Demystifying the Lending Process

Helping you make real financial progress.

Whether you need additional cash flow to cover overhead expenses, or you're looking to expand your product offering, you may need capital to support your business growth. If you're new to the process, applying for a loan can be overwhelming. We are here to demystify the lending process and help you make real financial progress.

Uncovering how lending decisions are made

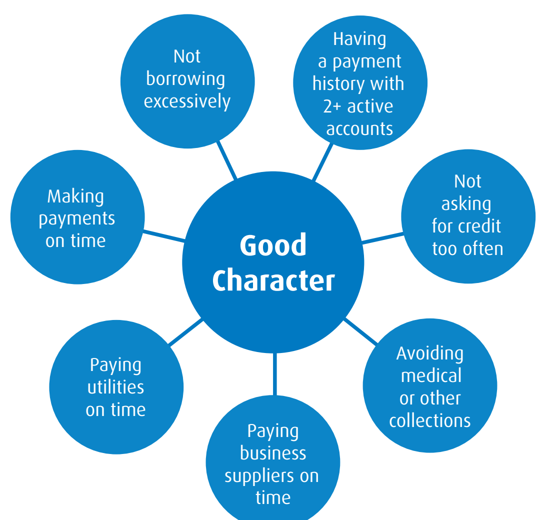
To start, banks perform a credit analysis to determine the risks associated with a loan. The analysis includes a review of your personal and business performance and analyzes the 5C's when making a lending decision:

Character	Capacity	Capital	Collateral	Conditions
Character is largely evaluated on the borrower's prior payment history from their credit bureau, their openness to answering questions and their business experience.	Capacity is an evaluation performed by the bank to make sure that the borrower has sufficient income to repay the loan.	Capital, also known as equity, is really important to a business as it will help a business when times get tough or when the business needs to grow. During these periods, a business needs capital to continue to operate.	Bank's generally ask for collateral to support a loan in the event the borrower doesn't make payments on the loan. If payments stop, the bank will try to sell the collateral to get repaid.	Lenders will consider external factors that may impact your business, such as the industry you operate in, the economy, supplier relationships and similar.

Character

Banks will review the character of the borrower by looking at the credit history obtained from a credit bureau report (CBR). While it is always important to keep a good credit history, it becomes increasingly important when making bigger personal or business purchases. In order to check your credit history and ensure the data included in the report is accurate, you can obtain a free copy of your credit report at www.annualcreditreport.com.

If you notice inaccurate information, please visit the Federal Trade Commission for more information on how to dispute it.



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Capacity

Banks determine the loan amount you qualify for by combining your personal and business income to ensure you have the capacity to make loan payments from the total income. Business income is determined using tax returns or accountant prepared financial statements which reflect the ability of a company to generate profits.

Personal Income
+ Wages
+ Other types of income (social security, retirement, etc.)
- Personal debt payments
- Personal taxes & living expenses

+

Business Income
+ Net income
+ Interest
+ Taxes
+ Depreciation
+ Amortization (non-cash)

Business Debt Service
+ All business debt

=

Capacity aka Debt Service Coverage
- Debt service coverage is expressed as a ratio such as 1.25:1
- The ratio can be interpreted that the bank expects $1.25 in personal and business net income to every dollar of business debt service
- The extra 25 cents is a cushion to protect against economic downturns

Capital

Banks view capital as a critical component of the lending decision. Capital in a business can be either cash or equity in business assets and is similar to the down payment on a home or when we buy a car. Another way to think about capital is considering it as a savings account for the business which is especially important during an economic downturn or business growth.

Example
Suppose your business got a new contract to custom design phone covers. Your business would have to invest in plastic and other materials needed to manufacture the product. You'd generate an invoice and ship the materials, however up to this point you haven't received payment. In this case, expenses would need to be paid for using business capital.

Collateral

Collateral is important to a lending decision as it is considered a secondary source of repayment. Ideally the business pays the debt first and if unable to, the business owner will incur the debt. When the possibility of payments being made ends, the bank considers using the collateral as a source of repayment.

Conditions

Lenders also consider external factors that can impact the demand for your goods and/or services as well as the supply of your inputs. For example, the impact of COVID-19 varies across industry types. Restaurants, special event spaces and gyms have been negatively impacted while online retailers and software companies have been stable due to increased demand.

Reminder
Although they are a useful guide, the 5 C's of Credit are not a guarantee for getting a loan approved. There are many factors that play a role in the lending decision and we encourage you to speak with your banker who can provide you with additional insights and help answer any questions you might have about the lending decision process.

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