

# INTRODUCTION TO COMMERCIAL LENDING

Brad Stevens

Stevens Risk Management



# COMMERCIAL LOAN



# *INTRODUCTION*

## **Brad Stevens**

BA, Degree Economics, MBA, Finance

30 Plus Years in Banking

Managed over \$40 Million in Commercial C & I and  
Commercial Real Estate Accounts

Senior Credit Officer of Two Troubled Banks

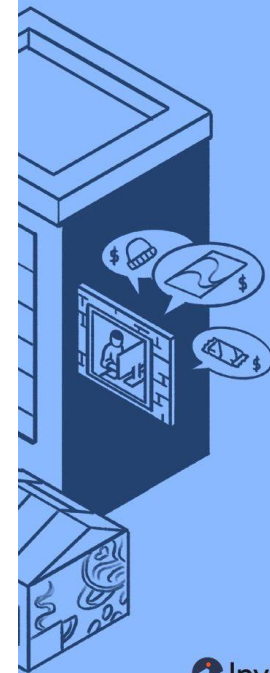
Nationwide Trainer and Bank Consultant





# AGENDA

- Understanding Credit Risk
- Types of Borrowers
- Solving Your Clients Problem
- Analysis and Process
- Need for Structure
- After Closing



## Business

*['biz-nəs]*

An enterprising  
engaged in co  
industrial, or p  
activities.

## *CORE CONCEPTS TO KEEP IN MIND*

Yesterday's Loans Are Repaid With Today's Cash Flow

Today's Loans Are Repaid With Tomorrow's Cash Flow, Is There Enough?

Every Loan Request Is The Result of A Cash Shortfall



**nding of the commercial**

# *CORE CONCEPTS TO KEEP IN MIND*

**Business Loans Are Made to Business Entities For Business Purposes**

**No Good Deal Ever Comes Through The Front Door**

**Always-Match the Loan Repayment With the Self Liquidating Asset That Supports the Loan**

**You Are Not Paid to Make Loans, You are Paid to Manage Credit Risk!**



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# *MANAGING CREDIT RISK*

$$P \times C = \text{Credit Risk}$$

Probability of An Event Occurring Or Not Occurring As Expected

Inquisitive Underwriting is Required

## Types of Credit Risk



# *MANAGING CREDIT RISK*

$$P \times C = \text{Credit Risk}$$

The Consequences to the Client and The Bank If The Events Do Not Occur as Planned Are Mitigated By Proper Structure

Documentation  
Pricing  
Collateral  
Covenants

## Types of Credit Risk





# *ESSENTIAL CONCERNS*

## Essential Concerns in All Lending;

Assess the Needs of Our Borrower

Review the Financial Condition of the Borrower

Structure the Loan Properly

Close Effectively

Monitor Profusely





# *COMMERCIAL LENDING PROCESS*

Request- Caused by A Cash Shortfall

Analysis- What Information, Why The Shortfall, Financeable?

Structure- Solving The Clients Problem

Monitoring- What To Look For After The Close



# *ANALYSIS*

Marketplace Factors Impacting the Borrower

Plus

Managements Response to the Marketplace Factors

Equals

**The Financial Statements**



# *MARKETPLACE IMPACTS*

Local Economy

National Economy

Labor Requirements

Supply Chain

Regulations

Transportation

Economic Geography

Technology

Competition





# *MARKETPLACE IMPACTS*

## **Type Of Industry;**

Manufacturing

Real Estate

Wholesale/Distribution

Agriculture

Service Sector

Retail

Hospitality/Food Service



# MANAGEMENT ASSESSMENT

		Management Appears	
		Strong	Weak
Management is Actually	Strong	Continue the Process	Continue the Process Carefully
	Weak	Dig Deeper But Decline Likely	No One Likes A Slow NO Decline Immediately

## agement Proces



Organizing



Coordinating



# *MANAGEMENT ASSESSMENT*

**Core Abilities, Strengths and Weaknesses;**

Breadth and Depth

Processes

Margin Control

Life Stage

Sales Management

Finance Acumen

Culture

## agement Proces



**Organizing**



**Coordinating**





FINANCIAL  
ANALYSIS

BALANCE SHEET;

Details the Resources and Funding of the Firm

Assets or Resources

Liquid

- Cash
- Accounts Receivable
- Inventory

Long Term

- Equipment
- Intangibles

SAMPLE  
BALANCE SHEET

ASSETS		LIABILITIES & EQUITY	
<strong>Assets</strong>		<strong>Liabilities</strong>	
Banking Account	5,000	<strong>Current Liabilities</strong>	
Accounts Payable	1,000	Accounts Payable	1,000
Cash	500	Line of Credit	2,000
Accounts Receivable	22,000	Payroll Liabilities	3,000
Inventory	15,000		
Health Insurance	6,000		
		<strong>Total Current Liabilities:</strong>	6,000
<strong>Current Assets:</strong>	49,500		
<strong>Noncurrent Assets</strong>		<strong>Noncurrent Liabilities</strong>	
Accumulated Depreciation	-4,500	Long-term Debt (loan)	4,000
Computer	7,000		
Building	65,000	<strong>Total Liabilities:</strong>	10,000
	60,000		
<strong>Noncurrent Assets:</strong>	127,000	<strong>Equity</strong>	
		Owner's Capital	3,000
		Retained Earnings	5,000
		<strong>Total Equity:</strong>	8,000
<strong>Total Assets:</strong>	177,000	<strong>Total Liabilities &amp; Equity:</strong>	177,000

Balance Sheet?

It is a financial statement that shows a company's assets, liabilities, and equity.



# FINANCIAL ANALYSIS

## BALANCE SHEET;

Details the Resources and Funding of the Firm

Liabilities or Funding Sources

Liquid

Accounts Payable  
Line of Credit  
Accruals

Long Term

Term Debt  
Shareholder Debt

## SAMPLE BALANCE SHEET

ASSETS		LIABILITIES & EQUITY	
<strong>Assets</strong>		<strong>Liabilities</strong>	
Banking Account	5,000	<strong>Current Liabilities</strong>	
Accounts Payable	1,000	Accounts Payable	1,000
Cash	500	Line of Credit	2,000
Accounts Receivable	22,000	Payroll Liabilities	1,000
Inventory	15,000		
Health Insurance	6,000		
		<strong>Total Current Liabilities:</strong>	3,000
<strong>Current Assets:</strong>	49,500		
<strong>Noncurrent Assets</strong>		<strong>Noncurrent Liabilities</strong>	
Accumulated Depreciation	-4,500	Long-term Debt (loan)	4,000
Computer	7,000		
Building	65,000	<strong>Total Liabilities:</strong>	8,000
	60,000		
<strong>Noncurrent Assets:</strong>	127,000	<strong>Equity</strong>	
		Owner's Capital	3,000
		Retained Earnings	5,000
		<strong>Total Equity:</strong>	9,000
<strong>Assets:</strong>	177,000	<strong>Total Liabilities &amp; Equity:</strong>	17,000

## Balance Sheet?

It is a financial statement that shows a company's assets, liabilities, and equity.



# FINANCIAL ANALYSIS

## BALANCE SHEET;

Details the Resources and Funding of the Firm

Equity or Owner Funding Sources

Paid In Capital

Retained Earnings

## SAMPLE BALANCE SHEET

ASSETS		LIABILITIES & EQUITY	
<b>Assets</b>		<b>Liabilities</b>	
Banking Account	5,000	<b>Current Liabilities</b>	
Accounts Payable	1,000	Accounts Payable	1,000
Cash	500	Line of Credit	2,000
Accounts Receivable	22,000	Payroll Liabilities	1,000
Inventory	15,000	<b>Total Current Liabilities:</b>	4,000
Health Insurance	6,000		
<b>Current Assets:</b>	<b>49,500</b>	<b>Noncurrent Liabilities</b>	
		Long-term Debt (loan)	4,000
<b>Long-term Assets</b>		<b>Total Liabilities:</b>	8,000
Accumulated Depreciation	-4,500		
Equipment	7,000	<b>Equity</b>	
Investing	65,000	Owner's Capital	3,000
	60,000	Retained Earnings	5,000
<b>Long-term Assets:</b>	<b>127,000</b>	<b>Total Equity:</b>	8,000
		<b>Total Liabilities &amp; Equity:</b>	177,000
<b>Total Assets:</b>	<b>177,000</b>		

## Balance Sheet?

What is a financial  
statement?  
It shows a  
company's assets, liabilities,  
and equity.





# *SOURCES AND USES OF CASH*

## Uses of Cash;

Increases of Assets/Resources

Repayment of Debt

Dividends

Losses



# *SOURCES AND USES OF CASH*

## **Sources of Cash;**

Decreases of Assets/Resources

New Debt

Paid In Capital

Net Income



# *FINANCIAL ANALYSIS*

## Income Statement;

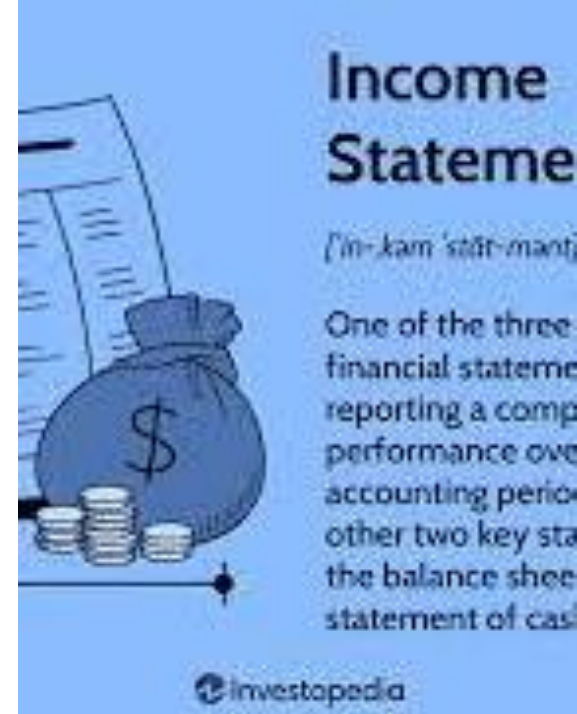
Sources of Revenue

Cost of Goods Sold To Create the Revenue

Gross Profit/Gross Profit Margin

Operating Expenses

Net Income/Net Loss



## **Example Corporation Income Statement Year ended December 31, 2023**

Revenues  
Operating Expenses  
Net Income  
Revenues, expenses, gains, losses, and other income tax expense  
Net Income/Net Loss

See notes to the financial statements

# *FINANCIAL ANALYSIS*

Key Ratios;

Current Ratio

Leverage Ratio

Gross Profit Margin

Cash Flow Coverage





# *FINANCIAL ANALYSIS*

Activity Ratios;

Accounts Receivable Days on Hand

Inventory Days on Hand

Accounts Payable Days on Hand



# *CORE CASH DRIVERS*

Sales Growth

Gross Profit Margin

Operating Expense Margin

Accounts Receivable Days on Hand

Inventory Days on Hand

Accounts Payable Days on Hand

Fixed Assets Need



## **Financial A**

[fə-'nan(t)-shəl ə-'nɑ]

The process of e  
businesses, proj  
and other financ  
transactions to c  
their performan  
suitability.

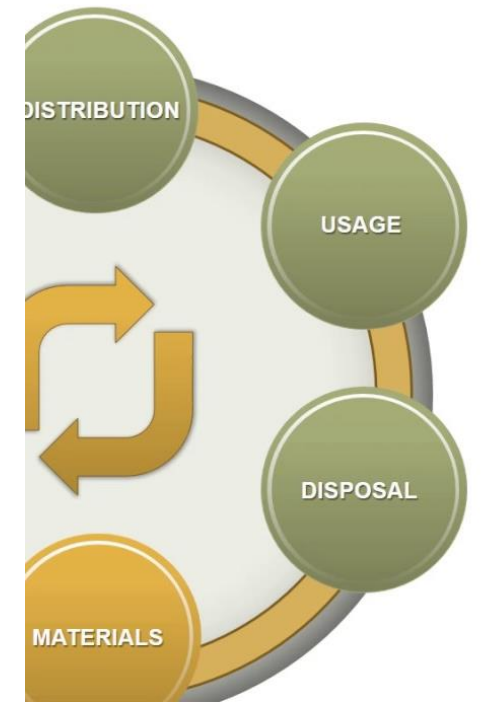
# *COMMERCIAL LENDING PROCESS*

Request- Caused by A Cash Shortfall

Analysis- What Information, Why The Shortfall, Financeable?

Structure- Solving The Clients Problem

Monitoring- What To Look For After The Close



# *STRUCTURE CONSIDERATIONS*

Managing Credit Risk is Primary

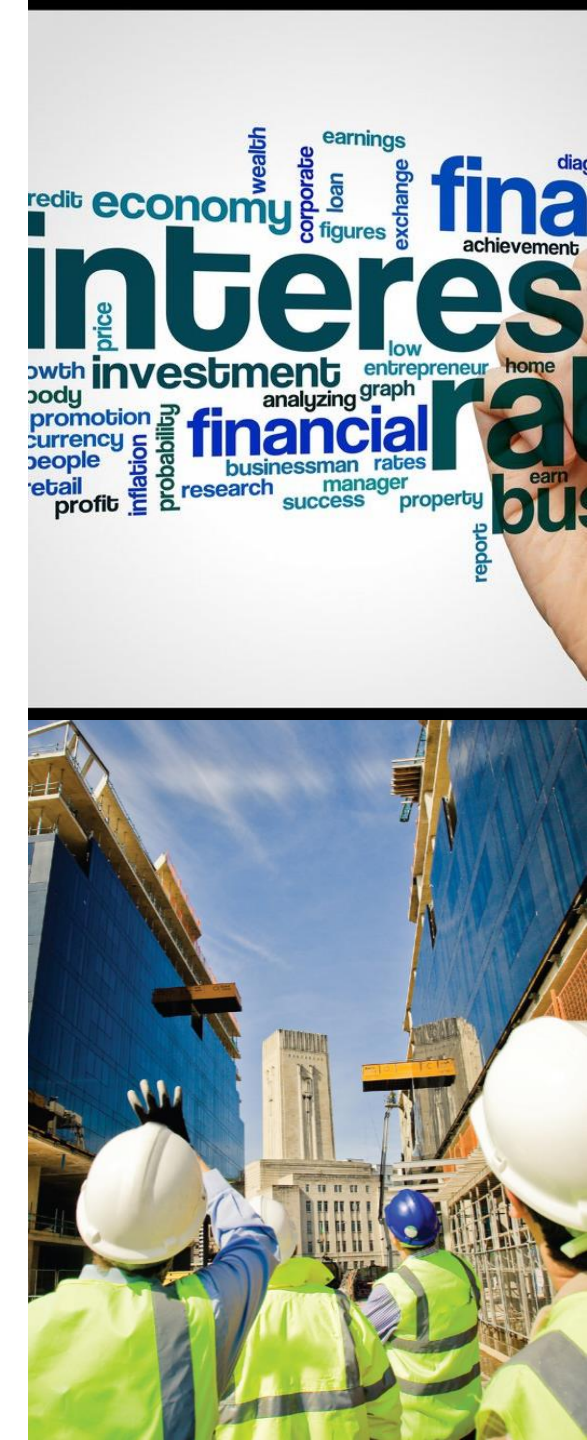
What Repayment Resources Does the Borrower Have?

What is The Self Liquidating Asset that Will Repay the Debt?

What Could Impair The Ability of Repayment?

What Guardrails Do I Need To have To Limit The Consequences of Impairment?

What is The Acceptable Repayment Term and Affordable Payment Amount





# *STRUCTURE CONSIDERATIONS*

## Types of Loans;

Lines of Credit

Term Loans

Balloon Loans

Interim/Bridge Loans

Long Term Working Capital Loans

## Common Lending Options



### Line of Credit

Cover planned or unexpected capital needs this year, in ten years or even twenty years.



### Term Loan

Tailor a fixed-term loan to fit your exact needs before a high-cost purchase or renovation.



# *STRUCTURE CONSIDERATIONS*

Documentation- The Right Documentation for the Right Loan

Pricing- The Right Return for The Risk

Collateral- The Alternative In Case of Default

Covenants- The Right Boundaries



# STRUCTURE CONSIDERATIONS

Setting Financial Covenants;

Loan Type Specific

Providing a Road Map, Not a Hurdle

Targeted to The Key Risks You Want to Control

Two Will Do

## Debt Covenants



### Examples



# *STRUCTURE CONSIDERATIONS*

Setting Control Covenants;

Management Concerns

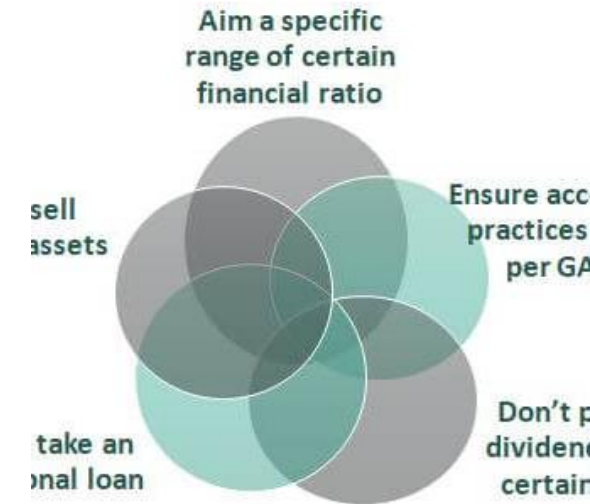
Ownership Concerns

Collateral Concerns

Cash Flow Concerns

Reporting Concerns

## Debt Covenants



### Examples





# *POST APPROVAL, PRE CLOSING*

Commitment Letters/Term Sheets

Negotiations, Best Alternative to A Negotiated Deal

Collect the Fees and Expenses

Preview of the Closing Documentation

## NEGOTIATIONS



# *CLOSING*

**Make it A Non-Event**

No Surprises

They Are Busy-You Are Busy, Non-Real Estate Closings, 5 Minutes

Real Estate, Let a Qualified Title Company Handle It

Multiple Payee Disbursements



# *MONITORING/RELATIONSHIP ENHANCEMENT*

## Tickler and Exception Reports

### Financial Report Analysis

Looking for The Next Opportunity  
Catching Early Warning Signs

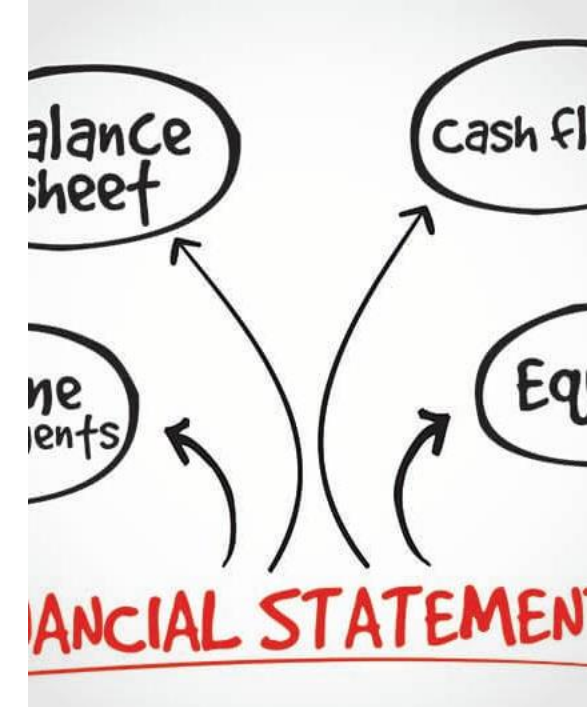
### A, B and C Clients, Managing Your Portfolio

### Mining Your Portfolio

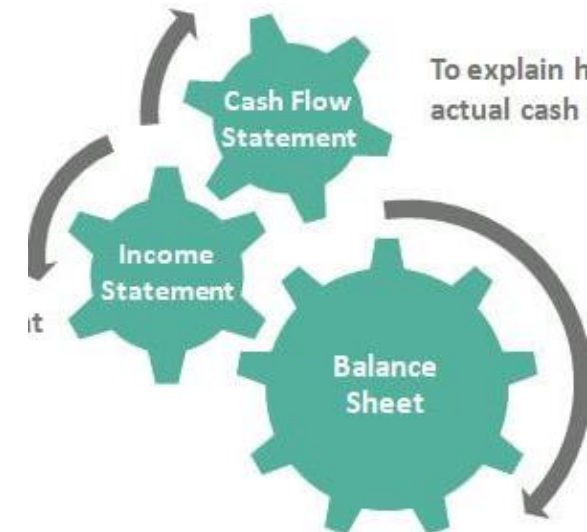


# RECAP

- Develop a Efficient Process
- Credit Risk Management
- Understanding the Request
- Effective Analysis To Address The Key Risks
- Structure Properly
- Close Effectively
- Manage the Relationships Profitably



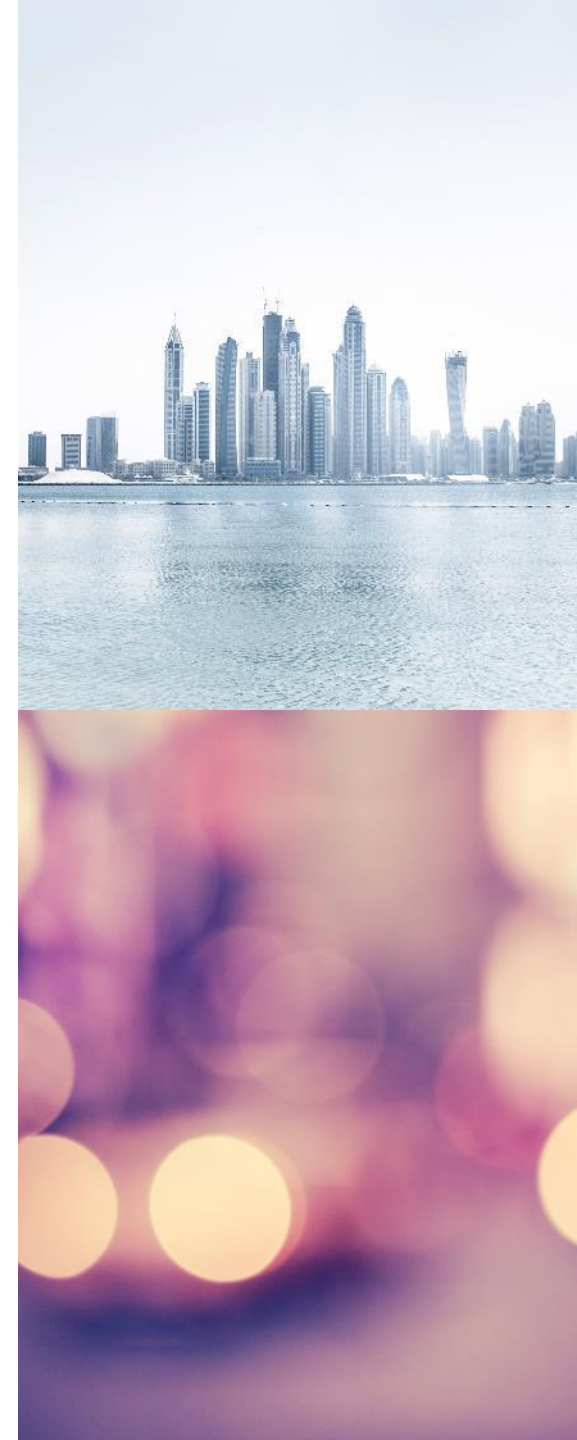
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# *UPCOMING ICBA OFFERINGS*

- Understanding C&I Lending, February 1, 2023
- February 22, 2023 Managing Troubled Loans
- March 28 ICBA Credit Analyst Institute





# *THANK YOU*

Brad Stevens

Stevens Risk Management, LLC.

Brad.Stevens@SRMALLC.net

SRMALLC.net



SRM

*Making Banking Better  
Making Bankers Better*

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