

The Commercial Credit Conundrum

BY REGINA OLIVER

IN one of the most competitive banking states in the country, a surprising number of businesses seem to have taken to heart the adage: "Neither a borrower nor a lender be." So just where does that leave banks?

Loaded, apparently. "Loan demand is very soft," says Dick Verrone, executive vice president of commercial loan administration at Centura Bank. "Companies are not making large capital expenditure decisions for (1992). They're not building new plants. They're not employing new people, so their borrowing needs accordingly have been reduced."

Corporations across the state and the nation are wary of incurring new debt as they enter 1992. Regular borrowing by small business, as surveyed by the National Federation of Independent Business (NFIB), hit a 19-year low in the '91 fourth quarter, when only 33 percent of businesses said they were seeking to borrow money.

Banks, on the other hand, say that they have plenty of money to lend but that changes in the marketplace have affected the conditions under which loans will be made.

"Bankers are eager to extend credit," says John Medlin of Wachovia Corp. Following a meeting last fall between President Bush and business leaders, Medlin said, "I encouraged the president to abolish 'credit crunch' from the vocabulary of administration officials. There is no credit crunch."

Hugh McColl of NNCB, which became NationsBank as of Jan. 1, agreed: "It was the lack of demand rather than intervention by regulators causing a problem."

"It appears that the companies that banks would like to lend to are not interested in borrowing," says William C. Dunkelberg, an economist with the NFIB. Other than in New England, which has been hardest hit by the recession and where the NFIB documents that money remains tight, as



'We're finding most of our customers are not confident of a speedy recovery to commit themselves to a significant capital expenditure program.'

**—Robert W. Helms
First Union,
Greensboro**

of the fourth quarter only 11 percent of small businesses surveyed were reporting that loans were harder to get, down a percentage point from the previous quarter. Nineteen percent said they were paying lower interest rates.

"There's still a fair amount of concern

about the economy out there," says Robert W. Helms, executive vice president with First Union in Greensboro. "We're finding most of our customers are not confident of a speedy recovery to commit themselves to a significant capital expenditure program. By the same token, their short-term borrowing needs are being very well managed on the part of corporate treasurers or business owners."

During the fourth quarter, the Federal Reserve Board reported that banks had ceased tightening their standards for loans, signaling a possible easing in the credit crunch, at least in terms of standards applied to borrowers.

However, the term "credit crunch" has been used to refer more generally to the availability of money, and both banks and the NFIB say a crunch doesn't exist.

"I define credit crunch as credit not being available under any circumstances," says Verrone. "Credit is available, and we continue to make loans in all sections of the

economy, including real estate. . . . I think banks have tended to revisit some of their policies and procedures they had some years ago and have maybe tightened them a little bit, but not to the point of being restrictive to the point borrowers can't get loans."

"We are currently looking at a fair amount of credit requests," says George A. Snead, senior vice president for commercial lending at NationsBank. Snead, based in Raleigh, says: "Relative to the last three or four years, we've made a number of significant commitments in the last three or four months. . . . We're making quite a few right now. . . . It's a significant increase from the last year and a half.

"If you ask me about real estate," he adds, "I'd have to couch that a little differently. . . . Because of what's happened in the market, the financial community gen-

continued

erally is requiring more equity in a real estate project, more pre-leasing and more substance in the developer. Other than that, I don't see that the market for credit has changed significantly."

"Credit was so easy to get for so long," says Dr. Campbell R. Harvey, a professor at Duke's Fuqua School of Business. "We had eight years of consecutive growth, and then all of a sudden . . . there's more uncertainty and banks are less willing to give it out, people say, 'There's a credit crunch and it's really hurting our chances of recovery.' In my opinion, it's just more conservative policy initiated by the higher-risk situation. That's the key thing for the banks, and it's something they've painfully learned, that you have to assess the risk of each loan very carefully."

That's what Hugh E. Carr, head of Trion Inc. in Sanford, has encountered. Although he's seen a "general tightening of credit availability," he says, "it has not impacted us other than there is much more due diligence in the review process." The company, which manufactures air filters for a variety of environmental applications, is borrowing money without difficulty. "We're a fairly credit-worthy company on the strength of our balance sheet," Carr says. "We do have a revolving line of credit. We have been in a loss situation (in 1991), and certainly the institutions are much more conscious of credit-worthiness and much more concerned about a client's ability to repay. . . . Money's available, but it's got more strings on it."

"Having said that, we are equally exerting a fair amount of renewed scrutiny on credit that we extend to our customers. The other side of borrowing is repaying, in other words, the cash-flow side. We have an on-going relationship with Wachovia, and we provide them with pretty detailed information on our forecasts and cash-flow projections."

In 1991, "we have cut back . . . in the money spent for modernization, upgrading and capacity additions," he says. "That's basically stimulated more by the economic uncertainty than it is on credit availability. We are not replacing some capital equipment that was in the budget, it's deferred. We also have cut out some consulting contracts that were originally in the budget." The amount involved totals about \$400,000, he says. "Our normal capital expenditures on an annualized basis would be about \$1 million, and we'll probably spend a half million instead of a million."

Pine Hall Brick Co. Inc., based in Winston-Salem, has not been borrowing money, says Fletcher Steele, head of the company, but the brick manufacturing company has encountered changes in credit availability in other ways. "There's a project that we've done on a joint venture in Richmond that it's been very apparent," Steele says. After the apartment-complex project was initiated a year and a half ago, "it went along as projected, on budget. Lease-up started in late summer and was ahead of schedule. But when it came to financing the project on a long-term mortgage, as would traditionally have been done, the financing was virtually not available. We are seeking alternatives and have been working with it for several months to try to come up with a realistic and workable alternative to what would have been very, very easy to do a year and a half to two years ago."

"I know from our customers' standpoint, our homebuilders," he adds, "their inability to get construction financing . . . is making it very, very difficult for those guys to operate. I hear that on a daily basis."

"Even though business is down and all the problems you hear about, you'd think it would be dead," Steele observes. "It's not dead. Construction business, particularly in single-family housing, is not where we'd like for it to be, but people find a way to get things done. We see it coming back. We probably bottomed out in March. . . . They're not coming back fast, but they are coming back. We had the best month of the year in October."

Brady Trane Service in Greensboro may not be borrowing, but it also has felt the effects of tight money. "There's a real choke on the construction industry," says Don Brady, head of the firm that supplies heating, ventilation and air-conditioning equipment for industrial, commercial and institutional uses. Companies in the business to supply such development are in what Brady calls the "trickle-down" portion of the economy. In his case, "we've been fortunate enough in that what has been out there we've been able to get a good market share." And he sees improvement ahead if several public-sector projects, including school and prison bond issues, move ahead.

Part of what has caused these new realities in commercial credit involves changes in general underwriting guidelines, says Ed McFarland, senior vice president responsible for corporate banking at

Wachovia Corp. "We believe we are continuing to lend under the same kinds of terms and conditions as we have in the past, but in general in the marketplace, there have been some changes in the behavior of banks with regard to how they lend money."

"I think the credit crunch is indeed the issue of credit availability and not whether banks have funds available to lend," he adds. "We're not in a liquidity crunch; there's no evidence, even with the crisis in some banks, that there is a liquidity kind of issue, but rather borrowers are perceiving there may be a credit availability (issue), which is . . . the willingness of their banks to lend them money in ways that they have borrowed previously."

"Bankers now tend to want more information than they have had in the past, so bankers are asking more questions before they grant credit and that would tend to make borrowers uneasy about their banker and about their relationship," McFarland says. "In times of crisis, particularly when some of the old ways of lending money haven't worked out, bankers are going to ask more questions. . . . That doesn't mean that a borrower is any more unlikely to be able to get credit from his bank; it just means the banker is more interested in all of the details, all of the information necessary to make the loan."

Also, the decision-making process within banks is taking longer. "More people in a bank are involved in the decision process of deciding to make a loan during times of crisis than during normal times," he says. "Over the last eight years, we've come to believe that normal times are times of substantial growth and expansion, where the economy was growing at 4 or 6 percent, and now GNP is expanding at a real rate of more like 2 percent. . . . That means there's more uncertainty, and more people have to be involved in the decision process."

This selectivity has caused some industries, such as textiles and health care, to be particularly appealing to bankers. "We have found that borrowers of truly superior kind of credit quality are finding it easier to borrow now because more banks are focusing their attention on the quality end," McFarland says. "There are companies in the textile industry in our state that are doing well, and I think those companies are finding it very easy to attract bank capital."

Dennis Julian, executive vice president of the N.C. Textile Manufacturers Asso-

ciation, agrees that access to credit hasn't been a concern for most textile companies, and cites the strength of a major equipment trade show recently completed in Germany. "That's typically a big time for capital investment," he says. "Companies place orders for future delivery. . . . They typically have their financing in line for when they do that."

He adds: "I have heard of people maybe scaling back their wish list a little bit because of market conditions or uncertainties about the economy. . . . (But) I feel like if it involved more than just a few companies, if it were an industry-wide thing, I think I would have heard something about it."

Textiles and health care aside, Verrone says, "it's hard to find companies in industries that have not been affected by the recession. All of them have, some to greater extents than others, like real estate and commercial real estate, which has been devastated. But it's coming back now, I think they're over the worst part of it."

Industrial recruiters, who typically witness a range of industrial intentions, are "definitely seeing a cautiousness with movement of industry," says Jay Tilley, plant coordinator for Johnston County's economic development office. "Financing is tight, so that's bound to be one of the reasons why. From our point of view, there are certainly people who can capitalize their own expansion, and those that can't generally aren't right now." Some projects have been postponed, he says, but "I doubt any development office in the state hasn't heard that story in the last six months or so . . . that certain projects have been looking but just decided to cool things to see how orders are going.

"We feel like we've been blessed with steady activity," he says, with Caterpillar and Glaxo both making major announcements this year. Caterpillar is retrofitting a former Data General plant in Clayton that will employ 200 to 250 people by late 1993, and Glaxo announced in the fourth quarter that it had completed a \$3 million deal to buy Bristol-Myers Squibb's facility in Kenly. "Caterpillar is the type of company with the resources that the credit crunch is not going to impact it the way it would a company that would like to supply a Caterpillar, and expand in the area in order to do that, but would not have the capital capabilities to do it without substantial credit," he says. "Those are the

continued

THE ART OF INSURANCE


Since 1868



Agency founder, retired General Joseph Johnston (left), pictured in Savannah with Gen. Robert E. Lee. This was the last photograph taken of Gen. Lee.

From the day General Joseph Johnston founded our company, through four generations of Cay and Carswell leadership, our relentless commitment to the client has never waned. For these reasons, a diverse group of business owners from "main street" to "Fortune 500" continue to bring their insurance needs to one of the nation's premier insurance brokers.

6100 Fairview Rd. • Suite 1400
Charlotte, NC 28210
Phone: (704) 553-0419
FAX: (704) 553-2316


PALMER & CAY
CARSWELL
Established 1868

companies, it appears, that this credit crunch is having the impact on."

"Experience, such as it is, teaches me that banks will make loans when they're good loans," says N.C. Banking Commissioner William Graham. "And what the bankers tell us is that 'we're not getting that many applications for good loans. . . . We're trying, but we're just not getting that many inquiries for good loans.' Now, the other side of that coin is that some of the banks simply have made bad loans and they probably are not chasing marginal loans as much as they were two years ago."

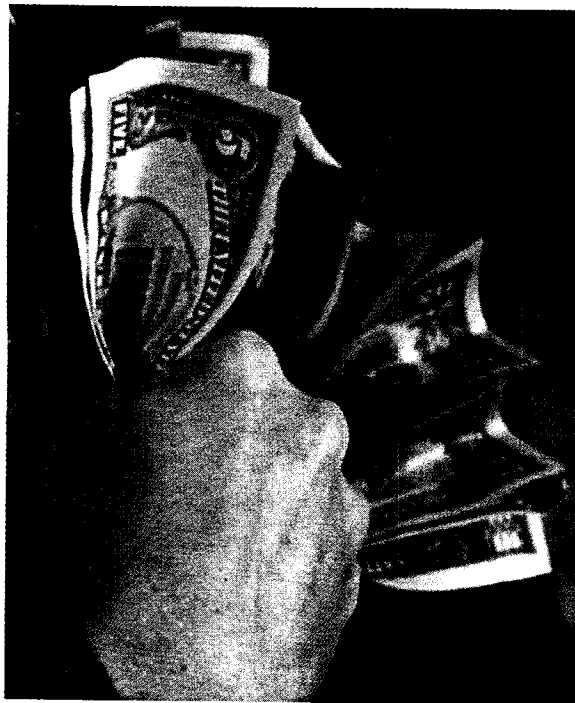
"There isn't any question but what when a bank gets hit, if it's got any sense at all, it's going to tighten up some. Sure, the regulators tell them to, but the good banks do it before the regulators ever get there."

With interest rates down, says Snead of NationsBank, credit requests are up. "Most rates have come down in the past 18 months significantly, whether it's short-term rates or long-term rates. We find that a number of people who have a (fixed-rate) term-loan facility . . . have come in to discuss refinancing those loans, whether they had the loans with us or with another bank."

The lower rates have not created a surge in new borrowing interest, however. "The situations we've seen," Snead says, "are more driven by dynamics of the project at this point than the cost of money."

McFarland adds: "What I think the Federal Reserve is finding is that moving interest rates down does not spur economic activity. Raising interest rates tends to retard economic activity, but lowering interest rates doesn't necessarily stimulate economic activity. In the commercial sectors, a lower interest rate doesn't create a need for the borrowing. What we're seeing now is (companies) still significantly reducing debt. . . . Companies are staying very lean on inventories, companies are not expanding capacity and companies are not making debt-financed acquisitions, by and large, so there just is not the need for borrowing regardless of the rate."

Helms of First Union agrees: A lower prime rate had "had very little impact, and again, that's driven by the stage where we are in what is hopefully an economic recovery. If you're concerned about the economy you're headed into, (rates) are



*'Money's available, but
it's got more strings on it.'*

—Hugh E. Carr
Trion Inc.

not the primary motivator for increasing borrowing."

However, Helms does see an emerging market for refinancing. "Over the past five years, there's been a substantial amount of real estate financed on what are traditionally referred to as mini-perms, that is, the standard amortization of anywhere between 15 and 25 years but with a five-year maturity. Statistically, there is a huge amount of that debt that matures in the next 18 months to two years, and consequently there will be some opportunities out there. That's not something you'll see all at once," he adds, "it's more gradual."

Currently, First Union is finding "some cases (where) people are shopping banks in an effort to determine their willingness to lend, anticipating that their mortgage comes due next year. What we're likely to see is that some of the banks that have those mortgages will choose not to maintain their heavy concentration in real estate financing, and you might find that to be true with life insurance companies and pension funds as well."

"We're in a real period of change," says

Graham. "An awful lot of things are moving . . . a whole lot faster than they did 20 years ago. And banks, along with everybody else, are going to have to adjust to that sort of thing."

Some of the biggest changes in banking involve recent mergers, which have created financial giants such as NationsBank as well as new banking entities like Centura.

The NCNB and C&S Sovran merger is, "I think, going to be very positive for us," says Snead. "We've had no negative effect whatsoever that I can see . . . and it's been a great positive effect. We've got tremendous recognition out of it nationally. We've had several companies come to us now of some size that have said, 'We believe NCNB is going to be one of the premier banking companies in the country, and we

would like to develop a relationship with you.'"

At Wachovia, which most recently acquired South Carolina National, bank mergers do not appear to have affected corporate customers. "Customers are concerned about the strength of their bank, about the ability of their banks to serve their needs," says McFarland. "I have not seen evidence that customers are leaving their banks because their banks are now merged and they behave differently."

Centura's Verrone says: "If anything, it's had a positive effect on corporate customers because the resulting combination has been a larger bank with higher lending limits."

One result for banks, however, will be increased competition, although Snead of NationsBank says: "It couldn't get any more competitive than it already is."

"North Carolina's already one of the most competitive banking states in the country, if not the most competitive," Verrone agrees.

"In a recessionary environment, the companies that are borrowing, the companies that are expanding, are very high-quality companies, and therefore the competition is even keener to chase those few loans that are out there . . . which means your margins are going to be a whole lot skinnier to get that business."

Helms adds: "Consolidation in our industry is something that's going to stay with us for 10 years or better." **NC**