Center for Urban Entrepreneurship at PIONEER INSTITUTE for Public Policy Research

COLLABORATION BETWEEN SPRINGFIELD COMMUNITY-BASED BUSINESS ADVISORS, CITIZENS BANK, HAMPDEN BANK, AND WESTBANK

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HARRY MONTALVO, Solutions CDC
AMY SHEEHAN, Senior Vice President, CRA, Westbank
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STATE STREET

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Acknowledgments

This manual was prepared as part of the Urban Business Alliance (UBA)- a unique initiative of Pioneer's Center for Urban Entrepreneurship that helps low- and moderate-income entrepreneurs by bolstering the skills of the community-based business advisors they look to for assistance.

For more information about the program, please contact:

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PART I - INITIAL BUSINESS ASSESSMENT – TECHNICAL ASSISTANCE PROCESS FOR START-UP BUSINESSES IN CONCEPT PHASE TO 2 YEARS OLD

Initial Intake

2-3 weeks

Referral
Walk-ins
Workshops (Personal Banking/Finance)
Community

By phone or in

Customer Intake/Interview

Complete Form
Assign Task – Obtain Credit Report

Client obtains credit

Sit-Down Interview

Review Credit Report & Form
(up to 2 hours)

6-18 months

Client complete s credit counselin

Recommend Credit Counseling to address credit

One-on-One or Consumer Credit Counseling

No

Is credit acceptable?
*Minimum 650 Credit Score**

Yes

*for traditional bank financing

Develop Action Plan

Business Plan

Establish checking account at a bank

Go to Part II

Minimum Requirements to Establish a Bank Account:

- Name
- Residential Street Address (individual) or principal place of business, local office, or other physical location (for a business)
- Date of Birth (individual)
- Identification Number (taxpayer identification number)

National Check Protection Service/Chex Systems – used to verify authenticity of SS# or TIN, account history (charge-offs, etc).

Appendix I

Credit Reporting Agencies

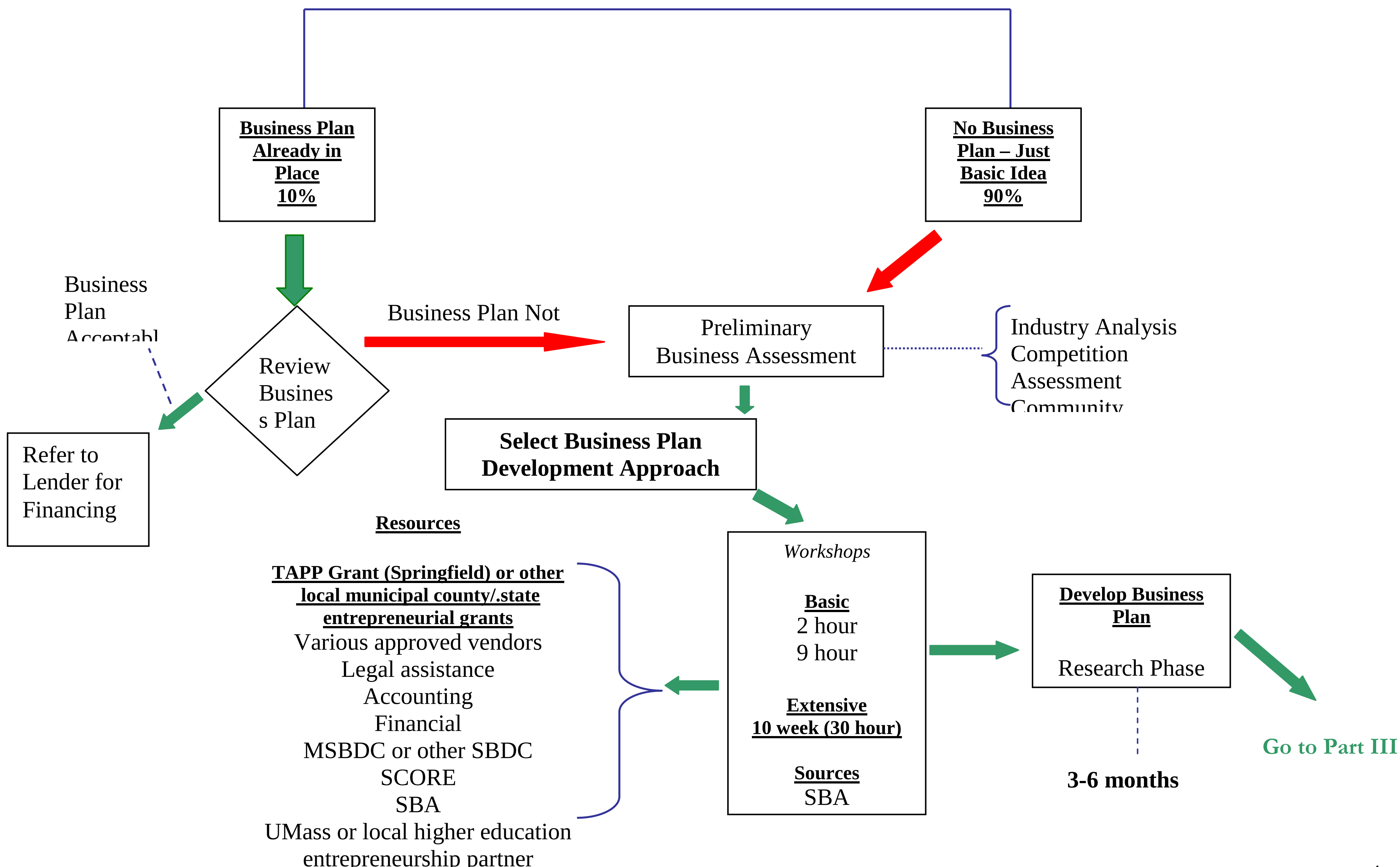
Equifax
P.O. Box 740241
Atlanta, GA 30374-0241
Tel: 1-800-685-1111
Fax: 1-866-233-3777
Website: www.equifax.com
customer.care@equifax.com

Experian
PO Box 2002
Allen Texas 75013
Tel: 1-888-397-3742
Fax: 714-385-7349
Website: www.experian.com
ncac.consumer@experian.com

Transunion
P.O. Box 1000
Chester PA. 19022
Tel: 1-800-916-8800
Fax: 716-626-1795
Website: www.transunion.com

PART II - PROCESS TO ASSESS EXISTING BUSINESS PLAN AND PROCESS TO ASCERTAIN LEVEL OF REQUIRED BUSINESS DEVELOPMENT ASSISTANCE

Develop Action Plan



Appendix II

Preliminary Business Assessment

1. Industry Analysis – An overview of market trends, growth rate, industry segmentation and strength of competitive forces dictating industry profitability

2. Competitive Assessment – An overview of key competitors, an understanding of competitors' strengths and weaknesses and an overall assessment of the strength of and sustainability of a competitive advantage in the industry

3. Community Assessment – An overview of the community economic climate, the strength of community need, demand and support for business

4. Financial Assessment – Overview of profitability potential, assessment of revenue drivers and relative cost position

Business Plan Development Resources

1. www.sba.gov/starting_business/planning/writingplan.html

2. www.nxlevel.org

PART III – BUSINESS PLAN DEVELOPMENT – CRITICAL REVIEW OF BUSINESS PLAN

<u>Elements of a Business Plan (www.sba.gov)</u>

Business

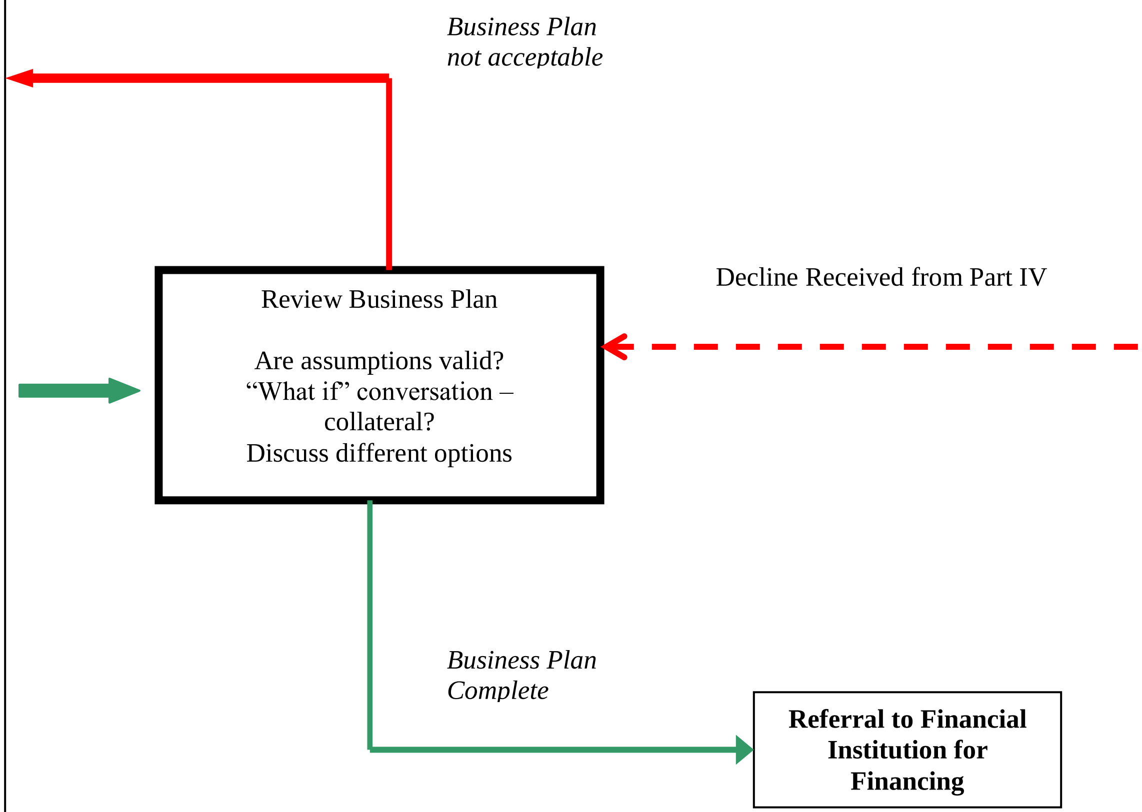
- Description
- Marketing
- Competition
- Operating Procedures
- Personnel
- Business Insurance

Financial Data

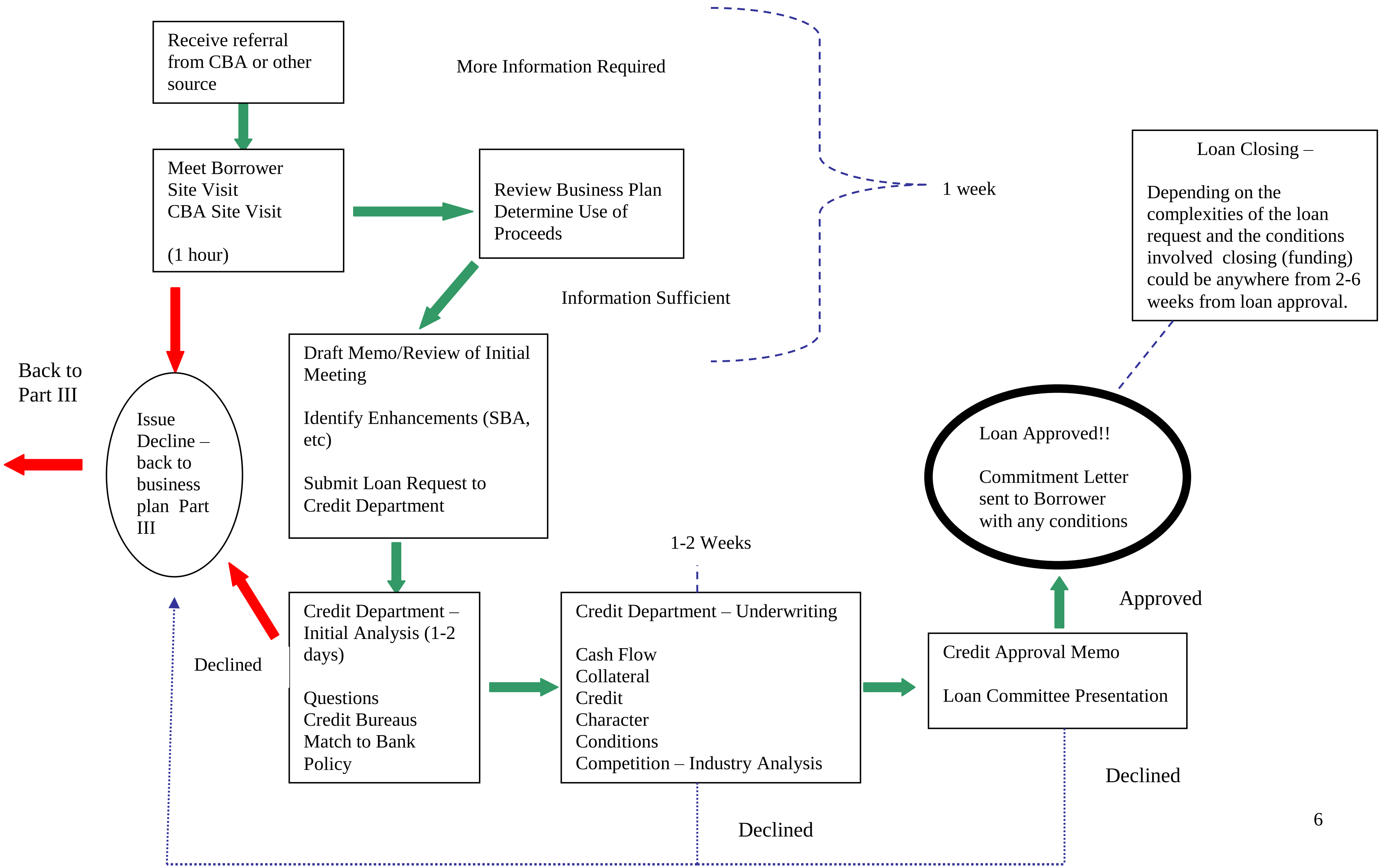
- Capital Investment (supporting documentation)
- Loan applications
- Capital Equipment and supply list
- Balance Sheet
- Breakeven analysis
- Pro-forma income projections
  - 3-year summary
  - Detail by month, 1^{st} year
  - Detail by quarters, 2^{nd} and 3^{rd} years
  - Assumptions
- Pro-forma cash flow

Supporting Documents

- Tax returns of principals for last 3 years
- Personal financial statements
- Copy of franchise contract and all franchisor supporting documents (if opening a franchise)
- Copy of proposed lease or purchase agreement for building space
- Copy of licenses and other legal documents
- Copy of resumes on all principals
- Copies of letters in intent from suppliers, etc



How Bankers Review Loan Requests from Start-up Businesses



Appendix III

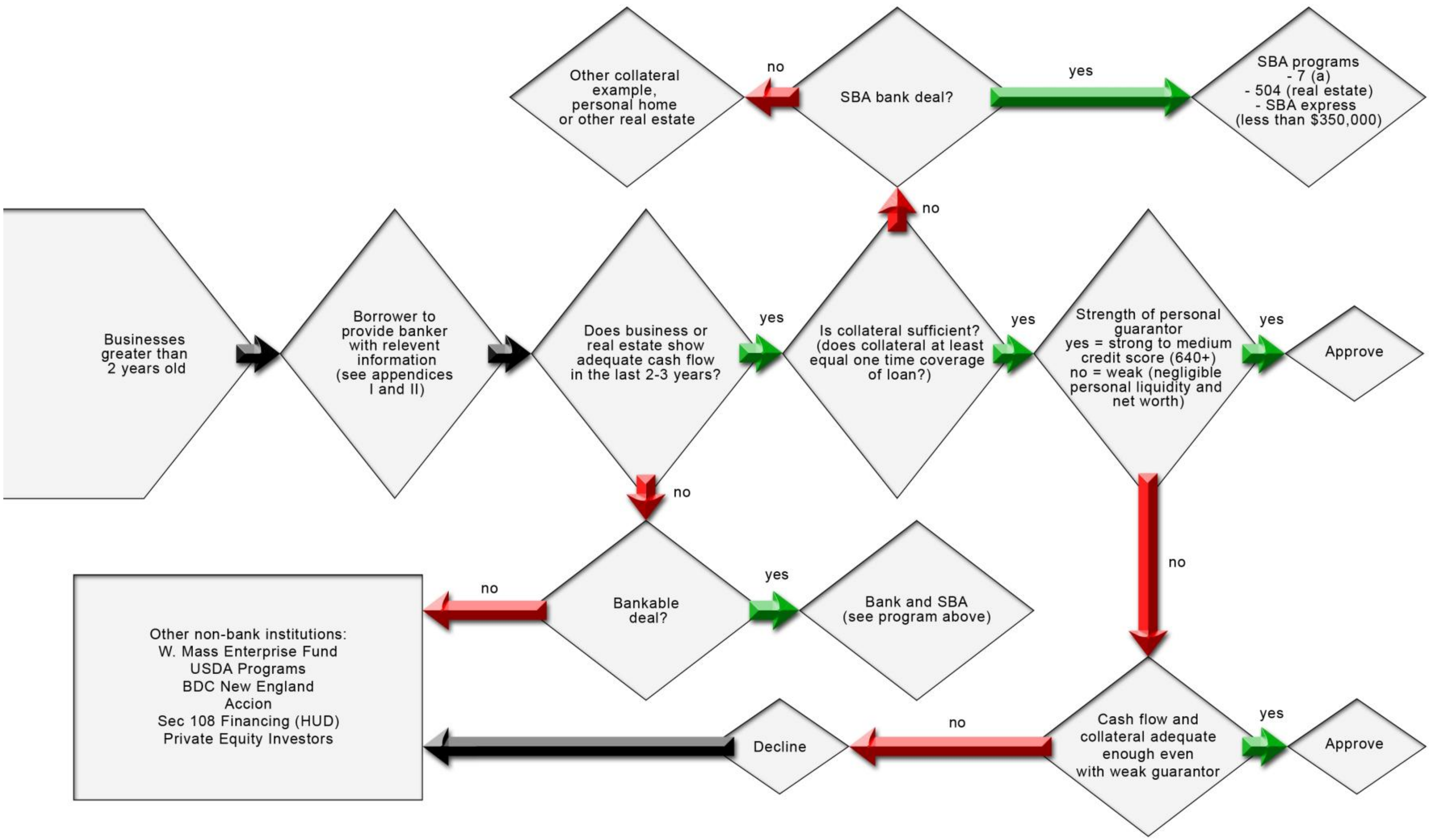
Decline Indicators

When a Banker declines an loan request it is an indication of the following:

- The business plan needs review and refinement

- The entrepreneur should seek alternative lenders such as community service organization, micro lenders or local economic development corporations.

FINANCING OPTIONS AND PROCEDURES FOR ESTABLISHED BUSINESSES AT LEAST 2 YEARS OLD



Appendix I

<u>*Application Documentation – Conventional Commercial Loan*</u>

1. Credit application
2. Personal financial statement
3. 3 years business tax returns (if over 4 months, provide interim)
4. 3 years personal tax returns
5. Brief history of business
6. Pictures of property, if available
7. Detailed debt schedule for business

In Addition, for a line of credit:

1. Account receivables aging
2. Accounts payable aging

Appendix II

Application Documentation – Investment Property

1. Complete description of property including # of units, total square footage, age, construction, address
2. Credit application
3. Personal financial statement
4. 3 years personal tax returns
5. Picture of property, if available
6. Copy of Sales contract (purchase)
7. 3 years of Schedule E's (if not available, a signed schedule of annual income and expenses, including taxes, insurance, utilities and repairs)
8. Current rent roll
9. Copies of leases (with Schedule E's – one lease per apartment type, without Schedule E's – all leases)

Appendix III

- Businesses need to understand that their tax returns need to show income. While it is understood that businesses strive to pay a minimum of taxes, if income is not documented then it cannot be used by a bank when underwriting a loan request.

- There is sometimes a lack of general financial statement literacy amongst business owners. Bankers, advisors need to assist businesses with this.

- Banks need to see CASH FLOW in addition to collateral. Sources of repayment for a bank loan are threefold: primary, secondary, and tertiary. The primary repayment source for a commercial bank loan is cash flow (usually calculated as EBITDA = earnings before interest, taxes, depreciation and amortization). Please note: what is important to a bank is the cash flow or EBITDA generated <u>historically</u>, i.e. in each of the past three years. This historic cash flow needs to be sufficient to cover existing debt payments already existing, in addition to the new loan payment being requested. What is considered sufficient varies amongst banks in accordance with each bank's own credit policy, but a "rule of thumb" is that banks look for historic cash flow to have been able to cover existing and proposed debt repayment by 1.2 times. <u>Banks in most cases derive less comfort from projections of cash flow than they do from historic cash flow. Projections, however, when used, should be realistic and appear to be based on reasonable assumptions.</u>

- The secondary source of repayment for a commercial loan is collateral. This may be in the form of a piece of commercial real estate, equipment, inventory, and account receivables. <u>Important to note here: collateral is SECONDARY to cash flow above, which means if a piece of commercial real estate has an appraised value far exceeding the loan request, this is NOT relevant if cash flow is not sufficient in the first place.</u> Cash flow is what makes the loan payments. Collateral needs to be sufficient if ever the loan payments could not be made, and the loan became delinquent to the point that the bank needs to foreclose on the collateral, to be repaid on the loan.

- The tertiary or third source of payment is personal guarantees. These only come into play if there is not enough collateral value in the business assets or the real estate after the foreclosure, to repay the loan.

- Commercial Mortgages: Businesses need to know the difference to a banker between owner-occupied commercial mortgages, and non-owner-occupied commercial mortgages (also known as investment real estate mortgages).

  An owner-occupied mortgage is where the business owner also owns and occupies all, if not the majority, of his own building. In this case, it is the income or cash flow generated by the business that will pay the commercial mortgage, because the business is the main tenant or occupant. Therefore, cash flow of the business is important as described previously above.

  On the other hand, the cash flow generated to pay the mortgage for a piece of investment real estate, such as a multi-family apartment building, are the rents generated by many tenants, and in this case, the historic cash flow of rents which cover building expenses and future loan payments determines available cash flow. Once again, according to individual bank's credit policies, what is deemed sufficient cash flow coverage may vary, but about 1.25 times coverage is typical. Another example of a non-owner-occupied commercial mortgage (or investment real estate loan) is when an individual owns a commercial building, occupied by commercial business which the landlord has no ownership in. In this case, we are relying on payment of the commercial leases to the landlord to pay the mortgage, not upon the cash flow of one or more companies. In these cases, because there is no underlying company generating cash flow, and because we are only relying on tenant leases for cash flow, the secondary and tertiary sources of repayment, i.e. collateral and personal guarantors, become more important.

- The maximum Loan to Value (LTV) assigned to a piece of collateral varies according to individual bank policies, types of collateral, types of transaction (i.e., purchase or refinance), and the overall perceived strength of the deal to the bank. Typically, LTV guidelines may be similar to those stated bellow:

Commercial Real Estate (purchase of refinance)	Multi Purpose (in good condition)	80% LTV*
Commercial Real Estate (purchase or refinance)	Single Purpose in good condition (e.g., church, bowling alley, etc).	70% or less LTV
Equipment	New/Used	80% to 100% LTV
Eligible Business Account Receivables	Supported by A/R aging	80% LTV
Eligible Inventory	Excludes WIP (work in progress)	50% LTV

*Other LTVs may be lower dependant on real estate type, condition and industry of occupant

- When looking to provide a business with a line of credit, <u>the distinction must be made if it is for cyclical working capital or permanent working capital.</u> Cyclical working capital is to provide financing for month to month expenses, prior to receiving payments from customers. It is understood that businesses have monthly operating expenses, but that the sales to repayment cycle might be two or three months or longer depending on the type of business. A working capital line of credit is to support that "funding gap." Because it is supporting a cyclical need, it assumes that at some point in the cycle cash will be generated. Banks will typically ask for a "clean-up" period of the working capital line of credit, e.g., your line of credit must be paid down to zero for 30 days once per year. This ensures that the line is being actually used for cyclical working capital, and not permanent working capital. Permanent working capital, such as for expansion costs, initial inventory, equipment, etc., should be financed by a term loan. <u>As a rule of thumb, the size of any company's working capital line should not be more that 15% to 25% of it total gross revenues, according to its most recent fiscal year end.</u>

- Many of the factors described above, mean that a commercial lender is going to consider a request for a commercial loan differently than when applying for a consumer loan. Whilst personal credit score and the discipline of keeping good personal credit are important, it is only one factor, as discussed above. A consumer loan decision will often be based largely on consumer credit score, whereas with a commercial loan, cash flow and collateral strength are just as important. Consumer credit scores are expected to be 640 or better. Time frames for commercial loans tend to take longer from application to close than consumer loans. Typically, a commercial mortgage takes 6 to 8 weeks from application to close.