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Rural and Farm Finance Policy Analysis Center

Commercial Lenders Bank on Relationships, Lead in Non-Real Estate Farm Loans

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Commercial banks include community banks serving nearby residents and businesses, and larger financial institutions with branches located throughout a region or the U.S. This brief details commercial banks' farm lending activity and their role in the communities they serve. It is part of a series detailing sources of financing available to American farmers.

Key Takeaways

- Until the early 1910s, commercial banks could not finance farm real estate. Even since commercial banks have had the authority to finance farm real estate, the Farm Credit System has typically captured the greatest share of annual real estate loan volume. Likewise, commercial banks tend to specialize in non-real estate loans.
- Branches of ag banks (those with at least 25% of loan volume linked to agriculture) concentrate in areas where total farm expenses tend to be larger. However, most towns of a certain size have access to a commercial bank branch office.
- For commercial banks in farm communities, the opportunity to form relationships with producers may differentiate them from other financing sources.

Modern farm lending system molded by policies from the early 20th century

Prior to the 1910s, commercial banks had limited authority to lend money to farms and could finance operating expenses but not real estate. However, a financial crisis and subsequent credit shortage in the early 1900s spurred the formation of a national commission and a re-evaluation of the U.S. financial system.

The commission's work led to the Federal Reserve Act of 1913, which created a U.S. central bank and allowed commercial banks to finance farm real estate. Today, the Federal Reserve assures commercial banks can borrow funds to meet their needs, even during uncertain times, through its discount window.

Also in 1913, Congress established an effort called the American Commission to address rural credit issues. Outcomes included the 1916 Federal Farm Loan Act and, ultimately, the Farm Credit System. The act provides certain tax benefits to Farm Credit institutions when they lend to borrowers purchasing real estate. Therefore, commercial banks, which do not share in those same benefits, and Farm Credit institutions often operate in a stiffly competitive environment.

This history has continued to shape commercial bank lending to farms. Released by the USDA Economic Research Service, the farm sector balance sheet shows commercial banks have ranked as the primary source for non-real estate lending with a 42% share in 2022, compared to Farm Credit's 39%.

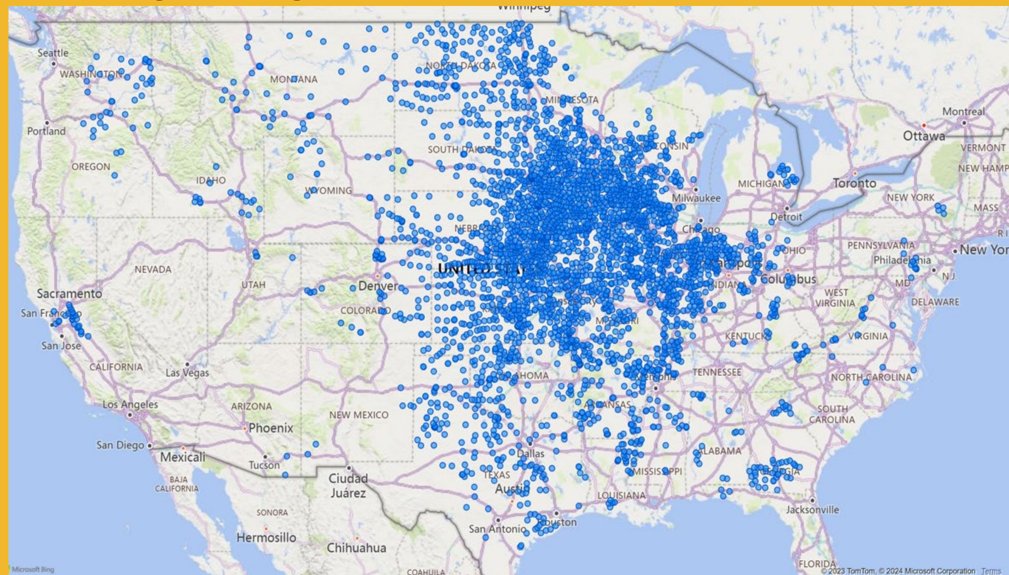
The balance sheet also reveals Farm Credit institutions have led in holding real estate debt. Market shares in 2022 were 49% for Farm Credit and 32% for commercial banks. Note, banks may originate ag loans but not hold them. They instead may sell the assets into a secondary market. Some farm real estate debt originated by banks is held by secondary lenders, including Farmer Mac, so these statistics may understate commercial banks' involvement in farm lending.

Relationship lending drives commercial banking

Most communities of a certain size are home to a bank branch. Therefore, farms may have closer proximity to commercial banks than other financing sources. Such presence can lead to producers making commercial banks their first stop when seeking credit.

Given their positioning in farm communities, commercial bank lenders and producers have an opportunity to form personal relationships — a possible point of differentiation. As such, lenders often prioritize relationship banking. In its 2023 survey of community bankers, the Conference of State Bank Supervisors found 40% of participants expected their banks' future dollar volume on transactional small business loans to be much less or less than the volume on relational small business loans.

Figure 1. Agricultural Bank Branch Locations, 2023

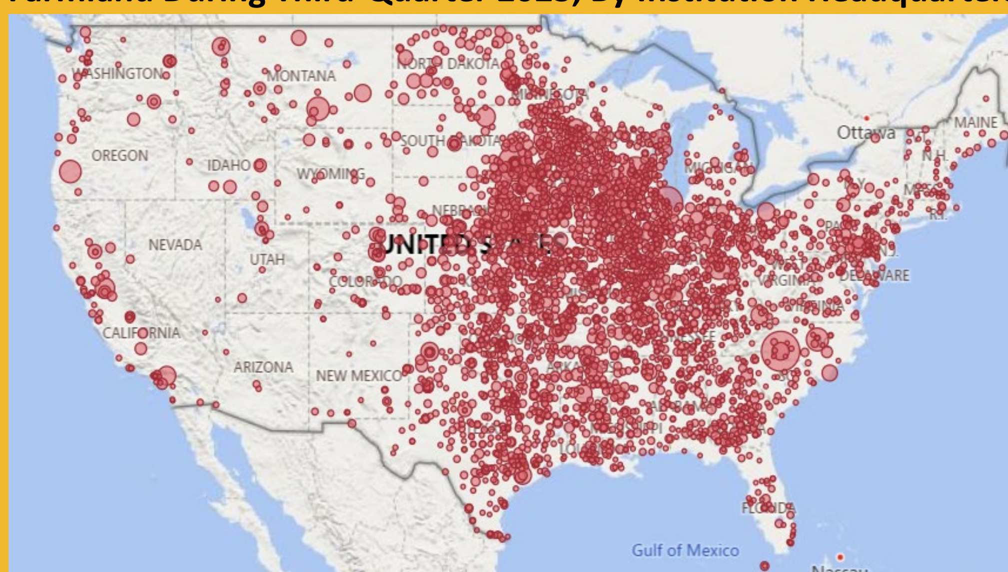


Source: Federal Deposit Insurance Corporation summary of deposits.

Many producers also likely live near at least one bank specialized in ag lending. Figure 1 shows where U.S. agricultural commercial banks had branch offices in 2023, based on summary of deposits data from the Federal Deposit Insurance Corporation (FDIC). An ag bank has at least 25% of its loan volume linked to agriculture. As noted in the map, commercial ag bank branches concentrate in the central U.S., where total farm expenses tend to be larger. Other pockets with densely located commercial ag bank branches include southern Georgia and the Salinas Valley in California.

For an alternative view of ag lending activity, Figure 2 presents the dollar volume of ag-related loans held during third-quarter 2023 by institution headquarters location. Note that the map, which sources call data provided by the Federal Financial Institutions Examination Council, ties all agricultural loans (loans to finance agricultural production that are not secured by farmland and loans secured by farmland) to an institution's headquarters location; the larger the point, the greater the loan dollar volume held by the overall institution. These figures may include lending only tangentially related to agriculture. For example, loans secured by farmland represent not only financing for farmland but also instances where farmland serves as collateral for another purpose, such as building a home. Much of the dollar volume stems from areas where ag banks operate branches. However, multiple banks headquartered in other areas, such as West Coast states, the mid-Atlantic and the South, report relatively large ag-related loan volumes.

Figure 2. Dollar Volume of Ag Loans and Loans Secured by Farmland During Third-Quarter 2023, By Institution Headquarters



Source: Federal Financial Institutions Examination Council call data repository.

As side-by-side comparisons of Figure 1 and Figure 2 suggest, ag doesn't always represent a large share of portfolios for banks engaged in ag-related lending. Published by the American Bankers Association (ABA), a list of farm lenders ranked by dollar volume shows several large national banks fit in the top 10 for third-quarter 2023. Some regional banks dispersed throughout the country ranked quite high, too. Again, the portfolio data may not reflect all loans originated by banks. The secondary market may be especially important for commercial banks that do not specialize in ag lending.

Bank interest in financing ag activities does shift over time. In 2019, Reuters published an analysis that found large banks had upped their farm loan holdings around the time of the Great Recession, when many home mortgages soured. However, by 2015, large banks' assets in farm loans began to decline as farm incomes also faced pressure.

Interest rates and competition top concerns for lenders

For the past two years, commercial ag lenders have been most concerned about interest rate volatility, according to those participating in the Agricultural Lender Survey from ABA and Farmer Mac. Not only were rates top of mind when lenders responded in August or September 2023, but many lenders also felt rates could go higher. Of those responding, 51.7% projected higher short-term rates in the next year, and 47.2% conjectured long-term rates would increase.

Results from the Federal Reserve Bank of Kansas City's third-quarter 2023 ag credit survey found bankers from institutions chartered in the Kansas City bank's district also had concern about higher funding costs. In similar surveys from the Federal Reserve banks in Dallas, Minneapolis and Chicago, lenders suggested credit conditions in the second half of 2023 were softening or showing signs of possible future softening.

Expectations for higher interest rates have eased in recent months, but rates will likely remain above the previous decade's average. Some lenders may benefit from increasing demand for non-real estate loans if crop prices continue to retreat during the next few years.

Lender competition ranked as the second greatest concern in the ABA and Farmer Mac survey. Recalling the historical context shared earlier, the top competitor named by 72.5% of participating lenders was Farm Credit institutions. Community banks ranked as the top one or two competitors for 71.5%.

All Riffs from RaFF are available at raff.missouri.edu/publications

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The Rural and Farm Finance Policy Analysis Center (RaFF) at the University of Missouri aims to help policymakers and stakeholders understand rural economic and financial conditions and trends and explore how existing and proposed policies affect rural and farm finances.

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