Global Cash Flow

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Global Cash Flow

Focus of the Course

- Define Global Cash Flow
- Identify Source Information
- Construct the Model
- Case Study

Define Global Cash Flow

- Simple put, it is the sum of business and personal cash flows

- Business cash flows are typically EBIDA based, although Net Cash After Operations can be used for a UCA basis

- Personal cash flows are typically after taxes and after living expenses. This is essentially an EBIDA equivalent for the individual

Define Global Cash Flow

- These cash flows are then compared to debt service, business & personal, to provide a Global Debt Coverage Ratio and Excess Global Cash Flow dollar amount

- Global Cash Flow should NOT be the primary repayment source – it is a secondary or tertiary repayment source

Define Global Cash Flow

- Two schools of thought on the focal point of Global Cash Flow
  - Personal focus
  - Business focus

- What difference does it make?

  It is subtle, but very different

Define Global Cash Flow

Personal Focus

- Each individual has a unique Global Cash Flow based on the personal cash flows and the pro-rata share of business cash flows

- Global Cash Flow analysis is part of the Personal financial analysis component of underwriting

Define Global Cash Flow

Business Focus

- Each business has a unique Global Cash Flow that is essentially the sum of the business cash flows plus the individual cash flows

- May include additional related business interests

- Global Cash Flow analysis is part of the Business financial analysis component of underwriting

Define Global Cash Flow

- So which school of thought is best?
  Both, of course

- Personal focus is particularly useful when there are multiple individuals involved that have varying degrees of financial capacity or have multiple related business interests

- Business focus is particularly useful when there are limited individuals involved that have similar degrees of financial capacity or have limited related business interests

Identify Source Information

Quantity and Quality of financial information is the key to a reliable Global Cash Flow

- What personal information do I need?
  - Personal Financial Statement
  - Personal Credit Report
  - Personal Tax Return with K-1s

    (W-2s and 1099s may be substituted for periods between year end and tax filing)

Identify Source Information

- What business information do I need?
  - Business financials, with debt listing, for all related interests which are significant to the individual

- How is "significant" defined?
  - Individual owns at least 50% of the related interest
  - Individual owns at least 25% of the related interest and is the largest owner
  - Individual reports significant income/loss from the related interest

Constructing the Model – Business Cash Flow

- Where do I find cash flow information?
  - Schedule C for sole proprietorships
  - Schedule E Part I for rental property
  - Schedule F for farming operations
  - Business financial statements/tax returns

- What else do I need?
  - Percentage ownership
  - Debt schedule for each business

Constructing the Model – Business Cash Flow

- What does a business cash flow look like?

	Net Income
+	Non-Recurring Expense
–	Non-Recurring Income
+	Depreciation/Amortization Expense
+	Interest Expense
–	Shareholder Distributions
=	Cash Flow Available for Debt Service
–	Debt Service, principal and interest
=	Cash Flow Excess (Shortfall)
	Debt Service Coverage (Cash Flow Available for Debt Service divided by Debt Service, principal and interest

Constructing the Model – Business Cash Flow

- Examples of non-recurring expenses
  - Loss on sale of assets
  - Uninsured fire/theft/wind & hail losses, net
  - Lawsuit settlements
  - One time business expenses (very rare, be careful)

- Examples of non-recurring income
  - Gain on sale of assets
  - Insurance proceeds, net
  - Lawsuit settlements

Constructing the Model – Business Cash Flow

- Types of Shareholder Distributions
  - K-1 distributions
  - Dividend distributions
  - Increases in loans to shareholders
  - Decreases in loans from shareholders

- How should I treat Shareholder Contributions?

  Do not include shareholder contributions unless netted from shareholder distributions

- What if Shareholder Distributions are Discretionary?

  Do not assume them to be discretionary as the cash flow will be reflected in the personal cash flow

Constructing the Model – Business Cash Flow

- Why do I need to know percentage ownership?

  To determine how much cash flow belongs to the individual on a pro-rata basis

- Where do I find percentage ownership?
  - K-1s
  - Organizational documents
  - Borrower provides

Constructing the Model – Business Cash Flow

- Why do I need debt schedules?

  Debt schedules are critical in determining the monthly/annual debt service to which cash flow is compared

- What if one is not provided?

  Estimate based on your knowledge of the business recognizing that a poor estimate may result in an inaccurate cash flow

Constructing the Model – Personal Cash Flow

- Where do I find cash flow information?
  - Personal Tax Return
  - K-1s from related interests

Constructing the Model – Personal Cash Flow

- What does an personal cash flow look like?

	Salaries & Wages Income
+	Retirement/Social Security Income
+	Interest/Dividend Income
+	Distributions from Related Interests
+	Other Recurring Personal Income
–	Taxes
–	Estimated Living Expenses
=	Cash Flow Available for Debt Service
–	Personal Debt Payments
=	Cash Flow Excess (Shortfall)
	Debt Service Coverage (Cash Flow Available for Debt Service divided by Personal Debt Payments

Constructing the Model – Personal Cash Flow

- How do I treat capital gains (losses)?
  - Exclude them from the cash flow
  - Make adjustments to income taxes

- Why exclude them?
  - Can't sell property but one time
  - Stock gains typically rolled back into investment account

Constructing the Model – Personal Cash Flow

- How do I determine taxes?
  - For Federal, use the amount on the Total Tax line on Form 1040
  - For State, use the actual Tax amount from the State return or use the amount itemized on the Federal return
  - For Property, use the amount itemized on the Federal return
  - For Payroll, use 6.2% of wages for FICA up to annual limit and 1.45% for Medicare

Constructing the Model – Personal Cash Flow

- How do I determine estimated living expenses?

  Greater of $30,000 or 35% of After Tax Personal Cash Inflows

- That seems high. What is the logic behind 35%?

  – Consumer underwriting

    40–45% DTI

    20–25% Taxes

    5–10% Pretax expenses (401k; insurance)

    Leaves 20–35% unallocated on pre-tax earnings

Constructing the Model – Personal Cash Flow

- What is included in living expenses?
  - Utilities (Power, water/sewer, cable, cell phone)
  - Automobile (Insurance, Gas, Service & Repairs)
  - Entertainment
  - Dining Out
  - Groceries
  - Clothing
  - Household Goods & Services
  - Health & Welfare
  - Charity
  - Education
  - Children Activities

Constructing the Model – Personal Cash Flow

- What if it is a joint tax return but only one spouse is the borrower/guarantor?
  - Exclude other spousal income, adjusting for taxes
  - Adjust personal debt payments accordingly using estimates taking into account the level of income provided by each and the level of debt expected to be paid by each.

Constructing the Model – Personal Cash Flow

- Where do I find the personal debt payments?
  - Personal Financial Statement
  - Credit Bureau Report
  - Asking the question

Global Cash Flow

- Let’s Do One!!!!