

Lenders want collateral to finance your business

Local business owners seeking financing tell me Cherokee County's banks are "real estate lenders." More specifically, they mean that lenders require real estate collateral as a second way to get repaid.

The first way to repay loans is from the business' cash flow. I wrote about it in my column in the March 16 edition of the *Cherokee Scout*. But lenders also want enough collateral pledged to make them whole if the borrower's cash flow is inadequate.

Real estate, furniture, machinery and equipment are examples of collateral. They prefer real estate, however, because it depreciates less in value. In the event of default, the lender sells off the collateral to repay the outstanding debt.

"The lender will discount the market value of the collateral assets so as to maintain an adequate excess



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Jerry Chautin

margin to cover the loan balance," Charles Green wrote in his third edition of *The SBA Loan Book*. "You will generally be required to provide a minimum of 100 percent collateral coverage over the entire term of the loan," says the former community bank president and small business lender.

An exception is sometimes made for existing companies with strong balance sheets and a history of steadily increasing cash flow. Moreover, the type of collateral can vary depending upon the lender and strength of the borrower.

The U.S. Small Business Administration says a loan should not necessarily be denied if an otherwise qual-



Attorney Katie O'Brien of Pennsylvania specializes in small-business lending.

fied borrower lacks collateral. However, most lenders will reject applicants who don't have enough collateral whether the loan is government guaranteed or conventional.

Katie O'Brien, a lawyer with Starfield & Smith, PC in Fort Washington, Pa., said, "SBA considers a loan as fully secured if the lender

has taken security interests in all available assets with a combined liquidation value up to the loan amount."

She adds that, "Liquidation value is the amount expected to be realized if the lender took possession after a loan default and sold the asset after conducting a reasonable search for a buyer and after deducting the costs of taking possession, preserving and marketing the asset, less the value of any existing liens."

Many lenders discount non-real estate collateral more deeply because they anticipate fire-sale prices from liquidation-jobbers who might pay them 20 percent of the assets' market value.

"Lenders differ on their approach to assigning collateral a liquidation value," O'Brien says. It depends upon their "liquidation practices, relationship with borrowers, specifics of the

deal, etc.," she e-mailed me.

She also notes that spousal assets might have to be pledged "when an individual alone or an individual and his or her spouse together own 20 percent or more of the borrowing entity." In that case, SBA requires that "a lender must consider taking assets that are owned individually by either spouse, as well as assets owned jointly, as collateral to secure the loan."

"This requirement often leads to questions about whether a principal's spouse must guarantee the loan," O'Brien says. "An individual who owns 20 percent or more of the borrowing entity must provide an unlimited full personal guarantee of the loan."

Both SBA and conventional lenders want to lien your home. In addition to securing your equity, lenders believe that you will work harder to make the business

successful when your home is at risk.

Green, the former banker, says you do not have to accept the lender's first offer and it might be possible to renegotiate the terms.

"Everything is negotiable," he adds. And if the lender will not budge, "sometimes qualified borrowers can find other lenders hungrier for business that offer easier terms."

Jerry Chautin is SBA's 2006 Small Business Journalist of the Year award winner. He's a volunteer SCORE business counselor, writes about business and real estate, answers your questions and provides free business advice and mentoring. SCORE is a nonprofit resource partner of SBA. Its Web site is www.score.org. Send questions and story leads to: P.O. Box 254, Murphy, NC 28906 or e-mail: JKChautin@aol.com.