

## Obtaining Bank Credit

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### SUMMARY

Developing a good relationship with a local banker is a wise decision for firm owners. Obtaining bank credit is easier to establish once a relationship of trust has been built. A well-crafted loan proposal that requests a reasonable amount of credit based on an objective evaluation of the firm's financial statements is equally important. Tips on developing a sound loan proposal and maintaining personal contact with a lender is included.

### BORROW BEFORE YOU NEED IT

Even if a firm is not in need of a bank loan, it is always prudent to develop and maintain a relationship of trust with a local banker and to establish a line of credit.

Every business encounters unusual growth for which credit may be needed temporarily or unforeseen delays in receipt of accounts receivable. A line of credit is easier to obtain before, rather than after, the need arises. When a need does arise, you may not be in as advantageous a position to negotiate favorable terms with the bank. Large firms or firms with multiple offices should consider lines of credit with more than one bank.

A good loan proposal demonstrates that you manage your firm's financial affairs properly, understand your financial needs, and have carefully considered the need for credit. A typical loan application or proposal includes the following elements:

- A summary letter indicating the amount to be borrowed, the purpose of the loan, and the proposed date of final repayment. Your desired terms, such as a revolving line of credit for one year on which interest will be paid quarterly, may also be included.
- Your most recent year-end financial statements (i.e., your balance sheet and income statement) and your most recent interim financial statements

- The aging schedule for accounts receivable and work in progress
- A cash-flow projection showing the effects of borrowing and repaying the loan
- A list of major projects under contract by building type or category (e.g., schools, churches, or homes). Provide enough information to indicate your firm's financial stability, but not so much that the banker can call your clients for credit references; such additional information can always be provided later upon request.
- A list of major proposals pending by building type or category
- A firm brochure and resumes of firm principals

Lenders may also request personal financial statements, including income tax returns, of all firm principals. These documents should be prepared but provided only upon request with specific instructions to the lender that personal financial information is highly confidential.

Determining the limit on the line of credit to request can be difficult. What you believe you need may differ from what you may be able to obtain. As a rule of thumb, lenders will lend no more than 75 to 80 percent of the accounts receivable that they *are certain* will be collected. Examine your financial statements and loan proposal objectively, as a lender might, and make a good faith estimate of an appropriate figure. Note that asking for too little may be as detrimental as asking for too much, as it indicates to the lender that you do not fully understand your financial needs.

Maintain personal contact with your lender. Arrange to meet with your lender at least twice yearly, more frequently if possible. Discuss the credit line and review the firm's prospects for the future. Assuming that you prove your firm's creditworthiness by making loan payments on schedule and providing financial statements monthly or quarterly as specified in the loan agreement, your lender's

personal knowledge of your business will increase the lender's comfort level and increase the likelihood of renewal of the credit line.

## LOANS AND CREDIT LINES

Architecture firms may seek credit lines to finance their short-term capital needs and possibly loans to finance longer-term requirements. The above section details what items you should bring with you to your bankers office and this section offers information on what bankers look for when determining amounts of credit lines and loans.

## CURRENT RATIO

Lenders look carefully at two indicators in assessing the borrower's ability to repay and therefore, the lender's interest in lending. The first is the current ratio, which measures solvency:

Current Ratio= Current assets / Current liabilities

In examining the firm's current ratio, bankers seek to ensure that current assets are sufficient to cover (pay for) the firm's current liabilities, plus a significant buffer. The current assets are usually in the form of cash, work in progress, and accounts receivable. Current liabilities usually include amounts owed to consultants, vendors, and other short term creditors. The banks will want the current ratio to exceed 1:1 and will prefer a ratio closer to 2:1. The second performance indicator is the debt-to-equity ratio, which measures leverage:

## DEBT-TO-EQUITY RATIO

Debt-to-equity= Total liabilities / Owner's equity

In considering the debt-to-equity ratio, bankers seek to ensure that the owners have an appropriate level of personal investment in the firm relative to outside lending. They commonly want the ratio to be at least 1:1.

## RESOURCES

### More Best Practices

The following AIA Best Practices provide additional information related to this topic:

- 08.01.02 Starting a Firm: Basic Financial Principals
- 08.03.01 Financial Management: 10 Key Performance Indicators
- 08.02.03 Choosing Accounting Software

## Feedback

The AIA welcomes member feedback on Best Practice articles. To provide feedback on this article, please contact [bestpractices@aia.org](mailto:bestpractices@aia.org).

## For More Information on This Topic

See also "Acquiring Capital," by Peter Piven, FAIA, *The Architect's Handbook of Professional Practice*, 13th edition, Chapter 8, pages 183, 194, 203, and 214, respectively.



See also the 14th edition of the *Handbook*, which can be ordered from the AIA Bookstore by calling 800-242-3837 (option 4) or by email at [bookstore@aia.org](mailto:bookstore@aia.org).



## Keywords

- Practice
- Financial management
- Banking
- Loans