Community Banking Bulletin

Feature: Agricultural loan growth has returned to pre-pandemic levels

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Community banks continue to play an integral part in commercial bank agricultural lending.

In recent months the farm economy moderated as farm income softened alongside higher cost pressures and lower prices for most agricultural (ag) commodities. Though the outlook for ag credit conditions remains strong, rising uncertainties could pressure farmer liquidity causing increased credit demand.

Competition for ag loans stems from a diverse group of lenders. According to data from the United States Department of Agriculture (USDA), ag loans from commercial banks accounted for over 35 percent of the debt that farmers held in 2022. Within ag lending at commercial banks, community banks[1] (CBOs) play an integral role. As of 3Q2023, approximately 88 percent of all CBOs have ag loans on their balance sheets, and nearly 80 percent of all ag loans made at commercial banks are held by CBOs.

Chart 1 below shows the year-over-year (YoY) merger-adjusted growth in ag loans at CBOs over the past decade. The light blue line in the graph shows the YoY growth for loans to finance agricultural production and other loans to farmers (ag production), the purple line shows the YoY growth for loans secured by farmland (farmland), and the dark blue line depicts the YoY growth for total ag loans.

Outside of the COVID-19 pandemic, ag lending at CBOs has experienced mostly positive growth over the past decade. As of 3Q2023, YoY merger-adjusted growth in total ag loans sits at 6.5 percent, with ag production loans and farmland loans growing at 8.4 and 5.4 percent respectively. Over the last year, total ag loan balances increased in over half of all CBOs. Though ag loans are growing in aggregate, not all CBOs are experiencing the same level of growth across the board. For CBOs, the median growth level in total ag loans is 2.6 percent as of 3Q2023, with slightly over a third of all CBOs having ag loan growth at or above the aggregate level of 6.5 percent (see Chart 2).

With overall ag loan growth rates back at pre-pandemic levels, assets quality metrics for ag loans at CBOs remain at low levels. As of 3Q2023, total nonperforming[2] ag loans sit at 0.9 percent of total ag loans, with nonperforming ag production loans and farmland loans at 0.7 and 0.9 percent of their respective loan types. Though asset quality issues remain benign, potential headwinds could pressure the ag lookout. One of the potential rising uncertainties are interest rates. Yields on ag production loans started to rise shortly after the Federal Reserve started to increase the federal funds rate to help curb inflation (see Chart 3).

For CBOs, the yield on ag production loans is 6.9 percent (as of 3Q2023), up 240 basis points (bps) since March 31, 2022, when yields were at 4.5 percent. According to data from of the National Survey of Terms of Lending to Farmers, the average maturity of all non-real estate bank loans made to farmers, remained near the recent historic average, and as of 3Q2023 is a little over 15 months in duration, with loans made for operating expenses under one year in duration.

Looking ahead, for farmers that have used cash reserves to reduce loan levels, elevated cost pressures and lower prices across most ag commodities could increase demand for ag lending. Given the short duration of ag loans on average, as existing loans near maturity, higher interest rates could create pressure on repayment capacity and overall ag conditions.

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

Endnotes

[1] Community banks are defined as commercial banks having less than $10 billion in total assets.

[2] Nonperforming loans include loans 30-89 days past due, loans 90+ days past due, and nonaccrual loans.

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