



CALCULATING GLOBAL CASH FLOW AND DEBT SERVICE COVERAGE FOR THE SBA AND BUSINESS LOAN CREDIT MEMO

The NCUA is now underscoring that calculating global cash flow and global debt coverage is part of prudent underwriting and risk assessment that institutions should practice for Small Business Administration and member business loans. For SBA's Small Lender Advantage program (<http://www.sba.gov/content/small-loan-advantage>) it's required.

Rather than just measuring the income and debt service requirements of the borrower, global analysis combines available cash flow from the borrower and all affiliates and all guarantors, to give a global - combined picture - of cash available for meeting all global debt service obligations of all parties.

This assessment helps measure the risk of non-borrowing but related entities (and guarantors), of their becoming a drain on the borrower's cash flow resources. To make this analysis, you'll need:

- Financial statements and tax returns of the borrower and all related entities
- Tax returns of *all* individuals
- Borrower's personal financial statement
- Debt schedules on the borrower, and all related entities and individuals
- K-1's from all entities and individuals

Why do you need K-1s? Remember that reported taxable income from a tax return is not the same as cash flow. For individuals, taxable income from Schedule E partnerships and S-corps is not cash flow. You need the K-1's to determine true inflow or outflow of cash from these entities.

What's an Acceptable Global Debt Service Coverage Ratio?

Guidance from SOP 50 10 5 (F) effective January 1, 2014

Lenders must demonstrate the Small Business Applicant's ability to repay the loan from the cash flow of the business by documenting:

- For loans under \$350,000:
 - The Small Business Applicant's debt service coverage ratio exceeds 1:1 on a historical or projected cash flow basis; and
 - With the exception of loans under \$50,000, the Small Business Applicant's global cash flow coverage ratio

- exceeds 1:1 on a historical basis or, projected cash flow basis. Lender must document in the loan file the definition or formula used to calculate global cash flow
- For loans over \$350,000 up to and including \$5 million:
 - Analysis of historical cash flow should demonstrate total debt service coverage after the SBA loan;
 - Define operating cash flow (OCF) as earnings before interest, taxes, depreciation and amortization (EBITDA);
 - Analysis must document additions and subtractions to cash flow such as:
 - Unfunded capital expenditures;
 - Non-recurring income;
 - Expenses and distributions;
 - Distributions for S-Corp taxes;
 - Rent payments;
 - Owner's Draw; and/or
 - Assessment of impact on cash flow to/from any affiliate business.
 - Debt service (DS) is defined as required principal and interest payments on all business debt inclusive of new SBA loan proceeds. The small business applicant's debt service coverage ratio (OCF/DS) must be 1.15 to 1 or greater on a historical and/or projected basis:
 - For projected cash flows, the Lender should provide the calculation of debt service coverage using the definitions above, and provide analysis of the assumptions supporting the projected cash flow.

In short, the cash flow ratio of 1:1 for loans under \$350,000 is based on the lender's calculation. For loans over \$350,000 the 1:15 cash flow ratio is based on the SBA's specific EBITDA formula.

At J.R. Bruno & Associates, we're experienced in calculating global cash flow and global debt service coverage - and have given presentations on this technical, but critical underwriting element of the credit memorandum. In fact, we're expert at every facet of SBA and business lending. You may call me directly at 626.688.2125 to discuss working together on your institution's needs. Or check out JRB's array of services at www.jrbrunoassoc.com.

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