

## JUNE 2013 NEWSLETTER

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## HOW TO NEGOTIATE COMMERCIAL LOAN DOCUMENTS

### NEWS ALERT:

A. Free Online CLE/CPE LawLine Seminar

**Pozzuolo Rodden, P.C. is pleased to announce the opportunity to attend the following upcoming CLE/CPE seminar for free either in person or via webcast:**

**“How Middle Income Families Should Plan for Retirement Including Ethics”**

Wednesday, June 12, 2013

New York, NY

*Also available via Live Webcast*

Presenter: Joseph R. Pozzuolo, *Esquire* &  
Jeffrey S. Pozzuolo, *Esquire*  
Pozzuolo Rodden, P.C., Philadelphia, PA

Further Ed/LawLine.com  
61 Broadway, Suite 1105  
New York, NY 10006

5:00p- 5:30p- Registration

5:30p-7:30p- Course Instruction

Register at: [www.pozzuolo.com](http://www.pozzuolo.com) Click under Seminars and follow the link.

**B. Pozzuolo Rodden, P.C. is pleased to announce the opportunity to obtain free CPE/CLE credits by viewing the Lawline webcast course taught by Joseph R. Pozzuolo titled “The Negotiation and Documentation of Commercial Financing Documents Including The Use of Convertible Loans With Put and Call Options”. Please contact [chrissy@pozzuolo.com](mailto:chrissy@pozzuolo.com) for the free credit link that allows you to watch the seminar, free of charge, and to obtain the credit as well.**

**C. Joseph R. Pozzuolo, Esquire and Jeffrey S. Pozzuolo, Esquire will be presenting a CPE/CLE seminar for Penn State University, Doylestown Campus, entitled “ The Basics Of Estate Tax Planning After The American Taxpayer Relief Act of 2012”. The seminar will take place on June 20, 2013 from 1-5pm. Please contact Theresa M. Bloom at: [tmb17@psu.edu](mailto:tmb17@psu.edu) for reservations.**

**D. Pozzuolo Rodden is pleased to announce that Jeffrey S. Pozzuolo received his Masters in Taxation law degree “summa cum laude” from Temple University’s Beasley School of Law last month. Jeff Pozzuolo also has JD/MBA degree from Temple University’s Beasley School of Law and the Fox School of Business and graduated magna cum laude from the University of Pennsylvania with a BS in economics (Finance and accounting) from the Wharton School and a BA in Mathematics from the College of Arts and Sciences.**

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- **QUESTION OF THE MONTH:**
  - How Can A Custodial Parent Relocate With Their Child?
  - **Answer-See Page 7 of this Newsletter**
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## **HOW TO NEGOTIATE COMMERCIAL LOAN DOCUMENTS**

In the current financial environment after the recent booms and recessions of the late 1990's and 2000's, and in light of new financial regulations it can be difficult to obtain commercial loans. The following article discusses steps that can be taken to make it easier to obtain commercial and real estate financing. This involves the proper preparation, identifying the proper lending institutions, and identifying the terms that can and should be negotiated.

### **Types of Debt:**

A borrower needs to determine what type and amount of debt it needs. There are a number of debt instruments, but the two most common are lines of credit and term loans. A line of credit is a credit arrangement in which a financial institution agrees to lend money to a business on demand up to a specified amount. A term Loan is a loan for a fixed amount that has a specified repayment schedule and a fixed or floating interest rate. Term loans almost always mature between three and ten years with a balloon principal payment.

Lines of credit provide the flexibility to draw at any time to cover fluctuating needs such as day to day working capital. The borrower can decide how much principal to pay off or increase the amount borrowed without bank intervention. The maximum borrowing base (maximum amount that can be borrowed) is normally based off of a percentage of current accounts receivable and inventory. Term loans are less flexible but allow for more stability with fixed payments throughout the term. Term Loans are usually used for long term financing for purchases or new ventures. The amounts are usually based off of the value of the collateral and/or the future cash flow of the business.

A borrower must determine which loan it desires and how much. If it is looking for stable payments to purchase property, capital improvements, machinery, or to purchase an existing business, usually a term loan is desired. If it is looking for flexibility to cover basic expenses, payrolls, or to cover working capital expenses then a line is usually desired. Most businesses combine a line of credit with a term loan.

### **Preparing for Negotiating:**

Next, the borrower must prepare the following paperwork in anticipation of approaching banks to convince that it is a good loan candidate. Lending institutions are essentially looking for evidence of the ability to repay a loan, the promises of future business and the growth of the business.

Lending institutions will want financial documents indicative of past performance and current net worth. Businesses will need to provide a full set of financial statements whereas individual borrowers/guarantors need to provide personal financial statements. With these, lenders require tax returns with backup documentation/verification to help verify such amounts. This shows a borrower's past profitability and asset pool that can be used to satisfy the loan payments.

Lending institutions will also look for documents projecting future ability to pay. For long term stable businesses or rental real estate with a history, this may simply be the prior three year's income statements as they can reliably project future income from the past income. For new/less stable businesses, this requires proformas projecting future cash flows along with a description of assumptions and sensitivity analysis to show robustness with different assumptions. Many lenders have specific rules they look to meet such as the cash flow must cover 1.3x of payments, or the loan to value ratio cannot be greater than 70%.

Last, a borrower should prepare any other documents that a bank may ask for and anticipate troublesome inquiries. A lender may want to review leases, permits and environmental reports after an initial review of the statements and future projections to verify the ability to operate the business. Further, a borrower should address any anticipated questions. If a borrower has a recent poor performance trend, a borrower should prepare what measures have been taken to reverse such recent trend.

### **Where to Obtain the Loan?**

Different banks have different lending profiles so it is best to shop around. One bank may have an expertise in servicing business or commercial real estate loans versus consumer real estate loans while another may not want to touch one or the other. Further, different banks may have different administrative rules in terms of charging points, lending limitations, administrative fees, and audits. Some may also have reputations that precede them both positively or negatively in dealing with borrowers. It is important to shop and research to find the appropriate bank.

Additionally, if larger amounts are required than local banks can risk, it may be desirable to explore other types of financial institutions such as insurance companies or investment banks. Insurance companies may have more flexibility to negotiate specific terms (discussed below) than a rigid local bank. Also, if substantial funds are necessary, an investment bank or private

equity firm may be the only options, but this may require surrendering some management control or equity interest to the private equity firm.

It is important that the borrower match its needs to the proper financial institution that usually services such needs.

### **Terms that Can be Negotiated:**

After narrowing the banks down to one or two, there are a number of terms that should be negotiated. It may be favorable to be flexible on less important terms to receive better terms in other areas. Below discusses a non-exhaustive list of different terms that should be negotiated.

#### ***Loan Origination Fees:***

Loan origination fees may include a direct payment to the bank for indirect additional profits and to cover bank expenses, the bank's legal fees for drafting the lending agreements, the additional costs of appraisals, and other relevant closing fees and costs. Many times banks will reduce these fees for business or use alternative or in house attorneys or appraisers to lower legal fees and appraisal costs. Sometimes banks make these fees higher than necessary hoping to make an extra profit if the borrower will not ask.

#### ***Interest Rates:***

Interest rates can be negotiated down or higher interest may entice a bank to add certain other desired features. A bank might start with 6% interest, but when pushed may offer a one year fixed rate of 4.5% for a new customer. Also, if a borrower desires higher borrowing base off of its collateralized assets, an extra .25% or .5% of interest may allow this.

#### ***Loan Origination Fees vs. Interest Rates:***

A borrower needs to balance loan origination fees versus the interest rate. Sometimes, a higher origination fee can obtain lower interest rates. For example, 2 points on a \$1,000,000 loan would be \$20,000. However, the points may allow a lower interest rate which will save \$50,000 (accounting for the time value of money) over the two year life of the loan leading to a net \$30,000 in savings. Thus, the different point vs. interest rate options should be analyzed.

#### ***Collateral Limits:***

If borrowing off of real estate, accounts receivable or inventory, banks may give a lower valuation of the underlying asset or place low borrowing limits on such value. For instance, a bank may initially offer a line of 45% of the inventory value and the bank values inventory at 80% of its fair market value by characterizing certain inventory as obsolete etc. It is important for the borrower to recognize these issues and attempt to negotiate with the bank to value the inventory at its full market value with a line up to 60% of inventory nearly doubling the effective

borrowing base.

***Longer Amortization Periods:***

A goal of all borrowers should be to analyze and obtain the right payment amount for the principal portion of any term loan. If the loan term is shorter than the amortization period, a balloon principal payment will be due at the end of the loan term. However, based on the cash flow of the business, it may be in the best interest of the borrower to obtain a longer amortization period and a lower monthly installment payment.

***Prepayment Penalties:***

Many banks charge a percentage fee for early principal payments. These may be from 2% to 4%. This will be incurred in a refinancing situation. A borrower can ask for no or lower fees or could ask for an option to refinance after 3 years without any fees or a decreasing prepayment or cancellation fee over a 2 to 5 year period.

***Limiting Guarantees:***

A business owner may be asked to provide unlimited personal guarantees for a loan so that the bank may seize personal assets in the event of default. However, if the borrower can demonstrate sufficient profitability, post sufficient collateral, or provide the bank other business, it may be able to reduce the guarantee to a fixed dollar amount, a fall back guarantee, or no guarantee at all.

***Notice to Cure Defaults and Less Stringent Loan Covenants:***

Loan covenants are one very important area to negotiate as this is what normally determines an event of default even if 100% of payments have been made. A bank may be able to call a loan if the current ratio (current assets/current liabilities) drops below 1.4 or if the loan to value goes above 80% of the collateral. Banks may even place subjective “catch all” terms that a bank may call a loan at its discretion if it feels the security of the loan has been impugned. This gives a bank a license to call the loan at any time and may be used as a pretext to receive extra fees or higher interest rates. It is best to understand and negotiate less stringent and/or realistic covenants and remove such subjective conditions to avoid being sideswiped by an event of default even with a perfect payment history.

At the very least, the borrower should negotiate an ability to cure any covenant defaults which is typically thirty (30) days.

Additionally, a borrower can request a bank to take seasonality of a business into account. The bank could have less stringent offseason breaching covenants for 2 to 3 months out of any 12 month period so a borrower is not punished for the seasonal nature of the business.

**Conclusion:**

In the current economy with added regulations and bank red tape it can be difficult to find proper financing. However, if a borrower makes the proper preparations and presentation, shops around, and negotiates on specific terms, a business may be able to find a diamond of a loan in the rough.

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QUESTION OF THE MONTH:

- **How Can a Custodial Parent Relocate With Their Child?**

In January 2011, the Child Custody Act (“Act”) adopted by the Pennsylvania Legislature became effective for all disputes related to child custody. The new Act directly deals with the concerns that arise when a parent having primary physical custody of a child or children desires to relocate or move out of the jurisdiction of the Court with the child or children. Not every move qualifies as “relocation” under the Act, which defines relocation as a “change in residence of the child which significantly impairs the ability of a non-relocating party to exercise its custodial rights.”

In C.M.K. v. K.E.M., 2012 Pa. Super. 76 (Pa. Super. 2012) the Superior Court of Pennsylvania held that merely providing notice of a move and filing a Petition for Relocation with the Court does not mean that filing party concedes that a move qualifies as a relocation under the Act. In C.M.K. the Court found the mother’s move sixty-eight (68) miles away qualified as a relocation under the Act because, even though father received greater custodial time with the child, he would be unable to participate in weeknight dinners, teacher meetings, doctors appointments and coaching the child’s athletics.

The Act only permits relocation when all individuals with custody rights consent to the relocation or if the Court approves the relocation. The party wishing to relocate must provide notice to all other parties with custodial rights to the child at least sixty (60) days prior to the intended relocation. The party receiving the notification of relocation then has a chance to object to the proposed relocation. If the relocation is not consented to, then the Court will consider the matter on a case-by-case basis and the party requesting the relocation has the burden to show that the relocation would be in the child’s best interest.

The Act enumerates the factors considered by the Court in considering the proposed relocation, including: (1) the child’s relationship with the party opposing the relocation; (2) the impact of the relocation on the child’s physical, educational and emotional development; (3) whether the relationship between the child and non-relocating party could be preserved; (4) the child’s preference; (5) whether any of the parties have a history of attempting to thwart the

child's relationship with the other party; (6) the benefit of the relocation to the moving party; (7) if the relocation benefit the child's quality of life; (8) the reasons the parties request and oppose the relocation; (9) history of abuse and/or risk of harm to the child; and (10) any other factor relating the child's best interest.

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- If there are any legal questions you would like this office to answer in the future, please email the question to us at [info@pozzuolo.com](mailto:info@pozzuolo.com). Each month, the question with the most relevance to our privately held business clients, advisors, and friends will be answered in our monthly newsletter. The questions can relate to any of the areas practiced by this office including business planning and transactions, corporate law, commercial litigation, employment law and litigation, commercial real estate and development, construction law and litigation, estate planning, estate administration, tax and pension law, family law litigation.
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## UPCOMING CLE AND CPE SEMINARS FOR ATTORNEYS, AND CPA's - PLEASE JOIN US

**A. Pozzuolo Rodden, P.C. is pleased to announce the opportunity to attend an upcoming CLE/CEP seminars for free either in person or via webcast:**

(1) "How Middle Income Families Should Plan For Retirement" on Wednesday, June 12, 2013 in New York, NY from 5:30p-7:30p. Also available via Live Webcast.

(2) "Fundamentals of Starting a Business" on Wednesday, July 10, 2013 in New York, NY from 5:30p-7:30p. Also available via Live Webcast.

\*To register free of charge please visit [www.pozzuolo.com](http://www.pozzuolo.com) under Seminars and follow the link.

B. Joseph R. Pozzuolo, Esquire and Jeffrey S. Pozzuolo, Esquire will be presenting a CPE/CLE seminar for Penn State University, Doylestown Campus, entitled "The Basics Of Estate Tax Planning After The American Taxpayer Relief Act of 2012". The seminar will take place on June 20, 2013 from 1-5pm. Please contact Theresa M. Bloom at: [tmb17@psu.edu](mailto:tmb17@psu.edu) for reservations.

C. Joseph R. Pozzuolo, Esquire will be presenting a CPE seminar for the Montgomery County CPA Society on Wednesday, July 10, 2013 at Cedarbrook Country Club, Blue Bell, PA. Please contact Diane McLeen at [DMcLeen@Janne.com](mailto:DMcLeen@Janne.com)

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## PUBLICATIONS

All of the following professional publications and past newsletters written by attorneys of this office are available by clicking here: [http://pozzuolo.com/Pubs\\_Articles.shtml](http://pozzuolo.com/Pubs_Articles.shtml)

### • **Corporate/Tax Articles**

- Bankruptcy - How To Prevent It And How To Cope With It Should It Happen To Your Business
- Deferred Compensation Rewards And Retains Key Employees
- Design Buy-Sell Agreements For Maximum Utility
- How An S Corporation Avoids The Double Taxation Incurred When Excessive Compensation Is Treated As A Dividend
- How Mortgage Lenders Should Draft Broker Agreements To Avoid RESPA Violations
- How To Look, Act And Sound Like A Professional Corporation
- How to Structure a Suitable Buy-Sell Agreement
- How To Use Non-Qualified Deferred Compensation Arrangements As A Business, Retirement And Tax Planning Tool
- Money Purchase Pension Plan Falls Out Of Favor
- Protecting A Client's Business From Unfair Competition Using Restrictive Covenants
- Structuring Loans From Qualified Plans - How To Handle The Strict Tax Rules
- What Type of Qualified Corporate Retirement Plan Best Serves Your Business, Tax And Retirement Needs
- Why An Employment Contract Is Mandatory

### • **Estate Planning Articles**

- Adapt Estate Planning Strategies to Fit the Needs of Same-Sex Couples
- College Funding Tool Offers Estate Planning Advantage
- Diversify Strategies For An Effective Estate Plan
- Divorce and Estate Planning
- Divorce Raises The Need For Performing An Estate Planning Review
- Drafting The Durable Power Of Attorney For Wealth Protection Purposes
- Estate Planning For Pet Owners
- Remarriage Situations Can Raise Special Estate Planning Considerations
- Six Proven Estate Planning Techniques
- Special Needs Trust - An Estate Planning Tool For The Disabled
- The Limited Liability Company -A Sophisticated Tool For Estate Planning

- Using Trusts To Maximize Family Protection And Minimize Estate Tax
- Why Living Wills- Advance Directives Are An Essential Part Of Estate Planning

***Actual resolution of legal issues depends upon many factors, including variations of facts and state laws. This newsletter is not intended to provide legal advice on specific subjects. It is to provide insight into legal developments and issues. You should always consult with legal counsel before taking any action on matters covered in our updates.***

This newsletter is courtesy of Pozzuolo Rodden, P.C.

To subscribe, unsubscribe, or for any questions, please contact us at [INFO@POZZUOLO.COM](mailto:INFO@POZZUOLO.COM).