CREDIT STRUCTURING

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MOVEMENT BANK

Risk Management Association
Carolinas-Virginias Chapter

NCBankers ASSOCIATION
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WHY -What is the *WHY* for the customer?

WHY – What is the *WHY* behind Credit Structuring?

* *Credit Structure must meet Deal Design!*

FIVE C'S OF CREDIT: (Creditworthiness)

Character:	Person, Company
Capacity:	Cash Flow, Sales, Margins
Capital:	Liquidity, Inventory, Net Worth
Collateral:	Amount, Type, Equity, Ownership
Conditions:	Market, Product, Supply and Demand

<u>MAKE IT PERSONAL:</u>

FACE to FACE MEETING…… (**Especially if a new client**)

- You want to **<u>read</u>** someone's character; it must be in person!
- It gives you a chance to visit with the person, property, business, home, or office!
  - What can you learn from a visit?
    - Look for connections!
    - Look for lies!
    - What's NOT in the numbers

THREE "D" of Credit Structuring

- DIVORCE
- DEATH
- DESEASE..........(Medical, Gambling, Alcohol)

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INDUSTRY

(Print, Radio, Conventions, Internet, Journals/Software)

- Research Local and National
- Growth, Stabilizing, Decreasing
- Barriers of Entry
- Major Red Flags

KNOW YOUR INSTITUTION

- Bank’s Policy’s
- Credit Departments: (Layers / Boards)
- Bank’s Hot Buttons – (Local/Regional/Product Type)
- National, Regional, Community Banks – Policies Vary at Each

KNOW YOUR MARKETS

- Research Local, State, and National
- Growth, Stabilizing, Decreasing
- Barriers of Entry……(Hotel Moratorium)
- Supply and Demand
- Local Governments

FINANCIAL NUMBERS

- Current Financials (Business & Personal)
- 2-3 Years Minimum Financials
- Inventory Financials
- When in Doubt – ASK Questions!
- Something seems OFF – ASK for PROOF!
- Year over Year Trend/Changes

EXAMPLES OF LOAN STRUCTURE….(Talk Through)

A: Operating Line of Credit

Business: Vending Machine Business for Downtown City Offices

Collateral: FFE&I (Furniture, Fixture, Equipment, Inventory)

Per YTD Books, Inventory Equaled: $500,000

Loan Amount for LOC: $250,000……..LTV = 50%

LOC Term: 36 Months

Cash Flow: 2 yr. History of 1.55x Debt Coverage

Business Ownership: 70/30 Husband and Wife

Borrower: Business Entity

Guarantor: Husband-Managing Member

WHAT HAPPENS WHEN THE WRONG STRUCTURE IS USED:

"The Rest of the Story"

A: Operating Line of Credit

- Owner Buys Girlfriend car with cash from LOC: $100,000
- Owner puts car in girlfriend's name
- 26 months into the LOC, You find out Divorced Filed, Husband Found cheating on wife.
- Line is Maxed Out
- Inventory is NO GOOD-Expired, due to COVID no one is working in the office for two years. Sales Drop, Cash Flow Drops!
- Line Can't be repaid.
- Husband has no assets, Can't go after wife, did not sign on loan!

HOW SHOULD THIS DEAL HAVE BEEN STRUCTURED

- 30 Day Zero Out Clause
- 12 Month Line of Credit Term
- Covenant: 12 Month Line Reviews
- Wife on Loan due to her Ownership Percentage

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EXAMPLES OF LOAN STRUCTURE….(Talk Through)

B: ***Industrial Building-Vacant…Rehab for Large Local Grocery Tenant for Corporate Offices in Industrial Park outside of the city:***

$1,000,000….Loan Amount

20,000sqft……5 Yr. Lease with 2 – 5 Yr. Options

Loan to Value based on Credit Tenant and Lease Contract

70% Loan to Value

Loan Term 10 year Fixed, 15 year Amortization

Fixed Rate: 5% **Origination Fee:** 1% **12months Interest Only**

108 Months Principal & Interest Payments

Cash Flow Based off New Lease: 1.45x (All In)

WHAT HAPPENS WHEN THE WRONG STRUCTURE IS USED:

"The Rest of the Story"

B: Problem! National Grocery Chain Buys company in the 4th year and pays out owner the last 12 months of rent payments. Doesn't Renew Lease!

10 Years Still Left on Amortizing Debt of $1,000,000

Owners-Can't Re-Lease a 20,000sqft CLASS A Office Building in an Industrial Park.

Building Stays Vacant for 2 years,

One of the Two Owners Passes Away. Estate requires the property SOLD

Property Can't be Sold for what is owed

Remaining Owner Refinances building and uses cash to convert 10,000 sqft of Class Office back to Mix Used Industrial Building: Fits in Area!

HOW SHOULD THIS DEAL HAVE BEEN STRUCTURED

Term of Loan Should have matched the FIRST Renewal Term

I.E. 5 Year Term….Loan should have been amortized over 5 years or shortened to at least 10 years. DUE TO – Special Building in Special Location……(I.E. Class A / 20,000sqft Office Building) Located in an industrial park full of Ware-Houses and Flex Buildings!

<u>EXAMPLES OF LOAN STRUCTURE….(Talk Through)</u>

C: Fleet Vehicle Term Loan….(10 Pieces of Excavating Equipment to handle large job/contract company just received)…I.E-Dozers, Back-Hoes, Dump Trucks, Skid-Steers!

3 Year Project-Contract

$1,000,000 Loan…….7 Year Term on Equipment (Life Exp 10+yrs)

Loan to Cost 90%

Rate 4.5%....(Dealership would loan 4.95%)….Competitive Bid!

<u>*Made Loan to Equipment LLC*</u>…so owner could lease it back to his Excavating Company at higher rate, lower taxes

Cash Flow Coverage: 1.30x…due to short amortization….1.50x Life Exp!

No Guarantors….Match Dealership Financing

Straight Balance Sheet Equipment Loans: No Liens Filed on Titles

WHAT HAPPENS WHEN THE WRONG STRUCTURE IS USED:

"The Rest of the Story"

C: Problem!

Due to Funding Delay's by DOT, certain parts of the contract work was canceled, changed, and put on hold. Borrower of Loan, did not have any other large contracts on the calendar to use the 10 pieces equipment for since he bought them for this contract.

Cash Flow Slows, Payments Become Slow, then Stop!

You Find Out, Borrower sold some of the equipment to make payments and payroll and did not pay down PRINCIPAL DEBT.

You End Up with Equipment and Take a Loss due to LTV too high for sale of used equipment.

HOW SHOULD THIS DEAL HAVE BEEN STRUCTURED

Always Lien All Titled Equipment, Vehicles, Mobile Homes

Always Watch News….regarding large projects you fund!

Time in the SEAT! BOOTS on the Ground!

LOAN PURPOSE:

- What does the **borrower** perceive is the LOAN PURPOSE/NEED?
- What does the ***lender*** perceive is the LOAN PURPOSE/NEED?
- What will the funds be used for? (*Solving the Problem or Need*)
- You must determine what the CAUSE is of the NEED!
- Who benefits from the funds? (*Borrower, Guarantor, Property, Business, Another Person*)

NOTE: *Not fully understanding the purpose could result in a band-aid instead of a cure!*

PROBLEM’s……………..(*Key Watch for White Elephants*)

- What is the specific problem to be fixed or improved?
- **Examples of Problems:**
  - Accounts Receivables Slowed
  - Inventory has grown too much or not enough
  - Loss of Major Customer
  - Fraud - AI
  - Expenses out of control
  - Payroll….(On Books vs Contract)
  - Operating Losses

COLLATERAL:

TYPES:

- Real Estate
- Equipment
- Inventory
- Cash/Investments
- Vehicles, Mobile Homes, Planes, Crops, Minerals, Materials, Livestock
- FF&E….(i.e. *Basically Unsecured*)
- Key Man Life Insurance

SECRURING YOUR COLLATERAL TYPES:

- Deed of Trusts
- Lien's…..(*Positions Matter, Check yearly*)
- Contracts
- Titles
- Notes
- State Regulations
- Who has ownership of the collateral

MOVE FORWARD OR NOT

- ? GUT Feeling
- ? Credit Worthy Financials : (SUBJECTIVE)
- ? Meets Bank Policy: (NOT-SUBJECTIVE)
- ? Can we secure our loan reasonably with collateral: (NOT-SUBJECTIVE)
- ? Can you determine whether this is a CORE ISSUE or an

  Operational Blip or a Market Blip!

<u>LOAN STRUCTURE……..(No One Size Fits All)</u>

Depends on Bank Policy

Collateral: (*Beware of collateral mismatch*)

Secure & Monitor

Unsecured…..(*Financial Monitoring is a must!*)

Strength of Deal

Type of Deal

Financials

Market

Match NEED to REPAYMENT

Short Term to Short Term

Long Term to Long Term

EXAMPLES:

Line of Credits – Seasonal or Operations: Paid by Current Asset Conversion

Permanent Working Capital – Term Loan to Stock Shelves, Initial Payroll

Paid back over time by profits.

Term Loans – Real Estate/Equipment: Paid back over time by profits or asset conversion.

One Time Notes: Bridge Loans – Non Revolver, Paid back by Asset Sale

NOTE: *Improper loan structure can do more harm than good to your client and to your Bank!*

LOAN COVENANTS:

(Allows the bank to have conversations with borrowers prior to payment issues coming up!)

- Debt Service Coverage Ratio
- Loan to Value or Loan to Cost
- Leverage Ratio
- Percentage of Sales Price
- Zero Out of Lines of Credit in 30 days
- Margin Requirements
- Inventory Turn Times

NOTE: Covenants do NOT mitigate Risk…..They strengthen and protect the credit.

QUESTIONS?

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