

Forefront

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

Rosie the Refiner? Two Manufacturing Industries' Rising District Importance



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**How Stretched are Today's Borrowers?
Debt Service Levels in Fourth District States**

Large Loan Review Finds Higher Risk Persists

State of Households

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Presidential Pulls

Loretta J. Mester, president and chief executive officer of the Federal Reserve Bank of Cleveland, recently discussed Federal Reserve structure, workforce development, and the Fed's policy path.

For the full text of President Mester's speeches, search www.clevelandfed.org, keyword "speeches."



POLICY PATH

"Timing isn't the thing. The real thing is the path. . . . Over the medium run, I believe that policy rates have to come up from where they are now. . . . The real thing [to look at] is it is appropriate to gradually move interest rates back up and definitely move them up, not moving them up every time but assessing, moving them up, assessing conditions, assessing the outlook."

—From an interview on CNBC, Jackson Hole, Wyoming, August 26, 2016

LABOR MARKET IMPROVEMENT

"I believe the US labor market remains sound and that we'll continue to see further improvements in the job market, although the pace of improvement will necessarily slow given the progress that's already been made."

—From a speech in London, United Kingdom, July 1, 2016

FEDERAL RESERVE STRUCTURE

"We have had two other central banks in the US that did not last beyond 20 years, and yet the Fed structure, which is this complicated balancing act, has lasted for over a hundred years. . . . I think it's very good that when I go to the FOMC [Federal Open Market Committee] meeting, I can bring in information from my District, talking to a whole swath of constituents here about what they're seeing in the economy. And I make it a point at every meeting to bring that in, because I know that's one of the values of the current Fed structure is that we've got regional presidents coming in and bringing that perspective."

—From an interview in the Wall Street Journal, Cleveland, Ohio, July 7, 2016

RETURNING TO NORMALCY

"If we fail to gracefully navigate back toward a more normal policy stance at the appropriate time, then I believe there is a non-negligible chance that these [nontraditional monetary policy] tools will essentially be off the table because the public will have deemed them as ultimately ineffective. This is a risk to the outlook should we ever find ourselves in a situation of needing such tools in the future."

—From a speech in Sydney, New South Wales, Australia, July 13, 2016

ECONOMIC GROWTH

"In an economy with lower trend growth and productivity, the average level of interest rates that balances supply and demand . . . will be lower. But just because monetary policy can't move the trend growth rate higher doesn't mean there aren't other steps the country can take to address these longer-run issues: policies that encourage investments in technology and human capital, tax and regulatory changes, and longer-run fiscal policy should all be under consideration."

—From a speech in Cleveland, Ohio, September 28, 2016

HUMAN CAPITAL

"Technological advances and globalization are changing the nature of available jobs and the skill sets needed to perform those jobs. To raise our shared standard of living and to make us more competitive in the global economy, the US needs to ensure that people can enter and remain productive members of the transforming economy."

—From a speech in Lexington, Kentucky, September 1, 2016

Fed Officials Hold Discussion with Fed Up

Federal Reserve Bank of Cleveland President and Chief Executive Officer Loretta J. Mester and 10 of her Fed colleagues met with the Center for Popular Democracy's Fed Up campaign on August 25, 2016, before the opening of the annual Federal Reserve Bank of Kansas City's Economic Policy Symposium in Jackson Hole, Wyoming. In a packed meeting room at the Jackson Hole Lodge, President Mester and other Fed officials engaged in an open dialogue with Fed Up members about Federal Reserve governance, monetary policy, and the economy.

Fed Up members urged the Fed to hold off on further interest rate increases, arguing that low rates are needed to improve job prospects for unemployed and

underemployed African Americans and Hispanics. President Mester fielded a question about the Fed's willingness to research issues around high unemployment and racial- and gender-based discrimination in labor markets.

"The Fed has a number of researchers who are working on issues," she said. "We certainly have a lot of research going on that addresses urban areas as well as rural areas, community development issues, [and] workforce development issues."

She told Fed Up representatives that she and her Federal Reserve System colleagues hear what they're saying: "We may disagree on the precise tool of monetary policy to achieve what you want to achieve, and

whether that tool is the right tool, but we certainly are sympathetic with wanting to pursue those goals."

Another meeting was held at the Cleveland Fed with Common Good Ohio, an affiliate of Fed Up, on October 14. The discussion centered on the economic struggles of low-income and working class residents and how interest rates impact job prospects for the unemployed and underemployed. ■

—*Anne M. DiTeodoro*

Watch it



Want to see the complete video of the Federal Reserve and the Center for Popular Democracy's Listening Session? The Kansas City Fed has it here: tinyurl.com/jng9a3r. President Mester's portion begins at 1:07:11.

Maximizing Supplier Inclusion

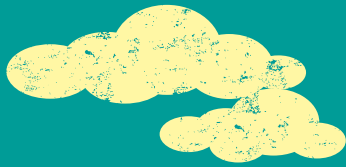
On August 18, the Federal Reserve Bank of Cleveland hosted the 2016 Maximizing Supplier Inclusion Summit, attended by representatives of minority- and women-owned business enterprises (M/WBEs) looking to learn how to do business with the Bank, to expand their business structures, and to network with Bank representatives, other business owners, and community strategic partners.

Keynote speaker Joset Wright-Lacy addressed the following

question: What is the best way to assist M/WBEs? It begins with a simple conversation, she said. As president and chief executive officer of the National Minority Supplier Development Council (NMSDC), Wright-Lacy shared her insights. She noted that events such as the summit promote innovation through the entrance of new products, services, and solutions and drive competition by offering multiple channels through which to procure goods and services.

The event proved beneficial to the summit's approximately 110 participants, including several Cleveland Fed employees. Supplier diversity is a component of the Federal Reserve System's overall mission to add economic value and encourage the growth of diverse businesses. ■

—*Staff*



How Stretched are Today's Borrowers?

Debt Service Levels in Fourth District States

Data show that states within the Fourth Federal Reserve District have lower total debt service ratios than the nation as a whole, primarily because these states have lower mortgage and bank card debt.

The DSR has implications for how much income households can spend on consumption or save for future needs. (p. 5)

Both nationally and in the Fourth Federal Reserve District, which comprises Ohio, western Pennsylvania, the northern panhandle of West Virginia, and eastern Kentucky, the debt service ratio, or the DSR, has stabilized.

The financial crisis of 2008 crystallized the importance of understanding household debt burden, as unsustainable debt levels led to a spike in mortgage defaults and threatened the stability of the financial sector.

A simple measure of debt burden, the DSR is the average share of disposable income that is devoted to required minimum payments on debt obligations. In other words, the DSR is how much of one's post-tax income is used to pay for things such as auto loans and mortgages, among others.

When the DSR is high, the average family has high levels of debt payments relative to its income—a large mortgage payment in relation to the family's monthly post-tax pay, for example—a situation which may hinder the family's ability to pay for other things. Of course, when the average debt service level is high, many households will have even higher debt burdens, while other households will still be relatively untroubled by their debt payments.

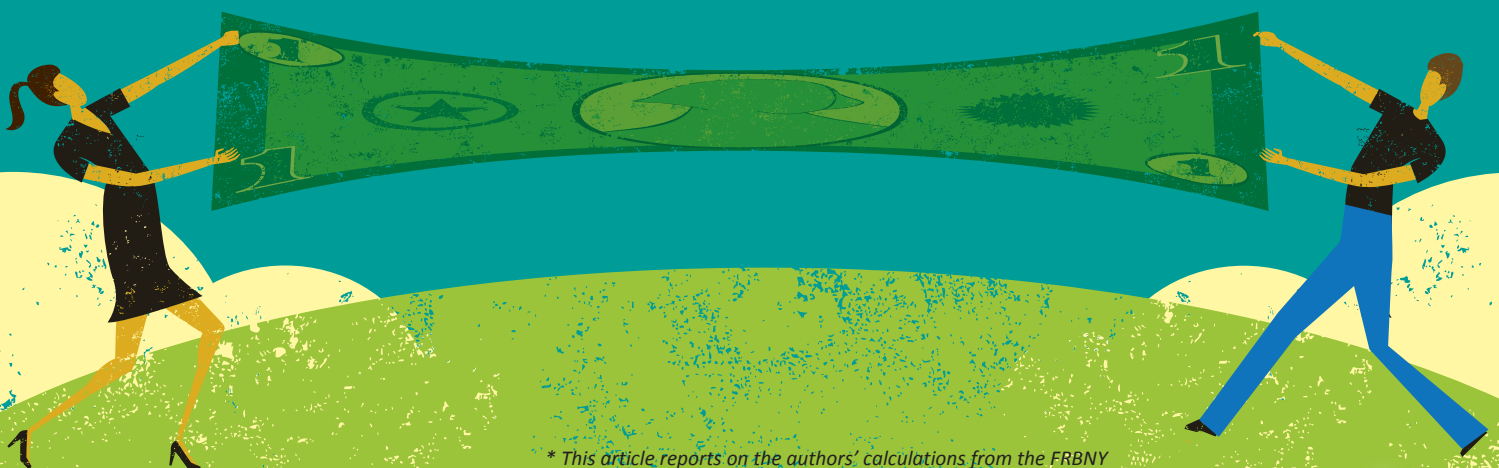
The Federal Reserve Board of Governors publishes the DSR for the nation as a whole. This series is based on national-level data on debt balances, data which get combined with information from other sources to estimate the sum of payments. These data have proven valuable, but they cannot capture differences across states or provide much detail on what type of debt service—auto loan, bank card, home equity loan, mortgage, student loan, or other debt—is changing.



Joel A. Elvery
Economist

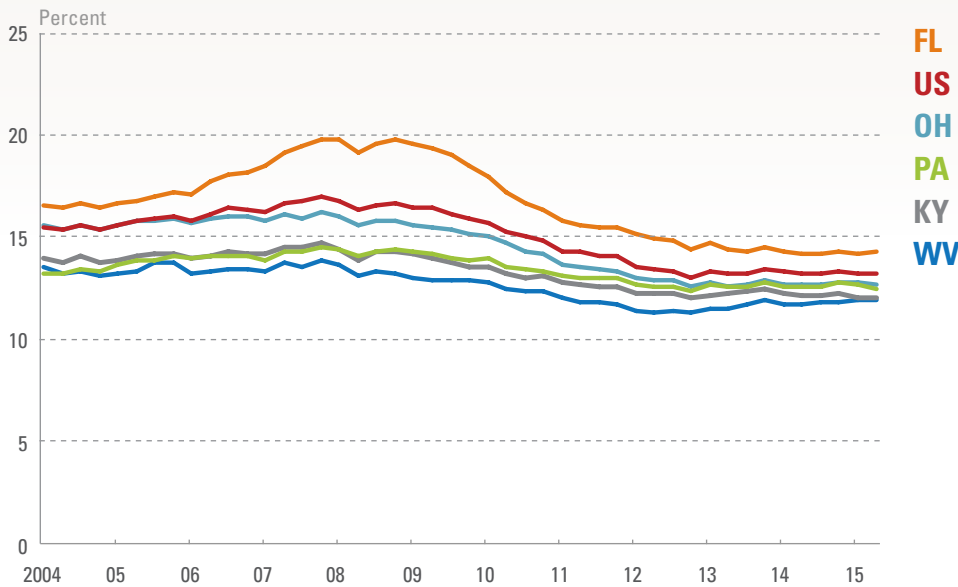


Mark Schweitzer
Senior Vice President



* This article reports on the authors' calculations from the FRBNY Consumer Credit Panel/Equifax and the Bureau of Economic Analysis.

The share of income devoted to required debt payments fell after the recession and remains historically low.



Total Debt Service Ratio			
	2005: Q2	2015: Q2	Change
FL	16.6	14.3	-2.3
US	15.8	13.2	-2.6
OH	15.8	12.7	-3.1
PA	13.8	12.4	-1.4
KY	14.1	12.0	-2.1
WV	13.4	11.9	-1.5

Source: Authors' calculations from the FRBNY Consumer Credit Panel/Equifax and the Bureau of Economic Analysis.

Research underway at the Federal Reserve Bank of Cleveland is helping to increase our understanding of household finance by estimating DSRs for individual states.

Newly available data in the form of the Federal Reserve Bank of New York's Consumer Credit Panel (CCP) make it possible to observe payments directly rather than having to estimate them based on aggregate balances. The CCP is built from a random sample of credit reports from Equifax, with personal identifiers such as name and address removed to protect consumer privacy.

The Cleveland Fed creates its DSR estimates from the CCP, providing an alternate national DSR and, for the first time, state-level DSRs.

Consumer debt trends can vary greatly across states and can signal when there are unusual increases in debt. For example, during the recent housing boom from 2004 to 2007, Florida's DSR rose from 16.6 percent to 19.8 percent, a rise of 3.2 percentage points, double the nation's increase of 1.6 percentage points during this same time period. Having such information can help policymakers better connect trends in consumer credit to changes in a state's economy.

Nationally, the share of incomes devoted to debt service has gone through 3 phases in the past decade:

1. The DSR rose 1.4 percentage points from the first quarter of 2005 to the fourth quarter of 2007, the years leading up to the Great Recession.
2. Then it fell from 17 percent at the end of 2007 to 13 percent at the end of 2012 as households deleveraged and as institutions discharged delinquent debt. The decline in DSR in these 5 years was more than twice as large as its increase from 2004 to 2007.
3. Deleveraging tapered off in 2012, and the DSR has been relatively stable since. In the middle of 2015, it was 13.2 percent.

When the DSR is high, the average family has high levels of debt payments relative to its income—a large mortgage payment in relation to the family's monthly post-tax pay, for example—a situation which may hinder the family's ability to pay for other things.

For most states in the Fourth District, increases prior to the recession were not as large because these states did not experience the housing boom that occurred in other parts of the country.

While the Cleveland Fed's estimates begin in 2004, the Board's DSR goes back to 1980. Currently, the Board's DSR is below levels seen at any time prior to 2012. This level suggests that balance sheets of households are relatively healthy and that households are in a position to take on new debt.

The national trend is similar to those of the 4 states that are at least partially in the Fourth District, Ohio, Kentucky, Pennsylvania, and West Virginia. The key difference is that 3 of the 4 saw much smaller increases in the DSR from 2004 through 2007. The exception was Pennsylvania, where the DSR rose one-third less than it did in the nation.

It's not surprising that for most states in the Fourth District, increases prior to the recession were not as large because these states did not experience the housing boom that occurred in other parts of the country.

Though District states did not experience much increase in the DSR leading up to the recession, they did have substantial declines during the recession and in the first years of the recovery. Ohio had the largest drop, with its DSR falling 3.6 percentage points, from 16.2 percent at the end of 2007 to 12.6 percent at the end of 2012. As in the nation, the DSR in each of these 4 states has been fairly stable since the end of 2012.

Why is the DSR so important to household finances?

The DSR has implications for how much income households can spend on consumption or save for future needs. When the DSR is up, the share of income available for consumption or savings is down. When the DSR falls, income for other expenditures rises.

This is clear when you compare changes in real per capita disposable personal income, or "disposable income" for short, and the portion of this income that is not spent on debt service, real per capita available income, or what we'll call "available income."

Between the start of 2004 and the end of 2007, a time when the DSR was rising, on average the nation's disposable income grew \$743 per person per year while available income rose just \$456, a figure \$287 less. During the recession, the DSR fell, and while disposable income fell \$496 per person per year, available income fell only \$190. As the DSR continued to drift down after the end of 2009, on average, available income rose \$140 more per person per year than disposable income, \$564 and \$424, respectively. In recent years, then, the amount of money that households have available to spend on consumption has risen more than the disposable income measure would lead one to believe at first glance.



The primary reason the states in the Fourth District have lower total DSRs than the nation does is that they have lower mortgage and bank card debt burdens.

The differences in the growth of disposable and available income followed a similar pattern in the Fourth District states, though the magnitudes were smaller because Fourth District states experienced smaller changes in the DSR than did the nation.

For example, in Kentucky, disposable income fell \$1 per year during the recession, but available income rose \$181 per year during the same time period. In Ohio, the average annual increase in available income since 2009 was \$100 more than the annual increase in disposable income, \$615 and \$515, respectively.

Outside the Fourth District, Florida, an example of a “housing boom state,” saw its DSR rise and fall more dramatically than the nation’s or than that of any Fourth District state, producing starker differences in disposable and available income growth. Since the end of 2009, following the mortgage crisis, the average annual increase in available income in Florida was more than double the state’s increase in disposable income.

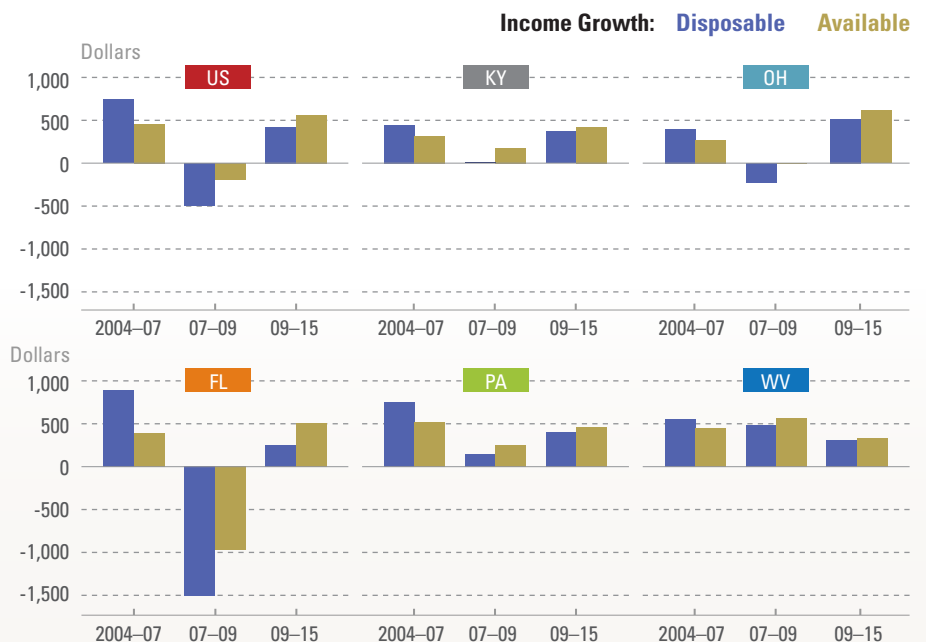
This is one example of the kind of analysis that our new DSR measures permit.

Another benefit of using the CCP to estimate the DSR is that the DSR can be broken up into different debt types. Doing so can show whether there are particular types of debt that lead a state to have a lower DSR than the nation’s. The state-level DSR divides payments into 6 categories: auto loan, bank card, home equity loan, mortgage, student loan, and other debt.

Mortgage debt is the largest component of the DSR in all 4 District states and the nation and is the largest source of the difference between the DSRs of District states and that of the nation. Mortgage payments consume 5.5 percent of disposable income in the nation, while for District states this ratio ranges from a low of 3.6 percent in West Virginia to a high of 4.8 percent in Ohio.



Since the end of 2009, the amount of income available after debt payments has risen faster than disposable income, suggesting that consumer spending has room to grow.



Source: Authors' calculations from the FRBNY Consumer Credit Panel/Equifax and the Bureau of Economic Analysis.

The mortgage and bank card debt service ratios are notably lower in Fourth District states than in the nation as a whole.

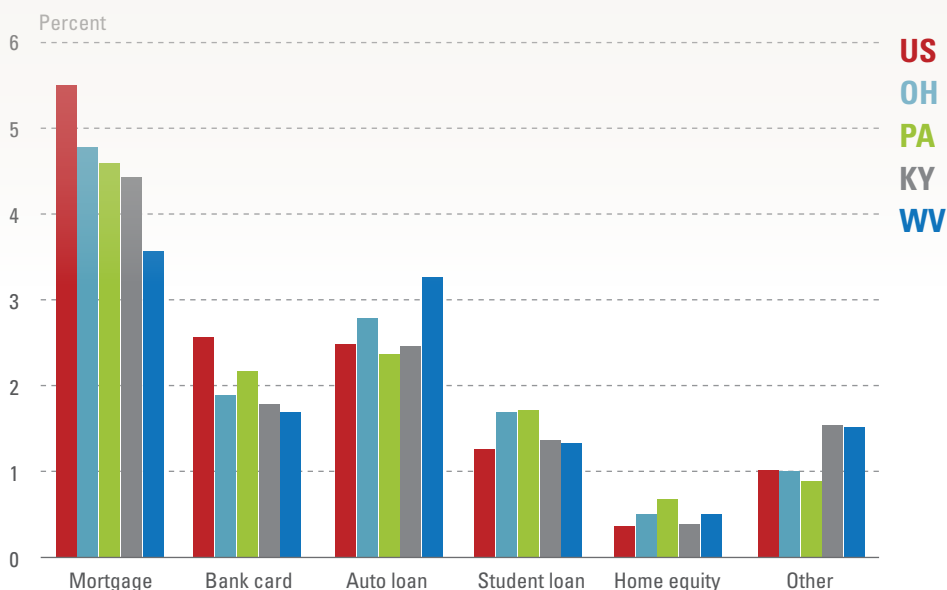
This difference is a result of District states' having relatively low home prices and a larger share of older homeowners, who are more likely to have paid off their mortgages.

The fact that District states have older populations is also a factor behind these states' having lower bank card DSRs than the nation's. Typically, older adults carry less bank card debt than do younger adults. In District states, bank card DSRs range from 1.7 percent in West Virginia to 2.2 percent in Pennsylvania, compared to 2.6 percent in the nation. The nation's auto loan and bank card DSRs are similar to each other, but in District states, auto loan DSRs are larger than bank card DSRs. In fact, the auto loan DSR overall has been rising as car sales have gradually rebounded from recession levels, though auto loan debt service levels are still below pre-recession levels. West Virginia leads the pack, with 3.3 percent of its disposable income devoted to auto payments.

Student loan debt is the fourth largest component of the nation's total DSR. The student loan DSRs of Ohio and Pennsylvania are about a third larger than the nation's 1.3 percent, with both at 1.7 percent. Those of Kentucky, 1.4 percent, and West Virginia, 1.3 percent, are comparable to the national level.

Home equity loans are the smallest DSR component in the nation and in all 4 District states, with DSRs ranging from a low of 0.4 percent for the nation to a high of 0.7 percent for Pennsylvania.

The other debt category includes a variety of uncommon debt sources, such as loans from retail stores. The other DSR is 1.5 percent in both West Virginia and Kentucky, a number which is notably higher than it is in the nation, at 1.0 percent.



Source: Authors' calculations from the FRBNY Consumer Credit Panel/Equifax and the Bureau of Economic Analysis.

The primary reason the states in the Fourth District have lower total DSRs than the nation does is that they have lower mortgage and bank card debt burdens. Since the recession ended, the DSRs of the states in our region have fallen along the same trend as the national DSR. Because households in the region are devoting less of their income to covering debt payments than in the past, they may be in a good position to increase consumption spending. ■

SUM AND SUBSTANCE

States in the Fourth Federal Reserve District have relatively low debt service ratios, especially for mortgage and bank card debt, leaving District households with more income for other purposes.

Read more



For more information on the current state of the economy in Fourth District cities, read our regional publication *Metro Mix*: tinyurl.com/z7sc4v7.

State of Households

The financial state of US households has improved, but challenges including underemployment and stagnant wages persist. Action by policymakers and bankers can make a difference.



Michelle Park Lazette
Staff Writer

The overall financial state of households nationwide and regionally improved mildly in 2015 compared to that of 2014 and 2013, but low- and moderate-income families shared in less of that improvement than others, and many households faced emerging and persisting financial challenges, according to local experts and a recent Federal Reserve Board of Governors report.

Locally, mortgage delinquencies are down generally, as are foreclosure rates, and a few metropolitan statistical areas (MSAs) are enjoying increased home values, Cleveland Fed community development research analyst Brett Barkley says, citing the Bank's Community Stabilization Index. The index provides a relative measure of housing market conditions in MSAs throughout the Cleveland Fed's region of Ohio, western Pennsylvania, the northern panhandle of West Virginia, and eastern Kentucky.



Brett Barkley

However, “different metropolitan statistical areas are experiencing different things,” Barkley notes. The same is true of neighborhoods within those MSAs.

“The American Community Survey showed that roughly 50 percent to 70 percent of low-income renters are housing-cost burdened compared to around 10 percent of non-low-income renters,” says Barkley.

Being housing-cost burdened is defined as spending more than 30 percent of one’s income on rent and housing costs, including utilities.

Barkley notes, too, that more than 30 percent of low- and moderate-income households in the Cleveland Fed’s region have had one or more collections actions in the past 2 years, a figure which is double the 15 percent of middle- and upper-income households that did. It’s clear some households have stretched their borrowing, perhaps to meet expenses, he says.



Lou Tisler

There’s a divide, too, in who can take advantage of the present opportunities in the housing market, says Lou Tisler, executive director of Neighborhood Housing Services of Greater Cleveland.

“There are some people who are participating in a renewed economy,” he says. “All of a sudden, the housing market in Northeast Ohio is back on fire, and people are looking to buy and have access to credit, but, generally, that is not equally divided among either economic class or race.”

The Federal Reserve Board also reveals a mixed picture of the financial state of US families in its latest *Report on the Economic Well-Being of US Households in 2015*, based on a survey it conducted in October and November 2015.

Individuals with lower incomes, people with parents of modest financial means, and racial and ethnic minorities reported greater financial challenges, the survey found, and 21 percent of respondents with a

Regionally, the reasons for continued financial struggles include stagnant wages and underemployment.

high school degree or less said they were worse off financially compared to their situations 12 months ago. Fifteen percent of respondents with at least a bachelor’s degree reported the same.

“The new survey findings shed important light on the economic and financial security of American families 7 years into the recovery,” Federal Reserve Board Governor Lael Brainard says in a release. “Despite some signs of improvement overall, 46 percent say they would struggle to meet emergency expenses of \$400, and 22 percent of workers say they are juggling 2 or more jobs. It’s important to identify the reasons why so many families face continued financial struggles and to find ways to help them overcome [such struggles].”

Persistent challenges

Regionally, the reasons for continued financial struggles include stagnant wages and underemployment, sources say. Even in the face of continued decline in the unemployment rate, concern about jobs has been the number 1 issue for several years running, as identified by community leaders polled by the Cleveland Fed’s Issues and Insights survey.

“The main reason people cite jobs is that people are finding work but without very good benefits, or it’s part-time and they are needing to work multiple jobs,” Barkley says.

While clients of Neighborhood Housing Services of Greater Cleveland have higher credit scores and savings in general than they did 2 years ago, Tisler also observes jobs-related hurdles.

“I don’t think people are seeing any cost-of-living adjustments or increases in their salaries, and there’s still an incredible amount of underemployment,” says Tisler, whose organization administers programs toward homeownership in 3 counties in Northeast Ohio. “What we’re seeing is if people are moving from a position, it’s either to the same [type of pay and position] or below as opposed to a move up.”

““ Property taxes are something that people are really talking about in terms of what is hurting them. ””

In its latest survey on US households’ economic well-being, the Federal Reserve Board found that optimism about future income growth in the coming year is tempered compared to that seen in the 2014 survey.

Barkley can’t say he’s surprised.

“We’re hearing in Cleveland, in Cuyahoga County, a lot of talk of homeowners’ having disposable income to reinvest in their homes, to update and conceivably increase the property value of their homes, but they’re not doing it,” he says.

Though this lack of reinvestment speaks primarily to expectations regarding the local housing market, it could reflect income-related concerns, as well, Barkley notes.

“If people are bracing for lower income levels, they may be less willing to invest in their homes, especially if they’re not sure they’re going to get a return on that investment,” Barkley says.

An insufficient amount of affordable housing is another challenge for local households, according to Barkley. The Issues and Insights survey results published in April 2015 revealed that housing affordability ranked among community leaders’ top 3 concerns for the first time. The next year, it ranked the same, second only to jobs.

The cities in which housing affordability is emerging as a challenge in this region (Cincinnati and Pittsburgh, to name 2) are places generally thought to be affordable, Barkley notes.

“I hear a lot of talk in national media about housing affordability and gentrification in cities like New York or San Francisco,” he says. “But even among middle-of-the-road markets in the Fourth District, we’re seeing these concerns.”

How policymakers can help

An emerging challenge for households regionally is an inability to pay property taxes, say Barkley and Tisler. Tisler says property tax foreclosures are nearing the level of mortgage foreclosures.

“Property taxes are something that people are really talking about in terms of what is hurting them,” Tisler says.

“In Ohio, in other midwestern states, the way that municipalities fund schools is through property taxes,” Tisler adds. “As states continue to cut back on local government funds, cities must make up [the funds for] basic services, so people continue to see their property taxes go up. Also, as we recover, housing values on a 3-year basis are going up [and causing taxes owed to rise]. So you get the double whammy.”

Because of tax hardships, those who secured tax abatements are likely to sell when those abatements conclude, Tisler predicts.

Another newer difficulty for households is how lenders now consider student loan debt in evaluating mortgage readiness, Tisler says. Before, if someone’s student loans were in deferment, bankers didn’t include them in debt-to-income ratio considerations. Today, they include a percentage of that debt in the calculation.

“A lot of these issues facing households are just so structural and hard to overcome without changes in our policy environment.”

“That has placed a chill on purchasing homes for those who are burdened by student loans,” Tisler says.

Intentional policymaking and investments can improve the state of households, say both Barkley and Tisler. So, too, would financial education for more people, Tisler adds.

“A lot of these issues facing households are just so structural and hard to overcome without changes in our policy environment,” Barkley says. “There’s a part for households to play in thinking about how they can equip themselves for the economy, but there’s a big role to be played by policymakers and different stakeholders, from nonprofits and banks doing the investing to local governments guiding programs that assist and help people get the skills they need to find and maintain a job, especially in low- and moderate-income communities.”

Sometimes, part of finding and maintaining a job is simply being able to get to work, Barkley says. Civic leaders and elected officials echoed this sentiment in June at the 2016 Regional Workforce Development Forum, citing increased transit funding to connect low-income residents with employment opportunities as a key need in the region’s future workforce policy.

Where bankers are involved, increasing households’ access to affordable capital is key, Tisler asserts.

“First, it was the Wild West, and then it was no one without a 740 credit score could get a mortgage,” he says. “I think the pendulum is starting to swing a little bit to the middle.”

Read more



A Cleveland Fed analysis finds that jobs in Northeast Ohio are least accessible for the people who need them most. Read *A Long Ride to Work: Job Access and Public Transportation in Northeast Ohio*: tinyurl.com/jrvjtyl.



Tisler advocates, too, for increased oversight of lenders who are making “little slices to people’s economic well-being,” citing check-cashing services, auto title lenders, and others. And, he adds, the state of households also rests in the hands of those issuing paychecks.

“To move the economy, people need to get paid,” he says. “If businesses want to make money because people are spending it, then their employees need to get paid a living wage.” ■

SUM AND SUBSTANCE

Underemployment and stagnant wages continue to challenge US households, but, overall, Americans reported mild improvement in their financial state in 2015 compared to that of recent years.

Large Loan Review Finds Higher Risk Persists

Federal regulators say the credit risk of large, shared loans remains elevated in large part because of challenged oil and gas sector borrowers. On a positive note, regulators also found improved underwriting practices.



Michelle Park Lazette
Staff Writer

The credit risk of loans totaling \$20 million or more and made by 3 or more federally regulated financial institutions remained elevated in the first quarter of 2016, 7 years after the recession ended. But underwriting of such credits did improve.

Those are the core findings of the Shared National Credits Program (SNC) examination released in July 2016. Federal regulators found that the percentages of adversely rated credits have climbed since the last review.

The percentages of classified credits—those rated substandard, doubtful, or loss—and non-pass credits—those rated special mention, substandard, or doubtful—climbed to 6.9 percent and 10.3 percent, respectively. In 2015, the percentage of classified credits was 5.8 percent, and the percentage of non-pass credits was 9.5 percent.

“Normally—and we have data going back decades—during a recovery period, the percentages of classified assets and of non-pass assets decline, and they decline to a relatively low level,” explains John C. Shackelford, a senior bank examiner with the Federal Reserve Bank of Cleveland.



John C. Shackelford

“During this recovery, percentages are still quite elevated, and, in fact, as a result of challenged oil and gas credits, they’ve actually started ticking back up somewhat,” explains Shackelford, who for more than a decade has worked with SNCs and is currently assigned to the national program in Washington DC.

In fact, the asset ratios of special mention credits, or those with potential weaknesses meriting close attention, and classified credits continue to be double those of the precrisis period, according to the examination.

“Rather than using a period of low rates to de-lever their balance sheets as has been typical in past cycles, borrowers have taken on additional debt” that, notes the SNC review, “may be more difficult to service in the years ahead.”

The review explains that the “agencies remain concerned about the overall level of special mention and classified commitments, as they have not recovered to the same level as previous periods of economic expansion in the mid-1990s and in the 2003–2007 period.”

In conducting the SNC examination, the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation assess a sample of the large shared (or syndicated) loans.

Banks in the Fourth Federal Reserve District, which comprises Ohio, western Pennsylvania, the northern panhandle of West Virginia, and eastern Kentucky, are among those participating in such loans.

The incidences of non-pass originations, or newly lent credits that don’t pass muster from the beginning, “were very, very low this time.”

‘A better job of underwriting’

Though higher risk persisted, this year’s review uncovered good news, too: Underwriting and risk management practices had improved.

“I can see, looking at transactions and the underwriting, that bankers are doing things differently,” Shackelford says. “They have changed and improved some of their practices.”

The incidences of non-pass originations, or newly lent credits that don’t pass muster from the beginning, “were very, very low this time.”

Bankers “are doing a better job of underwriting,” Shackelford explains. “We like to see that. We hope it continues. I think good underwriting foretells the ability to withstand unknown economic events and over time should allow banks to mitigate the reserves that they have to build.”

Said another way, when institutions’ underwriting of the loans they make is such that they may appropriately reserve less money for losses, those institutions have more earnings to distribute in the form of dividends.

If underwriting and risk management have improved, when might that improvement translate to declines in adversely rated credits?

It’ll take time, Shackelford says, to work through older leveraged loans, which are those that have high debt levels relative to their equity. In order to see improvement in the performance of leveraged loans, highly levered borrowers need stronger earnings growth. As for loans made to the oil and gas sector, asset quality will improve as oil prices rise, he explains, enabling that sector’s borrowers to increase operating activity and enhance profits, which can be used to reduce their debt loads.



“ Bankers need to continue to be diligent in their administration of loans, particularly through distressed economic times such as those presently for the oil and gas industry. ”

Eyes on oil

As they did in the prior year’s SNC review, the regulatory agencies paid special attention to leveraged lending, often borrowed for merger and acquisition purposes, and on credits extended to the oil and gas sector, whose borrowers’ capacity to repay loans has been weakened by the decline in oil prices that began in mid-2014.

A number of energy sector companies have laid off workers and filed bankruptcies. Fourth District banks’ exposure to the oil and gas industry is “modest,” Shackelford says.

“Bankers need to continue to be diligent in their administration of loans, particularly through distressed economic times such as those presently for the oil and gas industry,” he says. “We expect bankers to work with their borrowers and to do so in a prudent fashion.”

The Shared National Credits review dates back to 1977. The next findings will be published following the first quarter 2017 examination. ■

The SNC review noted, however, that “some gaps between industry practices and the guidance remain [that] require continued attention by the agencies.”

These gaps, according to Shackelford, included weakness observed in some institutions’ risk-rating of their credits and in slow updating of price decks, which track commodity price changes. In addition, several institutions could improve the frequency of redeterminations of borrowing bases, or the amount a borrower can borrow based on current economic conditions. Institutions, he adds, are extending more credit than they normally do as a result of weak borrowing base determinations.

SUM AND SUBSTANCE

The early 2016 Shared National Credits examination found that credit risk remained higher than it has been in other economic recoveries, but federal regulators also found a positive: Bankers had improved their underwriting.

Read more



For the full Shared National Credits review, definitions of the various types of credit ratings, and a breakdown by industry of loans, see tinyurl.com/gr7r7q5.

Forefront’s “State of Banking, 2016” report also touches on underwriting practices, the energy sector’s role in increased projected losses, and more: tinyurl.com/z6fu4km.



Rosie the Refiner?

Two Manufacturing Industries' Rising District Importance

On the whole, the composition of manufacturing industries has remained fairly consistent across the District. (p. 16)



Rubén Hernández-Murillo
Senior Policy Economist



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Research Analyst

Many manufacturing industries' real output in the Fourth District has declined or remained steady from 1997 to 2014, but for 2, real output has increased notably.

In an era of pervasive declines in manufacturing across the United States and the Fourth Federal Reserve District, which includes Ohio, western Pennsylvania, the northern panhandle of West Virginia, and eastern Kentucky, 2 District industries seem to be fighting against the downward trend: petroleum and coal products and computer and electronics products.

From 1997 to 2014, the longest period for which there are complete regional data, petroleum and coal products moved upward in terms of real output from the thirteenth largest manufacturing producer in the District to the sixth largest. Computer and electronics products, in turn, rose from the sixteenth to the tenth.

Back in 1997, manufacturing accounted for 26.3 percent of the Fourth District's entire output, the sum of the value added by all economic activity in the region. This figure dwarfed the 13.6 percent that manufacturing contributed to the nation's overall economy and served to underscore the importance that manufacturing has had in our region. By 2014, however, declining output across most manufacturing industries lowered this District figure significantly to 14.7 percent, only slightly above that of the nation as a whole at 11.3 percent in the same year.

District manufacturing output decreased during the period, not only in share, but also in real dollar value. In 1997, manufacturing was worth \$128 billion, but it decreased to \$125 billion by 2014 (in chained 2009 dollars). This decrease is significant when considering the remarkable gains in overall District output during this period: In 1997, District output was at \$489 billion, but it rocketed to \$852 billion by 2014.

But in the Fourth District, where manufacturing has a long and storied importance, petroleum and coal products and computer and electronics products have been fighting the tide of declining manufacturing production.

At a time when no other manufacturing industry in the District grew at an average annual pace larger than 1 percent, petroleum and coal products grew at an average annual pace of 7.8 percent, and computer and electronic products grew at an average annual pace of 10.4 percent. They are the only industries to have meaningful real output gains in the District.

But in the Fourth District, where manufacturing has a long and storied importance, petroleum and coal products and computer and electronics products have been fighting the tide of declining manufacturing production.

Output and employment numbers for manufacturing industries provide a view into changes in the composition of the manufacturing landscape in the nation and the region. These 2 measures serve as indicators of how central an industry is to the region's economy, but because of changes in productivity, they do not necessarily move together.

On the whole, the composition of manufacturing industries has remained fairly consistent across the District.

Two industries have risen significantly in the ranks of regional manufacturing output.

Industry	Output									
	District					US				
	2014 Rank	2014 Share	1997 Rank	1997 Share	Move	2014 Rank	2014 Share	1997 Rank	1997 Share	Move
Transportation equipment	1	17.1%	1	15.0%	0	4	8.8%	4	9.7%	0
Chemical products	2	12.6%	2	14.4%	0	1	16.3%	1	16.7%	0
Food, beverages, and tobacco products	3	12.0%	4	11.4%	1	3	12.2%	2	13.7%	-1
Fabricated metal products	4	11.0%	3	12.9%	-1	5	8.1%	3	10.3%	-2
Machinery	5	7.9%	5	8.1%	0	6	7.9%	5	8.3%	-1
Petroleum and coal products	6	7.7%	13	2.1%	7	7	5.5%	7	4.9%	0
Plastics and rubber products	7	5.8%	7	6.3%	0	9	4.0%	8	4.6%	-1
Primary metals	8	5.4%	6	6.5%	-2	12	2.7%	12	2.7%	0
Electrical equipment and appliance	9	4.0%	8	5.0%	-1	10	2.8%	10	3.7%	0
Computer and electronics products	10	3.8%	16	0.7%	6	2	15.9%	14	2.5%	12
Nonmetallic mineral products	11	3.1%	9	4.6%	-2	13	2.4%	11	3.4%	-2
Paper products	12	2.6%	10	4.4%	-2	11	2.8%	6	5.3%	-5
Printing and related support activities	13	2.3%	12	2.2%	-1	14	2.3%	13	2.6%	-1
Miscellaneous	14	2.3%	11	2.4%	-3	8	4.3%	9	3.8%	1
Furniture and related products	15	1.1%	14	1.7%	-1	15	1.4%	15	2.5%	0
Wood products	16	0.9%	15	1.0%	-1	16	1.2%	17	1.6%	1
Textile and textile product mills	17	0.4%	18	0.6%	1	17	0.9%	16	2.0%	-1
Apparel, leather, and allied products	18	0.2%	17	0.6%	-1	18	0.6%	18	1.6%	0
Manufacturing's share of total output	—	14.7%	—	26.3%		—	11.3%	—	13.6%	

Source: Bureau of Economic Analysis.

Note: District-level output values are estimated as the sum of the output values for each state in the District weighted by the proportion of that state's total manufacturing employment that falls within the Fourth District portion of the state. Industry output values are not available at the county level. Output values reflect chained 2009 dollars.

The 5 largest manufacturing sectors in terms of output in 1997—transportation equipment; chemical products; fabricated metal products; food, beverages, and tobacco products; and machinery—continued to be the 5 largest producers in 2014. These sectors together accounted for 61.8 percent of total manufacturing output in the District in 1997 and 60.5 percent in 2014. Fabricated metals and food, beverages, and tobacco traded places in the rankings, but, overall, the big players in the District’s manufacturing have stayed stable.

The remainder of the sectors in the District kept essentially the same ordering, as well. Changes in their rankings that are not a direct result of the rise of petroleum and coal products and computer and electronics products are minimal. Similarly, at the national level, the distribution of manufacturing industries in terms of output remained very stable during the period.

So why, against a backdrop of relative consistency, did these 2 industries experience such a rise?

Petroleum and coal products

The petroleum and coal products category consists of all processes that transform crude petroleum and coal into useable products. Primarily, this means oil refineries, but it also includes a variety of other types of producers. (Note that increases in the real value of crude oil during this time period do not factor into this industry’s output values.)

The industry grew dramatically in its importance to the District’s economy during the 1997 to 2014 period. In 1997, the industry accounted for only 2.1 percent of the District’s manufacturing output and was, by output, in the bottom 5 manufacturing industries. But by 2014, it comprised 7.7 percent and was ranked sixth. This movement represents a growth from less than \$3 billion in real output to almost \$10 billion.

In the nation at large, the industry remained relatively steady by share of output, ranking seventh place at both the beginning and the end of the period in question and consistently comprising around 5 percent of the nation’s manufacturing

output. The District’s petroleum and coal output leapfrogged the national average in this timespan, moving during the period from less importance to the District than to the nation at large to greater importance to the District than to the nation.

Interestingly, this significant shift in output was not mirrored by a correspondingly large increase in the share of manufacturing employment that petroleum and coal products contributed to the District.

The industry’s employment did rise 2 ranks in the District, but from last place to third last. It contributed only 0.2 percent more of the District’s manufacturing employment in 2014 than it did in 1997 despite its significant increase in value.

Here’s why this matters: A great increase in output without a corresponding increase in employment implies a large increase in labor productivity in this industry in the District, one that was not matched by a similar increase in petroleum and coal products’ labor productivity in the nation at large.

A great increase in output without a corresponding increase in employment implies a large increase in labor productivity in [petroleum and coal products] in the District, one that was not matched by a similar increase... in the nation at large.

Labor productivity is typically defined as output per hour worked, but hours worked are not readily available at the regional level. As a rough approximation, then, output estimates are divided by employment estimates to approximate the output per worker. By this measure, petroleum and coal products’ labor productivity increased by 4.23 times in the District, while it increased by only 1.65 times in the nation overall. To provide a frame of reference, note that the median increase in this measure among 18 manufacturing industries during this period was 1.3 times for the District and 1.4 times for the nation.

Computer and electronics products

In computer and electronics products, an even more striking increase in labor productivity—and in innovation—within the Fourth District has occurred in recent years. The industry comprises manufacture of computers, computer equipment, audio and video equipment, semiconductors and electronic components, and several kinds of electronic and control instruments.

Transformative innovation has been the status quo for computer and electronics products. So relentless was advancement in this industry that many expected this growth would continue at breakneck speed. In fact, Moore's Law, championed by Intel, states that the number of transistors in a computer chip, a central factor in continued improvement of computer and electronic products, would double every 2 years—a prediction that held remarkably true before and during the period in question. The improvement rate was so high, Intel says, that if the same kind of improvement would've occurred at the same rate in motor vehicle technology, cars would travel hundreds of thousands of miles per hour, get more than 2 million miles per gallon, and cost less than a nickel each.

It's unsurprising, then, to see remarkable growth in output in this industry nationally. In 1997, computer and electronics products was ranked fourteenth among manufacturing industries and contributed 2.5 percent of manufacturing output. But by 2014, the industry had vaulted to second place, behind only chemical products, comprising a full 16 percent of the nation's manufacturing output.

While computer and electronics products has not been a player in the District's economy historically, it seems to have moved into a new, economically relevant role in the District since 1997.

In that year, computer and electronics products was the third-smallest manufacturing industry by output, accounting for only 0.7 percent of the District's manufacturing output. By 2014, though, the industry had jumped 7 places, to tenth of 18, with a share of 3.8 percent total manufacturing output, suggesting that the industry within the District is beginning to follow the national trends and grow into a meaningful role in the District's economy. It contributed less than \$1 billion to the District output in 1997 but almost \$5 billion in 2014.

What makes these booms so impressive is that both in the District and in the nation overall, they have occurred despite a notable decline in the industry's employment.

This decline is evident not only in overall employment numbers, which are declining for manufacturing industries across the board in both the District and the nation, but also in terms of share of total manufacturing employment. In the District, computer and electronics products dropped 4 places in share of manufacturing employment, from tenth to fourteenth. Nationally, the industry fell from second to fifth.

Taken together, these facts suggest a spectacular increase in labor productivity in computer and electronics products.

While computer and electronics products has not been a player in the District's economy historically, it seems to have moved into a new, economically relevant role in the District.

These industries have not seen a similar increase in employment share.

Industry	Employment									
	District					US				
	2014 Rank	2014 Share	1997 Rank	1997 Share	Move	2014 Rank	2014 Share	1997 Rank	1997 Share	Move
Transportation equipment	1	16.3%	1	16.3%	0	2	12.8%	1	11.6%	-1
Fabricated metal products	2	14.6%	2	12.6%	0	3	11.9%	4	9.7%	1
Machinery	3	10.7%	3	10.6%	0	4	9.2%	5	8.6%	1
Food, beverages, and tobacco products	4	10.6%	6	7.0%	2	1	13.9%	3	10.1%	2
Plastics and rubber products	5	7.8%	5	7.8%	0	7	5.5%	7	5.4%	0
Chemical products	6	6.5%	7	5.6%	1	6	6.6%	6	5.7%	0
Primary metals	7	5.9%	4	7.9%	-3	10	3.3%	12	3.7%	2
Electrical equipment and appliance	8	4.2%	10	4.3%	2	12	3.1%	16	3.4%	4
Nonmetallic mineral products	9	3.7%	11	4.1%	2	11	3.2%	17	3.0%	6
Printing and related support activities	10	3.5%	9	4.4%	-1	9	3.7%	8	4.7%	-1
Miscellaneous	11	3.4%	13	3.1%	2	8	4.8%	10	4.1%	2
Computer and electronics products	12	3.3%	8	4.5%	-4	5	8.6%	2	10.4%	-3
Paper products	13	3.2%	12	3.4%	-1	13	3.1%	13	3.6%	0
Wood products	14	2.4%	14	2.4%	0	14	3.1%	15	3.4%	1
Furniture and related products	15	2.2%	15	2.3%	0	15	3.0%	14	3.5%	-1
Petroleum and coal products	16	0.8%	18	0.6%	2	18	0.9%	18	0.8%	0
Textile and textile product mills	17	0.5%	17	1.2%	0	16	1.9%	11	3.9%	-5
Apparel, leather, and allied products	18	0.5%	16	1.8%	-2	17	1.4%	9	4.4%	-8
Manufacturing's share of total employment	—	11.6%	—	17.2%		—	8.8%	—	14.2%	

Source: Bureau of Labor Statistics' Quarterly Census of Employment and Wages.
 Note: District-level employment values are estimated as the sum of the employment values for each state in the District weighted by the proportion of that state's total manufacturing employment that falls within the Fourth District portion of the state. Three-digit North American Industry Classification System (NAICS) industry employment values are often suppressed at the county level to protect the privacy of large firms.

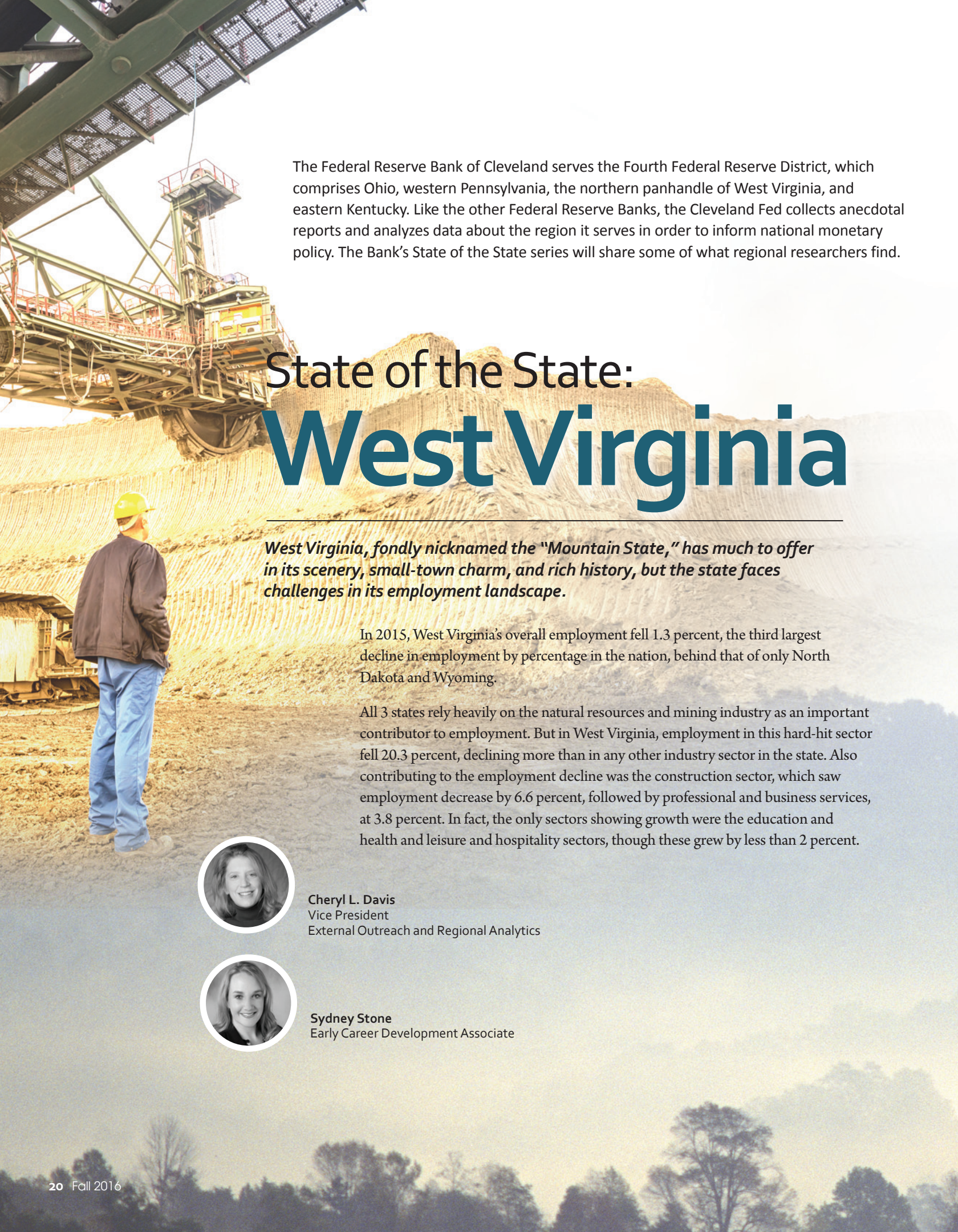
Our estimate of output per worker suggests that labor productivity in [computer and electronics products] has increased elevenfold in the District and thirteenfold in the nation.

Our estimate of output per worker suggests that labor productivity in this industry has increased elevenfold in the District and thirteenfold in the nation. Remembering that the median increase in this measure across manufacturing industries is around 1.5 times, this increase speaks powerfully to the impact that innovation in computer and electronic products is having on economic growth in the District and the nation.

While manufacturing overall continues to decrease in economic importance for the District, petroleum and coal products and computer and electronic products seem to be stepping into greater roles. Because these 2 industries are increasing in both output and labor productivity, it's possible they will play increasing roles in the District's economy in years to come. ■

SUM AND SUBSTANCE

Two manufacturing industries, petroleum and coal products and computer and electronics products, are growing dramatically in the Fourth District despite manufacturing's downward trend overall.



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: West Virginia

West Virginia, fondly nicknamed the "Mountain State," has much to offer in its scenery, small-town charm, and rich history, but the state faces challenges in its employment landscape.

In 2015, West Virginia's overall employment fell 1.3 percent, the third largest decline in employment by percentage in the nation, behind that of only North Dakota and Wyoming.

All 3 states rely heavily on the natural resources and mining industry as an important contributor to employment. But in West Virginia, employment in this hard-hit sector fell 20.3 percent, declining more than in any other industry sector in the state. Also contributing to the employment decline was the construction sector, which saw employment decrease by 6.6 percent, followed by professional and business services, at 3.8 percent. In fact, the only sectors showing growth were the education and health and leisure and hospitality sectors, though these grew by less than 2 percent.



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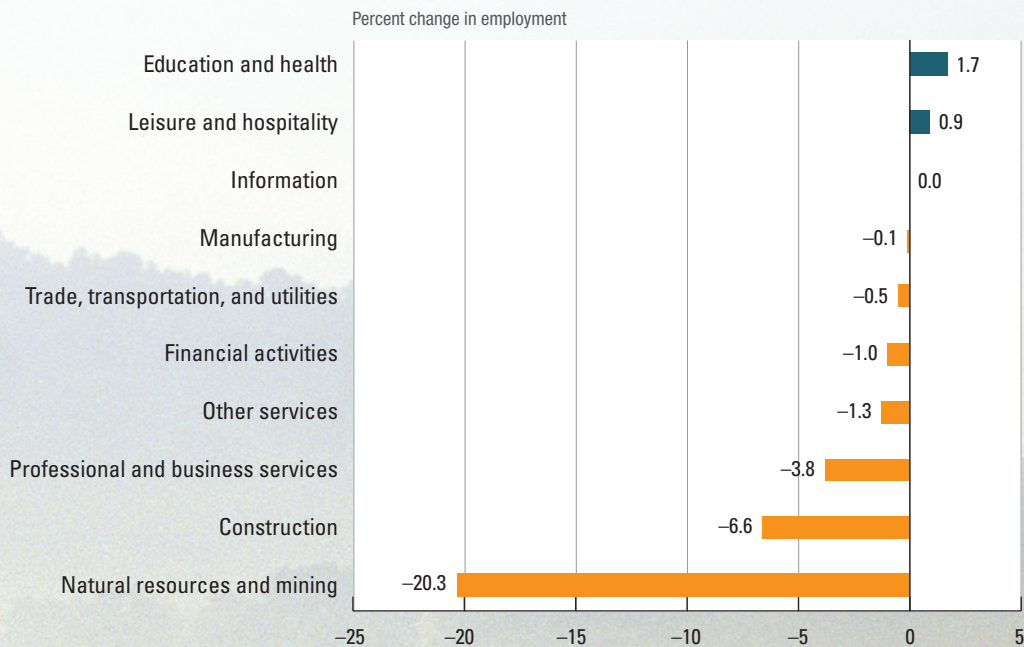
West Virginia's portion of the population aged 65 and older, at 17.8 percent, is among the highest in the nation.

Despite the overall decline in employment, West Virginia's unemployment rate has also decreased through 2015 and the first two quarters of 2016, barring some short-lived fluctuations. The unemployment rate began its slow downward trend after a post-recession high of 8.8 percent in November 2010 and has decreased to 6.0 percent. It remains higher than the national average of 4.9 percent, however.

How can the unemployment rate be falling when employment growth is also low?

The answer most likely lies in West Virginia's notable decline in population growth, resulting in a decrease in the size of the labor force. This downturn in population growth has been on a steady path since mid-2010, in large part because of both workers' relocating to other states for better employment opportunities and an aging population. In fact, as of this year, West Virginia's portion of the population aged 65 and older, at 17.8 percent, is among the highest in the nation, bested by those of only Florida and Maine.

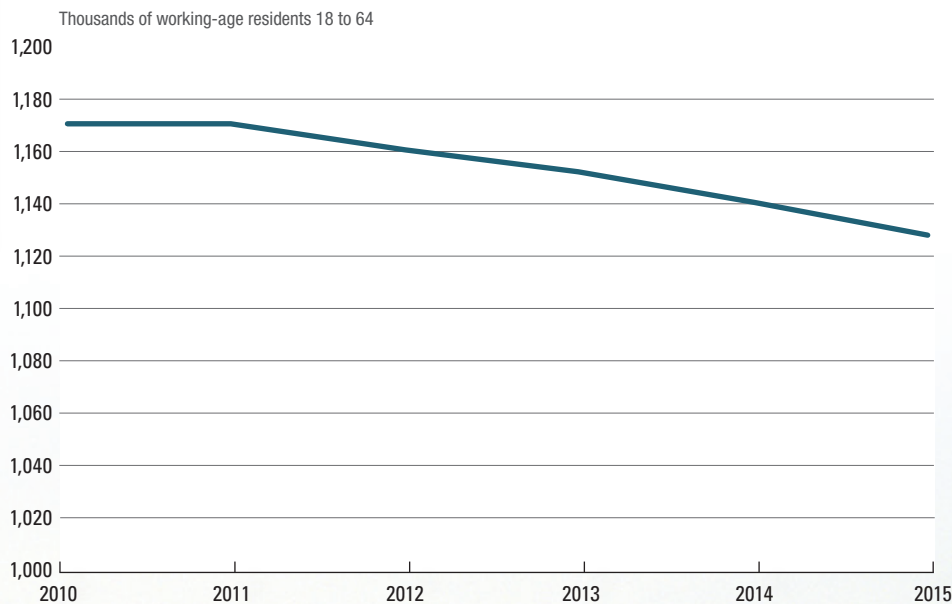
Employment grew in just 2 sectors throughout 2015, and the largest negative employment change was in natural resources and mining, a 20.3 percentage point decline.



Source: Bureau of Labor Statistics' Quarterly Census of Employment and Wages. Last observation occurred December 2015.

West Virginians have been pursuing higher education at an increased rate.

In West Virginia, the number of working-age residents (ages 18 to 64) has fallen since 2011.



Source: United States Census Bureau. Last observation occurred July 1, 2015.

Local contacts indicate qualified workers are also in short supply, contributing to the economic health of the job market. Educational attainment and social factors such as frequent opioid and heroin use present challenges to employers. Both of these factors contribute to the state's low labor force participation rate, currently the lowest rate among those of the 4 states that lie at least partially within the Fourth Federal Reserve District, Ohio, Pennsylvania, Kentucky, and West Virginia.

Census data collected in 2014 show that just 32.6 percent of West Virginia's working-age adults hold a 2- or 4-year college degree, well below the national rate of 40.4 percent. The dramatic uptick in drug abuse has also contributed to the ineligibility of many potential employees—especially in the construction and mining and logging sectors. The Centers for Disease Control and Prevention notes approximately 34 drug overdose

deaths per 100,000 West Virginia residents from 2011 to 2013, more than double the nation's average of 13.4 deaths per 100,000 residents during that same time period.

Despite these discouraging statistics, the first 2 quarters of 2016 have shown a slight upward movement in the labor force participation rate. Additionally, there was a 1.1 percentage point decline in the unemployment rate from June 2015 to June 2016,

the third largest decline of the unemployment rate in the country for that time period. West Virginians have been pursuing higher education at an increased rate, as well, with a 4 percentage point increase since 2013 of adults who hold either a 2- or 4-year college degree.

We are hopeful that this positive momentum will continue into the next chapter of West Virginia's employment story. ■

SUM AND SUBSTANCE

West Virginia's employment rate fell in part because of the large decline in the state's hard-hit natural resources and mining industry, nonetheless the state's unemployment rate has also decreased.

Proximity and Access for All

Distrust, lack of access, and language barriers are among the reasons millions of Americans don't use mainstream banks. The Cleveland Fed's Bonnie Blankenship explains how that disconnect impacts the economy and what community leaders can do.



Bonnie Blankenship
Regional Community
Development Advisor

It was supposed to be a safe place.

In 1865, with slavery abolished, a bank for ex-slaves, African American veterans, and their families opened its doors: The Freedman's Bank.

Not even a decade later, in 1874, the bank failed, taking the savings of most depositors with it. That failure was a tremendous blow that some historians say created within African American communities a deep distrust of banks.

So shares an exhibit on display through December at the Federal Reserve Bank of Cleveland.

“During its brief life, the Freedman's Bank expanded to serve nearly 100,000 customers—an indication that former slaves understood the connection between financial empowerment and well-being, a tenet that continues to be true today,” says Loretta J. Mester, president and chief executive officer of the Cleveland Fed. “The bank's failure and the ensuing lack of confidence in the banking system is a lesson for us today, as the Federal Reserve works to ensure that the financial system remains stable and that people in low- and moderate-income communities have access to the financial services they need to ensure a better future for themselves and their communities.”

Millions of adults in the United States today are without such access.

In industry-speak, people who do not use conventional bank services and products are “unbanked.” Those who use some services and products but also tap nonbank sources such as payday lenders and check-cashing services are “underbanked.”



According to its 2013 National Survey of Unbanked and Underbanked Households, the Federal Deposit Insurance Corporation (FDIC) found that 7.7 percent of US households (or 1 in 13) were unbanked and 20 percent (or 1 in 5) were underbanked. Those percentages represented households composed of millions of children and approximately 16.7 million adults and 50.9 million adults, respectively.

A worker can pay as much as \$40,000 in fees over the course of his career by using check-cashing services rather than having a checking account.

Bonnie Blankenship, a regional community development advisor for the Federal Reserve Bank of Cleveland, is concerned the numbers could grow as banks shutter more branches as people increasingly bank online and as mergers and acquisitions continue to consolidate the industry.

“When there’s a lending institution that pulls a branch out of a low- and moderate-income neighborhood, it makes access harder,” Blankenship explains. “If there are transportation issues and people can’t readily get to a bank to conduct everyday business, they’re going to look at alternative lenders.”

Blankenship, who previously worked on an initiative in Cincinnati and Lexington—called Bank On—to encourage and assist unbanked and underbanked people to engage in banking relationships, is involved presently in a series of listening sessions wherein bank supervisors and staff of nonprofits are meeting to discuss access to credit. It’s a series convened by the Federal Reserve Bank of Cleveland, the Office of the Comptroller of the Currency, and the FDIC. The latest was scheduled for October 4 at the Boone Tavern Hotel in Berea, Kentucky.

Forefront asked Blankenship about what’s at stake for the broader economy when so many are disconnected from banks, the role that trust plays in banking, and more. An edited transcript of the conversation follows.

Forefront: Who is generally unbanked and underbanked, and why?

Blankenship: Generally, unbanked and underbanked individuals are the working poor or those living in poverty. Many of these individuals have become accustomed to using payday lenders or check-cashing services as their financial institutions.

Many are minorities. In Cincinnati, there are a few neighborhoods that have large Hispanic populations. In one of them where I ran a nonprofit [Carthage], we found that residents in the community were more comfortable carrying their cash or having cash at their residence. They were suspicious of banks. Part of it possibly could be a language barrier. Another could be documentation: They may not be documented citizens, and banks recognize only certain ID cards.

Forefront: What are the advantages and disadvantages of being unbanked and underbanked?

Blankenship: I’ll start with the disadvantages. It’s typical that somebody will pay higher fees for general banking services such as check cashing or obtaining money orders. A 2008 study by the Brookings Institution found that a worker can pay as much as \$40,000 in fees over the course of his career by using check-cashing services rather than having a checking account. Individuals without a banking relationship are prone to paying higher interest rates. It’s also difficult for them to establish credit for mortgages, and there’s a lack of ability to store their money away from their residences. Folks who carry their money are targeted.

The primary advantage I see is convenience and ease of transactions at alternative lending venues. Many payday lenders have nontraditional hours, so they’re accessible for people.

Forefront: *How is the broader economy impacted when millions of people are unbanked and underbanked?*

Blankenship: Unless you're already wealthy and you have enough cash to buy a home, without a banking relationship to build wealth, you're not in a position to establish credit, and you will have a hard time obtaining a loan and purchasing a home. I do believe that homeownership can be one mechanism for wealth building.

I think the number of unbanked and underbanked is a challenge for all of society because if you're not moving up through the economy, you're not participating in overall economic growth.

If you work with somebody and you help him establish credit and build wealth into an asset, there's also residual business from that. There are lending institutions that earn interest on the loans. There are title companies, and there's somebody who's selling him furniture. It just goes on. It ties into the overall economic engine of our country.

Forefront: *Many unbanked and underbanked consumers use products and services such as payday loans. Consumer advocates have called for more agency oversight, regulation, and enforcement of the payday loan industry. The Consumer Financial Protection Bureau proposed in early June a new rule for payday loans. What might you suggest the industry be required to do? Not to do?*

Blankenship: I know that payday lenders are looked at in a very negative way, but they are supplying a need for some individuals. If there were a way these entities could be monitored so that the interest rates are not as high, where the fees are not as great, where somebody is not in a perpetual cycle of not getting his or her loan paid because the fees and the rates are so high, that would fulfill a need. It would be terrific if we could figure out a way to encourage mainstream financial institutions to offer small-dollar loan products and to make them accessible. Doing so would help people build a credit score.

Five Ways to Better Bank the Unbanked

In late May 2016, the FDIC published research titled "Bank Efforts to Serve Unbanked and Underbanked Consumers" and identified 5 major strategies banks and other stakeholders can use to enhance their efforts to serve unbanked and underbanked consumers:

1 "Recognize that trust is the foundation for strong relationships with unbanked and underbanked consumers."

The gist: Consumers may not trust banks because of their own past negative experiences or because of the experiences of people they know. Adopting strategies to build or increase consumers' trust is a first step to increasing their participation in the mainstream financial system. Maintaining and strengthening partnerships with nonprofits that serve residents of low- and moderate-income (LMI) communities is an advantageous strategy.

2 "Adopt a multi-pronged approach to serving LMI (low- and moderate-income) consumers."

The gist: A wide range of challenges may hinder unbanked and LMI consumers from opening and retaining bank accounts. Banks seem to be most successful when they simultaneously implement multiple approaches to address these challenges, such as offering a range of relevant products and services, establishing accessible and welcoming branches, and hiring and training bank staff to serve said consumers.

3 "Nurture longer-term relationships with community partners."

The gist: Nonprofits and local government agencies can facilitate stronger relationships between banks and residents of LMI communities. Banks can provide financial and knowledge-based resources to help organizations pursue their goals. Ideally, partners should build into initiatives a process for regular check-ins and a process for adapting implementation to ensure all partners' goals are being addressed.

4 "Use technology to increase efficiencies for the bank, its partners, and its customers."

The gist: Technology is a crucial battleground on which the competition between bank and nonbank financial services providers takes place. LMI consumers will use the financial services that are most convenient for them, and banks can use technology such as remote deposit capture to increase that convenience.

5 "Develop an understanding of unbanked and underbanked consumers in the bank's market area."

The gist: The most common reason previously banked consumers cite for being unbanked is they feel they don't have enough money to keep in an account or to meet a minimum balance. Others closed accounts following a negative experience, and some had their accounts closed involuntarily by banks. The unbanked and underbanked are a diverse group; products and strategies that attract someone who thinks she doesn't have enough money for an account will likely be different from those that will attract the interest of an immigrant unfamiliar with the US banking system. Banks seeking to serve such consumers will benefit from understanding their needs.



The role that I see people and businesses and financial institutions playing is to ensure that community branches remain in low- and moderate-income neighborhoods so people have access to a local financial institution.

Forefront: *Much has been made about ongoing efforts to ensure access to capital and credit, including technical assistance providers' showing people how to use different products. Are there barriers other than access? What role does trust play in the choices people make regarding their finances?*

Blankenship: It's a combination of both: It's access and comfort. I think that with branches closing, yes, that would be an issue, but there is also an issue if you're not familiar or not comfortable in a bank.

While in a previous role, I walked into financial institutions with people. There was a gentleman who had a felony conviction, and I was trying to help him reestablish a work history and trying to coach him a little bit financially. When he walked into the bank with me, this great big man kind of shrank. He was intimidated.

I think some of it is history. Maybe someone had a bad experience or even no experience with a bank. If you don't see your parent doing something, if you're used to going to a payday lender, you're going to go to what's comfortable and familiar to you.

Forefront: *What message would you share with people who distrust conventional banks?*

Blankenship: I tell many people who don't have conventional banking relationships to look up and attend free financial fitness days. I also tell people that Community Reinvestment Act officers will meet with customers. I've seen them work one on one to talk about products that are available.

Forefront: *What role can people, businesses, and financial institutions play in local communities to help address the issues of the unbanked and underbanked? What efforts do you see in the Fourth Federal Reserve District (Ohio, western Pennsylvania, the northern panhandle of West Virginia, and eastern Kentucky)?*

Blankenship: The role that I see people and businesses and financial institutions playing is to ensure that community branches remain in low- and moderate-income neighborhoods so people have access to a local financial institution.

Some of those conversations are being handled through different councils. One is in the Fourth Federal Reserve District in Dayton, Ohio, the Human Relations Council. It's working with financial institutions and looking very closely at branches that will be closing or where there's a threat of closures. The council wants to make sure there's the ability in low- and moderate-income neighborhoods to access financial institutions. It frequently meets with banks to discuss the needs of the neighborhood and stresses the importance of having an anchor financial institution. ■

—Michelle Park Lazette

SUM AND SUBSTANCE

For reasons such as distrust and lack of access, millions of Americans do not use mainstream banks, and the ways in which that disconnect limits them has consequences for the broader economy.

See the Exhibit

The Freedman's Bank: An American Story of Faith, Family, and Finance

Where: Federal Reserve Bank of Cleveland Learning Center and Money Museum, 1455 East Sixth Street, Cleveland, Ohio

When: Through December 2016 during normal Money Museum hours: Monday through Thursday, 9:30 am to 2:30 pm (except bank holidays)

The Importance of Equitable Transit-Oriented Development

Affordable housing near transit is a focus for many in the region, including the Cleveland Fed.



Joseph Ott
Regional Community Development Advisor

The need for and the barriers involved in developing affordable housing near public transit were major points of discussion for more than 110 people from the Pittsburgh, Cleveland, and Philadelphia regions at a daylong event in late August.

Convened by the Federal Reserve Bank of Cleveland and the Port Authority of Allegheny County, the Equitable Transit-Oriented Development (ETOD) Symposium featured researchers and practitioners who shared models currently employed elsewhere in the country. They also discussed what can be done locally to include equitability in transit-focused development.

The concept of equitable transit-oriented development incorporates fundamental tenets of community development such as mixed-income residential development and greater access to employment opportunities. Much of the discussion focused on affordable housing near transit, as it tends to be more expensive than similar housing in less transit-rich areas.

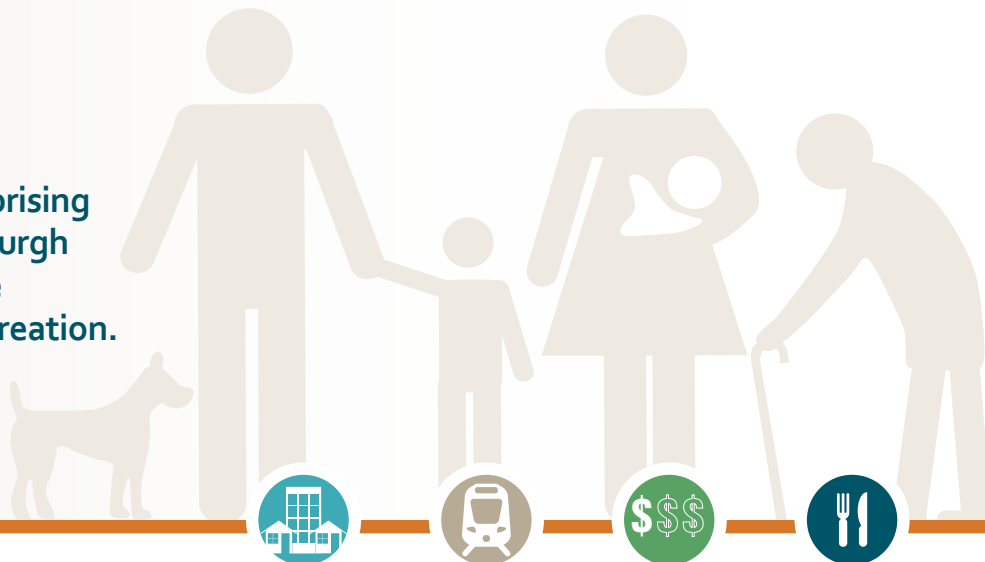
Speaking to the need for ETOD, Michael Spotts, a senior analyst at Enterprise Community Partners, cited significant housing affordability challenges in the United States. According to Harvard University's *The State of the Nation's Housing 2016*, 11.4 million renter households are severely cost burdened, spending 50 percent or more household income on housing costs. Researchers project that this number will increase 11 percent by 2025. Such housing-affordability challenges are exacerbated in transit-served communities, where demand is higher for housing and drives up rents and housing prices. "There are affordable housing subsidies, but it often isn't enough," Spotts noted. "Households are still burdened by unaffordable housing and transit costs. We need to think about ETOD because job accessibility is important to economic growth."

There are barriers to ETOD, however. Spotts pointed to myriad regulatory and cultural hurdles for development that often don't coincide with actual demand and single-use zoning requirements. Communities have found ways to overcome such hurdles, including efforts to adopt proactive collaborative strategies:

- Alignment of new and existing transit service
- Reformation of municipal and zoning codes, in part to assist affordable housing development
- Expansion in the availability of capital for projects
- Enhancements in site access and viability

Housing-affordability challenges are exacerbated in transit-served communities, where demand is higher for housing and drives up rents and housing prices.

Most members of a panel comprising practitioners local to the Pittsburgh area expressed a desire to have dedicated affordable housing creation.



Dace West, executive director of Mile High Connects, shared information regarding ETOD efforts in the Denver, Colorado, region. Once again referencing the unaffordable cost of housing and transportation for low- and moderate-income households, she noted that Denver’s “housing prices have increased 20 percent, while wages increased only 3 percent, leading to even greater affordability disparities.”

In response, the Denver region regularly convenes a broad coalition of more than 300 stakeholders across multiple sectors to discuss and strategize ways to address affordability, workforce issues, and transit service routes. West reported that one of the most significant resources Denver has at its disposal is a transit-oriented development fund—created with the support of foundations, banks, and investors—dedicated to the creation and preservation of affordable housing.

Most members of a panel comprising practitioners local to the Pittsburgh area expressed a desire to have dedicated affordable housing creation, similar to the program utilized in the Denver region, and highlighted the need to engage developers and stakeholder groups as early in the development process as possible.

In delivering the program’s keynote address, Dan Bartholomay, chief executive officer of Rail~Volution, a national nonprofit focused on the links between land use, transit, and development, stressed the importance of collaboration and bold leadership in the ETOD approach.

To that end, he urged audience members to think about equitable transit-oriented development on 5 levels: region, corridor, community, station, and local. Such levels will, in turn, help practitioners think about their regions as “a set of destinations” and help them consider the scale, value, and feasibility of projects.

“Pittsburgh has great energy and a lot of capable organizations, so there’s a huge opportunity to align resources for ETOD impact,” Bartholomay added, urging the Pittsburgh region to “think big” and focus on the outcomes of its work. ■

SUM AND SUBSTANCE

Many are coming together in this region and beyond to discuss funding, strategies, and ways to clear hurdles to achieve equitable transit-oriented development.

Keeping Connected

Engagement is a key part of what we do at the Federal Reserve Bank of Cleveland. My colleagues and I collect real-time information on current economic and business conditions by talking to business, civic, community development, and labor leaders throughout the Fourth Federal Reserve District: Ohio, western Pennsylvania, the northern panhandle of West Virginia, and eastern Kentucky.

We gather this information in several ways. The Federal Reserve Bank of Cleveland, like the 11 other Reserve Banks across the country, is led by a 9-member main office board of directors. These directors and members of our Branch boards in Pittsburgh and Cincinnati share insights with us from their own industries and communities. It's just one of the ways we stay connected to our region.

We also connect to our communities through business advisory councils in 9 District cities, as well as through our Community Depository Institution Advisory Council and the Federal Advisory Council, both of which gather views from financial institutions. And our community development team is always in the field, working with stakeholders to identify regional and national issues that affect underserved individuals and communities in our District such as workforce development, lead poisoning, and affordable housing.

Just recently, our Community Development Department partnered with the Kentucky Philanthropy Initiative to bring together leaders in the philanthropic, workforce, and community development spheres to discuss economic challenges in eastern Kentucky. This region has suffered mightily, losing some 13,000 jobs during the last decade. The group visited a job training site to learn how workforce retraining efforts can help to rebuild the region's economy. In Cincinnati, we met with labor leaders who shared their concerns about workforce challenges and the rising cost of healthcare. In other parts of the District, business owners shared insights on their future capital investment plans. And later this year, we will convene contacts in the financial services sector to discuss our nation's payment system.

By building relationships throughout the District, and by listening and learning, we're able to identify important issues and emerging trends, investigate these issues through applied research, and, as appropriate, influence public policy. The information keeps us informed about what's happening in our region, keeps our economists current on emerging economic trends, and prepares our Bank president for Federal Open Market Committee meetings. But in order to do this, we need to make sure the information we gather represents views from people of diverse backgrounds and different geographic regions and from an assortment of industries and organizations.

More than 100 years ago, the creators of the Federal Reserve System envisioned a system that would seek the views of many. The way we gather this information and the issues we uncover have changed, but the importance of hearing from our stakeholders hasn't.

To recommend a candidate for our boards or councils, visit tinyurl.com/jyzz7ln.

For those who serve or have served as contacts, I thank you for your time and public service. The information we gather and the research we conduct is richer because of your participation.

Sincerely,



Mark Schweitzer
Senior Vice President, External
Outreach and Regional Analytics

* To view a list of our directors and advisory council participants, please visit our website: clevelandfed.org. For additional information about engaging with the Federal Reserve Bank of Cleveland, contact Mark Schweitzer at Mark.Schweitzer@clev.frb.org.

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This 4-part series on the economies of states within the region served by the Federal Reserve Bank of Cleveland concludes with a report on Kentucky.

State of small business

Explore what data show and what Cleveland Fed experts say is the current landscape for small businesses.

Branch numbers continue to shrink

Many hundreds of bank branches have closed during recent years. *Forefront* explores how bankers are staying compliant with regulation requiring that they meet the credit needs of their communities.

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