

RURAL DEPOPULATION – WHAT DOES IT MEAN FOR COMMUNITY BANKS?

**Economic Development in Rural America
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The views expressed in this presentation are those of the presenter and do not necessarily reflect official positions of the FDIC. If reporters are present, all remarks and slides should be considered background information.

FDIC'S FUTURE OF BANKING STUDY

- A series of papers delivered beginning in Summer 2004 – www.fdic.gov
- The purpose of the study was to examine future banking trends and consider policy issues that will result
- My office's paper discussed national rural depopulation trends, then focused on the future of community banks in the Great Plains

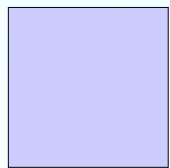
AGENDA

- Trends and causes of rural depopulation
- The effects of depopulation on rural financial institutions
- Looking ahead – what does the future hold for banks in depopulating areas?

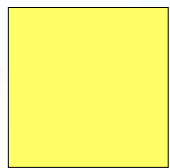
RURAL DEPOPULATION – THE DEMOGRAPHIC STORY



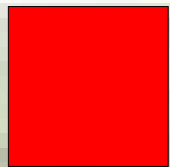
Our Methodology: We Compared the 2000 Census to the 1970 Census



Growing County = 2000 Population GREATER than 1970 Population

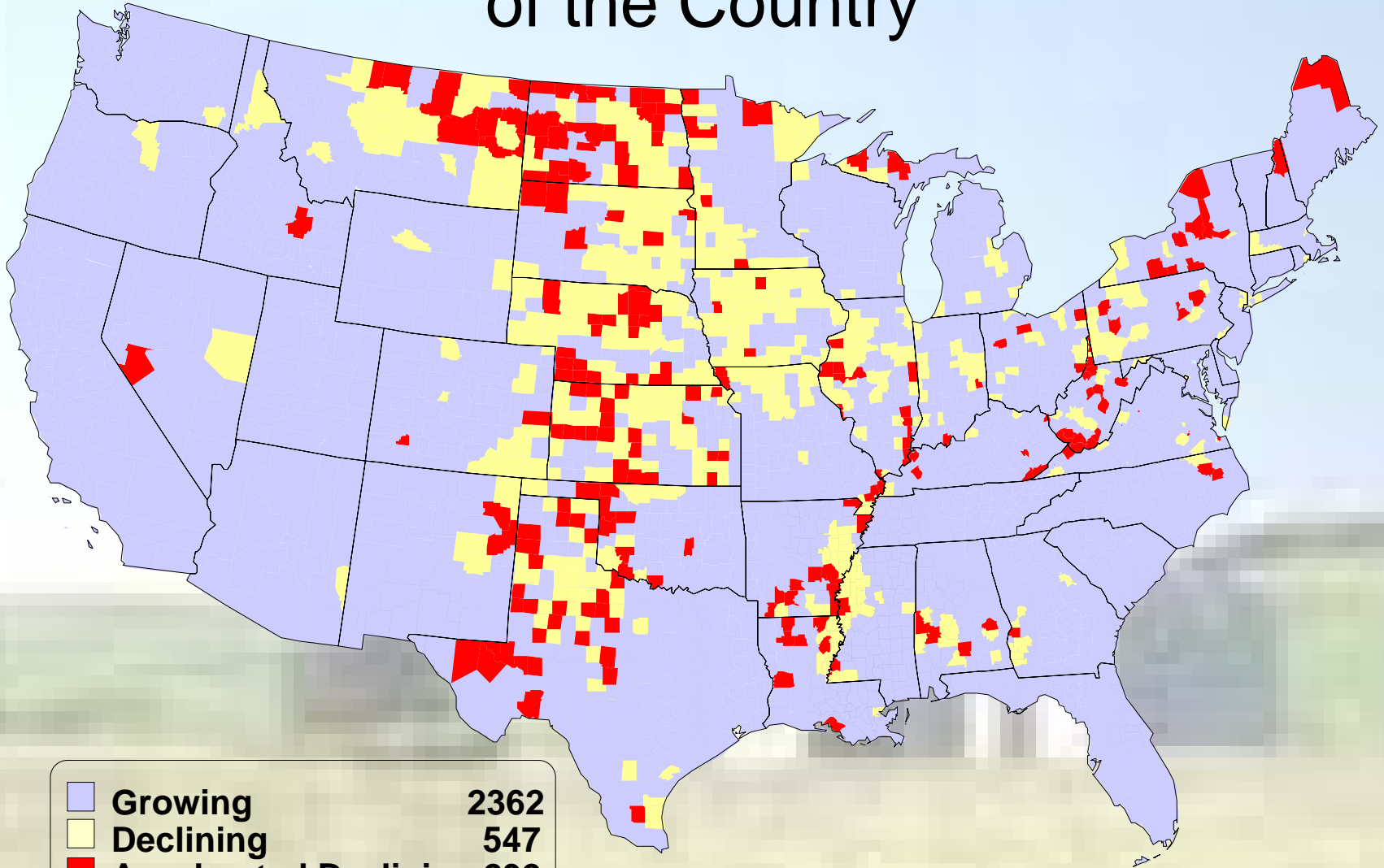


Declining County = 2000 Population LESS than 1970 Population



Accelerated Declining County = Declining Population AND Rate of Decline 1990-2000 greater than Rate of Decline 1970-1990

Depopulation Is Most Prevalent in the Center of the Country

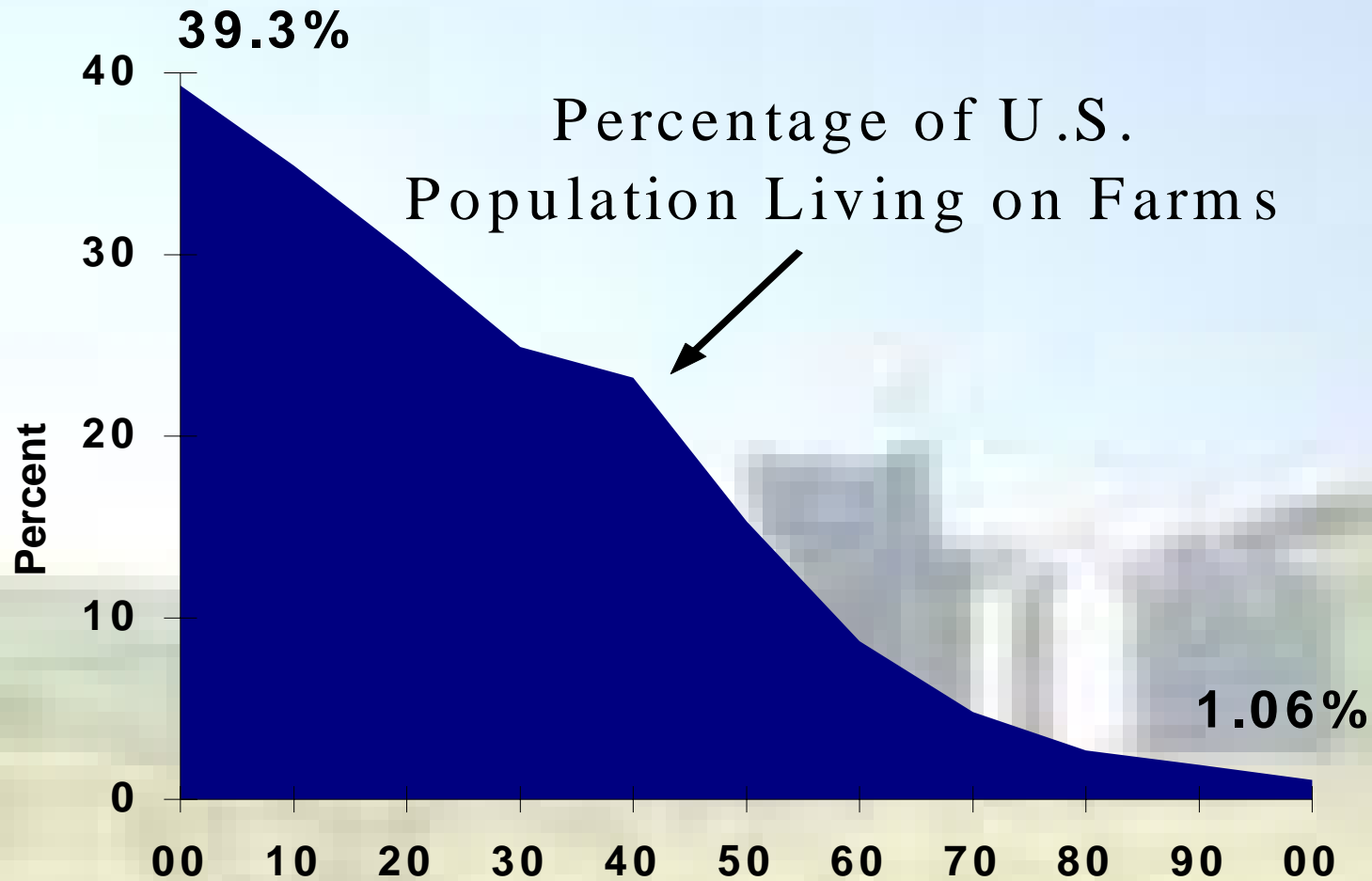


**2000 Census
compared to 1970 Census**

Why does the map look this way?

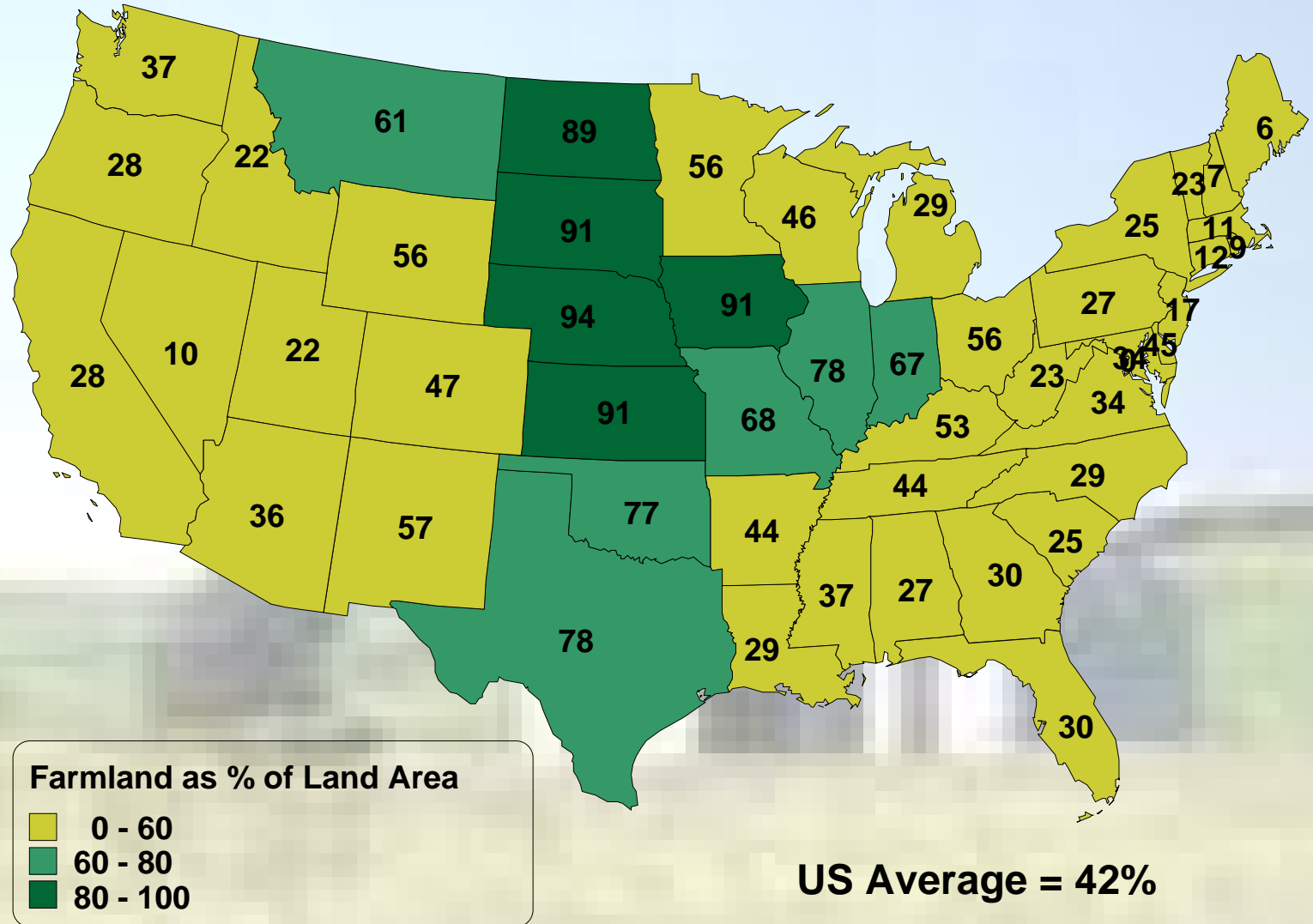
- Declining counties are highly dependent on agriculture
- Technological change in agriculture has substituted capital for labor
- Displaced farmers and their children have migrated to urban centers
- Small towns that traditionally supported farmers have declined due to disappearing demand and competition from larger urban centers

The Farming Community Reduced Significantly in the 1900s



Source: Figures for 1900 through 1980: *Population and Community in Rural America*, Lorraine Garkovich; figures for 1990 and 2000: Calvin Beale, USDA., Personal Communication

States Experiencing the Most Significant Depopulation Have the Highest Proportion of Farmland

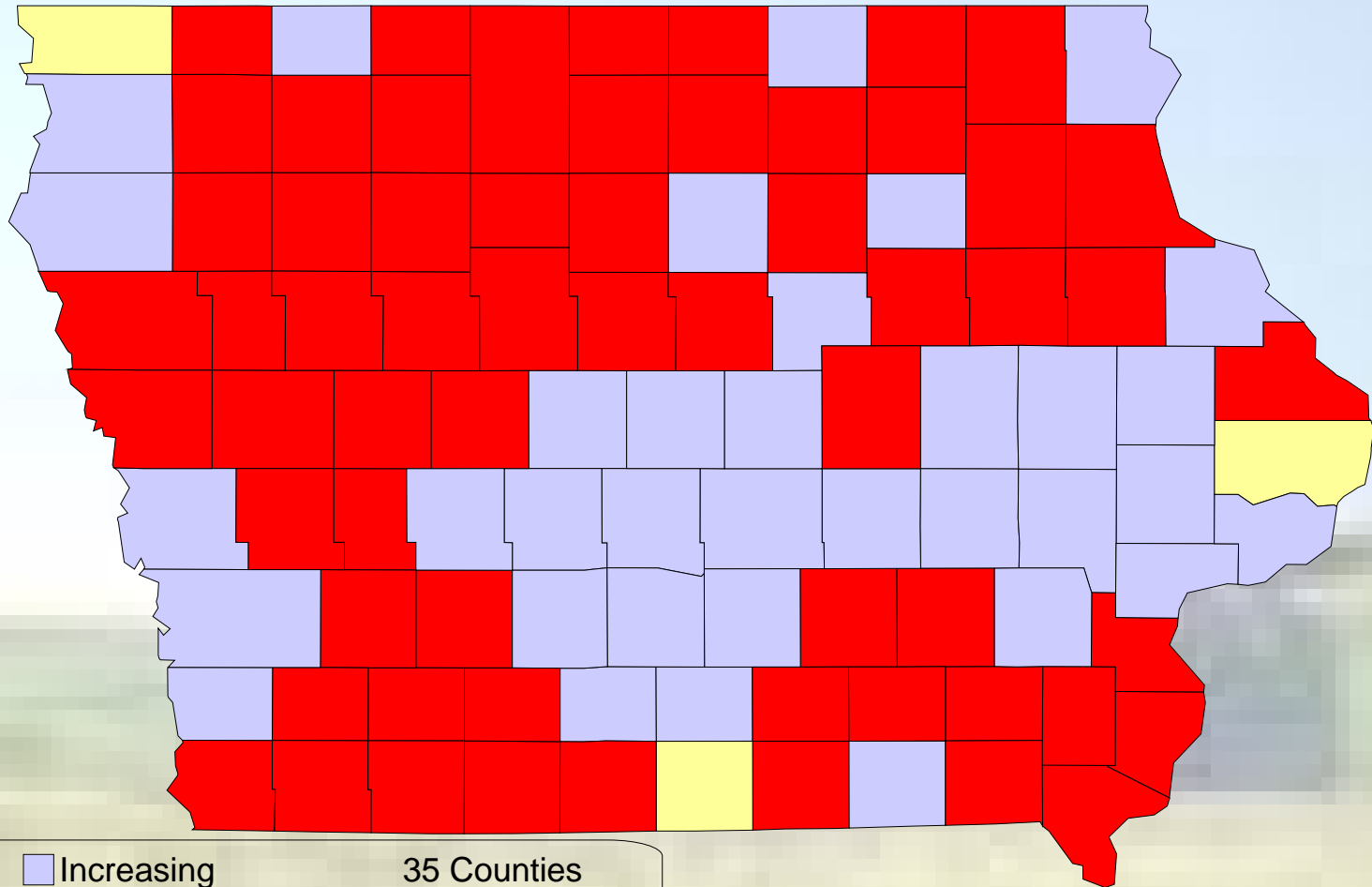





The Great Plains Has the Most Depopulating Counties

	Rural Counties			Metro Counties	Total
	Growing Counties	Declining Counties	AD Counties		
Great Plains					
Counties	120	189	115	53	477
Average population	19,250	6,093	5,849	135,805	23,756
Density (People per Sq. mile)	11.6	5.2	4.8	97.4	17.8
Corn Belt					
Counties	292	166	28	263	749
Average population	30,343	17,609	17,025	179,700	79,468
Density (People per Sq. mile)	46.7	30.3	26.5	324.3	132.3
Delta-South					
Counties	213	49	25	164	451
Average population	26,185	16,673	24,049	95,801	50,348
Density (People per Sq. mile)	46.6	28.4	33.4	181.1	89.6
Appalachia-East					
Counties	87	12	18	96	213
Average population	44,312	61,470	38,392	304,555	162,071
Density (People per Sq. mile)	65.0	99.5	62.4	556.4	264.8
Other					
Counties	678	36	24	513	1251
Average population	32,082	9,359	14,466	255,176	122,574
Density (People per Sq. mile)	14.9	8.4	10.6	243.1	74.1
Total					
Counties	1,390	452	210	1,089	3,141
Average population	30,471	13,199	13,280	211,490	89,596
Density (People per Sq. mile)	20.9	15.1	12.7	256.6	79.6

Source: U.S. Census

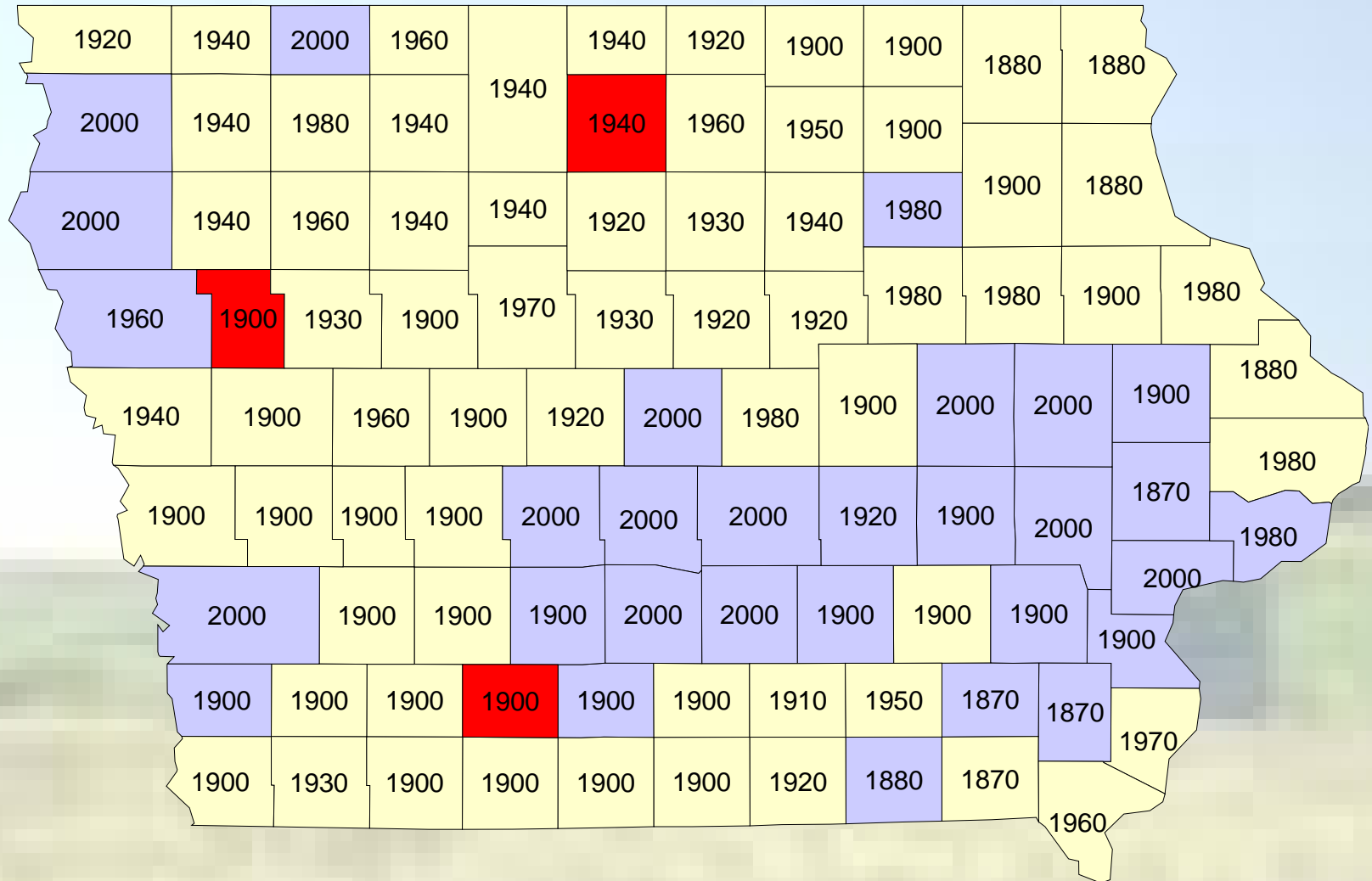
Iowa's Rural Counties Have Continued to Lose People in this Decade



 Increasing	35 Counties
 Declining	3 Counties
 Declining faster than previous decade	61 counties

**2004 Population
Estimates compared
to 2000 Census**

Most of Iowa's Depopulating Counties Reached Maximum Population Early in the 20th Century



Source: 1870 to 2000 Censuses

Iowa's Declining Rural Counties Differ Considerably with Growing Rural Counties

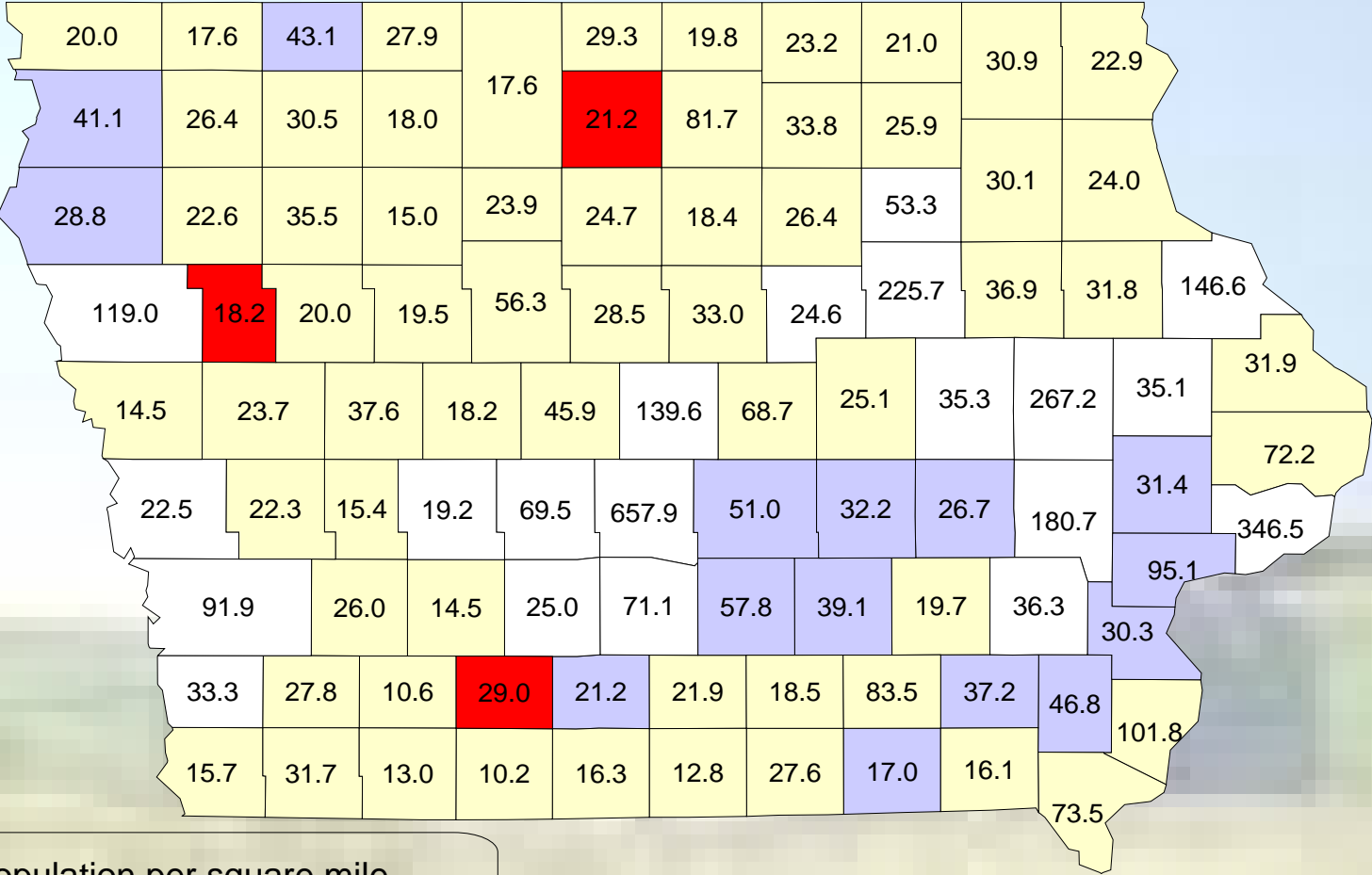
- Rural Counties -

	Growing Counties	Other Declining Counties	AD Counties	Metro Counties	total Iowa
Number of Counties	15	61	3	20	99
Average Population (2000 Census)	21,682	16,480	10,749	78,180	29,559
Total Population	325,231	1,005,255	32,246	1,563,592	2,926,324
Proportion Of Total Population in %	11.1	34.4	1.1	53.4	100.0
Average Population density	39.4	29.6	22.6	128.4	52.4
% Farm Population 1990 Census	13.5	15.0	19.2	4.0	9.2
Real Personal income Growth Avg. Annual % Increase	2.1	1.3	1.2	2.6	2.1
Net Migration 1990-2004 % of 1990 Pop.	1.9	-3.4	-5.2	1.7	-0.2
Natural Increase 1990-2004 % of 1990 Pop.	4.7	-0.3	-1.3	10.3	5.2
Proportion Older % than 65 -2000 Census	15.7	18.6	19.1	12.3	14.9

Note: "AD" counties refers to accelerated declining counties.

Source: U.S. Census -2000 Census and 1999 County Estimates

Depopulating Counties Typically Have Low Population Densities



Population per square mile	
■ Growing Counties	39.4
■ Declining counties	29.6
■ Accelerated Declining counties	22.6
■ Metropolitan Counties	128.4

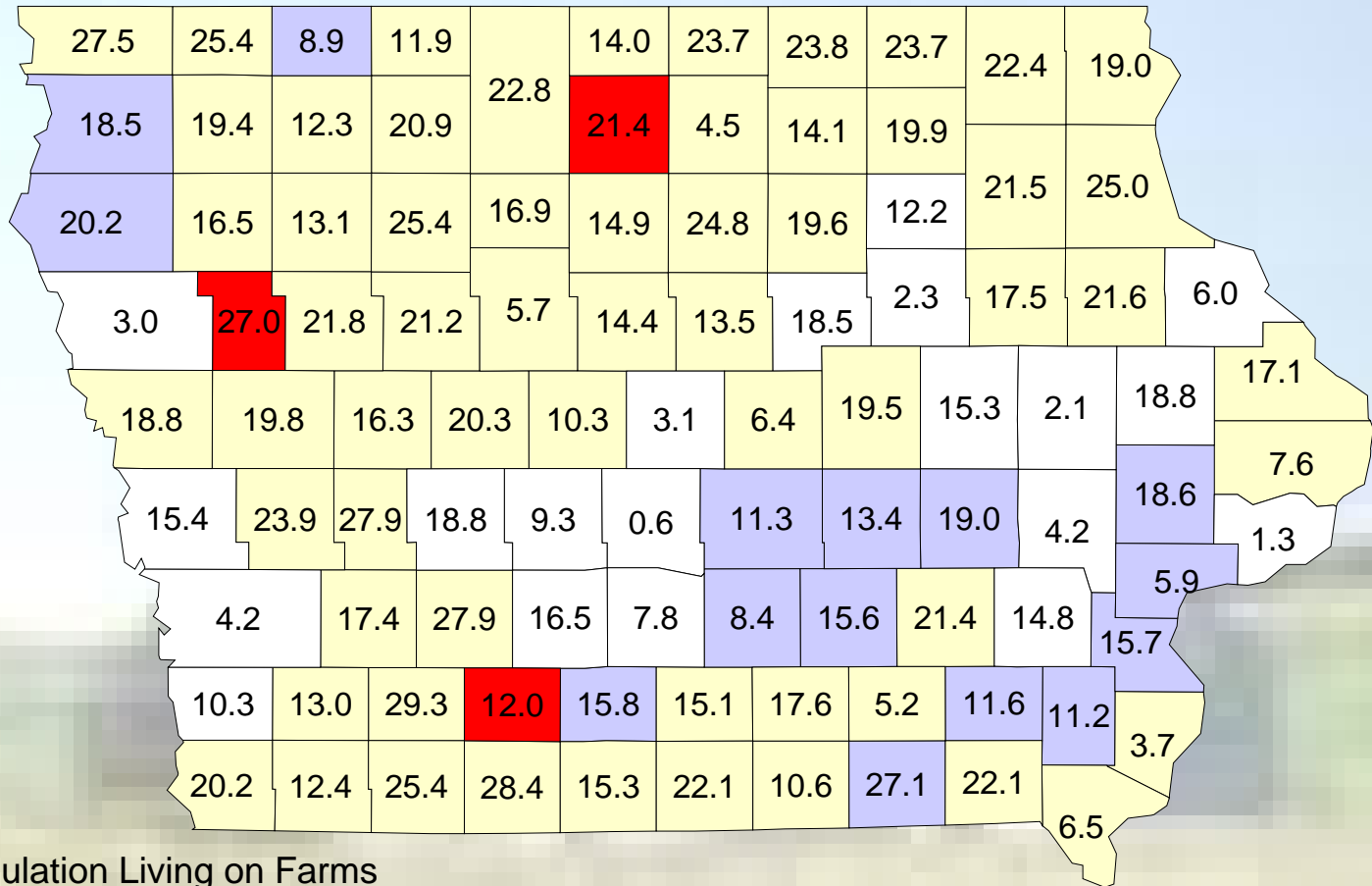
Iowa density = 52.4

U.S. density = 79.6 Source: 2000 Census

Implications of low population densities:

- Sparsely-populated counties lack “critical mass” necessary to maintain economic viability
- Per capita costs of providing services high and increasing
 - Government
 - Infrastructure
 - Education
 - Health Care
- A “vicious circle” of decline is the result
 - Current residents have increasing incentives to leave
 - Sparsely-populated counties have difficulty attracting new businesses

Depopulating Counties Have Larger Farm Populations



Percentage of Population Living on Farms

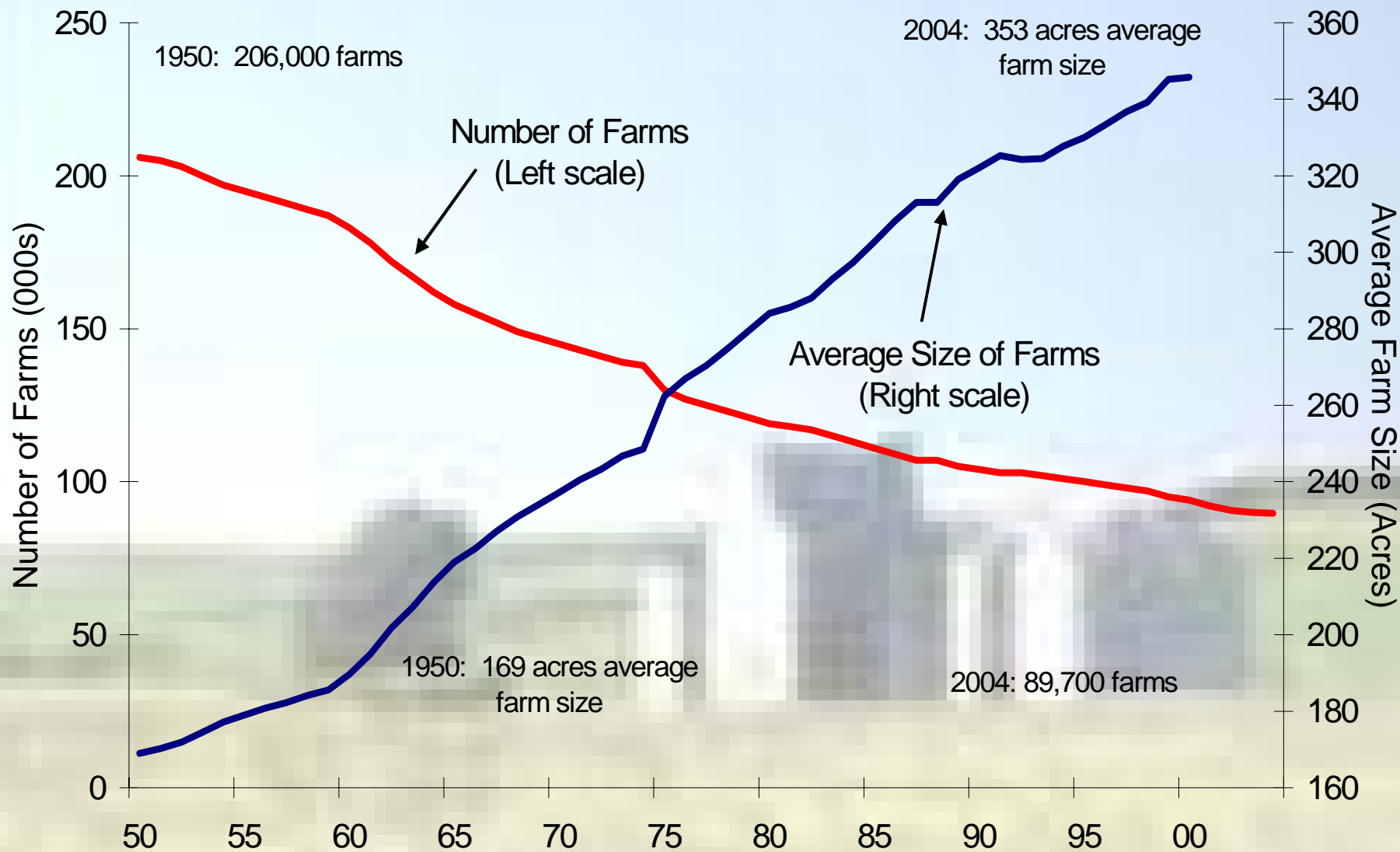


Iowa 9.2

U.S. 1.6

Source: 1990 Census

Iowa Farms Consolidated Substantially in the Last Half of the 20th Century



Source: USDA

Beyond Lower Population Densities, Big Problems Exist in Depopulating Areas

- Age Structures
- “Brain Drain”
- Declining Commercial Activity

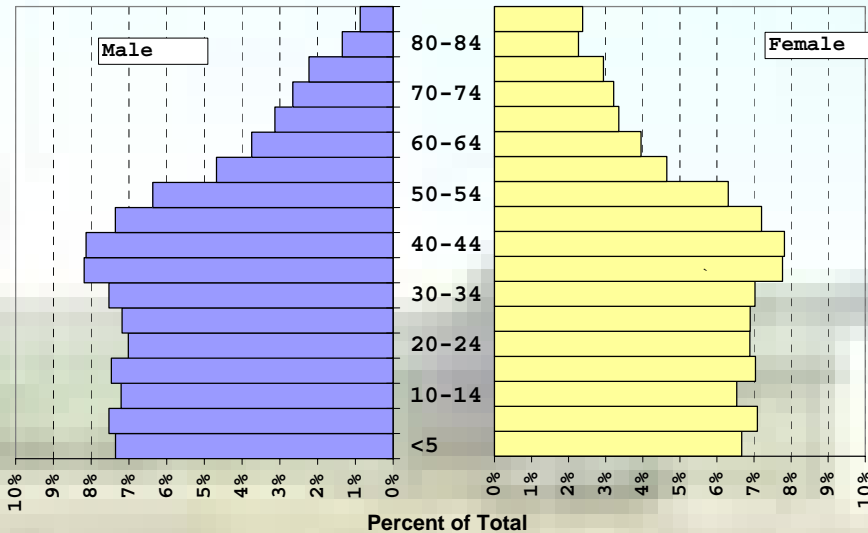
Age Structures of Metropolitan and Rural Depopulating Counties Vary Significantly

Metro County – Cedar Rapids

Declining County

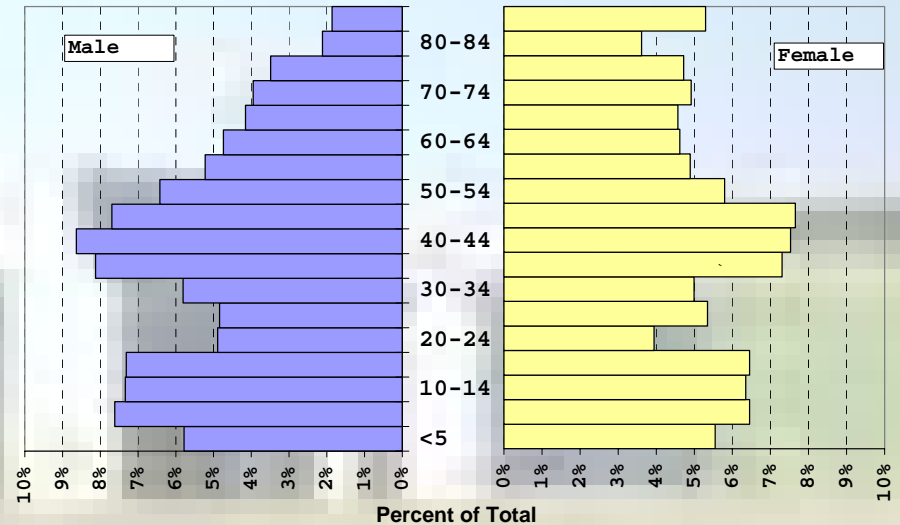
Linn County, Iowa

Total population 191,701
 Density 267.2
 Maximum population 2000



Worth County, Iowa

Total population 7,909
 Density 19.8
 Maximum population 1920



Source: 2000 Census

The “Brain Drain” Is Reaching Critical Proportions in the Great Plains

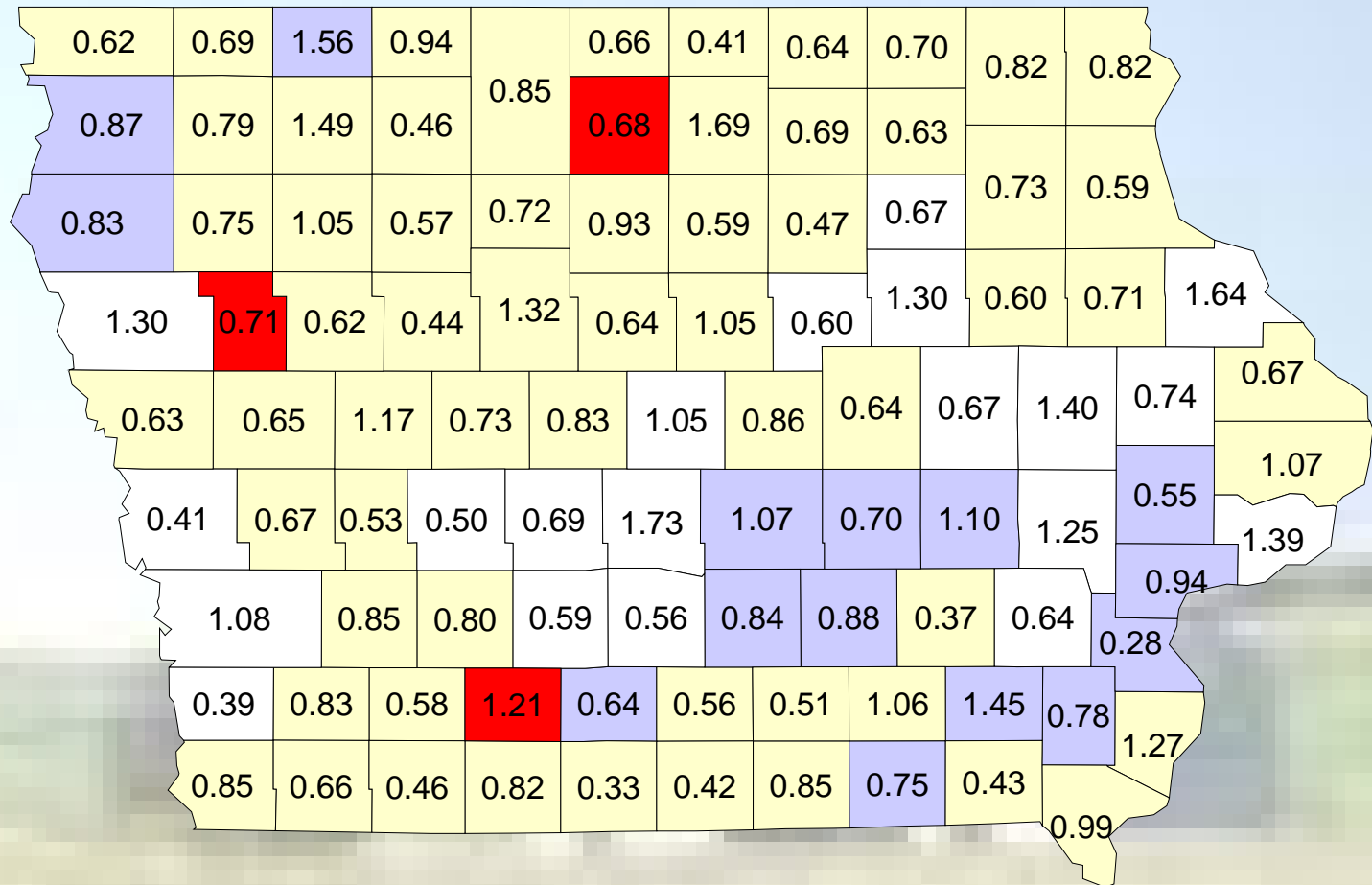
State	Estimated Number of Persons Over 25 Years Old with a Bachelor's Degree		Estimated Change in Bachelor's Degree 1989-1999	Number of Bachelor's Degrees Produced 1989-1999	Estimated Net Brain Drain or Net Gain 1989-1999
	1989	1999			
Minnesota	577,920	953,920	376,000	234,945	141,055
Montana	106,977	134,160	27,183	42,976	-15,793
North Dakota	89,244	89,200	-44	45,022	-45,066
South Dakota	79,672	110,848	31,176	40,669	-9,493
Wisconsin	571,725	790,600	218,875	269,647	-50,772


Note: Population data were revised by the Federal Reserve Bank of Minneapolis.
Source: Postsecondary Education Opportunity

Commercial Activity in Depopulating Counties Is Trending Downward

- **Smaller towns feel the effects of fewer and larger farms**
 - Fewer farms leads to less retail activity
 - Larger farms outgrow the ability of small town businesses, including bankers, to meet their needs
- **Smaller town businesses succumb to competition from larger towns**
 - Larger retailers attract business from the small towns – the “Wal-Mart effect”
 - Agricultural supply companies such as farm machinery dealers, chemical distributors, and feed salesmen consolidate into fewer and larger operations

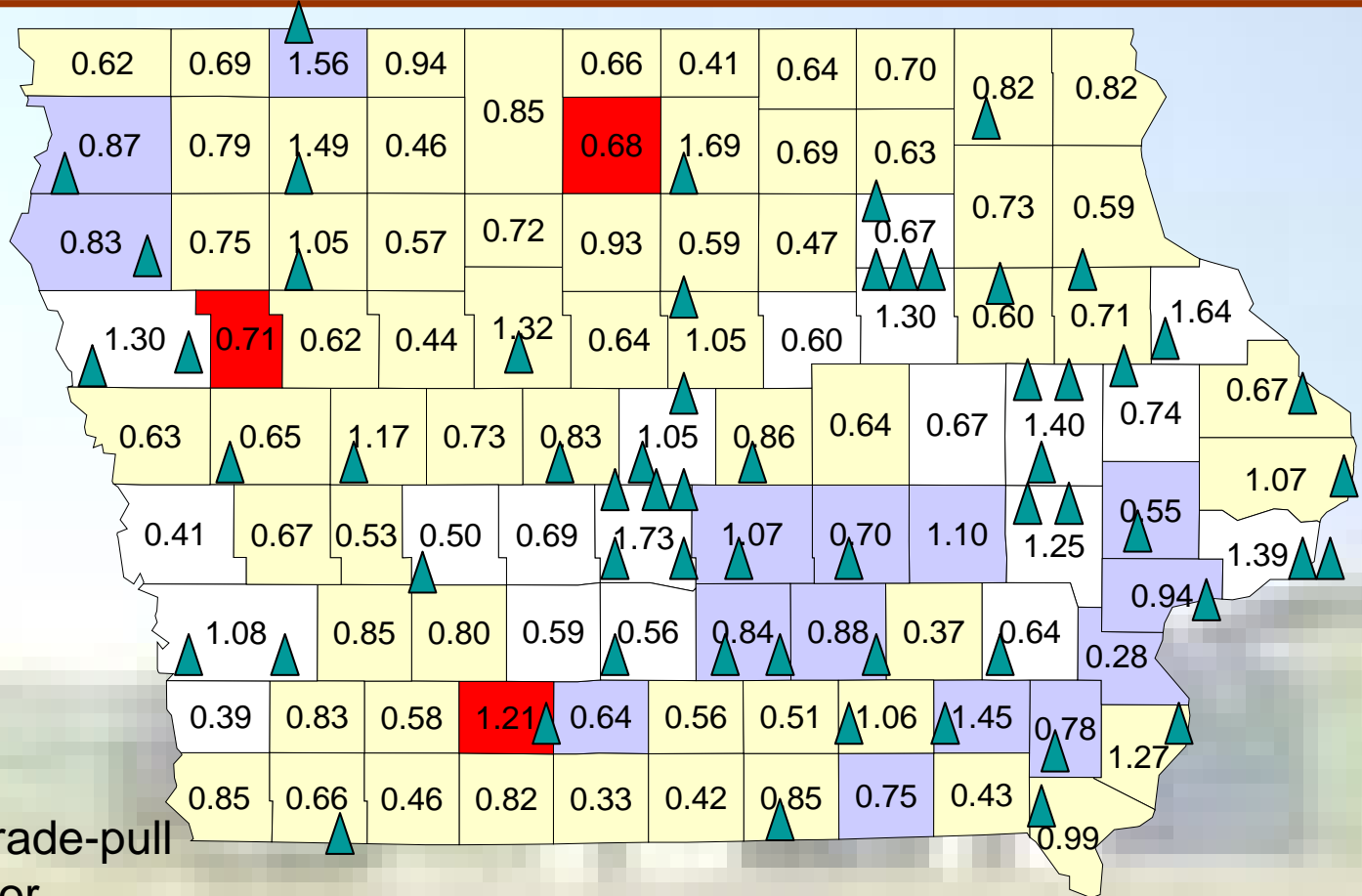
Trade "Pull-Factor" Analysis Suggests Depopulating Counties Lose Trade to Neighbors



	Growing	0.91
	Declining	0.86
	AD	0.89
	Metro	1.31

Source: Iowa Department of Revenue, 2004 receipts

Growing Counties Are Much More Likely to Have a Wal-Mart

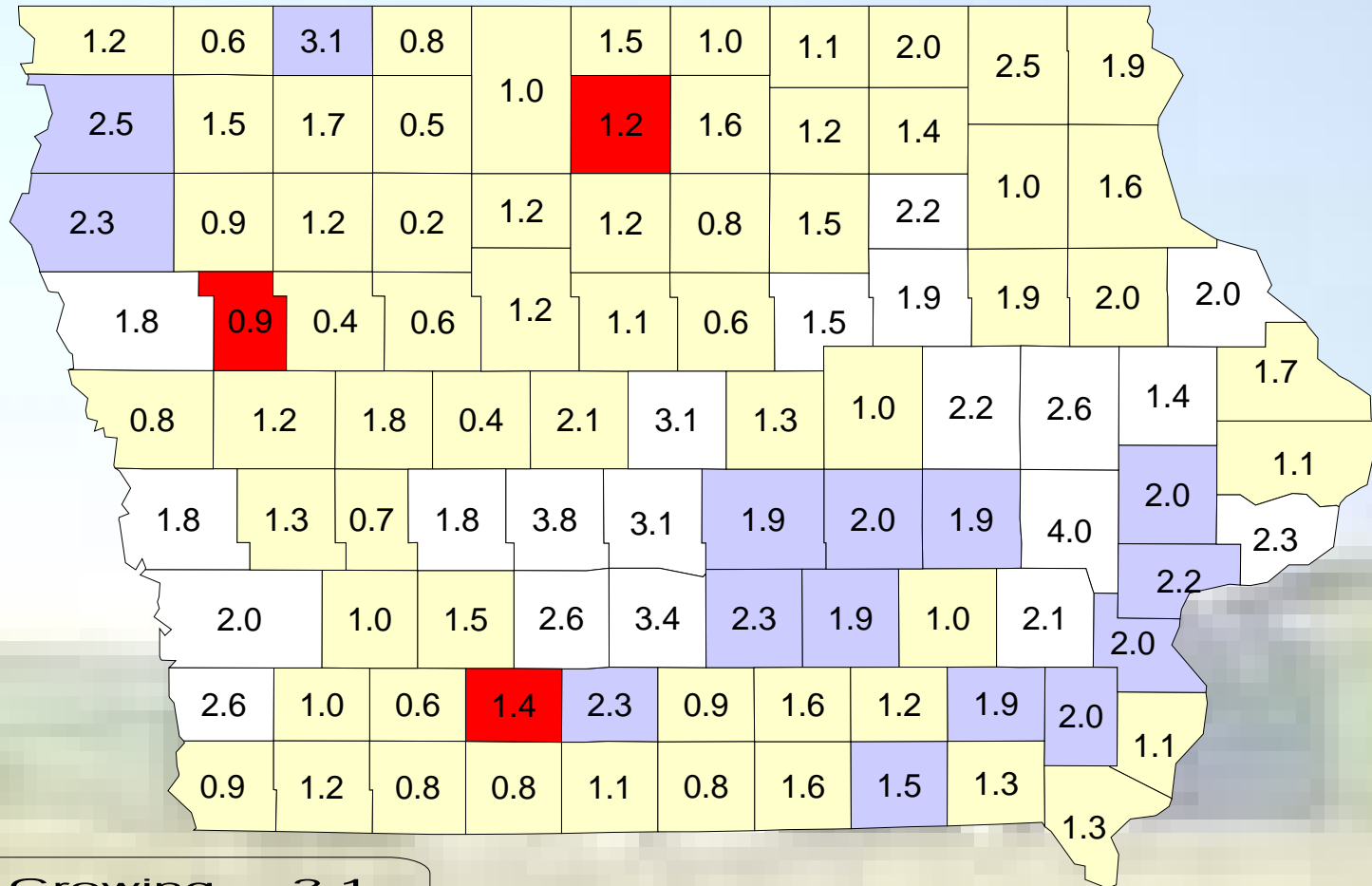


Average Trade-pull Factor

	Growing	0.91
	Declining	0.86
	AD	0.89
	Metro	1.31

= Wal-Mart location

Depopulating Counties Lag Growing Counties in Personal Income Growth



**Average Annual Percentage Growth Rate
of Real Personal Income 1970-2003**

Source: Bureau of Economic Analysis

RURAL DEPOPULATION – EFFECTS ON COMMUNITY BANKS



There Are Over 500 Banks and Thrifts in Great Plains Depopulating Counties

Number and Assets of Banks and Thrifts by Type of County, by Region

	Rural Counties			Metro Counties	Total
	Growing Counties	Declining Counties	AD Counties		
Great Plains					
Number of Institutions	306	323	184	286	1,099
Total Assets (in billions)	37.9	20.1	12.1	91.1	161.2
Median Assets (in millions)	70.8	39.3	39.0	106.9	55.6
Corn Belt					
Number of Institutions	862	610	85	1,649	3,206
Total Assets (in billions)	108.0	52.6	7.9	1,843.1	2,011.5
Median Assets (in millions)	84.0	57.3	53.1	118.0	88.5
Delta-South					
Number of Institutions	386	81	58	438	963
Total Assets (in billions)	74.5	10.8	5.9	470.7	561.9
Median Assets (in millions)	106.3	78.4	79.4	128.2	111.1
Appalachia-East					
Number of Institutions	147	18	34	429	628
Total Assets (in billions)	58.4	8.7	8.0	1,998.7	2,073.8
Median Assets (in millions)	150.6	96.1	84.2	246.5	193.4
Nation - Total					
Number of Institutions	2,692	1,061	390	5,021	9,164
Total Assets (in billions)	490.8	93.9	37.9	8,374.8	8,997.4
Median Assets (in millions)	94.9	52.7	50.6	147.9	105.8

Source: Bank and Thrift Call Reports, December 31, 2003

Our Analysis Focused on Institutions in the Great Plains

- Consolidation patterns – are Great Plains institutions disappearing at a faster rate than elsewhere?
- Performance – have Great Plains institutions been adversely affected by their demographic challenges?
- Best practices – have bankers found recipes for success?

Bank Consolidation Trends

- Since 1984, about half of Great Plains rural banks have disappeared
- Surprisingly, approximately the same percentage of rural banks outside the Great Plains are gone
- Within the Great Plains, consolidation rates have been similar in rural growing, declining, and AD counties

Bank Consolidation Trends (cont.)

While overall institution consolidation is similar, the Great Plains has a disproportionate number of counties without local banks.

- 76 of 424 (18%) rural Great Plains counties have no headquartered institution
- The proportion is 13% in rural counties elsewhere
- South Dakota (32% of its counties) and Montana (20%) have the most counties without local banks
- Total branches are still relatively stable, as consolidated banks tend to turn into branches

Performance Analysis – What Institutions Did We Examine?

- “Community banks” – banks and thrifts with less than \$250 million in assets, headquartered in rural counties
- All balance-sheet growth rates were merger-adjusted

Despite the Challenges, GP Rural Institutions Are Performing Similarly to Those Elsewhere

- Over the past five years, earnings, asset quality, and capital levels in rural Great Plains banks have been similar to those in rural banks elsewhere
- The same is seen within growing, declining, and AD counties in the Great Plains
- However, major differences can be seen in the level of farm lending and the percentage of institutions that are considered farm banks
- And balance-sheet growth rates show differences as well

Where We Do See Significant Differences Are in Balance Sheet Growth Rates

Balance-Sheet Growth Rates by Type of County, Rural Great Plains, Year-end 1993 to Year-end 2003

Great Plains County Type	Annualized Growth Rate (%) between Year-end 1993 and Year-end 2003			
	Total Assets	Total Loans	Total Deposits	Core Deposits
Metropolitan	8.87	11.16	8.61	7.87
Rural	4.37	6.77	3.84	3.04
Growing	4.78	6.96	4.28	3.47
Declining	4.04	6.32	3.45	2.64
Accelerated Declining	4.10	7.16	3.61	2.84

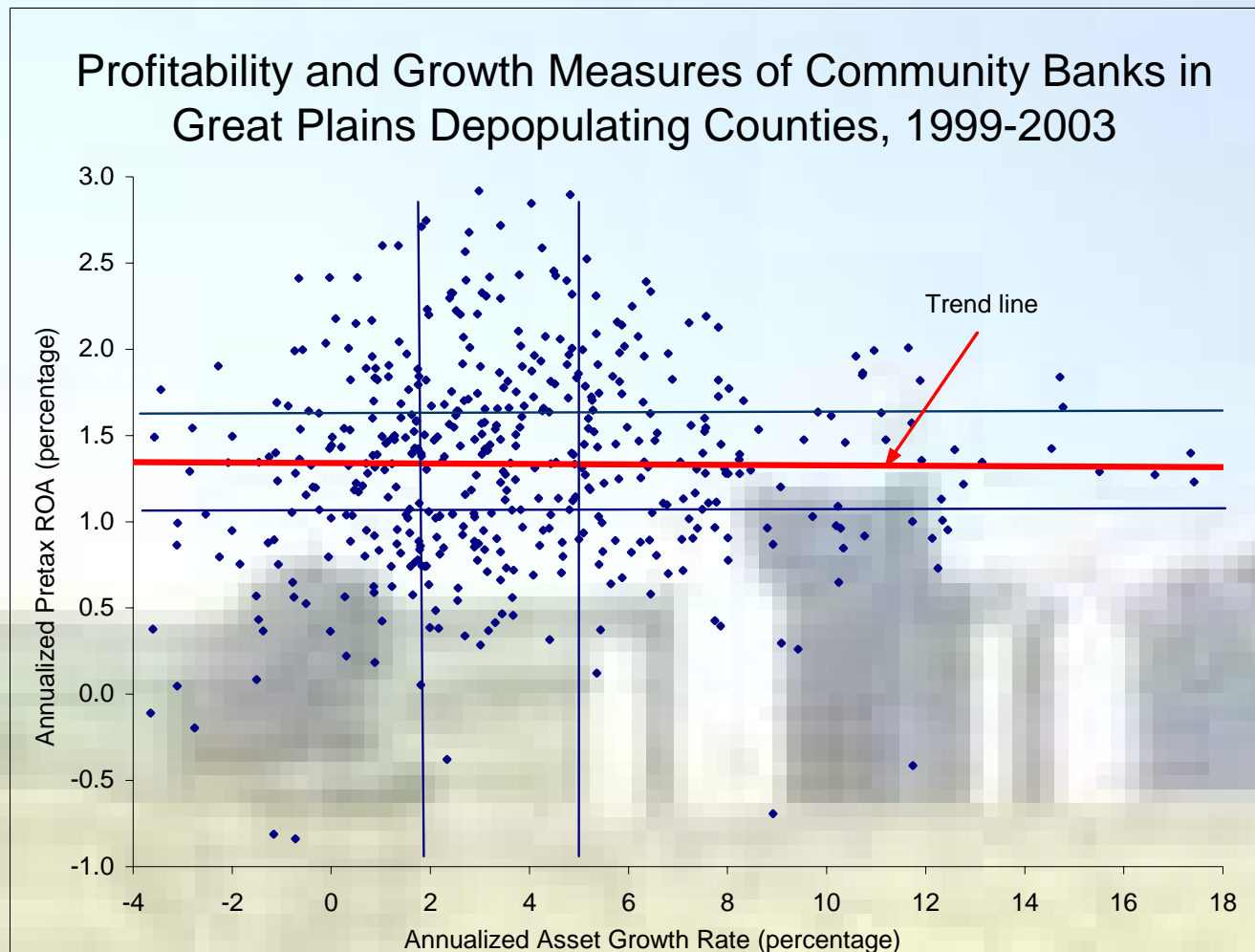
Source: Bank and Thrift Call Reports.

Note: All growth rates are merger adjusted. Community banks are defined as banks and thrifts with less than \$250 million in total assets.

“Best Practices” Analysis

- We focused on banks and thrifts headquartered in Great Plains depopulating counties
- We looked only at “community banks” (under \$250 million in assets) that have been in operation at least 10 years
- We analyzed two metrics as proxies of success
 - earnings and asset growth
 - 5-year pretax ROA and 5-year annualized asset growth

Great Plains Community Banks Reported Wide Variations in Earnings and Asset Growth



Source: Bank and thrift Call Reports for institutions in Great Plains rural depopulating counties that reported less than \$250 million on December 31, 2003, and were established on or before December 31, 1993.

The Same Scatterplot – Much Simpler Format

Profitability, Growth Rates, and Asset Size of Community Banks In Great Plains Depopulating Counties, by Segment, 1999-2003				
5-Year Annualized Pretax ROA Range	1.57% to 3.53%	Low Asset Growth/High Pretax ROA Number of Institutions 44 Median Total Assets \$41.2MM Asset Growth Rate 0.56% Pretax ROA 1.90%	High Asset Growth/High Pretax ROA Number of Institutions: 49 Median Total Assets \$54.8MM Asset Growth Rate 7.47% Pretax ROA 1.96%	
	1.05% to 1.57%	Middle Cross Number of Institutions: 280 Median Total Assets \$40.4MM Asset Growth Rate 3.99% Pretax ROA 1.44%		
	(1.07)% to 1.05%	Low Asset Growth/Low Pretax ROA Number of Institutions 61 Median Total Assets \$21.5MM Asset Growth Rate -0.80% Pretax ROA 0.64%	High Asset Growth/Low Pretax ROA Number of Institutions 49 Median Total Assets \$37.5MM Asset Growth Rate 9.10% Pretax ROA 0.76%	
		(11.71)% to 1.91%	1.91% to 4.88%	4.88% to 79.65%
5-Year Annualized Growth Rate Range				

Why are these banks in those quadrants?

- High-growth/high-earnings banks have achieved prudent growth and profits through branch expansion, higher net interest margins
- Low-growth/high-earnings banks have controlled costs extremely well
- High-growth/low-earnings banks have also opened non-local branches, but with less success
- Low-growth/low-earnings banks have not actively pursued possible growth strategies (branching, etc.), and have not controlled costs well

What Did This Analysis Teach Us?

1. Size matters, especially in controlling operating expenses
2. Net interest margins are key, as they always have been
3. Branching strategies – and their success – vary widely

Aggressive Branching Strategies Worked for Some, Not for Others

High-Growth Banks Tend to Be More Aggressive in Branching

	High Growth/ High Earnings Banks	Low Growth/ High Earnings Banks	Middle Cross Banks	High Growth/ Low Earnings Banks	Low Growth/ Low Earnings Banks
<u>Branching Characteristics (% of institutions)</u>					
Unit Banks	38.78	70.45	53.57	34.69	65.57
Multibranch – all in HQ county	14.29	20.45	13.93	16.33	19.67
Multibranch – some branches in metro counties	6.12	2.27	8.93	16.33	4.92
Multibranch – no metro branches, but some in growing counties	18.37	0.00	8.21	10.20	4.92
Multibranch – but only in depopulating counties	22.45	6.82	15.36	22.45	4.92

Source: Bank and thrift Call Reports.:

Note: Branch data are as of June 30, 2003.



**LOOKING AHEAD –
THE FUTURE OF GREAT PLAINS
COMMUNITY BANKS**

Will the Internet Save Depopulating Rural Areas – And Their Banks?

- Some analysts predict that the Internet – aided by broadband access – will revitalize rural areas
- However, the Internet is a double-edged sword
- Despite similar optimism, prior technological advances did not prove beneficial to rural areas

Looking Ahead at Rural Community Banks

- Rural depopulation trends are not reversing, and in many areas they are accelerating
- Some community strategies have proven beneficial
 - on a very small basis
- The Internet holds promise, but may also be construed as a threat
- Bank consolidation in the rural GP may significantly increase over the next 20 years
 - Management succession plans?
 - Large “bubble” of extremely elderly
- Those banks with strong management and prudent growth plans will likely be left standing

COMMENTS/QUESTIONS

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