**Bank Line of Credit Application** **Teacher Guide**

The objective of the bank line of credit application is to familiarize students with the complexity and demands of a bank line of credit application.

(Updated: July 2016)

The table below compares the different type of credit (or debt) that small businesses use.

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| **Type of Debt** | **Typical 2016 Interest Rates** | **Origination Fee\*** | **Available to Small Businesses?** | **Effort to Complete an Application** | **Best Use** |
| Secured Line of Credit | 6 – 15% | 0 – 3% | Sometimes | Substantial | To purchase equipment the business will use for a long time |
| Unsecured Line of Credit (Credit Card) | 18 – 30% | No | Usually | Minor | Make a quick purchase the business needs urgently when cash is not available; to help a small business maintain operations during a period of slow sales |
| Online Credit | 24 – 60% | Typically No | Almost Always | Minimal |

\* - an origination fee is the percentage of a loan a bank charges when a small business receives a loan. Origination fees add to the cost of the loan.

Clearly a secured bank line of credit is the most affordable source of credit for a small business. But the process of obtaining a bank loan is typically more detailed and involved than obtaining other types of credit.

The bank’s goal in extending a loan: to minimize the possibility that the small business owner will “default” on this debt. (To “default” on debt is to fail to repay the debt in the amounts and on the timetable promised.)

Given the complexity of a bank line of credit application, it may be most appropriate to teach this section of the Micro-Enterprise Credential materials as a team exercise. *Students working in groups to correctly complete an application should be considered successful for the purposes of satisfying the Bank Line of Credit application requirement.*

Students (and teachers) will want to refer to both the Credit Application Definitions Sheet and the actual Full Bank Line of Credit Application as they review and complete this assignment.

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| **Business Contact Information** |

This section seeks information about the business (or the start-up company) applying for credit. The most important questions the applicants must answer in this section are:

***Application cells that require information not provided should be left blank****.*

(This is the same as the “real world,” where applicants may not need to respond to each application question.)

1. Nature of the Business – banks tend to lend to companies they “understand” and that they believe meet a market need;
2. Amount of Loan Requested – the amount requested often determines whether or not a bank is interested in this loan. Banks typically specialize in loans of a certain size – big enough to be profitable to them, but not so big that they incur too much risk with a single customer; and
3. General Purpose of Loan – the bank will want to confirm that their funds will be used for a specific purpose they can endorse. Banks may in fact check up to make sure companies are using their loans in appropriate ways.

***Note*** *– we’re asking students to assume all companies are LLCs for the purpose of their loan applications.*

A simple explanation: the different types of corporations (either a standard “C” corporation, a Limited Liability Corporation [LLC] or an S Corporation) are all ways individuals can create a business in ways that protect them from some liabilities. Corporations are “individuals” under commercial law – this means that when someone takes a legal action against a corporation they’re suing a legal entity and *not* the owners of the company as individuals. This form of protection has limitations, but that’s the basic concept.

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| **Bank Information** |

Banks want to be able to check the banking relationships applicants have maintained. Their goal is simply to confirm that the other bank has not experienced any problems with the applicants (like overdrafts or failure to pay back loans).

Some banks request that companies that take out loans consolidate all of the company’s banking services with them.

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| **Business/Trade References** |

Banks also want to be able to check that the applicants have maintained appropriate, “event-free” relationships with their suppliers and other companies they do business with.

(“Event-free” means that the company applying for a loan pays its other bills on time and in full. “Suppliers” mean companies that provide materials or services that a company needs to operate. For example, a company that sells beauty supplies like hair coloring or skin moisturizers would be a supplier to a beauty salon. An accountant that helps that beauty salon maintain their financial records and file their tax returns is also a supplier. The beauty products company supplies products, the accountant supplies services.)

“Type of Account” is asking what type of relationship the applicant has with that supplier. For example, the beauty salon might answer this question one way for the beauty supplies company: “Monthly supply company with a revolving 90 line of credit up to $5,000.” The beauty salon might answer this question another way for the accounting firm: “Provides on-demand accounting services that are paid upon invoicing, rarely above $500 per invoice.” The bank is simply looking for a way to understand what the business relationship is between the applicant and the company listed.

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| **Personal Information** |

This section seeks complete personal information about the applicants. Applicants and guarantors can expect to have the bank request a full credit report based on the information they provide.

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| **Business Pro Forma** |

This section asks the applicant to provide business projections for the next 12 months of an operating business, or the first 12 months of a start-up business. The form then asks the applicant to provide information on company assets and liabilities.

This information enables a bank to complete the ratio analysis component of their evaluation of each credit applicant.

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| **Required Schedules** |

The remainder of the application seeks to gather complete information about the applicants’ financial assets.

It’s obvious why a bank contemplating providing credit to a company would want to have complete information about the applicants’ financial assets – these will be the assets the bank will use to “satisfy the loan” (i.e., bet paid back) if the company is unable to make all of its required payments on schedule.

Schedule A seeks the current balances of the bank account(s) listed in the earlier Bank Information section.

Schedule B seeks information on the value of the “securities” (see Definitions sheet) the individuals own.

Schedule C seeks information on the real estate, including: a) what you think the current (or market) value of the real estate is (you can expect the bank to ask for why you believe your value is correct – students can check Zillow.com for the value of a house); b) the current balance of your mortgage; c) your monthly mortgage payment; and d) any income you get from that real estate.

Schedule D seeks information about any other Notes Payable (see Definitions sheet).

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| **Personal Statement of Financial Condition** |

The remainder of the application seeks to gather complete information about the applicants’ personal financial assets.

It’s obvious why a bank contemplating providing credit to a company would want to have complete information about every applicant’s personal financial condition. The information requested here includes both Balance Sheet and Income Statement information.

Schedule E then requests a great deal of additional detail about each applicant’s expenditures.

*Banks seek to learn everything about an applicant’s financial status and history in order to minimize the risk of extending credit to an owner / business that may default on the loan.*