

*THE ESSENTIAL*

# Guide to Online Small Business Loans

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# Reasons to get a small business loan

We've heard it all. So have you. Nothing clears a room faster than a business owner who mentions that he or she needs a loan. People who don't own a small business can never appreciate what it takes to get by in this economy. Moreover, they don't fully appreciate how much the banking industry has changed in the past few years.

Many people assume that banks are fixed, flush with cash and lending at full speed again. It's generally recognized that there's more red tape and bureaucracy, but little appreciation for what is happening in the small business banking sector. [Banks simply aren't lending to small businesses](#) on the scale that they used to. Economists estimate that small business loans are down 15 percent to 18 percent from pre-crisis levels. As a percentage, that doesn't sound all that terrible, but expressed in dollars, it represents tens of billions.

There are several good reasons to borrow money for your small business. Yet no matter how good your reasons are, it's important to be reasonable.

## **Take what you need, not what you want.**

These are words to live by. Marketplace lenders have grown dramatically in the past few years to supply liquidity to the small business space. This is a positive development, but not a license for small business owners to engage in profligate borrowing.

“Who on Earth would apply for a loan like this?”

“Surely the borrower has issues if they need this kind of loan.”

“Why are people borrowing money again? Didn't everyone learn a lesson from 2008?”



# Here are several common uses for small business loans:

## **Pay Down Credit Card Debt.**

Replace debt with debt? Believe it or not, some of the marketplace lending rates are competitive or even below standard credit card rates. Although the Credit Card Accountability Responsibility and Disclosure (CARD) Act stopped credit card companies from forcing usurious and unreasonable rates on consumers, credit card rates remain high. Even if a business owner obtains a term loan at a rate similar to or higher than his or her business credit card, some owners might still want to dispense with this obligation. There are two good reasons for this: It creates financial discipline that credit rating agencies like to see. It gets you away from paying the minimum and forces you to pay down the balance to free up your cash flow eventually.

## **Technology Upgrades.**

You might want to party like it's 1999, but you can't run a business that way. Technology is an essential part of our lives, and businesses are no exception. Businesses can maintain or gain a competitive edge, whether it's investing in state-of-the-art dentistry tools or installing GPS tracking devices for your fleet of delivery vans.

## **Bank Fees.**

Many small businesses have irregular cash flow. As a result, they can experience periodic overdrafts at the bank. If you're tired of marking down "bank fees" as a business expense, you should consider an infusion of working capital to help regulate your cash flow.

## **Moving Expenses.**

You might be upgrading your space. Perhaps you are downsizing. Whatever the reason, moving happens and businesses rarely reserve enough for the costs associated with relocating. It's more than putting your belongings on a truck and putting them somewhere else. Moving your small business often involves security deposits, new wiring, furniture purchases, and a host of other considerations. Because many small business lenders require proof of location, you might be asked to supply a recommendation from your former landlord and a signed lease and proof of deposit for the new space before you can set up shop.

## **Seasonality.**

Cyclical. Seasonal. Business owners call it "ups and downs." It happens in nearly every industry, but the down cycles can be particularly painful for a small business. Bolstering your accounts to prepare for these cycles, particularly if you can predict them, can relieve an enormous amount of pressure and preserve a great deal of sleep.

## **It's Not Personal; It's Strictly Business.**

Inevitably, business owners who are locked out of the liquidity markets will dip into personal savings or assets to make it through a rocky period. [Small business loans](#), while often tied to the business owner's credit, help keep your personal life personal.

# Key components lenders look for in borrowers

The most important consideration to a lender is the same thing that has always mattered, whether it's a bank, an [alternative lender](#) or a family member. Can you pay back the loan? Several factors go into determining whether a business can sustain new loan payments.

**Here are the most common:**

## Time in business

Lenders, whether traditional banks, peer-to-peer, direct lenders or MCA companies, want to know that you're established. Startup companies will always have the hardest time securing funding. Even if an applicant has a perfect credit score, he or she will find it hard to get financing for a new enterprise. But if you are seeking funds via a platform like Kickstarter, you may have more flexibility. In general, most lenders want to know that you have been in business for at least a year.

## Credit

If you have existing debt, you might actually be in better shape than if your balance sheet is clean. Sounds counterintuitive, but it makes sense. Debt is important. Strike that. Debt that is *consistently paid in a timely fashion* is important. Lenders want to know that you are a responsible business owner, so demonstrating a solid personal and business credit report is essential. If you have had difficulty maintaining these obligations in the past but have been current for the past one to two years, there's no need to worry. Behind every lending institution are people who understand that we just came out of the greatest financial crisis in two generations.

## Industry

Put simply, there are some industries that lenders like more than others. Below are a few industries that lenders typically look favorably upon and a few that might be more challenged in their eyes.

## TOP INDUSTRIES

- Automotive Parts and Repair Shops
- Medical Practices
- Health Care Stores
- Hotels
- Restaurants and Bars
- Beauty Salons
- Furniture Stores
- General Retailers
- General Merchandise Stores

## CHALLENGING INDUSTRIES

- Trucking
- Online Retailers
- Gyms
- Schools
- Accountantsg
- Golf Courses
- Residential remodeling
- Vitamin Retailers
- Staffing companies



## But don't worry if your business is on the challenging list, because an increasing number of specialty lenders are filling the void. This is a general guideline:

### Revenue

Most alternative lenders want to see a minimum of \$100,000 in annual sales. It goes without saying that the higher the sales, the greater the loan potential. Loans will always be capped at a percentage of sales because it demonstrates your company's ability to pay the lender back. Some lenders will require financial statements or a year-end tax return. Original Funding recommends supplying both in advance. It makes it easier to communicate any issues and/or demonstrate your ability to pay. No lender, unfortunately, is interested in your forward business plan. Regardless of how much you think you can make in the future, your business will be judged by what it has done in the immediate past. The great thing about the alternative lending market is that the distant past means a lot less time in this space than it does to traditional banks that customarily require multiple years of financial statements. Alternative lenders typically give more benefit of the doubt in terms of your past struggles.

### Average Bank Balance

Do you frequently have negative balances? If so, this will be a consideration. Then again, it could be your primary reason for seeking a loan. Many businesses have operated on what is typically referred to as a "float." This is when your traditional bank will allow your business to maintain a negative balance for a short time. It's routinely accompanied by extremely high fees, so if your business falls into this category and you're looking to eliminate these fees and establish a better credit rating for your business, make sure you let prospective lenders

know. The most important thing regarding bank balances is to maintain positive balances at the end of every month. It shows that you have awareness of your situation and the ability to collect revenue on a consistent basis, even if you're sometimes negative in between.

### Number of Deposits

Here's an example: Two businesses have \$1,200,000 in annual sales. One has 20 accounts that pay \$5,000 per month, and the other has two accounts that pay \$50,000 per month. Both businesses look the same from the outside, but the lender will view the latter as a greater risk and likely decline the loan. When put in these terms, it should seem obvious. If Company A loses one client, it hardly impacts the top line. If Company B loses one client, it loses half of its revenue. *Advantage: Company A—by a long shot.*

### Owner Credit Score

This factor is important, but not as significant as some might think. The owner credit score is typically the final check when lenders consider a loan. If a business owner has a great business but a credit score of 500 or less, most lenders will likely walk away. But many business owners have destroyed their personal credit to keep their businesses alive so it's always worth a shot, *particularly if the worst stuff is far in the rear-view mirror.*

# Go Unsecured

## The risk of using personal assets

Using personal assets as collateral for a business loan is a gamble. When underwriting a loan, many lenders will insist on some sort of collateral for security. Business owners may not have the adequate collateral available in their business so they may have to utilize some sort of personal asset as a guarantee.

As a result, some lenders may force a borrower to put up a personal asset as collateral, such as their private residence or their own investments. For any number of reasons, using personal assets as collateral for a business loan is quite risky. Moreover, business owners may not want to risk their personal assets no matter how badly they may need capital.

**Let's explore why using personal assets for business loan collateral is a risky proposition.**

### Time Factor

A business owner may need funding for only a short amount of time, or need money as a result of a sudden emergency. Though the fortune-telling industry remains subject to many economic uncertainties (no pun intended), one economic certainty is that a small business may find itself in immediate need of capital. It is not so much a question of "if" as it is a question of "when."

**“Money may come and go, but time never comes back.”**

Utilizing personal assets as collateral may have its own set of time-related risks. For starters, a company may discover that it cannot liquidate its assets quickly enough to meet a sudden obligation and realize it did so for nothing. Worse is when the company incurs a liability, such as a tax liability from selling an asset. Another unfortunate situation may be that the company owner had to scramble to liquidate personal assets for access to capital that added more debt, which is costly in terms of money and time.

Money may come and go, but time never comes back. Make sure that if a [personal guarantee](#) is used, the assets can be liquidated immediately.

### Valuation

Kevin O'Leary, one of the entrepreneurs from the Shark Tank reality television show, may give differing accounts about how he earned his "Mr. Wonderful" nickname. But one explanation that cannot be disputed is the weight that O'Leary places upon business valuations, and for very good reason. For any type of underwriting in any asset class, valuation of the assets is an extremely important consideration. Valuation plays a large part in what the loan amount, terms and conditions will be.

For example, a business owner may possess shares of a stock that are "restricted", which falls under the legal purview of [Rule 144](#) of the U.S. Securities and Exchange Commission. These shares are subject to a holding period of one year and certain other reporting rules,

especially if the owner holds a significant amount of the shares outstanding, making the owner a “material owner”.

If these shares are not valued properly, there are serious consequences for both borrower and lender. For the lender, they may find themselves handcuffed to a loan that is already underwater with little chance of recourse or recouping the value. They may also have to utilize other [hedging instruments](#) that increase the cost of lending and due diligence. Borrowers may also find that not only has their investment been mispriced, it could possibly lead to legal action against the lender. Borrower and lender in this situation may also face charges from the Securities and Exchange Commission if the 144 paperwork was not filed properly.

So when utilizing personal assets for guarantees, be sure to have those assets properly evaluated and make sure that these assets are not subject to wild price fluctuations.

## Type of Collateral

Besides shares of stock, other assets can be used for a business loan guarantee. Inventory, equipment, real property and even receivables can be collateral as well. In some instances, the business collateral may be sufficient enough that personal guarantees are no longer necessary or they’re significantly scaled back.

Evaluating the type of collateral available and how the lender will consider its value becomes a very important lending consideration. Not only will its valuation be different, each type of collateral also matters in establishing the loan’s duration. For instance, collateralized real estate or cash accounts will elicit different terms and conditions compared to collateralized securities or receivables.

But remember that as lenders and borrowers differ, so does the acceptable collateral. For

instance, raw land is not typically considered a collateralized asset, but an industrial building can be collateralized. Cash in a trust fund or a business checking account may be readily used as collateral, but securities in a brokerage account might not be.

Evaluating the type of collateral that can be used and how a lender will collateralize the asset is an important consideration. It can prolong the term of the loan and even affect the ability of a borrower to secure capital, as well as the ability to pay back the loan in the first place.

## Why It’s Important

Neither every lender nor every lending situation may necessitate a personal guarantee. But that is not to say that it doesn’t matter. In fact, determining whether a personal guarantee is necessary is one of the basic considerations for any business loan. But deciding which personal assets to pledge towards the loan is not a decision to be made lightly.

**“ There are numerous questions that a borrower must answer before making the decision.”**

Whether or not an asset is expendable, whether control of the asset can be regained and how the asset will be collateralized are among a few of the many questions that must be answered.

But more importantly, even before taking out a loan, the borrower must determine how much he or she wants to risk. The borrower must remember that every lending transaction must result in a net positive gain to the business. If not done properly, there could be a net loss.



# Why you should use a **small business loan broker**

Technology has [revolutionized the financial landscape](#). Now entrepreneurs can use an online small business loan broker to secure the capital they need. Not only can they find the information they need to get a loan quickly, they can get that loan underwritten rapidly as well because so many aspects of the underwriting process have been automated.

Whether you want to refinance an existing business loan or to decide which funding option is best for your business, you'll find that it's immensely helpful to use [online resources](#) to locate a business loan broker. Borrowers and lenders have a new medium for correspondence, and they can communicate and share loan documentation in real time. Loans can now be funded in days, if not hours.

## Want more reasons why you should use an online small business loan broker?

**Here are three good reasons why:**

### 1 **Faster Responsiveness**

In today's fast-paced world, being able to respond rapidly to your environment is essential to your business's success. For a business owner seeking a fast source of business financing, having a lender who can respond quickly is key.

Faster responsiveness means faster underwriting, faster approval and faster funding. Businesses can meet their challenges quickly if their lenders are also quick with their funding. More importantly, time-sensitive

opportunities can also be turned to the businesses' advantage if the resources are readily available.

From submitting automated applications to using algorithms that analyze the borrower's creditworthiness and documentation as well as the convenience of uploading all required financial information, doing it all online enables you to get the funding you need much faster than ever.

### 2 **Quicker Underwriting & Approvals**

If you are going online for a small business loan, it could be underwritten and approved quickly because technology has let borrowers and lenders easily share financial documentation, communicate rapidly about any issues that may arise, and facilitate funding for the loan and repayment of the debt.

**“Today's digital business landscape has allowed lenders to extend their reach beyond their local domain.**

But handling an influx of prospective borrowers requires lenders to have the right infrastructure to deal with that kind of volume. Lenders with reliable technology can meet the needs of their borrowers more responsively than those who

don't.

When it comes to finding an online small business loan broker, a rapid underwriting and quick funding process should be key considerations.

### 3 Due Diligence & Access to Information

Today's digital landscape means that access to all sorts of information about a borrower, a lender and even the type of collateral is almost instantaneous.

Prospective borrowers can also use technology to their advantage, particularly in conducting their own due diligence on a potential lender. Besides checking out the business records and the website of a lender, a borrower can also research the "Tombstones," or past deals, that the lender completed.

#### THINGS TO THINK ABOUT:

The rise of loan exchanges, such as Lending Club and Prosper, and direct funders, like OnDeck and CAN Capital, should make anyone question why brokers are even necessary. Major funders such as these have their own application processes and underwriting criteria meant to eliminate brokerages entirely. Yet for every new funding platform, it seems that 100 new brokers simultaneously enter this space.

**Here are some things you should know—and some questions you should ask—about brokers and lenders before deciding to part with your personal and business financial information.**

#### 1. Small Business Brokers Don't Require a License.

That's right. There is no test or certification to

become a small business broker. Right away, this caveat should give you pause before you send along your personal information. It's important to understand, however, that most of the funding companies you will approach aren't licensed, either. If a lender is a public company, such as OnDeck Capital, it will be subject to scrutiny from the US Securities and Exchange Commission, but it still will not require a license to be a lender. Private funding companies will likewise not be required to obtain a license, and will operate with little to no oversight. This lack of compliance is an important, but likely temporary advantage for the alternative lenders in the United States. How long this situation will remain without direct governmental supervision is up for debate, but it will likely be years before an agency is assigned supervisory and [regulatory authority over marketplace lending](#). It's tempting to conclude that this lack of oversight is dangerous for the borrower. But it's less so if the borrower is fully informed about his or her options. A true business broker can help a borrower navigate the sometimes murky waters of marketplace lending to avoid pitfalls and scams. Moreover, a good broker knows the players in the industry and their specialties. This knowledge allows the broker to connect borrowers with the right financing partner instead of sending applications all over the country.

#### 2. How is your broker compensated?

Most brokers work on a percentage of a successfully funded loan. A standard commission is approximately 5 percent of the loan, which is what Original Funding receives on its deals. Finding customers is one of the more expensive aspects of operating a funding platform, so most lenders are happy to compensate the broker on a successful loan. But it's important to ask your broker how they get paid, because some operate very differently. For example, some brokers will charge an origination fee, and deduct this fee directly from the borrower when the loan closes. Other brokers will try to negotiate a higher percentage and place it on top of the loan amount. In some cases, this charge can be anywhere between 8 percent and 12 percent on top of the loan—we've seen it as high as 20 percent! When a broker stacks a commission on top of the loan, the loan amount plus the commission is what the borrower pays back. Be sure to read your loan documents carefully to ensure that the lender is paying your broker out of their spread and not stacking it on top for you.

### 3. How can I tell if my broker is legitimate?

Whenever possible, try to speak directly with the broker. It doesn't hurt to do a little research as well. Does your broker have a website? An actual place of business? Social media? You wouldn't volunteer your personal information to an offshore telemarketer without an office, website or phone number. So why would you trust someone who is soliciting your company to apply for a loan who doesn't have any of these characteristics? The Original Funding platform is mostly automated, but we make sure to connect with our applicants. It's important to understand their needs, just as it's important for them to feel comfortable with us. We work in a real office with real people, and puppies (on Fridays). We work in-house with our technology platform partner, Morey Publishing, and have a robust support staff.

### 4. Why can't I just be my own broker?

You can. Deciding whether or not to work with a business loan broker is a matter of time and energy. It's a lot like working with a real estate broker. A great real estate broker will understand the marketplace, know what's available, what's overpriced, and what's a steal. They also do the legwork required to find the best available option based on your needs. Having said that, some people choose to sell their own homes and do just fine. It's a matter of time and energy. A good business loan broker also stays on top of regulatory trends, loan options and new entrants into the lending field.

### 5. Applying for a loan seems pretty easy.

Marketplace lenders have a great technological advantage over traditional banks, which makes it faster and easier to apply for loans on several digital platforms. Because marketplace lending is a relatively new phenomenon in the United States, the leaders in this field were unburdened by legacy systems that hamstrung traditional banks. Additionally, there are virtually no regulatory hurdles to jump through, which allowed these companies to bring new technology to market quickly. But just because an application is simple doesn't mean you should be filling out every one that you see. Every time a prospective borrower fills out a loan application with a different lender, he or she will have a hard credit check. You might think you're doing the proper due diligence by applying for

several loans and comparing terms, but in reality you might be damaging your credit in the long run..

There are certain important items that we ask for to help us guide your application into the right hands. For example, if you have outstanding loans, we might direct your application to a lender that specializes in loan consolidations and refinance. If a borrower is in need of a small amount of quick cash and has proven credit card receipts, we might put you in touch with a merchant cash advance company. There are myriad factors that affect the direction of an application. It's our job to take them into account and find the best solution. Sometimes the best answer is to not apply for an alternative market loan but to apply for an SBA loan or go to a traditional bank that understands your industry. Remember, just because the marketplace lending industry is growing rapidly doesn't mean that traditional lending is gone!

**The Original Funding team evaluates your application to make sure you have everything required to successfully obtain financing. If we see any potentially disqualifying pieces of information, we will let you know—instead of submitting your application to a lender blindly.**

**Like everything else in business, you have to protect your own best interests. Hopefully, the information above helps clarify the role of the business loan broker and offers some insight into the marketplace lending industry.**

# How to avoid hidden fees

One of the reasons behind Original Funding's success is our commitment to transparency. We take great pains to explain [our process](#) to our clients and help guide them through the procedures of getting a small business loan. Moreover, we partner with lenders who share our value system in order to provide a clear understanding of loan options.

It's surprising to many of our clients that, for the most part, the [marketplace lending industry is unregulated](#). That lack doesn't mean that it's a complete free-for-all. Most of Original Funding's partner lenders are at the forefront of the movement toward greater transparency and they volunteer information normally required by regulatory bodies in traditional finance. But there are bad actors in the middle market – the brokerage space – that have raised concerns. Original Funding was established as the antidote to this behavior and it's why we have garnered confidence in the industry.

Fortunately, our way of doing business is already beginning to overtake the market. But it doesn't mean we're in the clear. Here are some things you should be aware of when contemplating an [online loan](#) and what we have done to protect our clients as a result:

## Credit Score

The ease of applying for a loan online has generated great excitement on both sides of the coin. Borrowers love the ability to receive information in minutes or hours and be funded potentially within days. Lenders love the access these portals provide to a wider audience. But borrowers would be wise to exercise caution before volunteering their information to multiple sources.

First off, it's sometimes difficult to tell whether you're submitting your information to a broker or a funder. Some brokerage sites are cleverly disguised as lenders. These sites exist to aggregate data to send to multiple sources.

**“ The danger here is not only losing control of your personal and business information, but also by having multiple “hard checks” on your credit.**

Technically, authorization to run your personal credit must be given directly by you to the lender, but there's no way to be certain of this when authorizing a broker who may claim you have given authority to multiple lenders. Multiple checks on your credit may ultimately negatively impact your credit score, which can have deleterious consequences in all phases of your life.

*Original Funding does not run an applicant's credit.* We ask all borrowers to “self-identify” their credit score if they know what it is, or estimate it. We collect enough information from our borrowers to get a realistic assessment of whether or not they might [quality for a loan](#). Once we have made this risk assessment, we speak to our funders to see if the applicant might be a good fit before releasing any data. Once we determine this fit, we reach out to the prospective borrower to acquire more documentation and submit the entire package to the funder we believe is best suited for the file.

## Securing your data

The other obvious danger in submitting your information to several places or to unscrupulous brokers is that it places your data in jeopardy. Fraud in the technological era is unfortunately running rampant, and it can have lasting harmful effects on both your personal life and your business.

## No fees or surcharges

This brings us back to the original subject matter. Hidden charges, outsized commissions and application fees have unfortunately become all-too-common in the world of marketplace lending. The good news, as we mentioned before, is that this is beginning to change. But there are still predatory practices out there to be aware of when you're applying for a loan through a broker.

To begin, many brokers will ask for your bank account information and the authority to debit your account. This is a sure sign that there is an additional origination fee that the broker will charge your account on top of the loan payback. Original Funding simply doesn't do this. Many brokers have the ability to "upsell" a file by placing a commission on top of a loan. Believe it or not – and hold on to your hats – some brokers have actually charged upwards of 20 percent on loans! Thankfully, funders are beginning to crack down on this practice, but borrowers should know that it still exists. At Original Funding, we easily addressed this issue by stating up front that our commission on every deal, regardless of size, scope, term or other factors, is always 6 percent. Moreover, this commission is inside the loan, not in addition to the loan, so the borrower receives one payback number instead of having to decipher the total payback on a loan. We only accept payment on successful deals from the lender and never take an application, commission or origination fee from the borrower.

## The Upshot

Buyers beware. Marketplace lending is still largely unregulated and bad actors are out there looking for one-time scores. When applying for a loan online, always make sure to ask whether there are origination fees or additional charges beyond the stated payback amount. If you are applying through a broker, ask them to identify their commission structure. Never authorize them to debit your bank account directly.





# How to avoid a lending scam

Small businesses have come to depend on the alternative banking industry more than ever. Traditional banks currently [only approve](#) 19 percent of lending applications versus a 64 percent approval rating in the alternative lending sphere.

The alternative lending marketplace is quickly headed toward becoming a [trillion-dollar industry](#), with a diverse and vast increase in the number of alternative lenders popping up every year. With this influx of alternative lending companies, it's no surprise that some of them aren't exactly who or what they appear to be.

As long as there is money to be made, there will always be scammers or dishonest businesspeople.

**In order to help you avoid an alternative lending scam, we have compiled some key red flags to look out for:**

## Website Isn't Secure

When you're doing internet research on potential alternative lenders, make sure to look out for secured websites. A website without a valid Secure Sockets Layer (SSL) Certificate, which certifies that private information is transferred securely, may be out to sell your information to a third party. Want to know easy ways to know if a website is secure? Check for the added "s" on the end of "http(s)" in their URL, along with a lock icon in the search bar.

## Company doesn't have a physical address or working phone number

Scammers tend to use P.O. boxes and have non-existent phone numbers. Reputable

companies, even legitimate online lenders, will have physical offices and real phone numbers, along with actual employees who can answer any and all questions you may have.

## Can't find the fine print on their website

Legitimate companies are transparent. A legitimate lending company will provide their privacy policy, terms and conditions and other legal disclosures in the form of fine print. If you cannot find the fine print on a company's website, you might find yourself tacitly consenting to some negative situations, like your information being sold, without even realizing it.

## You can't perform much research on them

A legitimate lender will have a solid paper trail for you to search for. Aside from a robust, functioning website, real companies will have genuine customer reviews and an active social media presence. If the company isn't very searchable, aside from a not-so-put-together website, they probably aren't reputable.

## Try to force you to borrow more money than you need

[Legitimate companies](#) look out for you and your business's success, but they also want to make sure that your debt will be repaid. Therefore, legitimate lenders aren't going to set you up for failure, and they certainly won't try to pressure you into taking out more capital than you can financially handle. If a company tries to do this, it's a clear indication to end the relationship immediately.

# Can I get a loan if I have **outstanding liens**?

**You may have wondered: Can I get a loan if I already have existing liens against my company?**

**In short: Yes you can – but there are some aspects to consider.**

In general, lenders tend to most value whether your business has sufficient and consistent cash flow to handle any outstanding obligations. By showing that you have the financial ability and discipline to cover your current debt, lenders will more likely view you as a responsible borrower. In fact, being able to prove your ability to pay off your debt can be more important than your having a clean slate.

Although there is no set rule on how many liens are acceptable to have out against your company at one given time, it's considered good practice to keep your business's current and proposed indebtedness (ie. equipment loans, lease payments, liens and business loans) at no more than 6% of your business's total revenue.

In the event that you have liens out against your company while you're shopping for a new loan, make sure that you're upfront with the new lender about your situation. Any liens filed against your company are visible on your credit report. Trying to hide them will only make your potential lender suspicious.

Since traditional banks have more restrictive guidelines throughout the lending process, it

can be difficult to obtain a business loan from them. Banks do not have a high risk threshold, so if you have liens out against you that will deter them from investing in you.

If you do have liens, you can find a great option in the alternative lending sphere. With more flexibility at their disposal, alternate lenders have the ability to look past certain factors that may halt a bank loan. If your loan has been turned down by a bank, or you have marks on your credit due to outstanding liens, a legitimate alternative lender is your most viable choice.



# Minimizing tax consequences

A small business loan could have potential tax consequences. Small business owners, therefore, must be attentive to several factors that can affect their tax status should they pursue a small business loan. More often than not, tax liabilities come about due to considerations business owners simply overlook.

Fortunately, business owners can utilize several strategies when pursuing a business loan that may reduce their potential tax liability. Knowing them can not only help business owners save time and money, but also attain better lending rates and terms, without the prospect of a tax lien weighing on them.

## Keep Business and Personal Expenses Separate

Business owners are sometimes far too tempted to use their business assets for personal expenses, especially in tough times. The media are replete with stories of business owners turning their companies into their own personal piggybank, as well as their subsequent embezzlement indictments. A business line of credit enjoys a tax deduction, provided the proceeds are used for business expenses. If that line of credit is used to obtain cash for personal expenses, however, a business owner may jeopardize the tax deduction on the interest.

A business owner should retain all appropriate records of all business expenses paid from the business loan or line of credit to support any deductions. Since the tax code requires that many small business owners must submit their claims for deductions in order to find out if they

qualify with Internal Revenue Service guidelines, the proper documentation will make that determination much easier.

## Business Incorporations Have Unique Tax Consequences

The incorporation structure of a company also affects the available tax deductions and allowable losses for a small business loan. In pass-through entities, such as sole proprietorships or limited partnerships, a business owner may only take losses to the extent of his or her basis. If they invest more, their basis in the organization increases. A small business loan shows more assets to the company, hence, it has allowed the business owner to deduct more losses on his or her personal tax return, at least on the surface.

Since business owners have to submit their claim for a deduction on their small business loan, a liability could arise should they not properly document and report the business loan or misuse its proceeds as intended. This problem becomes even more pronounced when the company is organized as a C-corporation or S-corporation.

A C-corporation is allowed to take a deduction on the interest expense and a tax deduction, as it has its own tax liability. The lender, however, would still have to pay taxes on the interest. An S-Corporation cannot take the loan into consideration when calculating any pass-through losses from the business to a personal return, since tax law guidelines generally limit such losses to the amount of the investor's basis in the stock and any direct outstanding loans

## Leasing vs. Owning

The decision to lease holds several advantages as opposed to owning. Leasing preserves credit lines, since money is not borrowed during a lease. Leasing also preserves capital by providing an alternate source of financing via cost savings on depreciating assets and lease-backs.

If you're seeking a small business loan, there are also important tax benefits to consider when leasing. Since lease payments are made from pre-tax earnings, as opposed to after-tax earnings, lease payments may be fully deductible, depending on the structure of the lease.

Leasing is also advantageous when you're facing budget limitations associated with the demands of long-term growth. Leasing allows for a longer depreciation cycle on equipment, which means that a small business loan can be used to purchase newer and more efficient equipment. Leasing can also reduce monthly payments and increase working capital, since lease payments can be structured by size and frequency.

Most importantly, leasing allows for more flexibility. It can potentially help your company with tax deductions from any pre-tax earnings and help avoid the Alternate Minimum Tax. Leasing can also help avoid restrictive covenants and certain types of restrictive loan requirements, which may limit a borrower's ability to pursue a small business loan.

## Plan Ahead

Small business owners must prepare and execute a plan to limit their business tax liabilities when they're getting a small business loan. First and foremost, a business owner should consult their tax preparer to ensure that their loan does not adversely affect their tax situation.

Small business owners should also plan as much as possible to show how the loan will be used. When seeking a small business loan, business owners should also plan around any discharged debt that they may have. Discharged debt might be classified as income to the organization, and could possibly have an influence on any negotiations with a lender for a new line of credit.

Planning also allows business owners to re-think their lending needs and reduce any potential tax liabilities. Re-assessing the strategy and direction of the company goes a long way in seeking \$250,000 in capital, versus seeking \$500,000. Logically, since a lower amount is being sought, the potential for any tax liabilities will be reduced accordingly.

The real value of effective planning is identifying the long-term considerations that may affect a business. Since both tax consequences and financing are important, recognizing and strategizing around potential tax considerations for a small business loan will help make the entire process that much easier and efficient.





# Online Lending Outlook

(Hint: It's a Borrower's Market)

Heading into last year, we had predicted that increased competition in direct online lending, or Marketplace Lending, would benefit borrowers. The second half of last year proved this theory as new entrants into the market continued to compress rates being offered to borrowers. This year will be no exception to this trend as the market will be flooded with new direct lenders. Not to be outdone, larger funding entities will go on pouring enormous resources into gaining market share.

**That's not to say borrowers shouldn't be wary of offers that seem too good to be true. Here are some things to watch out for if you're in the market for an online loan:**

## Stacking

Stacking is an industry term for taking multiple loans within a short time. Although there can be good reasons to take out more than just one loan (see our article on stacking), borrowers must be extremely cautious when doing so. Common sense is king when borrowing money.

The industry is still plagued with bad actors who prey on borrowers seeking working capital. Borrowers who have managed to secure funds from online lenders typically have a lien placed on their business. Called a UCC filing, this lien is standard practice for all types of lending. Unfortunately, it is common practice for brokers and lenders alike to purchase UCC lists and barrage borrowers with offers to secure additional capital. Often times, the people making these calls are less concerned with

your ability to pay back a loan than they are with getting a commission on newly originated loans.

## Rate Compression

Direct lenders today typically offer "advances" rather than loans. In most cases, it is a difference without a distinction so it's important to understand why this is done. On the lender side, there are advantageous tax consequences by simply calling this funding an advance and not a typical loan because this type of lending is still largely unregulated. From the borrower's perspective, it operates very much in the same way. Money is given, or "advanced," to the borrower who promises to pay it back at a premium. In this respect, it is considered an advance against future billings or earnings. But, for all practical purposes, it behaves just like a loan.

We draw attention to this definition because most online lenders offer a "factor," without necessarily quoting an interest rate. One reason they do this is because the payback figures are typically much higher than conventional loans, and the offers don't sound nearly as appealing when they're quoted as an interest rate. Factor rates range between 1.1 and 1.4 for most lenders. The terms of these advances can vary anywhere between 3 months and 36 months, though there are always exceptions. The payback is determined by multiplying the amount of the advance by the factor rate. The term is the amount of time you're given to pay back this total amount.



**“...now that there are so many funding options, even lenders with the highest cost of capital have had to reduce their factor rates.**

Factor rates have been all over the map since the online lending industry began just a few short years ago. They can vary greatly depending on the borrower's personal credit rating, the number of negative balance days in the business's bank account or the total outstanding debt. Much of the variation has less to do with the borrower's profile and more to do with the lender's business model. Lenders with a high cost of capital could charge high factor rates to their clients to offset the potential risk of default. But now that there are so many funding options, even lenders with the highest cost of capital have had to reduce their factor rates. Which brings us to the next trend to look out for:

### **Cost of Capital**

So who are these non-bank lenders that comprise the online lending marketplace anyway? It's a good question. Non-bank lenders have entered the online lending arena at a surprising rate. They range from wealthy individuals or family office funds to hedge funds and investor pools. OnDeck is the only online lender that has gone public thus far. Given all the variations, there is no central underwriting standard. In fact, every company seems to have its own "secret sauce" and its favorite type of business. Navigating a lender's sweet spots and learning what kind of borrower's profile it prefers are important when trying to connect borrowers and lenders.

Because lenders get their funding from different sources, it helps to understand their pricing methodology. Marketplace lenders have the dual advantage of operating in a relatively

light regulatory environment and having no brick-and-mortar overhead. As a result, they can make faster decisions when they compete for a borrower's business. One would think that their offerings should be much less expensive than they really are.

**The reason they are not so competitive is due to these primary cost drivers:**

#### **1. Cost of Capital**

Unlike traditional banks that can access a percentage of deposits from their customers, most marketplace lenders use outside money from funds or credit sources that require a basic return on investment. Therefore, increases in interest rates will have a dramatic impact on lenders that haven't secured long-term funding at low interest rates. This situation may be the biggest driver of capital costs over the coming months and years because rates have been artificially suppressed since the financial collapse of the Great Recession and the Fed has recently shown its willingness to raise them.

#### **2. Cost of Customer Acquisition**

Because marketplace lenders don't have established banking relationships, they must generate interest in their products essentially from scratch. This is an expensive proposition, and one of the primary reasons companies like Original Funding and other brokers exist.

#### **3. Personnel**

No matter how sophisticated the underwriting procedures are for marketplace lending companies, human interaction is a necessary component to building a solid platform. Now that online lending is expanding and its reputation is steadily improving, quality people are being recruited into the space. Look for this trend to continue. It is a positive development for the industry as a whole, but it comes at a cost, particularly because these players have a multitude of options.

#### **4. Defaults**

Although it's difficult to ascertain true default rates from most marketplace lenders, borrowers who can't secure traditional banking loans are simply more risky. Therefore, lenders have no choice but to build premiums into their offerings to offset the inevitable. No matter how tight the underwriting practices might be at any given lender, defaults are a reality, and borrowers will continue to pay the price.



## The Upshot

Greater pressures on the lenders from the rising cost of capital to increasing competition will have a positive net benefit for the borrowers. Several lenders in the market today won't be able to withstand the strain, which will only ensure that lenders who are well capitalized, have mature underwriting practices and quality personnel will be the ones who make it through the year. These lenders will ultimately win by providing better rates and better service, which are both better for the borrowers.

# Glossary of Lending Terms and Acronyms

When applying for a small business loan, you will inevitably come in contact with numerous jumbled and confusing loan acronyms that require you to do some solid research in order to understand them.

**Fortunately, we have compiled the most common loan acronyms in a handy list to help make deciphering lending language that much easier.**

## **ACH**

### **Automated Clearing House.**

An electronic network that processes financial transactions by transferring funds from one account to another through public and private sectors. You can set up your loan payments to be made by ACH transactions to make sure that you don't miss a payment.

## **APR**

### **Annual Percentage Rate.**

APR compiles your loan's yearly interest rate with any fees or additional charges that you have to pay for that cash. In short, it's the true cost of a loan.

## **ABL**

### **Asset-Based Loan.**

An ABL is secured by business assets, most often by inventory or receivables. Lenders make these loans based on a formula that calculates a percentage of those assets' value. The percentage can vary depending on the type of collateral.

## **BVI**

### **Borrower Viability Index.**

Your BVI is similar to a credit score, but takes into account a broader range of factors that tell a lender more accurately if you are qualified for a business loan. The BVI considers your credit score, but puts more weight on factors like track record, profit-and-loss metrics, and intent.

## **CDC**

### **Certified Development Company.**

The Small Business Administration certifies and regulates these nonprofit organizations, which work with participating lenders nationwide to lend to small businesses under the SBA's 504 Loan Program. SBA 504 loans provide financing for the purchase of major fixed assets such as real estate or equipment.

## **CDFI**

### **Community Development Financial Institution.**

These financial institutions—generally banks, credit unions, or loan funds—are government-certified organizations that offer financial services to underserved markets and individuals. CDFIs might offer business loans to entrepreneurs who can't get traditional financing as well.



## **CPLTD**

### **Current Portion of Long-Term Debt.**

This figure represents the amount of long-term debt that you need to repay within one year.

## **DSCR**

### **Debt Service Coverage Ratio.**

This ratio tells lenders how much cash you have available to service the debt you're considering taking on. Lenders arrive at this figure by dividing your company's net operating income by the amount you'll need for debt service. This number is important, because if you don't have adequate cash to service your debt, lenders won't front you the money you want.

## **EBITDA**

### **Earnings Before Interest, Tax, Depreciation, and Amortization.**

Lenders use this measurement to assess your company's creditworthiness and your ability to pay back your debt.

## **FICO**

### **Fair Isaac Corporation.**

FICO is the largest and most well-known company that provides software for calculating a person's credit score.

## **GAAP**

### **Generally Accepted Accounting Principles.**

Standards set by the Financial Accounting Standards Board of accounting principles, standards and procedures that companies use to compile their financial statements for potential lenders.

## **ISO**

### **Independent Sales Organization.**

ISO is an individual or an organization that is not an association member (i.e., not a Visa or a MasterCard member bank), but still has a bank card relationship with an association member bank. ISO's provide payment-related services to members of an association, either directly

or indirectly, including customer service, sales, merchant solicitation and training activities.

## **LO**

### **Loan Officer.**

The person at the lending organization who handles your loan.

## **LOC**

### **Line of Credit.**

A type of financing in which a lender extends you credit for a certain amount that you can draw on whenever you need. You don't have to start repaying the credit line until you actually draw from it, and once you repay all the money, you'll again have access to the full amount of the credit line.

## **LTD**

### **Long-Term Debt.**

Long-term debt is any loan that has a future maturity date of more than one year.

## **LTV Ratio**

### **Loan-to-Value Ratio.**

The ratio of outstanding debt to the value of the collateral for the loan. Lenders have a maximum LTV that they're willing to accept, depending on the type of collateral you're putting up for the loan.

## **P&I**

### **Principal and Interest.**

Figures combined by your loan officer to calculate your scheduled loan payment amounts.

## **PP&E**

### **Property, Plant, and Equipment.**

This term describes business assets or property that is not liquid—in other words, it can't be quickly turned into cash. PP&E is also sometimes known as fixed assets or tangible assets, in contrast to liquid or current assets such as cash or money in the bank.

## **SBA**

### **The U.S. Small Business Administration.**

The SBA provides a wide variety of resources and services to small business owners. Most importantly for borrowers, this federal agency guarantees small business loans—known as SBA loans. But the SBA doesn't actually make loans. Instead, it works with approved lenders and guarantees a certain percentage of the money they lend to small businesses via SBA loans, typically 80-90 percent. The SBA's main guaranteed loan program is the 7(a) loan.

## **SBSS**

### **Small Business Scoring Service.**

The SBA's loan guaranty processing center uses SBSS scores when screening small businesses' loan applications. The SBSS score, generated by FICO, is based on factors like the business's credit history and the business owner's individual FICO score. The SBSS score can range from 0 to 300. In 2014, the SBA set a minimum score of 140 to be considered for its 7(a) loan program.

## **USDA Loan or B&I Loan**

### **U.S. Department of Agriculture loans or Rural Department of Business and Industry Loans.**

U.S. Department of Agriculture loans, offered through the federal agency's Rural Department of Business and Industry, help to develop or finance businesses with the goal of improving the economic and environmental climate of rural communities. Like SBA loans, many of these loan programs provide guarantees to lenders to encourage lending

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