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Small business loans from your local bank

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I was recently contacted by a restaurant owner looking for financing to help pay for a renovation. They had been doing business for many years with a large lender and had always been profitable. The banker was more than happy to increase their loan to pay for the renovations but would not go one penny past $250,000. Why?

If you've been in business for any length of time you've probably heard about "small business loans." Since 1961, the federal government has had a program in place to help small businesses borrow money from traditional lenders. Today, this program is called CSBFA or The Canadian Small Business Financing Act. Basically, the federal government will guarantee 85% of a loan's value up to a loan value of $250,000.

CSBFA loans can only be taken on real estate, leasehold improvements or equipment and for improvements to any of these. The loan can cover up to 90% of the price of these assets, meaning that a certain level of equity is still required by the borrower.

The application process on the bank's part can be quite arduous, requiring lots of forms and applications. In addition to certain limits on the size of the eligible borrower, the one important caveat of the CSBFA program is that the bank must use it's normal lending criteria in determining whether a loan should be made or not. Did you catch that? The government will only guarantee loans that a banker would make anyway. As a taxpayer, I have to admit that I am a little comforted by this. Otherwise, we might suspect that all kinds of bad loans would be made with the lender knowing that they would simply be bailed out by the government.

During the economic downturn of the early nineties, many, many banks had to come seeking their guaranteed payouts. One banker who was doing commercial loans at the time told me, "they (the federal government) started to get very technical with application details, they would look for any reason they could find not pay the loss on a guaranteed loan." This history of making claims difficult for banks has led many large lenders to unofficially shy away from the program. This is often frustrating for entrepreneurs who know about the program but can't find a bank willing to write the loan.

Recently, changes have been made to the program to allow for capital leases to also be covered. One of the program features is that the CSBFA loans are subject to an interest rate cap. This is no doubt intended to protect the borrower from excessively expensive loans. The downside to this is that it also means that second-tier lenders cannot participate because they often charge interest rates above the government stated cap.

If you have a business opportunity that could benefit from the CSBFA program and you find a lender willing to write the loan, be aware of the fees. The federal government will charge a 2% fee for setting up the guarantee and the bank must forward a portion of the interest to the federal government each year for maintaining it. This is another reason why lenders don't like them. On top of all this, the guarantee does not mean that you're in the clear in case of default. The bank can still ask you to sign a personal guarantee of up to 25% of the value of the loan.

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