THE FIVE THINGS THAT LENDERS LOOK FOR WHEN ASSESSING YOUR APPLICATION FOR FINANCE?

October 16, 2013: Credit assessment is often called a 'black art' and the standards that are used to assess a credit proposal change with the business and economic cycle.

Some credit assessments are done on the basis of a matrix. That is, a set formula or matrix is created and scores are given based on the answers to the questions in the matrix. These questions will be fashioned on the application of statistical data. For example, the matrix might automatically reject an application from anyone in business for less than three years. The lender may be working off statistical data that shows the chance of default is less with a business established for 3 or more years.

Thankfully most commercial lending assessment is not done by a matrix but the keen eye, brain and gut of a credit officer. Listed below are the five main areas that credit officers address when making a lending decision.

1. CREDIT

Payment of obligations in a timely manner is imperative. Lenders expect that agreements will be kept. The reference to a missed direct debit or a bounced cheque as a "dishonour" tells a tale as to how a lender views these events.

Lenders divide borrowers into four main categories:

Those who can pay and do
Those who can pay but don't
Those who can't pay but would if they could
Those who can't pay and wouldn't even if they could

If you have good credit ensure that you do everything in your power to preserve and prove it.

2. CAPACITY

Capacity to repay the debt is calculated by the majority of lenders on an historical basis. That is, they work on last year's figures to attempt to prove next year's repayments.

The calculation is typically; earnings before interest, tax, depreciation and amortisation (EBITDA) less annualised current and proposed repayments. Some lenders do the calculation after tax and some add an additional margin or hurdle.

Let's look at that typical calculation. Go to your Profit and Loss account in your most recent finalised financials add up the profit (or loss) before tax, amortisation, depreciation and interest (interest may also be shown as hire purchase charges, lease charges or terms charges). This figure is your EBITDA. Next, add up all of your current and proposed monthly payments, then multiply that figure by 12 which gives your annualised repayments. Then take your annualised payments from your EBITDA and if there is a surplus then you have "historical servicing."

If a Lender can "prove" from historical data that a borrower is able to service its debts then the lender has what is known as its "first way out ". That is the loan will be repaid be the receipt of monthly payments from the borrower.

3. COLLATERAL

Collateral relates to the security that the asset being financed offers the Lender. Assets are often graded as being a primary security or a tertiary security. Motor vehicles for example are regarded as a primary security because they are usually easily saleable whereas a fit out of a restaurant kitchen would be regarded as a tertiary security because the stainless steel benching is made to measure and the cost of removal may exceed the sale or recovery value.

Collateral relates to the "second way out". That is, in the event that the security has to be enforced and the asset is repossessed and sold will there be sufficient funds from the sale to repay the outstanding debt?

4. CAPITAL

Capital relates to the asset backing of the borrower and/or its guarantors. The Lender looks to see that the borrower has sufficient equity in assets that it can pledge in order to ensure access to working capital.

5. COMMON SENSE

Common sense is defined as "sound and prudent judgment based on a simple perception of the situation or facts"

Thus, "common sense" equates to the knowledge and experience which most people already have, or which the person using the term believes that they do or should have.

The test that Lenders apply relates to the rationale for the borrowing. Will the new asset make the business more efficient, more profitable, more sustainable or better able to compete?

Has the borrower considered and identified the risks that committing to new debt may pose?

Has the borrower proposed migrants for those risks?

These are the questions that prudent Lenders want to see addressed in a quality finance application.
It is said that common sense is not that common. When it comes to finance, Lenders approve those applications where these " 5 C's are demonstrated.

To find out more, talk to a Credit One 'finance for business' consultant today on 07 3103 9401 or our National Service line 1300 Credit (273 348)