RISK RATING LOANS FOR BUSINESSES IMPACTED BY COVID-19

In their *Interagency Statement on Loan Modifications and Reporting for Financial Institutions Working with Customers Affected by the Coronavirus* issued on March 22, 2020, the regulatory agencies made it clear they "…will not automatically adversely risk rate credits that are affected by COVID-19, including those considered TDRs." Adverse risk ratings are Special Mention, Substandard, Doubtful, and Loss. Consequently, just because you modified a loan for a borrower impacted by COVID-19, does not mean you have to rate those loans Special Mention or worse.

However, these borrowers do represent a higher risk than those that did not ask for modification during this crisis. In order to capture this additional risk, TGA recommends borrowers requesting modifications be moved to the financial institutions highest Pass risk rating, often referred to as Pass/Watch. This will allow the financial institution to calculate the increase risk in the portfolio using the Weighted Average Risk Rating (WARR) by comparing the WARR before and after the crisis.

In addition, TGA highly recommends financial institutions modify their credit approval memorandums, or loan presentations, used to approve or conduct annual reviews of loans to include a "COVID-19 SECTION." This section should be used to capture and discuss key items such as:

- Was the business considered essential or non-essential?
- What was the impact on the business (complete shutdown, partial shutdown, stayed open with reduced production, etc.)?
- Were any loans modified or did the business receive any state/federal financial assistance as result of COVID-19.
- What is the national industry outlook?
- How long will it take the business to recover to a normal level of operations?
- What is needed for the businesses to return to normal operations?
- Who are the customers of the business, and will there be sufficient customers for the business to recover?
- Who are the suppliers of the company, and will the supply chain be open to support the business?
- How committed are the owners? Do they have the experience to get through this?
- What are their personal financial resources (they must also have a stake in the recovery)?

We will be using the following guidelines when assigning risk during 2020 and 2021 independent loan reviews:

- Loan reviews conducted in 2020: Overall risk rating will be based on full year financial performance during fiscal year 2019 rather than interim performance during fiscal year 2020.
- Loan reviews conducted in 2021: Little reliance will be placed on financial performance during FYE 2020, as this will have been impacted by business closures as a result of COVID-19 and will be considered an extra-ordinary event. Risk rating will be based primarily upon if operations have returned to normal levels and if business is projected to be profitable in 2021.

SATISFACTORY RISK RATING:

- Acceptable primary DSCR (above 1.20x) based on current financial statements.
- Good liquidity (deposits and personal liquidity able to handle at least 6-months of loan payments).
- Did not require any loan modifications.
- Obtained increased availability on lines of credit or additional debt with the DSCR remaining at an acceptable level.
- Took advantage of PPP loans or other stimulus benefits to improve cash flow and retain employees.
- Current on all loan payments.
- Business remained open, even with limited operations.

PASS/WATCH RISK RATING:

- Acceptable or tight primary DSCR (above 1.00x) based on current financial statements.
- Unacceptable primary DSCR (less than 1.00x) but acceptable global DSCR (above 1.20x) based on current financial statements.
- Asked and obtained loan modifications (such as going to interest only payments, delay of P&I payments, lower payments with extension of maturity date, etc.) from lenders.
- Current on all loan payments.
- Business may be open or closed during pandemic, but is expected to return to normal operations in 2021.

SPECIAL MENTION RISK RATING:

- Unacceptable primary DSCR (less than 1.00x) but acceptable global DSCR (above 1.20x); however, financial statements are not current (more than 18 months old).
- Asked and obtained loan modifications (such as going to interest only payments, delay of P&I payments, lower payments with extension of maturity date, etc.) from lenders.
- Current on all loan payments.
- Business may be open or closed during pandemic, but is expected to return to normal or reduced operations in 2021.

SUBSTANDARD OR WORSE RISK RATING:

- Unacceptable primary and global DSCR (less than 1.00x) based on most recent financial statements available, current or not current.
- Asked and obtained loan modifications (such as going to interest only payments, delay of P&I, lower payments, etc.) from lenders.
- Not current on all loan payments.
- Business is closed and is not expected to reopen after the pandemic is over.

The above are general guidelines and may be impacted by other factors.

If you have any questions regarding this information, please don't hesitate to contact us at info@tgschwender-assoc.com

ABOUT US: Bo Singh is the President of T. Gschwender & Associates, Inc. (TGA). TGA is a diversified consulting company that has been providing services to financial institutions since 1984. We like to describe ourselves as a highly sophisticated "Credit Department," able to handle all functions from initial borrower due diligence to collateral liquidation, and everything in between. Our goal is to provide these services in a timely and cost-effective manner, allowing our clients to tap into resources they would not otherwise be able to employ internally. Contact us at info@tgschwender-assoc.com.