Financing

What can I do to raise money for my small business?

Although the process is complex and frustrating, raising capital is the most basic of all business activities. When looking for financing, there are various sources to consider. For most new businesses, the main source of capital comes from savings and other forms of personal resources. There are better options available than credit cards that are often used for financing, even a small business loan.

When beginning, entrepreneurs usually look to private sources like friends and family. Generally, the money is loaned at a low interest rate or interest free, which is very beneficial at the beginning.

The most common source of funding, not including personal resources, are credit unions and banks who will provide a loan if it is possible to show that your offer is worthwhile. Other sources are venture capital firms that aid businesses in exchange for partial or equity ownership.

For business financing, what kinds of loans exist?

You must know the exact amount of money that you need, what your purpose is and how you will repay it in order to be successful in getting a loan. You must convince the lender in a written proposal that you are a good credit risk.

There are two basic kinds of loans, although terms vary by lender:

Short-term and long-term, maturity periods of up to one year are generally short-term, which include accounts receivable loans, working capital loans and lines of credit.

Maturities greater than a year and less than seven years is a typical long-term loan. Equipment and real estate loans can have maturity up to 25 years. Major business expenses such as purchasing real estate and facilities, durable equipment, construction, vehicles, furniture and fixtures, etc. are a few purposes for long-term loans.

When considering a loan request, what do banks look for?

The bank official who reviews the loan request is focused on repayment. Most loan officers request a copy of your business credit report to determine your ability to repay.

The lending officer will consider the following issues while using the information you provided and the credit report:

Have you invested at least 25% or 50% of savings or personal equity into the business for the loan you are requesting? (Keep in mind that 100% of your business will not be financed by an investor.)

Do your work history, your credit report and letters of recommendation show a healthy record of credit worthiness? This is a key factor.

Do you have the training and experience necessary to operate a successful business?

Do your loan proposal and business plan document your knowledge of and dedication to the success of the business?

Is the cash flow of the business sufficient to make the monthly payments on the requested loan?

What do I need to include in a good loan proposal?

The following main points should be contained in a good loan proposal:

General Information

Reason for the loan: the exact purpose of the loan and why it is necessary.

Amount needed: the specific amount needed to reach your goal.

Business name and address, names of officers and their social security numbers.

Description of Business

Describe the type of business you have, its age, current business assets, and number of employees.

Structure of ownership: describe the legal structure of the company.

Management Profile

Prepare a short statement that is focused on each principal in your business; give details about education, background, accomplishments and skills.

Market Information

State clearly the products of your company as well as its markets. Name the competition and explain how you plan to compete in the market. Describe what the business will do to satisfy the needs of its customers.

Financial Information

Submit your own personal financial statements as well as those of the principal business owners.

Financial statements: the income statements and balance sheets for the past three years. If you have a new business, provide the projected balance sheet and income statement.

Specify the collateral that you are able and willing to give as security for the loan.

Getting a Loan

What are the advantages of prepaying a mortgage, and should I if I can?

It is highly recommended that you prepay as much of your mortgage as possible every month, which will drastically reduce the total amount that you pay.

However there are times where this could be disadvantageous.

If you are in a situation where you don't have funds to cover three to six months of expenses, it is recommended that you save that amount before you pay additional amounts on your mortgage.

If you have a large amount of credit card debt, over the long run, you will save more money by knocking down those high interest loans first.

There also may be times where that money would be more wisely invested in the market, depending on the expected rate of return versus how much you would save in early payments.

Should I refinance?

In order to refinance your home, the current market rate should be at least 2 percentage points lower than what you are paying on your mortgage. Speak with a lender to see what rate you may be able to get. Remember to factor in costs like appraisals, points from the lender, and others, which may not be apparent in your initial price assessment.

After assessing that cost, get a quote of what your total payment would be after refinancing. The simplest way to find out how long it will take to recover the refinancing costs will be to divide your closing costs by the monthly savings with your new monthly payment.

Also take into consideration how long you plan on holding your home. It may not make sense to refinance the home if you plan on selling in the near future.

Does borrowing against my securities make sense?

This could be a low-cost option for borrowing but there is some risk involved. Deductions are not allowed for the interest unless that loan is used to invest in a business.

Can a Home Equity Line of Credit be beneficial?

A home equity line of credit is a form of credit which allows you to borrow and use your home as collateral. Since for many, a home is their greatest asset, they tend to use these sorts of credit lines for large things like a college education for their children, medical expenses or for large unexpected bills as opposed to luxuries or day to day expenses.

After receiving a home equity line, one is approved for an amount of credit, or a maximum that may be borrowed at any given time for the duration of the plan.

On many occasions a lender will set a credit limit on a home equity loan by setting a percentage, after considering the amount of the appraised value of the home and the amount owed on the home.

After the line of credit is approved, you will be able to borrow up to the set limit, usually in the form of checks. In some instances a borrower may be given credit cards to utilize, sometimes with minimum spending requirements.

What costs are associated?

The costs associated with getting a home equity loan are basically the same as a refinance.

- Appraisal
- A non-refundable application fee
- Up front points, which equal one percent of the entire credit limit
- Closing costs, which are the same as the closing costs you would pay upon purchasing a home
- Yearly fees and the possibility a transaction fee per draw

How can you lock in an interest rate?

After choosing a lender, you may be quoted a rate, which may "float" until the actual closing, meaning that it is not guaranteed. With a lock-in you are guaranteed that the interest rate will not change before your closing. You may want to ask for an agreement that ensures that your rate is capped, but allows you to take advantage of a lower rate if the rate lowers before your close.

There is usually a time limit that a lender will put on this guarantee, and if you don't close before that time, they no longer have to honor that lock-in. It is recommended that you stay in close contact with your loan officer during the process to ensure that you are able to close in a timely manner and get the locked-in rate.

What disclosures should I get from my lender?

The lender is obligated by the Truth in Lending Act to provide you with a written statement with a list of all of the costs associated with the loan and the terms of financing. This statement must be delivered to you before the settlement.

If you want to rescind the loan, you may do so within 3 business days of the receipt of the Truth in Lending paperwork, receipt of cancellation notice, or your settlement, whichever was the most recent.

You will want to carefully review the disclosure that you are given before you sign. This disclosure will have all of the pertinent information about your loan, the finance charge, the amount financed, the payment schedule and the APR.

How does a reverse mortgage work?

A reverse mortgage is a way for you to take advantage of some of the equity that is currently tied up in your home. A reverse mortgage works in the same manner as a normal one, reversed, and the homeowner is paid monthly versus having to pay. The major difference between this and a home equity loan is that you aren't required to pay anything back to the lender as long as your retain ownership of the home.

The major benefit of a reverse mortgage is that it allows homeowners to take advantage of some of the equity that they have built up in their homes without the burden of having to pay it back in monthly payments. This could be used to supplement income, defray the cost of medical aid, pay for college education, stop a foreclosure or to make it possible to retire.

When the homeowner sells the home or dies, the home must be paid off and, if sold, the remainder of equity is given to its rightful heirs.

Is any loan interest tax deductible?

These interests are deductible, some fully, some partially:

- Education-related interest
- Business interest
- Investment interest
- Mortgage interest

Can you stop paying Private Mortgage Insurance (PMI)?

Usually people that make a down payment of less than 20% are required to pay private mortgage insurance by their lender. Once you reach 20% equity, PMI is cancelled, and any money accrued in your escrow account towards it will be credited to you.

Loan FAQ

What are the possible implications if I co-sign for a loan?

The co-signer enters an agreement to be responsible for the repayment of the loan if the borrower defaults. A lender will usually not go after the co-signer until the borrower defaults, but they can lawfully go after the co-signer at any time.

It has been stated by finance companies that in the case of a default most co-signers actually pay off the loans that they have co-signed for including the legal and late fees that end up being tacked on. Clearly this can be a large financial burden, and it can also reflect negatively on the co-signer's credit.

If you do agree to co-sign on a loan for someone, you can request that the financial institution agrees that it will refrain from collecting from you unless the primary borrower defaults. Also, make sure that your liability is limited to the unpaid principal and not any late or legal fees.

Upon co-signing you may have to brandish financial documents to the lender just as the primary borrower would have to.

Co-signing for a loan gives you the same legal responsibility for the repayment of the debt as the borrower. If there are late payments, this will affect your credit as well.

If you are asked to co-sign for someone, you may want to provide another option and suggest that they get a secured credit card. This way, they can build up their own credit history and not open themselves up to the possibility of taking on a debt too large, placing themselves, and you, in financial danger.

How can I ensure that I get the best possible rates on my loans?

Be careful when signing up for a home equity loan or line of credit - the disclosed APR does not reflect the total fees that are associated with the loan, such as closing costs and others. Do not forget to compare this cost, as well as the APR, across multiple lenders.

The vast majority of home equity plans will utilize variable interest rates instead of fixed. A variable rate reflects the current prices of a publically available index, like the prime rate, or the U.S. Treasury Bill rate, and the rate of your loan will oscillate accordingly.

Generally a lender will offer a discounted introductory rate, often referred to as a "teaser rate". Take caution - these rates can sometimes fluctuate unless it is stated that there is a fixed rate. Sometimes the lender will give you a great introductory rate that is variable and can change with time to a rate much higher than you originally agreed to.

Since the rate is linked to an index rate, find out which one it is and how much their margin is. Some companies will have a cap on how much your rate can vary within a particular period of time.

Is it better to get a home equity line of credit or a traditional second mortgage?

With a second mortgage you will have a fixed amount of money that is repayable over a fixed period of time or is due in full at a given time. A home equity line of credit, on the other hand, is much more open-ended. You have a line of credit that can be borrowed from as you wish, and generally has a variable rate as opposed to a fixed rate.

Pay attention to the fact then when the APR is calculated it takes into account the interest rate charged plus points, finance charges and other fees, whereas with a home equity line the APR is calculated with solely the periodic interest rate.

What will the loan cost?

Before you are charged any fees, the Truth in Lending Act requires that the lenders disclose to you all pertinent terms of the agreement: the APR, payment terms, other charges, and any information about variable interest.

Generally you will receive these disclosures at the same time that you receive an application form and any additional disclosures promptly after. If any of the terms change prior to the loan closing, the lender must return all fees that have been applied, should you choose to back out of the deal.

The finance charge is the total amount paid in exchange for the use of credit, which includes the interest rate, service charges and insurance premiums. The Annual Percentage Rate (APR) is the percentage paid on a yearly basis.

Bank Accounts FAQ

Which banking fees should I watch for with a new bank account?

Keep in mind that banks are always required to notify you of the fees for their accounts. The best account to choose is usually the one with the lowest fees, regardless of the interest rate.

Keep an eye out for potential extra charges when shopping for checking accounts. Ask about monthly fees, check processing fees, and ATM fees. Also be wary of cost-free checking accounts, as the bank may charge you if your balance drops below a certain amount. Also, the charges for printing new checks can often be much higher at your bank than through an outside printing provider.

In this day and age, it doesn't really benefit you to put money into an old fashioned "passbook" savings account. Often monthly account fees overshadow the small amount of interest you will earn. Instead, put your money into a checking account. If it is a larger sum, look into a money market account. In this type of account you will earn more interest than in a savings account, but watch out for additional charges if your balance drops too low.

What are the different types of bank accounts I can choose from?

Checking Accounts

Checking accounts provide you with quick, convenient access to your funds. You are able to make deposits as often as you wish, and most banks provide you with an ATM card to access your funds, or to charge debits at stores. Of course, you can also use the conventional method of writing checks.

Some checking accounts pay interest. These are called negotiable order of withdrawal (NOW) accounts. The more commonly used type, a demand deposit account, does not pay interest.

There are several fees that are associated with checking accounts, other than the check printing fees. These will vary depending on the bank you choose. Some will charge a monthly maintenance fee regardless of your balance, others will charge a monthly fee if your balance drops below a certain point. Further, some institutions charge you based on the transactions you make, such as each ATM withdrawal, or each check you write.

Money Market Deposit Accounts (MMDA)

An MMDA is basically an account that accumulates interest. You can also write checks from it. The rate of interest is usually higher than that of checking or savings accounts. However, they require a higher minimum balance in order to earn that interest. The higher your balance becomes, the higher your interest rate may rise.

However, it is less convenient to withdraw money from an MMDA than it is from a checking account. You are limited to six transfers from the account a month, and only three of these can be through writing a check. Also, there are usually transaction fees associated with these accounts.

Savings accounts

You may make withdrawals from savings accounts, but there is less flexibility than with a checking account. Like an MMDA, the number of withdrawals or transfers may be limited.

There are a few different types of savings accounts. The two most common are passbook and statement. Passbook accounts involve a record book that tracks all deposits and withdrawals and must be presented upon making these transactions. With a statement savings account, you are mailed a statement showing all withdrawals and deposits.

Minimum balance fees may also be charged on savings accounts.

Credit Union Accounts

These accounts are similar to those of banks, but with a different title. In a credit union, you would have a share draft account (a checking account), a share account (savings account), or a share certificate account (certificate of deposit account).

The great thing about credit unions is that they usually charge less for banking services than banks do. If you have access to one, use it!

Certificates of Deposit (CD)

CDs are time deposits. They offer a guaranteed rate of interest for a specified term which can be as short as a few days or as long as several years.

When you pick the term you generally can't withdraw your money until the term expires. In some cases the bank will let you withdraw the interest you have earned on the CD. Because CDs are for a set amount of time, the rate of return is usually higher - and the longer the term, the higher the annual percentage yield.

A penalty can be issued if you withdraw your funds before the maturity of your term. Sometimes the penalty can be quite high, eating into your interest earned as well as your principal investment.

Your bank will notify you before your CD matures, but often CDs renew automatically. You should keep track of your maturity date if you would like to take out your funds before the CD rolls over into a new term.

What type of account should I go with?

This depends on how you plan to use the account. If you want to grow your money and do not need to access it readily, put it in a CD.

If you need ready access to your money, a savings account could be a good option.

If your primary concern is paying bills, a checking account would be easiest.

Remember, if you only write 2-3 checks a month, an MMDA could suit your needs very well. They have a higher rate of return, but also have a higher minimum balance requirement.

Checking accounts can be very efficient. They simplify your recordkeeping - if you cancel a check, you have a receipt at tax time, and the check register is an easy way of tracking monthly expenses.

Bank institutions have varying fees and features with each of their accounts, so it is important to find out what these are before making a final decision on which bank and which type of account to choose.

A good way to get the most out of a checking account is to inquire into what the minimum balance is and make sure you maintain that amount. Another way to maximize efficiency is to get a checking account that pays interest, or go with a bank that lets you distribute funds into both checking and savings accounts that, combined, reach the minimum balance.

How should I "shop around" for an account?

There are several features of accounts you should investigate at various banks.

Interest Rates

- Find out what the interest rate is and whether the bank can change it after the account has been established.
- Also, find out if the bank pays different interest rates based on how much you have in the account, and if so, how it is calculated.
- Ask when the interest starts being compounded (when they pay you interest based on your principal plus your earned interest).
- Ask what the annual percentage yield is. This is a rate that will tell you how much interest you will earn on a deposit.
- Ask the minimum balance required before you start earning interest.
- Ask if you start earning interest when you deposit a check, or when the check is actually credited to the institution.

Fees

- Ask if you will pay a flat per-month fee.

- Find out if there is a penalty fee for dropping below a minimum balance.
- Ask if there is a charge for each deposit or withdrawal and how much.
- Inquire about ATM fees: making deposits, withdrawals, and how these fees vary if you use an ATM owned by the bank.
- See if there is a charge for bill payment by phone or online.

Additional questions:

- Will I be charged per check I write?
- Will my fees be reduced if I have multiple accounts with the bank?
- Will fees be waived if I use direct deposit?
- Is there a fee for canceling a check?
- Is there a fee per balance inquiry?
- Will there be a fee if I close my account soon after it is opened?
- Am I charged a fee if I write a check that bounces?

Limitations

- Find out if there is a limit to the dollar amount of withdrawals or frequency of withdrawals.
- If you close the account before your interest is credited, ask if you will still receive that interest.
- Find out how long it takes a check to clear, and how long you must wait to withdraw funds you have credited to your account.

CDs

- Establish the term of your account.
- See if the account will roll over automatically, and see if there is a grace period in which you can withdraw your funds after your term comes to maturity.

How much protection do I get from federal deposit insurance?

Only deposit accounts at federally insured depository institutions are protected by the FDIC. Check to see if your bank falls into this category. In general, the government will protect accounts up to $250,000. If you have an account with special ownership, such as a trust, or an account with co-owners, this may change the amount of coverage you receive.

If you invest in an annuity or mutual fund with the institution these are usually not protected by the FDIC.

Can I negotiate my checking account fees with my current bank?

Yes. Here are some tips on how to approach this:

- See what your fees and charges have been over the past 3 years.
- Write down your checking needs, i.e. how many checks you write a month, how many ATM visits, how many deposits, how many times you have overdrawn, how often you go below the minimum balance.
- Take this info and do some research into other banks in the area. Compare their rates and fees to your bank.
- Go to your bank and ask to speak to a manager. Tell them you want to reduce your banking costs. If they don't negotiate, bring up their competition. If they don't want to lose your business they will negotiate. Also ask them other ways to cut costs.
- Keep in mind that many banks offer free checking to seniors, students, and the disabled.
- Don't rule out smaller banks as they may be more willing to cut your costs just to get your business.

What is overdraft protection and should I have it?

This protects you from the possibility of bouncing checks. If you write a check and do not have sufficient funds, it will draw money from your line of credit to make sure the check goes through.

This is a good service for people who are self-employed because if business is seasonal and there are times of the year that have low cash flow, the overdraft protection can help you pay less interest than other forms of borrowing.

What is the Truth in Savings Act?

This is a federal law that requires depository institutions to inform you of the following:

- Annual percentage yield and interest rate
- Costs, fees, extra charges
- Other info including minimum balance requirements

Because of this act, you will get a disclosure of all this info from the bank you are opening an account with. This act also requires that banks provide you with this info upon request.

The Act also requires that interest and fee information be provided to you in periodic updates, and that if you have a rollover CD, you will be notified before the maturity date.

ATM Transactions

How do ATM transactions work?

There are a variety of electronic transactions one can execute:

- ATMs allow you to bank electronically, get cash, make deposits, pay bills, or transfer funds between accounts. These machines are used with a debit or ATM card and a personal identification number.
- Point of Sale Transactions. Some ATM cards and debit cards can be used in stores to charge merchandise. Money is electronically drawn from your account and paid to the store.
- Pre-authorized transfers. This is allowing for the automatic deposit of fund or withdrawal of funds to or from your account. For example, one can authorize the direct deposit of wages, social security, or dividends directly to their account. You can also pre-authorize your bank to make automatic transfers for bill paying.
- Telephone transfers. You can transfer funds from one of your accounts to the other, or order bill payments over the phone.
- Most ATMs provide you with a receipt for the transaction, as do point of sale purchases. These receipts are the records of your electronic transactions and should be kept. Additionally, your periodic bank statement will show all the electronic transfers performed. This monthly statement is your proof of payment to another party and is your record for tax and other purposes. Any inconsistencies can be taken up with your bank.

What should I do if I find an error on an EFT or ATM transaction?

Call your bank as soon as possible, or within 60 days of the error. They may ask you to submit your account information and the alleged error in writing. Generally they have 10 business days to investigate the error, and if they fail to come up with an answer your funds should be reimbursed. If the funds in questions were withdrawn from a point-of-service debit or a foreign electronic transfer, the bank may be allowed more time to investigate the error. In the meantime, however, you should have full access to the funds in question.

Your bank should notify you immediately of their findings. If you were correct about the error, they must immediately finalize the re-credit to your account. If there was no error, they must present in writing the findings of their investigation, and notify you of any funds they have deducted after you had been re-credited.

What if my ATM card is lost or stolen?

It's important to note the difference in how you will be reimbursed for credit cards vs. ATM or debit cards. For a credit card your loss is limited to $50.

However, for an ATM or debit card the loss is limited to $50 if you notify your institution within 2 business days after the card is lost or stolen.

Keep in mind that the loss could be up to $500 if you do not tell your bank within two business days of the loss or theft.

If you do not report unauthorized transfers within 60 days of your statement being mailed to you, you run the risk of having unlimited loss on transfers made after the 60 days.

Can I use my ATM card abroad?

Yes, there are plenty of ATMs all around the world, but it is wise to check beforehand. With Visa and MasterCard, you can pinpoint ATM locations worldwide on their website.

Often it is a good idea to travel with an ATM card because you can withdraw foreign currencies at a better exchange rate, and also if you lose your card and report it promptly you will not experiences the type of losses you would with cash. Be wary of fees your bank will charge you for each withdrawal - it may be wise to withdraw larger sums to minimize the frequency of transactions.

How do I know when a pre-authorized credit has been deposited into my account?

Your institution may notify your employer, or you. Many times your bank may only notify the recipient if a scheduled credit does not come through. Often, you can check your statement online or call your bank to check on your credits.

How do I cancel a pre-authorized payment?

You can call or write your bank, or often stop the payment by going to your bank's website. Do this at least 3 days before the scheduled payment. It is a good idea to request a written confirmation of giving a telephone notice to stop the transfer.