LOAN WORKSHEET #7 – OIL & GAS LENDING

Oil and gas loans are borrowings secured by, or dependent upon, the production and sale of encumbered hydrocarbons. Risks associated with this type of lending stem from volatile market prices, dependence upon technical production assumptions to determine collateral value, and the depletion of collateral. Oil and gas lending requires specialized skills and a detailed knowledge of the oil and gas industry. Management should demonstrate sufficient knowledge of exploration, development, production, and transportation of hydrocarbons. In addition, management must have knowledge of, and access to, current market information and independent engineering or valuation reports. Because collateral is depleted through production, lien perfection and control of collateral proceeds are of great importance. Banks with a significant oil and gas loan portfolio that do not have the benefit of detailed policy and procedure and qualified staff could be subjecting themselves to undue loss.

Evaluate	Comments
______ **1.** Does written policy contain the following criteria pertinent to oil and gas lending?	
A. A clear statement of lending philosophy?	
B. Minimum collateral margins to provide protection against significant declines in price?	
C. Limit on advances to a percentage of proven producing reserves?	
D. Periodic independent and detailed analysis of reserves include pricing, discount, and timing factors?	
E. Required re-engineering of the reserves when actual production and price are significantly different from original assumptions?	

LOAN WORKSHEET #7 – OIL & GAS LENDING (continued)

Evaluate	Comments
F. Limits against lending for exploration of unproven reserves and near-field drilling (wildcat wells) or shut-in reserves?	
G. Appropriate terms of repayment?	
H. Officer loan limits commensurate with officer skills?	
I. Management information systems of sufficient detail to provide senior management with timely and accurate portfolio performance indicators in volatile market conditions?	
_____ **2.** Evaluate underwriting and servicing.	
A. Obtain and review loan committee packages on loans being reviewed. Consider the following:	
• Are packages of sufficient detail to make an informed credit decision?	
• Is the use of proceeds clearly defined?	

LOAN WORKSHEET #7 – OIL & GAS LENDING (continued)

Evaluate	Comments
• Are terms established in conformance with policy? • Are engineering reports summarized or are they provided in detail? • Are monitoring requirements and/or loan agreement covenants detailed? • Are borrower profiles or debt summaries of sufficient detail to assess past performance, collateral margins and related debt? • Are repayment terms commensurate with the use of proceeds? **B.** Are collateral proceeds controlled or monitored? **C.** Is actual production periodically compared to original engineering assumptions? **D.** Are repayment terms adhered to? **E.** Are advances for unrelated purposes routinely granted against existing collateral?	

LOAN WORKSHEET #7 – OIL & GAS LENDING (continued)

Evaluate	Comments
F. Are borrowers allowed to advance against equity resulting from price increases?	
G. Determine if management overly relies on the collateral, tending to ignore risks associated with poor management, deteriorating financial condition, improper structure, and failure to adhere to repayment terms?	
_____ **3.** Evaluate financial statements. Financial statement analysis should focus upon the borrower's ability to amortize debt when collateral proceeds fall short of debt service requirements.	
A. Determine if the borrower has sufficient liquidity to meet margin requirements in the event of rapid declines in price.	
B. Evaluate secondary sources of repayment through excess cash flow, sale of assets or access to additional borrowing.	
C. Evaluate the level of contingent liabilities in relation to available cash after debt service.	