THREE DEADLY HABITS OF THE WELL-MEANING BORROWER

Third in a series: Getting past these habits helps borrowers, banks, and communities

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Lenders are constantly vigilant for any signs of inappropriate behaviors by borrowers. We do, after all, want to be diligent in policing the Character issue in our loan portfolios.

What interests me in this week's blog is identifying behaviors that borrowers often exhibit that are not evidence of poor character but that can still significantly impact the relationship between borrower and lender in unproductive ways.

These are tendencies that lenders should try to root out, while encouraging the customer to modify their behavior, to eliminate potential points of friction or concern by the bank toward the borrower.

1. When the borrower holds back some facts...

At the top of my list of Deadly Habits is the one that suggests that it's not important for the borrower to freely share all information with the lending officer.

There's an ancient saying, I think in the Torah, which says: "A half-truth is a whole lie."

It's not that our customers deliberately lie to us, but rather that sometimes we are not in possession of all the facts that are material to a proper assessment of credit risk.

I remember helping a friend buy a used car many years ago. He had not done any borrowing from a bank other than for his home mortgage. As a consequence, he was a novice when it came to preparing a financial statement or putting his best foot forward in the process of presenting his financial circumstances.

His credit bureau report reveal additional financial information of a mildly negative nature. I commented about it to him.

"You don't have to tell your banker everything" was his surprised and innocent reply.

"Hell you don't" I responded.

To the extent that withholding information is deliberate and selective it could rise to the level of inappropriate behavior and become a character issue. Most of the time, though, it's not. It's just that small business owners, particularly, are very private about their business affairs. That's an understandable tendency. They consider any financial details about themselves or their businesses to be proprietary and competitively sensitive.

In hindsight, my borrowing friend really had no idea about the type and quality of appropriate financial disclosures to make. I've seen this sort of behavior since and over larger issues, so I'm not surprised. Nor am I quick to suspect bad faith.

Rather, it's a part of the educational process that most all lenders have to invest in with their borrowers. Lenders ignore this at their peril.

Customers need to understand that all material information on the business and its risk profile is not only important but absolutely necessary to know.

2. Diddling around with the deal's details

The second Deadly Habit of borrowers (or at least some of them) is to constantly tinker with the terms of the deal.

I banked a large real estate developer in Broward County, Fla. (just north of Miami) who had a CFO whom I both trusted and respected. Yet the CFO was a "nudge" to me in the sense that he was constantly trying to negotiate and renegotiate the deal.

He didn't seem to appreciate that a $5 million commitment was very serious business to my bank and every modification meant a representation of the credit to committee or to our internal system of credit authorities.

My bosses concluded that he showed unstable borrowing habits--though I had already concluded that he was trying to demonstrate his worth to his ownership.

I had to have a serious talk with him. And that wasn't easy, as he was probably 25 years older than I.

The time to tinker is before the commitment is issued. But how often have we seen our customers come back and try to continue to trade on some of the deal points?

I'm talking more about covenants in a loan agreement than I am about rate or primary terms of repayment. But those factors frequently seem to be on the table for ongoing discussion too.

3. Perils of the rose-colored crystal ball

The third Deadly Habit of borrowers is the tendency of some to be unrealistic in their outlooks for their businesses.

If borrowers are too pessimistic, we probably won't become advocates within our banks for their credits. Rather, I'm talking about the tendency of many to underestimate or underappreciate the risks their businesses face, and the assumptions that underlie their business plans.

This is one area where there is no substitute for an account officer with sound lending experience. We must listen to the owner's hopes and dreams and apply a degree of independent judgment in situations where we may not have direct or relevant experience. Where the borrower is "fluffing" or being just too optimistic isn't always easy to spot. But we have to apply a standard of reasonableness in a business situation we don't always fully understand or appreciate.

The late Steve Jobs had the tendency to not only see the future of Apple in his terms but also the demonstrated ability to make the future conform to his vision of it. It was a triumph of insight, focus, and will.

We have to recognize that people who can produce such outcomes are rare.

Business credit is the ultimate product of the applications of a series of lending principles--the interplay of character, collateral, capacity, and conditions when some of these factors may appear to be in conflict or not combined in a harmonious whole.

We have to figure out what trumps what and what ultimately makes the credit risk acceptable.

Why the customer must do it "our way"--and why it matters

For the most part, our banks have to rely on what we see, what we're told, and what we perceive in the assessment of credit risk on a transaction-by-transaction basis.

This means that our customers must adapt to a significant degree to our rules and our manner of doing business. It's not that they don't necessarily want to conform (or won't). It's up to us to "train" them--and be sure that they understand what we need, when we need it, and how we process it.

This is another way of describing the value-added of the relationship of the local lending officer to the borrower. It must be built on trust and respect, qualities that must be learned and then practiced with a high degree of consistency and fidelity.

It's a two-way street but so many independent banks just don't seem to appreciate the potential to make this sort of relationship a niche way of doing business.

Let's not lose the opportunity to save our banks, our borrowers, and our communities by setting our relationships on the right footing and working smarter at keeping them personal and professional.

Trust is the super glue that will tie business to our banks and make competitive encroachments very difficult.

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.

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