The Curious Loan Approval

Topic: Commercial Bank Management (Loan Evaluation)

Characters: Adam, Financial Analyst at Farmwood National Bank
Mary Ryan, Commercial Loan Officer at Farmwood National and Adam's boss

As a commercial loan officer-trainee at Farmwood National Bank, Adam's future looked very bright. He had recently completed a series of credit analysis exams, earning the highest score in his training group and capturing the attention of the bank's senior commercial loan officers. In the second phase of his training program, Adam was promoted to a financial analyst's position and assigned to work for Mary Ryan, one of the bank's most productive commercial loan officers. Like Adam, Mary had earned the highest score on the analysis exams among her training group five years ago, and she and Adam quickly became a team to be reckoned with inside the bank's corporate banking division.

In the first few months of his new assignment, Adam quickly grew to admire his new boss. In most cases, when he evaluated the creditworthiness of a new customer for Mary, she readily agreed with his analysis and praised his attention to detail. However, one recent loan application left Adam totally confused. Evaluating a request from Mitchell Foods, Inc., for a $5 million short-term loan to finance inventory expansion, Adam noted that the firm was dangerously overleveraged. Mitchell Foods represented a retail grocery chain with 35 stores located in the greater metropolitan area served by Farmwood National, and the firm was financing its retail outlets with operating leases. Unlike financial leases, operating leases only appear in the notes accompanying the firm's financial statements, and Mitchell Foods' current balance sheet gave the appearance of far less leverage than the firm actually carried.

Adam promptly noted this fact in a memorandum of concern that he forwarded to Mary for inclusion in the Mitchell Foods credit file. Much to his surprise, Mary discounted the problem and told Adam to destroy the memo. After the bank's senior credit committee approved the Mitchell Foods loan request, Mary defended her position by telling Adam that the issue of operating lease leverage never surfaced during the credit committee meeting.

In spite of Mary's reassurances, Adam knew from his days in credit school that Mitchell Foods' operating lease liability was handled improperly. While pondering this problem over coffee in the employee cafeteria, Adam overheard Mary talking excitedly among a group of young commercial lenders. It seems she had just received word that her personal mortgage loan application at Bay Street Savings and Loan had been approved, and the terms of this loan were most attractive. The savings and loan willingly waived its normal down payment requirement and gave Mary 100 percent, fixed-rate financing of 25 years at 2 percent below the going rate of interest on fixed-rate mortgage loans.

Given his recent credit analysis, Adam recalled that the president of Mitchell Foods was also Chairman of the Board at Bay Street Savings. He began to wonder whether Mary's actions as a commercial loan officer had been compromised by her personal financial affairs, or whether he was simply thinking too much. After all, Mary was an outstanding commercial loan officer, and she was his mentor. What should Adam do next?

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