

POINT LOMA ADVISORY PERSPECTIVES

The True Cost of Rapid Loan Growth

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KEY TAKEAWAYS

- Loan growth produces revenue immediately, while the costs of exceeding an institution's operating capacity can take years to surface.
- Staffing, expertise, and systems should reflect the volume and complexity of the business being booked.
- Growth targets should come with a clear plan for administering the resulting portfolio throughout its life.

Loan growth is easy to celebrate. Production increases, interest income builds, and the institution gains new relationships. Lenders meet their goals. Management has a positive story to tell the board. All good things.

The additional work created by that growth receives considerably less attention. That additional work is an expected part of growth. Giving it too little attention is where the trouble begins.

Every new loan creates obligations that extend well beyond approval and closing. Someone must collect financial information, monitor covenants, maintain collateral controls, process advances, manage exceptions, and recognize deterioration. Those obligations accumulate as the portfolio grows.

An institution can increase production much faster than it can build the capacity to manage what it has produced. When that happens, the growth carries costs that may not appear in the financial statements for quite some time. I've seen this happen with both banks and credit unions, and the truth is that it's more common than one would think.

GROWTH CREATES A LASTING WORKLOAD

A production goal measures how much business the institution intends to book during a particular period. It does not necessarily measure how much ongoing work that business will create.

Two loans of the same size can require very different levels of attention. A straightforward CRE or simple term loan may create a manageable monitoring burden. A construction loan, borrowing-base line, or transaction with multiple entities and collateral types can require substantial attention throughout its life.

That distinction matters when management evaluates capacity. Portfolio balances and loan counts tell part of the story. Structure, complexity, borrower characteristics, and reporting requirements determine much of the actual workload once the loan has been booked.

The institution also continues administering the loans it booked last year and beyond. A lender who had ample time to manage a portfolio twelve months ago may now be responsible for substantially more relationships while carrying an even higher production goal.

At some point, the math stops working.

THE FIRST COSTS OFTEN LOOK LIKE MINOR INCONVENIENCES

The early signs of strain rarely arrive as a major credit loss.

Financial statements take longer to collect. Annual reviews fall behind. Exceptions remain open. Closing staff receive incomplete files and increasingly urgent requests because production is paramount. Experienced employees spend their days resolving problems that should have been addressed earlier.

Each issue may have a reasonable explanation. Someone is out. A position is vacant. The borrower is slow to respond. The system requires a workaround. The lender promises to clean it up after closing. The goals need to be hit. The borrower's earnest money is at risk.

Individually, these explanations can be legitimate. Collectively, they can reveal an operation that is no longer keeping up. As a sailor, I'd describe this as the moment when the wind picks up and a ride that was fun and exhilarating becomes stressful and potentially dangerous.

The danger is that management begins treating the backlog as a normal consequence of success. Employees are praised for making things happen, even as the work depends increasingly on overtime, memory, and a few people who know how to get around the process.

That can keep production moving for a while. It also makes the institution more vulnerable to mistakes, turnover, and missed warning signs.

CAPACITY INCLUDES EXPERTISE

Adding employees does not automatically solve the problem.

An institution can have enough people to process its familiar business and still lack the expertise to manage a new product, industry, or loan structure. Growth into unfamiliar territory creates a different capacity problem.

The lender may understand how to sell the product. Credit may be able to evaluate the financial statements. But who understands the closing requirements? Who knows which controls are essential? Who can identify when the borrower's reporting no longer supports continued advances?

Those capabilities need to exist before the institution commits to the business.

"We will figure it out as we go" might work in some industries, but in lending it becomes expensive when the learning occurs after funds have been disbursed.

THE FINANCIAL RESULTS ARRIVE IN THE WRONG ORDER

One reason rapid growth is so tempting is that its benefits and costs appear on different schedules.

Revenue begins accumulating as loans are booked. Staffing, training, and systems require spending today. Management therefore faces a visible expense to address a risk that may still seem theoretical.

Deferring that investment can make the growth look more profitable than it really is.

Eventually, the institution may have to pay for file remediation, outside reviews, additional legal work, emergency staffing, or systems changes under pressure. Borrowers may experience delays and inconsistent service. Employees may leave. Credit problems may become more costly because deterioration was recognized late or important protections were never put in place.

By then, management is funding the operation it should have built earlier while also paying to repair the consequences of the delay.

PRODUCTION GOALS NEED AN OPERATING PLAN

The right response is not to abandon growth. It is to make the supporting capacity part of the growth decision. It is about recognizing that talent and expertise are worth the investment.

Before approving an ambitious production plan, leadership should be able to answer a few practical questions:

- What additional closing, servicing, and portfolio-management work will this business create?
- Which functions are already operating near capacity?
- Does the institution have the expertise to manage the proposed mix of loans?
- What staffing, training, or system investments must occur before volume increases?
- What conditions would cause management to slow production?

That last question deserves particular attention.

An institution should establish its limits before employees are overwhelmed and the backlog becomes difficult to unwind. An increasing backlog of overdue annual reviews, unresolved documentation exceptions, closing errors, and persistent overtime should prompt a decision about capacity and production.

They should also be presented alongside production results. A board reviewing strong loan growth needs to understand whether the operation supporting that growth is becoming stronger or falling behind.

GROWTH SHOULD LEAVE THE INSTITUTION STRONGER

Successful growth creates earnings, relationships, and a portfolio the institution can manage with confidence.

If production rises while expertise, controls, and service deteriorate, the institution is accumulating obligations faster than it can fulfill them. Today's results may still look attractive, but part of the cost has simply been deferred.

Leadership's responsibility is to recognize that gap while there is still time to address it.

Set ambitious goals. Pursue worthwhile business. But without exception, also invest in the people and processes required to support it. That is how a financial institution builds a real growth engine.

The true cost of loan growth includes everything the institution must do after the loan closes. A growth plan that ignores that work is an incomplete plan.