

Pre and Post-Loan Closing and Servicing

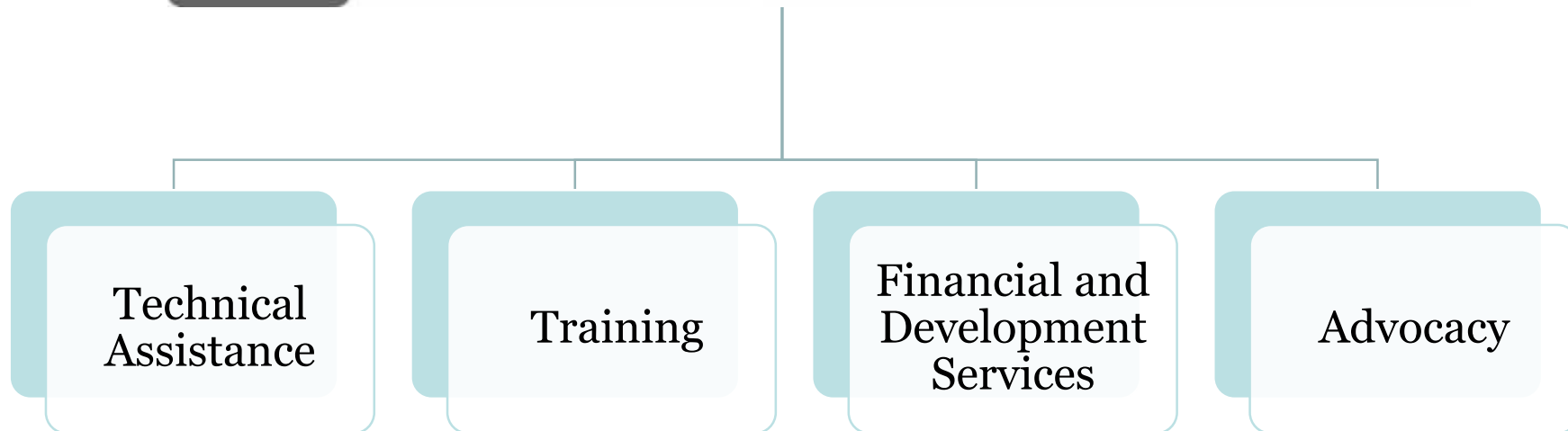
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Who Is NDC?



National Development Council

Partners In Community Development Since 1969



Technical Assistance

- **Create EDF systems**
 - **Business credit**
 - **Investment real estate**
 - **Affordable housing**
- **Deal structuring**
- **Negotiation and loan packaging**

Training

- **Four-course Economic Development Finance Professional (EDFP) Certification Program™**
- **Four-course Housing Development Finance Professional (HDFP) Certification Program™**
- **Professional Development and Online Trainings**
- **Customized courses**
- **Sponsored Training**
- **Entrepreneurial training**
- **NDC Academy**

Financial and Development Services

- **Grow America Fund (GAF)**
- **NDC Corporate Equity Fund, L.P. (CEF)**
- **Housing and Economic Development Corporation (HEDC)**
- **HEDC New Markets, Inc. (HEDC-NM)**
- **Public-Private Partnerships (PPP)**

Advocacy

- Advocate for community and economic development organizations and programs across the United States.



How Does NDC Work?

Contractual relationships

- Public entities
- Non-profit organizations

CLOSING AND SERVICING A LOAN

Awarding the loan is just the beginning of a longer process. This session will cover pre- and post-loan closing, including the documents that are needed in various collateral situations and the importance of file preparation. Also discussed will be establishing a servicing process to assure quick detection of issues within the RLF portfolio.

Loan Review Procedures for RLFs

- **Loan Review Process**
 - **Composition of the loan review committee**
 - **Officials of the RLF (director, etc.)**
 - **Private sector lender**
 - **Accountant**
 - **Local economic development officials**
 - **Realtor/appraiser/contractor**
 - **Architect/engineer**
 - **Small business person**

Loan Review Procedures for RLFs (cont.)

- **Loan review criteria**
 - **Application requirements fulfilled**
 - **Quality of venture**
 - **Probability of success and payback**
 - **10 credit questions**
 - **Is $CF > D/S$?**
 - **All potential risks and assumptions examined**
 - **Other pieces of financing in place**
 - **Terms and conditions of loan met**
 - **Loan is consistent with the RLF's goals and Administration Plan rules**

Closing an RLF Loan

Closing Process

- **Commitment letter review and pre-closing conference with borrower and borrower's attorney**
 - **Review all the terms and conditions of the commitment letter to insure borrower's understanding of the terms and agreement with them**
 - **Schedule a pre-closing conference with all lenders to identify and assign responsibilities for the documents among the parties**
 - **Pre-closing conference will actually save the borrower money and establish your credibility with other lenders**

Closing an RLF Loan (cont.)

Document preparation

- Closing the bank loan is the private lender's responsibility, but you must make sure it happens
- Closing the RLF loan is the responsibility of the Economic Development Staff person (or staff member assigned to program) and the RLF attorney - facilitated by creation of standard loan documents
- Standard loan documents - make sure your attorney reviews them for legal issues specific to your state

Closing an RLF Loan (cont.)

Closing

- Closing involves both signature of requirements and follow-up to insure mortgages and collateral documents are filed and recorded
- Bank and RLF closing can be done separately or simultaneously
- Biggest surprise - RLFs discover liens are not perfected because documents are not filed or not filed properly

Closing an RLF Loan (cont.)

- **Major Closing Documents**
 - Bank commitment letter
 - Promissory note
 - Loan agreement
 - UCC filing
 - Inter-creditor agreement
 - General security agreement
 - Opinion of counsel
 - Corporate guarantees
 - Personal guarantees
 - Hazard insurance and assignment



Closing an RLF Loan (cont.)

If you take Real Estate as collateral:

- **Deed of trust or mortgage (attach appraisal)**
- **Title insurance**
- **Survey of property**
 - **Can be other documents depending on structure, location and ownership of the project**
 - **Depending on deal specifics, all of these documents are not always needed**

Other Items that are good to obtain:

- **Life insurance policy and assignment, if required by loan**
- **Succession Plan**

Closing an RLF Loan (cont.)

Bank Commitment Letter

- **Contract between borrower and lender executed when loan was approved**
- **State terms and conditions**
 - **Property description**
 - **Loan amount**
 - **Term of loan**
 - **Rate of loan**
 - **Collateral**
 - **Guarantees required**
 - **Special conditions**

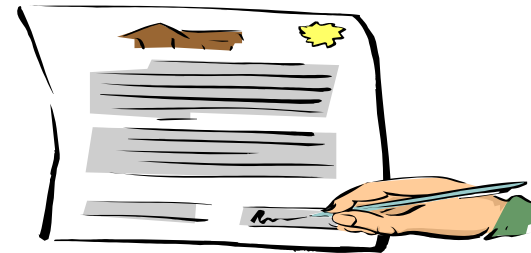
Closing an RLF Loan (cont.)

- **Protects lender by giving ways out of the commitment based on conditions of the company**
- **Common problems**
 - **Not detailed enough**
 - **No time limits to terms and conditions**

Closing an RLF Loan (cont.)

Promissory Note

- Business promises to repay debt (obligates borrower to the debt)
- Outlines monthly payments or refers to attached amortization table
- Defines
 - Amount of indebtedness
 - Collateral required

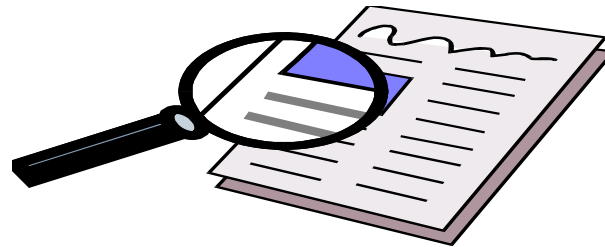


Closing an RLF Loan (cont.)

- **Outlines**
 - **Pre-payment terms**
 - **Default rights**
 - **Liquidation of assets**
 - **Late fees**
 - **Personal guarantees**
- **Common problems**
 - **Improper description of repayment terms**
 - **Improperly signed**
- **Can include a personal guarantee provision**

Closing an RLF Loan (cont.)

- **Loan Agreement**
 - Defines all terms and conditions of the loan
 - Includes representations and warranties that the borrower can legally borrow
 - Conditions of loan that must be met by borrower (legal documents)



Closing an RLF Loan (cont.)

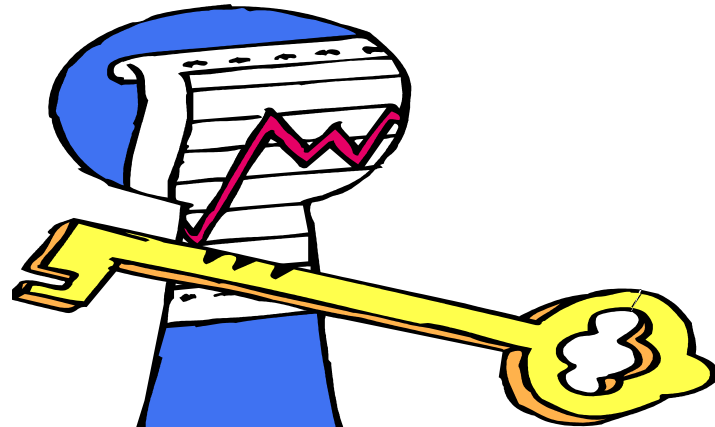
- **Covenants to Be Met or Prevented while Borrowing**
 - **Affirmative**
 - Pay loan
 - Pay other debts
 - Provide equity
 - Maintain site
 - Pay taxes
 - Overruns
 - Inspections
 - Provide regular financial statements
 - **Negative**
 - No extra debt
 - Cannot sell assets
 - No change in ownership
 - No change in project

Closing an RLF Loan (cont.)

- **Events of default - allows lender to accelerate or demand payment in full**
 - **Non-payment of RLF loan**
 - **Non-payment of other loans**
 - **False representations**
 - **Default on covenants**
 - **Insolvency**
 - **Judgments in excess of insurance coverage**
 - **Inability to get necessary permits**

Closing an RLF Loan (cont.)

Problem - lack of financial performance and financial reporting covenants (key to successful portfolio management)



Closing an RLF Loan (cont.)

- **Mortgage or Deed of Trust**
 - **Documents real estate collateral for loan and places a lien upon subject property**
 - **Provides legal description of property**
 - **Notice of lien must be filed with governmental unit with jurisdiction over real estate (typically the county)**

Closing an RLF Loan (cont.)

- **Must be supported by**
 - **Evidence of recording the lien (deed of trust)**
 - **Title report showing no prior liens**
 - **Title insurance guaranteeing a secure lien**

Closing an RLF Loan (cont.)

- **Common mortgage problems**
 - **Inaccurate description of the property - solved by having a current survey of property**
 - **Failure to record lien in county**
 - **When refinanced, failure to change or add new amount**

Closing an RLF Loan (cont.)

- **General Security Agreement for Financing M&E**
 - **Used to secure machinery and equipment (chattel) as collateral for a loan**
 - **Notice of lien must be filed with Secretary of State - some states also require filing with county**

Closing an RLF Loan (cont.)

- **Uniform Commercial Code Filings**
 - Notice to the world of your indebtedness
 - Legal filing of notice on machinery and equipment - perfects the lien
 - Description of collateral
 - Date is critical - first to file will be first satisfied

Closing an RLF Loan (cont.)

- **UCC is on personal property - mortgages on real estate**
- **UCCs expire every five years - date will be essential part of tickler file in loan portfolio management system**

Closing an RLF Loan (cont.)

- **Common problems**
 - **UCCs are not filed**
 - **UCCs are not renewed (every five years)**
 - **Improper collateral description**
 - **Check for previous filings**
 - **May need to file a blanket lien prior to the purchase of equipment if serial numbers are not available and re-file lien after purchase**

Closing an RLF Loan (cont.)

- **Inter-creditor Agreement**
 - **Outlines relationship of primary lenders to subordinated lenders**
 - **Specifies**
 - **Security positions**
 - **Events to occur in case of a default**
 - **Notification procedures**

Closing an RLF Loan (cont.)

- Shows that the public sector lender has power in any potential negotiation
- Common problem – inter-creditor agreement does not exist; not needed when RLF provides 100 percent of the financing

Closing an RLF Loan (cont.)

- **Opinion of Counsel**
 - **Loan is legally binding on the borrower**
 - **The business is properly organized and legal**
 - **The borrower will not violate any laws**
 - **The security deeds are legal and enforceable**
 - **There are or have not been any adverse actions**



Closing an RLF Loan (cont.)

- **Tips on Disbursement**
 - **Control how your dollars are spent**
 - **Think of who the end recipient is - make check out to the supplier, not the company**
 - **Make “periodic” draw vs. “lump sum” draw downs - especially on construction projects**

Closing an RLF Loan (cont.)

- **Counter checks signed by RLF as lender and the company as borrower**
- **Protect your collateral position!**
- **Contract financing - disburse directly to vendors and receive payments from contractors**

Closing an RLF Loan (cont.)

- **Escrow Accounts**
 - **Escrow accounts set up when funds cannot be disbursed at closing**
 - **Most common reason - go to closing but all documents not yet signed (time deadline requires closing)**
 - **Escrow may also be “normal” way of doing business for lender - e.g., HUD requires escrow accounts for some programs**
 - **Projects with several lenders may require that funds go into escrow to protect lien positions**

Closing an RLF Loan (cont.)

- **Critical issue - provide specific instructions to escrow agent regarding actions to be taken**
 - **Escrow agent can be bank or RLF's attorney**
 - **Escrow agent makes no decision - follows your directions**

Portfolio Management and Loan Servicing

Purpose of Servicing Your Portfolio

- Monitor performance of individuals loans
 - Continued repayment ability
 - Strength and condition of collateral
 - Adequate insurance coverage

Who does Portfolio Management/Loan Servicing

- Designated staff to work with businesses regularly and catch any small issues before they become big problems; or
- Outsource loans to Portfolio Management companies

Portfolio Management and Loan Servicing (cont.)

- **Preventive strategy - keep minor problems from becoming major problems**
 - **Active servicing is the best solution for delinquencies**
 - **Cost effective approach to safeguarding capital base and earnings potential**
 - **Invest in personnel to manage this task**

Portfolio Management and Loan Servicing (cont.)

- **Servicing Roles of the RLF Lender**
 - **Billings and collections**
 - **Use terms in note, coupon book system or contract out billing responsibilities**
 - **Enforce timely repayment with penalties for late payment - borrowers must perceive that you are serious about being paid**
 - **Develop clear and enforceable policies on delinquencies to ensure that collections are taken seriously**

Portfolio Management and Loan Servicing (cont.)

- **Key factor - ongoing portfolio management**
 - **Repayment ability of the loan - tracking of loan repayments**
 - **Status of collateral and guarantees securing the loan**
 - **Compliance with loan covenants**



Portfolio Management and Loan Servicing (cont.)

- Annual review process - ongoing portfolio management
 - Takes place within 60 to 90 days after the end of the borrower's fiscal year - divide portfolio by quarters, if possible
 - Identify non-fiscal year-end borrowers



Portfolio Management and Loan Servicing (cont.)

- **Involves the following steps**
 - **Spreading and analyzing financial statements**
 - **Updating credit and payment history**
 - **Verifying collateral and guarantee status (need updated personal financial statement)**
 - **Checking for loan covenant violations through financial statement analysis**
 - **Preparing status report**
 - **Developing action plan to correct delinquencies**
 - **Setting deadlines for steps in action plan**

Portfolio Review Summary Sheet

- **Borrower**
- **Type of Business**
- **Closing & Maturity Date**
- **Interest Rate and Payment Amount**
- **Adjustment Period Information**
- **Fiscal Year End**
- **Next Update**
- **Next Annual Review**
- **Current Classification**
- **Previous Classification**
- **Loan Officer/Servicing Officer**

Portfolio Review Summary Sheet (cont.)

- **Note: These Deadlines Must Be Entered into Tickler File**
 - **Date of Final Disbursement**
 - **Maturity Date**
 - **Due date for life insurance premium; review coverage**
 - **Due date for hazard and liability insurance; review coverage**
 - **Property tax(es) due**
 - **Lease renewal date**
 - **Updates on corporate and personal financial statements (including those of guarantors)**
 - **Check on corporate guarantees**
 - **UCC renewal dates (must renew every 5 years)**

Portfolio Review Summary Sheet (cont.)

- **Number of Jobs at Application Date**
- **Number of Jobs to Be Created** **As of**
- **Numbers of Jobs Created** **As of**
Minorities **Women**
- **Other Applicable Community Impact Thresholds**
- **Financial Statements (A,Q,NR)**
- **Requested**
- **Received**
- **Violation Covenant Requirement**

Portfolio Review Summary Sheet (cont.)

- **Financial Condition Concerns**
- **Loan Documentation Deficiencies: Changes**
 - Any changes in insurance?
 - Business license renewed?
 - Any changes in leases? Other?
 - Changes in ownership?
 - Has client incurred additional debt?
 - Property taxes current?
- **Site Visit**
- **Date**
- **Has Collateral Been Maintained?**

Portfolio Review Summary Sheet (cont.)

- Reason for Classification

- Corrective Action Plan

Site visits performed annually to discuss/update financial condition and examine loan collateral

- Compare existing collateral to collateral originally pledged
- Report on condition of the collateral
- Ask questions regarding future plans, other lenders

Portfolio Review Summary Sheet (cont.)

- **Loan classification system**
 - **Each loan classified based on**
 - **Payment status**
 - **Financial condition**
 - **Collateral value**
 - **Violation of financial covenants**
 - **Classification system becomes major management tool for identifying priorities for servicing in portfolio**
 - **Develop classification for loans that evaluates the relative risk/performance of the loans**
 - **Classify existing portfolio to identify problem loans and potential problem loans**

Portfolio Review Summary Sheet (cont.)

- **Managing delinquencies and workouts**
 - **Develop defined policies and written procedures to handle delinquent loans**
 - **Consider transferring responsibility from servicer to “work-out” specialist or committee**

Portfolio Review Summary Sheet (cont.)

- **Conduct new credit analysis to use as basis for generating possible workout strategies such as**
 - **Extend term**
 - **Lower rate**
 - **Deferral of payments**
 - **Partial moratoriums**
 - **Refinancing**
 - **Infusion of additional capital**
- **Work closely with senior lender(s) in developing strategy**
- **Prepare cost/benefit analysis to weigh different options (should undertake prior to abandoning collateral)**

Portfolio Review Summary Sheet (cont.)

- **Warning signs in portfolio loans**
 - **Drop in cash**
 - **Slow down in collections**
 - **Slow down in inventory turnover**
 - **Large increases in accounts payable or accruals**
 - **Rising debt to equity ratios**
 - **Shrinking margins**
 - **Increasing bad debt losses**
 - **Notices of cancellation of life insurance or other insurance**

Portfolio Review Summary Sheet (cont.)

- **Portfolio reporting**
 - **Depends on funding source**
 - **Monitor and report loan payments monthly**
 - **Monitor job creation and other economic development compliance issues**
 - **Prepare annual report on active portfolio**
 - **More emphasis on community impacts to satisfy non-traditional funding sources such as foundations, NMTC investors, etc.**

In Conclusion

- **Closing a Loan**
 - **Gather appropriate collateral documentation**
 - **Personal and Corporate Guarantees**
 - **Gather any leveraged lending info**
 - **Work with your attorney for all legal documents**
- **Portfolio Management**
 - **Visit Borrower and gather updated information on a regular basis (at least annually)**
 - **Contact borrower if there is a missed payment sooner rather than later**
 - **Keep a classification system to track good, bad and problem loans**
 - **Look to outsource Portfolio Management**
- **RLFs Improve Communities, Businesses and the Lives of Target-area Residents**

Contact

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