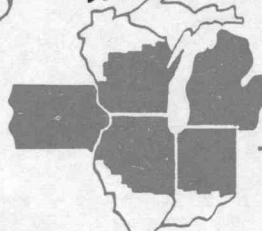


Federal Reserve Bank of Chicago - -

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Agricultural IN LIBRARY USE ONLY Letter



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USURY CEILINGS on larger agricultural loans have been increased in several states as the result of recent federal legislation. Because of differing statutes governing usury ceilings, the effect of the new legislation will vary from state to state. The amendments should have the effect of permitting farmers in all states to compete more effectively for loanable funds.

Title II of the Financial Amendment Act of 1974 amends previous legislation pertaining to national banks, state banks carrying Federal Deposit Insurance, and federally insured savings and loan associations. The new amendments permit these institutions to charge interest on business or agricultural loans totaling \$25,000 or more at a rate of not more than 5 percentage points in excess of the Federal Reserve Bank discount rate on 90-day commercial paper. The current discount rate at the Federal Reserve Bank of Chicago is 8 percent. Thus, rates up to 13 percent, where applicable, would be permitted under the amended provisions. The amendments were signed late in October, and they supersede all state laws that call for lower usury ceilings on business and agricultural loans; they have no effect in states where business and agricultural loans are exempt from usury ceilings.

The new legislation is temporary in that it expires on July 1, 1977. Moreover, a special provision allows state legislatures to prohibit the charging of the new higher interest rate. Interest rates on home mortgages, consumer loans, personal loans, and on business and agricultural loans totaling less than \$25,000 are unaffected by the federal legislation and remain subject to existing state usury ceilings.

The effect of the recent federal amendments within the individual states of the Seventh District is as follows.

Iowa. Agricultural loans under \$35,000 are exempt from the state's general 9 percent usury ceiling but are subject to a 15 percent maximum ceiling. Agricultural loans over \$35,000 are subject to the 9 percent state ceiling. Thus, the new federal usury ceiling will be applicable to agricultural loans that exceed \$35,000.

Wisconsin. The state usury ceiling is 12 percent on agricultural loans exceeding \$500, with an exception applicable on loans involving farm machinery. The new federal usury ceiling will be applicable whenever it exceeds the state's 12 percent limit—and, of course, where the loan totals \$25,000 or more.

Illinois. State law exempts business loans from interest rate limitation. There is no expressed statement about agricultural loans in the Illinois statutes. However, after numerous inquiries the Office of the

Illinois Commissioner of Banks and Trust Companies issued a statement saying ". . . a loan for the purpose of assisting him (a borrower) in his farm enterprise may be considered a business loan."

Indiana. The usury ceiling on consumer loans is 18 percent, and there is no maximum rate on other loans.

Michigan. State law allows banks to charge up to 25 percent on business loans. Farmers may sign an affidavit stating that an agricultural loan is for business purposes and will be so classified.

Although the intent underlying low usury ceilings may be commendable, in practice, such ceilings most often hurt the people or sectors they are designed to help. Frequently, because of such ceilings, loan funds become unavailable to the borrower. Most states exempt business loans from usury ceilings, but three states—Arkansas, Tennessee, and Montana—do not exempt either business or agricultural loans. Apparently, the situation in these states was the motivating factor behind the amendments. As money market rates rose to record levels last summer, loan activity in the three states was sharply curtailed.

There are restrictions on the maximum interest rate that can be charged on agricultural loans in many states. Seventh District bankers have suggested that such restrictions were limiting fund availability for agricultural loans during 1974. One-fourth of the bankers responding to the October 1 Land Value and Credit Conditions Survey indicated that higher yields on alternative investments would have some restrictive effect on agricultural loans during the fourth quarter of 1974.

Other legislation amended the Truth-in-Lending Act to exempt agricultural loans exceeding \$25,000 secured by real estate from the provisions of that act. Prior to the most recent change, agricultural loans exceeding \$25,000 and not secured by real estate were exempt from Truth-in-Lending requirements. Banks had sought the latest modification for some time, and the amendment was recommended by the Federal Reserve Board.

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