

## Bank Loan Problems & Your Business

2008

THE PREMIER BUSINESS  
MANAGEMENT FIRM FOR  
EMERGING AND  
GROWTH COMPANIES



We're On The Web  
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Now is the time to check your business's financial condition so that you're not surprised when your lender changes the loan terms, increases the interest rate, requires more collateral, or worse yet requires your business to pay off the loan!

We've helped numerous businesses to develop contingent strategies, options, and how to best present their business to a nervous lender.

Almost daily you read about banks problems with sub prime real estate loans and the terrible losses they are forced to right off. The FDIC has closed 11 banks and reports a 30% increase from the 1st quarter of 2008 to 2nd quarter in problem banks.

How do the banks problems potentially become your company's problem? Banks have been aggressively chasing loans for the past few years and this resulted in banks lowering their credit/loan standards and lowering interest rates, due to competition for the new loans. This creates potential loan problems, less profit for the bank, and consequently less money available for lending. Many independent and regional banks factored into their loan decision the equity value of the business owner's home. Bankers operated on the assumption that home values would continue to accelerate and thus the business owners homes would provide an asset cushion if the business were to encounter problems.

Lender's secure business loans with all of the business assets and require the owners to provide their personal unlimited guarantee — effectively getting any assets of the business owner. A personal guarantee is certainly not uncommon or unwarranted (after all the owner controls the business). The owner may not realize the affect of a personal guarantee.

What many business owners may not fully realize is that the bank was counting the equity in the business owner's home to support the business's loan to value computation. Why can this now be a problem? With falling home values the business owner's home equity has declined and the lender, at the loan review date, will include the reduced equity in the loan to value computation. If the business assets are nearing full depreciation this reduces the collateral value supporting the loan. Couple that with any problems the business may have with its profits, sales, accounts receivable or valuation of its inventory and you have a nervous lender — **one looking for more collateral!**

### THE DOMINO AFFECT CAN HIT YOU



Your bank's problems can become your problem!

## LET OUR GROUP HELP YOU

- We have assisted hundreds of small and medium sized businesses prepare for difficult lender negotiations. We know the lenders concerns and how to mitigate those concerns — provided we have the time to act with management!
- Our Group will help you think through the issues critical to growing your business and getting you the cash required to implement your business's plans.
- **The top 3 reasons for business failure are; 1) MANAGEMENT, 2) SALES & 3) CASH.** Without adequate cash the best manager is unlikely to be able to achieve sales that can create a profitable business! We can get you the cash you require!

**Your bank's problems can become your problem.** If your bank is like most banks they made too many residential real estate loans to buyers (mortgage & home equity) who had marginal credit and were just able to make the payments. Banks also made too many commercial real estates loans that were more risky than residential loans because the building may be for a 'special purpose'; meaning it was designed for a specific restaurant concept or car wash and converting it to another use is very expensive. Many home buyers purchased their homes believing that "real estate always goes up in value". Today most real estate is overvalued and the real estate loans may be at or above the fair market value of the property, meaning there is little or no equity in the property.

The bank still has a problem even if the home owner and the commercial owner are current on their loans. Banks are audited by the FDIC and often by public accounting firms as well. The auditors will review the bank's loans and if that review shows too many real estate loans have little or no equity the auditor will require the bank to increase its reserve for loan losses. The reserve for loan losses is designed to cushion a bank's assets from loan losses. The money to increase the reserve for loan losses comes from the bank's profits. Auditor's classify problem loans as **sub-standard**, **doubtful**, or **loss**. Too many **sub-standard** loans may require the bank to increase its loss reserve. A **doubtful** rating requires the bank to write off 50% of the loan. A **loss** requires the bank to write-off the entire loan. The reserve for loan losses must then be replenished from profits. Most bankers maintain a low loan loss reserve so that profits are higher and they can grow their bank. Increases in the bank's loan loss reserve directly and immediately impacts its ability to make new loans.

Banks generally have 10% capital, or owners investment, with the remaining 90% coming from depositors. If the bank's loan losses are too large and exceed profits, the bank must get more cash/capital from its owners. Small and regional banks have a difficult time getting fresh cash/capital because they are often owned by a relatively small group who collectively may not be able to purchase more bank stock because their assets aren't liquid, they are having financial difficulties, or their businesses are not profitable.

**Here's how your bank's problems may become your business's problem:** 1) the bank estimates the collateral value of your business's assets and may require additional collateral to reduce its risk, 2) they may shorten the term of your loan, 3) raise the interest rate due to the increased risk, 4) freeze any revolving loans, and 5) they may require you to pay off the loan. **These actions are likely to occur as a result of your annual credit review.** National and regional banks are more likely to request that the loan be repaid knowing that you will then attempt to secure a new loan at a small community bank. However, with nearly ever bank having credit problems related to real estate loans, unless your business is or can be made "bankable", you have a serious problem. Loan agreements give the bank the right to take almost any cash in your business accounts and apply that to the loan — instantly you can be without cash! Local banks want good loans but if your business looks risky they will avoid you as well.

If the bank pushes you to use some of your home equity loan to pay down the business loan you may have 2 problems; 1) increased personal payments for the home loans and 2) difficulty getting more cash from the business which translates into less cash for the family. The bank may require that your spouse or minority business owners also provide their personal guarantee to shore-up the loan. Larger banks will transfer your loan to "special credits". This group's goal is to reduce bank risk and even have you move your loan to another lender.

**What can you do to prepare for your business's annual credit review?** First, you must have your financial statements current. You must understand what has occurred on them both good and bad, and the affects on your business. You must really understand your industry and your customers — especially the top 20%. What are your customers' prospects and risks? How might that affect your business? **There are a multitude of other potential actions you can take but they are specific to each set of circumstances. Our Group has worked with hundreds of companies to help them avoid problems. Call us for an introductory meeting to see how we can help you with existing debt financing issues or future debt financing.**

**We have helped many companies obtain new credit or credit sources for a variety of industries.**

**We can help your company!**



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