

Forefront

New Ideas on Economic Policy from the FEDERAL RESERVE BANK
of CLEVELAND



Change is Afoot in Eastern Kentucky

INSIDE:

Bankers' Appetite for Small-Business Loans Grows
Is There a Student Loan Crisis? Not in Payments
Issues and Insights 2016

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Presidential Pulls

Loretta J. Mester, president and chief executive officer of the Federal Reserve Bank of Cleveland, has shared her views on the Federal Reserve's independence, the uncertainties of forecasting inflation, and the complications created by regulatory complexity. For the full text of President Mester's speeches, search www.clevelandfed.org, keyword "speeches."



SIGNALS AMID THE NOISE

"'Data-dependent' policymaking does not mean that policy will react to every short-run change in the data—that would be a mistake. One of the challenges for monetary policymakers is making low-frequency policy in a high-frequency world. We need to extract the signal about where the economy is headed from economic and financial market information that can often be noisy."

— From a speech in Cleveland, Ohio, April 6, 2016

ADDRESSING WEAKNESSES

"We haven't really faced a situation where the orderly liquidation authority has come into play. Even though Dodd-Frank has been passed for a while now, you asked is it foolproof? I don't think we can answer that yet. But I think the financial system is in better shape than we think it was. I think I'd like to see those provisions work themselves out before we move in another direction."

— From an interview in the Cincinnati Enquirer, April 17, 2016

NATIONAL AND REGIONAL OUTLOOK

"My view of the economy supports a gradual upward tilt in interest rates over the year, but monetary policy will still remain very accommodative as we move rates up. We have some insurance towards downside risk."

— From an interview in the Cincinnati Enquirer, April 17, 2016

FED INDEPENDENCE

"Congress has wisely given the Fed independence in making monetary policy decisions in pursuit of our statutory goals of price stability and maximum employment. I say 'wisely' because a body of research and practical experience both here and abroad show that when central banks formulate monetary policy free from short-run political interference, the policy is more effective and yields better economic outcomes."

— From a speech in New York, New York, April 1, 2016

FINANCIAL STABILITY

In my view, a central bank should care about financial stability to the extent that it affects the health of the real economy. Volatility or minor disruptions in financial markets that represent the ebb and flow of a dynamic economy but do not threaten the health of the economy are not something the monetary policy authority should respond to.

— From a speech in Stockholm, Sweden, June 4, 2016

CONSTANT UNCERTAINTY

"We must be forward looking, which means we must rely on models to forecast inflation, but there is no one model that forecasts with much accuracy. The best we can do in this situation is to recognize that there is uncertainty around our forecasts. I am in favor of the FOMC [Federal Open Market Committee] providing some type of error band around its projections. Not only will it help the public understand some of the risks around our forecast, but it will also be a helpful reminder to policymakers that we constantly live with uncertainty."

— From a speech in Insel Reichenau, Germany, May 12, 2016

The Freedman's Bank and the Importance of Trust



A special exhibit exploring a financial institution created specifically for African Americans is on display in the Learning Center and Money Museum of the Federal Reserve Bank of Cleveland, offering a view into one of the first American banks established to serve a specific population. *The Freedman's Bank: An American Story of Faith, Family, and Finance* provides a glimpse into post-Civil War banking options for former slaves, African American veterans, and their families.

Congress created the Freedman's Saving and Trust Company, widely known as the Freedman's Bank, on March 3, 1865, after the end of the Civil War. This institution, with oversight by an appointed board of trustees and supervision

by Congress, offered security for depositors' funds while also providing depositors with basic financial education. For many of the bank's patrons, it was the first time they were handling cash.

The bank grew quickly, eventually opening 37 branches. More than 100,000 people opened accounts.

When depositors put their money—and their trust—in a bank, they expect the institution is stable and complies with the law. But the Freedman's bank always struggled financially, and it suffered from a lack of Congressional oversight. When a financial panic hit the country in 1873, most of the bank's investments lost value. Cash reserves were depleted, and the bank was on the verge of collapse.

At least 100 banks failed nationwide, including the Freedman's Bank.

In recognition of the bank, the legacy of which stands as a reminder of the importance of financial inclusion, the US Department of the Treasury has recently renamed its annex the Freedman's Bank Building. It stands on the site of the original

Freedman's Saving and Trust Company and currently displays a traveling version of the Cleveland Fed's exhibit.

The Freedman's Bank is on display in the Learning Center and Money Museum of the Cleveland Fed through December 2016. Visitors will find more information on the bank, including timelines and interactive resources such as the Freedman's Bank records database of genealogical information. The display is free and open to the public during regular Money Museum hours: Monday through Thursday, 9:30 am to 2:30 pm (except bank holidays). A traveling version of the exhibit is available for loan. Call 216.579.3188 for additional information.

—Tasia Hane-Devore

Experience it



The Panic of 1873 wasn't the only banking panic to hit the United States. Watch *The Panic of 1907* and *the Creation of the Federal Reserve System* to learn more: tinyurl.com/jhzg4ct.

This institution, with oversight by an appointed board of trustees and supervision by Congress, offered security for depositors' funds while also providing depositors with basic financial education.

Survey Sheds Light on Small-Business Experiences

Federal Reserve Banks asked, and more than 5,000 answered: A majority of small employer firms reported they were operating profitably and were able to secure financing.

Small employer firms, or those that have at least one employee and no more than 500 in addition to the owner, had positive things to say about recent profitability and revenue growth, and they expressed optimism for the year to come, according to the *2015 Small Business Credit Survey: Report on Employer Firms* released in March 2016.

The Small Business Credit Survey (SBCS), on which the report on employer firms is based, was conducted by the Federal Reserve Banks of Cleveland, Atlanta, Boston, New York, Philadelphia, Richmond, and St. Louis.

Seventy-four percent of those in the employer firm sample have fewer than 10 employees, and 70 percent have annual revenues of \$1 million or less. Respondents represent a range of industries including professional services, retail, healthcare, and manufacturing. Notably, the 2015 SBCS sample includes a significant number of newer firms: 21 percent of the employer firms have operated for 2 or fewer years.



Ann Marie Wiersch
Senior Policy Analyst



These findings suggest some strengthening in small businesses' collective financial condition.

The report, which analyzes the fall 2015 responses given by more than 3,400 employer businesses, reveals that the majority of respondents reported favorably on their companies' financial standing, as 55 percent said their companies were operating profitably, and 54 percent said revenues had increased in the previous 12 months. Thirty-four percent of respondents reported their firms added employees.

While business owners shared positive sentiments about the previous 12 months, they were even more optimistic about the coming year: 72 percent said they expect their revenues to increase, and 45 percent planned to hire additional employees.

But the reality is that small firms often face barriers to planned growth in addition to their day-to-day challenges. The foremost challenges reported by respondents included cash flow and the costs of running the business. Others reported concerns with hiring or retaining qualified staff.

The growth in the SBCS coverage area from 10 states in 2014 to 26 states in 2015 and adjustments to the questionnaire necessitate caution when comparing survey results from both years. That said, a look at only the employer firms in those states surveyed in both 2014 and 2015 shows that a higher share of 2015 respondents are operating profitably, 27 percent as compared to 15 percent in 2014. A higher share also reported growth in both revenues and employment. These findings suggest some strengthening in small businesses' collective financial condition.

Credit outcomes

Among employer firms responding to the survey, 47 percent indicated they had applied for financing in the previous 12 months. Sixty-one percent of applicants said they sought to borrow in order to fund expansion of their business or to pursue a new opportunity. Others applied for funding to cover operating expenses or to refinance existing debt.

In total, 82 percent of employer firms that applied for credit in the 12 months prior to taking the survey were approved for at least some financing, and 50 percent received the full amount of funding they sought. A comparison of the 2014 and 2015 SBCS responses suggests a positive trend. An analysis of the employer firms in only those states surveyed in both years reveals that approval rates were, in fact, higher in 2015, as 38 percent of this group was fully funded in 2014 compared to 45 percent in 2015.

Where 50 percent of applicants were approved for all of the financing they sought, the other 50 percent were approved for either less than the amount applied for or no funding at all.

Applicants reported the greatest success being approved for credit with small banks and online lenders, with 76 percent of applicants at small banks receiving at least some of the financing they sought. At online lenders—defined as nonbank alternative and marketplace lenders—applicants reported a 71 percent approval rate.

Where 50 percent of applicants were approved for all of the financing they sought, the other 50 percent were approved for either less than the amount applied for or no funding at all. These financing shortfalls were most common among smaller firms.

When asked about the impact of their financing shortfalls, respondents who reported they were approved for less than the financing amounts they sought said they would either be unable to meet all of their expenses or would have to delay plans for expansion. Owners of new and growing firms reported they would dip into their own personal funds to finance their operations.

While the *2015 Small Business Credit Survey: Report on Employer Firms* details the responses of firms with employees, future analyses will dive deeper into the data and insights regarding the self-employed and other subsets of respondents. ■

SUM AND SUBSTANCE

Results of the *2015 Small Business Credit Survey* reveal that many of the small employer firms surveyed were successful in securing some or all of the credit they sought.



Read more

The *2015 Small Business Credit Survey: Report on Employer Firms* reveals what small-business owners say about credit conditions, but what do bankers and Cleveland Fed banking examiners observe? *Forefront* shares their insights on page 6.

About the Small Business Credit Survey

The Federal Reserve's Small Business Credit Survey gathers insights about small-business owners' financing decisions and credit outcomes. Here's an overview of the survey itself.

Who: The most recent Small Business Credit Survey (SBCS) gathered more than 5,400 responses from small businesses, both employer firms and nonemployer firms. The Federal Reserve Banks of Cleveland, Atlanta, Boston, New York, Philadelphia, Richmond, and St. Louis conducted it. The number of participating Banks grew to 7 in 2015 from 4 for the 2014 survey, the first survey that was a joint endeavor.

What: The survey gathered insights on business performance, financing needs and decisions, and borrowing experiences of firms with 500 employees or fewer. The *2015 Small Business Credit Survey: Report on Employer Firms* was released in March 2016, and a report about self-employed respondents is slated for release later this year. A look at small-business owners' experiences with alternative lenders is also forthcoming.

When: The most recent SBCS was conducted online between September and November 2015. The next annual survey will launch in September 2016 and is expected to cover an even larger area.

Where: Small businesses responding to the 2015 survey hailed from 26 states mainly in the Northeast, Southeast, and Midwest.

Why: Following the financial crisis, small-business lending declined significantly and was slow to recover. Because small businesses play an important role in the economy and in local communities, policymakers sought a better understanding of small-business credit conditions; however, they found such data not readily available. To help address that gap, Reserve Banks have conducted numerous regional surveys of small-business owners since 2010. Those efforts laid the foundation for collaboration on the SBCS.

How: The SBCS reaches small businesses via partnering organizations, including chambers of commerce, industry associations, nonprofits, and government agencies. The SBCS is not a random sample survey, so its results should be viewed as suggestive of conditions for firms in the coverage area rather than as a statistical representation of small businesses in the nation.

For more survey background, visit tinyurl.com/h6vo7ug.

Bankers' Appetite for Small-Business Loans Grows

Lenders and Cleveland Fed banking examiners say small companies' balance sheets have improved, making for increasingly competitive lending conditions.

A report released early this year by 7 Federal Reserve Banks contains 78 pages that detail what small businesses, or those that employ one or more employees besides their owner(s), say about their need for and access to financing. Here, bankers weigh in.

Cleveland Fed banking examiners and bankers in the Cleveland Fed's region—Ohio, western Pennsylvania, the northern panhandle of West Virginia, and eastern Kentucky—say there's evidence that suggests that credit has become more readily available for small businesses.

The Small Business Credit Survey revealed that financing success rates improved in 2015 compared to those of 2014. Half of small businesses that applied for financing in 2015 got all of the financing they sought from a variety of sources, including large and small banks and online lenders.

Available numbers suggest the climate for small-business borrowers is warming: The nationwide dollar amount of small-business loans outstanding has increased since 2010, notes Jenni M. Frazer, a vice president with the Federal Reserve Bank of Cleveland.



Michelle Park Lazette
Staff Writer



Where lending is heating up, competition can mean loosening of underwriting as bankers vie to win business. (p. 8)

Anecdotes suggest improvement, too: Bankers are telling Gil Goldberg, director of the US Small Business Administration (SBA) Cleveland District, that the competition to lend to small businesses is greater than it was 2 or 3 years ago.

“We are seeing more competitive situations where banks are entertaining small business loans without our support,” he says. “SBA bankers are telling me that now they are losing loans because other banks will do them without an SBA guarantee.

“In roundtables with lenders across northern Ohio, lenders are telling me the customers they’re seeing now have stronger balance sheets, stronger equity positions, and stronger cash flows than they had 2, 3, 4 years ago,” Goldberg adds.

From Timothy T. O’Dell’s vantage point, this should be an opportune time for businesses that want credit and have solid business plans.

“I know that many of our peers are out there looking for good loans,” says O’Dell, president and chief executive officer of Central Federal Corp. and CFBank, which operates 5 branches in Ohio. “I would say the appetite for good loans of all sizes and all types is as competitive as I’ve ever seen it.”

Is the survey’s finding that 50 percent of small businesses secured all of the financing they sought good news or bad? O’Dell goes with glass half full.

“If you’re able to say yes to 1 out of 2 applications, that’s pretty good,” he explains. “Credit extension is always a function of creditworthiness and prior experience, of how well the owners of the business have handled their credit and their financial responsibilities. You have a lot of people apply for loans, [but often] the purposes are not for something that would be of interest, or they’re not creditworthy or don’t have a good business plan.”



Bankers say “yes” more often

How strong the demand is for small-business loans differs from region to region, according to the SBA's Goldberg. In areas such as Fremont, Ohio, he hears that rural lending has plateaued. In Ohio's metropolitan areas, specifically Dayton, however, lending is growing significantly.

Where lending is heating up, competition can mean loosening of underwriting as bankers vie to win business.

Regulators evaluate lending growth and the risk it presents through the lens of what an institution's underwriting standards are and how loans adhere to those standards, explains Eric Richmond, a Cleveland Fed supervisory examiner of large banking organizations. If there are exceptions or deviations from the standards, the number of such exceptions and the way they are aggregated and reported to management is important.

For his part, O'Dell says CFBank has not changed its underwriting.

“Today, we're able to say, ‘yes’ more often than we were able to 2 years ago,” he says. “That's without lowering credit standards.

“We're cautiously optimistic that things will continue to strengthen,” he continues. “We all know there are a lot of headwinds out there, but we believe that it's much more likely than not that the economic conditions for small businesses will continue to get better.”

Some of those headwinds, O'Dell notes, are the geopolitical incidents in Europe and rising interest rates.

The loss rates, or net charge-offs, of small-business loans, defined as loans less than \$1 million granted for a business purpose, increased more than the loss rates of many other types of loans during the financial crisis, the Cleveland Fed's Frazer says. Now those rates are more in line but still slightly higher than loss rates of other commercial loan types.



Timothy T. O'Dell

“We all know there are a lot of headwinds out there, but we believe that it's much more likely than not that the economic conditions for small businesses will continue to get better.”

Small but mighty

The Small Business Credit Survey also revealed that small businesses that did borrow were most satisfied by their experiences with small-bank lenders.

One reason could be that smaller institutions' lenders have more time to spend developing an understanding of a business and its borrowing needs, Frazer of the Cleveland Fed observes.

"It was a bit surprising to me," Frazer says of the satisfaction being higher with small institutions versus large, "because the large banks have made a number of investments in recent years in customer satisfaction-type processes." She cites as an example the training of customer service reps. "The survey results appear to indicate that those investments are not yet paying off," she notes.

Goldberg, though, observes that the lion's share of the SBA lending in northern Ohio is done by large institutions such as Huntington Bank. (Importantly, northern Ohio is only 1 region in 1 state covered by the credit survey.)

No matter the size of the institution extending the credit, Cleveland Fed examiners stress that the loans any bank is making should fit that bank's tolerance for risk. Where small businesses' financial performance and financing needs don't meet

institutions' risk tolerances, it's a positive that other sources of capital such as angel investors and online lenders exist to support them, Frazer notes.

"It's good for the small business, for the startup, for the economy, to have that avenue for growth," she says. ■

SUM AND SUBSTANCE

Results of the 2015 Small Business Credit Survey suggest that credit has become more readily available, and, likewise, Cleveland Fed examiners and area lenders say bankers' appetite for small-business lending has improved, as has the creditworthiness of small companies.

Read more



Find background information on the Small Business Credit Survey, the *2015 Small Business Credit Survey: Report on Employer Firms*, SBCS data, and the SBCS questionnaire all in 1 place: tinyurl.com/h6vo7ug.





PART **3** Through the
Lens of Change

Part 3 of a 4-part Forefront series examining eastern Kentucky's transition away from a coal-centric economy.



Bonnie Blankenship
Regional Community
Development Advisor

How can one organization located in the foothills of eastern Kentucky provide a view of a largely hidden yet broad segment of American history and culture in the midst of transition? Ask Appalshop.

The story of Appalachia is remarkable, and Appalshop—a media, arts, and education center—seeks to preserve it. Since its creation, Appalshop has received a mixed pool of investments from an assortment of funding mechanisms: local and national donors, federal and state sources, the National Endowment for the Arts, the National Endowment for the Humanities, the Kentucky Arts Council, and private and corporate foundations. It also receives support from online sales of its films and stories. By preserving the past, it allows for future growth in the region by acknowledging the area's rich cultural heritage while visioning new economic possibilities.

Appalshop is located in Whitesburg, Kentucky, a town of approximately 2,100 located in the heart of the Appalachians. The surrounding county of Letcher has a population of roughly 24,000. In the 1950s and 1960s, Whitesburg and the surrounding towns and counties were hit hard by the mechanization of the coal mines, and the resulting unemployment made the region a central focus of President Lyndon Johnson's War on Poverty.

The importance of local business development in Whitesburg can't be overstated, especially given the area's decline in coal production. Within just 3 square miles, there's a new restaurant, a cooperative record store, and a new entertainment venue and distillery, providing cultural entertainment and jobs. This economic activity seems to be taking hold in other parts of the region, as well. For the past 47 years, Appalshop has brought new residents, businesses, and investment to the area, creating a positive dynamic within the community.

A view of the PAST

Initially 1 of 10 Community Film Workshops born of a partnership between the Office of Economic Opportunity and the American Film Institute, Appalshop was the only rural workshop and is the only workshop of the 10 that is still in existence today. Through media training, storytelling, cultural events, and preservation of Appalachian traditions, it's an energizing force in Whitesburg.

Appalshop—and the popularity of film and availability of new equipment—has played a significant role in countering adverse descriptions and stereotypes of the Appalachian region.

Established in 1969, Appalshop started at a time of renewed interest in the telling of the Appalachian story. After the original government funding for Appalshop expired, it became an independent nonprofit with the mission to amplify the voices of the Appalachian people through radio, theater, music, fine arts, storytelling, filmmaking, and photography. From the very beginning, filmmakers turned the camera inward, demonstrating an early example of how the utilization of more portable video equipment could influence social change through storytelling.

In its early years, Appalshop's connection to Appalachian social movements, organizations, and individuals was integral in shaping the work. The depictions offered in those early films were authentic and poignant, resulting in the films' success. Praise for Appalshop's initial work propelled the organization to a position of prominence as a media production company, subsequently connecting it to a network of social justice advocates, activists, and academics who participated in the social movement to provide a truer representation of the region.

Appalshop—and the popularity of film and availability of new equipment—has played a significant role in countering adverse descriptions and stereotypes of the Appalachian region. Josh May, Appalshop's communications director, says, "There was nothing like it in the community. What developed was an honest representation of the area and the people." Allowing residents to speak for themselves, to one another, and to the nation at large, telling the unique story of Appalachia, allowed residents and Appalshop to contest adverse perceptions of the region. Even though there are various individual views among Appalshop's

filmmakers, they all agree on one fundamental aspect of regional representation: It is critical for Appalachians to tell their own stories. This media space provides a window into regional conditions and into the hardships of living in this beautiful but challenging place. These films record Appalachia's cultural legacy, offering participants room in which to participate actively in current issues affecting their communities.

The materials Appalshop artists have produced serve as benchmarks for those prone to study, idealize, and evaluate the area's culture and history. Individuals within the local community or in the region or those who are connected regionally and nationally to other groups drive this work. Many reform initiatives developed to address a variety of Appalachia's social problems such as labor issues, inferior educational systems, environmental destruction, and limited access to healthcare. These problems became subject matter for Appalshop documentaries.

Initially, the filmmakers were not entirely aware of the impact of their work. Ideas developed as they became more experienced with the subject matter, and the influence of their work, and of Appalshop, unfolded slowly and in sometimes unpredictable ways. Appalshop, and its cohort of artists, provided a view of the culture and community that drew a new generation to the area. Its presence in the community acted as an entrepreneurial center for all types of media and assisted in the development of new shops, restaurants, bars, and other entertainment venues. Word spread about Whitesburg's attracting visitors, new residents, and, ultimately, new businesses.

Appalshop, and its cohort of artists, provided a view of the culture and community that drew a new generation to the area.

A view from the PRESENT

Every manner and aspect of Appalshop's programming serves the Appalachian community. A prioritized connection to the region is central to the organization, originating with hiring its staff. Appalshop is a major employer in the community, with more than 30 employees, and everyone from local student interns to local on-air personalities is from and committed to the region. This specificity has resulted in a group of people who feel responsible for and invested in the success of the organization as well as in the future of eastern Kentucky and its residents. After all, it's their future as well.

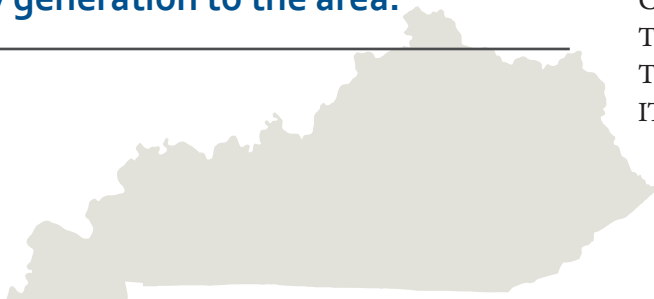
A view into the FUTURE

Appalshop is in a unique position to act as a change agent for new ideas and to explore strategies for individuals and organizations striving to improve the region.

The creative output reflects the relationships developed between filmmakers and area stakeholders. These connections played a significant role in Appalshop's development as a regional institution by solidifying its position in the local community.

Now Appalshop has come full circle, going back to its workforce development roots. In partnership with the Southeast Kentucky Community and Technical College, Appalshop is providing a certificate program in media production. For this inaugural class, a consortium of employers in Letcher County is committed to providing 20 new jobs in the region.

Going back to its original workforce development focus, Appalshop in late 2015 received a \$200,000 Economic Development Administration grant and \$75,000 from the Appalachian Regional Commission for the Southeast Kentucky High Tech Workforce (SKHTW) Certificate Project. The SKHTW project "will develop a 1-year IT workforce certificate program targeted to



communities affected by the reduction in coal employment.” The program in information technology and media production will be offered at Southeast Kentucky Community and Technical College campuses in Kentucky’s Letcher, Harlan, and Bell Counties and provide 30 county residents with educational experience using both classroom and hands-on instruction.

Appalshop looks at ways to shift the conversation, moving from a community supported by extractive resources to one supported by creative placemaking.

The project seeks to fill the technology and media skills gap identified by employers in the region, providing an educational framework, connecting graduates with local businesses looking to hire, matching graduates with entrepreneurs working to establish new businesses, and working with graduates to apply their new skills in starting their own businesses.

The SKHTW Certificate project is financed by a grant from the federal Partnerships for Opportunity and Workforce and Economic Revitalization (POWER) Plus initiative. POWER provides more than \$55 million in funding for job training, job creation, economic diversification, and other efforts in communities that have experienced layoffs as a result of declines in the coal industry. Of this amount, \$20 million is earmarked for coal miners or coal plant workers who have lost their jobs in recent years. The money will go toward job transitioning services and programs. Another \$25 million is designated for the Appalachian Regional Commission, which works to improve economic opportunities in Appalachia.

Appalshop has evolved during nearly 5 decades from early programs, screenings, performances, and

community involvement to providing educational classes in many focus areas, including photography, guitar, piano, clogging, and basket weaving. The program has since expanded to include cake decorating, darkroom, square dancing, banjo, sewing, calligraphy, drawing, and painting. This evolution brings us to the current approach centered on workforce development and job training in the region.

Through all of these programs, Appalshop connected with residents, providing influence for social change in residents’ hometown of Whitesburg. Appalshop looks at ways to shift the conversation, moving from a community supported by extractive resources to one supported by creative placemaking. May, Appalshop’s communications director, sums up the organization’s role in this new economy as a practice of allowing “the community to think outside the box and create a place for conversations on ways to develop the area’s potential and possibilities.” This line of thinking demonstrates a bond to the town, even as the organization stretches its presence from a regional institution to a national one. Appalshop’s role as a regional arts institution encourages local artists to realize their roles in preserving the Appalachian identity. ■

SUM AND SUBSTANCE

Appalshop provides important tools for cultural self-representation and economic growth in eastern Kentucky.



Read more

Eastern Kentucky is the focus of intensified state and federal attention to outmigration and high unemployment rates resulting from the depletion of coal reserves and from the lack of economic diversity. For parts 1 and 2 of this 4-part series, visit tinyurl.com/hqogzwe and tinyurl.com/zl46uaa.

For further information about Appalshop, check out appalshop.org.



Issues and Insights 2016



Matt Klesta
Policy Analyst

We surveyed community leaders across the Fourth Federal Reserve District regarding challenges facing their communities. The results of the annual survey, now in its fifth year, are in: Jobs, affordable housing, vacant properties, and state financing issues top their list of concerns.

Covering over 75,000 square miles, the Fourth Federal Reserve District contains nearly 17 million people living in large urban metropolises, rural Appalachian towns, and everything in between.

Keeping track of issues across the Fourth District, which includes Ohio, western Pennsylvania, the northern panhandle of West Virginia, and eastern Kentucky, can be challenging. To help meet that challenge, the Community Development Department at the Federal Reserve Bank of Cleveland has been distributing a short survey to hundreds of community leaders across the District to better understand current and emerging issues facing leaders' communities. This year, 145 people responded.

The rankings haven't changed much from last year's. In fact, they're nearly identical except for a single difference: a tie for third place.

CURRENT ISSUES

JOBS



Jobs continue to top the list of current issues. Some common themes respondents cited were weak job availability, lack of jobs that pay a living wage in both urban and rural areas, and employers' having a difficult time finding qualified workers.

Wrote a director at a Dayton community development organization, "jobs that pay a living wage are still a challenge to come by . . . , and for those people who do try to seek even menial employment, they then may not qualify for social services they rely on."

It's a double-edged sword: A job may be available paying minimum wage, but that income, well below a living wage, could lead to a dramatic decline in various federal benefits because of means testing. Better known as the "benefits cliff," the steep drop in benefits such as food stamps or childcare subsidies occurs when a household attains a certain income. In some instances, a rise in earned income can actually cause damage to a household's finances by limiting access to benefits and services.

Access to employment is another concern, encompassing both training and viable transportation options. The president of a Northeast Ohio foundation explained that "there is a significant disconnect between available jobs and those who need them, and much of that disconnect is due to training needs and barriers such as transportation."

AFFORDABLE HOUSING



Access to quality affordable housing, or the lack thereof, is number 2 on the list. The executive director of a Northeast Ohio foundation noted that the supply of current housing options resembles a barbell: very expensive housing for rent at one end, very poorly

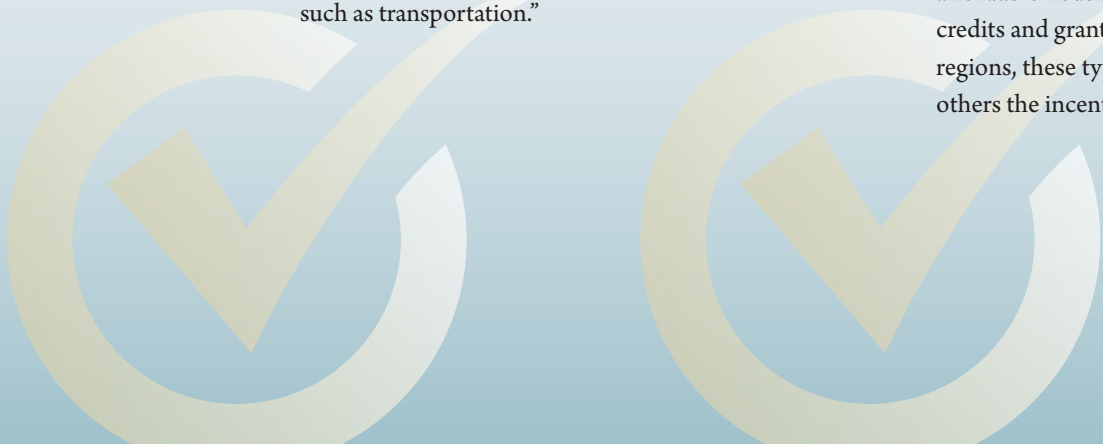
maintained housing at the other, and "nothing in between that is decent and affordable."

The reality is that many developers working on affordable housing projects rely heavily on tax credits and grants to finance projects.

Another issue in the affordable housing category concerns property maintenance: "Homeowners and landlords cannot seem to come up with the money to make necessary home repairs . . . ; there is no savings for emergencies, and many landlords in poor areas cannot secure equity loans," writes a director at a Montgomery County, Ohio, community development organization.

Several other respondents commented that a growing number of seniors will place increasing pressure on the need for affordable housing.

The reality is that many developers working on affordable housing projects rely heavily on tax credits and grants to finance projects. In some regions, these types of funding are strong, while in others the incentives are distributed imperfectly.



TIE BETWEEN VACANT PROPERTIES AND BUDGETARY CUTS AND FINANCING ISSUES AT THE STATE GOVERNMENT LEVEL



Perennial concern about vacant properties is tied with state budget and financing issues as the third most important current issue.

Regarding vacant properties, most respondents cited such properties' contribution to declining property values, concerns over increased crime, negative neighborhood perceptions, and neighborhood instability. The sheer magnitude of the problem makes securing enough resources to deal with vacant properties nearly impossible at best.

The Fourth District lies in the heart of the Rust Belt, where many communities have been dealing with neighborhood instability because of vacant and abandoned property since well before the Great Recession. One byproduct of this instability, noted a chamber of commerce vice president, is disconnect between population and necessary infrastructure. When a city has more housing than population, city government needs to determine how to reduce overall city infrastructure appropriately in order to meet current reality.

Concerns about state budget and finance issues were driven by a combination of those frustrated by the Pennsylvania state budget impasse and those concerned about the impact of continued cuts to the state of Ohio budget.

In Pennsylvania, political disagreements prevented the state from passing an on-time budget by June 30, 2015. Instead, a stopgap budget was implemented at the end of 2015 to help restore some lost funding, and by the end of March 2016, the 2015–2016 state budget became law. Public service agencies are particularly hard-hit by the impasse, as are public schools and universities, local government, nonprofits, and vendors and contractors who do business with the state. A Pennsylvania banker wrote that such “dependence on state funding has crippled a number of nonprofits and government-funded agencies during the ongoing budget state crisis.”

It's much the same in Ohio in terms of reductions, as recent state budgets have included cuts to local government funding. According to the state director of a federal agency, “state cuts to the local government fund,” or the portion of general revenue tax collections distributed to counties and municipalities across the state, “have imperiled local infrastructure.”

The Fourth District lies in the heart of the Rust Belt, where many communities have been dealing with neighborhood instability because of vacant and abandoned property since well before the Great Recession.



EMERGING ISSUES, POSITIVE AND NEGATIVE

POSITIVE

Neighborhood revitalization and improved economic conditions:

Several positive comments identified recent influxes of population revitalizing downtowns in cities across the Fourth District, as well as potential for this revitalization to spill over into surrounding neighborhoods. Increasing corporate involvement around community issues has made for a stronger region.

Energy: States in the Fourth District are no strangers to natural resource extraction, as evidenced by the natural gas boom in Ohio, Pennsylvania, and West Virginia. Recent major declines in natural gas prices, however, have dramatically slowed drilling and exploration. The hope is that when prices rebound, development and investment will resume. Several comments referenced a long-term project, the potential location of an ethane cracker plant in the District. This plant would process natural gas and separate it into components used by the region's petrochemical and plastics-manufacturing companies.

Although Kentucky's coal industry has seen dramatic job losses, mine closures, and bankruptcies of some of the largest producers, it has also stimulated action throughout the

state to develop a more diverse economy not centered on coal, particularly in eastern Kentucky. One example is Strengthening Our Appalachian Region (SOAR), "an initiative of the governor's office and Rep. Hal Rogers that has brought together key stakeholders and identified solutions to big issues in our region. The common view that we need to be people of action is now held by many," writes the chief executive officer of an economic development organization in eastern Kentucky.

Housing: A new phase of funding for the US Department of the Treasury's Hardest Hit Fund (HHF) spurred several comments. The HHF was established in 2010 following the housing crisis and provided money to housing-finance agencies in 18 states and the District of Columbia to use for foreclosure prevention and neighborhood stabilization activities. The Fourth District contains 2 states receiving HHF money: Kentucky and Ohio. Original funding gave Kentucky \$149 million and Ohio \$570 million. Recently, a second phase of funding was announced. Based on an allocation formula, Kentucky and Ohio will receive \$98 million and \$30 million, respectively. However, through an application process, up to \$250 million in additional funding can be awarded to each state based on its specific needs.



How are you building better communities in the Fourth District?

“Northeast Shores has instituted a renter equity model to allow renters in our multifamily properties to earn money with long-term positive rental history.”

Northeast Shores, Cleveland, Ohio

“We are launching a new partnership with Cincinnati Children's Hospital focused on decreasing infant mortality in our community. Lack of healthy, affordable housing is one factor in our service area's high infant mortality rates, so working with low-income mothers to improve their housing will be one part of this program.”

Legal Aid Society of Southwest Ohio, Cincinnati, Ohio

“I volunteer through the Northern Kentucky Chamber of Commerce on the Advanced Manufacturing Coalition. I will go into 30 high schools in the next 4 weeks to talk to students about accepting apprenticeship positions that begin at \$14 per hour, and these companies will pay full-ride tuition and books. I am begging students to take these positions. We need 600 workers in this industry sector, and these seniors are the answer to the equation. The students don't have resumes, don't know how to access company applications online, and have not applied to college. The lack of counselors and the lack of preparation of the students are truly worrisome.”

Taylor Career Strategies, Ft. Thomas, Kentucky

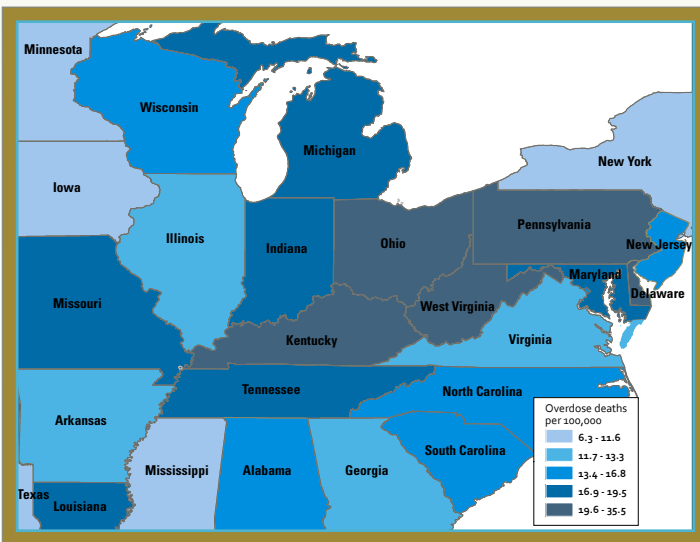
NEGATIVE

Health and safety: Drug abuse is a major concern, and several respondents cited resultant community impacts such as the strain placed on social services, foster homes, law enforcement, and families. According to analysis by the Centers for Disease Control and Prevention, Fourth District states have some of the highest drug-overdose fatality rates in the country. In fact, West Virginia has the highest rate, more than double the national average.

Displacement and public transportation: “Poor public transportation infrastructure is becoming a bigger problem as several centrally located and well-served neighborhoods become unaffordable because of rising rents and home prices,” writes a senior attorney at a nonprofit legal service agency, and “As low-income renters and homeowners are pushed to areas that are less well-connected by transportation options, opportunities for these citizens to get and keep employment and to access other services are being diminished.” A deputy director for a Pennsylvania county department of planning additionally reminds us that “an overlooked component of vibrant and revitalizing communities is a strong, multi-modal transportation network.”



In 2014, Fourth District states had some of the highest drug-overdose death rates in the country.



Source: CDC/NCHS, National Vital Statistics System, Mortality.

Others saw a difference of opinion within community development theory and practice, a growing divide between “those who support and believe in intensely focused, place-based initiatives such as the place matters model” and “others who want to spread funding over all neighborhoods and all communities to allow for simultaneous development opportunities regardless of location.”

To participate in future surveys, contact Lisa Nelson, community development advisor, at lisa.a.nelson@clev.frb.org. ■

Community development capacity and theory:

Several respondents expressed concerns about the community development field. Some suggested there may be too many community and economic development organizations and thus a “need to draw these organizations together to partner together to accomplish common goals.” In this landscape of limited available resources, organizations could benefit from such things as sharing services or merging when geographies and missions overlap.

Others commented on the types of programs that should be funded. A program officer at a Pennsylvania foundation writes, “We keep wanting to fund intervention programs, but never prevention programs,” and thus “we are not addressing the root causes of social disparities, but putting Band-Aids on the problems.”

SUM AND SUBSTANCE

Fourth District community leaders find the most significant challenges facing their communities aren’t much changed from last year’s, including job, housing, and state financing issues.

Read more



Employment issues are on the minds of others in the Fourth District. Check out “Eastern Kentucky: A Region in Flux” for a deeper look into employment challenges in Kentucky: tinyurl.com/z3lyqff.

Lacking transit access, some lower-skilled workers miss out on jobs. See “Job Accessibility in Northeast Ohio” for more information: tinyurl.com/jhhcjvg.

Is There a Student Loan Crisis? Not in Payments

The number of people obtaining student loans is rising—and so is the average loan balance. But a Cleveland Fed economist notes that monthly payment amounts are less of a hindrance than many believe.

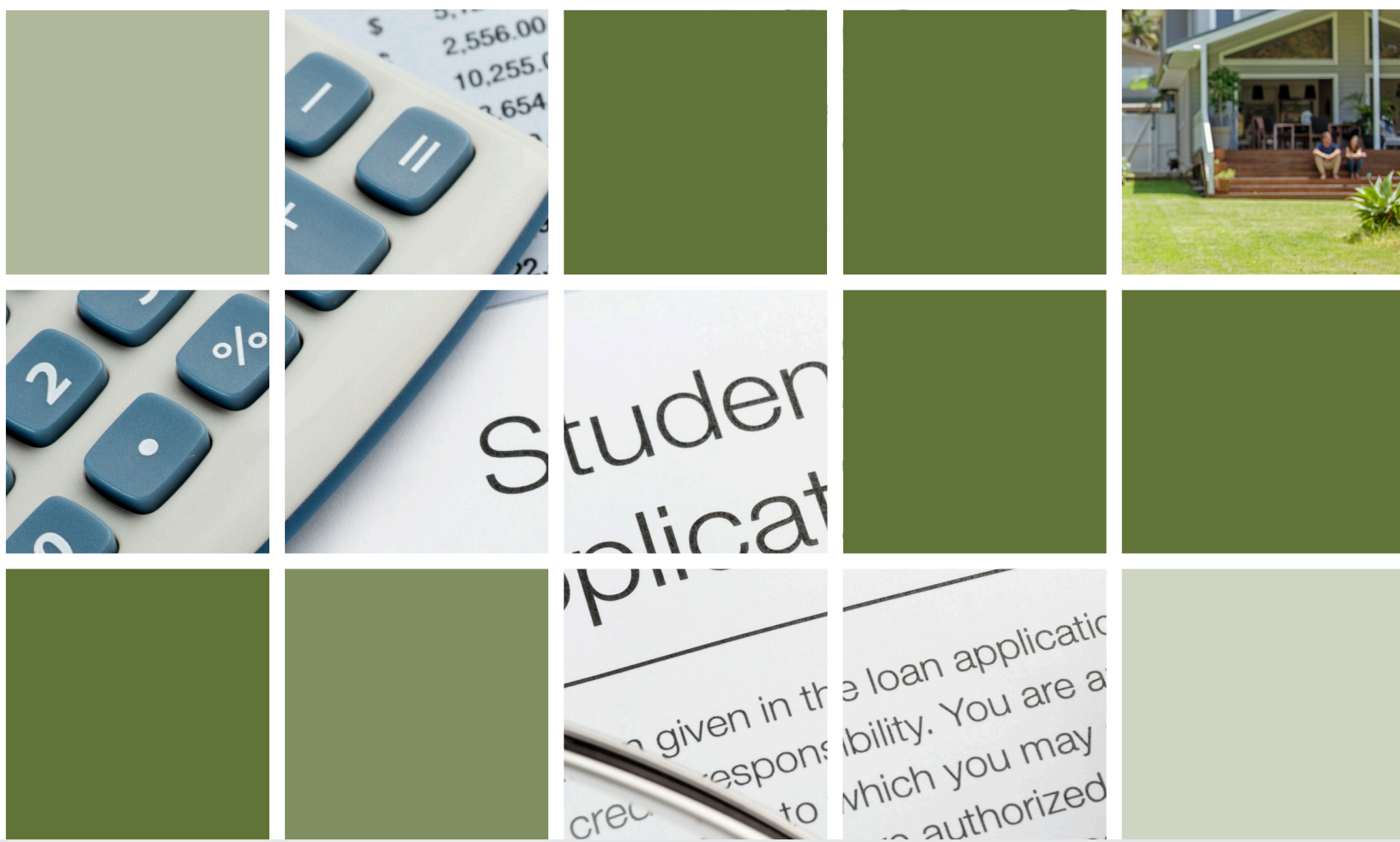


Joel A. Elvery
Economist

Compared to other people who attended college, student loan borrowers are less likely to own a home. (p. 22)

Outstanding student loan balances reached \$1.2 trillion in the fourth quarter of 2015, making student loans the second largest category of debt after mortgages. And according to estimates from the Federal Reserve Bank of New York, student loan balances are rising faster than any other category of debt. Accounting for inflation, overall student loan balances almost tripled between the start of 2005 and the end of 2015. This dramatic growth has spurred concern that students are coming out of college with so much debt that their ability to purchase homes or start businesses is limited.

Much of the attention paid to the growth of student loans has focused on balances, overlooking payments. However, a loan balance may be an abstract concept to a borrower, while a payment is the immediate responsibility that affects his or her daily life.



Student loans are like mortgages: A large balance gets paid over time in a series of payments, the amount of which is typically fixed, such that even a large balance may be manageable month-to-month when viewed in these terms. The amount of student loan payments paints a different picture of student loan debt than one gets from balances. In fact, while outstanding balances have risen 280 percent since 2005, the average payment rose just 50 percent in that same period.

In the second quarter of 2015, the average student loan payment for those in the 20- to 30-year-old range was \$351, according to the Federal Reserve Bank of New York's Consumer Credit Panel data. This amount is just more than 50 percent higher than it was in 2005 (\$227 when adjusted for inflation).

But a small fraction of borrowers have very large student loan payments, pulling up that average. Fifty percent of the borrowers had payments of \$203 or lower, and another 25 percent had payments between \$203 and \$400. This means that 75 percent of student loan borrowers in this age range would be, in the simplest sense, better off with a student loan if going to college increased their monthly take home earnings by \$401 or more. In 2014, labor force participants aged 20 to 30 who had at least some college on average earned \$2,353 per month, \$750 more than people the same age with just a high school degree. This is more than double the average monthly student loan payment, suggesting that the increase in earnings from going to college more than offsets the cost of student loan payments for most borrowers.



The increase in earnings from going to college more than offsets the cost of student loan payments for most borrowers.

Student loans have an attractive feature that most debt doesn't have: Payments can adjust to current income levels. Direct federal student loans enable borrowers to apply to make their payments a fixed percent of their discretionary income, with the percent ranging from 10 percent to 20 percent depending on the program. These programs also set a maximum number of years that people have to pay, up to 25 years, and any debt remaining at the end of that period is forgiven.

There are other advantages that student loans have over most other forms of debt. During periods of unemployment, a borrower can apply to suspend payments on federal student loans until the borrower resumes work (note this doesn't apply to private student loans). And interest paid on these loans is tax deductible up to \$2,500 annually. One downside, though, is that student loan debt is extremely difficult to eliminate through bankruptcy.

Recent research has looked at the link between student loans and homeownership and wealth accumulation. Researchers from the Federal Reserve Bank of Boston find that compared to other people who attended college, student loan borrowers are less likely to own a home and that a 10 percent increase in student loans is associated with about 1 percent lower total net worth.

If the share of young people pursuing college degrees is going to rise, it will probably be because of increases in college enrollment by low- and middle-income students, to whom student loans are especially important.

But, if people can only afford college by borrowing, we would want to compare student loan borrowers to people who never went to college. Stephan Whitaker of the Federal Reserve Bank of Cleveland finds that millennials with student loans were more likely than millennials without student loans between 2007 and 2015 to move to a higher-income neighborhood, a sign of economic mobility. The people without student loans included both people who never attended college and people who attended college. If it were possible to compare student loan borrowers only to people who did not attend college, the differences in mobility would almost certainly be even larger.

Forecasts suggest that postsecondary education will continue to be increasingly important, both for individuals' incomes and for the growth of our economy. According to the latest estimates from the National Center for Education Statistics, 79 percent of high school graduates from high-income families enroll in college 1 year after graduation versus 64 percent of graduates from middle-income families and 46 percent of graduates from low-income families. If the share of young

people pursuing college degrees is going to rise, it will probably be because of increases in college enrollment by low- and middle-income students, to whom student loans are especially important. Like any borrower, a potential student loan borrower should focus on whether the debt is enabling her or him to make a valuable investment in the future. ■

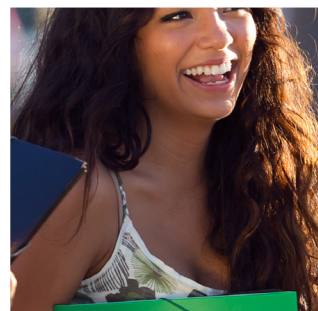
SUM AND SUBSTANCE

Student loan debt is on the rise, but average student debt burdens are more than offset by students' average financial gain in the long term.

Did you know?



Student debt has ballooned to unprecedented levels in recent years. Read "Are Millennials with Student Loans Upwardly Mobile?" at tinyurl.com/j7h4kkg to find out how student loan debt may be affecting social mobility.



State of Banking, 2016

Cleveland Fed bank examiners and regional bankers say challenges abound for the banking industry, but, overall, bank performance remains solid.





Michelle Park Lazette
Staff Writer

The banking industry remains strong, but the operating environment is extremely challenging, and an uptick in provisions for credit losses suggests that bankers expect asset quality to deteriorate in the near term, say banking supervisors with the Federal Reserve Bank of Cleveland.

“Profitability is high from an absolute dollar standpoint,” says Stephen Ong, a vice president who oversees risk supervision and financial stability. “But return on average assets for banking organizations remains below pre-crisis levels. Capital is strong, liquidity is adequate. There may be a turning of the corner relative to asset quality and lending conditions. We’ve been noticing over the last several months that bankers have been increasing their provisions [for loan and lease losses], a situation which indicates they are expecting higher losses. The bankers may be recognizing losses coming up in the near future, so they’re reserving a little more in their allowance for loan losses.”

According to Call Report data, the dollar amount for provisions for loan and lease losses (PLL) increased nationwide between December 2014 and December 2015 for the first time since 2008–2009. And in the Fourth Federal Reserve District, which comprises Ohio, western Pennsylvania, the northern panhandle of West Virginia, and eastern Kentucky, while PLL actually dropped, it was the smallest decrease in PLL (-1.27 percent) since 2005 (-0.77 percent). The rest of the past decade, PLL either grew in the Fourth District by double or triple digits or dropped by 9 percent and often by much more.

Still, provisions for loan and lease losses remain low comparatively, notes Nadine Wallman, a vice president overseeing the supervision of banking organizations with less than \$50 billion in assets. “Increased provisions don’t mean we’re heading for a credit crisis,” Wallman says. “We’re coming off a timeframe of loan loss reserve releases [when banks withdraw funds they’d set aside for losses]. Provisions for loan and lease losses are nowhere near the levels we saw before the crisis.”

Such provisions are increasing primarily because of concerns related to the energy sector, bank examiners say. That said, banks’ exposure to energy assets relative to overall bank loan portfolios is very small both nationwide and in the Fourth Federal Reserve District, notes Ong.

According to the Federal Reserve Board’s April 2016 Senior Loan Officer Opinion Survey on Bank Lending Practices, of those domestic banks that had made loans to firms in the oil and natural gas drilling or extraction sector, a majority reported that such lending accounted for less than 5 percent of their outstanding commercial and industrial (C&I) loans.

The easing of commercial real estate (CRE) underwriting standards prompted federal regulators to issue guidance in December, reminding institutions to maintain appropriate risk management practices.

Not only did banks report that they expect delinquency and charge-off rates on loans to firms in the aforementioned sector to deteriorate somewhat over the remainder of 2016, but they also indicated that “the credit quality of loans made to businesses and households located in regions of the United States that are dependent on the energy sector had [also] deteriorated somewhat.”

“In our District and nationwide, it’s the energy sector that’s contributing to the uptick in losses and projections for losses,” explains Jenni Frazer, a Cleveland Fed vice president overseeing the supervision of large banking organizations with more than \$50 billion in assets. “Otherwise, there’s not a particular industry or portfolio that we’re concerned about. Even on the real estate side, it’s a



Daryl Patterson

“All banks will be challenged to show material revenue growth. As a result, expenses will continue to be under strong scrutiny from a control perspective.”

longer trend. We’re seeing relaxation of underwriting, but it’s not translating into losses yet.”

That may be, but the easing of commercial real estate (CRE) underwriting standards prompted federal regulators to issue guidance in December, reminding institutions to maintain appropriate risk management practices.

“The agencies [Federal Reserve Board of Governors, Office of the Comptroller of the Currency, and Federal Deposit Insurance Corp.] have observed that many CRE asset and lending markets are experiencing substantial growth,” the statement reads.

It also states, “The agencies’ examination and industry outreach activities have revealed an easing of CRE underwriting standards, including less-restrictive loan covenants, extended maturities, longer interest-only payment periods, and limited guarantor requirements. In light of the developments mentioned above, financial institutions should review their policies and practices related to CRE lending and should maintain risk management practices and capital levels commensurate with the level and nature of their CRE concentration risk.”

More often than not, the relaxation of underwriting standards leads to increases in nonperforming assets and net charge-offs over time, the Cleveland Fed’s Ong explains.

Still solid

There’s not a major difference between banking conditions of last year and this year, Frazer says.

“Last year, the banking industry was in sound condition, and that’s the case today. Despite some trends,” she explains, “the fundamentals are still very solid.”

Compressed net interest margins and nonbank competition for what’s been modest loan demand continue to challenge bankers, as do the needs to mitigate cybersecurity risks and to be mindful of geopolitical risks such as the extension of credit to entities doing business in countries experiencing downturns and negative interest rates.

Daryl Patterson, chief credit officer for Fifth Third Bancorp based in Cincinnati, regularly asks his team members if they are seeing anything particularly bad or unusual in the marketplace in terms of underwriting, especially given the pressure that unregulated nonbanks put on terms, covenants, and other structures. So far, the answer’s been no, Patterson says, but the possibility of underwriting deterioration remains.

“We’re in the pretty late innings of an extended cycle,” he says. “We’re very mindful of loosening of terms and stretching too far. It can happen out there. It tends to happen in a tight growth environment.”

From a loan demand perspective, Patterson says, “it’s been slow and steady both on the consumer and commercial sides.”

Still, banks’ C&I lending by dollar volume has increased year over year, albeit slightly. The same is true of banks’ CRE lending. Net income, or profit, is also up year over year in the aggregate in both the region the Cleveland Fed serves and in the nation.

“One current driver to boost earnings is to reduce noninterest expense,” explains Frazer. “That’s reductions in people and systems and delays in infrastructure investments, and that’s something that’s not sustainable. The second area is a focus on fee-generating businesses. We’re seeing a lot more investment in asset management and payment services.”

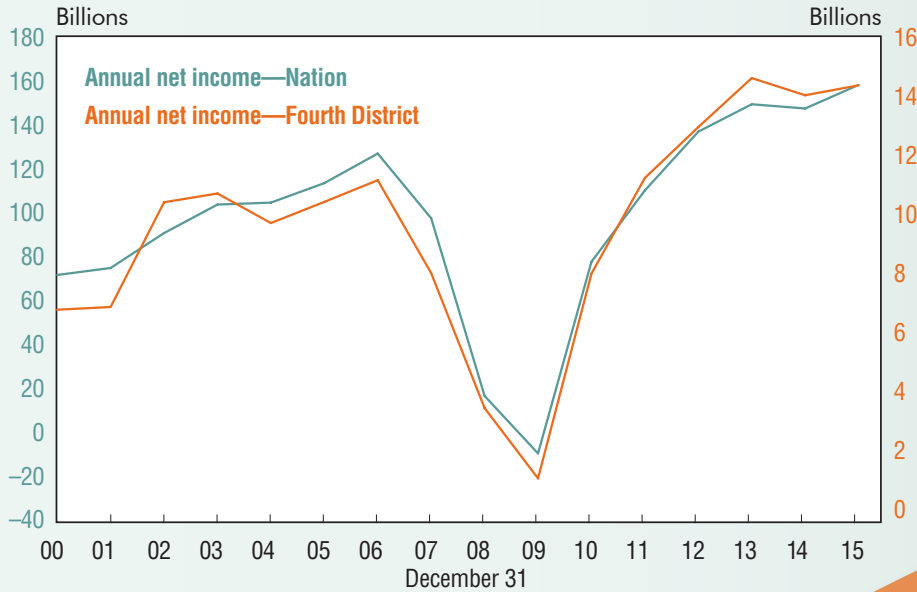
Fifth Third’s Patterson agrees that keeping down costs is a pressing focus for bankers.

“As far as the economic environment and loan demand, it’s a fairly tough environment in terms of growing the top line,” he says. “All banks will be challenged to show material revenue growth. As a result, expenses will continue to be under strong scrutiny from a control perspective.”

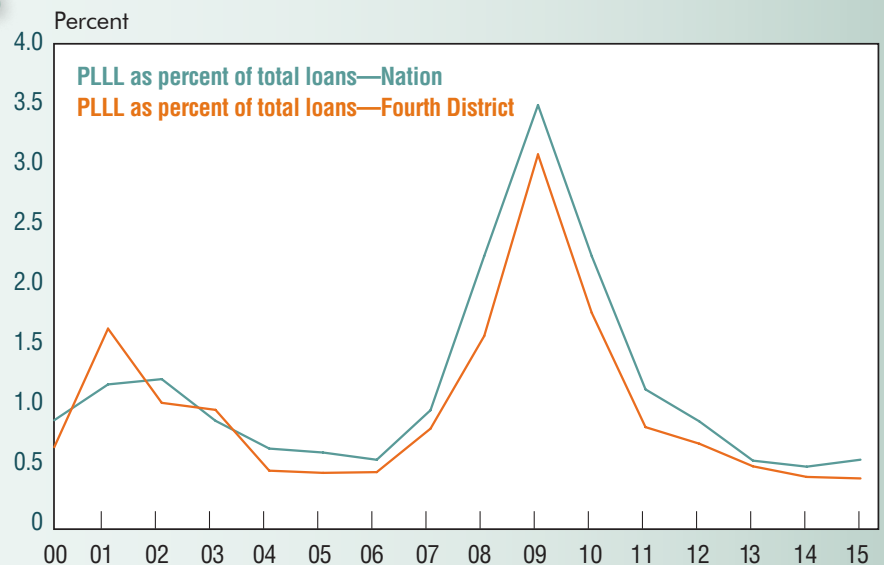
Some large banks are also acquiring fintech, or financial technology, companies, though it’s too early yet to gauge a return on those investments, bank examiners say.

BY THE NUMBERS

Bank year-end profits have increased nationwide and in the Fourth Federal Reserve District* since 2009–2010, but profit growth has slowed in recent years.



Provisions for loan and lease losses as a percentage of total loans have stabilized at low levels in the nation and the Fourth Federal Reserve District.*



*The Fourth Federal Reserve District comprises Ohio, western Pennsylvania, the northern panhandle of West Virginia, and eastern Kentucky. Source: Call Report data.



Sally Cline

“Further changes are to be expected, particularly the global economy, technology, cyber risk. Consolidation is on the minds of a lot of bankers right now. You have increasing competition from the nonbank financial providers. Those are all areas that will pose a challenge to bankers in the months and years to come.”

Banks also appear to be acquiring each other with more frequency, as merger and acquisition (M&A) activity and interest in M&A are higher than they were last year, Wallman says, undoubtedly as bankers seek to grow revenue, expand their business activities, and build efficiencies.

Regulators already are evaluating mergers involving 3 large banking organizations in the Cleveland Fed’s region, Wallman notes. Columbus-based Huntington Bancshares Inc. and Akron-based FirstMerit Corp. have announced an agreement wherein Huntington would acquire the latter, and the Federal Reserve in July approved Cleveland-headquartered KeyCorp’s acquisition of First Niagara Financial Group Inc. of Buffalo, New York.

“Given that regulators consider factors such as an acquiring bank’s financial condition and the soundness of its risk management and compliance programs prior to approving any application, the condition of the industry has to be sound overall to support any type of expansionary activity,” Wallman notes.

Wallman expects such industry consolidation to continue.

Banks in the aggregate hold substantially more liquid assets, namely cash and held-to-maturity securities, on their balance sheets than they did 5 years ago. For example, Fourth Federal Reserve District banks held \$69.5 billion in cash as of December 31, 2015, up 117 percent from \$32.1 billion in cash as of December 31, 2010. As of the end of last year, those same banks held \$79.5 billion in held-to-maturity securities, up 493 percent from \$13.4 billion in such securities at the end of 2010.

The spikes in liquid assets are a direct result of regulatory action, bank examiners and bankers say, specifically the liquidity coverage ratio, which requires certain large banking organizations to hold a minimum amount of high-quality liquid assets that can be converted readily into cash in order to meet net cash outflow needs over a 30-day time horizon. Such assets are lower yielding, and “that, too, has affected banks’ earnings performance,” Ong says.

Challenges on the horizon

Sally Cline classifies the mood among the bankers she knows as “relatively somber,” at least for many of the local independent banks. An executive vice president with the West Virginia Bankers Association, Cline calls regulatory burden the industry’s primary challenge.

“Bankers are just burned out,” she says. “You hear time and time again that banking is not fun anymore. Because of all the laws and regulations, they don’t have discretion to help their customers the way they would like to. There’s fear of enforcement actions and regulation.”

There are also succession-related hurdles to clear.

“A lot of the C-suite bankers are baby boomers entering retirement, and I’m seeing a lot of these banks, particularly in rural communities, having a hard time attracting people to replace them,” Cline explains. “I see that as a significant weakness in West Virginia.”

When asked how banking conditions are likely to change in the second half of 2016 into early 2017, Cline replies, “There’s a lot of uncertainty. Further changes are to be expected, particularly the global economy, technology, cyber risk. Consolidation is on the minds of a lot of bankers right now. You have increasing competition from the nonbank financial providers. Those are all areas that will pose a challenge to bankers in the months and years to come.”

SUM AND SUBSTANCE

Though net income and commercial lending continued to increase in the aggregate in 2015, the present state of banking remains challenging.

Read more



Bad debts and mergers and acquisitions are just 2 topics Cleveland Fed bank examiners tackled in Forefront’s “State of Banking, 2015,” available here: tinyurl.com/hassahc.

Find out more about the Federal Reserve Board’s April 2016 Senior Loan Officer Opinion Survey on Bank Lending Practices: tinyurl.com/h68nv86.

The Federal Reserve Bank of Cleveland serves the Fourth Federal Reserve District, which comprises Ohio, western Pennsylvania, the northern panhandle of West Virginia, and eastern Kentucky. Like the other Federal Reserve Banks, the Cleveland Fed collects anecdotal reports and analyzes data about the region it serves in order to inform national monetary policy. The Bank's State of the State series will share some of what regional researchers find.

State of the State: Ohio

economy

Ohio's unemployment rate rose half a percentage point during a recent period, a larger increase than that of many other states. A Cleveland Fed senior regional officer explains what that may or may not mean.



Guhan Venkatu
Vice President and
Senior Regional Officer

The unemployment rate in Ohio increased half a percentage point in the 6 months ending in April, from 4.7 percent to 5.2 percent, in turn raising the following question: Does an increase of this magnitude signal the start of deterioration in the state's labor market conditions?

While Ohio's unemployment rate remains low—it fell slightly to 5.1 percent in May 2016—its increase during this recent 6-month interval is among the largest for any state. Of interest is that several other midwestern states saw unemployment rate increases as large as or larger than Ohio's during this time period, including Pennsylvania (up 0.5 percentage points) and Indiana and Illinois (both up 0.7 percentage points). Prior to the recent increase, in the third quarter of 2015 Ohio's unemployment rate had reached its lowest point in nearly 15 years.

Using US unemployment rate data, some analysts have noted that an increase in the unemployment rate above a certain threshold over a predefined period has, in fact, been a good guide to impending economic weakness.

Some analysts have noted that an increase in the unemployment rate above a certain threshold over a predefined period has, in fact, been a good guide to impending economic weakness.

unemployment

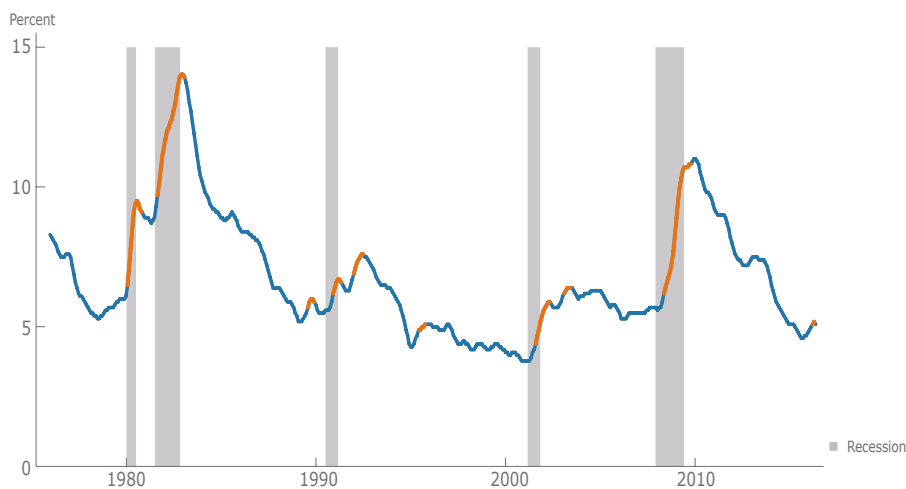
It's important to be cautious in interpreting the recent increase in Ohio's unemployment rate because of the annual revision process that often changes these data in significant ways.

Edward Leamer, professor of economics and statistics at UCLA, reported in a 2008 paper titled "What's a Recession, Anyway?" that an increase in the national unemployment rate that exceeds 0.8 percentage points in a 6-month period has presaged every recession in the post-World War II period, with only 1 false positive. Similarly, analysts at Goldman Sachs have noted that an increase in the 3-month average of the US unemployment rate that exceeds 0.3 percentage points has also been a reliable indication that the US economy is either currently in recession or headed for a recession in the subsequent 6 months. The single exception is in periods immediately following a recession, during which time the unemployment rate may continue to trend up before beginning to decline during an ensuing recovery.

In Ohio, when considering data back to the mid-1970s, a 6-month increase in the unemployment rate of the magnitude we've witnessed recently has indeed tended to occur around US business-cycle turning points. The only exception was in the mid-1990s, when Ohio's unemployment rate rose for several months after falling to 4.3 percent, a rate that was more than a percentage point below the US average at the time. In the other cases, by the time the 6-month increase in Ohio's unemployment rate had equaled or exceeded 0.5 percentage points, a national recession had already begun or had recently ended.

Can we conclude, then, that a recession is imminent or perhaps already underway? Not necessarily.

Ohio's unemployment rate remains low, but it increased during the 6 months ending in April from 4.7 to 5.2 percent and then slightly decreased to 5.1 percent in May 2016.



Source: Bureau of Labor Statistics.

Ohio's unemployment rate

Shading indicates trailing 6-month change in unemployment rate \geq 0.5 percentage points

The national unemployment rate continues to decline, and other indicators continue to point to ongoing growth. In addition, it's important to be cautious in interpreting the recent increase in Ohio's unemployment rate because of the annual revision process that often changes these data in significant ways.

A good example of such change is the most recent annual revision to the 2015 data. Initially, the unemployment rate for June was estimated to be 5.2 percent, but it was subsequently revised down to 4.8 percent, a 0.4 percentage point change. Similarly, the initial estimate for October was reported to be 4.4 percent, but was subsequently revised up to 4.7 percent, a 0.3 percentage point change. Clearly, revisions—which can change several years' worth of data—could eliminate the recent increase in the state's unemployment rate.

The recent increase in Ohio's unemployment rate . . . could be the result of more people entering the labor force because they believe their likelihood of securing jobs has improved.

There is a far more benign interpretation of the recent increase in Ohio's unemployment rate: It could be the result of more people entering the labor force because they believe their likelihood of securing jobs has improved. Indeed, after remaining relatively flat for several years at about 5.7 million workers, Ohio's labor force

has increased—and sharply. Over the 6-month periods ending in April and May, the state's labor force grew by 2.3 percent and 2.4 percent, respectively, the largest increases in any 6-month period since the mid-1970s.

However, these recent increases seem surprisingly large, and they therefore may not survive later revisions. If there are downward revisions to the recent labor force estimates without meaningful revisions to the estimates of employment, these numbers could cause a downward revision to the unemployment rate, thereby moderating or erasing recent increases.

While increases in the unemployment rate *can* be a good predictor of economic conditions to come, it's too early to conclude that a downturn is imminent. Indeed, many other indicators, including anecdotal reports from our District contacts, continue to point to ongoing moderate growth in the economy. ■

SUM AND SUBSTANCE

Ohio's unemployment rate has increased more than that of many other states during a recent 6-month span, something that could signal a turn in the business cycle; however, most indicators continue to point to ongoing growth.

Read more



Forefront's Q&A with Charles Manski digs into how data can be revised materially after their initial release and what can be done to best address the resultant uncertainty: tinyurl.com/j9by23m.



PART

4

Comings and Goings in Eastern Kentucky

Part 4 of a 4-part Forefront series examining eastern Kentucky's transition away from a coal-centric economy.

Eastern Kentucky is challenged with demographic issues as it tries to attract and retain a more diverse mix of jobs.



Matt Klesta
Policy Analyst

What do births, deaths, and migration have in common? They're the only things that change a region's population. But why is it important to track and understand population change in a region?

A school superintendent, for example, may need to know if a district's population is growing or shrinking in order to ensure there are enough teachers. A site locator may be tasked by a chain of stores to find new locations, so she'll want to know how the region's population is changing in order to ensure enough customers. Or a group of councilmembers may need to understand how the size of the tax base is changing in order to update the community's budget appropriately.

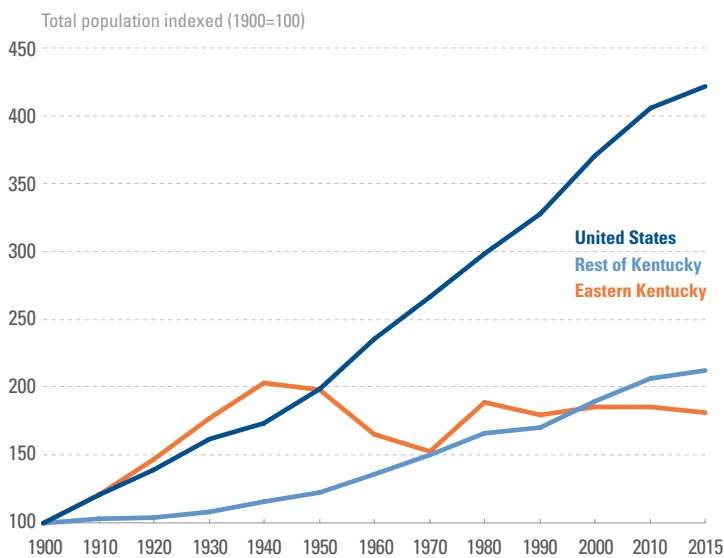
The issues these examples demonstrate are especially important in eastern Kentucky, which is in a state of flux as it seeks to reorient its coal-centric economy. The loss of coal mining jobs has sent ripples throughout the region, one that has struggled with its share of economic and social issues over decades.

Population change in eastern Kentucky: The long and short runs

Let's start by examining the bigger and longer-term picture when it comes to population trends in the region, say, for the past 115 years. That's a big chunk of time, but it provides an idea of the broader changes taking place. Looking across this time span, a few things stand out:

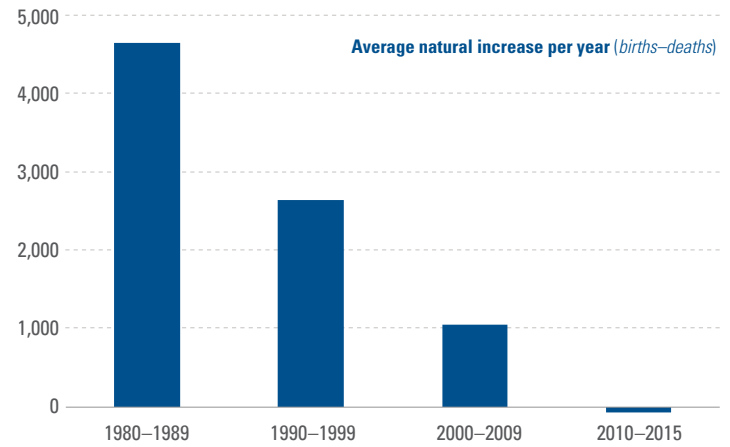
1. The United States' population increased fourfold at a strong, consistent rate.
2. Eastern Kentucky's periods of population growth tend to coincide with booms in coal production, but that impact has lessened as coal mining has become more automated.
3. The rest of Kentucky saw a population that doubled at a steady, albeit slower rate than that of the US.

A long-run look at population trends in eastern Kentucky.



Source: US Census Bureau/Haver Analytics.

The birth-to-death ratio is declining faster in eastern Kentucky.



Source: US Census Bureau, Population Division.

Now zoom in to look at the short run, the past 25 years from 1990, the peak in eastern Kentucky coal production, to 2015. Eastern Kentucky saw stagnant population levels, which began to decline in the last few years as the bottom dropped out of the coal industry. On the other hand, the US and the rest of Kentucky saw positive growth at similar rates.

Digging into the details

BIRTHS AND DEATHS

Otherwise known as "natural increase," the difference between the number of live births and the number of deaths is calculated annually down to the county level by the US Census Bureau's Population Estimates Program (PEP). The data are based on birth and death certificates provided by the National Center for Housing Statistics. For the past 35 years, the average rate of natural increase per year has been dropping dramatically in eastern Kentucky. In the 1980s, the region averaged more than 4,600 more births than deaths per year; but by the 2010s, deaths began outpacing births on average. Calculating a birth-to-death ratio (births divided by deaths) allows us to compare eastern Kentucky to the rest of the state and to the US. While all regions have seen a decline in the ratio, eastern Kentucky's is the largest, dipping to below 1.00 (deaths outpacing births).

Birth-to-death ratios

Region	2010-2015	Change from the 1980s
Eastern Kentucky	0.99	-0.58
Rest of Kentucky	1.37	-0.20
US	1.54	-0.27

Source: US Census Bureau, Population Division.

Comings and goings

In order to understand exactly how much migration is occurring as well as where people are coming from and going to, a good place to start is reviewing data from the Internal Revenue Service (IRS).

DATA SPOTLIGHT

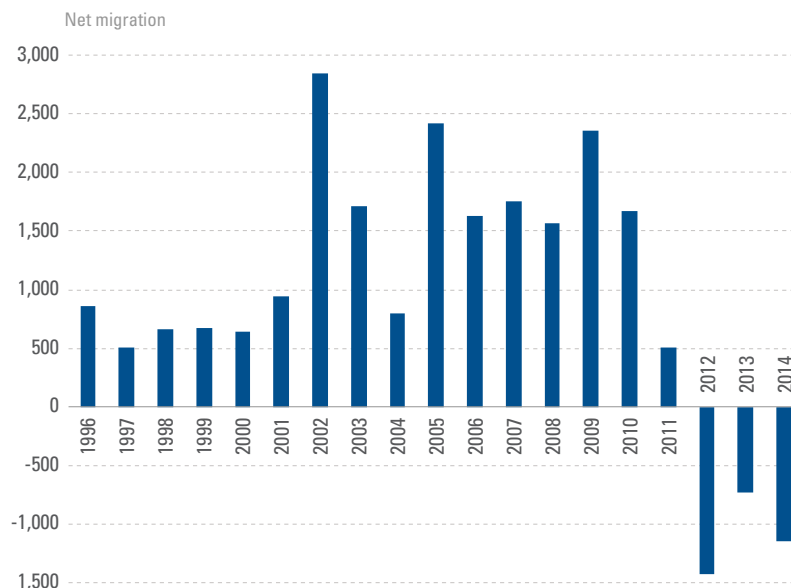
IRS Migration Data are released annually and based on year-to-year address changes reported on filed individual income tax returns.

CAVEATS: *The dataset tends to undercount first-time filers, the elderly, the informal economy, immigrants, and some low-income tax filers, though the Earned Income Tax Credit alleviates the last of these. In addition, the methodology was adjusted starting in 2011–2012.*

BOTTOM LINE: *It's a solid dataset to use when trying to understand broad migration trends in a region because it's an actual count, not a sample that is subject to potentially large margins of error.*

From 1995 to 2011, total net migration between eastern Kentucky and different states was positive as more people moved to eastern Kentucky than away from it: a net gain of around 1,300 people per year. However, from 2011 to 2014, a period that coincides with the recent decline of the coal industry, net migration became negative to the tune of -1,100 people per year.

Recently, more people are leaving eastern Kentucky for other states.



Source: IRS, Statistics of Income Division.

The majority of migration in eastern Kentucky is movement within eastern Kentucky counties.

A closer look at net migration rates between individual counties from 2011 to 2014 demonstrates that in terms of total flow, the vast majority of migration occurred either within Kentucky or between Kentucky and states sharing its border. Eastern Kentucky had the greatest net loss to Fayette County, Kentucky, home to the fast-growing city of Lexington. Conversely, eastern Kentucky had the greatest net gain from Wayne County, West Virginia, where preliminary numbers suggest that natural resource and mining employment has declined 67 percent from 2011 to September 2015 (a loss of 604 jobs). One final point is that the counties with the highest total migration (in-migration plus out-migration) are counties within eastern Kentucky. In other words, the majority of migration in eastern Kentucky is movement within eastern Kentucky counties. (Note that the IRS does not disclose data for counties in which fewer than 10 observations occurred, a circumstance which means some county-to-county migration is excluded in a given year.)

Who's migrating

The final piece involves looking at migrant demographics, including education and income levels and employment status. Data from the US Census Bureau's American Community Survey's (ACS's) 5-year county-to-county migration files suggest clear differences when comparing movers to eastern Kentucky with movers to the rest of the state. Of the people moving to eastern Kentucky from other states, a majority fall into at least one of the following categories when comparing eastern Kentucky to the rest of Kentucky, respectively:

- Have a high school education or less (64 percent versus 38 percent)
- Earn less than \$25,000 per year (47 percent versus 24 percent)
- Are not in the labor force (52 percent versus 33 percent)
- Haven't worked in a year or longer (42 percent versus 25 percent)

In other words, people who move to eastern Kentucky from other states tend to be less educated, have lower incomes, and/or be out of the labor force.

Even though eastern Kentucky's population is declining, people are still entering the region, and a significant number of them are not working.

Tying it all together

There are 3 major takeaways in this analysis of population and migration trends in eastern Kentucky.

Eastern Kentucky is shedding population through a combination of out-migration and deaths that are outpacing births, circumstances that have accelerated as the coal industry has declined. But even though eastern Kentucky's population is declining, people are still entering the region, and a significant number of them are not working.

This detail underscores the importance of attracting new jobs to and cultivating existing jobs and entrepreneurship within the region, particularly as the elimination of coal-related jobs continues. To this end, the state's initiative to construct a broadband network in eastern Kentucky could help the region to diversify its job opportunities.

A large number of the people coming into the region from other states have a high school diploma or less, further underscoring the need for jobs that don't require a college degree yet pay a decent wage. Jobs that can be obtained via certificate training are one option (though many of these, too, require a high school diploma or General Education Development certificate). Financial support for such training could come from a pool of federal dollars called the Partnerships for Opportunity and Workforce and Economic Revitalization (POWER) Plus initiative, mentioned in part 3 of *Forefront's* 4-part series on eastern Kentucky (see page 10). This \$68.5 million fund is earmarked to help coal-dependent communities diversify their economies and retrain their workforces.

Finally, however the region moves forward, doing so will take a concerted effort from policymakers and stakeholders working together toward the same or similar goals. It's evident through this look at population and migration trends that the region is still seeking its equilibrium. ■

SUM AND SUBSTANCE

The eastern Kentucky population is declining overall, but those who are entering the region are often poorly educated, low-wage earners, and/or not in the labor force, circumstances which are putting an additional strain on already-burdened local resources.

Read more



Eastern Kentucky is the focus of intensified state and federal attention to outmigration and high unemployment rates resulting from the depletion of coal reserves and from the lack of economic diversity. For parts 1 and 2 of this 4-part series, visit tinyurl.com/hqogzwe and tinyurl.com/zl46uaa.

Toward Sustainable Workforce Pathways

Community Development's June regional workforce development forum is part of an ongoing effort to address labor and workforce issues in Northeast Ohio.



Anne O'Shaughnessy
Communications Advisor

On June 1, the Cleveland Fed together with workforce investment boards (WIBs) that represent Ashtabula, Cleveland–Cuyahoga, Geauga, Lake, Lorain, Medina, Portage, and Summit Counties convened some 230 professionals for a 1-day forum on the region's key workforce issues, including skills gaps, jobs in demand, and economic inclusion.

Cleveland Mayor Frank Jackson welcomed the group, joining Cuyahoga County Executive Armond Budish and the Department of Labor's Christine Quinn, both of whom also spoke. Each leader's comments underscored the importance and value to the region of successful workforce development efforts. "Too many talented people in the community are chronically underemployed," noted Budish, adding, "We need multiple, sustainable pathways to connect employers and residents."

A key aim of the forum was gathering input for an overarching plan to address workforce challenges across Northeast Ohio. Under the Workforce Innovation and Opportunity Act (WIOA), enacted in 2015, the region's WIBs have an obligation to create a unified regional plan to complement plans at the state and local levels.



Attendees of the regional workforce development forum convene in small discussion groups to tackle questions related to in-demand jobs and employers' needs.

"With so many stakeholders engaged in some component of workforce development—from educational institutions training students and employers seeking skilled workers to nonprofits that support individuals looking for jobs, the WIBs, and funders—it can be difficult to get a comprehensive view of what's occurring in our region, let alone ensure that these efforts are coordinated in a meaningful way," noted Mary Helen Petrus, assistant vice president of the Community Development Department at the Cleveland Fed. "This forum allowed leaders of the WIBs and their consultants to gather the invested parties together, present them with a quantitative look at the region's challenges, and elicit feedback through small-group discussions about the issues and how best to move forward."

A key aim of the forum was gathering input for an overarching plan to address workforce challenges across Northeast Ohio.

At the forum, Mark Schweitzer, senior vice president of the Cleveland Fed's Outreach and Regional Analytics Department, moderated the opening panels that examined inclusive economic development and provided an economic and labor analysis of the region. One participant, Joel A. Elvery, a Cleveland Fed economist, presented a new strategy to ensure regional prosperity.

Breakout sessions engaged participants in discussions on a number of topics, including employers' needs and concerns, incumbent-worker training, the relationship between employers and the region's institutions of higher education, and developing a youth skills-development pipeline. One particular set of questions focused on individuals who are being excluded from sustainable-wage employment. For what reasons might they be left out—education or skills deficiencies, disabilities, drug use, or felony convictions—and what actions are needed to bring these individuals and awareness of their needs back into the conversation? One recurring lament of those assembled concerned the limited employer participation in the forum. While several offered their perspectives as speakers, there were very few employers in attendance overall. Employers' input, several noted, is vital to assessing accurately the needs of the region's workforce.

A final session elicited attendees' input on a regional plan for Northeast Ohio. Participants weighed in on consultants' questions regarding the importance of developing a regional plan, using data to best inform workforce development policy, determining key sectors on which to focus in the region, and creating strategies to measure progress and success.

What are some of the reasons for developing a regional plan? Job access is one place to start.

Consultant Jim Shanahan, hired by the WIBs to help develop a plan for Northeast Ohio, asked the audience to consider several statistics concerning job access. "Fifty-three percent of all jobs in the 8-county region are located in Cuyahoga County. Just 44 percent of all workers live within reasonable access to public transportation.

“Fifty-three percent of all jobs in the 8-county region are located in Cuyahoga County. Just 44 percent of all workers live within reasonable access to public transportation.”

“And in 3 of the counties—Portage, Geauga, and Lorain—almost half the residents work outside their counties,” he stated. “That’s a pretty good argument for regional cooperation.”

In the wake of the Great Recession, community leaders in the Fourth District have repeatedly ranked jobs as their number 1 concern. In survey responses, they noted that employers have challenges finding employees with the required technical and soft skills to fill open positions at their firms, while jobseekers and the training, academic, and support organizations that provide workforce development services to them pointed to underemployment, lack of transportation access, and non-inclusive hiring practices among the impediments to jobseekers' gaining full and sustainable employment.

Next steps include the consultants' sharing their collective notes from and analysis of the breakout discussions from the forum. The regional plan is due to the State of Ohio by September 29, 2016. ■

SUM AND SUBSTANCE

Workforce investment board members, workforce policy experts, and representatives of the Cleveland Fed gathered at a forum in June to offer their input for a plan to address workforce challenges across Northeast Ohio.

Read more



Find the forum agenda and links to presentations at tinyurl.com/gqp4bjv.

The Cleveland Fed's Community Development Department focuses in part on workforce development issues across the Fourth District. See, for example, *Opportunity Occupations in Ohio: Identification, Online Postings, and Employer Education Preferences* (tinyurl.com/jrgxabn), "The Prospects of Non-College-Bound Workers in the Fourth District" (tinyurl.com/lj4u547u), and "A Long Ride to Work: Job Access and Public Transportation in Northeast Ohio" (tinyurl.com/hybqjh8).

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State of Households

American families overall reported continued mild improvement in their financial well-being in 2015, though many families were struggling financially, according to the Federal Reserve Board's latest *Report on the Economic Well-Being of US Households*. We ask regional experts, if the same is true for households here, what are the challenges for households going forward?

Unbanked and Underbanked

A Cleveland Fed advisor discusses why millions of Americans don't use mainstream banks and what community leaders can do to better connect these Americans to financial services.

Regional Report

Our third State of the State installment continues to examine conditions in the region the Cleveland Fed serves.

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