Submission

to the

Primary Production Committee

on

Rural Banking Lending

3 May 2024

NEW ZEALAND BANKING ASSOCIATION – TE RANGAPŪ PĒKE
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About NZBA

The New Zealand Banking Association – Te Rangapū Pēke (**NZBA**) is the voice of the banking industry. We work with our member banks on non-competitive issues to tell the industry's story and develop and promote policy outcomes that deliver for New Zealanders.

The following eighteen registered banks in New Zealand are members of NZBA:

- ANZ Bank New Zealand Limited
- ASB Bank Limited
- Bank of China (NZ) Limited
- Bank of New Zealand
- China Construction Bank
- Citibank N.A.
- The Co-operative Bank Limited
- Heartland Bank Limited
- The Hongkong and Shanghai Banking Corporation Limited
- Industrial and Commercial Bank of China (New Zealand) Limited
- JPMorgan Chase Bank N.A.
- KB Kookmin Bank Auckland Branch
- Kiwibank Limited
- MUFG Bank Ltd
- Rabobank New Zealand Limited
- SBS Bank
- TSB Bank Limited
- Westpac New Zealand Limited

Contact details

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Introduction

New Zealand's agri banks have been backing farmers for more than 150 years. Banks have been with farmers through all the ups and downs, knowing that agriculture and rural New Zealanders will always be the backbone of the country.

Banks understand the changes and complexity that confront farmers in the 21st century, including increased global competition, complex trade environments and the impacts of climate change and environmental standards.

Amidst such challenges, rural New Zealanders want to be sure their banks are giving them the best deal possible. It's understandable that, on the face of it, someone in Auckland getting a better mortgage rate for their house than a person in rural New Zealand gets for their farming business looks unfair. We are pleased to have the opportunity to address these concerns.

Banking industry support for rural New Zealand

Each agri bank has their own ways of supporting rural communities, with many offering community funds, hands-on support or skills development. Rural banking often involves bankers going to the farm to talk face to face over the kitchen table.

Agri banks also partner with the Rural Support Trusts (RSTs) to deliver the Farm Business Advice Fund that provides independent business development advice to farmers. RSTs, participating farmers, and banks have found this to be an excellent programme that helps farmers identify strategies to move their business forward.

Recently, banks worked closely with the government, farmers, and local councils to support farmers and horticulturalists affected by Cyclone Gabrielle. Banks are a part of the North Island Weather Event Scheme that helps free up lending to affected businesses.

Not all of NZBA's 18 members lend on farming, which is a specialist category of lending with a limited number of customers. However, at least eight banks lend to rural New Zealand, with a fairly even spread across the largest five rural lenders (ANZ, ASB, BNZ, Rabobank and Westpac), making the market competitive.

Key points

1. The gap in rural and residential interest rates has expanded in recent years due to the rapid increase in the Official Cash Rate (OCR).

2. Risk weighted assets set by the Reserve Bank are higher for agribusinesses than home lending.

3. Businesses are inherently riskier than homes as both an asset and in terms of income and expenditure.

1. Interest rates for agribusiness lending

Agribusiness lending is riskier than home lending, for the reasons set out in point three below. This is a significant factor in the interest rate for agribusiness loans generally being higher than for home loans.

Rapid increases to the OCR over the past two-and-a-half years has led to substantial increases in debt servicing costs for all borrowers, including agricultural borrowers. In just 18 months from November 2021 to May 2023 the OCR rose 500 basis points from 0.5% to 5.5%.

The subsequent rise in interest rates has made the gap between residential and farming business lending more noticeable. This has led to understandable questions coming from rural communities.

2. The role of risk weights

The Reserve Bank requires banks to hold capital against different categories of lending according to the relative riskiness of the type of lending. Broadly speaking, this is done by requiring banks to apply different "risk weights" to different categories of lending (eg home loans, business loans, commercial property loans) according to their riskiness. The higher the risk weight, the more capital a bank is required to hold against a loan.

Lending to businesses is typically riskier than lending to households, for the reasons set out in point 3 below. Therefore, risk weights for business lending (which includes agribusiness loans) are typically higher than for home lending. The risk weight that is applied will vary depending on the model each bank uses to determine its minimum capital requirements (eg standardised versus internal ratings-based approaches).

The requirement for business loans (including agribusiness loans) to have a higher risk weighting reflects the risk that the Reserve Bank determines these loans have, which is relevant to its financial stability mandate. The size of the agriculture sector in New Zealand compared to other economies make this assessment particularly important for New Zealand's financial stability.

The capital treatment of a loan is a key factor for banks when setting lending rates. Holding capital is a cost to the banks. Therefore, the higher the risk weight that applies to a loan, the more capital the banks will need to hold against the loan. This increases the cost of the loan to the bank, which in a competitive market may be reflected in a higher lending rate.

3. Home loan risk vs agribusiness risk

For lending purposes, farms (apart from the home) are considered a business. This makes them inherently riskier than a home loan as risk (and price) is based on the ability to repay the loan if something goes wrong. In almost all situations, agribusiness loan rates are set on a case-by-case basis, whereas home loan rates are generally more consistent.

In the case of a home loan, the ability of the borrower to repay the loan largely depends on their employment status and income, which tends to be fairly predictable (eg if the borrower is on a salary). The borrower's expenditure and outgoings are also relatively predictable. Unemployment for home loan borrowers tends to be temporary and borrowers have a greater capacity to reduce their outgoings (eg by reducing discretionary spending). Banks can also support home loan borrowers who temporarily lose their income (eg through payment deferrals, changes to interest-only terms etc) as there are usually greater prospects that the borrower will be able to resume repayments in the near future.

Credit events for home loan borrowers also tend to be less correlated (eg downturns tend to be limited to a particular company, region or industry). This means that, in the event the borrower can no longer continue to service the loan, the market for the collateral (the property) is relatively liquid and the price is relatively stable.

In the case of an agribusiness loan, the ability of the borrower to repay the loan also depends on the borrower's income. However, the borrower's income largely depends on external factors which are out of the borrower's control, in particular global commodity prices of exports like wool, beef, and milk powder. These external factors often reflect changes in the global economy (eg competing supply, downturns in trading partners' economies, outbreaks of infectious diseases etc) which are more structural. If an agribusiness borrower loses their income due to an external shock, they often have few alternative sources of income to service the loan and it is less certain when the borrower will be able to resume repayments, if at all. These borrowers also have less capacity to reduce outgoings.

Agribusiness borrowers are also typically exposed to the same external factors meaning the risk drivers for agribusiness loans are highly correlated. This means during a downturn many agribusiness loans may experience stress at the same time (eg a downturn in global dairy prices affects every dairy farmer). This means, in the event a borrower can no longer service the loan, the market for the collateral (farms) tends to become less liquid and the price of the collateral falls.

The above are examples of factors taken into consideration when setting a rural lending rate but are often irrelevant in the case of a home loan.

Conclusion

The banking industry understands the pressures facing rural New Zealand right now.

As interest rates continue to bite, it is understandable to look to the banking sector. However, the New Zealand rural lending market has functioned throughout our country's history, and is competitive, stable, and adaptable.

Banks will continue to support the industry through cyclical ups and downs and help it adapt to new and complex challenges.