# CITY OF HOUSTON GUIDE TO BUSINESS FINANCING FAOS





#### **HOUSTON BUSINESS SOLUTIONS CENTER**

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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.



# **ABC'S OF BANKING**

#### www.money.howstuffworks.com/personal-finance/banking/bank1.htm

When you deposit your money in the bank, your money goes into a big pool of money along with everyone else's, and your account is credited with the amount of your deposit. When you write checks or make withdrawals, that amount is deducted from your account balance. Interest you earn on your balance is also added to your account.

Banks create money in the economy by making loans. The amount of money that banks can lend is directly affected by the reserve requirement set by the US Federal Reserve (Fed). The reserve requirement is currently 3 percent to 10 percent of a bank's total deposits. This amount can be held either in cash on hand or in the bank's reserve account with the Fed

To see how this affects the economy, think about it like this- When a bank gets a deposit of \$100, assuming a reserve requirement of 10 percent, the bank can then lend out \$90. That \$90 goes back into the economy, purchasing goods or services, and usually ends up deposited in another bank. That bank can then lend out \$81 of that \$90 deposit, and that \$81 goes into the economy to purchase goods or services and ultimately is deposited into another bank that proceeds to lend out

a percentage of it.

In this way, money grows and flows throughout the community in a much greater amount than physically exists. That \$100 makes a much larger ripple in the economy than you may realize!

# FINANCING FAQ SHEET

# 1. WHAT IS A CO-SIGNER/GUARANTOR AND WHY MIGHT I NEED ONE IN ORDER TO GET A LOAN?

A co-signer/guarantor/co-borrower is someone who guarantees the loan will be paid if the borrower defaults on the loan. Lenders require co-signers when there are concerns regarding the borrower. Generally, first time borrowers will require a co-signer due to a lack of history and experience regarding credit. Likewise, borrowers with limited credit, a poor credit history, or existing debt may need a co-signer when approaching a lender for a larger amount than previous accounts. In a tightened credit market, even borrowers with good credit scores and history may require co-signers. A co-signer must have well-established credit to help the borrower qualify for the loan.

# 2. WHAT IS COLLATERAL? HOW DOES THE AMOUNT OF COLLATERAL I HAVE IMPACT MY ABILITY TO GET A LOAN?

Collateral are assets that have been pledged by the borrower as security on the value of the loan. When lenders demand collateral for a loan, they are seeking to minimize the risks of extending credit. The higher the amount of collateral provided by the borrower, the more likely the loan is to get approved. Examples of collateral include real estate property, equipment, inventory, cash and accounts receivables. Generally, 20% of the loan is the standard amount of collateral needed to obtain a loan, although more may be required for startup businesses. Without collateral, a startup business will most likely not be able to obtain financing from traditional or alternative lenders.

# 3. HOW LONG WILL THE LOAN APPLICATION TAKE TO COMPLETE AND WHEN WILL I KNOW IF MY LOAN APPLICATION HAS BEEN APPROVED?

The amount of time it takes to compile all requested documents highly depends on you, the borrower. All lenders request a fairly standard set of documents from borrowers. Some lenders and loan programs require additional information, so be sure to ask loan representatives for their loan application package well in advance.

Provided you have submitted all necessary documentation, the loan underwriting process with commercial banks typically takes 2 - 4 weeks. If you apply for a loan with an alternative or non-profit lender, the underwriting time can be lengthier, about 4 - 12 weeks.

During the underwriting process, you may be required to provide additional documentation. It is important to respond to any requests from the underwriter promptly in order to minimize delays in the processing of your loan application.

# 4. HOW MUCH CAN I BORROW AND WHAT FACTORS WILL A LENDER TAKE INTO ACCOUNT WHEN DETERMINING THE SIZE OF THE LOAN THEY WILL GIVE ME?

The amount you can borrow depends on many factors. A lender starts by looking at the 5 C's of Credit: Capacity, Character, Capital, Collateral and Conditions.

- Capacity to repay is the most important to traditional lenders and reflects the cash flow of the business.
- Capital is the money you personally have invested in the business and is an indication of how much you have at risk should the business fail.
- Collateral is the assets pledged by the recipient as security on the value of the loan.
- Character is the general impression you make on the prospective lender or investor, and includes the relevant
  experience and transferable skills you bring to the business. Character is especially important for startups and
  is generally a more important component of the decision making process for alternative lenders than for
  banks.
- Conditions refer to the current economic climate and how the business fits into it.

Lenders also typically expect clients to have done the following:

- Established a legal structure
- Obtained a tax id
- Acquired all necessary licenses and permits
- Be up to date on all existing financial obligations such as existing loans, credit cards, and taxes
- Written a business plan

# 5. WHAT ARE SOME COMMON OBSTACLES SMALL BUSINESS OWNERS AND ENTREPRENEURS FACE WHEN SEEKING FINANCING? WHAT TYPES OF ISSUES MAY PROHIBIT ME FROM QUALIFYING FOR A LOAN?

The following are considered "red flags" in a borrower's loan application:

- Tax liens with the IRS or other Federal, State and City agencies
- Poor credit due to bankruptcy or non-payment of credit obligations. (Some exceptions can be made if poor credit is due to unforeseen major events, such as loss of a loved one, medical expenses, divorce, natural disaster, etc.)
- Insufficient cash flow from business to make loan payments. Use a simple "loan payment calculator" online to determine what your monthly loan payments might be. Then look back to your monthly leftover cash flow do you have enough to make that loan payment?
- Lack of co-signer or collateral. (Not required by all lenders)
- Less than 2 years in business (typically requested by larger commercial banks)
- Delinquent bills (rent, utilities, etc.)

# 6. WHAT INTEREST RATES SHOULD I EXPECT TO PAY AND WHAT DOES THIS MEAN FOR MY MONTHLY PAYMENTS?

The interest rate you will pay depends on a variety of factors, including the type of organization lending you the money, the amount you are borrowing, your personal credit score, the amount of collateral you can provide, and the purpose of the loan. Rates typically range from 6-15%, although specific programs may offer loan products that fall outside of this range.

# 7. HOW IMPORTANT IS MY CREDIT SCORE? IF I HAVE POOR CREDIT, HOW WILL THIS IMPACT MY CHANCES OF RECEIVING A LOAN AND THE NUMBER OF LENDERS I MAY QUALIFY FOR? HOW DO I GET MY SCORE AND A COPY OF MY CREDIT REPORT?

Maintaining an excellent credit score is very important for any consumer and even more important for a small business owner. Generally speaking, a low credit score will negatively impact the chances of getting a loan and will limit the lending options available. Poor credit stemming from bankruptcy or non-payment of credit obligations are automatic disqualifiers for many lenders. However, some exceptions can be made if poor credit is due to unforeseen major events, such as loss of a loved one, medical expenses, divorce, natural disaster, etc.

To be eligible for a commercial bank loan, a credit score greater than 700 is generally required. Keep in mind, however, that banks are increasingly utilizing SBA loan programs, which have more flexibility in approving loan requests from borrowers whose credit is less than stellar. Alternative lenders certainly consider a borrower's credit score, but will also look at other factors such as cash flow and future earnings potential. Everyone is entitled to request a free credit report from each of the three major credit bureaus each year at www.annualcreditreport.com or by calling 1 877-322-8228.





# 8. WHY DO MOST LENDERS REQUIRE A BUSINESS PLAN IN ORDER TO APPLY FOR A LOAN? WHY SHOULD I TAKE THE TIME TO WRITE A BUSINESS PLAN?

First and foremost, a business plan opens dialogue with a lender and compels them to take you seriously. It shows that you have taken the time and effort to put all of your ideas onto paper in a professional and organized fashion, and that you have thought out all necessary steps to implement your plan. It also conveys that you, as the entrepreneur, assessed the financial feasibility of your business by detailing your product or service, your customers, your competition, and YOU (your skills to implement all plans and make the business a success).

Besides attracting lenders, business plans act as a road-map for any start-up or existing business. It is a process that enables you to organize all of your ideas and then focus on what customer need you will fulfill, where you want to be in the short and long-term and how you will achieve it.

# 9. I APPLIED FOR A LOAN AT MY LOCAL BANK AND WAS DENIED. WHAT OTHER FINANCING OPTIONS ARE AVAILABLE?

If a borrower is rejected by a bank for a business loan, the cause for rejection should be evaluated. A borrower should know his or her personal and business credit history and current financial situation. The borrower should meet with a loan officer or banker to determine the cause of the denial and the next steps to take in approaching another lender. If the borrower has excellent credit and is in good financial condition, then another bank may be a good option. If the borrower has a low credit score, a loan officer or banker will help identify the best fit to obtain financing from an alternative lender or to establish/rebuild credit.

# 10. WHAT IS A LINE OF CREDIT? HOW IS THIS DIFFERENT THAN A LOAN?

Lines of credit are often provided to overcome short-term liquidity issues, offering borrowers flexibility to draw on the line of credit at any time. In contrast to a traditional loan, interest is not usually charged on the part of the line of credit that is unused (For example, if your line of credit limit is \$5,000 and you draw \$1000, you would only pay interest on that \$1,000). Another difference is that the interest rate on a line of credit is variable, which means it fluctuates according to the market.

# 11. WHAT IS SBA LENDING, AND WHAT ARE SBA APPROVED LENDERS?

The US Small Business Administration (SBA) does not lend money. Instead, it backs loans provided by lenders that range from banks to community development organizations. The SBA guarantees that the loan will be repaid even if the business itself fails. The SBA also helps businesses obtain surety bonds and regulates Small Business Investment Companies that can help a small business partner with a venture capitalist.

What are the advantages of an SBA-backed loan? SBA loans generally have longer terms than the loans businesses can obtain on their own. This is particularly important for new businesses. Many lenders will only give a new business a short term loan, a year or even less. Because this reduces the payments, it can make it easier for your business to qualify for a larger loan. Additionally, banks are not allowed to impose prepayment penalties on SBA loans. These loans are also fully amortized, meaning that if you need to renew the loan, there will be no associated fees and the bank cannot charge you for reappraisal of collateral or hit you with unexpected balloon payments.

The US Small Business Administration (SBA) offers a range of loan programs that in essence guarantee a portion of the funds lent to a small business by a local bank. These sources of capital funding can be especially beneficial for a small business owner thanks to their less stringent qualification process, lower interest rates and monthly payments, and flexible terms. Some SBA loan programs even allow a business to finance soft costs such as goodwill, as well as closing costs.

#### 12. WHAT IS CROWDFUNDING AND CAN MY BUSINESS BENEFIT?

Crowdfunding tools like Kickstarter AND Indiegogo are popular in the startup world. These relatively new financing tools have shaken up the startup community by allowing entrepreneurs to reach consumers directly – not just for funding but for input on their ideas as well. Additionally, these resources allow startups to bypass traditional financial backers like angel investors and venture capitalists.

In the wake of tight credit markets, crowdfunding -- also known as crowdsourcing -- arose as a source to provide capital to startups, especially the creative types. This new form of equity financing enables a company to raise funding through small contributions from a large group of individuals via an online platform. Essentially, an entrepreneur makes an online pitch to a virtual audience, which then decides whether or not to support the venture by pledging money towards it. Here's how it works: an entrepreneur posts a description of his or her project, product or service, outlines the business plan, proposes the amount of capital needed, and explains what contributors will receive in return. Retail businesses sometimes provide product in return for the funds they provide. (You give me startup funding for my bakery, and I will deliver gourmet cupcakes to you for the next 10 Fridays.) Other times, the entrepreneurs pledge cash repayment or they may offer an equity stake in the venture.

#### **CROWDFUNDING RESOURCES:**

(not an endorsement)

KICKSTARTER.COM STARTSOMEGOOD.COM INDIEGOGO.COM ROCKETHUB.COM FUNDABLE.COM POZIBLE.COM CAUSES.COM (NPO'S) RAZOO.COM CROWDRISE.COM (NPO'S)



#### 13. ARE GOVERNMENT GRANTS AVAILABLE FOR MY BUSINESS?

Government grants are funded by your tax dollars and, therefore, require very stringent compliance and reporting measures to ensure the money is well spent. As you can imagine, grants are not given away indiscriminately.

Grants from the Federal government are authorized and appropriated through bills passed by Congress and signed by the President. The grant authority varies widely among agencies. SBA has authority to make grants to non-profit and educational organizations in many of its counseling and training programs, but does not have authority to make grants to small businesses. The announcements for the counseling and training grants will appear on grants.gov. If Congress authorizes Specific Initiative Grants, organizations receiving such grants will receive individual notifications. Some business grants are available through state and local programs, nonprofit organizations and other groups. For example, some states provide grants for expanding child care centers; creating energy efficient technology; and developing marketing campaigns for tourism. These grants are not necessarily free money, and usually require the recipient to match funds or combine the grant with other forms of financing such as a loan. The amount of the grant money available varies with each business and each grantor.

If you are not one of these specialized business, both federal and state government agencies provide financial assistance programs that help small business owners obtain loans and venture capital financing from commercial lenders.

# 14. I HAVE POOR CREDIT AND MAY NEED CREDIT COUNSELING. CAN I GET A BUSINESS LOAN?

Credit counseling is a process that involves offering education to consumers about how to avoid incurring debts that cannot be repaid through establishing an effective Debt Management Plan and Budget. Credit counseling revolves around credit education and the psychology of spending habits, and establishes a planned method of debt relief, typically through a Debt Management Plan. Credit counseling often involves negotiating with creditors to establish a debt management plan (DMP) for a consumer. A DMP may help the debtor repay his or her debt by working out a repayment plan with the creditor. DMPs, set up by credit counselors, usually offer reduced payments, fees and interest rates to the client. Credit counselors refer to the terms dictated by the

creditors to determine payments or interest reductions offered to consumers in a debt management plan.

For a referral to a credit counseling agency, contact the Better Business Bureau of Metropolitan Houston @ www.houston.bbb.org



# FDIC SMALL BUSINESS HOTLINE

#### www.fdic.gov/consumers/banking/businesslending/contact.html

The Federal Deposit Insurance Corporation (FDIC) encourages bank lending to creditworthy small businesses. The FDIC also encourages small businesses that may have an inquiry or concern about the availability of credit to contact our new Small Business Hotline at 1-855-FDIC-BIZ. The FDIC responds to inquiries about policies and financial institutions under the FDIC's jurisdiction as well as makes referrals to other government agencies and information resources or you can use the Business Assistance Form at www.fdic.gov/baf/

FDIC Small Business Hotline: 1-855-FDIC-BIZ (1-855-334-2249)

Monday through Friday: 8:00 am ET to 8:00 pm ET Saturday / Sunday: 9:00 am ET to 5:00 pm ET



# **CREDIT REPORTING**

www.fdic.gov/consumers/consumer/ccc/reporting.html

#### **CREDIT REPORTING AGENCIES- FREE CREDIT REPORTS**

The amended Fair Credit Reporting Act permits consumers to request a free copy of their credit report once every 12 months from each of the three major credit reporting agencies (i.e., Equifax, Experian, Trans Union). Do not contact the three nationwide consumer reporting companies individually.

#### ORDERING A FREE CREDIT REPORT:

On the Internet: www.annualcreditreport.com

On the phone: call 1-877-322-8228

By mail – complete the Annual Credit Report Request Form found at:

https://www.annualcreditreport.com/cra/requestformfinal.pdf - PDF 41k (PDF Help)

and mail to:

Annual Credit Report Request Service P.O. Box 105281 Atlanta, GA 30348-5281

For more information visit:

Your Access to Free Credit Reports (www.ftc.gov)

#### **CREDIT REPORTING AGENCIES**

If you do need information about the specific national agencies it is provided below.

#### Equifax (www.equifax.com)

P.O. Box 740241 Atlanta, GA 30374-0241 1-800-685-1111

#### **Experian** (www.experian.com)

P.O. Box 2104 Allen, TX 75013-0949 1-888-EXPERIAN (397-3742)

#### Trans Union (www.transunion.com)

P.O. Box 1000 Chester, PA 19022 1-800-916-8800

# CONSUMER ALERTS - FAIR AND ACCURATE CREDIT TRANSACTIONS ACT (FACT ACT)

There are a variety of local credit reporting agencies as well. Check your local telephone directory under headings such as "Credit Reporting Agencies" for names of similar companies in your area.

#### **CREDIT SCORES**

To find out about your credit score – what it is and how it affects you, visit: Credit Scoring (www.ftc.gov)

#### FIXING CREDIT REPORTS

If your credit report contains inaccurate information, or the report shows accounts that you never applied for, how do I have this information removed? For information, see: How to Dispute Credit Report Errors (www.ftc.gov)

#### BANKRUPTCY AND NEGATIVE INFORMATION

A consumer reporting company can report most accurate negative information for seven years and bankruptcy information for ten years. For more information see: Your Access to Free Credit Reports (www.ftc.gov)

#### **CREDIT REPORTS AND DIVORCE**

If you had a joint account with your spouse, you are both responsible for the debt even if you are divorced. For more detailed information see: Credit & Divorce (www.ftc.gov) Cosigning a Loan (www.ftc.gov)





# SBA LENDING INFORMATION



www.sba.gov/about-offices-content/2/3151

Houston District Office 8701 S. Gessner, Suite 1200 Houston, Texas 77074 713-773-6550

Email: Houston@sba.gov

Since its founding on July 30, 1953, the U.S. Small Business Administration has delivered millions of loans, loan guarantees, contracts, counseling sessions and other forms of assistance to small businesses. SBA provides assistance primarily through its four programmatic functions. SBA provides small businesses with an array of financing from the smallest needs in microlending --- to substantial debt and equity investment capital (venture capital). SBA also provides free individual face-to-face, and internet counseling for small businesses, and low-cost training to first stage entrepreneurs and established small businesses in over 1,800 locations throughout the United States and US territories. The SBA's Office of Government Contracting sets goals with other federal departments and agencies to reach the statutory goal of 23 percent in prime contract dollars to small businesses. This office also provides small businesses with subcontracting procurement opportunities, outreach programs, and training.

### **SBA LOAN PRODUCTS**

#### 7(a) Loans

The 7(a) Loan Program is SBA's primary program for helping start-up and existing small businesses, with financing guaranteed for a variety of general business purposes. SBA does not make loans itself, but rather guarantees loans made by participating lending institutions. In this way, taxpayer funds are only used in the event of borrower default. This reduces the risk to the lender but not to the borrower, who remains obligated for the full debt, even in the event of default.

#### CDC/504 Loans

A Certified Development Company (CDC) is a nonprofit corporation set up to contribute to the economic development of its community. CDCs are located nationwide and operate primarily in their state of incorporation (Area of Operation). CDCs work with SBA and private-sector lenders to provide financing to small businesses through the CDC/504 Loan Program, which provides growing businesses with long-term, fixed-rate financing for major fixed assets, such as land and buildings.

#### **Loans and Grants Search Tool:**

www.sba.gov/sba-direct/article/13710 www.sba.gov/category/lender-navigation/search-sba-lenders?select=proximity





For more information, visit www.houstontx.gov/obo or call 832.393.0600

