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STATEMENT ON
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FINANCIAL PROBLEMS FOR FARM LENDERS,

PRESENTED TO *the*

House SUBCOMMITTEE ON ECONOMIC STABILIZATION,

OF THE

COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS,
UNITED STATES HOUSE OF REPRESENTATIVES

BY

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Mr. Chairman, and members of the subcommittee, I appreciate the opportunity to discuss with you the current agricultural situation and its implications for insured commercial banks engaged primarily in servicing agricultural areas. My statement will be brief, summarizing the present condition of agricultural banks.

In previous testimony the FDIC has noted that, as a group, agricultural banks were not in worse condition than the banking industry as a whole -- in fact, they were stronger in some areas, such as capital, than the rest of the industry. In addition, we noted that in spite of record numbers of failures, of both agricultural banks and other banks, we have yet to see an agricultural bank fail solely because of the condition of the agricultural economy. These generalities are still true but the problems in the agricultural economy are increasingly permeating the agricultural banks. While agricultural banks overall are still sound, the number of individual banks with problems is increasing and short of a dramatic and unexpected recovery of the agricultural economy, deterioration within the agricultural banking sector can be expected to continue.

Even though further deterioration is expected, we do not foresee a major crisis that would affect the safety and soundness of all agricultural banks regardless of their present condition and management abilities. The FDIC believes that agricultural banks do not represent a threat to the banking system as a whole.

We define an agricultural bank as one in which agricultural loans comprise 25 percent or more of total loans. Agricultural loans are defined as loans secured by farm land, loans to finance agricultural production and other loans to farmers. As of June 30, there were 3,983 agricultural banks. These banks represent 27 percent of all banks, however, just 5.5 percent of total bank deposits. Agricultural banks operate in 37 states but 61 percent of these banks are in Iowa, Illinois, Kansas, Minnesota, Nebraska and Missouri. These are among 16 Midwest and Plains States which contain 84 percent of the Nation's agricultural banks and 85 percent of agricultural loans made by commercial banks. As of year-end 1984, total farm credit reported by the Department of Agriculture was \$190 billion. Commercial banks provide about 25 percent of this credit comprising about 43 percent of the non real estate portion of farm credit. The Farm Credit System accounts for roughly 33 percent of total farm credit, the Farmers Home Administration has about 12 percent, life insurance companies have about six percent, and the remaining 24 percent comes largely from individuals.

It is useful to compare the performance of agricultural banks with nonagricultural banks. Historically, agricultural banks as a group have enjoyed higher earnings, higher capital levels, and lower loan losses. A traditional measure of earnings performance is the return on assets (i.e., net income divided by assets). As a group, agricultural banks began this decade with high returns -- 1.7 percent at midyear 1981, compared to 1.2 percent for nonagricultural banks. Returns have dropped for both groups each subsequent year but the decline has been much greater for agricultural banks. At midyear 1985, a comparison among banks under \$100 million in assets showed the average annualized return on assets for agricultural banks was 0.72 percent, slightly less than the return of 0.84

percent earned by nonagricultural banks. These are comparable returns and well-above problem levels but obviously the rapid decline in the profitability of agricultural banks will result in safety and soundness problems if it continues for an extended period of time.

The primary source of a bank's earnings is the spread between the interest it earns on loans and investments and the interest it pays for funds (i.e., net interest income). This source of earnings has been roughly the same for both agricultural and nonagricultural banks through 1983, but beginning in 1984 and continuing in 1985 there has been a modest decline for agricultural banks which has not occurred in nonagricultural banks. Nevertheless, margins are more or less stable and holding up well in both groups.

The source of earnings problems in agricultural banks, not surprisingly, has been high levels of loan losses and problem loans which require increased expense charges to maintain valuation reserves at reasonable levels. Loan losses are typically measured as a percent of loans. Agricultural banks at midyear 1981 had a ratio of net loan chargeoffs to loans of 0.18 percent -- significantly better than the ratio for nonagricultural banks of 0.29 percent. These ratios have risen for both groups but at a much faster rate for agricultural banks. At midyear 1984 loan losses were running at a rate of 0.84 percent for agricultural banks. This rate had nearly doubled at midyear 1985 to 1.59 percent, compared to 0.69 percent for nonagricultural banks.

The final line of defense against financial problems is a bank's capital. It is comforting that in spite of the obvious problems, agricultural bank capital is,

on the whole, reasonably strong. The three Federal bank supervisory agencies earlier this year adopted common capital standards which provide that banks without material problems should maintain capital of at least six percent of assets. Only one percent of agricultural banks were below this level at midyear 1985. In fact, 48 percent had capital ratios in excess of ten percent, and 37 percent had capital between eight and ten percent. The remaining 14 percent of agricultural banks had capital between six and eight percent of assets at midyear 1985.

In summary then, at midyear 1985, agricultural and nonagricultural banks as groups were not in significantly different conditions. Earnings were comparable. Asset problems were more serious at agricultural banks but this weakness was offset by stronger capital levels.

Even though the two groups are comparable as a whole, it would be erroneous to conclude that there is no farm bank problem. Within the agricultural bank group there is a much greater disparity in the condition of individual banks which does not show up when looking at group averages. That is, there are fewer "average" banks within the agricultural groups and a greater number of weak banks offset by a greater number of banks that continue the historical pattern of strong performance. For example, roughly 15 percent of agricultural banks operated at a loss for the first six months of 1985 -- about twice the 7.6 percent level experienced by nonagricultural banks. Since the resources and strengths in good banks cannot be used to correct the weaknesses in other banks, it can be concluded that earnings problems are more serious in agricultural banks than nonagricultural banks.

We have previously indicated that loan problems are the main reason agricultural bank earnings have declined. The disparity is readily apparent when looking at the rate of losses to date in 1985. Among agricultural banks, 37 percent have experienced loan losses in the first half of 1985 at an annualized rate in excess of one percent of loans while only 17 percent of nonagricultural banks had loss rates of that level.

Earlier this month we had the 100th FDIC-insured bank failure in 1985. Of these 100, 50 met our definition of an agricultural bank. These 50 banks had aggregate assets of approximately \$871 million or an average of \$17 million each. The average size of nonagricultural commercial banks that have failed in 1985 was \$42 million or roughly two and one-half times larger than the average agricultural bank. Since agricultural banks number only 27 percent of total banks, the rate of failure among agricultural banks is clearly higher than among nonagricultural banks. While problems within the agricultural economy obviously contributed to this failure rate, we have yet to see a bank failure which can be solely attributed to these economic problems. Rather, what has happened to date is that weak lending policies and procedures made the banks vulnerable to external problems and the managements that fostered weak practices have been incapable of correcting the resulting problems.

What can we expect in the near future? Presently there are 1,100 banks considered problems by the FDIC. Of these, 413 or 37 percent are agricultural banks. In the 16 states accounting for 85 percent of agricultural loans carried by commercial banks, 8.5 percent of the banks are currently considered problem institutions by the FDIC. This is only slightly higher than the ratio of 7.5

percent for the country as a whole. Asset quality problems are becoming more pervasive within the agricultural bank community. As of midyear 32 percent of agricultural banks had nonperforming assets (past due, renegotiated and nonaccrual loans) greater than five percent of total assets. Only 15 percent of nonagricultural banks had ratios of nonperforming assets at that level. These loans are not all potential losses but it is reasonable to expect that agricultural banks will continue to suffer significantly higher levels of loan losses than the industry as a whole.

It should not be assumed that 413 problem banks today imply 413 failures in the near future. Only a small percentage of problem banks ultimately fail. For example, there were 642 problem banks as of December 31, 1983. During 1984, 502 banks were added to the problem list, 79 banks failed and 217 banks were removed from the problem list because of improved condition.

One of the common recurring problems among farmer borrowers is that their total debt has grown over a period of years to a level that is beyond their capacity to service from farm income. Interest rates have come down from the recent past but remain at high levels. Crop prices are low and projected good harvests this year could depress these prices further. Lower farming returns and increasing supplies of land and equipment on the market could cause a continuation of the decline in loan collateral values. Until there is some indication that these basic adverse trends have bottomed out, farmer borrowers will continue to have credit problems. Those banks whose primary business is concentrated in farm loans can be expected to suffer as well and some will fail. We do not expect

any improvement in the number of failed agricultural banks during 1986 and there could be an increase.

Nevertheless, I want to emphasize that most agricultural banks are coping well with their problems and remain sound institutions. The FDIC does not believe there is yet a systemwide crisis in agricultural-based commercial banks.

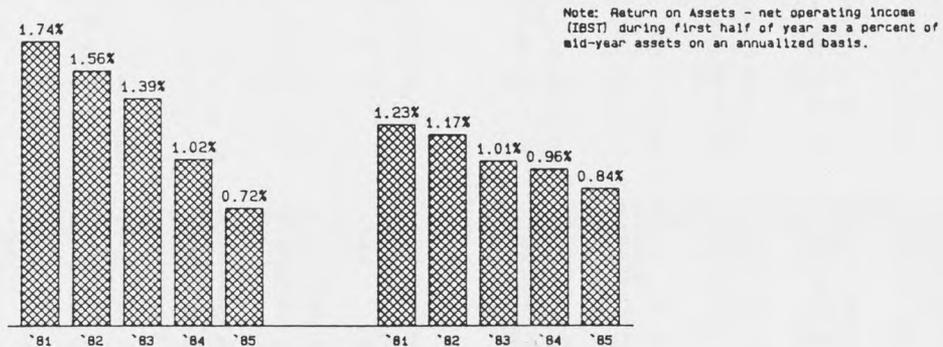
However, it is plain that problems in these banks over time will become less a result of different management abilities and more systemic if the agricultural economy continues in its weakened condition for an extended number of years.

Attached are schedules showing past and current performance characteristics of agricultural and nonagricultural banks in 16 Midwest and Plains States containing over three-fourths of the Nation's agricultural banks. Several graphs comparing performance characteristics of all agricultural banks with nonagricultural banks are also included.

Chart 1 - Mid-Year Call Report Data for Banks with Less than \$100 Million in Assets

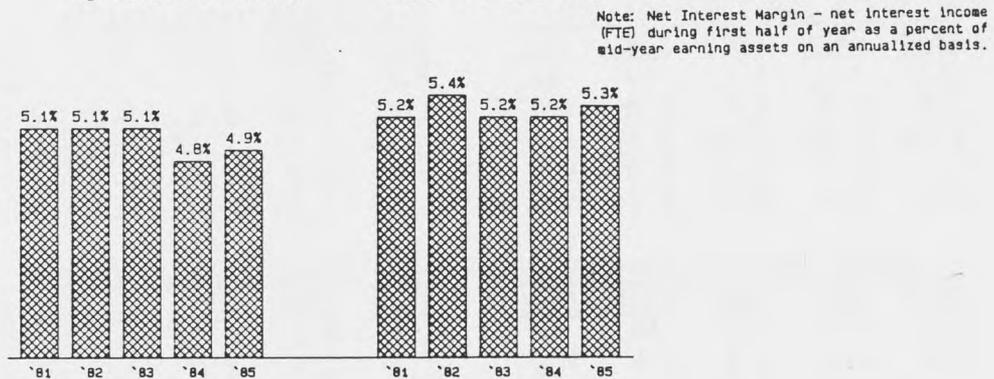
Return on Assets

agricultural banks other small banks



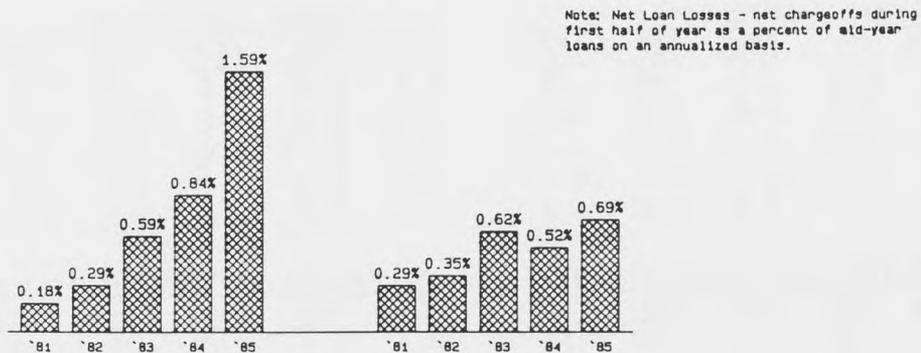
Net Interest Margin

agricultural banks other small banks



Net Loan Losses

agricultural banks other small banks



AGRICULTURAL STATES SUMMARY

---- AGRICULTURAL BANKS ----

	1981	1982	1983	1984	6-85
<u>COLORADO</u>					
NONPERFORMING	NA	NA	3.1	4.5	5.8
CAPITAL RATIO	10.3	10.7	10.3	10.1	10.7
LOANS/ASSETS	57.4	56.9	57.8	58.6	57.2
ROA	1.6	1.4	1.3	0.9	0.8
NIM	6.7	6.5	6.0	5.9	5.6

-- NON-AGRICULTURAL BANKS --

	1981	1982	1983	1984	6-85
NONPERFORMING	NA	NA	2.8	3.0	3.3
CAPITAL RATIO	9.7	9.4	9.0	8.8	9.1
LOANS/ASSETS	57.5	58.8	57.9	60.2	62.1
ROA	1.6	1.3	1.2	1.1	1.0
NIM	7.9	7.7	7.0	7.0	6.6

---- AGRICULTURAL BANKS ----

	1981	1982	1983	1984	6-85
<u>IOWA</u>					
NONPERFORMING	NA	NA	2.7	3.6	4.6
CAPITAL RATIO	9.4	9.5	9.8	10.0	10.3
LOANS/ASSETS	52.0	49.1	47.5	48.4	48.9
ROA	1.3	1.2	1.2	0.8	0.8
NIM	5.1	4.9	4.9	4.6	4.7

-- NON-AGRICULTURAL BANKS --

	1981	1982	1983	1984	6-85
NONPERFORMING	NA	NA	2.8	2.8	3.4
CAPITAL RATIO	8.4	8.3	8.3	8.5	8.7
LOANS/ASSETS	52.4	50.2	48.9	52.5	53.9
ROA	1.0	0.8	0.7	0.7	0.7
NIM	4.9	4.8	4.7	4.7	4.8

---- AGRICULTURAL BANKS ----

	1981	1982	1983	1984	6-85
<u>IDAHO</u>					
NONPERFORMING	NA	NA	2.7	3.3	4.4
CAPITAL RATIO	8.5	8.8	9.0	8.6	9.1
LOANS/ASSETS	58.6	59.7	61.2	61.8	63.8
ROA	1.2	1.1	1.0	0.7	0.9
NIM	6.2	6.4	6.1	5.4	5.2

-- NON-AGRICULTURAL BANKS --

	1981	1982	1983	1984	6-85
NONPERFORMING	NA	NA	2.6	3.1	3.4
CAPITAL RATIO	8.3	7.7	7.4	7.2	7.4
LOANS/ASSETS	57.8	61.1	61.4	64.6	67.0
ROA	0.4	0.4	0.7	0.7	0.3
NIM	5.6	5.6	5.5	5.1	4.8

---- AGRICULTURAL BANKS ----

	1981	1982	1983	1984	6-85
<u>ILLINOIS</u>					
NONPERFORMING	NA	NA	2.5	2.9	3.8
CAPITAL RATIO	9.6	9.7	9.9	10.0	10.2
LOANS/ASSETS	49.1	46.5	45.1	47.2	46.9
ROA	1.2	1.1	1.1	0.9	1.1
NIM	4.9	4.9	4.9	4.7	4.9

-- NON-AGRICULTURAL BANKS --

	1981	1982	1983	1984	6-85
NONPERFORMING	NA	NA	2.7	2.5	2.7
CAPITAL RATIO	8.4	8.3	8.2	8.3	8.5
LOANS/ASSETS	51.0	48.8	47.4	48.8	49.8
ROA	0.8	0.8	0.9	0.9	1.1
NIM	4.7	4.8	4.8	4.8	5.0

---- AGRICULTURAL BANKS ----

	1981	1982	1983	1984	6-85
<u>INDIANA</u>					
NONPERFORMING	NA	NA	2.4	2.8	3.2
CAPITAL RATIO	9.7	9.6	9.5	9.6	9.7
LOANS/ASSETS	54.5	52.6	51.0	53.2	52.5
ROA	1.0	0.8	0.8	0.8	1.0
NIM	4.5	4.4	4.5	4.5	4.8

-- NON-AGRICULTURAL BANKS --

	1981	1982	1983	1984	6-85
NONPERFORMING	NA	NA	2.2	2.1	2.3
CAPITAL RATIO	8.5	8.4	8.2	8.4	8.5
LOANS/ASSETS	55.2	54.1	51.6	52.9	54.1
ROA	0.7	0.6	0.8	0.8	1.0
NIM	4.4	4.3	4.4	4.5	4.7

---- AGRICULTURAL BANKS ----

	1981	1982	1983	1984	6-85
<u>KANSAS</u>					
NONPERFORMING	NA	NA	2.1	3.0	3.9
CAPITAL RATIO	9.3	9.5	9.7	9.7	10.2
LOANS/ASSETS	51.2	50.6	50.8	51.9	51.8
ROA	1.4	1.3	1.1	0.8	0.9
NIM	5.7	5.6	5.4	5.1	5.1

-- NON-AGRICULTURAL BANKS --

	1981	1982	1983	1984	6-85
NONPERFORMING	NA	NA	2.2	2.3	2.6
CAPITAL RATIO	8.6	8.6	8.6	8.5	8.9
LOANS/ASSETS	51.6	50.8	51.0	53.3	54.2
ROA	1.0	1.0	1.0	0.9	1.1
NIM	5.4	5.5	5.4	5.1	5.2

---- AGRICULTURAL BANKS ----

	1981	1982	1983	1984	6-85
<u>MICHIGAN</u>					
NONPERFORMING	NA	NA	3.0	3.7	4.0
CAPITAL RATIO	8.8	9.4	9.1	8.3	8.6
LOANS/ASSETS	55.1	53.3	54.1	55.7	56.6
ROA	0.8	1.0	1.0	0.3	0.7
NIM	4.6	5.0	4.7	4.2	4.4

-- NON-AGRICULTURAL BANKS --

	1981	1982	1983	1984	6-85
NONPERFORMING	NA	NA	2.5	2.1	2.2
CAPITAL RATIO	8.2	8.1	7.9	8.0	8.1
LOANS/ASSETS	56.3	52.8	51.2	53.6	54.5
ROA	0.6	0.6	0.7	0.8	0.9
NIM	4.6	4.6	4.6	4.7	4.8

AGRICULTURAL STATES SUMMARY

	---- AGRICULTURAL BANKS ----					-- NON-AGRICULTURAL BANKS --				
	1981	1982	1983	1984	6-85	1981	1982	1983	1984	6-85
<u>MINNESOTA</u>										
NONPERFORMING	NA	NA	2.7	3.4	5.0	NA	NA	2.7	2.8	3.3
CAPITAL RATIO	9.0	9.2	9.5	9.8	10.1	8.3	8.3	8.1	8.3	8.5
LOANS/ASSETS	54.5	54.1	54.1	55.6	55.9	57.7	57.1	56.3	58.1	59.1
ROA	1.4	1.2	1.1	0.9	1.0	1.0	0.9	1.0	0.9	1.1
NIM	5.4	5.3	5.1	4.9	5.0	5.3	5.3	5.2	5.2	5.3
<u>MISSOURI</u>										
NONPERFORMING	NA	NA	2.8	3.9	5.2	NA	NA	2.1	2.1	2.2
CAPITAL RATIO	9.5	9.8	9.6	9.6	10.0	8.5	8.4	8.3	8.3	8.4
LOANS/ASSETS	51.9	50.9	49.7	50.9	50.6	53.3	51.7	51.3	53.1	54.4
ROA	1.3	1.3	1.0	0.6	0.9	1.0	1.0	1.0	0.9	1.0
NIM	5.4	5.4	5.0	4.7	4.8	5.3	5.2	5.0	5.0	5.0
<u>MONTANA</u>										
NONPERFORMING	NA	NA	3.7	4.7	5.9	NA	NA	3.5	4.0	4.7
CAPITAL RATIO	9.0	9.1	9.3	9.4	9.8	8.4	8.6	8.3	8.3	8.7
LOANS/ASSETS	49.5	49.3	48.2	49.7	50.7	57.2	58.2	58.4	59.0	59.6
ROA	1.5	1.4	1.5	1.1	1.2	1.0	1.1	1.0	1.0	1.0
NIM	5.4	5.6	5.6	5.3	5.2	5.6	6.0	5.9	5.8	5.7
<u>NORTH DAKOTA</u>										
NONPERFORMING	NA	NA	3.1	3.8	4.8	NA	NA	3.0	3.8	4.1
CAPITAL RATIO	9.2	9.2	9.3	9.6	9.9	8.8	8.4	8.2	8.2	8.9
LOANS/ASSETS	49.0	48.3	47.7	47.9	46.1	54.6	52.8	52.4	52.9	53.4
ROA	1.4	1.2	1.1	1.0	1.3	1.0	1.0	0.7	0.8	1.1
NIM	5.6	5.5	5.1	5.0	5.1	5.3	5.5	5.0	5.0	5.2
<u>NEBRASKA</u>										
NONPERFORMING	NA	NA	2.6	3.3	4.2	NA	NA	2.9	3.3	3.7
CAPITAL RATIO	9.7	9.6	10.0	10.1	10.6	8.3	8.5	8.4	8.4	8.4
LOANS/ASSETS	56.8	55.4	55.5	56.2	54.8	56.6	55.3	54.7	56.9	57.2
ROA	1.7	1.4	1.2	0.8	0.9	1.0	0.9	1.0	0.7	0.8
NIM	6.1	5.9	5.5	5.1	5.3	6.2	6.0	5.6	5.5	5.5
<u>OKLAHOMA</u>										
NONPERFORMING	NA	NA	2.5	3.2	4.0	NA	NA	2.9	3.6	4.2
CAPITAL RATIO	9.1	9.3	9.8	9.9	10.5	8.7	8.9	9.0	8.9	9.2
LOANS/ASSETS	48.7	49.7	49.4	48.4	47.9	53.2	55.0	55.4	55.8	55.8
ROA	1.8	1.6	1.3	1.0	1.4	1.5	1.4	1.0	0.8	1.0
NIM	6.4	6.2	6.0	5.4	5.7	6.3	6.3	6.0	5.6	5.6
<u>SOUTH DAKOTA</u>										
NONPERFORMING	NA	NA	2.7	3.8	5.0	NA	NA	2.0	2.1	2.3
CAPITAL RATIO	9.6	9.8	10.1	10.4	10.8	9.6	9.5	9.3	9.1	9.2
LOANS/ASSETS	50.2	49.6	50.3	51.5	52.1	57.5	57.5	53.7	56.7	57.8
ROA	1.4	1.3	1.2	0.9	1.1	0.9	0.6	0.8	1.1	1.4
NIM	5.7	5.5	5.4	5.2	5.3	5.6	5.3	5.6	5.7	6.0

AGRICULTURAL STATES SUMMARY

WISCONSIN	---- AGRICULTURAL BANKS ----					-- NON-AGRICULTURAL BANKS --				
	1981	1982	1983	1984	6-85	1981	1982	1983	1984	6-85
NONPERFORMING	NA	NA	3.3	3.7	4.2	NA	NA	2.9	2.7	2.8
CAPITAL RATIO	9.4	9.6	9.7	9.8	10.1	8.6	8.6	8.4	8.6	8.7
LOANS/ASSETS	58.5	56.4	54.6	56.7	56.3	58.9	57.0	54.7	57.1	58.1
ROA	1.2	1.3	1.2	0.9	1.1	1.0	1.0	1.0	1.0	1.1
NIM	5.0	5.2	5.0	4.7	5.1	4.8	5.1	5.0	5.0	5.2

WYOMING	---- AGRICULTURAL BANKS ----					-- NON-AGRICULTURAL BANKS --				
	1981	1982	1983	1984	6-85	1981	1982	1983	1984	6-85
NONPERFORMING	NA	NA	3.1	3.6	4.6	NA	NA	4.1	4.9	5.3
CAPITAL RATIO	9.7	9.6	9.7	9.6	10.2	9.4	9.4	9.2	9.1	9.4
LOANS/ASSETS	52.6	53.4	52.4	51.1	50.5	52.5	54.1	54.2	54.5	53.2
ROA	1.8	1.6	1.4	1.0	1.0	1.4	1.3	0.9	0.7	0.7
NIM	6.4	6.5	6.0	5.5	5.8	7.0	6.8	6.1	5.8	5.7

STATE AVG.	---- AGRICULTURAL BANKS ----					-- NON-AGRICULTURAL BANKS --				
	1981	1982	1983	1984	6-85	1981	1982	1983	1984	6-85
NONPERFORMING	NA	NA	2.7	3.4	4.5	NA	NA	2.6	2.7	2.9
CAPITAL RATIO	9.4	9.5	9.7	9.9	10.2	8.6	8.5	8.4	8.4	8.6
LOANS/ASSETS	52.6	51.3	50.6	51.7	51.5	54.6	53.4	52.3	54.1	55.0
ROA	1.4	1.3	1.1	0.8	1.0	1.0	0.9	0.9	0.9	1.0
NIM	5.4	5.3	5.2	4.9	5.0	5.3	5.3	5.2	5.1	5.2