REINVESTMENT ALERT

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New Small Business Data Show Loans Going To Higher-Income Neighborhoods in Chicago Area

In October, federal banking regulators released new data reported to them by banks and thrifts on the distribution of small business loans by geography and by size of loan. Revisions to Community Reinvestment Act (CRA) regulations adopted in 1995 enabled banking regulators to collect, for the first time, data on the locations of small business loans. The 1975 Home Mortgage Disclosure Act has required banks to report home mortgage data for years, but no such requirements existed for small business loans until recently.

This first analysis of these data for the Chicago region describes the basic patterns of small business lending, identifies where access to credit is lacking generally, and provides some basic statistics on the largest banks and thrifts in the area. While the Institute will be doing considerably more work on these data, this report suggests significant cause for concern over access to small business credit in lower-income communities. In the 6-county Chicago area, the number of loans per 100 businesses in 1996 was only 16.6 in low-income areas and 18.4 in low- and moderate-income tracts, combined, while this rate was 21.8 in middle-income areas and 23.1 in upper-income areas.

Credit and capital are key determinants of business viability for small, young firms. The available evidence has indicated that minority-owned firms, particularly those owned by African-Americans, and businesses in lower-income and minority neighborhoods have greater difficulty accessing credit than white-owned firms and those located in more affluent areas. This lack of access creates a barrier to community economic development and job creation.[1] A 1993 survey of small business owners in the Chicago area by Yankelovich Partners found that firms in minority census tracts reported lack of access to credit as a very serious problem 2.5 times more often than firms in predominantly white tracts (38 percent to 15 percent).[2]

The Data

The new CRA regulations require the annual disclosure of selected data on small business lending by banks and thrifts. For all banks as a group, lending volumes are provided by census tract, with some break-out by

[1]Timothy Bates, *Banking on Black Business*, Joint Center for Political and Economic Studies, 1993; Faith Ando, *An Analysis of Access to Bank Credit*, Center for Afro-American Studies, UCLA, Los Angeles, CA, 1988; Frank Ford, et.al., *Survey of Small Business Lending in Denver*, Colorado Center for Community Development, University of Colorado, Denver, 1996.

[2]Yankelovich Partners, *Identifying the Unmet Credit Needs of Small Businesses in Cook County*, Chicago, October, 1993.

loan size and size of business. For individual banks, however, geographic data are limited to information describing the distribution of lending across different *types* of census tracts. Unfortunately, the data are much less detailed than the Home Mortgage Disclosure Act (HMDA) data, which provide information on residential mortgage applications, including race and income of applicant. The small business data provide summary information only, lacking details on business ownership characteristics, such as race or income. Many CRA advocates argued for more detailed business loan disclosure during the comment period on the new regulations, but regulatory agencies decided on more limited disclosure.

While the data are limited, they provide much more information than has been available in the past on the geographic patterns of business lending. Figure 1 shows the general pattern of small business loan originations across the 6-county metropolitan area, as well as income levels across the region.[3] Many of the clusters of lending activity occur where there are many businesses, which is generally expected. While poor access to credit in lower-income areas is a deterrent to business development, it is not the only factor in business location and growth. Zoning, land costs, transportation access, and other factors may be as or more important in determining the number of businesses in a neighborhood. Because of these other factors and because most business loans are made to existing businesses rather than for relocation purposes, we cannot expect to see very many loans in areas with very few businesses. We should, in fact, expect the distribution of lending to correspond to the distribution of businesses across different types of neighborhoods.[4] Thus, if no bias exists in the market, the distribution of businesses in lower-income versus more affluent areas creates an expected pattern of business loans.

Aggregate Lending Patterns

Table I breaks out 1996 business loan originations for the 6-county Chicago area into four neighborhood income levels: low, moderate, middle, and upper. Approximately 50,000 loans were made in the region, for a total of more than $4 billion.[5] Of these, only 1,931, or 3.9 percent, went to low-income

[3]Small business loans, as reported to regulators, include any loan of $1,000,000 or less at origination and classified as nonresidential/nonfarm real estate or commercial/industrial loans on balance sheet reports to regulators, regardless of the size of business receiving the loan. Thus, it is more accurate to call the set of loans here "small loans to businesses." However, the great majority of loans in these data are made to businesses with fewer than 200 employees, since such firms far outnumber larger firms. The new data also include, separately, loans made to very small firms (those with sales of less than $1 million). Note that small business owners may obtain financing for business purposes through personal credit cards and home equity loans, which are not contained in these data. However, given that access to such sources are tied to personal net worth and home equity, these sources are expected to be less accessible in lower-income areas vis-à-vis higher-income ones.

[4]At the same time, poor access to capital may partially explain the small number of business in low-income neighborhoods. Also, it is important to note that a lack of business lending in a neighborhood may affect more than the number of businesses in an area. It may also affect the growth and health of area businesses.

[5]Omitted from these numbers and from Tables I and II are loans made in tracts in which no income figure is available due to lack of residential population. These loans represent less than three percent of all loans.

Figure 1. Median Income and Business Loan Originations for Chicago 6-county Area, 1996

Table I. Small Business Lending by Income of Census Tract in Chicago, 6-County Area*
1996 Originations

	Income Level of Census Tract				
	Low	**Moderate**	**Middle**	**Upper**	**Total****
Number of Loans to All Businesses	1,931	5,567	20,428	21,895	49,821
Number of Businesses	11,600	29,060	93,771	94,731	229,162
Number of Businesses with 5+ Employees	4,363	10,636	37,082	34,765	86,846
Loans per 100 Businesses	16.6	19.2	21.8	23.1	21.7
Loans per 100 Businesses with 5+ Employees	44.3	52.3	55.1	63.0	57.4
Percent of Loans to All Businesses	3.9%	11.2%	41.0%	43.9%	100.0%
Percent of All Businesses	5.1%	12.7%	40.9%	41.3%	100.0%
Percent of Businesses with 5+ Employees	5.0%	12.2%	42.7%	40.0%	100.0%

* Small business loans include all business loans of $1,000,000 or less to firms of *any* size.
** Total does not include loans or businesses in tracts of unknown income level.

neighborhoods (those with incomes below 50 percent of the MSA median family income), and only 7,498, or 15.0 percent, went to low- and moderate-income neighborhoods combined (less than 80 percent of the MSA median income).[6] Not shown in Table I is the fact that only 4.1 percent of loan dollars went to low-income areas and only 14.5 percent went to low- and moderate-income areas.

What does this distribution suggest? To understand this pattern, we first must compare the break-out of loans to the spatial distribution of businesses in the region. Dun and Bradstreet data on business locations for the same year, coded by census tract are also presented in Table I.[7] As shown in the table, 5.1 percent of businesses are located in low-income tracts and 17.8 percent are located in low- and moderate-income tracts. The result is that the number of loans per 100 businesses in low-income areas is only 16.6 in low-income areas and 18.4 in low- and moderate-income areas, combined, but is 21.8 in middle-income tracts and 23.1 in upper-income tracts. Thus, commercial lending rates are substantially lower in lower-income neighborhoods. Figure 2 maps these lending rates by census tract across the Chicago area. Lending rates are generally lowest in the city, with the most noticeable concentrations of very low lending on the city's South and West sides.

Figure 2. Business Originations per 100 Businesses for Chicago 6-county Area, 1996

[6] Middle-income tracts are those with median family income from 80 to less than 120 percent of the metropolitan statistical area median (which is equal to $42,758 in 1989); upper income includes those tracts with median incomes of 120 percent or more than the MSA median. The MSA includes the Chicago 6-county area (Cook, DuPage, Kane, Lake, McHenry, and Will counties) plus Grundy, DeKalb, and Kendall counties.

[7] Dun and Bradstreet data were obtained from *CRA Wiz*, the software used by many federal bank examiners in their analysis of lending patterns.

Some may argue that including in business counts the very smallest firms -- which may be less likely to demand or qualify for a loan--may bias these results. However, Table I also shows that, even when excluding businesses with fewer than five employees from the business counts, loan-per-business rates are substantially lower in lower-income communities. Loans per 100 businesses (with five or more employees) is equal to 63.0 in upper-income neighborhoods and only 44.3 in low-income neighborhoods.

Table II. Small Business Lending to Firms with Annual Revenues of $1,000,0000 or Less by Income of Census Tract in Chicago, 6-County Area* 1996 Originations and Purchases**

	Income Level of Census Tract				
	Low	Moderate	Middle	Upper	Total***
No. of Loans to Businesses with <=$1MM in Revenue	898	2,745	9,878	10,661	24,182
No. of Businesses with <=$1MM in Revenue	8,347	20,645	65,160	65,776	159,928
Loans per 100 Businesses with <=$1MM in Revenue	10.8	13.3	15.2	16.2	15.1
% of Loans to Businesses with <=$1MM in Revenue	3.7%	11.4%	40.8%	44.1%	100.0%
% of Businesses with <=$1MM in Revenue	5.2%	12.9%	40.7%	41.1%	100.0%

* Small business loans include all business loans of $1,000,000 or less to firms of *any* size.
** Loan originations and secondary market purchases to businesses with revenues of $1,000,000 or less are not distinguished, although purchases constitute a very small fraction of originations and purchases.
*** Total does not include loans or businesses in tracts of unknown income level.

Loans to the Smallest Firms

A particular concern to many is access to credit among very small firms. The new data shed some light on this issue by providing information on loans to such firms. Table II is similar to Table I, except that it compares only the business loans made to firms with annual revenues of $1 million or less. It also provides data on the spatial distribution of such firms. These firms are distributed across types of neighborhoods similarly to all firms as a whole. The distribution of lending to such firms is skewed a bit more towards upper-income areas than is the case for all businesses. This is somewhat expected because loans to such firms may rely more on owner characteristics, including personal net worth, and very small businesses in more affluent areas are likely to have more affluent owners, on average.

Table II shows that, while 5.2 percent of businesses with $1 million or less in sales are located in low-income tracts, only 3.7 percent of loans to such businesses were made in these tracts. Low- and moderate-income tracts, combined, account for 15.1 percent of all loans to very small businesses, while accounting for 18.1 percent of such businesses in the region. Thus, lower-income areas are also receiving fewer loans per business when considering only loans to very small businesses. The loans per 100 businesses rate is only 10.8 in low-income tracts and 12.6 in low- and moderate-income tracts, combined, compared to 15.2 in middle-income tracts and 16.2 in upper-income tracts.

Lending Patterns of the Largest Banks

The new data also provide some information on the distribution of small business loans by individual banks. Unlike HMDA data, however, the small business data do not indicate precisely which tracts loans are originated in, but only the types, by income level, of tracts where loans are made, and some information on the distribution of loan and business size.

Table III provides the number of business loans in the 6-county Chicago area made by each commercial bank in the Chicago area with assets over $5 billion.[8] The proportion of each bank's business loans that go to businesses in low- and moderate-income census tracts is given. Then, the share of the market each bank has in low- and moderate- and, separately, in middle- and upper-income tracts is calculated. From these two market shares a low-mod market share ratio is calculated, which equals the ratio of the bank's market share in low- and moderate-income tracts to its market share in middle- and upper-income tracts. Similar analysis is done for Cook County, separately. A low-mod market share ratio significantly below 1.0 suggests that a bank is serving lower-income areas less well than the market as a whole. A market share ratio significantly above one suggests that a bank is serving lower-income areas better than the market as a whole. Because the analysis above indicates that the market is underserving lower-income areas, *a market share ratio of 1.0 does not suggest that a lender is adequately serving lower-income markets*, only that it is serving them as well as all banks do as a group.

A strong word of caution is warranted in interpreting bank-specific data. Many banks are affiliated with other financial institutions through bank holding companies. Thus, examining the performance of a bank without looking at its affiliates does not give a complete picture of the holding company's activity.[9] (On the other hand, federal regulators give CRA ratings to individual banks, not to holding companies.) Thus, examining Harris Trust and Savings Bank does not capture the lending of its many affiliate suburban banks. Likewise, LaSalle National Bank has affiliates such as LaSalle NI and LaSalle Northwest National. Thus, both Harris Trust and Savings Bank and LaSalle National Bank figures should be interpreted with care. Harris Trust and Savings, for example, might be expected to have a higher low-mod market share ratio than some other large banks because the Harris family of banks is organized in a geographic manner, with many loans to suburban companies being handled through suburban affiliate banks.

Harris Trust and Savings Bank has a low-mod market share ratio substantially above 1.0, for both Cook County and the 6-county area, where it reaches 1.92. Lending by affiliate Harris Banks in more affluent,

[8]Thrifts are not included here, due to their very limited levels of small business lending. Bank size is measured based on individual banks, not bank holding companies. Any holding companies with assets of more than $5 billion but with no single subsidiary this large are not included here. Moreover, some of the banks listed are part of holding companies which own affiliate banks not examined here. For example, LaSalle National Bank is affiliated with a number of other financial institutions, including LaSalle Bank NI, etc. Lending of such smaller affiliates is not examined here. Note also that the First National Bank of Chicago and American National Bank are both owned by First Chicago NBD, a holding company.

[9]Affiliates are not examined here. Further research is needed to examine the lending patterns of some affiliates of these institutions.

suburban communities is not included here, and so these ratios are unlikely to reflect the lending of the entire family of Harris banks, as a group. Bank of America Illinois has a market share of 1.68 for the MSA, but the ratio goes down to 1.13 for Cook County, where the bank makes the bulk of its loans. However, Bank of America Illinois makes very few business loans of $1,000,000 or less given its asset size of $16.6 billion.

The First National Bank of Chicago, The Northern Trust Company, and First of America Bank Illinois, NA all have low-mod market share ratios significantly below 1.0. American National Bank and Trust Company, which is owned by First Chicago NBD (the parent of the First National Bank of Chicago), has a low-mod market share ratio near 1.0 as does LaSalle National Bank. LaSalle National, like Harris, belongs to a family of banks owned by a holding company, and so it is important to point out that this ratio does not apply to the entire family of LaSalle banks.

Whether a bank should be evaluated based on a low-mod market share ratio for Cook County or the 6-county area depends on whether the bank has significant activity outside the county.[10] For banks making a bulk of their loans in Cook County, such as Bank of America Illinois, Harris Trust and Savings, and LaSalle National, the Cook County ratio is more appropriate. For those making many loans outside of Cook County, especially First National, Northern Trust, American National, and First of America, the MSA figure is more appropriate.

The lower part of Table III details, for the 6-county area, the proportion of business loans each bank made for amounts of $100,000 or less and the approximate proportion made to very small firms, those with revenue of no more than $1,000,000. Over 50 percent of the business loans of $1,000,000 or less made by First National, Northern Trust, and First of America were for amounts of $100,000 or less, while fewer than 30 percent of Bank of America Illinois loans and 40 percent of LaSalle National loans were in this size range.

While loan size tells us something about the markets banks serve, many small loans go to businesses of substantial size. The data also provide information on the number of loans made to very small businesses, those with annual revenues of $1,000,000 or less.[11] Table III shows that, among the seven banks, First of America made the largest percentage of its loans to such businesses, with First National and The Northern Trust both making sizable proportions of their loans to such businesses. On the other end of the spectrum, Bank of America Illinois and LaSalle National made very few of their business loans to such businesses, at 2.6 and 5.5 percent respectively. Again, caution is warranted in interpreting the LaSalle National data. LaSalle National does very few loans to very small businesses, but its affiliates, which are not examined here, may do many more.

Market share ratios comparing each lender's percent of the market to very *small* businesses to their percent of the market to *all* businesses, were also calculated. All lenders except First of America, who scored highest at 1.28, had ratios of less than one. Bank of America, Illinois and LaSalle National Bank's small business market share ratios were both significantly below the market at 0.05 and 0.11, respectively.

Conclusion

The analysis above shows that lower-income neighborhoods suffer from inferior access to business credit. Lending rates per business are significantly lower in lower-income census tracts. The report also shows that some lenders serve lower-income areas and very small businesses better than others. CRA action has clearly resulted in improvements in access to residential credit in many lower-income communities. Innovative home-purchase financing programs, home purchase counseling, the role of community development financial institutions and other factors have been used by banks to improve their CRA performance in the residential sector. This report suggests that similar attention is warranted in the small business sector and that

[10]Bank examiners evaluate banks based on bank-specific delineated assessment areas, which banks are allowed to specify with limited examiner oversight. Large banks like these tend to choose an area at least as large as one county, and often several counties, for their assessment area.

[11]The data only provide the number of loan originations and purchases made to very small firms, an idiosyncrasy in the data which is likely to be corrected by regulators in the future. However, purchases in the MSA constitute less than three percent of all originations plus purchases. So the sum of both originations and purchases is used as an estimate of originations.

more needs to be done to increase the amount of lending to firms in lower-income and minority communities.

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Table III. Business Lending Patterns of Chicago Area's Largest Banks, 1996

	First National Bank of Chicago*	American National Bank and Trust*	Northern Trust Company	Bank of America Illinois	First of America Bank Illinois, NA	Harris Trust and Savings Bank	LaSalle National Bank
Chicago 6-county MSA**							
# of originations	2,584	2,269	352	74	540	347	517
% to low-moderate income areas	9.60%	15.50%	11.60%	23.00%	8.10%	25.40%	17.60%
% of market in low-moderate income areas	3.31%	4.68%	0.55%	0.23%	0.59%	1.17%	1.21%
% of market in middle-upper income areas	5.52%	4.53%	0.73%	0.13%	0.91%	0.61%	1.01%
Low-mod market share ratio	0.60	1.03	0.74	1.68	0.64	1.92	1.21
Cook County**							
# of originations	1,456	1,433	208	69	225	282	428
% to low-moderate income areas	15.50%	23.40%	17.30%	24.60%	10.70%	31.20%	21.00%
% of market in low-moderate income areas	3.34%	4.99%	0.53%	0.25%	0.36%	1.31%	1.34%
% of market in middle-upper income areas	5.28%	4.71%	0.74%	0.22%	0.39%	0.83%	1.45%
Low-mod market share ratio	0.63	1.06	0.72	1.13	0.90	1.57	0.92
Chicago 6-county MSA							
# of originations under $100,000***	1,648	1,085	202	22	364	239	197
% of originations under $100,000	63.36%	46.35%	53.02%	28.95%	66.42%	66.95%	36.15%
Ratio of loans to very small businesses to total originations****	42.68%	25.80%	33.60%	2.63%	62.23%	28.01%	5.50%
% of market to very small businesses	4.59%	2.50%	0.53%	0.01%	1.41%	0.41%	0.12%
% of market to any size businesses	5.22%	4.70%	0.76%	0.15%	1.10%	0.72%	1.09%
Very small business market share ratio	0.88	0.53	0.69	0.05	1.28	0.58	0.11

* First National Bank of Chicago and American National Bank and Trust are both owned by First Chicago NBD.
** Figures do not include loans with unknown census tract income.
*** Figures include loans with unknown census tract income.
**** Very small businesses include those with annual revenue <= $1 million. Numerator includes secondary market loan purchases as well as originations. However, purchases make up only 2.7% of business lending so that almost all loans are originations.

Substantial local business lending by the Harris and LaSalle family of banks (or holding companies) are not included in the data.

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