FINANCIAL INSTITUTIONS

TOUGH TALKS

Banks approved fewer small-business loans at the end of 2022, the result of rising interest rates.

By GINA HALL

Banks are having to manage tough conversations with borrowers to evaluate whether their businesses can withstand the increased strain of higher loan payments because of higher interest rates.

Bankers report that the burden is on the borrower to prove to lenders that they have the cash flow to support new loan requests at the current elevated rates. Some borrowers may think twice about obtaining growth-oriented capital, for, say, equipment or acquisitions, while interest rates are high. But others may still be seeking debt capital to keep their businesses operational.

Large banks were approving fewer small business loans at the end of 2022, with approval percentages in November dipping to 14.6%, the second lowest total in 2022, according Biz2Credit's Small Business Lending Index.

Other lenders were approving small business loans at slightly higher rates — credit unions at 20.3%, small banks at 21.1%, institutional lenders at 25.8% and alternative lenders at 27.4%. Still, the approval numbers weren't much different year over year, with approval rates actually about 1% higher at most lending institutions, except at large banks, whose approval rates were .2% higher year over year. Only credit unions, down .4%, were approving fewer loans than in 2021.

"We are having conversations with our existing borrowers to better understand the impact higher rates are having on their business or property and to determine if a loan modification might be needed to assist the borrower for a period of time," **Matt Fuhr**, executive vice president and chief credit administration officer at **Hanmi Bank**, told the Business Journal.

Tough lending parameters haven't necessarily slowed potential borrowers from requesting access to capital, but some bank executives are seeing a decrease in the number of borrowers who are qualified to take on the extra debt with higher interest rates.

"In some instances, the existing cash flow doesn't support the amount of debt requested," said Fuhr. "In these situations, we either ask for an additional equity contribution from the borrower or a lower loan amount. In general, qualified borrowers are in sound financial health and can meet these additional requirements."

Assessing health

Noor Menai, chief executive of **CTBC Bank**, noted that his bank, which has its U.S. headquarters in downtown Los Angeles, is not necessarily asking for more collateral, but is taking extra care to assess the health of a business seeking a loan, ensuring owners can put up with the increased burden.

"Our priority in underwriting is based on how much cash you're generating," Noor told the Business Journal. "It's based on past track record and what is going to happen to the underlying business. Will the customers stop buying?"

Business borrowers may have had strong financials to show from early last year, but if their year went poorly, then updated tax returns and financial statements may cause loan rejection rates to rise in the coming year.

THOMAS WASPER

Boss: Noor Menai, chief executive of CTBC Bank, and the company's downtown offices.

"By end of year (2022), we continued to see high demand and high volume," **Brandon Ferrera**, **Fifth Third Bank**'s Southern California market president, told the Business Journal.

According to a November survey by the **National Federation of Independent Businesses**, 62% of small business owners said they were not interested in a loan and 5% reported their last loan was more difficult to qualify for than previous attempts. About 23% of owners reported paying a higher rate on their most recent loan.

Banking industry executives said that their financial institutions continue to be conscientious when it comes to underwriting and credit administration. The impact of the 2008 financial crisis still has a major effect on how banks take on risk today.

Banks are being more cautious, but not because we are risk-averse," Noor said. "Since 2008, banks have been very careful as to how they lend. The underwriting has been much better."

"We always emphasize sound underwriting, diligent credit administration and ongoing client communication in both good and challenging times," Fuhr said.

Interest rates have risen dramatically in the past year as the Federal Reserve Board continues to battle inflation. Small business loans are based on the prime rate, which is currently at 7.5%, the highest since 2007 and up from only 3.25% a year ago. This puts most Small Business Association loans at an interest rate of 10.5%, according to CNBC.

Restoring price stability

The Federal Reserve in December reminded investors and borrowers that it remained committed to returning inflation to 2% — which portends more interest rate hikes in the future.

In the United States, inflation remains high because of the pandemic-caused shortages and pandemic-related money injected into the economy as well as other pressures. Fed Chair **Jerome H. Powell** recently confirmed what many suspected: high interest rates appear to be around for the long haul.

"It is likely that restoring price stability will require holding policy at a restrictive level for some time," he said in a speech at the Brookings Institution in November. "History cautions strongly against prematurely loosening policy. We will stay the course until the job is done."

If there is a decrease in lending, executives and experts feel that the banking business at large is still in good shape. "The economic environment is more complicated than it has been in recent history," said Ferrera.

Executives cited inflation, threat of recession, supply chain issues and the war in Ukraine as concerns, but not cause for alarm.

"There has been no shift in our lending focus, which is intentionally diversified by loan type and industry," said Fuhr. "We're remaining consistent with our underwriting discipline, which may temporarily put pressure on the number of loans that we fund in one area, but we would expect that to be offset by loan demand in other areas of our business."

In a 2023 outlook on banking and capital management, tax consulting firm **Deloitte** advised interest income would likely not be enough for many banks and most institutions should be expanding their non-lending and transaction banking productions.

"We've seen an increased interest in our financial risk-management products," said Ferrera.

"The ripple effects from a more fragile and fractious global economy will be felt disparately across the global banking industry," Deloitte noted in the report. "Large, well-capitalized, diversified banks should weather the storms reasonably well."

"We are in good health," Noor agreed.