Economic Report
Office of Regulatory Policy
Agricultural and Economic Policy Team

September 30, 2016

Summary

The Farm Credit System and commercial banks are the primary suppliers of agricultural credit. Banks focused on lending to agriculture (or "farm banks") account for nearly half of the over $172 billion in farm debt reported by financial institutions to the Federal Deposit Insurance Corporation. Farm loan volume at farm banks has been growing at about double the pace of the entire banking industry in recent years.

While bank numbers have been declining steadily, the number of farm banks has been declining slowly. Most farm banks are headquartered in the Midwest, concentrated within the Corn Belt, and are relatively small, with 95 percent having total assets of less than $500 million.

After a period of historically high loan quality, nonperforming rates on farm loans have been rising. The ability of farm banks to weather declines in farm loan quality could be tested in the coming year if the Midwestern farm economy weakens more. Some key banking statistics suggest that, on average, farm banks are in a relatively strong position going into 2017.

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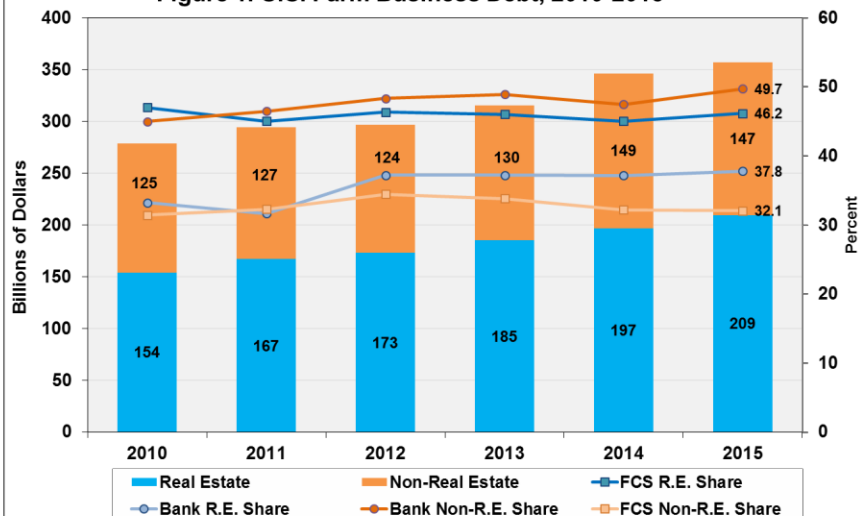
Ag Loan Volume Grows at Farm Banks; Loan Quality Is Declining

U.S. farm debt has been rising despite a contracting farm economy. USDA estimates that total farm business debt stood at $357 billion at the end of 2015, up from $346 billion in 2014 and $279 billion in 2010 (figure 1). The latest USDA estimates show that farm business real estate debt outstanding rose 36 percent and non-real estate farm business debt rose 18 percent in the five years ending in 2015.

Figure 1. U.S. Farm Business Debt, 2010-2015



Source: USDA, Economic Research Service data as of 8/30/16. Year-end estimates shown.

The USDA data show that commercial banks and the Farm Credit System (System) continue to be the dominant lenders to U.S. agriculture. Commercial banks held nearly half of all non-real estate (production) farm debt, with the System holding over 46 percent of farm business real estate debt (farmland-secured debt) in 2015. These market shares have been fairly constant over the past five years.

Farm Bank Numbers Decline

During the past six years, the total number of commercial banks, savings banks, and thrifts insured by the Federal Deposit Insurance Corporation (FDIC) have been declining at a brisk pace. As of June 30, 2016, there were 5,238 active U.S. commercial banks, which is 21 percent fewer than just six years ago (figure 2). Also during this period, the total number of FDIC-insured institutions with savings or thrift charters fell nearly 30 percent to 820.

The number of these FDIC-insured institutions focused on lending to agriculture has declined at a slower pace. The FDIC defines an institution as an "agricultural bank" or "farm bank" if at least 25 percent of its total outstanding loan volume was made to agriculture. The number of banking institutions meeting this definition fell 7 percent to 1,466 over the past six years.[1]

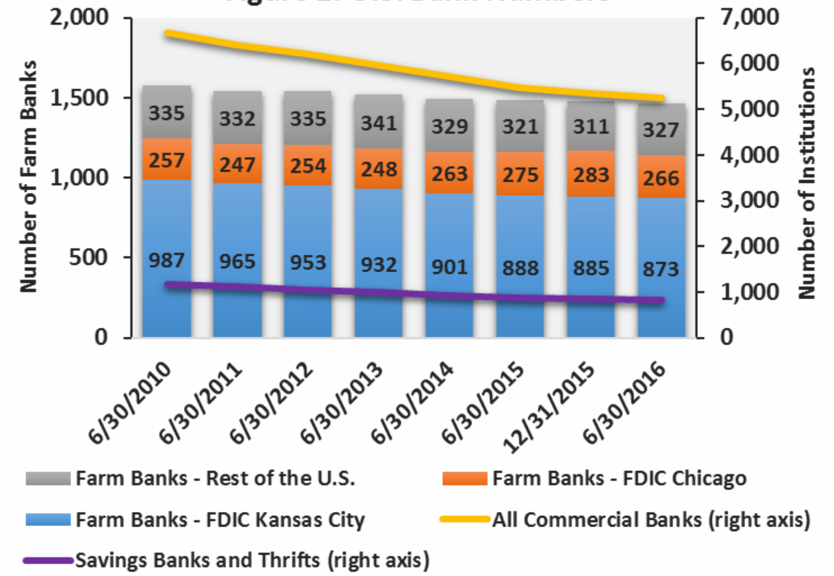
Farm Banks Are Geographically Concentrated and Small

Farm banks are geographically concentrated in the Midwest where the number of farm operators is the greatest (figure 3). Farm banks headquartered in states of the FDIC's Kansas City district (Iowa, Kansas, Minnesota, Missouri, Nebraska, North Dakota, and South Dakota) accounted for about 60 percent of all farm banks as of June 30. The number of farm banks in this district fell to 873 by mid-2016 from 987 six years earlier.

Farm bank numbers in the FDIC's Chicago district and the other FDIC districts have been more stable. The Chicago district includes states of the eastern Corn Belt: Illinois, Indiana, Kentucky, Michigan, Ohio, and Wisconsin.

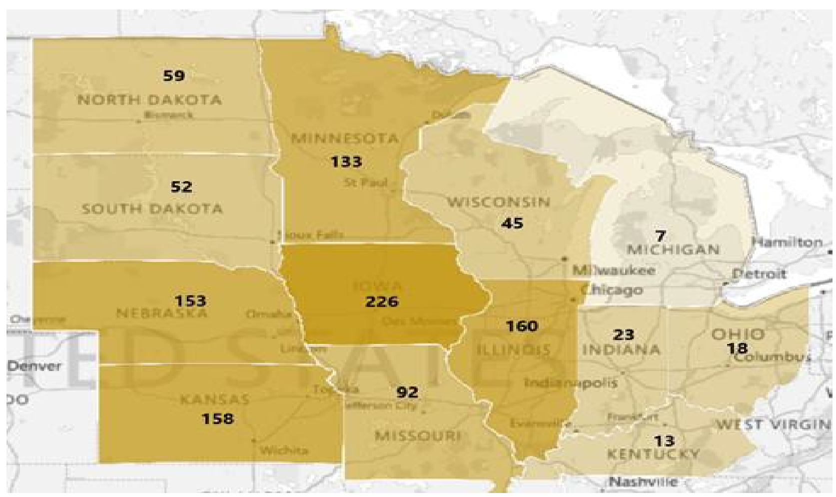
In comparison with System institutions, farm banks are relatively small in size. Approximately 95 percent of these banks have total assets of less than $500 million, and 21 percent have total assets of $50 million or less (figure 4).[2] Only 1.6 percent of farm banks have total assets exceeding $1 billion. The two largest farm banks by total farm loans outstanding on June 30, 2016, were John Deere Financial, FSB, headquartered in Wisconsin, and Rabobank N.A., headquartered in California.

Figure 2. U.S. Bank Numbers



Source: FDIC data accessed 9/10/16.

Figure 3. Farm Bank Counts by State, June 30, 2016



Source: FDIC data as of June 30, 2016.

Farm Bank Agricultural Loan Portfolios Are Growing

Farm banks account for nearly half of the over $172 billion in farm debt reported to the FDIC as of June 30, 2016. Farm banks have been adding to their agricultural production and farmland-secured loan volume at about twice the pace as the entire banking industry since 2010 (figure 5). From mid-2010 to mid-2016, outstanding farmland-secured loan volume at farm banks rose 68 percent, and outstanding agricultural production loan volume rose 57 percent.

[1] A small number of FDIC institutions with thrift or savings bank charters (17 as of June 30, 2016) met the farm bank definition. These institutions were included with commercial banks for this analysis.

[2] As of June 30, 2016, 26 percent of the System's associations reported total assets of less than $500 million. Only two associations reported total assets of less than $100 million.

Farm Loan Quality Is Declining

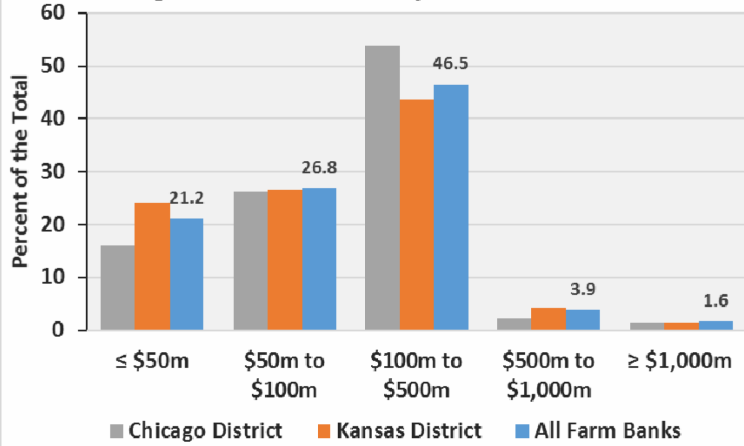
Following the end of the last recession and with a robust farm economy, farm loan quality at farm banks improved, with nonperforming loan rates bottoming out in 2013 (figure 6).[3] Despite an increase, nonperforming loan rates for both farmland-secured loans and agricultural production loans remain historically low. The nonperforming loan rates on production loans are lower than on farmland-secured assets, although the gap has narrowed somewhat recently. Nonperforming loan rates on farm loans held by farm banks are typically lower than the rates reported on farm loans by the entire banking industry.

The states in the FDIC's Kansas City district accounted for approximately 55 percent of the value of the U.S. corn crop in 2015, while states in the FDIC's Chicago district accounted for 33 percent of its value. Given the prospects for continued weakness in cash grain profitability and declining farmland values, farm banks headquartered in these states might experience deeper deterioration in farm loan quality than elsewhere. The capacity of these farm banks to service customers undergoing debt repayment shortfalls is a potential concern for some rural credit markets.

Loan volume and performance trends at farm banks in these two farm-dependent districts can be seen in figures 7 and 8. While farmland-secured volume rose steadily over the time period in both FDIC districts, production credit volume grew more quickly in the past few years. This growth has occurred because lower profitability has reduced the ability of farmers to pay down their credit lines and boosted their need for production credit.

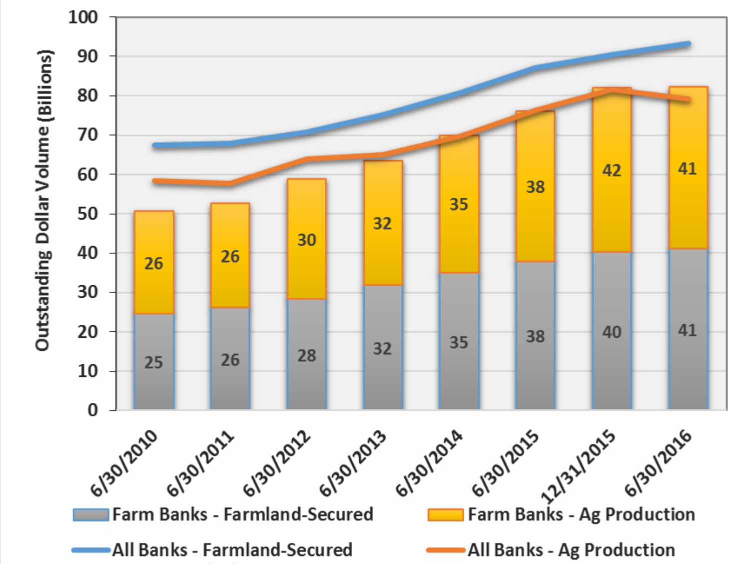
The trends of nonperforming loan rates for agricultural production loans at farm banks in these two districts are similar. However, nonperforming rates on farmland-secured loans at Chicago district farm banks bottomed out at a higher level and at an earlier date than at farm banks in the Kansas City district. Regardless, growth in delinquent farm loan volume (30 to 89 days past due) and expected weaker 2016 farm incomes suggest nonperforming rates will likely continue to rise.

Figure 4. Farm Banks by Asset Classification



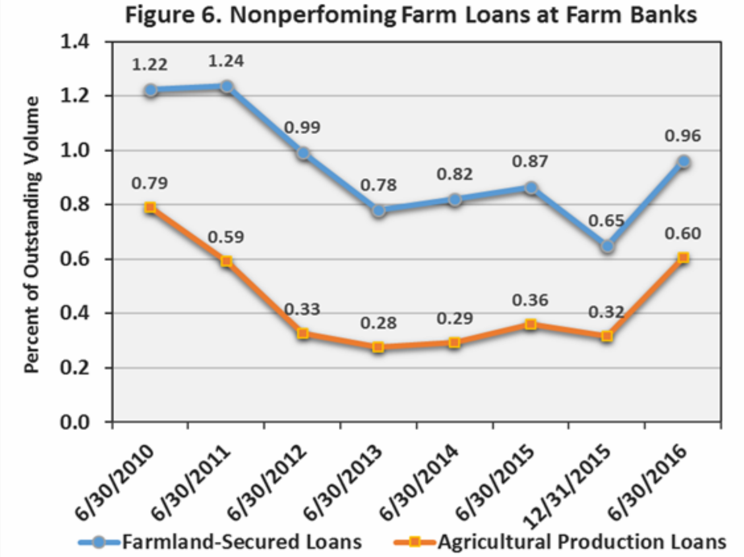
Source: FDIC data accessed 9/20/16.

Figure 5. Farm Loan Volumes for Banks and Farm Banks



Source: FDIC data accessed 9/20/16.

Figure 6. Nonperfoming Farm Loans at Farm Banks



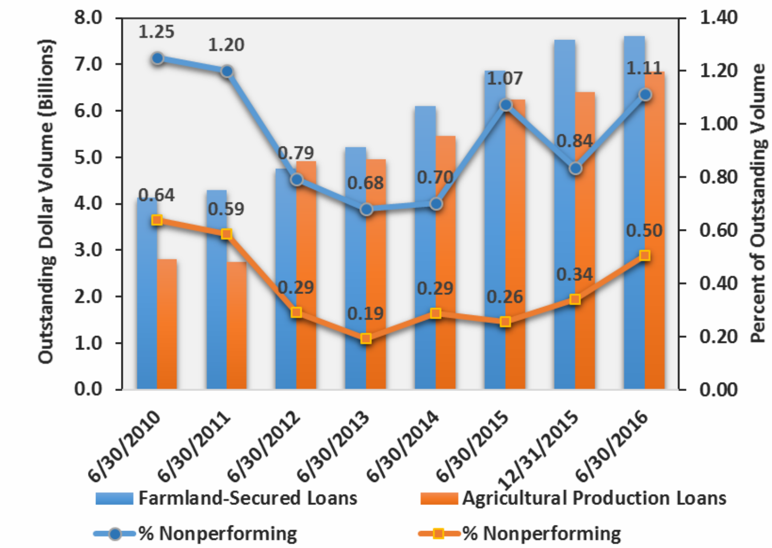
Source: FDIC data accessed 9/10/16.

[3] Nonperforming loans includes those past due 90 or more days and those in nonaccrual status.

The majority of agricultural production loans have payments due and loan renewal dates after harvesting is complete.

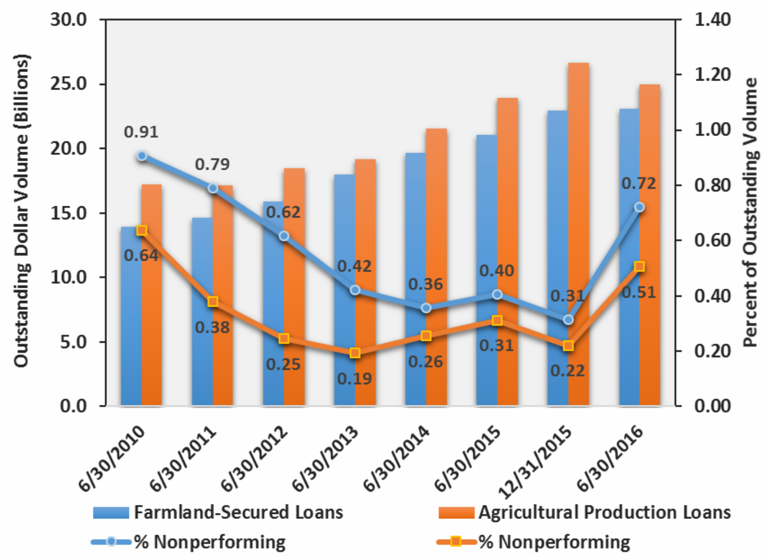
Farm Bank Financials Are Relatively Strong
The ability of farm banks to weather declines in farm loan quality could be tested in the coming year if the Midwestern farm economy continues to slide. However, some key banking statistics indicate that profitability measures at farm banks are generally more robust and capitalization measures are greater than for all commercial banks (table 1). This could be important given the concentration of farm bank assets in the cyclical farm economy.

Figure 7. FDIC Chicago District Farm Banks



Source: FDIC data accessed 9/10/16.

Figure 8. FDIC Kansas City District Farm Banks



Source: FDIC data accessed 9/10//16.

Table 1. Performance and Condition Statistics

	Commercial Banks	Farm Banks[1]
Performance Ratios[2]	As of 6/30/2016	
Yield on earning assets	3.39%	4.16%
Cost of funding earning assets	0.35%	0.47%
Net interest margin	3.04%	3.69%
Noninterest income to assets	1.56%	0.67%
Noninterest expense to assets	2.52%	2.54%
Return on assets (ROA)	1.04%	1.23%
Net charge-offs to loans and leases	0.44%	0.16%
Condition Ratios[2]		
Loss allowance to noncurrent loans/leases	89.47%	146.38%
Noncurrent loans to loans	1.48%	0.96%
Net loans and leases to deposits	71.48%	80.41%
Core capital (leverage) ratio	9.49%	10.88%
Tier 1 risk-based capital ratio	12.59%	14.54%
Total risk-based capital ratio	13.97%	15.66%

1. Includes savings banks and thrift charters meeting the FDIC farm bank definition.
2. Quarterly weighted averages.
Source: FDIC - Statistics on Depository Institutions, accessed 9/20/2016.