
PREPARING LOAN PROPOSALS

SECOND EDITION

John C. Wisdom



Preparing Loan Proposals

Second Edition

John C. Wisdom, M.B.A., C.P.A.



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Preface

Preparing Loan Proposals, Second Edition, contains practice-tested worksheets, checklists, and step-by-step procedure outlines that give you all the information you will need for successfully preparing, presenting, and negotiating loan proposals. For the experienced practitioner trying to deliver good work at a fair price, shortcuts are provided that explain key areas to be handled carefully and shows how to make the important decisions about banks, loans, and financing. In addition, this book provides:

- Banks, addresses, and phone numbers for micro lenders
- Limited guaranty details
- Contracts regarding collateral—the 45-day rule
- Consumer regulatory compliance
- Assessing the quality of earnings
- Commitment letters for loan negotiations

Benefit from the author's years of experience and find the numerous time-saving checklists and worksheets that will help you make more efficient use of your time. You will also find the chronological order of the material tells you what data to gather and how to organize and present it to successfully obtain financing for your client(s).

JOHN C. WISDOM

Dallas, Texas
February 1997

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John C. Wisdom is a Certified Public Accountant practicing in Dallas, Texas. He graduated from the University of Alabama in Tuscaloosa with a B.S. in Mathematics. He has a Masters in Business Administration from the University of Alabama in Birmingham. His certifications include: Registered Representative, Registered Investment Advisor, and life and health insurance license.

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1.1 INTRODUCTION

This book will help to prepare a well-documented loan proposal to obtain the loan needed. The book is designed with the following points in mind:

- *Time.* Saving the accountant's time, the firm's time, and the banker's time. As we know, "time is money." This manual will help maximize your time by guiding you in defining your goals, locating the proper financing sources, and packaging the loan properly.
- *Working Knowledge.* Assisting the firm in selecting the financial information appropriate for inclusion in the loan proposal, guiding the accountant in the detailed preparation of the loan package, and aiding the lender in accurate and efficient analysis of the data.
- *Obligation of Duty.* The firm, the accountant, and the lender have an obligation and responsibility to one another for professional interaction throughout the loan procedure.
- *Simplicity.* Assisting the firm in attaining its main objective: an approved loan. It will guide the accountant by selecting the appropriate financial data to be packaged and will assist the lender in obtaining meaningful and direct information.
- *Example.* Worksheets, sample forms, illustrations, charts, and checklists illustrate the process for successfully obtaining a loan.
- *Consideration.* Each party involved in the loan process is guided through professional interaction by an understanding of the other's viewpoint.
- *Character.* How best to "pull the deal through," whether from the viewpoint of the firm, accountant, or lender.
- *Patience.* The firm, the accountant and the lender must work patiently through the loan process, each understanding the other's limitations.
- *Perseverance.* Guiding your client through the loan process of gathering data, analyzing data, packaging the data, and selecting alternate loan sources.

(a) The Loan Process

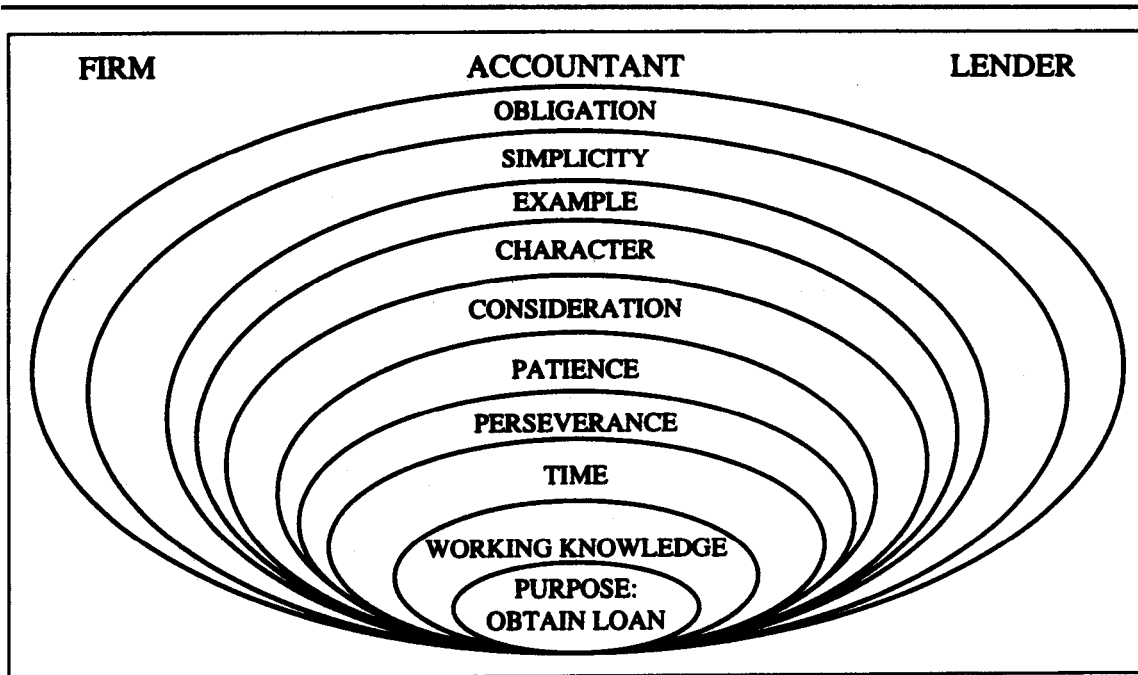
This book is not a standards book on how to prepare financial statements, nor does it explain the professional guidelines in preparing financial statements and the required disclosures. This book covers interactions in the loan process with the banker, and provides guidance concerning supplementary financial information other than the required financial statements. It is designed to illustrate additional financial information to aid the banker in his decision-making process.

(b) Elements of the Loan Process

Exhibit 1.1, Elements of the Loan Process, should be reviewed with the client in the formative stages of the loan process. Each party should retain a copy of the overall formative strategy.

The Loan Process Summary Points in Worksheet 1.1 should be completed with both the accountant and client determining their best "overall strategy." Develop and obtain agreement with the client on key areas such as consideration, patience, and perseverance.

Exhibit 1.1: Elements of the Loan Process



- Don't wait until the last second and "force" your information on your banker.
- When your banker is reviewing your information, be "politely" quiet, so he may concentrate on your numbers.
- Don't try to hurry or rush your banker into a decision.
- Show consideration by answering your banker's questions carefully and completely.

(c) Credit Availability

Good credit availability is one of the most valuable assets a business may have. Credit availability is not booked and does not show on the firm's financial statements. Good credit will not guarantee success but, abused credit may defeat many plans.

The accountant must know

- which lender to approach,
- the financial situation of the firm,
- what type of loan is most suitable, and
- the firm's ability to repay the loan.

The ultimate goal of the accountant is to obtain for the firm a loan stamped "approved" not "rejected."

Worksheet 1.1: Elements of the Loan Process Summary Points

Time:

1. _____
2. _____
3. _____
4. _____

Working knowledge:

1. _____
2. _____
3. _____
4. _____

Obligation of duty:

1. _____
2. _____
3. _____
4. _____

Simplicity:

1. _____
2. _____
3. _____
4. _____

Worksheets, forms, charts:

1. _____
2. _____
3. _____
4. _____

Consideration:

1. _____
2. _____
3. _____
4. _____

Character:

1. _____
2. _____
3. _____
4. _____

Patience:

1. _____
2. _____
3. _____
4. _____

Perseverance:

1. _____
2. _____
3. _____
4. _____

(d) Cash Flow

A Banker Speaks: Cash flow from operations is my number one concern. I want my loan to be repaid from cash—I do not want repayment from liquidating collateral.

Cash flow problems are one of the most critical issues facing a firm. Liquidity is not a passive variable, but is the lifeblood of the firm. To the lender, liquidity is the ability of the firm to service its debt. The lender must be convinced that the firm has the current assets to meet its debt obligations.

The lender will want to know whether the firm will have adequate cash receipts during the term of the loan to meet the required payments. The accountant must also convince the lender that should financial difficulties arise, the firm will have adequate financial flexibility and resources to survive.

1.2 ASSESSMENT CHART INDEX: QUESTIONNAIRE

Use this questionnaire (see Worksheet 1.2) to provide an overall feel of the condition of the firm and its ability to obtain financing. A high, solid point total provides positive assurance to proceed with the loan. A low point total may indicate inability of the firm to obtain financing at this time.

The questionnaire may be completed by the

Firm: Assessment of its own image

- A positive, strong, growing company.
- A stable company.
- A failing company.

Accountant: Professional analysis

- Assessment of borrowing ability.
- Timing of loan request.
- Depth of analysis to perform.

Lender: Professional view and "gut feeling"

- Categories of concern.
- Points to "pull the deal through."
- Can the firm repay the loan?

The questionnaire may also be completed by summarizing these viewpoints.

1.3 CAPITAL, CONDITION, CHARACTER, CAPACITY

Capital, condition, character, and capacity are the elements the lender considers when analyzing a loan proposal.

Worksheet 1.2: Assessment Chart Index

Business Ability to Obtain Financing

Company: _____ Date: _____

Analysis prepared by: _____

Firm: _____ Accountant: _____

Lender: _____ Summary: _____

Assess point values to each category by placing an "X" in the appropriate column.

| | | Points | | | |
|--|-----------|--------|---|---|---|
| | | 10 | 5 | 3 | 0 |
| I. How long has business been in existence: | | | | | |
| Over 5 years | 10 points | | | | |
| 2-5 years | 5 points | | | | |
| Less than 2 years | 3 points | | | | |
| New business | 0 points | | | | |
| II. Does business have other established banking or fund source relationships? | | | | | |
| Banking | 10 points | | | | |
| Other sources | 5 points | | | | |
| No current sources | 0 points | | | | |
| III. Rate current business general credit standing with vendors. | | | | | |
| Excellent | 10 points | | | | |
| Good | 5 points | | | | |
| Average | 3 points | | | | |
| Poor or not rated | 0 points | | | | |
| IV. Does business have a current Dun and Bradstreet rating? | | | | | |
| Excellent | 10 points | | | | |
| Good | 5 points | | | | |
| Average | 3 points | | | | |
| Poor | 0 points | | | | |
| V. What is business purpose for obtaining financing? | | | | | |
| Expansion—Growth Capital | 10 points | | | | |
| Operations—Working Capital | 3 points | | | | |
| Business Start-up—Risk Capital | 0 points | | | | |
| VI. Business risk rating: | | | | | |
| Growing, steady income assured | 10 points | | | | |
| Growing income likely | 5 points | | | | |
| Steady income likely | 3 points | | | | |
| Declining income | 0 points | | | | |
| VII. Company prestige: | | | | | |
| Outstanding reputation with long solid record of operation | 10 points | | | | |
| Satisfactory reputation with well established environment | 5 points | | | | |
| Average reputation and operation | 3 points | | | | |
| Recent start-up—no history | 0 points | | | | |
| VIII. Employees' perception of company: | | | | | |
| Aggressive with strong employee benefits | 10 points | | | | |
| Personable with average benefits | 5 points | | | | |
| Average with moderate benefits | 3 points | | | | |
| Provides minimum benefits | 0 points | | | | |

Worksheet 1.2: Assessment Chart Index (Continued)

| | | Points | | | |
|--|--|-----------|---|---|---|
| | | 10 | 5 | 3 | 0 |
| IX. Business desirability rating: | "Professional" business—Licensed professional | 10 points | | | |
| | Prestigious business in respected environment | 5 points | | | |
| | Respected business in satisfactory environment | 3 points | | | |
| | "No status" business—Dirty or rough work | 0 points | | | |
| X. Business profitability history and projection: | Excellent performance expected | 10 points | | | |
| | Strong trend likely | 5 points | | | |
| | Steady trend possible | 3 points | | | |
| | Inconsistent or possible losses | 0 points | | | |
| XI. Company growth: | Business has shown dynamic growth | 10 points | | | |
| | Business has shown steady, solid growth | 5 points | | | |
| | Business has remained relatively constant | 3 points | | | |
| | Business has shown decline | 0 points | | | |
| XII. How would business' key employees be evaluated by lender in relation to competence, experience, knowledge, and company loyalty: | Excellent | 10 points | | | |
| | Average | 5 points | | | |
| | Adequate | 3 points | | | |
| | Below Average | 0 points | | | |
| XIII. Has business provided lender a formal business plan? | Formal—written | 10 points | | | |
| | Informal—verbal | 3 points | | | |
| | None | 0 points | | | |
| XIV. Does business provide adequate and proper insurance? | Excellent in all important areas | 10 points | | | |
| | Adequate in key areas | 5 points | | | |
| | Average for business's industry | 3 points | | | |
| | Little or none | 0 points | | | |
| XV. Competitive rating: | Little competition in industry | 10 points | | | |
| | Normal competition | 5 points | | | |
| | Highly competitive in stable market | 3 points | | | |
| | Highly competitive in unstable market | 0 points | | | |
| XVI. Does business have strong internal accounting controls? | Excellent in most areas | 10 points | | | |
| | Formal in most areas | 5 points | | | |
| | Informal in some areas | 3 points | | | |
| | Little or none | 0 points | | | |
| XVII. Business industry or market: | Dynamic industry | 10 points | | | |
| | Industry outpacing inflation | 5 points | | | |
| | Industry stable | 3 points | | | |
| | Industry declining | 0 points | | | |

Worksheet 1.2: Assessment Chart Index (Continued)

| | | Points | | | |
|--|-----------|--------|---|---|---|
| | | 10 | 5 | 3 | 0 |
| XVIII. How does business' current ratio compare with industry? | | | | | |
| Well above average | 10 points | | | | |
| Above average | 5 points | | | | |
| Average | 3 points | | | | |
| Below average | 0 points | | | | |
| XIX. How does business' net income percentage compare with industry average? | | | | | |
| Well above average | 10 points | | | | |
| Above average | 5 points | | | | |
| Average | 3 points | | | | |
| Below average | 0 points | | | | |
| XX. Business' comparison with industry competitors: | | | | | |
| Excellent | 10 points | | | | |
| Good | 5 points | | | | |
| Fair | 3 points | | | | |
| Poor | 0 points | | | | |

Total Points: _____

Business Ability to Obtain Financing Summary

| Firm's Ability to Obtain Financing | Point Total Scale | Company Total |
|------------------------------------|-------------------|---------------|
| Excellent | 150-200 | |
| Good | 80-149 | |
| Average | 30-79 | |
| Poor | 0-29 | |

Business Loan Indicator

Darken in the "Yes" loan indicator below based on point total.

| Point Scale | | |
|-------------|-----|---------------------|
| 150-200 | YES | Excellent-Proceed |
| 80-149 | | See Recommendations |
| 30-79 | | See Recommendations |
| 0-29 | | See Chapter 8 |

Recommendation Analysis

| Item Number | Current Points | Recommendations for Improvement | Target Points |
|-------------|----------------|---------------------------------|---------------|
| | | | |
| | | | |
| | | | |
| | | | |

Total Current _____

Total Target _____

Conclusions

Company: _____

Accountant: _____

Lender: _____

- *Capital.* The capital attribute analyzes the financial strength or net worth of the firm. Capital represents the retained earnings, collateral, backing, or security that is available.
- *Condition.* The condition attribute considers the external situations or restraints. For the firm, it is the condition of the industry, the economy, or governmental regulations. For the bank, it is federal or state regulations and limitations. For the loan officer, it is his position or authority in the bank.
- *Character.* The character attribute is the reputation, conduct, or judgment of the firm. Does the firm have an outstanding reputation, excellent management skills, and positive past credit reports? Will the firm use the funds wisely? For the lender, consider whether promises are kept by the loan officers or broken, and whether the lender has a reputation of inflexibility or one of helpfulness and good working relationships.
- *Capacity.* The capacity attribute is the inflow of resources, or the ability to pay when obligations are due. For the firm, is the current and projected future income sufficient to cover the debt amortization? Is the income reasonably assured to continue? For the lender, capacity is the excess cash available to repay the loan; cash flow generated by the business cycle, not profit which may still remain in accounts receivable or inventory.

Use the sample Worksheets 1.3 and 1.4 to analyze the firm's credit risk. Use the sample worksheets 1.5 and 1.6 to analyze the target lender. Select the criterion and assign weights based on your experience and the particular needs of each analysis.

The following sample credit risk assessment charts illustrate the completion of typical examples.

(a) The "Cs" of Bad Credit

The following are the 5 Cs of bad credit. These are considerations that the lender will analyze in its attempt not to make a bad loan decision.

1. *Complacency.* Will the loan officer fall into the trap of saying the customer has always paid on time in the past, and assume the same in the future?
 - Will the lender place too much emphasis on past performance? Past success does not guarantee future success.
 - Overreliance on large net worths?
 - Overreliance on guarantors?
2. *Communication.* The lender will seek to have clear credit quality guidelines, like certain loan-to-value ratios.
 - The owner and the banker must communicate openly and honestly.
3. *Contingencies.* The lender will try to analyze all the bad things that can happen and the likelihood of those things occurring.
4. *Carelessness.* The lender will seek not to become complacent regarding loan covenants and documentation.
 - Lack of current financial information.
 - Lack of protective loan covenants.
 - Lack of documented calls and contacts.