# Small Business Financing – Weighing Your Options

Entrepreneurship provides phenomenal opportunities that can defy most financial models and calculations. How a deal is financed may be as important as the business itself, but accessing the necessary capital should not be a difficult task. Most people simply don't realize what is available to them and how to go about seeking out these resources. The following are some common funding options:

**Cash** – A lot of people have cash available in savings or securities and opt to purchase their new business or franchise that way. However, many individuals who use available cash tend to stretch themselves too thin and then don't have sufficient cash on hand when "life happens." For example, if you don't have cash on hand, where do you go when your kids need braces, your car needs fixing, etc.? Just like a business allows you to leverage employees, financing gives one the ability to leverage other people's money without depleting their personal reserve.

**Home Equity Line of Credit (HELOC)** – A HELOC allows people to use the equity in their home to qualify for a sizable amount of credit with a relatively low interest rate that they can use when and how they please. The appeal of these loans fluctuates with rates, since terms are typically variable; but this is a good option for people who don't want to or can't use cash or retirement funds. As with any financial decision, the costs should be weighed against the benefits. Borrowers should also carefully consider which terms best meet their needs without posing undue financial risk. The main risk associated with a HELOC is that, if borrowers fail to pay amounts they have borrowed and the associated interest, they could lose their home. The cost of a HELOC is the interest paid plus a percentage to originate the loan. With variable interest, borrowers could expect to pay around 8-10 percent during a 20-year loan.

**Retirement Funds** – It is possible to purchase a business using retirement funds without taking a taxable distribution or incurring penalties. Thousands of people invest their IRA and 401(k) funds into their businesses each year. Using retirement funds allows new business owners to start with equity, not debt. Making the initial investment with money they already have allows the money the new business generates to be reinvested into the business instead of being paid to a bank in the form of interest payments. This method also enables individuals to avoid pledging their home or their credit as collateral. (This is the strategy behind Guidant's Audeo plan.)

**SBA Financing** – The Small Business Administration does not lend money for people to buy businesses; they guarantee loans, up to a certain amount, made by lenders for small business acquisitions. In essence, they guarantee the loan for the lender, not the borrower. SBA loans have benefits and drawbacks. They will lend up to $2 million and have terms of up to 10 years. Both of these can be extended when real estate is involved in the purchase. However, SBA loans typically require about 25 percent as a down payment and they require collateral. The borrower's financial history, dating back two to three years, is reviewed to make sure they have a strong ability to repay. These loans tend to take at least 60 days to close. They cost about 1 to 3 percent to originate and have interest rates of 10 to 12 percent over 10 years.

**Signature Loans** – These are expensive business-funding methods, yet they're appealing in certain circumstances. Signature loans are unsecured loans, typically granted for up to $75,000 for a new business owner, and up to $150,000 for one who has already been in business for two years. They are generally granted at rates around prime plus 1-3 percent (similar to HELOCs and SBA loans). The cost to originate these loans, however, is fairly high. This type of loan is meant for a borrower who has limited home equity, retirement funds and/or cash. These loans may make sense if the borrower's earning potential is high and they have other investments they would like to use existing cash or credit for. These loans cost 8 to 10 percent to originate, and have interest rates of 10 to 14 percent over 5 to 8 years.

### So Which Form is Best?

As an attorney might say, *that depends*. If a borrower has money in an IRA or 401(k), it makes sense to use equity instead of debt. For borrowers, not having to make payments or put their home or credit on the line is a tremendous advantage. HELOCs have the added benefit of being deductible. SBA loans are a great option for those who don't have enough retirement funds or home equity. A signature loan is a viable option for those who need fast cash or are using existing funds for other priorities. The bottom line is that each borrower faces different circumstances and should get in touch with a company that will help them evaluate their options and find the loan that is right for them.

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