Credit Factors

To determine if you qualify for SBA's financial assistance, you should first understand some basic credit factors that apply to all loan requests. Every application needs positive credit merits to be approved. These are the same credit factors a lender will review and analyze before deciding whether to internally approve your loan application, seek a guaranty from SBA to support their loan to you, or decline your application all together.

Equity Investment

Business loan applicants must have a reasonable amount invested in their business. This ensures that, when combined with borrowed funds, the business can operate on a sound basis. There will be a careful examination of the debt-to-worth ratio of the applicant to understand how much money the lender is being asked to lend (debt) in relation to how much the owner(s) have invested (worth). Owners invest either assets that are applicable to the operation of the business and/or cash which can be used to acquire such assets. The value of invested assets should be substantiated by invoices or appraisals for start-up businesses, or current financial statements for existing businesses.

Strong equity with a manageable debt level provides financial resiliency to help a firm weather periods of operational adversity. Minimal or non-existent equity makes a business susceptible to miscalculation and thereby increases the risk of default on—failing to repay—borrowed funds. Strong equity ensures the owner(s) remains committed to the business. Sufficient equity is particularly important for new businesses. Weak equity makes a lender more hesitant to provide any financial assistance. However, low (not non-existent) equity in relation to existing and projected debt—the loan—can be overcome with a strong showing in all the other credit factors.

Determining whether a company's level of debt is appropriate in relation to its equity requires analysis of the company's expected earnings and the viability and variability of these earnings. The stronger the support for projected profits, the greater the likelihood the loan will be approved. Applications with high debt, low equity, and unsupported projections are prime candidates for loan denial.

Cash Management

Financial obligations are paid with cash, not profits. When cash outflow exceeds cash inflow for an extended period of time, a business cannot continue to operate. As a result, cash management is extremely important. In order to adequately support a company's operation, cash must be at the right place, at the right time and in the right amount.

A company must be able to meet all its debt payments, not just its loan payments, as they come due. Applicants are generally required to provide a report on when their income will become cash and when their expenses must be paid. This report is usually in the form of a cash flow projection, broken down on a monthly basis, and covering the first annual period after the loan is received.

When the projections are for either a new business or an existing business with a significant (20% plus) difference in performance, the applicant should write down all assumptions which went into the estimations

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of both revenues and expenses and provide these assumptions as part of the application.

All SBA loans must be able to reasonably demonstrate the “ability to repay” the intended obligation from the business operation. For an existing business wanting to buy a building where the mortgage payment will not exceed historical rent, the process is relatively easy. In this case, the funds used to pay the rent can now be used to pay the mortgage. However, for a new or expanding business with anticipated revenues and expenses exceeding past performance, the necessity for the lender to understand all the assumptions on how these revenues will be generated is paramount to loan approval.

Working Capital

Working capital is defined as the excess of current assets over current liabilities.

Current assets are the most liquid and most easily convertible to cash, of all assets. Current liabilities are obligations due within one year. Therefore, working capital measures what is available to pay a company’s current debts. It also represents the cushion or margin of protection a company can give their short term creditors.

Working capital is essential for a company to meet its continuous operational needs. Its adequacy influences the firm’s ability to meet its trade and short-term debt obligations, as well as to remain financially viable.

Collateral

To the extent that worthwhile assets are available, adequate collateral is required as security on all SBA loans. However, SBA will generally not decline a loan where inadequacy of collateral is the only unfavorable factor.

Collateral can consist of both assets which are usable in the business and personal assets which remain outside the business. Borrowers can assume that all assets financed with borrowed funds will collateralize the loan. Depending upon how much equity was contributed towards the acquisition of these assets, the lender also is likely to require other business assets as collateral.

For all SBA loans, personal guarantees are required of every 20% or greater owner, plus others individuals who hold key management positions. Whether or not a guarantee will be secured by personal assets is based on the value of the assets already pledged and the value of the assets personally owned compared to the amount borrowed. In the event real estate is to be used as collateral, borrowers should be aware that banks and other regulated lenders are now required by law to obtain third-party valuation on real estate related transactions of $50,000 or more.

Certified appraisals are required for loans of $100,000 or more. SBA may require professional appraisals of both business and personal assets, plus any necessary survey, and/or feasibility study.

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Owner-occupied residences generally become collateral when:

- The lender requires the residence as collateral
- The equity in the residence is substantial and other credit factors are weak
- Such collateral is necessary to assure that the principal(s) remain committed to the success of the venture for which the loan is being made
- The applicant operates the business out of the residence or other buildings located on the same parcel of land

Resource Management

The ability of individuals to manage the resources of their business, sometimes referred to as “character,” is a prime consideration when determining whether or not a loan will be made. Managerial capacity is an important factor involving education, experience, and motivation. A proven positive ability to manage resources is also a large consideration.

Mathematical calculations on the historical and projected financial statements form ratios which provide insight into how resources have been managed in the past. It is important to understand that no single ratio provides all this insight, but the use of several ratios in conjunction with one another can provides an overall picture of management performance. Some key ratios all lenders review are: debt to worth, working capital, the rate at which income is received after it is earned, the rate at which debt is paid after becoming due, and the rate at which the service or product moves from the business to the customer.

Taken from **http://www.sba.gov/services/financialassistance/loanapplication/qualify/index.html**