



KREDED



HELPING BUSINESSES
KEEP THEIR LIGHTS ON

LET'S TALK ABOUT TERM SHEETS & COMMITMENT LETTERS

A beginner's guide to Term Sheets and
Commitment Letters

www.kreded.com

CONTENTS

- 2 Introduction
- 3 What is a term sheet
- 4 Main sections of a Term Sheet
- 5 How to negotiate a Term Sheet
- 6 What is a Commitment Letter
- 7 Main sections of a Commitment Letter
- 8 How to negotiate a Commitment Letter

INTRODUCTION

For many business owners, the borrowing process seems daunting to the point that they rather struggle on their own and delay adding new products or services, investing in new technology, or expanding into a new market.

While some of that fear is rooted in bad personal experiences, in many cases is due to the lack of proper guidance and noise on social media and other channels. It is true that, at times borrowing capital can be complex, but in no way it outweighs the benefits that additional money can do to your business.

In this third series, we are going to discuss two essential tools you have to make your borrowing experience easier and more valuable. The Term Sheet and the Commitment Letter. Both are considered preliminary documents as they are prepared in anticipation of the final loan agreement.

We will review their main sections, what to look for, and what is binding and non-binding. Our goal is to give a roadmap to negotiation and hopefully ignite the courage to ask for the capital you need with confidence.

WHAT IS A TERM SHEET?

The Term Sheet is the first document. It is prepared to lay out what the lender is willing to lend you, on what terms, some potential conditions, and covenants. It is a proposal before full due diligence (due diligence is the process used to perform a financial analysis of the company, market research, borrower's and owner's background check, etc.).

While each lender has specific loan programs, it is worth noting that market conditions drive this document. For example, some lenders price their loans based on an index, such as the 5YR US Treasury, 7YR US Treasury, or the 10YR US Treasury. As you know, these indexes move up and down daily; therefore, the term sheet will provide you with an indicative rate, not a final rate.

Although the term sheet is not binding, it sets the tone for the future and transaction. Some lenders will request an engagement fee, sometimes called an origination fee or commitment fee, and it can be stated as a percentage of the proposed loan. Some will require a portion of this fee to be paid when acceptance of the term sheet. Paying this fee indicates that the borrower is committed to the process and is unlikely to go with a competing lender.

MAIN ELEMENTS OF A TERM SHEET

1

Borrower's name

2

Guarantor(s)

3

Proposed loan type

4

Proposed loan amount

MAIN ELEMENTS OF A TERM SHEET

5

Proposed repayment terms

6

Proposed interest rate

7

Potential financial covenants

8

**Proposed or potential
prepayment clauses**

MAIN ELEMENTS OF A TERM SHEET

As noted above, the term sheet is a preliminary document to the final loan agreement, so that the main items will include the name of the borrowing entity and guarantors (corporate guarantors and personal guarantors). It will also have the proposed loan type and amount, for example, a \$1,000,000 Revolving Line of Credit. It also includes an indication of the interest rate, for example, 250 basis points over the US Prime Rate.

Note that while this is a rate the lender proposes, it can change after a full review or underwriting of your file. Also, note that for lines of credit, this rate is variable for the life of the loan.

Most lenders will price their loans using a base index plus a margin or spread for term loans. For example, let's say 250 basis points over the 5YR US Treasury Index.

The term sheet will also include the proposed maturity and amortization; let's say at 10-year maturity and a 10-year amortization schedule—this is a straight loan.

It might also include a potential pre-payment penalty clause. You want to know about this, ask about this, and understand how the pre-payment clause will read.

More comprehensive term sheets will also include any potential financial covenants, negative covenants, and special guarantees. If you don't see any of these items listed, ask if there is a chance they will come up later in the process, and if so, what are the typical terms.

HOW TO NEGOTIATE A TERM SHEET

When you receive a term sheet before signing it, review the proposed terms, shop around, and compare rates and terms with other lenders. You will sometimes get several term sheets without you paying a fee. This is how KREDED likes to represent borrowers. We will have several lenders compete for your deal, and you will review each proposal and decide which lender you think provides the best option.

The best way to negotiate a term sheet is by analyzing how the proposed terms will benefit you and answering the following questions:

- Will the proposed terms deleverage your balance sheet?
- Will it provide you with the capital you need?
- Are the proposed terms in line with your business goals?

If you receive several term sheets, run this exercise for each term sheet.

Then, compare the result against each other. Remember, not always the cheaper loan, the lowest interest rate, or the longer amortization is the most appropriate loan for you. When in doubt, it is best to consult an expert. As the adage says, money well spent today will give you peace of mind tomorrow. Ok, it is not an adage, we just made it up, but it is true.

WHAT IS A COMMITMENT LETTER?

Like its counterpart, the term sheet, commitment letters are preliminary to loan agreements; however, when a lender issues a commitment letter, it has already verified your credentials, and you have done enough follow-up work to prove you are committed to completing the process and obtaining funding.

With a few additions, the commitment letter will include the same elements in the term sheet, but these may have been affected by underwriting, therefore looking different.

In addition, the commitment letter will consist of additional fees and estimates due to third parties vendors, such as appraisal reports and environmental reports (if you are applying for a real estate loan). Finally, it will also include the origination fee. Remember that some term sheets might list them, and you might have already paid for a portion.

However, sometimes, half of the origination fee is due when you accept and sign the commitment letter.

Note that the life cycle of the commitment letter is relatively short, meaning you have a certain number of business days to accept the terms offered. Past the deadline, the lender has the right to revisit the terms and the entire offer, as market conditions might have changed. Recall that market conditions drive the term sheet.

WHAT IS A COMMITMENT LETTER?

A final piece of information is to ensure you know the deadline for closing the loan. After you have signed the commitment letter, the lender will begin working on the pre-closing conditions; there is typically a deadline to complete the loan, which can be 30-90 days from the approval of the loan. Again, you will have this information in the commitment letter. If it is not there, make you ask your lender.

MAIN ELEMENTS OF A COMMITMENT LETTER

1

Borrower's name

2

Guarantor(s)

3

Proposed loan type

4

Proposed loan amount

MAIN ELEMENTS OF A COMMITMENT LETTER

5

Proposed repayment terms

6

Proposed interest rate

7

Potential financial covenants

8

**Proposed or potential
prepayment clauses**

HOW TO NEGOTIATE A COMMITMENT LETTER

You have two well-drafted documents that precede your final loan agreement. You have also extensively communicated with your loan advisor (lender).

The next thing is to compare the original terms presented on the first document, the term sheet, to the new proposed terms on the commitment letter and answer the following questions:

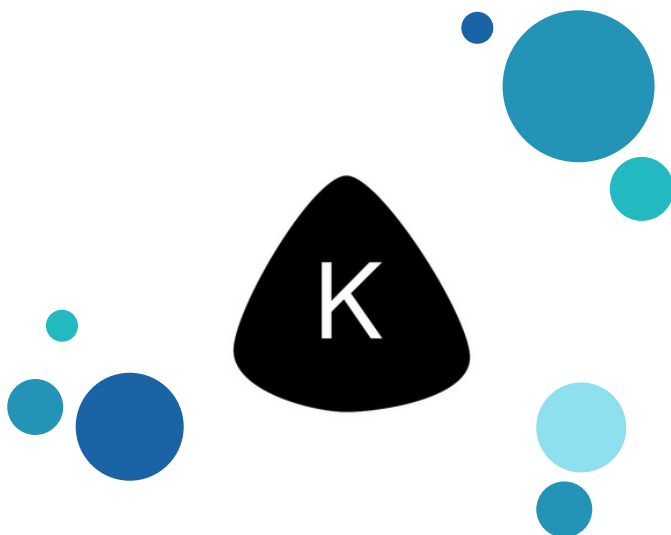
- How much different are they?
- What is different?
- Are they new terms less advantageous to you than the first ones?

If you were to accept the new terms, would your business be negatively or positively impacted?

Now reach out to your lender to review these items and ensure you are satisfied with the answers.

Make sure to request an extension of the commitment letter if you know you will not be able to accept the terms by the deadline provided. This helps you to retain the proposed terms, and you know that the market is worsening.

ABOUT KREDED



KREDED

KREDED is an innovating commercial loan marketplace, servicing middle market companies. Our mission is to help businesses keep their lights on by giving decision makers more time to focus on operating their businesses; while providing convenience and a streamlined funding process.

You can email KREDED at capital@kreded.com
