



# Bank Credit



Mr. Tom Lofland

**BANK CREDIT**  
**SYLLABUS**  
**FIRST YEAR 2023**

**INSTRUCTOR:** Thomas W. Lofland  
Director / North East Economic Development Commission  
Town of North East

**COURSE DESCRIPTION:**

This course will cover the fundamentals of consumer and commercial lending. Students will learn the basics of the consumer and commercial lending from the application process to loan closing procedures. The course will also cover the importance of loan pricing as it impacts the balance sheet and the income statement.

**COURSE OBJECTIVES:**

The student should come away with a basic understanding of both the consumer and commercial loan credit process and should understand the importance of asset quality in today's banking environment. Various types of loan offerings will be understood by the student. Compliance issues and their impact will be addressed. Also asset recovery and adjustments will be discussed.

**FORMAT:**

Lecture and class discussion.

**BANK CREDIT**  
**SYLLABUS**  
**FIRST YEAR 2023**

**INSTRUCTOR:** Thomas W. Lofland

**CONSUMER LENDING:**

**A. Loan Processing**

1. Interview and Application Process
2. Credit Investigation
3. Evaluation – Judgment Vs. Credit Scoring
4. Loan Documentation and Closing

**B. Pricing/Profitability**

1. Loan Cost
2. Fixed Rates
3. Variable Rates
4. Adjustable Rates

**C. Loan Policy – Guidelines/Procedures**

**D. Direct Loans – Closed End**

1. Automobile
2. Personal
3. Home Improvement / Home Equity – (Second Mortgage)
4. Boat

**E. Indirect Loans**

1. Automobiles
2. Home Improvements
3. Boat

**F. Lines of Credit – Open End**

1. Overdraft Protection
2. Personal Line of Credit
3. Credit Card
4. Home Equity Lines

**G. Future Consideration**

1. Competition in the Indirect Auto Market
2. Automated Processing
3. Leasing as an Alternative to Purchase
4. Tax Reforms

**H. Compliance**

1. Equal Credit Opportunity Act
2. Truth in Lending
3. Fair Credit Reporting
4. Community Reinvestment Act

**I. Asset Quality**

1. Underwriting Standards
2. Policy Review
3. Portfolio Review
4. Loan review
5. Audit Process

**BANK CREDIT**  
**SYLLABUS**  
**FIRST YEAR 2023**

**COMMERCIAL LENDING:**

**A. Commercial Loan Process**

1. The Role of the Commercial Loan Officer
2. The Characteristics of a Good Loan Officer
3. Competition

**B. Commercial Lending Business**

1. Types of Commercial Loans
2. Type of Business Operations
3. Conducting an Interview
4. Credit Investigation

**C. Financial Analysis**

1. Spreading the Statements
2. Statement Quality and Reliability
3. Income Statement
4. Reconciliation of Changes in Net Worth
5. Balance Sheet

**D. Loan Structuring**

1. Loans to Finance Current Assets
2. Loan to Finance Fixed Assets
3. Supporting a Commercial Loan
4. Loan Pricing
5. Loan Decision Making

**E. Loan Negotiation**

1. Borrower and Bank Perspectives
2. Loan Committee
3. Loan Officer – Salesperson

**F. Loan Documentation and Closing**

1. Authority to Borrow
2. Evidencing the Debt
3. Terms and Conditions
4. Evidencing the Collateral

**G. Loan Follow – Up**

1. Monitoring

**H. Problems Loans**

1. Cost to Bank
2. Major Causes
3. Different Past Due Situations
4. Resolutions

# BANK CREDIT

FIRST CLASS

2023

## 50 WAYS TO MAKE YOUR CUSTOMER SEE **RED**

- ▣ 1. "Sorry, we can't be of help"
- ▣ 2. "Sorry, we don't do that here"
- ▣ 3. "Sorry, I don't have the authority"
- ▣ 4. "Sorry we're short staffed"
- ▣ 5. "Sorry you will have to call back"

## 50 WAYS TO MAKE YOUR CUSTOMER SEE RED

- ▣ 6. "Everyone else may know you, but I don't know who you are"
- ▣ 7. "It won't do you any good to talk to someone else"
- ▣ 8. "I don't know who you talked to before, but that's not something we would say"
- ▣ 9 "I don't care who told you that, but it wasn't me!"
- ▣ 10. "I don't care who told you that, but it wasn't me"

## 50 WAYS TO MAKE YOUR CUSTOMER SEE RED

- ▣ 11. "If you would have read over the agreement carefully, you'd known that"
- ▣ 12. "If you had asked a few more questions, you'd been told that"
- ▣ 13. "If you would have filled out the form correctly this wouldn't have happened"
- ▣ 14. "If you would have followed the directions, you wouldn't have this problem"
- ▣ 15. "If you would have contacted us sooner, then maybe we could have help you"



## 50 WAYS TO MAKE YOUR CUSTOMER SEE **RED**

- ▣ 16. "That's our policy"
- ▣ 17. "That's the rule"
- ▣ 18. "That's required by law"
- ▣ 19. "That's the procedure"
- ▣ 20. "That's final"

## 50 WAYS TO MAKE YOUR CUSTOMER SEE **RED**

- ▣ 21. "The person who does that isn't here right now, call back later"
- ▣ 22. "The person you need to speak to is busy right now. Call back later"
- ▣ 23. "Our computers are down. Call back later"
- ▣ 24. "He/she is in a meeting. Call back later"
- ▣ 25. "I'm with a customer right now. Call back later"

## 50 WAYS TO MAKE YOUR CUSTOMER SEE **RED**

- ▣ 26. "No, we don't"
- ▣ 27. "No, I won't"
- ▣ 28. "No, you can't"
- ▣ 29. "No, I didn't"
- ▣ 30. "No, no one ever told me"

## 50 WAYS TO MAKE YOUR CUSTOMER SEE **RED**

- ▣ 31. "In the future, we will not do this for you"
- ▣ 32. "In the future, have all your paperwork with you"
- ▣ 33. "In the future, try not to let this happen again"
- ▣ 34. "In the future, please do it the right way"
- ▣ 35. "In the future, ask someone before you do that"

## 50 WAYS TO MAKE YOUR CUSTOMER SEE **RED**

- ▣ 36. “Ever since I’ve been here we’ve always done it this way”
- ▣ 37. “We don’t do that here. You’ll have to go somewhere else”
- ▣ 38. “There is nothing I can do about it”
- ▣ 39. “We’ve done everything we can. What more do you want”
- ▣ 40. “So, what do you want me to do about it”

## 50 WAYS TO MAKE YOUR CUSTOMER SEE **RED**

- ▣ 41. “Okay, but this is an exception”
- ▣ 42. “Okay, but this is not the way it’s normally done”
- ▣ 43. “Okay, but this is the last time I’ll do it this way”
- ▣ 44. “Okay, but this is news to me”
- ▣ 45. “Okay, but this will take some time”

## 50 WAYS TO MAKE YOUR CUSTOMER SEE **RED**

- ▣ 46. “That’s just the way we do things”
- ▣ 47. “That’s just what I’ve been told”
- ▣ 48.” That’s just too bad”
- ▣ 49. “That’s just because”
- ▣ 50.” That’s just the way it is”

## BANK CREDIT

- WHO ARE OUR COMPETITORS?
- HOW DO WE COMPETE IN THESE MARKETS?
- WHAT IS THE BIGGEST CHALLENGE TODAY?
- MAKING PROFITABLE LOANS AT A  
REASONABLE RISK AT A REASONABLE RATE.

## BANK CREDIT

- WHAT IS THE FUNDAMENTAL TRADE OFF?
- LOAN QUALITY VS. LOAN QUANTITY!
- LOAN GROWTH – PATH TO LONG TERM SURVIVAL?

## THE CREDIT PROCESS

- ▣ OBJECTIVES OF THE CREDIT PROCESS –
- MAKE PROFITABLE LOANS AT A MINIMAL RISK LEVEL
- TARGET SPECIFIC INDUSTRIES OR MARKETS WHERE THERE IS EXPERTISE
- LOAN QUALITY AND LOAN QUANTITY SHOULD BE BALANCED

## THE CREDIT PROCESS

- ▣ 1. BUSINESS DEVELOPMENT AND CREDIT ANALYSIS
- ▣ 2. CREDIT EXECUTION AND ADMINISTRATION
- ▣ 3. CREDIT REVIEW

## THE CREDIT PROCESS

- EACH OF THE THREE PROCESSES AFFECTS THE BANK'S WRITTEN LOAN POLICY.
- A LOAN POLICY FORMALIZES LENDING GUIDELINES ON HOW THE BANK IS GOING TO CONDUCT BUSINESS AND HOW THE BANK WILL REDUCE RISK.
- POLICY IDENTIFIES PREFERRED LOAN QUALITIES
- POLICY ESTABLISHES PROCEDURES OF GRANTING, DOCUMENTATION, AND REVIEWING LOANS

## LOAN POLICY

### ▣ PURPOSE:

- ▣ TO GUIDE LENDERS THROUGH THE CREDIT DECISION PROCESS

## COMPONENTS OF SUCCESSFUL LOAN POLICY

### ▣ ELEMENTS:

- BOARD OF DIRECTORS LENDING PHILOSOPHY STATEMENT – THIS IS A GENERAL STATEMENT TO THE LENDING STAFF AS TO WHAT THE PHILOSOPHY IS ALL ABOUT
- TRADE AREA DESCRIPTION AND LIMITATIONS – USUALLY FOLLOWS CRA GUIDELINES

## COMPONENTS OF SUCCESSFUL LOAN POLICY

### ▣ CREDIT CRITERIA:

- FINANCIAL STATEMENT REQUIREMENTS
- REPAYMENT TERMS
- COLLATERAL REQUIREMENTS – A LIST OF ACCEPTABLE AND UNACCEPTABLE POSITIONS
- APPRAISAL POLICY
- GENERAL APPROVAL POLICY (BY TYPE)  
DESIRABLE /UNDESIRABLE LOANS

## COMPONENTS OF SUCCESSFUL LOAN POLICY

- MAXIMUM MATURITIES
- TERM OF DIFFERENT LOANS
- LOAN PRICING LOAN ADMINISTRATION  
PROCESS



## COMPONENTS OF SUCCESSFUL LOAN POLICY

### ▣ LOAN ADMINISTRATION PROCEDURES:

- SPECIFY AREAS OF RESPONSIBILITY
- MECHANISMS FOR PERIODIC REVIEW AND OVERSIGHT
- LOAN APPRAISAL PROCESS
- LENDING LIMITS
- LOAN COMMITTEES
- CONCENTRATION OF CREDIT GUIDELINES
- REGULATION O POLICY

## COMPONENTS OF SUCCESSFUL LOAN POLICY

### ▣ PROBLEM LOAN MANAGEMENT :

- GRADING
- IDENTIFICATION
- REPORTING
- MONITORING

## COMPONENTS OF SUCCESSFUL LOAN POLICY

- NON-ACCRUAL POLICY AND LOAN CHARGE-OFF POLICY
- RESERVE FOR LOAN LOSS
- COMPLIANCE STATEMENT
- MAY INCLUDE CRA STATEMENT
- WHO IS RESPONSIBLE FOR POLICY

## COMPONENTS OF SUCCESSFUL LOAN POLICY

- EFFECT ON SAFETY AND SOUNDNESS
- EFFECT ON PROFITABILITY
- EVALUATION OF POLICY EFFECTIVENESS
- LOAN POLICY VS. LOAN PROCEDURE

## LOAN POLICY /PROCEDURES

- ▣ ELEMENTS OF CREDIT ADMINISTRATION:
  - RESPONSIBILITY
  - ORGANIZATION

## LOAN POLICY /PROCEDURES

- ▣ TWO TYPES OF LENDING ORGANIZATION
- ▣ A. CENTRALIZED:
  - USEFUL WITH
  - SMALLER BANKS
  - LARGER CREDITS
  - AN INEXPERIENCED AND UNSEASONED LENDING STAFF
  - FEWER BRANCHES

## LOAN POLICY /PROCEDURES

- ▣ A. CENTRALIZED
- ▣ ADVANTAGES:
  - CONTINUITY IN LOAN DECISION MAKING
  - LENDING EXPERTISE
- ▣ DISADVANTAGES:
  - TIME CONSUMING FOR MANAGERS
  - LACK OF KNOWLEDGE OF BORROWER

## LOAN POLICY /PROCEDURES

- ▣ B. DECENTRALIZED:
- ▣ USEFUL WITH:
  - LARGER BANKS
  - SMALLER CREDITS
  - WIDELY BRANCHED
  - SEASONED LENDING STAFF
- ▣ ADVANTAGES
  - QUICK TURN AROUND TIME
  - LESS CUMBERSOME

## LOAN POLICY /PROCEDURES

- ▣ B. DECENTRALIZED:
- ▣ DISADVANTAGES:
  - INCONSISTENCE IN CREDIT DECISIONS
  - HARDER TO MONITOR CREDIT QUALITY

## ELEMENTS OF A STRONG CREDIT CULTURE

- CREDIT QUALITY IS A CORPORATE VALUE
- TOP MANAGEMENT SUPPORTS CREDIT QUALITY
- LINE MANAGEMENT SUPPORTS CREDIT QUALITY OBJECTS.
- THERE IS STRONG MANAGEMENT AT THE TOP OF THE CREDIT FUNCTION
- LENDING EXCEPTIONS ARE INFREQUENT AND DIFFICULT TO OBTAIN
- STRONG COMMITMENT TO LENDER TRAINING
- STRONG CREDIT SYSTEMS AND CONTROLS EXIST

## ELEMENTS OF A STRONG CREDIT CULTURE

- LENDERS ARE REWARD OR PENALIZED FOR CREDIT PERFORMANCE
- CREDIT STANDARDS, CREDIT POLICY, BUSINESS PLANS, INCENTIVE PLANS, AND CREDIT COMMUNICATIONS ARE HARMONIOUS
- LENDERS DESCRIBE THE CREDIT CULTURE USING THE SAME WORDS
- LINES OF BUSINESS ARE MANAGED PRUDENTLY

## LOAN POLICY /PROCEDURES

- ▣ QUALITY
- ▣ VS.
- ▣ QUANTITY

## CONSUMER LENDING

- LOAN DOCUMENTATION AND CLOSING
- ALL DOCUMENTS NEED TO BE REVIEWED BEFORE CLOSING
- COLLATERAL MUST BE PRESENT AT TIME OF CLOSING
- AUTO - MVA
- BOAT - DEPART. OF NATURAL RESOURCES
- DEED OF TRUST- CLERK OF THE COURT
- NON-TITLE GOODS - UCC FINANCING STATEMENT

## CONSUMER LOAN TYPES

- ▣ DIRECT LOANS - CLOSED END
- AUTOMOBILES
- PERSONAL/UNSECURED LOANS
- HOME IMPROVEMENT/HOME EQUITY
- BOAT

## CONSUMER LOAN TYPES

### ▣ INDIRECT LENDING:

- AUTOMOBILE DEALERSHIPS
- BOAT DEALERSHIPS
- THIRD PARTY RETAILERS

## CONSUMER LOAN TYPES

### ▣ LINES OF CREDIT – OPENED END

- OVERDRAFT PROTECTION
- PERSONAL LINES OF CREDIT
- CREDIT CARD
- HOME EQUITY LINES OF CREDIT



## COMPLIANCE

- ▣ EQUAL CREDIT OPPORTUNITY ACT
  - PROHIBITS DISCRIMINATION AGAINST AND APPLICANT FOR CREDIT BASED ON AGE, SEX, MARITAL STATUS, RELIGION, RACE , COLOR, NATIONAL ORIGIN, OR RECEIPT OF PUBLIC ASSISTANCE

## COMPLIANCE

- ▣ TRUTH IN LENDING ACT - (TILA)
  - PROMOTING THE USE OF CONSUMER CREDIT BY REQUIRING DISCLOSURES AND IT'S TERMS AND COSTS IN GENERAL.
  - TILA IS TENDED TO ENABLE THE CUSTOMER TO COMPARE THE COST OF CASH VERSUS CREDIT TRANSACTIONS
  - STANDARDS FOR ADVERTISING THAT REFERS TO CERTAIN CREDIT TERMS
  - BORROWER'S RIGHTS -
    - RIGHT OF RESCISSION
    - BILLING DISPUTES

## COMPLIANCE

- ▣ FAIR CREDIT REPORTING ACT
  - ENABLES INDIVIDUALS TO EXAMINE THEIR CREDIT REPORTS PROVIDED BY CREDIT BUREAUS
  - PROTECTION AGAINST INACCURATE DATA AND INFORMATION IN DISPUTE

## COMPLIANCE

- ▣ COMMUNITY REINVESTMENT ACT - (CRA)
  - ACT WAS PASSED IN 1977 TO PROHIBIT REDLINING AND TO IMMEDIATE TRADE AREAS AND THE MARKETS WHERE BANKS COLLECT DEPOSITS.

## COMPLIANCE

- ▣ FINANCIAL INSTITUTIONS RECOVERY AND ENFORCEMENT ACT - (FIRREA)
- MANDATED PUBLIC DISCLOSURE OF BANK LENDING POLICIES AND REGULATORY RATINGS OF BANK COMPLIANCE

## THE FIVE C'S OF CREDIT

- ▣ 1. CHARACTER - REFERS TO THE BORROWER'S HONESTY
- ▣ 2. CAPITAL - REFERS TO THE BORROWER'S WEALTH POSITION MEASURED BY FINANCIAL SOUNDNESS AND MARKET STANDING
- ▣ 3. CAPACITY - INVOLVES BOTH THE BORROWER'S LEGAL STANDING AND ABILITY TO REPAY DEBT. AN INDIVIDUAL MUST BE ABLE TO GENERATE INCOME.
- ▣ 4. CONDITIONS - REFERS TO THE ECONOMIC ENVIRONMENT
- ▣ 5. COLLATERAL - THE LENDERS SECONDARY SOURCE OF REPAYMENT OF SECURITY IN THE CASE OF DEFAULT

## THE CREDIT APPLICATION

▣ REVIEW IN NOTES

## REAL ESTATE ASSESSMENT LOAN TO VALUE RATIO

• <u>DEBT</u>	<u>MORTGAGE</u>
• MORTGAGE	\$200,000
• <u>REQUEST</u>	<u>\$ 50,000</u>
• TOTAL DEBT	\$250,000
• HOME VALUE	\$500,000
• \$250,000 / \$500,000	50%

## CREDIT REPORTS

- CREDIT SCORES
- THE REPORT :
- R - REVOLVING
- I - INSTALLMENT
- M - MORTGAGE
- NAME OF CREDITOR
- DATE OPENED
- MONTHLY PAYMENTS
- TIMES DELINQUENT - 30 - 60 - 90 (DAYS)
- INQUIRES
- JUDGMENTS
- BANKRUPTCY



## OTHER CREDIT TOOLS

- MARYLAND DEPARTMENT OF ASSESSMENT AND TAXATION
- MARYLAND JUDICIARY
- MARYLAND DOC FIND
- IRS - FORM 4506C REQUEST FOR TRANSCRIPT OF TAX RETURN

## NOTICE OF ACTION TAKEN

- WRITTEN NOTIFICATION OF A DECLINED OR AN INCOMPLETE APPLICATION
- REASON FOR DECLINATION
- ITEMS NEED TO COMPLETE APPLICATION
- COUNTER OFFER
- SOURCES OF INFORMATION

## COMMERCIAL LENDING

▣ WHAT IS A COMMERCIAL LOAN ?

▣ A COMMERCIAL LOAN IS :

▣ “A LOAN TO A BUSINESS OR COMMERCIAL ENTERPRISE WHERE THE PROCEEDS ARE USED TO CREATE OR SUPPORT ASSETS FOR PURPOSE OF GENERATING REVENUES AND PROFITS”

## WHY DO FINANCIAL INSTITUTIONS MAKE COMMERCIAL LOANS?

- ▣ COMMERCIAL LOANS:
  - ARE MORE PROFITABLE THAN OTHER ACCEPTABLE INVESTMENTS
  - HELP SUPPORT THE UNDERLYING BUSINESS STRUCTURE OF THE COMMUNITY
  - PROVIDE BORROWED CAPITAL TO CREATE JOBS AND INVESTMENT

## WHY DO FINANCIAL INSTITUTIONS MAKE COMMERCIAL LOANS?

- BASICALLY SHORT-TERM ASSETS THAT MATCH THE OFFSETTING DEPOSITS USED TO FUND THEM
- PROVIDE THE BASIS FOR OTHER FINANCIAL SERVICES OFFERED BY THE FINANCIAL INSTITUTION

## COMMERCIAL LENDING

- ▣ COMMERCIAL LOAN PROCESS
  - THE ROLE OF THE COMMERCIAL LOAN OFFICER
  - THE CHARACTERISTICS OF A GOOD LOAN OFFICER
  - COMPETITION

## COMMERCIAL LOAN TYPES

- ▣ SHORT TERM COMMERCIAL LOAN
  - USE - PROVIDES TEMPORARY WORKING CAPITAL NEEDS
- ▣ EXAMPLES -
  - REVOLVING LINE CREDIT
  - TIME NOTE THAT HAS A MATURITY OF LESS THAN ONE YEAR
  - SEASONAL LOANS



## COMMERCIAL LOAN TYPES

### ▣ CONTRACTUAL OR FORMAL CREDIT LINE

- A LINE OF CREDIT WHERE THE BANK CHARGES A FEE FOR MAKING CREDIT AVAILABLE REGARDLESS OF WHETHER THE CUSTOMER ACTUALLY USES THE LINE.
- ANNUAL FEE IS USUALLY CHARGED
- VARIABLE RATE STRUCTURE

## COMMERCIAL LOAN TYPES

### ▣ TERM COMMERCIAL LOANS

- USE - CAPITAL EXPENDITURE - PURCHASE OF AN ASSET SUCH AS:
- EQUIPMENT - REAL ESTATE
- MATURITY EXCEEDS ONE YEAR
- PAYMENTS OF PRINCIPAL AND INTEREST

## BUSINESS STRUCTURES

- ▣ SOLE PROPRIETORSHIP –
  - THE SIMPLEST AND MOST COMMON STRUCTURE CHOSEN TO START A BUSINESS
  - IT IS UNINCORPORATED BUSINESS OWNED AND RUN ONE INDIVIDUAL
  - NO FORMAL ACTION IS REQUIRED TO FORM
- ▣

## BUSINESS STRUCTURES

- ▣ SOLE PROPRIETORSHIP –
- ▣ ADVANTAGES:
  - EASY AND INEXPENSIVE TO FORM
  - COMPLETE CONTROL
  - SIMPLIFIED TAX PREPARATION

## BUSINESS STRUCTURES

- ▣ SOLE PROPRIETORSHIP –
- ▣ DISADVANTAGES:
  - UNLIMITED PERSONAL LIABILITY
  - HARD TO RAISE MONEY
  - HEAVY BURDEN

## BUSINESS STRUCTURES

- ▣ PARTNERSHIP-
  - A PARTNERSHIP IS A SINGLE BUSINESS WHERE TWO OR MORE SHARE OWNERSHIP
- ▣ THREE TYPES:
  1. GENERAL PARTNERSHIP-EQUAL LIABILITY
  2. LIMITED PARTNERSHIPS- LIMITED LIABILITY
  3. JOINT VENTURES – LIMITED TIME PERIOD

## BUSINESS STRUCTURES

### ▣ PARTNERSHIP-

### ▣ ADVANTAGES:

- EASY AND INEXPENSIVE
- SHARED FINANCIAL COMMITMENT
- COMPLEMENTARY SKILLS

## BUSINESS STRUCTURES

### ▣ PARTNERSHIPS-

### ▣ DISADVANTAGES OF A PARTNERSHIP:

- JOINT AND INDIVIDUAL LIABILITY
- DISAGREEMENTS AMONG PARTNERS
- SHARED PROFITS

## BUSINESS STRUCTURES

### ▣ CORPORATIONS-

- PROSPECTIVE SHAREHOLDERS EXCHANGE MONEY, PROPERTY, OR BOTH FOR THE CORPORATIONS CAPITAL STOCK.
- A “C CORPORATION” IS RECOGNIZED AS A SEPARATE TAX PAYING ENTITY

## BUSINESS STRUCTURES

### ▣ CORPORATIONS-

### ▣ ADVANTAGES-

- STOCKHOLDERS’ LIABILITY IS LIMITED TO AMOUNT OF INVESTMENT
- OWNERSHIP IS TRANSFERABLE
- CAPITAL IS GENERALLY EASIER TO SECURE.

## BUSINESS STRUCTURES

- ▣ CORPORATIONS-
- ▣ DISADVANTAGES:
  - ACTIVITIES ARE LIMITED BY CHARTER AND LAWS.
  - EXTENSIVE LOCAL, STATE, AND FEDERAL LAWS APPLY
  - CONSIDERABLE EXPENSE AND PAPERWORK ARE REQUIRED TO SET UP.
  - TAXES

## BUSINESS STRUCTURES

- ▣ LIMITED LIABILITY COMPANY - (LLC)-
  - AN “LLC” IS A BUSINESS STRUCTURE ALLOWED BY STATE STATUTES
  - EACH STATE MAY USE DIFFERENT REGULATIONS.
  - OWNERS ARE CALLED MEMBERS
  - NO MAXIMUM NUMBER OF MEMBERS
  - NO RESTRICTIONS ON OWNERSHIP

## BUSINESS STRUCTURES

- ▣ LIMITED LIABILITY COMPANY – (LLC)-
- ▣ ADVANTAGES-
  - NO LIMITATION ON NUMBER OF MEMBERS
  - ANY MEMBER OR OWNER IS ALLOWED A FULL PARTICIPATORY ROLE IN THE BUSINESS'S OPERATION

## BUSINESS STRUCTURES

- ▣ LIMITED LIABILITY COMPANY – (LLC)-
- ▣ DISADVANTAGES:
  - “LLCs” DO NOT HAVE A PERPETUAL LIFE.
  - TECHNICALLY, THE COMPANY DISSOLVES WHEN A MEMBER DIES, QUILTS, OR RETIRES.

## LOAN PRICING

### ▣ CONSIDERATIONS:

- RISK ASSESSMENT
- COST OF FUNDS
- FIXED OR FLOATING
- INDEX
- TERM OF LOAN

## LOAN OFFICER PREPARATION

- KNOW YOUR INSTITUTION'S LOAN AND PRICING POLICIES
- BE AWARE OF INDIVIDUAL LENDING LIMITS
- UNDERSTAND YOUR BANK'S APPROVAL PROCESS AND PROCEDURES
- BE FAMILIAR WITH ACCOUNTING AND LENDING TERMINOLOGY
- KNOW YOUR LIMITS



## LOAN OFFICER PREPARATION

- DETAILED RESEARCH ON POTENTIAL BORROWER AND LIKE INDUSTRIES.
- LEARN AS MUCH AS POSSIBLE ABOUT READING AND ANALYZING FINANCIAL STATEMENTS

## CONDUCTING THE INTERVIEW

- ESTABLISH A GOOD RELATIONSHIP WITH THE CUSTOMER
- MAINTAIN CONTROL OF THE INTERVIEW
- ASK QUESTIONS - MANY QUESTIONS
- STATE CLEARLY THE LOAN REQUEST, TERMS, AND PLAN OF REPAYMENT
- AVAILABLE COLLATERAL
- DETERMINE THE PURPOSE OF THE LOAN REQUEST
- CHECK FOR COMPLIANCE WITH LOAN POLICY
- ESTABLISH ACTION REQUIRED BY THE LOAN REQUEST - TURN DOWN OR FURTHER CONSIDERATION

## QUESTIONS TO BE ANSWERED

- ▣ THE LOAN REQUEST:-
  - IS THE REQUEST CLEAR AS TO THE DOLLAR AMOUNT AND TERMS
  - WHAT IS THE PURPOSE
  - IS THIS THE REAL PURPOSE
  - WHAT SITUATION CREATED THE NEED
  - WILL THE REQUEST MEET THE NEEDS OF THE BORROWER
  - IS THE REQUEST FOR PRODUCTIVE PURPOSE
  - IS IT LEGAL
  - DOES IT COMPLY WITH YOUR BANK'S LOAN POLICY

## QUESTIONS TO BE ANSWERED

- ▣ FINANCIAL CONSIDERATIONS:-
  - WHO PREPARES THE FISCAL YEAR END FINANCIAL STATEMENTS AND TAX RETURNS
  - WHAT TYPE OF YEAR END STATEMENT IS PREPARED- AUDITED, REVIEW, OR COMPILATION
  - DOES THE BUSINESS PREPARE INTERIM STATEMENTS.
  - ARE ALL TAXES CURRENT
  - ARE ALL FINANCIAL STATEMENTS READILY AVAILABLE
  - WHAT DOES AN AGING OF ACCOUNTS RECEIVABLES SHOW
  - WHAT ARE THE SELLING TERMS TO CUSTOMERS

## QUESTIONS TO BE ANSWERED

- HOW IS THE INVENTORY VALUED.
- WHAT IS THE COMPOSITION OF THE INVENTORY
- WHAT IS THE CONDITION OF THE INVENTORY
- WHAT ARE THE AGE AND CONDITION OF THE PLANT AND EQUIPMENT
- IS THE PLANT AND EQUIPMENT ADEQUATE TO PRODUCE GROWTH IN GOODS OR SERVICES
- HOW CURRENT ARE ACCOUNTS PAYABLE
- ARE SHORT TERM AND LONG TERM DEBT OBLIGATION CURRENT
- WHAT ARE THE TERMS OF LONG TERM AND SUBORDINATED DEBT

## QUESTIONS TO BE ANSWERED

- WHAT IS THE BUSINESS'S POLICY ON RETAINED EARNINGS AND DIVIDENDS
- WHAT TAX YEARS HAVE BEEN CLEARED BY THE IRS
- DOES THE BUSINESS HAVE A STRATEGIC PLAN
- ARE PROJECTIONS AND BUDGETS PREPARED ANNUALLY
- ARE THERE ANY CONTINGENT LIABILITIES
- WHAT ARE THE CURRENT SALES TRENDS
- ARE COST BY FUNCTIONAL CATEGORY WITHIN INDUSTRY STANDARDS
- WHAT IS THE COMPENSATION FOR OWNERS / MANAGEMENT

## QUESTIONS TO BE ANSWERED

- WHAT METHOD OF DEPRECIATION IS USED
- IS INSURANCE COVERAGE ADEQUATE
- IS ANY LITIGATION PENDING AGAINST THE BUSINESS
- WHO ARE PRINCIPAL OWNERS
- HOW DOES THE OWNERSHIP BREAK DOWN
- WHO ARE THE KEY MEMBERS OF THE MANAGEMENT TEAM
- WHAT IS THE EXPERIENCE MANAGEMENT
- IS THERE BACK UP FOR KEY MANAGERS – SUCCESSION PLANNING
- HOW LONG HAS THE BUSINESS BEEN IN OPERATION

## QUESTIONS TO BE ANSWERED

- WHO ARE THE BUSINESS'S OUTSIDE PROFESSIONALS – ATTORNEYS, CPAS, CONSULTANTS, AND INSURANCE BROKERS
- HOW MANY EMPLOYEES ARE IN THE BUSINESS
- ARE THEY REPRESENTED BY A UNION
- WHAT IS THE AVAILABILITY OF SKILLED LABOR
- WHO ARE THE PRINCIPAL SUPPLIERS
- IS INVENTORY READILY AVAILABLE
- WHAT ARE THE TRADE TERMS OFFERED TO THE BUSINESS
- DOES THE BUSINESS OPERATE UNDER A FRANCHISE

## QUESTIONS TO BE ANSWERED

- WHAT ARE THE TERMS AND CONDITIONS OF THE FRANCHISE

## QUESTIONS TO BE ANSWERED

- ▣ MARKETING ASPECTS-
  - WHAT ARE THE PRODUCTS OR SERVICES OF THE BUSINESS
  - WHO BUYS THE PRODUCTS OR SERVICES
  - ARE SALES SEASONAL OR CYCLICAL
  - HOW DOES THE BUSINESS SELL IT PRODUCTS OR SERVICES
  - WHAT INDUSTRY IS THE BUSINESS PART OF
  - DO SALES DEPEND ON PRICE, BRAND IDENTIFICATION, OR STYLE
  - WHAT IS THE REPUTATION OF THE BUSINESS IN IT'S INDUSTRY
  - IS THIS A GROWTH INDUSTRY

## QUESTIONS TO BE ANSWERED

- WHERE IS THE BUSINESS IN IT'S LIFE CYCLE - GROWING, MATURE, OR DECLINING
- DOES THE INDUSTRY OPERATE IN A REGULATED INDUSTRY
- IS FOREIGN COMPETITION SIGNIFICANT
- IS THE MARKET LOCAL, NATIONAL, OR INTERNATIONAL
- HOW DOES THE BUSINESS PLAN TO MEET IT'S GOAL

## ANALYSIS OF FINANCIAL STATEMENTS

- REVIEW THREE YEARS OF FINANCIAL STATEMENTS AND TAX RETURNS
- COMPARE OPERATIONS TO INDUSTRY NORMS
- CONDUCT CREDIT INVESTIGATIONS WITH OTHER FINANCIAL INSTITUTIONS AND CREDIT BUREAUS
- DETERMINE NATURE AND STATUS OF INDUSTRY AND COMPETITIVE STRUCTURE
- WEIGH CUSTOMER'S ABILITY, KNOWLEDGE, AND SKILL AS A MANAGER
- ANALYZE THE SOUNDNESS OF THE FUTURE OPERATING PROJECTIONS AND REPAYMENT PLANS
- CHECK PAST PERFORMANCE AND PAYMENT HISTORY
- DETERMINE IF THERE IS PENDING LEGISLATION TO AFFECT OPERATIONS OF THE BUSINESS

## FINANCIAL STATEMENTS

- ▣ WHAT WILL BE REVIEWED IN THE LOAN APPROVAL PROCESS?
  - BALANCE SHEET
  - INCOME STATEMENT
  - RECONCILIATION OF CAPITAL ACCOUNTS
  - SOURCES AND USES OF FUNDS STATEMENT

## TYPE OF AUDIT REPORTS

- CERTIFIED AUDIT - MOST COMPLETE AND ACCURATE REFLECTION OF THE BUSINESS
- REVIEW - REPORT PREPARED FROM THE BOOKS OF THE BUSINESS AND DOES NOT CONFIRM BALANCES
- COMPILATION - REPORT PREPARED FROM THE BOOKS OF THE BUSINESS BUT DOES NOT CONFIRM AND BALANCES AND DOES NOT EXPRESS AN OPINION AS THE FINANCIAL CONDITION OF THE BUSINESS.



## ACCOUNTANT OPINIONS

- UNQUALIFIED OPINION - INFORMATION IS PRESENTED FAIRLY AND RESULTS OF OPERATION IN CONFORMITY WITH GENERALLY ACCEPTED ACCOUNTING PRINCIPALS.
- QUALIFIED OPINION- FINANCIAL REPORTS PRESENT FAIRLY THE FINANCIAL POSITION AND RESULTS OF OPERATIONS.
- DISCLAIMER OPINION - STATE THE EXAMINATION WAS LIMITED OR THERE ARE UNCERTAINTIES AND THE FUTURE WHICH COULD AFFECT THE BUSINESS AND CANNOT BE ESTIMATED
- ADVERSE OPINION - STATE S THE FINANCIAL REPORTS DO NOT PRESENT FAIRLY THE POSITION OR RESULTS OF OPERATION IN ACCORDANCE WITH GENERALLY ACCEPTED ACCOUNTING PRINCIPLES

## KEY RATIOS FOR SHORT TERM LOANS

- CURRENT RATIO
- QUICK RATIO
- INVENTORY TURNOVER
- DEBT TO NET WORTH RATIO
- FIXED ASSETS TO NET WORTH RATIO



## KEY RATIOS FOR LONG TERM LOANS

- NET INCOME TO SALES
- NOT INCOME TO NET WORTH
- ACCOUNTS PAYABLE TURNOVER
- DEBT TO NET WORTH RATIO
- TIME INTEREST EARNED RATIO
- FIXED CHARGE COVERAGE

## MOST COMMONLY USED FINANCIAL RATIOS

- ▣ LIQUIDITY:
  - CURRENT RATIO -
    - ▣  $\frac{\text{TOTAL CURRENT ASSETS}}{\text{TOTAL CURRENT LIABILITIES}}$
  - QUICK RATIO -
    - ▣  $\frac{\text{TOTAL CURRENT ASSETS} - \text{INVENTORY}}{\text{TOTAL CURRENT LIABILITIES}}$

## MOST COMMONLY USED FINANCIAL RATIOS

- ▣ LEVERAGE -
  - DEBT TO WORTH -
    - ▣  $\frac{\text{TOTAL LIABILITIES}}{\text{NET WORTH}}$
  - FIXED ASSETS TO WORTH -
    - ▣  $\frac{\text{TOTAL FIXED ASSETS}}{\text{NET WORTH}}$

## MOST COMMONLY USED FINANCIAL RATIOS

- ▣ PROFITABILITY:
  - RETURN ON SALES -  $\frac{\text{NET PROFIT}}{\text{SALES}} \times 100$ 
    - ▣  $\frac{\text{NET PROFIT}}{\text{SALES}}$
  - RETURN ON ASSETS -
    - ▣  $\frac{\text{NET PROFIT} + \text{INTEREST EXP.} - \text{TAX BENEFIT OF INTEREST EXP.}}{\text{TOTAL ASSETS}} \times 100$
  - RETURN ON EQUITY -  $\frac{\text{NET PROFIT}}{\text{AVERAGE NET WORTH}} \times 100$ 
    - ▣  $\frac{\text{NET PROFIT}}{\text{AVERAGE NET WORTH}}$

## MOST COMMONLY USED FINANCIAL RATIOS

- ▣ ACTIVITY RATIOS:
  - ASSET TURNOVER RATIO-
  - ▣  $\text{SALES} / \text{AVERAGE ASSETS}$
  - ACCOUNTS RECEIVABLE -
  - ▣  $\text{CREDIT SALES} / \text{AVERAGE ACCOUNT RECEIVABLE}$
  - INVENTORY TURNOVER -
  - ▣  $\text{INVENTORY} / \text{COST OF GOODS SOLD} \times 365$

## CASH FLOW SOURCES AND USES OF CASH

- ▣ SOURCES OF CASH
  - INCREASE IN ANY LIABILITY
  - DECREASE IN ANY NONCASH ASSET
  - NEW ISSUE OF STOCK
  - ADDITIONS TO SURPLUS
  - REVENUES

## CASH FLOW SOURCES AND USES OF CASH

### ▣ USES OF CASH

- DECREASE IN ANY LIABILITY
- INCREASE IN ANY NON CASH ASSET
- REPAYMENT / REFUNDING STOCK
- DEDUCTIONS FROM SURPLUS
- CASH EXPENSES
- TAXES
- CASH DIVIDENDS

## COLLATERAL

- SAVINGS ACCOUNT
- CERTIFICATE OF DEPOSIT
- MOTOR VEHICLE
- ASSIGNMENT OF LIFE INSURANCE
- REAL ESTATE
- ACCOUNTS RECEIVABLE
- EQUIPMENT
- INVENTORY
- FURNITURE AND FIXTURES
- ASSIGNMENT OF RENTS AND LEASES

## LOAN REQUEST NARRATIVE

- LEGAL NAME OF BORROWER
- TYPE OF ENTITY
- DESCRIPTION OF REQUEST -  
· USE OF FUNDS
- PRIMARY AND SECONDARY SOURCES OF REPAYMENT
- LOAN TERM / AMORTIZATION PERIOD
- RATE OF INTEREST
- BUSINESS TYPE
- YEARS IN BUSINESS

## LOAN REQUEST NARRATIVE

- OUT LOOK FOR INDUSTRY
- NUMBER OF EMPLOYEES
- MANAGEMENT
- BALANCE SHEET INFORMATION
- PROFIT AND LOSS STATEMENT
- COLLATERAL
- GUARANTORS
- CREDIT REPORTS

## LOAN REQUEST NARRATIVE

- MAJOR OR MINOR POLICY EXCEPTIONS
- JUSTIFICATION FOR MAKING EXCEPTION
- ALL REQUIREMENTS AND CONDITIONS FOR LOAN
- ITEMS TO BE REQUIRED SUBJECT TO APPROVAL
- RECOMMENDATION

## RISK RATING

▣ SEE NOTES

## PROBLEM LOANS

- ▣ REMEMBER
- ▣ THE LENDING PROCESS IS BY NATURE -  
IMPERFECT !

## PROBLEMS LOANS

- COST TO THE BANK
- MAJOR CAUSES
- DIFFERENT PAST DUE SITUATIONS
- RESOLUTIONS

## PROBLEMS LOANS

- ▣ MEASURES OF LOAN LOSSES:
  - GROSS LOAN CHARGE-OFFS
  - RECOVERIES
  - NET LOAN CHARGE-OFFS
- ▣ (MINUS RECOVERIES)

## MAJOR CAUSES

- ▣ THE MAJOR CONTRIBUTING FACTORS :
  - MANAGEMENT QUALITY
  - INADEQUATE CAPITALIZATION
  - HIGH FINANCIAL AND OPERATING LEVERAGE
  - HIGH SALES GROWTH
  - STRONG COMPETITION
  - ECONOMIC DOWNTURNS
- ▣



## PREVENTING PROBLEM LOANS

- RECOGNIZING AND DETECTING PROBLEM SITUATIONS EARLY IS THE KEY
- LENDING DIFFICULTIES CAN BE REDUCED IF MANAGEMENT ESTABLISHES AND ADHERES TO LOAN POLICY AND GUIDELINES THAT RESTRICT UNACCEPTABLE ACTIVITY

## DIFFERENT PAST DUE SITUATIONS

- CUSTOMER WANTS TO PAY AND CANNOT PAY
- CUSTOMER DOES NOT WANT TO PAY AND CANNOT PAY
- CUSTOMER CAN PAY, BUT WILL NOT PAY

## PROBLEM LOAN ACCOUNTING

- LOAN PROVISIONS FOR LOSSES
- LOAN LOSS RESERVE
- NON-ACCRUAL LOANS
- PAST DUE LOANS
- RESTRUCTURED LOANS
- OTHER REAL ESTATE OWNED

## HERETOFORE UNPUBLISHED LENDING LAWS

- NEVER MAKE A LOAN OF SUBSTANCE TO A BUSINESS WITHOUT VISITING THE BUSINESS FIRST
- IF SOMETHING DOESN'T FEEL RIGHT , IT USUALLY ISN'T
- THE FASTER AN APPLICANT WANTS TO RUN, THE SLOWER YOU WANT TO GO
- DON'T LET YOURSELF BE TALKED INTO MAKING A LOAN YOU FEEL YOU SHOULDN'T MAKE
- SUBSCRIBE TO THE "GREATER FOOL THEORY"
- IF YOU MAKE A LOAN OUTSIDE OF POLICY, HAVE A STRONG REASON WHY-NOT JUST A REASON
- DO NOT ASSUME A CUSTOMER WILL (OR CAN) REPAY A LOAN BECAUSE HE HAS REPAID THEM IN THE PAST

## HERETOFORE UNPUBLISHED LENDING LAWS

- A CO-SIGNER DOES NOT MAKE A BAD LOAN GOOD
- EMOTIONAL INVOLVEMENT IN A CREDIT IS DEADLY – TO THE BANK, - TO THE LENDING OFFICER, AND SOMETIMES TO CAREERS
- IF THE COLLATERAL EATS OR GROWS, BE CERTAIN YOU HAVE SUFFICIENT EXPERIENCE AND STAFF TO HANDLE THE CREDIT
- DO NOT ASSUME – ANYTHING
- FOLLOW UP, FOLLOW UP, AND FOLLOW UP
- RE-REVIEW THE LOAN DOCUMENTS EVERY TIME YOU TAKE ACTION ON A FILE.
- STUDY FINANCIAL STATEMENTS. DON'T JUST INITIAL THEM AND PUT THEM IN THE FILE.

## HERETOFORE UNPUBLISHED LENDING LAWS

- DON'T IGNORE WARNING SIGNS OF PROBLEMS.
- DON'T PUT ANYTHING IN THE FILE THAT YOU WOULDN'T SAY IN COURT
- RE-EVALUATE COLLATERAL VALUES AND REGULARLY AND CONSERVATIVELY
- TROUBLE FOLLOWS SOME PEOPLE. DON'T MAKE LOANS TO THEM
- DON'T SECURE A LOAN WITH COLLATERAL YOU ARE UNWILLING TO PICK UP AND SELL OR DON'T KNOW ANYTHING ABOUT
- ALWAYS GET YOUR DOCUMENTATION IN HAND BEFORE THE MONEY LEAVES THE BANK

## HERETOFORE UNPUBLISHED LENDING LAWS

- A BAD LOAN IS ALMOST  
ALWAYS WORSE THAN YOU  
THINK