

Guide to Commercial Lending

There are many Chinese start to become self employed. Some of them are youngsters and new immigrants. Most of them engaged in catering businesses, such as restaurant, fast food, Chinese takeaway, fish & chips and cake shop. Other industries include arts gallery, barber, grocery shop and some related to catering businesses. Even the nature of businesses may different; the general concepts of commercial lending are similar.

Source of capital

Most of the initial capital is mainly from saving or realized from property. But the price of ideal business is always high; seller always demands a higher price. It is not affordable by normal people. Some get help from parent, relatives or friends. But most people get finance from banks. The interest pays to banks can be deducted from profit for tax purpose.

Where to get help?

Commercial lending is relatively complex. For high risk business, banks' requirements are high. The administrative procedures and loan application procedures have great different amongst banks. It is not easy to understand and to deal with by ordinary people. Due to increase of bad debts from in recent years, most lenders have tightened the lending requirements, especially for the leasehold business. If you have difficult, you should seek help from professional consultant. You should find the reliable one. It is better be introduced by accountant or solicitor. It is preferable to get advice from those who are Associate Member of The Chartered Institute of Bankers (ACIB) and those with qualification of Master of Business Administration (Finance) [MBA finance]. It is because they have passed the strict tests of the qualifications and have the most reference experience. After analysing the financial requirements of the borrower, they will recommend suitable methods of finance and lender. All commercial consultants will charge a fee. General speaking, the fee will not higher than 1% of the loan amount, it is cheaper than the fee of the estate agent. Commercial consultant will negotiate the best deal and prepare the business plan and documents required by the lender. An appropriate arrangement and suitable finance can save a lot of time and money for customers, for both new and experience businessmen.

Commercial Lending

It is simpler for a residential lending. If you have regular income, no bad financial history and can fulfil simple income multiple formula, you are relatively easy to get an approval of residential mortgage. For some low risk categories, even if you cannot fully fulfil all the lending criteria, there are lenders always willing to consider your borrowing on a case by case basis?

Regarding commercial lending, lending risk and bad debt ratio are relatively higher. Statistical history revealed that the failing rate of new companies is higher than 50%. Therefore, banks need to consider a lot of factors, there are no unique formula. Every bank will base on its own experience and bad debt history to establish different lending requirements during different economic cycle. Commercial interest rate is higher than residential mortgage too. Without commercial borrowing experience, borrowers always lose time and money such as valuation fee. At last, they still can not fulfil the strict requirements of lender and be refused the loan. They lost their opportunity of new business too.

General Principle of Commercial Lending

Loan purpose

All borrowing must be used for legal purpose and acceptable to the bank criteria. For different purposes of loan will have different risk profile, banks will have different procedures, different lending ratio, criteria and conditions.

Experience

For business start up, experience is very important. Most new businessmen may not have the financial and management experience, but they must have related operational experience. Expected events always happens, if you do not have the experience, you will not know how to respond. The worst case scenario, you may lose your business.

Credit Record

The creditworthiness and repayment record of the borrower is very important. If you have record of bankruptcy, county court judgement, unauthorised overdraft, bound cheque, delay payment on credit card, personal loan or mortgage, these will seriously affect your chance of getting loan approval. People always think that small amount of bad record may not have much problem on borrowings. In fact, lenders will think from other angle and feel that you can not handle such a small amount, how can you handle big loan amount when you face difficulty in business. Therefore, lenders may ask for details of any bad record even for a small amount.

Lenders normally require one year mortgage repayment record and 6 months current account record so as to assess the financial management ability and repayment habit. Due to information technology, lenders are very easy to obtain your bad credit history via credit reference agent. They know your old credit card details and loan applications history too. Some people think that they do not have current account, credit card or any loan record. Their record is completely blank and would easily get loan approval. In fact, there is no evidence to show that you are good, lenders will more cautious in granting loan. In such case, you need the professional help of a reliable commercial consultant.

Feasibility of the business

Different industry will have different risks. Banks will base on economic environment and condition of individual industry to adjust the conditions and lending criteria. If lending risk is too high or the probability of success is low, banks will not lend at all. In order to show the feasibility of the business, banks will require the borrower to present a business plan. This must be in details without missing, realistic with no exaggeration. This is a professional job, it is better be prepared by professional commercial consultant.

Stand by Capital

All businesses have risk. Business investment needs special care. Even with detailing planning, business may encounter accidents or obstacles. Therefore, banks need to understand whether borrowers have sound financial background. If you have sufficient assets or standby capital to solve the unexpected obstacles, banks will more easy to grant you a loan.

Securities

The lending of pawnshops is simple. Based on securities value, they can provide instant fund. Normally, the lending ratio is very low. Upon maturity date, the pawnshops will forfeit and sell the securities if you do not repay in time.

But banks are not pawnshops. Most banks' policy does not like to forfeit or sell the securities for repayment. It is not good for the banks' image and goodwill. Besides, the administrative time and legal fee will be very high. It is not beneficial to borrower too. Therefore, even you have sufficient securities, if the business risk is high with poor feasibility and inexperience of borrower, banks will not lend at all. Banks lending is governed by Financial Conduct Authority who also needs to protect depositors, therefore, most bank lending needs securities. If the borrower becomes insolvent, banks will auction your securities to repay the loan. In addition to

commercial risks, the realized value of commercial property is normally less than the percentage of residential property. Therefore, banks need to charge a higher interest rate. Normal securities include freehold and leasehold properties. Due to the low realization value of leasehold property, banks normally request additional securities or lend at a very low lending ratio. Other than the purchasing property itself, banks can consider other securities such as residential property, third party's deposit, share, saving plan, guarantee etc. Share must be blue chip and guarantor must have sufficient assets and income.

Business planning

In UK, most banks require business plan. Most banks have their own business plan format too. All qualified professional consultant would prepare the business plan for you. Basic content includes:

- **Nature of business**, business name and address

Type of organisation such as limited company, partnership, sole trader or franchise; nature of business such as catering; business target such as turnover, market share

- Staff

Details of major management, name, age, educational and working experience; other staff details and experience

- Product and market

Details such as target market, products and services provided; price of competitors and their strong and weak points; target turnover, strengths and weaknesses of own business

Marketing plan such as advertisement, leaflet; sourcing and methods of payment and breakeven analysis

- Business property

Location, floor area, freehold or leasehold, purchase price or rental, rate etc. If leasehold, who is responsible for maintenance?

- Tools and equipments

List out all major required equipments and cost

- Other assets

Personal assets and business assets; and assets available for securities

- Financial requirements

Total capital requirements include working capital, source of funding, saving and lending on application

- Budgeting

Make assumptions and forecast business results and list out all breakout figures include administrative and financial cost, depreciation etc. Make sure monthly income is sufficient for repayment.

- Fund flow statement

Detail all monthly incomes and expenses so as to ascertain that there is sufficient cash flow to run the business in the forthcoming year. It helps to avoid financial difficult if unexpected happen.

Meeting

Unless there is special arrangement by the consultant, most banks manager will need to interview borrower with the aim to promote business in the future and to probe more understanding of borrowers. Most topics are related to business plan, it is better to discuss with the professional consultant first.

Documents requirements

Other than business plan, most banks will require the following documents (requirements are different for different types of loan and borrowers; not all documents are required):

Bank loan application form

Authorization for credit checking

Proof of identity, mainly passport

Proof of address (documents with issue date within three months)

Latest current account statements for 6 months

Latest annual mortgage statement

Details of new business / property

Proof of initial capital

Details of experience

Three years financial record if any

Proof of financial standing

Questionnaire of guarantor

Common clauses of lending offer

Overdraft will be reviewed annually and the banks reserve the right to withdraw on demand

Term of lending between 5 years to 15 or 20 years; up to retirement age, i.e. age 65

Lending ratios normally are 50% to 70% or 80% of the property value or business proposal, depending on types of loan. With additional securities, lending ratio can be higher

If lending ratio requirement is too high or valuation too low, banks will require additional securities or decline application

Borrowers need to purchase sufficient life protection policy

Sufficient building insurance on mortgaged property up to required amount by surveyor

If limited company, banks will require directors' guarantee personally

If borrower is too young, banks will require additional guarantor

Interest rate is variable depend on various situation, normally it will not more than 4% over Base Rate.

If mortgage property needs repair, banks may withhold the repair cost from the loan amount until the repair have been done

After mortgage, if there is any change or grant of new lease needs the approval by banks. It is because the term of lease can be tied for a long term and can have substantial effect on the property value or saleability. Banks can request a new valuation and partial repayment to refresh the valuation adjustment. For example, the rent is substantially lower than market value; it will affect the property value seriously.

Banks will appoint their acceptable surveyor.

Banks normally will only accept solicitors firm with more than two partners.

Conclusion

Commercial lending is very complicated with many variables. Lending criteria of various banks always differ substantially. If you have any queries, you should consult a reliable and experience professional consultant. Otherwise you will waste a lot of time and lose business opportunity.

As a new businessman or experience businessman, you should look forward but do not too optimistic. You should forward step by step and do not pursuit a target beyond your ability. Always prepare for the worst case scenario. What if !

For potential new businessmen, you should care about your credit record. You should not make any unauthorised overdraft or unpaid cheque record. You should pay your regular loan repayment promptly; otherwise, it will affect your chance to obtain finance.

Prepared by Prosperity Solutions Co. Ltd.

Tel: +44 (0) 20 8467 9728

Website: www.prosperitysolutions.co.uk

email: info@prosperitysolutions.co.uk