

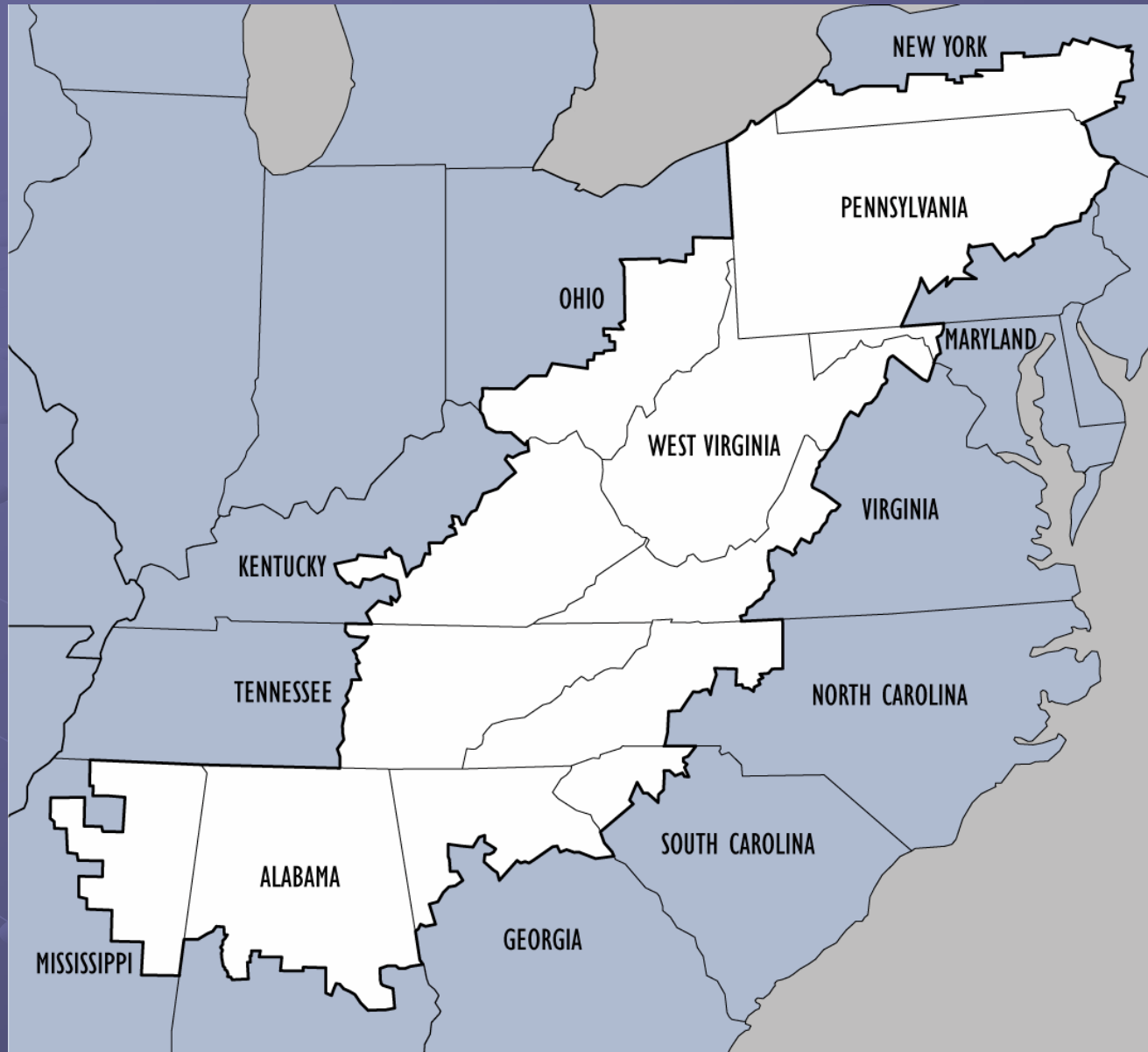
Access to Capital and Credit for Small Businesses in Appalachia

Presented
by
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at
Federal Reserve Bank of Cleveland
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Access to Capital and Credit for Small Businesses in Appalachia

- ARC commissioned a study by *National Community Reinvestment Coalition* to examine access to capital and credit in the Appalachian Region.
- Examined a range of issues, including:
 - Impact of bank consolidation, relationship and transactional lending, credit scoring, role of bank branches, discrimination, and the impact of CRA on access to capital & credit.
 - Released in April, 2007

Appalachian Region



- 13 States
- 410 counties
- 200,471 sq. miles
- 23 million people
- \$680 billion GRP

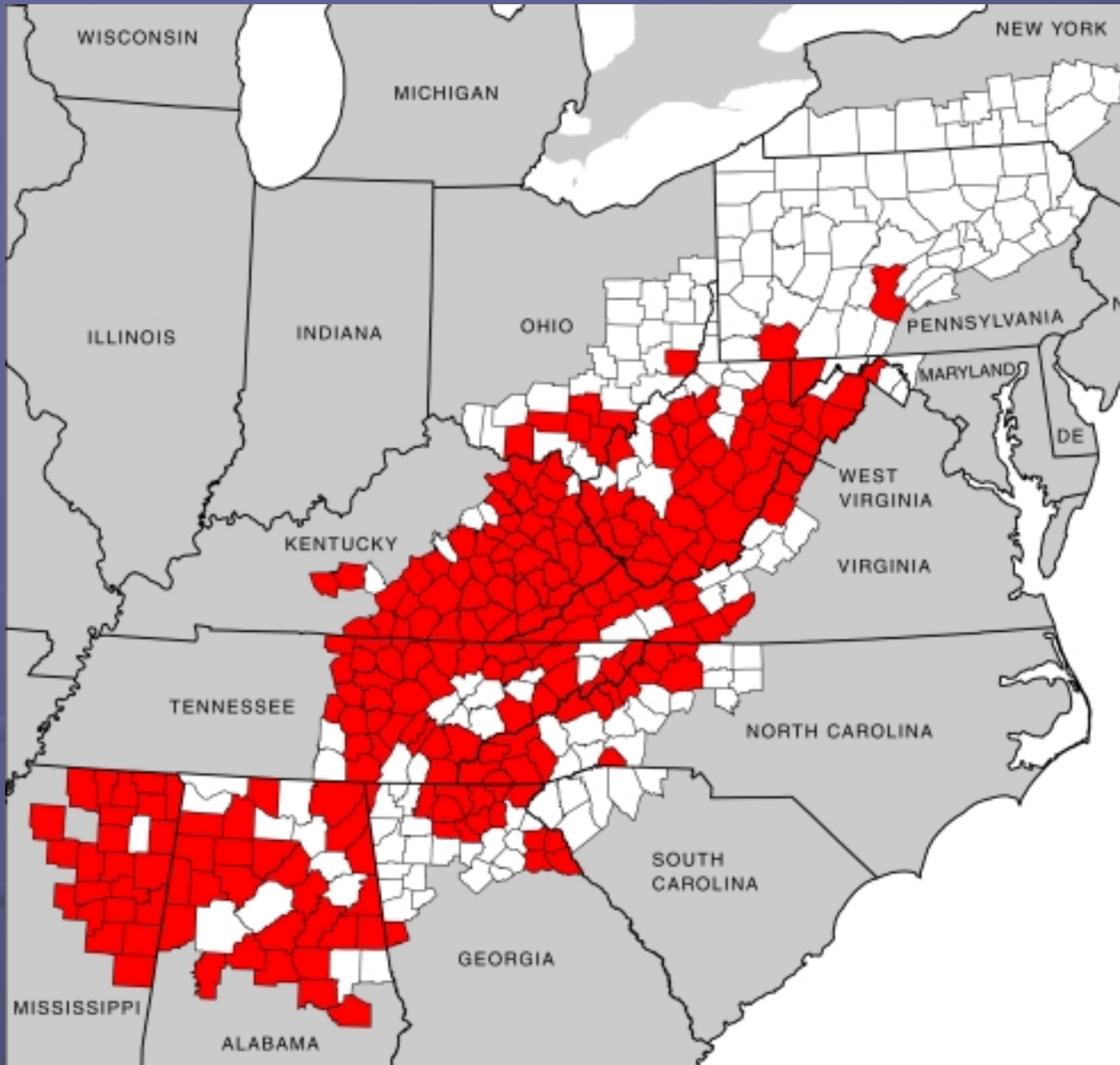
**By the mid 20th century, Appalachia had become
“a region apart—geographically and statistically.”**

– PARC report, 1964

- **One of three Appalachians lived in poverty, 50 percent higher than the national average.**
- **Unemployment was 40 percent higher than the national average.**
- **Between 1950 and 1960, net migration data showed a population loss in the region of more than two million people.**
- **The high school dropout rate in Appalachia exceeded 50 percent.**



Distressed Counties in Appalachia



■ Distressed (223)
1960

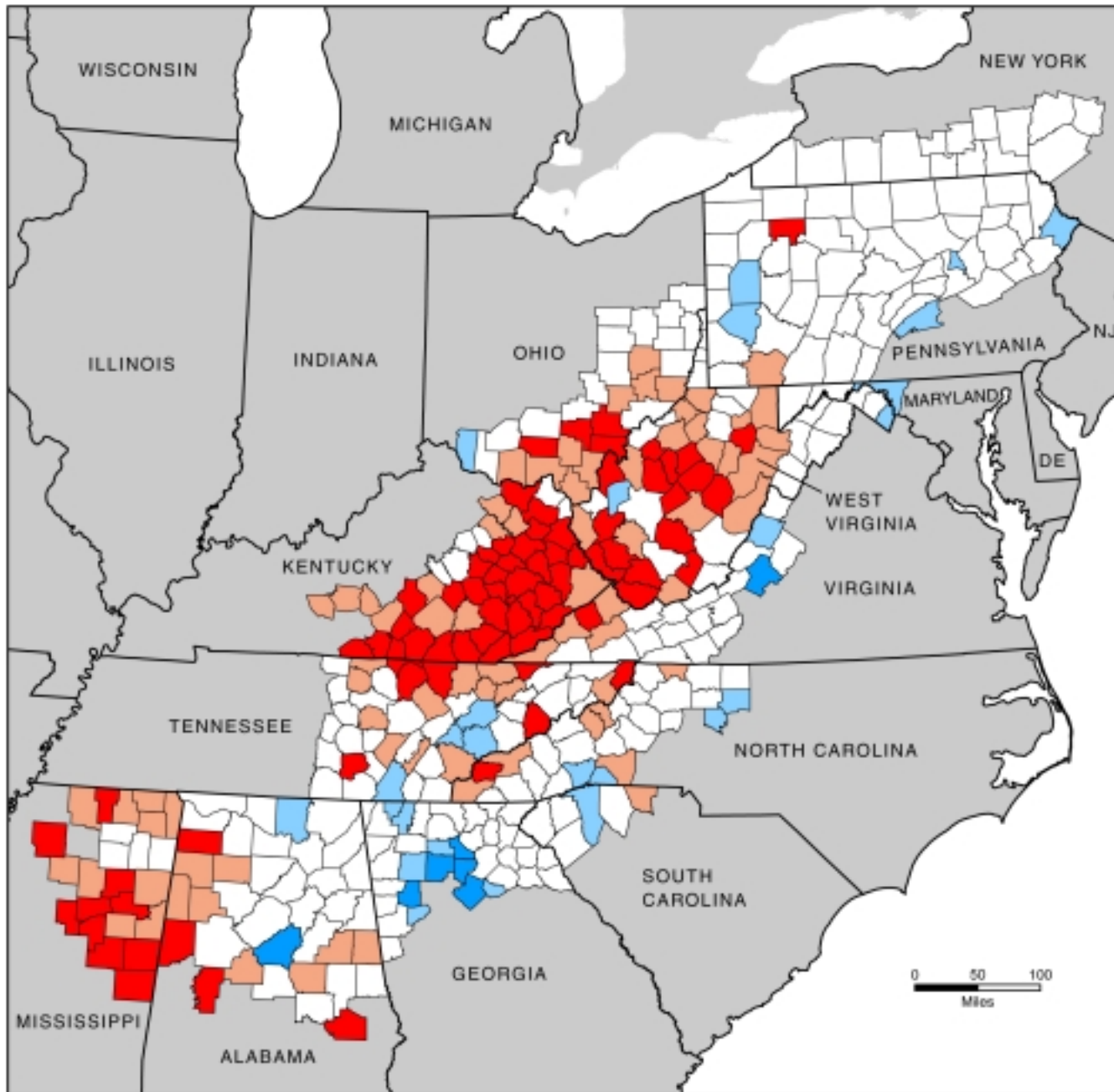
Distressed counties:

- 150% or more US unemployment rate
- 150% or more US poverty rate
- 67% or less per US capita income

County Economic Status, Fiscal Year 2007

Economic Status

-  Distressed (78)
-  At-Risk (78)
-  Transitional (221)
-  Competitive (26)
-  Attainment (7)



Measures of Progress in Access to Capital and Credit

- Appalachia compares favorably to Nation on key indicators of lending.
- Appalachia also is similar to the nation in its business demographics.
- Appalachia has significant infrastructure for lending.
- Despite progress, significant credit gaps remain and need to be addressed.

Lending Infrastructure in Appalachia

- An evolving lending infrastructure which has enhanced access to credit, albeit with gaps.
- 227 banks with \$500 billion in assets.
- These banks made \$5.4 billion in CRA community development loans and investments over the 2.5 years period examined.
- 100 Community Development Financial Institutions including CDFIs, ARC Revolving Loan Funds.

Appalachia Compares Favorably to Nation in Key Indicators

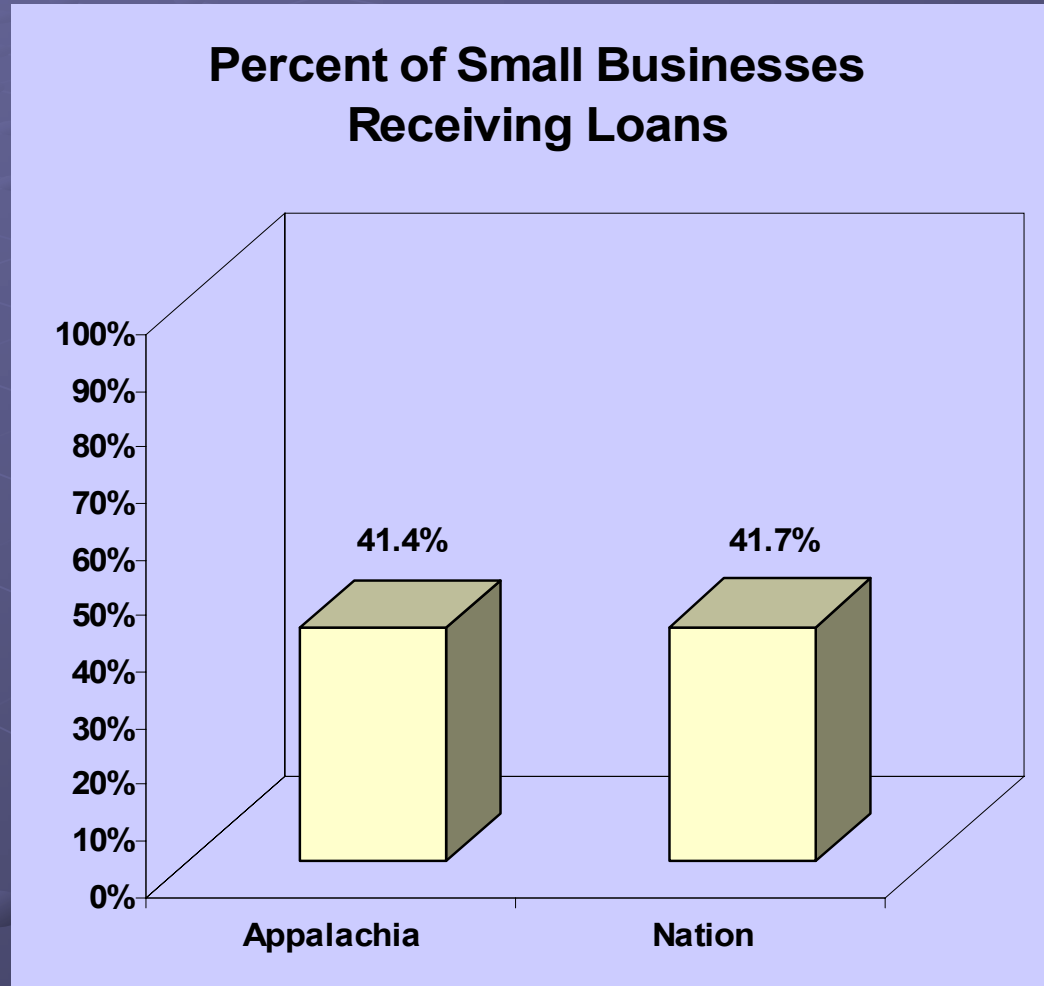
- Small business loan-to-deposit ratio for Appalachia was 7% versus 5.2% for nation
 - 35% higher in Appalachia.
- Banks in Appalachia provided 57.5 small business loans per branch in non-metro counties.
- Nationally banks provided 53.2 loans per branch in non-metro counties.

Lending by Minority Population Share in Counties: Appalachia vs. Nation

Minority Population	#of counties*	# SB Loans/#SB
Minority Pop 0-20%		
Appalachia	371	39.4%
Nation	2,100	41.8%
Minority Pop 20-50%		
Appalachia	41	51.4%
Nation	831	42.4%
Minority Pop >50%		
Appalachia	6	53.6%
Nation	263	40.2%

* Includes Virginia Independent Cities

Similarities in Lending Trends: Appalachia and Nation

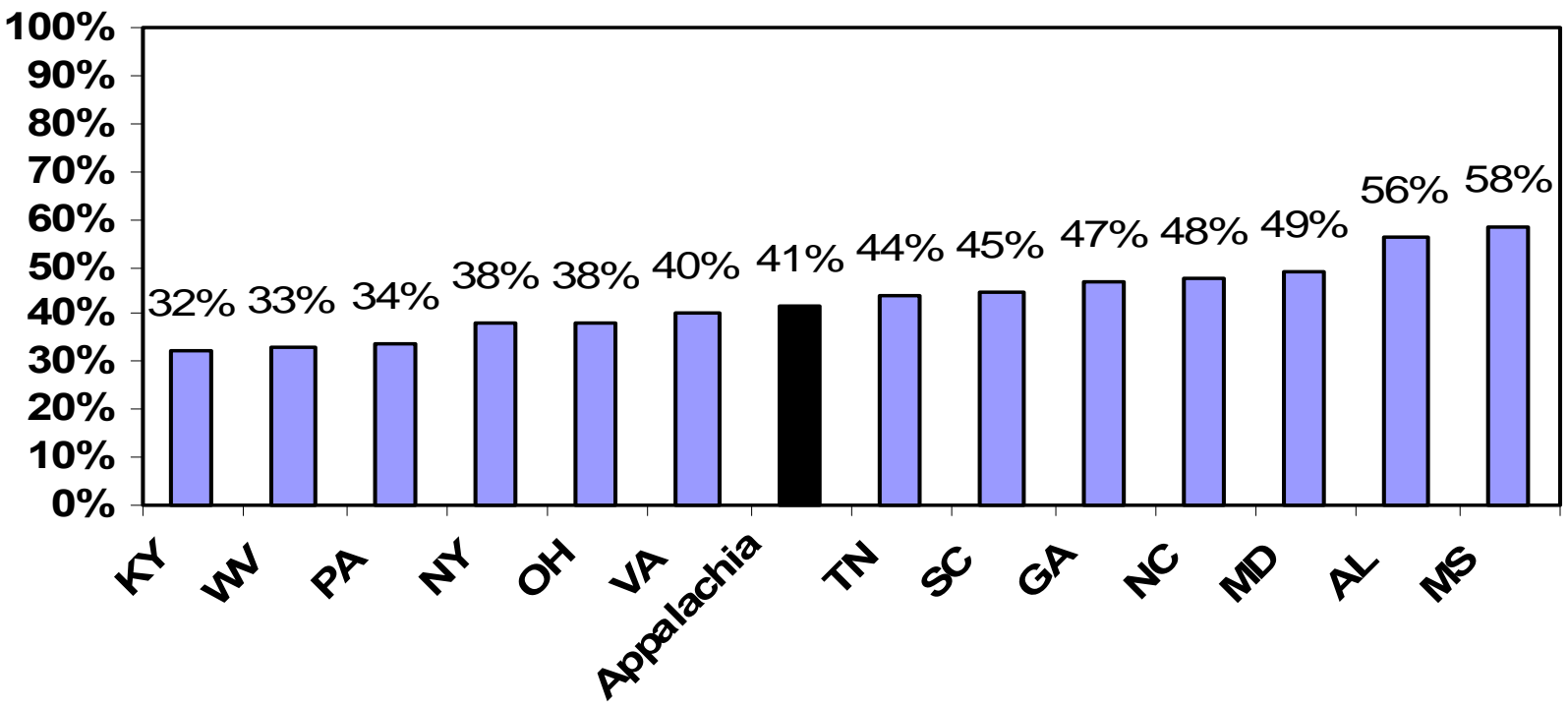


Within Appalachia, Differences in Access to Credit

- Differences by State.
- Differences in Metro and Non-Metro Counties.
- Differences by Size of Business
 - Just 28% of businesses with less than \$1 million in revenues received loans.
- Less Access in Distressed Counties:
 - 32% of businesses in distressed counties;
 - vs. 42% in non-distressed counties receive loans.
- Less Access in Low & Moderate-Income Census Tracts.

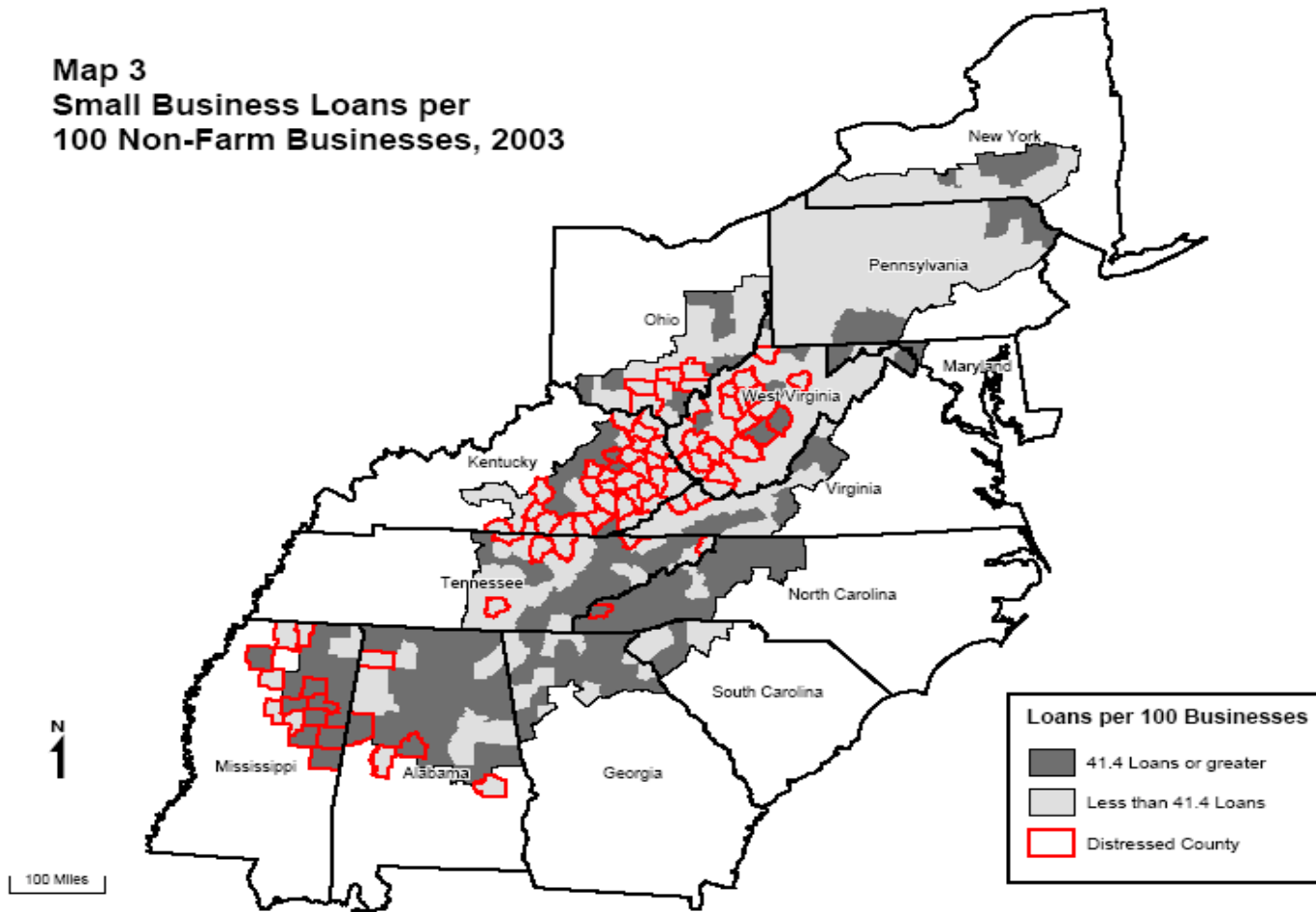
Differences by State in Credit Access

Percent of Small Businesses Receiving Loans

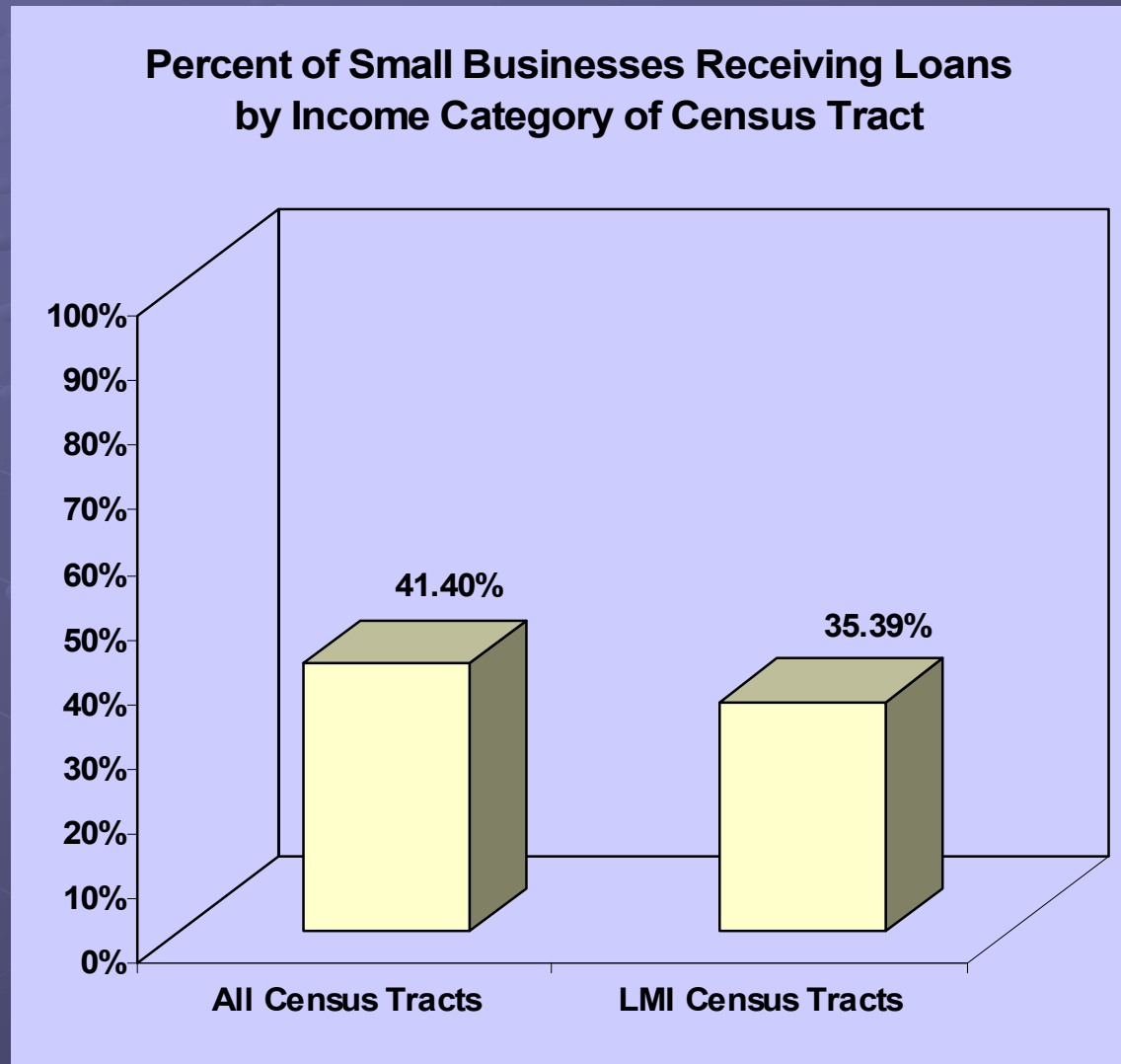


Lending in Distressed & Non-Distressed Counties

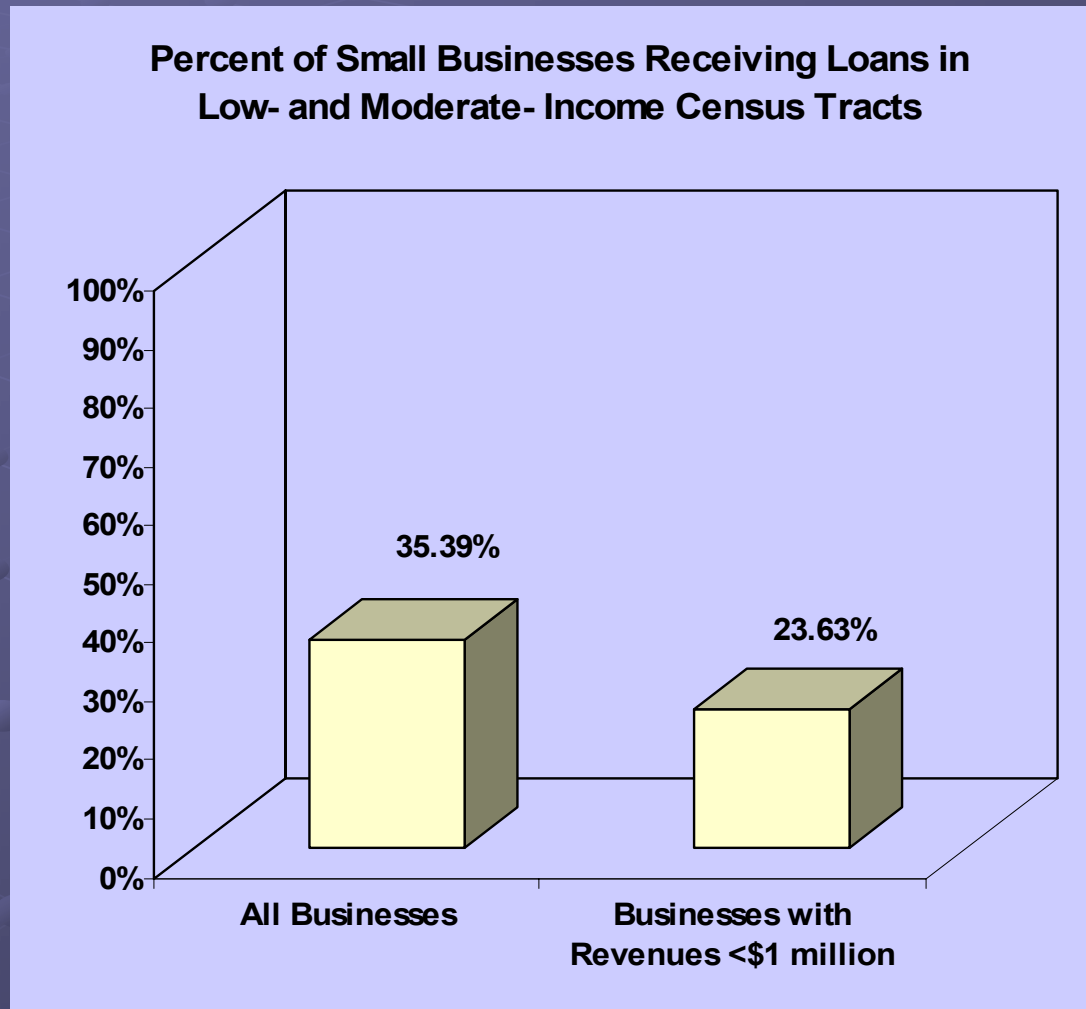
Map 3
Small Business Loans per
100 Non-Farm Businesses, 2003



Lending by Income Group of Census Tract



Lending to Smallest Business in Low/Mod Census Tracts



Role of Branches: More Branches Means More Loans

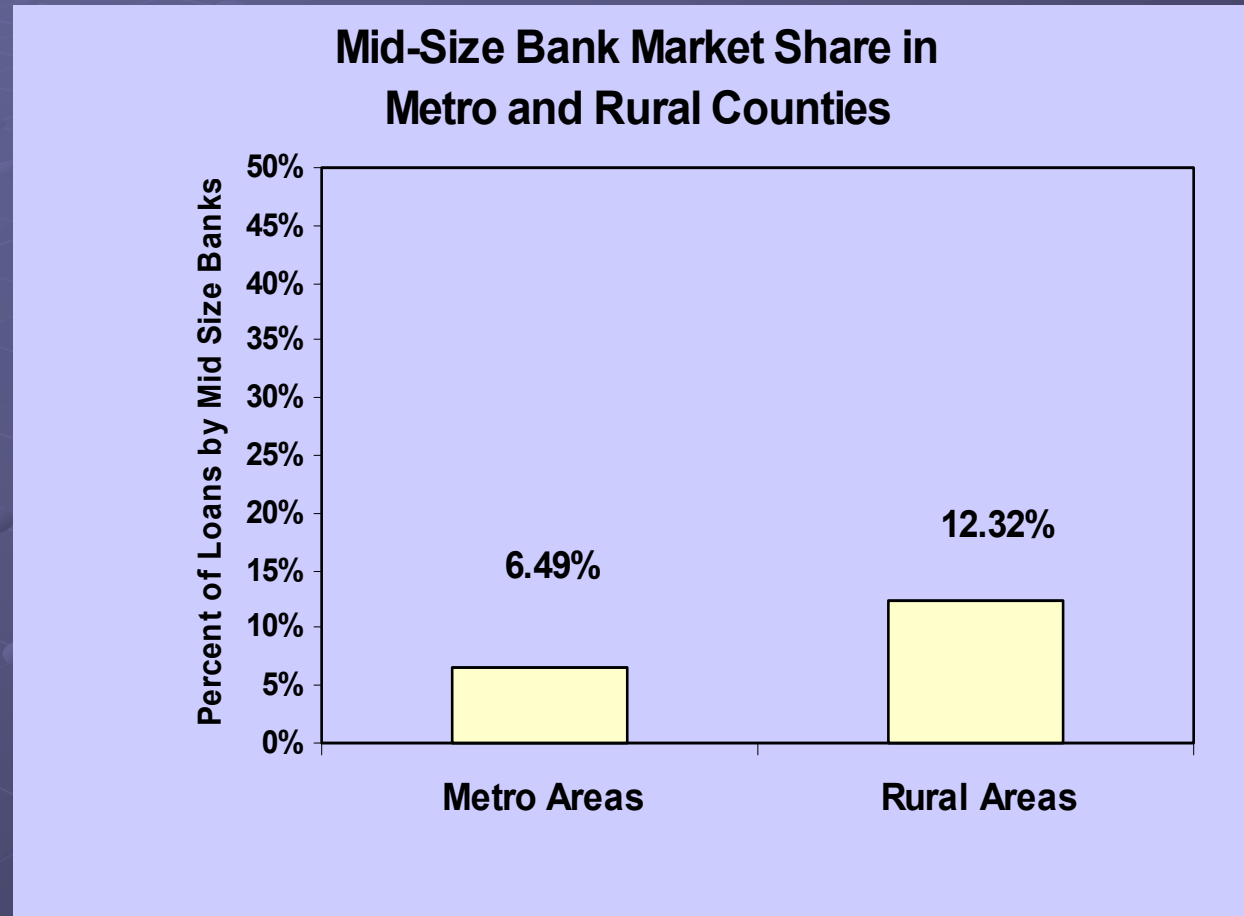
	# Branches - All Lenders	Total #SB Loans - All Lenders
Median # Branches =11		
Below median - total	1,324	66,834
Median	6	235
Above median - total	7,020	463,475
Median	22	1,287

Influence of Credit Scores on Lending Levels

- Higher the score (lower the risk), the higher the number of loans in a county
- Distribution of scores not much different by distress or metropolitan status of county
- Mid-size bank lending levels do not vary by differences in credit scores

Role of Mid-Size Banks

- Higher Market Share in Rural & Distressed Counties
- Relationship Lending not influenced by credit scores



Role of SBA Lending

- SBA Lending has small overall market share
- Higher market share in rural counties than metro counties.
- Not as successful in reaching minorities as non-SBA backed lending.
 - Particularly African-Americans;
 - May reflect the relatively high non-SBA lending to minorities which may reduce demand for SBA lending by minorities in Appalachia.

Regression Analysis of Small Business Lending in Appalachian Counties 2003

- Three models for different dependent variables:
 1. lending by all lenders of all asset sizes reporting CRA small business loan data,
 2. lending by mid-size banks with assets between \$250 million and \$1 billion, and
 3. SBA lending.

- These models were developed to analyze the impact on lending of county level demographic & economic factors as well as:
 - the influence of bank concentration;
 - credit scoring;
 - the number bank branches, and other factors.

All Lenders: Log No. Small Business Loans (Full Model)		
R Square	Adjusted R Square	Explanatory Variables
0.7815	0.7737	
Estimated Coefficients	t-score*	Coefficients
5.1486	20.5293	Intercept
-0.3346	-3.4101	Distressed/Non-distressed
0.1519	1.7897	MSA/Non-MSA
0.8410	2.7037	% Black
5.7996	2.8462	% Hispanic
0.0000	6.2512	Median Household Income
0.0133	12.3147	Number of Branches
-0.0002	-11.9991	HHI, ICB + THRIFT @50%, COUNTY LEVEL
0.5733	1.4023	Personal Income Growth
0.2083	2.9515	Credit Score (Low Risk) 1
-0.0869	-1.3258	Credit Score (small risk) 2
-0.0675	-0.9786	Credit Score (medium risk) 3
0.0029	0.0431	Firm Size (1-4 employees) 1
0.0830	1.1474	Firm Size (5-9 employees) 2
0.2136	2.8075	Firm Size (10-19 employees) 3

***Highlighted - 5% level of significance**

Significant Findings

- More bank branches result in more small business loans for banks of all sizes
 - and for SBA 7(a)-guaranteed loans.
- Lower lending occurred in distressed counties than non-distressed counties.
- Counties with higher minorities population shares had higher lending levels.
- Mid-size bank lending on a county level was unaffected by the distribution of credit scores.

Additional Findings

- Lending by all banks was lower in counties with higher levels of concentration.
 - County-level bank concentration however did not impact mid-size bank lending.
- Lending by all banks was higher in counties with a higher portion of businesses with 10 to 19 employees.
 - small businesses employment size did not affect mid-size bank lending.
- Findings suggest that SBA 7(a) program was focused on non-metro areas.

Analysis of Appalachian CRA Exams

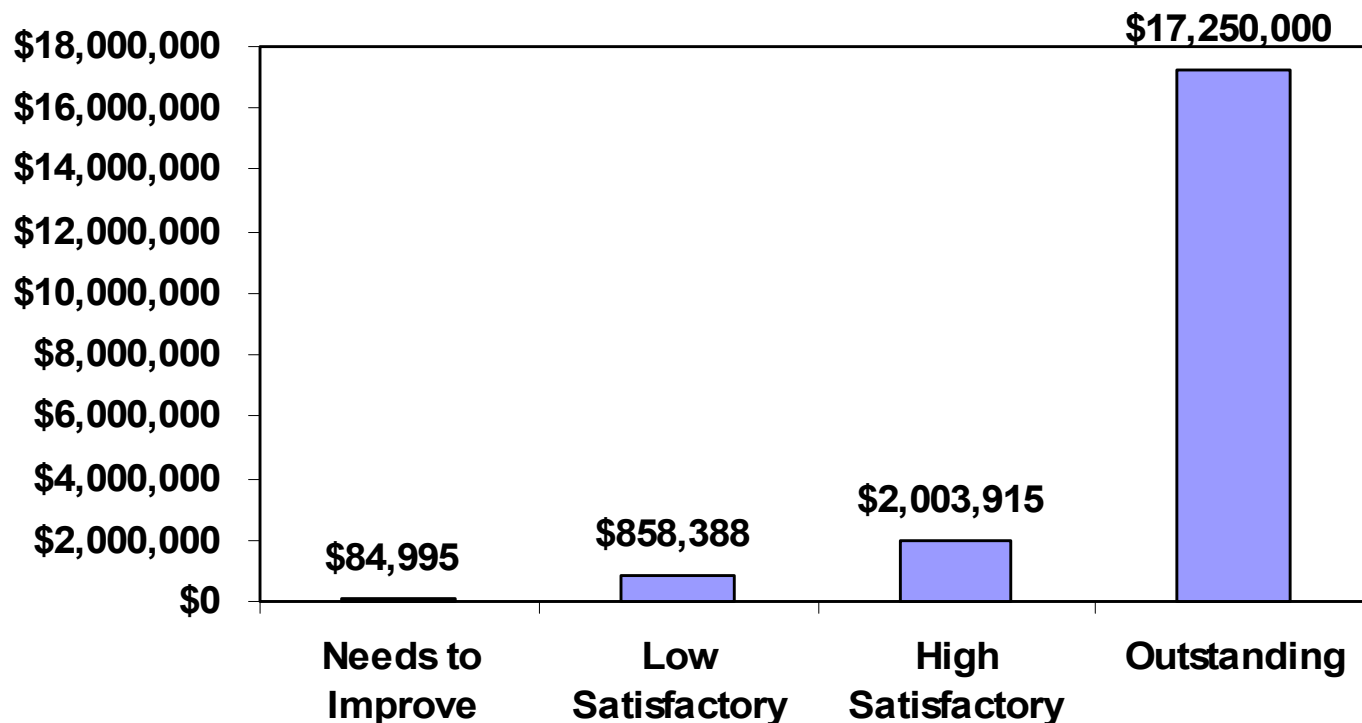
The regulatory agency break down for the bank sample:

	All Banks	Small Banks	Large Banks
FDIC	51.8%	57.7%	48.6%
FRB	15.0%	9.0%	18.3%
OCC	25.5%	25.6%	24.4%
OTS	7.7%	7.7%	7.7%
Sample Size	220	78	142

Sample drawn from 2001-2005, with 90% from 2002-2004 period.

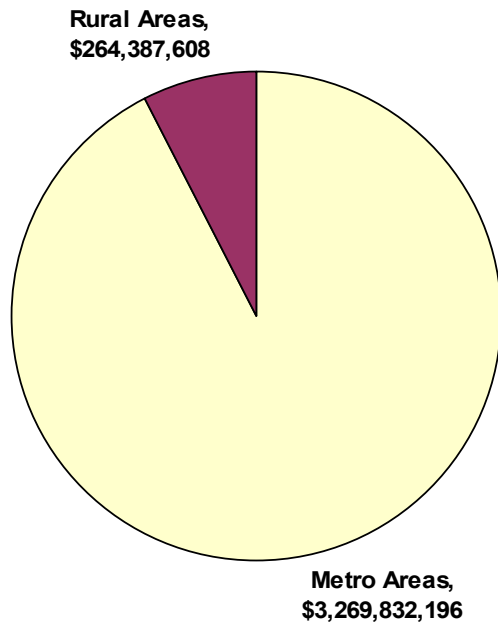
Role of CRA – Ratings Matter: \$5.4 Billion in CD Financing

**Median Community Development Investments
by CRA Rating**

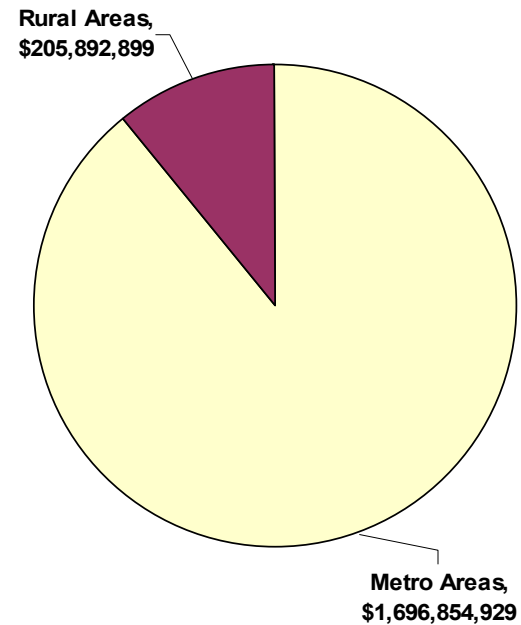


More Community Development Financing by Metro Banks

**Community Development Lending
in Metro and Rural Areas**

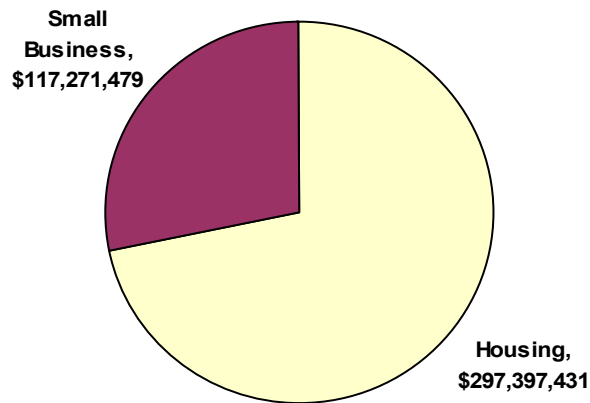


**Community Development Investment
in Metro and Rural Areas**

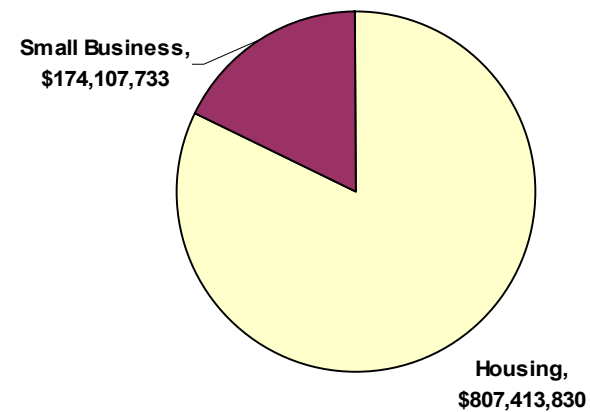


CRA Community Development Financing: More Housing than Small Business

**Community Development Loans by Purpose:
Housing and Small Business**



**Community Development Investments by Purpose:
Housing and Small Business**



Key Findings & Implications

- Consider incentives for developing more bank branches and growth of community banking.
 - e.g. NY Banking Development District program.
- Ensure continued efficacy of CRA
 - integrity of mid-size exams & enhance small business data.
- Increase capitalization and sustainability of Community Development Financial Institutions in region.
 - Particularly development venture capital.
- Conduct longitudinal research to assess the impact of CRA and further explore lending trends to distressed counties and minority communities.

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