



Providing insights on community banking

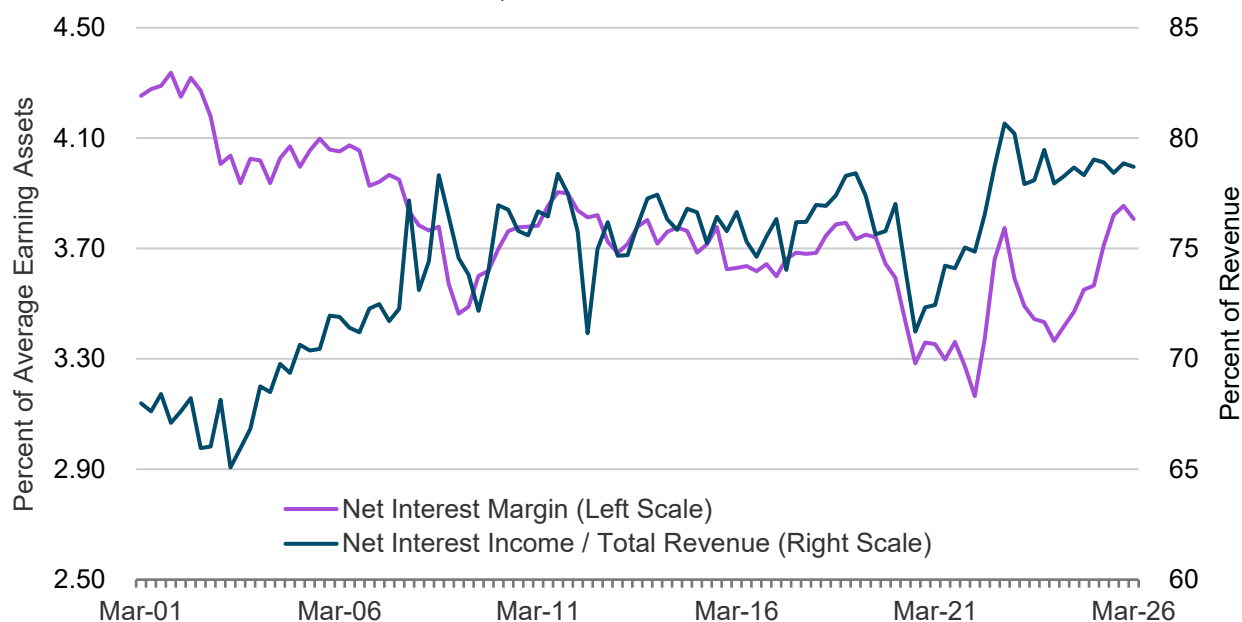
Community banks are increasingly reliant on lower margins

By Mary Bongers

Compared to 25 years ago, community bank net interest margins are lower but account for a greater portion of total revenue.

Net interest income is the primary revenue source for community banking organizations (CBOs)¹ and has become increasingly central to community bank business models over the past 25 years, even as the margins generated have narrowed.

Chart 1: Net Interest Income Trends, CBOs

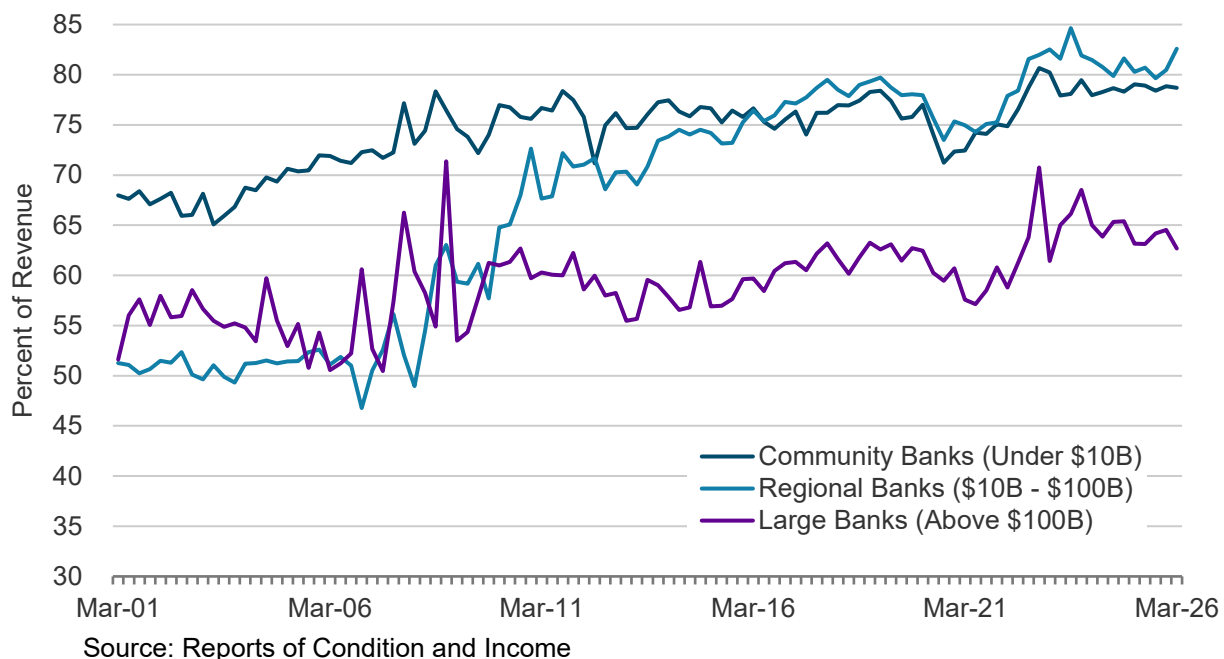


Source: Reports of Condition and Income

Note: Revenue includes net interest income and non-interest income.

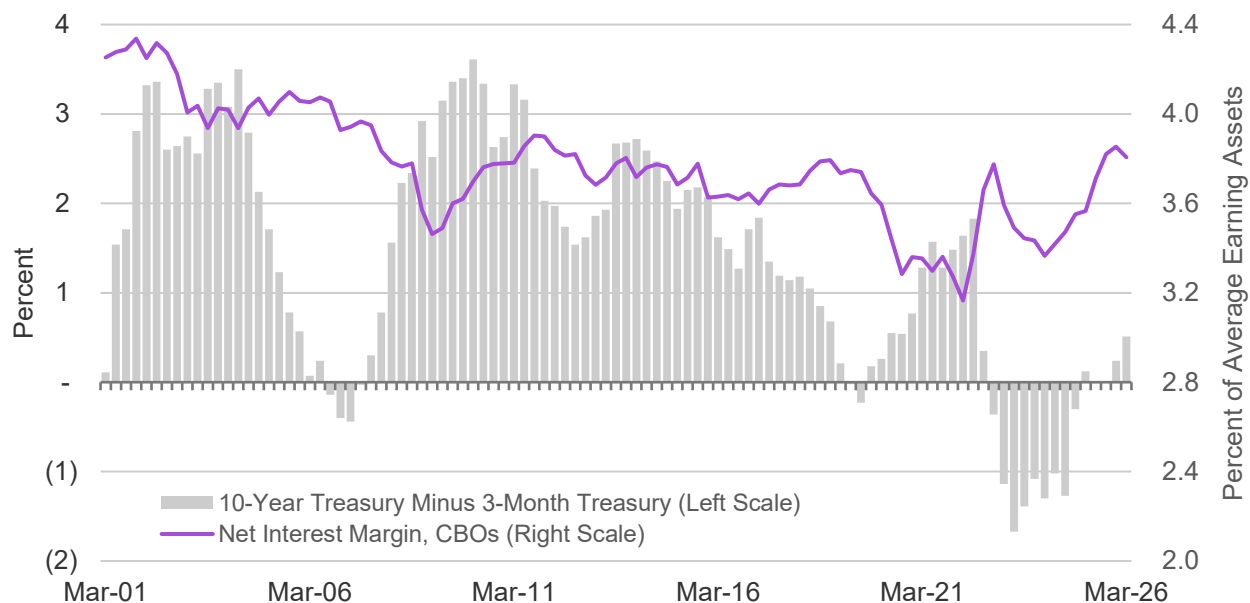
As shown in Chart 1, the aggregate CBO net interest margin (NIM) decreased from 4.25 percent in March 2001 to 3.81 percent in March 2026, a decline of approximately 10 percent. After reaching a low of 3.17 percent in March 2022, NIMs have since partially recovered but remain compressed compared to historical norms.

Despite lower margins, community banks have become increasingly dependent on net interest income. The share of revenue from net interest income rose from 68 percent in 2001 to 79 percent in March 2026, reaching a peak of 81 percent in 2022 following a series of rapid federal funds rate increases. This increased reliance on net interest income reflects declining non-interest income over the period, leaving community banks more reliant on traditional lending and deposit activities even as those activities generate lower margins than in the past.

Chart 2: Net Interest Income as a Percent of Revenue

Across all US banking organizations, smaller banks are more dependent on net interest income. As shown in Chart 2, net interest income represents a greater portion of total revenue at CBOs (79 percent) and regional banks (83 percent) compared to large banks (63 percent). This reliance reflects general differences in business models across bank sizes. As examined in the Federal Reserve Bank of Kansas City’s [The Critical Role of Community Banks](#), “Benefits of scale typically allow [larger] institutions to offer a broader array and greater complexity of products and services than community banks... The balance sheets of community banks are generally more traditionally structured than those of larger banks given the nature of offerings and investments.”

Notably, regional banks have experienced the most dramatic shift over the past 25 years, with reliance on net interest income increasing to levels comparable with CBOs. This shift reflects declining non-interest income over the period, with significant decreases particularly in securitization income, servicing fees, deposit service charges, fiduciary income, and other areas. While community banks also experienced declines in non-interest income, particularly in deposit service charges and fiduciary income, the impact was more muted given already low reliance on fee-based activities.

Chart 3: CBO Net Interest Margin vs Yield Curve Spread

Source: Federal Reserve Economic Data (FRED)

Note: Yield curve spread calculated as quarterly average, not seasonally adjusted.

The yield curve spread, measured as the difference between 10-year and 3-month Treasury rates, has contributed to community bank margin compression. In the early to mid-2000s, community banks benefited from a steeper yield curve, with spreads frequently exceeding 2 to 3 percentage points. Combined with shorter asset maturities and increased mortgage lending activity, conditions supported higher yields on earning assets and higher NIMs. In contrast, the past decade has seen prolonged yield curve flattening and even inversion, limiting banks' ability to generate spread income compared to historical norms. However, banks mitigated further NIM compression over the 25-year period by reducing their cost of funds. Funding costs have declined, though to a lesser extent than the decline in earning asset yields, impacted by a significant shift in deposit composition away from time deposits toward lower-cost non-maturity deposits.

Questions or comments? Please contact KC.SRM.SRA.CommunityBankingBulletin@kc.frb.org

¹ Community banking organizations are defined as having less than \$10 billion in total assets.

Mary Bongers is a risk specialist at the Federal Reserve Bank of Kansas City. The views expressed are those of the author and do not necessarily reflect the positions of the Federal Reserve Bank of Kansas City or the Federal Reserve System.