

# Inside the Credit Black Box – How Banks Make and Price Credit Decisions

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# Objective

- ◆ This session will: Provide an overview of how banks make and price credit decisions
- ◆ Focus on:
  - Lines of Credit-traditional working capital
  - Revolvers-a more formal structure with possible long term take out
  - Liquidity facilities – Generally available to stronger credits
    - Standby Bond Purchase Agreements
    - Letters of Credit
  - Structured credit transactions – Off-balance sheet facilities
    - Capital project financing
- ◆ This session will not: Be a review of credit benchmarks, medians or metrics

# Planning

- ◆ Understand the need:

- Traditional: Facility to bridge operating revenue/expenditure mismatch
- Evolving: Accommodate capital calls; Supplement investment policy; Manage early construction costs
- Bank Credit Profile
  - Certain facilities may require minimum underlying ratings

- ◆ Understand debt capacity limits:

- Restrictions based on prior loan/bond agreements
- Other balance sheet restraints

- ◆ Size and Utilization matter:

- Have a realistic assessment of the appropriate size and estimated utilization of the facility
- Size drives costs
- Utilization drives return

# Communication

- ◆ Help your banker help you
  - Maintain an on-going dialogue
- ◆ Anticipate information requests
  - Financials, demographics, projections
  - More is better
- ◆ Ask for input / ideas
- ◆ Negotiate from a position of strength
- ◆ Appreciate procurement requirements / request for proposal

# Factors Impacting a Bank's Credit Appetite

- ◆ **balance sheet capacity**
- ◆ **size of requested facility**
- ◆ **industry profile and "house limits"**
- ◆ **facility type limits**
- ◆ **credit cycle**

# Credit Decisioning

- ◆ **CREDIT, CREDIT, CREDIT**
- ◆ **client or prospect**
  - **opportunity to deepen relationship**
- ◆ **process: is timing critical?**
  - **local**
  - **committee**
  - **in between**

# Factors Impacting Pricing-I

- ◆ **CREDIT, CREDIT, CREDIT**
- ◆ **understand and price risk**
  - ◆ **typical risk "buckets"**
    - **borrower**
    - **facility**
    - **probability of default**
    - **loss given default**
- ◆ **risk based capital allocation**
- ◆ **overhead allocations**

# Factors Impacting Pricing-II

## ◆ **facility size and utilization**

\* **A "right sized" facility minimizes costs and required spread**

## ◆ **TERM**

\* **risk and therefore pricing increases with tenure**

\* **may be offset by renewal risk and cost of re-documentation**

# Factors Impacting Pricing-III

## ◆ **structure**

### ▪ **unsecured**

- **risk varies by borrower**

### ▪ **secured**

- **revenue pledge**
- **mortgage**
- **pledge of investments (non tax-exempt transactions)**
- **typically more costly to document**

## ◆ **covenants**

- **performance benchmarks for both parties**
- **can impact future renewal and pricing decisions**

# Factors Impacting Pricing-IV

- ◆ **cost of funds indexes**
  - **libor based and prime are most common**
  - **London interbank offered rate is market determined**
  - **prime is an administered rate**
- ◆ **most treasury facilities will have a floating rate \* cost of funds + credit spread**

# Pricing Decision

- ◆ **transactional vs. relationship pricing**
  - **deal specific and relationship hurdle rates**
  - **opportunity to deepen relationship with client/prospect**
  - **opportunity to establish market presence**
- ◆ **product tying is problematic in most cases**

# Summary

- ◆ **develop and maintain relationship with bank(s)**
- ◆ **understand that bank's credit appetite and capacity can vary**
- ◆ **right size the facility**
- ◆ **understand the interplay among term, structure and utilization**
- ◆ **minimize risk\*minimize cost**