



MARBIDCO's Underwriting Considerations in Rural Business Lending

The Basic Five 'Cs' of Credit

Character refers to the financial history of a borrower typically demonstrated by a credit score (also called a FICO score). Lenders examine a credit report to see if a customer has a responsible credit record. MARBIDCO also uses FICO score information combined with certain borrower financial information to determine an "AgScore."



Capacity refers to the ability of the borrower to generate sufficient revenues to pay back the loan. Lenders are particularly interested in periodic income and loan obligations as well as current operating costs. A monthly operating budget helps demonstrate what is feasible for a borrower to pay each month. A borrower who can show a positive cash flow – that is, one where income exceeds expenses -- for a sustained period has a good chance of getting a business loan.

Capital refers to the capital assets of the business and is often compared relative to debt obligations to determine financial solvency. Capital assets might include machinery and equipment, as well as product inventory. From a project financing perspective, capital is sometimes equated with "equity," or cash or other tangible contributions to a particular business activity that is proposed to be financed. A direct financial investment made by borrowers demonstrates a financial commitment to the project and shows lenders they are not taking all the financial risk.

Collateral is the asset(s) a borrower pledges to secure a loan. In addition to having good credit, a proven ability to make money (or at least a good plan), and business assets, lenders will often require borrowers to pledge their personal assets as security for the loan. Lenders require collateral because borrowers who have personal assets at risk are more likely to work to keep the business going rather than walk away from a business failure. Real estate is the most preferred form of collateral, followed by certain financial securities and equipment that is easily recovered in the event of a loan default.

Conditions refer to the larger economic and regulatory environment within which a new, existing or expanding business will operate. Factors related to marketplace demand and industry trends also come into play. Lender who don't consider the economy and conditions relative to the applicant's business may take unnecessary risks. Cyclical businesses, which are often seasonal, are particularly difficult to finance due to the irregularity of cash flow and the possibility that bad weather will jeopardize the borrower's ability to service debt. Since cyclical businesses play an important role in many rural communities, MARBIDCO exercises caution in not rejecting a loan applicant due to unpredictable receivables, but rather structures a loan that recognizes the variables and sets flexible terms and conditions that address these situations.



General Underwriting Requirements

Commercial Lender Participation is required in some fashion for nearly all loans. A commercial lender recommendation or referral must accompany a MARBIDCO loan application. In some instances, a commercial lender must participate financially in the project being proposed for funding.

Borrower Credit History – MARBIDCO reviews the principal borrower's credit score (sometimes called a FICO Score), AgScore and all variables associated with credit worthiness before awarding a loan. There should also be no history of bankruptcy for 7 years.

Borrower Equity – It is preferred that the borrower have at least 10 percent equity at risk in the project to be financed.



MARBIDCO Executive Director Stephen McHenry meets with Leslie Hendrickson-Hart, Washington County Agriculture Marketing Specialist, Dale Johnson, University of Maryland Extension Senior Agent and Farm Management Specialist, and Misty Meadow Farm owners David and Besty Herbst

Cash Flow (or Debt Service) Coverage Ratio – Previous financial performance (if available) and a pro-forma income statement with realistic assumptions of the project to be financed should project a positive cash flow (projected revenues against expenditures) with a realistic margin for error and unforeseen expenses.

Collateral – Loans for land, equipment and working capital to be financed by MARBIDCO normally need to be fully collateralized, preferably with real estate. Some exceptions are made in some lending programs that are funded by other agencies for special purposes, such as farm energy efficiency improvement projects.

Personal Guarantee – All MARBIDCO loans must be personally guaranteed by the principal business owners.

MARBIDCO requires:

- 2 years of tax returns for the business (if existing) and principal owners of the business;
- Balance sheet for the business and principal owners of the business;
- Pro forma income statement for the business;
- Debt repayment schedule for the business and principal owners of the business;
- Description and history of the business operation; and
- Resumes or working history of principal owners of the business.

MARBIDCO prefers: A detailed business plan for a proposed project, but a good written description of the production activity, all needed inputs (including labor), and anticipated market opportunities may suffice for some smaller loans. Your local University of Maryland Extension (UME) and/or Small Business Development Center (SBDC) office may be a source of help in preparing a small business plan. (*Visit a useful website for agricultural/natural resources entrepreneurs: www.mredc.umd.edu.)*