Farm Credit: Uses and Sources for South Dakota Farmers

Canute M. Johnson

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Farm Credit: Uses and Sources

For

South Dakota Farmers

By

Canute M. Johnson
ACKNOWLEDGMENTS

Most of the ideas presented in this pamphlet are not new. They have been accumulated from many sources, chiefly farm credit publications from other Agricultural Colleges and the literature published by the various lending institutions.

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PART I. USE OF CREDIT IN FARMING

Today, success in farming requires good management—not only good soil, crop, and livestock management, but also good financial management. Farming is becoming more and more commercialized because of the increasing size of farm businesses which has resulted from greater mechanization and specialization in agricultural production. Consequently, more capital than ever before is required to operate a successful farm business and it is becoming ever more necessary to use some borrowed capital (credit) in operating the farm business. Therefore, it is as necessary for farmers to have a knowledge of the uses and sources of credit as it is for them to have a knowledge of crop varieties, cultural practices, feeding programs, etc.

The purpose of this pamphlet is to provide farmers with some basic ideas about the use of credit and some information about the sources of farm credit that they need to know in order to use credit wisely and effectively in the operation of their farm businesses.

A. WHEN TO USE CREDIT

Most people use credit for one or more of three basic purposes and credit may be classified accordingly as:

1. **Consumption Credit** or credit used to finance living expenses, the purchase of cars, TV sets, etc., and other types of personal consumption expenditures such as vacations, education, medical care, etc.

2. **Production Credit** or credit used to finance farm (or business) production or operating expenses and to finance the purchase of feed, seed, fertilizer, livestock and equipment (or non-farm business equipment and inventories).

3. **Mortgage Credit** or credit used to finance the purchase of land and buildings for farm and business purposes or to finance the purchase of homes. Frequently, however, funds obtained by using farm and business property or a dwelling as collateral are used for other purposes.

Five questions should be fully answered in making a decision to use credit.

1. How much and for what purposes is credit needed?
2. How and when will the loan be repaid?
3. Who will make the loan?
4. Will I qualify for a loan?

5. What are the costs of obtaining the loan from alternative credit sources?

In discussing the question of when to use credit more fully, it is necessary to classify the uses of credit in a slightly different manner than above. Here too, a threefold classification will be used: (1) consumption credit; (2) operating credit; and (3) business expansion credit.

1. **Consumption credit** is credit used for purchasing major items of consumers goods, etc. It should normally be used only when there will be income available with which to make installment payments. Available income for this purpose is income over and above the amount necessary to provide shelter, food, clothing, and recreation to a reasonably adequate degree. Thus, installment payments should never take so much of current income that the basic necessities for living cannot be provided. Two other important factors to consider are the stability and certainty of income. If income is unstable, that is, variable from month to month or year to year, then it may be best not to use consumption credit beyond the amount that can be reasonably handled on the basis of the minimum expected income. In cases where income is not certain because of seasonal employment or the possibility of job layoffs, it may be best not to have any installment payments to meet. In addition, price and income trends should be carefully evaluated. If price levels or incomes are tending to decline, credit should be used sparingly. One of the most difficult debt burdens to bear is the debt created to buy high priced goods which must be repaid out of reduced income. Failure to pay the debt normally results in the loss of both the goods purchased on credit and the payments on the debt up to the time of repossession under conditional sales contracts or foreclosure sale under chattel mortgage contracts.

2. **Operating credit** is credit used to finance farm production operations. It should be used whenever necessary to finance basic farm operating expenses in order to complete the production cycle (feeding operations or the crop year). A good deal of caution should be exercised in using credit to finance farm operating expenses when prices are falling and in cases where little or no financial progress is being made. In situations such as these, it is very easy for the farmer to find himself faced with an ever increasing indebtedness simply because there is not enough income to pay living and operating expenses, and in addition, pay the cost of financing these expenses. The practical guide in the use of operating credit is to use it only when it appears that farm operations will produce at least enough income to pay family living expenses and repay the debt contracted to pay farm operating expenses plus the cost of financing.
3. Expansion credit is credit used to expand farm operations either through intensification (increasing the production per acre or per head of livestock, etc.) or extensification (adding more acres, more livestock, etc.) of farm operations.

A farmer who plans to expand should obtain answers to three questions before making his decision:

1. Will expansion increase net farm income? If so, which enterprises should be expanded?

2. How much should these enterprises be expanded? (Estimated net returns for different sizes of enterprise are needed for this purpose).

3. Is the time right for expansion? (Price, weather, and management risks must be evaluated here).

Complete farm budgets for both the present and the proposed scales of farm operations are needed in answering the above questions. Your County Extension Agent can furnish you with a "Farm and Home Development Work Book" and the basic information needed for making complete farm budgets. He, or other agencies of the Department of Agriculture and agricultural representatives of lending institutions, can give you information, supply facts, and discuss principles of organization and management that will help you in planning your farm operations.

Budgets are necessary in determining whether the loan will enable you to make more net income, and in particular, enterprise budgets are necessary in determining which enterprises should be expanded. These budgets should show the present farm income and expense situation and the probable increase in income and expenses including interest and debt payments that can be expected from expanding the farm business. If there is a probable increase in net income according to budget estimates, a judgment will have to be made by the farmer as to whether the additional net income is enough to justify the extra work involved in expanding a particular farm enterprise. The principle to be observed here is that the enterprise financed with a loan should produce enough gross income to repay the loan, the cost of the loan, the expense of operating the enterprise, and give the farmer a reasonable reward for his time and management. Conservative prices and realistic costs should be used in these budgets because they provide a margin of safety in case prices decline or unexpected expenses arise.
There is no magic formula which will guarantee financial success. Likewise, no formula has yet been devised which eliminates risks and insures profits. However, a complete farm budget accurately prepared and based on conservative prices and realistic costs along with an affirmative answer to the questions—Will expansion increase net farm income, and is the time right for expansion?—will reduce the likelihood of loss or failure in expanding the scale of farm operations. It is better to evaluate the possibilities of repaying a loan out of increased income beforehand rather than become involved with a debt and repayment schedule that increased income will not justify. Constructing several farm budgets for this purpose takes time and effort, but the job of being a top-notch farm manager takes a lot of hard work and that is why the highest farm incomes are earned by farmers who are willing and able to make the effort it takes to become a top-notch farm manager.

Expansion in the scale of farm operations usually involves both a business expansion (increased volume of production) and a financial expansion (increased amounts of capital). There are three ideas or theories about when and how financial expansion should take place.

One theory prescribes that a business (farm or other) should expand only to the extent that its earnings can be ploughed back into assets. The purposes in following this method of expansion are to avoid debt and to stifle the enthusiasms that accompany boom times. Another theory holds that a business should expand to create more profits and that expansion is justified as long as the return on new capital (or credit) is greater than the cost of obtaining it. Then there is the theory that the size of business which will yield the greatest profit should be determined and that new capital (or credit) acquired to finance this size of business is justified on the basis of the earnings it will produce.

The individual farmer or other businessman may wish to follow one or some combination of the above methods in expanding his business. The best single guide to the use of credit (new capital) for expansion or other purposes is to avoid, if possible, contracting a heavy indebtedness during prosperous times which may have to be repaid from reduced income during periods of economic recession or depression.

In any event, a farm business can be considered a financial success when:

1. It produces enough income to:
   a. Pay all farm operating expenses including depreciation.
   b. Pay the operator wages in cash or non-cash values equivalent to those which he might earn according
to his ability and experience in some other occupation.

c. Pay the prevailing rates of interest on all capital including borrowed capital invested in both working assets (livestock, feed, and equipment) and fixed assets (land and buildings).

2. It leaves the farm as productive as it was originally.

B. RULES FOR USING CREDIT

The two most important considerations in using credit are (a) to obtain credit with reasonable rates and terms and (b) to use credit effectively for productive purposes or to good personal advantage. Other rules for using credit are:

1. Obtain credit where they specialize in selling it, i.e., banks, production credit associations, Federal Land banks, life insurance companies, Farmers Home Administration, etc.

2. Keep the amounts borrowed within the debt carrying capacity of the farm business. Borrow enough to materially assist in increasing net income but an amount which can be reasonably repaid from farm income.

3. Limit borrowing as nearly as possible to productive purposes and be sure that the money actually serves the purpose for which it was borrowed. If credit is used for personal or family living purposes, it is justified only if repayment out of future savings or earnings is possible.

4. Develop a definite plan for using the loan amount and for the repayment of the loan. Also, budget probable income and expenses associated with the loan. Loan repayments should be scheduled to fall due when farm income is expected.

5. Make credit contacts well in advance of the time when funds will be needed; file credit statements with the lending agency, and keep lending officers informed about your plans and progress.

6. Select a lending agency and the type of loan best suited to your needs; and other things being equal, borrow from a lender who charges reasonable rates of interest and who grants prepayment privileges.
7. Investigate market conditions and price prospects for the farm commodity to be produced, particularly when the enterprise is to be financed in part by borrowed funds. The enterprises to be financed should be those which offer the best net income prospects.

8. Loan term and repayment should be limited to the production period of the enterprise which is being financed or to the useful life of an article or equipment purchased "on time" or on the installment credit basis.

9. Obtain credit at reasonable rates in order to get discounts on purchases by paying cash. Ordinarily, the amount saved by paying cash will be greater than the cost of credit.

10. Obtain credit from one lending institution insofar as possible. This is necessary in order to establish a good credit rating and a good credit relationship with the lending institution. It is necessary to "stay with" a lender over a period of years in order to build a good credit rating. In addition, the credit rating depends upon the borrower's actions in handling his debts in both good and bad times. A lender will normally lend more or "go-along further" with a borrower who obtains most or all of his credit from him. Lenders are generally extremely cautious about extending credit to people who have many creditors or who have "bills all around town."

You should keep your credit rating good by:

1. Making all payments promptly when due; and if you are not able to make a payment on time, explain the circumstances which prevent payment to the lender in advance and he will usually grant an extension if your credit rating is good and if your reasons are sound.

2. Using the loan proceeds only for the purposes indicated when the loan was granted or obtain the lender's approval for other uses beforehand.

3. Providing the lender with a credit statement at the end of each year. A credit statement consists of (1) a balance sheet showing assets, liabilities, and net worth and (2) an operating statement showing income from all sources and expenditures for all purposes. A farm record book is essential to making accurate credit statements.
A borrower should, whenever possible, borrow on a \textit{straight interest basis} or a simple annual rate of interest charged on each unpaid balance for the actual length of time it is outstanding, and then pay cash in making a purchase rather than get involved in high-cost installment credit contracts. People who "buy on credit" using installment credit contracts or borrow from small loan or personal finance companies will save money by buying more advantageously and avoiding excessive credit costs if they will follow the rules given below for buying on time and comparing credit costs.

1. Compare quality and cash prices; bargain as though you intend to pay cash; buy the article rather than let it be sold to you.

2. Bargain for credit as a separate transaction—see at least two lenders one of which should be a commercial bank.
   a. Find out what the charges are: Total interest or finance charges, investigation fees, service fees, legal fees, insurance costs, prepayment penalties, and charges made if delinquency occurs.
   b. Compare financing costs on the basis of:
      (1) The \textit{total dollar cost} when the same loan amount may be obtained from two or more sources with the same term and method of payment. Differences in interest rates and fee charges will result in different total dollar costs.
      (2) The \textit{true or effective annual interest rate} when the loan amount may be obtained from two or more sources differs or when the term and methods of payment differ. Differences in fee charges and insurance costs should also be recognized and compared.

3. Normally, obtain credit from the cheapest sources available to you but only after carefully considering other services which the lender provides and the need for establishing and maintaining a credit rating and a line of credit.

The \textit{true or effective annual rate of interest} charged on an installment loan can be easily and quickly determined by means of the following formula:

\[
\text{Effective Annual Interest Rate} = \frac{2 \times \text{(Total number of required payments + 1)}}{\left(\frac{\text{(Total amount of finance charges)}}{\text{(Original unpaid balance)} \times \text{(Total number of required payments + 1)}}\right)}
\]
A problem to illustrate the use of the formula follows. What is the effective rate of interest on a loan for $120.00 at a stated rate of interest of 6\% percent which requires 12 monthly payments of $10.65 each? First, multiply the monthly payment $10.65 by 12 to get the total amount of principal and interest to be paid ($127.80). Then, subtract the original principal, $120.00, from the total amount to be repaid, $127.80, to get the total amount of the finance charge, ($7.80). Using the formula, compute the effective rate of interest as follows:

\[
r = \frac{2 \times (12) \times (7.80)}{(120) \times (12+1)} = \frac{187.20}{1560} = .12 \times 100 = 12 \text{ percent}
\]

The total number of payment periods in a year was 12 in this case; but if weekly payments were made, it would be 52, or if quarterly payments were made, it would be 4, etc. The total number of required payments depends upon the term of the loan. If the loan in the above illustration had been made for 18 months rather than 12, then the total number of required payments would have been 18, the monthly payments $7.30, and the total finance charges, $11.40. Using the formula again, we find the effective rate of interest is still 12 percent.

\[
r = \frac{2 \times (12) \times (11.40)}{(120) \times (18+1)} = \frac{273.60}{2280} = .12 \times 100 = 12 \text{ percent}
\]

Some installment lenders now require the borrower to purchase credit insurance (life, health or sickness, and accident insurance) on installment loans. The cost of this insurance will depend upon the size of loan and length of the repayment period. There are those who maintain that the cost of credit insurance should be added to the total finance charge in computing the effective interest rate when the borrower is required to pay this cost. The reason for doing this is that the borrower does not normally carry this specialized type of insurance and it may be required even though the borrower has adequate life, health, and accident insurance protection. In this sense, it is as much a part of the cost of credit as the finance charge. In any event, this insurance expense should be recognized in comparing credit costs. This line of reasoning does not apply to other forms of insurance such as, automobile insurance, fire insurance on dwellings and personal property, etc., because most people ordinarily have these types of insurance protection as property owners.

Credit always costs something and the more credit you use, the greater the total cost. The use of credit is fully justified whenever it will enable you to earn more net income than you otherwise could even though it does have a price that must be paid. In all other situations, such as, credit used in the purchase of a home, car, etc., the use of credit can be justified only on the basis of forced saving and the convenience of using the item purchased while paying for it.
Nevertheless, the hard, cold facts about financing the purchase of anything are:

1. The cheapest way to buy anything is to pay cash, except possibly in situations in which the credit customer may be given more and better consideration on merchandise returns and allowances or in periods of creeping inflation.

2. The next cheapest way is to pay as much down as possible and repay the balance as soon as possible provided the lender is charging you interest only on the unpaid balance of the loan.

3. The most expensive way is to make as small a down payment as possible and to stretch out the repayment period as long as possible except in cases where interest is a flat charge regardless of how long it takes to repay the loan.

C. REPAYMENT TERMS

Repayment terms will be discussed as they relate to the term of the loan. Short-term loans are loans made for periods up to one year in length but generally the period is one to six months. Intermediate-term loans are made for one to three years. Long-term loans are made for five to forty years on dwellings and farm real estate and for longer periods on some types of business property. Mortgage credit is, as a rule, extended on a long-term basis while consumption and production credit may be extended for either a short or an intermediate-term.

1. **Short-term loans**: The repayment of short-term loans is usually arranged to coincide with the months or season of the year when farm income is expected. Loans to finance crop production (to purchase seed, fertilizer, etc., and to pay for labor and custom work) are usually made in the spring and repaid in the fall when the crops are sold. Loans to dairymen (to purchase cows, to finance operating expenses, or to finance a Grade A milk setup) are usually repaid on a monthly basis, and generally, the amount repaid monthly is withheld from the borrower’s milk check and paid to the lender by the milk processing firm under an assignment contract given by the borrower at the time the loan was granted.

2. **Intermediate-term loans**: Like repayment of short-term loans, the repayment of intermediate-term loans is usually arranged to coincide with expected receipts of farm income or income from the specific project financed on the intermediate-term basis. Often repayments during the early months or part of the term are small and become larger in the later part of the term when increased income from the project financed is expected. Repayment terms for intermediate-term loans are not as uniform as they are with short-term loans; and with both short- and intermediate-term loans, repayment terms vary from lender to lender and
according to the size of the loan, credit standing of the borrower, the borrower's ability to pay, etc.

3. Budgeted loans: Budgeted loans are becoming more popular with both lenders and borrowers in the agricultural credit field. The budgeted loan closely resembles the "line of credit" type of lender-borrower relationship that has been available to many businessmen and it is being used in extending both short- and intermediate-term credit to farmers.

A budgeted loan is a loan which is disbursed in installments as needed by the borrower up to a specified maximum amount and is repaid in installments when products from the farm enterprises financed are sold. The budgeted loan offers many advantages to the farmer. First, it assures the borrower that funds will be available as needed to meet expenses. Second, the interest costs will be less because interest is charged only for the actual number of days each dollar is outstanding rather than on the entire amount loaned for a specified period of time. Third, it saves time, effort, and the expense involved in making numerous small loans. Fourth, orderly retirement of the loan is provided by the requirement that the loan be repaid as the products are sold. An illustration of the transactions involved in a budgeted loan of the all-purpose barnyard type with a specified maximum of $2,000.00 is given in the table below.

<table>
<thead>
<tr>
<th>Date</th>
<th>Purpose of Advance or Repayment</th>
<th>Amount Advanced</th>
<th>Amount Repaid</th>
<th>Balance Outstanding</th>
<th>Days Outstanding</th>
<th>Interest at 6%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Jan. 10</td>
<td>Purchase 5 cows</td>
<td>$1,000.00</td>
<td></td>
<td>$1,000.00</td>
<td>63.83</td>
<td>0.1052</td>
</tr>
<tr>
<td>Mar. 15</td>
<td>Seed</td>
<td>200</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Fertilizer</td>
<td>300</td>
<td>500.00</td>
<td>1,500.00</td>
<td>17</td>
<td>4.19</td>
</tr>
<tr>
<td>Apr. 1</td>
<td>Fuel</td>
<td>200</td>
<td>300.00</td>
<td>1,800.00</td>
<td>44</td>
<td>13.02</td>
</tr>
<tr>
<td></td>
<td>Feed</td>
<td>100</td>
<td>100.00</td>
<td>2,000.00</td>
<td>16</td>
<td>5.26</td>
</tr>
<tr>
<td>June 15</td>
<td>Feed</td>
<td>200</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>July 1</td>
<td>Sale of sows</td>
<td>200.00</td>
<td>200.00</td>
<td>1,800.00</td>
<td>106</td>
<td>31.36</td>
</tr>
<tr>
<td>Oct. 15</td>
<td>Sale of corn</td>
<td>1,000.00</td>
<td>800.00</td>
<td></td>
<td>46</td>
<td>6.05</td>
</tr>
<tr>
<td>Nov. 30</td>
<td>Sale of hogs</td>
<td>800.00*</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Totals</td>
<td></td>
<td>2,000.00</td>
<td>2,000.00*</td>
<td></td>
<td></td>
<td>70.40</td>
</tr>
</tbody>
</table>

*Plus interest, 70.40
If the farmer in this illustration had borrowed the entire $2,000 at the beginning of the year and repaid it in a lump sum at the end of the year, his interest cost at the same rate of interest would have been $120 or nearly double the interest cost on a budgeted loan. In contrast, if this farmer had made arrangements for a separate loan each time he needed funds, this would have taken more time, effort, and expense than arranging for either a budgeted loan or a lump-sum loan.

Budgeted loans for short- and intermediate-term credit needs are very advantageous to farmers and farmers probably should seek to obtain short- and intermediate-term credit on this basis. However, not all lenders are willing to make budgeted loans nor are all borrowers willing to give the lender the kind of cooperation and information necessary to making this type of loan.

4. **Long-term loans**: The methods for repayment of long-term mortgage loans on real estate that are in common usage are:

   a. **The common-end or lump-sum payment plan.** This plan calls for the payment of interest each year on the anniversary date of the loan with repayment of the entire principal and the interest then due at the end of a specified term, usually five years. If the borrower is unable to repay the entire principal at the end of the term, he must seek an extension or renewal of the unpaid balance or refinance this amount with another lender. This type of loan can easily lead to financial difficulties, particularly if the principal falls due at a time when farm income is low. In the past, this type of loan coming due during depression periods has resulted in many mortgage foreclosures; and consequently, it is no longer a popular method of repayment.

   b. **The partial payment plan.** (Partial Amortization). This plan calls for small annual or semi-annual payments on the principal during part or all of the term in addition to interest payments with the bulk of the principal repaid in a lump-sum at the end of the term. The term of loans calling for partial repayment is usually 5 to 15 years. Partial repayment offers some protection to the borrower against the difficulty of repayment if farm income is low when the loan becomes due. Both borrower and lender have some protection against loss of equity if prices decline.

   c. **The amortization plan.** This plan provides for annual or semi-annual payments of both interest and principal which will repay the loan completely by the end of the term. The term for this type of loan is usually 5 to 40 years. It is the popular plan or method of repayment used for
almost all types of loans at the present time. This method of repayment is relatively easy on the borrower's finances because it gets rid of debt gradually. It also avoids most of the difficulty of making loan repayments when farm income is low. Both borrower and lender have some protection against loss of equity if prices decline.

The two most common methods of amortization are:

1. **The equal (even or constant) payment plan.** The annual or semi-annual payments under this plan remain the same throughout the life of the loan with the interest portion of the payment decreasing while the principal portion increases with each payment. The operation of this plan is shown in the following table.

### EQUAL PAYMENT PLAN WITH ANNUAL INSTALLMENTS

<table>
<thead>
<tr>
<th>Installment number</th>
<th>Annual Payments (Interest)</th>
<th>Annual Payments (Principal)</th>
<th>Annual Payments (Total)</th>
<th>Unpaid Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>500.00</td>
<td>300.00</td>
<td>800.00</td>
<td>9,700.00</td>
</tr>
<tr>
<td>2</td>
<td>485.00</td>
<td>315.00</td>
<td>800.00</td>
<td>9,385.00</td>
</tr>
<tr>
<td>3</td>
<td>469.25</td>
<td>330.75</td>
<td>800.00</td>
<td>9,054.25</td>
</tr>
<tr>
<td>4 to 17 omitted</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>18</td>
<td>112.39</td>
<td>687.61</td>
<td>800.00</td>
<td>1,560.28</td>
</tr>
<tr>
<td>19</td>
<td>78.01</td>
<td>721.99</td>
<td>800.00</td>
<td>838.29</td>
</tr>
<tr>
<td>20</td>
<td>41.91</td>
<td>838.29</td>
<td>880.20</td>
<td>0</td>
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<tr>
<td>Total</td>
<td>6,080.20</td>
<td>10,000.00</td>
<td>16,080.20</td>
<td>---</td>
</tr>
</tbody>
</table>

2. **The decreasing (diminishing or declining) payment plan.** The annual or semi-annual payments under this plan decrease throughout the life of the loan with the principal portion of the payment remaining constant while the interest portion decreases. The operation of this plan is shown in the following table.
DECREASING PAYMENT PLAN WITH ANNUAL INSTALLMENTS

<table>
<thead>
<tr>
<th>Installment number</th>
<th>Interest</th>
<th>Principal</th>
<th>Total</th>
<th>Unpaid Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>500.00</td>
<td>500.00</td>
<td>1,000.00</td>
<td>9,500.00</td>
</tr>
<tr>
<td>2</td>
<td>475.00</td>
<td>500.00</td>
<td>975.00</td>
<td>9,000.00</td>
</tr>
<tr>
<td>3</td>
<td>450.00</td>
<td>500.00</td>
<td>950.00</td>
<td>8,500.00</td>
</tr>
<tr>
<td>4 to 17 omitted</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>18</td>
<td>75.00</td>
<td>500.00</td>
<td>575.00</td>
<td>1,000.00</td>
</tr>
<tr>
<td>19</td>
<td>50.00</td>
<td>500.00</td>
<td>550.00</td>
<td>500.00</td>
</tr>
<tr>
<td>20</td>
<td>25.00</td>
<td>500.00</td>
<td>525.00</td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>5,250.00</td>
<td>10,000.00</td>
<td>15,250.00</td>
<td></td>
</tr>
</tbody>
</table>

A modified decreasing payment plan under which the payment on the principal equals the interest due is available through some lenders.

The variable payment plan. The borrower using this plan makes larger principal payments than called for by the amortization schedule in good income years and smaller payments in poor income years. Payments either above or below scheduled payments may be varied according to price or crop yield indexes or a combination of these two indexes or according to the net rent the landlord would receive if the farm were rented. However, the method most generally used to vary the payments is to determine the amount which can be reasonably paid from net farm income. This requires the borrower to keep a relatively complete and accurate set of farm records. (This he should do anyway for income tax purposes.)

Both the borrower and the lender, particularly the borrower, are protected under the variable payment plan against loss of equity if prices and incomes decline. Technically, the borrower is never delinquent in the repayment of his loan as long as he makes the payments called for under the plan regardless of whether the payment is large, small, or nothing. In addition, the borrower who follows this plan may find his mortgage paid off in a much shorter period of time than called for by a regular amortization schedule with a substantial saving in interest cost. However, it should be recognized that the opposite situation could occur. If the borrower should experience a series of poor income years early in the term of the loan, it might take a longer period of time to pay off the mortgage than called for by the regular amortization schedule. This, of course, would result in a higher total interest
cost, but at least, the farm will not be lost in foreclosure because of delinquency in making payments.

e. Prepayment privileges. The privilege of making advance payments is granted by some lenders as a matter of policy and by others, but not all others, upon request. It is advisable to obtain this privilege, if possible, when negotiating for a loan. The repayment provision should be written into the mortgage contract if it is not an established policy of the lender to grant this privilege.

One common prepayment plan permits the borrower to make advance payments upon the principal and thus stopping interest charges on this amount of principal. However, these advance payments are applied to the far end of the loan so that next payment is due and payable on schedule. All the borrower does under this payment plan is to shorten the term of the loan and reduce the total interest cost. If the borrower should be unable to meet his scheduled payments, he may still become delinquent in spite of having made advance payments.

Another prepayment plan, the prepayment reserve, is coming into common usage. Under this plan, advance payments are placed in a reserve account to be used in making regular payments when the borrower either is unable or does not wish to make the regular payment from current income. Interest is either not charged on an equal amount of principal or the lender pays interest on the advance payments at the same rate charged the borrower on the loan principle. Thus, use of the prepayment reserve plan permits a borrower to reduce the total interest cost on his loan and at the same time provide a cushion against low income and inability to make regularly scheduled payments.

5. Credit Instruments. Four credit instruments of major importance in farm finance will be briefly explained in this section. A complete explanation of all the provisions and their legal effects could not be undertaken in a publication of this type. In using these credit instruments, you should carefully read the entire contract and be sure you thoroughly understand all the provisions it contains. Legal counsel should be obtained in many instances before these contracts are made and in many instances a legal representative should be on hand when the contract is made.

State laws vary with regard to the provisions contained in and the rights of the parties under these contracts. Therefore, if you are moving to or going to transact business in another state, you should carefully check the provisions in the contract and perhaps seek legal advice before entering into these contracts.

a. The Promissory note is an unconditional written promise to pay a certain sum of money with interest then due to a named payee or to his order or to the note bearer on demand or at some fixed or determinable future date. A common variation of the promissory note is the installment note which provides for the repayment of the principal and interest in a
specified number of installments due monthly or at some other specified regular interval. If payment of the note is not made as specified, the holder (lender) of the note may secure a judgment against the maker (borrower) of the note and all cosigners for the amount due plus the expenses of obtaining a judgment.

b. A Mortgage is a legal document which creates a lien (a legal claim against property) or makes a conditional transfer of title to property for the purpose of assuring the performance of a contract, usually the payment of a debt. The mortgage constitutes a pledge of property as security which a borrower gives in addition to his promise to pay given in the promissory note signed by him. The property pledged is described in the mortgage document which is also signed by the borrower. The mortgage document contains provisions governing use, care, payment of taxes, disposal of the property pledged, etc., and the rights of the mortgagee (lender or seller) in event the mortgagor (borrower) fails to make the specified payments or keep any of the provisions of the mortgage contract. Mortgage contracts are normally recorded at the Register of Deeds office of the county in which the borrower lives; and when recorded, these mortgage contracts constitute a public record of the fact that the borrower has pledged certain personal property or real estate as security on a loan.

1. The chattel mortgage is employed where personal property is pledged as security. Generally when default on a chattel mortgage occurs, the debtor and creditor agree to a public sale of the mortgaged property and the debtor assigns the sale proceeds to the creditor up to the amount needed to repay the debt and the cost of the public sale. Formal foreclosure action can be taken in cases where the debtor and creditor fail to agree to an out-of-court foreclosure procedure. In either type of foreclosure action, the debtor can exercise his right of redemption (to pay up late and retain ownership of the property) up until the time the mortgaged property is sold at public sale.

2. The real estate mortgage is employed where real estate is pledged as security. In case of default in payments or other provisions of the mortgage contract, the lender or seller usually goes through foreclosure proceedings unless the buyer is willing to deed the property to the mortgagee in satisfaction of the mortgage. The mortgagor (borrower) is granted a redemption period, usually one year, either before or after the judicial sale during which he can redeem the property by paying the sale price plus the foreclosure and sale expenses.

c. The Land Contract or a contract for deed is frequently used in the purchase of real estate. The down payment on farms purchased under land contracts is usually smaller but the interest rate is higher than farm purchases on a mortgage and deed basis. Title to the property remains with the seller while the buyer takes possession of the property under a land contract. The buyer agrees to do many things in regard to insurance, taxes, use and care of the property, and the making of periodic payments of specified amounts. Failure of the buyer to faithfully fulfill any of the provisions of the land contract may become the basis for repossession of the farm by the seller. However, repossession usually cannot take
place during the crop year in which the default occurs, and under certain conditions, the farm must be sold at a judicial sale. The original buyer is usually granted the right to correct the default at any time before the judicial sale and he is usually entitled to any proceeds from the sale that exceed the amount due the seller and the sale expenses.

d. The conditional sales contract is a contract of sale of personal property under which the buyer takes possession of the property purchased but the title to the property remains with the seller until full payment has been made. Conditional sales contracts usually provide for payment by installments due monthly or at some other specified interval. In case the buyer fails to make the specified payments or in keeping any of the provisions of the conditional sales contract, the seller may repossess the property. The seller, after repossessing the property, can elect either to keep the property and the amount paid by the buyer with no right to a deficiency judgment or to sell the property at a public sale and sue the buyer for any balance due plus expenses incurred in repossessing and reselling the property. If the buyer has paid at least 50 percent of the purchase price, the seller must offer the property at public sale and return to the buyer any amounts received that exceed the indebtedness and sale expenses. The buyer has the right to redeem the repossessed property at any time prior to the public sale by making full payment plus the expenses incurred in repossessing the property.

D. RISKS IN USING CREDIT

There are risks for both the borrower and the lender in using credit. These risks are particularly great when credit is used in farming. Some of these risks are:

1. A drop in farm prices or an increase in farm costs or both. All too often farmers find that they have borrowed when prices were high and have had to make repayment when prices were low. The way to avoid this situation is to keep the amounts borrowed as small as possible and to repay the loan as rapidly as possible especially when prices are high.

2. Adverse weather. Drought, temperature extremes, excessive moisture, hail, and wind are adverse weather factors which are unpredictable and, for the most part, uncontrollable. Any or all of them powerfully influence crop production to an extent that can seriously reduce farm income and the farmer's ability to pay his debts. Hail insurance will help to replace some of the income lost as the result of a hail storm but there is no way to replace income lost because of other adverse weather conditions. The only ways in which a farmer can protect himself financially from the effects of those other adverse weather conditions are to keep crop production expenses as low as possible, to borrow only the absolute minimum needed if it is necessary to finance crop production expenses, and to keep ample financial and feed reserves.

3. Illness, accidents, and death. Illness or an accident will usually reduce the debt-paying ability of a borrower, particularly if he is the one affected. Illness or accidents involving members of his family or
hired labor may be equally or more serious. Health (sickness), accident, and hospitalization insurance will pay for part of the medical bills; and if income indemnity insurance is carried by the operator, it will replace part of the income that may be lost if he becomes incapacitated.

Workmen's compensation insurance can be carried on the hired labor so that the farmer-employer is protected against financial loss from indemnifying an employee in case the employee suffers an accident on the job. If workmen's compensation insurance is not carried, the farmer-employer may wish to carry employer's liability insurance as protection against judgments that may be awarded to employees who are injured as a result of employer negligence. Some casualty insurance companies now offer farmers a farmers' comprehensive personal liability policy which will protect him from financial loss because of injuries sustained by employees or exchange labor.

Life insurance on the operator's life to the extent of his indebtedness and potential final expenses in event of death is very desirable. Forced liquidation of the operator's assets is likely to result in case of death unless there is this much life insurance as a minimum. Preferably, there should be more than this minimum amount of life insurance to give the family some money to go on while they make adjustments such as hiring labor to complete the crop year, selling the farm, etc., made necessary because of the operator's death.

4. Losses to property. Losses to property occurring from natural causes, such as, wind, fire, and hail can seriously reduce the debt-paying ability of the borrower. Property insurance—fire insurance with extended coverage for wind storm, hail damage, etc.—will at least partly replace the financial loss when these natural catastrophes occur. Livestock can also be insured against theft and natural catastrophes.

5. Public liability judgments. Public liability judgments are indemnification awards resulting from lawsuits in which the farm operator is held to be legally responsible for the injury or death of persons or damage to their property in which he is ordered to pay the injured parties the amounts determined by court and jury action. This type of judgment can arise out of the use of farm equipment, a truck, or an automobile and they can also arise from damage done by livestock, particularly from accidents caused by livestock strayed onto public roads.

Two forms of insurance are essential to protect the farm operator from financial losses involved in public liability judgments: (a) Automobile bodily injury and property damage liability insurance and (b) Farmer's comprehensive public liability insurance. It should be noted that these forms of insurance do not provide unlimited financial protection against liability judgments but only to the extent stated in the policies. Often a personal injury judgment is large enough to force either partial or complete liquidation of a farmer's assets to satisfy it unless an adequate amount of liability insurance is carried. Therefore, it is advisable to carry relatively large amounts of liability insurance coverages.
A farmer's entire insurance program should be reviewed periodically with a competent insurance adviser to be sure that the necessary kinds and amounts of insurance are being carried at reasonable rates.

E. SELECTING A CREDIT AGENCY

A man's judgment can be no better than his information. "Get the facts, get all the facts, or the facts will get you." Getting the facts applies to our investments, to our everyday life, and to our use of credit.

In selecting a credit agency, a farmer needs to study the advantages and disadvantages of obtaining credit from the various sources of credit available to him and he should carefully evaluate the lender and the terms of the loan. In particular, the farmer would do well to bear in mind the caution to obtain credit from financial institutions that specialize in extending credit to farmers. The following chart will aid the farmer in studying the advantages and disadvantages of the various sources of credit available to him. A column should be used for each source of credit and each source might be described or rated in one or two words for each item listed in the left hand margin of the chart. Separate comparisons should be made for sources of consumption credit, production credit, or mortgage credit. The farmer should select the credit source which in his judgment, based upon a careful comparison of credit sources, will best serve his needs.

In particular, you should look for the following characteristics in the lender for:

a. A production loan (either short- or intermediate-term):
   1. A dependable source—a lender who is able to extend and does extend credit in bad as well as good times.
   2. Interest charged only on the unpaid balance of the loan at a reasonable simple annual rate.
   3. A repayment schedule geared to the time and the amount of farm income receipts.
   4. A lender who considers present and potential repayment ability as well as character and security in making loans.
   5. A lender who understands farming, gives competent counsel, and is available for prompt service on the loan.

b. A mortgage loan (long-term real estate loan):
   1. A low, simple annual rate of interest.
   2. An amortized repayment schedule fitted to the time and amount of farm income receipts.
3. A lender who will be in business for the life of the loan and who is available to give good service on the loan.

4. A lender who understands farming—the price and weather risks involved in farming—and who will not foreclose a delinquent borrower until the borrower has had a reasonable opportunity to clear up his delinquent payments.

5. A lender who will grant prepayment privileges.

**CHART FOR COMPARING SOURCES OF CREDIT**

<table>
<thead>
<tr>
<th>Item</th>
<th>SOURCE</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Reputation:</strong></td>
<td></td>
</tr>
<tr>
<td>Honesty and fair dealing</td>
<td></td>
</tr>
<tr>
<td>Confidential dealing</td>
<td></td>
</tr>
<tr>
<td>Providing adequate credit services</td>
<td></td>
</tr>
<tr>
<td>Dependability as a source of credit</td>
<td></td>
</tr>
<tr>
<td><strong>Lending Policies:</strong></td>
<td></td>
</tr>
<tr>
<td>Eligibility requirements</td>
<td></td>
</tr>
<tr>
<td>Security requirements</td>
<td></td>
</tr>
<tr>
<td>Interest rates</td>
<td></td>
</tr>
<tr>
<td>Consideration of repayment ability</td>
<td></td>
</tr>
<tr>
<td>Other charges</td>
<td></td>
</tr>
<tr>
<td>Repayment plans</td>
<td></td>
</tr>
<tr>
<td>Prepayment provisions</td>
<td></td>
</tr>
<tr>
<td>Delinquency treatment</td>
<td></td>
</tr>
<tr>
<td><strong>Experience:</strong></td>
<td></td>
</tr>
<tr>
<td>Knowledge of farming</td>
<td></td>
</tr>
<tr>
<td>Experienced in extending farm credit</td>
<td></td>
</tr>
<tr>
<td>Capable of giving competent counsel</td>
<td></td>
</tr>
<tr>
<td><strong>Miscellaneous:</strong></td>
<td></td>
</tr>
<tr>
<td>Convenience</td>
<td></td>
</tr>
<tr>
<td>Other financial services</td>
<td></td>
</tr>
<tr>
<td>Speed of loan service</td>
<td></td>
</tr>
</tbody>
</table>

Present your plans to the lending officer of the credit agency you select as the one which can best serve your credit needs. If your plans are sound, you do not have to hesitate in asking for a loan interview. In fact, a sound plan for using credit will impress the lender.
F. BORROWER QUALIFICATIONS THE LENDER CONSIDERS

The lender before granting a loan almost invariably considers three very important qualifications in the borrower--character, collateral or security for the loan and capacity. These three qualifications are known as the three "C's" of credit and they generally determine whether a loan will be made.

1. Character is the primary quality a lender looks for in the borrower. An established reputation for honesty, a willingness to pay debts and a record of prompt debt payment are the key character qualifications of interest to the lender. In addition, and equally as important, a lender looks for debt consciousness in the borrower—a borrower who is deeply concerned about and aware of his obligation, who has a strong sense of personal responsibility for his debts, and who will repay his debts under adverse circumstances even though he could legally obtain release from his financial obligations.

2. Collateral refers to assets such as land, livestock, machinery, stored farm products, or growing crops which the borrower can pledge as security on the loan in addition to his promise to pay given in the note or bond signed by him. Property pledged as security or collateral for a loan is described in a document called a mortgage contract which the borrower signs. This pledge of assets given by the borrower protects the lender by providing property which can be sold on a foreclosure sale to satisfy the debt if the borrower does not or is unable to pay the debt and it protects both borrower and lender by preventing other creditors, if any, from seizing the borrower's assets.

3. Capacity refers to the ability of the borrower to repay the loan. Important factors which the lender will consider here are the income-producing capacity of the farm business, the borrower's managerial ability and financial progress, and the purpose of the loan.

The income-producing capacity of a farm business depends upon a number of factors all of which are necessary to efficient operation, high income-producing capacity, and meeting the standards of financial success noted on page 4. The key factors governing income-producing capacity are:

a. An adequate size of business so that labor and equipment are used efficiently.

b. Attainment of high production per unit of livestock or acre of land by using improved crop varieties, breeds of livestock cultural practices, and operating methods.

c. Low cost of production through efficient use of labor and equipment and improved farm management practices to produce a large net income.

d. Managerial ability sufficient to handle an adequate size of business, large amounts of capital, and new ideas, equipment and methods on a commercial farm basis.
The managerial ability of the borrower is probably the most important consideration in making a loan because both financial progress and income-producing capacity largely depend upon this factor. Modern day farming requires a high degree of managerial ability and technical "know-how" because success depends upon using large amounts of capital in producing and marketing farm products with specialized equipment under high-cost conditions. Small mistakes or miscalculations can result in large losses or even financial ruin. In addition, farming is becoming increasingly scientific and it requires intelligence and managerial ability to make good use of the new, more scientific methods of tillage and livestock feeding. Failure to use scientific methods and cost-cutting techniques in farming today will almost inevitably result in poor financial progress or actual financial decline.

The financial progress the borrower has been making is a very important indication of income-producing and debt-repayment capacity. Financial progress also indicates managerial ability and the ability to use the loan proceeds in such a manner that earning capacity will very likely be increased. Lack of financial progress, unless it can be adequately explained as being due to factors beyond the borrower's control, is often taken as an indication of poor management and a low income-producing and debt-repayment capacity. This will ordinarily cause the lender to be very cautious about making a loan.

The purpose of the loan is of interest to the lender since loans for the purpose of increasing the borrower's earning capacity are normally more sound than convenience loans or loans for consumption purposes because the increased earning capacity is an additional assurance that the loan will be repaid.

The amount of credit a lender will extend to an individual farm operator depends primarily upon this man's ability to use credit efficiently and to produce the additional income necessary to repay the loan. Often, a loan that is too small will restrict the operator in developing his farm business into an efficient, high-income producing unit. Just as often, too much credit or debt proves burdensome and hinders a farmer's financial progress.

The problem is to use credit in such a manner that it is your servant and not your master. The borrower must convince the lender about his credit needs, his debt-repayment capacity, and the soundness of his plan for using credit.
PART II. FARM CREDIT SOURCES

Farm credit sources will be classified first, and then, in subsequent sections, information concerning types of loans, terms, and other basic information will be presented for each source.

FARM CREDIT SOURCES CLASSIFIED

1. Private Sources:
   a. Commercial Banks
   b. Life Insurance Companies
   c. Merchants and Dealers
   d. Personal Finance and Small Loan Companies
   e. Individuals

2. Cooperative Sources:
   a. National Farm Loan Associations
   b. Production Credit Associations
   c. Building (or Savings) and Loan Associations
   d. Credit Unions

3. Government Sources:
   a. Farmers Home Administration
   b. Commodity Credit Corporation
   c. Veterans Administration (direct loans under special conditions)

4. Government Guaranteed or Insured Loans
   a. "G.I. Loans"
   b. Federal Housing Administration Title I Property Improvement Loans
   c. Commodity Credit Corporation Farm Commodity and Storage Facility Loans
   d. FHA Farm Ownership and Soil and Conservation Loans (Some loans are made by the Farmers Home Administration from funds obtained from private credit agencies.)

There are many other sources of farm credit, such as, mortgage and investment companies, state credit agencies, pension and endowment trust funds, etc., that have not been classified because they do not constitute important sources of farm credit. The relative importance to South Dakota farmers of some of the farm credit sources classified above can be determined by examining the following table.
Farmer Debt in South Dakota
Amounts Held by Principal Lenders
on
January 1, 1955

<table>
<thead>
<tr>
<th>Farm Real Estate Debt:</th>
<th>Dollars</th>
<th>Per cent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Commercial Banks</td>
<td>44,999,000</td>
<td>3.8</td>
</tr>
<tr>
<td>Federal Land Bank</td>
<td>44,050,000</td>
<td>37.6</td>
</tr>
<tr>
<td>Farmers Home Administration</td>
<td>4,053,000</td>
<td>3.5</td>
</tr>
<tr>
<td>Life Insurance Companies</td>
<td>42,133,000</td>
<td>36.0</td>
</tr>
<tr>
<td>Others</td>
<td>22,440,000</td>
<td>19.1</td>
</tr>
<tr>
<td>Total</td>
<td>117,175,000</td>
<td>100.0</td>
</tr>
</tbody>
</table>

Non-Real Estate Farm Debt*

| Commercial Banks (Including 41,126,000 in CCC loans) | 105,314,000 | 65.9 |
| Production Credit Associations                      | 10,025,000  | 6.3  |
| Farmers Home Administration                          | 14,705,000  | 9.2  |
| Commodity Credit Corporation (Direct Loans only)     | 29,802,000  | 18.6 |
| Total                                                | 159,846,000 | 100.0 |

* The amount of non-real estate farm debt held by merchants and dealers, individuals, finance companies, etc. is not available.

A. COMMERCIAL BANKS

The hub of financial activity in any community is its commercial bank(s). In fact, the commercial bank is the only financial institution in most communities which is in a position to render complete financial services to its patrons.

Many people do not know about the many services a bank can render besides being a place where loans can be obtained and a place of safekeeping for funds placed in checking or savings accounts and valuables placed in safe deposit boxes. Among these other services which commercial banks render are the issuance of cashier's and certified checks; bank money orders, commercial letters of credit, and travelers cheques; notary, investment, and trust services; estate planning; and property management. In rendering these services, particularly in making loans, bank officers assist and advise patrons in financial
planning and in solving financial and other problems.

Checking (demand) and savings (time) deposits constitute the major sources of loanable funds for commercial banks. Checking and savings deposits are funds entrusted to commercial banks by their depositors. The primary obligations of the bank are to safeguard these funds and to be in a position to return the funds upon request. Furthermore, the lending practices of banks are limited and regulated by either state or national laws and supervised by state and federal agencies. Moreover, banks are required to keep specified amounts of cash reserves to insure their ability to meet deposit withdrawals. This requires that the loans and investments made by commercial banks be of high quality and short-term so that funds are available to meet the normal flow of deposit withdrawals.

In addition to making a wide variety of business, housing, and convenience loans, such as, inventory and accounts receivable loans; home mortgage and improvement loans; and life insurance, signature, auto and appliance loans; commercial banks in agricultural communities also make farm mortgage loans and a wide variety of farm production loans.

1. Where to Apply—Any commercial bank that makes farm loans, preferably a bank in the community in which the applicant does the majority of his business. One of the bank's officers will take the application, unless the bank has an agricultural loan specialist, in which case, he will most likely take the application.

2. Who is Eligible to Borrow—Anyone who can qualify as a good credit risk and who can show evidence of repayment ability or provide satisfactory collateral.

3. Type and Purpose of Loans: Terms, Collateral, Interest Rates, and Amounts—Commercial banks can and do make loans for almost every conceivable purpose; and if the bank makes farm loans, the borrower can, if he qualifies, obtain loans for reasonable amounts for all agricultural purposes.

a. Production loans are made to finance farm operating expenses, the purchase of livestock, feed, seed and equipment, and any other purpose related to the operation of a farm business. This type of loan is sometimes titled according to the type of enterprise or specialized use to be made of the funds, such as, feeder loans, dairy loans, broiler loans, etc., or the all-purpose barnyard loan.

Production loans are made for periods up to one year depending on the specific purpose of the loan. Usually, production loans are renewable on mutual agreement. Interest rates will vary from 5 to 8 percent depending upon the purpose, size, term of the loan, and the credit rating of the borrower. Normally one-third (tenants) to one-half (farm owners) of the value of the collateral constitutes the maximum amount that can be borrowed. A chattel mortgage on the collateral is frequently required.
b. **Real Estate loans** are made to finance the purchase of a farm or additional land, to finance land and building improvements, and to refinance chattel mortgage or personal debts. Special laws govern farm real estate loans made by commercial banks. In general, commercial banks can loan 50 percent of the appraised value of the property for a period not to exceed five years but the loan may be renewed on mutual agreement.

Most banks, however, also have what is known as a correspondent relationship with one or more life insurance companies whereby either (a) the bank assists the farmer in negotiating a loan with a life insurance company or (b) the bank actually makes the loan which the life insurance has agreed to purchase upon request or at the end of a stipulated period of time. Real estate loans made under either of the above circumstances are usually long-term loans.

Most real estate loans made directly or indirectly through commercial banks call for 4 1/2 or 5 percent interest, a first mortgage on the real estate, and amortization of the principal. In addition, the mortgage contract will frequently contain provisions for advance or optional payments and a prepayment reserve.

c. **Installment loans** are usually made on a note and chattel mortgage basis; but increasingly at the present time, they are being made on conditional sales contracts which the bank purchases from the dealer who sold the merchandise (automobiles, farm equipment, home appliances, etc.).

The term of installment loans varies from less than one year up to three years according to the type of merchandise purchased. The interest rate on installment loans will vary from 6 percent simple annual interest to an 8 percent discount or add-on with weekly or monthly payments required. Usually a down payment in cash or trade-in allowances equal to one-third of the value of the merchandise is required.

Title to the merchandise purchased under a conditional sales contract remains with the seller or lender until the loan and interest are fully paid. In case of a default of any kind on the contract, the seller or lender can repossess the merchandise without court action.

d. **Unsecured signature or convenience loans** are based upon the borrower's credit statement (financial statement), his character or reputation for honesty and his willingness and ability to pay debts. These loans are made for one to six months for almost every reasonable purpose at 4 to 8 percent simple annual interest. They are usually made only to regular, long-standing bank customers with excellent credit ratings. The amount that can be borrowed on an unsecured basis depends upon the purpose of the loan and credit rating of the borrower.

4. **Amount of Time to Obtain a Loan**—Unsecured loans can be obtained in a matter of minutes or the time it takes the borrower to explain the situation for which credit is needed. If the unsecured loan is
for a large amount, it may take one or two days or whatever time it takes for the lending officer to consult with his loan committee. Likewise, chattel mortgage loans may be obtained immediately or it may take several days, and frequently, an inspection of the chattels is made before the loan is granted. Real estate loans obtained through commercial banks, like those obtained from other financial institutions making this type of loan, may take several days to several weeks depending upon the time it takes to obtain a title opinion or an up-to-date, acceptable abstract of title.

5. Further Information—Large banks often will have literature placed in convenient places or on racks in the bank lobby which explain in a general way the services available to its customers. Further information about bank loans in the case of smaller banks and the details concerning loans from either large or small banks can be obtained by having a conference with one of the bank's officers.

A small, easily read book entitled Your Bank by George L. Loffler containing answers to 200 questions about the services and operations of a bank is being distributed to public schools by bankers in our state. You might be able to obtain a complimentary copy from your banker or possibly your son or daughter in high school has received one or could obtain a copy from the school library for you to read.

B. LIFE INSURANCE COMPANIES

1. Where to Apply—Life insurance company mortgage loans are usually obtained through loan correspondents. Banks, real estate brokers, and other local persons and firms, such as lawyers, loan companies, etc., act as loan correspondents for life insurance companies. Some life insurance companies either have fieldmen or mortgage loan offices located at various points in South Dakota. In some instances, these fieldmen and mortgage loan offices accept applications for loans directly but their chief duties and responsibilities are to develop loan business through loan correspondents, to appraise properties being pledged as collateral for loans, and to service outstanding loans.

2. Who is Eligible to Borrow—Any owner of real estate (farm, business, and family or multiple housing units) which is acceptable as collateral for a loan and who has a good credit standing is eligible to borrow from life insurance companies provided they are making mortgage loans in the particular area in which the applicant lives or in which the property is located.

3. Loan Purposes—Loans obtained from life insurance companies are used for every conceivable purpose for which money would be needed or could be used.

4. Type of Loan—A farm (real estate) mortgage loan.

5. Terms—Life insurance company mortgage or real estate loans are made on a long-term basis of 5 to 40 years, and usually they are
amortized on a quarterly, semi-annual, or annual basis with installments that fit the repayment ability of the individual or the property pledged as collateral for the loan or both.

Prepayment privileges vary from none to full prepayment of the loan at any time when the funds for prepayment represent income from the property pledged as collateral. Prepayment terms are usually negotiated at the time the loan is made and designed to fit each individual case. One of the most common prepayment plans permits repayment of 20 percent of the original principal in any one calendar year if the payment represents income from the property. Prepayment privileges on life insurance company loans are currently more liberal than they have been in the past and some companies also have a prepayment reserve plan similar to that offered with Federal Land Bank loans.

6. **Interest Rates and Fees**—Most farm mortgage loans made by life insurance companies call for 4 1/2 or 5 percent simple annual interest. Most companies charge no loan fees but the borrower may be required to pay the abstracting, recording, and possibly title insurance fees.

7. **Loan Amounts**—The amount loaned depends upon the appraised value of the collateral as determined by an appraiser employed by the life insurance company. Loan amounts will vary from one-half to two-thirds of the appraised value or the amount requested if it is less than those limits.

8. **Collateral Required**—The collateral (security) required for life insurance company loans is a first mortgage on the real estate being pledged for the loan. In the case of farm mortgage loans, the farm or ranch unit must be of sufficient size and earning power to meet all farm expenses (both operating and living expenses) and the principal and interest installments on the loan. Very few, if any, junior or second mortgage loans are made by the life insurance companies at the present time.

9. **Amount of time to Obtain a Loan**—It usually takes about one week to obtain a loan from a life insurance company if there are no complications in obtaining a clear title to the real estate. Several days to one week is all it may take to obtain a loan in cases where the borrower has an established credit connection with the company concerned or where an additional or supplementary loan that is within the established loan limits is being requested from the same company.

10. **Source of Funds**—Premiums paid by policy holders constitute the primary source of funds for life insurance company loans. Premiums received by the company that are not paid out immediately as death benefits and operating expenses or to policy holders as dividends and maturity benefits are invested by the company in business and government securities, real estate, policyholder loans, and secured loans (mostly real estate or mortgage loans) to business firms and individuals.
11. **Further Information**—The Equitable Life Assurance Society of the United States publishes an excellent little booklet on farm mortgage loans: "What to Look for In a Farm Loan." This booklet can be obtained from loan correspondents for this company or by writing to the Farm Loan Service, Equitable Life Assurance Society, 332 Paulton Building, Sioux Falls, South Dakota. Other companies may also have very good booklets on this subject. The Farm Credit Administration booklets listed on page 30 will also be helpful to farmers interested in learning more about farm mortgage loans.

12. **Life Insurance Policy Loans**—Most life insurance policies have cash values which the insured (policyholder) can utilize as a source of needed funds in one of three ways. First, he could surrender the policy to the company for its cash value. This is not advisable unless the insured no longer has a need for insurance protection or is absolutely unable to pay the premiums. Second, the insured could borrow as much of the cash value as he needed from the life insurance company. This method for using life insurance policy cash values as a source of needed funds is generally preferable to surrendering the policy because the insurance will remain in force as long as future premiums are paid or as long as the indebtedness does not exceed the cash value of the policy. If the insured should die with a loan against his life insurance policy, the company will pay the face amount of the policy minus the indebtedness to the named beneficiaries or to the insured's estate. A life insurance policy with a loan against it is better than no life insurance at all which would be the case if the policy were surrendered for its cash value.

It takes several days to several weeks to obtain a life insurance policy loan. Interest on policy loans varies from 4 to 6 percent on policies issued in the last twenty to thirty years and 6 to 8 percent on older policies. The rate of interest charged varies from company to company but it is usually charged on a simple annual basis. Generally no questions are asked about the reasons for obtaining a policy loan and the loan can be repaid at the convenience of the borrower. Life insurance companies usually encourage the borrower to make regular payments on his loan and to pay the loan off as soon as possible. This is in the best interests of the policyholder because the longer the loan is outstanding the greater the total interest cost to him and benefits to his beneficiaries are reduced by the amount of the indebtedness if he dies before the loan is repaid. In addition, there is less likelihood that the insured will let the policy lapse if there is no indebtedness against it.

The third way in which life insurance policies can be used as a source of needed funds is to use them as collateral for a loan from some other lender. The loan can usually be obtained the same day that application is made, and frequently, at a lower rate of interest than the insurance company would charge on a policy loan. The lender will require the borrower to give an assignment of the insurance policy as collateral for the loan and that the insurance company be notified about the assignment. Then, to protect the lender's interests in the
policy if the borrower dies before the loan is repaid, the insurance company will pay the balance due on the loan first before paying the balance of face amount of the policy to the insured's beneficiaries or estate.

C. FEDERAL LAND BANK AND THE NATIONAL FARM LOAN ASSOCIATIONS

1. Where to Apply—Federal Land Bank loans are obtained through National Farm Loan Associations. National Farm Loan Associations are locally owned credit cooperatives organized to make and service Federal Land Bank loans. Membership in these associations is limited to those who obtain loans through the association. A board of directors elected by and from the membership of the association hires a secretary-treasurer who is the managing officer and conducts the affairs of the association.

2. Who is Eligible to Borrow—Any person who can qualify as a good credit risk and who is the owner or about to become the owner of a farm or farm land that will serve as acceptable collateral for a Federal Land Bank loan. The applicant becomes a member of the association upon approval of the loan and the purchase of capital stock in the association equal to 5 percent of the loan (one $5.00 share for each $100 borrowed). Membership in the association is terminated when the loan is repaid and the capital stock held by the member is retired at full value.

3. Loan Purposes—Federal Land Bank loans may be obtained to finance the purchase of farm real estate, livestock, equipment, and supplies; to finance the cost of farm soil and building improvements and the construction of farm buildings; to finance farm operating and family living expenses; and, under specified circumstances, to refinance debts.

4. Type of Loan—A farm (real estate) mortgage loan.

5. Terms—Federal Land Bank loans are made on the amortized repayment basis (annual or semi-annual payments of principal and interest) for periods ranging from 5 to 40 years. Either of two amortization plans may be selected:

a. Even Payment Plan—The annual or semi-annual installment under this plan includes both principal and interest and remains the same throughout the life of the loan (see illustration on page 12).

b. Decreasing Payment Plan—The annual or semi-annual installment under this plan calls for a fixed payment on the principal of the loan plus the interest due. Thus, each installment becomes smaller because the amount of interest due with each payment becomes less as the principal amount of the loan outstanding becomes smaller (see illustration on page 13).

The term or length of the loan from 5 to 40 years and the installment
amounts can be arranged to fit borrower needs, income flow, and the
debt paying capacity of the borrower and his farm. The prepayment
reserve plan is available to all borrowers as an established policy
of the Federal Land Bank but it is not written into the mortgage
contract.

6. **Interest Rates and Fees**—The rate of interest on Federal Land
Bank loans in this district is 4 percent charged on a simple annual
basis. No application, appraisal, or loan service fees are charged.
However, the borrower must furnish satisfactory evidence of title and
pay mortgage recording fees and the charges for a certificate of
title or for bringing the abstract of title up-to-date.

Most National Farm Loan Associations now pay dividends to their
members. These dividends, which may be large enough to reduce the
cost of a Federal Land Bank loan, are based upon the amount of stock
a member owns in the association.

7. **Loan Amounts**—Federal Land Bank loans of $100 up to $200,000
can be obtained but the amount that can be borrowed in any particular
case is limited to 65 percent of the appraised normal agricultural
value of the farm or ranch.

8. **Collateral Required**—The collateral (security) required for
a Federal Land Bank loan is a first mortgage on a farm or ranch unit
of sufficient size and earning power to meet all expenses: farm
operating expenses including depreciation, soil and building maintenance,
property insurance and taxes, living costs, and the principal and
interest installments on the loan. Small farms or farms operated on
a part-time basis may serve as acceptable collateral for a Federal
Land Bank loan if the operator has a dependable source of non-farm income.

9. **Amount of time to Obtain a Loan**—It usually takes about one
week for a new member-borrower to obtain a loan if there are no com-
lications in obtaining clear title to the land. The normal period for
an established borrower is less than one week, and under emergency
conditions, two days or less.

10. **Source of Funds**—Funds for Federal Land Bank loans are obtained
chiefly from the sale of federal farm loan bonds. These bonds are
purchased by the investing public—commercial banks, insurance compan-
ies, endowment funds, pension trusts, etc.

11. **Further Information**—Six booklets published by the Farm Credit
Administration, obtainable at any National Farm Loan Association office
or by writing to the Farm Credit District, Omaha, Nebraska, will be
helpful to farmers interested in learning more about Federal Land
Bank loans:

D. PRODUCTION CREDIT ASSOCIATIONS

1. Where to Apply—Application for a Production Credit Association loan may be made at the main association office in your area or at any of its field offices and other contact points. Production Credit Associations are locally owned credit cooperatives organized to make and service farm production or operating loans to members of the association. Voting membership in the association is limited to those members who have within the preceding two years borrowed from the association. A board of directors elected by and from the voting membership hires a secretary-treasurer who is the managing officer and conducts the affairs of the association.

2. Who is Eligible to Borrow—Any farmer, rancher, or stockman who can qualify as a good credit risk is eligible to borrow funds for agricultural purposes from the association in the area in which he lives. The applicant becomes a member of the association upon approval of the loan and the purchase of capital stock in the association equal to 5 percent of the loan (one $5.00 share for each $100 borrowed.) A member may retain ownership of capital stock in the association after his loan is repaid or he may sell it to another eligible borrower.

3. Loan Purposes—Production Credit Association loans may be used for any general agricultural purpose, such as, financing farm production or operating and family living expenses, the purchase of livestock, feed, and equipment, the repair and alteration of farm buildings, etc. and refinancing debts incurred for the above purposes.

4. Type of Loan—Commonly, this type of loan is called a farm production or operating loan.

5. Terms—Loans obtained from Production Credit Associations usually have a term of one year or less. The term of the loan is governed largely by the purpose to which the loan proceeds are to be applied and repayment is expected upon completion of the project. A loan obtained to purchase feeder cattle, for instance, is to be repaid when the fat cattle are marketed. The term specified on the note and chattel mortgage is usually the same length as the expected feeding period.

Sometimes, an agreement to renew the unpaid balance at the end of the term is made when the loan is granted. Such a renewal agreement is usually made dependent upon faithful performance on the contract—and failure to perform faithfully, generally means that renewal of the loan will not be granted. Frequently, partial payment during the term of the loan is required.

6. Interest Rates and Fees—The rate of interest charged by associations in South Dakota varies from 5 to 6 percent. The rate of
interest charged is subject to change because it depends upon the
cost of operating the association and how much it costs the association
to obtain funds from the Federal Intermediate Credit Bank. However,
the association may not charge more than 4 percent above the cost
funds (the discount rate) obtained from the Federal Intermediate
Credit Bank. Interest is charged only for the length of time each
dollar is actually used.

All associations may charge an inspection fee. The amount of
this fee varies and some associations do not make a loan service charge
but most associations do require the borrower to pay chattel mortgage
abstract charges and chattel mortgage recording fees.

Most Production Credit Associations now pay dividends on stock
owned by their members and some associations make patronage refunds
based upon the amount of interest paid to the association by the
member. These dividends and patronage refunds may be large enough
to reduce the cost of a loan obtained from the association.

7. Loan Amounts—The maximum loan amount generally depends upon
the purpose of the loan, the collateral (security) back of the loan,
and in particular, the capacity of the farmer and his farm to repay
the loan.

Most loans are made on a budgeted basis whereby the loan amount
up to a specified maximum is granted in installments as needed by the
borrower and repaid when income is received from the production
enterprises financed with the loan (see illustration on page 10).

8. Collateral Required—In general, most associations require a
first chattel mortgage on farm livestock, equipment, feed and some-
times growing crops as security for the loan. Unsecured loans may be
made to established borrowers when all credit factors are favorable and
the financial position of the borrower is satisfactory.

9. Amount of Time to Obtain a Loan—The established borrower
can obtain a loan immediately or essentially "over-the-counter"service.
The new borrower can under emergency conditions obtain a loan on the
same day the application is made but it usually takes one or two
two days to make a new loan because it is necessary to obtain a chattel
abstract and credit committee approval. Frequently a field report on
the borrower's farming operations is made before funds are made
available.

10. Source of Funds—Production Credit Associations obtain most of
their loan funds from the Federal Intermediate Credit Bank which ob-
tains its funds through the sale of debenture (general credit) bonds.
These bonds are purchased by the investing public—commercial banks,
insurance companies, endowment funds, pension trusts, etc.

11. Further Information—Two booklets published by the Farm Credit
Administration, obtainable at any Production Credit Association
office or by writing to the Farm Credit District, Omaha, Nebraska, will
be helpful to farmers interested in learning more about Production Credit Association loans:

a. "Using Your Production Credit Association," Circular E-17
b. "The Production Credit System"

E. FARMERS HOME ADMINISTRATION

The Farmers Home Administration makes five major types of loans to farmers; namely, Production and Subsistence, Farm Ownership, Soil and Water Conservation, Emergency, and Special Livestock. The general requirements for eligibility and the general characteristics of these loans will be presented first followed by a chart presenting some of the details about each type of loan.

Production and Subsistence, Farm Ownership, and Soil and Water Conservation loans are made only to citizens of the United States who have had sufficient farm experience and training to enable them to conduct a successful farming operation. Production and Subsistence and Farm Ownership loans are made only to families who operate or will operate family-type farms, who need credit, and who can otherwise qualify for the loan. Soil and Water Conservation loans are not confined to operators of family-type farms and may also be made to partnerships and corporations engaged in farming. Applications from veterans for these three types of loans are given preference, that is, their applications are considered first; and if loan funds are limited, loans to veterans are granted before non-veterans may receive loans.

Emergency loans are made only in areas which have been designated by the Secretary of Agriculture as eligible to receive Emergency loans because of production losses due to natural catastrophes or the inability of the normal sources of credit to meet the credit needs of agriculture in the area. Three types of Emergency loans are made: Production, Economic, and Special.

Special Livestock loans are made to farmers and ranchers who have a satisfactory agricultural background, who have in the past conducted successful farming or ranching operations, and whose primary need is for temporary credit to meet emergency situations for which credit from local sources is not available. The Special Livestock loan may be used to finance the restocking of farms and ranches where it was necessary for the operator to dispose of his livestock under adverse conditions. The granting of Emergency and Special Livestock loans is not confined to operators of family-type farms.

The usual FHA credit services are available only to farm families who are unable to obtain credit with reasonable rates (not to exceed 5 percent) and terms through other credit sources. The applicant must normally have sufficient numbers of livestock of such quality and equipment adequate enough to enable him to efficiently operate his farm unit or satisfy this requirement by means of the loan; he must be approved by the county FHA committee; the farm unit he desires to
purchase in the case of a farm ownership loan must meet FHA specifications for buildings and building construction and it must classify as a family-sized farm unit; and he must agree to comply with other FHA requirements, such as, keeping farm records, preparation of farm budgets, etc.

All FHA loans are based upon a plan of operation developed with the applicant for the current year and usually for a period of five years ahead to determine potential debt payment ability. Repayment amounts on all FHA loans are based upon the debt payment ability as determined from the plan of operation; and if scheduled repayments are too large, they are usually modified according to farm income information as shown by the borrower's farm records.

The county FHA committee has three chief functions: (1) it approves applicants for loans which involves verification of the applicant's character, experience, and farming ability; (2) it certifies the reasonable value of farms purchased under the farm ownership program; and (3) it acts in a general advisory capacity to the County FHA supervisor who is a federal employee.

The expression "supervised loan" is often used in connection with any FHA loan. However, this now applies only to Production and Subsistence and Farm Ownership loans. Supervision where it does apply to FHA loans involves both financial and farm management assistance when needed. Financial management assistance is provided through farm and home planning (farm and home budgets and record keeping), while farm management assistance is directed chiefly to encouraging borrowers to employ more of the time-tested and approved farm management practices.

Congress appropriates the funds for all FHA loans except insured Farm Ownership and Soil and Water Conservation loans. Commercial banks; life insurance companies; trust, endowment, and pension funds; other lending and investment agencies; and private individuals are the chief sources of funds for insured FHA loans.

FHA loans are particularly helpful to young people in getting started in farming and those farmers who have suffered financial reverses and wish to get a fresh start in farming.

Further information concerning FHA loans can be obtained at any FHA county office.

F. MERCHANTS AND DEALERS

More and more merchants and dealers are offering so called "easy credit" services to their customers. In fact, the situation is approaching the point where the merchant or dealer who does not offer credit services is at a competitive disadvantage unless charge accounts are used. However, charge accounts are not very practical for large purchases.

Merchants and dealers extend contracted forms of credit under a number of arrangements several of which are: (a) the sale of these
## Farmers Home Administration Loans

<table>
<thead>
<tr>
<th>Type</th>
<th>Purpose</th>
<th>Terms</th>
<th>Rates</th>
<th>Limits</th>
<th>Security</th>
<th>Special Features</th>
</tr>
</thead>
<tbody>
<tr>
<td>Production and Subsistence Loans</td>
<td>1. Purchase feed, seed, equipment, and livestock.</td>
<td>Usually 5 years but may be 7 years.</td>
<td>5%</td>
<td>$7,000 initial, up to $10,000 principal plus interest.</td>
<td>Mortgage on purchased property plus additional property to secure the loan.</td>
<td>Supervised. First payment may be deferred to end of second crop year.</td>
</tr>
<tr>
<td></td>
<td>2. Finance farm operating and living expenses.</td>
<td>Amortized.</td>
<td></td>
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<tr>
<td></td>
<td>3. Refinance debts.</td>
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<tr>
<td>Emergency Loans</td>
<td>Finance farm operating and living expenses, building renovation, and land reclamation in areas suffering production losses over 25 percent from natural catastrophes.</td>
<td>Depends upon amount and purpose of the loan. Maximum 20 years.</td>
<td>5%</td>
<td>No definite limits.</td>
<td>Mortgage on crops, chattels, or real estate depending on purpose of the loan.</td>
<td>Non-supervised. Made only in areas designated by the Secretary of Agriculture and in areas where there is an unusual need for credit which cannot be met locally.</td>
</tr>
<tr>
<td>Special Livestock Loans</td>
<td>Finance restocking and operating expenses of livestock enterprises of farm and ranch operators temporarily unable to obtain credit from local sources.</td>
<td>Maximum 3 years. Amortized.</td>
<td>5%</td>
<td>No definite limits.</td>
<td>The loan is secured by the best lien obtainable on the chattels and real estate.</td>
<td>Non-supervised. Program was to expire July 13, 1955 but it has been extended for another two years.</td>
</tr>
<tr>
<td>Soil and Water Conservation Loans</td>
<td>Finance cash cost of materials, supplies, equipment and services for purposes consistent with soil and water conservation and land use adjustment.</td>
<td>Maximum 20 years. Amortized.</td>
<td>$25,000</td>
<td>Loans under 7 years, first lien on chattels.</td>
<td>Loans over 7 years, the best lien available on the real estate.</td>
<td>Non-supervised. First payment may be deferred two crop years.</td>
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<tr>
<td></td>
<td>a. Direct</td>
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<td></td>
<td>b. Insured</td>
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<tr>
<td>Farm Ownership Loans</td>
<td>1. Farm purchase</td>
<td>Maximum 40 years.</td>
<td>4 1/2%</td>
<td>100% of certified value. Insured loans 90% of certified value.</td>
<td>Usually a first mortgage on the real estate is required.</td>
<td>Supervised. Direct loans to Veterans only. Variable payments.</td>
</tr>
<tr>
<td></td>
<td>2. Farm enlargement</td>
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<td></td>
<td>3. Farm development</td>
<td>Amortized.</td>
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<td></td>
<td>4. Building improvement</td>
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</table>
contracts to a sales finance company or a commercial bank, (b) the financing of these contracts by the dealer's supplier or else the contracts are made under the supplier's name, and (c) the financing of these contracts directly by the merchant or dealer either from his own resources or by using his accounts receivable and inventory as collateral for a working capital loan or a line of credit from a sales finance company or commercial bank.

The method by which the merchant or dealer finances chattel mortgage or conditional sales contracts is not so important to the customer as are the factors of convenience of payment, the likelihood of reasonable treatment, and the cost of using this type of credit. The usual interest rate charged on merchant and dealer contracts is a flat charge which varies from 5 to 8 percent, and since for farmers quarterly, semi-annual, or annual payments are almost universally required, the effective or simple annual rate of interest is almost always higher than the stated rate.

In a very general way, the prices for all merchandise would be less if all people dealt with merchants and dealers on a cash basis. Most of us do not stop to realize that charge accounts are costly for the merchant because of bookkeeping, collection expenses, and losses on uncollectable accounts. The merchant must pass this cost on to his customers in one way or another. Sometimes, the cost of credit is paid by cash and charge customers alike in the form of slightly higher prices. Either that, or else in businesses where trade-ins are customary, cash customers are allowed higher trade-in allowances. Occasionally, merchants will have two prices, one for cash and the other for charge customers or give a discount for cash. Increasingly at the present time, merchants either extend credit on a monthly payment charge plan with 10 percent of the balance added as a carrying charge or they use the conditional sales contract for specific items. Actually most monthly payment charge plans are a blanket type of conditional sales contract which covers all items charged.

Normally, it is cheaper to obtain a loan from a reputable financial institution and pay cash for merchandise than to use monthly payment charge plans or conditional sales contracts. There are people whose credit rating will not permit them to obtain low-cost cash loans. These people are, of necessity, forced to use more costly credit services and some people have such a poor credit rating that they are unable to obtain credit at any price.

A great many farmers, who are at present using merchant and dealer credit, could save $50 to $200 or more dollars per year in credit costs by obtaining the credit they need from a commercial bank or a production credit association. However, commercial banks and PCA's are not likely to be as free in extending credit for farm machinery and automobiles as the dealers but this may be a very good thing for a farmer's financial condition. Ordinarily, bank and PCA loan officers will go along in financing purchases that are really and truly necessary to good farm operations.
G. OTHER LENDERS

1. Personal Finance or Small Loan Companies. Loans obtained from this source are used chiefly for meeting financial emergencies, refinancing and grouping a number of small debts, and to finance the purchase of consumers goods (TV sets, deep freezers, cars, etc.,). Interest rates charged by personal finance companies and certain other conditions governing the extension of this type of credit are established by state laws in most states including South Dakota.

Usually, loans up to $300.00 can be obtained on signature with or without a cosigner and without giving a mortgage, but for amounts over $300.00, a mortgage is usually required. Weekly or monthly repayments are the rule over a maximum loan term of two years on loans of less than $1,000.00 and a term of three years on loans over $1,000.00. A three percent interest rate is charged monthly on the unpaid balance of loans up to $300.00. Interest on larger loans is charged at the rate of three percent on the first $300.00 and 3/4 of 1 percent on loan amounts over $300.00 up to $2,500.00. Interest is computed in advance at the time the loan is made and added to the original principal. In addition, certain fees, the cost of credit insurance, and the cost of property insurance if purchased from the lender (but the lender cannot require the borrower to purchase property insurance from him) are also added to the original principal. The weekly or monthly payment is based upon the term of the loan and the total of the principal, interest, and other charges. Reputable personal finance companies usually limit debt payments to a maximum of 20 percent of the borrower's monthly income and the maximum amount loaned is governed by this factor and the term of the loan.

Personal finance companies make loans chiefly from their own capital funds obtained from the sale of stock and bonds to the incorporators and to the investing public if the company is large. Short-term call loans from banks constitute a secondary source of loan funds for these companies.

2. Building and Loan Associations. Some building and loan associations (or savings and loan associations) make farm real estate loans. The amount, interest rate, and other terms and conditions governing these loans are very similar to those of other lenders making real estate loans.

People who either own shares of stock or have pass book deposits in a building and loan association can borrow up to 90 percent of the value of their shares or deposits by pledging their stock or deposits as collateral. Loans of this type are made at a 4 percent simple annual rate of interest and usually no questions are asked concerning the purpose for obtaining a loan. This form of credit is cheap but it is limited in amount to the size of the borrowers deposits or share holdings. Further information concerning building and loan associations can be obtained by visiting the manager or secretary of one of these institutions.
3. **Credit Unions.** All credit unions in South Dakota are organized under the Federal Credit Union Act of 1934, and consequently, they are all known as Federal Credit Unions. Most credit unions are located in towns and cities but there are now sixteen farmer credit unions in South Dakota.

A credit union is a cooperative credit association which is owned and operated by its members for their mutual benefit. Credit union objectives are to promote thrift and regular savings among its members and to make loans to members at reasonable rates of interest. Control and management of a credit union are in the hands of its members. The membership elects a board of directors which in turn elects its own officers, a supervisory committee, and a credit committee.

Savings deposited in credit union shares earn dividends which may vary up to a legal maximum of 6 percent per year. The interest rate on loans may not legally exceed 1 percent per month on the unpaid balance. Three types of life insurance services are available to credit union members. First, the life savings insurance program insures all members for an amount equal to their deposits up to $1,000. In event a member dies, the beneficiary receives twice the amount the deceased member had on deposit. The cost of this insurance is paid out of credit union earnings. Second, the loan protection insurance program insures loan balances up to $10,000 for each member-borrower. In event of death or total disability, the loan balance is paid under this insurance program, and thus, relieving the disabled member or the deceased member’s family of the debt. The cost of this insurance is also paid out of credit union earnings. Third, individual ordinary life insurance contracts issued by the CUNA Mutual Insurance Society are available to members at premium rates which are about at par with the premium rates available to servicemen under the National Service Life Insurance program during World War II.

A federal credit union can be formed by any seven people provided there is a potential membership of at least 100 family units having a common bond of association, such as, a church membership, the employees of one employer, or a farm community. Further information about credit unions can be obtained by writing to W.O. Knight, Jr., Managing Director, South Dakota Credit Union League, City Hall, Sioux Falls, South Dakota.

4. **Individuals.** Individuals constitute an important source of credit to farmers. Individuals often extend credit in the form of a purchase money mortgage (a mortgage taken by the seller as partial payment) in the sale of their farm real estate. Generally, the buyer does not have sufficient cash to pay the full purchase price in buying a farm; and if he does not arrange for some other lender to pay the balance to the seller, then the balance is frequently carried by the seller either as a purchase-money mortgage or on a contract for deed basis. Usually interest rates are higher and the loan term shorter on real estate loans made by individuals than on contracts of the same kind available from other lenders.
Many farmers prefer to sell their farm property on a mortgage or contract for deed basis because it gives them interest income and they avoid paying all the capital gains tax, if any, in one year; and if the seller is retired, he may have little or no tax to pay on the capital gain realized from the sale depending upon the amount of his income from other sources.

The largest proportion of production credit extended by individuals is extended by merchants and dealers. Even so, an important source of production credit is the farmer, either active or retired, who finances the purchase of chattels for a son, other relative, friend etc., either by advancing cash for this purpose or by transferring the actual chattels in exchange for a note and chattel mortgage. Interest rates and other terms and conditions for production loans under these conditions are largely determined by mutual agreement. These terms and conditions will vary from a verbal agreement to pay without any stipulation as to term or method of repayment and without interest to contracts and agreements as highly formalized as those used by regular lending institutions. In fact, as a safeguard against misunderstandings, the details of loan contracts with individuals or relatives should probably be spelled out even more clearly and carefully than loan contracts with regular credit institutions.

H. GOVERNMENT GUARANTEED OR INSURED LOANS

GI Loans were made possible by the Serviceman's Readjustment Act of 1944 and the Veterans Readjustment Assistance Act of 1952. Anyone who served in the armed forces between September 16, 1940 and July 25, 1947 or between June 27, 1950 and the end of the Korean Police Action is eligible for a GI loan provided the discharge was honorable and the service period was 90 days or more. The veteran discharged because of a service-incurred disability is eligible even though the service period was less than 90 days. Unremarried widows of men who served in the armed forces during the above periods and who died in service or as the result of a service-connected disability may also qualify.

Veterans must ordinarily make arrangements for GI loans through credit institutions such as banks, building and loan associations, mortgage loan companies, etc. The Veterans Administration does not loan money directly to veterans except under specific conditions which will be mentioned below. The GI loan program is designed to encourage lending institutions to make loans to veterans at reasonable rates of interest and minimum down payments because the Veterans Administration guarantees part of the loan or because a part of the loan is insured against loss to the lender. The veteran-borrower is expected to repay his GI loan just as he would any other loan.

GI loans may be obtained for the following purposes:

a. To purchase, construct, or improve a home.
b. To buy a farm, farm land, stock, feed and seed, farm machinery, and other farm supplies and equipment.
c. To buy a business or otherwise to enable a veteran to undertake or expand a legitimate business venture.

The lender making a GI housing or farm purchase loan has a Veterans Administration guarantee against loss on 60 percent of the loan amount up to a maximum guarantee of $7,500. On other types of loans, the Veterans Administration guarantees the lender against loss on 50 percent of the loan amount up to a maximum guarantee of $4,000 on real estate loans and $2,000 on non-real estate loans.

The interest rate on VA guaranteed loans may not exceed 4 1/2 percent per year on the unpaid balance of the loan. Fees and charges may not exceed those permissable under VA regulations. The interest rate on insured real estate loans may not exceed 4 1/2 percent per year while the rate on insured non-real estate loans may not exceed a 3 percent discount rate or the equivalent simple interest rate of 5.7 percent per year.

The down payment and the term of the loan are matters to be agreed upon between the veteran and the lender. However, VA regulations permit lenders to make guaranteed or insured loans requiring no down payment and a repayment term up to 30 years in length.

New housing being purchased under the GI loan program must meet or exceed minimum VA requirements for planning, construction, and general acceptability and builders are now required to give veteran-purchasers a one-year warranty that their homes have been constructed in "substantial conformity" with VA approved plans and specifications. GI loans for the purchase of older housing may not exceed the VA appraised value of the housing.

The veteran in order to obtain a GI loan for financing either a farm or non-farm business must show that he has the ability and is qualified by education and experience to undertake the operation of a business. Both the Veterans Administration and the lender making a GI business loan will want to assure themselves that the veteran-borrower has at least a reasonable chance to succeed in his proposed business venture.

The Veterans Administration can make a limited number of direct loans to veterans in areas where the Administrator has determined that private mortgage financing at 4 1/2 percent is not available. The location of areas where direct loans can be made may be obtained from Loan Guaranty Officers at Veterans Administration Regional Offices. Direct loans are made only to build or purchase a home or to build or improve a farm house.

The veteran who wishes to obtain a GI loan must establish his eligibility for such a loan. This is done by submitting the original discharge certificate (photostatic or certified copies of the discharge certificate are not acceptable) to the Loan Guaranty Division at the Veterans Administration Regional Office nearest to the veteran's place of residence. South Dakota veterans would submit their request to the regional offices located at 2201 West 22nd Street in Sioux Falls. If the veteran is eligible for GI loan benefits, the VA will issue a certificate
of eligibility in his name and stamp his original discharge papers to indicate that such a certificate has been issued. The veteran then presents this certificate of eligibility to the lender upon applying for a loan; and if the loan is granted, the lender endorses the certificate and forwards it with other loan papers to the Veterans Administration. Applications for GI loans must be made within 10 years from July 25, 1947 by World War II veterans or 10 years from a date yet to be determined by veterans of the Korean Police Action if they wish to make use of the GI loan program.

There is considerable detail involved in obtaining a GI loan which either a representative of the Veterans Administration or the lender making GI loans will explain to the veteran-borrower.

Further information about GI loans and other veterans benefits can be obtained from County Service Officers, Veterans Organizations, and the Veterans Administration. Three booklets published by the Veterans Administration for veteran information are:

1. "Post-Korea Fact Sheet."
2. "GI Loans for Veterans--Questions and Answers," VA Pamphlet 4-1 Revised.

2. Federal Housing Administration property improvement loans are loans made by private or public lending agencies under Federal Housing Administration regulations. The Federal Housing Administration does not make any loans directly but insures loans made by other lenders.

There are several types of housing loans which may be made under the FHA insured mortgage loan program. However, only one, FHA Title I property (home) improvement loan, is of interest here because this type of loan is made for farm home improvement as well as for the improvement of homes in towns and cities.

FHA Title I property improvement loans are used to finance the modernization and repair of homes. These loans are made for amounts up to $3,000 for periods up to three years. The maximum finance charge is $5 per $100 borrowed for each year of the loan term. The finance charge may be either discounted (deducted in advance) or added onto the loan amount; and since repayment is usually made by monthly installments, the effective rate of interest on this type of loan is approximately 10 per cent.

Further information concerning FHA property improvement loans can be obtained from any lending institution making this type of loan. Farmers and others who are financing the modernization of their homes with FHA Title I loans should carefully check for luxury and non-utility home convenience items or appliances that have been ruled ineligible for financing under the property improvement insured loan program.
3. **Commodity Credit Corporation Farm Commodity Loans** (CCC Loans) are price support loans made to eligible producers of such agricultural commodities as corn, soybeans, flax, honey, wheat, oats, rye, barley, grain sorghums, etc. The major portion of CCC loans are made and carried by commercial banks for the convenience of their farmer-customers. CCC loans can be made by any approved lending agency which has entered into a lending agreement with the Commodity Credit Corporation. CCC loans are also made directly by the Commodity Credit Corporation through the county Agricultural Stabilization and Conservation (ASC) office. In either case, application for a CCC loan must be made at your ASC county office.

CCC loans are made for periods varying from four to fourteen months. They are secured by farm commodities as collateral under warehouse receipts or chattel mortgages. The commodities securing CCC loans must be stored in approved storage facilities which may be either on-the-farm or public warehouses. The interest rate is $3\frac{1}{2}$ per cent plus a service charge of one cent per bushel on farm stored commodities and one-half cent per bushel on warehoused commodities subject to specified minimum charges. CCC loans must be paid when due like any other loan. The repayment of a CCC loan can be accomplished either (1) by repaying the loan on or before maturity plus the interest then due or (2) by delivering the commodity securing the loan in accordance with instructions issued by the ASC county committee. Delivery of the commodity to the Commodity Credit Corporation cancels the loan and no interest is charged. CCC loan extensions are made under a re-seal program whereby payment of the loan or delivery of the commodity can be postponed one year at a time. The farm producer is paid a storage fee under the re-seal program which exceeds the interest cost should he elect to repay the loan.

The Commodity Credit Corporation also sponsors a Farm-Storage Facility loan program. Most of these loans are made directly by the Commodity Credit Corporation. Farm-storage facility loans are made to finance the construction of new movable or immovable grain storage structures on the farm and additions to existing on-the-farm grain storage structures. The maximum loan amount is 80 per cent of the cost of constructing the storage facility. The principal of the loan is repayable in four equal annual installments beginning one year after the loan is made with interest at 4 per cent charged on a simple annual basis. A service fee of 1 per cent of the loan amount plus mortgage recording fees must also be paid by the borrower. The structure is pledged as security for the loan; and therefore, a severance agreement is required so that the structure will not become permanently attached to the farm until the loan is repaid.

Other details about CCC loans can be obtained from your ASC county office. Legislation and the regulations governing the price-support program and CCC loans are subject to change; and accordingly you should seek up-to-date information about CCC loans early each year if you plan to qualify for a loan under the price-support program.

I. **FINANCING FARMER COOPERATIVES**

Just as individual farmers frequently need credit to finance their
farm enterprises, they also frequently need credit in financing cooperative associations which they have formed to purchase farm production supplies, to furnish farm business services, and to process and market farm products. The function of the cooperative is to serve its members. It is in business to increase the profits or reduce the expenses of its individual members and not to make a profit in its own right.

Cooperatives normally serve their members best if the members have final control over the operations of the association and if the necessary capital has been provided by its members or patrons. The initial capital for a cooperative is obtained directly through membership fees or the sale of common and preferred stock to its members and indirectly through deferred patronage refunds and contingency reserves.

Frequently, however, the capital provided by the members is not sufficient to adequately finance the cooperative; and therefore, additional funds must be obtained by borrowing. Borrowed funds may be obtained through the sale of Certificates of Indebtedness to members and others or by loans obtained from commercial banks, other lending institutions and suppliers. However, the chief source of credit for qualified farmer cooperatives in South Dakota at the present time is the Omaha Bank for Cooperatives. Loans may be obtained from the Bank for cooperatives to finance or refinance the purchase, construction, or lease of physical facilities (Facility Loans); to finance ordinary operating expenses, inventories, and other current needs (Operating Capital Loans); and to finance advances made to members on commodities delivered to the cooperative association (Commodity Loans).

Further information on financing cooperatives and the Bank for Cooperatives can be obtained from the following publications:

1. "Financing Cooperatives" Agricultural Experiment Station Bulletin 434, South Dakota State College, Brookings, S.D.
2. "Loans to Farmers' Cooperatives" Circular No. 6 and "Financing Farmers' Cooperatives," Circular E-20 which can be obtained from the Bank for Cooperatives at Omaha, Nebraska.