

Forefront

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

As Branches Decline, How Do Bankers Continue to Comply with the CRA?



INSIDE:

State of Small Business

How Low Can Employment Growth Go
without Boosting the Unemployment Rate
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Challenging the 'Kentucky Uglies'

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Presidential Pulls

Loretta J. Mester, president and chief executive officer of the Federal Reserve Bank of Cleveland, recently shared her views on Federal Reserve communication, workforce development, economic conditions, and more.



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

SEEKING TRANSPARENCY

"I think if we wait . . . , then there's a higher potential that we're going to have to raise interest rates on a steeper path. And in the past when the Fed and other policymakers have done that, and other central banks, it really doesn't turn out to be a good outcome. . . . We want to be as transparent as we can with the public about where we're seeing the economy going and what policy is associated with that."

—From an interview with Bloomberg, Cleveland, Ohio, October 3, 2016

INFLATION PREDICTIONS

"It takes quite a while for policy to affect the economy. And again, I don't think we're behind the curve. It's really whether we want to be consistent with our view that a gradual upward tilt to the policy path is right, and is it appropriate given the economy and given our outlook and given the risks."

—From an interview on Squawk Box, New York, New York, October 7, 2016

GRADUAL INCREASES

"The argument for why another 25 basis point increase on our gradual path makes sense is based on our two monetary policy goals, the dual mandate goals. Yes, there are other people who worry that if you keep interest rates at zero for a long time, there might be financial imbalances building up. My argument is really based on the outlook for the economy and really our dual mandate goals. But most economists would agree that with productivity as low as it is, we're going to have lower interest rates."

—From an interview on Squawk Box, New York, New York, October 7, 2016

GROWTH

"Some parts of the US economy have fared better than others. But overall, economic growth has proven to be resilient, and I expect growth over the next two years to be at or slightly above a trend of around 2 percent. The pace of growth, while lower than in other expansions, has been sufficient to generate significant and sustained progress in labor markets."

—From a speech in Pittsburgh, Pennsylvania, November 30, 2016

CLARIFYING DATA DEPENDENCE

"The concept of 'data dependence' was meant to reinforce the idea that the economy is dynamic and will be hit by economic disturbances that can't be known in advance. Some shocks will result in an accumulation of economic information that changes the medium-run outlook for the economy and the risks around the outlook in a way to which monetary policy will want to respond. But some of these shocks will not materially change the outlook or policymakers' view of appropriate policy."

—From a speech in New York, New York, October 7, 2016

SKILLS GAPS

"Technological advances and globalization are changing the nature of available jobs and the skill sets needed to perform those jobs. While the overall economy will benefit from these forces, many individuals and some regions are adversely affected by these structural trends. Government policies and programs, and public-private partnerships, can and should be brought to bear to help people and communities make the transition."

—From a speech in Pittsburgh, Pennsylvania, November 30, 2016

POLICY RULES

"I don't believe we are at the state of knowledge where a single policy rule can be used to set policy because no rule works well enough across a variety of economic models and in a variety of economic circumstances. But I do find it useful to look at the outcomes of an array of simple, robust monetary policy rules as a benchmark against which to assess current policy."

—From a speech in New York, New York, October 7, 2016

Regional Housing Markets Continue to Strengthen, Updated Index Reveals

The year 2016 marked a second consecutive year during which the glut of properties owned by banks because borrowers defaulted shrank for most areas of the Fourth Federal Reserve District, according to a December update of the Cleveland Fed's Community Stabilization Index (CSI).



Brett Barkley

The continuing decline in the stock of real estate owned, or REO, properties indicates that housing markets are

continuing to improve in the District, which comprises Ohio, western Pennsylvania, the northern panhandle of West Virginia, and eastern Kentucky, says Brett Barkley, senior research analyst with the Federal Reserve Bank of Cleveland.

As mortgage delinquencies and foreclosures have slowed, the number of properties banks own has also declined. One reason is that banks may have found in previous years that the housing demand simply wasn't there.

"The data suggest that banks have been more willing or more able to sell their properties of late," Barkley says. "Some may have held onto them, waiting for housing values to recover before selling them."

That wait is over in many places, reveals the CSI, an index that provides a relative measure of local housing market conditions and recovery potential. The index, comprising 6 specific measures of housing and credit conditions, is updated annually. For the first time since the CSI's inception in 2009, the median value of originations and refinances increased in all of the 15 metropolitan statistical areas (MSAs) tracked, and originations activity is up everywhere except in the Lima, Ohio, MSA.

Improvements aren't happening in all communities in the District, a reality visible via the CSI's interactive maps.

"We don't see this same kind of functioning housing market coming back to the hardest hit zip codes," Barkley notes. "In some of the neighborhoods we profile in this update, we've seen the stock of REO properties come down, so that trend is good, but originations activity and the median value of those originations have not experienced a sustained positive trend."

Public investment will continue to play a vital role to support innovative revitalization efforts ongoing in the corners of the region distressed most by the foreclosure crisis, among them Ohio locales such as the West Park neighborhood in Canton, the Slavic Village neighborhood in Cleveland, and parts of northwestern and southwestern Warren.

The CSI drills down to the zip code level, Barkley says. That's important for organizations working in places where social and economic data are not publicly available for small geographies like they are through databases such as NEO CANDO.

"Through the CSI, community development industry stakeholders can view these indicators in specific areas and have an idea of what the trends are, what investments are still needed, and where they could target their resources," he says. ■

—Michelle Park Lazette

Read more



The December 2016 update to the Community Stabilization Index zeroes in on locales that received and disbursed large amounts of federal Neighborhood Stabilization Program funds, including Warren, Ohio. Download the PDF for the executive summary and view interactive maps: tinyurl.com/gsmt6zg.

Ask the analyst

Contact Brett Barkley at Brett.Barkley@clev.frb.org for more about the index, including its applicability, the timing of updates, and how to interpret the results.

As Branches Decline, How Do Bankers Continue to Comply with the CRA?

Recent revisions to regulatory guidance do not strip the bank branch of its importance for achieving compliance with the Community Reinvestment Act. Still, regulators realize that bankers are serving communities in increasingly digital ways.



Michelle Park Lazette
Staff Writer

Bankers working to comply with the Community Reinvestment Act (CRA) might feel in times like these stuck between brick and mortar and a hard place.

At a time when US banks are closing hundreds of branches per year, financial institutions must continue to comply with the CRA, which places importance on the full-service branch in gauging how well banks are ensuring the availability of

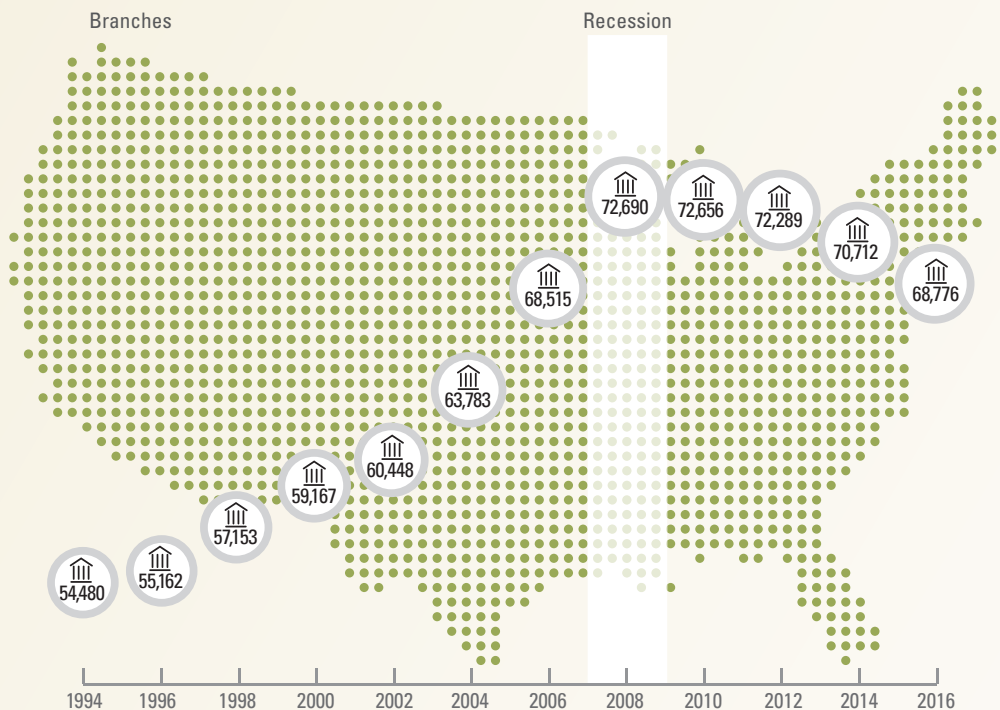
credit and services. Financial institutions shuttered more than 3,900 branches from June 30, 2011, to June 30, 2016, in metropolitan statistical areas in the Lower 48—a 5.4 percent decline—according to data from the Federal Deposit Insurance Corporation (FDIC). Those closures are the result of consolidation in the industry and a change in customer habits, according to industry insiders.

“One of the things bankers tell us is the physical presence is still important.” (p. 6)



Though closed in October 2016 when this photograph was taken, the bank branch pictured here located on Route 18 in Medina, Ohio, has reopened as a credit union branch. Photo courtesy of Pamela Tabar.

The number of bank branches in metro areas in the Lower 48 has been dropping since 2011 and is now nearly what it was a decade ago.



Data as of June 30 of given years.
Source: Federal Deposit Insurance Corporation (FDIC).

It's clear in recent revisions to regulatory guidance around the CRA that bankers have sought clarity on how examiners will weigh branches and alternative delivery systems as banks' business models continue to evolve. One banker says he can't recall a time when the scrutiny and community activism involving banks were "quite as intense" as they've been during the past 2 or 3 years. A number of institutions' CRA ratings have been downgraded, he notes.

The Community Reinvestment Act was passed in 1977 to encourage banks to help meet the credit needs of their entire communities, including low- and moderate-income (LMI) neighborhoods, in ways consistent with safe and sound bank operations. The aforementioned revisions to guidance about the act do not strip the bank branch of its importance but do expand the definition of alternative delivery systems that banks are using to serve customers today.

As part of the Federal Financial Institutions Examination Council, the 3 federal banking agencies with supervisory responsibility for the CRA collectively issued in July 2016 updates to the Interagency Questions and Answers Regarding Community Reinvestment, or Q&A, that provide further guidance on the interpretation and application of the CRA. The recent changes to the Q&A are the first since 2013.

In so issuing these changes, the agencies—the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, and the FDIC—gave notice that they'd withdrawn proposed revisions that would have deleted the statement that "performance standards place primary emphasis on full-service branches." They withdrew that particular revision, according to the notice, in order to avoid the unintended implication that branches are less important in providing financial services to low- and moderate-income neighborhoods.

Commenters from community organizations had opposed the proposed revisions, highlighting the importance of face-to-face contact in banking transactions in order to overcome language barriers and effectively provide services such as explaining terms and conditions. Those commenters also feared the proposed changes would result in more branches being shuttered.

Complying in the digital age

The number of bank branches actually climbed before and during the recent recession, but that number has declined since 2009, when the recession ended, in both the region the Cleveland Fed serves and the Lower 48.

“Really, the question is this: Is access to banking products and services declining as the number of bank branches declines? The answer may be no.”

According to FDIC data, the number of bank headquarters declined before, during, and after the most recent recession, but by a greater percentage in the Fourth Federal Reserve District—Ohio, western Pennsylvania, the northern panhandle of West Virginia, and eastern Kentucky—than it did in the Lower 48.

Area banks, among them Pittsburgh-based PNC Financial Services Group, Inc. and Cincinnati-based Fifth Third Bancorp, also continue to close branches both to reduce expenses and because of changing customer preferences.

Locally and elsewhere, mergers and acquisitions are another driver of main office and branch closures.

Poor CRA performance can stall bank mergers and acquisitions. Banks’ CRA records are considered, too, when banks apply to open new locations and business lines.

In 2014 and 2015, the Cleveland Fed examined 11 institutions for CRA performance. None of the institutions achieved the highest rating (“outstanding”), 10 received a “satisfactory” rating, and 1 received “needs to improve.” The lowest rating is “substantial noncompliance.”

CRA evaluations are about “more than just branches,” says Michael J. Coleman, a banking supervisor for the corporate compliance risk team of the Federal Reserve Bank of Cleveland.

“It’s pretty well known that examiners are going to analyze where a bank’s branches are, but bank management can also provide additional information for consideration such as what alternative service methods are being utilized,” Coleman says. “Does the bank offer mobile banking? Does the bank offer Internet banking? Where are the bank’s deposit-taking ATMs located?”

“Really, the question is this: Is access to banking products and services declining as the number of bank branches declines?” he continues. “The answer may be no.”

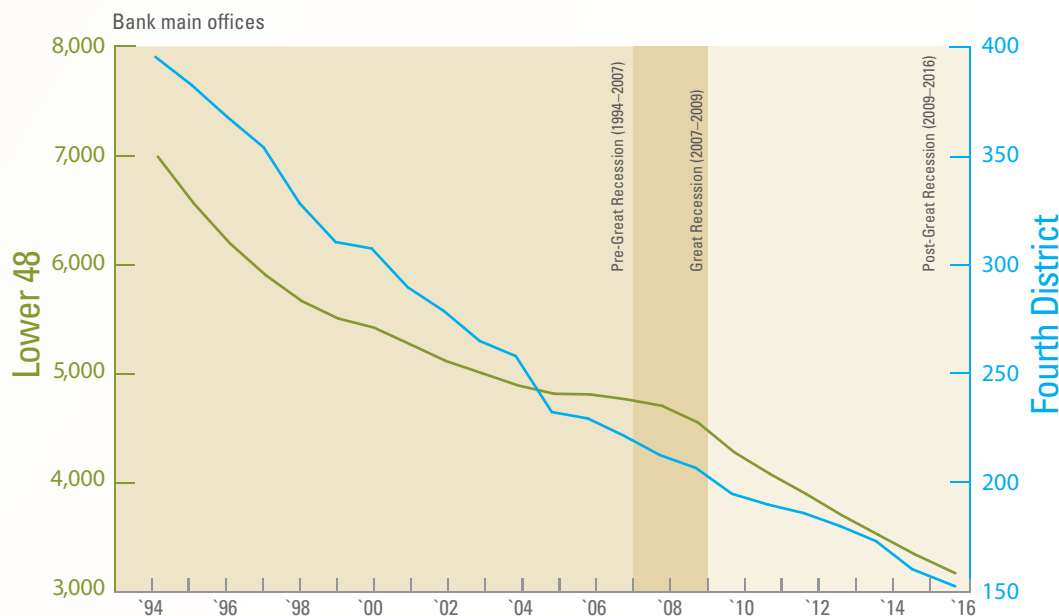
To that end, as a means of acknowledging that many other alternative delivery channels are utilized by financial institutions, a minor revision published in July 2016 to the Q&A removed references to automated teller machines (ATMs) as the only example of alternative delivery systems.

And newer channels are sure to come: The American Bankers Association’s Robert Rowe notes the trade group is increasingly hearing bankers ask how they can partner with fintech firms, or financial technology firms, to deliver financial services.



Robert Rowe

Metro areas in both the nation and the Fourth District* have seen significant consolidation of bank headquarters since 1994.



Data as of June 30 of given years.
 Source: Federal Deposit Insurance Corporation (FDIC).
 The year 1994 is the earliest for which data are available at the county level from the FDIC website.

* The Fourth Federal Reserve District is the region the Cleveland Fed serves and comprises Ohio, western Pennsylvania, the northern panhandle of West Virginia, and eastern Kentucky.

In assessing compliance with the CRA, examiners conduct lending, investment, and service tests. Lending, Coleman explains, is weighted the heaviest. The service test performance standards place primary emphasis on full-service branches while still considering alternative systems. The service test also considers an institution's community development activities.

But Coleman cautions, "We can't discount the impact of a branch distribution weakness in low- and moderate-income tracts and have that made up by strong community development services. If a bank closes all of its LMI branches but remains in the market and still has the profile of a retail branch bank, bank management still needs to demonstrate how they are serving the banking and credit needs of these communities."

As branch networks shrink, the concerns are people's being left with only check-cashing stores and similarly expensive options and small businesses' not having access to the financial services they need, Coleman explains.

"The large retail stores are not sending their employees into the branches; they're using armored cars," he says. "What about those small businesses that have needs such as for cash and coin or that want to apply for a loan? That's something that concerns me."

"I don't have the answer to what the future looks like, but the current expectation and requirement is still going to be out there that bankers need to serve the needs of their entire market areas," Coleman adds. "I recognize the challenge that the banking industry has. As you make strategic decisions to have less brick and mortar, banks still have to demonstrate how they are meeting the credit needs of their markets."



Jeff Thompson

How branches factor into the future

Some banks are opening and building new branches, notes Jeff Thompson, a certified regulatory compliance manager with United Bankers' Bank, headquartered in Minneapolis with an office in Worthington, Ohio. Of the approximately 35 banks he consults with, probably less than 10 percent are doing so, though many consider the best bet to be buying a competitor and its existing footprint. Building branches is a riskier

proposition than it used to be, given the stagnant interest rate environment, compressed margins, and more, Thompson explains.

"One of the things bankers tell us is the physical presence is still important," says Rowe, vice president and associate chief counsel, regulatory compliance, for the American Bankers Association. "Even though customers rely increasingly on technology, when opening accounts or when they have a problem, they like to go in and talk."

What Rowe is unsure of is how much of the credit bankers extend today is the product of someone's walking into a brick-and-mortar location versus using other channels.

"Part of the challenge with that is, what I hear from bankers is it's a mixed kind of interaction between the borrower and the bank," Rowe says. "The customer will take the first couple steps online and once they have an idea—I want this kind of loan—they'll go into a branch to talk to someone. [In this example] it started online, but it finishes in person."

Norman Bliss, senior vice president and director of community development for Cleveland-based KeyBank, which has received 8 consecutive outstanding CRA ratings, concurs.



Norman Bliss

FDIC data reveal that the share of operating branches that are standalone locations is declining. Meanwhile, the number of retail branches such as those in grocery stores has increased more in the Fourth Federal Reserve District than it has in the Lower 48.

“It’s not either/or, it’s both,” he says.

Bliss attributes KeyBank’s ratings, in part, to a branching strategy that involves KeyBank Plus centers that operate like traditional branches and also offer additional services related to financial education and literacy.

FDIC data reveal that the share of operating branches that are standalone locations is declining. Meanwhile, the number of retail branches such as those in grocery stores has increased more in the Fourth Federal Reserve District than it has in the Lower 48.

Such in-store presences have their advantages, the Cleveland Fed’s Coleman notes.

“It’s great for the retailer because it can lease out its space,” he begins. “It’s great for the bank because you have people coming in—a captive audience.

“They’re less costly to get up and running compared to traditional standalone branches,” he adds of such

locations. “You’re not investing in the overhead to build brick and mortar, pay to maintain the parking lot, the landscaping. These in-store locations, you just move right in. The buildout of the space is relatively simple and doesn’t require a long timeline.”

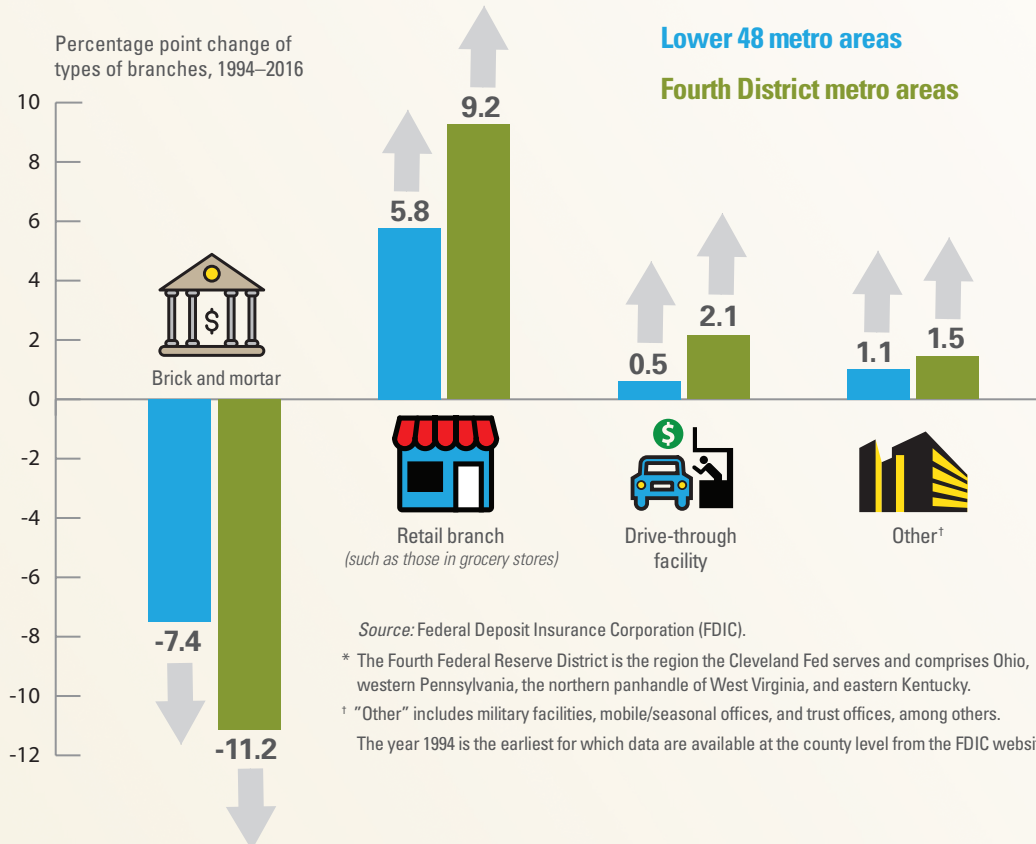
The downside is that retail locations also leave financial institutions without control. When, for example, a grocery store closes in a low- or moderate-income census tract, the bank’s location inside the store closes with it.

Plus, Thompson notes, in-store locations don’t tend to generate much lending activity.

“You’re not going to put a lender at a Walmart or a Kroger,” Thompson asserts. “That’s not where a customer’s going to go for a loan.”

Where do banking insiders expect banks’ revenue growth to come from in the near term, and how do branches, no matter their type, factor in?

The number of branches, despite recent years of decline, is higher than it was in 1994 in both the Lower 48 and the Fourth District,* but the share of branches that are standalone storefronts has dropped.



Rowe says it will be small business and commercial lending driving growth, and Thompson agrees. But Thompson notes that most commercial lending doesn't happen inside a branch.

"Most commercial customers don't come into the bank," he explains. "A good commercial loan officer isn't tied to his desk. He's out in the community talking through credit needs."

Rowe expects to see bankers increasingly banking with customers, not inside standalone and retail branches, but inside other places.

"I'm Rob Rowe [the banker], I've got a safe connection to the bank, I can go out into the local office of XYZ company and sit down there and chat with the president," he explains. "I can go call on customers, they can hand me a check, and we can do remote deposits. As a person, I can be a branch. From a community development perspective, instead of having people come into the branch, I can go [to a church, for example,] and open accounts for people and answer questions."

Indeed, KeyBank executives are considering partnering with local libraries to host forums on financial wellness, according to Bliss.

"So whereas we might not have a branch in that community, the library could be a point of access," he explains. "Those are ideas we're floating. How do we engage differently with our communities in places where we may have optimized [or closed] branches?" ■

SUM AND SUBSTANCE

It's a time of declining bank branch numbers, but bank examiners continue to expect bankers to meet the credit needs of their communities. How bankers meet those needs is evolving.

Federal Reserve Bank of Cleveland policy analyst Matthew Klesta contributed to this article.

Read more



A Cleveland Fed research economist finds that bank branches allow financial institutions access to better information about the local economy, information which in turn allows them to make better lending decisions. Read the *Economic Commentary*: tinyurl.com/h3hpsna.



Research Corner

The works featured here comprise a sampling of what Cleveland Fed research economists produce each year. Find other recently released working papers, commentaries, and more regarding conditions in the Fourth Federal Reserve District and beyond on clevelandfed.org.

How Do Lead Banks Use Their Private Information about Loan Quality in the Syndicated Loan Market?

Lakshmi Balasubramanyan, Allen N. Berger, and Matthew M. Koepke

WP 16-16R | tinyurl.com/jr3rs78

When banks make loans to small commercial borrowers, they typically originate loans and then hold onto them until the loans are paid off, a process known as “originate-to-hold.” By contrast, syndicated loans made to large commercial borrowers are often originated by a “lead” bank and then distributed in parts among other banks participating in the loan syndicate, a process known as “originate-to-distribute.” In the originate-to-hold approach, banks gather private information about borrowers, and then they use that information in their present and future dealings with borrowers. But little is known about how private information is used in the originate-to-distribute model. This paper studies how lead banks use information about the quality of the syndicated loans they originate. The researchers find evidence that private information is used differently depending on whether the loan has a fixed term or whether it is a revolving loan. Lead banks hold onto a greater proportion of fixed-term loans if they know that the quality of the loan is good. The authors also find that private information is used to determine the structure of the syndicate (all the banks participating in a distributed loan).

Trends in Expenditures by US Colleges and Universities, 1987–2013

Peter Hinrichs

9.14.2016 | *Economic Commentary* 16-10 | tinyurl.com/zcjoc2x

Rising college costs are often blamed on questionable spending by universities for “extras” such as student amenities and administrator salaries. This *Economic Commentary* studies trends in spending in broad categories by US colleges and universities between 1987 and 2013. The results reveal that spending per student has risen in most major categories at both public and private institutions, but some categories have experienced more dramatic increases than others. For example, research saw among the highest spending growth of all categories, both in terms of absolute levels of spending and on a percentage basis. In percentage terms, there has also been a large increase in student services spending. These results suggest the rise in college costs must have a broad-based explanation.

The Ins and Outs of Self-Employment: An Estimate of Business Cycle and Trend Effects

Mark Schweitzer and Scott Shane

9.14.2016 | WP 16-21 | tinyurl.com/gqbbku5

This paper studies whether recessions affect the number of people who choose to become self-employed. The authors find that on balance, recessions reduce self-employment. They do so primarily by altering the balance between the number of people entering self-employment and the number exiting it. Most of the time, the number of people exiting and the number of people entering are quite large but reasonably in balance. As a result, net entry into self-employment is relatively small. A recession leads to an increase in people both exiting and entering, but the magnitude of the effect is larger for those exiting so that the number of those self-employed falls.

The Unintended Consequences of Employer Credit Check Bans on Labor and Credit Markets

Kristle Romero Cortés, Andrew Glover, and Murat Tasci

11.28.2016 | WP 16-25 | tinyurl.com/z3mvu96

Lenders have traditionally used credit reports to measure a borrower’s riskiness, but credit agencies also market reports to employers for use in hiring. Since the onset of the Great Recession, 11 state legislatures have banned the use of credit reports in hiring. The authors study the effect of these laws and find a number of negative outcomes, namely that in states that restrict employer credit checks, unemployment rates rise faster, access to credit declines, and delinquencies increase. The authors argue based on their findings that employers use credit checks to screen applicants and that the screening improves the matching process. Taking away this relatively cheap screening device, credit reports, not only made getting a job more difficult, it resulted in negative credit market outcomes, as well.

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 shares some of what regional researchers find.

State of the State: Kentucky

Annualized payroll employment growth has slowed in the Fourth District and in the nation, but there are reasons to remain upbeat about the near-term outlook.



Gary A. Wagner
Vice President and
Senior Regional Officer

Despite the fact that annualized payroll employment growth in both Kentucky and the United States has slowed since the beginning of 2016, largely as a result of softness in the manufacturing and energy sectors, many regions in Kentucky continue to enjoy some of the strongest job growth in the Fourth Federal Reserve District, which comprises Ohio, western Pennsylvania, the northern panhandle of West Virginia, and eastern Kentucky.

In a recent 3-month period for which data are available (July, August, and September 2016), annualized payroll job growth in the commonwealth was 2.5 percent. This growth is well ahead of the 1.6 percent growth experienced by the United States during the same time period and more than 3 times faster than that of the closest Fourth District state, Pennsylvania, at 0.8 percent.

Recent job gains have been fairly broad based across different sectors and metropolitan statistical areas.

Although structural changes to the coal industry continue to create significant hurdles for job seekers in rural and eastern Kentucky communities in particular, recent job gains have been fairly broad based across different sectors and metropolitan statistical areas (MSAs).

In just the past 12 months, annualized payroll employment growth has exceeded 2 percent on 4 different occasions in the Lexington–Fayette MSA, 5 times in the Bowling Green MSA, 8 times in the Clarksville TN–KY MSA, 9 times in the Owensboro MSA, and 12 times

in the Elizabethtown and Louisville MSAs.

To put these figures in perspective, annualized payroll employment growth in the United States exceeded 2 percent just a single time in the same time period.

Job growth has also been fairly broad based across sectors in Kentucky and in the nation as a whole. Two notable frontrunners for the commonwealth are the financial services and education and health services sectors, both of which have outpaced the nation's job growth over the past year.

In 6 Kentucky metro areas, annualized payroll employment growth exceeded 2 percent at least 4 times and as many as 12 times during the past year. The same is not true for the nation.

Annualized payroll employment growth

	US	Kentucky	Bowling Green MSA	Cincinnati MSA	Clarksville TN–KY MSA	Elizabethtown MSA	Evansville IN–KY MSA	Huntington–Ashland WV–KY–OH MSA	Lexington MSA	Louisville MSA	Owensboro MSA
October 2015	2.01%	1.52%	1.67%	1.58%	2.51%	4.06%	0.51%	-0.90%	3.12%	2.52%	1.91%
November 2015	1.97%	1.70%	1.10%	1.48%	2.50%	4.03%	0.06%	-1.18%	1.39%	2.92%	1.72%
December 2015	1.95%	1.83%	1.37%	1.27%	1.92%	3.47%	-0.31%	-1.04%	1.13%	2.91%	2.46%
January 2016	1.91%	1.48%	2.43%	1.15%	1.73%	4.27%	-1.49%	-0.94%	1.13%	2.56%	1.72%
February 2016	1.89%	1.50%	1.97%	1.79%	1.83%	3.51%	-0.84%	0.22%	2.05%	2.14%	2.29%
March 2016	1.96%	2.00%	2.96%	1.94%	2.74%	4.79%	-0.38%	1.07%	2.07%	3.09%	2.48%
April 2016	1.88%	1.81%	2.07%	1.22%	2.48%	3.80%	-0.25%	0.56%	2.45%	3.37%	2.28%
May 2016	1.70%	1.18%	1.37%	1.39%	2.47%	3.77%	-1.57%	1.27%	1.70%	2.14%	2.26%
June 2016	1.73%	1.16%	2.21%	1.82%	2.40%	3.55%	-1.45%	0.93%	1.15%	2.58%	3.42%
July 2016	1.71%	1.00%	2.56%	1.89%	3.00%	4.30%	-0.89%	0.51%	0.64%	3.11%	2.47%
August 2016	1.72%	1.04%	1.53%	1.61%	2.38%	3.56%	-1.08%	1.36%	0.67%	2.24%	2.27%
September 2016	1.72%	1.36%	1.91%	1.59%	1.68%	3.36%	-0.82%	0.71%	0.40%	2.24%	2.84%

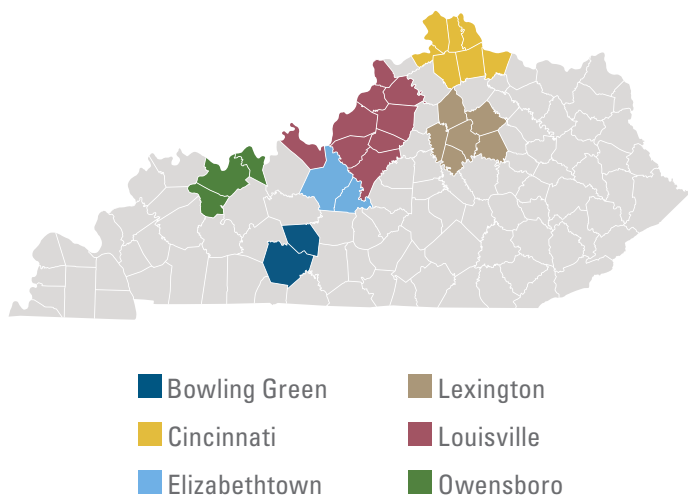
Source: Author's calculations from the Bureau of Labor Statistics / Haver Analytics data as of October 21, 2016.

There are reasons to remain upbeat about the near-term outlook in the service side of both the nation's and Kentucky's economies.

Slowing global economic growth conditions, the strong dollar, and low energy prices have been contributing to weakness in domestic manufacturing and energy sectors in the nation and in the Fourth District. The Huntington–Ashland WV–KY–OH and Evansville IN–KY MSAs, with higher concentrations of manufacturing employment in our District, are the only MSAs in the commonwealth to experience year-over-year job losses at any point during the past 12 months.

The timing of job gains we have witnessed in the nation and in the Fourth District during the past few years has corresponded closely to the bounce back in consumer spending that began in late 2013 or early 2014.

Six Kentucky MSAs have unemployment rates below pre-Great Recession levels.



Since consumer spending, which accounts for roughly 70 percent of the national economy, remains close to its historical average, and household balance sheets remain healthy in the aggregate, there are reasons to remain upbeat about the near-term outlook in the service side of both the nation's and Kentucky's economies.

While strong job growth can be a positive sign for workers because of expanding opportunities (and often expanding wages and salaries, as well), robust job growth may also lead to a tightening of labor market conditions and result in employers' struggling to find qualified workers or witnessing their labor costs increase, situations which could potentially dampen economic activity. Between September 2015 and September 2016, the time period examined here, the unemployment rate, one key metric of labor market tightness, fell from 5.4 percent to 5.0 percent in the commonwealth and from 5.1 percent to 5.0 percent in the nation overall. Moreover, in a majority of MSAs, the unemployment rate fell at least as sharply as the commonwealth's during the past year, and rates are now below pre-Great Recession levels in 6 of the 9 Kentucky MSAs.

Data limitations and reporting lags can make evidence of local tightness difficult to detect in a timely manner. Additionally, because it is generally easier for potential workers to relocate from county to county than from state to state, localized "hot spots" of employment can sometimes cool off rather quickly as workers migrate to better opportunities. Nevertheless, there are genuine reasons to anticipate continued growth in the service sectors of the commonwealth's economy, at least for the near term. ■

SUM AND SUBSTANCE

Payroll employment growth is strong in most Kentucky MSAs, and in 6 of them, the unemployment rate has fallen below pre-Great Recession levels.

*Data current as of October 21, 2016.



A Faster Foreclosure Option for Vacant, Abandoned Properties

Ohio law has been amended to allow for speedier foreclosures of so-called zombie properties, and Forefront asks Cleveland Fed community development experts if the new option will benefit neighborhoods.

An amendment to Ohio law that took effect September 28, 2016, establishes as an option the fast-tracking of foreclosures of vacant and abandoned properties, something the Cleveland Fed identified in a 2013 white paper as 1 of 5 policy considerations for improving Ohio's housing markets.

The success of the new fast-track option depends on how it's implemented, say Federal Reserve Bank of Cleveland community development experts.



Paul Kaboth

“The concept is good, the theory is good,” says Paul Kaboth, vice president of the Bank's Community Development Department. “But if it's implemented poorly, then the results will be poor. There are parts of this change in Ohio law that depend on the local county, and if the local county or the local foreclosure folks ignore this, then foreclosures of vacant properties won't speed up.”

Fast-tracking the foreclosures of vacant properties stands to save financial institutions some of the cost of securing and winterizing properties and repairing or otherwise renovating them in order to sell them.



Mary Helen Petrus

It's possible, too, that financial institutions won't seek the fast-track option for low-value vacant properties because once foreclosed, the properties become the institutions' responsibility, Kaboth notes.

The amendment includes changes that some neighborhood housing advocates oppose, says Mary Helen Petrus, a Cleveland Fed assistant vice president. One such change is that if a foreclosure goes to sale now, it can be sold for as little as \$1. Previously, a minimum bid of two-thirds of the property's appraised value was required. Low prices could create situations in which unscrupulous property owners scoop up properties and don't take care of them.



Kyle Fee

The recent amendment also stipulates creation of a public sheriff's sale website to allow the online sale of properties, explains Kyle Fee, a Cleveland Fed regional community development advisor. As with the other changes, how the online sales are executed is paramount, Kaboth says, stressing the need for them to be fair, fast, and secure.

"On one level, we're looking to see that the law does what its intent is, to speed foreclosures of vacant property," Kaboth adds. "Then, we need to identify unintended consequences from the implementation of the law."

Conceptually, the amendment should benefit housing markets in Ohio, 1 of 4 states served by the Cleveland Fed, Kaboth says. "Speeding foreclosures lowers the vacant, abandoned property cost to communities and financial

institutions," he explains. "Police win. City and county departments that no longer have to do the maintenance win. Immediate neighbors win."

Fast-tracking the foreclosures of vacant properties stands to save financial institutions some of the cost of securing and winterizing properties and repairing or otherwise renovating them in order to sell them, says Mike Adelman, president and chief executive officer of the Ohio Bankers League. There's a cost, too, to holding a mortgage for which no one is paying.

Cleveland Fed researchers reported in 2014 that fast-tracking foreclosures for vacant properties could eliminate tens of millions of dollars of annual deadweight losses in Ohio and Pennsylvania.

Across Cuyahoga County, the number of vacant 1- to 3-family homes has decreased during the past 6 years from a high of nearly 25,000 to 15,000, according to a March 2016 report by the Western Reserve Land Conservancy titled *Is the Cuyahoga County Foreclosure Crisis Over? A Report on Housing Trends in Cuyahoga County*.

Also down is the number of blighted 1- to 3-family homes requiring demolition, but 70 percent of them are concentrated in only 2 locations: the east side of Cleveland and the suburb of East Cleveland.

Those who drew up the fast-track legislation wanted to protect consumers' due process, says Todd Book, director of policy and government affairs at the Ohio State Bar Association, which worked to conceive the amendment at legislators' request. The amendment initially was House Bill 463 but passed as part of House Bill 390.

"A hearing [to determine if property is vacant and abandoned] is required, and if there's any kind of statement from a defendant [homeowner] at all, the ability to pursue the expedited process is gone," Book explains. "You can't do it."

For their part, lawyers representing creditors such as banks see the amendment as giving them another tool during the foreclosure process, Book adds. ■ —Michelle Park Lazette

SUM AND SUBSTANCE

Cleveland Fed community development experts and others see the potential for positive outcomes of a new foreclosure fast-track option for vacant properties, but how the new tool is implemented remains to be seen.

Read more



The Cleveland Fed's Community Stabilization Index offers a measure of local housing market conditions at the zip code level within MSAs served by the Bank: tinyurl.com/gsm6zg.

Coming soon

The Federal Reserve Bank of Cleveland will examine the changing dynamics in some urban areas in a report set to publish in early 2017.

Forefront also plans to explore why Ohio is one of 18 states plus Washington DC receiving Treasury funds for housing issues, how local officials decide what homes are demolished, and what possibly comes next.

State of Small Business

Why, if so much has improved in recent years relating to small business, are there fewer startup firms, comparatively? Forefront explores what's improved, what hasn't, and what's possibly to come for Main Street firms.

Editor's Note: The definition of "small business" varies, and often 500 employees is used as the cutoff. Here, Forefront focuses on the smaller end of the scale.

Though conditions for small businesses are hard to generalize because experiences vary greatly from firm to firm, Federal Reserve Bank of Cleveland experts say some data suggest an improving landscape for those businesses operating along Main Street.

Small businesses, defined here as those with 1 to 49 employees, have added in the aggregate more net jobs in recent years than have firms with 50 to 249 employees, and bank lending in amounts of less than \$1 million—typically lent to smaller enterprises—continues the year-over-year climb that began in 2013.



Mark Schweitzer

Mark Schweitzer, Federal Reserve Bank of Cleveland senior vice president in the External Outreach and Regional Analytics Department, described both developments during a presentation on the regional economic landscape for small businesses during an event at the Bank called Maximizing Supplier Inclusion. Held in August 2016, the event attracted the leaders of minority- and women-owned small businesses.

Following the event, *Forefront* delved into the state of small business with Schweitzer, Cleveland Fed senior policy analyst Ann Marie Wiersch, and Joset Wright-Lacy, president of the National Minority Supplier Development Council, who delivered the supplier inclusion event's keynote address.



Ann Marie Wiersch



Joset Wright-Lacy

Every year from 2010 through 2015, small businesses added more jobs than they lost, according to data from the Bureau of Labor Statistics. In fact, in all but one of those years (2010), small businesses added 600,000 or more net jobs, eclipsing the net gains of mid-sized firms, defined here as those employing 50 to 249 people.

Net job gains, Schweitzer emphasizes, involve a tremendous amount of hiring because to achieve growth, firms need to more than offset reductions in jobs.

"The public often neglects to account for the fact that hiring is very different from net employment gains," he explains. "We have very large hiring and very large reductions going on all the time."

"Small businesses are realizing there are opportunities in certain sectors. Government is hot right now with some infrastructure projects. There's also in-sourcing." (p. 18)

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Credit Experiences of the Smallest of Small Businesses

The Federal Reserve's 2015 Small Business Credit Survey in fall 2015 polled small business owners in 26 states about their firms' performance and borrowing experiences. A subsequent report in December 2016 zeroed in on small businesses staffed by only their owner(s)—firms that account for 80% of US businesses and have unique characteristics and challenges. Here are findings gleaned from the responses of **1,576** nonemployer firms.

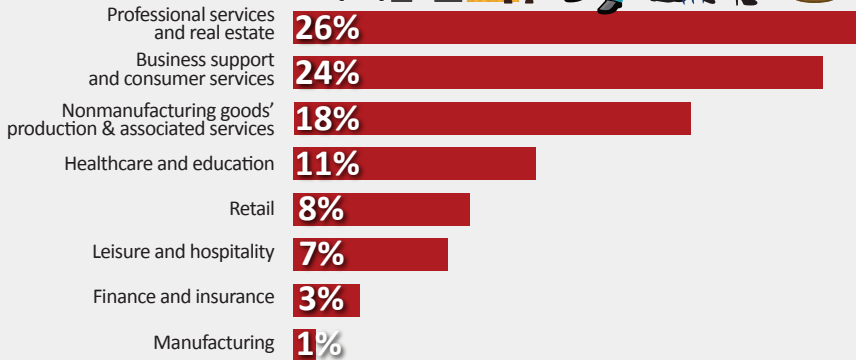


non·em·ploy·er firm

(noun)

A firm that has no paid employees other than the owner(s).

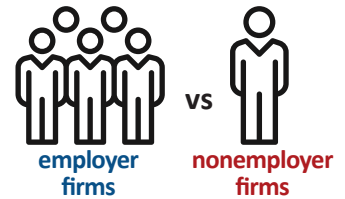
- 75% report annual revenues of **LESS THAN \$100,000**
- 64% are the owners' **PRIMARY SOURCE** of income
- 62% operate from a **HOME**
- Most are **SERVICE** businesses



Top 5 reasons for starting a business

- Flexibility and/or to be own boss (52%)
- New good or service to bring to market (42%)
- Extra income (28%)
- Start or continue family business (22%)
- No other employment options (14%)

Compared to employer firms, nonemployer firms



Reported profitable operations at the end of 2014
55% vs **35%**

Reported revenue growth
54% vs **41%**

Sought financing in the prior 12 months
47% vs **32%**

Were rejected more often by lenders*
82% vs **59%**

Borrowing activity

A majority of nonemployers (68%) **DID NOT APPLY** for financing during the survey period.

- WHY?**
- Reluctant to take on debt (33%)
 - Sufficient funding in hand for business (30%)
 - Believed they'd be turned down (25%)

Of the nonemployers that **DID APPLY** for financing



29% were approved for **ALL** they sought



41% were approved for **NONE** of what they sought

Nonemployer credit applicants were most satisfied with small banks. They reported the highest dissatisfaction with large banks (top reason: difficult application processes) and with online lenders (top reason: high interest rates).

*Includes only those who applied for financing.



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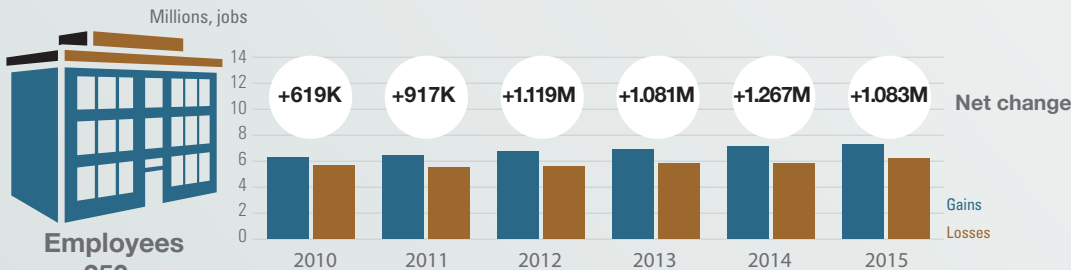
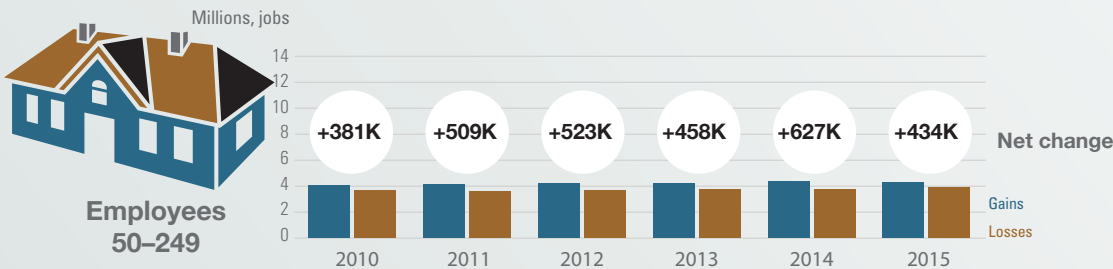
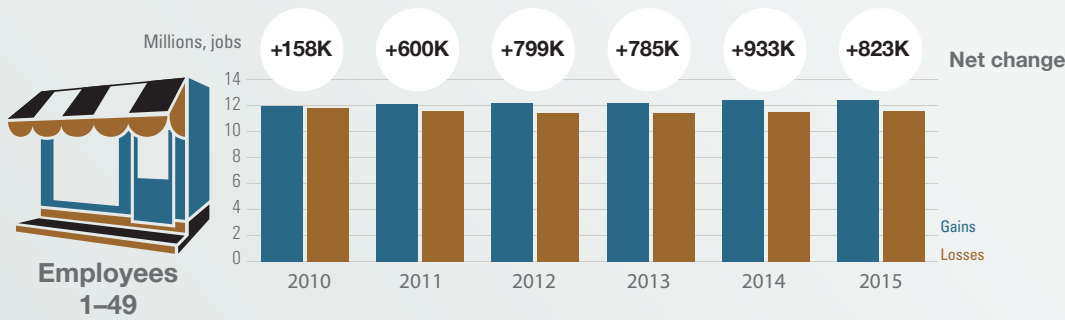
Small businesses are a significant source of employment for the US economy.

3 Takeaways

1 Net employment gains count on significant hiring to offset job losses.

2 In all but 1 recent year, the smallest firms, or those with 1 to 49 employees, generated more net job gains than firms with 50 to 249 employees.

3 Nevertheless, net job gains of firms with 250 or more employees led the pack.



Source: Bureau of Labor Statistics.

“Most of the new, net employment was at large firms, or firms with 250 or more employees,” Schweitzer notes of recent years. “Still, there are a lot of jobs being added in smaller businesses. It’s a vibrant and active part of our economy. Twenty percent of our jobs are in businesses with 1 to 49 employees.”

Most of the minority-owned businesses that Wright-Lacy’s organization represents, including Asian-, African American-, Hispanic-, and

Native American-owned enterprises, have an average of 25 employees.

Whether business is booming for them depends on whom you ask: “It’s a mixed bag,” she says.



Storefronts along Detroit Avenue in Lakewood, Ohio. Photo: Michelle Park Lazette.

“Small businesses are realizing there are opportunities in certain sectors. Government is hot right now with some infrastructure projects. There’s also in-sourcing: Instead of taking things over to Southeast Asia, some corporations are bringing manufacturing back to the States. For small businesses that are in this space, that is a good trend.”

Minority-owned businesses, however, can find building relationships with corporate America to be difficult, Wright-Lacy notes.

“A challenge is finding the right person within the corporation that you can build relationships with,” she says. “The business owner wants to have a relationship with the person making buying decisions.”

Recently, there’s been more pressure than usual for some businesses in the Fourth Federal Reserve District, which comprises Ohio, western Pennsylvania, the northern panhandle of West Virginia, and eastern Kentucky, because of the contraction in the energy and manufacturing industries, Schweitzer says, citing the District’s *Beige Book* findings.

As an example, the October 19, 2016, *Beige Book* report for the Fourth Federal Reserve District, which

is the region the Cleveland Fed serves, noted, “Factors tempering output growth for other manufacturing industries include lower business fixed investment, the strong dollar, and weakness in the energy sector. Year-to-date production through August at District auto assembly plants fell about 6 percent when compared to that of the same time period during 2015.”

While auto plants and oil companies tend to be large, many smaller businesses support them.

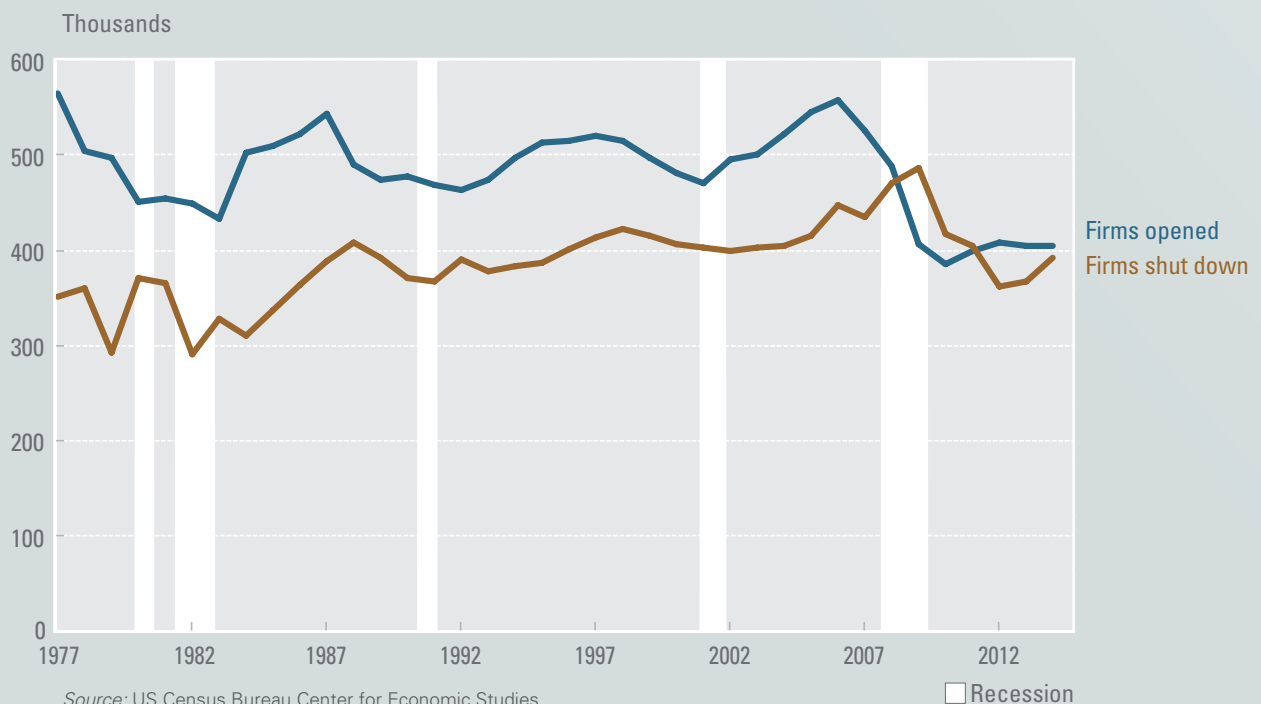
‘A puzzling issue’

Newly opened firms and firms that are shut down account for a lot of employment activity.

Though firm startup rates have recovered from the trough of the Great Recession, there’s been a “rather dramatic decline” in new firms in recent years, something Schweitzer calls “a puzzling issue.”

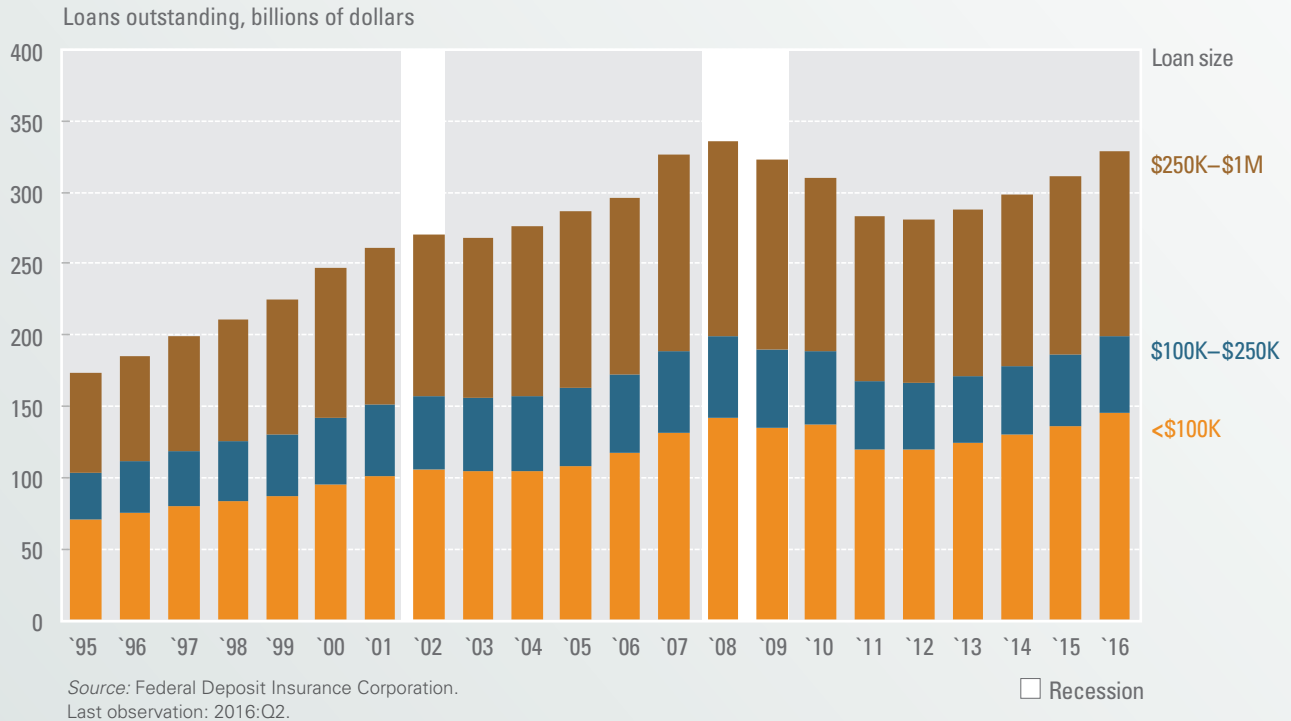
Startups contribute to fluidity for the US economy in which people move in and out of jobs, and that fluidity has been viewed as benefitting productivity and growth, Schweitzer adds. So whether the overall economy is becoming less dynamic because there are fewer startups is very important.

The rate of new firm startup has recovered from the bottom of the recent recession, but there is still a lower level of firms opened in recent years.



Source: US Census Bureau Center for Economic Studies. Last observation: 2014.

Small loans to businesses have grown since 2013 as banks have eased their lending standards and as small businesses' overall financial condition has improved.



There are a number of potential reasons for the lower level of new firms in recent years. Schweitzer and contributing authors Scott Shane and Ian Hathaway concluded in a 2014 Cleveland Fed *Economic Commentary* that new establishments have been increasingly provided, not by new firms, but by the owners of existing businesses establishing new locations.

“If I have 2 locations, that can be more efficient than just 1,” Schweitzer says. “It does look like there’s been a tendency for firms including dental firms, law firms, and accounting firms to open up second locations, [and that] seems to be substituting for some of the new-firm startups.”

Some researchers point to the regulatory environment. Both Cleveland Fed experts and Wright-Lacy cited financing hurdles, too.

The outstanding dollar volume of bank commercial and industrial (C&I) loans to small firms—defined here as loans of up to \$1 million—has increased since 2013 but is still 2 percent below 2008 levels, according to data from the Federal Deposit Insurance Corporation.



Some of the other channels through which entrepreneurs could access funds, including the savings of friends and family and home equity lines, were depleted or constricted during the recession.

Some bankers have indicated via the Federal Reserve's Senior Loan Officer Opinion Survey that they've eased their C&I lending standards, with many citing more aggressive competition as an important reason for doing so. And, "small businesses are more creditworthy in the last several years," says the Cleveland Fed's Wiersch, whose work focuses primarily on small-business issues. "Businesses are getting stronger. There's more demand for credit."

But stronger demand for credit isn't always met, and "there's room to question whether the financial recovery in lending has been enough to support new startups," Schweitzer says. "There are still startups that complain about their funding."

Some of the other channels through which entrepreneurs could access funds, including the savings of friends and family and home equity lines, were depleted or constricted during the recession, Cleveland Fed experts say. And, notes Wiersch, a large number of small businesses became and remain reluctant to take on debt, or their balance sheets haven't returned to what they were before the recession.

The Small Business Credit Survey conducted in 2015 by 7 Federal Reserve Banks, including the Cleveland Fed, found that 6 years after the Great Recession's end, smaller and newer firms report having a much more difficult time obtaining credit than do larger, more mature enterprises.

With so many credit products available from both banks and nonbank online lenders, small firms might also find it challenging to determine the option that is best for them.

"These businesses don't necessarily have the financial expertise that a larger firm would have and might not have the same experience and understanding for borrowing," Wiersch says. "They also lack the protections that a consumer would have. They're kind of caught in the middle."

Improvement expected

In opening his presentation at the Maximizing Supplier Inclusion event, Schweitzer stressed that he cares about small business and shared that his father owned a small software company.

"It's a tough world out there," he told the business leaders in the room. "Running a business is always a challenge of persistence and determination."

Schweitzer expects relatively steady growth for small businesses in the near term. The present regional pressures related to the energy sector should let up over time.

"I think it will generally be an improving picture," he says. "The better growth environment has been supportive of growth in small businesses, as well."

Asked how public officials can positively impact the near term for small businesses, Wright-Lacy urged the closing of the gap between what regulations and laws for small-business contracting require and the enforcement of them. She also encourages offering more incentives to organizations for doing business with small businesses, including minority-owned firms, when possible. ■ —Michelle Park Lazette

SUM AND SUBSTANCE

Small-business lending by banks continues to rise as do net job gains for small businesses, but business startups have been comparatively low for years.

How Low Can Employment Growth Go without Boosting the Unemployment Rate in Fourth District States?



Hal Martin
Policy Economist

The nation continues to add jobs as the economic recovery continues, but employment growth is slowing, and even reversing, in some states, including those in the Fourth Federal Reserve District. How will this impact the District's unemployment rate?

Working-age people are participating in the labor force at a lower rate as time goes on. (p. 22)

Current employment growth in the Fourth District appears to be above the level required to hold steady the District's unemployment rate at today's historically low levels. But the unemployment rate, or the fraction of people in the labor force who do not have a job, will hold steady only if employment grows at the same rate as the labor force, or the number of people who either have a job or want one.

How low can employment growth go before we would expect unemployment rates to rise, and, alternatively, what rate of employment growth would it take to hold the District's unemployment rate steady?

The answers to these questions depend on state-level measures of growth in the working-age population, net in-migration to a state, and labor force participation. This article examines these factors for states in the Fourth Federal Reserve District, which comprises Ohio, western Pennsylvania, the northern panhandle of West Virginia, and eastern Kentucky.

The first variable is a matter of demographics: The faster the working-age population, or the population aged 16 and older, grows, the higher the number of jobs required in order for the unemployment rate to remain steady.

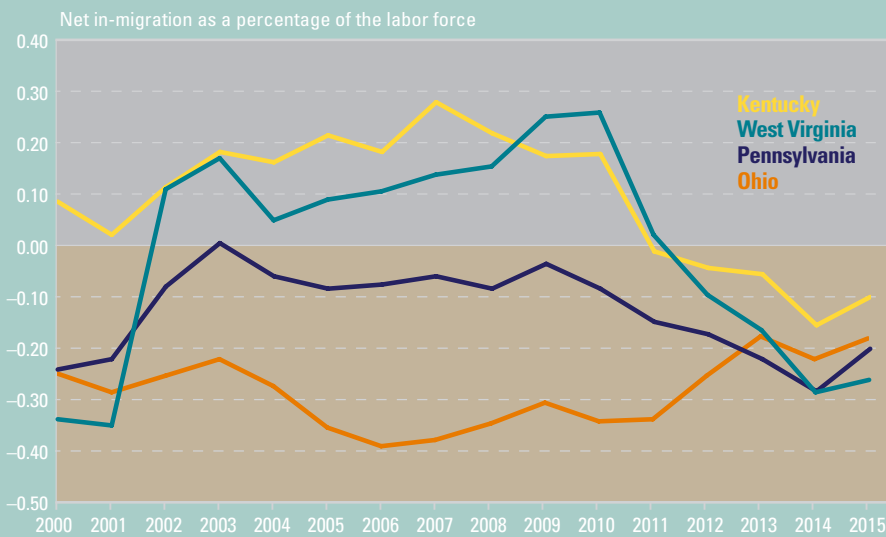
Population dynamics vary across the country.

Data from the US Census Bureau show that the working-age population for the country as a whole increased by 0.98 percent per year from 2011 through 2015. Compare that to Ohio's rate of working-age population change: an increase of just 0.33 percent per year during the same period. Of Fourth District states, West Virginia had the most negative working-age population change during this period: -0.06 percent per year.

The Census estimates incorporate realized migration among states, but it's useful to think about this factor separately in order to look at a variety of migration rates in the following estimates. District states differ widely in how much net in-migration contributes to changes in each state's labor force.

Ohio, for example, experienced a steady outflow—more workers moving out than moving in—from 2000 through 2015, while Kentucky and West Virginia have had intervals of both positive and negative net in-migration. When more people migrate into a state, that state needs to add jobs in order to hold the unemployment rate steady.

Ohio experienced a steady outflow from 2000 through 2015, while Kentucky and West Virginia have had intervals of both positive and negative net in-migration during the period.



Source: Author's calculations from the IRS Statistics of Income Division's US Population Migration data and the Census Bureau's American Community Survey and Population Estimates Program data.

Changes to the labor force participation rate (LFPR), or the fraction of the working-age population in the labor force, also factor into the overall equation. In the simplest terms, when more working-age people enter the labor force, the LFPR rises. If there are not enough new jobs to absorb the new labor force entrants, then the unemployment rate will rise as a result.

There are predictable and unpredictable factors that affect the LFPR. Demographic factors such as an aging workforce and baby boomer retirement are relatively well anticipated. Business cycles, however, are not.

The Cleveland Fed's Bruce Fallick, vice president of research, in a joint paper with other Federal Reserve economists, modeled the demographic and cyclical aspects of labor force participation at the national level. Their estimates suggest that between 2011 and 2015, change in the LFPR as a result of these factors was -0.54 percent on average per year, with projected change in the near future at similar levels. For a variety of reasons, working-age people are participating in the labor force at a lower rate as time goes on, a situation which decreases the number of jobs needed to hold the unemployment rate steady.

Using historical trends as a guide, then, allows one to examine how different assumptions about future trends in each of these factors affect the employment growth needed to hold the unemployment rate steady.

Five employment growth scenarios

While the calculations are relatively straightforward, several assumptions are required. Varying the assumptions about LFPR and migration trends offers different levels of employment growth that correspond to a steady unemployment rate, but there's no single "right" scenario. Let's look at 5 possibilities.

1. Constant LFPR, average net in-migration.

Keeping the LFPR constant and net in-migration at the average level seen from 2011 through 2015, this relatively optimistic scenario implies that employment growth needs to be 0.98 percent per year nationally to hold the unemployment rate steady throughout the nation. But because the working-age population is growing more slowly in Fourth District states than it is in the nation, and more working-age residents have been leaving than entering, the employment change needed per year in the District is lower, ranging from 0.50 percent in Kentucky to -0.06 percent in West Virginia.

2. National LFPR trend, average net in-migration.

If we instead presume that the recent national LFPR trend growth rate of -0.54 percent applies evenly to all states, including those in the Fourth District, while keeping the same assumption about average net in-migration, the employment growth needed to hold the unemployment rate steady in the nation falls to just 0.45 percent per year, acknowledging

the reality that fewer working-age people are entering the labor force because of changes in age composition and other factors. District states can tolerate negative employment growth under this assumption and still maintain steady or falling unemployment rates.

Fourth District states would need different levels of employment growth to hold the unemployment rate steady under various assumptions.

Scenario		Kentucky	Ohio	Pennsylvania	West Virginia	Fourth District	Nation
1	Constant LFPR, average net in-migration <i>Number of jobs (monthly)</i>	0.50% 824	0.33% 1,532	0.30% 1,582	-0.06% -36	0.34% 2,294	0.98% 126,520
2	National LFPR trend, average net in-migration <i>Number of jobs (monthly)</i>	-0.03% -58	-0.21% -970	-0.23% -1,197	-0.59% -377	-0.20% -1,351	0.45% 60,724
3	State-adjusted LFPR trend, average net in-migration <i>Number of jobs (monthly)</i>	-0.12% -202	-0.13% -610	-0.07% -353	-0.71% -451	-0.12% -832	0.45% 60,724
4	State-adjusted LFPR trend, low net in-migration <i>Number of jobs (monthly)</i>	-0.20% -336	-0.29% -1,341	-0.15% -753	-0.90% -574	-0.25% -1,738	0.44% 60,042
5	Constant LFPR, high net in-migration <i>Number of jobs (monthly)</i>	0.85% 1,398	0.38% 1,795	0.51% 2,659	0.36% 226	0.46% 3,109	1.07% 144,831

Source: Author's calculations from the IRS Statistics of Income Division's US Population Migration data, the Census Bureau's American Community Survey and Population Estimates Program data, and data found in Bruce Fallick et al., "Labor Force Participation: Recent Developments and Future Prospects."

Employment growth has been notably above the level required to hold the unemployment rate steady under reasonable assumptions.

- 3. State-adjusted LFPR trend, average net in-migration.** But let's adjust the national LFPR trend growth rate to account for different LFPR trends at the state level, using the Census's American Community Survey (ACS) to obtain the state-level LFPR trend for 2011 through 2015 to construct our data. Ohio's LFPR growth rate is less negative than the national rate in the ACS by 0.08 percentage points. Adding these 0.08 percentage points to the national LFPR trend growth rate of -0.54 percent per year brings Ohio's state-adjusted LFPR trend growth rate estimate up to -0.46 percent. Similar adjustments are applied to other District states. Doing so raises the level of employment growth needed to hold the unemployment rate steady in Ohio and Pennsylvania and lowers it in Kentucky and in West Virginia.
- 4. State-adjusted LFPR trend, low net in-migration.** Let's keep the state-adjusted LFPR trend and examine what happens if states experience low net in-migration, applying the lowest level of net in-migration seen in each state between 2000 and 2015. If Fourth District states entered a period of low net in-migration, they could tolerate even further declines in employment growth without facing increases to the unemployment rate. West Virginia in particular could tolerate negative employment growth of nearly 1 percent per year.
- 5. Constant LFPR, high net in-migration.** The final scenario considers the most optimistic of assumptions: returning to a constant LFPR and taking the highest net in-migration for each state in the 2000 through 2015 period. If this were to occur, states in the District would need positive employment growth ranging from 0.36 percent per year in West Virginia to 0.85 percent per year in Kentucky to hold the unemployment rate steady.

District impacts

Comparing these estimates to the District's November employment growth rate of 0.8 percent per year, we see that employment growth has been notably above the level required to hold the unemployment rate steady under reasonable assumptions. And under reasonable assumptions, District employment growth could slow further without boosting the unemployment rate. District states can accommodate lower employment growth than the rest of the country, primarily because of their lower population growth.

One might ask, then, why did Ohio's unemployment rate just rise from 4.8 percent in August 2016 to 4.9 percent in October 2016 if employment growth is above the hold-steady rate?

There could be several reasons. First, the unemployment rate is measured using a survey of people, but the level of employment is measured using administrative data on jobs. Relating the two data sets is thus an imprecise exercise.

For one, survey samples don't always match the characteristics of the underlying population, so the unemployment rate in a survey sample may be different from the rate one might calculate by surveying the entire population. The statistical uncertainty means that a 0.1 percentage point change in the unemployment rate at the state level likely is not significant.

Also, when a person holds more than one job, each job counts in the employment measure. For example, a person working one part-time job might accept a second part-time job from an employer who decides to add part-time workers. The employer's expansion increases employment. Taking the second job does not decrease unemployment, however, because the person was already employed.

In other words, if 10,000 jobs were added to the economy in a month, and all those jobs were second jobs for existing workers, employment growth would be positive, but the unemployment rate wouldn't change at all.

Finally, these calculations are based on recent trends in population growth, the LFPR, and net in-migration. They aren't projections of future trends. If any of the trends change, such change moves the level of employment growth needed to hold steady the unemployment rate. A sudden rise in working-age population, say, or a change to the LFPR away from the trend used here can have significant impacts. ■

SUM AND SUBSTANCE

Employment growth appears to be above levels required to hold the unemployment rate steady in the District the Cleveland Fed serves. But trends can change, and change affects the level of employment growth needed to hold unemployment steady.

Source file:

For more information on the model referenced in this article, please consult "Labor Force Participation: Recent Developments and Future Prospects," available at tinyurl.com/jhgj2o6.

The ACS data referenced was collected from Steven Ruggles et al.'s Integrated Public Use Microdata Series: Version 6.0, available at usa.ipums.org/usa/.



Challenging the 'Kentucky Uglies'

Part of a continuing Forefront series examining eastern Kentucky.



BONNIE BLANKENSHIP
REGIONAL COMMUNITY
DEVELOPMENT ADVISOR

Organizations such as Kentucky Homeplace have been working in eastern Kentucky to reduce health disparities and build a healthier and more productive population and a stronger regional economy.



Matt Klesta
Policy Analyst

Back in 2014, the *New York Times* released a ranking of the “hardest places to live.” It synthesized several education, health, and economic metrics for nearly every county in the United States. Eastern Kentucky contained 6 of the 10 lowest-ranked counties out of the more than 3,000 measured. Understandably, residents of these counties were hurt. Here was yet another blanket analysis, missing the local nuances and adding yet another story to a region regularly inundated with negative press. Dr. Fran Feltner, director of Kentucky Homeplace, remarked that “We don’t consider it the hardest place to live. We have community ties with the people here. Our aim is to work on the issues that affect our community and make conditions better for our neighbors and friends.”

Lee Todd Jr., a former University of Kentucky president, referred to these types of studies in which Kentucky counties perform so poorly as the “Kentucky uglies.”

But underlying many of these types of rankings is a hard layer of truth, particularly regarding the health of the region’s residents. Since 2010, the Robert Wood Johnson Foundation and the University of Wisconsin Population Health Institute have collaborated on the County Health Rankings & Roadmaps program, which tracks nearly every county in the United States. The program looks at

a host of measures in an effort to present a more nuanced ranking of a county’s level of health. Counties are ranked separately by health outcomes (how long people live and how well they feel) and health factors (behavioral and social). In the 2016 ranking of Kentucky counties by health outcomes, the bottom 20 counties were all in eastern Kentucky; and when ranking health factors, 19 of the bottom 20 were in eastern Kentucky.

Improving the health of a region’s residents can have a far-reaching impact on the region’s economic stability and lead to vibrant, thriving communities.

The region isn’t the only one that scores poorly in health rankings, but it’s in a difficult position, in the midst of a thousands-strong deluge of unemployed coalminers and battered with high levels of generational poverty, unemployment, and drug abuse.

Yet, what may be a surprise to some is that improving the health of a region’s residents can have a far-reaching impact on the region’s economic stability and lead to vibrant, thriving communities.

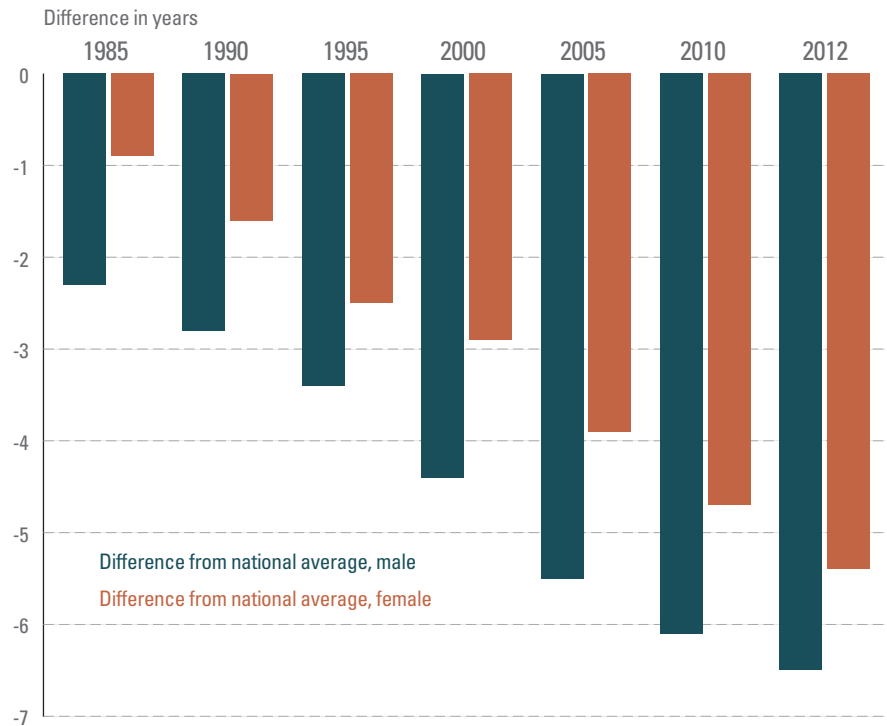
Three things to know about the region's health

Before viewing examples of organizations and programs working to improve health in eastern Kentucky, it may help to look at 3 things.

Life expectancy at birth in eastern Kentucky is lower than the national average, and the gap has been widening over time.

A male born in 1985 in eastern Kentucky could expect to live 68.5 years, or have a lifespan roughly 2 years shorter than the national average. Fast forward 27 years to 2012, and a male born in eastern Kentucky that year could expect to live nearly 6 years fewer than the national average. To put it another way, from 1985 to 2012, the US life expectancy for males increased nearly 6 years; but in eastern Kentucky, the increase was less than one-third of the national gain, at just 1.6 years. This divergence from the national rate is seen, too, in females born in eastern Kentucky, where the life expectancy at birth has actually declined by a year, from 76.9 years in 1985 to 75.9 years in 2012. The widening gap in life expectancies between those of eastern Kentucky and

Life expectancy in eastern Kentucky is diverging from the national average.



Note: Zero line represents the national average.
Source: Institute for Health Metrics and Evaluation (IHME). Life Expectancy: Kentucky Counties.

those of the nation overall is driven by a variety of reasons, among them high rates of lung cancer, heart disease, diabetes, smoking, and obesity.

The number of disabled workers per capita in eastern Kentucky is roughly 3 times greater than the nation's.

In 2015, eastern Kentucky's per capita rate of disabled workers was nearly 3 times the national rate, according to data from the Social Security Administration. That's roughly 800 disabled workers for every 10,000 people in eastern Kentucky, an increase of 25 percent from the 2004 rate.

According to work done by the Center on Budget and Policy Priorities, there are 4 factors that influence a region's disability rate that apply to eastern Kentucky and to Appalachia in general:

1. A less-educated workforce that has more difficulty switching employment sectors when unemployed
2. An older workforce that is more likely than a younger workforce to develop disabling conditions
3. A lower number of immigrants who are less likely to collect disability benefits largely because of program rules
4. A large share of physically demanding jobs that take a bodily toll, such as mining and manufacturing



Eastern Kentucky is older and aging faster than the nation.

The share of eastern Kentucky's population that is more than 40 years old is larger than the nation's—4 percentage points greater—and that share is growing faster than the nation's, 1.5 times faster from 2009 to 2014, the most recent 5-year period for which we have data.

Changing the trajectory of Kentuckians' health

There are many organizations working in the region to address health disparities, and Kentucky Homeplace is one. Founded in 1994, Kentucky Homeplace, which covers 30 counties located in eastern Kentucky, was developed by the University of Kentucky's Center for Excellence in Rural Health to help address health gaps in eastern Kentucky. The need was especially great given the unusually large number of residents with high blood pressure and conditions such as diabetes, cancer, asthma, and heart disease. A variety of factors contribute to these conditions: inadequate health insurance, limited knowledge of how to utilize healthcare, environmental factors, and lifestyle choices, for example.

A majority of Kentucky's 120 counties are designated "medically underserved areas," or MUAs, which are areas that have too few primary care providers, high infant mortality, high poverty, or a large older-adult population. An MUA can include a whole county or a group of contiguous counties.

Residents in an MUA experience a shortage of personal health services and may include groups of persons within an area of residence who face economic, cultural, or linguistic barriers to health care.

Residents of MUAs are less likely to have medical coverage, are poorer and less educated than residents in other parts of the state, have inadequate transportation, and have less information about available services and their personal health conditions.

Kentucky Homeplace is located in the eastern Kentucky coalmining town of Hazard, and for more than 20 years, this community health initiative has linked tens of thousands of Kentucky residents from rural areas to medical, social, and environmental services. These are residents who otherwise may not have received even limited services or would have simply gone without services of any kind.

The services at Homeplace are offered at no charge to its clients. Beneficiaries of the program are the medically underserved, and most are at 100 percent to 133 percent of the federal poverty level, a guideline based on household income and size that is used to help determine eligibility for a number of assistance programs. In 2016, "poverty level" translated to a household income of less than \$24,300 annually for a family of 4.

The widening gap in life expectancies between those of eastern Kentucky and those of the nation overall is driven by a variety of reasons.

A critical piece of the success of Kentucky Homeplace is the role of community health workers (CHW).

CHWs are lay health workers selected from the communities in which they reside. Lay health workers are trained in the context of intervention, but they have no formal degree in medicine. Their mission is to overcome barriers to help improve clients' access to healthcare and to assist in acquiring crucial resources such as eyeglasses, dentures, home heating assistance, food, diabetic supplies, and free medical care.

CHWs provide an important bridge among clients with the highest need, primary care physicians, and other health providers in the community.

Because each CHW is a community member, he or she knows the community, residents, and service providers in the area. CHWs are better able to assist with residents' access to medical, social, and environmental services and to deliver education on prevention and disease self-management. This commonality builds patient trust and facilitates provider sensitivity regarding clients' health disparities and special needs. In this way, CHWs help patients and providers alike in overcoming economic, physical, social, and cultural health inequities.

In many capacities, CHWs provide an important bridge among clients with the highest need, primary care physicians, and other health providers in the community. They assist in facilitating communication between clients and physicians, aid clients to effectively comply with medical care instructions, and help educate clients to improve their health behaviors related to nutrition, physical activity, weight self-management, smoking cessation, and diabetes self-management.

Tying it all together

The economic impact stemming from the increasingly rapid decline of the coalmining industry has taken center stage in eastern Kentucky. What perhaps gets overlooked is the connection between the health of a region's population and how it impacts that region's economy. For some time, eastern Kentucky residents have suffered from lower life expectancies and higher rates of disability and a population whose average age is increasing faster than the nation's overall as young people leave the region.

To some extent, this rapid physical decline can be attributed to the region's dependence on mining and manufacturing jobs, professions that are physically demanding.

Recent county health rankings produced by a variety of news outlets have exposed the region's health disparities to a wider audience. Whether doing so leads to increased investment to improve the health outcomes of the region's residents remains to be seen. In short, however, a healthy population is a more productive population, and a more productive population creates a stronger regional economy. ■

SUM AND SUBSTANCE

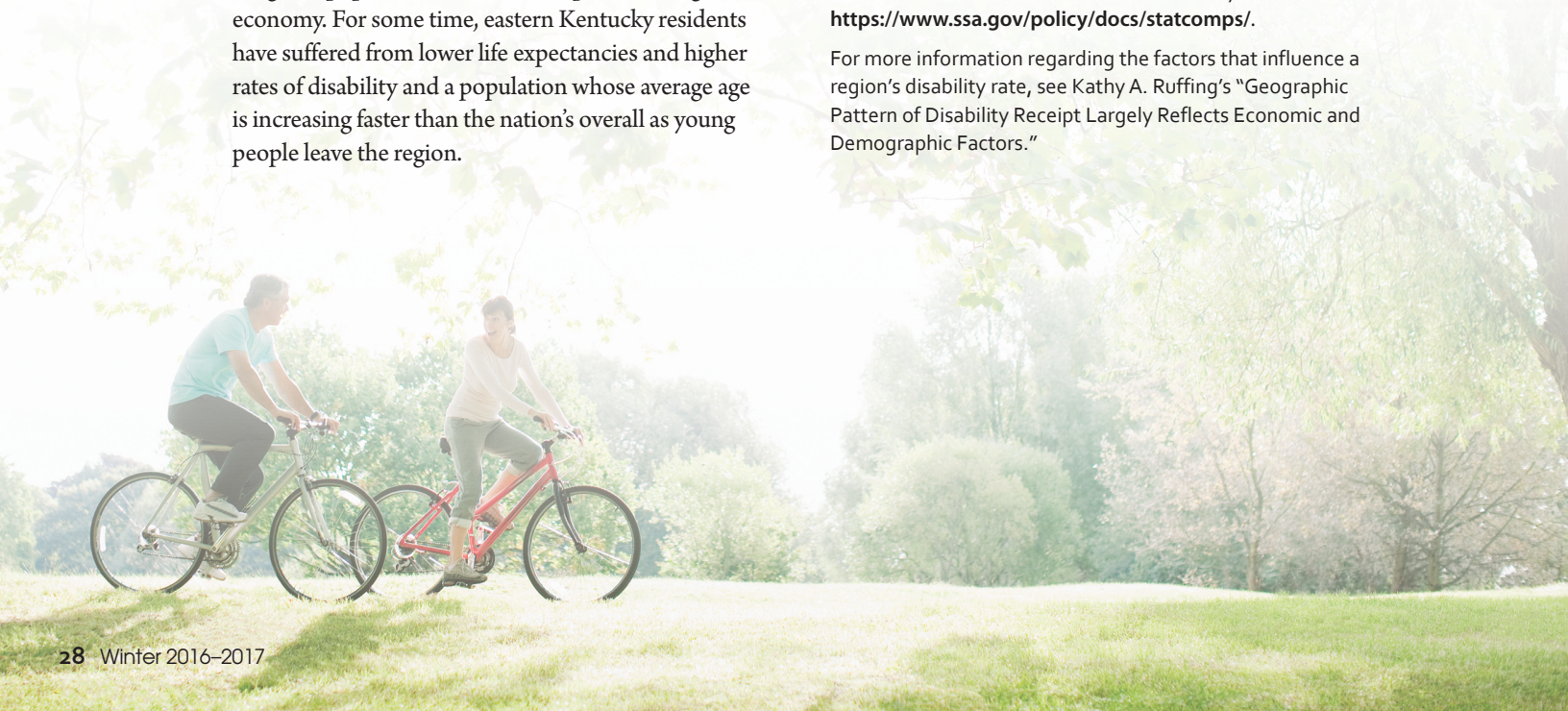
Organizations in eastern Kentucky are working with the population to help overcome negative health outcomes, such as decreasing life expectancy and high levels of disability, that impact eastern Kentuckians' health and wellness.

Source file:

Eastern Kentucky refers to the 31 coal-producing counties in 1988: Bell, Boyd, Breathitt, Carter, Clay, Clinton, Elliot, Floyd, Greenup, Harlan, Jackson, Johnson, Knott, Knox, Laurel, Lawrence, Lee, Leslie, Letcher, McCreary, Magoffin, Martin, Morgan, Owsley, Perry, Pike, Pulaski, Rockcastle, Wayne, Whitley, and Wolfe.

Analysis, reports, and data on per capita rates of disabled workers are available from the Social Security Administration at <https://www.ssa.gov/policy/docs/statcomps/>.

For more information regarding the factors that influence a region's disability rate, see Kathy A. Ruffing's "Geographic Pattern of Disability Receipt Largely Reflects Economic and Demographic Factors."



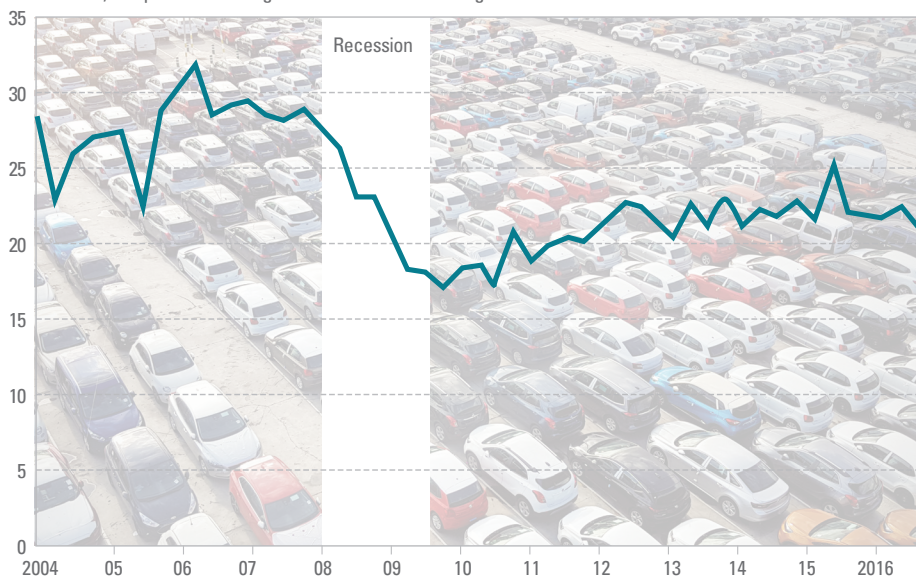
Auto Loans Reach Trillion-Dollar Heights, but Is Deceleration in Sight?



At a time when scrutiny of subprime auto loans is high, Cleveland Fed examiners see signs that banks in the Fourth District may be beginning to rein in their auto lending.

Subprime* auto loan and lease originations as a percentage of total auto originations have exceeded 20 percent since the third quarter of 2011 but remain below prerecession levels.

Percent, subprime auto originations of total auto originations



*Subprime is defined here as credit extended to borrowers with credit scores lower than 620.
Source: Federal Reserve Bank of New York Consumer Credit Panel/Equifax/Haver Analytics.

Auto lending by banking institutions, automobile financing companies, and auto dealers has climbed since 2011—and with it, so has subprime auto lending—but Cleveland Fed bank examiners say that bank holding companies, or BHCs, in this region have not grown their subprime auto lending portfolios as much as others, particularly nonbanks.

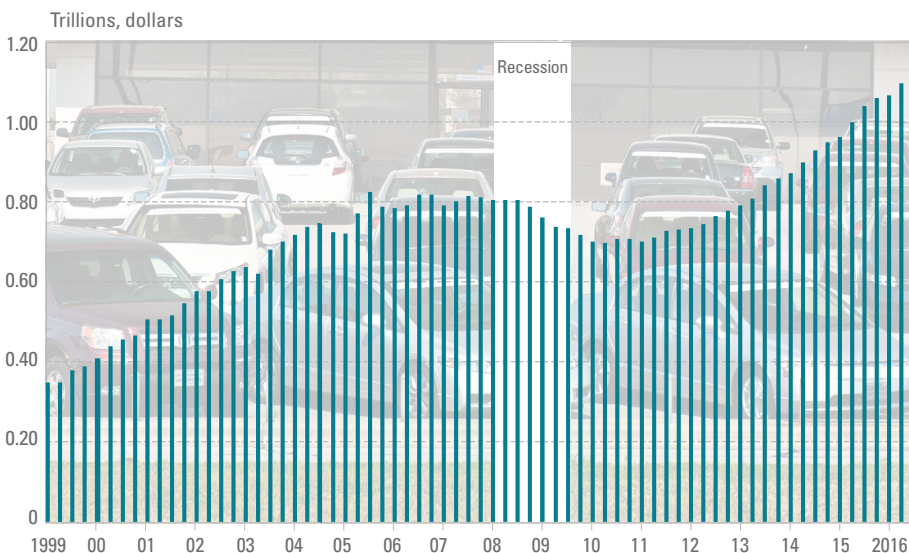
It's been the case for years that at least 1 in 5 auto loans originated is subprime, defined here as loans to borrowers with credit scores lower than 620. Specifically, the percentage of total auto originations that is subprime has exceeded 20 percent since the third quarter of 2011, according to data from the Federal Reserve Bank of New York Consumer Credit Panel, Equifax, and Haver Analytics.

Still, it's not 30 percent, the percentage at which subprime originations hovered during the quarters preceding the Great Recession. And subprime originations are focused with specific lenders. Federal Reserve Bank of Cleveland examiner Michael R. Metalonis notes that “there are a few banks and bank holding companies that participate heavily in the subprime space—none of which is based in the Fourth District. A lot of the subprime originations are occurring outside of banks and actually are occurring in auto finance companies.



Michael R. Metalonis

Outstanding auto loans and leases extended by banking institutions, automobile dealers, and automobile financing companies have risen every quarter since the second quarter of 2011.



Source: Federal Reserve Bank of New York Consumer Credit Panel/Equifax/Haver Analytics.

“Most banks don’t originate a lot of subprime auto loans because of the intense competition, and they cannot achieve the appropriate risk-adjusted return,” Metalonis adds. “Furthermore, for most banks, originating a lot of subprime auto loans is outside their risk appetite.”

Generally, pertaining to auto lending, Metalonis says, “We are seeing increasing risk because of layering in risk: a combination of lower FICO scores, longer terms, higher advance rates. The combination of these tends to lead to higher default rates and higher losses over time.”



Jenni M. Frazer

When it comes to the more than 170 bank holding companies in the Fourth Federal Reserve District, which comprises Ohio, western Pennsylvania, the northern panhandle of West Virginia, and eastern Kentucky, subprime originations have been relatively stable during the past couple of years, says Jenni M. Frazer, a Federal Reserve Bank of Cleveland vice president overseeing the supervision of large banking organizations, or those with more than \$50 billion in assets.

“In terms of performance, we’re seeing stable underwriting criteria,” Frazer adds. “We’re not seeing anything now in our District that is overly concerning to us about the quality of originations or large growth in subprime-type loans.”

The vast majority of subprime loans are originated by auto finance companies, according to the Federal Reserve Bank of New York’s *Liberty Street Economics* blog. In a November 30, 2016, post, the authors note, “A worsening performance among auto loans issued by auto finance companies is masked by improvements in the delinquency rates of auto loans issued by banks and credit unions. The +90-day delinquency rate for auto finance company loans worsened by a full percentage point over the past four quarters, while delinquency rates for bank and credit union auto loans have improved slightly.”

“In terms of performance, we’re seeing stable underwriting criteria. We’re not seeing anything now in our District that is overly concerning to us about the quality of originations or large growth in subprime-type loans.”

The post’s authors conclude that the data they analyzed suggest “some notable deterioration” in subprime auto loans’ performance. Roughly 6 million individuals are at least 90 days late on their auto loan payments, they write, and even though the balances of subprime loans are somewhat smaller on average, the increased distress is likely to have ongoing consequences for affected households.

A trillion dollars—and counting?

Driven by demand for new and used vehicles, total auto loans and leases have climbed for years and for the past 6 quarters have topped \$1 trillion—heights not reached in all the years dating from 1999, the earliest year for which data from the Federal Reserve Bank of New York Consumer Credit Panel, Equifax, and Haver Analytics are available.

In addition to the way in which auto manufacturers’ growth has fueled auto lending’s rise, Metalonis notes that such loans generally are desirable for bankers to book. Their terms are shorter compared to other loans, and they can be sold into active secondary markets through securitizations. Securitizations can provide additional liquidity for banks to continue making new loans.

Low interest rates and attractive incentives by manufacturers continue to fuel the growth, too, notes Janice Sung, a senior examiner with the Cleveland Fed.

Year-over-year growth in auto loans for US BHCs was 7 percent in the third quarter of 2016, the lowest it’s been since the fourth quarter of 2013, according to data pulled from Consolidated Financial Statements for Holding Companies.

Meanwhile, year-over-year growth in auto loans for BHCs in the Cleveland Fed’s region in the third quarter of the same year was 4 percent, roughly what it was in the preceding quarter. Before then, growth hadn’t been 4 percent or higher since the first quarter of 2015.

Federal Reserve Bank of Cleveland examiners see signs that the multiyear acceleration in auto lending will abate in coming years.

“Overall, we’ve been hearing through analysts’ calls that there does seem to be some growing sentiment from investors of concerns of potential slowing in auto loan growth,” Sung explains. “And there’s evidence of banks’ already reducing some of their exposure and changing some of their limits.”

Generally, the expectation is that volume will decline as interest rates rise, she adds.

Federal Reserve Bank of Cleveland examiners see signs that the multiyear acceleration in auto lending will abate in coming years.

Problem loans and concerns

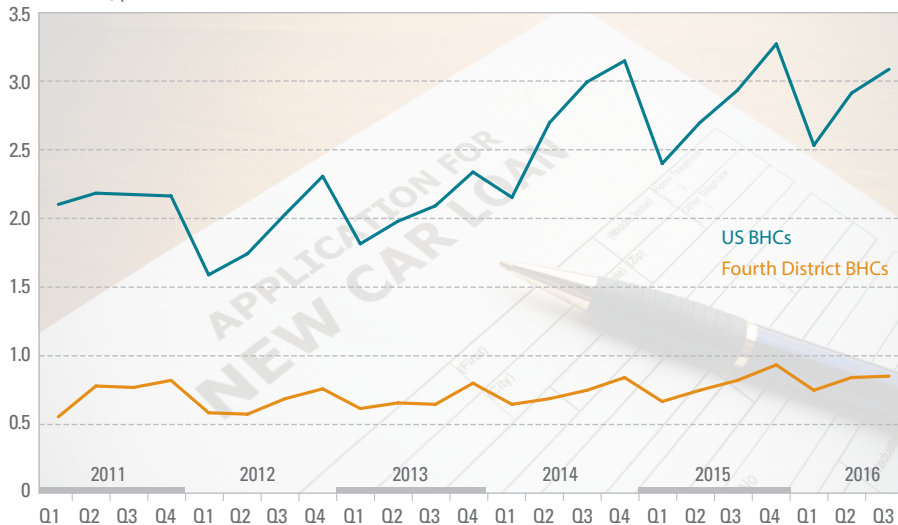
Bank holding companies in the Fourth Federal Reserve District have fared better in at least one metric of auto loan performance—the percentage of delinquent and nonperforming auto loans to total auto loans—when compared to all BHCs in the United States, according to data from Consolidated Financial Statements for Holding Companies.

Whether there is cause for concern from a regulatory standpoint if auto lending by banks continues to rise is a “case-by-case scenario,” Metalonis says.

“It depends on what institution you’re looking at and what its risk appetite is and what its underwriting practices are, how it achieves that growth,” he explains. “There are some banks that

The percentage of problem auto loans* at bank holding companies (BHCs) in the Fourth Federal Reserve District** has been relatively stable and less than 1 percent in recent years.

Percent, problem auto loans of total auto loans



*Problem loans include 30 to 89 days past due, 90+ days past due, and nonaccrual loans.

**The Fourth Federal Reserve District includes Ohio, western Pennsylvania, the northern panhandle of West Virginia, and eastern Kentucky.

Source: Consolidated Financial Statements for Holding Companies (FRY9C). Auto loan data begin as of March 2011.

only originate auto loans in the prime and super-prime space. There are other banks that operate in the subprime market.”

Discussions regarding risk management, underwriting practices, and the like are not specific to auto loans, Sung says. Bank examiners have ongoing discussions with bankers regarding many different asset classes.

What is unique to consumer products such as auto loans is regulators’ emphasis on the need for bankers’ compliance with laws and regulations related to consumer protection, Frazer says. Several banks face public enforcement actions brought by the Consumer Financial Protection Bureau related to their indirect auto lending.

Indirect lending comprises auto loans originated by dealerships and funded by banking institutions.

“Indirect lending is a concern for the banking industry and the regulatory agencies because of the complexities of how these loans are originated, typically through third parties,” Frazer says. “If you’re going to be in this business, you need to make sure you have the risk management infrastructure to comply with laws and regulations relating to consumer protection.”

Of paramount importance is bankers’ ensuring they’re making loans fairly and transparently through disclosures and that no group is receiving preferential or disparate treatment, she says. ■

—Michelle Park Lazette

SUM AND SUBSTANCE

At a time when riskier auto lending is making headline news, bank holding companies in the Fourth Federal Reserve District have maintained a stable volume of subprime auto loan originations.

Federal Reserve Bank of Cleveland senior examiner, credit analytics, Juan Carlos Calzada contributed to this article.

*This article reports data from the FRBNY Consumer Credit Panel/Equifax/Haver Analytics.

Read more



How much of one’s posttax income is used to pay for things such as auto loans and mortgages is called the “debt service ratio,” or DSR. *Forefront* recently reported that data show that states within the Fourth Federal Reserve District have lower total DSRs than the nation as a whole. Read why: tinyurl.com/je22g2g.

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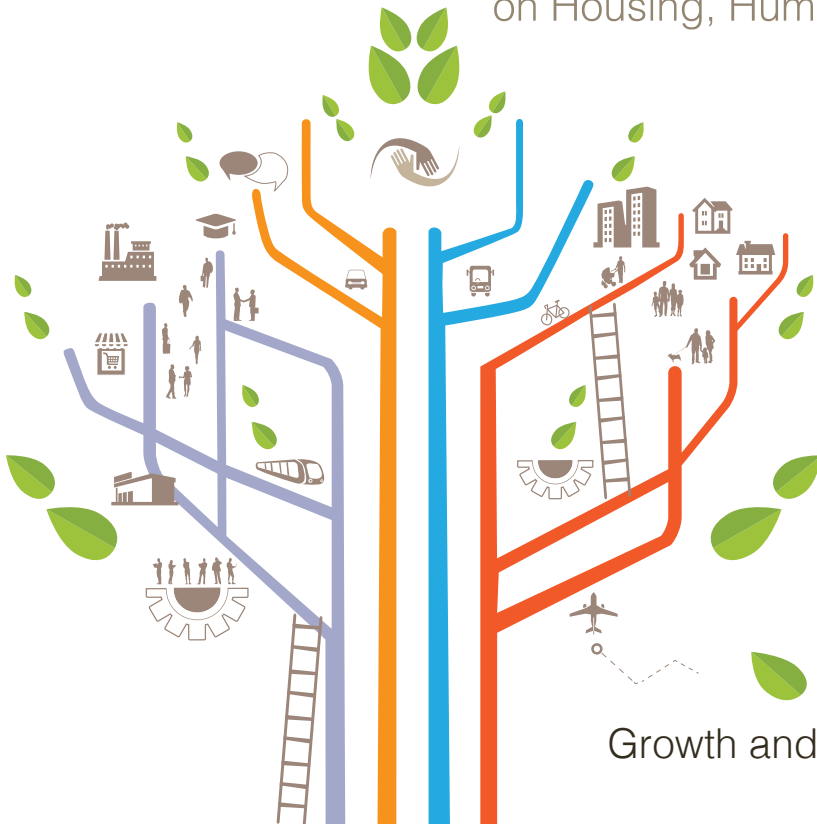


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KEYNOTE SPEAKERS



Loretta J. Mester

President and Chief Executive Officer
Federal Reserve Bank of Cleveland



J.D. Vance

Author of the #1 *New York Times* bestseller *Hillbilly Elegy: A Memoir of a Family and Culture in Crisis*

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