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The 11 Biggest Mistakes Commercial Borrowers Make

There is a lot to consider when your business applies for a commercial loan. And it is hard to consider everything when what you really want to do is run and grow your business. So it is not surprising that borrowers often end up with less than an ideal arrangement once the ink dries.

Through decades of experience working with business borrowers from both across the table and on their side, we have compiled a list of the top 11 mistakes we see business borrowers make when securing credit commitments. They are not intended to be ranked by importance, because some will be more relevant to you than will others, but it's wise to consider them all.

1. **Taking the Path of Least Resistance**-Too often, borrowers will approach the bank where they hold their checking accounts, and maybe one other, and then take the resulting offer if it seems reasonable. We see this all the time. The lending market is too deep and competitive not to take the time to first consider those institutions that may have expertise in your industry, an appetite for loans to your industry, and who may provide the services and culture most important to you.

2. **Only considering one type of lender**: We have said this before, and we say it again here. While it is true that it is often harder to get the attention, much less an approval, from a large national bank, if you have a long term capital need, and you are above average in credit strength, you should also seek proposals from big banks. Not only may you get a lower rate due to their considerable pricing power versus community based banks, you will also be able to fix that rate for durations of 5 years, 7 years, and sometimes even longer. Smaller, local banks sometimes struggle to fix a rate for 5 years. Conversely, if you require that your lender "think outside the box" to get the credit you need, it will usually come from a small community lender more intimately familiar with the collateral and the business.

3. **Not understanding your Strengths or Weaknesses**-You may not realize how strong your cash flow is relative to the request, in the lender's eyes anyway, how readily convertible to cash and marketable your collateral is, how much your personal guarantee is valued, or how concerned the lender is with your type of inventory. Much better to know 'where you stand' so to speak relative to the market,

if you want to negotiate with confidence and drive your best deal, or head off obstacles before they become insurmountable and lead to wasted time and effort.

4. **Not helping the lender understand your Historic and Projected Cash Flows**: Nothing is more important to the majority of lenders than the cash generated by your business or real estate property. Rare is the borrower who helps the lender understand exactly what cash flow has been historically, what expenses were discretionary or one-time in nature, and what cash flow is expected to be going forward. Business owners will usually focus on Profit & Loss Statements, and very rarely supply a Cash Flow Statement, which is what the lender will be busy trying to assemble from your P&L and Balance Sheet. A borrower can help his cause by helping the lender understand cash flow, where discretionary expenses in the P&L lie, and how much cash is truly available to service debt.

5. **Depressing earnings to save on taxes, often leading to a lack of retained earnings and lower book net worth**: Smart is the business owner who realizes that paying Uncle Sam a portion of the year's profits as he goes along will help him or her down the road in a couple of potentially crucial ways: 1) The business will likely qualify for more credit should the need arise than it would have had it historically tried to shield most earnings from taxes 2) And when it comes time to sell, buyers will place a higher value on the business that reported higher earnings and paid taxes than the one with under-reported earnings due to running discretionary expenses and personal expenses through the business P&L.

6. **Submitting an incomplete credit package**-This happens all of the time, where a prospective borrower sends in one or two tax returns, then later the interim results, still later personal financial information, and after those steps, the lender still needs key items to make an offer or credit decision. You can stand out from the typical borrower by submitting everything required at one time. For tax returns, have 3 years worth for any entity or individual who would likely be a party to a final loan agreement, including owners and guarantors. You'll make a great first impression on how organized and tight your operation is, and get a much more rapid response from the lender.

7. **Not keeping financials not up to date**-Want to impress a prospective lender? Show them that you are able to produce interim results in a timely manner, as well as other key reports such as a Business Debt Schedule, Accounts Receivable and Accounts Payable Agings, Equipment lists with values, Rent Rolls at each month end, all the stuff you know you should have current to make the best decisions for your business.

8. **Myopic focus on rate and fees**-Yes, getting the best rate possible, and keeping fees down are very important when borrowing, all the more so the larger the loan request.

But too often borrowers will get hung up on one rate being a half point or one percentage point lower, without calculating what the true difference in interest expense will be annually. If you are borrowing $250,000 or less, it may well be worth paying a .50% higher rate to one lender over another, or $1,250 more in interest per year, if you are going to get other valuable benefits, like access to senior management, excellent responsiveness to future requests, personal service and timely advice. Equally important to rate and fees are some loan structure items, such as how high of an advance rate they will allow for different types of collateral, what covenants or restrictions they will put on the business until they are repaid, what types of personal guarantees will be required, and many others.

9. **Lack of negotiation**-Some terms offered by a lender are negotiable, others may not be. But most borrowers take the terms presented as firm and non-negotiable, and make their decisions accordingly. When borrowers do their homework, and get their request in front of the best lenders for their business, they have the knowledge and confidence to know where there may be some room for improvement in terms with their lender of choice.

10. **Being unaware of personal credit history and its impact on terms**: Most lenders view your personal credit history as a reflection of your business credit worthiness. If your personal credit is not strong, borrowers need to be pro-active in addressing the reason(s) behind this black mark and share the plan as to how that will improve.

11. **Agreeing to punitive prepayment penalties on fixed rate loans**: Sometimes a borrower has to agree to some form of a prepayment penalty in order to get the best and longest-term fixed rate for long-term asset loans. But these prepayment penalties come in many strips, from as high as 5% of the loan amount and ratcheting down with each passing year, to creatively tailored prepayments that allow for some prepayment if it comes from excess business cash flow, to no prepayment penalty at all. And sometimes they are somewhat hidden in the stack of documents signed at closing, under what is called a “Make Whole Provision”, which more or less says you can prepay as long as we the lender make as much money on this loan as we thought we were going to had you not prepaid. It’s not called a prepayment penalty, but it looks, smells and acts like one.