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MARKET VALUES, EARNING POWER,  
AND LENDING STANDARDS

IT IS a common belief that differences in farm land values depend, in the long run, on farm earning power—except for deviations due to amenities. The differences are regarded as the result of a highly competitive land market, in which the earnings potentials of the various grades of land are constantly reappraised, the more productive properties then being bid up and the less productive beaten down until the rates of return are equalized.

Although that belief has many adherents on the long-run theoretical level, it has few on the short-run practical level. Indeed, the contrary belief is quite general, and farm income studies bear this out, that in the short run the rates of return on different grades of land within an area may be quite unequal. Lack of adjustment between land values and income on different grades of land within a type-of-farming area, combined with the appraisal and lending practices of farm mortgage lenders before the thirties, is commonly accepted as the cause of the traditionally poor mortgage experience on the less productive land in many parts of the United States during the interwar period.

But if deviations between market value and earnings value are so clearly recognized, why do they persist, even in the short run? Why do not the forces of competition come into play and equalize the relation between earnings and market values on all grades of land?

*Imperfections of the Land Market*

Probably the most important single factor preventing a more precise adjustment of market values to earning power is inadequate knowledge of essential facts on the part of many land buyers and mortgage lenders. This is most strikingly illustrated in newly settled regions where buyers and lenders have to make decisions without benefit of crop yield data, weather records, or soil maps. As a result, serious mistakes may be made in appraising the productive potentiality of a whole region, and many mistakes are almost certain to be made in appraising individual properties. As experience accumulates, appraisals will improve,

but it is noteworthy that progress is often slow, particularly if differences in farming returns within a region trace to causes that are not readily apparent, such as local differences in climate or internal soil drainage.

The process of adjusting market values to earning power may also be retarded by customs or apathy. In northern Idaho, the customary one-third share rental resulted in a price discrepancy between the more productive and less productive lands in relation to earnings, the more productive land being undervalued. Yet mere recognition of the price discrepancy apparently was not sufficient to readjust land values as long as the rental system persisted.

Another deterrent to a good adjustment between land values and earnings on different grades of land within an area is social and technological change, which creates new maladjustments even while existing ones are being eliminated. The productivity of land depends only partly on soils and climate; it is also greatly affected by farming organization and practices—by the crop and livestock systems used, by the insecticides and fertilizers applied, and by the kind and amount of machinery employed. Financial returns from farming depend, moreover, not only on physical productivity but also on price relationships and markets, which frequently change. Over the past several decades we have seen important technological advances that have greatly increased the productivity and profitability of agriculture in general; yet the advances have not affected all farms equally. Often technological advance operates to the disadvantage of some farms by giving other farms a competitive advantage. Population movements or widespread changes in the demand for specific products may have the same effect.

Examples of the disorganizing effect that may sometimes be exerted by rapid technological change on the agriculture of a region are abundant. Among them are the development of railroad transportation in the latter half of the nineteenth century, which had an adverse effect on many types of farming in the Northeast; the development of the automobile, which had an adverse effect on commercial hay producers; and the invention of the cotton picker, which gave producers on the level, high-yield lands of the Mississippi River delta an increased competitive advantage over producers on the hilly eastern piedmont. Examples to illustrate the differential effects of technological change on individual farms within a type-of-farming

area are not so easily found, although it is generally believed that technological change rarely affects all farms in an area equally. One such example is provided by the study of the Newfane fruit area, discussed in the preceding chapter. There was little evidence of variation in average rates of return for Newfane farms according to their soil productivity, in either the 1913-19 or the 1920-29 period. But in 1930-39, after important changes in technology and price-cost relationships, farmers on the best adapted land were earning substantially higher rates of return than other farmers. To do this, they were farming the best grade of fruit land very intensively, and producing a premium grade of fruit for specialty markets.

Limitations of capital are often cited as a cause of differences in rates of return on different grades of farm land within type-of-farming areas. Even in a relatively imperfect land market, the more productive properties may sell at substantially higher prices than the less productive ones. Those higher prices may be insufficient to reflect the higher earning power of the productive properties, and yet more than sufficient to discourage purchasers with little capital. It is not enough for the prospective land buyer merely to recognize that a tract of exceptionally well adapted land is underpriced, and therefore able to earn a higher rate of return than the inferior tracts in the neighborhood. He needs the wherewithal to make the purchase, and although a portion of it can usually be borrowed, the remainder, which may be large, will ordinarily have to be raised in the form of cash. Hence, it is argued, the better-adapted land may consistently sell for less in relation to earnings than the poor land simply because there are relatively few buyers with sufficient cash or credit to pay premium prices.

#### *Amenities and Other Factors*

Although imperfections of the farm mortgage and real estate market no doubt account in part for the failure of market values fully to reflect differences in the earning capacity of land, particularly within type-of-farming areas, it should not be overlooked that people buy farms for many reasons other than to obtain a financial return. There are those who farm as an avocation, who buy farms for year-round or summer homes, who practice subsistence or part-time farming, who seek independence or job security in a farm, or who are willing to forgo some financial advantage to live in a congenial neighborhood with

good schools, churches, and other community facilities. As long as persons buying farms for such purposes, and there are many of them, have the necessary purchasing power to make their demands effective, they can affect the market quite as distinctly as do those who buy purely for investment. It would not be surprising, therefore, to find that market values rarely equal earnings values, even in the long run.

*Market Values versus Earning Power  
as Loan Security*

The soundness of a long-term loan, whether a farm mortgage, a business loan, or a corporate bond issue, ordinarily rests upon two sources of financial security: first, the market value of the collateral assets that can be seized in case of default or liquidation; second, the earning power of the enterprise, which determines its ability to meet interest charges and avoid default. For years credit men have debated the relative importance of these two sources of security, and in recent years emphasis has shifted from assets toward earning power. The feeling has strengthened that the assets of a business have value and command a price primarily because of their ability to earn a return. Furthermore, the strategic value of the mortgage lien has been limited by legal restrictions deterring creditors from taking actual possession of assets. Bankruptcy courts have frequently argued that the complete dissolution of a business, particularly a railroad or other public utility, is contrary to the public interest and have usually preferred to reorganize a company and keep it in operation. Reorganization often prevents creditors with prior liens, even first mortgage bondholders, from exercising their rights of foreclosure. In much the same fashion, moratorium legislation during the twenties and thirties prevented many farm mortgage holders from foreclosing, and in states where there was no such legislation, mass action by farmers was often sufficient either to prevent foreclosure or to mitigate its effects.

There are, of course, many techniques of appraising farms for loans, but almost all of them can be related to one of two basic methods. One involves an estimate of capitalized earning power—either current or average earnings, usually the latter—and seeks to obtain the going-concern or investment value of the farm. The other attempts to determine what the farm would realize in an actual sale. The latter method, depending upon

needs, might involve an estimate of current selling price, forced-sale price, selling price under an assumed level of farm prices and business activity, or the long-term average selling price. In any case the purpose is to ascertain the collateral or liquidation value, rather than the going-concern value, of the property.

Many writers on farm finance appear to expect an appraisal to do double duty: to reflect simultaneously both the liquidation value and the going-concern value. If the capitalization and market value methods produce different results, some average or compromise value is taken, apparently with the idea that the long-term going-concern value and the long-term liquidation value are basically the same thing. That might be a reasonable expectation if farms were bought and sold by thoroughly competent and informed persons for the sole purpose of obtaining a financial return. Actually, as has been pointed out, the land market is far from perfect. Some buyers are well informed but others are not, and the best informed are not necessarily the ones with the greatest purchasing power. Moreover, regardless of perspicacity or purchasing power, buyers buy for a multitude of reasons. To some a farm is a strictly financial investment. As landlords they may want an investment income from rentals without taking an active part in the actual operation, or as owner-operators they may want a fair investment return on their capital in addition to a reasonable reward for their labor and management. But there are many who are motivated by other than purely financial considerations. Consequently, market values rarely equal going-concern values, and a single estimate cannot adequately reflect both.

In financial analyses of corporations and corporate securities, it is quite common to make several evaluations in order to fit possible contingencies. In the reorganization of a utility holding company, for example, several possibilities arise, and the value of the company to those who own its stocks and bonds varies accordingly. The company may consolidate and become an operating company. It may become an investment trust, relinquishing control over its subsidiaries. It may sell its subsidiaries for cash, which it then pays out to its security holders. It may distribute the actual stocks and bonds of its subsidiaries.

A farm, of course, presents fewer alternatives, but there are still several possibilities. When a loan is closed, the lender hopes that payments will be made regularly and that there will be no other difficulties. Realization of his hopes is more likely if

the farm has stable earnings adequate to cover the payments. But since farming is an uncertain business, the lender must face the possibilities of default and foreclosure, in spite of all efforts to make loans that can be repaid. And if foreclosure does occur, he faces two very different sets of alternatives for dealing with the property. First, he may hold it as an income-producing investment, either through rental or by operating it himself. Second, he may sell it, either for cash or by extending a new mortgage or sales contract. If the lender anticipates the first contingency, he will certainly want an estimate of the income that he will probably derive from operation; and he may or may not capitalize the probable income to obtain a going-concern value for the property itself. If, however, he anticipates the second, he will need a market value appraisal. Some lenders are able to choose whichever alternative appears more attractive. Others, however, are unable to hold the property for income and must perforce sell it; and they will be vitally concerned with the probable resale value. Evidently an appraisal of market values is an important part of most loan analyses, regardless of how the income account is appraised.

*Relation of Loan to Long-term  
Market Value*

It is generally held, particularly by those who emphasize market value appraisals, that the amount of a mortgage loan should be substantially less than the long-term market value of the mortgaged property, taken either as a normal agricultural value or as some other average of past or expected future market values. The amount should be such that the property probably can be sold under most circumstances for enough to cover the loan with a margin to spare. The margin of safety protects the lender against a number of contingencies: (1) The property may have to be disposed of in a period of depressed prices. This is a common occurrence because land values fluctuate widely at times and most of the mortgage distress occurs when values are low. (2) Often considerable time is required to foreclose a delinquent property and to find a suitable buyer for it. In the interim there will be an accumulation of taxes, depreciation, and maintenance expenses, which the lender will probably have to assume; there will also be an accumulation of unpaid interest. (3) In spite of care in making appraisals, a few properties will have been overvalued and overgenerous loans extended.

The lender hopes that the safety factor will provide some coverage for those loans. (4) Finally, the borrower derives a psychological impetus if he has a substantial amount of his own capital tied up in the farm. Knowing that he may lose it if the farm has to be sold in a bad market, he may be more inclined to thrift and hard work.

The commonest device for providing such a margin of safety is the limitation of loans to a stipulated percentage of appraised market value. Although farm credit experts have thought much about what constitutes the maximum safe ratio of loan to value, opinions vary. Some lenders will extend a maximum loan of not more than 50 percent of the appraised value. Some will lend considerably more—say 75 percent. Many lenders vary the maximum percentage according to the quality of the property. One large institutional lender, for example, classifies farms in five grades from A to E. The maximum loan on a Grade A farm is ordinarily 60 percent; on a Grade D farm it is only 40 percent. On a Grade E farm, or even a low D, no loan would ordinarily be made. Sometimes the lender will vary the percentage to be loaned on land and buildings. Until recently, for example, the federal land banks would lend 50 percent on land but only 20 percent on buildings.

Varying opinions on the maximum safe loan-to-value ratio may represent more than mere differences in judgment. Lending standards depend upon the lender's own specific requirements. What is suitable for one may be entirely unsuitable for another. In the first place, since appraisal policies are not uniform, each lender must gear his lending standards to his appraisal policy. To a limited extent, at least, conservative loan-to-value ratios can compensate for liberal appraisals and vice versa. A 60 percent loan on a liberal appraisal, for example, might be the equivalent of a 75 percent loan on a conservative appraisal. In the second place, lenders' ability to carry risk varies. Because of liquidity requirements an institution like a commercial bank may be unable to carry a delinquent borrower through a period of general depression; and at the same time it may incur serious losses if it forecloses and sells the property while the land market is still weak. Such a lender must necessarily pursue a more conservative policy than one with less need for liquidity.

But the most important reason for variations in lending standards is the wide geographical differences in lending risks,



which were discussed in Part I. In general, high risk areas like the Great Plains will require more conservative loans than low risk areas like the Northeast. Wherever farms are hard to sell, or where land values fluctuate excessively, lenders are liable to incur losses on foreclosures unless they limit their loans to an exceptionally small percent of probable market value.

### *Earnings Coverage*

In the study of farm income in Frederick county, discussed in the preceding chapter, O. H. White assumed that the maximum possible loan was one for which interest and minimum amortization charges could just be met by net cash income for 1938 less estimated living expenses. If 1938 is considered a normal year, that criterion would appear to provide no margin for safety. In poorer years debt service charges could not be met out of current earnings, except possibly by rigorously curtailing living expenses; and a succession of poor years might produce a cumulative deficit large enough to result in default.

It is difficult to determine, so many years later, how agricultural prosperity in 1938 was appraised on the basis of information then available. Clearly, 1938 was a depressed year for industry, but the historical record of farm income suggests that 1938 may have been viewed as approaching normal for agriculture. For the United States as a whole, net cash income of farm operators in 1938 was \$2.4 billion.<sup>1</sup> It was somewhat below the prevailing level of the late twenties—\$3.9 billion in 1925, \$3.8 billion in 1929—but it was much higher than 1932's \$0.9 billion or the \$1.4 and \$1.6 billion received in 1931 and 1933 respectively. The period 1935-39 is often taken as a base for agricultural calculations. For the United States, net cash income of farm operators in that period averaged \$2.7 billion, only slightly above the 1938 amount.

In comparison with the subsequent era of farm prosperity, however, 1938 might well be considered a conspicuously subnormal year. Its net cash income, \$2.4 billion, has been exceeded in all subsequent years except 1940, when the total declined somewhat to \$2.3 billion, and in recent years has been dwarfed by such records as \$10.2 billion in 1946 and \$11.7 billion in 1947. A loan that was just covered in 1938 according to White's standards would have been covered many times

<sup>1</sup> *The Farm Income Situation* (Bureau of Agricultural Economics), August-September 1952, Table 17, p. 43.

over during those prosperous years—in fact, could probably have been retired out of two or three years' income.

In corporation finance a substantial margin of safety is customarily provided in calculating maximum debt loads. It is commonly assumed that a corporation should be able to cover interest charges out of current income in all years and have a substantial margin to spare on the average. As a measure of the safety margin, financial analysts often use the ratio

$$\frac{\text{net operating income}^2}{\text{interest charges}}$$

called the times-fixed-charges-earned ratio. One well-known authority states that this ratio, based on average net operating income (before taxes) for seven to ten years, should be at least 4 for a public utility, 5 for a railroad, and 7 for an industrial corporation.<sup>3</sup> If White had used any of those standards, his estimates of the maximum permissible loan would have been greatly reduced.

The margin of safety provided by limiting loans to a fraction of the apparent debt carrying capacity can serve two purposes. First, it supplies a cushion to absorb normal variations in income, which are probably as large in agriculture as in many forms of corporate enterprise. Second, it gives some protection against the ever present possibility of making an excessive loan on the basis of an overestimate of long-term income. Although variable payment mortgages, to be discussed later, are also capable of providing a cushion to absorb variations, they do not give protection against basic overlending.

Adaptation of the principle of times-fixed-charges-earned from corporation to agricultural finance will naturally require modifications and adjustments. Most important, probably, is the adjustment for family living expenses. Off-farm work, unpaid family labor, and amortization also deserve attention.

#### *Adjustment for Living Costs*

In corporate financial analysis, net operating income, which appears in the numerator of the times-fixed-charges-earned ratio, is usually regarded as the amount available to meet interest

<sup>2</sup> For definitions of net operating income and other technical terms used in this chapter, see Appendix B.

<sup>3</sup> B. J. Graham and D. L. Dodd, *Security Analysis*, third edition (1951), pp. 320 ff.

charges.<sup>4</sup> That is, interest charges constitute a claim against net operating income that takes precedence over claims by the stockholders for dividends or by the Treasury for income taxes. For a family-sized proprietorship, such as a farm or a corner grocery store, however, net operating income must be divided between interest charges and family living expenses. Although interest charges theoretically take precedence, many farm financial experts take the view that family living costs, at least those required for essentials, constitute in effect a first lien against earnings; hence only income in excess of necessary living costs can be considered available to meet mortgage interest.

Since estimates of farm family living costs are hard to make and not abundantly available, the adjustment of farm income for living costs presents difficulties. Most available estimates—like those of the Bureau of Home Economics, used by White—cover average actual rather than minimum living costs. For farms in land class v, Frederick county, Maryland, average net cash income was \$3,450 and average living costs were estimated at \$1,398, leaving \$2,052 for debt service. It is clear, however, that individual family expenditures must have varied considerably from the \$1,398 average, and that many families could, by reducing their actual expenditures, have commanded larger sums with which to meet mortgage payments.

#### *Adjustment for Off-farm Work*

On small farms or part-time farms the income from strictly farm operations is often a very poor indication of the capacity to repay debt. If there is real or potential income from nonfarm activities that can be used to help meet mortgage payments, it should be taken into account. Indeed, many part-time farms have no debt carrying capacity in terms of income from strictly farming operations. Yet mortgage experience on such farms is often good because off-farm income can be used to meet mortgage payments.

#### *Adjustments for Unpaid Labor*

Some analysts will argue that an adjustment for unpaid family labor, other than that of the operator, is quite as necessary as the adjustment for living costs. Farms with a large number of

<sup>4</sup> Sometimes there is additional, nonoperating income available to meet interest charges. An example would be interest from securities owned by a manufacturing corporation.

boys in the family may be capable of earning a high net operating income merely because of the large amount of unpaid labor. As long as that situation continues, loan carrying capacity will be high. But the boys may leave home, or the farm may pass to a new owner without such a family. The accordingly diminished repayment capacity is more typical of the farm.

#### *Adjustments for Amortization*

When the loan contract stipulates amortization, which is now common practice, the mortgagor must be able to meet the interest charge plus an additional amount to retire the loan. Although lenders may be more lenient about deferring the amortization payment than the interest payment, failure to meet either payment often constitutes a legal default.

The effect of the amortization requirement on earnings coverage is not entirely clear. At first it would appear that a correspondingly larger income is required to cover the larger combined payment. That is true when there is no provision for deferring amortization; but with such a provision, expressed or implied, the need for additional income is much less definite.

For example, a farm is estimated to earn \$2,000 (net operating income) on the average, and family living expenses are estimated at \$1,200, with some leeway under pressure. Can such a farm carry a \$10,000 debt at 5 percent interest? The annual interest charge of \$500 without amortization is covered 4 times by net operating income, and 1.6 times after allowance for living costs. After interest and living expenses there is an estimated margin of \$300 under average conditions, and perhaps \$500 with some enforced economy in the home.

If, however, the contract requires level-payment amortization in twenty years, annual charges would be \$802, covered 2.5 times before allowance for living expenses and exactly once after the allowance. Average income and expenditures would provide no margin of safety, and enforced economy would provide only \$200. With so small a margin, a default is more likely with the amortized loan. But if a default occurs, particularly after several years have elapsed, it will be less serious with the amortized loan. At the end of ten years, for example, the principal amount will have been reduced from \$10,000 to \$6,193 and the interest payment proper from \$500 to \$310. If the lender is willing to make adjustments, the principal payment of \$492 (\$802 less \$310) can possibly be deferred during a financial

emergency, or the loan can be refinanced on terms that will reduce the borrower's annual burden. On a new thirty-year loan, say, the total annual payments would be only \$403, about half the original \$802.

In the early years of a long-term level-payment contract, annual payments consist mainly of interest with very little amortization, and a generous adjustment of the type described above is hardly feasible—unless the lender is willing to reduce the interest rate or make the borrower an outright gift of part of the principal. Suppose that the hypothetical farm family above borrowed \$13,100 for 35 years instead of \$10,000 for only 20 years. The larger, longer-term loan has the same annual payment of \$802 as the other, but the annual amount of amortization is much smaller, being only \$147 the first year as against \$302 for the \$10,000 20-year loan. At that rate the farm family would have to wait 25 years before the loan could be refinanced on a new 30-year basis with payments reduced to \$403.

#### *The Variable Payment Mortgage*

Some farm financial experts advocate variable payment mortgage contracts, according to which annual payments vary with farm income.<sup>5</sup> In poor years amortization of principal and even interest could be skipped, in good years substantial prepayments required. The land banks, without actually adopting variable payment contracts, have achieved a somewhat similar effect in practice. They extend to deserving borrowers privileges of reducing or waiving payments in bad years, and they encourage farmers to make prepayments during prosperous years.

The variable payment mortgage is designed to adapt the otherwise inflexible mortgage contract to the typically variable incomes of agriculture. It offers the farmer a means of avoiding embarrassment or in some cases disaster when his income falls temporarily below its normal level. But the advantages of variable payments cannot be realized unless long-term debt-carrying capacity is conservatively estimated. According to a recent publication, "Variable payments may serve to decrease delinquency, but do not necessarily aid in paying off the loan; that is, variable payments cannot be expected to compensate for misjudgments in long-run debt-paying ability, for over-

<sup>5</sup> See, for example, *Improving Land Credit Arrangements in the Midwest* (Purdue University Agricultural Experiment Station, Bulletin 551, June 1950), pages 31-39.

lending, or for serious errors in appraisal. No system of variable payments can be expected to deal with the non-business demands on farm income. Examples are heavy family expenditures for medical purposes and decreases in income which result from faulty management.”<sup>6</sup>

*Earnings Coverage, Loan-to-value Ratios,  
and Rates of Return*

When farm appraisals are made strictly according to the capitalization method, a simple and direct relation exists between times-fixed-charges-earned and the loan-to-value ratio. Suppose, for example, that a lender’s standards stipulate the following: appraisals will be made by capitalizing the estimated net operating income at 5 percent; loans will be limited to 66 2/3 percent of the appraised value; and interest will be at 5 percent. This is equivalent to requiring that interest be covered at least one and one half times according to the ratio

$$\frac{\text{net operating income}}{\text{interest charges}}$$

as is shown in Example A below:

	<i>Example A</i>	<i>Example B</i>	<i>Example C</i>	<i>Example D</i>
Net operating income	\$1,000	\$1,000	\$1,000	\$1,000
Capitalization rate	5%	5%	6%	5%
Appraised value (capitalization basis)	\$20,000	\$20,000	\$16,667	\$20,000
Maximum loan ratio	66 2/3%	50%	66 2/3%	66 2/3%
Maximum loan	\$13,333	\$10,000	\$11,111	\$13,333
Interest rate	5%	5%	5%	4%
Annual interest charge	\$667	\$500	\$556	\$533
Times-fixed-charges-earned	1.5	2.0	1.8	1.9

Examples B, C, and D show that greater interest coverage can be achieved if the maximum loan-to-value ratio is reduced, say, to 50 percent; or if the capitalization rate is increased, say, to 6 percent; or if the interest rate is lowered, say, to 4 percent.

When farm appraisals are based partly or wholly on market comparisons, rates of return usually vary from farm to farm, exerting a considerable influence on earnings coverage. In the table below, five hypothetical farms are appraised at \$20,000 each (basis, long-term market value):

<sup>6</sup> *Ibid.*, pp. 31 f.

Examples Showing the Effect of Profitability  
on Earnings Coverage

	<i>Farm A</i>	<i>Farm B</i>	<i>Farm C</i>	<i>Farm D</i>	<i>Farm E</i>
Appraised market value	\$20,000	\$20,000	\$20,000	\$20,000	\$20,000
Return on real estate investment	\$1,000	\$1,200	\$1,200	\$1,200	\$2,000
Rate of return	5%	6%	6%	6%	10%
Loan-to-value ratio	66.7%	66.7%	60.0%	50.0%	66.7%
Amount of loan	\$13,333	\$13,333	\$12,000	\$10,000	\$13,333
Interest rate	5%	5%	5%	4%	5%
Interest charge	\$667	\$667	\$600	\$400	\$667
Times-fixed-charges-earned	1.5	1.8	2.0	3.0	3.0

Farm A is assumed to have a somewhat poorer soil than the others; but it has a larger and better farm dwelling, which suffices to equalize market values. Thus Farm A earns only 5 percent on appraised value, or \$1,000; whereas Farms B, C, and D earn \$1,200, or 6 percent. Farm E earns 10 percent through a combination of better-than-average soil and management. The farm dwelling, however, is somewhat below community standards, and the market value of the farm is estimated to be \$20,000.

As between Farms A and B, the only difference is in the rates of return, which give a slightly better times-fixed-charges-earned coverage for Farm B; the loan-to-value ratios are the same. Farm C has a dual advantage over Farm A. Not only is it more profitable, but the loan-to-value ratio is lower; hence Farm C is carrying a smaller interest burden with a bigger income. Farm D has a still lower loan-to-value ratio and a lower rate of interest. The result of that combination is a times-fixed-charges-earned ratio of 3.0—just twice that of Farm A. To produce a comparable coverage on Farm A would require a loan-to-value ratio of 33 1/3 percent instead of 66 2/3 percent. Farm E also covers its interest three times; but that is due solely to the extraordinarily high rate of return, for Farm E has the same size of loan and the same interest burden as Farm A.

The foregoing examples indicate that good interest coverage can be achieved either through an ultraconservative loan or through a rate of return substantially higher than the mortgage interest rate. Thus it is clear why farm mortgage lenders prefer the following three types of borrowers: first, the man who makes

a substantial down payment on his farm or otherwise acquires a substantial equity, giving assurance of a conservative loan; second, the man who buys his farm at a bargain price in terms of its earning capacity and finances it on a conventional basis; and third, the man who is an uncommonly efficient operator. The third type, of course, involves some risk, for the efficient operator may die or sell out and be replaced by someone who is less efficient.