Debtor-Proposed

Repayment Solutions

The Coming Paradigm Shift From Creditor to Debtor in Seasons of Default and Restructuring

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(NCARA.org)

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INTRODUCTION

It's About Time You Get a Little Attention – I'm very concerned about the near-term economy, and those businesses whose annual revenues are up to $10 million. This guidance is just a little common sense, and covers some of the basics the creditor (i.e., a commercial lender) is likely to follow and their expectations for you as a borrower. For my part in all this, I know what I'm talking about. I was a commercial banker involved with "Special Assets" or classified or troubled commercial loans of many shapes and sizes for nearly three decades, through the recessionary periods since the early 1980's. Also, as a Commissioned Creditor Examiner for the Federal Reserve Bank of San Francisco, at the time of the Great Recession up until 2021, I saw behind the scenes at large banks from Wall Street to the regional and smaller community banks. So, I know what's going on. This is my wheelhouse. And, hardly anybody will be paying any real attention to small businesses like yours during the next economic downturn.

Guidance for Small Business with Revenues < $10 Million

The Coming Debt Crisis – I believe the US Government is on an unsustainable debt path that will, due to any number or combination of shock events, effectively result in national and international debt crises. What do you think? Let's compare notes. You can find a list of my 20 shock risk events in the Addendum below. In short, in the next several years, due to the overwhelming case load of defaults coming, there will be a natural shift to the debtor to help come up with its own repayment solutions primarily through pro forma forecasting. The business owner that understands the banking system and how most regulated banks (must) operate, the better the odds of having a successful repayment strategy outcome that keeps you in business. I know there's a huge gap coming due to the higher, overwhelming, volume of debtors needing guidance vs. the level of assistance financial institutions can even offer. Because most debtors are not prepared sufficiently prepared to step up, the creditors will not be able to do their job well enough without all this mis-match causing a paradigm shift. The shift will be that the debtor will have to learn to prepare its own repayment solutions. And, that's where NCARA.org comes in. I'm going to do what I can to help create a stronger bridge between debtor and creditor, or the borrower and the lender. You may be quite surprised as you see behind the lender's curtain in this publication. Be certain to seek appropriate guidance and oversight of legal counsel in your financial affairs.

Paradigm Shift from Creditor to Debtor

You Must Have Your Say as to What is Appropriate in Terms of Your Ability to Repay – When it comes to debt resolution in periods of economic downturn, there's going to be gaping canyons between debtors and their creditors that causes a paradigm shift from the old model where creditors took the lead. Lenders are pretty good at getting loans approved in just days, if not minutes – depending on the size and complexity of a deal. Creditors, however, are not as good at getting the money back. This paradigm shift from the creditor taking the lead and formulating restructuring plans to that of the debtor preparing, presenting, and negotiating with creditors, will allow the debtor to repay the loans

they promised to pay. Debtors need to step forward, prepare, and take full responsibility for their debt repayment obligations. They should know that they are also entitled to negotiate repayment solutions on a regularly adjusted best-effort basis. In a severe downturn, debtors need to take charge and demonstrate ownership of their own debt repayment strategies. Debtors are expected to repay their obligations in full, even throughout periods of serious economic downturn, in good faith.

Coming Soon to An Economy Near You (Default and Restructuring)

Seasons of Default and Restructuring

Facing a World of Uncertainties and Shock Risk Events – With balance sheets laden with too much debt, facing a world of inflation and high costs, high interest rates, other uncertainties, and shock risk events, there will be a debt crisis. The debt crisis will result in economic turmoil and lead to 'seasons of default and restructuring'. The banking world will have to greatly enhance its debt repayment strategies to include debt repayment plans prepared by its borrowers. In fact, debtors, not creditors, will lead the way for resolution strategies going forward, as the creditors will be unable to otherwise manage the case-loads. You, the borrower, needs to be the one to call the shots on exactly how much and when you will repay on a best-effort and good-faith basis. Your repayment plans will have to be fully transparent, documented, and reasonably supported. As such, regulators are likely to consider these work-out plans as having been done in a safe and sound, or prudent lending manner. Work-out loan modifications are perfectly reasonable and expected by creditors. The debtor-prepared repayment plan may even include an orderly liquidation of assets, as that's often in the best interests of the creditors too. But these measures should be done right, within prescribed guidelines, and often under the direction and oversight of your legal counsel, and that of the creditor. That's the purpose of this publication, to show you how regulated lenders will likely be managing troubled loans. The marketplace will shift to having borrowers be responsible for preparing their own repayment plans during seasons of default and restructuring.

Deteriorating Asset Quality Credit Metrics on the Creditor's Financial Statements – With deteriorating asset quality credit metrics at financial institutions, it takes a lot of work and time for the creditor stakeholders to come up with the right repayment solutions. Creditors will need to seek additional exterior resources to service multitudes of underperforming borrowers. Don't count on the creditor's efforts to meet anyone's interests except their own. They will almost always put their interests first. You may get more attention for deal structuring when the creditor's credit metrics are still favorable (creditor has the capacity to work with you), but if the creditor's credit risk management practices become criticized by the regulators, it's a whole different story. They will often press you to exit your banking relationship with the creditor to right-size the creditor's financial performance. They are greatly concerned about their reputation and financial standing in the marketplace. The huge bonuses of senior and executive management are often tied to the creditor's financial performance. And, troubled loans are like 'pouring a bucket of water on the fire' each time a commercial loan becomes classified. The creditor's proposed repayment strategies may not be in your best interest, regardless of who is overly distressed. Don't be surprised if you find yourself in an 'automatic' foreclosure or liquidation environment, that mirrors that automatic (quick) approval you got in the first place. Miss a payment, and you're in default, paying the default interest rate, or worse. As deteriorating financial conditions arise in the economy, ask yourself if you think you're going to get the time and attention you deserve

when and if your financial institution's credit metrics become too stressed. You're not. So, beforehand, now, is the time to be prepared. Maybe you'll be one of those who will learn the hard way that the time to prepare is too late and has passed. You can still pick up the pieces and propose your own repayment plan assuming you know what you're doing.

When Loans are Rated 'Criticized or Classified' Due to Deteriorated Financial Conditions – As you can appreciate, financial institutions are regulated. Asset quality is often the big elephant in the room – commercial loans. Other risks include 'liquidity,' and 'interest rate sensitivity' as has been evidenced in the 2023 regional banking crisis. Concerns continue in 2024 as well. Most lenders are super experienced at understanding credit risk, structuring and monitoring your ability to repay pursuant to the terms and conditions outlined in Promissory Notes and Loan Agreements. Did you know that your loans are risk-rated accordingly? Once loans are criticized or even classified due to deteriorated financial performance, the clock really starts to click to get to resolution. This means that your creditor's new objective is to get your loan's risk rating upgraded back to a 'Pass' rating through adequate financial performance, or to a $0 balance through whatever means necessary. Lenders are required to be prudent, and maintain safe and sound banking credit risk practices. You will be required to fit within these so-called prudent terms and conditions. But where's your voice? Do you feel like you have a say? Have you ever spoken up? Would you speak up and drive repayment negotiations, especially if you're well-prepared? What are 'prudent' terms anyway? Will your repayment plans fall within the 'walls of reasonableness'? If you don't speak up, or know what you're doing, you and the lender could be missing out on the optimum repayment strategies. Therefore, you must have your say as to what is appropriate in terms of your ability to repay. What you think matters. When you're prepared, creditors will listen carefully to what you have to say. The challenge is that debtors often fail to understand what and how lenders think – especially during sensitive periods of economic downturns when pressures start to build. Hence, lenders will often take your financial statements and tax returns and come up with the repayment solution they feel is appropriate – for them, especially if the lender has a boat-load of criticized and classified loans. Yes, the lender likely holds the superior cards in the deck and can force your hand, but it's your signature on the Promissory Note and Loan Agreement. You do have more of a huge say in these negotiations as you're the one who promised to repay but you need to have the terms modified to fit your cash flow needs. However, you need understand what the lender sees from his side, and what he wants, so that you can show him what you intend to do. His conclusions may not actually be what works best for you at this time. The earlier you start this process the better the results you should expect. Unless you understand why the lender is offering what he offers, better yet, if you understand what you need and can pitch the appropriate repayment strategy, you will likely prevail and stay in business. You want a win-win result that's in everybody's best interest.

Are You a Zombie Business or Not? – So, step up, speak up, especially in times of serious economic stress. It is imperative that you, small business, stand-up and be responsible for understanding, preparing, and recommending debt repayment solutions with your creditors. Creditors need your assistance, and a cooperative win-win relationship is being prudent – even if the numbers are bad. Now, if your business is a 'zombie' business (no possible way of repayment), then, frankly, it's dead, and a cooperative self-liquidation (often with the creditor's assistance) may be in everyone's best interest too. You'll have to decide if it can somehow be brought back to life. If you can get a pulse, you may as well

approach your creditor and the two of you will have to decide if your plan is prudent or nonsensical. Yes, it's important and in the best interests for lenders to prudently work with their debtors and accept your best good-faith repayment recommendations. Again, in a downturn economy, it's unlikely creditors are going to be able to give you the necessary time and attention compared to those times when everything was going fine. You have to step up, even if you have a zombie business and get resolution. Regardless of your situation, as a small business owner, be an owner, and demonstrate it. Either way, you are capable so prepared and do your best. Be willing to step forward and offer solutions to your own repayment problems on a best-efforts basis. If you're a zombie business, there's only so much you can do anyway.

Debtor-Proposed Repayment Solutions (Pro Forma Cash Flow Statements)

Debtor-Prepared Pro Forma Cash Flow Statements

A Debtor-Prepared Pro Forma Cash Flow Statement is the Bridge for Repayment – This is all about the cash flow position at any given month or time. Commercial loans are typically structured to include regular financial reporting of business financial statements and tax returns, as well personal financial statements, and tax returns for guarantors. Such data are regularly analyzed, and if the creditor is doing his job correctly (i.e., monitoring) it should be apparent to all stakeholders when evidence begins to emerge of financial deterioration. At the end of the day, a well-prepared business cash flow pro forma statement is one of the strongest tools to use when negotiating a workout situation, loan modification, extension, or payment deferral. Sure, the creditors will always expect to have on file all required, appropriately prepared, financial statements and tax returns for the most recent year-end, and interim financial statements through the most recent quarter, together with any other required reporting. But special attention must be paid to your actual and pro forma or projected cash flows in a potential workout situation. A pro forma cash flow statement is the ability of your company to meet its estimated operational, investment, and financing activities. If you're in deteriorating financial condition, then you will have to make material adjustments to these activities and show the creditor the availability of cash, and when he will receive loan repayments.

Frequency and Quality of Financial Reporting – Depending on the severity of your financial condition, you may need to prepare the pro forma financial statements, including one for your cash flow, to include amounts, by month, for the next 12 months, quarterly, semi-annually, or annually. If there's risk of imminent failure, financial reporting on accounts receivable may be prepared daily as well. Cash flow statements will show the stakeholders your estimated cash position. This is no time to blow smoke by showing estimated amounts you think the creditor 'needs to see' (don't ever go there), when you know that's not accurate. Don't do it! Rather, be sure to show the cash position you honestly believe and expect to be there. Make sure you estimate the numbers you are very confident you can produce, regardless of how bad or good that may be. If it's bad, then so be it. That's why it's called a 'workout', meaning that there will need to be modifications to your loan documents that reflect your ability to repay. The creditor is already used to seeing deteriorating financial statements, so he won't be surprised at all. Once the parties have settled on the type of financial reporting is going to be provided, the cash flow statements, in particular, can be regularly refreshed as things change. Additional modifications can be made as well. Make sure you clearly understand that the pro forma cash flow statement reflects what you are truly comfortable with. Think about it. If you prepare and present your best case pro forma, the lenders are going to expect that performance, and will hold you to account for material variances. They may also not be all that forgiving if you come materially short. In other words, do not fudge and put numbers in there you think the lender expects to see there, that are too high. Put some

work into the pro forma projections, and 'own the numbers.' When they change, change the pro forma again, and send it in so the creditor is aware if you're off or not. Do not mess around with the numbers, especially when there's an economic downturn. Their job is to ensure your loans are returned to an acceptable "Pass" risk grade as soon as possible, or to a $0 balance. The more problem or classified loans the creditor has, the greater the pressure there will be on the creditor and you. You get the picture. There's going to be a ton of pressure on their end, and thus on you; expect it. Doing this wrong, by overestimating your cash position, will likely result in a stressed relationship, if not worse. So, figure out what you really expect to happen and tell it like it is – good or bad. After all, in the end it is what it is, and will be what it will be. In short, refreshed financial reporting is warranted anytime there are material changes to your operations, favorable or otherwise. The level of frequency for financial reporting (i.e., daily, weekly, monthly, quarterly, semi-quarterly, or annually) will likely depend on the level or severity of credit risk and size of the loans. The frequency will either increase or decrease as conditions merit – so always be ready.

Drilling Down into the Pro Forma Cash Flow Statement – The pro forma cash flow statement will focus on future cash receipts (inflows) and cash disbursements or payments (outflows), from activities in operations, investing, and financing. The net cash position from these activities at the end of the period will be added to the cash at the beginning of the period for the final period cash position. You will have documented, not what the creditor expects, but your best-estimated or most accurately estimated cash position for the respective periods. Make sure it is reasonable and that, barring any unforeseen emergency, you will hit those numbers. Be detailed, as appropriate. Such activities might include:

- *Operating Activities*: Include direct cash receipts from customers, and the collection of accounts receivable. Disbursements will include inventory purchases, general operating and administrative expenses, wage expenses, interest expense, and income taxes. Add the receipts, less the disbursements, to show the net cash flow available from operations.

- *Investing Activities*: Include cash receipts from the sale of property and equipment, the collection of principal on Notes Receivable, or the sale of any investment securities. Disbursements will include cash paid for the purchase of property or equipment, loans made to others, and the purchasing of securities. The difference in receipts and disbursements will be your net cash flow from investments.

- *Financing Activities*: Include cash receipts from any stock issuances or new borrowings, and cash disbursements from any stock repurchases, dividends or loan repayments. The difference in receipts and disbursements will be your net cash flow from financing activities.

A Simple Monthly Cash Flow Statement – For smaller, less complex small businesses, it's reasonable to prepare, say a simple monthly cash flow statement for each of the next 12 months (plus the 12-month total), and simply list all cash receipts (inflows) and cash disbursements (outflows) together. The cash inflows will include all cash sales, collections from accounts or notes receivable, sales proceeds from property and equipment, sale of investment securities, issuance of stock, proceeds from new borrowings, and cash from other sources – any and all cash received. The same holds true for the cash disbursements (outflows), including property and equipment purchases, investment securities purchases, inventory purchases, general operating and administrative expenses, wage expenses, interest expense, principal payments, and income taxes – any and all cash spent. Again, a debtor-prepared pro forma cash flow statement is the central bridge between the debtor and creditor; it's all about the cash. The pro forma cash flow statement will show the projected receipt of cash monthly, inclusive of all cash disbursements to vendors and operating costs, and debt repayment – the amount of debt that you can realistically repay at a given time over the pro forma period. This bridge, together with supporting financial documentation, should enable debtors to readily cross-over what can feel like a 'grand- canyon' between themselves and their creditors. During times of economic stress, effective repayment solutions are important to the financial well-being of all stakeholders. The repayment of your loans is in the best interest of the creditor too. Lenders need to avoid credit losses or charge-offs, and business owners want to stay in business.

Lenders Are to Prudently Work with Debtors

Recent Regulatory and Supervisory Guidance to Creditors – Creditors expect your full cooperation and assistance per the terms and conditions in the Promissory Note and Loan Agreement. They will likely or should want a win-win relationship based on prudent repayment terms. There may very well be a major disconnect from how you view your financial performance vs. what the lender thinks, especially if the numbers are bad. Debtors still must find a way to repay their obligations in full, eventually, but getting mutually acceptable repayment terms can be difficult. It's to be mutually acceptable. And you have a major voice in this process. Regulatory and supervisory agencies across the U.S. recently issued an Interagency Statement on April 7, 2020 regarding loan modifications during Covid19. Now, banks are allowed to do 'disclosable loan modifications' to work with their problem loan borrowers in a prudent manner, with 'safety and soundness' as their guardrails.

Interagency Statement on April 7, 2020 – "The agencies encourage financial institutions to work prudently with borrowers who are or may be unable to meet their contractual payment obligations because of the effects of COVID-19. The agencies view loan modification programs as positive actions that can mitigate adverse effects on borrowers due to COVID-19. The agencies will not criticize institutions for working with borrowers in a safe and sound manner. The agencies will not criticize

financial institutions that mitigate credit risk through prudent actions consistent with safe and sound practices. The agencies consider such proactive measures to be in the best interest of institutions, their borrowers, and the economy. This approach is consistent with the agencies' longstanding practice of encouraging financial institutions to assist borrowers in times of natural disaster and other extreme events although the agencies recognize that the effects of this event are particularly extreme and broad-based. The agencies also will not criticize institutions that work with borrowers as part of a risk mitigation strategy intended to improve an existing non-pass loan. Financial institutions have broad discretion to implement prudent modification programs consistent with the framework included in this statement." (Interagency Statement on April 7, 2020)

Disclosable Loan Modifications (DLM) – Regulatory guidance changed in December 2022 in the way regulated creditors reported and disclosed impaired loans. The DLM if for borrowers experiencing financial difficulty. These modifications include four ways: principal forgiveness, interest rate reduction, other-than-insignificant payment delays, and term extensions (or a combination thereof). DLMs show the four ways a creditor can participate with the debtor in developing repayment strategies. Loan forgiveness may include a charge-down of the amount owed to a lower balance, which helps with the ability to repay on the remaining balance. The difference can be repaid after the first portion is repaid. The interest rate, in a workout situation, could be reduced. Furthermore, payments can be temporarily deferred, or the repayment term extended.

Credit Risk Rating Classification System

Regulatory Guidance for Commercial Creditors

Creditors Assign Credit Risk Ratings to Commercial Loans to Manage Credit Risk – Commercial loans are assigned a risk rating for credit risk, or their expectations of being repaid as-agreed, or the risk of default. Creditor management is expected to run a 'tight' risk rating system, which means their assigned risk ratings must be both timely and accurate at all times (from loan origination until paid in full). Having such a system helps ensure or promote creditor safety and soundness. When the system is functioning properly it will help facilitate informed decision-making through measured credit risk ratings. Other purposes and functions of the system include credit approval, credit underwriting, guidance for price setting, relationship management, credit administration or credit administrator (CA), the creditor's allowance for credit losses (ACL), and the portfolio management information system (MIS). When we talk about credit risk rating accuracy and timeliness, the regulators insist this is a 'must.' Repayment risk is 100% dynamic and it changes when risk changes; hence, the risk ratings are subject to change anytime. Management is charged with ensuring that risk ratings change when they're supposed to change, and to the accurate rating. Each risk rating change must be well-supported and fully documented. You can begin to see how important your prompt remittance of your financial reporting covenants is to the creditor. If it can't measure your repayment risk, how can the creditor assign the right risk rating, and timely too? The creditor will likely need to follow-up with you to determine the root cause behind your underperformance so it can ensure the right modifications are in place. You can see how this is a two-way street, where the stakeholders need to work closely together. The lender's risk ratings will be well-documented and supported. Risk rating conclusions must reflect any credit risk weaknesses. If the creditor is doing its job, it will dig deep into the root causes. Keep that in mind as you communicate your debt repayment plan. Yes, it is okay to ask the creditor what your risk rating is currently. Knowing the rating will help you see building pressures.

Regulatory Credit Risk Ratings

Regulated financial institutions will have a risk rating system, usually numerical, that may include a Pass or acceptable rating (perhaps several levels of Pass). A loan properly underwritten may get a Pass rating, say 1 through 6. A loan secured by a Certificate of Deposit (cash) would be risk rated a 1. Different levels of a higher Pass risk would be rated 2 through 6. Furthermore, a loan that has some uncertainties may be designated as a Watch credit. A Watch designated loan means it is still a Pass rated loan, and when the uncertainties are cleared up, the Watch designation will be removed. Now for the fun part – the regulatory definitions of risk rating classifications (Source: Federal Reserve Bank, FDIC, OCC). A loan is a 'criticized' loan when it is rated Special Mention, and then it becomes a 'classified' loan when it becomes Substandard, Doubtful, or Loss. Creditors also call all these loans as being 'criticized loans' as well.

Special Mention (SM)

- Credit exposures that, while currently protected by the sound worth and paying capacity of the borrower, exhibit distinct weakening trends and or elevated levels of exposure, to external conditions

- If not checked or corrected, these identified potential weaknesses may result in deteriorated prospects of repayment

- These exposures require close management attention to avoid there becoming undue and unwarranted credit exposures

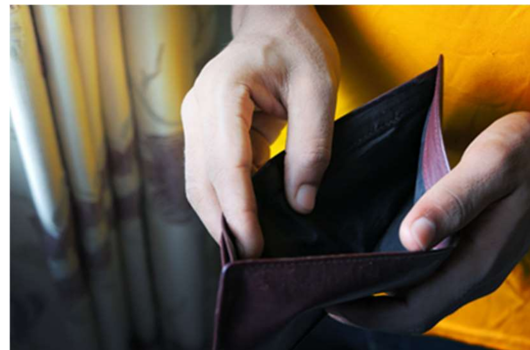
Example: Potential weaknesses in commercial real estate (CRE) loans may include construction delays, changes in concept or project plan, slower than projected leasing, rental concessions, deteriorating market conditions, impending expiration of a major lease, or other adverse events that do not currently jeopardize repayment. Such loans should receive an elevated level of monitoring.

Substandard (SUB)

- Credit exposure that is inadequately protected by the current sound worth and pain capacity of the borrower or of the collateral pledged, if any

- Exposures so classified must have a well-defined weakness or weaknesses that jeopardize the orderly repayment of the debt

- They are characterized by the distinct possibility that the creditor will sustain some loss if the deficiencies are not corrected



Example: Well-defined weaknesses in as CRE loan may include: slower than projected leasing or sales activity that may result in protracted repayment or default; lower than projected lease rates or sales prices that jeopardize repayment; changes in concept or plan due to unfavorable market conditions; delinquent property taxes; construction or tax liens; inability to obtain necessary zoning or permits necessary to develop the project as planned; diversion of needed cash from an otherwise viable property to satisfy the liquidity needs of a troubled borrower or guarantor; material imbalances in the construction budget; significant construction delays; the expiration of a major lease or default by a major tenant, without a replacement lease or remedy to default in the near term; poorly structured or overly liberal repayment terms; material collateral damage or other significant casualty losses; bankruptcy or replacement of the general contractor, major subcontractor, or suppliers; fraud or the misapplication of loan proceeds.

Doubtful

- Credit exposures classified as Doubtful have all the weaknesses inherent in one classified as Substandard with the added characteristic that the weaknesses may make collection or orderly repayment in full, based on currently existing facts, conditions, and values, highly questionable and improbable

- The possibility of loss is extremely high, but because of certain important and reasonably specific factors that may work to the advantage and strengthening of the exposure, its classification as an estimated loss is deferred until its more exact status may be determine

Example: Use a doubtful classification for a limited time to permit the pending events to be resolved; circumstances that might warrant a Doubtful classification for CRE loans could include collateral values that are uncertain due to a lack of comparables in an inactive market, pending changes such as zoning classification, environmental issues, or the pending resolution of legal issues that could affect the realization of value in a sale.

Loss

- Credit exposures classified as Loss are considered uncollectible and of such little value that their continuance as creditable assets are not warranted

- This classification does not mean that the asset has absolutely no recovery or salvage value, but rather it is not practical or desirable to defer writing off this basically worthless asset even though partial recovery may be affected in the future

- Losses should be taken in the period in which they surface as uncollectible

Example: As a general classification principle, for a troubled CRE loan that is dependent on the operation or a sale of the collateral for repayment, any portion of the loan balance that exceeds the amount that is adequately secured by the market value of the real estate collateral, less the cost to sell, should be classified as a loss if that portion of the loan balance amount is deemed uncollectible. This principle applies when repayment of the debt is provided solely by the sale of the underlying real estate collateral, and when there are no other reliable sources of repayment available.

Credit Risk Management – Roles and Responsibilities

Established 'Lines of Defense' to Ensure Accuracy and Timeliness – Internally, creditors may have various roles and functions for maintaining accurate and timely credit risk ratings. The first 'line of defense' will be your primary relationship officer (PRO), who is primarily responsible to continuously ensure the accuracy of the credit risk rating. This responsibility cannot be abdicated under any circumstance. This officer has the authority to recommend and approve credit risk changes, by carefully evaluating any perceived changes in risk characteristics. This includes upgrading or downgrading a loan' credit risk rating. The next 'line of defense' would be a rating validation from those individuals who have the (higher/highest authority to approve the loan. Such persons can change the credit risk rating if desired. A third 'line of defense' would come from individuals who belong to an independent group (generally reports to the board of directors, or committee thereof) called Loan Review, or Credit Review. Its risk rating decision is 'final' and overrides all other assigned credit risk ratings.

Deal Structure, Loan Approval, Leadership Support Team – CA staff are responsible to support the line lending staff in the review, structuring, and approval of credit requests. They serve as a 'second' line of defense as mentioned. CA ensures appropriate and consistent application of the lender's credit standards and credit policies. CA officials are in constant contact with the PROs in reviewing the loan portfolio, identifying early identification of potential problem loans, and review credit risk ratings. Once a loan is assigned a Watch designation for uncertainties, or even downgraded from a Pass rating to Special Mention or Substandard, CA will become more actively involved with the loan officer. The plan will be to assess the current situation, establish a written action plan (steps, completion dates) to get the credit risk rating back to a Pass rating, or exit the relationship altogether. These teams will also work together to analyze and determine the underlying root causes of credit deterioration based on the financial information reporting you provide. This may also include other sources besides financial reporting, like checking account activity, trade reports, market information, personal observations, and discussion interviews with you. Once your loan is downgraded to Special Mention, and especially Substandard, CA staff with work with the PRO on writing up regular (quarterly, monthly) repayment action plans. The purpose of these monitoring reports is to show how and why the action that will be taken to bring the loan back to a Pass rating or to a $0 balance as soon as possible. In those cases where a further downgrade or risk of nonaccrual (internally shutting off the accrual of interest) or loss is possible, a transfer of responsibility for the customer relationship from the PRO to another specialized department, called the Special Assets Department (SAD), may be appropriate and very likely.

Special Assets Team – While the PRO and CA teams will regularly service loans that are risk rated Special Mention and Substandard, on occasion, loans so rated that require 'extra time and attention' will likely be transferred to another group of specialist officers in SAD. This team will scale up, or down, as problem loan volume fluctuates over the years. They are equipped, depending on the size of the department, or otherwise have access to, legal professionals, appraisers, etc. In other words, when they feel a borrowing relationship is going to need additional work-out tools, legal maneuvers, collateral liquidation, or whatever it takes to force repayment, SAD can do the job. When the volume of problem loans overwhelms the creditor in a severe economic downturn, borrowers will be expected to propose their own repayment solutions (paradigm shift), which will be in everyone's best interest.

Commercial and Industrial Lending Evaluation

Financial Performance, Other Considerations

Creditor Analysis of Your Ability to Repay – Creditors will take a deep dive analysis into your financial performance of revenues, profit margins, income and cash flow, leverage, liquidity, and capitalization. They will look at the last three fiscal years and year-to-date (YTD) or the last quarterly performance to identify trends and anomalies that may have affected your past operating performance. Also, depending on the size and complexity of their lending exposure with you, creditors will uncover your repayment potential and their root causes, as applicable, for the following:

Cash Flow

- *Debt Service Coverage Ratio (DSCR - ability to repay); Global Cash Flow (individual and business); Interest Reserve (fund interest on construction loan)* – Creditors will monitor and know the adequacy of your ability to repay on a continuous basis. They will evaluate the cash flow trends, particularly declining trends, including a comparison to industry peer performance. They'll try to make sure any renewals or extensions are not just covering up repayment issues. They'll consider the level and trend of the DSCR in assigning a credit risk rating. In an economic downturn, it's possible you have placed increased repayment reliance from other (global) cash flow sources. Creditors will ensure they don't double-count your sources of cash flow. To do that, however, they will need to ask for your complete business and personal tax returns, including guarantors. They will be able to carefully review the financial contributory strength of all obligated guarantors, including individuals and legal entities. As for an interest reserve account, as applicable, the lender will confirm the reserve amount will be adequate for the needed financing period. They will make sure any cash flows generated from the collateral property go to service the debt, and continue monitoring the project lease-up. They, rightfully so, will be 'all over' any cash flow sources

Net Operating Income (NOI)

- *Stabilized NOI (fully leased with maximum rental income); Vacancy Impact (direct reduction of rental income); Operating Expenses (CRE maintenance); Debt Yield (DY: risk in deal, viability, stability)* – Lenders will focus on why units are vacant, for how long, and exactly how you intend on getting them leased. They will carefully review key (increasing) expenses from an historical perspective and ask you any necessary questions to understand these extraordinary expenses. As they monitor your loan's performance, they will compare the current DY to that of the original loan underwriting, and to policy underwriting thresholds for a similar new loan today. A low DY will require additional analysis and the guarantors will likely be asked to increase their personal guarantee, offering additional collateral, or even ask for resizing opportunity to increase the DY to policy norms. The creditor will look at the deal as if it had to take back the collateral property with the current DY, and see if that's not a problem that you'll be expected to fix. You need to fix it, because it's your problem, not the lender's

Profitability

- *Sales (top line revenue performance), Expenses (controlling costs), Profits (benefit)* – Lenders will measure efficiency and trends in sales revenues, gross and net profit margins, controlling other notable cost and expense ratios. They will determine the reason behind material changes in key metrics, identify material expense trend increases as a percentage of sales, and what the outlook is. They will understand what is driving the profit margins and what needs to happen in the future to improve the same. They will ask any necessary questions until they're satisfied, so be ready if you're not already prepared with the answers

Efficiency

- *Inventory Days (days to sell average inventory); Accounts Receivables Days (A/R days on hand); Accounts Payable Days (A/P days on hand, average time to pay trade suppliers)* – Lenders will request detailed inventory reports that can be used to conduct an inventory inspection by sample testing and to ensure accurate reporting; they will hold you to account for any material discrepancies. If there are material differences in the 'Days on Hand' (DOH) by comparison of values of similar, same industry companies, they'll dig deeper with an inspection. They will see if and how much functional or technically obsolete inventory is in stock. With a detailed current A/R ledger, and A/R Customer List reports on hand, they'll carefully analyze ineligible A/R (past dues, concentrations, etc.), and determine their collectability by asking you "how much, and when" for all material receivables. They want to have a clear idea of how much cash will be collected and by when. As suppliers obviously play a key role in the success of operations, they'll carefully analyze the A/P repayment capacity over time, to help determine how efficient you are operating, and if you're unable to pay your supplier creditors on time. Similarly, with an A/P Aging report in hand, you'll be asked "how much, and when" for material past due payables as to when these will be paid, and how that will affect future inventory purchases

Leverage

- *Funding Sources and Capacity (financial resources: earnings, debt capital, equity capital, to meet obligations; ability to manage finances)* – Lenders will determine the viability of each funding source and if those sources of capital are available or sustainable. They will determine how possible refinancing might be, and at what cost and on what terms. You'll be asked as either a sponsor or guarantor if you are both able or willing to inject additional capital. They'll check to see if the projected period to de-lever to a sustainable level is reasonable or acceptable. They will confirm if the cash flow analysis relies on overly optimistic or unsubstantiated projections, and even stress test the projections for a downside case. So, they will go deep. They will determine your ability to meet your obligations, and the extent of any variances to your performance plan. They will also document any poor structure elements of your loan, like limited or light covenants, and seek to install meaningful covenants going forward. Finally, they will check to see how vulnerable you are to a sharp economic downturn and any business cycle swings.

Liquidity

- *Sources (cash on hand, short-term funds, cash flow management, secondary sources, cash burn)* – Creditors will review your liquidity needs, if primary sources are sufficiently available, or if

secondary sources need to be liquidated to meet current obligations. This will include a review of current loan maturities, the size and timing of repayments, interest rates, uncollected receivables, and obsolete inventory. They will determine the root cause for liquidity problems. They'll analyze whether there's any net cash burn, confirm how much time is needed before returning to positive cash flow, and the sources to recapitalize. You'll be asked to defend the cash burn rate and how you intend to lower it

Performance to Plan (P2P)

- *Budget vs. Actual Variance Analysis (performance evaluation, expectation review*) – Variances need to be understood and explained as to why they occurred. The creditor needs to get and maintain confidence with your budgets, and whether they need to be 'stressed' or adjusted for the creditor's underwriting purposes (the lender's base case (stressed) pro forma). Will future pro forma forecasting be based on historical variances, and if not, what reasonable adjustments are necessary? Is the budget overly optimistic? If the creditor has any doubt, they will ask you questions. They will monitor any revisions to plan if necessary. Depending on your P2P results you may be asked to prepare a variance analysis on a monthly, quarterly, or annual basis

Pro Forma Outlook

- *Realistic Outlook (forecast future financial performance); Assumptions (projections, educated guesses); Cash Budget (budget plan on debt repayment workouts)* – During times of economic downturn, lenders will use pro forma statements to structure workout or loan modification repayment solutions. They will ensure these statements are conservative in both revenue and expenses, and include upcoming one-time expenses. Depending on how severe the current economic conditions are, you will be expected to prepare your own repayment plan supported by your pro forma statements. You should bring detailed, well-supported, and foot-noted explanations on the assumptions used. You can propose temporary repayment terms that are supported by the pro forma statements, with the updating and reporting frequency adjusted as necessary. Lenders will assign and adjust credit risk ratings as the repayment risk changes according to regulatory guidance. Under more extreme circumstances, you can use a cash-in and cash-out monthly budget to show possible debt repayment solutions

Management

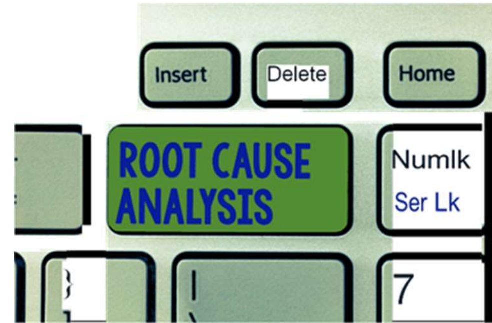
- *Succession Plan (transition of leadership)* – Economic challenges must be successfully unmanaged by skilled leaders, and creditors will need to understand your succession management tools and planning for all key positions, not just at the most senior level. Identify any recent or pending retirements, and how might those changes and their tangible contributions in staffing, impact your operations, and competitiveness

Competition

- *New or Pending Direct Competition (market share); Customers Lost to Competition (negative impact on borrower operations)* – New competition can affect your operations and ultimately your ability to repay your loans. Lenders will want to know the potential loss of market share because of lost customers, and the decline in revenue and profits. They'll determine if increased price competition is likely with new competitors that enter the market with lower prices,

affecting profit margins, and impact your repayment ability. Perhaps this will affect increased marketing and advertising expenses. They'll seek to understand the strategies you plan to use in being proactive in mitigating new competition risk, how you'll differentiate yourself from your competitors. That's a lot to ask for, so be ready. In fact, be prepared and ready to present your own repayment solutions before they even ask

Root Cause Considerations



Getting to Understand the Root Causes – Lenders seek to transact safe and sound underwriting, understand your company's management, your industry, all in conformity to the lender's credit policies, with any material exceptions adequately mitigated and documented. Underwriting is the process by which creditors structure a credit facility to minimize risks, and generate optimal returns for the risks they assume. Sound underwriting provides protections, such as coordinating loan repayment with the timing of your cash flows, effective use of financial performance and reporting covenants and having sufficient collateral, thereby increasing the likelihood of collection or full repayment. Management is also very important to creditors, as they want to understand and confirm your character, capability, and the stability of your management team. They consider your qualifications, experience, and effectiveness in developing and implementing appropriate business and financial strategies. Competency and integrity cannot be overstated. The ability of you and your management team to guide, exploit opportunities, develop, and execute plans, and react to market changes, is extremely important. For the creditor to succeed, they need you to succeed. Unexpected loss of even one or two key employees can be detrimental. Even the most experienced management teams can be challenged by high growth (common reasons for business failure), and other factors. Finally, creditors will seek to understand the conditions in which you operate your business, elements like cyclicality, competition, and technological changes you are likely to experience. Most industries exhibit some degree of cyclical volatility, and some industries are exposed to seasonal variances, too, affecting your operating performance and financial condition. Technological change and new competitors, or substitute products, also can affect your performance. When you prepare and present your own financial repayment plan, be sure to thoroughly address these factors (especially the root causes for any underperformance).

Structural Weaknesses and Underwriting Deficiencies; Be on the Lookout – Creditors will also be looking to identify any structural weaknesses in your loan(s). Structural weaknesses are underwriting deficiencies that can compromise a creditor's ability to control a credit relationship when economic or other events adversely affect the borrower. During an economic downturn, and especially during seasons of default and restructuring, creditors, and you, will quickly come to understand if there are structural weaknesses in your borrowing relationships. Here's what creditors will be reassessing as they address your ability to repay. Remember, they need to understand if there any structural deficiencies, as these can directly impact any negotiations you have.

So, why shouldn't you be aware of what the creditor is looking at too? Be on the lookout for an indefinite or speculative loan purpose; an indefinite or overly liberal repayment plan; nonexistent, weak, or waived covenants; inadequate debt service coverage (DSC); elevated leverage ratio; inadequate tangible net worth; insufficient collateral support; inadequate collateral documentation and valuation; overly aggressive loan-to-value (LTV) or advance rates; inadequate guarantor support; repayment highly dependent on projected cash flows; repayment is highly dependent on projected asset values; or repayment is highly dependent on projected refinancing or recapitalization

Yellow and Red Flags; Indicators of Potential Repayment Problems

Here are 18 yellow and red flags, or otherwise indicators of potential problem loans:
(Federal Reserve Bank – Commercial Bank Examination Manual, Section 2080.1)

- *Working-Capital Advances Used for Funding Losses* – A business uses advances from a revolving line of credit to fund business losses, including the funding of wages, business expenses, debt service, or any other cost not specifically associated with the intended purpose of the facility

- *Working-Capital Advances Funding Long-Term Assets* – A business will use working-capital funds to purchase capital assets that are normally associated with term business loans

- *Trade Creditors Not Paid Out at End of Business Cycle* – While the lender may be paid out, some trade creditors may not get full repayment. This can cause a strained relationship as unpaid trade creditors may be less willing to provide financing or offer favorable credit terms in the future. In turn, the business will become more reliant on the lender to support funding needs that were previously financed by trade creditors

- *Overextension of Collateral* – The business does not have the collateral to support the extension of credit, causing an out-of-borrowing-base situation. Review borrowing-base certificates to verify that coverage meets the prescribed limitations established by the lender's credit policy for the specific asset being financed

- *Value of Inventory Declines* – If a business does not pay back the lender after inventory is converted to cash or accounts receivable, the value of the inventory declines (vendor retains a senior lien interest in the inventory superior to the lender's interests). Other causes of inventory devaluation include obsolescence; a general economic downturn; or, in the case of a commodity, market volatility. Declines in inventory value will commonly put a working-capital facility in an out-of-borrowing-base situation and require the excess debt to be amortized and repaid through future profits of the business

- *Collectability of Accounts Receivable Declines* – The increasingly past-due status of accounts receivable or, deteriorating credit quality of account customers, both result in the non-collection of receivables. This can also cause an out-of-borrowing-base situation for the lender

- *Working-Capital Advances Used to Fund Long-Term Capital* – Funds may be inappropriately used to repurchase company stock, pay off subordinated debt holders, or even pay dividends on capital stock

- *Accounts Receivable* – A slowdown in the receivables collection period. This symptom often reveals that the borrower has become more liberal in establishing credit policies, has softened collection practices, or is encountering an increase in uncollected accounts

- *Inventory* – Noticeably rising inventory levels in both dollar amount and percentage of total assets. Increases in inventory levels are usually supported by trade suppliers, and financing these increases can be extremely risky, particularly if turnover ratios are declining. The increase in inventory levels or lower turnover ratios may also be related to the borrower's natural reluctance to liquidate excessive or obsolete goods at a reduced price. Many businesses are willing to sacrifice liquidity to maintain profit margins

- *Slowdown in Inventory Turnover* – This symptom may indicate overbuying or some other imbalance in the company's purchasing policies, and it may indicate that inventory is slow-moving. If the inventory is undervalued, the actual turnover is even slower than the calculated results

- *Existence of Heavy Liens on Assets* – Evidence of second and third mortgage holders is a sign of greater-than-average risk. The cost of junior money is high. Most borrowers are reluctant to use this source of funds unless conventional sources are unavailable

- *Concentrations of Noncurrent Assets Other Than Fixed Assets* – A company may put funds into affiliates or subsidiaries for which the lender may not have a ready source of information on operations

- *High Levels of Intangible Assets* – Intangible assets, which shrink or vanish much more quickly than hard assets, usually have very uncertain values in the marketplace. In some cases, however, intangible assets such as patents or trademarks have significant value and should be given considerable credit

- *Substantial Increases in Long-Term Debt* – This symptom causes increasing dependence on cash flow and long-term profits to support debt repayment

- *A Major Gap Between Gross and Net Sales* – This gap represents a rising level of returns and allowances, which could indicate lower quality or inferior product lines. Customer dissatisfaction can seriously affect future profitability

- *Rising Cost Percentages* – These percentages can indicate the business's inability or unwillingness to pass higher costs to the customer or its inability to control overhead expenses

- *A Rising Level of Total Assets in Relation to Sales* – If a company does more business, it will take more current assets in the form of inventory, receivables, and fixed assets. Examiners should be concerned when assets are increasing faster than sales growth

- *Significant Changes in the Balance-Sheet Structure* – These changes may not be the customary changes mentioned previously, but they are represented by marked changes spread across many balance-sheet items and may not be consistent with changes in the marketplace, profits or sales, product lines, or the general nature of the business.

Commercial Real Estate (CRE) Lending Evaluation

CRE Collateral Considerations and Risks

CRE risk, the office market in particular, is getting plenty of attention these days, and rightfully so. The CRE market is likely to be pounded over the next couple of years primarily due to high interest rates and operating expenses, lower occupancy, increasing refinance risk, resulting in turmoil, frankly. Lenders, particularly CRE-concentrated regional banks in the US, will be taking an intense look at loans secured by CRE. You should already have a copy of the most recent appraisal on file, so you have the same information as the lender. The following points should be considered as you prepare your own debt repayment solutions if it involves CRE.

- *Relevant Market Conditions / Impact on Borrower* – Lenders analyze how market conditions, during an economic downturn, impact CRE borrowers: declining CRE valuations, inflation, increasing interest rates, employment rates, borrowing costs, increasing vacancy rates, decreased lease (rental) rates, increased operating expenses, decreased demand for CRE, lack of available financing, and less economic growth. They determine how these measures affect your ability to repay. Use these to build your case, whatever that may be

- *Extraordinary Assumptions* – Stakeholders, including the appraisal review function, analysts, underwriters, PROs, and CAs will need to read and understand any noted extraordinary assumptions in a CRE appraisal report. Such assumptions are important and may include, for example, the following assumptions that the property is free of: zoning violations, structural defects, encroachments, easements, liens, title defects, flood risk, fire hazards, mold, termites, environmental contamination, hazardous materials, asbestos, radon, lead-based paint, sinkholes, soil contamination, water damage, foundation issues, roof leaks, etc. Make the lender aware of (document) what is happening, and close any gaps of mutual understanding for such assumptions

- *Hypothetical Conditions* – Stakeholders, including the lender's appraisal review function, analysts, underwriters, PROs, and CAs will need to read and understand any noted hypothetical conditions in a CRE appraisal report; these may include, for example, the following conditions to which to subject property may/may not be subjected to: clear title, legal disputes, pending litigation, zoning changes, environmental conditions or regulations, building code violations, easements, liens, encroachments, leasehold interests, mortgage interests, restrictive covenants, adverse physical conditions, adverse economic conditions, adverse legal conditions, adverse market conditions, adverse political conditions, adverse social conditions, or any adverse technological conditions. Again, make the lender aware of what is going on

- *Leases/Rental Rates, Vacancy, Operating Expenses* – Lenders will review current rental rates and compare them to market conditions (interest rates, tenant demands, zoning). They will similarly analyze vacancy trends over time, its impact on borrower income, and the root cause for higher vacancy. They will anticipate changes to vacancy rates. They will observe material increases, as a percentage of gross income, the operating expenses, and determine the reason for the increases, including: improvement to the property to attract tenants, maintain and prevent deterioration, reflect changes in the market, tenant demands, zoning regulations, etc. They will also project any other material changes with supported and documented analysis. Give them the answers they are looking for; they need to know too

- *Capitalization Rates (CAP), the ratio of a single-year of NOI to the property asset value)* – In an increasing interest rate environment as CAP rates also increase, creditors will analyze the effect CAP rates are having on CRE valuations. In a down economy the CAP rate will increase as stakeholders become more risk-averse, thus making it more difficult to obtain financing, even resulting in lower CRE values. Lenders will analyze and document how the creditor's exposure on such CRE collateral needs to be handled. They will consider additional lender and borrower risks for current market conditions, credit, liquidity, collateral valuation, environmental, legal, zoning, construction, tenants, management, etc.

- *Discount Rates (the investor's required rate of return, discounting future cash flows during the holding period back to the present to determine value)* – In a down economy the CAP and discount rates tend to increase, and both rates share these risks. Lenders will focus on other risks leading to default risk, foreclosure risk where the lender must sell foreclosed properties in a down economy

- *Absorption* – Lenders will understand the rate at which commercial space is being leased up in the subject market. They will review the original appraisal absorption assumptions and compare that with the current demand for similar space today in a down economy. Absorption rates will be lower, as properties will take longer to sell, leased at lower prices, require more marketing or incentives like rent concessions, and tenant improvements to attract tenants or buyers. Lenders will also conduct a physical inspection of the property and identify any significant needed repairs

- *Leasehold Interest* – Lenders will confirm the remaining length of the leasehold interest, along with rent escalations for reasonableness; the loan structure will be adjusted if the CRE is a 'wasting asset' and when it becomes of no value upon expiration of the lease (loan to be repaid well beforehand)

- *Tenant Improvements (TIs)* – Lenders will carefully analyze the lender-financed TIs, whether they are cosmetic changes or major structural renovations; repayment will or should be aggressive since the lender is effectively unsecured or without realizable collateral

- *Appraisal Recommendation (new appraisal, validation, or evaluation)* – Based on relevant/material changes in market conditions, project performance, geographic conditions, variances from original appraisal assumptions, change in project specs, loss of lease or takeout, high pre-lease fallout, and especially as your financial condition deteriorates, a new updated valuation will be procured, likely at your expense

CRE Lending Considerations and Emerging CRE Risks

Everybody is closely watching new emerging risks in the CRE marketplace for all property types: office, retail, industrial, multifamily, hospitality, healthcare, and other special purpose properties. Of course, much is dependent on things like location, size, tenant mix, etc. There are trillions of dollars in CRE loans that will need to be either repaid or refinanced in the next couple of years. Consider these risks and how they will affect you and your business.

- *Interest Rate Risk* – Higher interest rates result in likely higher borrowing costs, making it more difficult for you to repay or obtain replacement financing. High interest rates can easily result in a higher likelihood of default and foreclosure. Lenders will look for any possible mitigating strategies for managing interest rate risk by using interest rate swaps (exchanging a variable rate for a fixed rate). Lenders will also cap interest rates to limit increases or maximize costs, or have floors that provide a minimum borrowing cost at your expense

- *Refinance Risk (higher interest rates have a material impact on refinance risk)* – With the increased cost of borrowing, it becomes more difficult for you to refinance, possibly leading to payment default and collateral liquidation. The property's value may become reduced and make it even more difficult to refinance. Lenders will pay close to the earlier 'resizing opportunities' before refinance risk increases too far, including: closely monitoring interest rates and market conditions, your creditworthiness, upping guarantees, and having you give additional collateral. As this takes place, lenders will determine if outside financing is even possible, if your loan risk rating will need to be downgraded, or your loan extended with disclosable modification terms, or if the collateral should just be sold. You may take measures to improve your creditworthiness and the property value, reduce debt levels, increase cash flow, obtain an additional interested guarantor, provide more collateral or guaranty percentage, or offer and negotiate a workout or loan modification

- *Resizing Opportunities* – Commercial lenders will determine if a CRE loan needs to be paid down or re-sized by considering various factors such as a higher interest rate environment, reduced net operating income (NOI) due to decreased rents and higher operating expenses, declining economic market conditions, lower debt yield, weak forecast, poor liquidity, uncertain repayment ability, etc. The lender will document the case for a resizing opportunity by using repayment tools like your debt service coverage ratio (DSCR), loan-to-value (LTV), debt yield (DY), and stressed interest rate sensitivity, and propose and document a resizing paydown recommendation. It will put the interests of the creditor first, and your interests second – unless you prepare and propose your own repayment solutions

- *Repricing Risk (the possibility a CRE loan may need to be refinanced at a higher interest rate upon maturity)* – Especially in an economic downturn and high interest rate environment, rates should cover the lender's cost of funds, loan servicing, probable loss as well as a reasonable profit margin. When pricing for risk, lenders will keep these things in mind, including when your creditworthiness, income, and the collateral property value have all declined. The repayment risk has increased, so which way should the interest rate go? And, let's add more risk, just for fun, where you've lost a major client, supplier, employee, large contract, customer, or vendor. Unless you're really in trouble, repricing risk will likely go up so don't be shocked at a higher rate.

- *Physical Inspection* – Lenders will identify potential risks by conducting a thorough physical inspection of the CRE. They'll start with reviewing the loan documentation (title, survey, zoning) to learn of potential legal issues. Their visual inspection will include the interior and exterior of the building and site to document any potential physical or environmental issues to avoid potential liability. They will review your balance sheet, income statement, and property lease agreements and note any other issues or questions for follow-up discussion with you. They may even conduct regular inspections, especially if their collateral consists of inventory and accounts receivable. They won't forget identified issues either. They should get your authorization to conduct all inspections, obtain necessary training, use proper safety precautions, and ensure proper supervision

- *Insurance Coverage (type; amount; timing; claims acceptance, doubt, or protracted resolution)* – Hazard and fire insurance coverage should help protect damage from fires, natural disasters (property, general liability, business interruption, equipment breakdown). Lenders will review the adequacy of insurance coverage for loans secured by CRE, and determine how sufficient it will cover the cost of repairs or replacement in comparison to the actual outstanding loan balance. If the land value is excessive, the cost to replace the damage may be less than the loan balance. They will ensure the policy is in force and has not lapsed. For claims, the insurance company will investigate the validity of a claim to confirm the destruction was caused by a covered event. They will work with legal counsel if the claim is doubted, or if the claim resolution is expected to be protracted

- *Environmental Risk (lender inspection, borrower questionnaire, base review, Phase 1 and 2 ESA reviews)* – Lenders will ensure the it has conducted sufficient environmental risk due diligence, including an environmental lender inspection, borrower-completed questionnaire, and obtain a Phase One environmental site assessments (ESA), or Phase Two ESA, as necessary. It will review documentation to confirm your responsibilities with respect to environmental compliance and remediation, considering the use of environmental indemnification agreements to shield the lender of potential environmental claims

Credit Risk (Asset Quality) Monitoring Process

Asset Quality Reporting

Watch List Designation Monitoring – A Watch designated loan is still a Pass rated loan (acceptable). Creditors who monitor credit risk by designating a Watch, use it as monitoring or early-warning system for loans that have temporary 'uncertainties.' There are not yet potential weaknesses with the loan identified, just uncertainties to bring to management's attention. The reporting may include documenting the following:

- *Borrower Exposure* – Lists each credit facility in the borrowing relationship
- *Current Uncertainties* – Unlike a loan risk-rated Special Mention (with potential weaknesses that may become well-defined weakness if not corrected), a Watch List credit is where there is some kind of uncertainty that needs close attention. These may include things such as: financial, operational, managerial, ownership, industry, technology, labor, legal, environmental, etc.
- *Current Trend* – Citing the trend of the uncertainty; is it improving or deteriorating?
- *Resolution Strategy* – Opinion as to the likely outcome on the uncertainty and a summary of what it will take and how long to get there
- *Accomplishments Since Prior Watch Reporting* – Documents what has transpired since the prior Watch reporting
- *Triggers for Watch List Removal or Further Downgrade* – Per the resolution strategy, the path will either be to remove it from the Watch List, or the prospect of a potential downgrade will be addressed. Either scenario will be broken down into smaller steps along with their estimated competition dates

"Criticized" Loan (Includes Special Mention, Substandard, Doubtful, Loss) Loan Monitoring – Loans risk rated Substandard, Doubtful, or Loss, are also called "classified" loans for regulatory purposes. Such loans are subjected to rigorous analysis and review by the PRO, WA, SAD, and senior management. The reporting is routinely reviewed by financial supervisors and regulators too. Such problem loans can have a great impact on the financial performance of the lender. Regular reporting will likely focus on the following:

- *Borrower Exposure, Collateral Protection, Guarantor Support* – Lists and documents each credit facility for each of the three areas, respectively

- *Deposit Relationship, Financial Reporting, Covenants* – Summarizes the deposit relationship, the overall financial reporting requirements, as well as other key financial performance covenants – and compliance thereto. Notes whether covenants have been waived or forborne (and shows the reason 'why')

- *Repayment Risks (Primary Source of Repayment, 'PSOR')* – Assesses the risk of repayment for each criticized loan. Cites the multiple reasons for there being increasing credit risk. Develops, as applicable, the facts that support: cash flow, net operating income (NOI), profitability, operating efficiency, leverage, liquidity, performance to plan (P2P), pro forma outlook, management, competition, and other red flag warnings

- *Lender Protection Risks (Guarantors, Liens, Collateral, Documentation)* – Serving as an additional secondary or tertiary source of repayment, each is thoroughly analyzed and documented. Why? Because each of these could, should the PSOR fail to pay, become the new PSOR in the near term. The creditor will develop the facts that support guarantor/sponsor strength, Mortgage/Deed CRE collateral lien perfection, Uniform Commercial Code (UCC) secured business assets, CRE risks, insurance, environmental risks, loan documentation, and even a character assessment

- *Root Cause Analysis, Risk Rating Disposition, Accrual Status, and Up/Downgrade Triggers* – After the Repayment Risks and Lender Protection Risks are adequately identified and documented, the root cause analysis will become clear, and the correct risk rating and accrual status can then be applied. Finally, the upgrade and downgrade triggers should fall automatically into place

- *Action Plans (Steps to a Pass Rating, or to a $0 Balance)* – With input from the PRO, CA, and SAD for the recommended action plan, a disposition will be made as to whether to keep or exit the current credit exposure. Measures may include: Workout/Retain-Renew, Restructure/A-B Note Split, 3rd Party Refinance, Collateral Liquidation, Note Sale, Litigation/Judgment, or Other. The creditor will predetermine what it wants to do with your borrowing relationship as your credit risk profile changes. And, they have documented rights to pursue the course they want, as well as the tools to do so. When creditors become overwhelmed, however, they will have to utilize debtor-prepared repayment solutions more fully. You have a strong voice all throughout this process, especially now that you can see the process, and understand what's happening. The Action Plans will identify the key steps necessary to return the credit back to a Pass risk rating, and best-estimated dates for completion, or, similarly, to exit the relationship

Divergent Views Between Creditor and Debtor

Stressful Times

Pressures and Stresses Happen Because They Are Real – So what's happening when the creditors themselves, not just you, are becoming stressed? When creditors face a serious economic downturn (or worse), pressures and stresses build quickly. People are still people and can only handle so much without becoming overwhelmed. The same holds true for your lender's balance sheet, as its capital standing could be at stake. Lending teams have a huge job pulling and fitting all the pieces together to make things work. It is a massive responsibility to keep the ship sailing in a safe and sound manner. As pressures build, indirect signals or messaging from senior management can take place that may impact the usual approaches used by the PRO, CA, and SAD, for the timing and accuracy of identifying, measuring, monitoring, and controlling credit risk. Unwarranted credit risk can build up by the lender becoming too lax (putting off the pain/costs of having to reserve for problem loans). Regulatory scrutiny increases. Senior management and the Board may ultimately be required to take (immediate) corrective action if their credit risk management practices are criticized by the regulatory agencies. Economic cycles seem to always come, and the stressful times come along with them. It happens all the time. So, what you though might be the ordinary channels of communication and expectations, the creditor may or may not take actions that seem unusual. Just be aware that things could be going on with the lender.

Be Professional, Diplomatic, and Respectful – As a borrower, this can be a tough period in your relationship with the creditor. Pressures and unforeseen stresses can quickly be placed on to your shoulders to perform. Through these times, it is imperative that you be professional, diplomatic, and respectful, as you may have a divergent view, or differing opinion as to how your loan should be repaid. Hopefully, there is an established culture where you can share your thoughts freely. However, that is not always the case, especially when pressures build for the creditor. Depending on where the culture really is, you can get better results if you stick with documented and supported facts, conclusions, and recommendations. Your repayment plans, as you see them, may look like 'divergent views' during these new stresses and pressures. That's totally possible. Management still needs to see the facts to make appropriate decisions. Rigorous loan discussions, monitoring, and reporting can be expected. This is a good thing. Just don't lose your cool during these times. Calmly ask questions, and seek understanding of their expectations.

Why Not Cooperate with the Creditor? – Is it not best to live up to every condition and covenant you agreed to, as signed by you, in the Promissory Note and Loan Agreement? If you don't like the way the creditor is treating you by asking that you just fulfill your end of the bargain, in good faith, you can always payoff the loan, right? What if you can't pay it off? Well, why not cooperate with the creditor, per the signed loan docs, and then use your well-prepared heart and brain to present documented facts that support your repayment solutions? Seriously, why not cooperate? Fear of the unknown? Fear being sued, and shut down? I suggest you confer with legal counsel, but I would also caution that the creditor wants to get to the bottom of the credit risk issues and get repaid as much as you do. Why not come

together and find common ground? You've seen what the creditor has already done to try to better understand and monitor your borrowing relationship, right? So, why not give him your fully prepared repayment plan before he even asks for it? Please consider not leaving your creditor left for wanting. The lender will likely do what you ask it to do as long as it's safe, sound, and prudent for your situation. But in order to do that it needs to see all the facts first, the ones it's entitled to see in the first place, the ones you already promised to give the, in writing (with your signature). To illustrate, let's suppose you had a wart on your foot, and you couldn't get it to go away. You cannot just shave off the top of it and expect it to not come back; it will because the root problem hasn't been solved yet. The remedy requires that you apply a treatment that will get to the root or bottom of the wart so it will go away once and for all. Similarly, when you have a repayment problem, you need to understand the facts, and eventually get down to the 'root cause' of the problem so you can apply the appropriate remedy/action plan. All the stakeholders need to get an understanding of these facts. After all, the creditor likely has more debt capital in your business than you have equity capital, right? So, let's get well-prepared, deliver a comprehensive repayment plan, and fully cooperate as much as possible. Even as you express a divergent view with the creditor, as you work through the issues, your lending relationship will be more solid than ever.

Respect and Dealing in Good Faith (with Borrowers Having Financial Difficulties)

Borrowers Can Get Pushed Around by Creditors

Why You, the Borrower Deserve Due Respect – Borrowers can get pushed around by creditors from time to time. They seem to be treated, on occasion, as just 'numbers on a balance sheet,' like a 'social security number,' or an 'account number.' Creditors need to give their borrowers more dignity as human beings. First, as you very well know, business owners are not 'numbers,' they're just like you. You deserve due respect, always, even when things get tough during a sharp economic downturn. You wake up each morning and get dressed just like your PRO, CA, SAD, and senior management officials do. They are no better than you, nor are they more superior than you. You have personal needs and desires just like they do. You take on heavy responsibilities and manage your company's operations so payrolls and debt repayment are possible. What can creditors do differently to give you, the borrower, the respect, and dignity you deserve? Second, getting respect builds trust. The borrowing relationship was built on mutual trust, else the extension of credit would not have funded in the first place. When the creditor treats you with respect, it fosters a spirit of cooperation, does it not? A cooperative and productive relationship is materially less expensive to the creditor and you, as opposed to an adversarial relationship. If necessary, set the tone from the beginning with the creditor, that you value and appreciate the lender, but that you expect to be treated with respect too. Let them know that you intend on maintaining a healthy relationship, and that you and the creditor should work together in a good-faith cooperative manner at this difficult time. Expect nothing less.

A Borrower with a Problem Loan, is not a Problem Person – While most creditors have conquered the complexities of cash flow, some lender's disrespect and treat borrowers who are having financial difficulties, not like human beings, but like objects to be tossed around and disposed of at their discretion. Many institutions value 'respect' as one of their core values. But does that respect only apply to interactions within the institution, or does it also include their customers who are in financial trouble? It should, right? But does it really happen though, during serious economic downturns? Is there a culture of disrespect when it comes to borrowers with problem loans? Probably, more than likely. Creditors should put themselves in your shoes. If you're in financial trouble, you will experience high stress and mixed emotions. Great uncertainty is at play. You may feel unsure what will happen if you default on your loan, or even make your next payroll, etc. How would your creditor PRO, CA, or SAD officer, whomever the person is that's responsible for your lending/deposit relationship, like to be treated if that person were in your shoes? Seriously. Think about it. Some creditors, dealing with borrowers experiencing financial stress, can easily forget to be respectful. Do your best to proactively live up to your loan covenants in the Loan Agreement, and be prepared to come up with a plan to fix the same.

Dealing in Good Faith – This is really a great fundamental principal that creditors should remember. Like a good referee, if you were the creditor, how would you describe what doing business in 'good faith' means when dealing with a borrower experiencing financial difficulties? Would not every party and stakeholder to the Loan Agreement expect such persons to act in good faith? Maybe it has something to do with being sincere, having good intentions, and what about being honest? Certainly, when the loan was originated, all the parties to the loan were honest and adhered to the terms of the Promissory Note and Loan Agreement. But why do many borrowing relationships become soured and contentious? Can the various parties, even when there is disagreement on proposed repayment terms and conditions, not exhibit respect and good faith during those negotiations? What if you become contentious and will no longer deal in good faith? What if the creditor loses his temper and wants to just foreclose on the collateral and put you into bankruptcy? The parties, including you, should carefully reread the Loan Docs (Promissory Note and Loan Agreement, to start), and highlight your rights and responsibilities under the terms of the loan docs. As you carefully read them, you will obviously see that the creditor 'holds all the heavy cards.' If you fail to keep your end of the agreement, the creditor is entitled to pursue its default remedies to recover the exposure. That is just the way it is, and they have the resources to do it too (at least under regular economic conditions). But no one should be exercising heavy-handed maneuvers, and display an over-bearing attitude that may be construed as being a bully, especially at the SAD level where few are paying close attention to such behavior. If it happens, speak up. Escalate the matter and set new mutual expectations. Another way for a creditor to view dealing with respect and in good faith with you would be the following example: "He could try to work out a deal, or as a last resort take you all the way through foreclosure, or even through bankruptcy, and when it was all over, still have lunch with you." Now, that's a high standard. But that's the right standard, what should happen. Do you not think you would have been given every opportunity to make and present your best repayment solutions, if there was that much respect and good will to the end? That's what I'm talking about. The creditor can and will get whatever it wants due to the loan structure. But the negotiated repayment will be what it should be. How well you manage your own behavior, and hopefully the creditor is watching its own behavior too, means everything. Determine to give and receive the utmost respect and good will as you negotiate through the repayment process. In short, if the creditor becomes disrespectful to you, it would be nice if someone could ask this person: "Who do you think you are? You just represent the lender, but the lender would never treat people like this!" So, what will be said of you, your attitude, and your actions? Smack down any animosity between you and the creditor. Finally, just avoid being over-bearing or mean-spirited, ever, and expected to be treated the same. It's just plain unacceptable. It is in the creditor's and your best interest to always be respectful, and deal in good faith with each other.

Addendum #1) Debt Crisis – The Problem

20 Risks That Will Soon Fuel a Serious Economic Downturn

NCARA.org, and tunbudget.com believe there will be a debt crisis here in the US in the near term, for several reasons (see the 20 risk events below). These risks outline the reasons for this crisis because of never-ending deficit spending at every level, everywhere, including consumers, businesses, and governments. The spending (debt) for these risks will ensure large structural deficit spending leading to a debt crisis that 'no one' wants to talk about or do anything about. As a result, overall debt levels are at overwhelming levels and are certainly not sustainable. While these risks are depressing in nature, they still need to be transparently debated so informed decisions and debt repayment solutions can be prepared. Otherwise, we have no one to blame but ourselves. So, bear with me – this is just the 'downside' case being made. The Tunabudget Solution, and Debtor-Proposed Repayment Solutions, provide the right answer to mitigate the effects of the downside case. These tools will help address the needs for small business (see NCARA.org) and the consumer (tunabudget.com). Finally, 2024-25 will be the beginning of times the likes of which we the people will hardly recognize. Things are going to change – big time. In plain English, enjoy this summary of 20 risk events that will soon fuel a serious economic downturn and debt crisis.

#1 – National Debt Levels

USA (USdebtclock.org, Rounded, January 2024)	January 1990	January 2000	January 2004	January 2008	January 2012	January 2016	January 2020	January 2024	January 2028
Total Unfunded Debt (Trillions)	$14	$27	$38	$51	$57	$68	$82	$97	$109
Federal (National) Debt (Trillions)	$3	$6	$8	$11	$16	$20	$27	$34	$46
Personal Debt (Trillions)	$5	$9	$13	$17	$16	$18	$17	$25	$28
Mortgage Debt (Trillions)	$4	$7	$11	$15	$13	$15	$16	$21 (e)	$24 (e)
Credit Card Debt (Trillions)	$0.7	$0.7	$0.8	$1.0	$0.9	$1.0	$1.0	$1.3	$1.5 (e)

- America's collective debt burden will increase and become unsustainably burdensome. The recent debt metrics are alarming, especially when we add in the US Government's unfunded obligation of $97 trillion (soon to be $109 trillion) for entitlement spending

- 37% of Americans lack enough money to cover a $400 emergency expense; for non-emergency expenses, 18% of Americans said the largest expense they could cover using only their savings was under $100

- Just 24 years ago, in 2000, the total debt per tax payer was $53 thousand; it is now $264 thousand, and soon to be $332 thousand

- There will be other disruptive risk events that will be widely felt between now and sometime through 2025; the result will be a debt crisis

#2 – Consumer Debt Spending

- We the people have become less disciplined, more selfish, and have a plastic 'buy it now, pay it later' attitude. We have a 'covetous' desire for more wealth and possessions, especially for automobiles and larger homes. With that came large installment and mortgage debts, and a more and more, and a me, mine, myself, mindset has set in

- In 2000, mortgage debt totaled $7 trillion, and just $4 trillion 10 years earlier in 1990. Today, mortgage debt is $19 trillion, a 271% increase in just 23 years. Similarly, total personal debt, which includes mortgages, increased from $8 trillion in 2000, to $25 trillion in 2023, a 313% increase, expected to increase to $27 trillion in the next few years

#3 – Deficit Spending

2031 (e)	$2.3 trillion	2026 (e)	$1.7 trillion	2021	$2.8 trillion
2030 (e)	$2.1 trillion	2025 (e)	$1.8 trillion	2020	$3.1 trillion
2029 (e)	$1.9 trillion	2024 (e)	$1.6 trillion	2019	$984 billion
2028 (e)	$1.9 trillion	2023	$1.7 trillion	2018	$779 billion
2027 (e)	$1.7 trillion	2022	$1.4 trillion	2017	$665 billion
2027-31 (e)	$9.9 trillion	2022-26	$8.2 trillion	2017-21	$8.3 trillion

- The annual trillion-dollar plus deficit spending from 2020 through 2031 totals $24 trillion in new debt in just 11 short years

- One honest question to ask is how will the debt be funded, or at what cost? The US Treasury will need to issue new debt instruments to cover these deficits. But, unlike the past when interest rates were much lower, what interest rate will investors bid at the upcoming Treasury bond auctions, not if, but when they finally come to realize that such deficit spending is not sustainable?

- The US Government is going to have to print even more new monies to cover its gargantuan deficits, besides the rolling over of trillions of low interest rate bonds at higher interest rates. Interest rates will also continue to remain high for even a longer period, which will exasperate the cost of serving existing debt

- The deficit spending addiction the US is experiencing can only result in a debt crisis, because it has not been nor is it sustainable. Hardly no one is willing to talk about it, because most know that the fix is in. We the people cannot make it without relying on debt

#4 – Debt Crisis

- The debt load is too heavy. The pending debt crisis is probably the most predictable crisis event society has ever seen, but nobody can see it, or they do see it, but refuse to even talk about it

- A debt crisis could lead to a depression (severe economic downturn). Since 2000, the debt/GDP ratio has increased from 56%

to 122% in 2024. That is an increase of 217%. It is increased two-fold in just 23 years. Does anyone believe that the US Government will cut its spending, ever? It cannot stop at this point without triggering an economic crisis

- The massive build-up in public debt is not sustainable. How in the world will any meaningful amount of the debt be repaid, or even serviced with interest-only payments, given higher interest rate environments that will come? Deficits can't go on like this

- US Government leaders and officials, I believe, are not serving the interests of the people, but rather, are being political and even misleading America

- If you look back to the Great Recession in 2008, where were the economists arguing or pointing to a pending recession or even a depression; officials later confirmed a depression was averted?

- What are the chances we could be on the brink of another Great Recession or depression? After all, we have just been living off a giant credit card that is unsustainable, and a debt crisis is closer than ever

#5 – Inflation / Stagflation

- In response to the Covid19 pandemic, the US Government spent roughly $5 trillion which contributed to strong economic demand in a period of supply chain disruptions. This, and the tight labor markets created upward pressure on wages and prices, along with other events

- In the 2020-23 period, inflation gained traction at 4.2% in 04/2021, increasing to 9.1% in 06/2022, and falling to 3.4% in 12/2023. Interest rates were increased 15 times during this period to bring down inflation

- Taking the average inflation rate from the 2021-2023 timetable, you would have 4.7%, 8.0%, and 4.1%, respectively. For example, if you have $1 price in 2021 at an average 4.7% inflation rate, at the beginning of 2022 the higher price starts at $1.05. Adding another 8% for the second year pushes the price higher to $1.13 at the end of 2022. Adding another 4.1% inflation for the third year pushes the price higher to $1.18 at the end of 2023

- When the next event takes place, many more people will start to realize the US Government will just spend trillions more, and we would likely see more or heavy inflation

#6 – High Interest Rates

- The Fed Funds rate was kept purposely low at or near 0% from 12/2008 for the next 10 years, peaked again at around just 2% in 07/2019, and then dropped back to near 0% in 04/2020 at the time when the Covid19 pandemic picked up. In my opinion, the 10-year period of ultra-low interest rates was not warranted. The Federal Reserve Bank politicized its monetary policy by not raising rates sooner. I believe interest rates were intentionally kept low to stimulate the economy 'much longer' than was needed

- The Covid19 panic helped fuel an asset bubble in housing pricing, together with trillions of dollars in deficit spending and more stimulus. This created inflationary pressures, where in 06/2022, US inflation hit a 40-year high. I would argue that the Federal Reserve Bank juiced the economy much longer than was necessary, and thus had to raise interest rates sooner, higher, and longer than most people expected

- Where is the real voice of the Federal Reserve Bank? Why is it in a position where it had to raise interest rates so high, so fast? Why did not Congress and the Federal Reserve Bank scream and demand over the last 20 years the US Government get on a budget, stop the deficit spending, issue warnings, anything? They just always ask for and print more money. And, now we the people find ourselves in a predicament that will lead to a debt crisis

- It is estimated that the interest cost has now reached nearly $2 billion every day, clearly an unsustainable course that is more than likely to increase and get worse, which makes it increasingly unsustainable. Interest never even takes a nap, not for a single minute

- Anyone who argues that we can still afford the interest payments will go away silently some day when there is another massive interest rate shock (debt crisis) and we all go into default and restructure mode. The first question they need to be asked, should be: "where was your warning voice before we got into this mess?"

#7 – US Government Default

- When the musical chairs game stops, the US government will default on its debt repayments, and print and borrow even more money, leading to high inflation and higher interest rates

- Default will take the global economy to new low places, with global debt restructurings through seasons of financial forest fires

- The standard of living will shrink as people are forced to live within their means, including drastic cut-backs in government spending and services. Renegotiated debt repayment terms with its creditors will need to take place, everywhere

- We the people are in trouble if we do extend the debt limit, and in trouble if we do not. That is the point. We will be having a debt crisis in the near term. How can we not?

- The deficit spending and debt levels are not sustainable as default conditions are only increasing daily. If you do not increase the debt limit, you are just going to start the default period within weeks of the debt ceiling expiration date (freeway landing). If you increase and extend the debt limit, you are just postponing the inevitable (mountain side crash)

- We do not even want to have a real conversation and hold people accountable about repayment default risk, because it is time to 'get back to the football game and the grill.' Life is good until the party is suddenly disrupted and people are caught unprepared. That is what is coming, and frankly, we the people will get the consequences of our choices when it comes to the burden of overwhelming debt. The day of reckoning will come soon enough as a complete shock to most people

- Then comes the fighting, blaming, contention, and so forth. We the people, we who should have known better, will be 'naked when the tide goes out,' embarrassed and hopefully full of shame. Others will be wandering around, upset, confused, dazed, and perplexed because they did not see it coming. Most will likely panic, and some will act dumb or innocent for having been caught being heavily in debt.

#8 – Banking System

- When Silicon Valley Bank collapsed in 03/2023, as well as Signature Bank, US regulators took action to prevent a banking crisis by backing deposits above the $250,000 FDIC insured threshold at these banks. Noting the fragile banking system, US Treasury Secretary Janey Yellen took additional measures by saying the Government could step in to guarantee deposits at other banks if they posed a threat to the banking system

- Many bank stocks experienced a sharp decline at the time in 1Q2023. Assets at regional banks, in particular, lost value in the rising interest rate environment, as existing loans and bonds at low interest rates had embedded losses in them (if they had to be sold to raise liquidity to cover deposit withdrawals on bank runs) as investors were looking at assets subject to higher interest rates

- Interest rates remain high, which affect the value of bank assets. Banks have, in many cases, failed to adequately manage interest rate mismatches on their balance sheets. They did not sufficiently match fund their loans with the cost of their funds on deposits. A bank run will force the bank to sell its assets (low interest rate securities and loans) to have sufficient liquidity to cover the deposit outflows

- The Federal Government's intention to guarantee uninsured deposits indefinitely is unrealistic at best, which may result in low confidence from uninsured depositors (depositors with balances over $250,000 that are not insured or guaranteed by the US Government). How safe and reliable, really, is the $250,000 deposit insurance during such crises?

- $203 trillion In derivatives held by Goldman Sachs, JPMorgan and other top banks is like playing a game of musical chairs, where the risks become increasingly higher and higher. Even experienced professionals do not fully understand the risks involved with derivatives, future contracts on commodities, option trading on stocks, currency swaps in foreign exchange markets, mortgage-backed securities (MBS), interest rate swaps for banks, credit default swaps (CDS) on bonds, and more. Do not forget in the 2008 financial crisis there was widespread use of these extremely complex financial instruments, like derivatives, which contributed to the severity of the economic downturn. Just like in 2008, the music will stop some day

- The entire derivative market has potential risks, including complexity, lack of transparency, potential for speculation, leverage concerns, concentration risk, counterparty risk, historical precedent, and delayed crisis recognition (think 2008), regulatory challenges (gaps)

- Interest rates will be high, and likely be triggered even higher for any number of a host of reasons, at any time. What are the chances these risks will not trigger more government spending, higher inflation, and higher interest rates to combat the same?

- High interest rates will plague banks with their embedded losses on low interest rate loans and securities they hold. They will eventually have to pay (high) interest on their deposits for customers to not pull those deposits. So-called 'sticky deposits will become slippery (deposit flight) and money will quickly move out of some banks with all the online tools currently in place. This will create an environment of more downward pressure on some banks and lead to more bank runs and failures in the near term

- Many banks will quietly raise their hands looking to sell

- Commercial real estate (CRE) loans will continue to come more into focus too, as such loans will experience higher interest carry costs when (and if they can) they are refinanced at higher rates, as well as increased operating expenses. Capitalization rates will increase and values will continue to be reduced, thus enabling vicious downward spiral cycles. Even heretofore safe bubble markets like those in Hawaii will not escape these risks and will also be materially impacted

- Credit repayment risk will increase for regular commercial loans, but especially the CRE office market where billions in loans are underwater. Such loans are subject to refinance risk at much higher interest rates, while experiencing high vacancy rates due to remote workers not being in the office

- Pricing for risk, in a higher refinance interest rate environment will further expose banks to potential impairments (losses). Kiss the dividends good bye, and downward pressure on bank stock valuations

- Banks will begin to sell CRE secured debt at discounts, demonstrating their own lack of faith in the CRE market. The higher the interest rates, the lower the collateral property values, and the higher repayment default risk

- The regulatory agencies will sharpen their pencils to ensure prudent credit risk management practices are accounting for all this action. All these forces will likely create a wave of merger and acquisition deals for acquiring banks to survive

#9 – Geopolitical Tension

- What are the far-reaching consequences and costs of geopolitical risk? Regional risks are everywhere. Where is there not political, social, economic, and now territorial issues that are ripping apart delicate international relationships? They include:

  > "confrontations, conflicts, crises, instabilities, civil wars, territorial disputes, and currently include Russia/Ukraine and NATO, Israel/Palestine, Taiwan/China, South China Sea, Myanmar, India/Pakistan, Afghanistan, Iran, Yemen, Iraq, Nagorno-Karabakh, Syria, Lebanon, North Korea, Somalia, Ethiopia, Sudan, South Sudan, Democratic Republic of Congo, Central African Republic, Libya, Western Sahara, Venezuela, Haiti, and Mexico" (Council on Foreign Relations, Global Conflict Tracker, 02/02/2024)

- International disputes on boundaries on the land and in the sea are emerging. Trade wars will increase tensions that include restrictions and tariffs on shipped goods

- Military conflicts will cause different countries to have to take sides, with possible sanctions and other diplomatic measures being set up to punish the so-called adversaries

- Uncertainties will increase in the North Atlantic Treaty Organization (aka NATO) relationship with Russia, and with the very complex relationships in the Middle East with countries like Iran and Israel as evidenced by recent missile strikes

- There will be nuclear tensions on the Korean Peninsula with North Korea's nuclear weapons program

- There will be disputes over control and access to energy resources like natural gas and oil reserves

- Cybersecurity risk will increase and become a major concern that will strain diplomatic relations between the US and China

- The cost of taking care of refugees fleeing from one country to another, including illegal migration, will only increase

#10 – Global Supply Chain

- We are just too used to there always being plenty of goods everywhere, always available, and at reasonable prices. Much of the world's shipped goods will be challenged due to hostile actors in the Red Sea and drought conditions in the Panama Canal. We will be found taking for granted the abundance of goods everywhere we look

- While the current global supply chain risk seems to be of some concern (i.e., moderate risk), the risk will, likely, escalate to high risk, and there be additional stresses added for the availability of goods. With high-risk geopolitical tensions, many will stare in disbelief at the bad actors who purposely disrupt lawful shipping with violent attacks

- Increases in US military action will stir the emotions in Congress in using war authorization powers with the US having to protect foreign shipping vessels at whatever cost it takes. All but about 3% of US imports and exports are shipped on foreign vessels. This will not only cost the US military budget to be overextended, it will contribute to higher inflation, especially when things get out of hand

#11 – Political Polarization

- It is not hard to estimate that political polarization will increase throughout the global community in the future, as well as in the US. In fact, likely, one must ask, how it could it not only increase?

- Political polarization will continue to build in 2024-25, resulting in extremism, intolerance, rejection of social order, new radical ideologies, possible revolution, political violence, social unrest, disruption in global supply chains, and, of course, protests everywhere

- The atmosphere will become more divisive with a more confrontational social environment, values will be questioned, new ideologies will affect your personal freedoms and an individual's rights. The result will be more uncertainty, disruptions to daily life, heightened tensions, and large peaceful (and many violent) protests to effectuate change

- Nevertheless, we the people will stick with peaceful voting and activism to express our opinions, while a few will not, but the overwhelming majority will. There will be a strong sense of 'community,' to help ensure we honor and respect the rule of law, 'with justice and liberty for all.' Good people, everywhere, will step up and do the right thing

#12 – Terrorist Attacks

- Terrorism risk will increase, including lone-wolf terrorists

- Are hundreds or even thousands of terrorists-minded individuals illegally crossing into the USA each month in the 'ones-that-got-away groups? When push comes to shove and before they are arrested, will these people resist and commit acts of terrorism against the US and its citizens? Are any of them aligned with State-sponsored terrorist groups?

- No one can dismiss that with well-funded resources and advanced planning, well-coordinated and State-sponsored terrorist attacks will happen, regardless of how well anyone is prepared to counter these risks

#13 – Housing Insecurity

- Housing insecurity is already an increasingly high-risk matter, and will continue to be in the near-term for 2024-25

- The fundamentals of housing, say a mortgage or rent payment that equates to about 20-25% of one's gross income, will be stretched. Many people already have their 'housing ratio' much higher, and that may include two incomes combined. Pressures to increase rent will continue in 2024-25 until the market place says it is too much

- Housing affordability will continue to get out of hand, and many people will struggle to pay rent, and even those who have low interest mortgage payments. The cost of everything jumped since inflation started ramping up since the Covid19 pandemic and all the government spending. Most prices will remain high and budgets will be stretched for the consumer, the small business owner, and so on

- Homeowners with low fixed interest rates will not be inclined to sell their homes, which will help dry up housing inventory available for sale, keeping upward price pressure on inventory that does make it onto the market

- Distressed people/sellers (divorce, job losses, sick, etc.) who must sell, will be forced to sell. Distressed properties will also go on the market and likely sold as-is (fixer uppers)

- People will demand the US Government to step in and help make housing more affordable. There will be more subsidizing vouchers, along with rent controls installed. More low-income housing subsidized by the local tax payers, will be funded

- People will be resigned to becoming long-term renters, with younger generations most willing to rent and work remotely in areas with lower costs of living

- When homes do become available, corporate America will actively buy up homes and pool them into rental property investments, thus making it even harder for others to buy their own first home

- The US Government will have to step in and help solve the housing crisis already underway to find refuge for some 8,000,000 to 10,000,000 illegal aliens who have crossed over into the US in the past few years. Some of the States are bearing the burden of trying to make accommodations for these people, but are demanding help from the US Government

- Hawaii will be asked to shoulder its 'fair share' for housing and help take care of the millions of illegal immigrants

- With housing insecurity will come mental, emotional, physical, and even spiritual breakdowns. Such measures will (often) lead to more divorces, and the disruption of the family unit. More homelessness will ensue, which will lead to even more issues

#14 – Energy Security

- Using common sense, we live in a world where global interests are in conflict. The risks to energy security will continue to increase in 2024-25. Whether or not there will be oil shortages that increase inflation, bad actors are and will certainly try to perpetrate cyberattacks on the energy sector in the US. There's just too much geopolitical tension for there not to be such activities

- Extreme weather events will likely continue as Mother Nature never ceases to amaze anyone

- Supply chain disruptions from areas in the world that export energy resources, will increase and add pressure to price inflation of many other goods

- The transition to renewable energy sources will be a while before they are sustainable. Meanwhile the transition to those sources will be subject to political, and hopefully much public debate over the costs, who will own and regulate those resources, where they will be stored, and whether the US should rely on other countries to supply the underlying minerals needed for renewable energy. It will be a 'messy' fight

#15 – Natural Disasters

- Everything is becoming fragile, complex, and interconnected, from living organisms, plants, animals, soil, rocks, minerals, water, and the air

- There is a 99.99% chance of there being natural disasters in the near term, where we will see more human suffering and loss of life. The financial price tag will also be very large, in the billions

- When the stakes are high, everyone will band together and the best of humanity will do what it takes to alleviate human suffering

- The system of aiding victims of natural disasters will become increasingly stressed, including local and State agencies, State governments, Federal assistance, and even nonprofit organizations

- Due to the high cost of addressing natural disasters, eventually, we the people will step up and take care of each other and those most in need

#16 – Public Health, Well-Being

- We the people largely want drugs, regardless if they are unhealthy legal addictive drugs such as alcohol and nicotine (smoking), or illegal (Federal) drugs like marijuana or other drugs

- Pornography, another addictive habit, is also destroying people's souls and busting up their families and finances

- "Among people aged 12 or older in 2022, 59.8% (or 168.7 million people) used tobacco products, vaped nicotine, used alcohol, or used an illicit drug *in the past month*

  "In 2022, almost 1 in 4 adults aged 18 or older had any mental illness in the past year (59.3 million or 23.1%); 1 in 20 adults had serious thoughts of suicide in the past year (13.2 million or 5.2%), 1.5% (or 3.8 million people) made a suicide plan, and 0.6% (or 1.6 million people) attempted suicide in the past year

  "Among adolescents aged 12 to 17 in 2022, 19.5% (or 4.8 million people) had a past year major depressive episode; Over 1 in 8 adolescents had serious thoughts of suicide in the past year (13.4% or 3.4 million adolescents), 1 in 15 made any suicide plans (6.5% or 1.7 million adolescents), and nearly 1 in 25 (3.7% or 953,000 adolescents) attempted suicide in the past year"

  – (SAMHSA Announces National Survey on Drug Use and Health (NSDUH) Results Detailing Mental Illness and Substance Use Levels in 2022, US Department of Health and Human Services, 11/2023)

- Over the next couple of years, despite millions with excellent health, the overall health of society will continue its negative trends. So many of our families and neighbors need help. However, we the people, largely, do not care anymore, and people won't speak up and opposed addictive substances. We are an increasingly addicted 'off to the next party' bunch to say the least

- Trillions of dollars will be spent throughout the world to address these health and well-being issues

#17 – Cybersecurity

- Cyber warfare, digital attacks on personal, business, and government computer systems and networks, will increase in 2024-25. This includes cyber tools, like bots, trolls, deep fakes, and the dark web. As geopolitical tensions rise, so will the cybersecurity threats, with more attacks

- As soon as cybersecurity defenses are in place, the bad actors will systematically work to penetrate these walls. If they cannot get through them, they will go above them, or around them, or below them, but they will not stop trying. Technological tools will be used for both good and evil purposes. Dark forces will seek to deceive, lie, and manipulate to impair the rule of law

- With billions of people participating in the global elections in 2024, people will demand transparency and accountability in the entire electoral process

- Cybersecurity risk with China will become an increasingly high threat risk to mitigate

#18 – Inequality in Wealth and Income

- "Americans said it takes an average net worth of $2.2 million to qualify a person as being wealthy. (Net worth is the sum of your assets minus your liabilities.) People with the top 1% of net worth in the U.S. in 2022 had $10,815,000 in net worth. The top 2% had a net worth of $2,472,000. The top 5% had $1,030,000. The top 10% had $854,900. The top 50% had $522,210." (Are You Rich? U.S. Wealth Percentiles Might Provide Answers; Kiplinger Personal Finance, Neale Godfrey, 06/16/2023)

- "The wealthiest Americans have never owned so much of the stock market, with the top 10% now holding a record 93% of US equities. Americans broadly have been participating in the stock market at a higher rate, with a record 58% of households owning stocks in 2023; the bottom 50% of Americans owned just 1% of all stocks and mutual fund shares in the third quarter." (The wealthiest 10% of Americans own 93% of stocks even with market participation at a record high; Jennifer Sor, 01/10/2024)

- It is doubtful that anyone would think that, throughout the world, the rich are not getting richer, and the poor are not getting poorer. What could possibly go wrong with something like this when the US experiences a debt crisis?

- In 2024-25, these asset classes, well-supported by asset bubbles from inflation, will take a hit, possibly the likes of which we have not seen in modern times. It is only a matter of time

- We the people will continue to believe that more and more stuff means more happiness, when it generally results in the loss of the most precious and important things in our lives. Money will give pleasure, but not happiness. Such will continue to be the trend in the near term

- Down the road a bit, there will come a time when those with wealth, the ones that understand what the highest and best use of it is, will use those resources to assist those who are poor and less fortunate. And for those who cannot take care of themselves at all, we the people will take care of them ourselves. Those that want none of that will simply build up their fortunes unto themselves, and when they die, they will leave it all here anyway

#19 – Labor Market

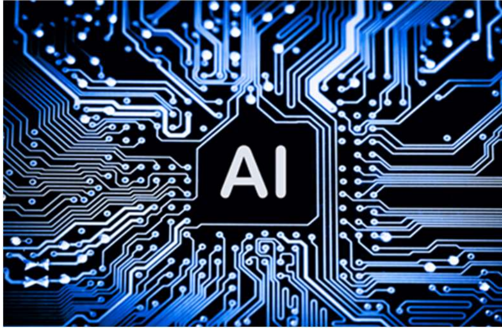
- On paper, the job market looks solid, strong, and surprisingly resilient. Under the cover in reality-land, however, unemployed people will find it increasingly difficult to find a good job, with only a handful of employer responses from dozens of applications. Burnout will increase in the near term

- The story of the low unemployment numbers will be questioned due to the low job numbers yet the difficulty finding good jobs becomes a concern. There will be a call for transparency when it comes to how many people are working more than one job, the number of government jobs and not private sector jobs used to pay for government jobs, retirees working longer to support their fixed incomes, the number of hours people are getting each week, jobs with any benefits, and the number of full-time vs. part-time jobs being offered

- High and now lower (but still) inflation has resulted in high costs or prices, which will continue in 2024-25. Wages will not keep up for the time being due to the so-called resilient job market

- The remote, or hybrid remote work environment will continue for the near term. The employee still has an advantage for the time being. Hopefully it will help strengthen work-life balance. Employers will push for more office time to build up fact-to-face knowledge sharing, collaboration, and mentoring other employees, to add long-term value to the enterprise

#20 – Artificial Intelligence (AI), New Technologies



- Concern over the impact of AI in disrupting election outcomes will be a very big risk for the 2024 global governmental elections for billions of people

- AI-powered solutions will be used to streamline operations and increase productivity in healthcare, transportation, manufacturing, retail, and finance

- AI and new technology risk will be disruptive for many good paying jobs in science, technology, engineering, and mathematics. The world is evolving and transforming with new technologies. It will change more quickly than most people realize

- AI may be coming after 300 million jobs globally. "The International Monetary Fund warned that nearly 40% of jobs across the globe could be affected by the rise of artificial intelligence, with high-income economies facing greater risks than emerging markets and low-income countries." (IMF warns AI to hit almost 40% of jobs worldwide and worsen overall inequality, Sam Meredith, 01/15/2024)

- Everybody knows that bad actors (individuals, groups, governments, etc.) will use these wonderful tools in evil and nefarious ways. They will use them to get power and control over others at any cost. Which means, most certainly, the US will spend countless billions of unbudgeted dollars to defend and protect its national security interests

- Military applications will obviously become more enhanced, thanks to the billions being spend on national defense

- How to govern AI will be a major undertaking, as policymakers and other organizations try to come up with guidelines, standards, and even regulations

- Upcoming technologies will include blockchain, quantum computing, and biotechnology

Addendum #2) Purpose

Dedication

To everyone, everywhere, who is experiencing (or may yet experience) the heavy burden of debt; those that are searching for debt repayment solutions, financial peace of mind, and well-being.

Mission Statement

To do good business, share good fruit, build true friendships

Principal / Founder

Jerry Staker founded the following companies:

- National Credit Awareness and Resolution Association, Inc. (NCARA.org) for small business, in 2020
- Tunabudget LLC (tunabudget.com) for individuals and families, in 2020
- Credit Risk Management Advisory, LLC (CreditRMA.com) for creditors, in 2023

The following points may be of interest:

- Birth: 1960
- Residency: Utah, Rhode Island, Arizona, Hawaii, Kentucky
- Family: Married, four children, five grandchildren
- 40+ Year Career: 28 years in commercial banking at community and regional banks: Workout Loans, Credit Review, Director/Credit Management Group; 12 years Creditor Supervision & Regulation (Commissioned Creditor Examiner – Federal Reserve Creditor of San Francisco
- Interests: Walking, traveling, gardening, writing, music, family, service, journal writing, family history work, fishing, feeding birds
- Hobbies: Earthquakes, volcanos, tornados, solar, water, wind, astronomy, consumer finance, politics, personal life histories, sunny beaches
- Ambitions: Sing, play Ukulele, under 200 lbs.