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Ag Banks-How Do You Compare?

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by Leslie S. Miller

With signs of improved farm credit conditions continuing, most banks are looking forward to increased profitability. Some progressive bankers are trying to identify new products and services that their customers might demand so that the bank can diversify its income sources with fee income. However, there are many bankers that are curious to know how their bank compares with others. They know the tough times they survived were experienced by other bankers, but to what degree? Why did some ag banks fail, but the majority stay solvent?

In response to these questions and the desire for more information, the Journal of Agricultural Lending will publish two reports on national banking statistics. The first report, excerpted in this article, gives a historical perspective on banking. The second report, to be excerpted in the next issue, gives a recap of the midyear survey and year-end 1988 comparisons.

The ABA has tracked some of the highlights of bank profitability during the past 10 years. The list includes:

- Return on assets for the farm sector fell to -8.8 percent during the 1984-86 period from 11.4 percent during

the 1972-75 period.

- Farm bank profitability as measured by return on equity (ROE) fell from 14.69 percent in 1980 to 5.72 percent in 1986 as farm income fell.
- Measured in 1986 dollars, real gains on farmland during the 1970's totaled \$500 billion. These gains were almost wiped out as capital losses on farmland totaled \$450 billion from 1980 through 1986.
- Nonperforming loans at farm banks almost doubled between 1983 and 1985. Farm banks with assets between \$25-\$100 million had the highest proportion of nonperforming loans during this period. Net charge-offs at farm banks more than doubled between 1980 and 1985.
- For farm banks in general, 1987 and 1988 were good years. In 1987, nonperforming loans as a percent of total loans fell by one percent from the 1985 peak.
- The commercial bank share of total farm debt continued to grow despite the downturn of the farm economy. Banks held 8.7 percent of the real estate farm debt in 1980 and 15.8 percent in 1987. Similarly, farm banks held 38.9 percent of the non-real estate farm debt outstanding in 1980 and 43.7 percent in 1987.
- During the past ten years, the number of "farm" banks — banks with 16 percent or more of their assets in farm loans — has been declining. This decline is partially due to asset diversification.
- Despite losses, farm banks have been successful in augmenting equity capital. Farm bank equity capital as a percent of assets at farm banks rose from 8.62 percent in 1980 to 8.92 percent in 1987.

The list could go on, but is of sufficient length now to document the historically conservative and sound lending policies practiced by the majority of rural community banks. The fact that many of these banks employ trained specialists in ag credit has proven to be a sound risk management strategy for the CEOs who run these banks. The importance of specialized training is underscored by the analogy that if 40% of the bank's deposits were to be invested in LBO (leveraged buy-out) participations, you'd want someone with LBO savvy on your staff.

Farm boom, bust, and recovery

In general, the past ten years are recognized as containing all the elements of farm boom, bust & recovery. During the boom period of 1978-79, farm income rose to \$200 billion. It's a recorded fact that this increase in farm incomes, expectations of continued income increases, and negative real interest rates led to an unprecedented rise in farmland values. Farmland values rose continuously from 1972 until they peaked in 1982 at a national average level of \$823 per acre. Measured in 1986 dollars, real capital gains on farmland during the 1970's totaled \$500 billion.

By 1981, however, the favorable conditions that had helped farmers accumulate wealth reversed. U.S. interest rates and the value of the U.S. dollar rose to historically high levels, making U.S. farm output much more expensive on world markets and U.S. crops more expensive to produce.

U.S. farmers became increasingly dependent on federal government programs and domestic demand. Unfortunately, these programs were not enough to offset income lost from ex-

ports. After peaking during the 1978-79 boom period, inflation adjusted farm income fell by more than 13 percent to \$174 billion during the 1980-83 period. By 1986, farm income fell by another eight percent to \$160 billion.

The falling income values were factored into land values that began a steep decline that would last well into 1986. Measured in 1986 dollars, real capital losses on farmland during 1980-86 were about \$450 billion. These capital losses overshadowed current income in determining the total return on farm assets during 1980-86. During the 1980-83 farm recession period, real capital gains on assets fell almost five percent resulting in negative ROA of -3.2 percent. As farmland values hit bottom during the 1984-86 period, total ROA for the farm sector fell to -8.8 percent.

It now appears that the farm economy is headed towards a recovery, thanks to the leveling off in farmland values, higher income, and real capital gains, which have become positive in 1987. (The Dallas Fed district, however, continues to experience weakening values.) Overall the USDA estimated that total return on assets for the farm sector was 5.5 percent for 1987.

There has been widespread concern regarding the effects of the drought of 1988 on farm credit. Past data on farm bank profitably indicate that, as a whole, farm banks have not been severely impacted during a drought year, or the year immediately following. However, common sense tells us that in areas where income is reduced by drought, the banks will certainly feel the effects. The American Bankers Association supported the steps taken by the Congress and the Administra-

tion in response to the crises caused by the drought.

We think banks' dispersal of risk, higher prices expected on crops that are produced, and government policies will lessen the drought's effect on farmers and farm banks. However, if the drought continues into 1989, current programs and responses may not be sufficient to stem a crises of large proportion and the current farm recovery may be short lived.

Financing farm operations

The credit needs of farmers met by various lenders — including commercial banks, insurance companies, agencies of the Federal Government, and individuals — have changed in the last decade. Banks continue to play a significant role in farm production lending and an increasing role in farm real estate lending markets. The bank market share of both production and real estate lending has increased during the 1980s. However, total dollars in ag production loans made by banks has decreased in recent years. This is largely due to the fact that government programs idling acres have reduced the need for borrowed funds. In addition, higher incomes, loan chargeoffs, high interest rates, and lower input prices have accelerated the payback of the debt by financially healthy farmers.

More recent characteristics of farm banks

Total loans and discounts of farm banks in 1987 approached \$900 billion, with the median for all farm banks at \$20 million. Total agricultural loans approached \$50 billion in mid-1987 and the median amount per farm bank was \$6 million. Banks in the corn belt had

the smallest median amount of farm loans, \$5.4 million, while western banks had the largest amount with just over \$8.4 million. Seventeen percent of the farm banks also reported having energy loans. Farm banks reported a .9% return on assets (ROA) for 1986, and anticipated a modest improvement in ROA to 1% for 1987.

Farmland ownership by banks

Slightly less than half (46%) of the farm banks reported holding some farm real estate in lieu of debt repayment as of September 1987. The likelihood of farm banks holding real estate declined as size increased, and farm banks in the south and west were less likely to have holdings. Farm banks held 1.7 million acres as of September 1987. The largest median holdings were among banks with assets exceeding \$300 million. The median holdings were among banks with assets exceeding \$300 million. The median book value of acres held was \$152,000 with the market value close at \$158,000. The lowest values were recorded for the northeast and plains, and the highest in the west.

Farm loan portfolio profile and interest rates

More than half of agricultural lending in 1987 was for annual operating expenses. The remaining agricultural lending volume was about evenly divided among machinery, feeder livestock, and land purchases, or improvements. This suggests banks could see a significant increase in lending activity as acres are returned to production. Loans advanced by large farm banks and western banks tended to be used for operating expenses.

The credit loan dollar volume was predominately in variable rate loans.

Depending on the type of loan—general operating, intermediate, or real estate secured—variable rate loan dollars accounted for from 57% to 65% of total loan volume. The split between fixed and variable rate loans was strongly related to bank size. The percentage of fixed rate loan dollars decreased as bank size increased. Large bank farm loan portfolios held almost totally variable rate loans. Variable rate lending increased as the geographic location shifted west, with western banks heavily invested in variable rate dollars. Small farm banks had nearly half of their loan dollars in fixed rate instruments.

Internal cost of funds to the bank was the most frequently cited basis used for determining variable interest rates for farm loans. One in two farm banks that offered variable rate loans reported using this basis. Other bases included: competitive rates (30%); combination of cost of funds and external index (21%); and the prime rate (29%). Small farm banks tended to utilize the cost of funds while large farm banks opted heavily for the prime rate.

Nine in ten farm banks with variable rate loans changed them three times during a 12-month period. Large banks were more likely to change rates than small and medium farm banks, except for real estate secured loans. For those loans, some large banks reported stable rates. Regional fluctuations were for the most part insignificant except for real estate secured loans.

The number of times rates were changed increased with bank size, but regionally, the median number of changes was fairly uniform with northeast and western banks showing slightly higher rates.

LOANS TO FINANCE AGRICULTURAL PRODUCTION,
OTHER LOANS TO FARMERS - Top 100 Lenders

RANK	BANK	STATE	Outstandings* 12/31/87 (\$000s)	RA
1	BANK OF AMERICA NT&SA	CA	705,000	50
2	WELLS FARGO BK NA	CA	580,363	51
3	SECURITY PACIFIC NB	CA	574,116	52
4	VALLEY NB OF ARIZONA	AZ	373,265	53
5	RAINIER NB	WA	246,349	54
6	CITIBANK NA	NY	242,000	55
7	SEATTLE-FIRST NB	WA	214,325	56
8	IDAHO FIRST NB	ID	204,664	57
9	SANWA BK CALIFORNIA	CA	170,763	58
10	FIRST NB OF AMARILLO	TX	167,059	59
11	FIRST INTERSTATE BK AZ NA	AZ	164,623	60
12	US BK OF WASHINGTON NA	WA	143,664	61
13	UNITED STATES NB	OR	125,148	62
14	NORWEST BK SD NA	SD	116,279	63
15	FIRST INTERSTATE BK CA	CA	113,627	64
16	CHEMICAL BK	NY	113,000	65
17	TEXAS AMERICAN BK FT WRTH NA	TX	103,736	66
18	FIRSTIER BK NA	NE	96,885	67
19	FIRST INTERSTATE BK OR NA	OR	85,841	68
20	NORWEST BK NEBRASKA NA	NE	77,702	69
21	VALLEY BK	ID	73,810	70
22	NCNB NB OF FLORIDA	FL	73,420	71
23	NORWEST BK ND NA	ND	70,285	72
24	MANUFACTURERS HANOVER TC	NY	65,000	73
25	FIRST SECURITY BK IDAHO NA	ID	64,260	74
26	BANK OF CALIFORNIA NA	CA	58,106	75
27	NCNB NB OF NC	NC	57,860	76
28	FIRST INTERSTATE BK WA NA	WA	54,359	77
29	BOATMENS FIRST NB OF K	MO	52,106	78
30	FIRST UNION NB NC	NC	51,208	79
31	FIRSTIER BK NA	NE	49,448	80
32	FIRST NB OF HOLDREGE	NE	48,933	81
33	CHASE MANHATTAN BK NA	NY	48,566	82
34	IDAHO B&TC	ID	44,654	83
35	AMARILLO NB	TX	43,830	84
36	NORSTAR BK OF UPSTATE NY	NY	42,825	85
37	MARINE MIDLAND BK NA	NY	41,304	86
38	MERIDIAN BANK	PA	40,511	87
39	SOUTHEAST BK NA	FL	40,288	88
40	SUNBURST BK	MS	39,840	89
41	FIRST INTERSTATE BK OK NA	OK	39,528	90
42	MONTICELLO ST BK	IA	38,410	91
43	FIRST VICTORIA NB	TX	37,782	92
44	DOMINION BK SHNDH VLY NA	VA	37,476	93
45	MORGAN GUARANTY TC OF NY	NY	37,445	94
46	KEY BK OF CENTRAL NY	NY	37,370	95
47	BANKWEST	SD	37,026	96
48	KEY BK OF OREGON	OR	36,857	97
49	FIRST INTERSTATE BK NA	CO	36,412	98
				99

* Source: Report of Condition and Income

LOANS TO FINANCE AGRICULTURAL PRODUCTION,
OTHER LOANS TO FARMERS - continued

RANK	BANK	STATE	Outstandings 12/31/87 (\$000s)
50	FIRST ALABAMA BK	AL	36,011
51	FIRST REPUBLICBANK DALLAS NA	TX	34,893
52	TWIN FALLS B&TC	ID	34,194
53	FIDELITY ST BK	KS	34,067
54	ADAMS B&TC	NE	33,050
55	WACHOVIA B&TC NA	NC	32,805
56	FIRST NB&TC COLUMBU	NE	32,326
57	KEY BK NA	NY	32,264
58	SHAWMUT BK NA	MA	32,220
59	MBANK DALLAS NA	TX	31,852
60	FIRST INTERSTATE BK ID NA	ID	31,687
61	FIRST NB OF HEREFORD	TX	31,442
62	FIRST SECURITY BK OF UTAH NA	UT	31,294
63	SECURITY ST BK	KS	30,936
64	THUMB NB&TC	MI	30,631
65	FIRST NB OF YORK	NE	30,209
66	LAMESA NB	TX	30,032
67	FARMERS & MERCHANTS ST BK	OH	29,973
68	FIRST NB&TC DODGE C	KS	29,130
69	FIRST ST BK	TX	27,445
70	TEXAS AMERICAN BK AMARLLO NA	TX	27,350
71	UNION BK	CA	27,267
72	BANK IV WICHITA NA	KS	27,227
73	BANCOHIO NB	OH	27,178
74	HUNTINGTON NB	OH	27,099
75	STATE STREET B&TC	MA	26,567
76	COLORADO NB OF DENVER	CO	26,081
77	CENTERRE BK NA	MO	25,954
78	CITIZENS ST BK OF DALHART	TX	25,287
79	PEOPLES NB OF KINGFISHER	OK	25,150
80	HARDIN COUNTY SVG BK	IA	24,669
81	AMERICAN ST BK	IA	24,481
82	FIRST REPUBLICBANK LUBBCK NA	TX	24,378
83	ARIZONA BK	AZ	24,330
84	UNITED BK GREELEY NA	CO	24,293
85	FIRST NB AT LUBBOCK	TX	24,287
86	FIRST NB IN BROOKINGS	SD	24,078
87	SOVRAN BK NA	VA	24,066
88	TRUSTCORP BK	OH	23,986
89	FIRST NB OF GREAT FALLS	MT	23,909
90	UNITED BK OF DENVER NA	CO	23,901
91	FIRST NB OF CHICAGO	IL	23,784
92	HUTCHINSON NB&TC	KS	23,330
93	SCOTTSBLUFF NB&TC	NE	23,159
94	FARMERS FIRST BK	A	23,007
95	CITIZENS BK	NM	22,843
96	GREELEY NB	CO	22,730
97	FIRST NB OF TULIA	TX	22,617
98	COMMERCE BK OF KS CITY NA	MO	22,486
99	FARMERS BK	IN	22,345
100	FIRST NB OF GOODLAND	KS	22,341

Business development and competition

Two thirds of farm banks reported that their level of agricultural lending had increased or almost remained the same since January 1, 1987. The remaining third experienced a decreased level of agricultural lending during the same period. Medium and large farm banks more frequently cited increased lending levels than small farm banks. Regionally, two of five corn belt banks reported decreased levels, while just one in four southern and western farm banks reported a drop.

Three in five farm banks considered other commercial banks to be the farm lenders most competitive with their own bank. Other institutions considered as most important competitors included: Commodity Credit Corporation (38%); Production Credit Association (30%); and Farmers Home Administration (27%). Those considered significant as the second most important competitor included: Federal Land Bank Association (45%); Production Credit Association (40%); and Commodity Credit Association (32%). Although there were differences among bank size and region categories. Discernable trends were not evident.

FmHA guaranteed loans

Three in five farm banks are FmHA approved lenders. Two thirds have made FmHA guaranteed loans in the past year with that proportion decreasing as bank size increases. When rating the FmHA guaranteed loan application process on a scale of 1 to 5 (1=complex and 5=easy to understand), more than half (55%) gave it a rating of 1 or 2. Only 4% considered the process easy to understand. Small

and medium farm banks most often rated the process as complex. Regional variations were little pronounced.

Two in five farm banks considered the paperwork associated with an FmHA guaranteed loan to be very burdensome. Only 10% view it as no problem, while almost half feel it is somewhat burdensome. Small and medium banks especially felt the paperwork to be very burdensome. The paperwork associated with filing a claim for an FmHA guaranteed loan was considered very burdensome by 47% of the farm banks. Two in five felt it was only somewhat burdensome. Southern banks were much less likely to consider the paperwork very burdensome than banks in other regions.

Three out of four of farm banks reported FmHA loan servicing requirements to be more demanding or much more demanding than servicing requirements for regular farm loans. Only one in five considered the requirements to be the same. Regional and size differences evidenced no trends.

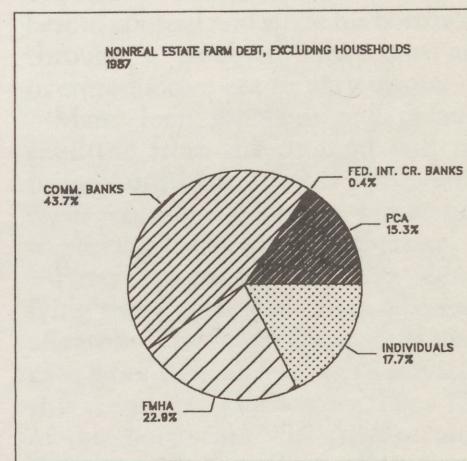
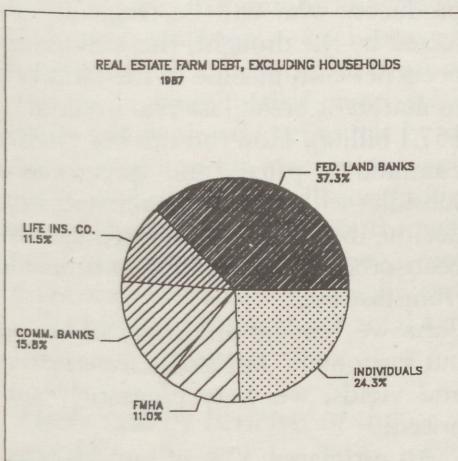
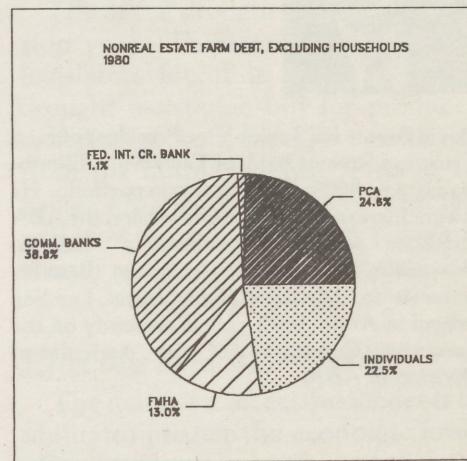
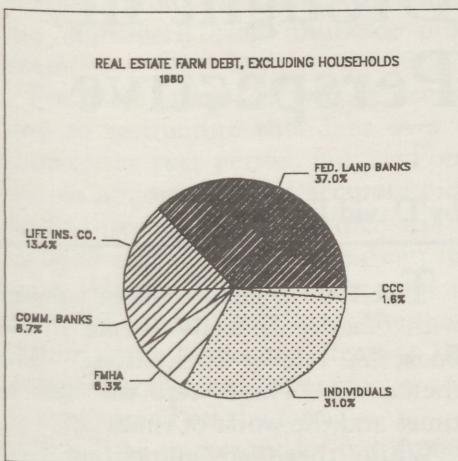
For FmHA approved lenders, the median number of days between an FmHA guaranteed loan claim and its payments was 60 days. But large farm banks and farm banks in the northeast region experienced a significantly higher number of days between claim and payment. For non-approved lenders, the median number of days was 90, with large farm banks reporting a higher number of days. Regionally, both northeast and southern banks experienced longer waiting periods.

Only 8% of FmHA approved lenders and just 2% of non-approved lenders reported selling FmHA guaranteed loans on the secondary market. Only small and medium banks sold loans.

Regionally, northeast, southern, and western banks were more likely to have sold FmHA loans among approved lenders, while southern banks dominated the non-approved lender segment.

Thirty percent of FmHA-approved lenders and 16% of non-approved lenders used the FmHA interest rate buydown program. For those farm banks that did not use the buydown,

reasons given by both approved and non-approved lenders included; one in five banks that did not want a fixed rate, and one in ten banks that found the forms too complex. In addition, 43% of approved lenders and 56% of non-approved lenders did not participate for other reasons. Most farm banks that did participate tended to be small and medium institutions located in the northeast, corn belt, plains regions.



*Source: Farm Banks: Trends in Performance 1978-1987
American Bankers Association, 1988