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Corporate Lending

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8 COMMERCIAL LENDING



- 8.1 Commercial Loans
- 8.2 Commercial Credit Analysis
- 8.3 Small Business Loan Programs
- 8.4 The 2008 Financial Crisis

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8.1

COMMERCIAL LOANS

GOALS

List purposes for commercial loans.

Identify types of commercial loans.

Identify types of businesses.

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TERMS

- Commercial lending
- Term loan
- Short-term loan
- Factoring
- Merchandiser
- Manufacturer



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THE NATURE OF COMMERCIAL LENDING



● Commercial lending

- Lending to business enterprises

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COMMERCIAL LOAN PURPOSES

- Real estate
- Construction
- Equipment
- Operations



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Name four purposes for commercial loans.



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TYPES OF COMMERCIAL LOANS



● Term loan

- Finances permanent working capital, equipment, real estate, business expansion, or acquisition of another business

● Short-term loan

- For a year or less
- Often used for seasonal or cyclical business costs

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LINES OF CREDIT



- An open-ended loan
- Rates and conditions vary with the particular lending agreement

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REAL ESTATE AND EQUIPMENT LOANS



- Particular commercial mortgage loans for real estate and equipment are tied to and secured by the asset being purchased.
- Typically long-term notes with 10- to 20-year repayment periods

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CONTRACT FINANCING



- Contract financing is secured by the value of a specific contract and allows for an orderly flow of funds to a company or organization performing services under contract.
- Funds are advanced as the work is performed.

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BRIDGE LOANS



- A particular form of short-term loan used to cover expenses until long-term financing is in place

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LEASING



- Can allow businesses to possess needed equipment for less total cost than they would be obligated for if they bought the equipment
- Usually with lease terms of three to five years

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ASSET-BASED LOANS



● Asset-based lending

- Banks analyze profit and loss (P&L) statements, tax returns, and business plans to make lending decisions based on business income.
- The loans are secured with the overall assets of the business.

● Factoring

- A specific form of asset-based lending that advances cash to a business in exchange for its receivables

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What is a bridge loan?



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TYPES OF BUSINESSES



- Ways to classify businesses include
 - Corporate structure
 - **Merchandiser**
 - Sells products made by others
 - Provides services for a fee
 - **Manufacturer**
 - Makes or build items for others to sell

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What is the difference between
merchandisers and manufacturers?



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8.2



COMMERCIAL CREDIT ANALYSIS



GOALS

Identify basic ratios used in commercial underwriting.

List other items used to evaluate commercial loans.

Explain how the importance of disclosure in commercial loans.

Notes

TERMS

- Debt ratio
- Debt service coverage ratio (DSCR)



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COMMERCIAL CREDIT ANALYSIS TOOLS



- **Debt ratio**

= debt ÷ income

- **Loan-to-value ratio**

= principal ÷ market value

- **Debt service coverage ratio (DSCR)**

= net operating income ÷ total debt service

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List three analytical tools used to evaluate commercial lending.

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OTHER EVALUATION



- Typically, lenders want to examine the following:
 - Federal and state income tax returns for three years
 - Company financial statements for three years
 - Year-to-date profit and loss and balance statements
 - Projected cash flow estimates
 - Valuations and appraisals for collateral used to secure the loan
 - Written business plan
 - Personal financial statements of owners

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Why does a lender need access to a company's financial records?

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DISCLOSURES



- Most commercial lending is regulated only by the terms of the loan agreement and some state laws.
- Desperate businesses sometimes provide inaccurate or incomplete information.
- It is the ethical and professional responsibility of all parties involved with commercial lending to see that loans are honestly and soundly underwritten.

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Why isn't commercial lending as heavily regulated as consumer lending?



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THE MORTGAGE CRISIS RIPPLE EFFECT



- Reasons for tightened underwriting standards included
 - A shift in appetite for risk
 - Less market liquidity
 - The slowing in the residential real estate market
 - The overall state of the economy

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What caused banks to increase underwriting standards for commercial loans?



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8.3



SMALL BUSINESS LOAN PROGRAMS

 GOALS

Describe the purpose of the SBA.

Explain SBA loan eligibility requirements.

Identify SBA loan options.

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TERMS

- Small Business Administration (SBA)

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THE SMALL BUSINESS ADMINISTRATION



● The Small Business Administration (SBA)

- Offers a number of financial, technical, and management programs to help businesses
- Has an ongoing mission of education and assistance for small businesses
 - Loan guaranties

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How do SBA loans differ from standard commercial loans?



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SBA ELIGIBILITY



- Type of business
- Size of business
- Use of loan funds

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What three factors determine SBA loan eligibility?

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SBA LOAN TERMS AND CONDITIONS



- 7(a) Loan Guaranty
- SBA Express Loans
- CAPLines
- Microloans
- Special-Purpose Programs

Notes



FRAUD PREVENTION



- The SBA is very serious about making sure that SBA loans go only to businesses that truly meet the small business qualifying criteria.
- The OIG investigates fraud.

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What general criteria must a borrower meet to obtain an SBA loan?

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8.4

THE 2008 FINANCIAL CRISIS

 GOALS

Identify the root causes of the 2008 financial crisis.

Discuss self-regulation and its effects.

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TERMS

- Risk averse
- Risk preferrer
- Credit default swap (CDS)
- Speculation
- Synthetic financial product



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THE PROFIT MOTIVE



● Risk averse

- A person who prefers to invest in products that have very little risk of failure

● Risk preferrer

- An investor who seeks a high level of return on investments
- Willing to invest in assets whose soundness or long term performance is not predictable

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RELYING ON EACH OTHER



- For investment structures to work
 - Each participant needs to make good on their financial commitments
 - Each participant needs to trust that all other parties will meet their financial commitments
- If expected financial commitments are not met
 - Participants will exit the investment structure

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REVENUE GENERATION FROM ASSETS OF DUBIOUS VALUE



- Mortgage-backed securities
- Credit default swaps (CDS)
 - An insurance policy to protect against loss against downside risks to the bond holder

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CDS COMPLICATING FACTORS



● Speculation

- When people make investments based on anticipated or hoped-for outcomes, without having an ownership stake in the asset being insured
- High risk

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SOMETHING FOR NOTHING



● Synthetic financial products

- Products that lack an underlying value in their assets

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What is a credit default swap?



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THE INEFFECTIVENESS OF SELF-REGULATION



- The industry did not self-regulate effectively.
 - CDSs
 - No regulation
 - Increased global demand for investment products
 - Lack of reserve requirements for CDSs
 - Regulators may not have fully understood the consequences of CDS growth

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THE AFTERMATH



- The 2008 financial crisis is the worst financial crisis since the Great Depression.
- In late November 2008, the U.S. government had already assumed about \$7.8 trillion in both direct and indirect financial obligations.
- The nation's unemployment was at 6.5 percent in October 2008.

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