CITY OF HOUSTON
GUIDE TO ALTERNATIVE LENDING RESOURCES

CITY OF HOUSTON
OFFICE
of
BUSINESS OPPORTUNITY

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MISSION STATEMENT

The Office of Business Opportunity is committed to creating a competitive and diverse business environment in the City of Houston by promoting the growth and success of local small businesses, with special emphasis on historically underutilized groups by ensuring their meaningful participation in the government procurement process.

WHAT IS AN ALTERNATIVE LENDER?

Alternative lenders lend to businesses that are unable to qualify for a bank loan but have a viable business. There are many common reasons why businesses might not qualify for a bank loan:

- No personal credit history or poor personal credit history
- Risky industry
- Start up/ less than 2 years in business
- Lack of formal financial documentation (tax returns, income statements etc)
- Tax returns show a loss
- Past bankruptcy or tax lien
- Business is informal and/or home-based
- Loan amount requested is too small

While the strict underwriting requirements at banks provide the tools to make quick decisions for clients , these requirements can also exclude many viable businesses from financing.

HOW CAN AN ALTERNATIVE LENDER HELP ME?

Alternative lenders exist to fill the gap that exists between bank requirements and many profitable businesses in need of financing. These lenders are usually nonprofit organizations targeting underserved communities to promote economic development in a designated area. While these lenders each have their own guidelines for loan approval, they are usually willing to look beyond traditional lending criteria in determining whether or not a client is creditworthy. They want to hear the business' story and assess the owner's character.

Alternative lenders will go beyond the numbers to take into account the human element when analyzing the viability of a business and work creatively to look for non-traditional strengths.

HOW DO ALTERNATIVE LENDERS WORK?

Some do not look at credit history at all – rather, they employ a group loan model in which each member is approved for a certain sum of money and is responsible for paying for other members if someone in the group encounters difficulties paying back the loan. Sometimes the alternative lender will add strength to the application by asking for a cosigner or collateral.

COLLATERAL: Something of value (usually a car, jewelry, property) that is put as a guarantee of the loan. If the loan is not repaid, then the lender has the right to keep the collateral in order to offset their costs of the client's default

CO-SIGNER: Is another person who agrees to be responsible for the loan if the borrower encounters difficulties and is unable to pay. This person signs the loan contract with the borrower and understands that if payments fall behind, he/she will be contacted and obligated to pay for the loan Most alternative lenders understand that clients may not be able to provide the kind of formal financial documentation that bigger business have such as professional financial statements, two years tax returns or a business certificate. Thereafter the alternative lender will work with the client to come up with a financial picture of the business in alternative ways such as:

- Site visit
- Sales receipts, recordkeeping book
- Bank statements
- Supplier and land lord references
- Verbal financials
- Contracts signed can be used as proof of accounts receivable
- Personal/household income outside the business is evaluated

Some alternative lenders work with clients that have no credit history in order to identify other ways the client can demonstrate responsibility. Examples include:

- A reference with a landlord
- An up to date bill
- A supplier reference
- A character reference

HOW IS WORKING WITH AN ALTERNATIVE LENDER DIFFERENT FROM WORKING WITH A BANK?

What is important to remember in working with alternative lenders is that the process is longer than with a traditional lender. Since the lender is assuming more risk, they may ask a lot of questions and you will have to work in partnership with your loan officer to build your application from the ground up. They will share their assessment of the type of documentation, guarantees ,

references, and other strengths you will need to bring to the table to be approved. It is your job to let them know what you can and cannot provide. The more forthcoming you are, the more likely it is that you will have a successful experience. It should be noted that many lenders practice what is called progressive lending. This is when you obtain an initial loan for a certain amount, and then, when you have a proven history of good payments, you are able to refinance for a larger amount if you so desire. This process allows you to build a relationship with the lender that will assist you in obtaining larger loan amounts over time.

DO ALTERNATIVE LENDERS CHARGE THE SAME FEES AND INTEREST RATES AS BANKS?

Fees and rates vary across alternative lenders. Usually (but not always) these lenders will charge a higher annual interest rate than a bank. This is because the loans awarded by alternative lenders take more time to process and therefore cost more money to the lender to approve. The loan sizes are also usually less than bank loans which makes them costlier to process.

WHAT ELSE CAN ALTERNATIVE LENDER DO FOR ME?

Many lenders also provide opportunities for networking, workshops and other technical assistance. Each alternative lender is different and offers a different program. If you need help assessing which lender is right for you and packaging your loan application, contact the Houston Business Solutions Center.

HOW DO I KNOW IF I AM READY FOR AN ALTERNATIVE LENDER?

Contact the UH SBDC, SCORE, or a local traditional or alternative lender so they can help you assess your business and the lending opportunities that could help you finding the financing you need. They can also help you package successful loan applications. In addition the business planning process can assist you in determining your financing needs.

WHAT IS FACTORING?

The most popular alternative financing programs for small business owners tie repayment of loans to company receivables, known as equity lending or "factoring." Factoring allows businesses to draw cash against outstanding invoices (receivables). Instead of dealing with traditional banks, companies apply to firms known as factors. Companies such as restaurants and service businesses can participate in factoring programs by running credit transactions directly through a factor’s merchant terminal. Factors retain a share of the proceeds, depositing the remainder into the client company's bank account. The relationship continues until the initial loan has been repaid.

WHAT IS MICROLENDING?

Some cities and neighborhoods have encouraged small business growth by sponsoring microlending programs. A microloan usually consists of a loan amount smaller than a typical, SBAbacked bank loan (not a guarantee). Most companies that apply for microloans do not qualify for corporate credit cards because they lack business credit histories or because they choose to operate in high-risk locations. Banks and credit unions often receive significant subsidies from governments and foundations to manage microloan programs.

HOW CAN PEER-TO-PEER LENDING HELP MY BUSINESS?

A new form of microloan has emerged with the help of online communities. Rather than seek the assistance of banks or credit unions sponsored by microlending programs, many small business owners turn to their peers for short term loans. Online lending clubs assess borrowers' risk using many of the credit scoring rules as traditional banks. However, individual investors can choose to participate in high risk loans in exchange for higher returns on investment. Lending clubs limit investor risk by pooling many contributions, often as low as $50. Borrowers repay loans through websites that manage repayment to investors over the life of the loan.

WHY SHOULD I BE WARY OF ALTERNATIVE LENDERS?

While alternative lenders look at more than just credit scores, sometimes it will be necessary to work on your credit before you can qualify for a loan with one of these lenders. This will be especially true if you have serious delinquencies that have gone unpaid over time as this is a red flag for the lender. Business owners with bad credit and companies with poor track records of generating profits will still encounter difficulty with alternative financing programs. Even though small business lenders understand the challenges of the marketplace, owners must deliver solid plans for growth to qualify for favorable terms. Predatory lending companies have seized on the recession to offer highinterest, short-term loans to business owners, not unlike payday loans. Unlike traditional factoring, annualized interest rates can rise into the triple digits, making repayment difficult. Instead, small business experts recommend setting stronger credit terms with customers or focusing on growing short term sales to generate cash flow.

JUMPSTARTING YOUR BUSINESS THROUGH NON-TRADITIONAL FUNDING

www.sba.gov/content/jumpstarting-your-business-through-non-traditional-funding

By: Michael Gallagher, Deputy District Director
North Dakota District Office (SBA)

Legislation titled the *Jumpstarting Our Business Startups Act*, also known as the Jobs Act, is currently making its way through Congress. This legislation aims to make it easier for small businesses to access capital by undoing some federal regulations on business startups. This bill includes provisions that are aimed at encouraging job growth by making it easier and less costly for companies to raise capital and go public.

Various provisions in the bill include the establishment of a new category of companies called "emerging growth companies" that have less than $1 billion in annual revenues at the time they register with the SEC. Another section would raise the number of shareholders that triggers when companies and smaller banks must start public financial reporting. Yet another provision would pave the way for a new type of capital-raising strategy known as "crowdfunding" that would let investors take small stakes in private start-ups over the Internet.

Crowdfunding is the term that usually describes the process where people network and pool their money and other resources together, usually via the Internet, to support efforts initiated by other people or organizations. For small businesses, the entrepreneur seeking to use crowdfunding or seed money normally makes use of online communities to solicit pledges of small amounts of money from individuals who are typically not professional financiers.

All of these non-traditional financing options are interesting and innovative, but decision makers are constantly challenged with how to balance protection of investors as well as the protection of those who are seeking the investment.

Most of the current discussion is on the federal level, but each state, including North Dakota, has its own set of regulations that govern this environment. Individuals who place these ads may be in violation of state law and may be fined, in addition to other civil or criminal penalties. As is typical fashion in North Dakota, however, the state has developed an understandable and reasonable process to make it easier for small businesses to consider this option for financing their business. Opportunities for *Solicitations of Interest – "Test the Waters"* and *Limited Offeree* are two practical approaches you should consider. Those wishing to pursue investments through these options should familiarize themselves with the regulations and seek competent advice from a professional who deals with these issues. (Edited)

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