

HOW TO USE THIS MANUAL

This manual was written to help you be a more effective commercial loan officer. We intend for you to use it as a desk reference — that is, for you to keep it at your fingertips and to refer to it several times a week. It contains answers to literally hundreds of questions that routinely arise at a commercial lending desk. In other words, we want to make it as easy as possible for you to do your job. As you use the manual, you will understand that the chapters are written and the manual is organized with this objective in mind.

PART I: DUTIES AND RESPONSIBILITIES

We begin the manual with five chapters of material relating to duties and responsibilities that are inherent in commercial lending functions in a bank.

1. **Commercial Loan Officer's Duties and Responsibilities.** In this chapter we describe all the functions that must be accomplished in the commercial lending area. We show you how these functions should be organized for efficient commercial lending in your bank.
2. **The Fundamentals of Loan Underwriting.** Chapter 2 leads you step-by-step through the processes involved in underwriting loans. The emphasis is on commercial lending, but the processes spelled out in this chapter apply to the underwriting of any type of loan. This chapter contains material that needs to be thoroughly understood by every person involved directly or indirectly with making or administering loans.
3. **Loan Grading Procedures.** Every bank needs an effective method of grading all the loans in the bank on an ongoing basis. This is the only way management and the people involved in lending can continually know the quality of the bank's loan portfolio. An effective and efficient loan grading method is the starting point for all loan portfolio administration procedures. The system we outline in this chapter is both pragmatic and easy to implement.
4. **Marketing Commercial Services.** It is a fact of life that loan officers must play a key role in a bank's marketing and new business development programs. In this chapter, we spell out in detail how this should be done.
5. **Coping with Bank Examinations.** Banks can take much of the hassle out of bank examinations and improve the results of their examinations as well. In this chapter, we recommend ways to do this from the perspective of the commercial loan officer.

PART II: HOW TO MAKE GOOD LOAN DECISIONS

Part I pertains to commercial lending, but the material contained in Part I does not provide detailed guidance on how to decide whether a loan should be made or not. In Part II we change directions: We present six chapters that contain practical material to be used daily in support of effective loan decision processes.

6. **Commercial and Industrial Lending.** Commercial lending is a specialty and, in this chapter, we cover the details involved in this specialty. We suggest how a commercial loan officer might

analyze a commercial loan application, correctly structure commercial and industrial loans, and price them, and we address when to lend secured and when to lend unsecured. We also discuss how to avoid conflicts of interest, how to approach loans to new businesses, and what supporting credit material will be needed before a loan can be booked.

- 6A. **Credit Information Exchange.** The exchange of commercial credit information is a fundamental principle, totally dependant on exchanges of information by firms that grant increasingly litigious business environment.
- 6B. **Credit Files Administration.** Chapter 6B guides you through cleaning up and streamlining your credit files. During a bank visit, your author was appalled at the condition of the customer credit files. The senior loan officer mentioned that examiners had noted the disarray of the files, but that the bank had yet to address the problem. Getting these files organized will ensure that your bank is on top of its customer credit.
7. **Guidance on Specific Types of Commercial Loans.** The material in Chapter 6 applies to all commercial and industrial loans. It is necessary background material for Chapter 7. In chapter 7 we instruct commercial loan officers with regard to lines of credit, term loans, lending to contractors, lending to small businesses, Small Business Administration (SBA) guaranteed loans, loans against stocks and bonds, aircraft loans, and lending to the affluent.
8. **Structuring and Pricing Loans.** This chapter gives you detailed examples of the costs involved in commercial lending and gives instructions on how to structure and price commercial loans.
- 8A. **Loan Administrative Costs.** This chapter was originally written for bank CEO's. The CEO version establishes a procedure for estimating the various costs associated with running a bank. This material was modified for the commercial loan officer so that it emphasizes how one determines loan administrative costs. If you follow the procedure accurately, you should arrive at a three-digit estimate of loan costs.
9. **Letters of Credit.** This chapter spells out in detail the procedures that should be followed before a letter of credit is issued by a bank.
10. **Real Estate Lending.** Commercial real estate lending is a subset of commercial lending. In our opinion, all commercial real estate loans, except construction loans, should be made through the commercial loan department (not through a real estate loan department), and most of them should be made by the bank's commercial loan officers. Real estate specialists should be consulted regarding collateral valuation, marketability, environmental issues, and documentation of real estate collateral. In this chapter, we explain to commercial loan officers the similarities and differences of commercial real estate loans when compared to commercial and industrial loans.
11. **Agricultural Loans.** Agriculture is a special form of business. Agricultural lending is a special form of business lending. In this chapter, we discuss in detail how the following types of agricultural loans should be underwritten and administered: crop production loans, grain and crop inventory financing, cow-calf operations, feedlot loans, dairy lending, swine production loans, and poultry production loans.

12. **Lending with Insufficient Financial Statements.** Commercial loan officers should insist on adequate financial statements from their borrowers. Today, with microcomputers a common business fixture, there is no excuse for a business to operate with inadequate financial statements. Yet thousands of businesses operate this way and most of them will change banks before changing their internal procedures.

PART III: HOW TO DOCUMENT COMMERCIAL LOANS

Every loan the bank makes must be legally collectable and the bank's credit files must be established so that the documents needed to collect a loan are up-to-date and readily available. The resulting documentation system must then pass the scrutiny of loan review, auditors, and bank examiners. Part III of the *Commercial Loan Officer's Desk Reference* contains four chapters of loan documentation guidance specifically written for commercial loan officers and their assistants.

13. **Secured Lending Under UCC 9.** The Uniform Commercial Code is a comprehensive statute that details what banks must do to establish legal claims to personal property used as loan collateral. In this chapter, we outline the requirements of UCC 9 using language that loan officers and loan assistants can understand. This is important reference material for your bank's loan officers, loan assistants, collateral control personnel, and credit administration personnel.
14. **Documenting Specific Loan Types.** Chapter 13 covers the general requirements of UCC 9 as it explains how the law of secured transaction operates. Chapter 14 explains how UCC 9 applies when you are involved in any of 25 specific types of loans.
15. **Real Estate Loan Documentation and Closing.** This chapter does for real estate loans what the UCC 9 chapter did for real property loans. All loan collateral is either real property or personal property. If personal property is involved as collateral, UCC 9 applies. If real property is involved, mortgage law applies. In this chapter, we suggest how commercial loan officers should prepare the documents needed to perfect security interests in real property.
- 15A. **Documenting Home Mortgage Lending.** This chapter contains useful charts depicting different types of loans, categorized based on Regulation Z definitions of closed-end loans and open-end loans.
16. **Loan Agreements.** Most larger, complex commercial loans should have a loan agreement as a part of their documentation. In this chapter, we recommend when to use, and when not to use, loan agreements. We explain how to prepare an appropriate loan agreement, and provide a model loan agreement.

PART IV: HOW TO COLLECT PROBLEM LOANS

More than 90 percent of the loans made in a bank never cause any problems and would pay as agreed even if all supporting loan documents suddenly disappeared. But approximately 10 percent of a bank's loans become problems before they are collected. Part IV of this manual instructs loan officers in how to administer and collect their problem loans.

17. **Detecting and Classifying Emerging Problem Loans.** Problems must be recognized before they can be solved. In this chapter, we instruct loan officers in how to detect emerging problem loans and what to do when an emerging problem is detected.

18. **Problem Loan Administration.** This chapter assumes that the problem has been detected and explains how the problem loan should be administered. The chapter deals with analyzing the problem loan from the perspective of collecting it, and discusses meetings with the customer, how to develop workout plans, how to get customers to agree to the workouts, how guarantors should be handled during a workout, and how to analyze workout performance. There is a special section on the complexities of managing problem real estate loans.
19. **Collecting Problem Commercial Loans.** This is a follow-up chapter to Chapters 17 and 18. In this chapter, we assume that the workout plan has failed and the loan must be called. Based on this assumption, this chapter instructs commercial loan officers on how to call a bad loan, and it explains the various options that are available to minimize commercial loan losses.
- 19A. **OREO Management Policy and Procedures.** There are three situations in which it would be appropriate for real estate that is owned by the bank to be shown on its book as OREO (other real estate owned). In this chapter, we provide important definitions, as well as guidance on OREO administration and accounting procedures.
- 19B. **How to Manage Problem Agricultural Loans.** A lot of our client banks have portfolios of problem agricultural loans. This chapter explains the early warning signs and gives helpful information on loan workout procedures.
- 19C. **Sell Your Problem Loans.** This chapter discusses the pros and cons of selling problem loans rather than working them out.

PART V: HOW TO STAY IN REGULATORY COMPLIANCE

20. **Truth-in-Lending Compliance Procedures.** This chapter contains about 60 pages of practical material to be used by commercial loan officers as daily reference on the complex subject of truth-in-lending compliance. It is easy-to-read material that explains Regulation Z in considerable detail.
21. **Equal Credit Opportunity Act Compliance Procedures.** This chapter focuses on the Equal Credit Opportunity Act and procedures for staying in compliance with Regulation B.
22. **Other Consumer Protection and Related Compliance Procedures.** In this chapter we discuss compliance procedures for the Fair Credit Reporting Act, Fair Debt Collections Act, Regulation U and lending against stocks and bonds, the Soldiers' and Sailors' Relief Act, and the Community Reinvestment Act.
23. **Real Estate Settlement Procedures Act Compliance Procedures.** RESPA does two things: It specifies disclosures that must be made when a family's home is the collateral for a loan, and it prohibits certain types of business arrangements and kickbacks. In this chapter we explain how to comply with RESPA requirements.
24. **Other Real Estate Compliance Procedures.** This catch-all chapter discusses how to comply with Fair Housing Act, the Flood Disaster Protection Act, adjustable-rate mortgage lending requirements, home ownership counseling, real estate appraisal requirements, a defensive strategy against fair lending allegations, reverse mortgages disclosure requirements, and the Home Mortgage Disclosure Act.

24A. **Miscellaneous Compliance Issues.** In this chapter we provide information on compliance procedures for Regulation O, the Tax Reform Act of 1976, and the Bank Holding Company Act of 1956 among others.

PART VI: HOW TO ANALYZE FINANCIAL STATEMENTS

The next six chapters in the manual contain sound guidance on financial statement analysis, while taking the mystique out of financial statements.

25. **Introduction to Financial Statement Analysis.** This chapter starts with the equations: assets equal liabilities and net worth, and profits equal revenues minus expenses. It then defines these six components of financial statements and explains how they are measured, using generally accepted accounting principles. Chapter 25 develops and explains example financial statements for a proprietorship in a service business and a retail partnership.
26. **A Corporation's Financial Statements.** Using Chapter 25 as background, Chapter 26 explains how financial statements are derived for a manufacturing corporation. Chapters 25 and 26 explain the why and how of financial statement preparation.
27. **Spreading Financial Statements.** It is fundamental that business financial statements must be spread before they can be analyzed. In this chapter we explain the fundamentals of spreading the example financial statements that were derived in the previous two chapters.
28. **Analyzing Financial Statements.** The next step in the process is to analyze the financial statements using previously prepared spreadsheets. We explain how to normalize financial statements, how to use sources and uses as an analysis tool, how to reconcile a firm's working capital, how to reconcile the firm's net worth, and how ratio analysis works.
29. **Cash Flows from Financial Statements.** The material in Chapter 28 explains how financial statements have been analyzed for over 100 years. In Chapter 29 we present an alternative way of analyzing financial statements. Here we tell you how to calculate a firm's cash flows using its financial statements.
30. **Analyzing Personal Financial Statements.** Chapters 25 through 29 concentrate on how a loan officer analyzes business financial statements. This material does not apply to how personal financial statements should be analyzed. Therefore, in Chapter 30 we show you how to analyze an individual's net worth and incomes, the demands on incomes, and the lifestyle an individual lives vs. the lifestyle one can actually afford. You will find this chapter interesting and useful.

PART VII: MISCELLANEOUS

Part VII is the closing section of your manual. It contains chapters of miscellaneous material that cannot be appropriately classified under one of the first six subject specific parts of the manual.

31. **The Fundamentals of Commercial Leasing.** Inquiries we get from client banks often concern leasing. One of the points banks need to understand early on is that leasing is not lending. The differences are discussed in this chapter.
32. **Lending to Bank-Qualified Municipals.** Local governmental agencies (municipalities, counties, schools, flood control districts, volunteer fire departments, etc.) represent a lot of potential

commercial lending business, and when it is available it is the most profitable business in the bank. The potential here is huge. Please study this chapter carefully. Then, we suggest you make a few calls to get a feel for just how much potential business there is in the local area for your bank.

USER GUIDE

The User Guide explains how to use the CD-ROM. The CD contains all the chapters in the manual, the white papers from 1999 and 2000, and the Excel files that were used to generate the example figures in the manual.

APPENDIX

- A. **Example Files from the CD-ROM.** Appendix A contains a user guide to the Excel files on the CD-ROM that supports this manual. This material explains how to use the CD and the files on it, how to spread and analyze financial statements, to price commercial loans, and to keep tickler files on future important dates.