
THE LENDER'S EYE: ARE MEDICAL PROFESSIONALS STILL A COMMUNITY BANK LENDING MARKET?

Final installment of series: Will medical loans become a troublesome concentration?

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This third installment completes Ed's series on lending to medical professionals. (Part 1, Part 2) We'd like to hear your views about this traditional banking strength, how it's going in your market, and where you think it is headed. Use the comment section below. Thanks! Steve Cocheo, executive editor

Community bankers used to talk with considerable pride about how their banks had developed efficient and appropriate ways to respond to medical professionals' credit needs. They saw lending opportunities at all points on the career cycle of doctors and dentists.

I'm not sure that's a valid assumption anymore.

As we discussed last week, sole practitioners are becoming an obsolete business model. They are rolling their individual or small practices into ever-larger group practices or in some markets, becoming employees of large health care providing institutions. Either way, they are less entrepreneurial and increasingly more like "hired help." They have credit needs but increasingly they are less attractive to a bank as there are fewer opportunities to sell our services to fewer, though larger, users. Trust, investment counsel, real estate facilities expansions are becoming relatively rare sales opportunities.

We are left with in many cases chronically overleveraged borrowers with decent incomes but outsized expectations.

The doctor who diagnosed his partner--and turned up his nose

A few years ago one of my health-care specialty providers broke away from a large and prestigious practice and went out on his own. He was in his early 40s and I suspect that this transition was hard. Within several months, he had joined forces with another doctor of about the same age and they moved into larger rental space for their joint practice.

Three years or so later, I was approached about my bank's interest in financing a new office for the two with expansion room for one more newly graduated doctor whom they hoped to recruit to join them in the next year or two.

Over the years of my lending career, I and virtually any of my competitors would drop everything and go call on similarly situated doctors hoping to beat out the competition for the deal. Naturally, I jumped at the opportunity.

But here's what my due diligence discovered. My doctor had been forced out of the big practice on a productivity issue. He was simply out, just like any hired hand in an employment-at-will state.

Though starting over, in a sense, he was far from destitute financially. But the big income was no longer assured and he had to build his new practice from scratch, except to the extent that patients like me were loyal to him. Many were ... but not everyone.

His partner, who would have been expected to sign personally on the approximate \$3.5 million credit facility, had a personal financial statement that looked like a train wreck. He had a decent income but also lots of leverage and a lifestyle that sucked up a good share of his revenue.

When my doctor became fully aware of the financial condition of his partner, he balked at our requirement of his joint and several guaranty.

So, for a very old-fashioned reason, the deal was DOA at my bank. The doctors got the deal done at another community bank but one, frankly, that some of my competitors and I had come to refer to in recent years as the "lender of last resort."

Examining the doctor-banker relationship of today

Here are the lessons learned that were unanticipated by me from many years dealing with doctors.

First, doctors are not equally creditworthy.

In fact, they can display some very ordinary sorts of risk shared with other borrowers in the community.

Second, as employees of large groups, doctors' earning power is not assured.

They can more or less start over, but the risks of operating and financial leverage in their business situations are not trivial. It was a bit of a revelation to see that personal income streams may be dependent on the favor and judgment of others who wield sharp pencils.

No doubt many of you bank doctors and their practices and that they are regular borrowers at your bank. Most probably have stable and prosperous practices and neither you nor your loan review department spends a lot of time concerned about changes in the health care providers' market. Could uncertainty in the future of health care in terms of funding and competition negatively impact your medical-related portfolio risk profile?

Does a concentration risk lurk in your portfolio?

This gives rise to a third potential concern. Do you have or might you develop a concentration of credit within a portfolio segment with a cloudy and possibly deteriorating long-term outlook?

I suggest that you carefully consider just how much the medical health care business model is changing in your local market. Government provides something like half of the total funding for health care in the United States today.

Is this source of funding likely to shrink or expand in years to come?

Is either one of these possible outcomes likely to be beneficial or negative?

Do you provide financing for your local community hospital? No longer is this sort of transaction typically within the reach of most community banks. If a hospital faces a major physical expansion, the deal is often done by an investment house in a major city like New York or Chicago and the financing often takes the form of revenue bonds that are not within the typical underwriting expertise of banks at the smaller end of the size spectrum.

This raises the fundamental question of whether banking medical professionals is still an attractive a commercial banking product line. There are many small medical groups that will rely on community banks and local sourcing of banking services for the foreseeable future.

This deserves a long, hard look. How many of us saw any of the changes I've discussed, now well underway in some communities, coming five years ago?

What other market changes are stirring beneath the surface not necessarily visible to us as day to day lending practitioners?

Be skeptical, but proactive

I'm not negative about the role of community banks in our national economy. But I am very concerned that the structural changes that are underway are not well understood in terms of risk or impact across a variety of industries including our own.

The changes for some banks, some businesses, and some communities will be wrenching. We need to have a better sense of what's coming.

Too often bankers think in terms of adapting the customers to the way that bankers think they will be doing their business in the future--the branch vs. smart phone sort of arguments that are fashionable today.

Perhaps the real issue--and where we can make the greatest impact to the benefit of our banks and our customers--is figuring out with them what their markets will look like and what they will need from us to survive.

That way we increase the possibilities for success for each of us and for the communities we serve.

About Ed O'Leary:

Veteran lender and workout expert O'Leary spent more than 40 years in bank commercial credit and related functions, working with both major banks as well as community banking institutions. He earned his workout spurs in the dark days of the 1980s and early 1990s in both oil patch and commercial real estate lending.

O'Leary began his banking career at The Bank of New York in 1964, and worked at banks in Florida, Texas, Oklahoma, and New Mexico. He served as a faculty member and thesis advisor at ABA's Stonier Graduate School of Banking for more than two decades, and served as long as a faculty member for ABA's undergraduate and graduate commercial lending schools.

Today he works as a consultant and expert witness, and serves as instructor for ABA e-learning courses and has been a frequent speaker in ABA's Bank Director Telephone Briefing series. You can hear free audio interviews with Ed about workouts [here](#). You can e-mail him at etoleary@att.net. O'Leary's website can be found at www.etoleary.com.

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