

## Pre and Post-Loan Closing and Servicing

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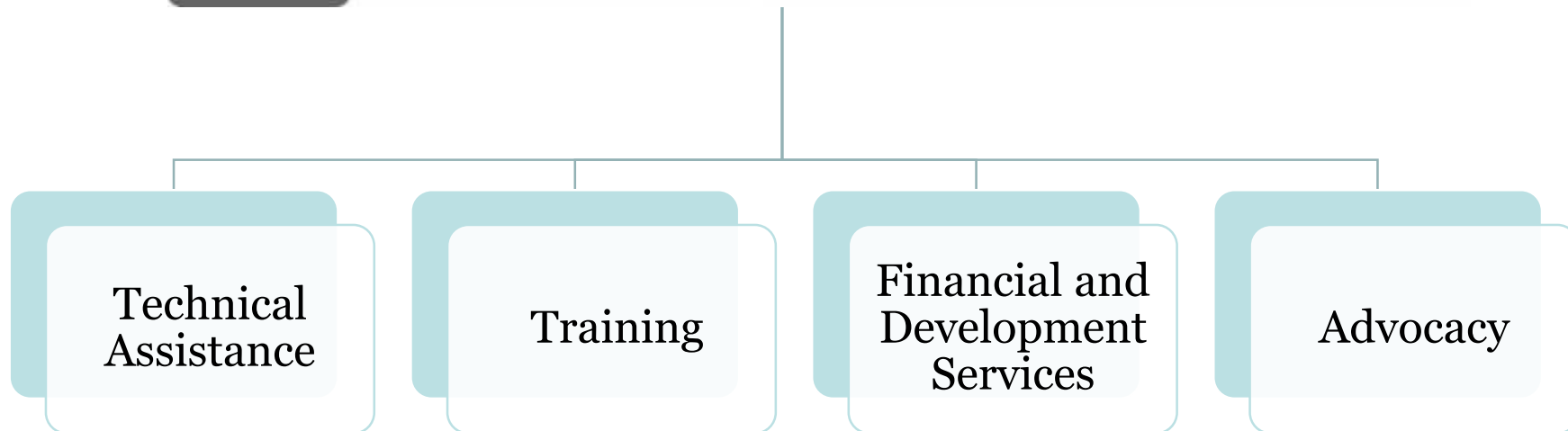
# Who Is NDC?

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## National Development Council

Partners In Community Development Since 1969



# Technical Assistance

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

# Training

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- **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

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- **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

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



# How Does NDC Work?

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## Contractual relationships

- Public entities
- Non-profit organizations

# CLOSING AND SERVICING A LOAN

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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

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- **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.)**

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- **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

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## 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.)

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## 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.)

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## 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.)

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- **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.)

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## **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.)

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## 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.)

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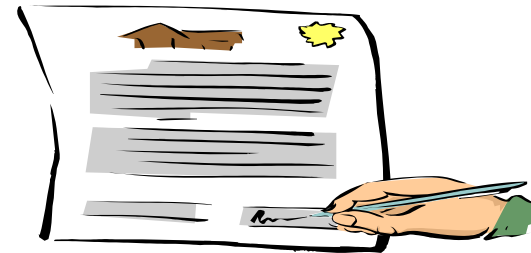
- **Protects lender by giving ways out of the commitment based on conditions of the company**
- **Common problems**
  - **Not detailed enough**
  - **No time limits to terms and conditions**

# Closing an RLF Loan (cont.)

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## 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.)

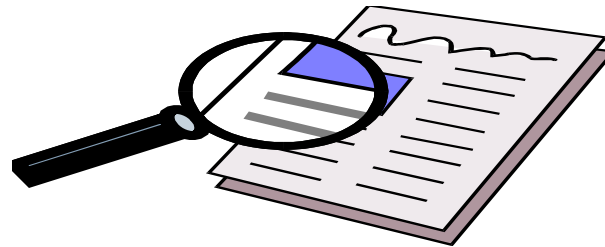
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- **Outlines**
  - **Pre-payment terms**
  - **Default rights**
  - **Liquidation of assets**
  - **Late fees**
  - **Personal guarantees**
- **Common problems**
  - **Improper description of repayment terms**
  - **Improperly signed**
- **Can include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

# Closing an RLF Loan (cont.)

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- **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.)

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- **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.)

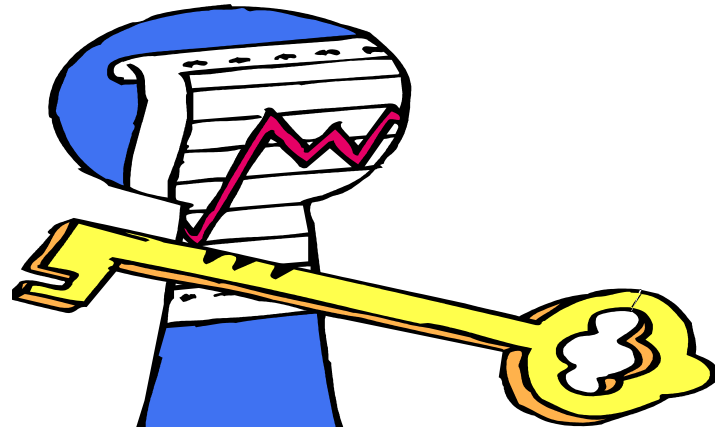
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- **Events of default - allows lender to accelerate or demand payment in full**
  - **Non-payment of RLF loan**
  - **Non-payment of other loans**
  - **False representations**
  - **Default on covenants**
  - **Insolvency**
  - **Judgments in excess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

# Closing an RLF Loan (cont.)

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



# Closing an RLF Loan (cont.)

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- **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.)

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- **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.)

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- **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.)

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- **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.)

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- **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.)

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- 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.)

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- **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.)

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- **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.)**

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- **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.)

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- **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.)

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- **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.)

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- **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.)

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- **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.)

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- **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

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## 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.)

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- **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.)

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- **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.)

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- **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.)

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- 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.)

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- **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

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- **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.)**

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- **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.)

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- **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.)

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- **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.)**

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- **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.)

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- **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.)

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- **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.)

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- **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.)

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- **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.)

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- **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

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- **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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