



Commercial Finance

ASSET BASED LENDING

What is a Commercial Loan?

A commercial loan is a loan that is extended to businesses by a financial institution. Commercial loans are generally used to purchase long-term assets or to help fund day-to-day operational costs.

Summary

A commercial loan is a loan extended to businesses by a financial institution.

The loan is commonly used by small and middle-market corporate borrowers.

Advantages of a commercial loan include access to capital, an easier application process, and retaining equity ownership of the business.

Understanding a Commercial Loan

It is unfeasible for small and mid-sized businesses to access equity and bond markets for financing due to regulatory hurdles, associated costs, and the time required to secure the funds. Therefore, small and mid-sized enterprises use debt products such as commercial loans and/or lines of credit.

Commercial loans can ultimately be used for any purposes required for the business – acquiring assets, purchasing supplies, meeting daily operational costs, paying payroll,



etc. In the loan application process, the business must specify what the commercial loan will be used for.

Process for Securing a Commercial Loan

Depending on the lender, the process to secure a commercial loan may be different. The general process for securing such a loan is as follows:

1. Pre-approval (Qualifying process)

The lender (bank) will begin a pre-approval process for the business by evaluating the financial history and income of the business. In addition, the lender will investigate the existing debt of the business and the purpose of the loan. Through a pre-qualifying process, the lender can gain a rough idea of how much the business would be able to borrow and the relative riskiness of the borrower.

2. Loan application

After the pre-qualifying process, the business must complete and submit a loan application. In the application, financial statements or similar documents dating back at least three years are generally required. This is to help ensure that the business can repay the loan.

3. Review of the loan application package

Once the application is submitted, a loan officer will review these due diligence documents. They will investigate things such as credit history, available collateral of the business, the current and projected income of the business, etc. A big part of the diligence process is the financial analysis.

4. Loan underwriter/Loan committee

If the loan request is deemed appropriate by the loan officer, a complete and formal credit application is submitted to a credit adjudicator or loan committee. The adjudicator reviews all relevant information and decides whether to approve or decline the loan. The process can take up to a week, and the business may be required to provide additional documentation during the review.



5. Term sheet

If approved, the processor will present the company with a term sheet. A term sheet is a formal document that outlines the parties involved, amount of financing, available collateral, fees, use of the loan, and the interest rate on the loan. After reviewing the term sheet and signing a letter of intent, payment may be required for third-party reports, e.g., appraisal reports.

6. Loan package and closing documents

Upon completing third-party reports, the complete loan application package is resubmitted to the loan underwriter for final approval. If approved, the business is required to sign finalized loan documents. Generally, businesses employ a closing agent (e.g., an authorized representative, an attorney, etc.) who handles all closing documents and completes any remaining paperwork.

Advantages of a Commercial Loan

1. Access to capital

A commercial loan provides additional cash for a business. The cash may be used to purchase new equipment, satisfy payroll expenses, etc.

2. Easier application process

Although the application process for a commercial loan may seem daunting, it is easier than raising money in the equity or debt markets. There are regulatory hurdles and significant costs and time required to raise money through equity and/or bond markets.

3. Retaining ownership

A commercial loan does not dilute the business owner's equity. For example, a business may issue equity to raise money. In doing so, the owner would be diluting their own equity in the business. As such, a



commercial loan allows an owner to raise money without diluting their stake in the business.

Disadvantages of a Commercial Loan

1. Paperwork and application process

A commercial loan requires a significant amount of paperwork and involves a tedious application process. For example, a business may be required to submit an outline of its business plan and give a presentation outlining its business goals and objectives.

2. Inflexibility in the use of funds

When applying for a commercial loan, the business must specify what the money will be used for and how it will pay back the loan. This results in the inflexibility of the funds, as the business is required to commit to its original plan(s).

3. Interest costs

A commercial loan comes with a stated interest rate, which may be floating or fixed. As such, the business is required to make monthly payments on the money it borrows.

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