Patterns of Disparity:
Small Business Lending in the Chicago and Los Angeles-San Diego Regions

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EXECUTIVE SUMMARY

Small, local businesses create economic opportunity within neighborhoods, increase local employment opportunities, and can lead to higher levels of income growth within neighborhoods. For small neighborhood businesses to grow, they need access to capital. Bank loans to businesses are an important element for success because businesses that have access to adequate levels of capital grow more rapidly, hire more workers, and make more investments than businesses that do not have access. Since the Great Recession, mainstream financial institutions have reduced their small businesses lending, leading some businesses to resort to alternative, non-bank financial technology (fintech) lenders for needed capital. While small businesses could potentially benefit from having an additional source of capital from fintech lenders, an analysis of loan terms and satisfaction surveys of business owners suggest that high interest rates, onerous terms, and relatively poor customer service are unfortunately common among such providers.

This report examines bank lending to businesses in the Chicago five county region and in the Los Angeles and San Diego region. The purpose is to determine the extent to which banks are meeting the credit needs of businesses throughout those two regions. The focus of the report is on the smaller value loans under $100,000 that are most likely to support smaller, local businesses that provide employment and wealth-building opportunities for local residents.

FINDINGS

● Small business lending nationally grew rapidly between 2001 and 2007, dropped dramatically between 2007 and 2010, and then increased slowly through 2014 according to data reported under the Community Reinvestment Act (CRA). Overall, the total number of loans in 2014 was down nearly 60 percent from the peak in 2007 and down by 10 percent since 2001, while the dollar amount of loans decreased by nearly 37 percent between 2007 and 2014 and is still six percent lower than in 2001.

● The number of CRA-reported loans under $100,000 nationally in 2014 remained 61 percent lower than in 2007 and nine percent lower than in 2001, while the total dollar amount of those loans decreased nearly 52 percent from its peak in 2007 but rose by five percent, from $67.0 billion to $70.3 billion, between 2001 and 2014.

● The number of CRA-reported loans nationally to small firms (businesses with gross revenues under $1 million) was just under five percent lower in 2014 than in 2001, and 51 percent lower than the peak in 2007, while the total dollar amount of those loans in 2014 was down nearly 47 percent from the amount in 2007 and down over 28 percent since 2001.

● Between 2008 and 2014, the number of CRA-reported loans under $100,000 to businesses in both the Chicago and the Los Angeles and San Diego region dropped by 49 percent, while the total amount of those loans in both regions dropped by 42 percent.

● Nationally, businesses in low-income census tracts comprised an average of 9.3 percent of all businesses for the period 2012-2014, but they received only 4.7 percent of CRA-reported bank loans under $100,000 and only 4.9 percent of the total amount of those loans. If those businesses had received loans in proportion to their share of businesses overall, they would have received over 687,600 more loans totaling over $8.8 billion more than they actually received between 2012 and 2014.

● In the Chicago region, businesses in low-income census tracts constituted an average of 6.6 percent of all businesses in the region between 2012 and 2014, but they received only 3.5 percent of CRA-reported bank loans under $100,000 and 3.0 percent of the total amount of those loans during that period. If those businesses had received the loans in proportion to their share of all businesses in the Chicago region, they would have received nearly 10,400 more loans totaling nearly $141.6 million more than they received between 2012 and 2014.

● In the Los Angeles and San Diego region, businesses in low-income census tracts constituted an average of 10.7 percent of all businesses in the region between 2012 and 2014, but they received only 5.1 percent of the number of CRA-reported bank loans under $100,000 and 5.5 percent of the amount of those loans during that period. If those businesses had received the loans in proportion to their share of all businesses, they would have received nearly 60,800 more loans totaling over $746.4 million more than they received between 2012 and 2014.

● In the Chicago region, businesses in predominantly minority census tracts constituted an average of 15.1 percent of businesses, but they received only 8.2 percent of the number of CRA-reported loans under $100,000 and only 6.7 percent of the total amount of those loans. If those businesses had received the loans in proportion to their share of businesses overall, they would have received more than 23,000 additional loans totaling over $335 million between 2012 and 2014.

● In the Los Angeles and San Diego region, businesses in predominantly minority census tracts constituted an average of 31.8 percent of businesses, but they received only 21.5 percent of the number of CRA-reported loans under $100,000 and only 20.6 percent of the total amount of those loans. If those businesses had received the loans in proportion to their share of businesses overall, they would have received more than 111,500 additional loans totaling over $1.63 billion between 2012 and 2014.

● In the Chicago region, businesses in predominantly Hispanic census tracts constituted an average of 2.9 percent of all businesses, but they received only 1.8 percent of CRA-reported loans under $100,000 and only 1.6 percent of the total amount of loans. If businesses in predominantly Hispanic census tracts had received the loans in proportion to their share of businesses in the Chicago region, they would have received 3,700 more loans totaling over $54 million between 2012 and 2014.

● In the Los Angeles and San Diego region, businesses in predominantly Hispanic census tracts constituted an average of 10.3 percent of all businesses, but they received only 5.8 percent of CRA-reported loans under $100,000 and only 6.1 percent of the total

amount of those loans. If those businesses had received the loans in proportion to their overall share of businesses, they would have received over 48,500 more loans totaling more than $600 million more than they received between 2012 and 2014.

POLICY RECOMMENDATIONS

● **Make CRA examinations more rigorous.** CRA examiners need to be more stringent in the scoring of performance with respect to all types of lending, including small business loans, as well as mortgages and other personal loans. Examiners also need to consider the type of small business loans banks are offering, rather than aggregating term loans, lines of credit, and credit cards, into a single category. In addition to the lending test, regulators need to be more critical in enforcement of the service test and should exercise their authority to require banks to obtain non-objection letters from their regulator whenever seeking to close branches in low- and moderate income neighborhoods.

● **Promulgate rules under Section 1071 of the Dodd-Frank Act to require small business lenders to report loan data to the Consumer Financial Protection Bureau (CFPB).** In the rules, the CFPB should require small business lenders to report the loan amount requested, the type of loan requested (e.g., term loan, credit card, or merchant cash advance), the action taken on the application, the amount loaned, the Annual Percentage Rate on the loan, whether the loan is payable by ACH debit, and the lender's default rates in addition to any borrower demographics and business attributes necessary for fair lending analysis. If the Office of the Comptroller of the Currency (OCC) grants a special purpose charter to any fintech lender, the OCC should require the lender to report these same data.

● **A federal charter issued by the OCC to a fintech lender should impose CRA-like requirements on the lender, including requirements for investment in low- and moderate-income census tracts, fair lending, consumer protection, and safety and soundness oversight similar to those for banks.** A federal charter will provide significant benefits to the emerging fintech industry, and, in exchange for those benefits, the federal charter for fintech lenders must include strong protections to reduce the chances that lenders can make predatory loans and provide the same level of oversight for fintech lenders as for the banks with which they compete or partner.

● **Support and increase funding for Community Development Financial Institutions (CDFIs) and the New Markets Tax Credit (NMTC) Program.** Both CDFIs and the NMTC program are important sources of business capital in low-income neighborhoods and communities of color and need to be expanded to increase the level of investment they bring to their service areas.

● **Use responsible banking ordinances to reward banks that lend to businesses in low- and moderate-income neighborhoods and communities of color.** Local governments should use responsible banking ordinances that link government bank deposits to community reinvestment performance to encourage

financial institutions to make more small loans to businesses in low- and moderate-income neighborhoods and communities of color.

● **Require strong Community Benefits Agreements (CBAs) with community input and enforceable goals for approval of mergers and acquisitions.** Mergers and acquisitions present good opportunities for the prudential regulators to use their authority under the CRA to require banks to fully meet their obligations to invest in low- and moderate-income census tracts. Recently negotiated CBAs with banks seeking regulatory approval for mergers or acquisitions or improved CRA ratings can serve as performance models for the future.

● **Extend consumer protections to small business loans.** Business borrowers, many of whom assume personal liability for repayment of loans to their businesses, should receive the same types of protections for small business loans as they would receive were the loan for personal use. Lenders should be required to disclose the loan terms clearly, in a way that enables the borrower to understand the cost of the loan and repayment terms, to determine the borrower's ability to repay the loan without additional borrowing, and be prohibited from engaging in abusive collection practices.

INTRODUCTION

Small, local businesses create economic opportunity within neighborhoods. Local businesses can increase local employment opportunities, and that can, in turn, lead to higher levels of income growth within the neighborhood. In addition to employment and income, local businesses generate sales tax revenue, provide access to goods and services for local residents, and can attract new residents to neighborhoods.[1] Local businesses also generate more local economic impact than national chains. "For example, a study by the Maine Center for Economic Policy found that every $100 spent at locally owned businesses generates $58 in local impact, while the same amount spent at a national chain store generates only $33 in local impact."[2] A study of the Opportunity Fund's small business microloan program found that it generated nearly $2 of economic activity for every $1 loaned, including about $0.56 in additional wages for the workers at the businesses that received a loan.[3]

Local businesses can also provide residents with a means of wealth building: entrepreneurship. "[S]mall business ownership provides an opportunity for minorities, women, and immigrants to increase their income and independence and to move into the economic mainstream of the American economy."[4] While people of color and women are still under-represented as a percentage of business owners, they did become a larger share of all business owners between 2007 and 2012.[5]

For small neighborhood businesses to grow, they need to be able to access capital. Some business owners have personal assets, such as home equity or investments, or personal lines of credit that they can tap to meet the needs of their businesses. Others may be able to borrow from family or friends. Those personal sources of capital, however, may not be as available to people in low- and moderate-income neighborhoods or communities of color because they are less likely to have significant equity in their homes or other assets that can be used to support a business.[6] The downturn in the housing market due to the Great Recession and lack of recovery in some lower-income neighborhoods and communities of color have exacerbated the situation

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[1] Bahn, Kate, Regina Willensky, and Annie McGrew, 2016. *A Progressive Agenda for Inclusive and Diverse Entrepreneurship*. Center for American Progress. Downloaded October 15, 2016, from https://www.americanprogress.org/issues/economy/report/2016/10/13/146019/a-progressive-agenda-for-inclusive-and-diverse-entrepreneurship/.

[2] Ibid., at p. 5, citing Amar Patel and Garrett Martin, "Going Local: Quantifying the Economic Impacts of Buying from Locally Owned Businesses in Portland, Maine" (Augusta, ME: Maine Center for Economic Policy.)

[3] TXP, Inc., 2016. Ripple Effect: The Macroeconomic Impact of Small Business Lending, A case study of Opportunity Fund's Small Business Microloan Program from 1995 to 2015. Downloaded October 17, 2016, from http://www.opportunityfund.org/assets/docs/Ripple%20Effect_The%20Macroeconomic%20Impcact%20of%20Small%20Business%20Lending_Opportunity%20Fund_2016.pdf.

[4] Dilger, Robert Jay, 2013. *Small Business Administration and Job Creation*. Congressional Research Service 7-5700, www.crs.gov.

[5] Bahn et al., 2016, p. 10.

[6] Fairlie, Robert W., and Alicia M. Robb, 2010. *Disparities in Capital Access between Minority and Non-Minority-Owned Businesses: The Troubling Reality of Capital Limitations Faced by MBEs*. Washington, DC: U.S. Department of Commerce, Minority Business Development Agency, 2010. Downloaded December 13, 2016, from http://www.mbda.gov/sites/default/files/DisparitiesinCapitalAccessReport.pdf. See also Robb, Alicia, 2013. *Access to Capital among Young Firms, Minority-owned Firms, Women-owned Firms, and High-tech Firms*. Washington, DC: Small Business Administration, 2013. Downloaded December 13, 2016, from https://www.sba.gov/sites/default/files/files/rs403tot(2).pdf.

by leaving many homeowners underwater, with negative equity in their homes,[7] depriving them of the equity they may have accumulated before the crash that could have been used to support a business.

Apart from personal wealth, common sources of capital for small businesses are loans, lines of credit, and business credit cards issued by banks and other financial institutions.[8] Bank loans to businesses are an important element for success because businesses that have access to adequate levels of capital grow more rapidly, hire more workers, and make more investments than businesses that do not have access.[9] Conversely, a decline in the availability of bank loans for businesses, especially smaller businesses, has been a serious impediment to the recovery of lower-income neighborhoods and communities of color, which were most adversely affected by the Great Recession.[10] Although some economists question the impact of bank loans on the net long-term growth of jobs throughout the national economy,[11] bank loans can have important local benefits, which is why they are frequently seen as a tool to promote the local job growth necessary for neighborhood recovery and prosperity.

Since the Great Recession, mainstream financial institutions have been reluctant to make small loans to businesses,[12] and so businesses have increasingly been resorting to alternative, non-bank financial technology (fintech) lenders for needed capital. The business models for fintech lenders vary, from direct providers of capital to intermediaries (or "marketplace lenders") that connect borrowers with lenders, and include both online lenders and merchant cash advance[13] companies. A California Department of Business Oversight survey of 13 online lenders found that their total business lending nationally increased from 12,868 loans totaling $403 million in 2010 to 240,277 loans totaling $2.94 billion in 2014, an increase of over 1,700 percent in the number and about 630 percent in the total amount of loans.[14] The amount of loans the 13 alternative lenders made nationally in 2014 was 29 percent more than the Small Business Administration made in loans of under $150,000 in FY 2015 through its 7(A)

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[7] Cowan, Spencer and Katie Buitrago. *Struggling to Stay Afloat: Negative Equity in Communities of Color in the Chicago Six County Region.* Woodstock Institute, March 2012.
[8] Business loans, lines of credit, and business credit cards are collectively reported to the Federal Financial Institutions Exanimation Council (FFIEC), which oversees financial institution reporting to regulatory agencies, as "loans." For consistency, this report will, therefore, use the term "loan" to refer to extensions of credit to businesses that would be reported as a loan to the FFIEC.
[9] Cole, Rebel A., 2012. *How Did the Financial Crisis Affect Small Business Lending in the United States*. A report prepared for the Small Business Administration, Office of Advocacy. Downloaded April 11, 2014, from www.sba.gov/advocacy.
[10] Mills, Karen G., and Brayden McCarthy, 2014. "The State of Small Business Lending: Credit Access During the Recovery and How Technology May Change the Game." Harvard Business School Working Paper, No. 15-004, July 2014. See also Cowan and Buitrago, 2012, and Fairlie and Robb, 2010.
[11] Dilger, 2013.
[12] Mills and McCarthy, 2014.
[13] A merchant cash advance differs from a traditional business loan in the way it is repaid. With a merchant cash advance, the business borrower assigns a percentage of its receipts to the lender instead of making periodic payments of a fixed amount. For example, a business might agree to pay 15 percent of its credit card receipts, up to a total of $56,000, for a cash advance of $38,830, with the payments made every business day until the lender receives the full $56,000.
[14] *Survey of Online Consumer and Small Business Financing Companies – 01/01/2010 through 06/30/2015: Summary Report of Aggregate Transaction Data*, available at *www.dbo.ca.gov/Press/press_releases/default.asp*, under the headline California Online Lending Grows by More Than 930% Over Five Years, dated 04/08/2016,

program.[15] Another report stated that marketplace lenders in the United States originated 60 percent more in loans in 2015 than they did in 2014.[16]

While small businesses could potentially benefit from having an additional source of capital from fintech lenders, analysis of loan terms and satisfaction surveys of business owners suggest that high interest rates, onerous terms, and relatively poor customer service are unfortunately common among such providers. Woodstock Institute's analysis of 15 loans found interest rates ranging from 26 to nearly 368 percent. Every loan with a repayment term of under 250 days, or eight months, had an effective interest rate of over 100 percent, and every loan with a repayment period of less than 150 days, or five months, had an effective rate of over 200 percent.[17] The Opportunity Fund conducted a study in which it analyzed 150 fintech loans made to 104 businesses in California. The businesses came to the Opportunity Fund to refinance their loans. The average interest rate on the loans it analyzed was 94 percent, with a high of 358 percent.[18] Moreover, the Opportunity Fund analysis showed that the average monthly payment on the loans was 178 percent of the net income of the borrower available to pay the loans. As the report states, ". . . every month theses borrowers owed more to the lender than they had available from both business and personal net income."[19]

The loans that Woodstock analyzed came with fees that amounted to as much as 14 percent of the gross loan amount. For example, the origination fee on most of the loans was around $300, with a high of $2,800. Other fees included a fee, commonly around $395, for setting up the Automated Clearing House debit for payment, and a fee of between $100 and $200 for releasing any lien filed under the Uniform Commercial Code.

Two common features of the fintech loans Woodstock Institute analyzed are associated with high levels of dissatisfaction among businesses that received loans. [20] All but one of the loans analyzed required automatic ACH payments daily (every business day). That requirement means that the business owner has no ability to prioritize payment of the fintech loan among the range of financial obligations that small businesses have, such as payments for payroll, taxes, suppliers, and the rent or mortgage. The fintech loan automatically is paid ahead of any other obligation, directly out of cash flow or retained

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[15] The data are from www.sba.gov/content/sba-lending-statistics-major-programs-09-30-2015, reported on the federal fiscal year. FY 2015 runs from 10/1/2014 to 9/30/2015.

[16] Bulling, Jim, and Michelle Chasser, 2016. Regulators notice small business loans are big business. Downloaded October 17, 2016, from https://www.fintechlawblog.com/2016/07/regulators-notice-small-business-loans-are-big-business/.

[17] The small sample size, 15 loans, and the fact that the loans were not a random sample from a larger population, means that the data provide only descriptive statistics of the specific sample and are not generalizable to the larger field of fintech loans as a whole.

[18] Weaver, Eric, Gwendy Donaker Brown, Caitlin McShane, and Tim St. Louis, 2016. Unaffordable and Unsustainable: The New Business Lending on Main Street. Opportunity Fund. Downloaded October 17, 2016, from http://www.opportunityfund.org/assets/docs/Unaffordable%20and%20Unsustainable-The%20New%20Business%20Lending%20on%20Main%20Street_Opportunity%20Fund%20Research%20Report_May%202016.pdf.

[19] Ibid., at p. 7.

[20] *2015 Small Business Credit Survey: Report on Employer Firms*, 2016. Downloaded on October 15, 2016, from https://www.clevelandfed.org/community-development/small-business/about-the-joint-small-business-credit-survey/2015-joint-small-business-credit-survey.aspx.

earnings. In a survey of business by several banks in the Federal Reserve System,[21] businesses that received fintech loans expressed exceptionally high levels of dissatisfaction with the interest rate and repayment terms compared with loans from small or large banks. For example, 70 percent of survey respondents reported dissatisfaction with the high interest rates on fintech loans, compared with 15 percent for loans from small banks and 18 percent for loans from large banks, while 51 percent were dissatisfied with the fintech loan repayment terms, compared with 15 percent for small bank loans and 16 percent for large bank loans. [22]

This report examines bank lending to businesses in the Chicago five county region and in the Los Angeles and San Diego region.[23] The purpose is to determine the extent to which banks are meeting the credit needs of businesses throughout those two regions and whether the disparities in access to credit for businesses in the Chicago region,[24] shown in analysis of lending data for the period between 2008 and 2014, persist in the region and may be consistent with possible disparities in access to credit for businesses in another part of the country. The focus of the report is on the smaller value loans that are most likely to support smaller, local businesses that provide employment and wealth-building opportunities for local residents.

BACKGROUND AND INTRODUCTION

One consequence of the Great Recession was reduced access to credit, especially for businesses needing small loans. Senior Loan Officers and business owners agreed that credit contracted dramatically between 2008 and 2010, with differing opinions for more recent years. Loan officers thought conditions had improved, with credit more readily available, while business owners felt that they had not improved significantly.[25] Data on business lending show that both are true; business lending has increased since 2010 but remains well below the levels of the years leading up to the Great Recession.

The primary source of data on small loans to businesses[26] at the neighborhood level is from reports that large financial institutions insured by the Federal Deposit Insurance Corporation (banks) must submit to the Federal Financial Institutions Examination

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[21] The Federal Reserve Banks in Atlanta, Boston, Cleveland, New York, Philadelphia, Richmond, and St. Louis participated in the survey and report.

[22] *2015 Small Business Credit Survey: Report on Employer Firms*, 2016.

[23] For purposes of this report, the Chicago region is defined as Cook, DuPage, Kendall, McHenry, and Will counties. The Los Angeles and San Diego region includes Los Angeles, Orange, and San Diego counties.

[24] Cowan, Spencer M., 2012. *Discredited: Disparate Access to Credit for Businesses in the Chicago Six County Region*. Woodstock Institute, August 2014. For that earlier report, the Chicago region was defined as Cook, DuPage, Kane, Lake, McHenry, and Will counties.

[25] Mills, Karen Gordon, and Brayden McCarthy, 2016. *The State of Small Business Lending: Innovation and Technology and the Implications for Regulation*. Downloaded November 30, 2016, from http://www.hbs.edu/faculty/Publication%20Files/17-042_30393d52-3c61-41cb-a78a-ebbe3e040e55.pdf. NFIB Research Foundation, 2012. See also *Small Business, Credit Access, and a Lingering Recession*. Downloaded March 25, 2014, from www.NFIB.com.

[26] Small loans to businesses are more commonly referred to as "small business loans." That terminology frequently causes confusion, however, because some people think that "small" modifies "business," and so they think that the term refers to loans made to businesses below a certain size. The adjective "small" modifies "loans," not "business," which means that the loans are in amounts of less than $1 million and may be made to any size business.

Council (FFIEC) under the Community Reinvestment Act (CRA).[27] The banks report on the number and amount of loans they make, broken down by three loan amount ranges (less than $100,000, $100,000 to $249,999, and $250,000 to $1,000,0000) and by the census tract in which the business is located. In addition, the banks report the number and amount of small loans they make to businesses with gross revenue of under $1 million, also at the census tract level. For purposes of reporting, banks generally aggregate any extension of credit, including traditional loans, lines of credit, and credit cards, in the amount reported as loans.[28] They also aggregate all extensions of credit to a single business in the reported loans, and so the number of loans is roughly equal to the number of businesses receiving loans.[29]

Longer-term National Trends

After extraordinary growth in CRA-reported small business lending between 2001 and 2007, the total number and amount of all CRA-reported small loans to businesses dropped dramatically between 2007 and 2010 and then increased slowly through 2014 (Chart 1). The total number of loans increased by 123 percent between 2001 and 2007, decreased by 69 percent between 2007 and 2010 and then rebounded by about 29 percent between 2010 and 2014, leaving the total number of CRA-reported small loans down by nearly 60 percent overall from the peak in 2007 and down by 10 percent since 2001. The total dollar amount of CRA-reported small business loans increased by 48 percent between 2001 and 2007, decreased by 47 percent between 2007 and 2010 and then increased by 19 percent through 2014. Overall, the total dollar amount of CRA-reported small loans decreased by nearly 37 percent between 2007 and 2014 and is still six percent less that the amount in 2001.

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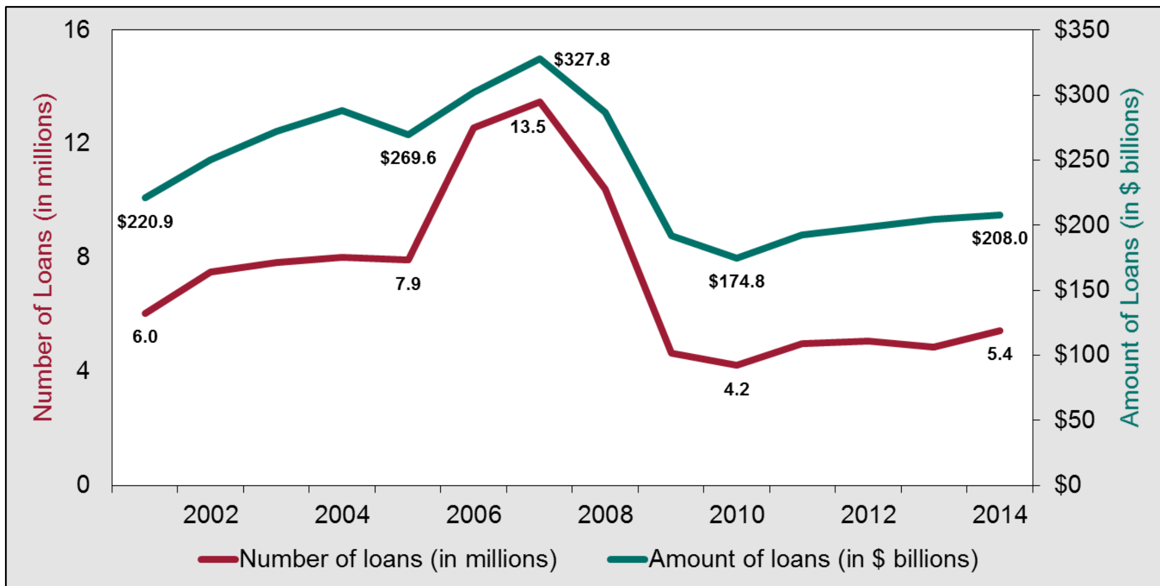
[27] While only large financial institutions are required to report to the FFIEC under the CRA, some smaller lenders report voluntarily. In 2014, a total of 603 commercial banks and 164 savings institutions reported, with 503 required to report and 264 voluntarily reporting. The threshold for reporting in 2014 was $1.202 billion in assets. Together, they provided 88.4 percent of the number and 69.3 percent of the amount of all small loans to businesses. Downloaded October 24, 2016, from *https://www.ffiec.gov/hmcrpr/cra15tables1-5.pdf#table1*. For simplicity, the reporting financial institutions will be referred to as "banks" regardless of their technical, legal status.

[28] The aggregation of different kinds of credit – credit cards, lines of credit, and term loans – obscures an important distinction among those different forms of credit. In general, credit cards can provide flexible access to short-term capital for small purchases and to manage cash flow, while term loans would be more appropriate for major capital expenditures, such as for purchasing new equipment, that may require a longer-term repayment option. Some advocates have expressed concerns that too many of the loans are in the form of credit cards and not enough as term loans which might better suit the borrowers' needs or the purposes for which the loans are intended.

[29] The number of loans and businesses receiving loans may not be exactly the same because some businesses may receive loans from more than one reporting bank, and, under some circumstances, banks may report multiple loans to one business without aggregating them.

Chart 1: Total Number and Amount of CRA-reported Small Loans to Businesses Nationally, 2001-2014

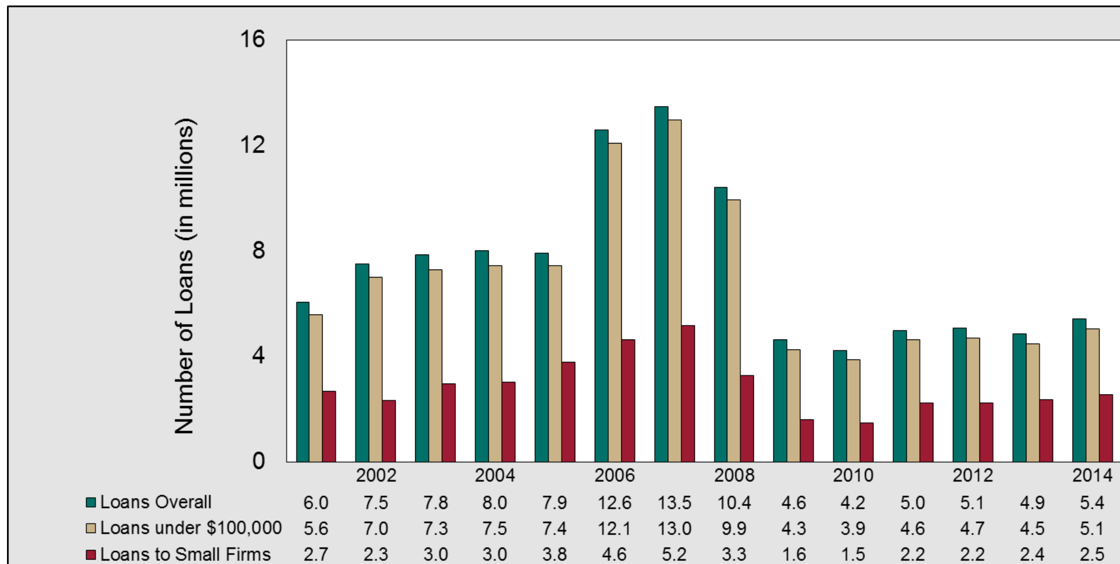


Source: FFIEC CRA Nationwide Summary Statistics, 2001-2014, Table 2.

Loans under $100,000, the amount of capital that the smallest businesses are most likely to seek, constitute the vast majority of the total number of loans reported under the CRA, consistently over 92 percent of all loans nationally (Chart 2). "The reality is that for most banks, lending to small businesses, especially below $100,000, is costly and risky. But it is these lower dollar loans that actually are most important to startups and small businesses that are critical to accelerating the current recovery."[30] The data for CRA-reported loans in amounts under $100,000 nationally follow a pattern similar to that for CRA-reported small business loans overall, with an increase of 132 percent between 2001 and 2007, a rapid decrease of 70 percent between 2007 and 2010, followed by a modest, slow recovery of 30 percent through 2014. The number of loans under $100,000 that CRA-reporting banks originated in 2014 remained 61percent lower than in 2007 and nine percent lower than the number of loans under $100,000 originated by CRA-reporting banks in 2001. Because those banks aggregate extensions of credit to individual businesses, the decline in the number of reported loans indicates that fewer businesses received credit, especially in the form of small loans most critical for the smallest businesses, from the banks reporting under the CRA.

[30] Mills and McCarthy, 2014, p. 23.

Chart 2: Total Number of CRA-reported Loans, Loans under $100,000, and Loans to Small Firms Nationally, 2001-2014

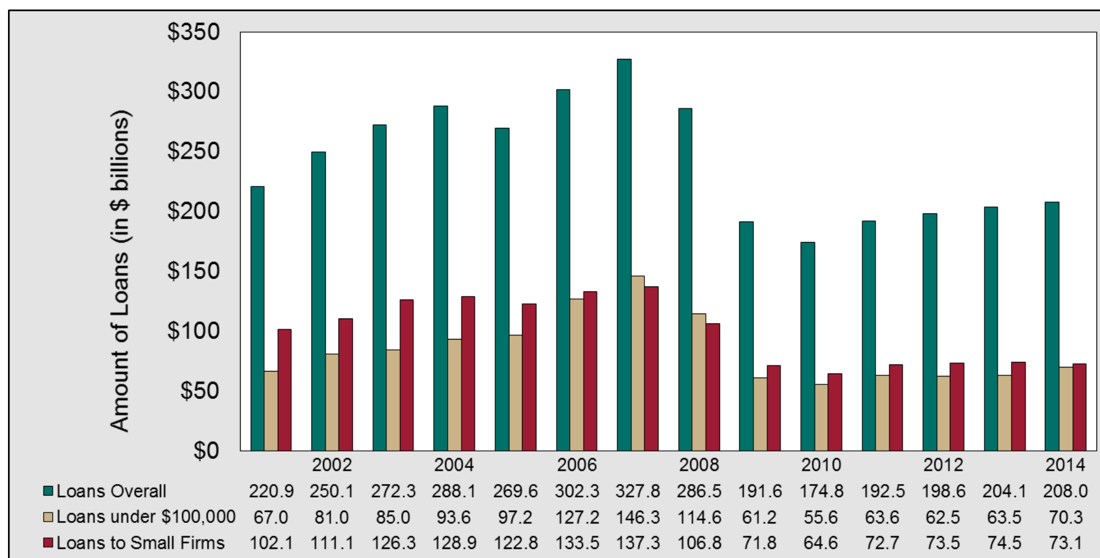


Source: FFIEC CRA Nationwide Summary Statistics, 2001-2014, Table 2.

The number of CRA-reported loans to small firms, those with gross revenues under $1 million, followed a similar pattern of increasing rapidly between 2001 and 2007, up by 94 percent, followed by a collapse through 2010, and then a modest recovery into 2014, although the recovery in the number of loans was a little stronger than for either loans overall or loans under $100,000. Between 2007 and 2010, the number of CRA-reported loans to small firms fell by over 71 percent, followed by an increase of 70 percent in the number of loans through 2014. The number of loans to small firms was just under five percent lower in 2014 than in 2001, and 51 percent lower than the peak in 2007.

The pattern for the total dollar amount of CRA-reported small loans to businesses overall was slightly different than the pattern for the total number of loans. The increase in the dollar amount of CRA-reported loans, from $220.9 billion in 2001 to $327.8 billion in 2007, or 48 percent, was not as dramatic as the 123 percent increase in the number of loans (Chart 3). The total dollar amount of CRA-reported loans then dropped by 47 percent between 2007 and 2010, followed by an increase of 19 percent through 2014. The total dollar amount of small loans to businesses from CRA-reporting banks is down just under 37 percent since 2007 and nearly six percent since 2001.

Chart 3: Total Amount of CRA-reported Loans, Loans under $100,000, and Loans to Small Firms Nationally, 2001-2014



		2002		2004		2006		2008		2010		2012		2014
Loans Overall	220.9	250.1	272.3	288.1	269.6	302.3	327.8	286.5	191.6	174.8	192.5	198.6	204.1	208.0
Loans under $100,000	67.0	81.0	85.0	93.6	97.2	127.2	146.3	114.6	61.2	55.6	63.6	62.5	63.5	70.3
Loans to Small Firms	102.1	111.1	126.3	128.9	122.8	133.5	137.3	106.8	71.8	64.6	72.7	73.5	74.5	73.1

Source: FFIEC CRA Nationwide Summary Statistics, 2001-2014, Table 2.

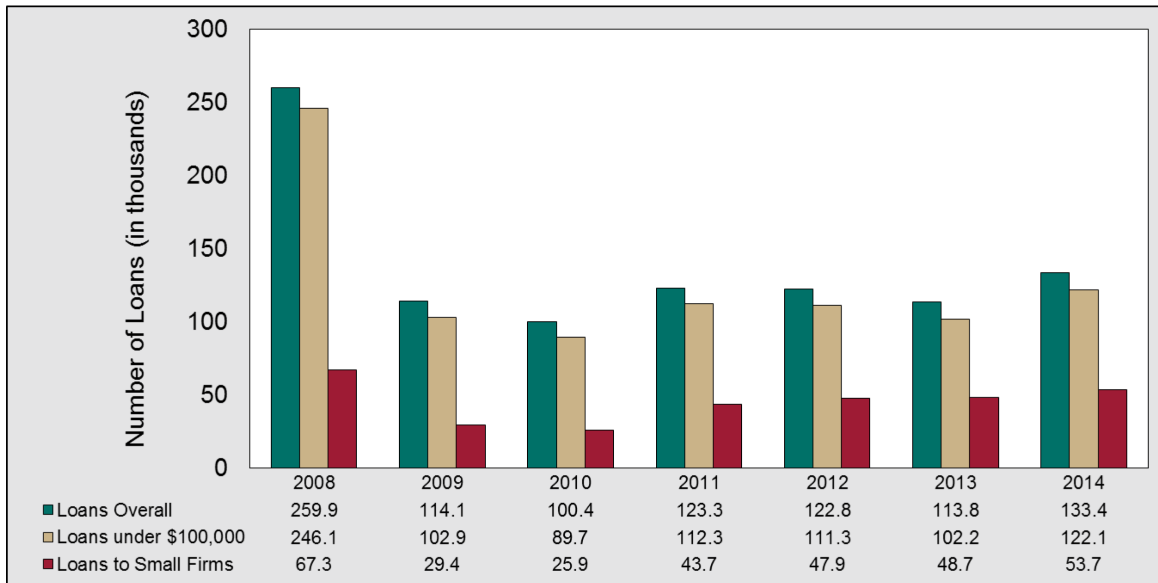
The changes in the total dollar amount of CRA-reported loans under $100,000 more closely paralleled changes in the number of loans, increasing by 119 percent between 2001 and 2007, then contracting by 62 percent between 2007 and 2010, increasing by 26 percent through 2014. The total dollar amount of CRA-reported loans under $100,000 decreased nearly 52 percent from its peak in 2007, but it is up by five percent, from $67.0 billion to $70.3 billion, since 2001.

The total dollar amount of CRA-reported loans to small firms showed much more modest changes than either the amount of loans overall or loans under $100,000 between 2001 and 2007, increasing by only 34 percent. The decline in the amount of loans to small firms between 2007 and 2010, however, was similar in magnitude, 53 percent, to the decline in the amount of loans overall, and the recovery was weaker, with the amount up only 13 percent between 2010 and 2014. As a result, the total dollar amount of CRA-reported loans to small firms is down nearly 47 percent from the amount in 2007 and over 28 percent since 2001.

Trends in CRA-reported Small Loans to Businesses in the Chicago and Los Angeles and San Diego Regions

Data on the number and amount of CRA-reported small loans to businesses for the Chicago and Los Angeles and San Diego regions for the period from 2008 to 2014 show trends similar to the national data. The total number of all CRA-reported small loans to businesses, loans under $100,000, and loans to small firms declined sharply between 2008 and 2010, followed by a slow, partial recovery through 2014 (Chart 4 for the Chicago region and Chart 5 for the Los Angeles and San Diego region).

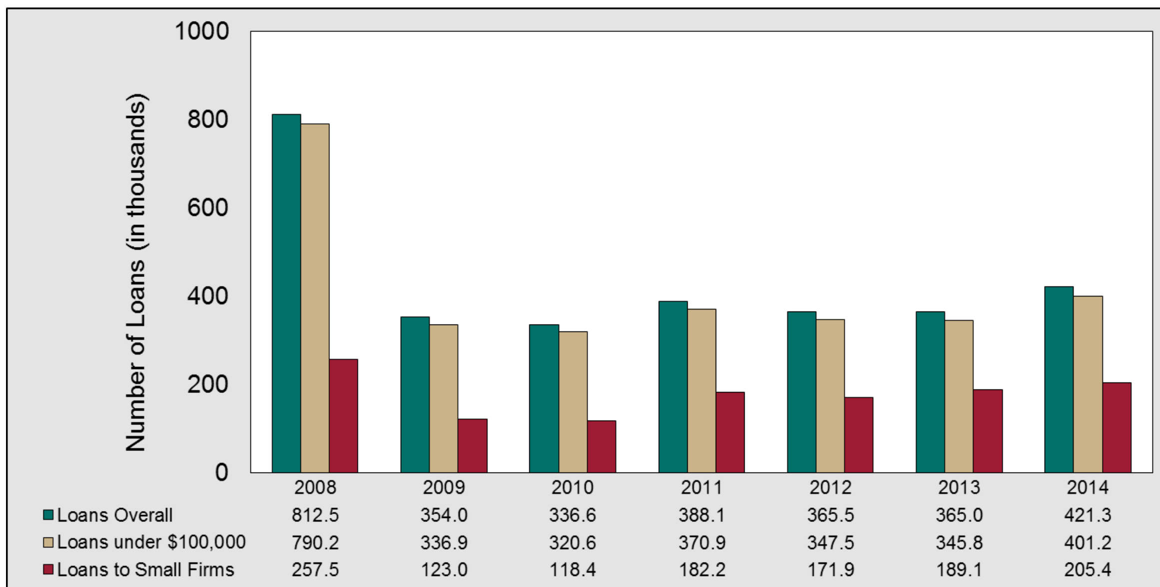
Chart 4: Total Number of CRA-reported Loans, Loans under $100,000, and Loans to Small Firms in the Chicago Region, 2008-2014



	2008	2009	2010	2011	2012	2013	2014
Loans Overall	259.9	114.1	100.4	123.3	122.8	113.8	133.4
Loans under $100,000	246.1	102.9	89.7	112.3	111.3	102.2	122.1
Loans to Small Firms	67.3	29.4	25.9	43.7	47.9	48.7	53.7

Sources: FFIEC CRA data for Cook, DuPage, Kendall, McHenry, and Will counties; Author's calculations.

Chart 5: Total Number of CRA-reported Loans, Loans under $100,000, and Loans to Small Firms in the Los Angeles and San Diego Region, 2008-2014



	2008	2009	2010	2011	2012	2013	2014
Loans Overall	812.5	354.0	336.6	388.1	365.5	365.0	421.3
Loans under $100,000	790.2	336.9	320.6	370.9	347.5	345.8	401.2
Loans to Small Firms	257.5	123.0	118.4	182.2	171.9	189.1	205.4

Sources: FFIEC CRA data for Los Angeles, Orange, and San Diego counties; Author's calculations.

The differences between the two regions and the national trends are relatively minor with respect to all CRA-reported loans and loans under $100,000. The Chicago region saw greater declines between 2008 and 2010 than the national average, followed by a slightly stronger recovery between 2010 and 2014, while the Los Angeles and San Diego region saw slightly smaller declines between 2008 and 2010 than the national average

and a weaker recovery between 2010 and 2014 (Table 1). As a result, for all CRA-reported loans and loans under $100,000, both the Chicago and the Los Angeles and San Diego regions suffered an almost 50-percent decrease in the number of loans between 2008 and 2014, about the same as the nation as a whole, meaning that about half as many businesses received CRA-reported loans or loans under $100,000 in 2014 than loans received in 2008.

Table 1: Change in the Number of Small Loans to Businesses, Loans under $100,000, and Loans to Small Firms, Nationally and in the Chicago and Los Angeles and San Diego Regions

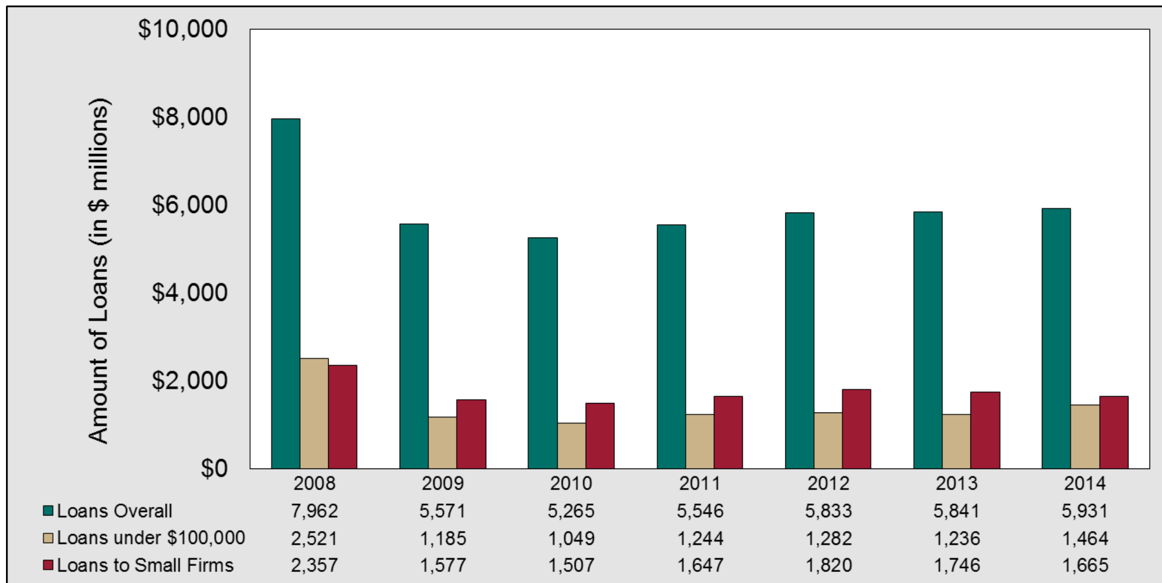
		2008-2010	2010-2014	2008-2014
Total Number of Loans	National	-59.5%	29.0%	-47.8%
	Chicago Region	-61.4%	32.9%	-48.7%
	Los Angeles and San Diego Region	-58.6%	25.2%	-48.1%
Loans under $100,000	National	-60.9%	30.2%	-49.1%
	Chicago Region	-63.5%	36.0%	-48.7%
	Los Angeles and San Diego Region	-59.4%	25.1%	-49.2%
Loans to Small Firms	National	-54.5%	70.4%	-22.4%
	Chicago Region	-61.6%	107.6%	-20.2%
	Los Angeles and San Diego Region	-54.0%	73.4%	-20.2%

Sources: FFIEC CRA data for Cook, DuPage, Kendall, McHenry, and Will counties for the Chicago region and Los Angeles, Orange, and San Diego counties for the Los Angeles and San Diego region; Author's calculations.

The Chicago region experienced a more severe reduction in the number of CRA-reported loans to small firms than the national average between 2008 and 2010, followed by a much stronger recovery between 2010 and 2014. The Los Angeles and San Diego region had a smaller decrease than the nation as a whole and a stronger recovery. For both regions, the overall decrease in the number of CRA-reported loans to small firms between 2008 and 2014 was smaller than the national average, although it still amounted to an over 20-percent decrease in CRA-reported loans to small firms in both regions, which means that 20 percent fewer small firms received loans from CRA-reporting banks in 2014 than in 2008.

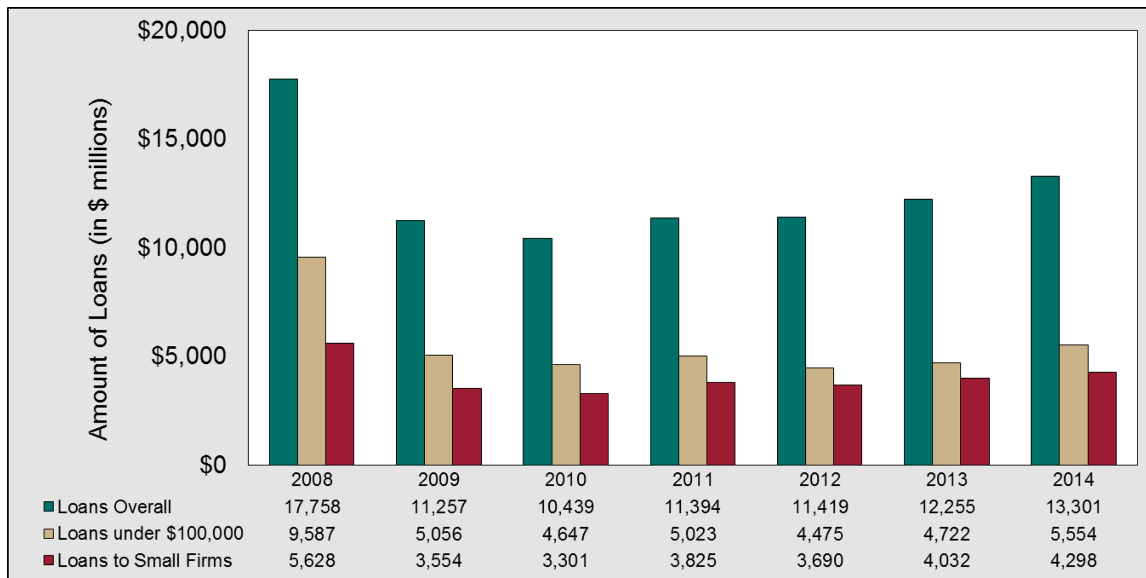
Data on the total dollar amount of CRA-reported bank small loans to businesses for both the Chicago and Los Angeles and San Diego regions for the period from 2008 to 2014 also show trends similar to the national data. The total amount of small loans to businesses, loans under $100,000, and loans to small firms declined sharply between 2008 and 2010, followed by a slow, partial recovery through 2014 (Chart 6 for the Chicago Region and Chart 7 for the Los Angeles and San Diego region).

Chart 6: Total Amount of CRA-reported Loans, Loans under $100,000, and Loans to Small Firms in the Chicago Region, 2008-2014



Sources: FFIEC CRA data for Cook, DuPage, Kendall, McHenry, and Will counties; Author's calculations.

Chart 7: Total Amount of CRA-reported Loans, Loans under $100,000, and Loans to Small Firms in the Los Angeles and San Diego Region, 2008-2014



Sources: FFIEC CRA data for Los Angeles, Orange, and San Diego counties; Author's calculations.

For all CRA-reported bank loans and loans to small firms, the Chicago region experienced less of a decline in the total dollar amount of the loans between 2008 and 2010 and a less robust recovery between 2010 and 2014 than the nation as a whole, while the Los Angeles and San Diego region had a more severe decline and stronger recovery in both of those categories of CRA-reported bank loans than the nation as a

whole during those same periods (Table 2). For loans under $100,000, the Chicago region reversed its pattern, with a more severe decline in the total amount of CRA-reported bank loans between 2008 and 2010, followed by a stronger recovery between 2010 and 2014 than nationally. The Los Angeles and San Diego region had about the same percentage decrease in the total amount of CRA-reported loans under $100,000, but a weaker recovery between 2010 and 2014, than the national average. In both regions, the total amount of CRA-reported bank loans under $100,000 was down more between 2008 and 2014 than in the nation as a whole.

Table 2: Change in the Amount of Small Loans to Businesses, Loans under $100,000, and Loans to Small Firms, Nationally and in the Chicago and Los Angeles and San Diego Regions

		2008-2010	2010-2014	2008-2014
Total Number of Loans	National	-39.0%	19.0%	-27.4%
	Chicago Region	-33.9%	12.7%	-25.5%
	Los Angeles and San Diego Region	-41.2%	27.4%	-25.1%
Loans under $100,000	National	-51.4%	26.4%	-38.6%
	Chicago Region	-58.4%	39.6%	-41.9%
	Los Angeles and San Diego Region	-51.5%	19.5%	-42.1%
Loans to Small Firms	National	-39.5%	13.3%	-31.5%
	Chicago Region	-36.0%	10.4%	-29.4%
	Los Angeles and San Diego Region	-41.3%	30.2%	-23.6%

Sources: FFIEC CRA data for Cook, DuPage, Kendall, McHenry, and Will counties for the Chicago region and Los Angeles, Orange, and San Diego counties for the Los Angeles and San Diego region; Author's calculations.

Comparing the percentage change in the number and dollar amount of CRA-reported bank loans shows that fewer businesses received loans in 2014 than received loans in 2008 across all three categories. For loans overall and loans under $100,000, the smaller decrease in total dollar amount of CRA-reported bank loans between 2008 and 2014 suggests that the businesses that received loans may have received, on average, somewhat larger loans in 2014 than they did in 2008. For example, the number of CRA-reported bank loans was down by over 48 percent in the Los Angeles and San Diego region between 2008 and 2014, but the dollar amount of those loans was only down by about 25 percent. In 2014, about half as many firms received a total of about three-quarters of the total loan amount, compared with 2008.

The situation was worse for small firms. Fewer small firms received loans in 2014 than in 2008, and the loans appear to be for smaller average amounts based on the larger decrease in total loan amounts than in the number of loans between 2008 and 2014. In the Chicago region, for example, about 80 percent as many small firms received CRA-reported loans in 2014 as did in 2008, but the total dollar amount of those loans was

down nearly 30 percent. In 2014, 80 percent of small firms split 70 percent of the total dollar amount of CRA-reported bank loans, compared with 2008.[31]

METHODOLOGY

This report focuses on the segment of CRA-reported lending by banks that is most crucial for neighborhood businesses, loans under $100,000. They constitute over 92 percent of all CRA-reported small business loans, and, as noted earlier, those are the loans that are "most important to startups and small businesses" and are also the bulk of loans that the rapidly growing fintech lenders are providing. For example, the average loan size that online lenders responding to the California Department of Business Oversight survey reported for 2014 was $12,236.[32]

In order to analyze the extent to which financial institutions reporting under the CRA requirements are meeting the credit needs of businesses in low- and moderate-income census tracts and in communities of color, the CRA-reported data provide only one part of the necessary information. The CRA reports include only loans that the reporting banks made, with no data on the numbers of applications or amount of loans applied for; they do not, therefore, have data on the level of demand for bank loans from businesses.

Data on aggregate demand for business loans suggest that many businesses rely on banks for their financing but, at the same time, have difficulty in accessing capital from their banks. A 2012 survey of businesses found that 85 percent relied on either a major bank or a regional or community bank as their main financial partner.[33]

> Based on regional survey data from the Federal Reserve Bank of New York, about 37 percent of all small businesses applied for credit in the fall of 2013. About 45 percent did not apply, presumably because they did not need credit, but about 20 percent did not apply because they were discouraged from doing so, either because they felt that they would not qualify or because they thought the process would be too arduous to justify the time commitment. Of businesses that did apply, over 40 percent either received no capital at all or received less than the amount that they requested.[34]

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[31] Not only are loans of all types less readily available for small firms, they also appear to be more highly dependent on a credit cards as the principal form for the loans they receive than businesses generally For example, in 2014 American Express, FSB, which essentially provides only credit cards for business customers, accounted for 31.9 percent of loans to small firms in the Chicago region and 35.8 percent of loans to small firms in the Los Angeles and San Diego region, compared with 20.4 percent of all loans in the Chicago region and 27.6 percent of all loans in the Los Angeles and San Diego region. Those percentages represent a lower limit on the extent to which businesses are receiving loans in the form of credit cards because other banks, such as Bank of America, Chase, Citibank, and Wells Fargo, also offer credit cards in addition to traditional term loans. While many businesses may want and need loans for the purposes for which credit cards are well-suited, such as short-term cash flow management or for routine expenditures, others may have needs, such as major equipment purchases, better met by more conventional term loans.

[32] *Survey of Online Consumer and Small Business Financing Companies – 01/01/2010 through 06/30/2015: Summary Report of Aggregate Transaction Data.*

[33] NFIB Research Foundation, 2012.

[34] Mills and McCarthy, 2014, p. 23.

While the data aggregated for the nation as a whole present one type of estimate for demand, the national averages do not necessarily reflect what is happening within any given metropolitan area or at the neighborhood or census tract level.[35] The Department of Housing and Urban Development (HUD) aggregates United States Postal Service (USPS) census tract address data (HUD/USPS Vacancy Data), including the total number of business addresses and the number of vacant business addresses, and the difference represents the number of active business addresses for each census tract. The number of active business addresses can serve as a proxy for the level of demand for business loans assuming that the demand for loans is roughly proportional to the number of businesses.

The CRA-reported data show the number and amount of small loans to businesses; the HUD/USPS Vacancy Data provide a proxy measure for the level of business loan demand, and census data from the FFIEC has the income level of each census tract relative to the median family income of the metropolitan area of which it is a part and the percentage of the census tract population that are minorities. By combining the three datasets, it is possible to compare the relative level of access to business capital from banks reporting under CRA requirements for businesses in census tracts with different income or population demographics. [36]

For purposes of analyzing the data by income level, this report uses the standard definitions of low-, moderate-, middle-, and upper-income that the FFIEC uses:

- A low-income census tract has a median family income less than 50 percent of the Area Median Family Income;
- A moderate-income census tract has a median family income from 50 percent to less than 80 percent of the Area Median Family Income;
- A middle-income census tract has a median family income from 80 percent to less than 120 percent of the Area Median Family Income; and
- An upper-income census tract has a median family income of 120 percent or more of the Area Median Family Income.

FINDINGS BY INCOME LEVEL OF CENSUS TRACT

Businesses in low- and moderate-income census tracts receive a smaller percentage of CRA-reported bank loans under $100,000, both by the number and amount of loans, than their respective shares of active business addresses nationally and in both the Chicago and Los Angeles and San Diego regions. Nationally, businesses in low-income

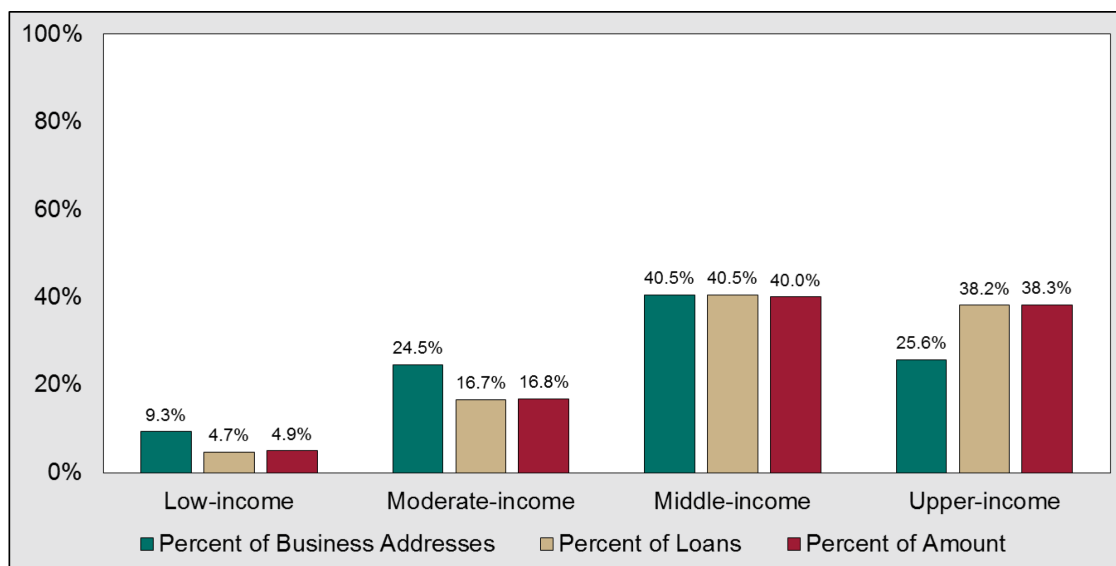
[35] The lack of data on the demand for small business loans was addressed in Section 1071 of the Dodd–Frank Wall Street Reform and Consumer Protection Act of 2010 which gave the Consumer Financial Protection Bureau (CFPB) the authority to require lenders to collect and report business loan application data, including the type and purpose of the credit applied for, the race and gender of the principal owners of the business, and the gross annual revenue of the business. The CFPB has not yet promulgated the rules for collection of those data; it was still in the pre-rule phase as of the end of 2016.

[36] This report examines lending to businesses in census tracts with different demographic characteristics, which is not the same as the ownership of the business. Businesses in predominantly Hispanic census tracts, for example, could have a non-Hispanic owner. The only consistent source of data on access to loans by the race or ethnicity of the business owner is from the SBA, which provides a relatively small percentage of business loans overall.

census tracts comprised an average of 9.3 percent of all businesses for the period 2012-2014,[37] but they received only 4.7 percent of loans and only 4.9 percent of the total amount of loans (Chart 8). In other words, they received 50.1 percent of the number of loans, and 53.1 percent of the amount of loans, that their share of businesses represent. If businesses in low-income census tracts had received CRA-reported loans under $100,000 in proportion to their share of business addresses overall, they would have received over 687,600 more loans totaling over $8.8 billion more than they actually received between 2012 and 2014.

Businesses in moderate-income census tracts were an average 24.5 percent of all businesses, but they received only 16.7 percent of CRA-reported bank loans under $100,000, and 16.8 percent of the total amount of those loans, nationally between 2012 and 2014. They received 67.9 percent of the number, and 68.3 percent of the amount, of loans under $100,000 that their share of businesses represent. If businesses in moderate-income census tracts had received CRA-reported loans under $100,000 in proportion to their share of business addresses overall, they would have received nearly 1.2 million more loans totaling over $15.7 billion more than they actually received in the period from 2012 to 2014.

Chart 8: Percent of Businesses, Loans, and Amounts for CRA-reported Bank Loans under $100,000 Nationally by Census Tract Income Level, 2012-14



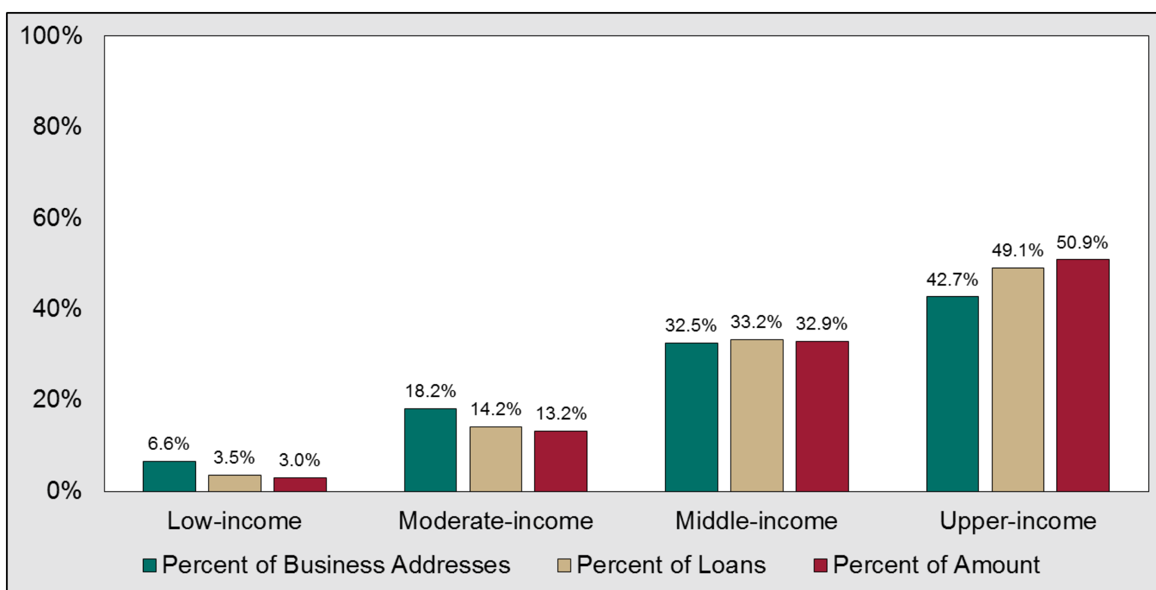
Sources: FFIEC CRA Nationwide Summary Statistics, Tables 4.1 and 4.2; FFIEC Median Family Income Percent data 2013; HUD/USPS Vacancy Data, Q1-4, 2012-2014; Author's calculations.

In the Chicago and Los Angeles and San Diego regions, similar patterns are evident, with businesses in low- and moderate-income census tracts receiving fewer CRA-reported bank loans under $100,000 and less in total loan amounts than their respective shares of businesses represent. For example, businesses in low-income

[37] For CRA reporting purposes, the census tract boundaries changed from the 2000 Decennial Census boundaries to the 2010 Decennial Census boundaries in 2012. The decision to analyze the census tract level data for the period between 2012 and 2014 was to keep the census tract geographies consistent for the entire period.

census tracts in the Chicago region were an average of 6.6 percent of all businesses in the region, but they received only 3.5 percent of CRA-reported bank loans and 3.0 percent of the total amount of loans between 2012 and 2014 (Chart 9). That is, businesses in low-income census tracts in that region received 53.0 percent of the number, and only 46.0 percent of the amount, of loans under $100,000 that their shares of businesses represents. If businesses in low-income census tracts had received CRA-reported bank loans under $100,000 in proportion to their share of all businesses in the Chicago region, they would have received nearly 10,400 more loans totaling nearly $141.6 million more than they received between 2012 and 2014.

Chart 9: Percent of Businesses, Loans, and Amount for Loans under $100,000 in the Chicago Region by Census Tract Income Level, 2012-2014



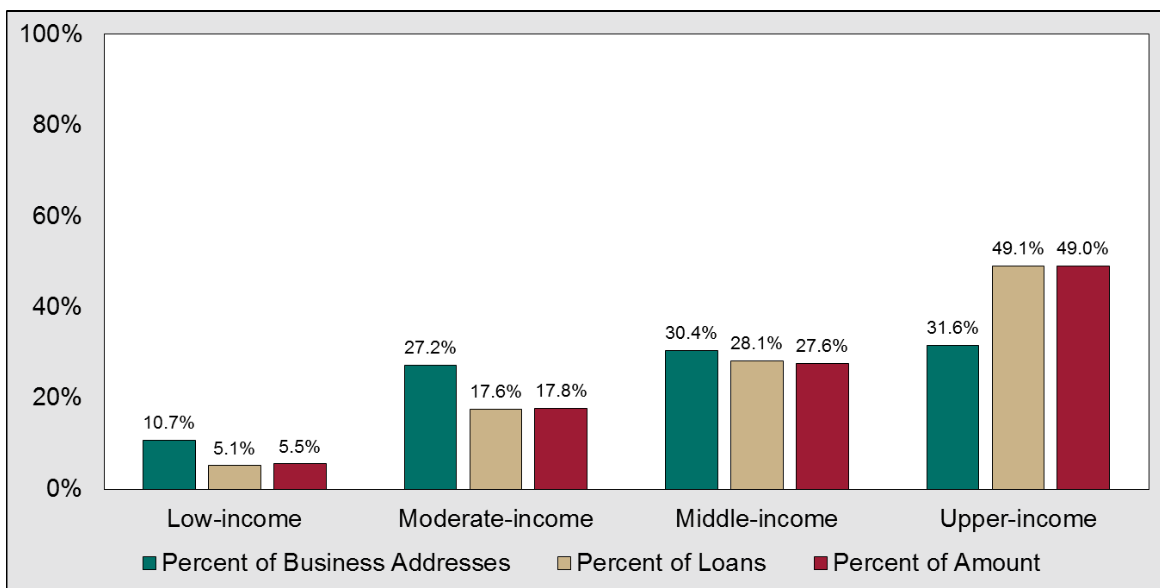
Sources: FFIEC CRA data for Cook, DuPage, Kendall, McHenry, and Will counties, 2012-2014; FFIEC Median Family Income Percent data 2012-2014; HUD/USPS Vacancy Data, Q1-4, 2012-2014; Author's calculations.

For businesses in low-income census tracts in the Los Angeles and San Diego region, the disparity between the percentage of businesses they represent and the number and amount of CRA-reported bank loans is similar to the disparity in the Chicago region. Businesses in those tracts receive about 47.9 percent of the number, and 51.3 percent, of the amount, of CRA-reported banks loans under $100,000 that their share of businesses represents (Chart 10). If businesses in low-income census tracts in the Los Angeles and San Diego region had received loans in proportion to their share of all businesses, they would have received nearly 60,800 more loans under $100,000 totaling over $746.4 million more than they received between 2012 and 2014.

While not as stark as the disparities for businesses in low-income census tracts, businesses in moderate-income census tracts in both the Chicago and Los Angeles and San Diego regions also received a smaller percentage of CRA-reported bank loans, both with respect to the number and amount of loans, than their overall share of businesses. Businesses in moderate-income census tracts in the Chicago region received 77.8 percent of the number, and 72.4 percent of the amount, of loans under $100,000 that

their share of businesses represents. If businesses in moderate-income census tracts in the Chicago region had received CRA-reported bank loans in proportion to their share of business addresses overall, they would have received over 13,500 more loans totaling over $199.5 million more than they actually received in the period from 2012 to 2014. Businesses in moderate-income census tracts in the Los Angeles and San Diego region received 64.8 percent of the number, and 65.4 percent of the amount, of CRA-reported bank loans under $100,000 that their share of businesses represents. If businesses in moderate-income census tracts in the Los Angeles and San Diego region had received CRA-reported bank loans in proportion to their share of businesses overall, they would have received over 104,200 more loans totaling over $1.37 billion more than they actually received in the period from 2012 to 2014.

Chart 10: Percent of Businesses, Loans, and Amount for Loans under $100,000 in the Los Angeles and San Diego Region by Census Tract Income Level, 2012-2014

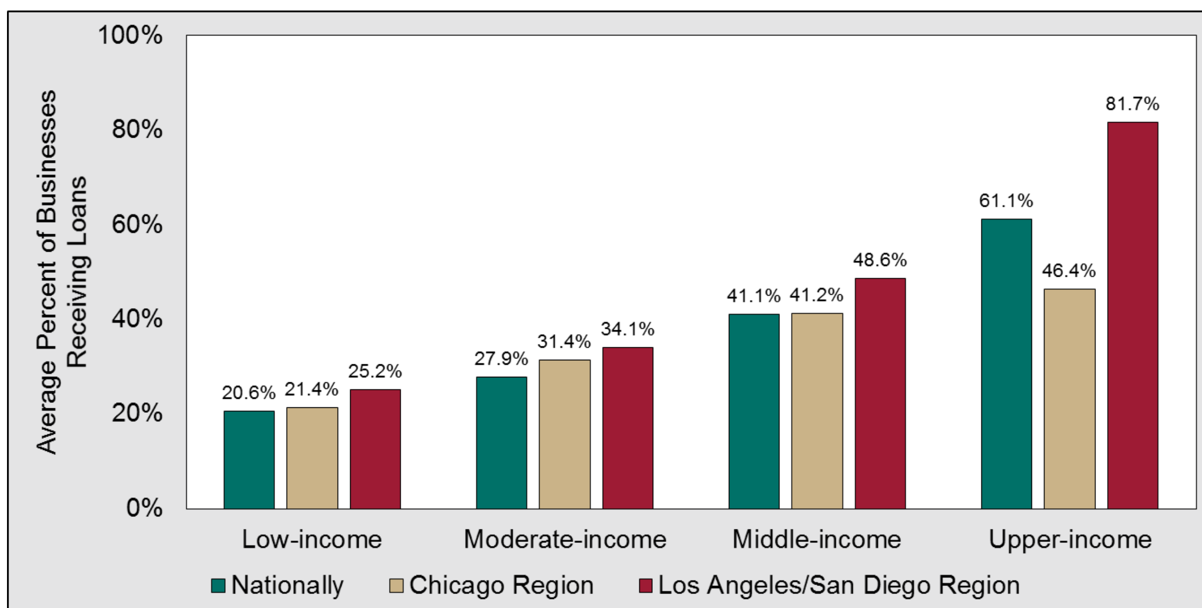


Sources: FFIEC CRA data for Los Angeles, Orange, and San Diego counties, 2012-2014; FFIEC Median Family Income Percent data 2012-2014; HUD/USPS Vacancy Data, Q1-4, 2012-2014; Author's calculations.

Nationally and in both the Chicago and Los Angeles and San Diego regions, businesses in lower-income census tracts were less likely to have received CRA-reported bank loans between 2012 and 2014 than businesses in higher-income census tracts (Chart 11). An average of one business in five, 20.6 percent, in a low-income census tract received a loan under $100,000 during that period nationally, compared with more than three out of five businesses, 61.1 percent, in upper-income census tracts. In the Chicago region, the degree of disparity was somewhat less than in the nation as a whole. Slightly over one in five businesses, 21.4 percent, in low-income census tracts received CRA-reported bank loans under $100,000, compared with just under half of businesses, 46.4 percent, in upper-income census tracts. In the Los Angeles and San Diego region, a higher percentage of businesses received loans than nationally, but the same pattern of disparity was evident. Slightly over one in four businesses, 25.2 percent, in low-income census tracts received CRA-reported bank loans under $100,000, compared with just

over four out of five businesses, 81.7 percent, in upper-income census tracts. Both nationally and in the Los Angeles and San Diego region, businesses in low-income census tracts were about one-third as likely to have received a CRA-reported bank loan under $100,000 as businesses in upper-income census tracts.

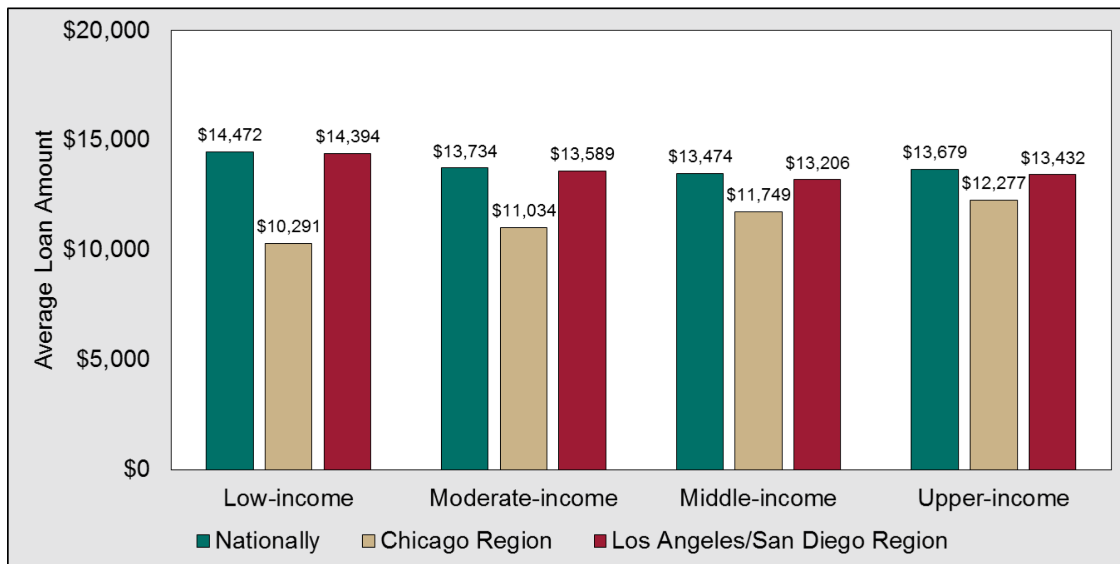
Chart 11: Average Percent of Businesses Receiving Loans under $100,000 Annually Nationally and in the Chicago and Los Angeles and San Diego Regions by Census Tract Income Level, 2012-2014



Sources: FFIEC CRA data for Cook, DuPage, Kendall, McHenry, and Will counties for the Chicago region and Los Angeles, Orange, and San Diego counties for the Los Angeles and San Diego region, 2012-2014; FFIEC Median Family Income Percent data 2012-2014; HUD/USPS Vacancy Data, Q1-4, 2012-2014; Author's calculations.

While the probability of a business receiving a CRA-reported loan under $100,000 increases as the income level of the census tract increases, nationally and in both the Chicago and Los Angeles and San Diego regions, the average loan amount does not, at least not nationally and in the Los Angeles and San Diego region (Chart 12). The average loan amount for loans under $100,000 was actually 5.5 percent, or $793, higher in low-income census tracts nationally, and 6.7 percent, or $962 higher, in low-income tracts in the Los Angeles and San Diego region, than in upper-income census tracts, respectively. In the Chicago region, however, the average loan amount increased as the income of the census tract increased. The average loan amount in low-income census tracts was 19.3 percent, or nearly $2,000, lower than the average loan amount in upper-income census tracts.

Chart 12: Average Loan Amount for Loans under $100,000 Nationally and in the Chicago and Los Angeles and San Diego Regions by Census Tract Income Level, 2012-2014



Sources: FFIEC CRA data for Cook, DuPage, Kendall, McHenry, and Will counties for the Chicago region and Los Angeles, Orange, and San Diego counties for the Los Angeles and San Diego region, 2012-2014; FFIEC Median Family Income Percent data 2012-2014; HUD/USPS Vacancy Data, Q1-4, 2012-2014; Author's calculations.

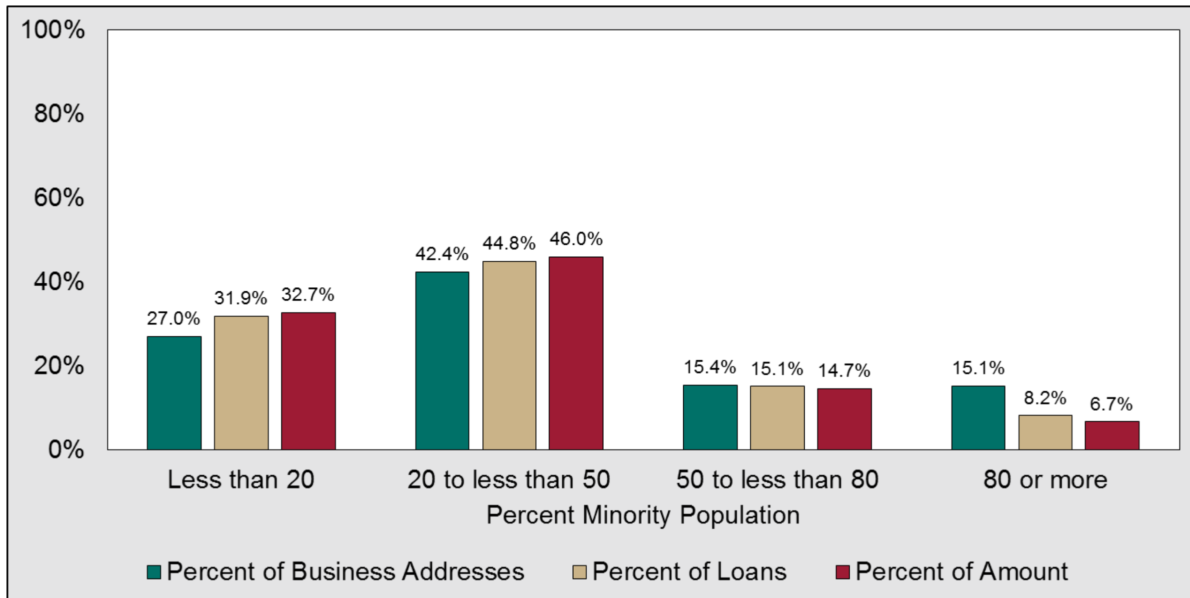
FINDINGS BY THE PERCENT MINORITY OR HISPANIC/LATION POPULATION

Percent Minority Population

Businesses in predominantly minority[38] census tracts in the Chicago region receive a smaller percentage of CRA-reported loans under $100,000, both by the number and amount of loans, than their respective share of businesses in the region (Chart 13). They constitute an average of 15.1 percent of businesses, but they receive only 8.2 percent of the number of loans and only 6.7 percent of the total amount of such loans. That is, they received 53.8 percent of the number, and 44.3 percent of the amount, of CRA-reported loans under $100,000 that their share of businesses represents. If businesses in predominantly minority census tracts in the Chicago region had received CRA-reported loans under $100,000 in proportion to their share of businesses overall, they would have received more than 23,000 additional loans in a totaling over $335 million between 2012 and 2014.

[38] "Minority" includes all of the non-white population in the census tract, based on the FFIEC census data. For simplicity and ease of reading, this report will use the following terminology: census tracts that were 20 percent or less minority or Hispanic/Latino will be "predominantly white" or "predominantly non-Hispanic;" census tracts that were 20 to less than 50 percent minority or Hispanic/Latino will be "majority white" or "majority non-Hispanic;" census tracts that were 50 to less than 80 percent minority or Hispanic/Latino will be "majority minority" or "majority Hispanic," and census tracts that were 80 percent or more minority or Hispanic/Latino will be "predominantly minority" or "predominantly Hispanic."

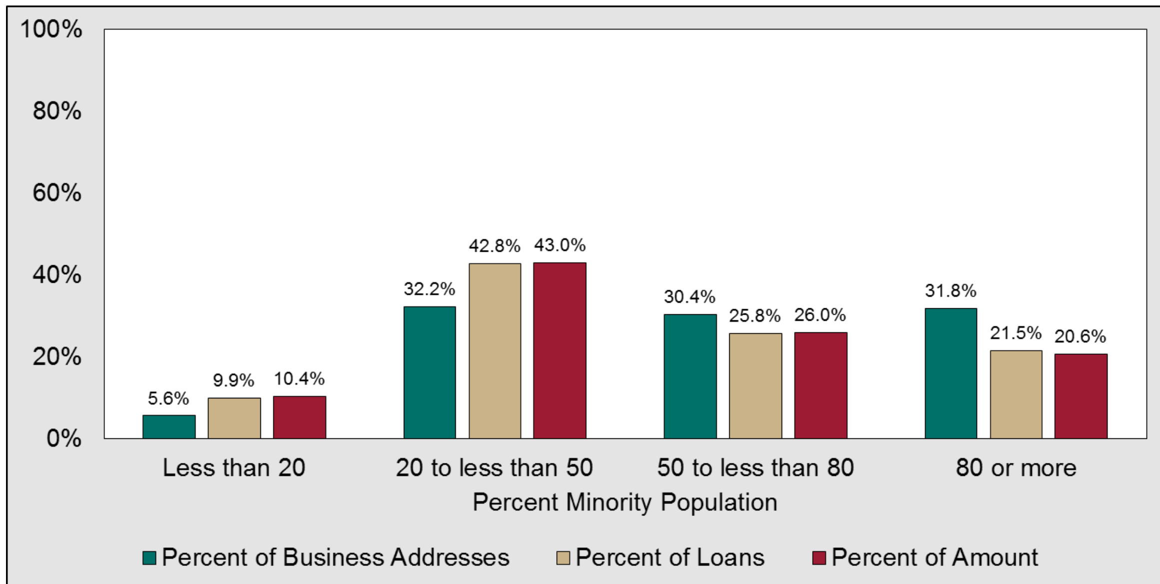
Chart 13: Percent of Businesses, Loans, and Amount for Loans under $100,000 in the Chicago Region by Percent Minority Population, 2012-2014



Sources: FFIEC CRA data for Cook, DuPage, Kendall, McHenry, and Will counties, 2012-2014; FFIEC Percent Minority Population data 2012-2014; HUD/USPS Vacancy Data, Q1-4, 2012-2014; Author's calculations.

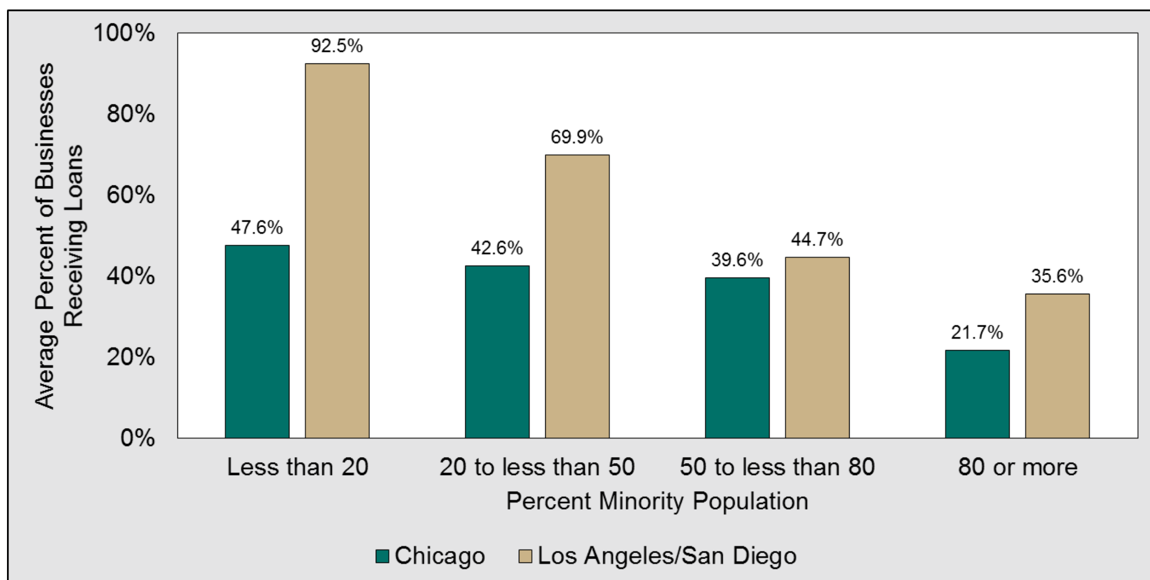
The disparities with respect to the number and total amount of CRA-reported loans under $100,000 for businesses in predominantly minority census tracts in the Los Angeles and San Diego regions are somewhat less pronounced than in the Chicago region. Businesses in predominantly minority census tracts in the Los Angeles and San Diego region constitute an average of 31.8 percent of businesses, but they receive only 21.5 percent of the number of loans and only 20.6 percent of the total amount of such loans (Chart 14). That means they received 67.6 percent of the number, and 64.8 percent of the amount, of CRA-reported loans under $100,000 that their share of businesses represents. If businesses in predominantly minority census tracts in the Los Angeles and San Diego region had received CRA-reported loans under $100,000 in proportion to their share of businesses overall, they would have received more than 111,500 additional loans totaling over $1.63 billion between 2012 and 2014.

Chart 14: **Percent of Businesses, Loans, and Amount for Loans under $100,000 in the Los Angeles and San Diego Region by Percent Minority Population, 2012-2014**



Sources: FFIEC CRA data for Los Angeles, Orange, and San Diego counties, 2012-2014; FFIEC Percent Minority Population data 2012-2014; HUD/USPS Vacancy Data, Q1-4, 2012-2014; Author's calculations.

Chart 15: **Average Percent of Businesses Receiving Loans under $100,000 Annually in the Chicago and Los Angeles and San Diego Regions by Percent Minority Population, 2012-2014**



Sources: FFIEC CRA data for Cook, DuPage, Kendall, McHenry, and Will counties for the Chicago Region, Los Angeles, Orange, and San Diego counties for the Los Angeles and San Diego region, 2012-2014; FFIEC Percent Minority Population data 2012-2014; HUD/USPS Vacancy Data, Q1-4, 2012-2014; Author's calculations.

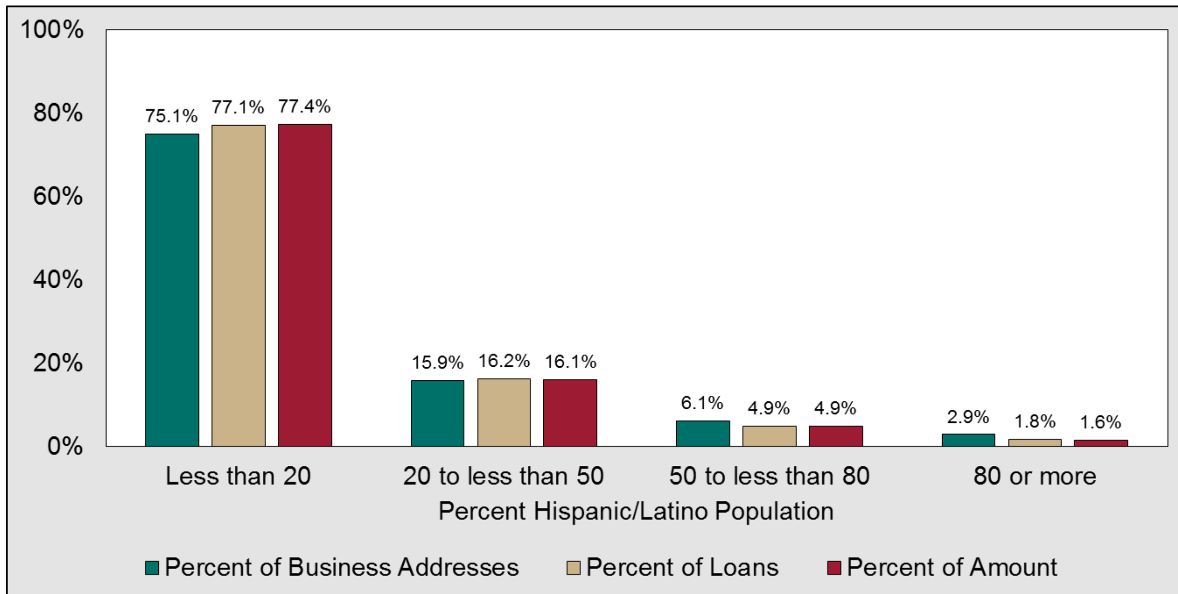
The pattern of disparities in access to CRA-reported loans under $100,000 in the Chicago region is consistent with the pattern of disparities in the Los Angeles and San Diego regions. The higher the percentage of minority population, the lower the percentage of businesses that receive loans, especially for businesses in census tracts that are predominantly minority. The difference in the extent of access between predominantly white and predominantly minority census tracts is much more pronounced, however, in the Los Angeles and San Diego region than in the Chicago region, although businesses in Los Angeles and San Diego region do enjoy substantially greater access than their counterparts in the Chicago region in all categories of census tracts (Chart 15).

Percent Hispanic/Latino Population

As with the analysis of the distribution of CRA-reported loans under $100,000 by the racial composition of census tracts, analysis by the percentage Hispanic/Latino population shows that the higher the percentage of Hispanic population, the lower the probability that a business receives a loan. In the Chicago region, businesses in predominantly Hispanic neighborhoods constitute 2.9 percent of all businesses, but they receive only 1.8 percent of CRA-reported loans under $100,000, about 61.7 percent of the number they would receive based on their proportion of businesses (Chart 16). Those businesses receive only 1.6 percent of the total amount of loans, or about 53.4 percent of the amount they would receive based on their share of all businesses. If businesses in predominantly Hispanic census tracts received CRA-reported loans under $100,000 in proportion to their share of businesses in the Chicago region, they would have received 3,700 more loans totaling over $54 million.

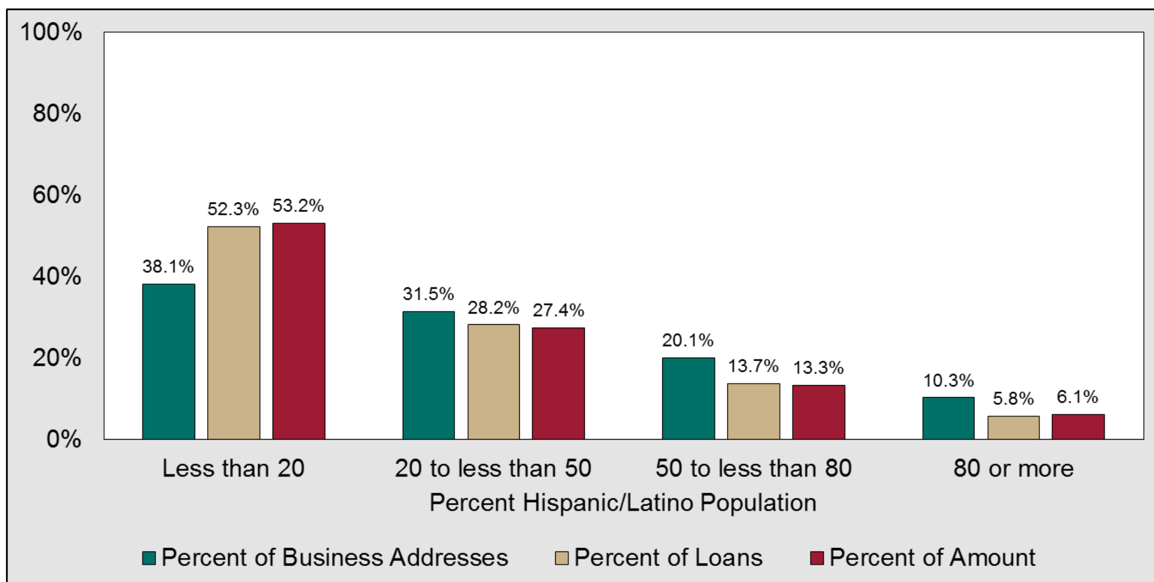
In the Los Angeles and San Diego region, 10.3 percent of all businesses are in census tracts that are predominantly Hispanic, but they receive only 5.8 percent of CRA-reported loans under $100,000, or 56.5 percent of the number they would receive based on their proportion of businesses (Chart 17). Businesses in predominantly Hispanic census tracts receive only 6.1 percent of the total amount of loans, or 59.6 percent of their ratable share of the total amount. Had businesses in predominantly Hispanic census tracts in the Los Angeles and San Diego region received loans in proportion to their overall share of businesses, they would have received over 48,500 more loans totaling more than $600 million more than they received.

Chart 16: Percent of Businesses, Loans, and Amount for Loans under $100,000 in the Chicago Region by Percent Hispanic/Latino Population, 2012-2014



Sources: FFIEC CRA data for Cook, DuPage, Kendall, McHenry, and Will counties, 2012-2014; FFIEC Hispanic/Latino Population and Population data 2012-2014; HUD/USPS Vacancy Data, Q1-4, 2012-2014; Author's calculations.

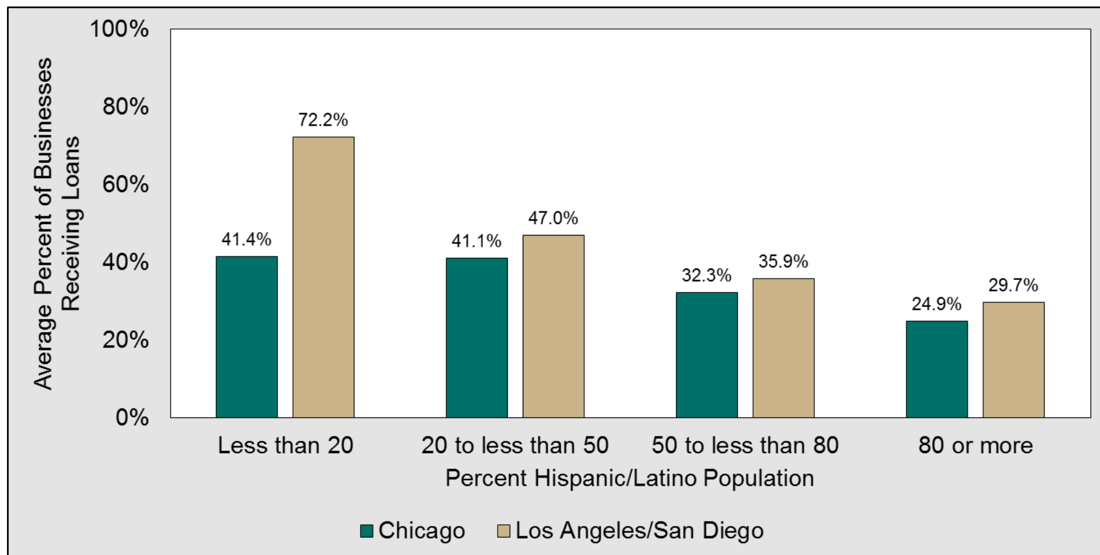
Chart 17: Percent of Businesses, Loans, and Amount for Loans under $100,000 in the Los Angeles and San Diego Region by Percent Hispanic/Latino Population, 2012-2014



Sources: FFIEC CRA data for Los Angeles, Orange, and San Diego counties, 2012-2014; FFIEC Hispanic/Latino Population and Population data 2012-2014; HUD/USPS Vacancy Data, Q1-4, 2012-2014; Author's calculations.

As with the analysis based on the racial composition of census tracts, the pattern of disparities in access to CRA-reported loans under $100,000 for businesses in predominantly Hispanic census tracts is consistent in both the Chicago and Los Angeles and San Diego regions. Businesses in predominantly Hispanic census tracts are 60.0 percent as likely in the Chicago region, and 41.2 percent as likely in the Los Angeles and San Diego region, to receive loans as businesses in predominantly non-Hispanic census tracts (Chart 18).

Chart 18: Average Percent of Businesses Receiving Loans under $100,000 in the Chicago and Los Angeles and San Diego Regions by Percent Hispanic/Latino Population, 2012-2014



Sources: FFIEC CRA data for Cook, DuPage, Kendall, McHenry, and Will counties for the Chicago region and Los Angeles, Orange, and San Diego counties for the Los Angeles and San Diego region, 2012-2014; FFIEC Hispanic Population and Population data 2012-2014; HUD/USPS Vacancy Data, Q1-4, 2012-2014; Author's calculations.

DISCUSSION AND POLICY IMPLICATIONS

Analysis of CRA-reported business loan data for loans under $100,000 shows clear disparities in the origination of loans to active businesses by the income level, racial composition, and percent Hispanic/Latino population of the census tract. While earlier research on lending in Chicago and the surrounding counties showed similar disparities,[39] the current research shows that they are not confined to a single region but are, in fact, potentially as bad or worse in at least one other major metropolitan area, that surrounding Los Angeles and San Diego. For example, between 75 and 80 percent of businesses in low-income census tracts, nationally and in both the Chicago and Los Angeles and San Diego regions, did not receive a CRA-reported loan under $100,000 during the period from 2012 to 2014 (Chart 11). Similarly small percentages of businesses in predominantly minority or Hispanic census tracts received loans in both

[39] Cowan, 2012.

the Chicago and Los Angeles and San Diego regions (Chart 15 and Chart 18).[40] Because the term "loan" includes lines of credit and business credit cards as well as traditional term loans, that finding shows that more than three out of every four businesses in low-income census tracts, and nearly as high a percentage in predominantly minority or Hispanic census tracts, do not even have a business credit card from any of the major providers, such as Capital One or American Express.

The lack of access to loans from large financial institutions has at least three potentially damaging impacts on businesses in those neighborhoods, with negative spillover effects on residents. First, without access to capital, businesses are less able to expand and hire additional workers, reducing the level of services and economic opportunity in the neighborhood. Second, without credit, businesses are less able to finance inventory and manage cash flow, making them more likely to fail than businesses that have that basic financial tool available. Third, business owners needing loans may have to use alternative lenders, such as InAdvance or Merchant Funding Services, which provide high-cost loans with interest rates as high as 367 percent.[41] The extraordinarily rapid expansion of fintech and other alternative lenders, increasing over 1,700 percent in the number and about 630 percent in the total amount of loans between 2010 and 2014 according to one study,[42] suggests that they are filling the vacuum left by mainstream financial institutions. The reliance on alternative lenders may be even greater for entrepreneurs from lower-income neighborhoods than for those from higher-income neighborhoods because they are less likely to be able to get loans from banks or to have significant equity in personal assets, such as a house, or personal credit cards with high available credit limits to use as a substitute for business loans.[43] The high cost of alternative loans drains capital from the business, reduces growth, and can lead to the same cycle of debt that consumers can be trapped in with payday loans.

The findings are particularly troublesome in an environment in which deregulation of the financial services sector appears increasingly likely. The disparities in access revealed in the data analysis have occurred within the current regulatory environment, one that provides some incentive under the CRA for banks to invest in low- and moderate-income census tracts within their service areas. Reducing regulatory incentives may exacerbate the problems that businesses in lower-income and predominantly minority or Hispanic census tracts have getting loans from banks, leading to even greater reliance on the unregulated, sometimes predatory, non-bank fintech and alternative business lenders.

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[40] Fisher, Alan, 2013. *Small Business Access to Credit: The Little Engine that Could: If Banks Helped*. Downloaded January 5, 2017, from http://www.calreinvest.org/publications/california-reinvestment-coalition-research, published by the California Reinvestment Coalition, is a study of small business lending using SBA data to examine disparities in access to loans to minority- or Hispanic/Latino-owned businesses. It found that the number of SBA loans by the five leading banks in California declined by 58.8 percent between 2007 and 2013, while the number of those loans to African American-owned businesses declined by 93 percent and the number to Hispanic/Latino-owned businesses declined by 73 percent.

[41] Woodstock Institute analysis of 15 alternative loans showed effective annual interest rates from 26.3 percent to 367.7 percent. All of the loans analyzed with repayment periods of less than nine months had effective annual interest rates of over 100 percent.

[42] *Survey of Online Consumer and Small Business Financing Companies – 01/01/2010 through 06/30/2015: Summary Report of Aggregate Transaction Data*.

[43] Robb, 2013. Fairlie and Robb, 2010.

POLICY RECOMMENDATIONS

● **Make CRA examinations more rigorous.** One way to improve the performance of CRA-reporting financial institutions in making small loans to businesses in low- and moderate-income census tracts is for CRA examiners to place more emphasis on the business lending part of the examinations than they currently do in determining CRA ratings. The change, however, should not be a zero-sum approach, placing more weight on business lending and diminishing the importance of the other types of lending, such as mortgages, in the lending component of the examinations. Instead, examiners need to be more stringent in the scoring of performance with respect to all types of lending.

Examiners also need to consider the type of small business loans banks are offering, rather than aggregating term loans, lines of credit, and credit cards, into a single category. Those different types of loans serve very different purposes and should not be considered fungible in determining whether banks are meeting the credit needs of businesses. The distinction among loan types would not apply to all lenders because some, such as American Express, FSB, offer only credit cards. Other banks, including Bank of America and Wells Fargo, offer both term loans and credit cards, and CRA examiners should consider the mix of loan types in their assessment of CRA performance. For example, examiners could compare separately for each loan type the percentage of small business loans in low- and moderate-income census tracts with the percentage of each loan type in all census tracts within the bank's service areas.

In addition to the lending test, regulators need to be more critical in enforcement of the service test, providing more incentive for banks to maintain brick-and-mortar branches in low- and moderate-income neighborhoods. Bank branches are essential for many low- and moderate-income customers and businesses in low- and moderate-income neighborhoods. Branches provide services that may not be available through Automatic Teller Machines (ATMs), such as help completing loan applications or sending remittances. Some customers, particularly the elderly, may not be comfortable with ATMs or mobile technology and prefer to bank in-person, as they always have. For neighborhood businesses, the local branch is a key source of credit and business loans. Research has shown that local bank branch closings resulted in a 13 percent decline in small business lending that lasts for several years, that the decline is concentrated in low-income and predominantly minority neighborhoods, and that the decline is not affected by the opening of new branches following the closings.[44] Given the importance of maintaining existing branches in low- and moderate-income neighborhoods to preserve small business access to bank loans, regulators should exercise their authority to require banks to obtain non-objection letters from their regulator whenever seeking to close branches in low- and moderate-income neighborhoods.

According to one analyst, over 96 percent of banks receive a satisfactory CRA rating or better.[45] When only one business out of five in low-income tracts, and one of four in

[44] Nguyen, Hoai-Luu Q., 2014. *Do Bank Branches Still Matter? The Effect of Closings on Local Economic Outcomes*. Downloaded from *http://economics.mit.edu/files/10143* on November 30, 2016. A later version of this study was published in October, 2015, by the University of California at Berkeley.
[45] Thomas, Kenneth H., Comptroller Curry: How About Some Real CRA Reform?, in *American Banker*, April 9, 2014.

moderate-income tracts, has a loan, line of credit, or credit card from a large financial institution, rating the performance of 96 percent of financial institutions as satisfactory seems to set very low expectations. The significance of more stringent CRA examinations is evident in the recent $30 billion Community Benefits Agreement (CBA) plan that Fifth Third Bank agreed to with the National Community Reinvestment Coalition to address its “Needs to Improve” CRA rating, without any merger or acquisition pending.

● **Promulgate rules under Section 1071 of the Dodd-Frank Act to require small business lenders to report loan data to the Consumer Financial Protection Bureau (CFPB).** In the rules, the CFPB should require small business lenders to report the loan amount requested, the type of loan requested (e.g., term loan, credit card, or merchant cash advance), the action taken on the application, the amount loaned, the Annual Percentage Rate on the loan, whether the loan is payable by ACH debit, and the lender’s default rates in addition to any borrower demographics and business attributes necessary for fair lending analysis. If the Office of the Comptroller of the Currency (OCC) grants a special purpose charter to any fintech lender, the OCC should require the lender to report these same data.

Currently, the CRA requires only FDIC-insured lenders with assets of over approximately $1 billion to report small loans to businesses. While CRA-reporting lenders make the majority of business loans, non-reporting institutions still make about a third of all loans by dollar volume.[46] The CFPB should include small lenders in its database to allow a more comprehensive analysis of how well regulated financial institutions are meeting the credit needs of businesses in low-income neighborhoods and communities of color.

In addition to expanding the number of banks reporting, the CFPB needs to expand the scope of data that banks report. Currently, CRA business lending reports do not include some key data that would allow for a more precise estimate of how well, or poorly, the large financial institutions are meeting the goals of the Act, which is to meet the credit needs of the community. The CRA-reported data cover only loans that are actually made, for example, but do not include business loan applications that did not lead to a loan being made. The data, therefore, do not show how many businesses sought credit but were denied. Nor does the CRA dataset include the amount of the loan applied for, which shows the level of demand for business loans. The CRA data aggregate loans originated into three categories, $100,000 or less, $101,000 to $250,000, and $250,000 to $1,000,000, but do not report the actual amount of the loan to allow analysis of the difference between the level of demand and the dollar amount of loans originated. Those changes, including all loan applications, the amount requested, action on the application, and the amount originated would much more accurately show the level of demand and how well banks are meeting the demand. In addition, the CFPB should require banks to report the type of loan applied for, whether it is a term loan, line of credit, or credit card, to show whether lenders are providing the types of credit businesses are seeking. For fintech lenders, the CFPB should require disclosure of loan

[46] See footnote 24.

originations, the Annual Percentage Rate on loans, whether the loan is a Merchant Cash Advance against future receivables, whether it is payable by ACH debit, and default rates to show how non-bank lenders are providing credit to their business borrowers.[47]

● **Incorporate the equivalent of CRA requirements for investment in low- and moderate-income census tracts, fair lending, consumer protection, and safety and soundness oversight similar to those for banks in any federal charter for fintech lenders.** Fintech lenders are filling the vacuum left by the failure of mainstream banks to make small business loans, and they may serve a valuable role in helping small businesses succeed, but only if the loans they make are beneficial for the business. Just as predatory consumer loans can trap borrowers in a cycle of debt and lead to financial ruin, predatory business loans can drain capital from businesses and lead to failures.

The Office of the Comptroller of the Currency (OCC) is ready to offer a federal charter for fintech lenders.[48] In its paper on innovation in banking,[49] the OCC recognized the role of fintech lenders and addressed some of the concerns it saw with banks working with or adopting the methods of the fintech lenders. The OCC's first guiding principle of understanding and evaluating new offerings was to support responsible innovation. It defined responsible innovation to mean, "the use of new or improved financial products, services, or processes . . . in a manner that is consistent with sound risk management and is aligned with the bank's overall business strategy."[50] Later, in a paper that the OCC released in conjunction with its announcement of the creation of a special purpose charter for fintechs, the OCC stated that it expected fintech lenders to "demonstrate a commitment to financial inclusion that supports fair access to financial services and fair treatment of customers."[51] The White House's National Economic Council also emphasizes the need for "safeguards to protect consumers, institutions, and the financial system."[52]

A federal charter will provide significant benefits to the emerging fintech industry, and, in exchange for those benefits, the federal charter for fintech lenders must include strong protections to reduce the chances that lenders can make predatory loans and provide the same level of oversight for fintech lenders as for the banks with which they compete or partner. As the OCC observed in its paper, not all innovations are beneficial, and the charter should ensure that the innovations it encourages do not do more harm than good. For example, the charter should include requirements to ensure

[47] Mills and McCarthy, 2016.
[48] Comptroller Curry made the announcement on December 2, 2016. See https://www.occ.gov/news-issuances/news-releases/2016/nr-occ-2016-152.html for a summary of his remarks and links to more information.
[49] Office of the Comptroller of the Currency, 2016. *Supporting Responsible Innovation in the Federal Banking System.* Downloaded from *https://www.occ.gov/publications/publications-by-type/other-publications-reports/pub-responsible-innovation-banking-system-occ-perspective.pdf* on November 30, 2016.
[50] Office of the Comptroller of the Currency, 2016, p. 5.
[51] Office of the Comptroller of the Currency, 2016. *Exploring Special Purpose National Bank Charters for Fintech Companies*. Downloaded from *https://www.occ.gov/topics/bank-operations/innovation/special-purpose-national-bank-charters-for-fintech.pdf* on January 19, 2017.
[52] National Economic Council, 2017. *A Framework for Fintech.* Downloaded from *https://www.whitehouse.gov/sites/whitehouse.gov/files/documents/A%20Framework%20for%20FinTech%20_FINAL.pdf* on January 19, 2017.

transparency in loan terms, with disclosures similar to those for consumer loans under the Truth in Lending Act. Most businesses are sole proprietorships and do not have attorneys and financiers to explain complex loan documents and terms.[53]

● **Support and increase funding for Community Development Financial Institutions (CDFIs) and the New Markets Tax Credit (NMTC) Program.** CDFI's are financial institutions with a mission to serve communities that are traditionally distressed or underserved by mainstream financial institutions. The NMTC Program provides private-sector investors a credit against federal income taxes for investments in Community Development Enterprises (CDEs), corporations with a primary mission to serve or provide investment capital in low-income communities.[54] Both CDFIs and CDEs are important sources of business capital in low-income neighborhoods and communities of color, but they can serve only a small fraction of the need. Community organizations, financial institutions, and policymakers need to support and increase funding for CDFIs and the NMTC Program to enable CDFIs and CDEs to expand the level of investment they bring to their service areas.

● **Use responsible banking ordinances to reward banks that lend to businesses in low- and moderate-income neighborhoods and communities of color.** Local governments should use responsible banking ordinances that link government bank deposits to community reinvestment performance to encourage financial institutions to make more small loans to businesses in low- and moderate-income neighborhoods and communities of color. As part of a revitalization strategy, for example, lenders that do the most to provide credit to businesses in neighborhoods targeted for revitalization could receive preference for municipal deposits and other banking services that the municipality needs. The effect would be to use the deposits and other services to make private capital available to support economic development in the neighborhood. Any responsible banking ordinance, however, must be carefully crafted as an incentive, not a mandate, to avoid having a court rule that it is preempted by federal and state bank regulations, as one court has done. Despite that ruling, other municipal responsible banking ordinances remain in effect.

● **Require strong CBA plans with community input and enforceable goals for approval of mergers and acquisitions.** As the recovery of the financial services sector has proceeded, the number of mergers and acquisitions has increased. These activities present good opportunities for the prudential regulators to use their authority under the CRA to require banks to fully meet their obligations to invest in low- and moderate-income census tracts. Recently, advocates and community groups have negotiated CBAs with banks seeking regulatory approval for mergers or acquisitions, and regulators should use those agreements as performance models for the future, both as to the process through which the agreements are reached and the substantive requirements that the agreements contain. For example, Huntington Bank agreed to $16.1 billion in a CBA as part of the approval process for its acquisition of FirstMerit Bank, and City National Bank agreed to commit a minimum of $11 billion in CRA-

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[53] Mills and McCarthy, 2016.

[54] For more information about CDFIs and the NMTC program, see https://www.cdfifund.gov/programs-training/Programs/new-markets-tax-credit/Pages/default.aspx.

qualified investments, including $4.2 billion in small business loans, over a five-year period in connection with its merger with the Royal Bank of Canada. Other banks seeking approvals for mergers and acquisitions should be required to make a similar commitment as a condition of the approval.

● **Extend consumer protections to small business loans.** Business borrowers, many of whom assume personal liability for repayment of loans to their businesses,[55] should receive the same types of protections for small business loans as they would receive were the loan for personal use. Lenders should be required to disclose the loan terms clearly, in a way that enables the borrower to understand the cost of the loan and repayment terms, to determine the borrower's ability to repay the loan without additional borrowing, and be prohibited from engaging in abusive collection practices.

[55] According to the Census Bureau, http://www.census.gov/econ/nonemployer/, the majority of all business establishments in the United States are nonemployers, that is, self-employed individuals operating unincorporated businesses (known as sole proprietorships). See also Mills and McCarthy, 2016.