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Understanding the Mechanics of a Loan

RYAN WENSLEY, VICE PRESIDENT/BUSINESS BANKER

TD BANK



About SCORE

As a resource partner of the SBA, we help small businesses by:



Providing free
business advice
and mentoring



Offering low or
no-cost business
training



Sharing free business
templates and
resources

Request a SCORE mentor at www.score.org/find-mentor

About Your Presenter: Ryan Wensley



- Ryan Wensley is a Business Banker/RM for TD since 2006 with over 25 years in commercial lending covering Northern NJ.
- He has experience with multiple lending products, including traditional loan/line lending for small businesses, commercial real estate mortgages and equipment financing.
- Ryan has works with traditional lending, SBA lending and healthcare practice financing partners to meet the needs of all small business owners. He has presented to SCORE in the past, in person and online.



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Objectives

This class is designed to understand how the "Five C's of Credit," can help business owners understand the performance and risk inherent in their businesses. This same risk assessment is done by potential lenders when they **"underwrite"** loans to ensure both the business and the lender benefit from the loan.



¹Forbes, May 24, 2021

"Understand the 5C's of Credit before Applying for a Loan, Forbes Advisor (May 24,2021), <https://www.forbes.com/advisor/credit-score/5-cs-of-credit/>

What is underwriting?

Underwriting is the process of determining and quantifying the financial risk of an individual or institution. Financial institutions employ underwriters to conduct risk analysis to determine a potential borrower's creditworthiness.

Underwriting allows financial institutions to:

- Asses the potential risk of the person or investment
- Establish fair rates on loans
- Set appropriate premiums to cover the cost of insuring policyholders
- Price investment risk accurately to establish a market for securities
- Ensure adequate assessment and coverage
- Help investors make informed investment decisions



The 5 Cs: Character

Pertains to the **general trustworthiness** of a borrower. In small business, character drills down into the business owner(s) and/or personal guarantor(s) more than the business itself.

Lenders want to ensure they are engaging in a credit relationship where the borrower is going to honor agreements, responsibly manage lending, and repay debt.

Character concerns may adversely affect business partnerships, investor opportunities, existing contracts, vendor relationship, or new customer acquisitions.

Character Inventory:

- Does the business participate in any prohibited industries?
- Any personal or business Bankruptcies?
- How are you handling your existing deposit accounts (any overdrafts)?
- Are there any open liens, lawsuits, judgments, negative news or public findings?
- Are you aware of any derogatory credit reporting on the owner(s) or company?
- Do you have any delinquencies?
- Any prior lending relationships sent to collections, charged off, or settled?



The 5 Cs: Character

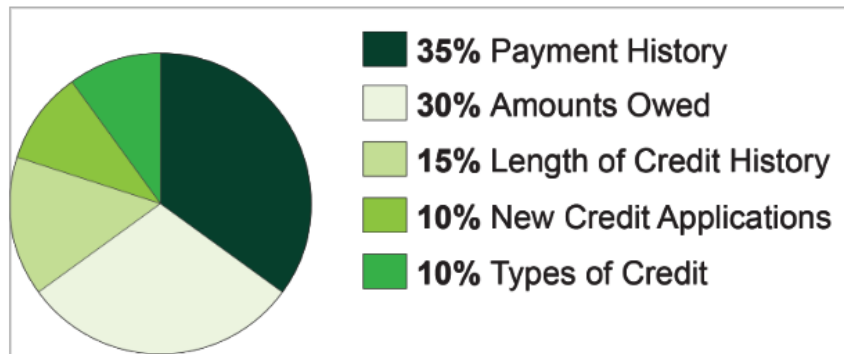
Credit Report Review Checklist

Download the checklist at

http://www.consumerfinance.gov/documents/2233/201701_cfpb_Credit-report-review-checklist.pdf

This step-by-step checklist walks through reading a credit report, watching for mistakes, and how to dispute inaccuracies.

Credit Score Factors



Credit report review checklist

Today's date: Name of credit reporting agency:

1. Is your name correct? YES NO
2. Is your Social Security number correct? YES NO
3. Is your current address correct? Is your current phone number correct? YES NO
4. Are the previous addresses they have listed for you correct? YES NO
5. Is your marital status listed correctly? YES NO
6. Is the employment history they have listed for you accurate? YES NO
7. Is everything listed in the personal information section correct? YES NO
8. Is there anything listed in the public record information?
Is it correct? YES NO
Highlight the information you think may not be correct.
9. Are the accounts on the list still open?
Review each item under the credit account (trade account) section. YES NO
10. Are all of the current balances correct? YES NO
11. Are accounts where you are an authorized user or joint owner listed? YES NO
12. Are zero balances recorded for debts discharged in bankruptcy?
For debts paid in full? YES NO
13. Are you listed as a co-signer on a loan?
Is this correct? YES NO
14. Are accounts that you closed listed as "closed by the consumer"? YES NO
15. Is negative information reported on each credit account correct?
Look for late payments and missed payments. Highlight those items you think are not correct. YES NO
16. Are any accounts listed more than once?
Check to make sure the same account is not listed multiple times in the collections section. YES NO
17. Is old negative information still being reported?
If yes, highlight the information that has exceeded the negative information reporting limit, which is usually seven years. YES NO
18. Do you suspect that you have been the victim of identity theft after reviewing your credit reports? YES NO

The 5 Cs: Capacity

Capacity is a borrower(s)' ability to repay. You will often hear this referred to as "cash flow."

Simplified Gross Receipts Formula = (X% of) Gross Annual Receipts

Debt Service Coverage Ratio =
$$\frac{\text{Net Operating Income}}{\text{Annualized Business Expense} + \text{Proposed Annualized Debt Expense}}$$

Global Debt Service Coverage Ratio =
$$\frac{(\text{Net Operating Income} + \text{Personal Net Income})}{(\text{Sum of Annualized Business and Personal Expense}) + \text{Proposed Annualized Debt Expense}}$$



Not only can you repay a loan, but can you be **profitable**? Assessing a business' capacity helps a company understand the health of their cash cycle and the risk of new expenses or undertakings.

The 5 Cs: Capacity

Cash flows help you detail the cash coming into and going out of the business monthly so you can forecast future surpluses and shortfalls, identify expenses to be managed, and the impact of future investments or lending.



Scan Above for TD's Cash Flow Template and How to Use it!

Are your strategic decision driving profitability? A cash flow statement can help!

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2

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Total
RECEIPTS													
Sales	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0
Other revenue	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0
Other	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0
Total receipts	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0
LESS PAYMENTS													
Direct costs													
Materials	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0
Stock	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0
Packaging	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0
Other	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0
Sub total for direct costs	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0
Overheads													
Accounting	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0
Bank Fees	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0
Cleaning	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0
Freight and postage	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0
Insurance	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0
Interest	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0
Marketing and advertising	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0
Motor vehicle expenses	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0
Power	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0
Rent	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0
Repairs and maintenance	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0
Salaries and employee expenses	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0
Subscriptions	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0
Tax	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0
Telephone	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0
Web site hosting and maintenance	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0
Other	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0
Other	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0
Other	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0
Sub total for overheads	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0
Total cash payments	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0
Net cash flow	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0
Opening bank balance	\$ 0												
Closing bank balance													\$ 0

The 5 Cs: Capital

The amount of money a business owner, partners, or management team have invested in a company.

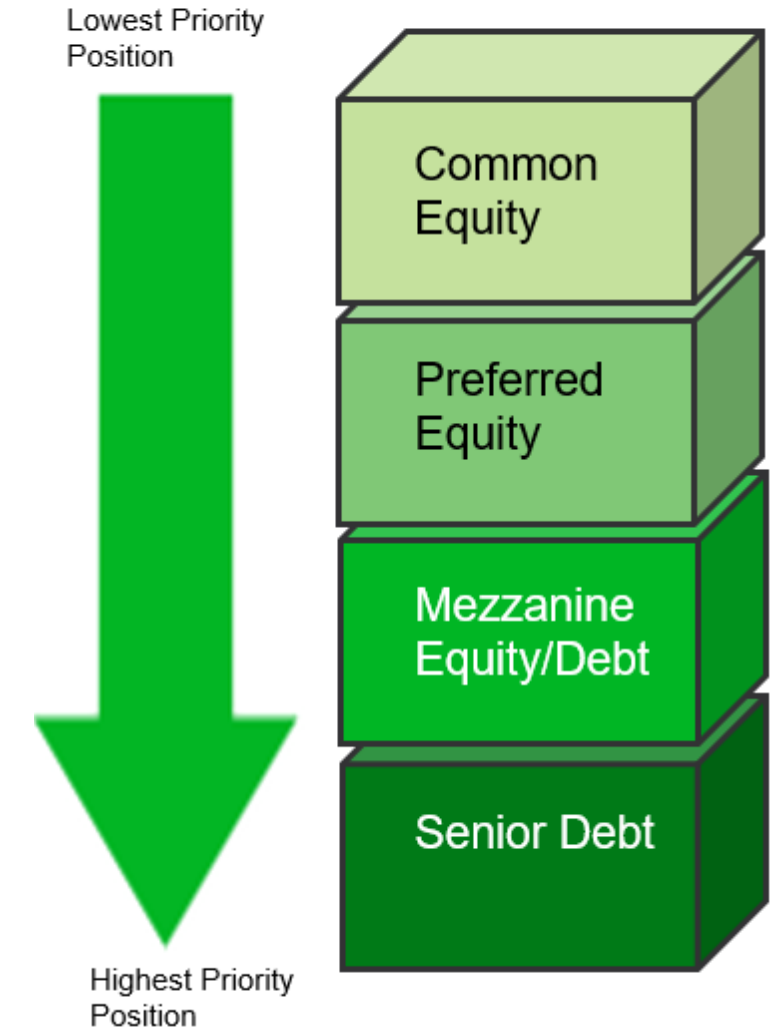
Opportunity Costs — businesses that invest a heavy concentration of cash restrict their ability to adapt, pivot, or take advantage of business opportunities.

The Bank Doesn't Own the Borrower — The Bank neither profit shares nor assumes stakeholder interest. Meaning the company is less constrained to profit or maintain existing ownership.

Paying Interest May Reduce Tax Burden — Cost of interest is reportable and reduces the taxable profit, which, may reduce the tax expense of a business.

Debt Is an Investment — If the credit solution is sound, it will increase revenue, savings or strengthen profit. Good debt will free up cash for more efficient investments and milestones.

Capital Stack



The 5 Cs: Collateral

Collateral is a tangible or intangible asset with a real monetary value, pledged as security for a loan.



\$1 : \$1

Every dollar borrowed is secured by a dollar of collateral at a percentage of its worth



Why do Lender's Want It?

Collateral security to help reduce the risk of nonrepayment. It is often a third recourse to remedy outstanding debt should a borrower fail to pay by traditional cash flow, or personal guarantee.

Why Should Business Owners Care?

Collateral, as evidenced on your balance sheet, plays a role of indicating material assets and liabilities to the company, how it is valued, if sales or collections are impacted, and net worth.

The 5 Cs: Collateral

Collateral Inspired Introspection:

- Are your assets realizable?
- How resilient is your company in slow seasons or market down turns?
- Do you have more inventory than you can sell?
- How is your performance in collecting on outstanding invoices?



Cash
Accounts Receivable
Real Estate
Life Insurance Surrender
New Equipment
Used Equipment
Finished Goods
General Inventory
Raw Goods
Works in Progress

The 5 Cs: Conditions

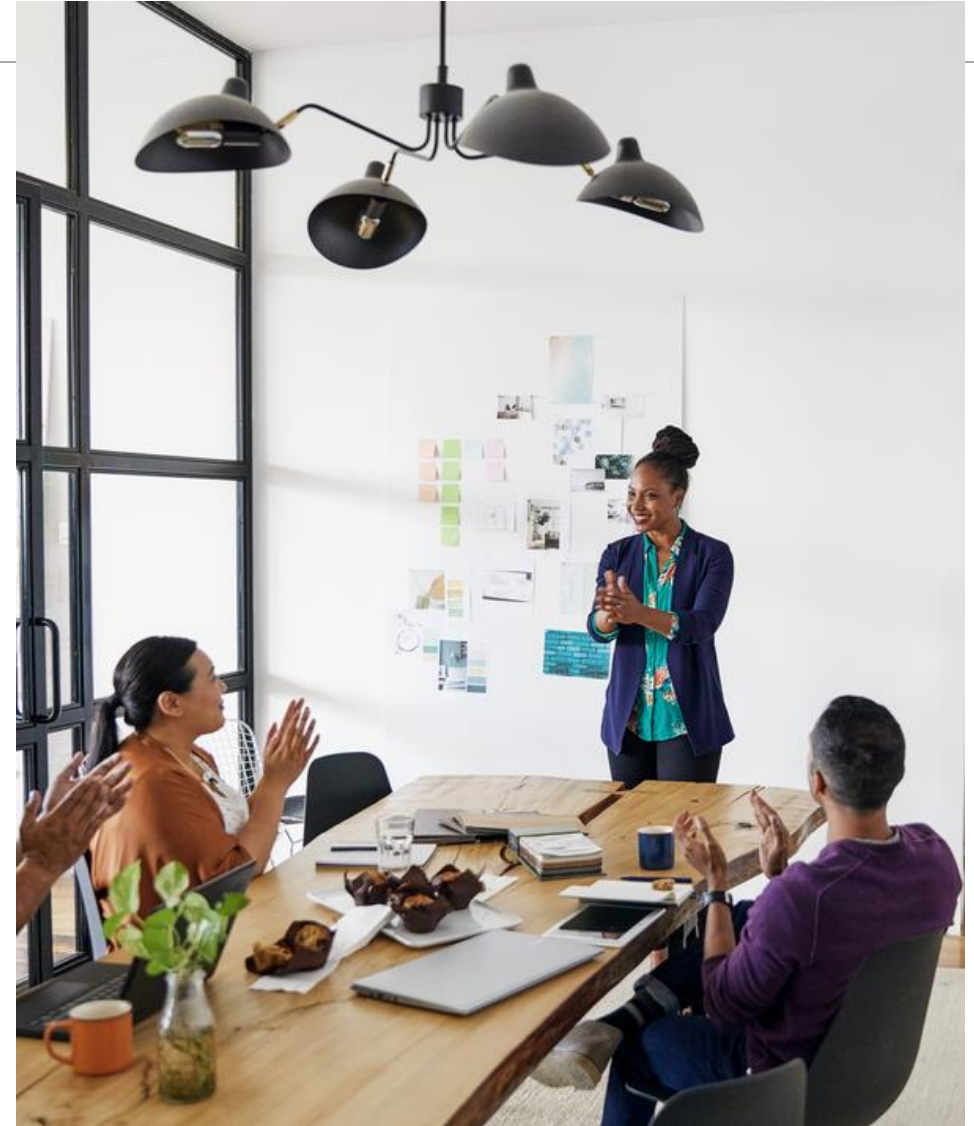
Conditions consider the overall environment of a borrower's industry, the prevailing economic landscape, and performance of the business.

Stay Up-to-Date on Industry Specific Conditions:

- Is the industry growing?
- What are the "Hot" trends within the industry?
- Are there any barriers to entry or expansion?
- What is driving or cooling the performance of your industry?

What Are Some External Influences to Your Business?

- Legislation
- World Events
- Inflation
- Pandemic



The 5 Cs: Conditions

There are many nonprofit, not-for-profit and government organizations that provide free business advisory, access to industry reports and insights, as well as access to continuing education for business owners. Get connected to your subject matter experts and **stay curious!**

- Small Business Development Centers of America
- United States Small Business Administration
- Small Business Services (state departments)
- Chambers of Commerce
- Community Development Financial Institutions
- S.C.O.R.E.

**Source-www.sba.gov

Focus	Goal	Reference weblink
General business statistics	Find statistics on industries, business conditions.	<ul style="list-style-type: none"> • NAICS(Link is external) • U.S. Census Business Builder(Link is external)
Consumer statistics	Gain info on potential customers, consumer markets.	<ul style="list-style-type: none"> • Consumer Credit Data(Link is external) • Consumer Product Safety(Link is external)
Demographics	Segment the population for targeting customers.	<ul style="list-style-type: none"> • U.S. Census Bureau(Link is external) • Bureau of Labor Statistics(Link is external)
Economic indicators	Know unemployment rates, loans granted and more.	<ul style="list-style-type: none"> • Consumer Price Index(Link is external) • Bureau of Economic Analysis(Link is external)
Employment statistics	Dig deeper into employment trends for your market.	• Employment and Unemployment Statistics(Link is external)
Income statistics	Pay your employees fair rates based on earnings data.	<ul style="list-style-type: none"> • Earnings by Occupation and Education(Link is external) • Income Statistics(Link is external)
Money and interest rates	Keep money by mastering exchange and interest rates.	<ul style="list-style-type: none"> • Daily Interest Rates(Link is external) • Money Statistics via Federal Reserve(Link is external)
Production and sales statistics	Understand demand, costs and consumer spending.	<ul style="list-style-type: none"> • Consumer Spending(Link is external) • Gross Domestic Product (GDP)(Link is external)
Trade statistics	Track indicators of sales and market performance.	<ul style="list-style-type: none"> • Balance of Payments(Link is external) • USA Trade Online(Link is external)
Statistics of specific industries	Use a wealth of federal agency data on industries.	• Statistics of U.S. Businesses

Let's Get Digital!

Visit the [TD Bank Small Business Resource Center](https://www.td.com/us/en/small-business/resource-center) for virtual workshops and more:

- Video tutorials on a variety of topics including:
 - Creating a competitive advantage
 - Preparing a balance sheet
- Download business plan templates
- Go to <https://www.td.com/us/en/small-business/resource-center>



Small Business
Resource Center

- Learn more about your personal finances and visit the [TD Bank Learning Center](https://tdbank.everfi-next.net/welcome/td-learning):
- Interactive lessons in less than 10 minutes – from any device!
- Topics include credit reports and scores, identity protection, financing higher education, and more.
- Go to <https://tdbank.everfi-next.net/welcome/td-learning>



TD Bank
Learning Center

Stay in Touch!



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Helpful Links

- Find SCORE resources for small businesses at www.score.org/templates-resources
- Find more SCORE live and recorded workshops and courses at www.score.org/get-business-training
- Book an appointment with a SCORE mentor at www.score.org/find-mentor





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