The Truth Behind Banking

Understanding what influences lending decisions is the first step to success

By Garry Barnes

Many businesses need to borrow money. In fact, many entrepreneurs will try to establish a credit relationship with a lender in the initial stages of business development. The ability to borrow money in a timely manner at reasonable terms and conditions is essential to meeting the demands of a growing organization. This is where commercial mortgage brokers come in. Experienced mortgage brokers understand that the borrowing process is more art than science.

Historically, some financial experts have believed that banks do not provide clear and concise explanations of the processes and standards they use to make capital available. The inner workings of banks appear esoteric, confusing and shrouded in mystery to many borrowers. Consequently, even the most experienced business owners may feel uncomfortable approaching banks to establish a credit relationship. Again, this is where brokers come in.

Of course, banks do not intentionally conceal their financial practices. In reality, borrowing business capital is not as onerous as it seems. Once a mortgage broker develops a basic understanding of lending processes, much of the mystery disappears. If you know the rules, you can win the game.

Understanding banks

The first thing to understand is that banks must make loans. Interest income represents anywhere from 60 percent to 80 percent of a bank's income, although this percentage has dropped over the past 20 years. Without a growing loan portfolio, banks will not achieve financial success. In other words, banks must loan money to make a profit and stay in business. They need good quality commercial loans.

But, there is more to the story. Many companies are in business to find a market niche, expand their customer base, sell products, and make a profit. So, the basic answer to the question of "why do banks exist?" is "to provide a variety of financial services to an ever- expanding customer base while generating a profit."

Banks must provide a reasonable financial return to their stockholders just like any other for-profit business, and like all investors, the people who invest in banks are looking to make a profit. To do that, banks should loan money and collect interest payments. Again, they need good commercial loans.

There are, of course, fundamental differences between banks and other local businesses. Banks are mandated by Congress and other regulatory agencies to meet certain social and community responsibilities, unlike many organizations in other fields. Specifically, banks must perform three basic functions:

- **Accept and safeguard deposits.** Banks hold money for people and organizations.
- **Make payments.** Banks honor checks and other financial instruments — in essence, return deposits.
- **Extend credit.** Banks make loans to help finance purchases made by businesses and people.

Influence

Banks' mandated functions, along with government oversight and the pressure of making a profit, have an impact on their policies. If you have ever wondered why a bank made a particular decision, you just have to understand the factors that influence that decision. Essentially, the forces that direct bank lending policies are:

- **Shareholders.** Shareholders expect the bank to be aggressive and expand market share with competitive, new products, while yielding an ever-increasing return on investment. The challenge is that being overly aggressive can lead to loan losses and a decreasing value of the shareholders' investment.
- **Borrowers.** On the other hand, borrowers generally ask for low rates, long terms, little or no collateral, and a quick answer. They can't be blamed for asking for these items, even though their requests are often contrary to shareholders' and regulators' expectations or needs.
- **Depositors.** Depositors want no-cost checking, high certificate of deposit rates, instant liquidity and a branch on every corner. Again, shareholders and regulators may have different expectations in these areas.

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■ **Regulators.** Perfection is what regulators expect. In most cases, regulators rule the day.

Finding the right bank

The last thing a busy mortgage broker wants to do is go through the laborious process of finding and developing a relationship with a new bank. It is not an easy task. It takes time, research and shoe leather to make the right selection. If you make a poor choice, the whole process starts over, so it's important to do it right the first time.

Unfortunately, as many brokers know, sometimes you have to change banks. In general the reasons for changing lenders can be narrowed to two valid concerns:

■ **The bank reached its maximum loan-concentration limits on the types of loan you broker.** There are ways around this limitation, however. The most frequent method is to find another lender to fund a portion of the borrower's credit needs, which is done through "loan participation." All arrangements for this are handled by the lead bank and the mortgage broker is generally not involved in the process.

■ **The bank's policies are inconsistent with the broker's objectives.** Bank policies may change suddenly because of abrupt events in the local or national economy. Alternatively, the company the commercial mortgage broker works with might require a course correction and the new direction is no longer consistent with the bank's philosophy.

Whatever the reason for needing a new lending partner, there is more to selecting a new bank than pulling out the yellow pages and making a few phone calls. A written plan is essential to this task. Commercial mortgage brokers must take the time to identify their on-going needs and expectations before beginning the process if they want to select a bank that can satisfy all of their requirements. Brokers should consider these four steps, which will make the process go more smoothly, with fewer frustrations for all parties involved.

1. **Develop requirements.** Some questions you should consider include: Are the bank's lending policies consistent with your client's needs? At what level are the loan decisions made? As your clients' businesses grow and expand, will the bank continue to meet your capital needs with a timely response?
2. **Create a list of candidates.** Using your list of requirements, find banks that appear to have the philosophy and resources to meet your clients' financial needs. Ask friends, acquaintances, and even competitors for recommendations, and inquire about their experiences with these lenders. Solicit objective opinions from accounting companies or other outside consultants, as well. If a particular bank sounds right, ask for an introduction.
3. **Obtain annual reports.** Use these reports to review the respective size and areas of lending activity for each bank on your list. You also can review product and service pamphlets to learn as much as possible about the bank before the first meeting.
4. **Contact the bank.** Try to speak with the chief lending officer or branch manager. The referral can do wonders in terms of opening doors. Briefly review the business model and estimated annual capital needs of your clients. If the lender shows interest, present your strategic plan for review. Finally, ask if the bank would like to review your next deal. Your relationship with the bank will be built one deal at a time.

Completing the process

More than likely, the bank will have questions that you must answer early in the discussion. Where is your current banking relationship? Why are you making a change? What other services do you need? How many deals can you generate annually? How big are those deals? Be candid and truthful when you answer these questions. An old adage says "You should never lie to your doctor, the tax collector or your banker." Believe it.

You may want to interview more than one bank. If so, thoroughly evaluate each lender relative to your needs and write down your thoughts and opinions so you can compare the characteristics of each bank. Keep in mind that rates should not be the single most important criterion.

In fact, a quick answer often is much more important than current rates when dealing with a bank, even if that answer is no. Time is your most valuable asset. Don't waste it waiting for a long, drawn-out decision from a bank. Once your interview process is over and your analysis complete, one particular bank will more than likely stand out. That's your new bank and the path to success in commercial lending. ■