Net Revenue and Debt Service Coverage –

What Is It and Why Is It Important?

Guidance

Always consult the bond covenants or loan agreement to determine the specific definition for Net Revenue. This may or may not involve consultations with your Financial Advisor and or bond counsel.

Definitions

“Net Revenue” is a term used to describe resources created annually and available to pay debt service (or other cash disbursement needs such as capital expenditures). These are normally gross revenues less gross expenditures, with noncash items such as depreciation and amortization added back to the net amount. The debt covenants may define which revenues or expenses are included or excluded from this calculation.

“Debt Service Coverage” is a term used to describe a comparison with resources created (*e.g.* Net Revenue) and available for debt service payment with the amount of debt service required. Resources created annually and available for debt service may be referred to as Net Revenue (see definition above).

Importance

Net Revenue is one indication of ability (resources created) to pay debt service.

Minimum Debt Service Coverage requirements may be established in the covenants. A borrower should always have at least a coverage of 1.0 indicating that for every dollar of debt service required, a dollar of “pledged” revenues is produced to pay for debt service. A preferred and ideal “Debt Service Coverage” would generally be much higher than 1.0 coverage.

Additionally, covenants usually have a “pledge” requirement which is a commitment to use “pledge” amounts as described to pay debt service. The Net Revenue is usually a calculation (quantification) of the “pledge.” A pledge must be “adequate” as indicated by whether or not the “pledge” is greater than debt service requirements.

It is possible, but not desirable, to have positive Net Revenue, but also a Net Operating Loss. This is an indication that Gross Revenues are too low, Gross Expenditures are too high, or a combination of both. It may also indicate a declining ability to continue to pay normal expenses and debt service.

Continued Net Operating Losses would be a concern to all stakeholders involved as Net Operating Losses are generally not sustainable in the long term.

A Net Revenue deficit (a negative amount) is usually an indication of loan covenant noncompliance and may also indicate economic stress.

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Typical Calculation

(Name of Bonds, Series 202x)	
Description	**Annual Amounts FYE xx/xx/xxxx**
Gross Revenues (see Definitions in Covenants for items to include or exclude)	$120,000
Gross Expenses (see Definitions in Covenants for items to include or exclude)	$60,000
Net Income (Revenues less Expenses)	$60,000
Add back:	
Interest Expense (if included in Gross Expenses above)	$25,000
Depreciation Expense (see Definitions in Covenants for guidance to include or exclude)	$10,000
Amortization Expense (see Definitions in Covenants for guidance to include or exclude)	$5,000
Net Revenue (estimate of cash flow produced before expenditures for debt service or capital items)	$100,000
Annual Debt Service:	
Principal	$25,000
Interest	$25,000
Total Annual Debt Service:	$50,000
Debt Service Coverage (Net Revenue divided by Total P&I)	2.0
Observation: this indicates that there are two dollars of Net Revenue produced for every dollar of debt service.	