



Yellow Flags on Commercial Real Estate

Jean Wojtowicz
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John Hodge, co-owner of Buffalo Wild Wings restaurant in Lafayette, clearly appreciates alternative financing he received for his restaurant. He says, "We could not have owned our own real estate without the SBA 504 program."

Hodge feels that owning its real estate gives BW3 an advantage not shared by most others in the BW3 chain that operate on leased land. The low fixed rate and low required down payment terms offered by the Small Business Administration and Indiana Statewide Certified Development Corp. helped Old National Bank's Stacy Roberts decide to seek alternative financing for Hodge and his business partner, Peter Watson.

In involving the SBA and Indiana Statewide CDC, Old National also shared some of its risk, but did so in the context of the BW3's ownership team's needs and ability to pay.

Commercial real estate is a staple of many lending portfolios, but the Federal Reserve recently cautioned bankers and other lenders to tread the

ground cautiously when considering new real estate loans. Susan Schmidt Bies, one of the seven members of the Federal Reserve Board of Governors, told the House Subcommittee

on Financial Services in September that the nation's largest banks may be issuing too many real estate loans. Between 1992 and 2005, she said, com-

— See *Yellow Flags* page 18



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mercial real estate concentrations almost doubled, and make up 294 percent of the capital of banks with assets

between \$100 million and \$1 billion.

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The danger, according to Bies, is that commercial real estate is one of the most volatile sectors of the economy. A downturn could trigger bank failures, or at least financial stress for banks, as hap-

pened in the late 1980s and early 1990s. The Federal Reserve is proposing new guidelines for bank management to limit concentration in commercial real estate.

“It is important to stress that the intent of the proposed guidance is not to restrict CRE [commercial real estate] lending, but rather to provide a framework for a safe and sound CRE lending program,” Bies told the House committee.

“The proposed guidance sets forth risk management practices that are well within the capabilities of many institutions and, in fact, a number of institutions already have many of these practices in place,” she said. The Federal Reserve is accepting public comment before enacting the new guidelines.

About the Author



Jean Wojtowicz is president of Cambridge Capital Management Corp. She founded the consulting firm in 1983 and soon after was awarded management contracts for the Indiana Statewide Certified Development Corp. (CDC) and the Indiana Community Business Credit Corp. The Indiana Statewide CDC provides fixed-asset financing to small businesses; the credit corporation lends working capital to businesses in a growth stage. Cambridge also holds the management contract for LYNX Capital Corp., established to link capital to minority business opportunities, and has assisted loan programs. Wojtowicz is a member of the board of directors of First Internet Bank of Indiana and of First Merchants Bank, NA, Muncie. She is a graduate of the University of Wisconsin.

Wojtowicz serves on the *Hoosier Banker* Editorial Board. She can be reached at 317-843-9704, e-mail: jwojtowicz@cambridgecapitalmgmt.com. Cambridge Capital Management Corp. is an associate member of the Indiana Bankers Association.

The guidelines amount to a common-sense review for most lenders. Any lender's policies should be under constant internal review to keep pace with rapid market and financial changes. That is why it is relevant to know the role of alternative loan programs such as the SBA 504 and 7(a) programs.

These programs help promising local businesses that might lack the credit history to gain conventional financing for the time being or may be used for an exceptional borrower who is looking for a better structure.

The programs also take some of the risk from local lenders. Alternative financing does not replace due diligence by lenders, but rather adds to it, as alternative programs are another tool that can be offered to borrowers.

Randy Richmond of Old National Bank in Indianapolis is a veteran lender of alternative funds. He says, “We determine the amount of debt each borrower can support.” The lender may mix alternative with conventional financing.

A successful business financial plan includes a foundation from which a business can stabilize and grow to serve its customers and create employment. Alternative loans, as created by Congress and managed by lenders, are valuable for bankers who want to off-load some of their risk and keep more assets to help other borrowers.

So rather than telling local borrowers that you have too much concentration in commercial real estate, it might be better to look at ways to limit your exposure while still meeting the needs of your customers by utilizing alternative loan products. ❖

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