

SAMPLE LOAN APPROVAL MEMORANDUM FORMAT

Borrower: _____ Date: _____

Transaction summary

- ABOVE, identify the borrowing entity by its exact legal name. Consider “To be Named Entity (XYZ Project or Key Person’s Last Name)” if needed or if it is anticipated that a new legal entity will be formed to undertake the loan
- IN THIS SECTION, further identify the borrower with an abbreviation, short name or initials to be used in remainder of memo, if needed
- Describe the amount, type, terms, repayment agreement, interest rate and fees, collateral and purpose. If these items are need further explanation, be brief and focus on why these items are being proposed
- Identify any guarantors and the extent of guarantees (usually unconditional and unlimited—otherwise, describe any limitations)
- If a renewal and any terms are being changed, identify the existing terms
- If a renewal, identify the original amount and date of the loan. For lines of credit, provide a chart or identify usage levels (high, low and average balance)
- If a new customer relationship, identify how we obtained the opportunity
- For real estate projects or business acquisitions, provide a summary of the sources and uses of funds, while clearly identifying the equity provided by the borrower. (Details of the equity sources and full project budgets can be provided later in the memo)
- Outline any conditions precedent to funding or closing
- Identify any loan policy waivers or exceptions to be approved
- Identify any deviations (that may not be actual policy exceptions) from normal lending practices
- Outline any loan covenants or other forms of monitoring that are being proposed, as well as financial reporting (business and personal) to be required, such as tax returns, financial statements, and level of CPA involvement (audit, review, compilation, etc.)

Overall, this section summarizes the credit request in a brief format. A separate paragraph is suggested for each credit; however, common features of each credit [such as guarantor(s) or financial reporting requirements] can be identified in one paragraph. It is important to identify key issues and save explanations for other sections of the memo. Bullet points are acceptable.

Background/Sponsorship

- Provide a brief history of the borrower and its line of business, products and services
- Identify the entity's legal structure (partnership, LLC, S corporation, etc.)
- Identify the owner(s) and the percentage(s) of ownership
- Provide brief background(s) of owner(s), with attention to experience directly applicable to the loan request
- Identify key employees, managers, and professional advisors (CPA, attorney, etc.)
- Draw conclusions about adequacy, depth and succession of management

Banking relationship

- Describe the deposit relationship and all significant credits with a summary of your bank's payment experience, plus comments on adequacy of collateral (LTV, DSC), status of occupancy, stage of completion, borrowing base compliance, etc.

This is not intended to be a duplication of the information on the loan approval form. Instead, it is a narrative description of the extent and type relationship that the borrower has with your bank—including the length of time—in order to convey the relative importance of the customer to your bank.

Industry and market analysis

- Summarize the type of industry the borrower is in
- Identify unique industry risks or trends
- Discuss competitive issues that affect the borrower
- For real estate projects, discuss trends for the market where the property is located, including lease and vacancy rates, competitive projects under development, and other relevant market statistics. If the customer has engaged a feasibility study or analysis, summarize the key findings, and implications for the proposed loan

Financial Analysis

- Provide a full discussion of the strengths, weaknesses, and trends of the following financial statements:
 - Income statement
 - Balance sheet
 - Cash flow
- Include partial information or tables derived from the financial statement spreads (that are attached to the memorandum) for significant items that directly affect the proposed loan or overall financial performance, such as accounts receivable and inventory turnover, gross margin, sales growth, working capital, and balance sheet leverage
- If financial covenants are proposed, discuss the historical values for these ratios or measures, compared to the proposed amounts
- Focus on the ability of the borrower to repay existing obligations from internally generated cash flow (or any other primary or secondary source of repayment that is identified for large liabilities). This includes fully detailing significant obligations, including principal amounts due each year, pending balloon maturities, drawn and undrawn lines of credit, and any standby letter of credits

- Be sure to use one of the following appropriate forms of analysis given the borrower's business activity and the purpose of the loan:
 - *Commercial and industrial* credits should focus on UCA cash flow as opposed to "traditional cash flow" (net income + depreciation), EBITDA, etc.
 - *Commercial real estate* credits tend to focus on net operating income (NOI) for the proposed loan and any related borrower debt
 - *Residential builder* credits utilize the builder cash flow model and a full disclosure of lines of credit plus homes financed under these lines along with the location, approximate percentage of completion, and status (spec or presale) of each home
- Address usual or recurring capital expenditures and the ability of the borrower to fund them from internally generated cash flow
- Discuss any related party transactions. If dividends or distributions are made to the owner(s), detail how much was for income taxes (if a "flow through" entity) or for compensation and/or investment return

You should obtain full financial information on any materially related businesses and briefly summarize the financial condition.

Pro Forma Debt Service Coverage (or Primary Source of Repayment Analysis)

- Analyze "pro forma" or projected debt service coverage (DSC) based on funding and repayment of new debt and reasonable projection of cash flow available for debt service
- Use historical operating results or analyze projected financial results. The purpose of this section is to clearly demonstrate the capacity of the borrower to repay the loan under normal or expected conditions with reasonable margin for error
- Stress test the projections to determine the extent to which the projections may fall below expectations while allowing the borrower to continue to meet its financial obligations
- If the primary source of repayment is not cash flow-related, analyze the primary source (for example, a permanent loan take-out or seasonal contraction of working assets), THEN analyze DSC as the secondary source of repayment

Collateral or Project Analysis

- Provide a detailed description of the collateral, its location and value
- Describe the valuation method and source
- Establish a most likely value of the collateral at the time of default as opposed to at the time the loan is granted
- If a borrowing base is in place, summarize the most recent reports and pertinent trends
- Outline any potential difficulties associated with monitoring, obtaining control or possession of the collateral or with liquidating the collateral

Guarantor Analysis

- Discuss the following overall financial condition of any guarantors and relate this to their existing debt and the proposed new loan(s), including amounts, composition, and trends of:
 - Liquid assets (excluding retirement accounts)
 - ✓ **Consider re-valuing significant holdings of publicly-traded securities if several months have passed since the financial statement date, or if general market levels have changed materially**
 - Non-marketable securities or ownership in related businesses
 - ✓ **We should obtain full financial information on any material, related businesses and briefly summarize the financial condition**
 - Real estate assets, including personal residence
 - Retirement accounts
 - Other significant assets
 - Amount and type of significant liabilities
 - Any material contingent liabilities
 - Income, and cash flow items
- Compute and discuss the outside net worth of each guarantor
- Establish a most likely value of the collateral at the time of default as opposed to at the time the loan is granted
- Consider including brief tables of data to show more than one year of data for key items in the above discussion
- If either the primary or secondary source of repayment of the debt is the income of the guarantor, you must include a complete cash flow analysis of the borrower by using income tax return data which compares ordinary, recurring income to direct debt obligations and to contingent debt obligations in order to demonstrate sufficient income to cover all debt service
- A simple summary of the guarantor's financial statement without relating this to debt repayment ability is not acceptable unless the guarantor clearly has sufficient liquid assets to repay his direct and contingent debt without materially affecting his income—a rare situation

Key Risks and Mitigating Factors

- List the most important risks that could prevent orderly repayment of the loan and describe the mitigating factors that apply to each risk. Show how the risks are made acceptable by these factors or other elements of the loan structure or proposed pre-conditions, covenants, monitoring, and/or financial requirements. The following can be key risks:
 - Customer-specific
 - Transaction-specific
 - Industry-specific

Example: A key risk could be the death of the guarantor who is essential to the operation of his company, the borrower. A mitigating factor would be the assignment of death benefits of life insurance sufficient to repay the loan in the event of his death.

- Comment on reasons for approving policy exceptions noted in the Transaction Summary
- Comment on the overall adequacy of any of the following proposed factors:
 - Pre-conditions
 - Covenants or monitoring
 - Financial reporting requirements

Risk Rating Conclusion

- Discuss the risk rating that you are recommending, including the key issues that influenced your recommendation. This should be consistent with your financial analysis and the important credit issues itemized in the appropriate Risk Grade Worksheet
- If applicable, discuss reasons for recommended upgrade or downgrade

Summary and Recommendation

- Summarize the specific reasons why you are willing to recommend the loan for approval. These reasons or key points should have been fully discussed or analyzed in the previous ten sections of the memo

Business Banker's Signature

Credit Analyst's Signature (if applicable)

Business Banker's Name

Credit Analyst's Name

As you can see, the example format involves most of the lending factors and analysis that has been covered so far in this curriculum. Again, it is intended to be more of a checklist of potential items to address in the memorandum, because many loan requests do not warrant discussion in each of the areas listed.