Tiers of Commercial Financing

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Small Business Development Centers (SBDC)

- The U.S Small Business Administration (SBA) administers the Small Business Development Centers Program to provide management assistance to current and prospective small business owners. SBDCs offer one-stop assistance to individuals and small businesses by providing a wide variety of information and guidance in central and easily accessible branch locations.
- The program is a cooperative effort of the private sector, the educational community and federal, state and local governments. It enhances economic development by providing small businesses with management and technical assistance.

- The SBDC Program is designed to deliver up-to-date counseling, training and technical assistance in all aspects of small business management.
- SBDC services include, but are not limited to, assisting small businesses with financial, marketing, production, and organization needs.
- Services are provided to for-profit businesses at no cost.

Today's Speaker

Karen Burns has a lifetime of experience in the Arizona commercial banking industry. She has worked as a corporate underwriter, portfolio manager, and litigation manager (Valley National Bank of Arizona, MeraBank, Resolution Trust Corporation, Bank of America). She received a Senate Confirmation to the Arizona State Land Department Board of Appeals and during five years of service held each board officer position, including President of the Board. Her work with Microbusiness Advancement Center included directing the loan portfolio and managing federal grants and contracts. She has served on the boards of Lohse YMCA, Friends of Sabino Canyon, Tucson Arts District Partnership, Fox Tucson Theatre Foundation Advisory Board, and has chaired the Annual Fund Campaign for St. Michael's School. She is a member of the Phi Beta Kappa Association of Greater Tucson and served as a charter board member of National Charity League's Tucson Chapter. She is a voting member of Business Development Finance Corporation. Karen received her MBA and BA from the University of Arizona. Currently, she works for the Pima Community College Small Business Development Center providing business consulting and creating measurable economic impact in Pima and Santa Cruz Counties. She brings a strong financial background and a long history of service to Arizona and her community.

Introduction

Today, we are going to discuss various types of small business lenders and the loans they may offer.

These commercial loans are generally underwritten on a custom basis for each loan request.

We will cover the attributes of each tier of these loans, beginning with the lower-priced loan types and considering progressively higher-priced borrowing options.

Cash Flow vs Collateral Lenders

- Lenders that charge lower rates and fees are often cash flow lenders and are making what they perceive to be the less risky loans in the market. They will still take collateral as an abundance of caution, but do not rely heavily on the liquidation value of the collateral when underwriting the loan request.
- Lenders that focus more heavily on collateral lending generally consider loan requests that are perceived to have a higher risk of default.

Loan Pricing

Loans are often priced according to the lender's perceived risk and cost of funds.

Interest rates and fees may become higher for those loans that a lender profiles as having higher overall risk:

- Friends, family, and private party lending
- Traditional commercial lending
- SBA and USDA government guaranteed lending
- Non-profit and alternative lending
- Factoring
- Asset-based lending

Friends, Family, and Private Parties

- Often the least expensive loan funds in terms of fees, interest, and liberal repayment terms.
- May carry a high personal relationship price.
- Understand the difference between "Handshake agreements" vs formal promissory notes.
- Gift funding is not a loan.
- If gift funding is received, it might become an asset on the business balance sheet without an associated liability.

Traditional Bank Commercial Lending

- Often these are "portfolio" loans for the financial institution. The lender may retain both the promissory note stream of principal, interest, and the loan servicing.
- Generally, these are among the least expensive loans in the market in terms of fees and interest rates.
- Commercial lenders fund these loans to those borrowers they perceive to represent the least amount of default risk.
- Start-ups, early-stage, and/or under-capitalized businesses may have difficulty accessing traditional loans.

Federal Government Guaranteed Loans (SBA & USDA loans)

- The Federal government splits the risk of the loan with a commercial lender.
- These loans are designed to mitigate some risk of the loan default risks for lenders and induce lenders to fund loans they might normally decline.
- Government loan guarantees usually are a percentage of the outstanding principal balance on the outstanding loan, depending on the loan type and underwriting criteria. The guarantee to the lender is not 100%.
- Guaranteed loans may be made by banks, credit unions, non-profit lenders, certified development companies, and alternative lenders, <u>if</u> the lender has formally established a relationship with the government loan guarantee program in question.

SBA and USDA Lenders

Not all lending institutions provide SBA and/or USDA loans.

Participating lending institutions may include commercial banks, credit unions, alternative, and nonprofit lenders.

Nonprofit Lenders and Alternative Lenders

- Sometimes have a social justice mission.
- May be willing to accept higher levels of risk.
- Generally, charge higher interest rates and have additional closing fees.
- May be more liberal in considering loan requests of start-up and early stage businesses.
- Are sometimes willing to be partially unsecured or accept non-traditional collateral.

Factoring

- Factoring lines of credit are another alternative.
- Commonly, the factor (lender) is essentially purchasing business accounts receivable at a discount from the book value of the receivable.
- This method can increase cash flow for a business, but may be relatively expensive form of borrowing.
- For businesses, this might be considered a short term solution to tight cash flow when less expansive alternatives are not available.

Other Asset-Based Lending

- Asset-based lending involves margining the loan against collateral. These lenders may be less focused on business cash flow as a source of repayment.
- The primary basis for making an asset-based loan may be the liquidation value of the collateral backing the promissory note.
- This is sometimes last-resort funding and may be relatively expensive.
- Once the loan is made it may be relatively difficult to renegotiate or modify the loan terms with the lender.
- Collateral is generally forfeited if the loan defaults.

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