*Small business loans come with conditions that are in place to protect both you and the bank's best interest. When your business needs a $100,000 or a $1 million line of credit from the bank, then you should be prepared and know what to expect.*


The terms of a business loan or line of credit are very different than those of personal loans. Many small businesses begin with a personal or business credit card to help manage their cash flow. But if things go well then, a $25,000 or even a $50,000 card limit won't be enough to give you the flexibility you need. When your business needs a $100,000 or a $1 million line of credit from the bank, then you should be prepared and know what to expect.

Unlike personal loans and lines of credit, business loans require that a company adhere to certain covenants. These are restrictions on how the company manages its finances, assets and operations. Given the large amount of money at risk, lenders aren't satisfied with simply knowing that you have enough collateral to cover the loan in case your business is forced into bankruptcy. They want to do everything they can to avoid reaching that point or coming anywhere near it.

Based on their experience, loan risk experts can determine that certain financial or operating conditions increase the risk of default. If a borrower violates these covenants, it typically leads to increased interest rates or can give the bank the option to accelerate the maturity of the loan, meaning that the principal is due immediately. If you can't pay it then you have a problem.

**HERE ARE THE TYPICAL COVENANTS REQUIRED BY LENDERS:**

1. **Financial covenants.**

These covenants relate to a borrower's income statement, balance sheet and cash flow statement. In addition to providing audited financials, the company must also maintain financial ratios within certain levels. The most common ratios used for financial covenants are the current ratio, equity ratio, debt-to-equity ratio and cash flow coverage ratio.

2. **Operating covenants.**

These covenants require your company to continue to operate moving forward, while applying for the loan. Complying with all laws, regulations and paying taxes are just a few examples of what is required. Significant changes to the business model may require bank approval.

3. **Reporting and disclosure covenants.**

Typically, these covenants require you to provide the lender with regular performance reports and to notify them of any material changes in your company's financial condition. In some cases, financial information of the owners may also be required. Banks will also want the option to request proof that you are complying with your covenants on demand.

4. **Collateral covenants.**

If your company uses specific assets as collateral for the loan, these covenants require you to maintain the lender's claim to the assets above all others. Additional encumbrances, like liens, are not permitted. The bank may also require that you maintain appropriate levels of insurance coverage on the assets in case of damage, theft or destruction. This also applies to selling any assets that are used as collateral without the lender's approval.

5. **Cash payout covenants.**

In some cases, lenders will also restrict what can be done with the cash your company generates. It may place restrictions on dividends or other payments to owners that would weaken the company's cash position.

Covenants—like everything in life—are negotiable. This is not a comprehensive list; there are other covenants as well. But all these covenants can be negotiated or waived, depending on how well you negotiate, how desperately the bank wants your business and the overall level of competition for loans in the market.

Have you taken a closer look at your loan covenants? Have you had any challenges complying with them?

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