Commercial and Industrial (C&I) Lending in Today's Competitive Market

Author/Lecturer

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I. Introduction: Commercial and Industrial (C&I) Lending

C&I Lending Defined:

Any type of loan made to a business or corporation and not to an individual. Commercial and industrial loans can be made in order to provide either working capital or to finance major capital expenditures (such as equipment).This type of loan is usually short-term in nature and is almost always backed with some sort of collateral.

Renewed emphasis on C&I Lending versus Commercial Real Estate Lending due to changes in the Commercial Real Estate market.

a) Change of Supply & Demand for Commercial Real Estate Loans

b) Change of attitude of Banking Regulators- FED, FDIC, OCC, State

c) Shift Back to Original Banking Roots!

II. Commercial & Industrial (C&I) Loan Products & Structure

a) Working Capital Line of Credit: 12 months, interest only

b) ABL Facility: 12 months, interest only

An asset based business line of credit is usually designed for the same purpose as a normal business line of credit - to allow the company to bridge itself between the timing of cash flows of payments it receives and expenses.

A non asset based line of credit will have a credit limit set on account opening by the accounts receivables size, to ensure that it is used for the correct purpose. An asset based line of credit however, will generally have a revolving credit limit that fluctuates based on the "actual" accounts receivables balances that the company has on an ongoing basis. This requires the lender to monitor and audit the company to evaluate the accounts receivables size, but also allows for larger limit lines of credits, and can allow companies to borrow that normally would not be able to.

Generally, terms stipulating seizure of collateral in the event of default allow the lender to profitably collect the money owed to the company should the company default on its obligations to the lender.

c) **Equipment Financing**:

1. Loans: 3, 5, 7, 10 year amortization

2. Leases: 3, 5, 7, 10 year amortization

   a. Note Payable (regular promissory note)

   b. TRAC Lease

This lease contains a Terminal Rental Adjustment Clause (TRAC) that guarantees your business a certain residual price for the vehicle when the lease expires. This is the most common type of lease for business owners who want the option of buying the vehicle for a pre-determined price at the end of the lease.

   c. "True" Lease

Leasing commercial equipment with a True Lease or Tax Lease means you will not have legal ownership of equipment, but will have use of such equipment for the term defined in the lease. If the equipment you need is subject to rapid advancements in technology, such as computers, the Tax Lease/True Lease is could be the best option. Financing commercial equipment with this lease option can mean lower monthly payments and in many cases tax deductions for lease payment amounts. (Lessor often retains "depreciation" rights).

d) Related Products & Structure

1. Letters of Credit (“carve out” of RLC)

   a. Standby

   b. Commercial

2. Bridge/Bullet Loan

3. Seasonal Loan

Polling Question # 1:

ABL stands for:

a) **Asset Based Lending**
b) **Asset Based Loan Commitment**
c) **Asset Based Lender**
d) **Asset Based Loan Referral**

III. Underwriting C&I Loans

a) Credit Scoring

b) Full-Underwriting

1. Basic Underwriting: Loan Purpose, Loan Amount, Sources of Repayment, Guarantor Support, Collateral Issues, Management Assessment, Risk Factors & Mitigation of Risk

2. Financial Statement Analysis

3. Tax Return Analysis

c) SBA Guarantee (7a)

IV. Accounts Receivable & Inventory Assessment and the Borrowing Base Certificate (BBC)

BBC Defined:

Borrowing base **is the total amount of collateral against which a lender will lend funds to a business. This typically involves multiplying a discount factor by each type of asset used as collateral.**

For example: *Accounts receivable*. 60% to 80% of accounts receivable less than 90 days old may be accepted as a borrowing base. *Inventory*. 50% of finished goods inventory may be accepted as a borrowing base. It is also common for a lender to only use the accounts receivable of a borrower as collateral - it may not accept *any* inventory as part of the borrowing base.

As an example of a borrowing base, ABC International applies for a line of credit. ABC has $100,000 of "eligible" accounts receivable and $40,000 of finished goods inventory. The lender allows 70% of the accounts receivable and 50% of the inventory as the relevant borrowing base, which means that ABC can borrow a maximum of $90,000 (calculated as $70,000 of accounts receivable and $20,000 of inventory) against its collateral.

IV. <u>Accounts Receivable & Inventory Assessment and the Borrowing Base Certificate (BBC) (Continued)</u>:

a) <u>Formula Based</u>:

<u>A/R Aging Report</u>:

0-30 days, 31-60 days, 61-90 days, Over 90 days

1. Ineligible A/R

2. Advance Rate

b) Timing: Monthly, Quarterly, Per Advance

c) Monitoring: Loan Officer vs. <u>Annual Collateral Audit</u>
(Time, Costs, Actual Work)

d) BBC Example (See below)

BORROWER: ABC, LLC

DETAIL OF INELIGIBLE A/R FROM INVOICE DATE

A/R BORROWING BASE COMPONENT	**ABC, LLC**
	Per A/R Aging
AGINGS AS OF 3/31/22	**1,000,000**
ACCTS OVER 90 DAYS	25,000
CRED. BALANCES OVER 90 DAYS	1,000
20% CROSS AGING < 90 DAYS	10,000
RETENTION UNDER 90 DAYS	20,000
20% EXCESS CONCENTRATIONS (1)	
25% EXCESS CONCENTRATIONS (2)	150,000
NON-PERFECTED US GOVT ACCTS	
STATE, CITY, MUNICIPALITY, ETC.	50,000
FOREIGN ACCOUNTS	
CASH/COD ACCOUNTS	
AFFILIATE/SUB/INTER CO. ACCOUNTS (3)	15,000
FINANCE/SERVICE CHARGES	
BK ACCOUNTS	
EMPLOYEES	20,000
PROGRESS BILLINGS	
CONSIGNMENTS	
CONTRAS	
OTHER:	
PRE-BILLINGS	
GL TO AGING VARIANCE	
SUBTOTAL A/R INELIGIBLES	**291,000**
TOTAL A/R INELIGIBLES	**291,000**
ELIGIBLE A/R	**709,000**
ADVANCE RATE	75%
AVAILABLE A/R	**531,750**

(1) Concentrations of accounts > 20% (< 90 days)

(2) Concentrations of accounts > 25% (< 90 days)

(3) Affiliates are defined as any company that the principals have a controlling interest in. This would include but is not limited to all affiliates listed in th annual audited financial statement.

V. Accounts Receivable Issues

a) General Source & Quality of the A/Rs?

b) Are Governmental A/Rs Always Strong? Collectability? Timing?

c) How Do You Measure the Risk of the Individual A/Rs?

d) Does the Borrower ever "Re-bill" or Make Adjustments to its A/Rs? What about the "30 day" Not-Yet Due category?

e) Does the Borrower Use the "Direct Write-Off" Method or the "Allowance Method" for Managing Bad Debt?

VI. <u>Valuation and Quality of Inventory (including Inventory Costing System)</u>

a) Raw Material, Work-In-Process or Finished Goods Inventory?

b) <u>Inventory Costing System (Timing)</u>:

FIFO

LIFO

Average

c) Age/Quality of Inventory

d) Site Visit

VII. <u>Equipment Issues in Lending (including Depreciation)</u>

a) Quality/Age of Equipment

b) Value of Equipment (How do you determine the FMV of the equipment?)

c) <u>Depreciation Methods</u>:

1. Straight-Line

2. Units-Of-Production

3. Double Declining Balance

4. Modified Accelerated Cost Recovery System (MACRS)

d) <u>Other Depreciation Issues</u>:

1. Section 179 Depreciation (Form 4562)

2 Bonus Depreciation

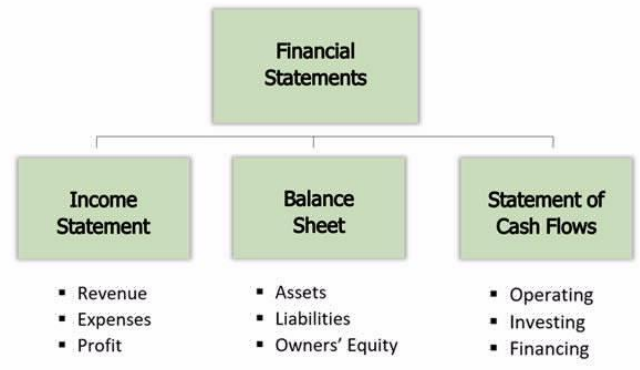
Polling Question # 2:

BBC stands for:

a) **Borrowing Base Cash Flow**
b) **Borrowing Base Credit**
c) **Borrowing Base Cash**
d) **Borrowing Base Certificate**

VIII. Evaluation of the Financial Statements:

a) Types of Financial Statements:



Four Basic Financial Statements

1. Income Statement

2. Statement of Retained Earnings (Owner's Equity)

3. Balance Sheet

4. Statement of Cash Flows

b) Five Step Analysis Model: Liquidity, Activity, Leverage, Operating Performance, Cash Flow

IX. Documentation & Collateral Concerns of C&I Loans

a) Standard: Promissory Note, Business Loan Agreement, Corporate Resolutions, etc.

b) Collateral Position:

1. Security Agreement

2. UCC-1 filing (General description or specific)

3. Vehicle Titles

X. Pricing and C&I Loans

a. Prime Based

1. Wall Street

2. Individual Bank (Base Rate)

b. Other "Short-Term" Pricing: Ex. "LIBOR" (London Interbank Offered Rate) to "SOFR" (Secured Overnight Financing Rate)

c. Fees: Commercial Real Estate vs. C&I Loans/Lines

d. Terms: Ex. 20 yr. amort./ 5 yr. call

Ex. 5 yr. amort. period!

XI. <u>Managing the C&I Loan Porfolio</u>

a) More “run-off” than Commercial Real Estate

b) More “time, money, and productivity” to create C&I “assets” than Commercial Real Estate Lending (on a <u>dollar</u> per <u>dollar</u> basis)

c) C&I Lending: More diverse, less concentration, in theory, less risk!

d) C&I Lending: Can be “niche” player- specialist!

Ex. Rental Car Fleet

Polling Question # 3:

The LIBOR pricing model is transitioning to SOFR:

a) **True**
b) **False**

VII. Marketing C&I Loans in Today's Competitive Market

a) Market Situation Analysis:

b) Market Segmentation:

c) Target Market:

d) Marketing Mix:

Four Ps of Marketing:

1. Product

2. Place

3. Price

4. Promotion: Advertising & Personal Selling

VII. Marketing C&I Loans in Today's Competitive Market (Continued):

e) Related Concepts:

1. Life Cycle: Birth, Growth, Maturity, Decline, Rebirth

2. Market Structure Continuum:

Pure Competition	Monopolistic Competition	Oligopoly	Monopoly

XIII. C&I Lending Scenarios

a) You are a VP-commercial loan officer and have worked for most of your banking career with large, "income producing," commercial real estate loans.

With the "downfall" of the local commercial real estate market, you have been reassigned to work almost exclusively with C&I lending clients providing lines of credit and equipment financing (including "work-out" situations). You realize that you have not worked on a "single" line of credit or equipment deal in over 12 years.

What do you do? Where do you start? What are the actual steps that you would take?

XIII. C&I Lending Scenarios (Continued):

b) You are a branch manager and work extensively with small to medium-sized business customers. You are currently working with a rapidly growing small manufacturing company. They seem to be a good potential client but you were just informed by your "assigned" commercial loan officer that the company is not currently "bankable" due to its growth.

You are perplexed. You know that the manufacturer is a well run company but you know that you will not be able to help this client (or obtain their deposit relationship) if the bank can not provide the requested line of credit.

How could an ABL facility help in this situation? What if your bank does not currently provide ABL financing? What do you do?

XIII. <u>C&I Lending Scenarios (Continued)</u>:

c) You are a <u>commercial lending center manager</u> and have recently returned from a meeting with the bank's senior management. You have been given the direction to significantly lower the center's loan portfolio concentration of commercial real estate loans and "immediately" replace these loans with new C&I loans/lines of credit.

You know you must make the transition quickly but you are not that familiar with marketing C&I lending products as your team has traditionally made its "annual" goals through commercial real estate loans.

What do you do (from a marketing standpoint)? Where do you begin?

XIV. <u>Conclusion</u>:

a) C&I Lending is “Old/New” Banking

b) C&I Lending is Here to Stay!

c) C&I Lending Can be Profitable for the Bank!