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The Financial Health of Banks Lending to Agriculture

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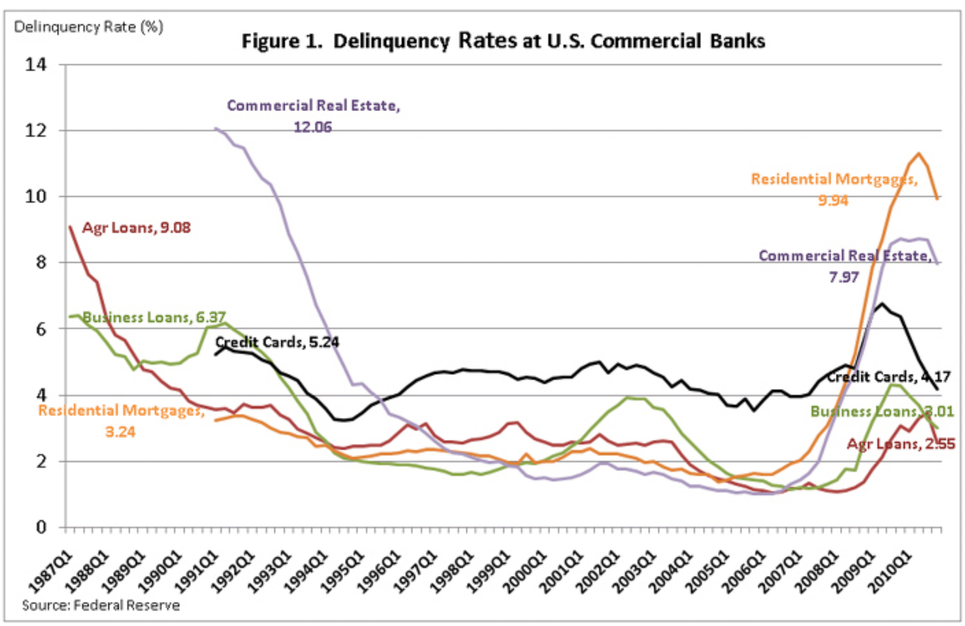
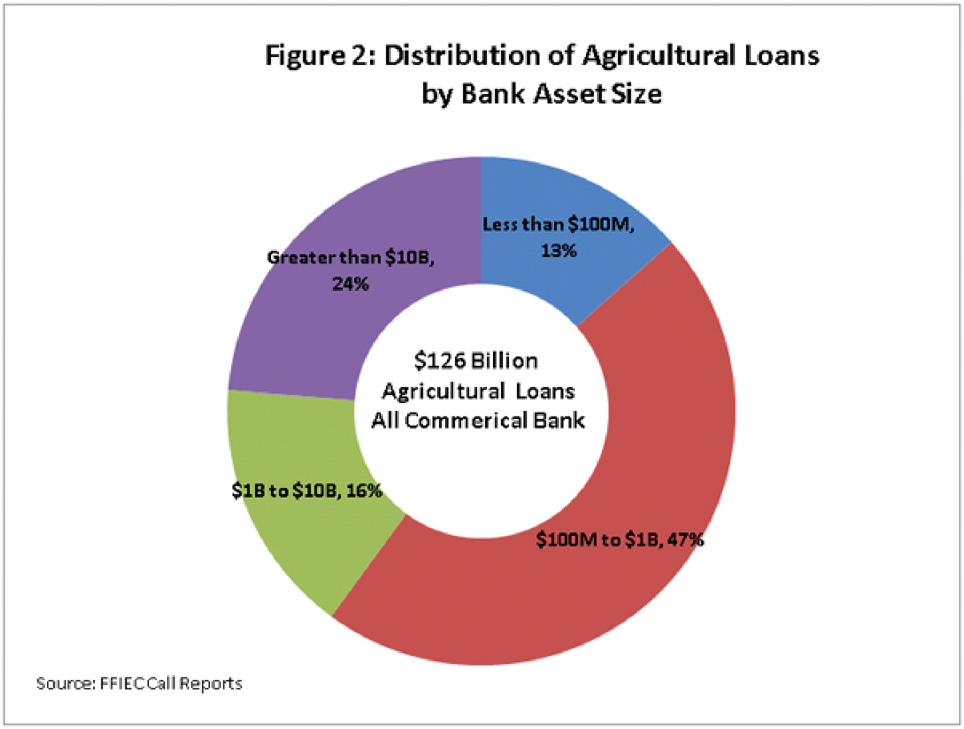
Most commercial banks lending to agriculture have weathered the financial tsunami of the past 36 months. Many of the agricultural-related banks did not participate aggressively in the high-risk housing or commercial real estate markets. As a result, agricultural banks did not sustain the substantial liquidity and capital problems faced by many global financial institutions. In general, credit remained available for farmers and ranchers throughout the financial crisis. The profitability of production agriculture through the crisis certainly played a critical role in credit quality and quantity at agricultural banks.

Agricultural lending increased $13 billion from 2007 through 2010. At the end of 2010, delinquency rates on agricultural loans (2.55%) are lower than the other loan types and far below agricultural delinquency rates exhibited during the agricultural financial crisis in the late 1980s.



Banks lending to agriculture are often characterized by small-rural banks. However, the distribution of banks lending to agriculture can be viewed as a barbell. A few large banks hold a large portion of the total portfolio and thousands of smaller, community-oriented banks lending to agriculture hold a large segment as well. At year end 2010, there were 5,703 banks in the U.S. that provided loans to agriculture. Illinois ranks second (459 banks) to Texas (548 banks) in the number of banks that provide loans for agricultural production or secured by farm real estate. The five largest U.S. institutions lending to agriculture hold 15% of the portfolio of bank loans to agriculture. The five largest agricultural lenders are Wells Fargo ($9.2B), Bank of the West ($3.0B), Rabobank ($2.6B), Bank of America ($2.5B) and U.S. Bank ($1.7B). Collectively, these banks hold more agricultural loans than the 2,468 banks with less than $100M in assets. Figure 2 shows the distribution of agricultural loans by bank size.



Based on data from FDIC, the profitability of banks with concentrations in agriculture improved in 2010. The average rate of return on assets (ROA) for banks with concentrations in agriculture was 0.88% in the 4th Qtr 2010 exceeding the average for all commercial banks (0.64%). The ROA in 2010 was also 63% higher than the same period in 2009. The average charge-off rate for banks with concentrations in agricultural also improved substantially in 2010 and was the lowest across all FDIC concentration groups.

Although credit conditions have improved across the banking sector, a substantial number of bank failures have occurred. Over the first four months of 2011, 34 banks closed while over 150 banks failed in 2010. However, only two of these banks had more than $100 million of agricultural loans. Collectively, these banks held about $1.2 billion of agricultural loans. There have not been substantial credit delivery disruptions to farmers and ranchers because of bank failures.

While the financial health of agricultural banks has improved, these institutions face new and significant challenges. New regulations from the Dodd-Frank Wall Street Reform and Consumer Protection Act will add regulatory compliance costs. Typically, as a share of total operating costs, these compliance costs are greater for smaller banks. There will likely be continued pressure to merge institutions and gain potential cost economies and synergies. Moreover, volatile commodity and farm input cost markets increase the cash flow risks faced by farmers and agricultural lenders. Agricultural banks will have to continue to manage and monitor risks and explore opportunities to maintain competitiveness and profitability.

In summary, prudent risk management and a strong agricultural economy have resulted in a banking industry that is well-positioned to meet the continued financial needs of farmers. Stay tuned for a future farmdocdaily column that summarizes the strong financial health of the Farm Credit System.