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RISKS AND REWARDS

Open communication is the key to successful business lending

BY *LISA KOPOCHINSKI*

Company owners know more than anyone that businesses need capital to survive. This is why the advice of a lender who understands their client's goals and helps them to reach those milestones is so important. And in this current economic environment, it's vital that business leaders know what to expect as interest rates rise.

Virginia Varela, president of Golden Pacific Bank in Sacramento, says working together through good times and bad is the key to any good relationship — including between a borrower and a lender.

"Borrowers need to consider that the lender wants to get paid back and will expect a thoughtful strategic plan that's lasting," she says. "Lenders need to understand that there are always economic unknowns and risks."

With rising rates, borrowers can generally expect longer payback periods with higher payments. "This also means money may be tighter and borrowers may qualify for amounts less than they may have previously expected," Varela says. "Rising rates also instill a concern for the potential of recession. That means that lenders will be more closely scrutinizing the ability of the borrower to be successful and repay the debt obligation."

DILIGENCE AND OPEN COMMUNICATION

Luke Parnell, executive vice president and chief credit officer at River Valley Community Bank in Yuba City, says business owners know their businesses better than anyone. So, in today's climate, as the supply chain recovers and materials and inventory become easier to source, owners should pay close attention to sales, margins and receivable collections.

"Close management of these, coupled with good expense control, can strengthen cash flow," he says. "In some cases, business liquidity has been supported by pandemic relief programs. Owners should monitor liquidity and leverage levels and adjust accordingly. Higher interest rates result in larger debt payments that lenders

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will necessarily incorporate into their underwriting while placing greater emphasis on the structure of a company’s balance sheet and its ability to handle the increased debt service and changing economic conditions.”

Jerry Gamboa, senior vice president and commercial banking regional manager at Exchange Bank in Roseville, notes that lenders will need to be more diligent in said underwriting. Lenders will “stress test” loan requests to see if the loan amount is adequate for the repayment source.

“The loan amount is tested with higher interest rates,” Gamboa says. “It will also be more important than usual for the loan sponsors to provide strong financial support and have access to cash and investments. Should there be an unexpected decline in business revenue or issues with tenants on a commercial real estate loan, the sponsors need to show the capacity to withstand a period of slowdown. Commercial buildings with short-term leases or unstable tenants will be more difficult to finance.”

He adds that borrowers need to maintain open communication with their lender to resolve a potential problem before it increases in size. “Most lenders will try to work with a borrower to resolve the problem as long as the borrower is trustworthy and responsive,” he says.

TIPS FOR BORROWERS

When it comes to what businesses hoping to borrow should look for in a lender, Varela says the borrower should begin with the lender where they bank.

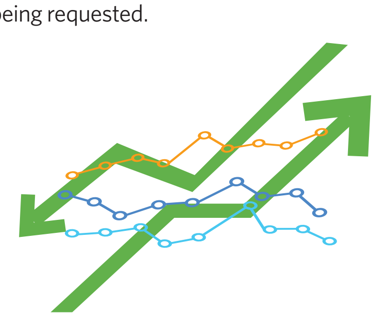
“Start there because they should know you and have some understanding of how you run your business,” she says. “Then, I suggest the borrower shop around and compare terms, rates, services and ease of business.”

She stresses the need for borrowers to be prepared to supply all requested financial information and to be ready to explain any hardships and corrective measures — and your business resumption plans — in advance. “Having ready answers and a well-thought-out plan for self-identified issues and challenges will go far to give a comfort level to the lender that you can repay your debt,” she says.

Parnell emphasizes that businesses should seek out lenders that take the time to understand their company and develop lending and banking solutions that are tailored to their specific needs.

“Borrowers should work to produce very clear financial statements that allow themselves and the bank to easily understand and analyze the current financial performance of their company and trends over time,” he says. “Lenders will use the historical and projected financial statements to structure and offer financing solutions.”

Essentially, the better prepared a borrower is with their financials, the more confident the lender will be relying on the reports, which can speed up the approval process when credit is being requested.



WHAT TO EXPECT IN 2023

As for what lenders can expect this year, Varela says the Federal Government is indicating that rising interest rates will likely continue in 2023 in an effort to curb inflation.

“The cost of borrowing may go up during the year and there will be further compression of capital to some business owners,” she says.

Parnell adds that those increased borrowing costs will ultimately push owners to reduce debt and look for efficiencies in other areas or reevaluate capital expenditures.

"The Fed's September Summary of Economic Projections is indicating central tendency GPD growth between 0.5 to 1.5 percent and many economists are expecting a recession at some point in 2023," he says. "The good news for business owners is that the longer end of the rate curve has moderated in recent months, so equipment and real estate financing costs have not been impacted as much as short-term borrowing costs."

A good lender can help a client analyze the aspects of their business that may be affected by these changes. "It's important for business owners to continually communicate with their lender and proactively communicate financial strain," Parnell says. "Your lender may be able to provide short-term solutions to help navigate potential cash flow issues. Review your current financing structure regularly with the aim of gaining efficiency or taking advantage of the current disparity between short-term and long-term rates."

He says lenders should proactively provide borrowers with suggestions that help them optimize their use of debt and treasury management products, as well as set the correct expectations regarding lending requirements.

Gamboa stresses the importance of being prepared for uncertainty and says stronger businesses and well-positioned investors may find opportunities this year.

"It will be important to retain cash and reduce debt to manageable levels," he says. "Strong businesses will continue to look for efficiencies to reduce costs."

With more than 25 years of journalism experience, Lisa Kopochinski has written and edited articles and publications for many companies, publishers and associations in the United States and Canada in a wide variety of industries. Visit LisaKCommunications.net.