



FINANCING YOUR FRANCHISE

Franchisees usually have an easier time borrowing money for their franchise business than do unaffiliated entrepreneurs looking for financing for their ventures. The established trademarks, proven business systems along with the lower default rates of franchises allow the franchisees to capitalize on better business loans.

The U.S. Small Business Administration (SBA) offers competitive rates and longer terms than other sources. Loans are typically made by a private bank or other lending institution, with a portion being guaranteed by the SBA. Some SBA guaranteed loans offer as much as 85% financing for amounts under \$150,000 and 75% financing on loans exceeding \$150,000. For example, if a total start-up package for a franchise is \$150,000, the franchisee may have to put down around \$30,000 and have the remaining \$120,000 financed. It is best that the franchisee come up with the \$30,000 on their own, rather than borrowing it. If they have to pay debt service on the SBA loan and the down payment, chances are the debt service will be too high. Interest rates vary around two to three points above prime rate and the term is usually around 10 years.

Other sources that are not using SBA guarantees are also available. Usually these sources will not require the franchisee to use a home or other personal asset as collateral. The loan is on the business itself and good credit. In many cases these sources can loan up to 80% of the total start-up. The origination fees are usually lower and the paperwork is much easier. The interest rates are usually higher and the term is shorter, usually 5 to 7 years.

Leasing is another option. Some lease companies can lease the equipment and other start-up costs. Leasing is often more expensive money but is much quicker. Your accountant can help you make the decision whether to lease or get a loan.

Sometimes the franchisor will offer financing. Most franchisors will offer assistance in finding a lender but very few of them will actually finance the franchise fee or other start-up costs.

Rather than working with venture capital firms which require some high interest rates, shorter pay back terms and often a piece of equity in the business, it is suggested that family or friends be contacted to invest with you.

Financial Options

<u>Type of Financing</u>	<u>Current Rates Or Expected Rates of Return</u>	<u>Terms</u>	<u>Comments</u>
Equipment Leasing Operating Lease	4%	5-7 yr. Amortization Personal Guaranties- case by case	Good Asset Depreciation to lessor
Equipment Leasing Financing Lease	6-8%	5-7 yr. Amortization Personal Guaranties- case by case	Good Asset Depreciation to lessee
Real Estate/ Sale/Leaseback	8-11% cap rate	Triple net lease Usually no personal Guaranties	Broad base
SBA Debt	Prime rate + 2% (200 basis points)	5-15 yr. Amortization Personal guaranties	Money limited to to owner/operators
Commercial Bank Debt	Floating 250-400 basis points over LIBOR or Prime + 0-200 basis points Fixed 6-8%	Limit on additional indebtedness. Fixed charge coverage ratio. Debt to net worth test. Personal guaranties. Flexible amortization. Broad covenants.	Strong credit
Commercial Finance Company	Floating 300-500 basis points over LIBOR Fixed 7-8 1/2 %	Fixed charge coverage ratios. Limited covenants. Personal guaranties. 5-15 yr. amortizations.	Strong concepts Positive cash flow
Subordinate Debt	12-20%	Warrant position Subordinate security interest. A portion of current interest deferred.	Defined cash flow Reasonable growth
Private Equity	18-30%	Control rights Preferred class	Substantial cash flow
Private Placement	30%+	Minimal IPO rights	Emerging concept
Angels	Undetermined	Minimal	Start-ups