

FINANCIAL CONDITION OF THE FARM SECTOR AND FINANCIAL INSTITUTIONS

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FINANCIAL CONDITION OF AGRICULTURAL BANKS*

Farm loan problems at commercial banks

In the preceding section, analyses of data reported by farm operators indicated that roughly one-fourth of the debt they owed to commercial banks was owed by operators who appeared likely to be experiencing current financial difficulty. Thus it is not surprising that the amount of delinquent farm loans at banks has been rising, and that banks have been charging off increasing amounts of farm loans. However, only about one-tenth of farm production loans at banks is past due as much as 30 days; therefore, many of the bank borrowers classified as financially stressed by the preceding analyses apparently have remained current on their bank loans.

Farm loan delinquencies. Delinquency rates on farm production loans at banks have been trending upward, as shown in figure 16. (Banks do not report delinquencies and charge-offs of loans secured by farm real estate, which constitute one-fourth of total farm loans at banks.) On June 30, 1986, past due and nonperforming farm production loans constituted 10.5 percent of such loans outstanding at all commercial banks, up from 8.6 percent a year earlier. Nonaccrual farm production loans reached 6.9 percent of outstandings, up from 5.2 percent. Table 16 shows trends and levels of these and other categories of delinquent farm loans reported by banks.

Much of the upward trend in total delinquent farm production loans has consisted of increases in the amount of loans in nonaccrual status, which

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are, in general, loans on which payment in full of principal and interest is not expected. The amount in nonaccrual status rose by only \$0.3 billion during the year ended June 30, 1986, compared with an increase of \$0.7 billion during the preceding 12-month period. But these increases in seriously delinquent loans occurred even though banks charged off over \$2 billion in farm production loans over these two years.

Farm loan losses. Net charge-offs of farm loans have trended upward since banks were first required to report such charge-offs in 1984 (lower panel of figure 16). In that year, net charge-offs totaled \$0.9 billion, or 2.2 percent of farm production loans outstanding at year-end. In 1985, net charge-offs rose to \$1.3 billion, or 3.7 percent of year-end loans. In the first half of 1985, farm loan charge-offs were nearly twice those of a year earlier, but their rate of increase then slowed markedly. In the first half of 1986, net charge-offs of \$590 million were up only modestly from \$520 million in the corresponding period of 1985 (table 17).

Loan experience of agricultural banks

With farm loan delinquency and charge-off rates rising, total loan experience has been deteriorating at banks that are heavily involved in farm lending. About 4,800 of the nation's banks can be characterized as "agricultural banks," in that their ratio of farm loans to total loans is above the unweighted average of such ratios at all banks, which was 16.21 percent as of June 30, 1986. At agricultural banks as a group, farm loans constituted 35.2 percent of total loans, far above the average of 3.3 percent in the banking system as a whole.

Figure 16

Delinquency and Charge-off Rates on Farm Production Loans Insured Commercial Banks

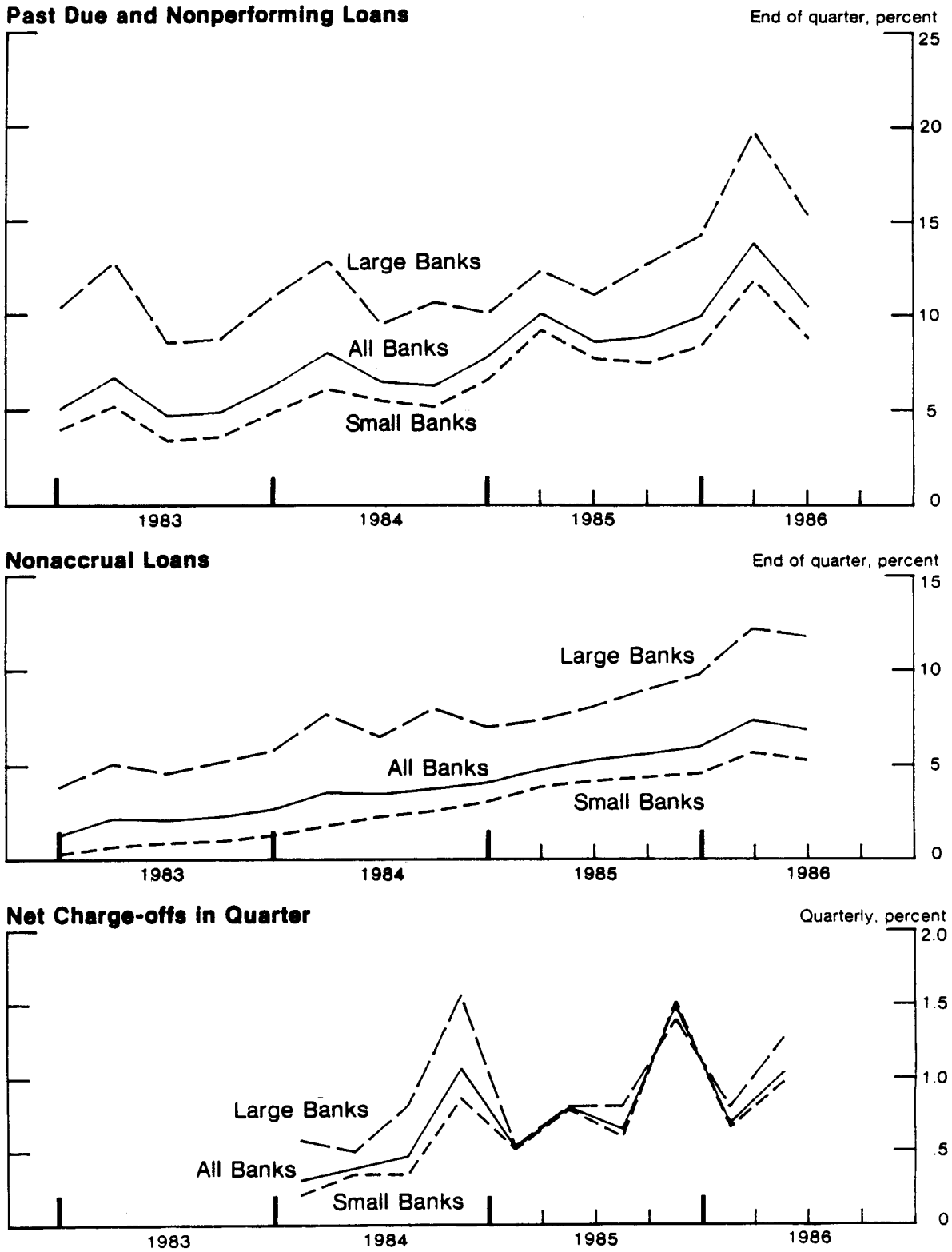


Table 16

Estimated delinquent farm production loans
Insured commercial banks
June 30

Class of delinquent loans	1983	1984	1985	1986
	<u>Billions of dollars</u>			
Total.....	1.9	2.6	3.4	3.6
Past due 30 to 89 days and still accruing.....	.5	.6	.7	.6
Nonperforming.....	1.4	2.0	2.7	3.0
Past due 90 days or more and still accruing.....	.5	.6	.7	.6
Nonaccrual.....	.8	1.4	2.1	2.4
	<u>As percentage of outstanding farm production loans</u>			
Total.....	4.7	6.5	8.6	10.5
Past due 30 to 89 days and still accruing.....	1.3	1.5	1.7	1.7
Nonperforming.....	3.4	5.0	6.9	8.8
Past due 90 days or more and still accruing.....	1.3	1.5	1.7	1.9
Nonaccrual.....	2.1	3.5	5.2	6.9
Addendum: Nonaccrual loans at--				
Large banks*.....	4.6	6.5	8.1	11.8
Other banks.....	.9	2.3	4.2	5.3

* Large banks have total assets of \$300 million or more.

Data are estimates of national totals for farm non-real-estate loans. After 1984, estimates are based on reports from banks that hold about 92 percent of such loans. Earlier, only large banks that held about one-fourth of such loans reported nonaccrual and renegotiated farm loans; for other banks, estimates of delinquent farm loans are based on study of delinquent total loans at these banks.

Table 17

Net charge-offs of farm production loans
Insured commercial banks

Period	Estimated amount, millions of dollars	As percentage of farm loans outstanding at end of period
<u>Annual</u>		
1984.....	900	2.2
1985.....	1300	3.7
<u>Quarterly</u>		
1984-Q1.....	120	.3
-Q2.....	160	.4
-Q3.....	195	.5
-Q4.....	425	1.0
1985-Q1.....	200	.5
-Q2.....	320	.8
-Q3.....	255	.6
-Q4.....	525	1.5
1986-Q1.....	235	.7
-Q2.....	355	1.0
<u>First half of year</u>		
1984.....	280	.7
1985.....	520	1.3
1986.....	590	1.7

Data are estimates of national charge-offs of farm non-real-estate loans, based on reports from banks that hold about 94 percent of the outstanding national volume of such loans. Additional uncertainty of the estimates arises because small banks report only charge-offs of "agricultural" loans as defined by each bank for its internal purposes. Banks first reported these data on the March 1984 Report of Income.

Delinquent loans. Delinquency rates on total loans at agricultural banks have been trending upward since banks first reported these data in December 1982, as shown in figure 17. Almost all of the increase in total delinquencies has consisted of nonaccrual loans, as other past due loans rose only slightly.

Beginning in June 1985, these banks have been required to report all of their farm loan delinquencies, as also shown in the chart. Delinquency rates on total loans are below those on farm loans alone; in particular, the proportion of loans in nonaccrual status is much lower. Thus the lower delinquency rates on nonfarm loans at these banks have been helping to mitigate the adverse trend in the quality of their farm loans, indicating that even the limited diversification of loans at highly agricultural banks has helped their financial condition.

Agricultural banks with relatively high problem loans are concentrated in a dozen contiguous midwestern states--Montana, Wyoming, Colorado, Oklahoma, Kansas, Nebraska, South Dakota, North Dakota, Minnesota, Wisconsin, Iowa, and Missouri. In each of these states, the ratio of nonaccrual loans to total loans at its agricultural banks exceeded the national average of 3.1 percent on June 30, 1986 (table 18). In the lower panel of tables 18 and 19, data for Iowa are shown to illustrate the loan experience of agricultural banks in this region.

The relatively poorer loan experience of agricultural banks in this region is a relatively recent development. Two to three years ago, their average loan experience differed little from that of agricultural banks elsewhere. Since then, their relative levels of nonaccrual loans and of loan charge-offs have climbed substantially above the national averages for agricultural banks.

Figure 17

Delinquency and Charge-off Rates on Loans at Agricultural Banks

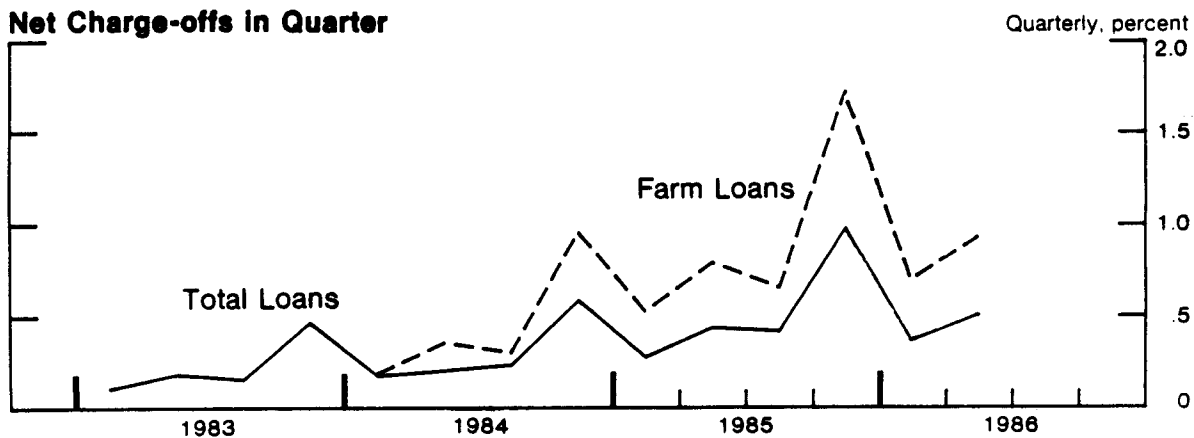
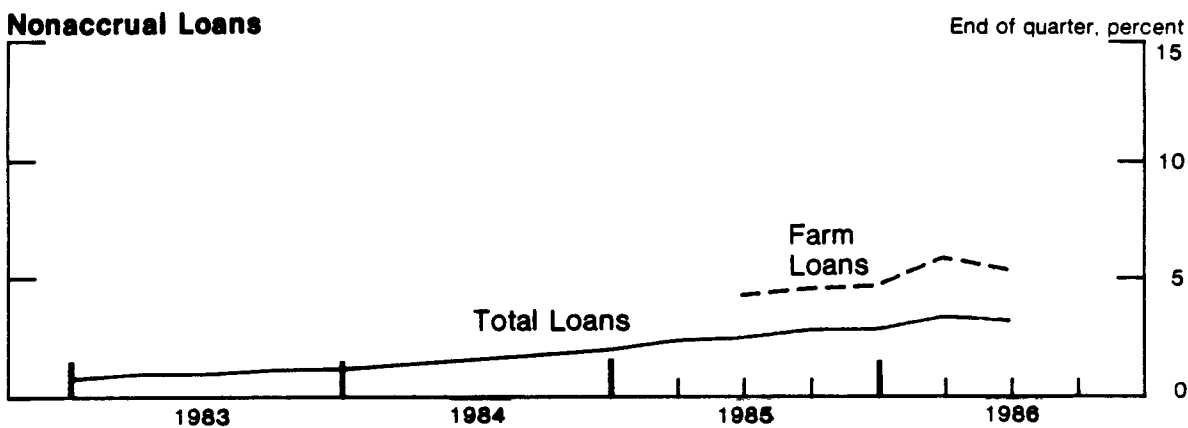
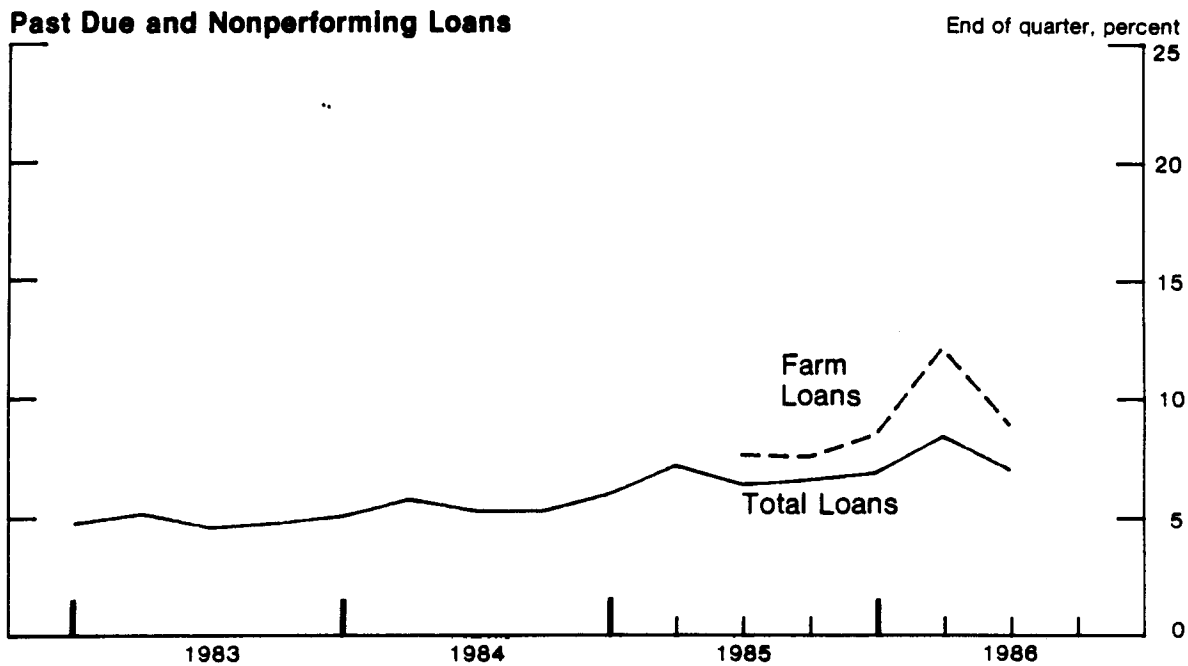


Table 18

Delinquent loans as a percentage of total loans outstanding
Agricultural banks
June 30

Type of delinquency	1983	1984	1985	1986
		<u>United States</u>		
Total.....	4.6	5.3	6.4	7.0
Past due 30 to 89 days and still accruing.....	2.0	2.1	2.2	2.2
Nonperforming.....	2.7	3.2	4.1	4.7
Past due 90 days or more and still accruing.....	1.6	1.6	1.6	1.6
Nonaccrual.....	1.0	1.6	2.5	3.1
		<u>Iowa</u>		
Total.....	4.1	5.2	6.7	7.2
Past due 30 to 89 days and still accruing.....	1.5	1.7	1.9	1.7
Nonperforming.....	2.6	3.4	4.8	5.5
Past due 90 days or more and still accruing.....	1.6	1.7	1.8	1.9
Nonaccrual.....	1.0	1.7	3.1	3.6

Agricultural banks are insured commercial banks at which the ratio of farm loans to total loans is above the unweighted average of such ratios at all insured commercial banks (16.21 percent on June 30, 1986). Farm loans were 35.2 percent of total loans at agricultural banks on June 30, 1986, and these banks held 58.6 percent of all farm loans in the banking system. Farm loans at all banks totaled \$46.4 billion, which was 3.3 percent of total loans at all banks.

Table 19

Net charge-offs as a percentage of total loans
outstanding at end of period
Agricultural banks

Area and year	First half	Full year
---------------	---------------	--------------

United States

1980.....	.07	.32
1981.....	.09	.43
1982.....	.15	.69
1983.....	.30	.93
1984.....	.39	1.22
1985.....	.72	2.12
1986.....	.86	

Iowa

1980.....		.31
1981.....		.34
1982.....		.67
1983.....		.92
1984.....		1.71
1985.....	1.31	3.49
1986.....	1.64	

Agricultural banks are defined in the note to
Table 18.

Loan losses. Total loan losses at agricultural banks nationally have been trending upward as shown in the lower panel of figure 17. As with delinquencies, losses on farm loans have been relatively greater than the losses on other loans at these banks.

At all agricultural banks, net charge-offs of all loans in 1985 averaged 2.12 percent of outstandings, compared with 1.22 percent in 1984 (table 19). In the first half of 1986, charge-offs were somewhat higher than those in the corresponding period of 1985, but the increase was much below the sharp rise of that year. During the last two years, losses at agricultural banks in the stressed midwestern region were substantially higher than at such banks nationally, as illustrated by the data for Iowa in table 19.

Variation among agricultural banks. Both delinquencies and losses are distributed unevenly among agricultural banks. Many agricultural banks have low levels of problem loans and losses, while a relatively small number have very high levels that are pulling up the average. At roughly two-thirds of the banks, relative levels of nonperforming loans and of net loan charge-offs are below the averages that have been cited.

Although still relatively small, the proportions of agricultural banks with very high levels of problem loans and of loan losses have been rising in recent years. As shown in the top panel of table 20, on June 30, 1986, nonperforming loans represented 10 percent or more of total loans at just over one-tenth of agricultural banks. The proportion of agricultural banks experiencing serious loan losses has also increased, as shown in the lower panel of the table. In 1985, one-tenth of agricultural banks charged off 5 percent or more of their total loans, and one-fourth of the banks charged off at least 2.5 percent of their loans.

Table 20

A. Distribution of agricultural banks by relative nonperforming loans

Nonperforming loans as a percentage of total loans	Percentage distribution, June 30			
	1983	1984	1985	1986
Total.....	100.0	100.0	100.0	100.0
Under 2.0.....	56.0	47.4	38.8	32.4
2.0 to 4.9.....	30.9	33.2	33.4	33.5
5.0 to 9.9.....	10.9	15.4	20.0	23.3
10.0 to 14.9.....	1.7	2.8	5.5	6.6
15.0 to 19.9.....	.4	.7	1.4	2.6
20.0 and over.....	.2	.5	.9	1.6

B. Distribution of agricultural banks by relative net charge-offs

Net charge-offs as a percentage of total loans	Percentage distribution			
	1982	1983	1984	1985
Total.....	100.0	100.0	100.0	100.0
Under 0.10.....	27.7	25.2	18.5	10.6
0.10 to 0.49.....	32.0	28.2	23.6	14.5
0.50 to 0.99.....	19.9	20.5	20.0	18.0
1.00 to 2.49.....	15.8	18.6	23.9	30.2
2.50 to 4.99.....	3.5	5.5	9.2	16.1
5.00 and over.....	1.0	2.1	4.8	10.5

Agricultural banks are defined in the note to Table 18.

Income experience of agricultural banks

Increases in loan losses and nonperforming loans have adversely affected the net income of agricultural banks. But these banks were relatively profitable for many years preceding the current difficulties. From 1970 through 1982, their average return on equity hovered between 14 and 16 percent. Within this narrow range, their most profitable years were those in which market interest rates were high and they thus reaped high rates of return on their short-term investments.

During the 1970s, loan losses at agricultural banks were very low each year--even years of general business recession--and only 1 percent of the banks reported negative earnings in any given year. In 1981, as loan charge-offs started to climb, the proportion of agricultural banks reporting negative earnings began to rise, reaching 13 percent in 1984 and 18 percent in 1985 (table 21). The average return to equity fell from 16 percent in 1980 to 6 percent in 1985. However, one-half of the banks still earned 10 percent or more on equity in 1985. And, as average net income remained positive, agricultural banks were able, through retention of earnings, to boost their capital at a faster rate than their assets were rising. As shown in the addenda to table 21, the ratio of total capital to assets thus rose from 9.2 percent in 1980 to 9.6 percent at the end of 1985.

Table 22, which shows trends since 1970 in the way agricultural banks as a group earned and disposed of their income, further documents that, apart from loan losses, these banks have coped well with the banking environment of this decade. (In table 22, all items of income, expense, and profit are expressed as a percentage of total assets. References to levels and trends of these items in the text that follows are to these ratios rather than to the aggregate dollar amounts.) Agricultural banks

Table 21

Percentage distribution of agricultural banks by rate of return to equity

Net income as percentage of average equity at bank	1977	1978	1979	1980	1981	1982	1983	1984	1985
All banks.....	100	100	100	100	100	100	100	100	100
Negative.....	1	1	1	1	2	4	7	13	18
0 to 4.....	4	3	2	2	3	5	7	9	11
5 to 9.....	16	14	8	9	12	15	18	23	22
10 to 14.....	45	46	36	33	33	33	36	36	33
15 to 19.....	28	28	38	35	32	28	24	15	13
20 to 24.....	5	6	12	14	13	11	7	3	3
25 and over.....	1	1	3	5	6	4	2	1	1
<u>Addenda:</u>									
Average rate of return to equity (percent).....	14	14	15	16	15	14	11	8	6
Net charge-offs as percentage of total loans....	.2	.2	.2	.3	.4	.7	.9	1.2	2.1
Average capital ratio, Dec. 31 (percent)*.....	8.7	8.9	9.0	9.2	9.2	9.3	9.4	9.5	9.6

* Total primary and secondary capital (items available in bank reports as of the date specified) as a percentage of total assets.

Agricultural banks are defined in the note to Table 18.

performed well during the introduction of money market certificates of deposit in the late 1970s, even though this innovation led to a marked increase in their interest expense when interest rates rose in national money markets and depositors shifted funds into these certificates. The banks increased their interest income even more rapidly, helped in 1980 and 1981 by relatively high yields on those assets invested in short-term securities. After 1981, their net interest margin declined toward the level that prevailed before the unusually profitable 1980-81 period; that is, interest received fell somewhat more than interest paid to depositors. (Tables 23 and 24 provide data on interest rates charged on non-real-estate farm loans made by all banks).

After factoring in noninterest income and expenses, which are both less important at agricultural banks than at other banks, relative total net income before provision for loan losses also declined somewhat from its peak in 1980. But the provision for loan losses increased sharply after 1980, reaching 1.2 percent of assets in 1985, and before-tax income felt the full brunt of that increase. Average income taxes fell almost to zero in 1985 as many agricultural banks received refunds under the provision that permits banks to carry losses back as much as 10 years on their federal tax returns. In effect, therefore, the reduction in income taxes absorbed roughly one-third of the increase in loan losses. Thus, although after-tax income fell considerably from its peak in 1980, it remained high enough to permit the agricultural banks to pay dividends to their stockholders at the rate in effect since 1981. (On average, even the agricultural banks with operating losses paid dividends in 1985, although at less than half the rate of the banks with operating profits.) By 1985, however, the margin by which dividends were covered was slim, and so the banks added relatively little in retained earnings to their capital.

Table 22

Income, expenses, and profits of agricultural banks as a percentage of total assets

Item	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985
Interest income.....	5.5	5.4	5.1	5.2	6.4	6.3	6.6	6.7	7.0	7.8	9.3	11.0	11.4	10.3	10.6	10.0
Less: Interest expense.....	2.1	2.3	2.3	2.5	3.0	3.1	3.3	3.4	3.6	4.1	5.3	7.1	7.5	6.5	6.9	6.2
Equals: Net interest margin.....	3.3	3.2	2.8	2.7	3.5	3.2	3.3	3.3	3.5	3.7	4.0	4.0	3.9	3.8	3.7	3.8
Plus: Noninterest income.....	.4	.4	.3	.3	.3	.3	.3	.3	.4	.4	.4	.5	.5	.5	.5	.5
Less: Noninterest expense, excluding loan losses..	2.2	2.2	2.1	2.0	2.1	2.2	2.2	2.2	2.3	2.3	2.4	2.5	2.6	2.6	2.6	2.7
Equals: Net income before loan losses.....	1.5	1.4	1.2	1.5	1.7	1.4	1.4	1.4	1.6	1.8	2.0	1.9	1.8	1.7	1.6	1.7
Less: Provision for loan losses.....	.1	.1	.1	.1	.1	.1	.1	.1	.2	.2	.2	.3	.4	.6	.8	1.2
Equals: Net income before taxes.....	1.4	1.2	1.1	1.4	1.5	1.3	1.3	1.3	1.4	1.5	1.7	1.6	1.4	1.1	.8	.6
Less: Income taxes.....	.4	.3	.3	.4	.4	.3	.2	.3	.3	.3	.4	.4	.3	.2	.1	.0
Equals: Net income.....	.8	.9	.9	1.0	1.1	1.0	1.1	1.0	1.1	1.2	1.3	1.2	1.1	1.0	.7	.5
Less: Cash dividends.....	.3	.3	.2	.2	.2	.2	.3	.2	.3	.3	.3	.4	.4	.4	.4	.4
Equals: Retained earnings.....	.7	.7	.7	.8	.9	.8	.8	.8	.8	.9	.9	.8	.7	.6	.3	.1

Table 23

Average effective interest rate on non-real-estate farm loans
made by commercial banks
(percent)

Period	All banks	Large banks	Other banks
<u>Annual</u>			
1977.....	8.8	8.5	9.0
1978.....	9.6	10.2	9.4
1979.....	11.9	13.6	11.4
1980.....	15.2	16.2	15.0
1981.....	18.5	19.8	18.1
1982.....	16.7	16.1	17.0
1983.....	13.5	12.1	14.1
1984.....	14.1	13.1	14.4
1985.....	12.8	11.2	13.4
<u>Quarterly</u>			
1983-Q1.....	13.8	12.5	14.1
-Q2.....	13.2	12.0	13.9
-Q3.....	13.6	12.2	14.1
-Q4.....	13.6	11.8	14.2
1984-Q1.....	13.5	12.2	14.1
-Q2.....	14.2	13.3	14.5
-Q3.....	14.8	14.4	14.9
-Q4.....	14.2	13.4	14.4
1985-Q1.....	13.2	11.7	13.8
-Q2.....	13.0	11.5	13.6
-Q3.....	12.3	10.6	12.9
-Q4.....	12.3	10.6	13.1
1986-Q1.....	12.0	10.3	12.8
-Q2.....	11.5	9.7	12.0
-Q3.....	11.4	9.3	12.1

Effective rates shown are estimates from the Federal Reserve survey of terms of bank lending to farmers.

In recent quarters, most "large banks" (survey strata 1 to 3) had over \$600 million in total assets, and most "other banks" (survey strata 4 to 6) had total assets below \$600 million.

Table 24

Percentage distribution of non-real-estate farm loans made by banks,
by effective interest rate

Effective interest rate (percent)	August										Aug. 1985	Nov. 1985	Feb. 1986	May 1986	Aug. 1986
	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986					
All loans.....	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100
Under 6.0.....	1	-	-	-	-	-	-	-	-	-	-	-	-	-	-
6.0 to 6.9.....	1	-	-	-	-	-	-	-	-	-	-	-	-	-	-
7.0 to 7.9.....	11	-	-	-	-	-	-	-	-	-	1	-	-	1	1
8.0 to 8.9.....	48	20	2	-	-	-	-	-	3	11	3	1	8	6	11
9.0 to 9.9.....	34	50	11	-	-	-	-	-	9	15	9	16	5	12	15
10.0 to 10.9...	4	22	29	1	-	-	4	-	12	12	12	7	7	11	12
11.0 to 11.9...	-	6	33	10	-	1	8	-	13	16	13	13	21	33	16
12.0 to 12.9...	-	1	14	17	1	7	22	4	18	25	18	21	23	22	25
13.0 to 13.9...	-	-	7	43	-	1	20	16	36	16	36	33	33	13	16
14.0 to 14.9...	-	-	5	19	1	2	35	32	6	3	6	7	7	2	3
15.0 to 15.9...	-	-	1	9	2	11	8	42	1	1	1	1	1	-	1
16.0 to 16.9...	-	-	-	1	5	23	1	5	1	-	1	-	-	-	-
17.0 to 17.9...	-	-	-	1	14	30	-	-	-	-	-	-	-	-	-
18.0 to 18.9...	-	-	-	-	16	21	-	-	-	-	-	-	-	-	-
19.0 to 19.9...	-	-	-	-	28	2	-	-	-	-	-	-	-	-	-
20.0 to 20.9...	-	-	-	-	11	1	-	-	-	-	-	-	-	-	-
21.0 to 21.9...	-	-	-	-	7	-	-	-	-	-	-	-	-	-	-
22.0 to 22.9...	-	-	-	-	6	-	-	-	-	-	-	-	-	-	-
23.0 to 23.9...	-	-	-	-	3	-	-	-	-	-	-	-	-	-	-
24.0 to 24.9...	-	-	-	-	3	-	-	-	-	-	-	-	-	-	-
25.0 and over..	-	-	-	-	3	-	-	-	-	-	-	-	-	-	-

Percentage distribution of the total dollar amount of non-real-estate farm loans of \$1,000 or more made by insured commercial banks during the week covered by the survey, which is the first full business week of the month specified.

Data are estimates from the Federal Reserve survey of terms of bank lending to farmers.

At 9.6 percent of assets, however, the average capital ratio at agricultural banks is about a full percentage point above that at other small banks. Furthermore, average capital ratios are higher (and have been rising most rapidly) at the more heavily agricultural of the agricultural banks. Total capital averages over 10 percent of assets at banks at which more than half of loans are farm loans.

The favorable capital position provides a valuable cushion for coping with adverse loan experience. But if a bank experiences relatively large loan losses in a short period of time and thus cannot cover them from current earnings, the capital of the bank can be depleted rapidly. At agricultural banks, loans average roughly 50 percent of assets and capital about 10 percent of assets; therefore, loan losses equal to about one-fifth of outstanding loans would, on average, exhaust all capital. Increasing numbers of agricultural banks have encountered such loan experience, and the number of failures has risen.

Agricultural bank failures

The number of agricultural bank failures first became conspicuous during the spring and summer of 1984. In most quarters since, they have represented more than half of all failures of commercial banks (table 25). The agricultural banks that have failed have been relatively small in size, however, and thus these failures generally have affected only the immediate communities. The 68 agricultural banks that failed in 1985 had, on average, total assets of \$21 million, only two-thirds the average size of all agricultural banks and only one-eighth the average size of all commercial banks. Only 3 had assets of more than \$50 million, while 23 had assets of less than \$10 million. Thus, although agricultural banks accounted for

Table 25

Agricultural bank failures and farm loans at failed commercial banks

Period	Number of bank failures			Farm loans at all failed banks	
	Total	Agricultural banks	Agricultural as percentage of total	Millions of dollars	As percentage of total loans
<u>Annual</u>					
1981.....	7	1	14	3	4
1982.....	35	11	31	49	3
1983.....	45	7	16	62	2
1984.....	78	32	41	199	10
1985.....	118	68	58	459	19
1986*.....	126	62	49	646	13
<u>Quarterly</u>					
1981-Q1...	3	1	33		
-Q2...	1	0	0		
-Q3...	1	0	0		
-Q4...	2	0	0		
1982-Q1...	5	2	40		
-Q2...	10	3	30		
-Q3...	11	3	27		
-Q4...	9	3	33		
1983-Q1...	11	1	9		
-Q2...	15	1	7		
-Q3...	12	2	17		
-Q4...	7	3	43		
1984-Q1...	13	3	23		
-Q2...	30	7	23		
-Q3...	17	10	59		
-Q4...	18	12	67		
1985-Q1...	20	12	60		
-Q2...	32	21	66		
-Q3...	33	17	52		
-Q4...	33	18	55		
1986-Q1...	26	14	54	84	10
-Q2...	38	15	39	162	14
-Q3...	42	23	55	318	13

* Data through November 15, 1986. Data for 1986 include three banks assisted to prevent closing. Agricultural banks are defined in the note to Table 18.

nearly three-fifths of bank failures last year, their assets were less than two-fifths of the assets at all failed banks. For the same reason, farm loans constituted only one-fifth of the total loans at all of the banks that failed--about \$460 million of the total loans of \$2.4 billion at failed banks.

In 1986, deterioration in the quality of several classes of nonfarm loans, particularly energy and commercial real estate loans, has reduced the relative importance of agricultural banks and farm loans in the data on bank failures. Through November 15, there have been 62 failures of agricultural banks, and thus the total number of such failures in 1986 is likely to be about the same as in 1985. Agricultural banks have accounted for 49 percent of bank failures, down from 59 percent last year. And, farm loans have constituted only 13 percent of total loans at all failed banks, compared with 19 percent in 1985 (table 25).

Disruption of borrower relationships. Problems faced by farm borrowers when their bank fails have been well documented by the rural media. Even borrowers in relatively good financial condition experience some inconvenience, at the least, as they must document their financial position and history to new and understandably wary lenders. But the failure is likely to pose a very serious problem for borrowers whose loans are delinquent or who are in a weak financial condition. Such borrowers may find it difficult, if not impossible, to find a new lender. Often, the FDIC faces the unpleasant task of foreclosing on their loans.

Community disruption. Because most deposits at agricultural banks are fully insured, most failures of such banks have minimal disruptive effects on the community at large. In most cases the FDIC is able to arrange an acquisition or merger and the offices of the failed bank are

reopened immediately. Local disruption is greater when the FDIC is unable to arrange for another bank or a new bank to take over the deposits and the good loans and other assets immediately after the failure occurs. Both depositors and borrowers must then seek new banking relationships. There were 22 cases of such deposit payoffs in 1985 (including 17 agricultural banks), and 21 in 1986 through November 15 (including 10 agricultural banks).

Observers have expressed most concern about cases of failure and deposit payoff at the only bank in a community, which causes immediate general disruption and has a longer-term negative effect if the bank is not replaced. However, such cases have occurred only in very small communities--which helps to explain why the FDIC did not find anyone interested in continuing or establishing a bank or branch office. In 1985, when there were 12 such deposit payoffs (11 were agricultural banks), the populations of the communities involved ranged from 80 to 600, and the combined population of all 12 communities was only 4,200. In 1986, through November 15, there have been only 7 cases of deposit payoff after failure of the only bank in the community. Five were agricultural banks in communities whose populations ranged from 100 to 440. Two were nonagricultural banks in rural towns with populations of about 1,000 and 2,000, respectively. A phone call to a reporter at the local paper in the latter town (how satisfying to turn the tables on the press!) indicated that (1) unusually large amounts of nonlocal deposits and nonlocal problem loans probably made the failing bank an unattractive acquisition, and (2) another bank opened a branch in the town immediately after the failure occurred, and thus local banking services were continued. The latter event, not mentioned in the FDIC's press release announcing the failure, raises the possibility that a similar event may have occurred in some of

the other 18 communities in which a sole bank failed during the last two years.

Potential community benefits. Rural communities that have retained local banking services after their economic life has been disrupted by a bank failure may experience some future recompense. In making good on the deposits of the bank that failed, the FDIC uses its insurance fund to replace the bad loans in the bank's portfolio. Thus the local bank or banks that receive the deposits also receive good assets to back those deposits, often including substantial amounts in cash. Such banks are thus placed in better position to consider future lending opportunities as they arise and to use future earnings to increase their capital and to improve their banking services. In contrast, had the troubled bank managed to survive, some of the banking resources of the community would have remained tied up in the old, poorly performing loans, and some future bank earnings would have been dedicated to covering losses on those loans.

Vulnerable banks

In recent years, a large majority of the banks that failed had earlier reported a relatively high level of delinquent loans. The ratio of nonperforming loans to total capital seems a particularly appropriate indicator of the possibility that a bank may fail because of large loan losses--depending, of course, on what proportion of the nonperforming loans cannot be collected. Table 26 shows that more agricultural banks have been moving into vulnerable positions as indicated by this ratio. However, most agricultural banks remain in relatively good position; at two-thirds of the banks, nonperforming loans amounted to less than one-fourth of total capital on June 30, 1986. At 197 agricultural banks and 167 other banks,

Table 26

Distribution of agricultural banks by ratio of nonperforming loans to total capital

Nonperforming loans as a percentage of total capital	Percentage distribution, June 30			
	1983	1984	1985	1986
All banks.....	100.0	100.0	100.0	100.0
Under 25.....	83.6	76.3	69.0	66.6
25 to 49.....	12.5	16.3	19.6	19.4
50 to 74.....	2.3	4.4	6.1	6.8
75 to 99.....	.9	1.6	2.3	3.0
100 to 124.....	.3	.6	1.3	1.4
125 to 149.....	.1	.3	.8	.8
150 to 174.....	*	.2	.4	.6
175 to 199.....	.1	.1	.2	.3
200 and over**.....	.2	.2	.4	1.0

* Less than 0.05 percent.

** Includes banks with negative capital.

nonperforming loans exceeded total capital; banks in this position are herein called "vulnerable banks." Their number has been trending upward, as shown in the middle panel of figure 18. And, as long the number of vulnerable banks continues to rise, it is likely that the number of failures (shown in the lower panel) may also tend to increase.

Although agricultural banks account for over half of all vulnerable banks, the other vulnerable banks tend to be much larger. Thus, as shown in the last column of table 27, farm loans constituted only 10 percent of total loans at all vulnerable banks on June 30, 1986. Farm loans totaled \$1.5 billion, whereas other loans totaled \$12.4 billion.

In 5 of the 11 states with ten or more vulnerable banks--California, Colorado, Louisiana, Oklahoma, and Texas--the low average farm loan ratio at vulnerable banks indicates that farm credit problems were not the main factor in the loan problems being experienced by these banks. Farm loans were less than a tenth of total loans at vulnerable banks in each of the five states--Alaska, California, Louisiana, Oklahoma, and Texas--in which such banks held significantly more than \$500 million in total loans. Thus, in terms of dollar amounts rather than number of individual banks, vulnerable nonagricultural banks overshadow their agricultural counterparts.

Trends in the number of vulnerable banks are shown in table 28. During the year ended June 30, 1986, the increase in the number of vulnerable agricultural banks slowed to 53 banks, compared with an increase of 76 banks during the preceding 12-month period. In contrast, the increase in the number of other vulnerable banks doubled, from 27 banks to 55 banks. The amounts of loans at these banks exhibited parallel changes, as shown in the addendum to table 28.

Figure 18

Number of Vulnerable Banks and Bank Failures

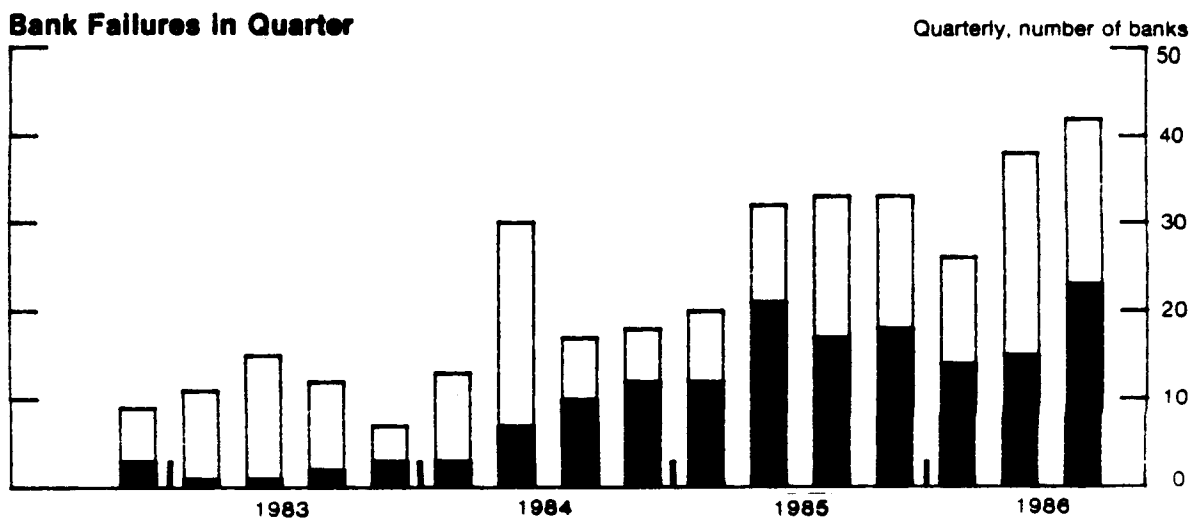
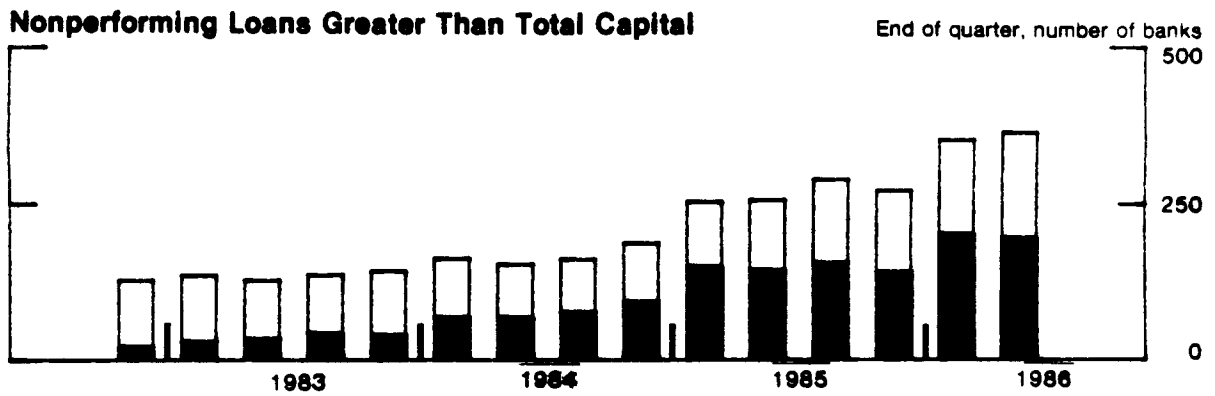
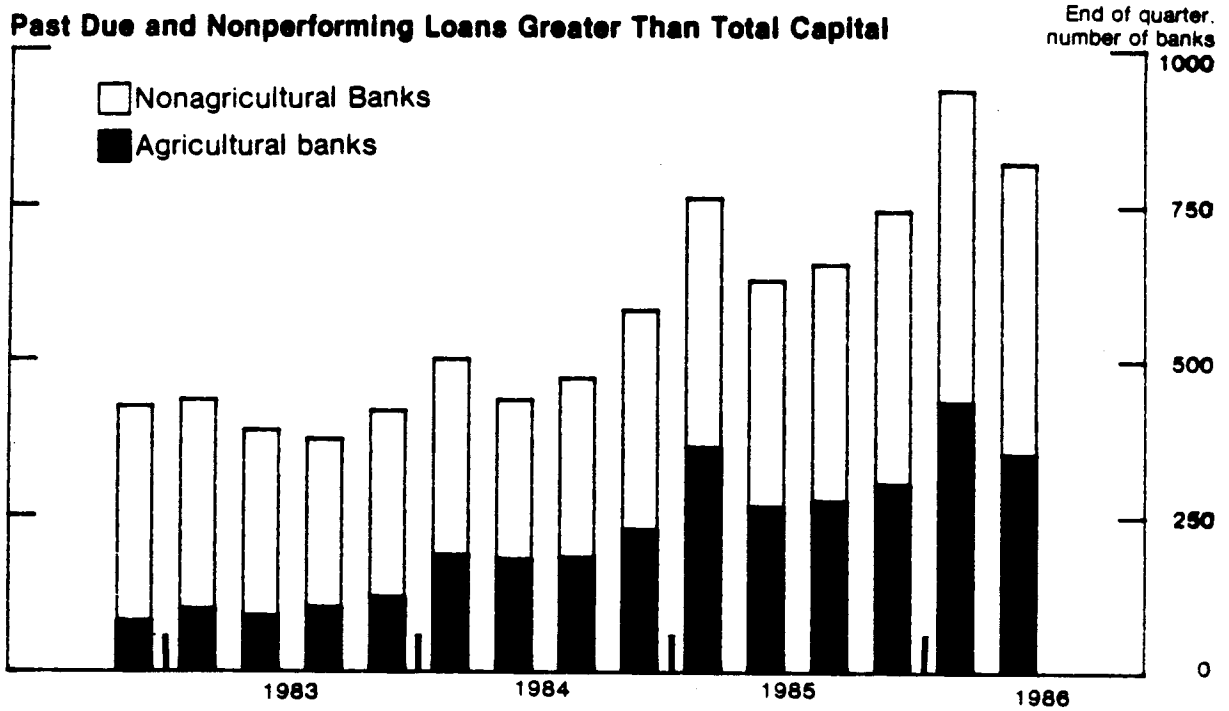


Table 27

Banks at which nonperforming loans exceeded total capital
June 30, 1986

State	Number of banks	As percentage of all banks in state	Loans at these banks (millions of dollars)		Farm loans as percentage of total loans
			Total	Farm	
United States....	364	2	13,899	1,452	10
Alabama.....	1	*	10	1	7
Alaska.....	4	25	1,129	3	*
Arizona.....	-	-	-	-	-
Arkansas.....	1	*	16	8	49
California.....	18	4	1,756	18	1
Colorado.....	21	5	333	31	9
Connecticut.....	-	-	-	-	-
Delaware.....	-	-	-	-	-
D. C.....	-	-	-	-	-
Florida.....	5	1	368	1	*
Georgia.....	1	*	7	*	*
Hawaii.....	-	-	-	-	-
Idaho.....	1	4	71	16	22
Illinois.....	7	1	123	52	42
Indiana.....	6	2	120	34	28
Iowa.....	24	4	466	203	44
Kansas.....	19	3	277	93	34
Kentucky.....	3	1	39	7	17
Louisiana.....	22	7	957	47	5
Maine.....	-	-	-	-	-
Maryland.....	-	-	-	-	-
Massachusetts....	-	-	-	-	-
Michigan.....	2	1	230	59	26
Minnesota.....	42	6	501	184	37
Mississippi.....	1	1	20	3	16
Missouri.....	21	3	330	93	28
Montana.....	13	8	175	54	31
Nebraska.....	14	3	208	106	51
Nevada.....	1	6	14	-	-
New Hampshire....	-	-	-	-	-
New Jersey.....	1	1	38	-	-
New Mexico.....	6	6	368	29	8
New York.....	-	-	-	-	-
North Carolina...	-	-	-	-	-
North Dakota.....	7	4	92	47	51
Ohio.....	1	*	-	-	-
Oklahoma.....	38	7	1,714	156	9
Oregon.....	3	5	33	3	10
Pennsylvania.....	-	-	-	-	-
Rhode Island.....	-	-	-	-	-
South Carolina...	-	-	-	-	-
South Dakota.....	9	7	98	59	60
Tennessee.....	3	1	110	12	11
Texas.....	56	3	3,872	72	2
Utah.....	2	3	22	3	16
Vermont.....	-	-	-	-	-
Virginia.....	-	-	-	-	-
Washington.....	2	2	32	11	33
West Virginia....	-	-	-	-	-
Wisconsin.....	3	1	45	24	52
Wyoming.....	7	6	323	25	8

* Less than 0.5

Table 28

Number of banks at which nonperforming loans exceeded total capital
June 30

State	All banks				Agricultural banks				Nonagricultural banks			
	1983	1984	1985	1986	1983	1984	1985	1986	1983	1984	1985	1986
United States....	127	153	256	364	34	68	144	197	93	85	112	167
Alabama.....	-	-	-	1	-	-	-	-	-	-	-	1
Alaska.....	-	-	1	4	-	-	-	-	-	-	1	4
Arizona.....	1	-	-	-	-	-	-	-	1	-	-	-
Arkansas.....	2	6	1	1	1	2	1	1	1	2	-	-
California.....	16	6	10	18	-	-	-	1	16	6	10	17
Colorado.....	2	8	17	21	1	5	6	9	1	3	11	12
Connecticut.....	-	-	-	-	-	-	-	-	-	-	-	-
Delaware.....	-	-	-	-	-	-	-	-	-	-	-	-
D. C.....	-	-	-	-	-	-	-	-	-	-	-	-
Florida.....	1	5	5	5	-	1	-	-	1	4	5	5
Georgia.....	1	-	1	1	1	-	-	-	-	1	1	1
Hawaii.....	-	1	-	-	-	-	-	-	-	1	-	-
Idaho.....	1	-	1	1	-	-	1	1	1	-	-	-
Illinois.....	14	7	4	7	2	2	4	6	12	5	-	1
Indiana.....	2	5	7	6	-	2	4	5	2	3	3	1
Iowa.....	4	6	16	24	4	5	16	23	-	1	-	1
Kansas.....	3	6	18	19	2	5	15	18	1	1	3	1
Kentucky.....	5	2	4	3	3	-	2	2	2	2	2	1
Louisiana.....	6	7	19	22	-	1	3	5	6	6	16	17
Maine.....	-	-	-	-	-	-	-	-	-	-	-	-
Maryland.....	-	-	-	-	-	-	-	-	-	-	-	-
Massachusetts.....	-	-	-	-	-	-	-	-	-	-	-	-
Michigan.....	2	1	2	2	1	1	2	2	1	-	-	-
Minnesota.....	6	6	20	42	1	2	17	35	5	4	3	7
Mississippi.....	1	-	1	1	-	-	-	-	1	-	1	1
Missouri.....	2	8	16	21	2	7	15	20	-	1	1	1
Montana.....	4	3	8	13	3	3	6	10	1	-	2	3
Nebraska.....	4	15	17	14	4	15	17	14	-	-	-	-
Nevada.....	-	-	-	1	-	-	-	-	-	-	-	1
New Hampshire.....	-	-	-	-	-	-	-	-	-	-	-	-
New Jersey.....	2	-	1	1	-	-	-	-	2	-	1	1
New Mexico.....	-	-	4	6	-	-	-	1	-	-	4	5
New York.....	2	-	1	-	-	-	-	-	2	-	1	-
North Carolina.....	-	-	-	-	-	-	-	-	-	-	-	-
North Dakota.....	1	1	4	7	1	1	4	6	-	-	-	1
Ohio.....	-	2	1	-	-	-	-	-	-	2	1	-
Oklahoma.....	6	8	17	38	2	2	9	11	4	6	8	27
Oregon.....	5	7	2	3	1	3	1	2	4	4	1	1
Pennsylvania.....	-	1	1	-	-	1	1	-	-	-	-	-
Rhode Island.....	-	-	-	-	-	-	-	-	-	-	-	-
South Carolina.....	-	-	-	-	-	-	-	-	-	-	-	-
South Dakota.....	-	2	3	9	-	2	3	9	-	-	-	-
Tennessee.....	14	17	7	3	1	2	2	1	13	15	5	2
Texas.....	5	9	22	56	1	-	4	9	4	9	18	47
Utah.....	3	4	5	2	1	2	-	1	2	2	5	1
Vermont.....	1	-	-	-	-	-	-	-	1	-	-	-
Virginia.....	1	2	-	-	-	-	-	-	1	2	-	-
Washington.....	3	-	2	2	-	-	1	1	3	-	1	1
West Virginia.....	1	1	1	-	-	-	-	-	1	1	1	-
Wisconsin.....	3	5	9	3	2	4	9	3	1	1	-	-
Wyoming.....	3	4	8	7	-	-	1	1	3	4	7	6
Addendum												
Loans at these banks, U.S., billions of dollars:												
Farm.....	.5	.6	1.1	1.5	.2	.5	1.0	1.3	.2	.1	.1	.2
Total.....	12.3	4.7	7.5	13.9	.6	1.1	2.3	3.1	11.7	3.6	5.2	10.8

Agricultural banks are defined in the note to Table 18.

In the year ended June 30, 1986, the number of vulnerable agricultural banks doubled in Minnesota, while many states shared the rest of the national increase. Minnesota's 35 vulnerable agricultural banks placed it well above other states with double-digit totals--Iowa (23), Missouri (20), Kansas (18), Nebraska (14), Oklahoma (11), and Montana (10). Oklahoma and Texas showed striking increases in the number of vulnerable nonagricultural banks, while California and Minnesota showed smaller gains. These four states accounted for virtually all of the national increase in the number of vulnerable nonagricultural banks. In total number of all vulnerable banks, Texas led with 56 banks (including only 9 agricultural banks), followed by Minnesota (42 total, 35 agricultural) and Oklahoma (38 total, 11 agricultural).

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