



Comptroller of the Currency
Administrator of National Banks

Community Developments

Fall 2001

Community Affairs OnLine News Articles

Commercial Lending in Indian Country: A Banker's Perspective

By Sam Frumkin, *Office of the Comptroller of the Currency*



Classy Closets is a company in the Gila River Tribe's Lone Butte Industrial Park which was financed by Arizona Business Bank.

How do you run a successful commercial lending program in Indian country? Lyle Frederickson, Senior Vice President of Arizona Business Bank, has been doing it for more than 20 years. His answer is straightforward: “Just like any other commercial loan, you must pay attention to the fundamentals of sound credit underwriting.”

If a bank follows this advice, Frederickson says, it's likely to find commercial lending in Indian country profitable and rewarding. A bank that ignores credit analysis, on the other hand, is asking for trouble — just as in any other marketplace.

About 10 percent of Arizona Business Bank's commercial loan portfolio is invested in Indian country. “Our Native American commercial loan portfolio has performed well when compared to the rest of the bank's commercial portfolio, by virtue of its lower default and delinquency rates,” says Frederickson.

Know your customer

Key to sound credit analysis in Indian country, Frederickson says, is “knowing your customer.” This principle encompasses some universal ground rules and a few that are particular to Indian country.

Foremost on the list of knowing your customer is one of the traditional “five Cs” of credit: character — the personal integrity of borrowers. Will the borrower make every effort to meet the financial obligations spelled out in a commercial lending agreement?

These basic questions of credit analysis must, of course, be answered to a lender's satisfaction in every transaction, but they can take on special significance in Indian country because tribal laws and sovereign immunity may leave a lender with limited recourse if a loan goes bad. This is due to the fact that tribal land is generally held in trust for the tribes by the U.S. government. In the case of a real estate loan, the bank has only a leasehold mortgage and cannot foreclose on the land itself. Frederickson is quick to note, however, that in the one instance he could think of where a commercial real estate project did not succeed, the bank's loan was still repaid. He also notes that binding arbitration is the most common method of resolving disputes between tribes and outside entities.

Arizona Business Bank has mitigated some of its risk through the U.S. Department of Agriculture's Business and Industry (B&I) Guaranteed Loan Program, managed by the agency's Rural Business-Cooperative Service (visit http://www.rurdev.usda.gov/rbs/busp/b&i_gar.htm for more information). This program guarantees up to 80 percent of a loan after the construction period is complete.

In Indian country, knowing your customer also means understanding tribal culture. "In Arizona, at least, this means a few things are different," Frederickson cautions.

While every community has leaders, decisions about tribal borrowing (and many other matters) are arrived at through consensus. When discussing a proposal to lend money to a tribe or tribally owned entity, a banker doesn't just negotiate one-on-one with a tribal council president. Instead, the banker presents a proposal at a council meeting — and should ensure that every member understands the proposal. Tribal business meetings are formal, Frederickson notes, and bankers who haven't attended one may miss the subtle nuances of how a presentation should be made.

Bear in mind, Frederickson adds that tribal decisions are made only after very careful deliberation, especially in matters concerning land. Tribes attach spiritual significance to their land, and anything that may be seen as even potentially infringing on their relationship with it is viewed with great gravity. And once a decision is made, especially one regarding land, how the decision is implemented is viewed just as seriously.

Success stories

In addition to building a strong portfolio for the bank, Arizona Business Bank's lending in Indian country has created jobs in areas plagued by persistently high unemployment rates. In a series of loans to the Lone Butte Industrial Development Corporation (wholly owned by the Gila River Indian Community), the bank financed build-to-suit commercial buildings in an industrial park south of Chandler, Arizona. Occupants include an aluminum extrusion plant and a builder of custom closets. Altogether the park's businesses have created more than 2,000 new jobs, including 600 that are held by Native Americans. In addition, the bank has lent money to the industrial development corporation for infrastructure improvements to accommodate existing businesses and attract new businesses. State and Federal tax incentives for businesses located on reservations has encouraged companies to locate their businesses at Lone Butte Industrial Park (see sidebar for summary).

The bank has also made loans to individuals, including one to finance the construction of a 74-room Hampton Inn Hotel near Monument Valley, Arizona. The new hotel created 50 new jobs, all of which are held by Native Americans — in an area with a 52-percent unemployment rate. Frederickson notes that the bank underwrote the loan as it would a loan to any other closely held company. For example, the bank required personal guarantees, appraisal on the collateral, and a feasibility study just as it would for similar lending off-reservation.

How does Arizona Business Bank measure its success in the marketplace? There are various ways, of course, but here's one that Frederickson particularly likes to point out. The bank was independently owned until recently, operating as First Capital Bank. Earlier this year it was acquired by CoBiz, Inc. (and subsequently given its present name). When conducting its due diligence review of First Capital's assets, the acquiring entity looked at the Native American commercial loan portfolio along with the rest of the bank's loans. And in the final analysis, CoBiz, Inc. still agreed to pay a premium for First Capital's stock.

Now *that's* a real measure of performance in the marketplace.

For more information, contact Lyle Frederickson at (602) 240-2720 or by e-mail at lfrederickson@azbizbank.com.

Federal Indian Investment and Employment Tax Incentives

Accelerated Depreciation of Property on Indian Reservations:

Section 168(j) of the Internal Revenue Code provides that certain “qualified Indian reservation property” (excluding gaming property) is eligible for accelerated depreciation. For example:

- 22 year recovery period for non-residential real property (such as a new building), normally depreciable over a 39-year period of off-reservation businesses,
- 4 year recovery period for certain machinery, normally depreciable over a seven year period for off-reservation businesses.

Indian Employment Credit

Section 45A of the Internal Revenue Code provides that employers of Native American “qualified employees” (whose annual wages fall below \$30,000) are eligible for a federal tax credit of 20 percent for up to \$20,000 of the employee’s wages and health insurance costs.