



Building Success. Together.

Problem Loan Management

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Agenda

- Avoiding Problem Loans
- Recognize Early Warning Signals
- Managing Problem Loans

On average, 50% of your bank's classified loans were originally booked how long ago?

- A. Within the last 12 months
- B. Within the last 18-24 months
- C. 3-4 years ago
- D. Over 4 years ago

Credit Discipline Tool Checklist

- Written credit policies
- Risk-driven credit analysis
- Uniform credit packages
- Experienced underwriting & informed decision making
- Credit and Lender training
- Valid, granular risk rating system
- Legally enforceable loan documents
- Loan performance monitoring and reporting
- Independent loan review and audit
- Adequate ALLL
- Skill problem asset management

Avoiding Problem Loans

- Know your target markets
- Common Characteristics of Problem Loans

Avoiding Problem Loans

An affirmative answer to one or more of these questions raises a red flag warning of questionable character:

1. Has any of the principals ever walked away from a loan or refused to pay a creditor?
2. Is the firm or its principals delinquent in payment of its taxes, fees, licenses, etc?
3. Do the firm and its principals fail to pay their creditors according to terms?
4. Do any of the firm's principals lack the skills, training, and experience necessary to perform their functional responsibilities?
5. Have any of the firm's principals misrepresented their background, experience, skills, training, or education?
6. Are the principals or the firm unwilling or unable to provide financial information?
7. Are the principals unwilling to offer personal guarantees, provide collateral, or accept any conditions or covenants?
8. Do the firm's facilities appear poorly maintained, look unsafe, or feel uncomfortable?
9. Does the firm's management and major stockholders or its partners disagree about the firm's goals and objectives?
10. Are the principals unwilling or unable to provide references from colleagues, competitors, suppliers, lenders, customers, lawyers, accountants, etc.?

Avoiding Problem Loans

- Which products or structures are riskier?

Avoiding Problem Loans



Avoiding Problem Loan – A Case Study

Higgins Microbrew & Restaurant, Inc.

How many red flags did you identify?

How Many Red Flags Did You Identify

- A. Less than 5
- B. 5 – 9
- C. 10 – 14
- D. 15 – 19
- E. 20 – 24
- F. 24 -29

Recognize Early Warning Signals

- Bank
- Customer
- Market / Economy

Recognize Early Warning Signals

- Typical Management Red Flags
 - Highly domineering management
 - High turnover
 - Slowdown in delivery of interim statements
 - Unexpected year-end transactions
 - Frequent changes in accountants/lawyers
 - Related party transactions
 - Diminishing communications
 - Declining civility

5 C's? How about the 6 D's!

- Death
- Disability
- Divorce
- Disagreements.....dissolution
- Drugs
- Disasters.....Pandemic!

Managing Problem Loans

- Rehabilitate
- Move
- Foreclose / Liquidate

Steps to take upon Identification

1. Customer
2. Bank Relationship
3. Credit File & Documentation
4. Collateral Review
5. Other: creditors, landlords, regulatory environment
6. Decide: Rehab or Exit

Strategy Determination

		OUTLOOK		
		Negative	Neutral	Positive
S T R A T E G Y	Maintain	Restructure, Rehabilitate, etc. <----- Timing of Upgrade -----> >12 Months 6 to 12 Months <6 Months		
	Decrease	Restructure, Partial Collateral/Asset Sale, Equity Injection, etc. <----- Workout Timeframe -----> 12 to 24 Months 6 to 18 Months <6 Months		
	Out	Litigation, Liquidation, Forbearance, Foreclosure, Refinance, etc. <----- Loss Potential / Discount -----> Higher Lower		

When Can Rehab Work?

- Cooperative management – willing to communicate
- Mgmt recognizes the problem and willing to make sacrifices to solve
- A viable core business
- Underlying cause is solvable and management must be competent to solve it
- Workout Plan – involve client

Risk Rating Changes

- Be timely, be accurate
 - Know your bank policy and regulatory definitions
 - Take responsibility
 - Don't wait until audits or credit risk review

Move the Relationship

- Sooner the better – more viable
- Greater fool theory
- Have a contingency plan if client is unable to find another bank
- Side benefit: if client cannot move, bank should have a more cooperative borrower for workout plan

Foreclosure / Liquidate

- Get to an expert ASAP
- Bankruptcy Issues
 - Stay
 - Preference

Mini-Case Studies

- Dr. Brighter, LLC
- Safety Security Systems, Inc.
- ABC Manufacturing, Inc.

Fraud

- Two Key Types:
 1. Bank
 - a) Know your customer
 - b) Know their customers
 - c) Know their advisors
 - d) Visit facility
 2. Internal
 - a) Reliance on one individual
 - b) What controls are in place

Problem Asset Report(PAR)

1. Borrower:		2. Location:		3. Business:		4. Previous LOB:		5. Current LOB:		6. For Period Ended:	
7. Total Credit Exposure:											
Obligor(s)/ Loan #s	Current Risk Rating	Commitment			Repayment		Secondary Repayment Sources				
		\$ Tot Exp	\$ O u t s t d g	Non-Accrual	CO's To Date	Maturity Date	Terms/Amortization	Collateral & Value	Guarantors: Type & Adjusted Net Worth		
Totals											
8. Other Bank Exposure: Depository, non-credit services											
9. History and Recent Events: Why this is a problem asset											
10. Condition: Change since last PAR											
11. Strategy: Retain or exit											
12. Progress: Actions this period											
13. Repayment Ability: Cash Flow, Collateral, Guarantors, Other Resources											
14. Proposed Actions This Period, if any:											
15. Additional Remarks, if any:											
16. Review and Approval											
16a. Date Prepared:	16b. Original Account Officer	16c. Current Account Officer:	16d. Current AO's Supervisor:				16e. Final Credit Approver				

PAR Example, Pg. 1

1. Borrower(s): Tony Montana's Place, Inc. (TMP) Tony's Bar & Grill, Inc (TBG)		2. Location: Miami, FL		3. Business/NAICS: restaurant/722110		4. Previous LOB: Commercial		5. Current LOB: Special Assets		6. For Period Ended: March 31, 2010	
7. Total Credit Exposure:											
Obligor(s)/ Loan #'s	Current Risk Rating	Commitment (\$M)				Repayment		Secondary Repayment Sources			
		\$ Tot Exp	\$ Outstdg	Non- Accrual	CO's To Date	Maturity Date	Terms/Amortization	Collateral & Value	Guarantors: Type & Adjusted Net Worth		
1. TMP/ 007734666-01	Dbtful	1,451	1,451	1,451	0	8/23/08	\$11,051 P&I mthly/ 19-year amtzn	Comm bldg on 2 acres valued on 8/25/09 at \$2.2MM	Antonio Montana's full guarantee; ANW of \$35M at 9/30/09		
2. TBG/ 00773468-01	Dbtful	61	61	61	0	10/27/09	\$2,389 P&I mthly/3- year fully amortizing	Restaurant equipment; \$100 cost at 6/1/06	A. Montana's full guarantee; ANW of \$35M at 9/30/09		
Totals		1,512	1,512	1,512	0		\$161,280/year				
8. Other Bank Exposure: Depository, non-credit services TMP and TBG incurred 14 NSF's in calendar year 2009, so we closed operating accounts 1/6/10											
9. History and Recent Events: Why this is a problem asset TMP is a real estate holding entity that owns the real estate in which Tony Montana's Place operates. The bank approved a \$1.5MM construction loan (note #1) in 9/05. The loan incurred 7 30-past due payments since inception, 3x30 in the past 6 months. Note #2 has been 14x 30 since inception, 5/30 in the past 6 months. Mr. Montana acquired the property and restaurant from the estate of a former business associate in 2004, changed the name to TBG, and experienced a fire in 8/07. The building suffered water and smoke damage estimated at \$600M. To date, the Bank has received \$490M in insurance proceeds, but Mr. Montana estimates revenues are down 30% due to the reduced seating while repairs continue. The Bank's construction loan administration unit has established a construction account to distribute insurance funds for repairs and reconstruction in order to restore the building to a marketable condition.											

PAR Example, Pg. 2

10. Condition: Change since last PAR Delinquent payments have increased sharply in last 6 months, and Mr. Montana now responds to bank payment demands through his attorney			
11. Strategy: Retain or exit Exit via investor/third party financing by 6/30/10; If no investor or third party financing, call loan, liquidate collateral			
12. Progress: Actions this period Potential buyer identified; has own financing and is negotiating with Mr. Montana			
13. Repayment Ability: Cash Flow, Collateral, Guarantors, Other Resources Annual Global cash flow based on 9/30/09 financials: <ul style="list-style-type: none"> TMP \$25M TBG 70M (after adding back rent to TMP and salary to Montana) T Montana salary 50M Total GCF \$145M P&I 161.3M GDSC 0.9x Collateral <ul style="list-style-type: none"> Real Estate LTV: 1451/2200 = 73%, adjusted for current damaged condition 1451/1600 = 91% Equipment LTV: 61/100 orig cost = 61% LTV, adjusted for current used condition 61/50 = 122% Total LTV (1451 + 61)/(1600 + 50) = 1511/1650 = 92% Guarantee as of 9/30/09 <ul style="list-style-type: none"> Total Assets \$5,000M Total Debts - 1,500M Total Net Worth 4,500M Adjustments -4,465M (\$4MM equity in TBG, \$300M equity in TMP, \$65M in HHG and autos) Adjusted NW 35M Conclusion: unable to repay from cash flow, \$139M in excess collateral, very limited guarantor strength			
14. Proposed Actions, if any: Extend forbearance maturity to 6/30/10 to allow time for third party investor's due diligence			
15. Additional Remarks, if any: No charge-off anticipated			
16. Review and Approval			
16a. Date Prepared: 4/1/10	16b. Original Account Officer: C. Barrow	16c. Current Account Officer: J. Dillinger	16d. Current AO's Supervisor: D. Schultz
		16e. Final Credit Approver A. Capone	

Bank & Lender Timidity

During origination did the bank:

- Feel intimidated, coerced, or threatened by the client into making a loan.
- Fail to include disclaimers in communication—conversations, e-mails, term sheets.
- Not ask client questions necessary to complete a thorough credit analysis:
 - Tax returns on borrowers, guarantors, and related entities
 - Complete financial statements:
 - Balance sheet/income statement
 - Receivables/payables aging
 - Other schedules as necessary

Bank & Lender Timidity (cont.)

- Acquiesce a loan for a purpose or industry where the bank lacked experience and was too proud to ask for help.
- Treat a long-term problem with a short-term remedy, e.g., fixed plant expansion without any evidence of the sales growth to justify it financed by a line of credit.
- Properly margin the collateral and/or not properly evaluate the collateral taken.
- React to bank competition by underwriting the loan less rigorously than appropriate, i.e., thin pricing, less collateral, less guaranty support, fewer conditions and covenants, etc.
- Relied on analysis of the “lead bank”
- Not trust your gut instinct.

Contact Information

Do not hesitate to text, call or email with questions

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