oak street funding

Q&A: Capital Options for Insurance Businesses

Financing for insurance professionals

a complimentary whitepaper for agents and brokers

Frequently Asked Questions: Capital Options for Insurance Businesses

Q: What are the primary credit capacity parameters?

A: Oak Street considers three primary credit capacity parameters to determine if an entity is in a position to borrow - cash flow, agency value and eligible commissions.

1. Cash Flow/EBITDA: EBITDA stands for Earnings Before Interest Taxes Depreciation & Amortization. Most traditional banks/lenders are comfortable lending one to three times a company's EBITDA. This is an easy way to determine the core cash flow a business is generating. If comfortable with the type of risk, some banks/lenders may get more aggressive and lend a multiple of up to three to five times EBITDA. Higher multiples typically result in greater loan and loan payment amounts, which make for a tighter cash flow. Consequently, higher interest rates may be charged with higher leverage.

2. Valuation: This represents the value of the agency or property, similar to an appraisal of a residential property or home. Lenders will use a third-party valuation to ensure they don't lend an amount of money that may exceed the value of the agency in the event it is sold. An agency that needs a valuation should consider utilizing an insurance industry expert that understands the value and nuances that occur in this space (carrier contracts, contingency bonuses, standard vs. non-standard business, etc.).

3. Commissions: Because Oak Street provides commission-based financing, the historic retention/persistency ratios of agencies have a significant impact on the amount of money available to borrow. The more business placed with A-rated carriers and with high retention ratios, the larger the loan amounts and longer the repayment terms tend to be. Agencies writing tougher classes of business with lower retention ratios may qualify for a lower leverage due greater uncertainty of policies renewing.

Q: How does Oak Street decide how much I can borrow?

A: Oak Street looks at three major factors to determine the risk profile and subsequent loan amount for which a borrower could qualify. Unlike most traditional lenders, we conduct an in-depth review of your book of business, taking into the account carrier ratings and contract rights, retention rates, loss ratios and other factors mentioned above. We also consider cash flow from commissions and the agency's ability to repay the debt while reasonably continuing operations with the amount of available working capital they have. We look closely at Funded Debt/EBITDA and Debt Service Coverage Ratio.

1. Funded Debt/EBITDA: Funded Debt is the total debt to the agency and EBITDA is Net Income adjusted for Taxes, Depreciation, and Amortization. So, when you look at Funded Debt to EBITDA, you should think about a range of 4 to 6 times.

For example: If debt is $2,000,000 and EBITDA is $500,000, the Funded Debt to EBITDAratio is 4 to 1.

2. Debt Service Coverage Ratio: Oak Street calculates the Debt Service Coverage Ratio by dividing EBITDA by Annual

EBITDA stands for Earnings Before Interest Taxes Depreciation & Amortization.

Debt Service. We target a minimum of 1.50, but this number often varies depending on factors such as type of agency, commissions, lines of business and carriers.

For example: If EBITDA is $500,000 and annual debt service is $300,000, the Debt Service Coverage Ratio is 1.66.

Based on our knowledge of the insurance industry and our lending experience, companies that meet the aforementioned criteria are typically strong and profitable (typical EBITDA margins are 15-30% of revenue) with predictable cash flows from renewal business. New business growth is challenged particularly when the market is softening; however ancillary sources of revenue such as policy fees, endorsements and reinstatements represent a growing component of the best agencies' revenue and profitability. The pressure on carrier commission levels is constant, as well as pressure from carriers for growth.

About Oak Street Funding

Since 2003, financial services professionals have benefited from hundreds of millions of dollars in loans from Oak Street Funding, a direct, non-SBA lender that understands their business model and appreciates their most valuable assets – even though they are intangible. Our strong financing expertise, innovative technology, proprietary actuarial models and experienced niche-lending team align to develop new products to meet the growing demand for insurance lending. To learn more, call 844-343-1417 or visit oakstreetfunding.com/working-capital-mga.