Chapter 4: Notable Lending Strengths of Community Banks

Community banks provide their local communities with valuable products and services, including offering various loan products to business owners and developers, small businesses, and farms. As discussed in Chapter 3, community banks are successful in areas that are experiencing a population inflow—areas filled with local small businesses. But community banks also continue to meet the credit needs of less economically vibrant areas, such as rural counties experiencing population outflows. Community banks tend to focus on loans as relationships, originating loans that require local knowledge, a greater personal touch, individual analysis, and continued administration rather than loans that can be made according to a formula.

In this chapter, we discuss three lending areas that are particularly important for community banks: CRE lending, small business lending, and agricultural lending. Though by definition community banks tend to be relatively small, in each of these areas their lending far exceeds their aggregate lending share: community banks represent 15 percent of the industry's total loans but 30 percent of its CRE loans, 36 percent of small business loans, and 70 percent of agricultural loans.

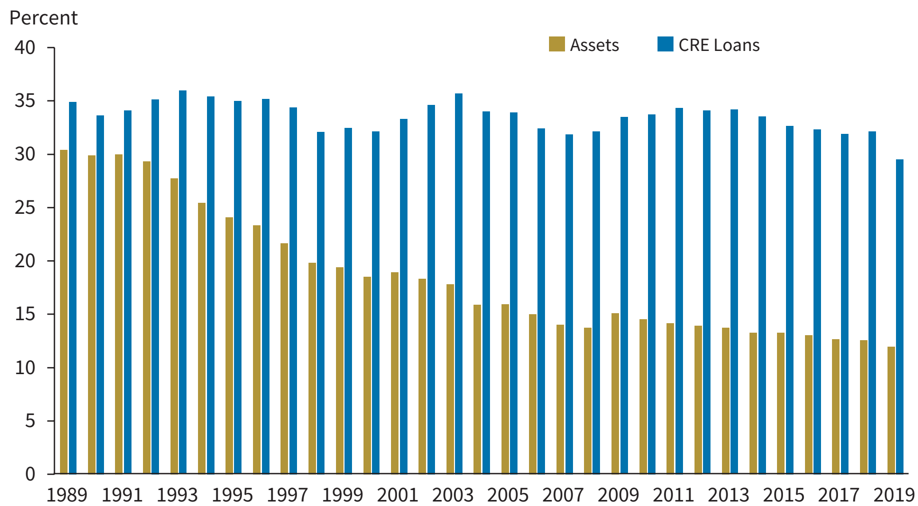
CRE Lending

Throughout the United States CRE lending is an important function performed by banks of all sizes, including community banks. As of year-end 2019, banks held $2.3 trillion in CRE loans, an amount that gave them a significant presence in the broader financial industry. Community banks in aggregate held almost one-third of this amount—$690 billion—despite having only a small share (12 percent) of the banking industry's total assets. Moreover, as Chart 4.1 indicates, community banks' share of CRE loans has been relatively stable since 1989 even while their share of total banking industry assets was declining.

Community banks' participation in CRE lending is widespread. Almost all 4,750 community banks hold at least some CRE loans, and many have substantial CRE loan portfolios. More than one-fifth of community banks have CRE loan portfolios equal to or greater than three times their amount of capital—above the share of community banks that have substantial portfolios in any other loan type.

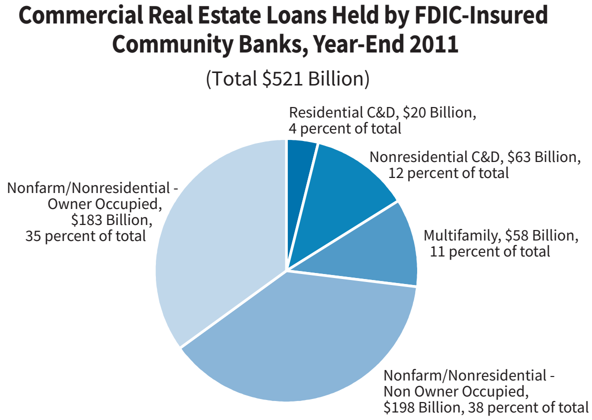
Chart 4.1

Community Banks' Share of the Banking Industry's Assets and CRE Loans, 1989 to 2019



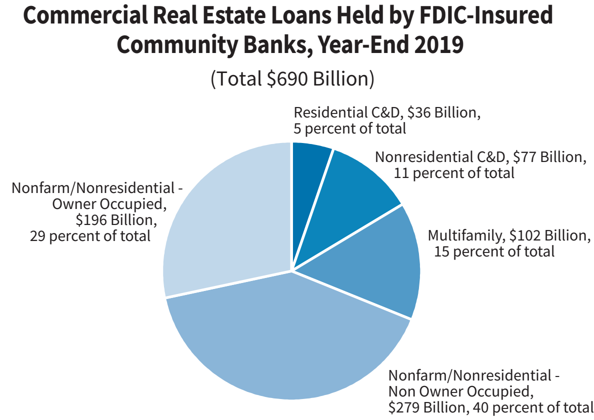
Source: FDIC.

Chart 4.2



Source: FDIC.
Note: C&D stands for acquisition, construction, and development loans.

Chart 4.3



Source: FDIC.
Note: C&D stands for acquisition, construction, and development loans.

Community banks provide various types of CRE financing. Charts 4.2 and 4.3 show the types of loans that constituted total CRE loans held by community banks at the time of the 2012 FDIC Community Banking Study (year-end 2011) and as of year-end 2019. The three main components of CRE loans are loans secured by nonfarm, nonresidential properties; loans for the acquisition, construction, and development of real estate (C&D); and loans secured by multifamily properties. Loans secured by nonfarm, nonresidential properties are further divided into two groups according to whether the property is occupied by an owner or by a non-owner. C&D loans are further divided into two groups according to whether they are secured by nonresidential construction projects or by 1–4 family residential projects.

Between 2011 and 2019, the balance of CRE loans held by community banks increased from $521 billion to $690 billion. Although all types of CRE loans grew in dollar amounts, the mix shifted toward multifamily loans, that is, loans secured by rental properties.[1]

Multifamily loans represented 11 percent of community banks' CRE loans in 2011 and rose to 15 percent in 2019. This shift reflects growth in multifamily lending in the broader financial industry during a period when multifamily living became increasingly popular. Nonfarm, nonresidential loans represented 73 percent of CRE loans in 2011 and dropped to 69 percent in 2019. And as the chart shows, nonfarm, nonresidential loans shifted toward those secured by non-owner-occupied properties. This shift suggests an increased focus on the financing of investor-owned properties as opposed to owner-occupied properties, that is, properties whose owners use the property to operate a business. Loans to finance construction of properties increased only modestly in dollar amount between 2011 and 2019; the modest increase likely reflects moves away from this type of lending in the wake of the construction-loan stress experienced by many banks during the Great Recession.[2] Between 2011 and 2019, construction loans' share of community banks' total CRE loans remained steady at 16 percent.

Community Banks Are Active Lenders Across the Spectrum of CRE Industries and Are Key Lenders in Small Communities

Banks' Call Reports categorize CRE loans by segment, such as the three just discussed: multifamily property loans; C&D loans; and nonfarm, nonresidential loans. This categorization provides some insight into the type of property that secures a CRE loan, but for banks' portfolios of nonfarm, nonresidential loans—that is, CRE loans that are not multifamily or C&D loans—the Call Report does not indicate the type of business or industry that uses the existing commercial property.

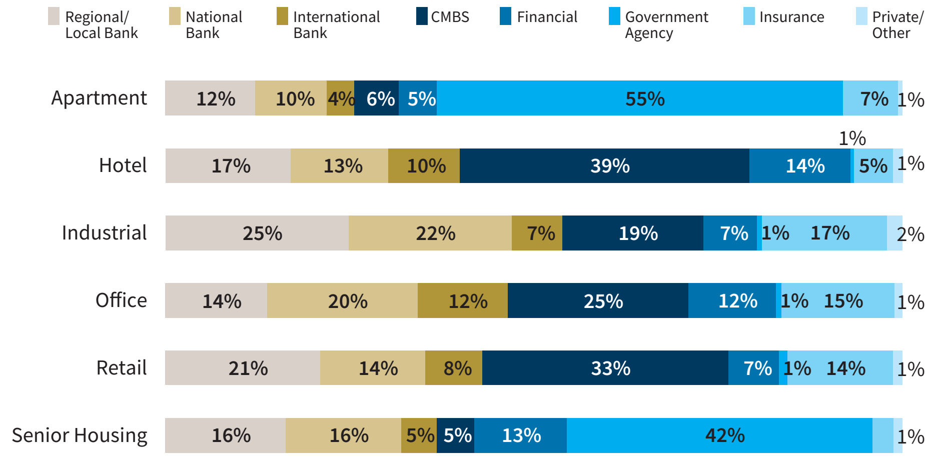
Other CRE industry data, however, suggest that regional and local banks, many of which are similar in profile to community banks, are active lenders to multiple industries. According to real estate firm Real Capital Analytics, regional and local banks lend across the

[1] Multifamily loans are those secured by properties with five or more housing units.

[2] Banks that held high levels of C&D loans before the Great Recession failed at a higher rate than those that did not *(2012 FDIC Community Banking Study* pp. 5–15).

Chart 4.4

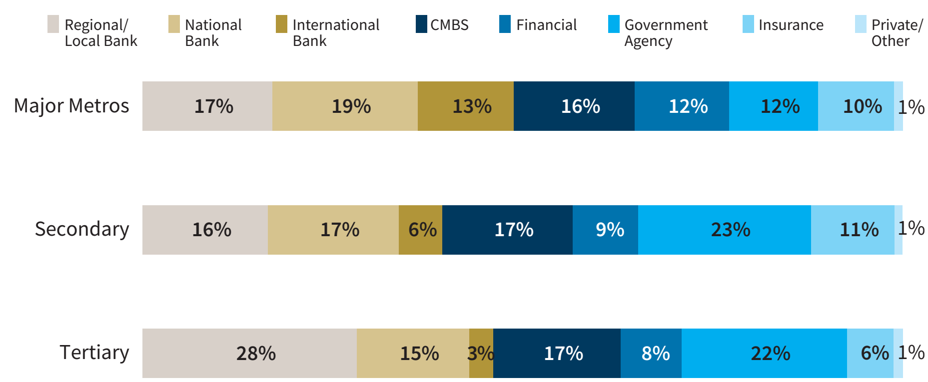
CRE Loan Origination Market Share by Lender Type and Industry, 2012 to 2019



Source: Real Capital Analytics.
Note: Financial includes financing companies, mortgage real estate investment trusts, and institutional debt funds.

Chart 4.5

Shares of CRE Loan Originations in Major Metro, Secondary, and Tertiary Markets by Lender Type, 2019



Source: Real Capital Analytics.
Note: Real Capital Analytics bases its market size categorizations on the amount of lending in a given market, not on population. Financial includes financing companies, mortgage real estate investment trusts, and institutional debt funds.

spectrum of industries that operate CRE. Chart 4.4 shows the distribution of CRE loan originations from 2012 through 2019 according to use of the underlying property. Regional and local banks' market share has been significant in several property types, including industrial and retail. During the period covered, these banks originated 25 percent and 21 percent of the dollar volume of industrial and retail loans originated, respectively—notable market shares, given the range of industry lenders.

In addition to lending across industry types, community banks have been active CRE lenders across all sizes of markets, and are particularly prominent in smaller communities. According to Call Report data, community banks headquartered in rural areas and small metropolitan areas in 2019 held 67 percent of CRE loans held by all banks headquartered in those smaller geographic areas. In larger metropolitan areas, the share of CRE loans held by community banks is lower, but still material: 28 percent of total CRE loans of all banks headquartered in these areas.

In contrast, community banks' share of non-CRE loans is only 9 percent.[3]

Although Call Report data are based on the location of a bank's headquarters rather than the location of the property securing the loan, other CRE industry data are based on property location and they, too, suggest that banks similar in profile to community banks are significant sources of CRE financing in smaller markets. As Chart 4.5 shows, according to Real Capital Analytics, regional and local banks provided 28 percent of CRE financing in smaller markets in 2019, a material market share compared with the shares of other lenders.[4]

Community Banks Became More Involved in Multifamily Property Lending After the Previous Study

By year-end 2019, the volume of multifamily mortgage loans had almost doubled from its level in 2011.[5] At year-end 2019 multifamily mortgage loans in the United States totaled $1.6 trillion. These loans are held by various intermediaries such as banks and life insurance companies, and are also held in agency commercial-mortgage-backed securities. Significant growth in multifamily mortgage loans reflects the increase in multifamily housing stock, and the increase in preference for renting following the Great Recession and its associated housing crisis. Nationally, from 2011 to 2019 the number of renter households grew more than 13 percent, while owner households increased only 6 percent.[6]

As the volume of multifamily loans industry-wide grew, the share held by banks kept pace. These institutions held approximately one-third of the $1.6 trillion in multifamily mortgages outstanding at year-end 2019, up slightly from 2011. As of year-end 2019 community banks in aggregate held a small share—22 percent—of all banks' multifamily loans, but since the prior study a large number of community banks have entered multifamily lending for the first time. Of the 4,750 community banks in 2019, 474, or 10 percent, had multifamily loans on their books in 2019 but had none at year-end 2011. In comparison, during the same period very few community banks newly entered other lending businesses. For example, only 59, slightly more than 1 percent of community banks, newly entered C&I lending between year-end 2011 and year-end 2019.

The increase in multifamily lending pushed community banks' average ratio of multifamily loans to capital from 27 percent at year-end 2011 to 39 percent at year-end 2019. The average ratio of multifamily loans to capital increased in almost all states between 2011 and 2019. But in some states, multifamily lending is more important to community banks than in others. In several states in the northeast, such as New York, New Jersey, and Massachusetts, and in California, community banks' average ratios of multifamily loans to capital at year-end 2019 were well above the national average. The higher ratios are consistent with the above-average prevalence of multifamily living in these states.[7]

Community Banks That Specialize in CRE Lending Became More Prominent in the Years After the Previous Study

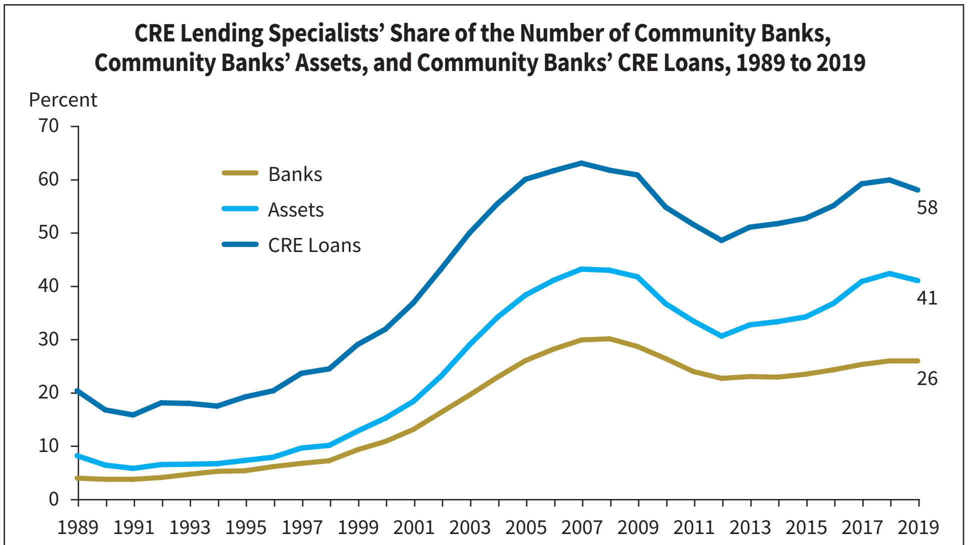
Community banks of all lending specialties provide CRE financing; however, the share of community banks considered to be CRE specialists has grown.[8] The *2012 Community Banking Study* found that at the highest point of their share of all community banks, in 2007, CRE specialists had come to constitute almost 30 percent of community banks. The share declined from 2008 to 2012, amid the economic slowdown and CRE market stress in the few years following the Great Recession, but after that the share recovered somewhat and then stabilized. As of year-end 2019, CRE lending specialists accounted for 26 percent of all community banks (Chart 4.6).

Notably, while CRE specialists accounted for, on average, about one-quarter of community banks from 2011 to 2019, their share of community banks' assets and

[3] Market size is determined according to data from the U.S. Census. "Larger metropolitan areas" are those designated by the U.S. Census as metropolitan statistical areas—those that have at least one urbanized area of 50,000 or more inhabitants. "Small metropolitan areas" are those designated by the U.S. Census as micropolitan statistical areas—those that have at least one urban cluster of at least 10,000 but less than 50,000 population. "Rural areas" are those not in a metropolitan or micropolitan statistical area.
[4] Real Capital Analytics bases its market size categorizations on the amount of lending in a given market, not on population.
[5] Federal Reserve, Report Z.1 – Financial Accounts of the United States, March 2020.
[6] U.S. Census Bureau, Current Population Survey/Housing Vacancy Survey, March 10, 2020.

[7] 2018 American Community Survey, 1-Year Estimates, U.S. Census Bureau. The four states mentioned in the text have a higher percentage of total housing identified as containing five or more housing units than the national percentage.
[8] As shown in Appendix A, CRE specialists hold construction and development (C&D) loans greater than 10 percent of assets OR total CRE loans (C&D; multifamily; and nonfarm, nonresidential loans) greater than 30 percent of total assets.

Chart 4.6



Source: FDIC.
Note: Data as of year end.

Table 4.1 CRE Lending Specialists' Share of the Number of Community Banks, Community Banks' Assets, and Community Banks' CRE Loans, by Market Size, 2011 and 2019

	Rural/Micro		Metro		Total	
	2011	2019	2011	2019	2011	2019
Percent of Community Banks	10	13	36	38	24	26
Percent of Assets	18	26	40	47	33	41
Percent of CRE Loans	33	41	57	63	51	58

Sources: FDIC, United States Census Bureau.
Note: Data as of fourth quarter. Market size is determined according to data from the United States Census Bureau.
A metropolitan statistical area must have at least one urbanized area of 50,000 or more inhabitants, while each micropolitan statistical area must have at least one urban cluster of at least 10,000 but less than 50,000 inhabitants. Rural areas are those not in a metropolitan or micropolitan statistical area.

CRE loans increased to an outsized degree. As of year-end 2019, CRE specialists accounted for 41 percent of aggregate community-bank assets and 58 percent of aggregate community-bank CRE loans.

Community-bank CRE specialists have maintained their significance across different sizes of geographic markets. Not surprisingly, these specialists are prominent in larger geographic markets, that is, where population densities and high volumes of real estate provide lending opportunities for all types of lenders. However, community-bank CRE specialists are also important providers of CRE financing in small communities. Despite accounting for only 13 percent of the number of community banks headquartered in rural/micro markets, community-bank CRE specialists held 41 percent of community banks' CRE loans in these markets in 2019, up from 33 percent in 2011 (Table 4.1).

The CRE Credit Environment Was Favorable at the Start of 2020

For much of the period since the prior study, community banks, like much of the CRE finance industry, experienced a benign credit environment. Delinquency rates among community banks' CRE loan portfolios declined for nine consecutive years, from 2010 through 2018, before flattening at a low level in 2019. As of first quarter 2020, the average CRE loan delinquency rate was about 1 percent, much lower than the peak of more than 7 percent reached in first quarter 2010.

As important providers of CRE financing, community banks will be among those lenders interested in CRE market dynamics in the years ahead. As 2020 began, the long economic expansion had been a positive backdrop to conditions in the CRE market. However, the landscape weakened significantly with the COVID-19 pandemic, and economic stress likely will be a headwind holding back the performance of numerous CRE property types. In addition, potential shifts in preferences for certain types of real estate over others may change the CRE lending environment. For insights into CRE market conditions and the COVID-19 pandemic, see Box 4.1.

CRE Lending: Summary

Despite challenges in CRE markets or the economy, community banks have been and continue to be CRE lending sources for business owners, property developers, and investors. Community banks hold a larger amount of CRE compared with their overall industry asset share. They fund a wide variety of properties in locations throughout the country, and as the demands of their communities change, their CRE lending changes to meet the need. Moreover, while some community banks may be considered CRE specialists because of the share of CRE loans in their portfolios, most community banks hold some CRE loans, supporting the premise that whatever a community bank's business strategy, the bank is focused on the various needs of its community.

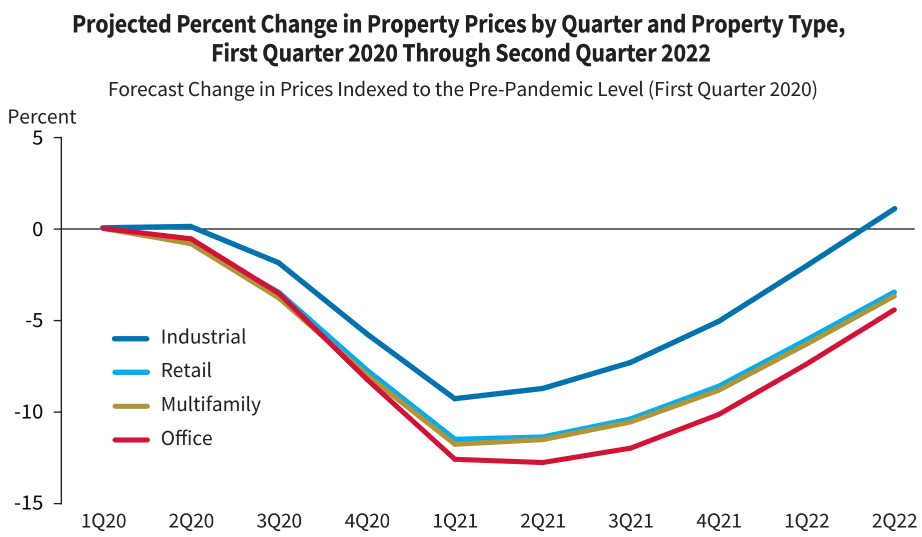
Box 4.1 CRE and the COVID-19 Pandemic

The COVID-19 pandemic has substantially altered the landscape of CRE markets in the United States. As businesses and industries reevaluate their use of space, questions have emerged about how CRE will be used, the amount needed, and the geographic implications.

Nationally, rents have declined and vacancy rates have increased in most property types since the onset of the pandemic, and projections call for continued weakness. For example, by the end of 2021, real estate firm CoStar projects that vacancy rates will increase by 20 percent or more in most property types.[a] As the pressure on rents and occupancy rates continues, ultimately CRE property prices are expected to show the strain. According to CoStar, prices in most property types are expected to decline by double digits into 2021 and to recover slowly from the COVID-19 pandemic (see Chart 4.1.1).

The effects of the COVID-19 pandemic have affected property types in different ways. As the pandemic emerged with government-mandated business and travel restrictions, immediate stress was felt in lodging and retail, as hotels, restaurants, and stores closed. Foot traffic at discretionary retail stores fell to near zero. The national hotel occupancy rate dropped to a low of 21 percent in April 2020, from a pre-pandemic monthly average in 2019 of approximately 66 percent.

Chart 4.1.1



Source: CoStar.
Note: Data are quarterly figures forecasted as of second quarter 2020.

continued on page 4-7

[a] CoStar forecast as of second quarter 2020.

Box 4.1, continued from page 4-6

Companies' use of office space slowed, and many cities' office markets may experience challenges in long-term demand as companies reevaluate their space needs. Office markets in some geographies may be strained more than others, depending on various factors such as long-term adoption of telework, challenges in cities highly dependent on public transportation, and the path of COVID-19 as a long-term health crisis.

Depending on the depth of economic contraction, the pace of recovery, and living preferences among renters, multifamily markets also may face headwinds. Some multifamily properties may be strained by delays in the payment of rents and by the recent large increase in multifamily supply in some markets.

Overall, CRE market weakness may manifest itself in the credit quality of CRE loan portfolios. Credit quality may suffer as economic strain from the COVID-19 pandemic increases vacancy rates, reduces properties' cash flows, and—potentially—hinders loan repayment ability.

Small Business Lending

Small businesses play a key role in the economy, making up the vast majority of all businesses by count and employing approximately 48 percent of the private sector workforce.[9] In addition, they are an important part of their community, not only by providing services and products but also by supporting local causes and charities. And just like large corporations, they need to borrow funds for a number of reasons, including to add to working capital and inventory, to finance accounts receivable, and to purchase properties that house their businesses.

In contrast to large corporations, which may be more likely to turn to the capital markets, small businesses more frequently turn to banks for credit, particularly if the business owner has a relationship with a lender.[10] Banks provide approximately 44 percent of small business financing, considerably higher than online lenders (22 percent) and credit unions (6 percent).[11] Although noncommunity banks may provide a larger portion of small business loans by dollar amount, figures for overall market share and the small-business-loans portion of total business loans make it clear that community banks tend to lend primarily to small businesses. An analysis of Call Report data in conjunction with responses to the 2018 FDIC Small Business Lending Survey and loan origination data from the Small Business Administration (SBA) shows that community banks are key providers of loans to small local businesses and are key resources for small businesses needing credit.

Study Definitions

In this study, business loans are all C&I loans and all nonfarm, nonresidential loans. Business loan growth reflects growth in all C&I and nonfarm nonresidential loans for all banks.

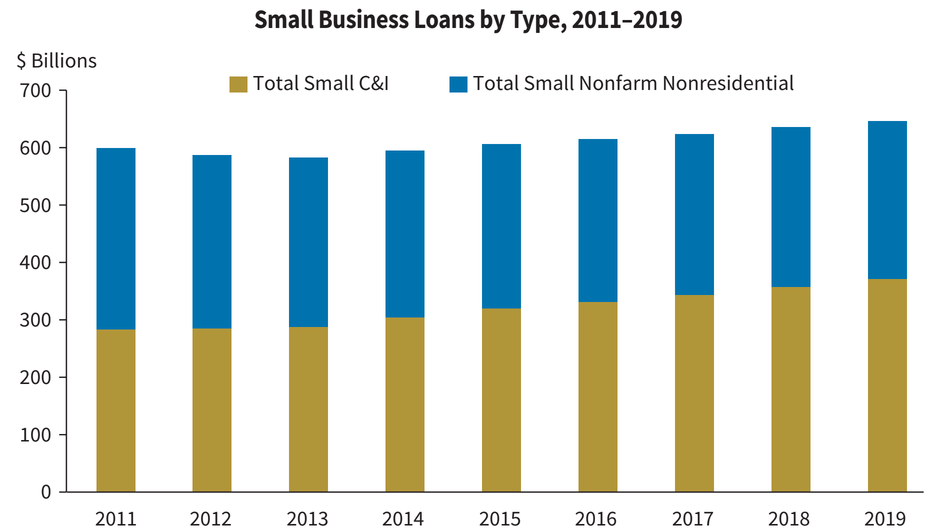
The Call Report defines small business loans as all C&I loans less than $1 million and nonfarm, nonresidential loans less than $1 million. This dollar limit was established in 1993 when this category was added to the Call Report. This study uses this definition.

Call Report Data Are Helpful but Do Not Show the Full Story

Call Reports are the primary source for analyzing growth and changes in banks' small business loans. According to Call Report data, small business loans grew from $599 billion at year-end 2011 to $645 billion at year-end 2019, for an average annual rate of loan growth of 0.98 percent. This growth rate is considerably less than the average annual business loan growth rate of 6.8 percent for the banking industry. Growth in small business loans was solely in small C&I loans, since small nonfarm, nonresidential loans fell from $316 billion to $275 billion during the period in question (Chart 4.7). Yet despite the slow growth trends, community banks' share of small business loans as of year-end 2019 continues to be larger than their overall share of the banking industry's total loans. Community banks hold 36 percent of total small business loans, which is double their share of the banking industry's total loans (15 percent).

9 Federal Reserve Banks.
10 Ibid.
11 Ibid.

Chart 4.7



Source: FDIC.
Note: Small C&I and small nonfarm nonresidential loans include all loans with origination amounts less than $1 million.

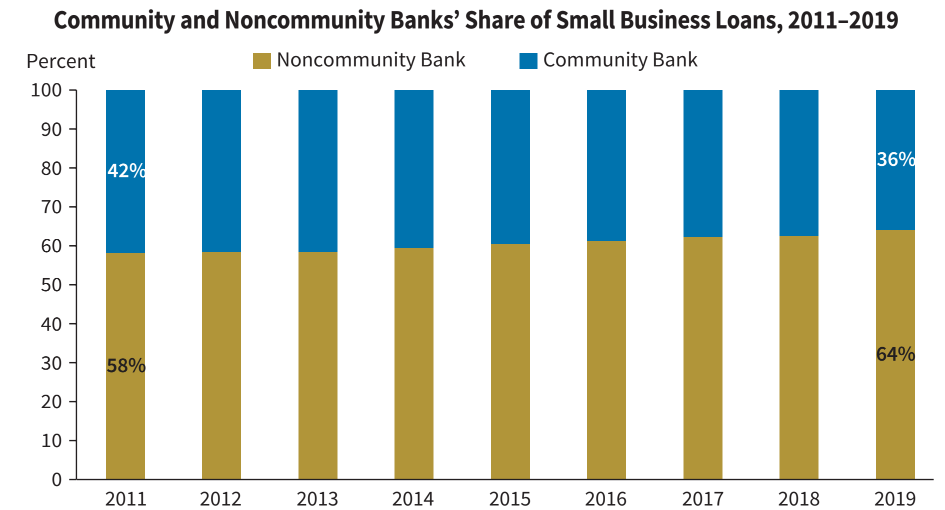
Community banks have, however, seen their share of small business loans decline since 2011; it shrank from 42 percent at year-end 2011 to the aforementioned 36 percent at year-end 2019 (Chart 4.8). This decline may be due to two factors: business consolidation and the typical size of loans made by noncommunity banks in contrast to community banks. The first factor (business consolidation) would affect community banks' lending if a decline in the number of small businesses (using small business employment as a proxy) meant a reduced demand for small business loans.[12] The period when the decline in the share of small business loans occurred was the period when small business employment declined (dropping from 50 percent in 2011 to 47 percent in 2017).[13] During that period, community banks' share of small C&I loans declined from 32 percent to 25 percent—but their share of small nonfarm, nonresidential loans remained relatively stable at 51 percent.

The second possible explanation for the decline in community banks' share of small business loans is the size of loans originated. Size of loan differs significantly between community and noncommunity banks. Noncommunity banks tend to help small businesses by offering business credit cards rather than other types of working capital or CRE loans. To determine whether to extend a loan, noncommunity banks use scoring models or other tools, and by using such technology, bank personnel do not have to build a relationship or take additional measures to learn about the business owner or the business itself. Using this model, noncommunity banks originate and hold more loans under $100 thousand than loans between $100 thousand and $1 million. Community banks, on the other hand, hold a greater share of loans between $250 thousand and $1 million than loans under $250 thousand (Chart 4.9). Community banks, therefore, focus on larger loans that require greater "touch" or interaction and analysis—loans that build a relationship between bank and borrower.

The fact that community banks originate larger small business loans than noncommunity banks leads us to an additional hypothesis as to the reason for the decline in community banks' share of small business lending. These larger loans would include those that exceed $1 million—the maximum small business loan limit (see the sidebar "Study Definitions" for more details). The reason for the limit was that there was no one measure to use in identifying a small business: Is the determination based on revenue? On number of employees? On capital invested by the business owner? Setting a loan limit for reporting purposes gave bankers a simple way to identify small business loans and ensure uniformity in Call Report filings. To provide support for our hypothesis that the decline in community banks' share of small business lending between 2011 and 2019 may be partly due to the size of some of their larger loans—with loans exceeding $1 million not being categorized as small business—

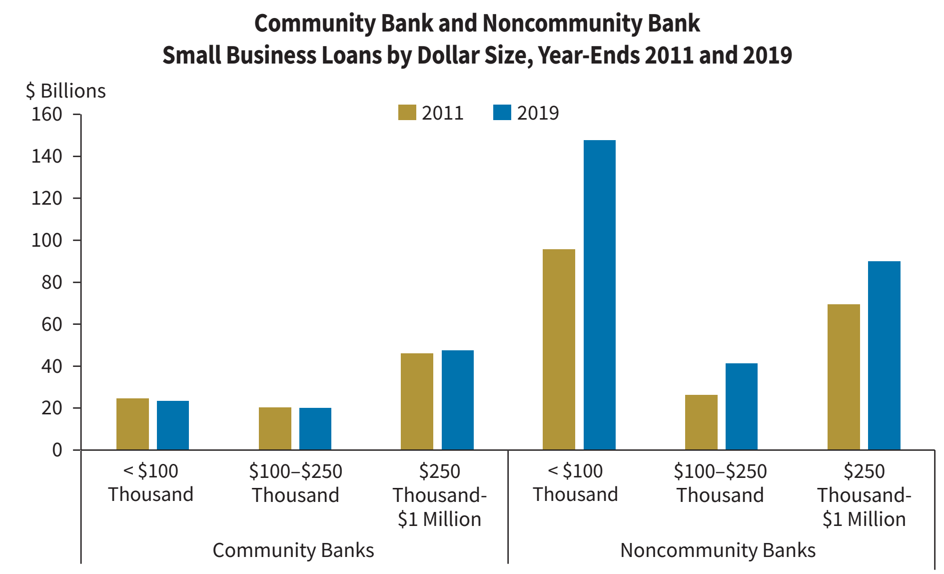
[12] Brennecke, Jacewitz, and Pogach.
[13] Ibid.

Chart 4.8



Source: FDIC.
Note: Small loans to businesses include commercial and industrial loans less than $1 million and nonfarm, nonresidential mortgages less than $1 million.

Chart 4.9



Source: FDIC.

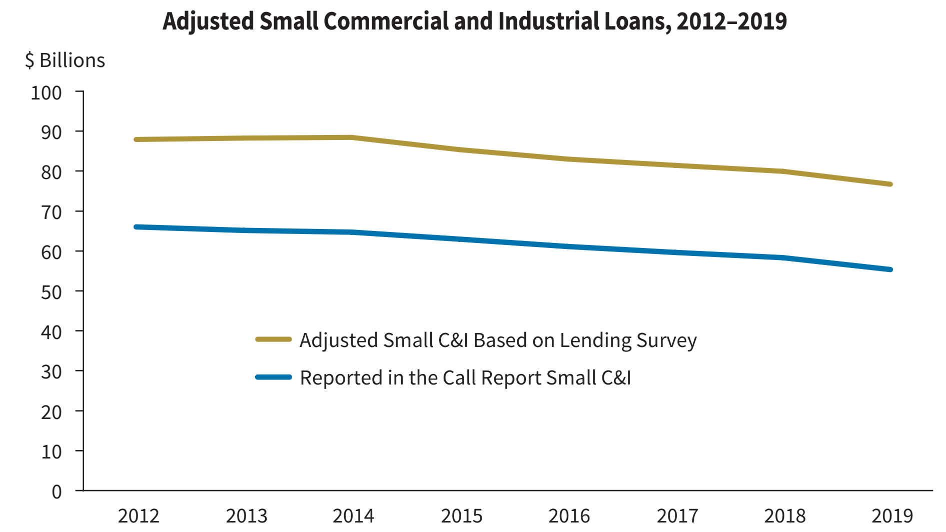
we look at responses to the FDIC's 2018 Small Business Lending Survey and to loan origination data from the SBA's 7(a) loan program.

What Do Bankers Consider to Be Small Business Lending?

Although community banks' share of *total business loans* is declining, within total business loans at community banks the share represented by *small business loans* has been growing. Small C&I loans as of year-end 2019 represent 43 percent of total C&I loans at community banks, whereas small C&I loans currently represent only 14 percent of total C&I loans at noncommunity banks.

In 2018, the FDIC, with assistance from the U.S. Census Bureau, conducted a small business lending survey (referred to hereafter as "Lending Survey") with direct responses from banks. Several questions centered on the topic of what the banker considers a small business

Chart 4.10



Source: FDIC.
Note: Represents commercial and industrial loans at banks with total assets less than $1 billion.

loan. The responses indicate that many bankers do not define a "small business loan" as a loan to a business with an origination amount less than $1 million, as Call Reports define it. Rather, bankers consider the "ownership structure, number of employees, business focus, and ownership characteristics" of the borrower to determine whether a loan is to a small business; often these loans exceed $1 million. The survey found that approximately 86 percent of banks with total assets less than $250 million responded that their C&I loans were "almost exclusively" to small businesses, regardless of the size of the underlying loans. For banks with total assets between $250 million and $1 billion, approximately 75 percent of respondents stated that their C&I loans were "almost exclusively" to small businesses. On the basis of these responses an adjustment to the share of C&I loans that are made to small businesses would have shown that small business loans as a percentage of total C&I loans at banks with total assets less than $1 billion jumped from 56 percent of C&I loans to approximately 78 percent in 2019 (or from $55 billion to $76 billion) (Chart 4.10).[14] Therefore, the responses from the Lending Survey provide additional support for the belief that community banks are lending to their local businesses despite the declines in share of small C&I loans and the slow C&I loan growth rates that are based solely on Call Report figures.

[14] The 2018 FDIC Small Business Lending Survey did not use the community bank definition to differentiate between banks; rather, it used the asset sizes of institutions.

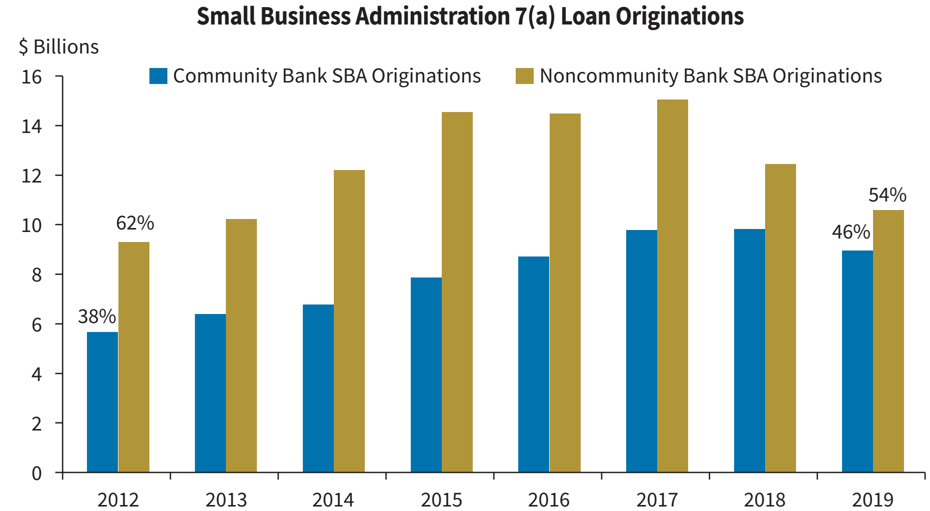
SBA Loan Originations Also Support the Belief That Community Banks Focus on Small Business Lending

Community banks are also key players in the SBA-guaranteed 7(a) loan program, which guarantees loans originated up to $5 million.[15] Between 2011 and 2019, community banks saw their share of SBA 7(a) loan originations increase from $5.7 billion to $9.0 billion. Of the loans originated by banks in that program in 2019, community banks originated approximately 46 percent. Between 2012 and 2019, noncommunity banks saw their share of loan originations fluctuate, going from 62 percent in 2012 to a high of 65 percent in 2015 and then dropping to 54 percent in 2019, while the dollar amount dropped from the 2015 high of $14.5 billion to $10.6 billion in 2019 (Chart 4.11).

Most important, Chart 4.12 shows that community banks' SBA loan originations support the assertion that community banks do not limit their small business loans to $1 million. Rather, as with the findings of the Lending Survey, SBA data show that a majority of the loans originated by community banks are for amounts greater than $1 million.

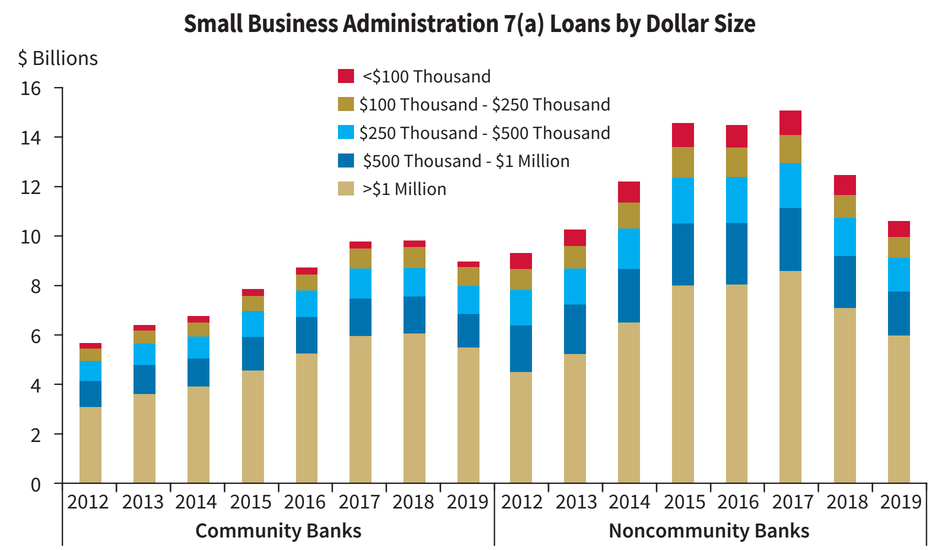
[15] SBA 7(a) program loans provide 75 percent guarantees on working capital loans to small businesses in varying amounts up to $5 million. Loans are originated through a bank, credit union, or community development financial institution. The total amount approved during the fiscal year ending September 30, 2019, was $23.6 billion.

Chart 4.11



Sources: Small Business Administration; FDIC.
Notes: Represents only those SBA loans made by insured depository institutions. Percentages on bars represent share of total.

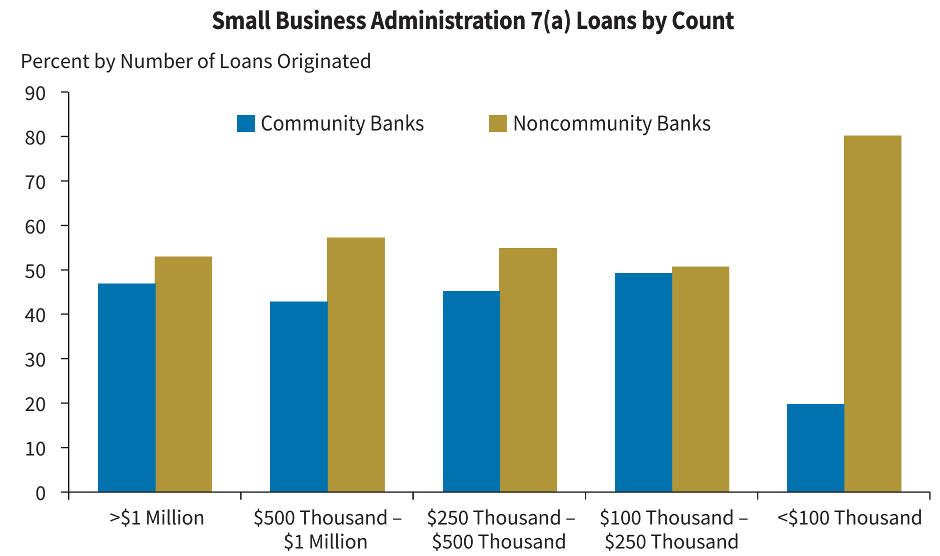
Chart 4.12



Sources: Small Business Administration, FDIC.

Like Call Report data, SBA loan origination data show that community banks tend to make more—by count—large SBA loans than small SBA loans, compared with noncommunity banks, which tend to focus on smaller SBA loans. As shown by Chart 4.13, noncommunity banks make the vast majority (80 percent)—by count—of loans below $100 thousand in value. This share has not changed since 2011. While noncommunity banks still make the majority of loans in other size groups, their share in these groups has been declining, and community banks are almost even in several categories. Community banks' share (by count) of loans originated for more than $1 million is almost equal to the share of loans originated by noncommunity banks. This level is not surprising because, as discussed above, community banks focus on loans that build relationships and may take more analysis and require an understanding of the business and the business owner.

Chart 4.13



Sources: Small Business Administration; FDIC.

Small Business Lending: Summary

Analysis of Call Report data, of responses to the FDIC Small Business Lending Survey, and of SBA 7(a) loan origination data reveals that community banks continue to play a key role in providing funding that support small businesses. Despite declines in the numbers reported in Call Reports, data from both the FDIC Lending Survey and the SBA show not only that community banks make loans to small businesses—loans often greater than $1 million—but also that small business loans often represent a majority of community banks' C&I portfolios. Moreover, for such community banks, the share of small business loans in the C&I portfolio may compare favorably with the share of small business loans in the portfolios of noncommunity banks. These local-minded banks focus on loans that build relationships: the loans tend to be larger and more hands-on, and they involve continued loan administration. The evidence indicates, therefore, that community banks continue to be key supporters of small businesses in their local areas, and there is no reason to expect this support to decline.

Box 4.2 Small Business Lending and the COVID-19 Pandemic

The federal government's first step in aiding small businesses was passage of the Coronavirus Aid, Relief, and Economic Security Act, which among other things provided $659 billion in funds for small businesses through the Paycheck Protection Program (PPP). The program is administered by the SBA and the U.S. Treasury, with applications for the funds submitted through banks, credit unions, Community Development Financial Institutions (CDFIs), and other financial institutions. The program was designed to provide an incentive for small businesses to keep their workers on the payroll during the initial weeks of the pandemic, when many states put stay-at-home orders into effect. The loan amounts were based on two months' salary and employee expenses (January and February 2020). Loan terms included an interest rate of 1 percent, a two-year maturity that was extended to five years for loans originated after June 5, six months of loan payment deferral, and loan forgiveness if certain criteria are met.

As of August 8, 2020, over five million loans totaling more than $525 billion had been originated.[a] Like community banks' share of the small business loans held by all banks, community banks' share of PPP loans outstanding held by all banks was larger than their share of total C&I loans held by all banks. As of June 30, 2020, community banks held 13 percent of all banks' C&I loans but more than 30 percent of PPP loans held at banks. Funding the PPP loans resulted in an annual C&I loan growth rate of 69 percent at community banks, compared with 16 percent at noncommunity banks.

continued on page 4-13

[a] U.S. Small Business Administration.

Box 4.2, continued from page 4-12

While the PPP helped many small businesses initially, economic challenges related to the pandemic have continued to affect many small businesses. According to the American Bankruptcy Institute, commercial bankruptcy filings have increased 44 percent when comparing filings from April through September 2020 to the same time period in 2019. Additionally, according to Yelp Economic Average, more than 163,000 businesses have closed through August 31, 2020, from the start of the pandemic (March 1, 2020). The full effect of the pandemic on small businesses may not be fully known for several years.

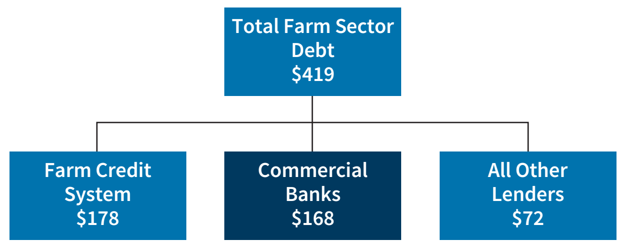
Agricultural Lending

In 2019, the more than two million farms in the United States held nearly $419 billion in debt, with about 83 percent of that amount split evenly between commercial banks and the Farm Credit System (FCS) (Chart 4.14). Although the aggregate volume of dollars lent is nearly evenly divided between commercial banks and FCS institutions, the number of institutions that extend the loans is vastly different. At year-end 2019, more than 4,300 banks (about 84 percent of all commercial banks) held agricultural loans, compared with the FCS network of 72 lending institutions.

Rural communities rely on their community banks to fund agricultural production. As Chart 4.15 shows, at year-end 2019, although community banks held just 12 percent of total banking industry assets, their share of farm loans at commercial banks was approximately 70 percent.[16]

Chart 4.14

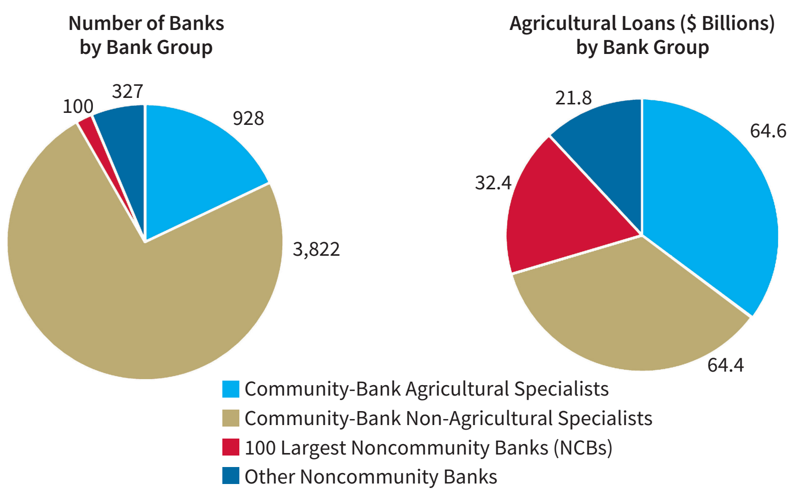
Distribution of U.S. Farm Sector Debt, 2019



Source: USDA.
Notes: Data are in billions of dollars. Sub-sectors do not add to total due to rounding.

Chart 4.15

Distribution of Agriculture Loans Among FDIC-Insured Institutions, Year-End 2019 ($183 Billion)



Source: FDIC.

[16] In 2019, community banks funded approximately 31 percent of farm sector debt.

At year-end 2019, there were 928 community banks that specialized in agricultural lending ("community-bank agricultural specialists").[17] They held 35 percent of all agricultural loans held by commercial banks but represented only about 18 percent of all banks. The rest of this section focuses on the performance and unique characteristics of the community-bank agricultural specialists.

Community-Bank Agricultural Specialists Performed Well Between 2012 and 2019

In the years leading up to and following the 2012 FDIC Community Banking Study, the lending emphasis of community-bank agricultural specialists largely played in their favor. Their exposure to the negative credit effects of the housing crisis and Great Recession was minimized, and instead they benefited from a strong, decade-long farming boom.

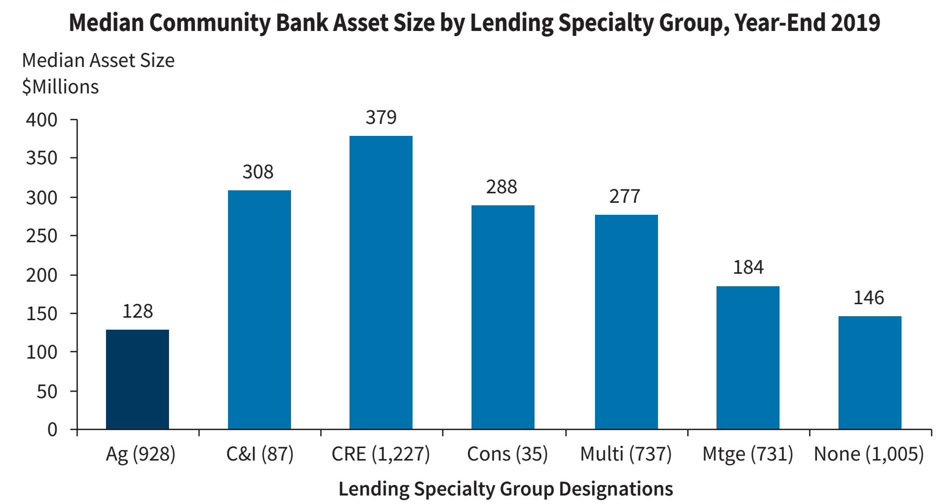
Starting in 2014 the agriculture sector struggled in terms of profitability, but erosion in farm financial conditions was gradual and generally modest in severity. Credit quality at community-bank agricultural specialists weakened but still remained favorable by long-term historical comparison, and earnings and capital were strong.

Community-Bank Agricultural Specialists Tend to Be Small and Heavily Concentrated in the Center of the Country and to Have Large Exposures to Row Crop and Livestock Production

Community-bank agricultural specialists are typically small, rural institutions. Remarkably, although as a group they hold about 35 percent of all agricultural loans, they hold just 1 percent of industry assets. The group's median asset size is just $128 million, compared with the nearly double $246 million for community-bank non-agricultural specialists. In fact, community-bank agricultural specialists tend to be the smallest of all community banks when the latter are grouped by lending specialty (Chart 4.16). More than 75 percent of the 928 community-bank agricultural specialists have total assets under $250 million, and just 19 have total assets in excess of $1 billion.

As shown in Map 4.1, 790 community-bank agricultural specialists, or 85 percent of the total, are concentrated in just ten states in the center of the country. In 2019, agricultural commodity receipts in these ten states totaled $152 billion, or 41 percent of the $370 billion in total U.S. agricultural commodity receipts. Agriculture in these ten states is heavily focused on a handful of commodities:

Chart 4.16

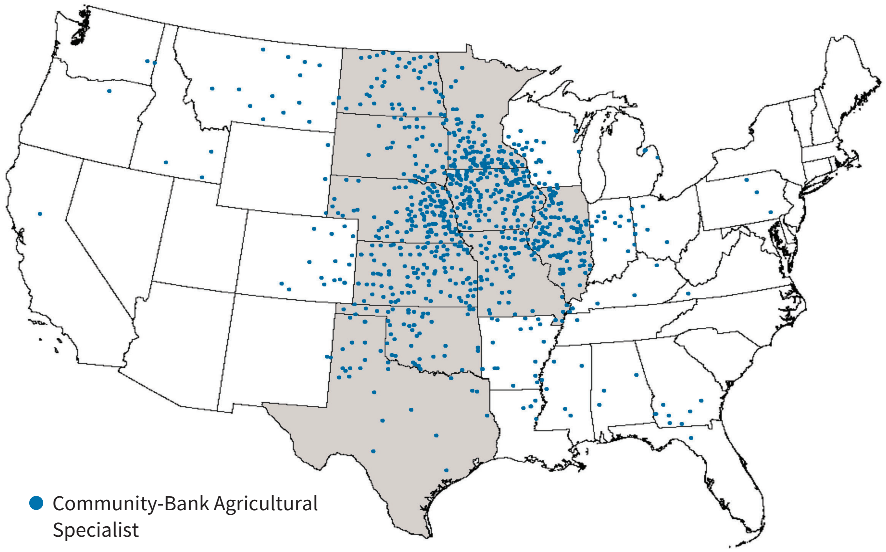


Source: FDIC.
Notes: Lending specialty groups are agricultural (Ag), commercial and industrial (C&I), commercial real estate (CRE), mortgage (Mtge), multi-specialty (Multi), consumer (Cons), and no specialty (None). Figures in parentheses denote number of community banks. Lending specialty group definitions can be found in Appendix A.

[17] As shown in Appendix A, the FDIC defines community-bank agricultural specialists as community banks that have total loans greater than 33 percent of total assets and agricultural loans greater than 20 percent of total assets, and are not considered a multi-specialist.

Map 4.1

Locations of Community-Bank Agricultural Specialists by Headquarters, Year-End 2019



Source: FDIC.
Notes: Dot positions are based on locations of bank headquarters. The 10 shaded states contain the largest numbers of community-bank agricultural specialists by state. There are no community-bank agricultural specialists headquartered in Alaska or Hawaii.

cattle, corn, hogs, and soybeans. In 2019, within these ten states, these four commodities totaled 77 percent of total commodity receipts, and the ten-state aggregate receipts of each of these commodities represented about two-thirds or more of total U.S. receipts for each commodity.[18] These states are less concentrated in dairy and poultry production and far less concentrated in fruits, nuts, and vegetable production.

Conversely, areas in these ten states that are heavily concentrated in dairy, poultry, fruits and tree nuts, and vegetables and melons are headquarters to few agricultural specialists. The seven states responsible for more than 90 percent of fruit and tree nut production and three-quarters of vegetable and melon production are headquarters to just 11 community-bank agricultural specialists.[19]

Therefore, while community-bank agricultural specialists are exposed to nearly all types of agricultural production, they are most heavily exposed to a handful of row crops and livestock, with significantly less risk posed by other agricultural production.

Agricultural Lending Is the Least Pervasive Lending Segment Among Community Banks

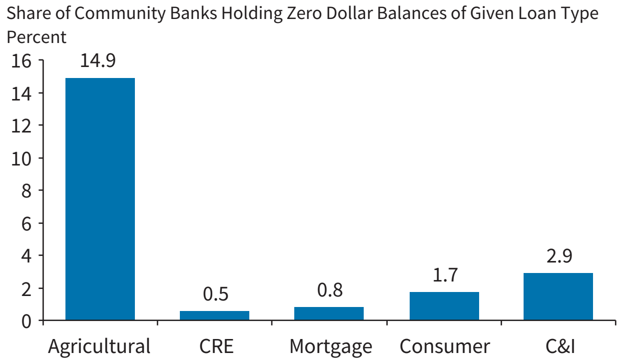
Although the vast majority of community banks hold at least some of each of the loan types constituting the various loan specialist groups, if a particular loan segment happens to be absent, it is most likely to be agriculture (Chart 4.17). A community bank is five times more likely to have no agricultural loans than to have no C&I loans, and 27 times more likely to have no agricultural loans than CRE loans.

Moreover, there is far greater polarization of concentration in agricultural loan holdings than in CRE, 1–4 family residential mortgage, and C&I lending. As shown in Chart 4.18, unless a bank holds sufficient agricultural loans to warrant the label “agricultural specialist,” it tends to hold agricultural loans in low proportion to its capital. The only other lending specialty with similar polarization is the consumer specialist group.

[18] Aggregate receipts in the ten shaded states of Map 4.1, as a percentage of total U.S. receipts, by commodity: cattle (65 percent), corn (72 percent), hogs (73 percent), and soybeans (65 percent).
[19] The seven states represent the top five states in each commodity, with overlap of some states. Similarly, there are just 34 community-bank agricultural specialists in the eight states whose leading commodity is dairy products (61 percent of U.S. production), and there are just 34 community-bank agricultural specialists in the nine states whose leading commodity is commercial chickens (71 percent of U.S. production).

Chart 4.17

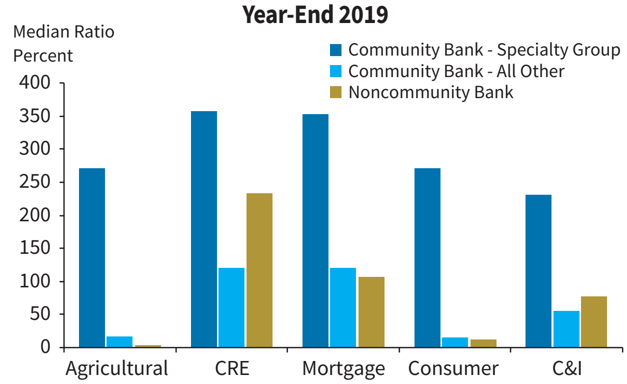
Shares of Community Banks Not Holding Loans by Loan Type, Year-End 2019



Source: FDIC.

Chart 4.18

Loan Type to Leverage Capital Ratios by Bank Group, Year-End 2019



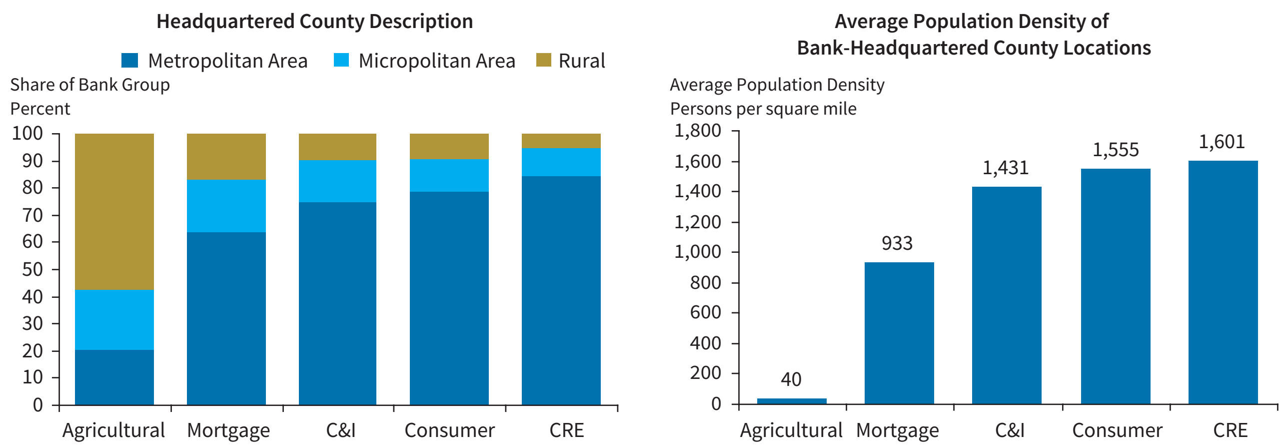
Source: FDIC.
Note: Lending specialty group definitions can be found in Appendix A.

Few New Banks Become Agricultural Specialists, and the Group Is Dominated by Community Banks That Have Historically Been Agricultural Specialists

Although agricultural activity occurs just about everywhere in the United States, it is naturally most concentrated in rural areas, and as a result community agricultural specialists are also heavily concentrated in rural areas (Chart 4.19).[20] At year-end 2019, 57 percent of community-bank agricultural specialists were headquartered in rural counties, and just 20 percent in metropolitan counties. That is the inverse of the rural-urban mix of other community-bank loan specialist groups. One consequence of this inversion is that community-bank agricultural specialists are located in areas with vastly lower population densities, as seen in Chart 4.19. Even when the focus is solely on metropolitan areas, the average population density for agricultural specialists is still just 100 people per square mile, suggesting that even when agricultural specialists

Chart 4.19

Shares of Community-Bank Loan Specialist Groups by County Urban Classification and Population Density, Year-End 2019



Sources: FDIC, U.S. Census Bureau.
Notes: Figures were compiled using community banks as of year-end 2019, metropolitan and micropolitan delineation files as of March 31, 2020, and county populations based on the 2010 decennial census. Lending specialty group definitions can be found in Appendix A.

[20] For purposes of this study, the FDIC has labeled all counties existing outside metropolitan statistical areas and micropolitan statistical areas as rural. This is consistent with the approach taken by FDIC authors in past studies on rural depopulation. See Anderlik and Walser (2004) and Anderlik and Cofer (2014).

are based in metropolitan areas, they tend to be based in smaller metros or in the less urban fringes of the metro areas.

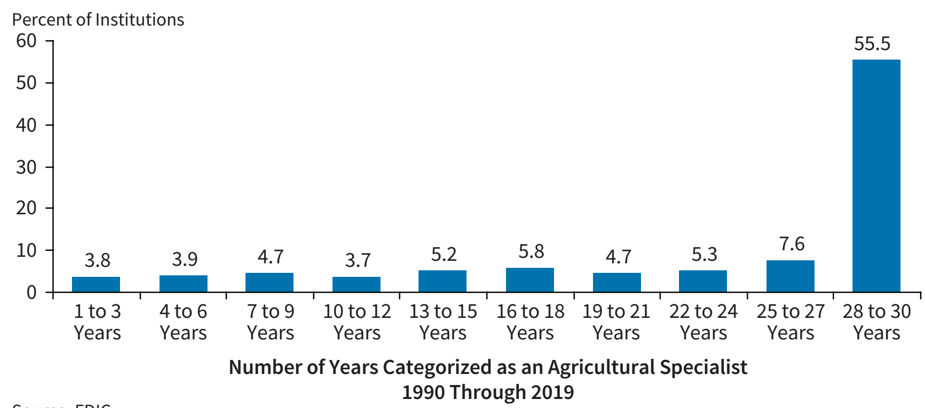
Moreover, half of agricultural specialists are headquartered in rural counties characterized by long-term population decline (see Box 3.1 in Chapter 3 for a more detailed analysis of such counties).[21] These counties tend to have sparse populations, greater proportions of elderly people, and less-vibrant and less-diversified economies than most other counties have.[22] Such conditions for the most part reflect the decades-long consolidation in agriculture. Since these dynamics are not conducive to new-bank formation, which largely occurs in areas experiencing strong population and economic growth, only 41 of the more than 1,400 new banks formed since the beginning of 2000 were identified as an agricultural specialist either at formation or in any quarter since formation.[23]

Meanwhile, absent branching into growing urban areas or purchasing assets, community banks in declining rural communities tend to reflect the characteristics of their communities and are marked by generally slower growth and high concentrations in agriculture. As a result, community-bank agricultural specialists tend to remain true to their agricultural roots. Chart 4.20 shows that 56 percent of the 793 community banks labeled as agricultural specialists in 1990 continued to have the same label in at least 28 of the subsequent 30 years.

For the reasons discussed above, this tendency to remain attached to their roots is most pronounced among community-bank agricultural specialists headquartered in rural areas. Chart 4.21 shows this by juxtaposing the pattern of community-bank agricultural specialists headquartered in growing metropolitan areas against the pattern of agricultural specialists headquartered in declining rural areas. Of the agricultural specialists in declining rural areas, 60 percent remained agricultural specialists throughout the entire 30–year period 1990–2019, whereas the comparable rate for agricultural specialists based in growing metro areas was only 23 percent.

Chart 4.20

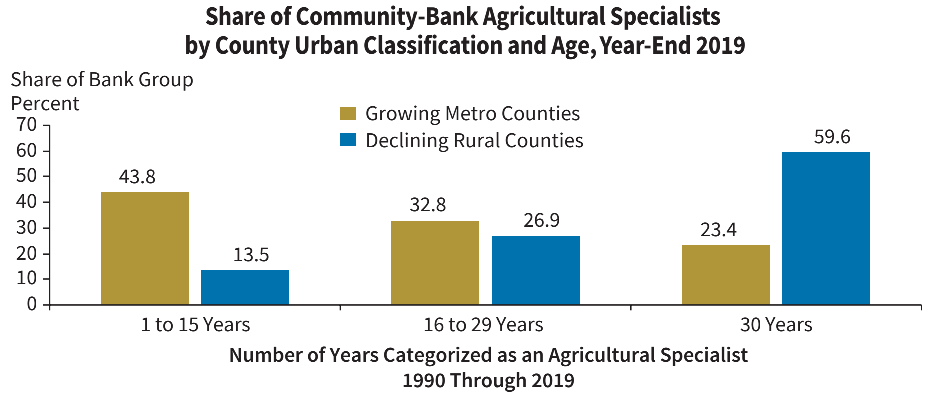
Shares of Community-Bank Agricultural Specialists by Number of Years Considered Agricultural Specialists, Year-End 2019



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. Because of seasonality in agricultural lending, 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.

[21] Anderlik and Cofer (2014). The FDIC defines counties as growing, declining, and accelerated declining on the basis of 30-year population trends.
[22] Anderlik and Walser (2004).
[23] Of these banks, 1,130 were identified as community banks in the quarter in which they were established, and 302 as noncommunity banks.

Chart 4.21



Source: FDIC.

Notes: Sample only includes banks open from January 1, 1990, through year-end 2019, that were considered a community bank at all quarters in 1990 and 2019, and were also considered an agricultural specialist in any quarter during 1990. Because of seasonality in agricultural lending, 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. Metro counties are counties that are part of a metropolitan statistical area; rural counties are counties that are not part of a metropolitan statistical area or micropolitan statistical area. Growing counties had an increase in population between 1980 and 2010; declining counties had a decrease in population between 1980 and 2010.

Community-Bank Agricultural Specialists Remain Committed to Agricultural Lending Through Agricultural Economic Cycles

In 2012, when the first FDIC Community Banking Study was published, a decade-long boom in U.S. agriculture was nearing its apex, buoyed by steep increases in commodity prices and farmland values. At that time, farm financial conditions and community-bank agricultural credit quality were as favorable as they had been in many decades. But in the years after 2013, when farm incomes reached their peak, the agricultural sector endured lower prices, weaker returns, and gradually deteriorating financial conditions.[24] Fortunately, most agricultural specialists maintained strong capital levels and loan loss reserves while simultaneously keeping in check their concentrations in farmland-secured lending. As a result, they had the strength and capacity to manage the rising stress in the farming sector, partly by cooperatively working with their borrowers to restructure operating shortages using the borrowers' strong equities in farmland.[25]

As their annual growth in loan volume has demonstrated, community-bank agricultural specialists have been strongly committed to lending to producers through the peaks and valleys of agriculture operating returns (Chart 4.22). In the period 2000–2019, they experienced only two quarters when aggregate agricultural production loan volume was lower than it had been in the same quarter one year earlier; those two quarters were fourth quarter 2016 (a decline of .08 percent from fourth quarter 2015) and first quarter 2017 (a decline of 0.81 percent from first quarter 2016). Never, however, did the group see a similar quarterly decline in aggregate farmland-secured loans. Noncommunity banks, on the other hand, demonstrated far greater volatility in lending activity through the sector's peaks and valleys; in particular, they were far more prone to pull back on agricultural loan volume as performance weakened. The largest noncommunity banks saw production loan volumes decline in a total of 25 quarters between 2000 and 2019, and farmland-secured loan volumes decline in 9 quarters. As Chart 4.22 shows, these declines occurred often during dips in U.S. farm income.

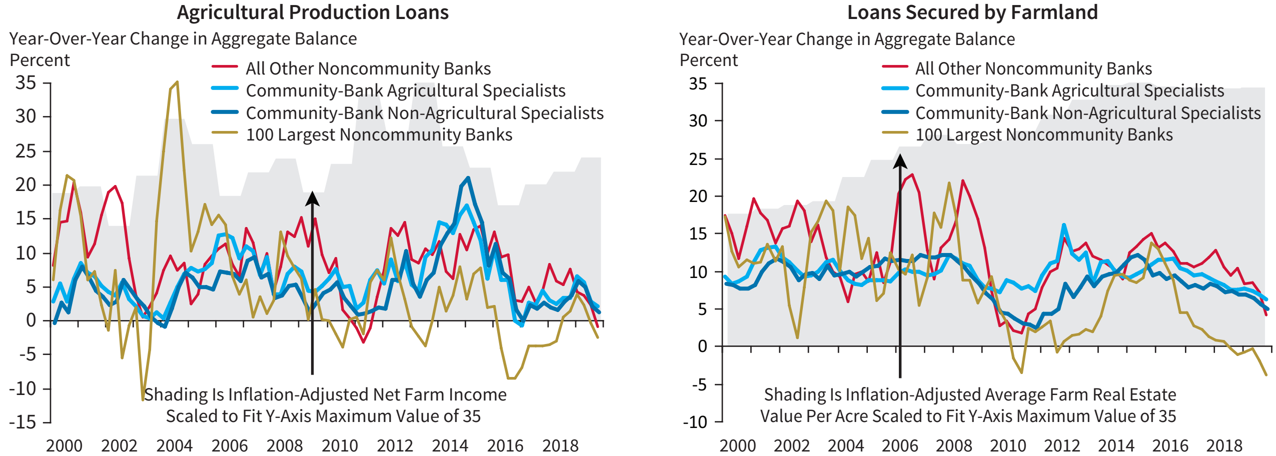
Among community banks, although agricultural specialists and nonagricultural specialists showed similar growth patterns in their agricultural lending and therefore presumably similar commitment to the agriculture sector throughout the course of its ups-and-downs, from a risk perspective the nonspecialists tend to have far less at stake because of much smaller agricultural concentrations.

[24] Reflective of the ongoing stress, the farm sector's aggregate working capital balance declined by more than one-third from 2014 to 2020, and its aggregate debt-to-asset ratio rose from 11.4 percent in 2013 to a forecasted 14 percent for 2020. See U.S. Department of Agriculture. Farm Balance Sheet and Financial Ratios, U.S.

[25] This assertion is based on many anecdotal accounts reported by examiners from the FDIC and other bank regulatory agencies, agricultural bank officers, and representatives of industry trade groups.

Chart 4.22

Year-Over-Year Growth in Agricultural Production and Farmland-Secured Loans, First Quarter 2000 Through Fourth Quarter 2019



Source: FDIC.

Notes: Data are quarterly figures from March 31, 2000 through year-end 2019. The bank sample only includes institutions operating throughout the entire period, and grouping designations are based on group designation as of year-end 2019.

The big difference, however, is not between the two community-bank groups—agricultural specialists and nonagricultural specialists—but between both groups, on the one hand, and noncommunity banks, on the other hand. For regardless of exposure and risk in the community-bank sector, both groups are committed to the farm sector through good times and bad. Meanwhile, noncommunity banks—and especially the largest, for which agricultural lending is generally immaterial in proportion to their loan portfolios and capital—are prone to add and subtract credit exposure to the agricultural sector as the sector's performance outlook changes.

Agricultural Lending: Summary

Through their lending activities, community-bank agricultural specialists are important to the nation's agricultural sector and rural communities. Although representing a small percentage of all commercial banks and an even smaller percentage of industry assets, they provide more than one-third of all agricultural credit funded by commercial banks. Agricultural specialists tend to be small, yet by tending to the credit needs of many small and mid-sized farmers, they are a backbone of their communities. Importantly, they are highly committed to meeting those farmers' credit needs even during periods of agricultural stress beyond their borrowers' control. Finally, by remaining committed to their agricultural roots, community-bank agricultural specialists keep banking alive in many rural areas whose demographic and economic profiles leave them unapproached by de novo activity.

Box 4.3 Agricultural Lending and the COVID-19 Pandemic

The COVID-19 pandemic disrupted the agricultural sector, with reduced demand and mismatches and bottlenecks in the food-supply chain causing commodity prices to fluctuate widely. COVID-19 outbreaks among workers caused temporary closures of dozens of large meat-processing plants in April and May, which created a backlog of market-ready animals. These processing issues drove animal prices much lower while at the same time drove meat prices higher for consumers. Closures of schools and restaurants cut demand for milk and dairy products, and some dairy farmers were forced to dump milk as a result. Crop and livestock prices fell sharply between March and June; prices have since rebounded to varying degrees. Strong sales commitments from export countries for corn, soybeans, and pork have been positive news since mid-2020.

In December 2020, the U.S. Department of Agriculture forecasted net farm income to increase from $84 billion in 2019 to $120 billion in 2020. However, the forecast included a $24 billion, or 107 percent, increase in direct federal farm payments to a record $46 billion. Most of the increased assistance was pandemic-related. The forecast also included a $5 billion reduction in expenses. Without the added direct payments and lower expenses, forecasted 2020 net farm income would be much lower at $90 billion, but still 8 percent above 2019's income level.