The Financial Health of Banks Lending to U.S. Agriculture

AgriFin (January 2013) | This article was contributed by Paul Ellinger (http://www.farmdoc.illinois.edu/ellinger/), Professor and Head of Agriculture and Consumer Economics Department, University of Illinois at Urbana-Champaign. For additional information please contact the author at pellinge@illinois.edu (mailto:pellinge@illinois.edu).

In recent farmdocDaily posts (http://farmdocdaily.illinois.edu/mt/mt-search.cgi?IncludeBlogs=8&search=ellinger), I have reported that most banks lending to U.S. agriculture have weathered the financial tsunami and the economic recession of the past 4 years. 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.

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. There are slightly more than 5,700 banks in the U.S. that provide loans to agriculture.

The health of many commercial banks in the U.S. has improved. Delinquency rates on agricultural loans are lower than the other loan types (http://farmdocdaily.illinois.edu/2011/04/the-financial-health-of-banks.html)and far below agricultural delinquency rates exhibited during the agricultural financial crisis in the late 1980s. However, many of the large U.S. banks continue to face significant challenges, especially in their residential and commercial mortgage portfolios. Additional regulatory costs including the Dodd-Frank Wall Street Reform and Consumer Protection Act present challenges for small and large banks. As a share of total operating costs, these regulatory costs are greater for smaller banks. Regulators are also placing higher regulatory emphasis on banks with significant concentrations in industry sectors such as agriculture.

In spite of these headwinds, agricultural banks have improved profitability in 2011 (http://farmdocdaily.illinois.edu/2011/10/agricultural-banks-improve-pro.html). The rate of return on assets (ROA) for agricultural banks (banks whose agricultural production loans plus real estate loans secured by farmland exceed 25 percent of total loans and leases) in the second quarter of 2011 was 1.13%, the highest quarter since the second quarter of 2008 (FDIC). This level exceeded the ROA for all FDIC insured banks (0.85) as well as banks with concentrations in commercial loans (banks whose commercial and industrial loans, plus real estate construction and development loans, plus loans secured by commercial real estate properties exceed 25 percent of total assets) and mortgage loans (banks whose residential mortgage loans, plus mortgage-backed securities, exceed 50 percent of total assets).

In summary, the health of agricultural banks remains relatively strong and shows signs of improving. Increasing input costs and land values have impacted the operating environment for smaller banks lending to agriculture. Small banks may reach their lending limits (http://farmdocdaily.illinois.edu/2012/04/challenges-facing-small-banks.html)more frequently and need to participate larger loans with correspondent banks. These challenges combined with new regulatory costs and increased stress in the housing and commercial real estate markets create ongoing challenges for smaller commercial banks. Stress in the agricultural sector would obviously increase the challenges of all lenders to commercial agriculture.