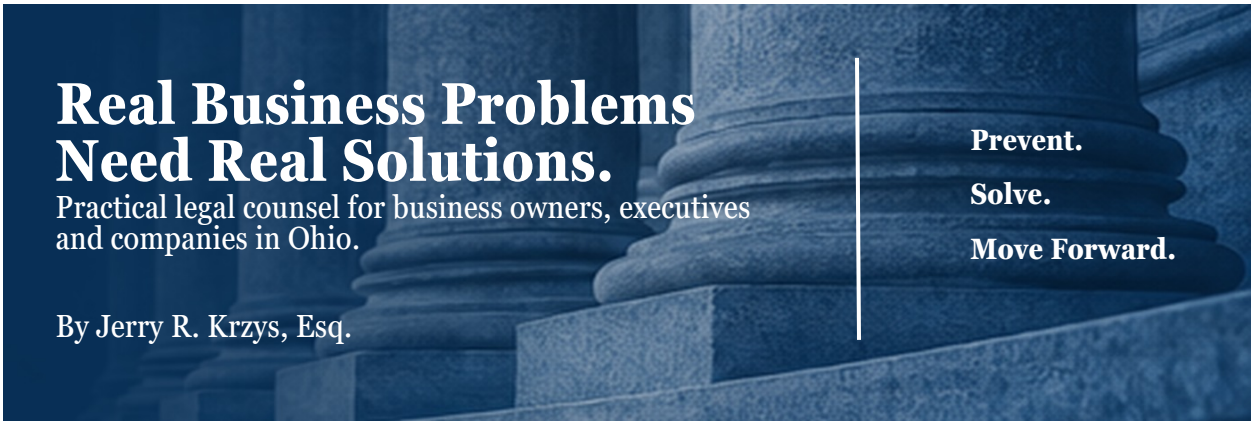
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From Loan Application to Closing: How the Commercial Financing Process Actually Works

A business needs money.

Maybe it needs a working-capital line to bridge the gap between paying employees and collecting receivables. Maybe it is buying equipment, acquiring another company, purchasing or developing real estate, opening another location, or refinancing debt that no longer fits the business. The owner talks to a banker. Financial statements and tax returns are exchanged. There are questions, projections, and perhaps a few uncomfortable conversations about collateral or cash flow.

Then the call comes: "**The loan has been approved**." It is easy to hear those words and think the financing process is essentially over. Usually, it isn't.

Credit approval is an important milestone, but there can be a significant distance between a lender agreeing to make a loan and the borrower actually receiving the money. During that period, the business terms are documented, collateral rights are created and perfected, guaranties are signed, closing conditions are satisfied, and the rules that will govern the relationship after closing are established.

Those rules can matter long after everyone has forgotten the excitement of getting the loan approved. A business owner does not need to become a commercial lender or finance lawyer to borrow money intelligently. But the owner should understand the process, know which questions matter at each stage, and recognize that **the interest rate is only one part of the deal**.

1. Start With Why the Business Is Borrowing

Commercial financing should begin with the business need, not the loan document. A company borrowing $500,000 to purchase a machine has a different need than a company borrowing $500,000 to finance receivables. A developer financing construction has different risks than an established company refinancing its headquarters. A seasonal business may need revolving credit availability that rises and falls with working capital, while a business purchasing equipment may be better served by a term loan amortized over the useful life of the equipment.

That sounds obvious. It is also where financing decisions sometimes begin to go wrong.
The first question should not simply be: **How much will the bank lend us?**

It should be: **What does the business need the money to accomplish, and what financing structure allows it to accomplish that without creating unnecessary constraints elsewhere in the business?**

Common commercial financing structures include term loans, revolving lines of credit, equipment loans, commercial real estate loans, construction loans, acquisition financing, and government-guaranteed programs such as SBA loans. The SBA's 7(a) program, for example, can be used for working capital, real estate, equipment, refinancing qualifying business debt, and complete or partial changes of ownership.

The right structure depends on the transaction and the business. Borrowing short-term money to finance a long-lived asset can create refinancing risk. Using a term loan where the real need is fluctuating working capital can leave the company without liquidity when it needs it. Pledging substantially all company assets for a relatively modest loan can affect the company's ability to obtain additional financing later.

Before approaching a lender, management should therefore understand at least three things: **how much money the business actually needs, what the money will be used for, and how the business expects to repay it**. Those are also among the questions the lender will ask.

2. The Application Is Really the Beginning of Underwriting

Commercial lending is fundamentally an exercise in assessing risk. The lender wants to know whether the borrower can repay the loan, what could interfere with repayment, and what sources of recovery will exist if the business cannot repay as expected.

The exact information requested varies with the lender, loan size, transaction, and type of financing. But a business should expect some combination of historical financial statements, tax returns, interim financial statements, accounts-receivable and accounts-payable information, debt schedules, ownership information, personal financial information from guarantors, projections, information concerning collateral, and an explanation of how the loan proceeds will be used.

For acquisition or real-estate financing, the lender may also want purchase agreements, leases, rent rolls, organizational documents, appraisals, environmental information, title materials, surveys, construction information, or other transaction-specific documents. The SBA similarly tells prospective borrowers to be prepared to explain the amount and use of funds, financial projections, credit history, collateral and the business itself.

There is a practical lesson here. **Do not make the lender reconstruct your business from a pile of documents.** A borrower that can explain what it needs, why it needs it, how the financing fits the business, and how the debt will be repaid makes the underwriting question easier to understand. That does not guarantee approval. It does make the business easier to evaluate.

3. The Proposal or Term Sheet Is More Important Than It Looks

If underwriting proceeds favorably, the lender may issue a proposal, term sheet, letter of interest, or similar document describing the contemplated financing. This is often where the borrower's attention narrows.

Loan amount? Good.

Interest rate? Acceptable.

Monthly payment? Manageable.

Closing fee? Annoying, but fine.

Sign it.

But those are not the only economic terms. Depending on the transaction, the proposal may also address maturity, amortization, variable versus fixed interest, interest-rate floors, prepayment charges, collateral, personal guaranties, loan fees, financial covenants, reporting obligations, minimum liquidity, debt-service requirements, borrowing-base requirements, deposit relationships, equity contributions, conditions to closing, and other requirements.

These provisions can change the practical economics of the loan. Consider a simple example. Two lenders each offer a business a $1 million loan at approximately the same interest rate. One requires a lien only on the equipment being purchased. The other requires a blanket lien on substantially all business assets, personal guaranties from the owners, restrictions on additional debt, and lender consent before certain distributions can be made. Those are not economically identical loans merely because the principal amount and interest rate are the same.

The best time to identify those differences is **before everyone has invested substantial time and money trying to close the transaction**.

4. A Commitment Letter Is Not the Same Thing as Money in the Bank

After credit approval, the lender may issue a commitment letter. A business owner understandably views a commitment as good news. It is.

But the word "**commitment**" should not cause the borrower to skip the conditions attached to it. A commitment may require the borrower to satisfy numerous conditions before the lender becomes obligated to fund. Depending on the transaction, those conditions might include satisfactory loan documentation, title and lien searches, appraisals, environmental review, insurance, organizational authorizations, equity contributions, landlord waivers, subordinations, lien releases, guaranties, financial information, no material adverse change, and completion of other transaction documents.

In a real-estate or acquisition transaction, this creates an important coordination problem. The borrower may have promised the seller that it will close by a particular date while the lender is obligated to fund only if its conditions are satisfied. Those two sets of obligations need to work together. A financing contingency in a purchase agreement does little good if it expires before the lender finishes underwriting. A lender commitment does not solve a title problem. A construction loan cannot fund smoothly if the construction contract, budget and draw process do not satisfy the lender's requirements.

The financing transaction does not exist in isolation from the transaction it is financing.

5. Then Come the Loan Documents

Once the basic financing has been approved, counsel for the lender typically prepares the documents that convert the credit approval into enforceable legal obligations. The particular documents depend on the loan, but they may include a promissory note, loan agreement, security agreement, mortgage, assignment of leases and rents, guaranties, deposit-account control agreements, environmental indemnities, landlord waivers, subordination agreements, resolutions, certificates, and other closing documents.

At this stage, borrowers sometimes experience a predictable psychological shift. They negotiated the business deal with the banker. They trust the banker. The loan has been approved. Closing is approaching. The legal documents arrive late in the process. It becomes tempting to view them as paperwork memorializing a deal that has already been made.

They are more than that. **The term sheet describes the financing everyone expects to have. The loan documents establish the financing the parties actually have**. That distinction matters.

6. Understand What You Are Giving the Lender as Collateral

One of the most important questions in a commercial loan is deceptively simple: **What is securing the debt?** If a company borrows to buy a piece of equipment, an owner may assume that the lender's collateral is that equipment. Perhaps.

But the security agreement may cover considerably more: equipment, inventory, accounts receivable, deposit accounts, general intangibles, investment property, contract rights, proceeds, after-acquired property, and other business assets. That is often described as a **blanket lien**.

Ohio's version of Article 9 of the Uniform Commercial Code governs most security interests in personal property. A security interest generally becomes enforceable against the borrower when the statutory requirements for attachment are satisfied, including that value has been given, the borrower has rights in the collateral, and the applicable requirements concerning the security agreement or control or possession of the collateral have been met. See Ohio Rev. Code § 1309.203. A security agreement may also cover after-acquired property and secure future advances, subject to statutory exceptions. See Ohio Rev. Code § 1309.204.

Attachment, however, is not the end of the analysis. A lender ordinarily also wants its security interest perfected so that its rights are protected against competing claimants. Filing a financing statement is a common method of perfection, although Article 9 provides different rules for certain types of collateral, including circumstances in which possession or control matters. See Ohio Rev. Code § 1309.310. Priority among competing claimants is then governed by another set of Article 9 rules.

For the borrower, the terminology matters less than the practical consequence. The security agreement determines what the lender can claim as collateral, while perfection and priority help determine how the lender's claim stands against the claims of others.

A lien on substantially all assets can affect what the company can do later. Another lender may be unwilling to extend credit without a first-priority lien. A new equipment lender may require a lien release or subordination. A sale of assets may require lender consent. Refinancing may require coordination with the existing secured creditor.

The borrower therefore should understand not only **what the lender is financing**, but **what the borrower is pledging in return**. Those are not necessarily the same thing.

7. The Personal Guaranty Changes the Risk for the Owner

One reason business owners operate through corporations and limited liability companies is to limit personal exposure for obligations incurred by the business. A personal guaranty can deliberately cross that line for a particular debt.

Suppose Buckeye Widget Works, LLC borrows $750,000. The company signs the note. Its assets secure the loan. The owner also signs an unconditional personal guaranty. If the company later

cannot repay the loan, the lender's remedies may not stop with the company's assets. The guaranty may permit the lender to pursue the owner personally according to its terms.

A guaranty is itself a contract. Ohio's Statute of Frauds generally requires a promise to answer for the debt or default of another to be evidenced by a writing signed by the party to be charged. See Ohio Rev. Code § 1335.05. Once the guaranty is signed, its language matters. The document may define the guaranteed obligations broadly enough to reach amendments, renewals, extensions, additional advances, or other indebtedness, depending on its terms.

That does not mean a business owner should never sign a guaranty. For many closely held businesses, particularly with a new credit relationship, a lender may insist on one. It means the guaranty should not be treated as the signature page that comes after the "real" loan documents. The important question for a business owner is not simply, "Am I guaranteeing the loan?" Rather, questions worth asking are:

Exactly what obligations have I agreed to guarantee and for how long?

Is the guaranty unlimited?

Does it cover only this loan or other present and future obligations?

Does it continue after amendments or extensions?

Are multiple guarantors jointly and severally liable?

Can the guaranty be reduced or released when the loan reaches a particular balance or the company satisfies specified financial tests?

What happens if ownership changes?

A business owner may ultimately decide to sign exactly the guaranty the lender requested. That is different from signing it without understanding what was agreed to.

8. Covenants Can Matter Even When the Business Never Misses a Payment

Borrowers tend to think about default in a straightforward way: **We make the payments, so we're not in default**. Commercial loan agreements can be considerably broader. A borrower may agree to maintain particular financial ratios, deliver periodic financial statements, maintain insurance, pay taxes, preserve collateral, keep certain accounts with the lender, limit additional debt, restrict liens, limit distributions to owners, restrict asset sales, or obtain consent before certain ownership or organizational changes.

A line of credit may also be subject to a borrowing base. The lender may advance only a specified percentage of eligible receivables or inventory, with exclusions for aging, concentration, related-party receivables or other categories.

That can produce an uncomfortable result. The business needs liquidity because receivables have deteriorated. But because receivables have deteriorated, the borrowing base falls. The business therefore has less availability **at precisely the moment it wants more cash**. That is not necessarily unfair or unexpected from the lender's perspective. The borrowing base is designed to tie availability to collateral quality. But the borrower needs to understand how the mechanism behaves **when the business is under stress**, not merely how much it can borrow on closing day.

9. Default Provisions Tell You What Happens When Things Stop Going According to Plan

Every business borrower intends to repay the loan. Loan documents are written in part to address what happens if that expectation proves wrong. Events of default may include nonpayment, covenant violations, inaccurate representations, insolvency events, judgments, defaults under other agreements, impairment of collateral, unauthorized transfers, or other negotiated triggers. Some defaults may have notice and cure periods. Others may not.

The consequences can be substantial: acceleration of the debt, termination of further advances, default interest, exercise of rights against collateral, foreclosure, collection against guarantors, or other remedies provided by the documents and applicable law.

For loans secured by personal property, these remedies are not simply creatures of the loan documents. Ohio's Article 9 gives a secured creditor significant rights after default, including rights to enforce the security interest and, in appropriate circumstances, take possession of and dispose of collateral. See Ohio Rev. Code §§ 1309.601, 1309.609, 1309.610. Article 9 also imposes requirements on that process, including that every aspect of a disposition of collateral be commercially reasonable. A sale of collateral does not necessarily end the borrower's exposure: depending on the circumstances, the proceeds are applied to the secured obligations and the obligor may remain liable for a deficiency. See Ohio Rev. Code § 1309.615.

This is another place where the borrower should resist focusing exclusively on probability. The natural response is: "**We're not going to default**." Hopefully not. But default provisions are not negotiated because either party expects failure. They allocate rights **if circumstances become materially different from what everyone expects today**. Businesses buy insurance for the same reason.

The relevant question is not simply whether default is expected. It is whether the consequences are understood and commercially reasonable for the transaction.

10. Closing Is a Process, Not an Appointment

Eventually, everyone wants to schedule the closing. But commercial loan closings often depend on a checklist rather than a calendar invitation. The lender and its counsel may need organizational documents and authorizing resolutions. Existing liens may need to be terminated or subordinated. Insurance certificates and endorsements may be required. Title and survey issues may need to be resolved. Mortgages and financing statements may need to be prepared. Equity may need to be contributed. Guaranties must be signed. Acquisition or construction documents may have to satisfy specified conditions.

The borrower should know who is responsible for each item and which items depend on third parties. A surprising amount of closing stress results not from legal disagreement but from discovering too late that someone needs a document from an insurer, landlord, existing lender, title company, government office, accountant or other third party.

A good closing process identifies those dependencies early.

11. Funding Is Not the End of the Financing Process

The loan closes. The money arrives. Now the borrower has to live with the deal.

A commercial financing relationship may require monthly, quarterly or annual financial reporting; borrowing-base certificates; tax returns; insurance renewals; covenant calculations; annual

reviews; updated personal financial statements; notices concerning litigation or other events; and lender consent for specified transactions.

Those requirements should become part of the company's operating calendar. The loan agreement should not disappear into a closing binder until the company needs another loan. This is particularly important when the business later wants to do something that seems unrelated to the financing: acquire another company, purchase equipment, distribute money to owners, sell an asset, change ownership, grant another lien, open another credit facility, or reorganize affiliated companies. The existing loan documents may have something to say about it.

12. What Should the Borrower's Lawyer Actually Be Looking For?

A borrower's lawyer is not there simply to tell the client that a promissory note requires repayment. The more useful questions are practical:

Does the documentation reflect the business deal the client believes it negotiated? Does the principal amount match? The interest calculation? Maturity? Amortization? Fees? Prepayment provisions?

What assets are being pledged? Is the lender receiving a lien only on identified collateral or substantially everything the company owns? Are there existing liens? Does the collateral package interfere with anticipated future financing?

What is the owner guaranteeing? Is the guaranty limited or unlimited? Does it reach future indebtedness? Are there circumstances under which it terminates?

What promises is the company making about future operations? What financial reporting is required? What ratios must be maintained? What transactions require consent? Are ordinary distributions, equipment purchases, additional debt or asset sales restricted?

What constitutes default? Are there notice and cure periods? Are there cross-default provisions? Can a problem under another agreement trigger a default under the loan?

What happens if the business needs flexibility later? Can the loan be prepaid? Is there a prepayment penalty? Can collateral be released? Can another lender obtain a lien?

What happens if the owners sell the company?

And sometimes the lawyer's most important job is simply to identify a mismatch between documents. The term sheet says one thing. The loan agreement says another. The purchase agreement requires closing on Friday, but the loan commitment still has unsatisfied conditions. The borrower expects a working-capital line, but the borrowing-base definition excludes a significant percentage of its actual receivables. The owner thinks the lender is financing one machine, but the security agreement grants a lien on substantially all business assets.

Those are much easier conversations **before closing** than after it.

13. Not Every Provision Needs to Become a Negotiation

There is another side to this. Commercial borrowers sometimes approach loan documents as though every provision should be negotiated because it *can* be negotiated. That is rarely productive.

Lenders have legitimate reasons for requiring collateral, financial reporting, guaranties, insurance, default remedies and operating covenants. A lender is putting its money at risk and is

entitled to protect its ability to be repaid. Some provisions will be standard for the lender, appropriate for the credit, and not worth spending legal fees trying to change.

The goal is not to turn every commercial loan into a battle between borrower and lender. The goal is to identify the provisions that **materially affect this borrower, this business, and this transaction**. A covenant restricting additional indebtedness may be irrelevant to one borrower and critically important to another that routinely finances equipment. A personal guaranty may be unavoidable for a young company but worth revisiting for a mature company with substantial assets and a long banking relationship. A prepayment provision may mean little to a borrower expecting to hold a real-estate loan for fifteen years but matter considerably to a company expecting a sale or refinancing in eighteen months.

Good financing counsel should know the difference between a provision that is merely lender-friendly and one that creates a genuine business problem.

14. The Best Time to Understand the Loan Is Before You Need the Money

Financing transactions create their own pressure. The equipment is waiting. The seller wants to close. Construction needs to start. Payroll is approaching. The acquisition opportunity will not remain available forever. As the need for the money becomes more immediate, the borrower's willingness to question the financing terms tends to decrease.

That is precisely why the process should begin earlier. There is considerably more room to discuss collateral, guaranties, covenants, structure and closing requirements when the business is evaluating financing than when everyone is waiting for the wire. A commercial loan is not simply a source of money. It is a contractual relationship that may govern parts of the business for years.

The rate tells you what the money costs. The loan documents tell you what the money requires. A business owner should understand both before signing.

A Practical Commercial Financing Checklist

Before closing a commercial loan, a business owner should be able to answer:

- What exactly are we borrowing, and what is the money for?
- Is this the right type and term of financing for that need?
- What is the interest rate, and how can it change?
- What fees and prepayment charges apply?
- What collateral are we pledging?
- What liens will the lender have?
- Who is personally guaranteeing the debt, and what does the guaranty cover?
- What financial and operating covenants must we satisfy?
- What reporting must we provide?
- What future transactions require lender consent?
- What constitutes default, and which defaults have cure periods?
- Are there cross-default or cross-collateralization provisions?
- What conditions remain before funding?
- Do the loan documents match the proposal or commitment?
- Do the financing documents work with the purchase agreement, lease, construction contract, acquisition agreement or other transaction being financed?
- What obligations continue after closing?

If management cannot answer those questions, the financing may still be a perfectly good deal.

But management does not yet fully understand the deal.

This article is for general informational purposes only and does not constitute legal advice. Commercial financing terms and applicable law vary depending on the lender, borrower, collateral, loan program, transaction documents, and particular circumstances.