# Financing FAQ

**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 cosigner 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 an Account Manager from an NYC Business Solutions Center 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, NYC Business Solutions 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.