



# 4 MUST-KNOW FINANCIAL CONCEPTS

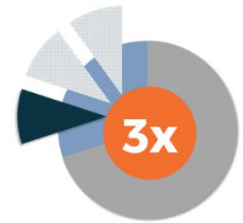
BEFORE YOU GO FOR A SMALL BUSINESS LOAN

## 1. Debt-service coverage ratio (DSCR)

**WHAT IT MEANS** | This equation calculates how much cash you have left after paying expenses to run the business to make all your debt payments, expressed as the number of times ("x") you could cover the payments .

**WHY IT MATTERS** | Lenders commonly use this calculation as a measure of the loan amount your business can afford to repay (each month or each year):

$$DSCR = \frac{NET\ OPERATING\ INCOME}{TOTAL\ DEBT\ SERVICE}$$



**<1x** CANNOT AFFORD TO PAY WITHOUT BORROWING MORE    **~1x** DIP IN CASH FLOW MAY AFFECT PAYMENT    **>1x** ENOUGH INCOME TO COVER DEBT PAYMENTS; MOST LENDERS WANT DSCR ABOVE THIS

## 2. Access to credit and payments



**WHAT IT MEANS** | Repaying a loan most often takes place gradually over time in monthly payments. Part of the payment goes to the balance you have left to repay, called the principal. The other part of the payment covers interest and fees, what the lender gets paid for making the loan. So the loan amount, your interest rate, fees and the length of the loan all go into determining your monthly payment.

**WHY IT MATTERS** | The cost of the loan goes up or down according to how likely your lender thinks you are to repay your loan in full, and so do the requirements for how often you'll make payments and how long you have to repay the loan.



A lower monthly payment doesn't mean a loan is affordable or costs less. Lenders can lower the monthly payment by adding more time to repay the loan and actually increase the amount of interest you pay back and with it the total cost of the loan.

## 3. Loan term

**WHAT IT MEANS** | Loan term refers to how long the lender gives you to pay back the loan. With shorter repayment periods, lenders generally assume your ability to repay the loan won't change and may charge less interest.

**WHY IT MATTERS** | The longer the term, the longer you'll pay interest on the loan. Calculating all of those interest payments is key to knowing the total cost of the loan.

\$50,000 Equipment Loan		
Interest Rate	8%	8%
Loan Term (years)	5	10
Monthly Payment	\$1013.82	\$606.64
Total Cost	\$60,829.20	\$72,796.80
Total Interest	\$10,829.18	\$22,796.56

## 4. Credit score and credit history



\$50,000 Equipment Loan			
Interest Rate	8%	8%	
Loan Term (years)	5	10	
<b>MORE PER MONTH: \$407.18</b>	Monthly Payment	\$1013.82	\$606.64
<b>TOTAL SAVINGS: \$11,967.60</b>	Total Cost	\$60,829.20	\$72,796.80
	Total Interest	\$10,829.18	\$22,796.56

**WHAT IT MEANS** | Lenders look to your credit score and credit history to gauge your track record of paying bills on time and an indication you'll repay your loans on time, too. With better credit come stronger chances a lender will offer more favorable interest rates or loan terms with your loan.

**WHY IT MATTERS** | Over the life of a loan, small differences can really add up. In the case of an equipment loan, the cost to pay back the loan in 5 years or 10 years differs by almost \$12,000 over the life of a loan. The difference would be even greater for a larger or longer-term loan.

## Loan decisions

**Most of the information above you give a lender with your application that the lender evaluates to decide to make the loan or not. If approved, the lender will send the funds, and you'll start making payments.**

**Loan decisions are about more than just numbers. Your relationship with the lender and how you present your business matters, too. Different lenders use different criteria and lenses for understanding your ability to repay.**

**Small businesses that don't qualify for traditional financing still have options. Nonprofits like Pathway Lending, which has a mission to strengthen communities by financing businesses, provides flexible loan products and business services in the Southeast U.S.**



A national leader in economic development lending, Pathway Lending is a Community Development Financial Institution that increases access to capital for underserved businesses in Tennessee & Alabama.