FDIC Advisory Committee of State Regulators

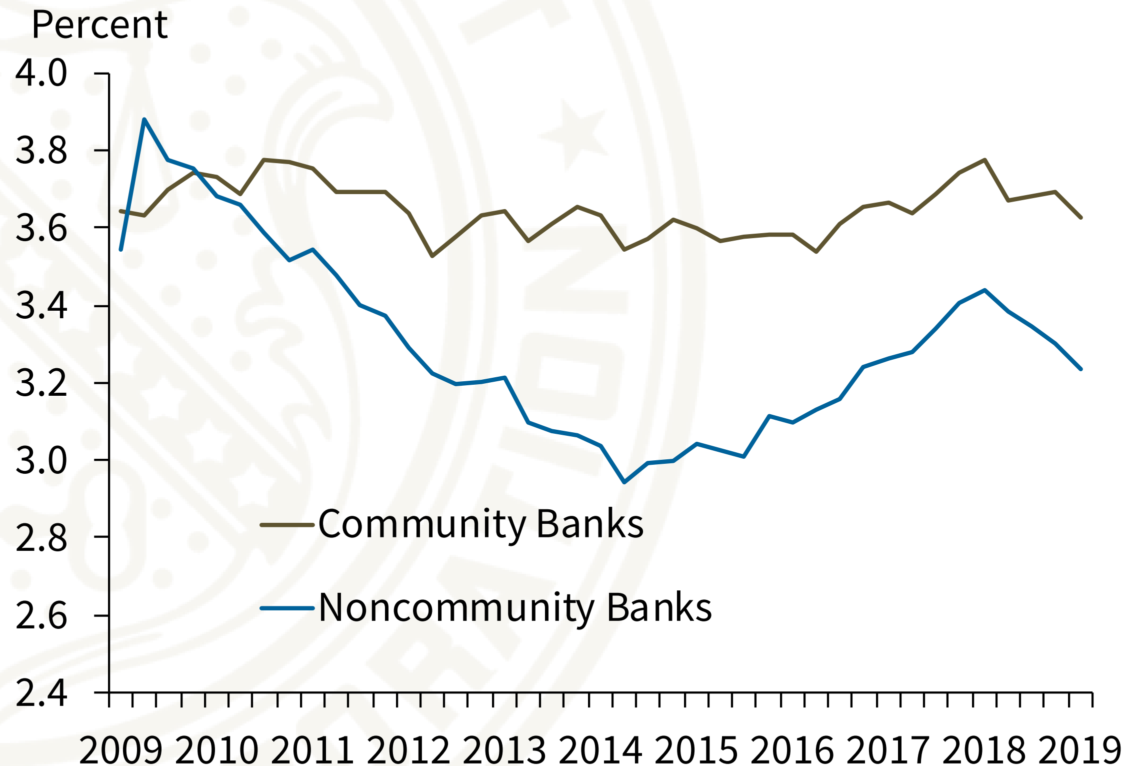
March 18, 2021

2020 Community Banking Study and FDIC Quarterly Article: "Farm Banks: Resilience Through Changing Conditions"

2020 Community Banking Study - Introduction

- This study is a follow-up to the original FDIC Community Banking Study, published in December 2012.
  - That study defined "community banks" and discussed the characteristics and performance of community banks compared to noncommunity banks.
  - That study used banking data from 1984 through year-end 2011.
- This study builds on several of the themes and conclusions of the 2012 study, bringing them forward through year-end 2019.
- This study also presents two new assessments: regulatory change and technology, and their respective effects on community banks.
- Though the study period ends at year-end 2019, each chapter includes an inset box regarding the pandemic's effects on the issue.

Chapter 1: Community Bank Financial Performance

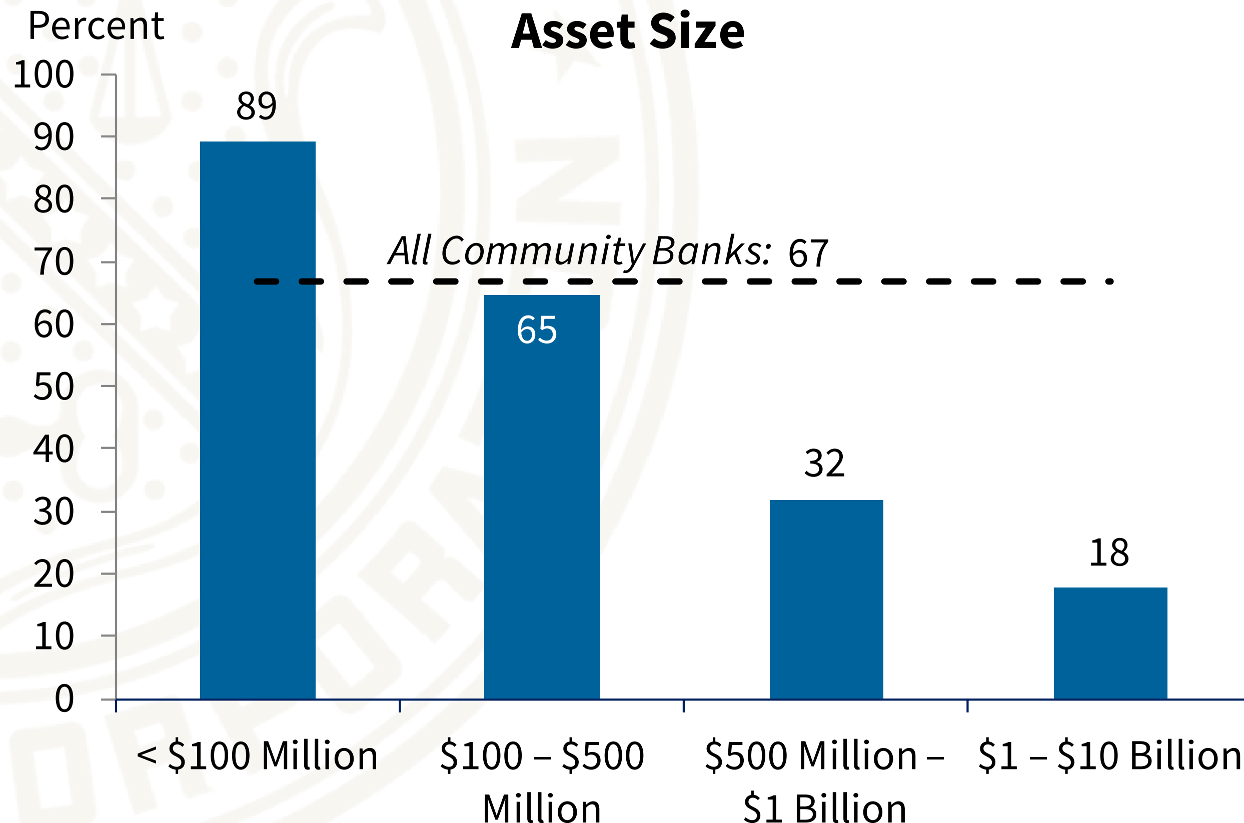


Key Question: How have community banks performed since the conclusion of the previous study?

Key Findings:

- Community banks have reported positive financial performance, with pretax ROA ratios steadily improving from 2012 through 2019.
- Community banks benefit from wide net interest margins and asset quality metrics that are superior to those of noncommunity banks.
- However, community banks earnings continue to lag noncommunity banks, primarily as a result of generating lower volumes of noninterest income.

Chapter 2: Structural Change Among Community and Noncommunity Banks



Source: FDIC.

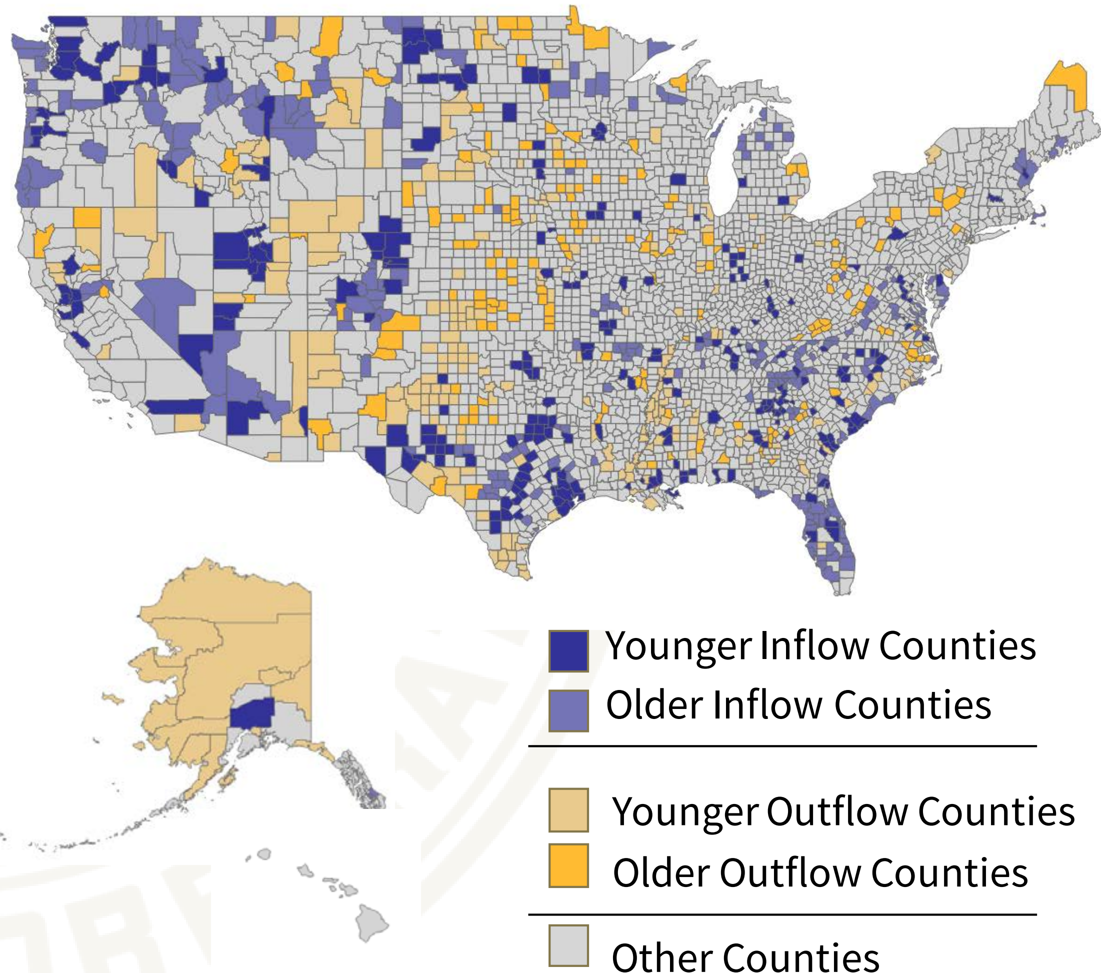
Key Question: How has banking industry consolidation proceeded between 2012 and 2019?

Key Findings:

Both community and noncommunity banks have continued to consolidate, although community banks at year-end 2011 were less likely to cease operating by 2019 than noncommunity banks.

- Voluntary mergers between unaffiliated institutions have increased in importance, while failures and mergers between institutions in the same holding company have declined. The rate of net consolidation, however, has risen because of a sharp decline in new charters after 2012.
- Community banks that cease operating do so primarily because they are acquired by another community bank.

Chapter 3: The Effects of Demographic Changes on Community Banks



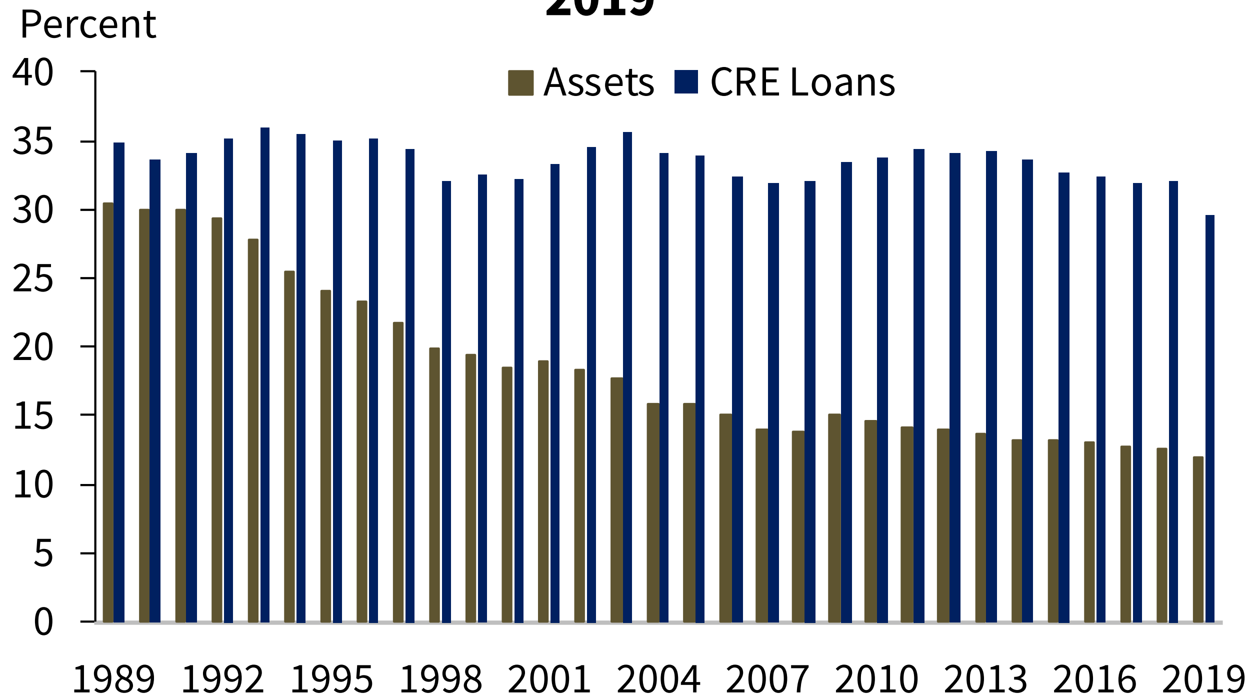
Sources: U.S. Census, 2018 Census American Community Survey.

Key Question: How has the changing demographic makeup of the U.S. affected demand for community bank services in their local communities?

Key Findings:

- Between 2011 and 2019 community banks headquartered in counties with lower median ages and the highest levels of net migration inflows experienced:
  - faster asset and loan growth rates;
  - higher profitability; and
  - larger shares of business loans.
- Community banks serving areas with higher median ages and highest levels of net migration outflows experienced fewer opportunities for growth.
  - Higher median ages have higher deposit-to-asset ratios.

Chapter 4: Notable Lending Strengths of Community Banks – Commercial Real Estate (CRE)



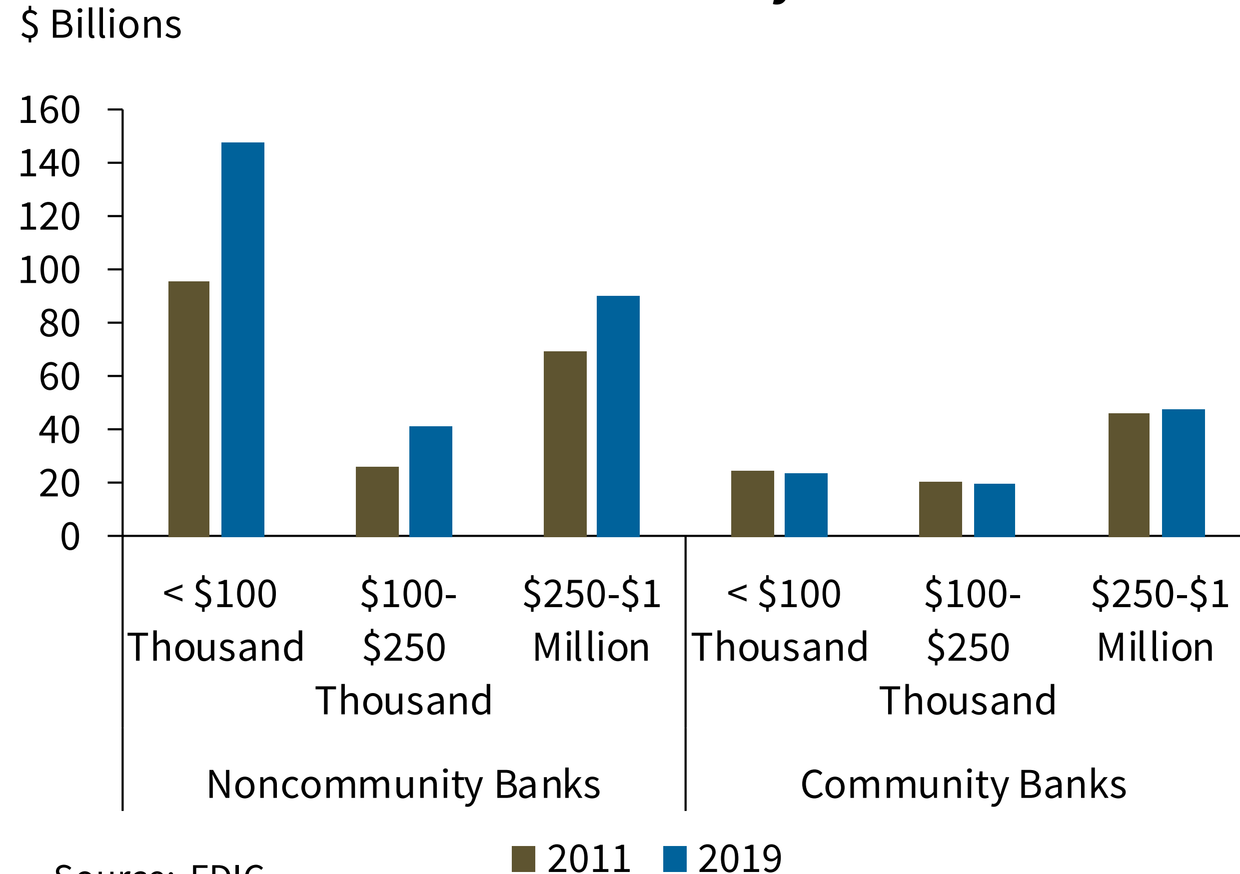
Source: FDIC.

Key Question: What role does the community banking industry play in commercial real estate lending?

Key Findings:

- Community banks hold almost one-third of the banking industry's CRE loans, despite having only a small share, 12 percent, of the banking industry’s total assets.
- Community banks are active lenders across the spectrum of CRE industries, including retail and multifamily housing properties.
- Community banks are important lenders to CRE property owners located in small markets.

Chapter 4: Notable Lending Strengths of Community Banks – Small Business Lending

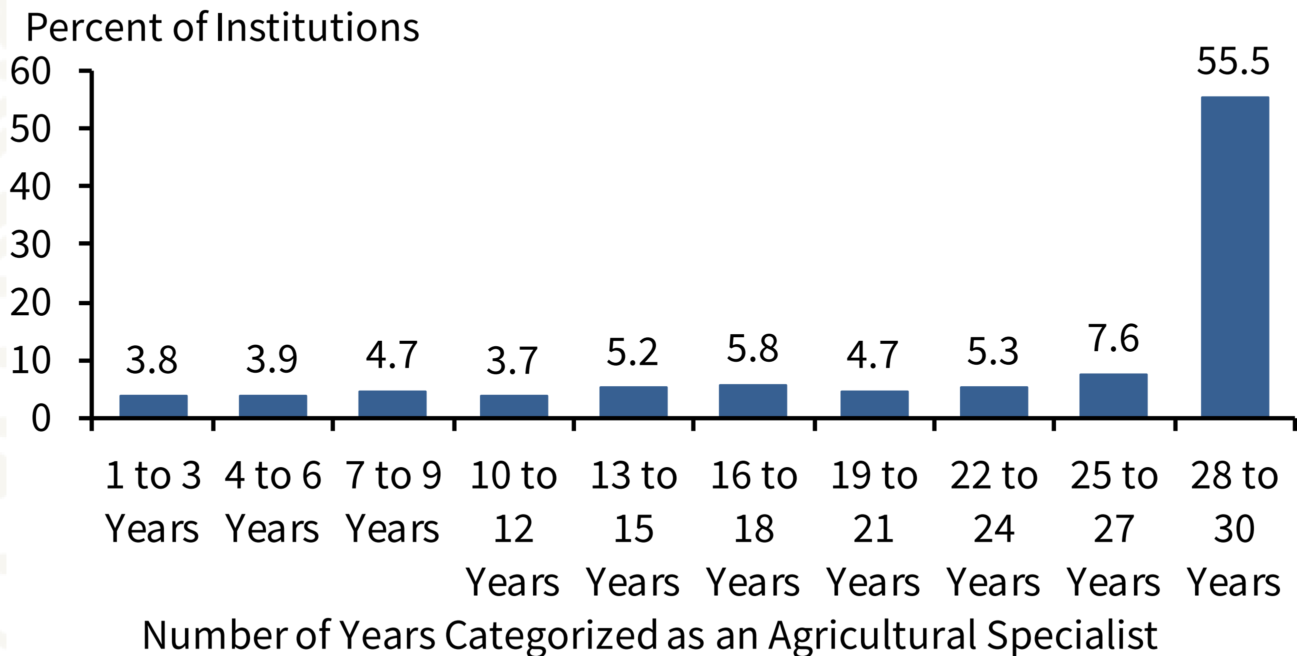


Key Question: Are community banks lending to small businesses in their communities?

Key Findings:

- Community bank small business loans represent 36 percent of total small business loans.
- Call Report numbers are showing a decline, but:
    - Community banks state that most of their C&I loans are to small businesses.
    - Community banks have seen a rise in their share of SBA 7(a) loan originations with many loans greater than $1 million.

Chapter 4: Notable Lending Strengths of Community Banks – Agriculture



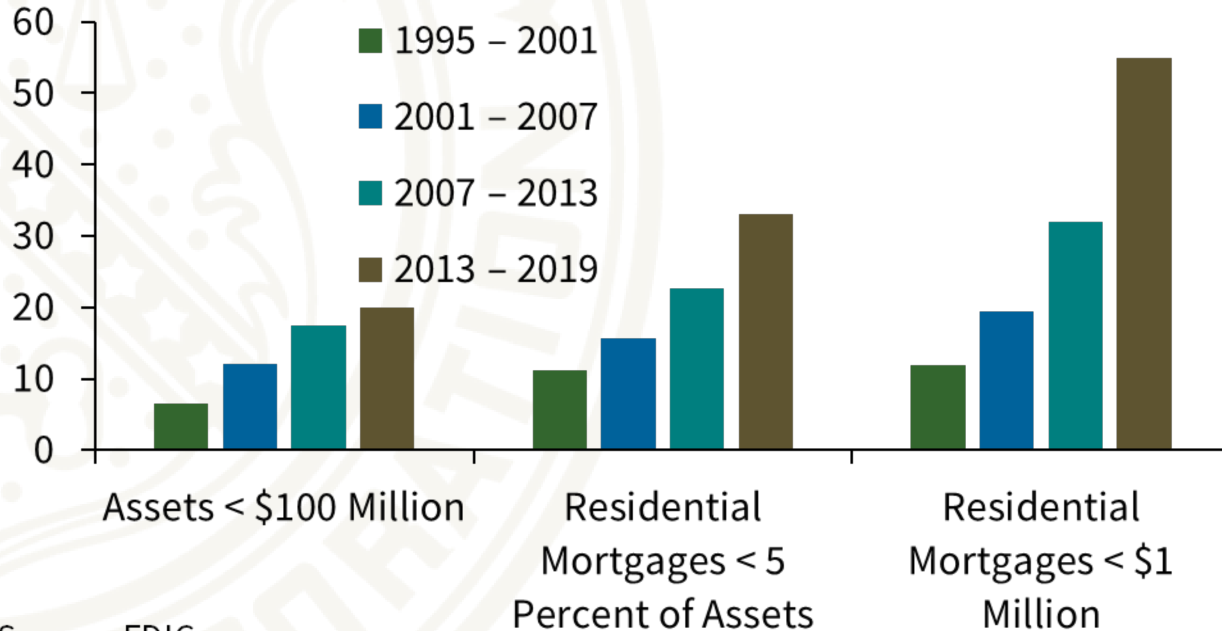
Source: FDIC.
Notes: Sample only includes banks open from January 1, 1990, through year-end 2019, that were considered a community bank during all quarters of 1990 and 2019, and were also considered an agricultural specialist in any quarter during 1990. A bank is considered as having been an agricultural specialist in a given year if it was identified as an agricultural specialist in any quarter during that year.

<u>Key Question:</u> What role does the community banking industry play in agricultural lending?

<u>Key Findings:</u>

- Community bank agricultural specialists hold more than one-third of the banking industry's agricultural loans despite holding just one percent of the banking industry's total assets.
- Community bank agricultural specialists are concentrated in the center of the nation where agriculture is heavily concentrated in row crops such as corn, soybeans, and wheat and in cattle and hog production.
- Most community bank agricultural specialists have a long history tied to agriculture, and there are few new entrants into this lending space.

Chapter 5: Regulatory Change and Community Banks



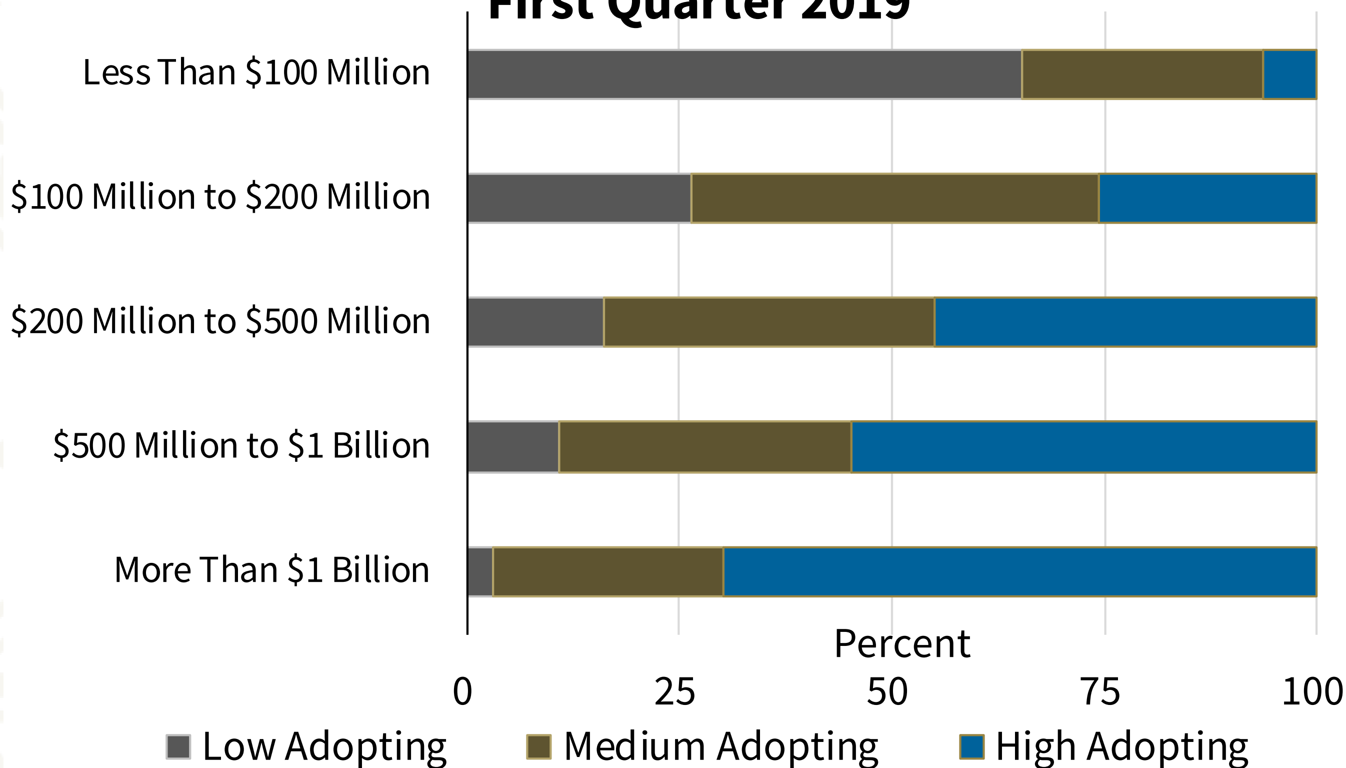
Source: FDIC.
Note: Bars represent the percentage of community banks in each small lender group that reduced 1–4 family residential mortgages holdings at an annualized rate of at least 5 percent during the six-year period.

Key Question: How have regulatory developments since 2008 affected community banks?

Key Findings:

- While loan growth and financial performance have recovered strongly from the crisis, the pace of regulatory change may be one factor influencing:
  - An apparent reduction in residential mortgage lending by small mortgage lenders;
  - A record rate of exit from the banking industry by community banks; and
  - An apparent increase in the target asset size of new small banks as reflected in their initial equity capital.
- The findings support the idea that if the benefits of a thriving community bank sector are to be preserved, regulations should achieve their goals in a way that accommodates, to the extent appropriate, the business models of community banks.

Chapter 6: Technology in Community Banks



Key Question: **How did community banks that adopted technology differ from those that did not?**

Key Findings:

- Community banks are most often focused on their customers when describing the opportunities of technology, and on cost when describing its challenges.
- Larger community banks and those with higher revenues were most likely to adopt certain technologies.
- Technology adoption was also associated with higher loans-to-assets ratio, higher growth, a stronger economic and competitive environment, and a more positive outlook by bank leadership.

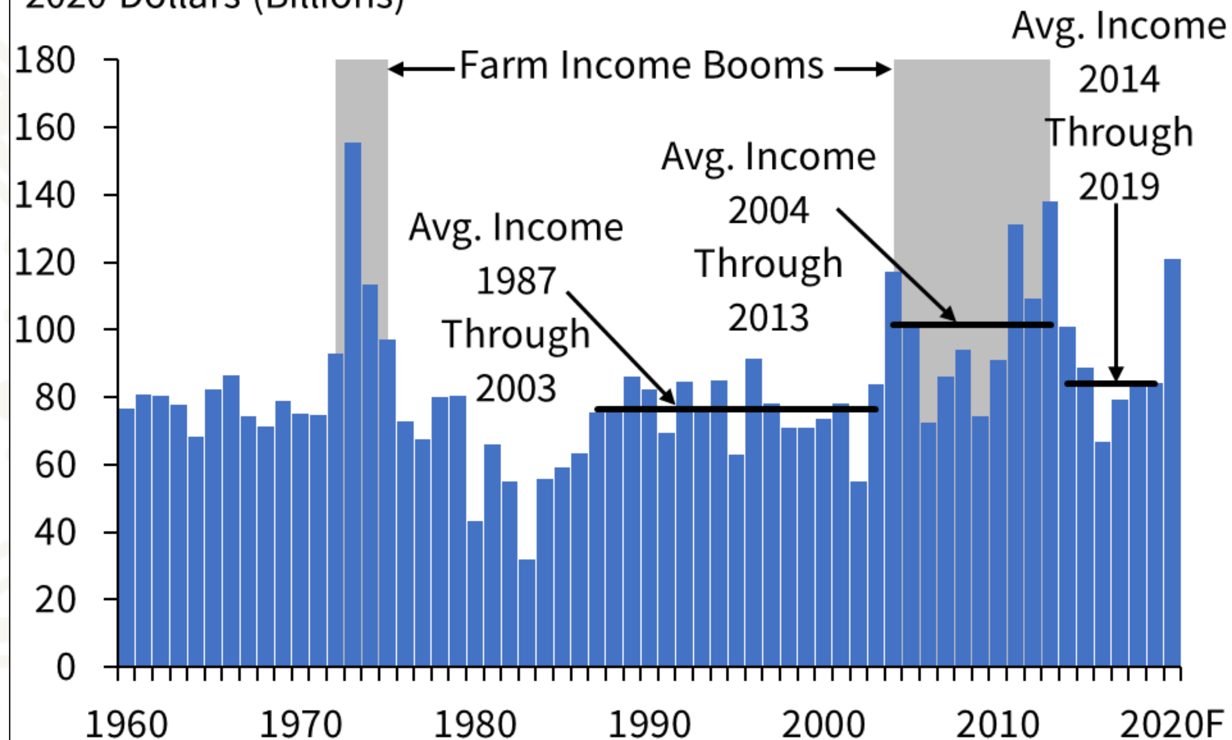
Sources: FDIC; CSBS.

FDIC Quarterly
"Farm Banks: Resilience Through Changing Conditions"

This paper is organized into two sections:

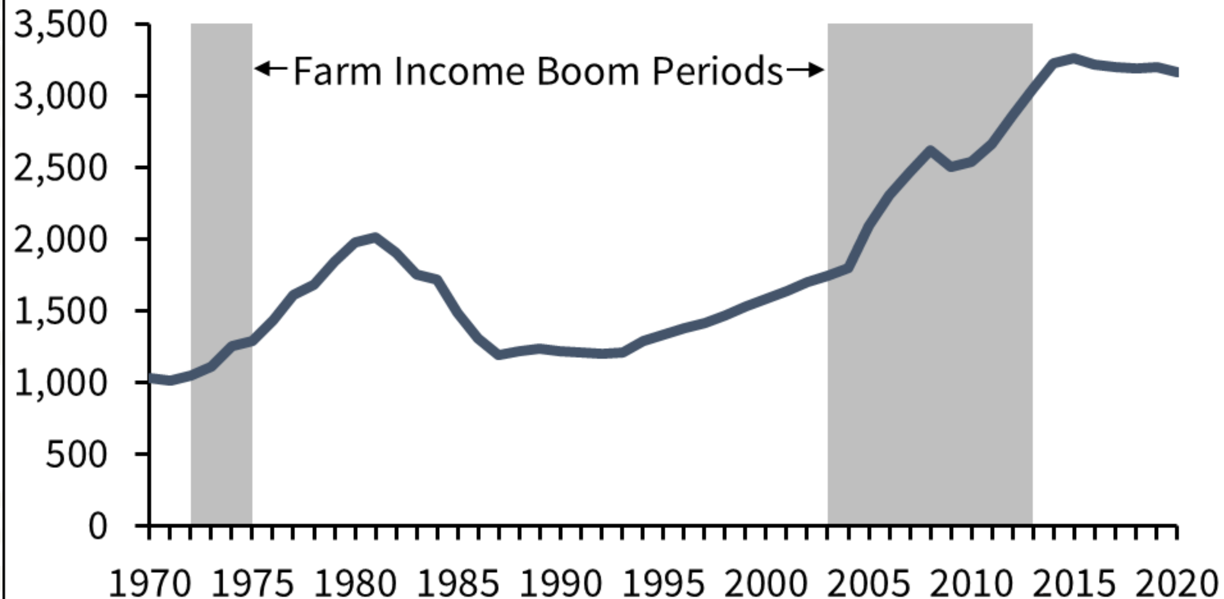
- The first analyzes the income boom in the U.S. agricultural sector from 2004 through 2013, weaknesses in the sector from 2014 through 2019, and the events of 2020.
    - We focus on 12 states in the Upper Midwest where the effects of the boom and subsequent downturn were most substantial.
- The second section discusses the impact of agricultural issues on farm bank conditions during the downturn and assesses potential challenges.

A Lengthy Period of Agricultural Prosperity Was Followed by a Slow Recovery



- From 2004 through 2013, farmers benefitted from the most prosperous conditions in a generation.
- Farm incomes boomed as a variety of factors drove commodity prices to record highs. Expenses rose as well, but not as fast.
- From 2014 through 2019, commodity prices fell while expenses remained sticky.
- 2020 started poorly for farmers, as the COVID-19 pandemic initially looked to be devastating for U.S. agriculture. But record government assistance and a rebound in exports and commodity prices late in the year propelled farm income to its highest level since 2013.

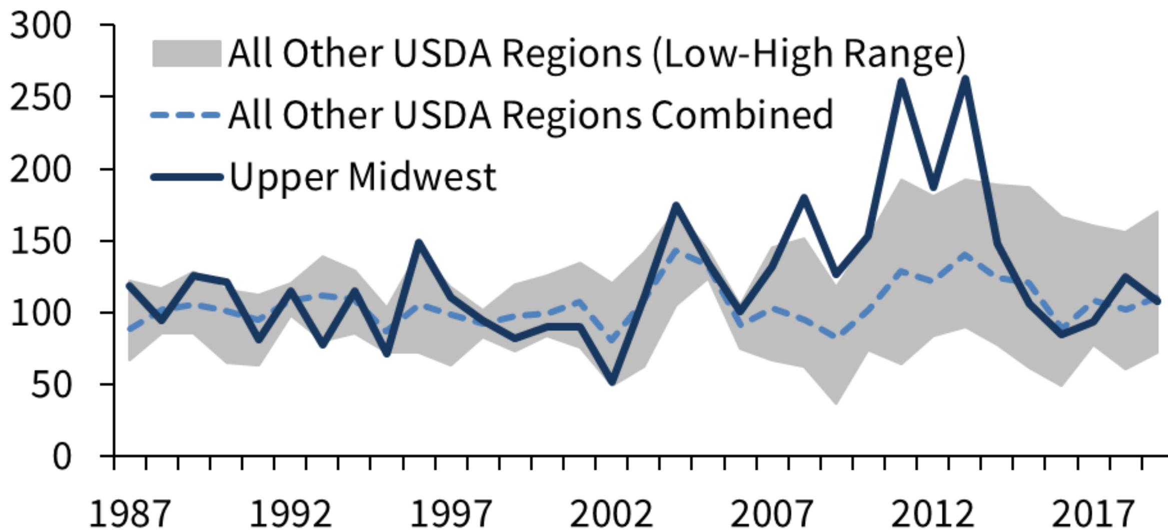
A Boom in Farmland Values Coincided With the Boom in Farm Income



- The recent farmland boom was far more geographically concentrated than the farmland boom of the 1970s.
- The eight states in which farmland values at least doubled during the recent boom all were in the Upper Midwest.*
- Historically low interest rates, combined with tight supplies and steady demand for farmland, helped farmland values remain high despite lower incomes.

* Upper Midwest (12 states): Illinois, Indiana, Iowa, Kansas, Michigan, Minnesota, Missouri, Nebraska, North Dakota, Ohio, South Dakota, and Wisconsin. Primary agricultural production in these states includes cattle, corn, and soybeans, and to a lesser degree dairy, hogs, and wheat.

Agricultural Incomes in the Upper Midwest Fluctuated Widely During and After the Boom

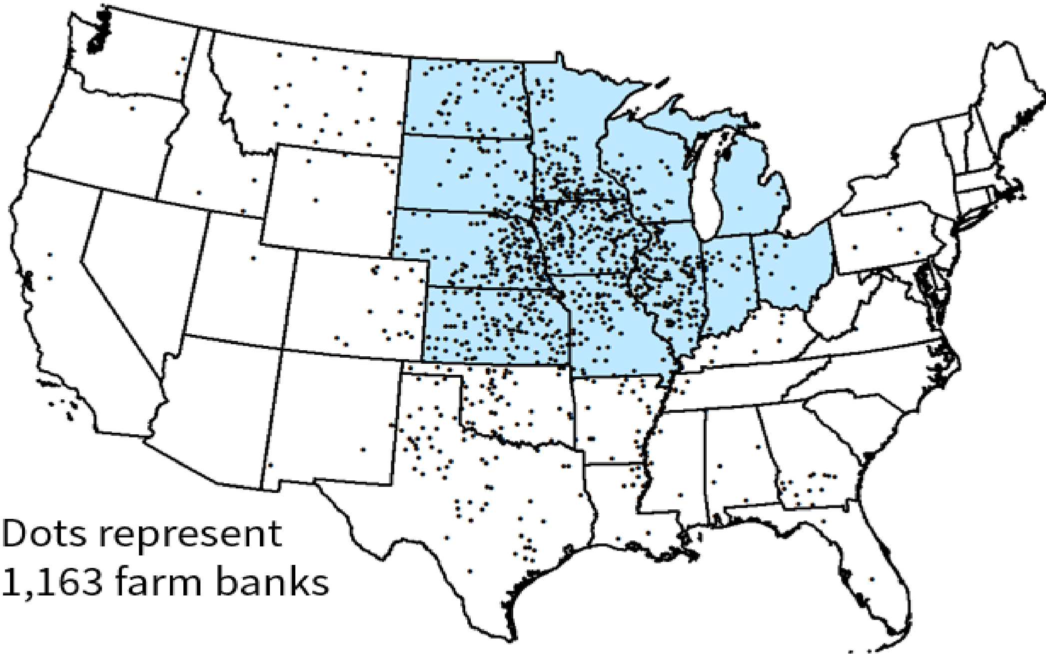


Source: U.S. Department of Agriculture (Haver Analytics).
Note: Data are inflation-adjusted net farm income figures from 1987 through 2019 and are aggregated by USDA economic regions. "Upper Midwest" contains USDA's Corn Belt, Lake States, and Northern Plains regions. The base index period of 1987 through 2003 spans the relatively more calm period between the tail end of the 1980s agricultural crisis and the 2004 through 2013 farm income boom.

- The Upper Midwest had among the lowest net farm income of any region in the early 2000s but then quickly rose and outperformed all other regions during the farm income boom.
- As the farm income boom ended, the Upper Midwest again experienced a sizeable swing and fell to among the lowest-performing regions.
- At its peak in 2011 and 2013, aggregate farm income in Upper Midwest states was 2.4 times greater than its long-term pre-boom average. Income then fell by more than two-thirds to its bottom in 2016.

Farm Banks Play a Vital Role in Supporting U.S. Agricultural Producers and Rural Communities

Three of Every Four U.S. Commercial Farm Banks Are Based in Upper Midwest States

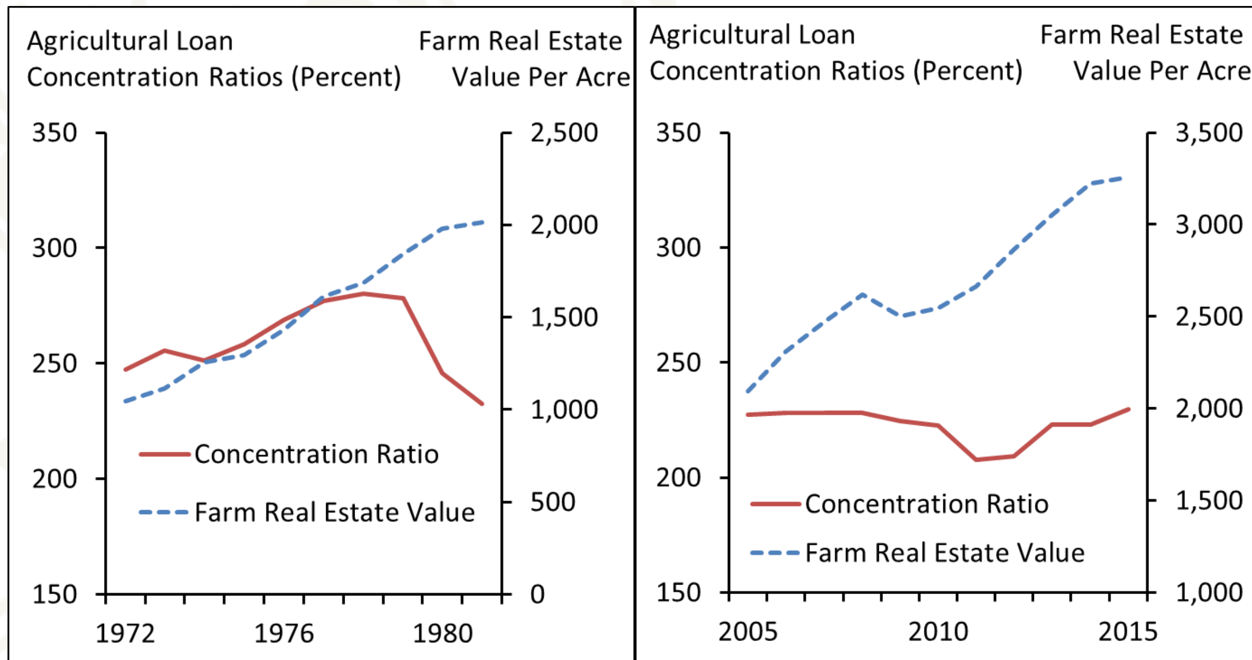


Source: FDIC.
Note: Data are as of December 31, 2020. The FDIC defines farm bank as an FDIC-insured institution with 25 percent or more of total loans concentrated in agriculture. Farm banks located based on state of headquarters office. Shaded states are defined as Upper Midwest states.

- Despite holding just 2 percent of all bank loans in the U.S., farm banks hold 44 percent of all bank-held agricultural loans.
- Farm banks, which tend to be small, are geographically concentrated in the Upper Midwest.
- The booming agricultural sector largely insulated farm banks from the effects of the collapse in housing and CRE markets that coincided with the Great Recession.
- Instead, farmers were flush with cash. As a result, farm banks simultaneously faced increasing deposit balances and declining loan growth.

A Cautious Attitude Generally Prevailed Concerning Borrowing Against Rapidly Rising Farmland Values

Agricultural Loan Concentrations at Farm Banks Remained Low During the Recent Boom in Farm Real Estate Values

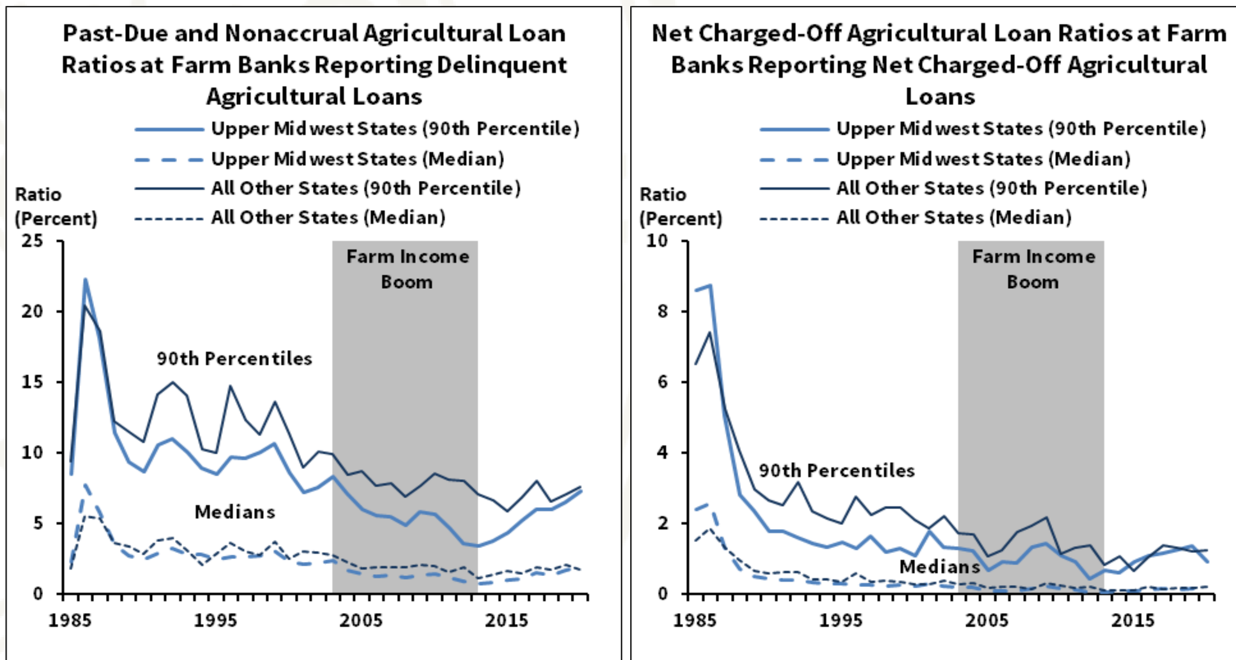


Sources: FDIC; U.S. Department of Agriculture.
Note: Farm real estate values are inflation-adjusted annual figures representing the average per-acre value of farm real estate in the United States. Concentration ratios are median fourth quarter ratios. Because total capital is not available prior to 1996, and for consistency, concentration ratios for all periods are calculated by dividing total agricultural loans by total equity capital and loan loss reserves.

- The boom in farmland values provided ample opportunities for bankers to sharply expand credit to farmers.
- Nevertheless, farm bankers and their borrowers were generally conservative during this period.
- This cautious behavior contrasted with the previous farm boom in the 1970s, a period in which farm banks responded to surging farmland prices by dramatically increasing lending to fund expanding farms.

Overall, Credit Conditions at Farm Banks Remain Favorable

Agricultural Loan Delinquencies and Charge-Offs Have Risen in Recent Years but Remain Low by Historical Measures



Source: FDIC.
Note: Agricultural loan delinquency ratios at farm banks typically spike in the first quarter while agricultural loan charge-offs typically spike in the fourth quarter. As a result, the data shown is first-quarter delinquency ratios and fourth-quarter net charge-off ratios from 1985 through 2020. Upper Midwest states are Illinois, Indiana, Iowa, Kansas, Michigan, Minnesota, Missouri, Nebraska, North Dakota, Ohio, South Dakota, and Wisconsin.

- Farm bank agricultural credit portfolios have held up well overall despite the agricultural industry's challenges since 2014.
- Where issues with delinquencies are becoming evident are in outlier farm banks, especially those in the Upper Midwest.
- FDIC bank examiners have noted increasing carryover debt at farm bank examinations, and industry participants have discussed the trend at meetings with regulators.