CREDIT ANALYSIS BASICS

Presented by: Osburn & Associates, LLC
DAVID L. OSBURN, MBA, CCRA

David Osburn, is the founder of Osburn & Associates, LLC that specializes in providing seminars, webinars, and keynote speeches to bankers, CPAs, attorneys, and credit managers on topics such as Banking/Finance/Credit, Negotiation Skills, Marketing, and Management.

David also functions as a Contract CFO and works with financial institutions, CPA firms, construction companies, and real estate developers. He is also an adjunct faculty member of both an accredited MBA program and the accounting department of a community college with over 29 years of teaching experience.

David’s extensive professional background includes 17 years as both a Business Trainer and Contract CFO and 16 years in banking (commercial lending) including the position of Vice President & Senior Banking Officer.

David has an MBA in Finance/Marketing from Utah State University and a BS degree in Finance from Brigham Young University. He is also a graduate of the ABA National Commercial Lending School held at the University of Oklahoma.

David also holds the professional designation of Certified Credit and Risk Analyst (CCRA) as granted by the National Association of Credit Management (NACM).

Osburn & Associates, LLC
A Business Training & Contract CFO Firm

7426 Alamo Summit Drive
Las Vegas, Nevada 89129

Direct: (702) 655-1187
E-Mail: dlosburn@cox.net
Web: dlosburn.com
I. The Lending Function

A. Defined: Includes various types of credit: consumer, residential (mortgage), and commercial (business)

1. Installment Loans (Closed-End Credit) Ex. Auto Loans, Boat Loans, 1st T.D., 2nd T.D. Mortgage Loans, Equipment, CRE

2. Revolving Lines (Open-End Credit) Ex. Home Equity Lines of Credit, RLC

3. Credit Cards Ex. Visa, MasterCard

4. Other: Personal Unsecured Lines of Credit, Bill Consolidation Loans, Student Loans, Equipment Financing, Letters of Credit
## II. The Five “Cs” of Credit aka Loan Underwriting

<table>
<thead>
<tr>
<th></th>
<th>Consumer</th>
<th>Residential</th>
<th>Commercial</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>A. Capacity:</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>B. Capital:</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>C. Collateral:</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>D. Conditions:</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>E. Character:</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
III. Using the Five “Cs” of Credit to Make Loan Decisions

A. Capacity (Cash Flow):

1. **Consumer**: Debt to Income Ratio vs. Credit Scoring

   Debt to Income Ratio: Ex. 50% max, 42% max

   Credit Scoring: Ex. FICO 350 to 850

2. **Residential**: Debt to Income Ratio (house vs. “combined”)

3. **Commercial**: EBITDA (Minimum DCR = 1.20X) (See below)

   Credit Scoring: Ex. 160
A. Capacity (Cash Flow) (Continued)

EBITDA (Traditional Cash Flow)

<table>
<thead>
<tr>
<th>Description</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>EBITDA</td>
<td>$1,200M</td>
</tr>
<tr>
<td>Less Debt Ser. (P&amp;I)</td>
<td>500M</td>
</tr>
<tr>
<td>Margin</td>
<td>$700M</td>
</tr>
<tr>
<td>DCR</td>
<td>2.4X</td>
</tr>
</tbody>
</table>

Note: Most lenders want to see a minimum company DCR of 1.20X.
A. Capacity (Cash Flow): (Continued)

Personal Cash Flow (Business Owner/Guarantor)

Salary + Business Income+ $500M
Rental Income, etc. = Total Income

Less: Federal & State Taxes 150M
Cash Flow Available $350M
For Debt Service

Less: Debt Service (P&I) $200M
Margin $150M

DCR 1.75X

Note: Most lenders want to see a minimum guarantor DCR of 1.00X-1.40X
A. Capacity (Cash Flow): (Continued)

**Global Cash Flow**

**Business Cash Flow + Personal Cash Flow (Business Owner/Guarantor)**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>EBITDA</td>
<td>$1,200M</td>
</tr>
<tr>
<td>Less: Debt Ser (P&amp;I)</td>
<td>$500M</td>
</tr>
<tr>
<td>Margin</td>
<td>$700M</td>
</tr>
</tbody>
</table>

**Personal Cash Flow:**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash Flow Available For Debt Service</td>
<td>$350M</td>
</tr>
<tr>
<td>Less: Debt Service (P&amp;I)</td>
<td>$200M</td>
</tr>
<tr>
<td>Margin</td>
<td>$150M</td>
</tr>
</tbody>
</table>

Combined Margin $850M

Combined DCR 2.21X
B. Capital (Debt Level vs. Equity Level):

1. **Consumer & Residential:**
   
   Equity in Real Estate: Ex. Home Equity Loan or Line of Credit

2. **Commercial:** Debt to Equity Ratio (Max. = 3.0)
C. Collateral:

1. Consumer & Residential

   Auto Loan: Down Payment? 100% Financing?

   Home Equity Loan: 75%-85% max LTV?

   (Purchase Money vs. Refinance Situation?)

2. Commercial: Personal Property (UCC-Filing) vs. Real Property (Mortgage Deed or Trust Deed)
D. Conditions:

Local:

Regional:

National:

International:
E. Character:

1. FICO Score- Accurate? Fair?

2. Other:
   a.
   b.
   c.
IV. Loan Structure

A. Borrower’ Needs

B. Type of Loan: 
   Open-end or Closed-end

C. Amount of Loan

D. Term of Loan

E. Pricing: Fixed or Variable Rate

F. Collateral

G. Other: Automated Loan Payments?, Credit Insurance Protection?
V. Loan Support

A. Consumer: (Auto Loan)

1. Promissory Note

2. Title to Vehicle (Bank named as Lien Holder)

3. Insurance in Place

B. Residential: (Mortgage)

1. Promissory Note & Mortgage/Deed of Trust in Place

2. Value Established via Appraisal

3. Insurance in Place
C. Commercial:

1. Promissory Note & UCC-Filing on A/Rs, Inventory, FF&E

   Promissory Note & Mortgage/Deed of Trust in Place

2. Value Established via F/Ss, BBC, Appraisal

3. Insurance in Place

4. Guarantee
VI. Loan Documentation

A. General:

1. Complete all documents - per bank policy and state/federal law

2. Prepare all documents in an efficient, accurate, and professional manner

3. Ensure that the customer understands “how the loan works.” The lender’s role as an educator!

4. Create a positive image for the bank

5. Use the opportunity to “cross-sale” other bank products (marketing efforts)
VI. Loan Documentation (Continued):

6. Promissory Note (Contract): Consumer, Residential, Commercial

Components:

A. Genuine mutual assent (Offer & Acceptance)

B. Legal contractual capacity

   1. Minors
   2. Drunken/drugged individuals
   3. Insane persons

C. Consideration (of value) (20% rule!)

D. Must be legal

E. Must be in writing (sale of land, guarantee other’s debts, more than one year, over $500)
VI. Loan Documentation (Continued):

B. Documentation Examples:

1. **Consumer: Fixed Rate Closed-End Ex. Auto Loan**
   
a. Promissory Note  
b. Security Agreement (and vehicle title)  
c. Truth in Lending Disclosures Ex. APR, Finance Charges, Payments  
d. Insurance Policy

2. **Consumer: Variable Rate Ex. Home Equity Line of Credit**
   
a. Promissory Note (with appropriate disclosures)  
b. Deed of Trust  
c. Rescission Notice  
d. Title Search  
e. Appraisal  
f. Flood Determination  
g. Insurance Binder/Certificate
3. **Consumer**: Fixed Rate Ex. Mortgage

   a. Promissory Note (with appropriate disclosures)
b. Deed of Trust
c. Title Search
e. Appraisal
f. Flood Determination
g. Insurance Binder/Certificate

4. **Commercial**: Fixed or Variable Rate Ex. RLC, CRE

   a. Promissory Note 
b. UCC-Filing, Deed of Trust 
c. UCC Search, Title Search 
d. FMV Established (Unsecured, F/Ss, BBC, Appraisal) 
e. Flood Determination 
f. Insurance Binder/Certificate
VII. Loan Compliance

Regulations

A. Reg B (Equal Credit Opportunity Act)

Prohibited Basis:
VII. Consumer Loan Compliance (Continued):

B. Reg Z (Truth in Lending Act)
   APR, Finance Charges, Payments (The “Black” Boxes)

C. Real Estate Settlement Procedures Act (RESPA)
   1. TILA-RESPA Integrated Disclosure (TRID) Rule
   2. Truth in Lending Act (TILA)-Real Estate Settlement Procedures Act (RESPA)

Consumer Financial Protection Bureau (CFPB) (Dodd-Frank Act)
VII. Consumer Loan Compliance (Continued):

D. BSA (Bank Secrecy Act): CTR, SARs

(On-Line)

E. Fair Credit Reporting Act (FCRA)

F. Unfair or Deceptive Acts or Practices (Federal & State Consumer Protection Laws)
VIII. Real Life Loan Case Studies

A. Consumer: Auto Loan

1. New auto, consumer wants low interest rate, long-term, no money down

2. Debt to Income ratio = 48% including new auto loan payment

3. FICO score = 575

4. Note: Consumer is next door neighbor to bank president
VIII. Real Life Loan Case Studies (Continued)

B. Residential: Home Loan

1. Wants 30 year amortization, low interest rate, low fees paid
2. Debt to Income ratio = 30% including new loan payment
3. LTV = 95%
4. FICO score = 825
VIII. Real Life Loan Case Studies (Continued)

C. Commercial: Revolving Line of Credit

1. $100M
2. Company has been in business 18 months
3. DCR = 1.30
4. LTV = 55% (based on BBC)
5. Guarantor has personal FICO score of 625
IX. Conclusion:

Bank Lending is vital to:

A. An economy - world, national, regional, local

B. An industry

C. An individual company

D. A household

E. An individual person