Borrowing 101

The BDC wants your business to succeed and in turn pay the BDC back. Our programs are revolving loan funds that require loans to be repaid so that we can lend our dollars to other businesses in the future.

Please remember the BDC is a public agency investing public (tax) dollars; the URA has a strict responsibility to invest these dollars prudently and with caution. To that end, beyond following standard commercial underwriting standards, the URA must work to assure to the best extent possible that our investments, as high risk loans, will get paid back and are collateralized as well as possible so that we can lend these dollars again in the future and protect the interests of the tax payers.

Please use this as a guide to your borrowing decision.

Resources

There are several resources available to help borrowers work through the business planning process. The BDC suggests the following:

- The University of Pittsburgh Small Business Development Center
  - www.sbdc.pitt.edu
  - ieeinfo@katz.pitt.edu (412) 648-1542
  - Small business planning, training, consulting, etc.
- Duquesne University Small Business Development Center
  - http://www.sbdc.duq.edu/default.cfm
  - mailto:duqsbdc@duq.edu (412) 396-6233
  - Small business planning, training, consulting, etc.
- Small Business Administration
  - http://www.sba.gov/smallbusinessplanner
  - Business planning
- Catalyst Connection
  - www.catalystconnection.org (412)687-0200
  - Strategic planning, operations consulting, product development, and more

These are just a sample of the network of service providers that the URA works with to help businesses grow and succeed. Please do not hesitate to contact us to find the right help for your business.

Are you ready to Borrow?

The BDC wants to make sure that you and your business are ready to borrow money. To that end, every borrower should be able to answer these important questions.

1. Do you have a written business plan?
2. Have you attended any business classes or workshops on how to run a business?
3. Does your business earn enough money to pay its expenses, pay you with enough left to repay a loan? Do you have a written cash flow to verify your ability to repay?
4. Do you know exactly how you will spend every dollar of your loan request? This is called a Sources and Uses statement.
5. Do you keep financial records for your business? Do you review and understand your statement of income and expenses each month? Need help with accounting?
6. A good credit history is a key part of being able to borrow money for a business. Have you borrowed and repaid loans in the past? Paid your bills and credit cards when they were due?

For most loan programs, the BDC will require, at the least these things when you apply for your loan:

1. Business Plan
2. Financing proposal sources and uses
3. Private lender, other financing sources commitment letters
4. Validated project cost estimates (i.e. contractor, quotes, invoices, etc.)
5. Business history
6. Key management resumes
7. Sales / lease agreements
8. Appraisal (i.e. property and/or equipment being financed)
9. Articles of Incorporation/Partnership agreements
10. Personal Credit history (can be pulled by BDC)
11. Business Financial statements
    a. Cash Flow, Balance Sheet, etc. (3 years)
    b. Corporate Tax Returns
    c. Business financial projections (3 years)
    d. Personal financial statements
    e. Personal Tax returns

BDC Commercial Lending Underwriting Criteria

Collateral

Collateral is an asset used to provide security for a loan. Collateral in commercial real estate transactions usually consists of the commercial real estate being purchased, constructed, or renovated. Collateral in business transactions (i.e. working capital, equipment, leasehold improvements, etc.) usually consists of the assets being financed and other business assets.

The collateral asset can be seized and sold by a lender to help repay a loan in the event of default by a borrower which is why lenders use these assets as security.

The value of this collateral is important in determining how much you can borrow. This is usually determined by using cost or appraised value.

In addition, most lenders will require personal guarantees and may require other forms of collateral to better secure their loan.

Cash Flow

Cash Flow is a key component in the underwriting process is the borrower's ability to repay the debt of the asset they are trying to acquire with financing. The BDC will look at the financials of any affiliate companies (any company in which the guarantors own 20% or more in) for repayment ability or its detraction. The BDC will evaluate a company's ability to repay their debt by using a Debt Service Coverage Ratio (DSCR). DSCR is defined as the amount of cash flow available to meet annual interest and principal payments on proposed and existing debt. The formula is: (see next page)

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DSCR = EBITDA + RR ***(E**arnings **B**efore **I**nterest expenses, **T**axes, **D**epreciation and **A**mortization + **R**ental expenses and **R**ental income, if applicable--this is also called cash available)/* **Total Debt Service**

EBITDA + RR	**TOTAL DEBT SERVICE**
Earnings (Net Income Before Tax)	1st Mortgage
+ Depreciation & Amortization	+ 2nd Mortgage
+ Interest	+ Existing Debt
+ Rent	Total Debt Service
+ Rental Income	
Cash Available	

$$\textbf{DSCR} = \frac{\textbf{Cash Available}}{\textbf{Total Debt Service}}$$

The BDC will require at least a 1.2 DSCR on any transaction.

Credit Analysis

Personal Credit: The BDC will also obtain personal credit reports to see how much personal debt the primary owner(s) of the business is/are carrying and their payment history. With the personal credit report, we determine if business owners are taking adequate salaries to cover their personal debt obligations. If an owner is not taking an adequate salary, the cash flow of the business might be reduced to compensate. If an owner is taking more than an adequate salary, a positive adjustment might be made to the company's cash flow. A personal debt calculation is determined for all principals by comparing the amount of annual debt payments they must pay to the amount of annual income they earn.

Business Credit: The BDC will also secure an overview of the operating company's credit history from a business credit report and do a similar analysis relating to the business' historical repayments of debt, amounts of debt, and so forth.

Character

The BDC evaluate the **character** of the guarantors of the loan (usually anyone owning 20% or more of the operating company) to try to determine how willing they will be to repay the loan, if they have a sense of responsibility for their obligations and if they have demonstrated responsibility for their debts in the past. The BDC wants to see that the operating company is under strong and experienced management with a good reputation in the industry and community. The BDC wants assurances that the operating company is currently being well managed in a legal and ethical manner.

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Some other considerations in evaluating character might include: the experience and ability of secondary managers and other key employees; availability of replacement management; availability of management resources; and the complexity of management duties.

In assessing management ability, generally the BDC will examine certain key areas:

- Industry experience.
- Direct experience with the operating company.
- Past management history.
- Experience managing a similar business.
- Educational background.

The BDC will also examine credit scores and look for the presence of any derogatory information on the report, including: judgments; liens; suits; late payments; etc. Lenders might also check public records.

Capital

The BDC wants to know that the business is well-capitalized. The BDC likes to see that owners are invested in the company and have a financial commitment. Business owners must have enough capital to support the business and themselves as the company grows. The business should have a "cushion" for repayment in the event of a setback.

The BDC requires proof that the company or the guarantors have the necessary down payment for the proposed project.