

Paducah Bank's Positive Impact on the Community through Small Business Lending

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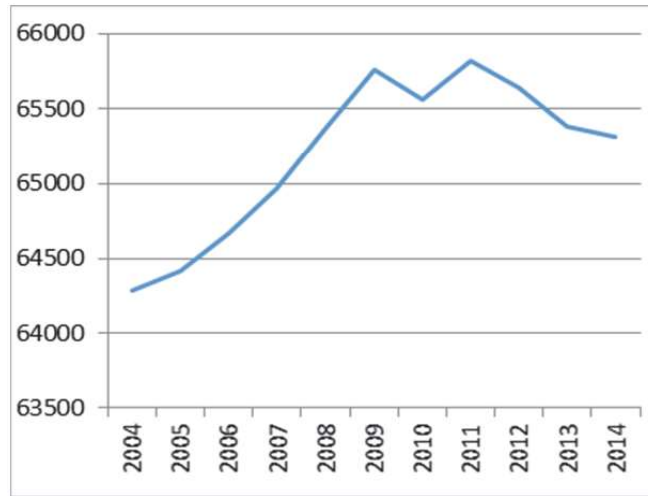
Small business lending by community banks has fallen in recent years due to community banks being acquired by larger counterparts (Jagtiani and Maingi, 2018). Regulatory requirements have incentivized larger banks to acquire smaller banks (Bonilla et al., 2018). To compete against larger competitors, community banks are taking a relationship based approach to lending (Bonilla et al., 2018). These institutions are uniquely suited for small business loans in that they know their community and their client base. The purpose of this paper is to examine a small community bank and assess their small business lending.

INTRODUCTION

Paducah, KY is located in the Jackson Purchase Region of Western Kentucky. Nestled at the intersection of the Ohio and Tennessee Rivers, Paducah quickly became a transportation mecca after its founding in 1815. Goods could be shipped by river and then transported to nearby railroad companies. As a result, manufacturers flocked to the community. Paducah was chartered as a city in 1856.

A significant historical moment for Paducah is The Ohio River Flood of 1937. At the river port in Paducah, the river crested at a historical high of over 60 feet. The flood waters spilled into much of the downtown area resulting in a state of emergency. In order to protect the city from future damage, the United States Army Corps of Engineers built a flood wall. Today, the flood wall is a tourist destination because of the beautiful hand painted murals depicting the city's rich and culturally-diverse history. According to the Kentucky Center for Statistics, over 60,000 residents currently live in Paducah and McCracken County (See Figure 1). Their contributions to the area have revived the historic arts district, vibrant downtown area, and many small businesses that can only be found in Paducah.

**FIGURE 1
POPULATION GROWTH IN PADUCAH, KY**



Paducah is also known worldwide as “Quilt City, USA”. It is recognized as a UNESCO City of Crafts and Folk Art. Each year in April, thousands of people from all over the world flock to Paducah for the American Quilter’s Society Quilt Week. Hundreds of vendors give classes and lectures as well as sell their goods to the dedicated attendees. The event has grown so large in recent years that Paducah is introducing a second Quilt Week beginning in the Fall of 2017 to accommodate the demand.

Paducah Bank was founded in 1948 with original assets of \$100,000. As the only locally owned bank in McCracken County, Paducah Bank and its employees truly understand this unique community and contribute to it significantly through living in the area, developing and maintaining strong customer relationships, and spending countless hours in volunteer service each year.

The vibrant arts community that is present in Paducah is strongly supported through Paducah Bank’s contribution to the Artist Relocation Program. The unconventional loan structure developed by Paducah Bank continues to allow artists to practice their trade while enhancing the value and appeal of homes in the Lowertown area of Paducah.

MANAGEMENT STRUCTURE

Paducah Bank’s chain of command is similar to the structure of most financial institutions. The bank President, Mardie Herndon, Jr., also serves as the Chief Operating Officer. Herndon received a bachelor’s degree in Finance from Georgia Southern University and brings more than twenty years’ experience working as a CEO at a financial institution in Georgia. He took office at Paducah Bank in 2013 when Wally Bateman resigned as COO after twenty years of service to Paducah Bank. Bateman continues to serve to the bank as a director and officer. The bank’s current Chief Executive Officer, Joe Framptom, reports directly to the president. The Chief Financial Officer is John Durbin. Paducah Bank also employs several key area leaders in departments including accounting, lending, retail, wealth management, operations, audit, and human resources. Each of these leaders report to the President.

GROWTH IN COMPARISON TO OTHER BANKS

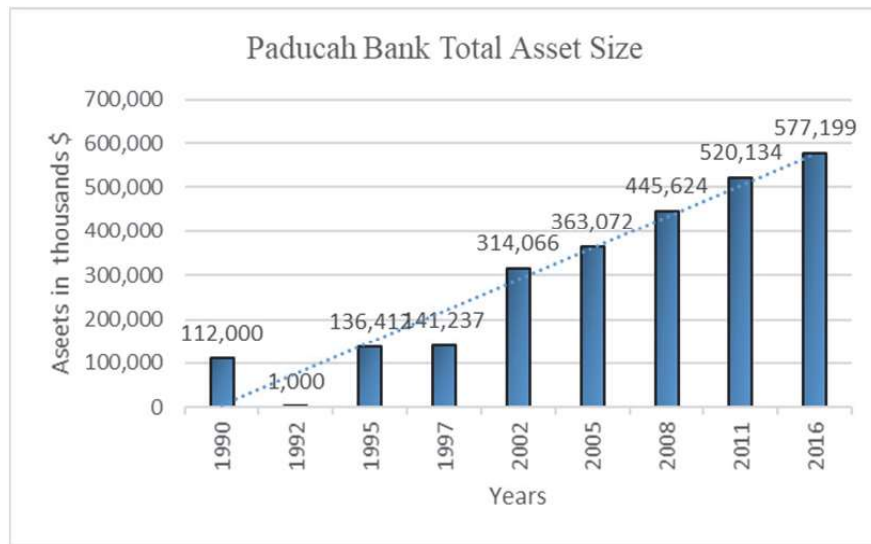
Paducah Bank and Trust Company employees approximately 150+ people throughout its six branches. Average employment in McCracken County is 37,953 people, meaning 1 out of every 250 people is employed by Paducah Bank. Since Paducah Bank employees more local people, it has a strong foothold in the region compared to other banks. Paducah Bank has a comparable advantage because of

their one-on-one interaction system with their customers. Due to their substantial community involvement, people feel more comfortable using Paducah Bank over its competitors.

PADUCAH BANK'S FINANCIALS

Paducah Bank has one of the largest asset accounts in terms of total assets among its peers. Years' worth of excellent financial management and lending practices have made this possible. Paducah Bank currently has assets of \$577,199,000 (See Figure 2). A major milestone, reaching \$100 million in total assets, was achieved in 1987. The most valuable resources to Paducah Bank are the Paducah Bank branches (land), capital/machinery, houses throughout Paducah, some small businesses due to failure in repayment and, of course, cash on hand. Paducah Bank reinvests its assets in different areas such as stock, businesses, and new branches.

FIGURE 2
PADUCAH BANK TOTAL ASSETS



Similar to other banks, the largest portion of Paducah Bank's liabilities comes from the risk associated with lending to customers. The Bank has to be willing to loan out its current customers' deposited money to people and businesses. The most common recipients of loan funding are small business owners due to a lack of capital and collateral when they are first starting. Each year, Paducah Bank helps over 100 small businesses throughout the region. This is an outstanding figure for a community bank as compared to larger national banks because it indicates that Paducah Bank not only knows the area, but also understands the individual needs of local small business owners.

Paducah Bank is 100% locally-owned through its own stocks, funds, and dealings with other companies' finances. This is due to Paducah Bank staying regional rather than being listed on the national stock markets. However, it was not until 1991 that Paducah Bank defined terms of employee equity ownership. When the Holding Board of Directors established a stock plan and a 401(k) for its employees, the company began to grow more from the inside. Employees had a new incentive to work harder and advance their position in the company itself. With these major financial opportunities, Paducah Bank became an ideal place for its employees to invest.

Paducah Bank's current Return on Equity (ROE) is 14.57% compared to the average for banks in the United States of 9.74%, which gives an outstanding bonus to Paducah Bank and its employees/shareholders. Capitalization percentage (cap rate) is the rate of return on a real estate investment property based on the income that the property is expected to generate. Paducah Bank's cap

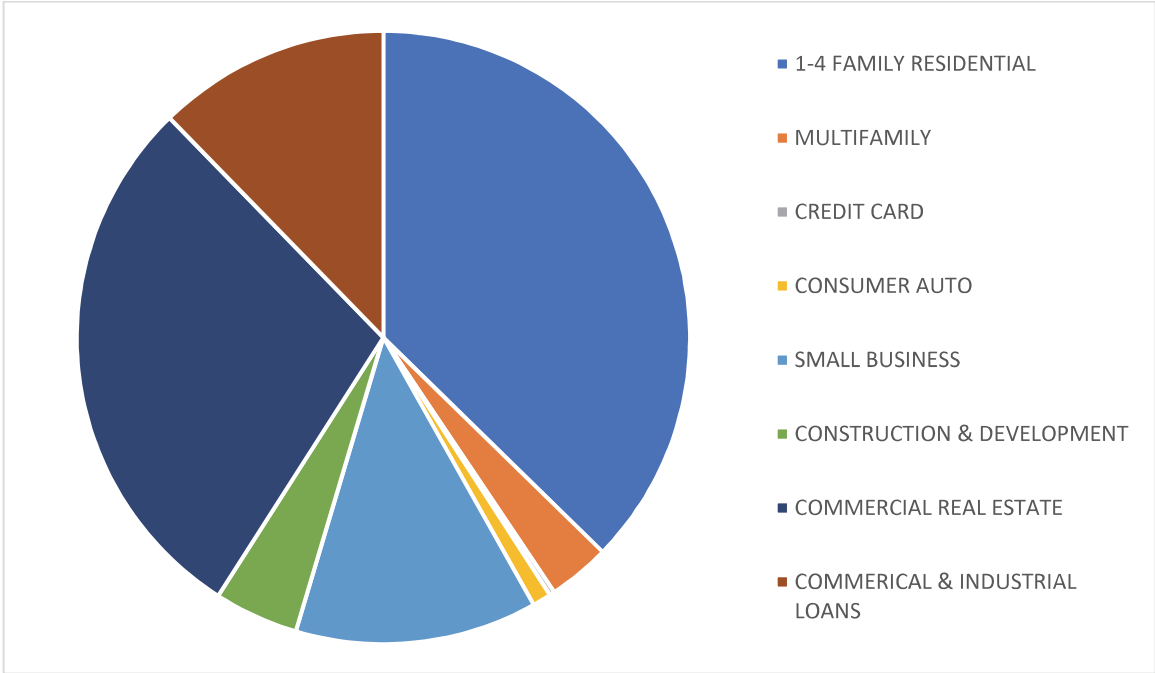
rate is 13.32% compared to the 11.23% of U.S. Banks, meaning Paducah Bank is more stable than many of its competitors when it comes to equity and security.

LENDING

Applying for a loan is simple with Paducah Bank. They have many financial advisors and personal bankers to ensure every person or business gets answers to all the questions they may have. Loan applications can be made in-person at a branch or online through Paducah Bank’s website and a lender will analyze and discuss the situation with the customer. Although most banks offer this type of application, most of them do not work as efficiently as Paducah Bank. Paducah Bank has the ability to process loans quickly and efficiently because all decisions are made in-house. All of Paducah Bank’s senior managers are located in Paducah, so there is no need to wait for a decision to be made by an officer in another state as is the case with bigger national banks. Transparency and knowledge of the customer base allow Paducah Bank to catch many bad loans before they are made. Other special services they offer to loan applicants are personal consulting and advising for businesses to guide them in the areas of financials, repayments, retirement, and stock options. These services go above and beyond the call of a regular loan officer, making Paducah Bank stand out as the region’s community bank.

Paducah Bank currently has an estimated \$370 million worth of loans out to the public. The majority of Paducah Bank’s loans are in single family residential loans. Commercial real estate makes up 32.07% of their portfolio (See Table 1).

**TABLE 1
PADUCAH BANK’S LOAN PORTFOLIO**



COMMUNITY INVOLVEMENT

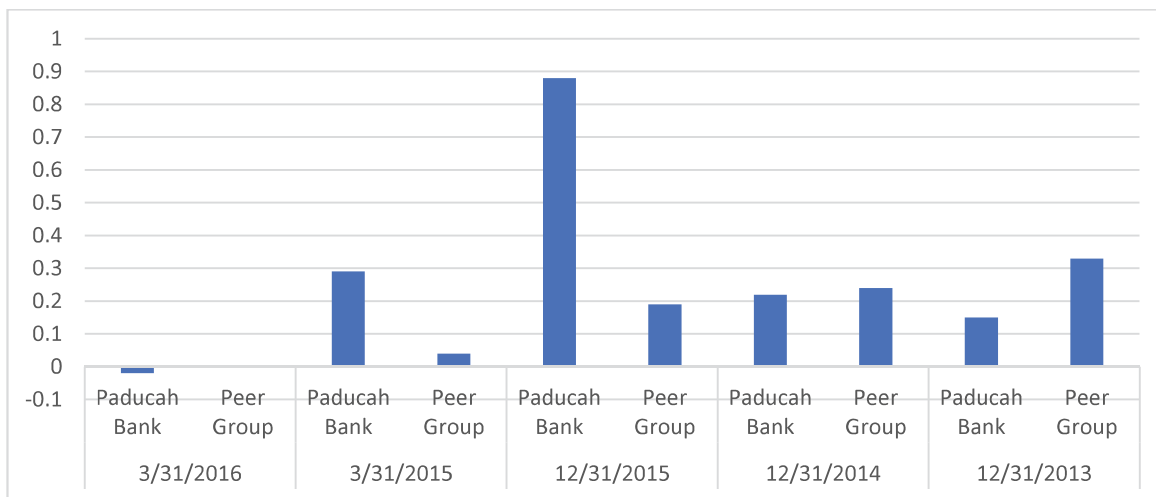
In the couple of decades preceding the year 2000, Paducah’s Lowertown district fell on particularly hard times. Drug trades were frequent and the historic Victorian homes were cut into low-rent apartments. This all led to the exponential decline of the neighborhood. In March 2000, Paducah Bank partnered with

the city and a local artist in launching the Artist Relocation Program (ARP). This program attracts artists from across the nation to relocate to the Lowertown neighborhood of Paducah, KY. The artists buy homes from the city for very low prices and renovate them to house their businesses on the main floor and residential space above. The main goals of the program are to increase homeownership and property values in Lower Town, rehabilitate historic buildings, reduce crime, and economically revitalize the Lowertown neighborhood with the addition of new retail and service businesses.

As of 2005, a total of \$14-15M had been invested in the Lower Town neighborhood. In 2005, Paducah Bank won the Rudy Bruner Award for Urban Excellence given by the Bruner Foundation (Shibley, et al., 2005). According to the Bruner Foundation, Paducah Bank is the “sine qua non of the Artist Relocation Program.” The bank has created an untraditional loan process to further aid the artists in their relocation efforts. A loan officer from the bank works with artists directly, and, upon determining their creditworthiness, loans up to 300% of the appraised value of the structure for rehabilitation and construction at the rate of 7% on a fixed 30-year term. Paducah Bank also provides \$2,500 for architectural and other professional rehabilitation fees. When the award was given in 2005, there had been no issues with late payments from customers with loans through the ARP. Unfortunately, since then, some artists have struggled making payments and a few have lost their homes through foreclosure. The current number of loans in the Artist Relocation Program is 19 for a total \$3,308,049. The artist relocation program has transformed Paducah’s lowertown into the ‘crown jewel’ of the city (Brundige, 2006).

Even though not 100% of the loans have been repaid, the efforts of Paducah Bank in the ARP are obvious to anyone driving through the historic arts district. The area has been revitalized and it continues to grow and improve each year. The artists have become a very important part of the culture of Paducah, and their contributions to the city are far reaching. Not only have they brought their business to Paducah, but they support other local small business as well, boosting the whole economy.

**FIGURE 3
PADUCAH BANK’S NET LOSS ON COMMERCIAL AND INDUSTRIAL
LOANS VS THE PEER GROUP AVERAGE**



Paducah Bank utilizes programs with the Small Business Administration (SBA) to give loans to small businesses. SBA guarantees to the bank that the loans will be repaid thus eliminating some of the risk to the bank. This allows Paducah Bank to help more customers start their small businesses each year than would be possible without the SBA. For several years, Paducah Bank has been in the top 3 banks for SBA loan volume in the state of Kentucky. The time and money spent to generate a loan is the same whether the loan is worth \$10,000 or \$250,000. Paducah Bank lenders believe so strongly in the small

businesses they service that they utilize all the resources available to them to ensure those small loans are able to be made.

Paducah Bank takes on a substantial amount of extra risk through the Artist Relocation Program as well as with other unique small business loans they create. However, because Paducah Bank lenders understand their customer base so well and maintain their relationships with them, Paducah Bank's default rates and net losses on these loans have remained comparable to their peer group average.

COMMUNITY REINVESTMENT ACT

Paducah Bank improved their Community Reinvestment Act rating from satisfactory in 2011 to outstanding in 2014. The employees of Paducah Bank showcase the commitment of the bank to serving the surrounding community. In 2015, the bank's 150 employees logged 4700 hours of volunteer service (approximately 30 hours per employee). Several financial officers of the bank go beyond this and sit on the board of various community organizations involved with low to middle income areas. They also teach financial literacy to local small businesses and provide financial education and budgeting seminars through community organizations serving low-income individuals.

As highlighted in the 2014 CRA report, the bank's "overall community development performance demonstrates adequate responsiveness to the community development needs of its assessment area." The bank not only has the capacity to assist with the development needs of the community, but also has the means of identifying and understanding the root causes of those needs which allows them to help financially while building future business through customer relations. An excellent example to demonstrate is an operating line of credit that was given to a local Boys and Girls Club. The mission of the Boys and Girls Club is to "enable all young people, especially LMI individuals, to be productive, caring, and responsible citizens." In total during the review period, the bank extended nine community development loans totaling \$581,676. Nine loans may seem like a small number, but they illustrate Paducah Bank's responsiveness to the needs of the community.

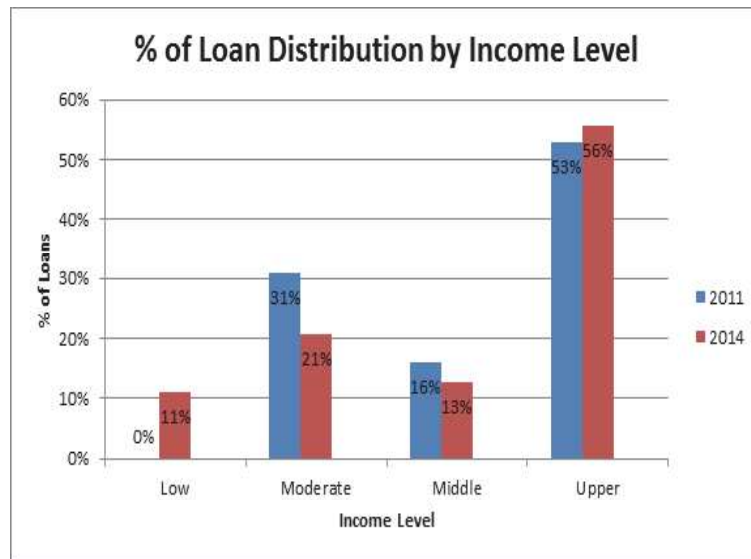
In conjunction with the qualified loans and investments, the bank donated a total of \$232,355 to 34 different organizations/programs having a community development purpose. Despite the limited opportunities for outreach available to Paducah Bank, they have remained creative and forward-thinking in their efforts to benefit the surrounding community.

Paducah Bank has done an exemplary job of distributing their efforts across the various income levels in the community. Although the majority of their customer base lies in the Moderate-Upper income level classes, they chose to open their newest branch in the low-income level "southside" area of Paducah in 2012. It is also important to note that the bank's main office is located in a low-income tract making 33% of the bank's offices located in low-income tracts (See Figure 4).

CONCLUSION

Paducah Bank has set itself apart as the region's community bank not only by being 100% locally-owned but by participating in, and contributing to, the culture that has been created in Paducah. Their focus on the individual needs of each small business is evident in their specialized services. They continue to donate financially, and with their time, to local organizations across all income levels, earning the "satisfactory" CRA rating.

FIGURE 4
PADUCAH BANK'S PERCENTAGE OF LOAN DISTRIBUTION BY INCOME LEVEL



The Artist Relocation Program is the best example of Paducah Bank's commitment to improving both the livelihood of their customers and the economy of Paducah. By loaning more than the value of the homes, they put their full faith in the capabilities of their customers and were willing to take a large risk that most financial institutions would not have considered. Taking the time to establish a working relationship with the artists who participate in this program is what made the extra risks involved pay off.

The management of Paducah Bank has worked tirelessly to maintain their strong financial standing while still catering to the needs of their customers. Their Asset Size, Return on Equity, and Capitalization Percentage have remained comparable to and exceeded their peers. Utilizing the Small Business Administration has helped greatly in these efforts.

Small businesses are what make Paducah the great city that it is. The owners use creativity, sense of community, and hard work to establish the businesses that are so important to the culture and economy of Paducah. They turn their passions into profit, and Paducah Bank is there to help them every step of the way.

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