

Business and Residential Finance Issues

Making Lemonade out of an Economic Lemon

By FRANCIS R. MIRKIN, Esq.

In Charles Dickens' *A Tale of Two Cities*, Sidney Carton utters a famous line set in the time of the French Revolution: "It was the best of times; it was the worst of times." The quote seems appropriate today as well, as we are bombarded with media headlines that describe the struggles of large financial institutions and the details of numerous business failures and layoffs.

At the same time, it is hard not to notice that interest rates are at historic lows. Shrinking property values and stronger underwriting requirements mean that borrowing money to finance business needs or purchase a home is not what it used to be. Just the same, this may be a great time, and perhaps the opportunity of a lifetime, to finance long-term business or personal indebtedness.

Delving below the surface of the headlines in Western Mass. produces some interesting findings, such as these:

Revolving Credit

Many companies fund their day-to-day business needs through lines of credit. This type of loan provides a business with revolving credit to support the ebb and flow of their cash needs. Typically, the cost of this money is tied to the prime rate, as published by the *Wall Street Journal*. Since the prime rate is at an historically low 3.25%, the cost of this form of borrowing has dropped. On the other hand, it is logical to expect that the potential benefit of less-expensive money is counterbalanced, to a certain extent, by the risks and costs associated with lending.

Glenn Welch, executive vice president of Hampden Bank, confirms that local banks are



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actively lending in our area. "Our continued perception is that Western Mass., though clearly impacted by difficult economic times, does not experience the highs or lows that affect many other areas of the country," he said.

"However," he continued, "today most banks in the area have a cost of funds of approximately 3%. The bank cannot build in a responsible profit margin to balance its lending risk in the absence of establishing a floor that is higher than prime rate. For most banks, the floor hovers around what is still an exceptionally low rate of interest of 4%."

Banks also review existing relationships from time to time. According to Jeffrey Sullivan, senior vice president of lending for United Bank, it is important to establish a correlation between costs of funds and rates being charged to a customer. "As a result, prime-rate loans are reviewed periodically and can be modified to either provide a floor or increase the margin added to the interest rate charged to a borrower in excess of prime rate," he said. "Even with insertion of a floor or other hedge against costs,

it is hard to remember a time in recent years when the costs of borrowing were less."

Long-term, Fixed-asset Loans

Conversations with Welch and Sullivan confirm that credit remains available for long-term loans, and this viewpoint is anecdotally confirmed by conversations with other bankers in the area. The good news, according to Welch, is that "pricing on loans is quite low. Generally, loans are priced at a fixed rate for a period of time of either five or 10 years. Payments are then tied in to a 20- or 25-year amortization period."

Both bankers agree that the most desirable long-term loan consists of financing to a business owner with a business that maintains good fundamentals to ensure resilience and long-term success. Said Sullivan, "banks are likely to analyze investor acquisitions in greater detail with more in-depth analysis of length and quality of leases, strength of tenants, and ability to maintain adequate debt service coverage."

Both bankers confirm the pos-

sibility, and in some instance a strong likelihood, of the bank agreeing in advance to extend the initial, fixed-rate portion of the loan. Interest rates for subsequent loan extensions of the loan are likely to be tied to indices such as the Federal Home Loan Bank or prime rate, with a floor that is somewhat higher than the short-term rates associated with revolving credit.

Borrowers or counsel for borrowers would be wise to attempt to negotiate a ceiling for the costs of funds or the interest rate that will be charged to the borrower after the expiration of the fixed rate period.

Residential Loans

In late February the *Wall Street Journal* published an article written by Amy Hoak headlined "Low Mortgage Rates Will Cost You." This article quoted several experts who agreed that rates are quite low.

Amy Bohutinsky, vice president of Communications for *Zillow.com*, a real-estate Web site, states in the article that "it is an interesting time, in that mortgage rates are historically low, but at the same time, while rates are low, lending standards are still really tight. What that means is that people who qualify for these really good rates ... fall under a strict set of guidelines."

Jeffrey Smith, senior vice president and head of Mortgage Lending for Florence Savings Bank, said his bank is "very busy taking in new loan applications." Smith has been in the business for 26 years and says that interest rates have become extremely attractive. The current rates are the lowest we have seen since 2003.

When asked about the probable future movement in interest rates, Smith's reply reflects the response of many experts. "It is a tough call as to whether rates will continue down or not," he said. "As of late February, rates for a 30-year fixed rate loan were at approximately 5.25% and 4.75% for 15 years."

Interest rates and the costs associated with the loans may move upward based upon lower-than-ideal credit scores or the loan-to-value ratio. Smith emphasizes that the bank is still actively lending money throughout Western Mass. and that the bank's foreclosure problems have been minimal due to consistently strong underwriting standards that preceded the precipitous drop in the economy.

Smith noted that one of the trends that some bankers view as

positive is that annual-review mortgages and other products with historically low introductory rates have become far less attractive. He said that Fannie Mae has tightened up its underwriting standards for these loans and that they often start out at a higher rate than a 30-year fixed-rate loan, which extinguishes their popularity.

Lisa Baltronis is a senior loan officer at New England Moves, a mortgage company affiliated with Coldwell Banker. Her sentiments are similar to Smith's. She has been involved in real estate in the banking and relocation field for more than 20 years. "Today, credit scores are more closely scrutinized and tied in to lending opportunities and/or the cost of borrowing than in the past," she said.

For instance, today a marginal credit score may result in avail-

ability of funds at a slightly higher rate, with additional costs in the form of points to offset the risk of underwriting the loan. That was not the case a short time ago.

Baltronis emphasized the fact that it is a great time to buy or refinance for those with good credit. In addition, there are still a lot of government programs available for first-time homebuyers. She often works with FHA loans, which currently require a 3.5% down payment. Both bankers agree that new governmentally based requirements increase the scrutiny on each individual borrower.

History is sure to mark these times as replete with some of the most difficult financial challenges ever encountered. But on the other hand, the potential to finance at historically low rates

remains available to people who are fortunate enough to have good credit and/or available equity to finance.

As a whole, representatives of the commercial and residential markets in Western Mass. retain a level of optimism that is bolstered by the somewhat regional nature of the local economy. It may be the worst of economic times, but, paradoxically, one of the best times to borrow money. ❖

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