

# **Business Lending Basics**

SAMPLE

## Table of Contents

Borrower Identification	Page 3
The Purpose of Loan	Page 3
Loan Structure	Page 4
Repayment	Page 8
The Five Primary C's of Credit	Page 11
Covenants	Page 12
Negotiating Loan Terms	Page 13
Relationship Building Tips	Page 14
Marketing Opportunities Based on Business Life Cycles	Page 14
Financial Statement Basics	Page 16
Credit Memorandum Basics	Page 17
Risk Analysis	Page 18
Collateral Analysis	Page 20
Personal Financial Statement Analysis	Page 21
Personal Tax Return Analysis	Page 23
Business Statement Analysis	Page 27
Cash Flow Analysis	Page 29
Financial Ratio Calculations	Page 35
Financial Definitions	Page 38
Standard Statement Spreading Guidelines	Page 42

## **Borrower Identification**

Question # 1 is “Who is the borrower?” It doesn’t matter if you are talking about commercial lending or consumer lending. This is the most basic piece of information you must learn about every loan applicant. Who is that person or entity that will sign the promissory note---“I promise to pay....” Borrower identification includes forms of business organization: sole proprietorship, general partnership, limited partnership, S Corporation, C Corporation, limited liability company, etc. You need to know your borrower’s form of organization so you know if you are analyzing the proper entity and who will sign the documents obligating the borrowing entity to repay.

*Ask: “How is your business currently structured?”*

**Refer to “The Basics of Small Business Loans and Deposits” training manual for additional specific information.**

## **The Purpose of Loan**

After you establish the identity of the borrower, you need to be certain of the purpose of the loan or use of the loan proceeds. This is particularly important in helping to determine:

- The appropriate loan amount
- The appropriate loan structure
- The probable source of repayment

When discussing the purpose of the loan, do not accept general responses such as “for working capital” or “for operating expenses,”.

*Ask: “What do you want the money for” or better yet,  
“Who will you write checks to with the loan proceeds?”*

## Credit Memorandum Basics

A Credit Memorandum is a package of basic background information and industry specific information about any existing or prospective borrower, the amount and cause for the loan request and current and historical financial information including the borrower's ability to repay.

### Purpose:

Credit Memorandums are basically used for the following:

1. To provide a vehicle that includes all the information necessary to make a sound credit decision together into one "package"
2. To provide an "approval document", one that will be signed evidencing that care and thought was given to making the credit decision
3. To provide a reference or review point for future reviews of the credit, historical trends, relationship building, etc

### Contents:

Generally a Credit Memorandum has the following components:

- **Description of "the business of the business"**
  - Location of the business
  - Market area of the business
  - Identification of owners
  - Identification of management team
- **Description of the loan request and the terms for repayment**
- **Collateral analysis**
- **Financial statement analysis**
  - Balance Sheet and Income Statement
  - Cash Flow Statement
  - Ratio Analysis
  - Peer Comparisons
  - Strengths and Weaknesses
  - Risk Identification
  - Cash Generation and Repayment ability
- **Guarantor Analysis**
- **Risk Rating**
- **Exceptions to Established Policies and Procedures**
- **Approval/Denial Authorities Signature and Comments**
- **Attachments**
  - Financial Statement Spreads

## Financial Ratio Calculations

**Ratio Analysis:** A comparison over time of the mathematical calculations that reflect the relationship between two numeric items such as two specific line items or categories of the financial statements. Typically ratio analysis is used to measure Coverage, Liquidity, Leverage, and Profitability

### Coverage-

<u>Cash Available for Debt Service</u>	2003	2002
Net Income	\$200	\$400
Depreciation & Amortization	\$ 20	\$ 20
Interest Expense	\$ 40	\$ 30
Plus any Discretionary Add Backs	\$ 0	\$ 0
<u>Less Distributions/Withdrawals</u>	<u>(\$300)</u>	<u>\$ 0</u>
Cash Available for Debt Service (CAFDS)	(\$ 40)	\$450

<u>Debt Service Requirement</u>		
Principal and Interest on Existing Debt*	\$	\$
<u>Principal and Interest on Proposed Debt</u>	<u>\$</u>	<u>\$</u>
Debt Service Requirement	\$	\$
<b>-or-</b>		
Prior Period Current Portion LTD	\$ 30	\$
Current Period Interest Expense	\$ 40	\$
<u>Principal and Interest on Proposed Debt</u>	<u>\$</u>	<u>\$</u>
Debt Service Requirement	\$70	
*Obtained from Business Debt Schedule		

<u>Debt Service Coverage Ratio (DSCR)</u>	<u>2003</u>
<u>Cash Available for Debt Service</u>	<u>(\$ 40)</u>
Debt Service Requirement	\$ 70
Debt Service Coverage Ratio (DSCR)	(0.57):1*
*For every \$1 in debt service, the company produced cash equal to negative \$0.57.	