those secured on commodities) and facility loans, the borrower must own or purchase \$100 worth of stock for each \$2,000, or fraction of that amount, borrowed. In the case of commodity loans the amount of stock required is prescribed by the Governor of the Farm Credit Administration. The present rule is \$100 worth of stock for each \$10,000, or fraction of that amount, borrowed. Stock already owned, however, may be applied to cover this requirement.

If the State law under which the association is organized does not permit it to own stock in institutions such as the banks for cooperatives, the borrower instead of buying stock can pay the purchase price into a guaranty fund. When the loan is paid off, if the borrower wishes, this is returned less his share of impairment, if any, of the bank's capital and guaranty fund. In the same manner, the bank redeems its stock when a loan is repaid, if the borrower wishes.

After operating expenses, losses, and amounts necessary to restore impairment of capital and guaranty fund, if any, have been deducted from earnings, each bank for cooperatives must apply 25 percent of the remainder to the creation and maintenance of a surplus equal to at least 25 percent of its capital and guaranty fund. Any sums remaining may be used to pay dividends, which shall not, however, exceed 7 percent.

Division of Lending Authority

The Governor of the Farm Credit Administration is authorized by law to prescribe the division of lending authority between the Central Bank for Cooperatives and the district banks for cooperatives.

The Banks For Cooperatives

Under present regulations a district bank for cooperatives may have outstanding operating loans (other than those secured by commodities) and physical facility loans to any one borrower at any one time in a total amount equal to 10 percent of the capital and surplus of the bank. In the case of effective merchandising loans secured by commodities, however, a district bank may have outstanding to any one borrower at any one time an amount equal to 20 percent of the capital and surplus of the bank. The total loans of any district bank to any one borrower shall not at any one time exceed 20 percent of the capital and surplus of the bank.

Applications for loans that, if granted, would make the total loans of a district bank to any one association exceed these limitations will be referred to the Central Bank for Cooperatives at Washington, D. C.

The Central Bank for Cooperatives may issue debentures in amounts not to exceed five times its paid-in capital and surplus, such debentures to be secured by cash, direct obligations of the United States, or notes or other obligations discounted or purchased or representing loans made by the bank.

The Central Bank for Cooperatives may discount any eligible loans with the Federal intermediate credit banks and make loans to and borrow from the district banks for cooperatives. The district banks for cooperatives also may discount eligible loans with Federal intermediate credit banks and make loans to each other.

Federal Intermediate Credit Banks

THE 12 Federal intermediate credit banks provide agricultural credit for periods that are "intermediate" between the maturities usually available through short-term commercial bank loans and those of long-term farm mortgage loans. They are not authorized to make loans directly to individual farmers and stockmen, but extend credit to financing institutions, such as production credit associations, State and national banks, livestock loan companies, and agricultural credit corporations. Such local institutions eligible to obtain credit from a Federal intermediate credit bank may do so either by borrowing upon their direct obligations, secured by agricultural and livestock paper, or may rediscount such paper with the intermediate credit banks.

The Federal intermediate credit banks are authorized, also, to make direct loans to farmers' cooperative marketing, purchasing, and business service associations. Under provisions of the Farm Credit Act of 1935, they are authorized to discount loans for the banks for cooperatives, and to make direct secured loans to such banks, and it is planned, insofar as it is practicable to do so, that the Federal intermediate credit banks will withdraw from the field of lending directly to farmers' cooperative associations.

Maximum Lines of Credit

The amount of credit which any credit institution may obtain from a Federal intermediate credit bank depends upon a number of factors, including the amount of its paid-in and unimpaired capital and surplus, the manner in which such capital is invested and the amount thereof pledged with the intermediate credit bank as collateral, the management of the corporation, the character of paper offered, and the provisions of law applicable to such institutions. The act

Federal Intermediate Credit Banks

under which the Federal intermediate credit banks operate provides that no paper shall be discounted for any bank if the amount thereof added to its other liabilities (other than bona fide deposit liabilities), exceeds twice the paid-in and unimpaired capital and surplus of such bank. In the case of other agricultural credit institutions, the ratio usually varies from three to eight times their unimpaired capital and, under the law, may not exceed an amount which, when added to their other liabilities, exceeds 10 times their paid-in and unimpaired capital and surplus.

Interest and Discount Rates

Under the law, a Federal intermediate credit bank, except with the approval of the Governor of the Farm Credit Administration, may not establish a discount rate which exceeds by more than 1 percent per annum the interest rate borne by the last preceding issue of debentures issued, or participated in, by such bank.

The rate of interest which a credit institution may charge the farmer on a note discounted by a Federal intermediate credit bank may not exceed the bank's discount rate by more than 3 percent per annum. Thus, if an intermediate credit bank sells debentures bearing a rate of 1½ percent it may, with the approval of the Intermediate Credit Commissioner, establish a discount rate of not exceeding 2½ percent. The present discount rate, September 1, 1936, is 2 percent and therefore the bank may discount notes on which the maker is charged interest at not more than 5 percent per annum.

Maturities

The experience of the Federal intermediate credit banks indicates that notes of farmers and stockmen should mature at the time the makers expect to market their crops or livestock. Maturities extending beyond 3 years may in no case be handled by an intermediate credit bank. Ordinarily, they range from 6 to 12 months, but,

Federal Intermediate Credit Banks

where the security and other conditions surrounding the paper justify, renewals at maturity may be accepted by the intermediate credit banks.

Individual Loan Limits

The maximum amount of credit which a Federal intermediate credit bank may grant to a credit institution on the paper of any one note-maker is 20 percent of the institution's paid-in and unimpaired capital and surplus, except on notes secured by warehouse receipts covering readily marketable agricultural products or on paper secured by chattel mortgages on livestock, in which cases the maximum individual line of credit is limited to 50 percent of the institution's unimpaired capital and surplus.

Loans to Cooperative Associations

As previously stated, it is contemplated that loans to farmers' cooperative associations, generally, will be made by the banks for cooperatives. However, loans may be made by the Federal intermediate credit banks to farmers' cooperative marketing, purchasing, or business service associations upon the security of such collateral, other than commodities, as may be approved by the Governor of the Farm Credit Administration.

Production Credit Corporations and Associations

A PERMANENT system of more than 550 cooperatively operated production credit associations has been organized, under the authority granted by the Farm Credit Act of 1933, to provide a source of low cost short-term credit to farmers and stockmen in every agricultural county in the country.

Loans to Finance Crops and Livestock

These production credit associations make loans to farmers and stockmen to finance the production, harvesting, and marketing of crops; for the breeding, raising, fattening, and marketing of livestock and commercial poultry; for the repair, improvement, and alteration of farm buildings; and for other general agricultural purposes. The loans are frequently used for the purchase of seed, feed, fertilizer, spray materials, farm machinery, supplies, workstock, cattle, or sheep, and for the purpose of hiring labor. Production credit associations are also authorized to make loans to oyster planters.

These associations obtain their loan funds by rediscounting the notes of their farmer-borrowers with the Federal intermediate credit banks of their respective districts. The intermediate credit banks obtain their funds for discount operations from the sale of debentures to the investing public.

Interest Rates

The interest rate on loans made by a production credit association is dependent to a large extent upon the discount rate charged by the Federal intermediate credit bank of the district. Production credit associations are limited in the interest rate they may charge farmers to 3 percent above the discount rate of the Federal intermediate credit banks. At present, September 1, 1936, the interest charged by the production credit associations is 5 percent.

Loans Self-Liquidating

Since loans made by the production credit associations are expected to be of a self-liquidating nature, they are usually dated to mature at the time the farmer-borrower intends to market his products. Most loans mature in 12 months or less. If the credit standing of a farmer and the condition of his security remain favorable, renewals of the outstanding balances of his loan may be made annually, but may not exceed a total of more than 3 years.

Production credit associations make loans to farmers on the security of chattel mortgages and liens on personal property such as crops, livestock, and farm equipment. Nominal inspection fees are charged by the associations to cover the cost of examining the security offered.

Budget Loans Reduce Interest Costs

Farmers borrowing from production credit associations pay interest on their loans only on the outstanding balances which they owe and only for the actual time they have the money. Many farmers have found it possible to reduce their interest costs considerably by planning their expenditures in advance and arranging to obtain their loans in a series of advances. For example, a farmer who borrows a total of \$1,000 and receives a \$300 advance for 9 months during the spring planting season, and another \$300 three months later for 6 months, and the balance of \$400 during the harvesting season for a period of 1 month, would pay \$20.41 in interest as compared to \$38.50 in interest if he had obtained the loan in one installment for 9 months at the beginning of the season.

Size of Loans

Production credit associations may not make loans for less than \$50. The maximum size of a loan depends on the amount of capital and surplus of the individual association. A farmer may not obtain a loan that is equal to more than 20 percent of the capital and surplus of his local asso-

Production Credit

ciation unless the security offered by him is approved by the production credit corporation of the district. If the amount applied for is equal to more than 50 percent of the capital and surplus of the association, the approval of the Production Credit Commissioner must be obtained before the loan may be made.

Farmers Purchase Stock

The production credit association's capital is provided from two sources. The class A, or non-voting stock of the association, is purchased by the production credit corporation of the district, and the class B, or voting stock of the association, is subscribed and paid for by farmer-borrowers in amounts equal to \$5 for each \$100 or fraction of \$100 borrowed.

Since each borrower-stockholder is limited to one vote regardless of the number of shares of stock he holds in the association, all members of an association have an equal voice in its management.

If a farmer or stockman has ceased to become a borrower from his association for a period of 2 years, he must exchange his class B stock at its fair book value (not to exceed par) for class A stock, or dispose of his class B stock by sale to other borrowers.

Reserve to be Created

Before an association may declare dividends on its capital stock, a guaranty fund equal to 25 percent of its paid-in capital must be created. In the case of dividend payments, class A and class B stock will share equally, the class A stock being preferred only in the event of liquidation.

As long as the production credit corporation of the district holds stock in a production credit association, the appointment or election of the association's directors, and the appointment of its secretary-treasurer and loan committee are subject to the approval of the president of the corporation, who also has the right to remove any such officer or committee member.

Production Credit

Applications Made to Local Associations

Farmers apply for loans directly to their local production credit associations. The associations usually have representatives in the various counties which they serve. If a farmer does not know the location of his association, he can obtain such information from his county agricultural agent or from the production credit corporation of the district. These corporations are located in the same cities and serve the same territories as the Farm Credit Administration district offices listed on the back cover of this circular.

Regional Agricultural Credit Corporations

THE EMERGENCY Relief and Construction Act of 1932 authorized the Reconstruction Finance Corporation to create in any of the 12 Federal land bank districts, when it appeared to be desirable, a regional agricultural credit corporation to make direct loans to farmers and stockmen for agricultural purposes (including crop production), or for the raising, fattening, or marketing of livestock. Corporations were organized in each of the 12 Federal land bank districts and in addition 21 branch offices were established in order to better serve these districts.

The supervision of the 12 corporations was placed under the Farm Credit Administration by Executive order of the President, effective May 27, 1933. These emergency credit institutions are now being liquidated as rapidly as is possible without causing undue hardship to their borrowers. Much of the business they formerly handled is now being taken care of through the permanent system of production credit associations.

Emergency Crop and Feed Loans

UNDER the President's Executive order of March 27, 1933, the responsibility for making and supervising emergency crop and feed loans was transferred from the Department of Agriculture to the Farm Credit Administration. For the year 1936, an Executive order of February 28, 1936, made available to the Governor of the Farm Credit Administration funds from the Emergency Relief Appropriation Act of 1935 for loans to farmers for the production and harvesting of crops and for feed for livestock. The gross amount allocated for this purpose, including administrative expenses, was \$37,000,000.

Emergency crop and feed loans are made only to farmers who are unable to secure credit elsewhere. If a farmer-applicant has security to offer, he should apply for credit for production purposes to other credit institutions, such as his local production credit association. (See p. 26.)

Source of Loan Funds

THE PERMANENT institutions under the Farm Credit Administration form a system whereby farmers collectively may obtain the credit they need from investors on satisfactory terms and at the lowest possible cost to themselves.

The Federal land banks are now obtaining the new funds they lend through the sale of bonds to the investing public.

The Federal intermediate credit banks obtain their loan funds through the sale of debentures to the investing public.

The banks for cooperatives are making their loans from capital funds. When additional funds are needed, however, they may discount loans with the Federal intermediate credit banks. The Central Bank for Cooperatives also may issue its own debentures and may lend to the district banks for cooperatives.

The production credit corporations are not engaged in lending activities, but the production credit associations, supervised by the corporations, obtain their loan funds by borrowing or discounting with the Federal intermediate credit banks.

**DISTRICT OFFICES OF THE FARM
CREDIT ADMINISTRATION**

INFORMATION on all institutions under the supervision of the Farm Credit Administration may be obtained from the district offices. Their locations with the district served by each are as follows:

Springfield, Massachusetts

Maine, New Hampshire, Vermont, Massachusetts, Rhode Island, Connecticut, New York, and New Jersey

Baltimore, Maryland

Pennsylvania, West Virginia, Virginia, Delaware, Maryland, and the District of Columbia

Columbia, South Carolina

North and South Carolina, Georgia, and Florida

Louisville, Kentucky

Tennessee, Kentucky, Indiana, and Ohio

New Orleans, Louisiana

Louisiana, Mississippi, and Alabama

St. Louis, Missouri

Illinois, Missouri, and Arkansas

St. Paul, Minnesota

North Dakota, Minnesota, Wisconsin, and Michigan

Omaha, Nebraska

South Dakota, Wyoming, Nebraska, and Iowa

Wichita, Kansas

Kansas, Oklahoma, Colorado, and New Mexico

Houston, Texas

Texas

Oakland, California

California, Nevada, Utah, and Arizona

Spokane, Washington

Washington, Montana, Oregon, and Idaho

The **FEDERAL
INTERMEDIATE
CREDIT BANKS**



Farm Credit Administration

W. I. Myers, Governor

Geo. M. Brennan

Intermediate Credit Commissioner

Circular No. 7

Revised January 1937

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SALES OF DEBENTURES

INQUIRIES concerning Federal intermediate credit bank debentures may be addressed to Charles R. Dunn, fiscal agent of the Federal intermediate credit banks, 31 Nassau Street, New York, N. Y., or to any Federal intermediate credit bank.

Debentures usually are offered between the 1st and 10th of each month, for delivery on the 15th. They may be obtained in denominations of \$5,000, \$10,000, and \$50,000, and for terms ranging from 3 to 12 months, with interest payable at maturity.

Consolidated financial statements and earnings statements of the banks may be obtained from the Intermediate Credit Commissioner, the fiscal agent, or from any Federal intermediate credit bank.

FEDERAL INTERMEDIATE CREDIT BANKS

FEDERAL intermediate credit banks are essentially banks of discount for agriculture. They were created to provide a permanent and dependable source of funds required by local institutions in financing the seasonal production and marketing credit needs of farm and range, at rates of interest comparable to those available to other industries and with maturities adapted to the normal liquidating seasons of agriculture. The banks obtain their loanable funds primarily through sales of short-term debentures in the investment markets. For more than 13 years they have been successful in coordinating the sound credit requirements of agriculture with the safety demanded by investors in prime, short-term securities.

HISTORICAL BACKGROUND

THE 12 Federal intermediate credit banks, operated under the supervision of the Farm Credit Administration, are the second oldest unit in that organization. They are located in the same cities as the Federal land banks. The Agricultural Credits Act of 1923, under which they were organized and now operate, was passed by the Sixty-seventh Congress as an amendment to the Federal Farm Loan Act of 1916, and was approved March 4, 1923.

Even before the World War agricultural leaders urged the establishment of a financing system, under Government supervision, to meet the intermediate credit needs of farmers; that is, credit which would cover the seasonal periods of production and marketing of farm and livestock products as distinguished from long-term farm mortgage loans. This demand be-

came so widespread that in 1921 a Joint Commission of Agricultural Inquiry was delegated by the Congress to make a study of available credit facilities and the need for additional sources of short-term financing.

In an exhaustive report of its findings, the Commission stated: "The debacle of prices in 1920 and 1921 has reduced the farmer to a condition worse than he has suffered under for 30 years." Further: "The banking machinery of the country is not adequately adapted to the farmers' requirements." At the time of this report, as later during the more serious phase of the recent depression, many commercial banks had withdrawn from the short and intermediate term agricultural credit field. There was no adequate source from which stockmen, grain growers, orchardists, and general farmers could obtain credit to carry them through their production and marketing seasons.

The War Finance Corporation, organized in April 1918, to finance industries essential to the prosecution of the World War, was authorized in 1921 to extend credit to banks, livestock loan companies, agricultural credit corporations, and similar financing institutions engaged in financing farmers and stockmen. The War Finance Corporation was created as an emergency institution, and the services which it was authorized to render to agriculture were intended to be strictly temporary. Unless more permanent facilities could be provided to finance farmers and stockmen it was evident that drastic, enforced liquidation might result, with inestimable losses to agriculture as well as to banks and other concerns with agricultural and livestock loans.

Having ascertained the need for more permanent and dependable credit facilities to serve the needs of agriculture, the Congress was next faced with the difficult problem of determining the best means of correcting the existing conditions. There developed two major schools of thought among the proponents of remedial legislation. One advanced the theory that the

Federal Reserve banks should be enabled to discount paper for agricultural lending organizations, such as livestock loan companies and agricultural credit corporations, as well as for country banks. The other held to the view that the facilities of the Federal Reserve System were not adapted to financing the seasonal production credit needs of agriculture. These two conflicting theories and several others, each represented by a separate bill introduced in Congress, were warmly debated in both Houses. When the debates failed to reconcile these widely divergent views, a joint committee was appointed to consider all phases of the question and to submit recommendations for legislative action.

Agricultural Credits Act of 1923

The investigations and deliberations of the Congress finally took form in the Agricultural Credits Act of 1923, which consists of two separate parts. One provided for the creation of 12 Federal intermediate credit banks, capitalized with funds supplied by the United States Treasury and placed under the supervision of the Federal Farm Loan Board, which also administered the Federal land banks and joint stock land banks organized under the Federal Farm Loan Act.

The second part of the act authorized the incorporation of national agricultural credit corporations, to be privately capitalized and to be chartered and supervised by the Office of the Comptroller of the Currency. They were empowered to make loans for agricultural purposes and to borrow money and rediscount paper. Although they were authorized, also, to issue and sell collateral trust notes or debentures, no debentures were issued by these corporations. Only three national agricultural credit corporations were formed, two of which liquidated after one season's operations, leaving only one corporation, which is now engaged in an orderly liquidation of its affairs. The provisions of the act authorizing the organization

of national agricultural credit corporations were repealed by section 77 of the Farm Credit Act of 1933, approved June 16, 1933.

SET-UP AND OPERATIONS

Organization and Supervision

THE Agricultural Credits Act of 1923 originally provided that the officers and directors of the 12 Federal land banks should be, ex-officio, the officers and directors of the Federal intermediate credit banks. This provision was modified by the Farm Credit Act of 1933 to permit the election of a separate staff of executive officers. However, the intermediate credit banks still retain the same directorates as function for the several Federal land banks, production credit corporations, and district banks for cooperatives.

General supervision of the Federal intermediate credit banks, with broad powers of regulation, is vested in the Governor of the Farm Credit Administration and the Intermediate Credit Commissioner. (These powers were exercised originally by the Federal Farm Loan Board, whose functions were transferred to the Farm Credit Administration by the President, under Executive Order No. 6084, dated Mar. 27, 1933, effective May 27, 1933.) The Farm Credit Act of 1933 created the Office of Intermediate Credit Commissioner. The Commissioner is appointed by the President, by and with the advice and consent of the Senate. Subject to applicable provisions of law and to the supervision of the Governor, the Commissioner issues rules and regulations governing the operations of the Federal intermediate credit banks; fixes the maximum interest spread permitted between the discount rates of the banks and the rates which financing institutions may charge on paper rediscounted or pledged with the intermediate credit banks; and prescribes procedures governing the receipt, custody, substitution, and release of collateral securing debentures.

Supervision of the banks involves the determination of general policies and practices to be followed by them as well as the coordination of their operations in a unified credit system, operating on a national scale, and in cooperation with other credit units of the Farm Credit Administration. Certain actions of the banks are subject to the approval of the Intermediate Credit Commissioner, including the borrowing of money; the issuance and sale of debentures and the rates of interest to be borne thereby; the establishment of loan and discount rates; the selection and appointment of officers and employees and the fixing of their compensation; and the approval of the bylaws of the banks.

Examination

All Federal intermediate credit banks are examined twice each year by examiners designated by, and responsible to, the Governor of the Farm Credit Administration. The reports of such examiners are reviewed by the Division of Examinations of the Farm Credit Administration and by the Intermediate Credit Commissioner, who prescribes such corrective action as may be necessary or advisable.

Capital

The original authorized capital of each Federal intermediate credit bank was \$5,000,000, or a total of \$60,000,000 for the 12 banks. The total amount authorized was subscribed for by the Secretary of the Treasury and was paid to the banks from time to time upon call of their respective boards of directors, with the approval of the Federal Farm Loan Board or, later, the Governor of the Farm Credit Administration. The first payment of capital was made by the United States Treasury on April 21, 1923, and the last of the original \$60,000,000 was paid in on June 26, 1933.

Under an amendment to the original act, embodied in the Federal Farm Mortgage Corporation Act of January 31, 1934, additional

capital for the Federal intermediate credit banks was provided. The Governor of the Farm Credit Administration was authorized, on behalf of the United States, to subscribe to the capital stock and/or paid-in surplus of the Federal intermediate credit banks, in such amounts as he might determine to be necessary to meet the credit needs of eligible borrowers in their respective districts, and a revolving fund of \$40,000,000 was made available for that purpose. The Governor, thereupon, subscribed the sum of \$10,000,000 to the capital and \$30,000,000 to the paid-in surpluses of the 12 Federal intermediate credit banks, all of which was paid in during the months of June and July, 1934. Thus, the paid-in capital of the banks was increased to \$70,000,000; in addition, the banks now have \$30,000,000 of paid-in surplus, aside from their earned surplus and undivided profits. Within the limitations of the sums made available for that purpose, as set forth above, the Governor is authorized to increase or decrease the capital and paid-in surplus of any Federal intermediate credit bank as he may determine to be necessary to meet its requirements.

Discount and Interest Rates

Under the law, the discount rate of a Federal intermediate credit bank may not, except with the approval of the Governor of the Farm Credit Administration, exceed by more than 1 percent per annum the rate borne by the last preceding issue of debentures which it issued or in which it participated.

Income and Expenses

All interest costs on debentures issued and other money borrowed, the expenses of issuing and selling debentures, as well as all salaries and other operating costs of the Federal intermediate credit banks are paid by them out of income. No part of such costs and expenses is paid by the United States Government. In

addition, they are assessed by the Farm Credit Administration for the expenses of the Division of Examinations, incurred in making examinations of such banks. Any Federal intermediate credit bank which has an earned surplus equal to its subscribed capital is required, by law, to pay 50 percent of its net earnings to the United States as a franchise tax.

Prior to an amendment to the original act, effective January 1, 1932, each Federal intermediate credit bank was required to pay a franchise tax equal to one-half of its net earnings, after all expenses had been paid or provided for. From date of organization to December 31, 1931, they paid franchise taxes aggregating \$2,496,778.70. In addition to the amounts paid to the Government, the banks have accumulated net earnings to December 31, 1936, amounting to \$8,385,596.32, which are reflected in earned surplus and undivided profits accounts. Since no intermediate credit bank has built up such a surplus equal to its subscribed capital, no tax has become due since January 1, 1932.

The Federal intermediate credit banks have two principal sources of income, namely, interest earned on loans and discounts and interest on securities owned. Ordinarily, net interest income arising from loan and discount operations should cover all operating costs as well as ordinary losses which may develop, thus leaving all other income to accumulate as a surplus to meet unforeseen contingencies and as an additional protection to investors in their debentures. The net interest income of the banks depends upon the spread in rate between the cost of funds and the rate charged by the banks on their loans and discounts. As a protection against adverse changes in the rate structure and to enable the banks to maintain a favorable lending rate, they give careful consideration to several fundamental factors in financing their operations. In addition to the present and prospective levels of short-term money rates, these fundamental factors include:

(a) Coordination of debenture maturities with the maturities of their loans and discounts;

(b) The issuance of debentures with 9- and 12-month maturities to finance the probable minimum amount of outstanding loans and discounts during the annual cycle, with shorter maturities to provide funds for their seasonal peaks.

Sources of Loan Funds

The Federal intermediate credit banks do not lend "Government money." Funds for lending purposes are obtained largely through sales of short-term debentures upon which the United States Government assumes no liability. With the approval of the Intermediate Credit Commissioner, any Federal intermediate credit bank may rediscount eligible paper with a Federal Reserve bank and may rediscount with or borrow from other banking institutions. The power to borrow money or rediscount paper has been used to a limited extent only, the major portion of the loan funds of the Federal intermediate credit banks having been derived from sales of debentures.

Debentures

The aggregate amount of outstanding debentures and similar obligations issued by or on behalf of any Federal intermediate credit bank may not, under the law, exceed 10 times the surplus and paid-in capital of such bank.

Prior to October 15, 1935, debentures were the primary obligations of the particular bank which issued them. Since that date, the banks have issued only consolidated debentures for which all 12 banks are jointly and severally liable. Although the banks are authorized to issue debentures with maturities up to 5 years, all except a relatively small amount sold from organization to date have carried maturities of 1 year or less.

Debentures of the Federal intermediate credit banks are secured, primarily, by notes and other such obligations representing their loans and

discounts, and by cash or United States Government obligations. The United States assumes no liability, direct or indirect, for any obligation incurred by any Federal intermediate credit bank. The collateral securing debentures is assigned to and held by the farm loan registrars of the several districts, who are bonded public officials, appointed by and responsible directly to the Farm Credit Administration. Notes of farmers and stockmen used as collateral for debentures ordinarily are secured by chattel mortgages on livestock and other personal property, crop liens, etc., and are required to be indorsed by the production credit association or other financing institution which made the loans in the first instance. Loans made direct to cooperative associations are secured by the pledge of warehouse receipts or other title documents covering approved commodities or by other acceptable collateral.

Investment Qualities of Debentures

Debentures issued by or on behalf of Federal intermediate credit banks are exempt from Federal, State, municipal, and local taxation. They are lawful investments and may be accepted as security for all fiduciary, trust, and public funds under the authority or control of the United States or of any officer or officers thereof. They are approved as collateral security for deposits of postal savings funds.

The Federal Reserve banks are authorized to buy and sell debentures issued by the Federal intermediate credit banks, with maturities at the time of purchase of not to exceed 6 months. Any Federal Reserve bank, also, may make advances to member banks for periods not exceeding 15 days on promissory notes secured by debentures which are eligible for purchase by the Federal Reserve banks.

The State of New York has made debentures of intermediate credit banks legal investments for insurance companies and savings banks, and the State of Florida has authorized the invest-

ment of fiduciary and trust funds in such debentures. The attorney general of the State of Kentucky has ruled that consolidated debentures are lawful investments for fiduciaries in that State. The statutes of some States authorize investments in any securities approved for that purpose by designated public officers. The laws of certain other States, while not referring specifically to Federal intermediate credit bank debentures, contain provisions relating to legal investments under which such debentures would appear to qualify.

Functions of the Banks

The Federal intermediate credit banks are designed to serve as permanent sources of agricultural and livestock credit. They are not emergency institutions or relief organizations. Their permanence and usefulness are dependent upon the exercise of sound credit policies and practices since, to procure funds for lending purposes, they rely primarily upon the marketability of their debentures at favorable rates.

The primary function of the Federal intermediate credit banks, as banks of discount for agriculture, is to provide funds for financing the seasonal production and marketing needs of stockmen and farmers, as distinguished from long-term amortized farm mortgage loans. In their lending operations they deal only with financing institutions and duly organized cooperative associations—not with individual farmers and stockmen. They do not accept deposits or otherwise engage in the customary functions of commercial banks. Under the act creating the banks, as subsequently amended, they are authorized to discount (or make loans upon the security of) paper offered to them by, and with the endorsement of, any production credit association or bank for cooperatives organized under the Farm Credit Act of 1933, or by any national bank, State bank, trust company, agricultural credit corporation, incorporated livestock loan company, savings institution,

cooperative bank, credit union, or cooperative association of agricultural producers organized under the laws of any State or of the Government of the United States.

The banks are authorized, also, to make loans to bona fide cooperative associations of farmers and stockmen, upon the security of warehouse receipts or shipping documents representing staple agricultural products or chattel mortgages on livestock, or upon the security of such other collateral as may be approved by the Governor of the Farm Credit Administration; and they may accept drafts or bills of exchange drawn by any such association when secured by warehouse receipts or shipping documents covering staple agricultural products. Advances to cooperative associations on the security of commodities or livestock only may not, under the law, exceed 75 percent of the current market value of the collateral.

By the provisions of the Farm Credit Act of 1935, which amended the 1933 act, the banks for cooperatives were enabled to make commodity loans to cooperatives, and the Federal intermediate credit banks now have virtually withdrawn from that field. The banks for cooperatives ordinarily rediscount their commodity loans with the intermediate credit banks.

Production Credit Associations

The basic lending policies of production credit associations are governed by rules and regulations prescribed by the production credit corporations of the several farm credit districts, with the approval of the Production Credit Commissioner. The provisions of such regulations conform to the general principles applicable to notes discounted by Federal intermediate credit banks for State and national banks and other privately capitalized financing institutions, and the acceptability of such paper offered to a Federal intermediate credit bank is determined by the bank in each instance.

Banks for Cooperatives

Only commodity loans made by the banks for cooperatives are rediscounted with the Federal intermediate credit banks. They are made upon the same general terms and conditions as those established by the intermediate credit banks for direct loans to cooperative associations. Applications for loans that are to be offered to a Federal intermediate credit bank by a bank for cooperatives are submitted to the credit bank to determine their acceptability before commitments are made to the applicant associations.

Other Financing Institutions

To qualify for the privilege of borrowing from or rediscounting with a Federal intermediate credit bank, a financing institution must be incorporated, with a paid-in capital commensurate with the volume and character of business it expects to handle; and, in any event, shall have a paid-in and unimpaired capital and surplus of not less than \$10,000. Ordinarily, such a corporation should have a minimum capital of \$25,000, to enable it to handle a volume of business that will produce earnings sufficient to provide competent management, cover other operating costs, and establish reserves for possible losses. Such corporations, also, must comply with State laws applicable to them.

Applications

Before a financing institution may be granted the privilege of borrowing from or rediscounting paper with a Federal intermediate credit bank, it is required to file with the bank an application in the form prescribed by the bank. A complete, current financial statement of the applicant, together with certified copies of certain documents evidencing the power of the corporation to do business, including articles of incorporation, bylaws, certificates of election and incumbency of officers, and resolutions of the board of directors authorizing the execution

of the application, are required to be filed with the intermediate credit bank.

As a condition to the granting of credit to any financing institution, the Federal intermediate credit bank requires an agreement on the part of the applicant to submit, at its own expense, to periodic examinations by examiners for the Federal intermediate credit bank, or the Farm Credit Administration or by national bank examiners. Any bank, trust company, or savings institution operating under the supervision of State or national banking authorities, in lieu of such agreement, may submit its authorization to such supervising authority, in writing, to furnish the Federal intermediate credit bank or the Farm Credit Administration, upon request, any report of condition or report of examination or other confidential information in the possession of such supervising authority.

Additional Collateral

A financing institution (other than a bank), as a condition precedent to borrowing from or rediscounting with a Federal intermediate credit bank, is required to pledge with the bank as additional collateral to any and all obligations to the bank, cash, United States Government bonds, or other readily marketable securities of high rating, in an amount equal to a substantial portion of its capital. In the discretion of the Federal intermediate credit bank concerned, banking institutions also may be required to deposit additional, acceptable collateral.

Limitations Upon Credit Lines

The maximum amount of credit which may be extended to any financing institution depends upon a number of factors, including the amount of net unimpaired capital and surplus of the applicant, how such capital is invested, the amount thereof pledged with the Federal intermediate credit bank as collateral, the

quality of paper it offers to the bank, and the character of its management. Total credit lines are subject, in any event, to the following maximum limitations prescribed by law:

(a) **Financing Institutions.**—Credit granted to a financing institution (other than a bank) is limited to an amount which, when added to its other liabilities, will not exceed the total liabilities which the corporation may incur under the laws governing its operations or, in any event, will not exceed ten times its paid-in and unimpaired capital and surplus.

(b) **Banking Institutions.**—Credit extended to any banking institution is limited to an amount which, when added to its other liabilities (other than bona fide deposit liabilities), will not exceed the amount of such liability permitted under the laws of the jurisdiction creating such bank or, in any event, will not exceed twice its paid-in and unimpaired capital and surplus.

The aggregate amount of credit which a credit corporation or loan company may obtain from a Federal intermediate credit bank, ordinarily, is substantially less than ten times the capital and surplus of such corporation.

Character of Paper

To be acceptable to a Federal intermediate credit bank, paper offered by a financing institution for discount or as collateral security for a loan shall be of such character as to assure liquidation of the obligation within a reasonable time, consistent with sound banking and agricultural practices. In any case where the collateral offered is the principal factor in determining the acceptability of a note, a margin of security adequate to protect the bank during the full term of the obligation will be required.

Each note or other item offered to a Federal intermediate credit bank for discount, or as collateral for a loan to a financing institution, is carefully analyzed and its acceptability determined on the basis of its merit, rather than upon the endorsement of the offering institution. Such endorsement, together with all

securities which the financing institution has deposited with the bank as additional collateral, constitute the additional margin of protection to the bank against losses.

Eligibility of Paper

To be eligible for discount for, or as collateral for loans to, privately capitalized financing institutions, notes offered to a Federal intermediate credit bank must meet the following requirements:

(a) The proceeds of the notes must have been advanced or used in the first instance for an agricultural purpose; that is, for the purpose of carrying on agricultural production, including the raising, breeding, feeding, or marketing of livestock, defraying expenses incident thereto, or paying an indebtedness arising therefrom.

(b) The maximum amount of the note maker's obligations to the financing institution may not, except with the consent of the Intermediate Credit Commissioner, exceed the following limitations:

(1) Twenty percent of the paid-in and unimpaired capital and surplus of the financing institution, in the case of crop production and general agricultural paper; or

(2) Fifty percent of the paid-in and unimpaired capital and surplus of such institution, if the notes are adequately secured by warehouse receipts representing readily marketable and nonperishable staple agricultural commodities, or by chattel mortgages on livestock.

These maximum amounts are subject to such further limitations as may be imposed by the laws governing the operations of the financing institution concerned.

(c) The rate of interest or discount charged the note maker may not exceed by more than 3 percent per annum the loan and discount rate of the Federal intermediate credit bank, in effect at the time the loan is made.

(d) No fee or commission for making the loan may be charged by the financing institution, aside from interest at a rate conforming to

the regulations of the Farm Credit Administration and reimbursement for reasonable and necessary actual costs incurred by the financing institution in making the loan, such as the expenses of necessary inspections of the security, obtaining chattel mortgage abstracts or other evidences of title and priority of its liens, and filing or recording mortgages.

(e) Maturities of notes should coincide, as nearly as may be practicable, with the usual time for the marketing of crops or livestock from which liquidation is expected. Ordinarily, maturities of such notes will not exceed one growing and/or marketing season, usually not more than 12 months. Notes of dairymen, secured by chattel mortgages on dairy cattle and made payable in regular monthly or semi-monthly installments, in amounts ordinarily sufficient to liquidate the paper at its maturity may be discounted or accepted as collateral when drawn to mature not more than 2½ years from the date of discount or pledge, except that in the event the dairy cattle are subjected to intensive feeding and milk production, the maturities shall be not more than 2 years from date of discount or pledge.

(f) Notes of a farming or livestock corporation will be required to be endorsed, or signed as comaker(s), by (1) the holder or holders of at least the majority of the outstanding shares of voting stock of the corporation or, (2) under certain conditions, by the principal stockholder or stockholders; or the bank will require that such stockholders execute a continuing guaranty of all indebtedness of such corporation to the financing institution and its successors or assigns.

(g) Notes of irrigation companies, canal companies, and similar concerns engaged in the business of supplying farmers with irrigation water or other services or supplies, are not eligible for discount, or as collateral for loans, by a Federal intermediate credit bank. Notes given by farmers and stockmen to merchants or dealers, for the purchase of livestock, machinery,

or farm supplies, fertilizer, etc., ordinarily are not eligible for discount by an intermediate credit bank, since the discounting of such paper would constitute financing of the merchant's credit sales.

SUMMARY

SINCE their organization in 1923 the Federal intermediate credit banks have become of increasing importance in financing those credit requirements of agriculture which lie between the maturities usually offered by commercial lenders and long-term mortgage loans. By discounting agricultural paper for local financing institutions these banks have extended credit to finance farmers throughout the United States, at rates of interest comparable with those paid by other industries.

Owing chiefly to the manner in which their lending operations are financed, the credit banks have at all times been able to obtain adequate funds to meet the needs of their customers. Consequently, the credit service offered by them is particularly valuable and stable during times of financial stress when the reduced flow of funds through other channels greatly restricts the making of new loans and frequently necessitates calls for liquidation of even the best of paper.

These banks have well-trained, competent personnel which, under the provisions of the law and the general supervision of the Farm Credit Administration, have been able to meet the legitimate credit requirements of agriculture upon a sound basis. Their debentures are recognized as prime short-term investments for banks and others desiring a high degree of safety and liquidity.

CHECKED

2003-04

Location of the
**FEDERAL INTERMEDIATE CREDIT
BANKS**

and the territory served by each



SPRINGFIELD, MASS.

Connecticut, Maine, Massachusetts, New Hampshire, New Jersey, New York, Rhode Island, and Vermont

BALTIMORE, MD.

Delaware, District of Columbia, Maryland, Pennsylvania, Virginia, West Virginia, and Puerto Rico

COLUMBIA, S. C.

Florida, Georgia, North Carolina, and South Carolina

LOUISVILLE, KY.

Indiana, Kentucky, Ohio, and Tennessee

NEW ORLEANS, LA.

Alabama, Louisiana, and Mississippi

ST. LOUIS, MO.

Arkansas, Illinois, and Missouri

ST. PAUL, MINN.

Michigan, Minnesota, North Dakota, and Wisconsin

OMAHA, NEBR.

Iowa, Nebraska, South Dakota, and Wyoming

WICHITA, KANS.

Colorado, Kansas, New Mexico, and Oklahoma

HOUSTON, TEX.

Texas

OAKLAND, CALIF.

Arizona, California, Nevada, and Utah

SPOKANE, WASH.

Idaho, Montana, Oregon, and Washington