June 2016

Testimony of

Shan Hanes

before the

Small Business Committee

Economic, Growth, Tax and Capital Access Subcommittee

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Chairman Huelskamp, Ranking Member Chu, and members of the Subcommittee, my name is Shan Hanes, and I am the President and CEO Board of First National Bank in Elkhart, Kansas. First National Bank is a $78 million bank with a main location in Elkhart, Kansas and one branch serving Rolla, Kansas and the surrounding area. We have 20 employees and we predominantly lend to agriculture. Despite our small size, the bank is the largest lender in the county and we represent an average sized bank in rural Kansas.

I am also a member of the American Bankers Association's Agricultural and Rural Bankers Committee. I appreciate the opportunity to present the views of the ABA on credit conditions and credit availability in rural America.

The nation's $16 trillion banking industry, which is composed of small, regional and large banks that together employ more than 2 million people, safeguard $12 trillion in deposits and extend nearly $8 trillion in loans. Rural credit issues are very important to the banking industry as banks have provided credit to rural areas since the founding of our country. Over 5,000 banks – over 82% of all banks – reported agricultural loans on their books at year end 2015 with a total outstanding portfolio of over $171 billion.

The topic of today's hearing is very timely. The rural economy has been slowing, with farm sector profitability expected to decline further in 2016 for the third consecutive decline. However, farm and ranch incomes for the past five years have been some of the best in history. With the new Farm Bill in place, farmers, ranchers, and their bankers have certainty from Washington about future agricultural policy and how it will affect rural America. Interest rates continue to be at or near record lows, and the banking industry has the people, capital and liquidity to help rural America sustain through any turbulence in the rural economy.

Banks continue to be one of the first places that farmers and ranchers turn when looking for agricultural loans. Our agricultural credit portfolio is very diverse – we finance large and small farms, urban farmers, beginning farmers, women farmers and minority farmers. To bankers, agricultural lending is good business and we make credit available to all who can demonstrate they have a sound business plan and the ability to repay.

In 2015, farm banks – banks with more than 15.5% of their loans made to farmers or ranchers – increased agricultural lending 7.9 percent to meet these rising credit needs of farmers and ranchers, and now provide over $100 billion in total farm loans. Farm banks are an essential resource for small farmers, holding $48 billion in small farm loans, with $11.5 billion in micro-small farm loans (loans with origination values less than $100,000). These farm banks are healthy and well capitalized and stand ready to meet the credit demands of our nation's farmers large and small.

In addition to our commitment to farmers and ranchers, thousands of farm dependent businesses – food processors, retailers, transportation companies, storage facilities, manufacturers, etc. – receive financing from the banking industry as well. Agriculture is a vital industry to our country, and financing it is an essential business for many banks, mine included.

Banks work closely with the Small Business Administration to provide credit through the 7(a) and Section 504 guaranteed lending programs. Additionally, banks like mine utilize USDA to make additional credit available by working with the Farm Service Agency to promote Guaranteed Farm Loan Programs and Rural Development for their many programs available for rural communities. The repeal of borrower limits on USDA's Farm Service Agency guaranteed loans has allowed farmers to continue to access credit from banks like mine as they grow, ensuring credit access for farmers across the country and the guaranteed funding of USDA's Rural Development programs has encouraged banks like mine to use these programs when applicable.

In my testimony today I would like to elaborate on the following points:

- Banks compete with competition on an uneven playing field;

- Banks must deal with the daily impact of new and enhanced bank regulations and impediments to growth for rural communities;
- Bank's specific impediments to growth and impact on rural lenders;
- The current issues with appraisers in rural America and the impact on our business as lenders.

I. Unfair competition

The Farm Credit System is a government sponsored entity that has veered away from its intended mission and now represents an unwarranted risk to taxpayers. The Farm Credit System was founded in 1916 to ensure that young, beginning, and small farmers and ranchers had access to credit. It has since grown into a $304 billion behemoth offering complex financial services. To put this in perspective, ***if the Farm Credit System were a bank it would be the ninth largest in the United States, and larger than 99.9% of the banks in the country***. This system operates as a Government Sponsored Entity and represents a risk to taxpayers in the same way that Fannie Mae and Freddie Mac do. It benefits from significant tax breaks – valued at $1.3 billion in 2015 – giving it a significant edge over private sector competitors. Moreover, the Farm Credit System enjoys a government backing, formalized by the creation of a $10 billion line of credit with the U.S. treasury in 2013.The Farm Credit System has veered significantly from its charter to serve young, beginning, and small farmers and ranchers, and now primarily serves large established farms, who could easily obtain credit from the private sector. In fact, the majority of Farm Credit System loans outstanding are in excess of $1 million. Any farmer able to take on over $1 million in debt does not need subsidized credit. Moreover, the volume of small borrower loans accounted for 14% of all new Farm Credit System loans in 2015. In addition to the Farm Credit System, the Credit Union industry has grown to over $1 trillion in assets and their tax benefit is estimated to exceed $26.75 billion over the next ten years.

II. Impact of new and enhanced bank regulations and impediments to growth for rural communities

One of the most daunting challenges has been the sheer volume of recent regulations. For many years, our compliance was primarily handled within the bank by employees. It allowed for cross-training of employees and fostered individual education regarding the regulations and bank policies. When necessary, the bank would outsource an audit to provide independence or a specific expertise. However, the rules and regulations change so often that a banker cannot stay abreast or competent to review the details of the new rules and regulations. Therefore, we have begun outsourcing most audits to a point that we are paying a full-time teller salary to compliance audit teams. <u>**The impact is one fewer bank employee serving customers on a daily basis and one less salary paid to a member of our community.**</u>

III. Specific impediments to growth and impact on rural lenders on real estate lending

Reduced Credit Offerings: Many banks in rural Kansas have moved out of the mortgage lending business. Not because the loans are not safe and profitable, but due to compliance. Historically, because we only make standard real estate loans with 20% down payment, these loans were safe and sound credit decisions with some of the lowest loss ratios and were the "bread and butter" for both the bank and community. In my bank, we don't sell mortgages on the secondary market, so a poor credit decision would affect our bottom line and shareholders directly. Due to these factors in banks similar to mine, banks are exiting the mortgage lending market not due to credit decisions, but due to compliance and regulatory decisions. The mortgage lending rules were intended to address the credit risk side; however the compliance risk has become greater than the credit risk. <u>**If the loan is held in the bank's portfolio, it should automatically be a qualified mortgage (QM) loan as the credit risk lies with the bank.**</u>

Loan Closings: To try and comply with the onerous regulations, we've hired an outside consultant to assist us completing pre-closing and post-closing real estate reviews of all consumer real estate loans. This added time and expense became necessary as we did not possess the necessary compliance expertise in house. Additionally, my bank doesn't close enough consumer real estate loans on a monthly basis to gain the expertise in house. <u>**This added compliance has increased the closing costs to the consumer and delayed the closing of their loan to allow for extra review of loan documents.**</u>

Payment Structure and Reduced Standard Loan Options: One of the biggest advantages that rural banks had over large commercial banks was the ability to customize payment structure to meet their specific needs. We know our customers, we know when they receive paychecks and we know their cash flow needs. We could leverage this to compete against large lenders and better serve our community. However, due to the regulatory constraints, we've moved to a canned loan product system. We now make "monthly payment consumer loans" regardless of how and when the customer is paid. Because this product "fits the system." In an effort to protect the consumer, the regulatory environment has harmed the consumer's access to credit and flexibility of their bank to tailor the repayment to their specific needs. **Local lending decisions should be made locally, not by a bureaucrat in Washington, D.C.**

Costs to Make a Real Estate Loan: Every rural bank has a similar story: A little elderly lady with her house free and clear comes to the bank for a loan because her air conditioner unit is out. Historically, the bank would have placed a small mortgage on her house, produced a quick valuation on the home, and funded the purchase of a new air conditioner unit. However, due to the costs and time required to close a consumer real estate loan, the loan is not a profitable loan. We have to make a choice to either make the loan going through the regulatory hoops and cost to the borrower, or make the loan unsecured to the customer at a significantly higher interest rate and shorter repayment terms. The sad reality is that due to compliance on loans like this, some banks will not be involved in this type of lending. **We have chosen to make more loans, like the above example, unsecured as we believe it is our duty to help the customer despite increased regulatory costs.**

Houses for Sale: Historically, our rural town has 40 to 60 homes for sale as customers have their existing home for sale and are looking to upgrade to a larger home. However, we currently have between 100 and 120 homes for sale in a small county of 3,000 people. The unusually high number of homes for sale may be partially due to other external factors, but I would argue strongly that it is partially due to increased regulatory compliance and few lenders in that credit market. The lenders who are still in the mortgage credit space are more conservative, have higher closing costs, and are much slower to complete the transaction. **These factors all further slow-down an already slowing down rural economy.**

Secondary Market: The most widely used secondary real estate market provider in our market recently changed their policy to not make any real estate loans less than $50,000. The average residential real estate loan at our bank is less than $33,000. **Many of our customers**

<u>would not qualify to even apply for a mortgage on the secondary market due to these new rules.</u>

IV. Current issues with appraisers in rural America and the impact on our business as lenders

Appraisers: When a bank is making a loan on an agricultural or commercial property, one of the initial steps is to receive a certified general appraisal. However, due to a shortage of appraisers and the ever increasing demands on appraisals, receiving a timely appraisal is very difficult. We've had to wait six months or more to receive an appraisal. Due to the impediments to becoming a certified appraiser, it is difficult for new individuals to acquire a license and there is limited desire for an existing appraiser to take on an apprentice who will eventually be his direct competitor. Customers shouldn't have to wait six months for a credit decision simply because the bank cannot receive a completed appraisal.

The American Bankers Association has been very involved in the issue of the lack of rural appraisers. The ABA has held two large meetings with various stake-holders to create a working solution on the appraisers issue. The most common them, however, is that there needs to be more incentive for individuals to become involved in the real estate appraisal business, especially in rural areas. Congress needs to get involved in making it easier to become an appraiser or we will continue to see long delays in customers closing on home mortgages.

Conclusion

Rural banks will continue to serve their customers to the best of their abilities despite the many obstacles that have hurt their business models. Rural banks will compete with anyone on a level playing field and they have not backed down from such competition in the past. But when there is a combination of an unfair playing field and over burdensome regulations, all banks have great difficulty in surviving, not just competing. Banks are drivers of the economy, and this is especially true for rural banks. With smart reforms to unfair competition, regulations that hold banks back from helping their customers and providing incentives for people to become involved in rural appraising, rural banks will once again be able to help their local economies grow.

Thank you for the opportunity to address the subcommittee and share my view on rural banking. I would be happy to answer any questions that you may have.