



Credit Where Credit is Due: Trends in Small Business Lending in New Hampshire

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I. Introduction and Overview

Concerns about the availability of credit for businesses nationally are influencing perceptions of credit availability in New Hampshire. Because many significant sources of business credit in NH also operate throughout the country, New Hampshire cannot completely escape important national business lending trends. Some New Hampshire small businesses report that they are experiencing increasing difficulty in obtaining credit to operate their businesses. But simply extrapolating lending trends that are occurring nationally and applying them to New Hampshire is inappropriate and may lead to inaccurate assessments of credit conditions in the Granite State. This is especially problematic if popular sentiment and political rhetoric lead policymakers to lay much of the blame for the recession and responsibility for recovery on the actions of banks and other lenders and prompts lawmakers to adopt policies that may have unintended effects on NH banks and on credit markets. This report looks to document small business lending trends in New Hampshire and determine how they compare to national trends. In addition, the report briefly examines some of the underlying factors influencing business credit trends in New Hampshire.

During times when employment in the U.S. was growing over the past three decades, businesses with less than 50 employees made up approximately one-third of the nation's employment growth. During the employment decline associated with the 2001 recession, small businesses with less than 50 employees comprised only 9 percent of job losses. In the current recession, though, these small businesses have borne 41 percent of the nation's job losses. Very small businesses, with fewer than 20 workers, have suffered 28 percent of the job losses in the current recession¹.

Some policymakers and elected officials in Washington, D.C. and elsewhere are attributing recent employment growth trends in small businesses to difficulties in obtaining credit. According to this view, beginning with the financial crisis in 2008, lack of access to credit has inflicted significant damage on small businesses across the country. But according to a survey by the National Federation of Independent Business released in November of 2009, the number one challenge for small businesses remains poor sales rather than access to credit, which ranks near the bottom of reported challenges currently facing small businesses.²

Still, there can be no disputing that across the nation lending standards have risen and the supply of credit to businesses and households has declined. Commercial and industrial loans outstanding are a good barometer of the availability of credit and nationally they are dropping at a record pace of over 15% annualized. The number of bank credit cards has also fallen from a peak of 425 million in the summer of 2008 to 335 million this November, and card credit lines are shrinking. The number of credit cards in circulation hasn't been this low in a decade. The rapid deleveraging of households and businesses nationally is driven, in part, by the desire of consumers and businesses to reduce their debt loads, but it is also driven by lenders who are less able or willing to extend credit. From an economic and public policy perspective, and for understanding the degree to which access to credit is influencing current employment trends, it is important to understand if the decline in small

¹ Author analysis of U.S. Department of Labor Statistics' "Business Employment Dynamics" dataset and U.S. Small Business Administration data.

² Dunkelberg, W.C. & Wade, H., "NFIB Small Business Economic Trends", National Federation of Independent Business. November, 2009.

business credit is due primarily to supply factors (less credit being made available) or if lower demand (businesses seeking less credit) is driving the drop in business lending.

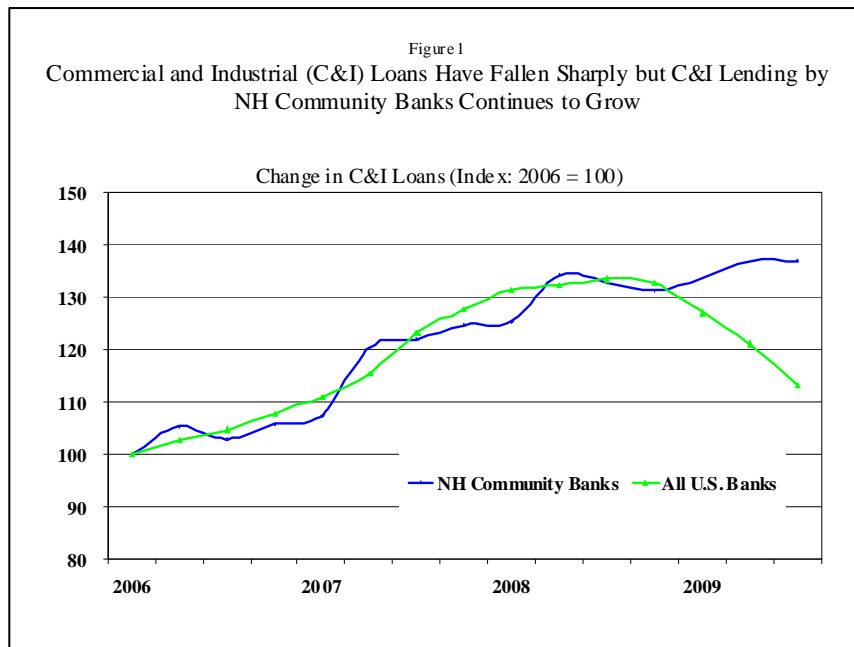
This report uses publicly available quarterly reports filed by banks with the FDIC as well as the annual Community Reinvestment Act reports filed with the Federal Financial Institutions Examination Council (FFIEC) to document business lending trends in NH. Our findings indicate that credit to New Hampshire's small businesses, like credit to small businesses nationally, has declined this recession, but that the decline in NH has only been about one-third as large as the decline in small business lending nationally. An equally important finding, from a public policy perspective, and for those who may be looking to regulate NH institutions into more business lending, shows that the drop in small business lending is primarily attributable to the institutions with little or no presence in, or attachment to, New Hampshire. Institutions responsible for the largest share of the decline in small business lending are, for the most part, those who are most affected by national and global financial forces over which policymakers in New Hampshire have the least influence. Positive lending trends were also found in the lending data. Overall lending to businesses and to small businesses by NH-based community banks has increased over the past several years, even during recession, but these NH-based institutions still provide only about one-half of the total credit extended to small businesses in New Hampshire.

II. Trends in Business Lending Nationally and in New Hampshire

Figure 1 shows that nationwide, business lending (commercial and industrial, or C&I loans) has dropped dramatically over the last year. Lending by NH's community banks³ generally kept pace with national trends since 2006, but has been stable or continued to grow even as national lending has declined since the financial crisis of 2008. Because of changes in the ownership and structure (acquisitions of other banks, changes in structure and reporting, etc.⁴) of NH's larger national and regional banks, we cannot develop a consistent measure of the trends in commercial and industrial lending for these institutions that will allow meaningful comparisons with overall C&I lending by U.S. banks or by NH's community banks. These multi-state banks do not report loan origination by state on a quarterly basis (but small businesses lending by state is reported in annual Community Reinvestment Act reports). Because the primary focus of this report is on small business lending, which is reported by state, our primary results are not affected by this limitation. However, our analysis of CRA data (which includes only lending through 2008) suggests that small business C&I lending by these national banks has declined somewhat in NH and that suggests that overall C&I lending by these banks likely has also declined.

³This group contains no changes in bank ownership or markets that affect overall lending trends (no additions of out-of-state institutions that would increase the volume of lending). Three new institutions were formed during the time period analyzed but these banks are entirely based in NH and their lending activity would either represent net additions to credit in the state, a shift in market share of lending among institutions in the state, or some combination of the two.

⁴For example, during the time period analyzed, Citizens Bank changed from reporting as a NH institution with data based on its NH locations to a national bank (RBS Citizens) with data for NH combined with data for all other states. Thus overall C&I lending trends for NH cannot be determined over the time period. However, small business lending by state is reported with annual CRA filings. Both Bank of America and TD Bank also experienced changes in their structure that significantly affect trends in reported lending and consistent trends impossible to determine.



Small Businesses are Most Affected by Bank Lending

The decline in bank lending to businesses mostly affects smaller businesses. Larger corporations have alternative sources of funding, including retained earnings, corporate bonds, securitized loans and new equity. Those other sources of capital have increased in recent months. Smaller firms have far fewer choices and depend more heavily on the banking sector—especially community and regional banks—for financing. Large businesses in the U.S. get just 30 percent of their financing from banks while small businesses rely on them for 90% of their financing needs. A Federal Reserve survey earlier in the decade showed that more than half of smaller firms had a credit line or loan with a bank. In addition, about half of these businesses used a personal or business credit card to finance working capital.

Entrepreneurs that borrow on credit cards to keep their firms going face tighter lending standards and new rules designed to protect consumers, but which also threaten to squeeze the flow of finance. Many small business owners also use their homes as collateral for borrowing, but that route is closed to the 28 percent of homeowners nationally, and 24 percent in NH, who are sunk in negative or near negative home equity⁵. Small businesses are also the least likely to have the resources to weather a prolonged recession without irreparably damaging their businesses finances, making them less creditworthy as the recession has continued.

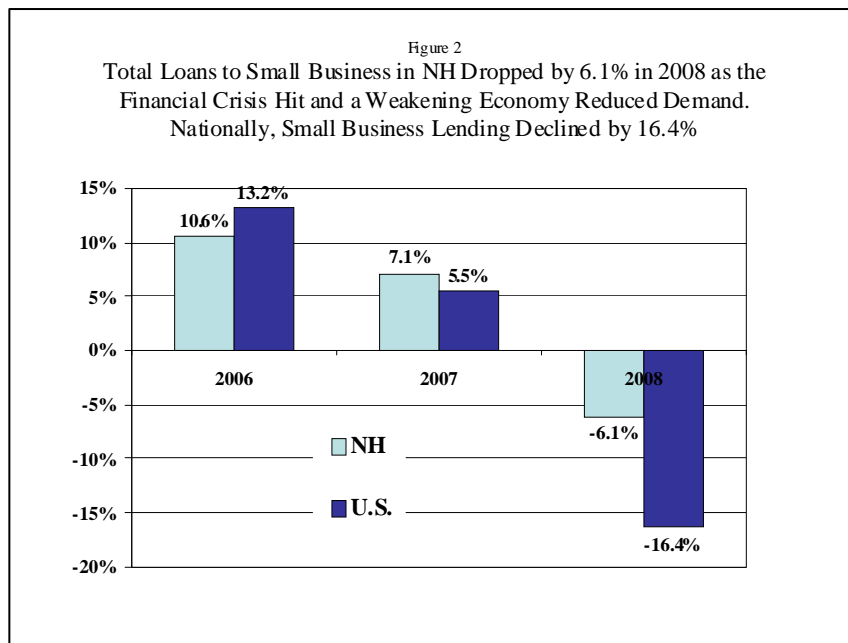
To capture small business lending trends in NH among lending institutions of all types, our analysis uses annual Community Reinvestment Act (CRA) reports filed with the Federal Financial Institutions Examination Council (FFIEC) to supplement the June quarterly “call reports” that are filed by each institution with the Federal Deposit Insurance Corporation (FDIC), and which contain small business lending data at the institution level. CRA reports require large banks and multi-state

⁵ First American CoreLogic’s “LoanPerformance” database and negative equity report by state.

and national organizations with at least \$1 billion in assets to report on their lending activity at the state and county level (others may report voluntarily), allowing analysts to isolate the lending activity in NH of large, multi-state, regional, and national lenders.⁶ In combination, the CRA and June quarterly call reports provide a more complete picture of small business lending trends in a state.

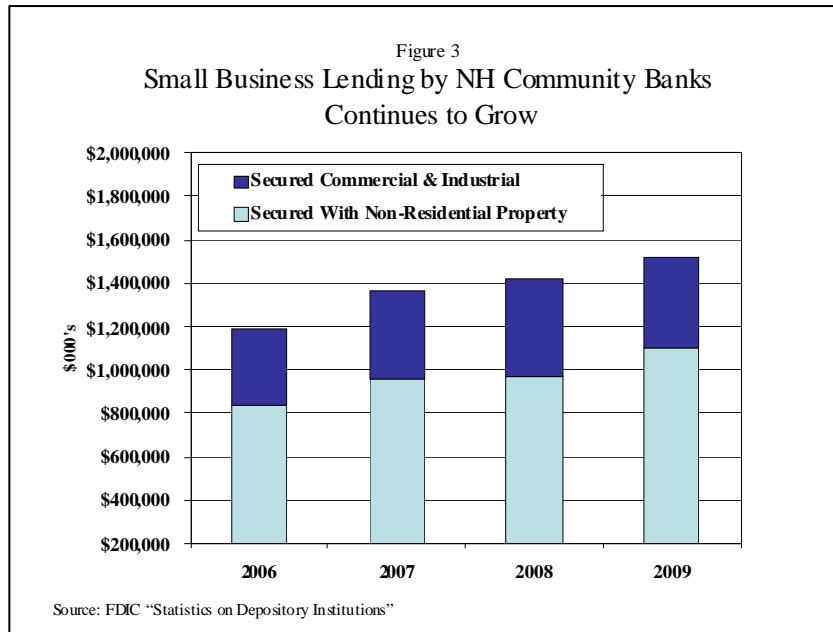
Figure 2 shows that according to regulatory filings, small business lending in NH dropped by 6 percent in NH in 2008, compared to a decline nationally of 16 percent over the same time period.

NH Community Banks Have Increased Small Business Lending



Smaller banking institutions in NH that have the least exposure to factors that have influenced national credit trends have continued to increase lending to small businesses. Figure 3 shows that small business lending at 25 community banks that operate in NH has increased overall during the years examined, including during the recession.

⁶ According to the Federal Financial Institutions Examinations Council: “Interpreting the CRA data can be challenging. For example, lending institutions are asked to report the geographic location of the loan. If the proceeds of a small business loan are used in more than one location, the institution can record the loan location as either the address of the borrower's business headquarters or the location where the greatest portion of the proceeds are applied, as indicated by the borrower. Further, although CRA data provides information on extensions of credit in a geographic area, they do not indicate the amount or nature of the overall demand for credit in that area. Consequently, caution should be used in drawing conclusions from analyses using only CRA data, as differences in local loan volume may reflect differences in local demand.”



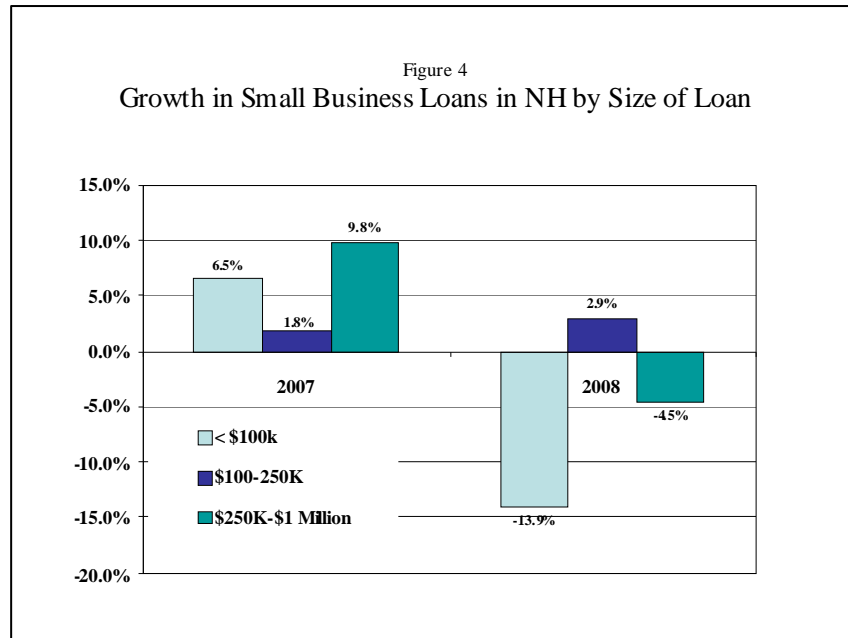
Smallest Loans Experience Biggest Decline

The decline in small business lending in NH is small in comparison to the national decline, but the rate of decline differs depending on loan size. Small business loans with a dollar value of under \$100,000 appear to be most affected by the overall decline in small business lending. Figure 4 shows that loans under \$100,000 declined by 13.9 percent in NH between 2007 and 2008, by far the largest decline of the three categories of loan size.

This drop may reflect the fact that the smallest businesses have seen larger declines in credit than overall small business lending trends suggest. But the decline in these smallest loans may also reflect larger forces affecting credit trends which are not directly related to the financial health of the smallest businesses. Both home equity lines of credit and credit cards are used more extensively by the smallest firms to finance their operations. As the president of the Federal Reserve Bank of New York stated in a recent speech:

*"For small business borrowers, there are three problems. First, the fundamentals of their businesses have often deteriorated because of the length and severity of the recession—making many less creditworthy. Second, some sources of funding for small businesses—credit card borrowing and home equity loans—have dried up as banks have responded to rising credit losses in these areas by tightening credit standards. Third, small businesses have few alternative sources of funds."*⁷

⁷ Lockhart, Dennis, "Economic Recovery, Small Business, and the Challenge of Commercial Real Estate", Speech before the Urban Land Institute's *Emerging Trends in Real Estate Conference*, November, 2009.



Business credit card accounts are included in reported small business lending data. As noted earlier, both the number of cards and circulation and credit lines has shrunk sharply since the financial crisis began. Most business credit card lines of credit fall in the small loan (<\$100,000) category and it is likely that the reduction in credit lines via credit cards has contributed to the disproportionate decline in the “under \$100,000” category of small business loans in NH. Evidence that reductions in business credit card lines of credit is a major contributor to the reduction in the smallest business loans in NH is provided in the following section of this report. The analysis below shows that national credit card banks contributed the largest share of the overall decline in small business credit in NH.

III. National Lenders Account For Most of the Decline in Business Credit

Almost two-thirds of the decline in small business lending that occurred in New Hampshire is attributable to less lending by national business lenders and business credit card providers with little or no physical presence in NH. Banks with at least one depository branch in New Hampshire account for just over one-third of the decline in small business lending.

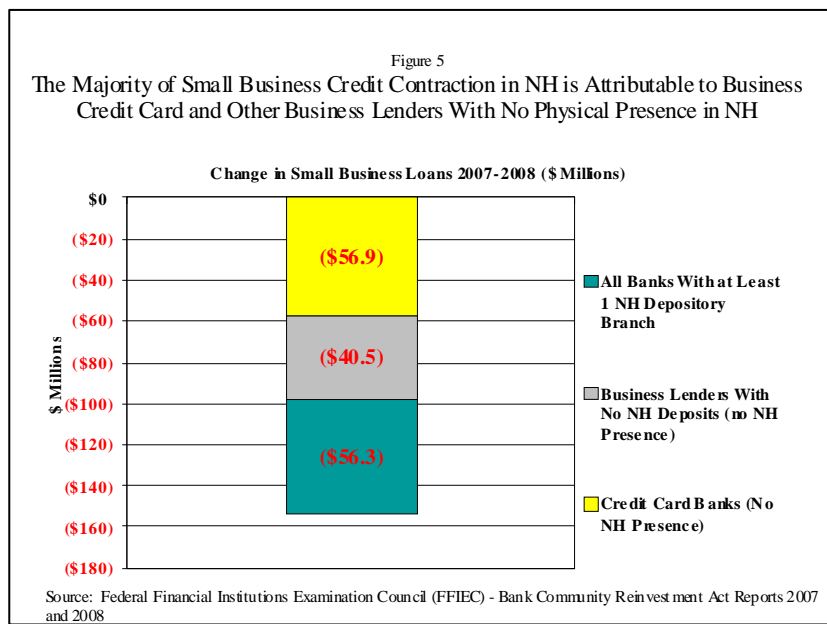
To determine how small business lending by national banks and lenders (who operate in many states) has changed this recession, we examined Community Reinvestment Act reports which have yet to be reported for 2009. This means that while we can assess small business lending for community banks (which report small business lending in June of each year), we cannot yet determine the volume of small business lending in NH by multi-state lenders for 2009. Thus our overall assessment of changes in small business lending ends in 2008, while our assessment of small business lending of community banks ends in June of 2009.

Our examination of small business lending in NH by institution reveals interesting patterns that

are consistent with some national trends and some media accounts. Using the CRA and call report data, we aggregate the changes in small business lending into three broad categories according to the nature of the bank or lender, including:

- National credit card banks which provide business credit cards (and perhaps credit cards to individuals but the numbers here reflect only business credit cards). Credit cards are an important source of credit for many of the smallest businesses and have retrenched dramatically across the country over the past year. These banks generally have no physical presence in the state to which they lend.
- National business lenders that primarily lend to business and do little retail banking. They generally have little or no physical presence in the state where they lend.
- All other banking institutions in NH. These primarily include community banks, large national banks, regional and multi-state banks that have one or more branch offices in NH, but also includes a few small lenders that may not have a retail branch in NH.

Figure 5 summarizes the changes in small business lending that occurred in NH between 2007 and 2008, as the financial crisis hit and business and household credit declined. It shows that the majority of the decline in small business lending in NH between 2007 and 2008 is attributable to institutions with little or no physical presence in NH. Combined, business credit card lenders and business lenders with no physical presence in NH account for 62 percent of the decline in small business lending in NH in 2008.

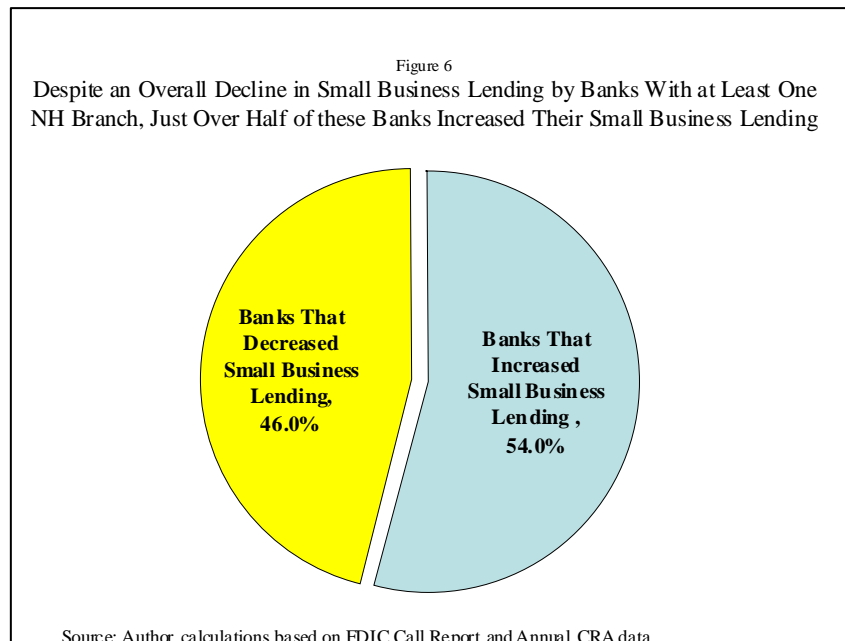


A closer examination of the institutions in these categories shows that many of the institutions that have the most significant decline in small business lending have experienced well documented financial strains or are subject to the national and international forces that temporarily crippled credit markets in 2008 and early 2009. A variety of factors, some related to the financial health of these institutions, and some regulatory, such as the need to raise capital or reduce assets to improve their capital ratios or write down the value of some loans, as well economic conditions and demand from borrowers, have all contributed to reduced lending by these institutions not only in NH, but across the

country.

The data in Figure 5 does not mean that all credit card, business lenders, or all banks with at least one NH branch reduced small business lending in the state. In the aggregate, however, the decline in lending among institutions that have a lower volume of small business loans in 2008 than they did in 2007 in each of these categories exceeds the total increase in small business loans among institutions that increased lending between 2007 and 2008. Figure 6 illustrates this point, it shows that, of banks with at least one depository branch located in NH and which do business lending (a few institutions in NH do no business lending), 54 percent of them increased the dollar volume of small business loans in 2008, while 44 percent experienced a decline in small business lending.

The implication of this finding is that local economies and market conditions play a significant role in determining credit trends for banks as well as borrowers. The banking industry is not



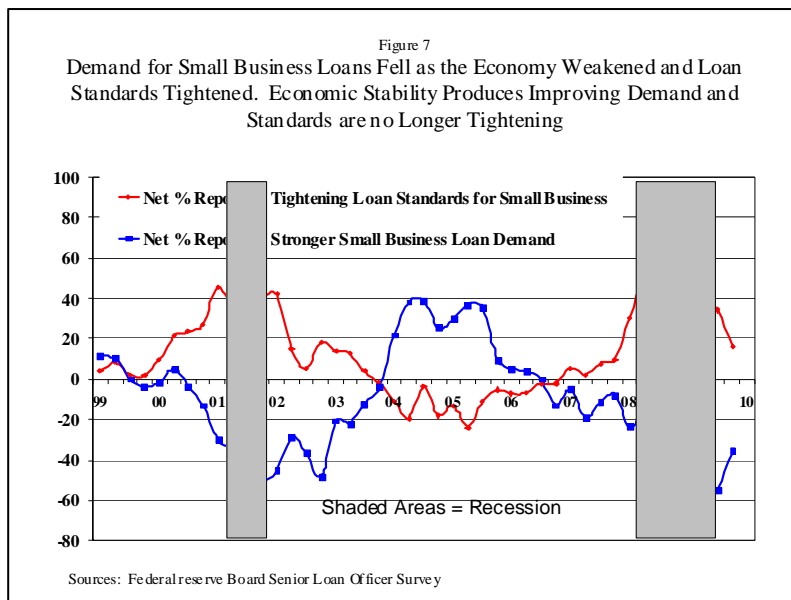
monolithic, individual institutions and their lending trends differ, as do the markets in which banks operate and the customers whom they serve. Some banks increased lending significantly while others reduced lending. Some businesses may have difficulty obtaining credit while others have ample lines of credit. These individual experiences, however, do not negate the aggregate lending trends documented in this report.

IV. Too Little Small Business Credit or Less Demand for It?

The financial crisis that began in the Fall of 2008 helped propel the U.S. economy into a downward spiral, but lending (or lack of it) did not remain the primary problem of small business for most of 2009. Rather, it was the weak economy that devastated sales and business profits and loan demand.

According to the Federal Reserve’s quarterly “Senior Loan Officer Survey”, demand for loans from small business plummeted after the financial panic that began in the Fall of 2008 (Figure 7). The chart below shows that demand for loans typically declines during recessions and credit standards tighten as the finances of businesses become more strained: that pattern has been followed to the extreme during the current recession.

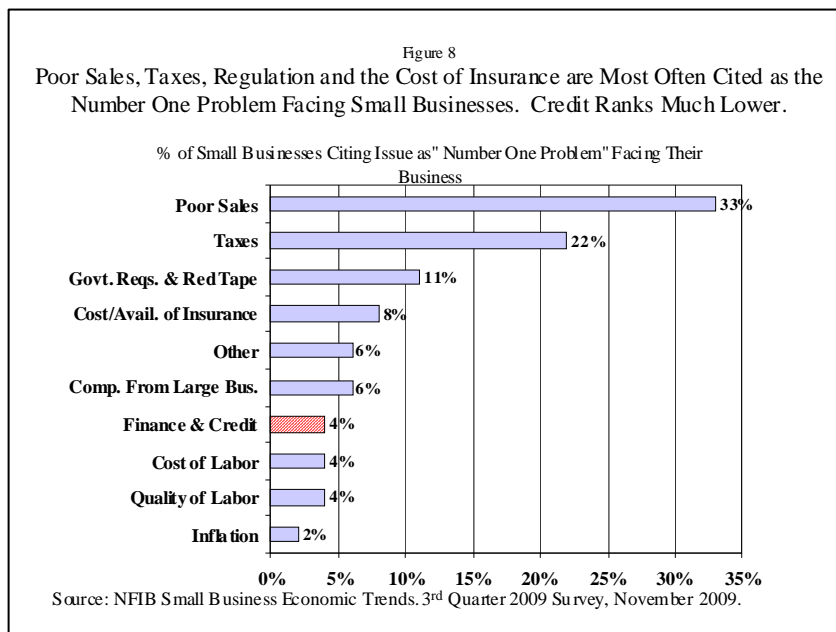
Nationwide, business owners themselves appear to see issues besides credit as their primary



impediment to growth. A November 2009 report by the National Federation of Independent Business on a nationwide survey of their members shows that financing and credit ranks low when business owners were asked about the most important issue facing their businesses (Figure 8). Figure 8 shows that “poor sales” and “taxes” are each cited four to five times as many small business owners as the “number one problem” facing their business. Financing and credit was cited as the number one problem by just four percent of businesses surveyed nationwide.

In discussing survey results and credit trends, the NFIB report notes that, overall, loan demand remains weak due to widespread postponement of investment in inventories and record low plans for capital spending. In addition, the continued poor earnings and sales performance has weakened the credit worthiness of many potential borrowers. This has resulted in tougher terms and higher loan rejection rates (even with no change in lending standards), and there is no rush to borrow money. In its commentary on survey findings, the report goes on to say:

“It sounds like the Administration thinks the reason small firms are not hiring is that they are not able to get credit. Although credit is harder to get, “financing” is cited as the “most important problem” by only four percent of NFIB’s hundreds of thousands of member firms. . . .— too many owners have no reason to borrow. Record low percentages cite the current period as a good time to expand, more owners plan to reduce inventories than to add to them, and record low percentages plan any capital expenditures. In short, the demand for credit is in short supply and failing to understand the more major problems facing small business leads to bad policy.....Few firms report credit availability as a problem, though those who are borrowing report more difficulty and tougher terms than during the expansion.”



V. Conclusions

New Hampshire businesses and residents have suffered dramatic losses during the recession that began as 2007 ended. The NH economy has lost 3.5% (or about 20,000) of its jobs since peaking in January of 2008, but that is significantly less than the 5.5% loss of employment nationally and only 10 states have lost a smaller percentage of jobs during the recession. This is a function of the underlying fundamental strength of the New Hampshire economy, but it also appears that, in part, NH's relative performance is the result of having greater access to credit than businesses overall across the U.S.

This report documents trends in bank lending to small businesses in New Hampshire and compares those trends with larger national trends. Small business lending declined overall in NH as the economy weakened and the global financial crisis hit in 2008. But overall, small business lending declined by a much smaller percentage in NH than in the nation as a whole. Moreover, NH's community banks have increased their lending to small business in recent years, including each year of the recession. Almost two-thirds of the decline in lending to small businesses in NH is attributable to national business credit card banks and business lenders with no presence in NH. Just over a third of the decline in loans outstanding is attributable to banking institutions with at least one branch in NH, but even among this group, over one-half (54%) increased lending to small businesses despite the aggregate drop in lending among this group of banks.

As importantly, it is unclear whether the decline in small business credit is mainly due to less willing lenders or lower demand by borrowers. There is evidence for both. If the drop-off in lending is mainly due to weak demand by businesses, then there is some hope that the recent upward momentum in output and sales could lead to more optimistic business sentiment, greater demand for capital, and more lending by banks. But if the decline is mainly due to weak banks unable or

unwilling to lend, then a turnaround in credit conditions may have to wait until banks' balance sheets are repaired, a process that could be delayed by additional defaults in consumer loans, mortgages and commercial real-estate loans.

The data in this report provides some clues as to the causes of the decline in small business lending. NH's community banks are healthy compared to the overall U.S. banking industry. None of the approximately 140 banks that have been closed by regulators was in NH nor are any of the 500+ banks currently on federal regulators "watch list" of troubled banks. One result, NH's community banks have been able and willing to increase business lending, even in a difficult economy. In contrast, our data shows that national institutions most affected by weakness in the banking industry have more significantly curtailed business lending in NH.

It would be counterproductive for NH policymakers to attempt to address credit conditions for small business by increasing expectations or expanding regulations on the NH institutions that have done the most to maintain access to business credit during this recession. Similarly, populist sentiment and political rhetoric seem misplaced when indiscriminately directed at all financial institutions in NH. This environment seems ripe to take a "step in the right direction", even if it means taking the wrong step. Understanding the dynamics that are contributing to the decline in credit for small business in NH is a "right" first step that can help prevent future policy missteps. This report is an effort to begin creating that understanding.