Strengthening nonprofits and the communities they serve
Serving the Midwest

IFF's LOAN READINESS INDICATORS

for Nonprofit Organizations

Though not the right solution for every situation, taking on debt can allow organizations to build net assets, plan for growth, and control cash flow—strategic use of debt can be a highly effective financial management tool. When managed carefully, project loans enable organizations to reserve cash for operations and programs or can act as a bridge during a fundraising cycle.

Lenders will evaluate many aspects of your organization, including the strength of your board and leadership team. The following are just a few indicators of loan "readiness" that give lenders confidence that your organization has the financial capacity to service debt.

For more helpful financial and real estate planning resources for nonprofit organizations, please visit iff.org or call (866) 629-0060.

LIQUIDITY/CASH RESERVES (MONTHS)

0 1 2 3 4 5+

WORKING CAPITAL (MONTHS)

0 2 4 6 8+

NET ASSET RATIO

0 25% 50% 75% 100%

DEBT COVERAGE RATIO

0 1.2 2.0 3.0+

DAYS RECEIVABLE

90+ 60 30 0

DAYS PAYABLE

90+ 60 30 0

LEGEND:

- Weak
- Acceptable
- Strong

Credit criteria vary by lender. Any lender commitment would be subject to a completed application, full underwriting, and appropriate approval.

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Calculating Key Financial Ratios

LIQUIDITY RATIOS

Months of Cash = (Cash and Cash Equivalents) / [(Expenses – Depreciation) / 12]
Measures how many months of expenses the agency could pay with the cash that it has on hand. Calculate this ratio by dividing the agency's cash, plus cash equivalents, by one twelfth of the agency's annual expenses, minus depreciation (a non-cash expense); the result of this calculation will be expressed in months. A good rule of thumb requires an agency to have three months of cash to cover an average month of expense. However, fewer months of cash should only be considered a cause for concern if the agency lacks other liquidable current assets to pay its current liabilities.

Months of Working Capital = (Current Assets – Current Liabilities) / (Expenses / 12)
Measures the number of months of average expenses that can be met with working capital.

FINANCIAL LEVERAGE RATIOS

Net Asset Ratio = Net Assets / Total Assets
Calculates the percent of total assets that the agency owns outright, or free and clear from debt obligations. In general, an agency should have a large enough net asset base to cover future fluctuations in net income.

Debt Coverage Ratio = (Surplus + Interest + Depreciation) / Annual Principal and Interest Payments
The debt coverage ratio (sometimes referred to as the "debt service coverage ratio") is the ratio of cash available for debt servicing to interest, principal and lease payments. It is a popular benchmark used in the measurement of an entity's ability to produce enough cash to cover its debt payments. The higher this ratio is, the easier it is to obtain a loan. The phrase is also used in commercial banking and may be expressed as a minimum ratio that is acceptable to a lender; it may be a loan condition/covenant. Breaching this covenant can be considered an act of default.

ASSET TURNOVER RATIOS

Days Receivable = Accounts Receivable Outstanding / (Annual Revenue / 360)
This ratio tells the analyst how many days it takes the agency to convert receivables into cash—it measures, in other words, the average collection period. Calculate this ratio by dividing the amount of receivables outstanding by average daily revenue.

Days Payable = Accounts Payable Outstanding / (Annual Expense / 360)
Measures the average amount of time it takes an agency to pay bills. To find this number, simply do the same thing you did for accounts receivable; that is, divide the amount of payables outstanding by average daily expense. As with the Days Receivable ratio, be sure to look at this ratio in a historical context to uncover possible payment problems.

One of America's leading community development financial institutions, IFF strengthens nonprofits and their communities through lending and real estate consulting.

We work with nonprofits throughout the Midwest with a focus on those that serve low-income communities and special needs populations.

To learn more about IFF, visit iff.org.