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How much credit could my business qualify for?

The answer to this question involves 3 key factors:

1) the type and quality of the collateral that will secure the loan
2) the size and consistency of the borrower's cash flow
3) what type of lender is making the loan?

Think in terms of percentages and multiples.

For collateral, the more readily it can be converted to cash, the higher percentage of its value they will lend.

For cash flow, provided its not for real estate, lenders will like to see that any debt extended could be reasonably be repaid within 3-5 years from existing cash flow. If real estate is driving the borrowing need, you would be able to borrow significantly more than 3 to 5 times your cash flow, given the long life of the asset and the expectation that it would be financed over a long period.

Let's talk about Collateral.

Yes, the secondary source of repayment is still often of primary importance to lenders. Some asset-based and other alternative lenders would consider collateral the primary source of repayment, but most lenders focus on cash flow first, and collateral second.

The more your lender controls the collateral, and the greater that collateral's liquidity, the more credit they will be willing to extend.

If you are pledging marketable securities, accounts receivable, or other easily valued and liquid assets, you'll likely be able to borrow as much as 80% of the value of these assets. If you pledge a Certificate of Deposit held at the bank you borrow from, you should be able to borrow 100% against that collateral.

If, on the other hand, inventory and older equipment make up the lion's share of your collateral, you will be looking at a maximum loan value of 50% of the value of these assets unless strong cash flow allows for a higher loan amount.

Inventory advance rates range from 40% - 60%, depending on the nature of the inventory and how long it would take to liquidate it.

You can expect to be able to borrow up to 80% of the value of newly purchased equipment, up to 100% if you lease, while older equipment will often get advance rates of 70% or less of the equipment's liquidation value.

Key Considerations for Cash Flow:

How much cash does your business generate on an annual basis, after all expenses and investments in working capital and fixed assets?

How consistent has that cash flow been in recent years?

What is the cash flow forecast for this year and next?

Your answers to those questions will have a large bearing on how much credit can be obtained.

For loans used to fund daily business operations, equipment purchases and other non-real estate assets, most lenders will want to see two things with respect to your cash flow:

1. Is it sufficient to cover all annual interest and principal due on all debt by 120% or more?

2. Is it sufficient to retire all non-real estate debt over a 3-5 year horizon?

By way of example, say that your business generates $400,000 of cash annually that can be used to service debt. Most lenders will want your annual debt payments in this case to be something less than $330,000 a year ($400,000/$330,000 = 121%), and they would want your total non-real estate debt to be no more than $1.2-$2.0 million ($400,000 x 3-5), thus allowing for full repayment in 3-5 years.

What type of lender are you working with?

While you may only be able to borrow 70-80% of the value of your accounts receivable with a bank, you could get as much as 90-92% of your receivables' value working with an Accounts Receivable Factoring lender, who is skilled in valuing and monitoring the collection of A/R.

With a bank, say a large national bank, the credit guidelines are usually more conservative, and the maximum amount of credit will likely be less than what you could borrow from a regional bank or a local community lender who is intimately familiar with you and your business. It may not be much less, but by and large, national credit policies tend to be more conservative than individually crafted policies that originate in market.

Further, if getting the most credit possible is your primary aim, then going to asset based lenders and other alternative lenders like Accounts Receivable Factors would allow for more credit than would a bank or credit union.

Summary:

The amount of credit your business will qualify for will be a function of how strong and reliable historic cash flows have been, what those cash flows are expected to be over the horizon of the loans, and the nature of the collateral that will support the debt.

For borrowers with stable cash flows, they should expect to qualify for non real estate credit up to 3 – 5 times their cash flow that would be available for debt repayment.