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**Agricultural Loan Loss Amortization**

**John Block**

**Proceedings of  
Regional Research Committee NC-161**

**FINANCING AGRICULTURE IN A CHANGING  
ENVIRONMENT: MACRO, MARKET,  
POLICY AND MANAGEMENT ISSUES**

**St. Louis Farm Credit Bank  
St. Louis, Missouri  
September 23-24  
1991**

Department of Agricultural Economics  
Kansas State University  
Manhattan, KS 66506  
February 1992

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# AGRICULTURAL LOAN LOSS AMORTIZATION

John Block

## HISTORY

### Partial quotes from selected SR Letters dealing with program

June 1984 - SR Letter (Farm and Agricultural-Related Loans)

It is requested therefore that you remind the Federal Reserve examiners in your District of the need to be particularly sensitive to agriculture problems at this time and to refrain from criticizing bank management for exercising appropriate forbearance in circumstances where farmers are suffering from financial pressures resulting from depressed commodity prices, declining land values and the aftermath of last summer's drought.

Often these problems are transitory and the borrowers are able to resume payments when economic conditions in agriculture improve.

Ensure that examiner's comments, conclusions or recommendations in the examination report do not imply criticism of bank management for exercising an appropriate and prudent degree of forbearance.

March 1986 - SR Letter (Problem Agricultural and Energy Loans)

FDIC, FRB, and OCC testified before Senate Committee on Banking, Housing, and Urban Affairs and the Committee approved legislation for consideration by the full Senate.

Banks with sizable portfolios of farm loans or energy loans or a combination of the two have come under growing strains as reflected by a large number of bank failures and mounting problem loans.

FFIEC agencies adopted policies for uniform approach in dealing with well-managed banks suffering from agricultural and energy loan problems.

Forbearance in applying capital guidelines where a bank has clear potential for replenishing capital over reasonable period of time.

Restrictions on salary increases, dividends, growth

Forbearance on writing off farm and energy loans if meet certain criterias.

May 1987 - SR Letter (Classification of Other Real Estate Owned)

For agricultural ORE, the examiner can exclude from classification that portion of carry value which is covered by a current appraisal based on realistic assumptions.

August 1987 - Reagan signs The Competitive Equality Banking Act of 1987 (CEBA)

Title VIII authorized federal banking agencies to permit "agricultural banks" to amortize losses on qualified agricultural loans over seven years.

November 1987 - SR letter (Regulation on amortization of farm loans)

FDIC, FRB and OCC issue regulations implementing Title VIII of CEBA

Eligibility

- a) Assets \$100 million or less
- b) 25% of total loans in qualified agricultural loans  
(or smaller amount if regulator approves)
- c) Located in area whose economy is agricultural dependent
- d) Must be in need of capital restoration and have realistic plan to restore capital
- e) Must be no evidence of fraud or criminal abuse that led to agricultural loan losses
- f) Must agree to maintain ratio of ag loans/total loans at 1/1/86 level or higher
- g) Bank must remain viable and fundamentally sound

Up to seven years amortization for losses on qualified loans (and ORE related to qualified loans) taken between 1/1/84 and 12/31/91. Amortization will terminate on 12/31/98

Can amortize losses on qualified ag loans booked between 12/31/83 and 1/1/92

Deferred loss amount reported as separate equity item, but allowed to count as primary capital

Current participants in program (as of 12/31/90)

Only 39 banks reporting deferred amounts totaling \$24.9 million

## Notes of Graphs

1. Commercial banks now hold largest share of agricultural credit as opposed to the Farm Credit System in 1980.

2. Currently, about 1/3 or all banks are classified as agricultural banks.

Defined as any bank having greater than the unweighted mean average of ag loans/total loans.

This figure is at its highest level since before the farm crisis; the lowest point being in 1988.

3. The loan portfolio mix for the 8th District is more heavily weighted to farm credit (7%) than all banks (4%). Eighth District banks also have a larger proportion of RE related loans.
4. Because the 8th District banks lend disproportionately large amounts to agriculture, they account for roughly 10% of all ag credit extended by commercial banks.
5. Missouri banks in the 8th District hold the largest share of ag loans (23%), with Arkansas close behind at 22% and Illinois at 19%.
6. The ag loan mix of 8th District banks is almost evenly divided between non-real estate and real estate (51% vs. 49%). This differs significantly from the national average which is roughly two-thirds non-real estate and one-third real estate. This is probably the result of the more conservative lending characteristics of Midwest bank - they might have a tendency to require real estate collateral for operating and production loans.
7. The health (or weakness) of the ag industry is illustrated by the graph showing quarterly dollar amounts of outstanding farm credit by U.S. banks. As the graph shows, outstanding credit dropped significantly during late 1984 through 1987. There has been a gradual increase since then, with a noticeable upturn since 1989.
8. The chart showing ag loan losses (non-real estate) vs. commercial loan losses also points out the difficult years of 1985 and 1986 when nearly 4% of these ag credits were reported as loss. The figure dropped dramatically in 1987 and again in 1988. Since 1988, ag losses have been much lower than commercial loan losses.
9. A similar story is presented by the chart comparing nonperforming ag loans to nonperforming commercial loans, although not as dramatic. Since 1988, ag nonperformings has been less than those for commercial.

10. Profitability of ag banks also shows the recovery of the industry. The return on assets for ag banks has increased from a low of .66% in 1986 to 1.16% for the first half of 1991. (These figures are for 8th District banks only). Today, ag banks are among the strongest banks in terms of both profitability and capital strength.

# **AGRICULTURAL LOAN LOSS AMORTIZATION PROGRAM**

# HISTORY

- June 1984 - SR Letter (Farm and Agricultural-Related Loans)  
Instruction to examiners to exercise prudence in  
criticizing management for appropriate use of forbearance  
on farm loans
- March 1986 - SR Letter (Problem Agricultural and Energy  
Loans)  
FFIEC agencies adopt policies for uniform approach in  
dealing with banks suffering from agricultural and energy  
loans
- May 1987 - SR Letter (Classification of Other Real Estate  
Owned)  
Agricultural ORE can be excluded from classification for  
portion covered by current appraisal based on realistic  
assumptions



## **HISTORY (Cont'd)**

- August 1987 - The Competitive Equality Banking Act of 1987 Title VIII authorizes federal banking agencies to permit agricultural banks to amortize losses on qualified agricultural loans over seven years
- November 1987 - SR Letter (Regulation on amortization of farm loans)  
FDIC, FRB and OCC issue regulations implementing Title VIII of CEBA

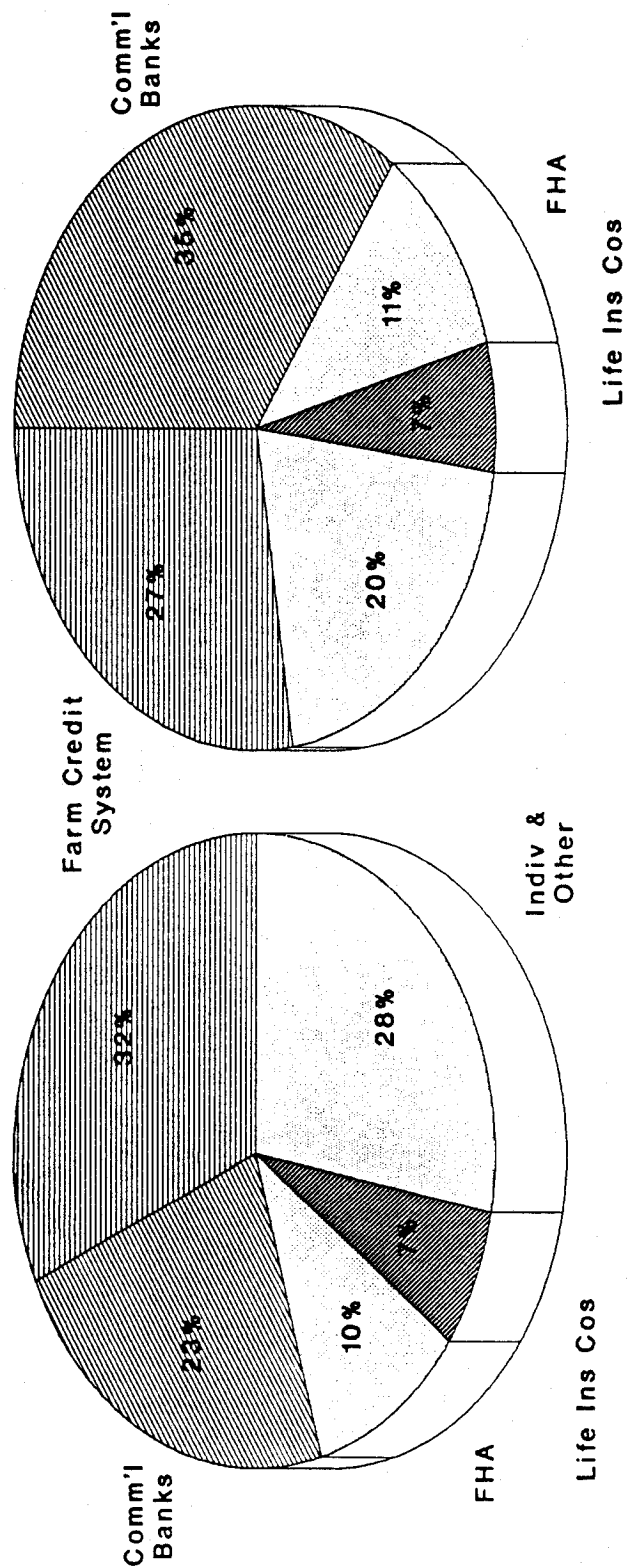
# Eligibility for Program

- Assets \$100 million or less
- 25% of total loans in qualified agricultural loans
- Located in agricultural area
- Capital in need of restoration
- Must have realistic capital restoration plan
- No evidence of fraud or criminal abuse
- Must maintain ratio of ag loans/total loans at 1/1/86 level or higher
- Bank must remain viable and fundamentally sound

## **Privileges**

- **Allows seven years amortization for losses on qualified loans taken between 1/1/84 and 12/31/91**
- **Deferred loss amount reported separately on Call Report**
- **Deferred loss counted as primary capital**

# Who Holds Agricultural Debt?

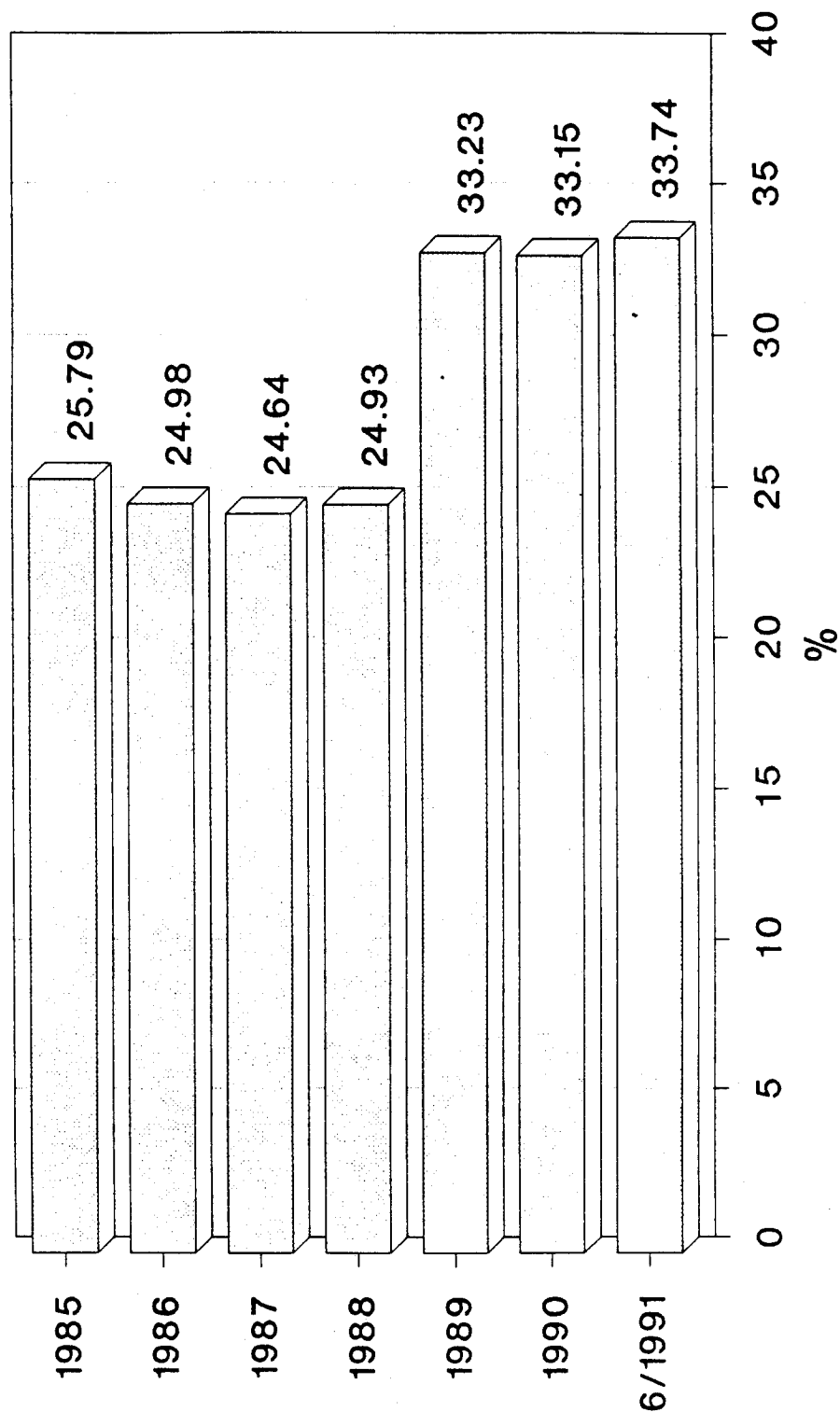


**1980**  
\$166.8 Billion

**1990**  
\$133.9 Billion

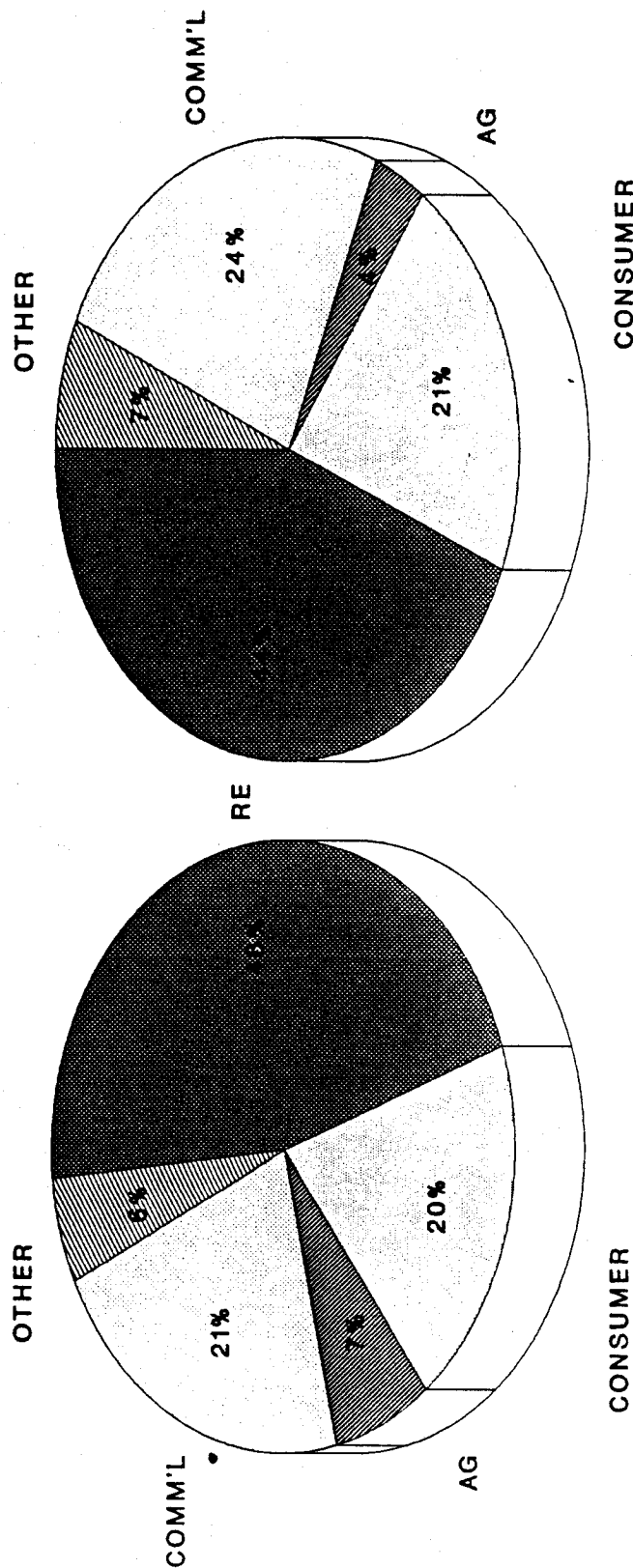
Source: U.S. Dept. of Agriculture  
(1990 Data is preliminary)

# Agricultural Banks/Total Banks in the United States



# Total Loan Portfolio Mix

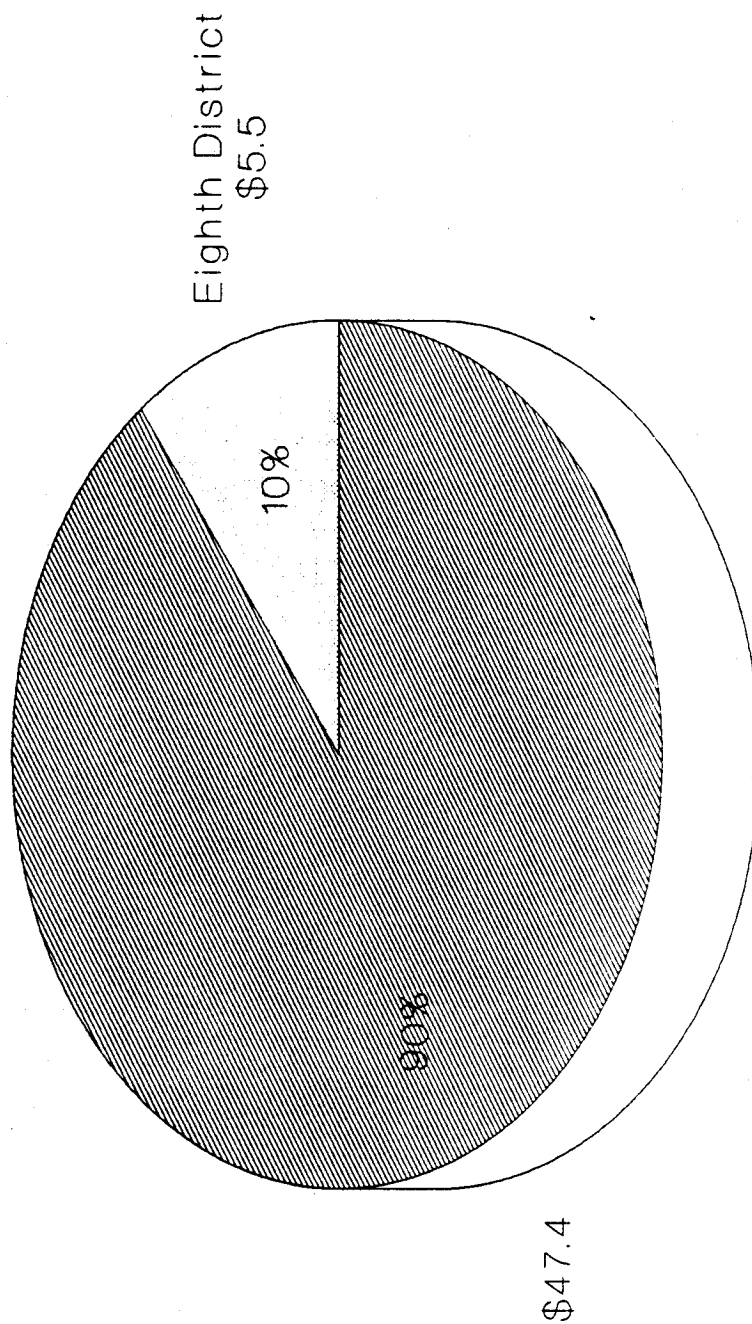
## June 30, 1991



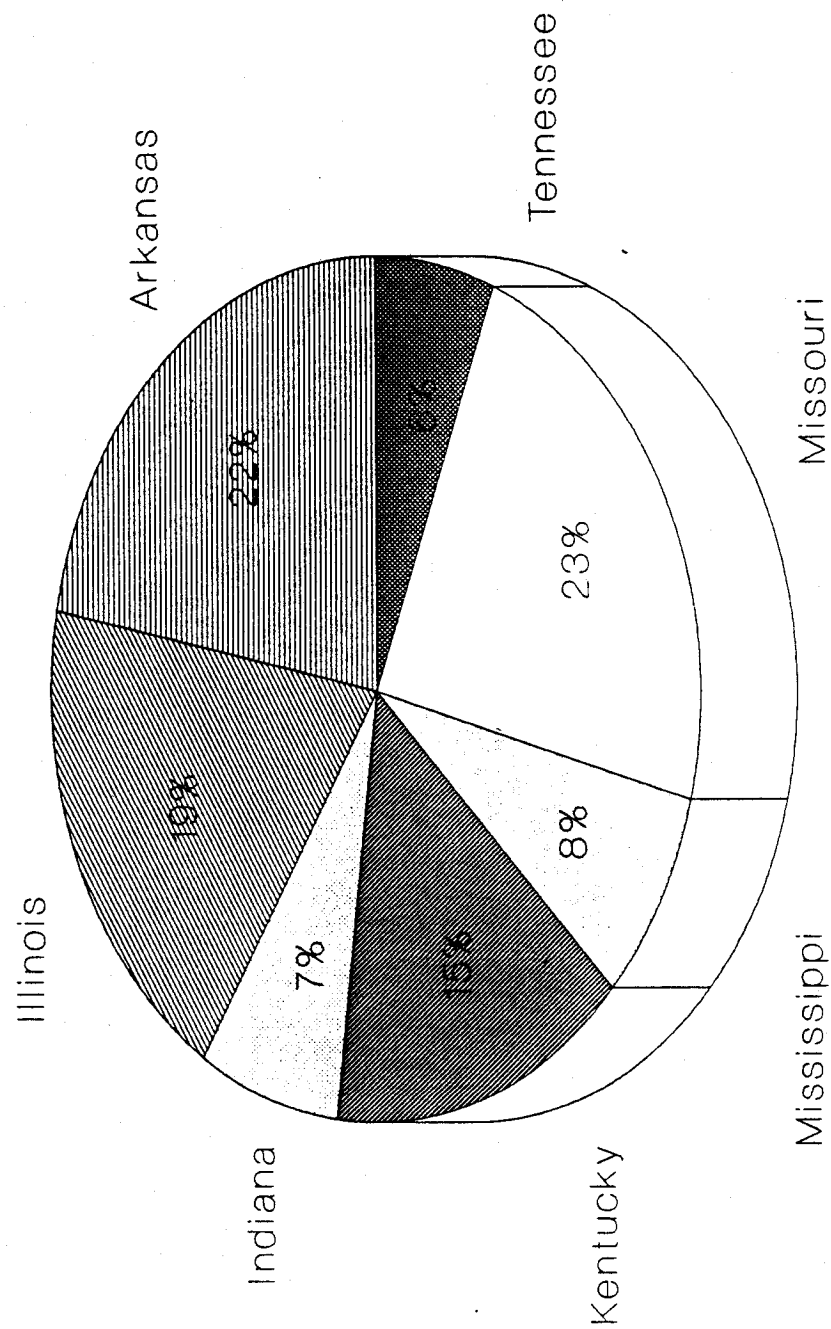
Eighth District Banks      U.S. Banks < \$15 Billion

Ag includes non-RE and RE loans

# Agricultural Lending by Commercial Banks \$52.9 Billion as of June 30, 1991



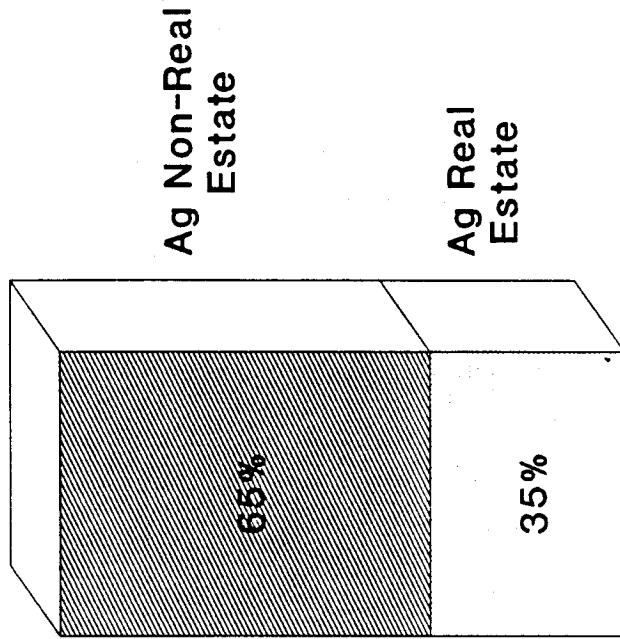
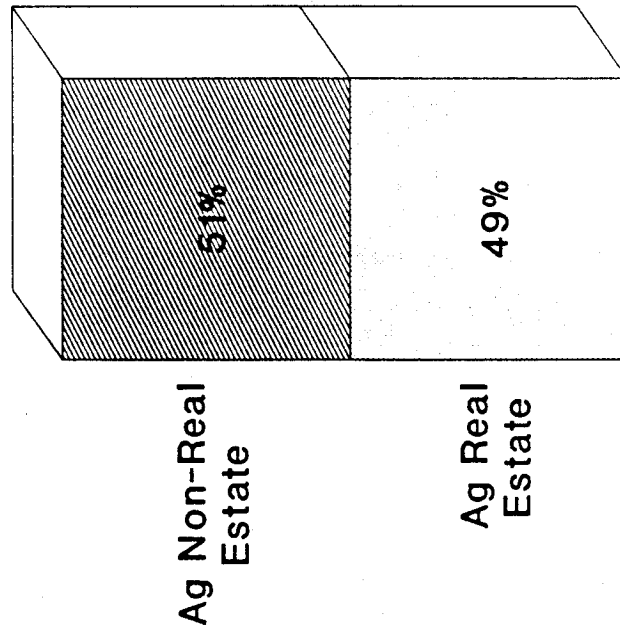
# Agricultural Lending in the 8th District \$5.5 Billion as of June 30, 1991





# Ag Loan Portfolio Mix

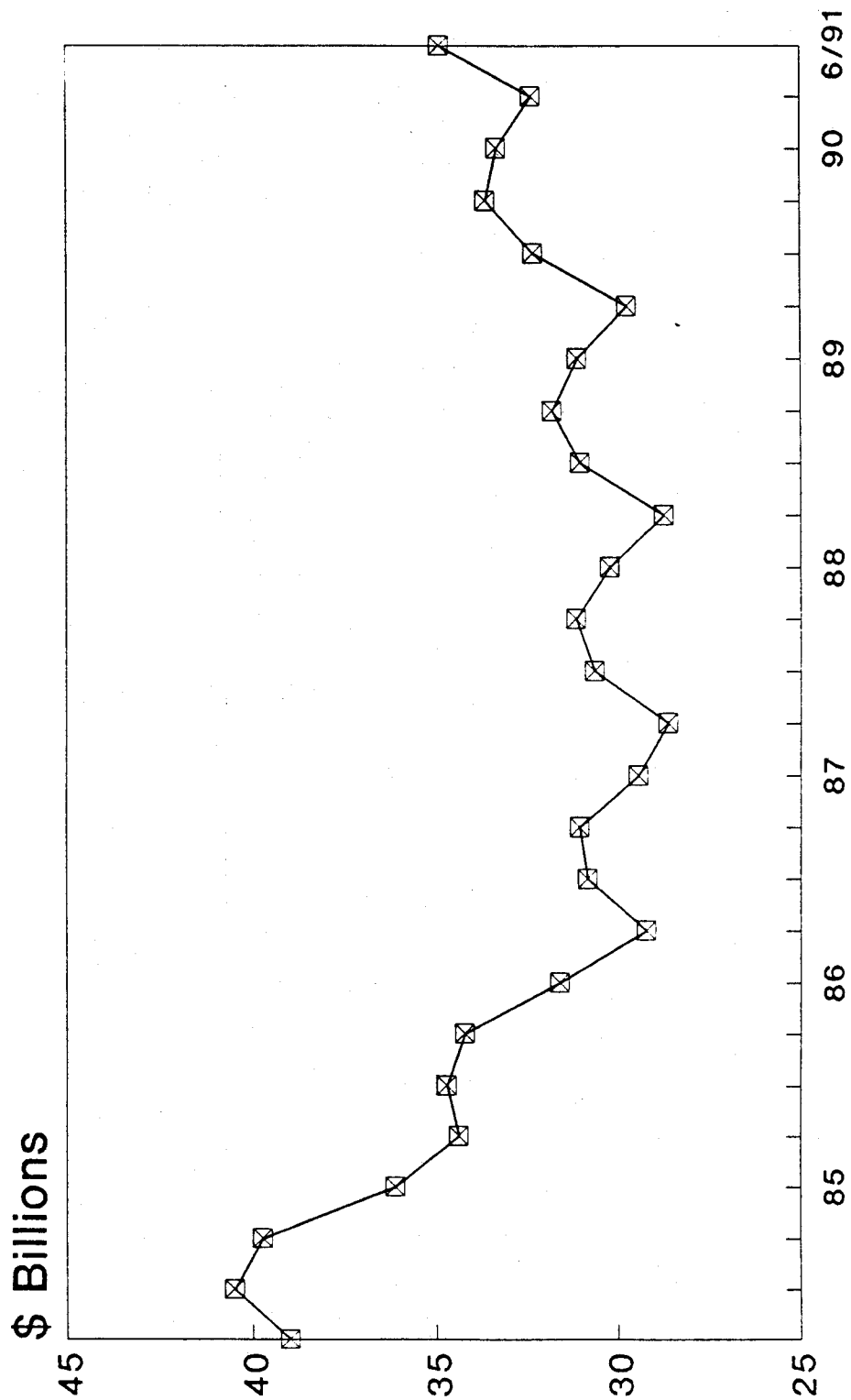
June 30, 1991



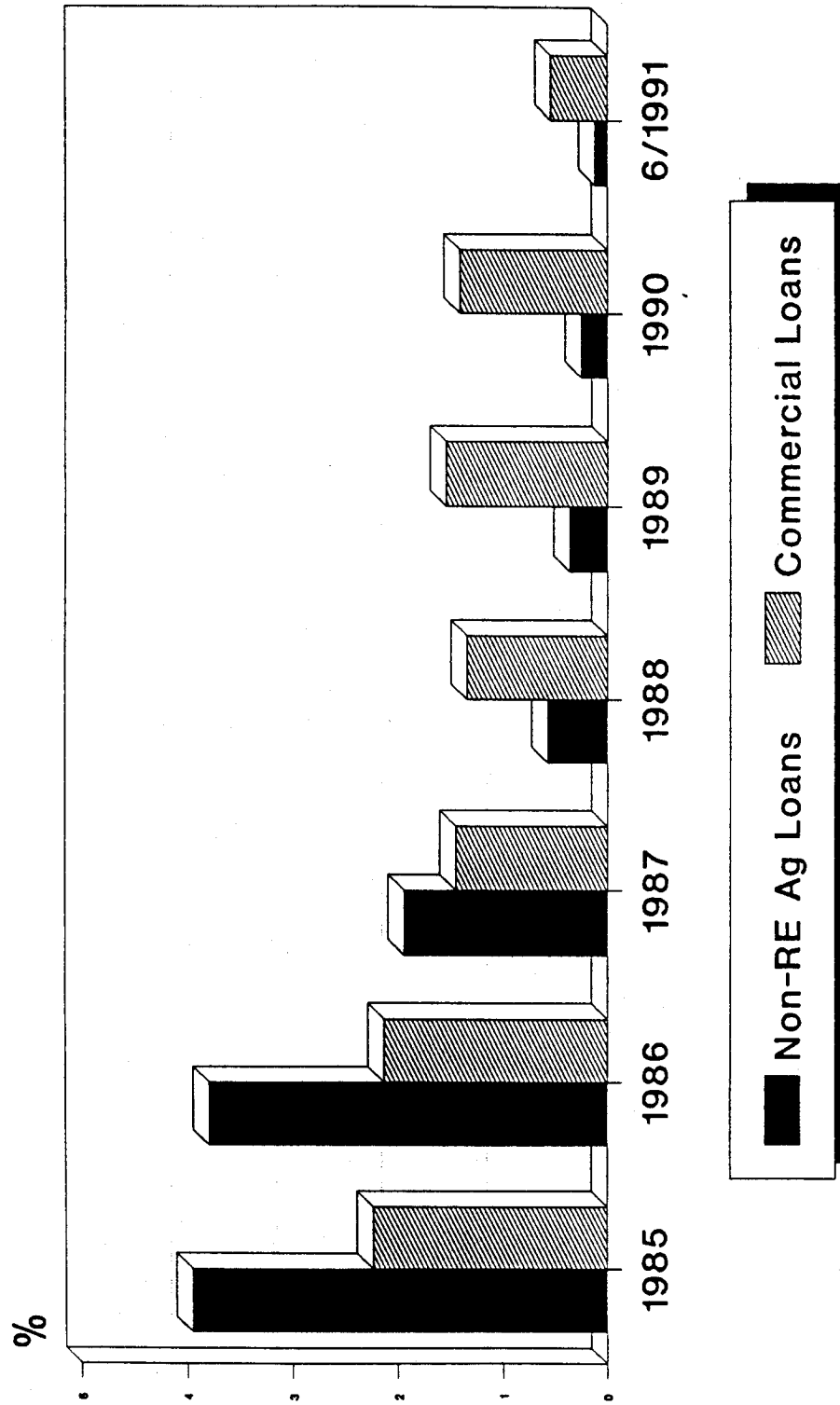
Eighth District Banks      U.S. Banks < \$15B

# Ag Non-Real Estate Lending

## Trend Analysis for All U.S. Banks

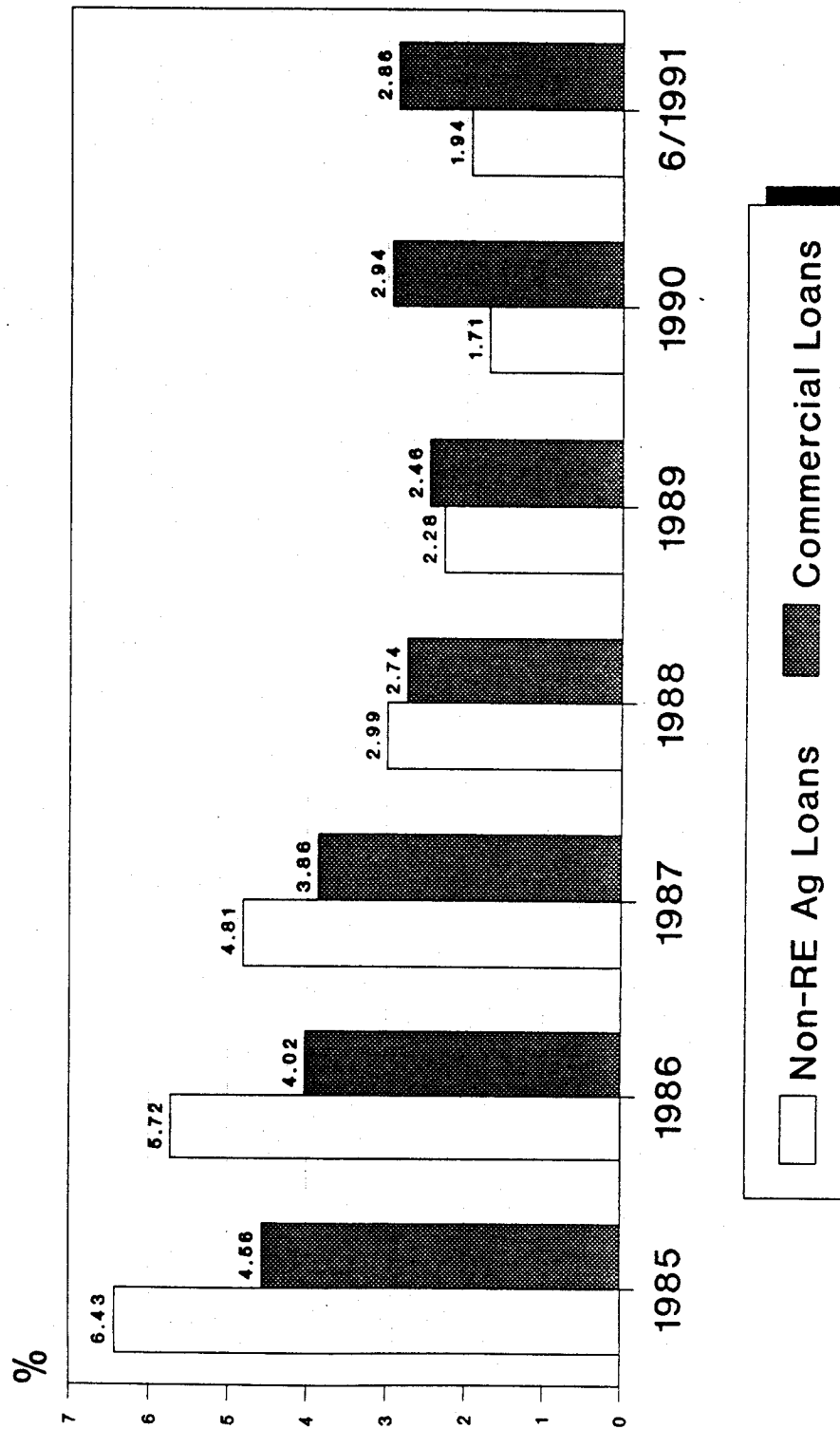


# Non-Real Estate Agricultural Loan Losses vs. Commercial Loan Losses



Eighth District Banks

# Nonperforming Non-Real Estate Ag Loans vs. Nonperforming Commercial Loans



Eighth District Banks

# Return on Average Assets

