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## Buying Land? Avoid Foreclosure

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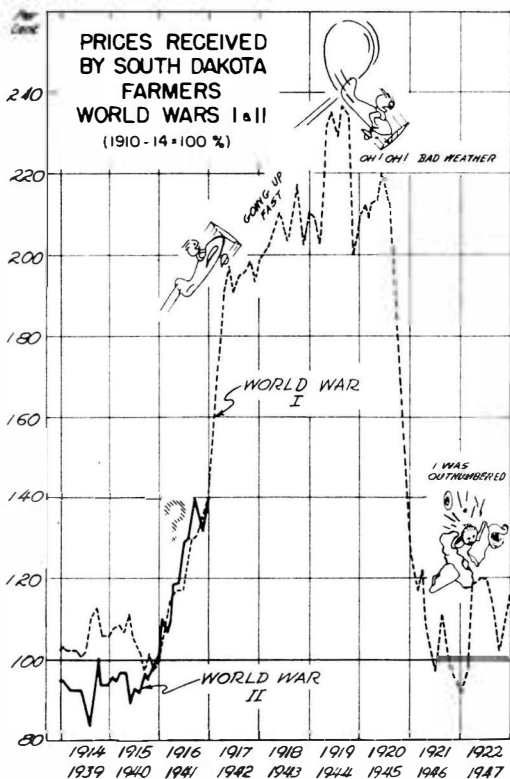
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# Buying Land?

## AVOID FORECLOSURE



Are farm land prices headed for another war-time inflationary flight to be followed by another inevitable depression crack-up? Before you borrow funds to buy that farm after inflated land prices arrive, read the following questions and answers by Gabriel Lundy, Agricultural Experiment Station economist and Head of the Agricultural Economics Department, South Dakota State College.

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# Buying Land?

## AVOID FORECLOSURE

### Introduction

The purpose of this publication is to help South Dakota farmers avoid being caught in another costly mortgage foreclosure epidemic some time after the present War has ended. In order to save themselves from such violent debt reduction by foreclosure, as a result of a possible after-the-War drop in prices of farm products, it may be advisable not to go heavily into debt for land after land prices may have risen beyond normal or prospective long-time values based on conservative income expectations from the land.

Obviously this warning is not intended to discourage farmers from buying at conservative, pre-inflation prices the land they want and need for efficient and profitable farm operations and for acquiring a home of their own. On the other hand, it would seem desirable to discourage purely speculative purchases of land to be resold to farmers at a higher price. Reminded of the fact that land prices have been rising and falling in broad swings or waves and that war inflations tend temporarily to raise prices dangerously high, farmers should be in a better position to judge when to buy.

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Q. Say, Mr. Economist, I've been thinking of buying some land. I can't see how a farmer or anyone else can fail to get rich buying land when prices of farm products apparently are heading for inflationary heights. What do you think about it?

A. You are asking an important question, Mr. Prospect. If you want to buy land you should buy before land prices go too high. It is just as important for a farmer to purchase his land when prices are reasonable as to refrain from buying on credit after land

prices have become inflated. No one can guess how high prices will go, nor how long they will stay up, but we do know that a most important thing to remember about war inflations is that they have always been followed by deflation. Farmers may gain on rising prices, but if they take on heavy mortgage debts at inflated values they are in danger of losing even more when prices finally collapse.

**Q.** Just a minute! We have to eat and, especially since they have obtained a much greater degree of production and price control through government assistance, farmers have a monopoly on food production, haven't they?

**A.** Not exactly; if farmers tried to get unfairly high prices city consumers would outvote them. Farming is still a highly competitive business of small units, with relatively large costs that are hard to reduce, slow turnover and narrow margin of profit. On this account the farmer's selling prices both rise and fall faster than his costs, and once his costs have been inflated and prices fall he is ground between the lower millstone of high costs and the upper millstone of low selling prices.

**Q.** But under inflation, money will be worth less. Wouldn't it be better to get my money into real wealth, such as land?

**A.** Possibly, especially if you can do it before land prices rise too much. One difficulty is that the average farmer has to borrow money and mortgage his farm when he buys land. Many of them will need good prices for some time before they can save enough for a down payment. By that time land prices may be too high. There is danger in buying land on credit at inflated prices. Just see what happened during World War I. Between 1910 and 1920 South Dakota land values, according to the Census, rose from \$38.63 to \$71.40 per acre but the percentage of owner-operated farms reported mortgaged rose from 37.4 percent to 57.0 percent, and the total farm mortgage debt rose from \$84,943,000 to \$315,897,000.<sup>1</sup>

**Q.** Well! Did all our farmers buy land on credit?

**A.** On the contrary, although there were 3,007 fewer farms in 1920 than in 1910, the number of owner-operated farms declined by 10,169.

**Q.** Then, how do you account for that farm debt increase?

**A.** There were many causes. Land prices had been rising for a quarter century when we entered the War in 1917 and a continually rising price of land may have seemed not only normal but certain. Many people still believed that population was increasing faster than the food supply. They were not aware of the decline in the birth rate and the drying up of the flood of immigrants seeking land and jobs. It was believed that Europe would always buy considerable quantities of our farm products. This, coupled with the knowledge that the best lands in the United States were already occupied seemed to form a substantial basis for the assumption that land always would be a profitable investment.

**Q.** What effect did the war have on land prices?

**A.** Farmers were urged as a patriotic duty and stimulated by higher prices to produce more food. As prices of farm products rose during the period of war inflation, farm income expanded and was capitalized into higher land values and activity in land sales increased. Speculators were active in buying land and pushing sales at higher prices. Farmers who wanted land either for themselves or for their sons became "sold" on the idea that they had "better buy now" before prices went still higher. Credit became relatively easy to obtain, and purchase-money mortgages expanded in size in harmony with rising land prices. In addition, the easy credit induced many farmers to borrow for farm improvements. Not only did the loans per acre become larger but mortgages were also placed on more acres.

**Q.** But where did all this money for loans come from?

**A.** Inflation usually results from a more rapid increase in the quantity and rate of turnover of money and credit than in purchasable commodities. Farmers and others borrowed at the banks to furnish credit for the government. More money was also put into circulation. The increased amount and rate of turnover of money and credit resulted not only in bidding up the price of commodities and land, but it also gave lending agencies more money to invest. For instance, whereas up to 1910 individuals had

been the chief source of loan funds in many South Dakota counties, by 1920 the life insurance company loans were the most important. The higher interest rates on South Dakota mortgage loans attracted much out-of-state money from corporate lenders during the War boom period. In addition, South Dakota borrowed 47½ millions of dollars on bonds and loaned farmers as much as 70 percent of the sale price of the mortgaged land.

**Q.** You said earlier that farm costs lag behind selling prices and “get” the farmer when prices drop. Any proof?

**A.** Yes, plenty. Taking the 1910-14 average as a base, prices received by South Dakota farmers dropped from an annual average of 218 in 1919 to 106 in 1921. Prices paid by farmers dropped so much less that the ratio of prices received to prices paid fell from 111 in 1919 to 75 in 1921.<sup>2</sup> Then there were the higher fixed interest charges and quadrupled tax payments on top of other high production costs. This put the farmer in such a tight financial nut-cracker that he had to mortgage more land and give second and third mortgages to pay expenses and give security to unsecured creditors who demanded cash or collateral. As a result the farm mortgage debt increased almost half again from 1920 to 1924, when it reached \$461,513,000.<sup>1</sup>

**Q.** Then what happened?

**A.** It had already begun to happen and it lasted about four times as long as the inflation. As soon as prices of crops and livestock dropped at the end of 1920 many farmers became unable to meet their inflated debt payments, and creditors had begun to foreclose their mortgages. Foreclosures instituted in 1921 were almost twice as many as those of 1913. The peak years were 1924 and 1932 when foreclosures started involved 836,205 and 850,826 acres, respectively. But even after 19 years of high foreclosure activity covering more than 11,000,000 acres, which should have wiped out all the excessive loans, there still were more foreclosures instituted in the relatively good year of 1940 than in 1913. Census values per acre dropped from \$71.40 in 1920 to \$12.80 in 1940.

**Q.** What happened to land ownership?

A. During the last two decades lending agencies such as life insurance companies, the South Dakota Rural Credit board and the Federal Land Bank have acquired enormous acreages of South Dakota farm land. During the depression thousands of South Dakota farmers not only lost their farms through mortgage foreclosure but also had to receive public relief assistance. Tenancy increased from 34.9 percent in 1920 to 53.0 percent in 1940. It is a repetition of such inflationary mortgage expansion and post-war foreclosure liquidation that South Dakota farmers need to guard against.

Q. Was South Dakota any worse off than the rest of the country with respect to the mortgage increase and decrease?

A. In some respects, yes. The estimated total United States farm mortgage debt rose from \$3,207,863,000 in 1910 to a peak of \$10,785,621,000 in 1923. In South Dakota the expansion continued to 1924, but in 1923 it was \$451,281,000.<sup>1</sup> For the same 13-year period there was a 236 percent increase in the United States farm mortgage debt and a 431 percent expansion in South Dakota. Up to 1924 the South Dakota percentage was 443. By 1940 the United States still carried 64.1 percent of its 1923 debt burden, whereas the South Dakota indebtedness had been squeezed down to 33.7 percent of the 1923 volume, or 32.9 percent of its 1924 peak. Foreclosures had wiped out not only many mortgages but also many owner-operating farmers. The Census says there were 47,815 South Dakota farms operated by owners in 1920 and only 33,803 in 1940, a 29.3 percent drop. For the United States the reduction was proportionally smaller, from 3.92 million to 3.69 million, or only 5.8 percent.

Q. How do you account for the more violent fluctuations in South Dakota?

A. There were many causes. In the light of subsequent developments the war-time price stimulus to farm production plus the better than average precipitation appear to have over-expanded South Dakota agriculture. Land in farms increased from 26 to 34.6 million acres between 1910 and 1920, a 33 percent expansion. Land since found better for grazing than

for farming was put into wheat. Most of the Great Plains states had a similar experience. The number of farms in South Dakota declined from 83,157 in 1930 to 72,454 in 1940. During the same decade rural population declined for the first time, with a drop of 77,068. This may be just one phase of becoming adjusted to our mid-continent environment. The annual precipitation during the last decade was less than the previous 40-year average and some yields were disappointing. For some years prices were also very low, resulting in greatly reduced farm income.

**Q. How about the effects of transportation and marketing costs?**

**A.** Let's take an extreme illustration. If the terminal market price of some farm product were \$1 and the South Dakota price were 50 cents, a terminal market price rise to \$1.50 and a South Dakota rise of the same amount to \$1 would mean a 100 percent rise in the South Dakota price and only a 50 percent rise at the terminal market. A drop works the other way. Capitalizing these larger percentage price changes in South Dakota into land values can result in more extreme fluctuations in our mortgage volume than would be the case near central markets and consuming centers.

**Q. If, as you say, we need to guard against another mortgage inflation and deflation, what are the prospects at the present time as compared with the World War I?**

**A.** Interest rates and land prices are much lower, but taxes and marketing costs are higher. The export outlook is less promising. At that time it was not realized that agricultural exports to Europe had been declining for a long time, and that the decline was simply temporarily arrested during the war by liberal extension of United States credit. Since that time Europe has sought to produce its own food or import from empire sources, for fear of starvation in another war and blockade. In this war the European countries open to our exports, that is, not subject to the British blockade or under Nazi control, are very few as compared with 1917-18. Furthermore, at the beginning of World War I we were a debtor nation.

**Q. What difference did that make?**



A. As a debtor nation we were under necessity to export more than we imported in order to pay interest and principal on our large debt to Europe. After that war we not only had repaid our loans but Europe owed us at least \$10,000,000,000. Since then, as a creditor nation, we should have imported more than we exported in order to assist our foreign debtors to pay us. Instead of doing this we raised our tariffs in 1922 and again in 1930. Then Europe not only reduced her food purchases from us, but our former allies in the War found it convenient to refuse to pay what they owed and still owe us.

Q. But the present food exports must be quite a source of profit to our farmers, aren't they?

A. Yes and no. It increases the farmers' cash income, but it must be remembered that the farmer as a taxpayer must help to supply the government with money with which to carry on both normal and war-time activities and supply Lend-Lease food and materiel to Britain and other anti-Axis countries. These outlets cannot be considered long-time sources of income for the purchase of land. Every effort should first be made to pay off old debts. In fact if the nations we are helping in this war again fail to pay us, the "profits" farmers might expect to use in paying for land will be greatly reduced by heavier federal taxes.

Q. But after the war is over Europe certainly will be in need of our food products, don't you think?

A. Temporarily, yes; but possibly even that will have to be on credit or even on a charitable basis. It partly depends on if Europe can escape another economically unsound peace treaty. But an economically sound and united Europe free from trade restrictions is only half of it. Unless we recognize that international lending and trade are two-way transactions and accordingly admit imports in payment for exports we may neither sell our food products to nor collect our loans from Europe, assuming her willingness to pay. Tariff reductions are not easy to bring about, however, because perhaps no group of producers wishes to admit foreign products to compete with its own. For these reasons South America, with its lesser industrialization, may be in better position

than we to export food products to Europe in exchange for manufactured goods.

Q. But don't you think farming should be profitable in the future even if we consider only our own home market?

A. It should be and it can be, relatively, if we solve our unemployment problem, increase factory production and jobs, arrive at a fair distribution of the national income as between capital, labor and agriculture, work efficiently and remove internal barriers to trade and mobility of resources.

Q. Then you admit, don't you, that conditions are favorable for the farmer who wants to buy land?

A. In some respects, yes, if he can buy before it is too late. During the past few years we have recommended the buying of land by farmers. Within recent years land prices have been lower than in 1910, interest rates are lower and farm income has been rising since the depression low. In general it depends on the ability of the farmer and on a lot of things beyond his control, including heavy federal war taxes.

Does he know the fertility of the soil he is going to buy and the variability of rainfall, yields and prices?

Has he made a conservative estimate of the net income, and debt-paying capacity of his farm-family combination?

Is he getting the land at a price that is reasonable in relation to its prospective long-time net income and on a long-term contract that will permit him to pay more in good years and less when income is low so as to be fairly sure to escape foreclosure in case of deflation?

Can he pay down enough to get a low rate of interest on the remainder and still have adequate working capital?

Q. What other factors beyond the farmer's control did you have in mind?

A. Less increase in demand for land than formerly expected, because our population may cease to increase in about 30 years. Further motorization of the farm will call for less land for horsefeed, and increased efficiency in production, as by the use of hybrid corn, also reduces the need for acreage. Land

taxes, which were twice as high in 1939 as in 1910,<sup>1</sup> and the higher marketing costs now, do not reduce the need for land but they do have a depressing effect on land prices. Furthermore, it is well to remember that public consciousness during peace-time has shifted from one of apprehension over food scarcity to one of concern over how to dispose of food surpluses. Just now land does not seem to offer the prospect in the foreseeable future of possessing unusual scarcity value. The purchase of land on credit at inflated prices certainly does not seem warranted.

**Q.** But aren't we sure to have higher prices on land and everything after this enormously expensive war?

**A.** No one knows. It is not impossible, however, permanently higher prices were also predicted after World War I, but we had a depression, as was the case after our other major wars.

**Q.** Might not even that be a reason for buying land? A friend of mine says, "When the war is over we are going to have a depression the like of which has never been seen before. Millions of idle workers will be walking the streets. If you own a piece of land you will be able to raise your own food and snap your fingers at the depression."

**A.** That may be true if your farm is paid for and you have some resources to work with. But remember that modern farming is a commercial venture; it is not self-sufficing. You have to buy many things and what you sell may be dirt cheap. Then if you have a heavy mortgage on your farm it may be more like a trap than a place of refuge.

**Q.** But wouldn't South Dakota be a better state if more farmers owned their own farms?

**A.** Yes, if they were getting ahead. South Dakota would benefit from an increase in the percentage of its farms profitably operated by owners. The increase in the proportion of tenant-operated farms from 24.8 percent in 1910 to 53.0 percent in 1940 is disturbing. All people who have the welfare of the state at heart wish to see a considerable increase in the proportion of our farm land operated by successful farmers who own their own farms. The recent increase in the purchase of land at conservative prices by operating farmers is commendable.

Q. Then if farmers can buy at prices and on terms that will enable them to succeed, you agree that it is desirable?

A. Correct. Although it appears positively dangerous to bid up the price of land and expand mortgage indebtedness on a scale similar to the World War I period, this does not mean that South Dakota farmers should not buy farms or add to their land holdings. Between 1920 and 1940, according to Census reports, the average value per acre of South Dakota farm land has dropped from \$71.40 to \$12.80. In many cases even the lender who acquired the land through foreclosure could not sell the land for as much as he had against it. Although admittedly there is proportionately more low-priced western South Dakota land included in the 1940 price average than was the case in 1910, for which year the average value per acre is given as \$38.63, it would seem that much South Dakota land now may be available at fair prices. Whether to buy or not to buy must be decided by the individual farmer. Clearly a farmer who has not already bought all the land he needs for a farm of economic size may want to consider whether to buy now or rent.

Q. For a while I thought you were a "crepe hanger," but you do favor having farmers own their own farms, don't you?

A. Of course, I do. We ought to have more successful owner-operators. Hence, it would seem well for farmers to acquire farm ownership without enriching land speculators. I'm simply trying to guard against a repetition of the mortgage excesses and destructive foreclosure losses traceable to the World War I inflation and deflation. The traditional thing seems to have been to go into debt during good times and then to go out of both debt and farm ownership during hard times. Having gone through this "practical" but expensive school of experience during the past 25 years in South Dakota, let us not be caught again. It is safer to pay off old debts with cheap money when prices and incomes are high than to expand indebtedness during an inflation and risk sacrificing both property accumulations and self-reliance during the following depression.

1. Agricultural Finance Review, November, 1939, and May, 1941.

2. Agricultural Statistician's office, Sioux Falls, S. D.

# Before Buying A Farm

## Get Reliable Information On

**Its soil.** Fertile, deep, dark surface soil of loam or silt loam, with moisture-holding silty or silty clay subsoil without clay pans, preferred. Avoid farms where soil blows or washes away, or farms run down by exploitive farming.

**Local precipitation.** Amount, timeliness and variability of rainfall.

**Crop yields** on this farm for as many years back as possible. Compare with yields on adjoining farms, reports of average county yields, etc.

**Prospective production** of livestock and livestock products on this farm.

**Prices likely to be received** in future for crops, livestock and livestock products.

**Cost of production** or total expenses, including taxes.

**Harmful weeds** and cost of extermination.

**Probable net income;** conservative estimate of amount available for payment on debt, after subtracting all costs, living expenses, etc. Is farm of adequate size?

**Price of farm.** Are you *sure* you are getting the farm at a price you can stand, and can earn back out of the place?

**Selling price** of this and similar land in same community since 1925.

**Best purchase** or loan terms available, including interest rate. The terms should permit paying in proportion to income each year.

**Working capital.** Will you have adequate working capital to survive some bad years?

**Community services**—roads, markets, schools, churches. Consideration of the above will involve thinking about many factors not specifically mentioned, such as the general price level, present land price in relation to “normal,” stage of price and production cycle for livestock, suitability and condition of buildings on farm, pasture, water supply, marketing costs, AAA productivity rating, etc., including an honest estimate of your own ability as a farm manager.