Module 2
Loan Structuring and Process of Commercial Loans

Learning Objectives:

After the completion of this Module you will be able to:

1. Describe the critical elements of loan structuring
2. Determine the critical documents used during a loan underwriting and closing process including authority to borrow, negotiate financial transactions and conditions of the loan
3. Describe the value of the personal guarantees
4. Perform collateral assessment in secured transactions

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Introduction:

-The operating cycle in a company usually dictates the purpose of the loan, amount and repayment terms.

- During the loan underwriting and structuring process the lender has the responsibility to lend funds to Borrowers that will be used properly and will fulfill the Borrowers financing needs.
- In loan structuring too strict payment terms may result in a Borrower with insufficient capital for the Company's operations.
- Liberal loan terms may present a scenario where the lender will lose control over the relationship.

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- Loan proceeds and purpose may be diverted to other needs including personal financing needs of the Borrower’s principals.
- It is the lender’s responsibility to ensure the Bank’s funds are managed properly against credit risk.
- In small business lending the Borrower will be active in the negotiation of interest rate on the loans, terms, collateral, guaranties and loan agreement stipulations.
- Conversely the Borrower will seek insight from the lender in terms of defining the length of the loan, repayment source and loan structure.

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- For an adequate loan structure the lender must have the following issues addressed:
- 1. Purpose of the loan
- 2. Use of the borrowed funds
- 3. Sources of repayment
- 4. A detailed loan interview
- 5. Credit investigation
- 6. Negotiations
- 7. Financial Analysis

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Commercial loans are divided into three (3) categories:

- Loans to finance trading/current assets
- Permanent working capital loans
- Term loans to finance fixed assets

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- **Loans to finance trading/current assets:** These loans support the everyday operational expenses, are short term in nature and repayment usually occurs within twelve (12) months
- This type of loans are used to finance inventory, accounts receivable and other current assets.
- **Permanent working capital loans:** Loans to finance permanent increases in inventory and accounts receivable associated to sales growth, expansion or a more permanent event in the life cycle of the company. Repayment of this loans is through profits generated from multiple operating cycles.
- **Term loans to finance fixed assets:** Loans to finance fixed assets are considered long term debt on the balance sheet. Maturity of these loans are between 3-7 years. Purpose of these types of loans are fixed assets, mergers and acquisitions.

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Loan Documentation:

- Presently loan documents in most banks are produced electronically
- The automated processes usually produce a loan documentation checklist that assist the lender and support staff in completing the loan package
- The main purpose of loan documentation is to have a written, legally enforceable understanding of the obligations of both parties: bank and the borrower.

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Loan Documentation:

- In loan underwriting there are some critical issues that must be taken into consideration:
- 1. A personal guaranty is considered additional support for a loan
- 2. Proper corporate documentation in file must attest the individuals who are authorized to act on behalf of the company. As a result the Bank will need written proof of authority to borrow.
- 3. The Bank must have evidence of the Borrower’s indebtedness to the Bank. This process is validating by the lender obtaining a signed and completed promissory note.
- 4. The Bank must have evidence of its right to the Borrower’s collateral. Including in this topic is detailed description of what collateral is securing the loan

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Loan Documentation:

In loan underwriting there are some critical issues that must be taken into consideration:

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- 4. The Bank must have evidence of its right to the Borrower’s collateral. Including in this topic is detailed description of what collateral is securing the loan. Evidence of collateral includes a securing agreement and a financing statement.

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Loan Documentation:

In loan underwriting there are some critical issues that must be taken into consideration:

- 5. The lender needs written evidence of the loan terms and conditions.

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Loan Agreements and Covenants:

- In a credit transaction there are two (2) basic forms of agreement between a bank and a customer as follows:
- 1. The Offering Letter: Declaration of intention to lend without a contractual obligation
- 2. Loan Agreement: A formal contract between the bank and the Borrower.

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Loan Agreements and Covenants:

- - When the Bank negotiates a loan agreement with a Borrower there is a legal contract established in the stipulations the Bank:
- 1. Agrees to lend a certain amount of money for a specific period of time under certain conditions
- 2. There is a promise to pay the money back to the Bank with interest on or before the maturity date.
- 3. If the loan will be secured by collateral the loan agreement will also include a stipulation where the Borrower agrees to allow the bank to take possession of certain assets and apply the proceeds from the sale of those assets for the repayment of the loan if the Borrower defaults on the loan.

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Loan Agreements and Covenants:

- The loan agreement stipulates the rights and obligations of the Bank and the Borrower with respect to a specific credit arrangement.
- The agreement establishes the parameters and conditions for which the loan is granted and in which the Borrower operates.
- Term loans and revolving credit agreements usually require loan agreements.
- The loan agreement is the basis for the entire lending relationship.

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Loan Agreements and Covenants:

- During the loan agreement process the Lender has several objectives:
- 1. Ensure regular and frequent communication with the Borrower to obtain an in-depth evaluation of the Borrower's financial condition and the evolution of the business.
- 2. Ensure the Borrower meets performance criteria associated with the loan repayment
- 3. Although the lender can not interfere in the Company's operations and management decisions the Lender should clearly state the loan conditions.

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Loan Agreements and Covenants:

- A loan agreement usually is comprised of seven major sections:
- 1. Loan :Includes amount, interest rate, repayment schedule and security
- 2. Representations and Warranties:
- 3. Negative covenants
- 4. Affirmative Covenants
- 5. Loan conditions
- 6. Events of default
- 7. Remedies

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Loan Agreements and Covenants:

- A loan agreement usually is comprised of seven major sections:
- 2. **Representations and Warranties**: This section provides certain attestations that the Borrower provides to the Bank including : a) the company is entering into the agreement legally, 2) financial statements are accurate 3) that no material adverse change has occurred to the business
- 3. **Negative covenants**: Section of the loan agreement the Borrower is expected to avoid certain actions and conditions during the life of the loan. Between the negative covenants limits the Borrower’s ability to sell assets, make capital expenditures, change the primary business, engage in mergers, pay dividends or change in management or ownership without notifying the Bank. In this section the Lender can also add the requirement for adherence to certain financial indicators. This can include limitations on cash flow coverage, minimum liquidity and maximum leverage ratios.

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Loan Agreements and Covenants:

- A loan agreement usually is comprised of seven major sections:
- 4. **Affirmative Covenants:** This section states the actions required that the Borrower needs to abide to in the future. This section may require maintaining insurance , financial statements, pay taxes, and abide to certain accounting procedures.
- **5. Loan conditions:** This section states the stipulations that must be made before the loan is funded. The stipulations include the requirements to have loan documents reviewed by legal counsel, proper completion and execution of loan documents and certifications from the Borrower’s management and accountants that the Borrower is in compliance with the loan agreement.

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Loan Agreements and Covenants:

- A loan agreement usually is comprised of seven major sections:
- 6. **Events of Default:** A default in a loan agreement is when the Borrower fails to perform an action required by the agreement. The agreement also states the timing of the default.
- **7.Remedies:** This section states the actions that the Bank will pursue with the Borrower if there is an event of default.

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Loan Agreements and Covenants:

- Usually loan agreements in complex transactions are drafted by experienced attorneys.
- The core of the loan agreement usually resides in the affirmative and negative covenants.
- The covenants including the conditions for default and remedies are directly related to the risk associated with the loan .
- Loan covenants must prevent or minimize the risks that were identified during the loan underwriting process.
- Every condition and stipulation established in the loan agreement should be measurable and intended to be enforced.

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Loan Agreements and Covenants:

- Covenants must be clearly defined and reasonable.
- Covenants are drafted to encourage Borrowers to reach the objectives in terms of liquidity, growth, profitability etc.
- Overall goal of covenants, default provisions and remedies are to give the Bank the option to act in the event the risk in the loan changes.
- The financial statement analysis and the projections define the Borrower's expected performance that will ensure the repayment of the loan

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Loan Agreements and Covenants:

- The Bank agrees to grant the loan based on specific risks and the expectation of a certain level of performance.
- If the Borrower’s performance falls outside the expected range of performance the lender needs to assess whether the risk assumed by making the loan has changed.
- Covenants will provide an option to renegotiate an agreement with the Borrower.
- Default on loan covenants especially with financial indicators, is considered a red flag that is telling the company’s risk is changing
- and the situation needs to be reassess

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Loan Covenants:

- With the covenants the lender should concentrate on the following objectives:
- 1. **Control Growth**: The Lender must encourage the Borrower to maintain an orderly and well –balanced growth.
- 2. **Increase in Equity**: Lender needs to ensure the company's ability to repay indebtedness and ensure the growth and quality of net worth
- 3. **Asset Quality Preservation**: The Lender should ensure that the Borrower continues as a going concern, generates profits and assets maintain adequate value in case of liquidation.
- 4. **Maintain cash flow**: Lender will want to monitor the cash flow and its quality so the company can service short term and long term loans.

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Loan Covenants:

- Covenants based on financial ratios, such as liquidity, working capital and leverage, provide an incentive for the Borrower to reach certain performance levels required to ensure repayment of the loan and provide early warning when the Borrower's performance is not consistent with repayment.
- Some of the covenants considered standard in a loan agreement are:
- 1. Insurance requirements
- 2. Liens on specific assets
- 3. Financial statements and accounting procedures
- 4. Inspection
- 5. Contingent liabilities

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Loan Covenants:

- 1. **Insurance requirements**: The Borrower must main insurance coverage for flood, fires and other natural disasters and protect the Borrower against lawsuits for damage or injuries suffered by employees or others.
- 2. **Liens on specific assets**: The Bank wants to maintain a security interest on the Borrower’s assets until the loan is fully repaid.
- 3. **Financial statements and accounting procedures**: The Lender should ensure regular and timely receipt of financials so the performance of the Borrower could be monitored. The Lender also needs to ensure that the Borrower’s financial statements maintain certain level of quality
- 4. **Inspection:** The Lender must have the Borrower agreed to an inspection of the Company’s assets specifically those that will be pledged as collateral for the loan
- 5. **Contingent liabilities:** This covenants will be included in order to protect the Borrower against legal claims, lawsuits, guarantees on other third party indebtedness and significant outlays of cash

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Loan Documentation:

- The following loan documents must be a requirement for the Lender during the loan processing process:
- **1. Evidence of Authority to Borrow**
- **2. Evidence of Indebtedness**
- **3. Evidence of collateral in the event of a secured loan**
- **4. Evidence of loan terms and conditions**

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Loan Documentation:

- **1. Evidence of Authority to Borrow:** Business borrowers may involved different legal structures such as sole proprietorship, partnerships, corporations, limited liability companies.
- **-** Each of these legal structures receive different treatments under the law and require adequate and applicable identification in loan documentation.
- Aside from determining legal structure and proceed with the identification of those individuals authorized to act on behalf of the company, the lender must verify the Borrower's exact name and location.
- Information to validate the Borrower's legal structure, corporate existence and management could be obtained via the Secretary of the State of corporate registration.

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Loan Documentation:

- **1. Evidence of Authority to Borrow:**
- **- Corporate resolution:** Required for corporations. S-Corporations, limited liability companies. A corporate resolution or a corporate certificate of authority can disclose the agents who will act on behalf of the company and execute financial transactions.
- \- **Partnership Resolution**: In this legal structure the lender must request a copy of the partnership resolution or partnership certificate that will disclose who can borrow on behalf of the partnership.
- **- Sole Proprietorship:** The Lender can verify the entity name via a copy of Schedule C of the personal income tax return. In some states proprietorship are required to file a certificate of doing business as (d/b/a/)

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Loan Documentation:

- **2. Evidence of Indebtedness:** This requirement is pursued via the inclusion of a promissory note. A promissory note is a written promise made by the Borrower to pay a certain amount of money on demand or at a specified maturity date.
- - The promissory note must include the Borrower's name, title and address.
- - The note also includes the name and address of the Bank, the amount of loan and maturity date
- - If the loan is repaid on demand, single payment or term basis the number of payments, amount and due date must be clearly specified.

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Loan Documentation:

- **3. Evidence of Other Conditions:** In secured loans the Lender must ensure there is evidence and description of the collateral pledged. Depending on the loan additional documentation such as subordination agreements, guaranties, loan agreements or insurance may be required.
- 4. **Evidence of Collateral:** The primary types of collateral to secure a commercial loan are accounts receivable, inventory, equipment and real estate.In secured lending when the Borrower fails to meet the debt repayment requirements the Bank may have to liquidate collateral to repay the outstanding balance on the loan. There are different State and Federal statutes that govern the documentation and registration of collateral.
- Collateral registration is pursued via Article 9 of the Uniform Commercial Code (UCC)

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Loan Documentation:

- 4. **Evidence of Collateral:** In this type of legal arrangement the Bank obtains an interest in the assets of the Borrower .Through Article 9 the creditor's interest can remain with the property if certain conditions have been met.
- - Before taking possession of the property (assets) securing the loan the Bank most show that the right to the assets is superior to the owner's right. This is called performing a security interest on the property.
- - To create a Bank's interest in the property the Lender must identify the ownership and type of collateral.
- - The Lender also needs to ensure the collateral is free and clear of any other liens
- The Bank's right to the Borrower's property is completed via attaching a security interest through a security agreement.

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Guaranties:

- Guaranties is considered another type of loan support.
- It is a legal documents where a third party agrees to pay the Borrower's debt if there is a default.
- The Guaranty is considered a tertiary source of repayment or a substitute for the Borrower's acceptable financial status.
- The strength of the guaranty depends on the guarantor's willingness and capacity to repay the debt if required, as a result the lender needs to ensure the guarantor meets the standard financial and credit standards.
- When a loan transaction carries a guaranty from a third party there are documentation requirements, monitoring and record-keeping.

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Guaranties:

- In cases of guarantees the Lender is required to maintain the guarantor informed of any significant changes in the Borrower's financial standing , the terms of the credit facility or changes in collateral.
- The guarantees from third party are used to exert added pressure on the Borrower to repay the debt.
- Guarantees could be secured and unsecured, limited or unlimited.
- Guarantees could also be personal, commercial or government guaranties.
- Types of guaranties are contingency guaranty, guaranty of payment or guaranty of collection

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Guaranties:

- A secured guaranty is secured by collateral. As such the lender is required to assess the value of the collateral in terms of liquidity, quality of the value, marketability and elements of control.
- Another critical factor when assessing the value of a secured guaranty is to determine if the Guarantor has other indebtedness or claims that may dilute its value.
- An unsecured guaranty is supported only by the guarantor's written promise to service the debt in an event of default.
- In unsecured guarantees the support is evident via a written document, considered legally binding as the Borrower's pledge to repay the loan.

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Guaranties:

- Unlimited guaranties covers all indebtedness incurred by the Borrower.
- A limited guaranty is attached to a specific loan and dollar amount.
- In commercial lending financial institutions prefer unlimited guarantees.

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Personal Guaranties:

- Personal guarantees are obtained from owners of different corporate structures including partnerships, limited liability companies and corporations.
- The assumption when obtaining a personal guaranty is to ensure personal and business interests of the Borrower are the same.
- Personal guaranties are considered critical if the guarantor exercises significant control on the business.

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Corporate Guaranties:

- In the corporate guaranty a business is obligated to cover for the debt of a company in case of default.
- This type of guaranty could be considered a secondary source of repayment in cases of a subsidiary.

Government Guaranties:

- In this type of guarantees a federal or state agency promises to pay in case that the Borrower defaults on the loan.
- The Small Business Administration (SBA) and the US Department of Agriculture provides guarantees to small and rural business facilitating borrowings for these type of businesses.

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Collateral:

- In secured lending transactions assets are pledged as collateral for a loan.
- When the Borrower does not qualify for an unsecured loan collateral is used to protect the Bank from the risk.
- In the event the Borrower does not pay the loan a Bank under certain legal conditions can take possession of the assets, sell them and apply the proceeds from the sale to repay the outstanding debt obligations.
- Primary assets used to secure a commercial loan include accounts receivable , inventory, equipment and real estate.

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Collateral:

- When estimating collateral value the lender must consider the following criteria for the collateral:
- **1. Liquidity**
- **2. Dependability,**
- **3. Marketability and**
- **4. Controllability**
- **1. Liquidity:** This criteria measures how quickly the assets pledged could be converted into cash. Current assets considered in the assessment includes stocks, bonds and other marketable securities, assets that could be easily converted into cash. Accounts receivable if used as collateral in this criteria, the Lender will have to assess their age, concentration and validity.

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Collateral:

- **2. Dependability:** In this criteria there are some factors to consider when assessing collateral value. This includes those assets that are sensitive to market devaluation due to technological obsolescence such as computers and electronic equipment and assets such as real estate tend to increase its value overtime.
- **3. Marketability:** In commercial lending transactions the Lender needs to evaluate the demand for the assets held as collateral. Collateral where the demand is suitable for a specific market niche has limited marketability when compared to specific collateral that is geared to a broad spectrum of clients. In addition when assessing the marketability of collateral, the costs associated to warehousing and security of the collateral are critical issues.

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Collateral:

- **4. Controllability:** This collateral assessment criteria includes the Bank's ability to locate and hold collateral. As such the Bank needs to research prior liens, assets offsets and warranties and any other legal claim that can preclude quick access to the assets held as collateral.
- Some of those restrictions include unpaid assessments on real estate collateral, to a purchase money security interest registered on inventory recorded by the supplier.
- In assessing collateral value the Lender needs to estimate the cost after all legal, appraisal, taxes, maintenance costs and selling expenses.
- Proceeds from the sale of collateral in the event of forced liquidation will be the net realizable value of the assets after considering all these costs.

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Collateral Liquidation:

- When performing an evaluation of the assets held as collateral banks perform an itemized assessment of the specific assets.

- Assets in this particular scenario are being considered as a secondary source of repayment when the Borrower is unable to generate enough cash flow for debt service.

- In this case the financial institution will exercise its right to the assets pledged as collateral and will initiate a forced liquidation.

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Collateral Liquidation:

- Assessment of collateral coverage will be completed starting with the most liquid assets pledged.
- The following is the collateral assessment:
- **Accounts Receivable:** In assessing collateral value from accounts receivable there are several factors:
- **1.** The lender will have to obtain from the Borrower the most recent A/R aging.
- **2.** Receivables considered in the assessment will be those in categories from current to 90 days. These receivables have a higher collection potential.
- **3.** The remaining receivables although not considered in the collateral assessment, will continue as part of the blanket collateral base pledged by the Borrower.

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Collateral Liquidation:

- **Accounts Receivable:** In assessing collateral value from accounts receivable there are several factors:
- **4.** Existing market standards will give accounts receivable in a forced liquidation a shrinkage value that will range from 70-85% of its value. It is assumed the collection of these receivable will not result in 100% given costs associated to its liquidation, marketability and disposition.

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Collateral Liquidation:

- **Accounts Receivable Collateral Assessment:**
- **Receivable Aging:**

	Book Valuation	Realization Percentage	Net Valuation
0 - 30 days			
30 – 60 days			
60 – 90 days			
90 – 120 days			
Over 120 days			
Blanket Lien			
Total Receivables			

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Collateral Liquidation:

- **Accounts Receivable Collateral Assessment:**
- **Receivable Aging: Example**

	Book Valuation (From Financial Statements)	Realization Percentage	Net Valuation
0 - 30 days	$135,000	80%	$108,000
30 – 60 days	$ 70,000	80%	$ 56,000
60 – 90 days	$ 50,000	80%	$ 40,000
90 – 120 days			
Over 120 days			
Blanket Lien	_________		_________
Total Receivables	**$255,000**	**Net Collateral Value**	**$204,000**

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Collateral Liquidation:

- **Inventory:** In assessing collateral value from inventory there are several factors:
- **1.** When assessing the value of inventory in a liquidation scenario the lender needs to first determine the Company's field of business.
- **2.** For manufacturers there are three (3) different types of inventory. As such the net realizable value in liquidation is different per category of inventory.
- **3.** Inventory for a manufacturer is divided in raw materials, work in progress and finished goods.
- **4**. For manufacturers work in progress inventory is assigned zero ($0) value in liquidation.
- **5.** For retailers and wholesalers the inventory is comprised of ***finished goods only.***

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Collateral Liquidation:

- **Inventory:** In assessing collateral value from inventory there are several factors:
- **6.** For manufacturers the work in progress inventory is considered unfinished inventory and as such its marketability is limited.
- **7.** Market standards for inventory when assessing its value in a liquidation scenario fluctuate from 30 – 50%.
- **8**. Inventory that could be subject to technological obsolescence such as computers or perishable such as produce, seafood, flowers or plants will bear a more conservative net realizable value. As such value could drop as low as 10% of book value.

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Collateral Liquidation:

- **Inventory Collateral Assessment:**
- **Example: Inventory (Manufacturers)**

	Book Valuation (From Financial Statements)	Realization Percentage	Net Valuation
Raw Materials	$275,000	50%	$137,500
Work in Progress	$ 80,000	0%	$ 0
Finished Goods	$ 30,000	50%	$ 15,000
Retail or Wholesale			
Blanket Lien	________		________
Total Inventory	**$385,000**		**$152,500**

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Collateral Liquidation:

- **Inventory Collateral Assessment:**
- **Example: Inventory (Wholesalers or Retailers)**

	Book Valuation (From Financial Statements)	Realization Percentage	Net Valuation
Raw Materials			
Work in Progress			
Finished Goods	$ 300,000	50%	$ 150,000
Retail or Wholesale (F. Goods)			
Blanket Lien	________		________
Total Inventory	**$ 300,000**		**$ 150,000**

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Collateral Liquidation:

- **Equipment:** In assessing collateral value from machinery and equipment (M&E) there are several factors:
- **1**. In assessing the value of pledged machinery and equipment collateral consideration must be given to the fact that once the fixed asset leaves the showroom or the manufacturing site market value automatically drops.
- **2.** Equipment that is subject rapid technological changes also encounters the challenge of decreased value as there is constant entrants to the market with new more advanced products. For computer and office equipment for example there are no barriers to entry. Therefore there are product substitutes that may impair the demand for the inventory the Bank is trying to liquidate.

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Collateral Liquidation:

- **Equipment:** In assessing collateral value from machinery and equipment (M&E) there are several factors:
- **3**. Aside from the issues discussed that may decrease the demand for the equipment collateral issues that must be built in when determining the value in a forced liquidation are:
  - 1. The useful life of the equipment
  - 2. The number of years the equipment has been in operation and how much it has depreciated.
  - 3. If the equipment or machinery is single used the ability of the Bank to sell this asset in a forced liquidation is dependent on finding a suitable buyer. In this situation the inclusion of an appraisal will assist in determining the real value of the equipment.

4. Market standards for the assessment of collateral value in a forced liquidation scenario may ranged from 10% - 30% of the book value of the equipment as it is reported in the most recent financial statements. The low end percentage parameters are associated to highly technological or single use type of equipment.

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Collateral Liquidation:

- **Machinery and Equipment Collateral Assessment:**
- **Example: Equipment**

	Book Valuation (From Financial Statements)	Realization Percentage	Net Valuation
Manufacturing			
Office, furniture and fixtures	$325,000	30%	$ 97,500
Less Superior Encumbrances	$ 0		
	_________		_________
Total Equipment Value	**$ 325,000**		**$ 97,500**

- When assessing the value of equipment in a forced liquidation scenario the Lender should first complete a UCC search on the Borrower to determine if there are any preferential liens on the equipment arising from manufacturer/vendor financing provided at time of purchase. This type of lien is recorded with the State via the UCC (Uniform Commercial Code). The lien is called in trade terms a "***Superior Encumbrance***"

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Collateral Liquidation:

- **Real Estate:** In assessing collateral value from real estate there are several factors:
- 1. When assessing the value of real estate pledged as collateral for a commercial loans the evaluation must have a certified appraisal as the base to determine the value I a scenario of a foreclosure due to default on the loan.
- 2. During the credit underwriting process and before the closing of the commercial loan if real estate is part of the collateral pool, the lender must:
- 1. Determine if the Bank will have a first or second mortgage on the property
- 2. Complete a title search to ensure there are no prior liens on the property
- arising from prior unsatisfied debt obligations with recorded mortgages
- that have not been released or liens or tax certificates due to default
- on the payment of taxes.
- 3. Determine whether or not the property pledged as collateral constitutes the
- primary residence or homestead of the Borrower's principals

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Collateral Liquidation:

- **Real Estate:** In assessing collateral value from real estate there are several factors:

  3. Real estate value as opposed to other assets is the only asset on the balance sheet
- that under favorable market conditions, the value will appreciate.
- 4. Depending on the property location and information provided on comparable sales as included in the real estate appraisal the shrinkage value assumed by the Bank will range from 75% - 80%.
- 5. In the balance sheet the Borrower may have provided information on leasehold improvements as part of fixed assets. Leaseholds are improvements to the existing property primarily decoration. As a conservative approach no value on liquidation is provided to this asset.

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Collateral Liquidation:

- **Real Estate Collateral Assessment:**
- **Example: Real Estate**

	Valuation (From Certified Appraisal)	Realization Percentage	Net Valuation
Land	$ 75,000	80%	$ 60,000
Property and Plant	$550,000	80%	$440,000
Leaseholds			
Less Superior Encumbrances	$ ________		_________
Total Real Estate Value	**$ 625,000**		**$ 500,000**

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Collateral Liquidation:

- **Other Assets Collateral:**
- In commercial lending transactions the Borrower may provided other assets as collateral for a loan.
- Some of these assets include:
- 1. **Cash or Certificates of Deposit**: In this scenario and when performing a collateral assessment the lender can provide up to 100% of its value as the collateral will constitute possessory collateral for the loan.
- 2. **Marketable securities and short term investments:** These assets are considered highly liquid and usually are pledged to the Bank through assignment and possessory collateral. In this specific type of assets and considering potential fluctuations in market value, shrinkage value is usually in the range of 70% - 80%.Although this type of collateral is considered liquid, time frames associated to settlement periods in the cancellation of the investment may delay the sale of the collateral and proceeds that will be applied to the outstanding debt.

Module 2
Loan Structuring and Process of Commercial Loans

Collateral Assessment:

	Book Valuation (From Financial Statements)	Realization Percentage	Net Valuation
- 0 - 30 days	$135,000	80%	$108,000
- 30 – 60 days	$ 70,000	80%	$ 56,000
- 60 – 90 days	$ 50,000	80%	$ 40,000
- 90 – 120 days			
- Over 120 days			
- Blanket Lien	_________		_________
- **Total Receivables**	**$255,000**	**Net Collateral Value**	**$204,000**
- Raw Materials			
- Work in Progress			
- Finished Goods	$ 300,000	50%	$ 150,000
- Retail or Wholesale (F. Goods)			
- Blanket Lien	________		________
- **Total Inventory**	**$ 300,000**	**Net Collateral Value**	**$ 150,000**
- Manufacturing			
- Office, furniture and fixtures	$325,000	30%	$ 97,500
- Less Superior Encumbrances	$ 0		
	________		________
- **Total Equipment Value**	**$ 325,000**	**Net Collateral Value**	**$ 97,500**
- Land	$ 75,000	80%	$ 60,000
- Property and Plant	$550,000	80%	$440,000
- Leaseholds			
- Less Superior Encumbrances	$ _______		________
- **Total Real Estate Value**	**$ 625,000**	**Net Collateral Value**	**$ 500,000**

Module 2
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	Book Valuation (From Financial Statements)	Realization Percentage	Net Valuation
- 0 - 30 days	$135,000	80%	$108,000
- 30 – 60 days	$ 70,000	80%	$ 56,000
- 60 – 90 days	$ 50,000	80%	$ 40,000
- 90 – 120 days			
- Over 120 days			
- Blanket Lien	________		________
- **Total Receivables**	**$255,000**	**Net Collateral Value**	**$204,000**
- Raw Materials			
- Work in Progress			
- Finished Goods	$ 300,000	50%	$ 150,000
- Retail or Wholesale (F. Goods)			
- Blanket Lien	________		________
- **Total Inventory**	**$ 300,000**	**Net Collateral Value**	**$ 150,000**
- Manufacturing			
- Office, furniture and fixtures	$325,000	30%	$ 97,500
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	________		________
- **Total Equipment Value**	**$ 325,000**	**Net Collateral Value**	**$ 97,500**
- Land	$ 75,000	80%	$ 60,000
- Property and Plant	$550,000	80%	$440,000
- Leaseholds			
- Less Superior Encumbrances	$ _______		________
- **Total Real Estate Value**	**$ 625,000**	**Net Collateral Value**	**$ 500,000**

Module 2
Loan Structuring and Process of Commercial Loans

Collateral Assessment Recap:

Example

	Valuation	Realization Percentage	Net Valuation
Cash	$ ------	100%	$ -------
Accounts Receivable	$255,000	80%	$ 204,000
Inventory	$300,000	50%	$ 150,000
Equipment/Machinery	$ 325,000	30%	$ 97,500
Real Estate Value	$ 625,000	80%	$ 500,000
Total Net Liquidation Proceeds (A)	**$1,505,000**		**$ 951,500**
Less Gross Loan Balance (B)			$ 400,000
Net (loss) collateral			$551,500
Collateral Coverage A/B			2.37