

Bank Lending in Today's Capital Market

By Kelly Arduino, Director of Financial Advisory Services
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Many an organization has relied on banks, rather than the bond market, to supply capital for financing facility renovations or expansions. If you are considering a bank loan, you should know that the current banking situation reflects a new era. Pre-September 2008, money was cheap and easy to come by, with little due diligence, loose or minimal covenants, and insignificant ongoing monitoring requirements. Today's world has changed dramatically and, according to a federal survey of banks, is not likely to improve until at least mid-2010. The survey reported that, 45% of the banks said they tightened lending standards over the last three months and expect standards to remain tighter through at least the second half of 2010.

Today's banking climate has little to do with your organization and much more to do with fixing the past. Banks are under significant pressure to shore up their balance sheet and improve their debt-to-asset ratios. For the borrower, this means that in exchange for a loan, all accounts (e.g., operating, investments, etc.) must be held at that bank. Banks have also taken significant losses on "participations." Participations are generally defined as transactions of a larger amount, which are sold to a number of banks. For the borrower, this means that larger loans may be more difficult to place because your local bank may have a lending limit that exceeds your capital need and other banks are reluctant to "participate." Further complicating the difficulty of placing larger loans is the reluctance or even inability of banks to lend outside of their service area. In the past, we saw regional banks a county or so away or even banks from outside of the borrower's own state provide loans; however, this practice is now uncommon as regulators require and bank boards have pledged to focus lending on their immediate geography.

Even if your organization is well-off financially and has not had difficulty securing capital before, you may be facing challenges today. For those clients able to access capital, there is a frustration that rates are at an all-time low, but banks are unwilling to commit to long-term rates long term or without significant strings. Because of the uncertainty of the future and the commonly held belief that interest rates will go up, most banks are offering 5-year resets on loans and, at the most, 10 years. Furthermore, penalties for refinancing debt before it reaches maturity have increased and often extend beyond the interest rate reset period. Many of my clients are concerned with this because it makes evaluating the affordability of a project in the future more difficult.

Other organizations that have stumbled financially in the last year find that they are unable to secure a bank loan at all, despite a long-term relationship with their local bank. Why? Because local branches of larger banks are subject to the directives of corporate headquarters. Believe me; your local banker is probably as frustrated as you are by this.

To counter the lending environment and prepare your organization for borrowing, there are considerations for planning. Specifically, what can organizations expect when preparing for a financing?

- More "equity" or capital contribution—approximately 35%-45%, depending on whether it is a new business line or expansion of existing services
- A solid track record of performance—preferably a minimum of two years of positive operating margin and demonstrated growth (i.e., revenue, volumes)
- A conservative proforma of future performance
- For a capital campaign, contributions in the future do not count—only actual money in the bank—so start your campaign early
- Cash flows from operations must support debt—investment income is not considered a reliable source for debt payments

As the regulatory environment and our economic future becomes more certain, I expect the bank lending environment will become less stringent, but not as loose as it was in our recent past. That said, although a bank loan is not the only capital source for smaller borrowings (i.e., less than \$10 million), it is likely one of the best in today's market, especially through local banks.

About the Author

Kelly Arduino has over 15 years of experience in health care with an emphasis in health care finance and strategy. As an unbiased financial advisor for clients which include critical access hospitals, independent community hospitals, and senior living facilities, her work centers on planning for and secure capital to finance large renovation/replacement projects. She also works with clients on an "as needed" basis to evaluate financing proposals and to provide advice on debt related decisions. To learn more, please contact Kelly at karduino@wipfli.com

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