



Building Success. Together.

Underwriting the Commercial Loan Request

Kevin Nickodem

Agenda

- Overview of the Risk Pyramid
- Recognizing critical industry issues
- Underwriting Cash Flow
 - Simple or UCA
 - Business Only or Global
- Collateral Evaluation
 - Underwriting A/R and Inventory
 - Real Estate issues

Credit Risk Triangle



Which Loan is the Most Risky?

- A. Equipment lease or term loan for 60 months
- B. Construction of an owner-occupied office/warehouse
- C. Construction of an 8 bay strip center
- D. Seasonal Line of Credit
- E. Finance the purchase of a business
- F. Purchase of a multi-use office building with 12 office condos
- G. Purchase of a 48-unit apartment complex
- H. Medical practice buy-in

Start with the Big Picture

- Purpose
- Amount
- Collateral
- Sources of Repayment Identified
- Term & Structure

Does this all make sense?

Which requests appear to be a poor match?

- A. 84-month term loan for a large printing press
- B. Line of credit to fund growth in A/R and inventory
- C. 60 month fully amortizing term loan to purchase real estate to a company with very strong cash flow
- D. Seasonal Line of Credit for a start-up retail clothing firm
- E. Maybe all of them?
- F. They all look good to me!
- G. Are you kidding? I wouldn't touch any of these

Big Picture (cont.)

In the credit memo has the lender conveyed:

- SWOT
 - ❖ Strengths
 - ❖ Weaknesses
 - ❖ Opportunities
 - ❖ Threats
- Mitigating Factors
- Porter's 5 Forces of Competitive Rivalry
 - ✓ Threat of Entry
 - ✓ Intensity of Rivalry
 - ✓ Pressure from Substitute Products
 - ✓ Bargaining Power of Buyers
 - ✓ Bargaining Power of Customers

Underwriting Cash Flow

- UCA Cash Flow vs. Simple Cash Flow
- Simple Global Cash Flow Template
- Machine Shop Case Study

Thinking only of an operating or service company, not real estate development, what cash flow method does your institution use to analyze debt coverage service?

- A. UCA Cash Flow
- B. Simple Cash Flow – Company Only
- C. Simple Global Cash Flow
- D. Other

Machine Shop, Inc.

- Corporate Debt Service:
 - New Equipment Lease: \$11,100/mo.
 - Refi Mortgage + New Money: \$5,270/mo.
 - Existing Debt: \$2,230/mo.
- Personal Assumptions (assume for all three years ex. distributions):
 - Wages: \$150 (000's)
 - Dividend & Interest: \$17
 - Living Expense: \$40 Debt Service
 - Fed & State Taxes: \$70 + Home Mortgage \$2,150/mo
 - FICA: \$11 + Mountain Home \$ 1,240/mo
 - Real Estate Taxes: \$6 +VISA \$ 850/mo
 - Personal Prop. Taxes: \$2
 - Charitable Contributions \$12
- VIS

Collateral Evaluation

- Equipment
- Real Estate
- Construction
- Lines of Credit

How do you determine the size of a seasonal LOC?

- A. Some percent of annual sales
- B. Some percent of A/R and/or Inventory
- C. The amount the borrower request
- D. Some other method

PFS Analysis

- Where is the focus?
- Does it provide “cushions of protection?”
- Common Errors
- Case Study Review

Covenants

- Keep them simple
- If you are not going to monitor – don't use
- Make sure client understands how to calculate.

Examples:

- Cash Flow Coverage
- Define Working Capital or Current Ratio
- Waive or Amending Covenants

Contact Information

Do not hesitate to text, call or email with questions

Kevin Nickodem
919.818.0692
kjnrun@gmail.com