

- Introductions
- Featured Product – *Budget Review*
- Company Picture

- Quality is the Defining Factor between Credibility and Redundancy

GMC-CMI LLC QUARTERLY GAZETTE

Financial Risk Management for
Lenders and Insurers
Volume 2 • Issue 5
April 2005



Introductions

Welcome 2005! This new year comes with new opportunities for GMC-CMI LLC. We are growing again and have two new additions to our staff. Lacey Fain is our new Administrative Assistant and Editor and Sam Casady and Court Carpenter join our team of experienced field inspectors. Our staff is growing and is more capable than ever to serve you. With this newsletter we want to inform you of exciting new changes at GMC-CMI LLC and keep you updated on happenings in the world of construction financial risk management.

Your feedback is encouraged as well as requests for information. You are welcome to submit your own content for publication in future issues.

Quarterly Featured Product: Residential and Commercial Budget Reviews

GMC-CMI LLC offers residential and commercial budget reviews for the benefit of our clients. In these reviews, GMC-CMI analyzes building plans and proposed budgets. We compare this information in with current regional averages to determine if the budget is adequate to construct the project as designed.

Quality is the Defining Factor Between Credibility and Redundancy

Quality counts in every business, and for most companies, the level of quality attained from their vendor's are the primary basis for determining the necessity for purchasing a product or service. When hiring an inspection company, it is critical to look for one that places the quality of their products above all else in justifying their role in the *construction loan* process.

For many years a debate has occurred in financial institutions about the methods they should apply to manage *construction loan* portfolios. Most institutions find their banking interests sharply divided between the sales nature of producing the business, and the more traditional nature of conservative banking portfolio management. Adding to the debate is the very competitive nature of capturing construction financing opportunities. Much pressure is placed on loan producers to develop strong relationships with borrowers, especially those who will require on-going financing needs. For that reason, many loan producers feel strongly that monitoring a construction project by an outside inspection firm is simply an additional loan cost to the Borrower.

On the other end of the spectrum is the ever present need for good risk

management to limit the possibility of the Lender accepting unwanted risks or liability. Making the decision about what funds to disburse from the loan places a great responsibility upon the Lender, and most credit officers prefer to rely on qualified third-party construction experts to recommend these payments. In so doing, the Lender reduces his direct liability, has based his disbursement on qualified information, and has demonstrated an effort to preserve the Producers relationship with his Client by making the inspection firm responsible for disputed claims.

In real estate construction loans, the loans are usually based upon *pending collateral* (the future finished building), and the *appraised value* of the proposed work when completed. In other words, the loan is collateralized and value is established on work that is not there. The components of a building (parts of the collateral) are generally "broken down" to line items with specific values. The values reflected in *line items* are considered to be the budget upon which the distribution of loan funds will be made as the work described in each line item is found completed. This method of disbursement of loan funds assures both Lender and Borrower that the value has been established as loan funds are used.

A consulting company that has developed products and services to help the Lender in determining if the construction loan is properly structured,

and assists in providing detailed documentation about where the construction process is at a given moment in time is essential. Additionally, the company should provide a financial performance trail that is collected and recorded, reflecting the condition of the collateral and the management of loan funds.

It is easy to see why Lenders might wish to have this information, however, many Lenders are torn between the cost of the information and the effect adding that cost has on the development of business.

The quality of the report is the key to determining if the report is actually going to be an asset to both the Lender and the Borrower, and worth the additional cost. A well written report, where the inspector has carefully evaluated the project, gathered photographs of those components completed, and made recommendations for loan disbursement based upon financial tracking of the project provides both additional security to the Lender and *added value* to the Borrower. A poorly written but less expensive report can (and often does) become an embarrassment to the Lender and renders the report useless.

If a consultant is being used to collect information about a project that a Lender will use to disburse loan funds, the Lender should ask the following questions:

- Is each month's project review (inspection) complete and does it inform the Lender of the present physical and financial condition of the property?
- Is the project reviewed and documented on a line item basis?
- Is the information provided inclusive of both a financial review of the funds and a physical review of the intended collateral and is it sufficient to document the distribution of funds?
- Does the report indicate to the Lender and/or Borrower if enough money remains in the budget to complete the project?
- Is the inspector qualified to provide this information and support it, even if it goes to litigation?
- Is the inspection firm capable of presenting itself as an independent, insured, unbiased, third party consultant?

When the above questions can be answered in the affirmative, then the

Lender purchasing the information can be certain that the documentation will substantially add to managing their risks. The Lender is assured that funds are disbursed as collateral is found in-place. Thorough documentation of the Lender's *prudent management* of the construction funds is a bi-product of the process. Most importantly, this information is provided by an independent third party observer, and the collected information adds credibility to the disbursement process.

This process of third party information gathering and documentation provides *added value* to both the Lender and the Borrower. It also helps the Loan Producer retain, and even improve his relationship with his Borrower, through providing assurance that when financial issues arise he can assist in crafting solutions.



From left to right: Jeff Gepner, George Casady, Tom Gepner, Jennifer Muschenheim, Lacey Fain, Court Carpenter, Sam Casady