Chapter 7 – Skin in the Game

In 2004, I was working in a Plano bank when I received a telephone call. A man named Sam said he wanted to borrow two million dollars and that he would like to come in and talk with me.

A lending officer is always trying to lend money. He or she is graded on how much he or she lends out each year, so I was eager to talk to Sam.

Sam came in the next day. He told me that he was going to buy a recreational vehicle dealership in North Dallas for three million dollars. I asked for details and he said he was putting down one million dollars and wanted to borrow two million.

As I have previously mentioned, I am always concerned about “skin in the game”- what a borrower has in a deal compared to what the bank has in the deal. So, having 33% equity in the deal was a great start.

Side note: if you will think about the mortgage crisis of 2008-2009, one of the main things that was occurring was the mortgage companies and banks were financing houses with little to no money down. No skin in the game.

I asked him if he had brought the financial statements and tax returns on the business he was buying. He said he had and gave them to me. I then asked for his personal financial statements and tax returns which he also had with him. I thanked him and asked him to return in a couple of days after I had had a chance to look over the information.

Over the next couple of days, I reviewed the tax returns and financials of the business. On paper, it appeared to be a good business and one that could support a loan of two million dollars. The business provided more than sufficient cash to play the debt over time.

I pulled Sam's credit; it was good. But as I looked over his financial information, I became concerned. He did not have a million dollars cash nor did he have assets that he could turn into a million dollars cash. He did not even have five hundred thousand in assets. He was simply not that strong financially.

Sam came back into the bank in a couple of days. I told him that I needed an explanation of how he was going to put down one million dollars on the purchase of this business. He explained that the seller was going to take back a note from the purchaser as the sale was completed. That was, by his explanation, his equity in the deal.

In my career, I have seen this approach many times. A borrower points out that since the transaction is three million and the bank is only lending two million, there is one million in "equity" in the deal. .