



Gary Webb
RFC® & CEO

In the Press:



Credit Crunch Hits Small Businesses

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Entrepreneurs looking to tap home equity for business capital are facing increased scrutiny from mortgage lenders.

Three years after scraping together \$100,000 from family, friends, and credit cards to bootstrap Zensah (zensah.com), a maker of athletic clothing in Hialeah, Fla., Ryan Oliver wanted expansion capital. He looked where thousands of entrepreneurs have found a ready source of funding - in the value his house. Applying for a \$25,000 home-equity loan, he figured he was a shoo-in. His credit score was 750 out of a possible 850, and his house was appraised for \$650,000, leaving him about \$100,000 in untapped equity. His 15-employee business, which counts among its customers such professional sports teams as the Miami Heat and the New York Jets, had a three-year track record and was profitable.

But three banks - Great Florida, Wachovia, and Washington Mutual - shot him down without

specifying why. "It's almost like they'd created new formulas," says Oliver, 34. No kidding. With the subprime mortgage market imploding and house prices slipping, lenders are making it far more difficult for entrepreneurs to leverage their homes to feed their businesses.

Until delinquencies and defaults began to spike, mortgage lenders were only too happy to write loans against home equity without demanding proof of income. That helped thousands of marginal entrepreneurs, who might not have been able to raise money by other means, launch and expand businesses. In an August survey for Discover Small Business Watch—

(rasmussenreports.com), 30% of respondents said they had used home loans for funding. A 2005 study of small businesses in Tennessee conducted by researchers at Middle

Tennessee State University (mtsu.edu) found that the entrepreneurs who used home equity relied on it for 43.1% of funding, on average.

Today that money is harder to tap. Many lenders who once offered 95% of a home's value to borrowers with credit scores as low as 600 now expect scores of 700 and are capping loans at 80% of property value, says Scott Yonehiro, senior board member of First Security Lending— (firstsecuritylending.com), in Burbank, Calif. "It will be this way for quite a few years," he predicts. In the meantime, business owners are finding alternatives (see below).

Brett Carter, owner of a Denver auto-lube shop, is feeling the pinch. After taking a second mortgage two years ago and using some of the money to buy a \$10,000 lift, Carter, 37, had planned to consolidate the two

mortgages, accounting for 93% of his home's value. But just when he was hoping to close in August, he got a call: The collapse of American Home Mortgage, an underwriter of Alt-A loans, which do not require income checks, was roiling the markets and Carter's bank had pulled its offer.

Unable to refinance, he saw the payment on his first mortgage (an adjustable rate loan) jump to \$1,529 a month from \$1,188. That extra expense, he says, is already crimping his business: "It affects everything, from whether we want to expand or put in another piece of equipment to whether we want to hire another customer-service rep."

Is the tough credit market strangling small business?

The credit crunch hits young, minority, and female entrepreneurs hardest, because they often lack the means to qualify for the best terms. And many own businesses that are difficult to finance; some 69% of woman-owned businesses are service firms, compared with 51% of companies overall, according to the Center for Women's Business Research (cfwbr.org). "There's not a lot of hard assets to claim as collateral for loans,"

points out Maria Coyne, executive vice president at Key-Bank. Without collateral, credit is costlier and harder to obtain.

Wayne State University professor Tim Bates, a specialist in urban economics (wayne.edu), crunched census data from 1992 and found that African Americans were almost 21D 2 times as likely to use credit cards to fund startups as other entrepreneurs. He says the figure is probably higher today.

Proving that there is an entrepreneurial solution for -every problem, however, Zen-sah's Oliver discovered a website that matches businesses with individuals wanting to lend money. Oliver found a three-year, \$15,000 loan at 10.5% interest, a higher rate than a home-equity loan. "But it's better to get it a little higher and get it," he notes, "than to not get it at all." That may become a familiar refrain for business owners.

Alternate sources of capital

If you were counting on home equity for funding and now can't get a lender to help you tap that capital, there are options.

RAID YOUR 401(k). If you have a solo 401(k), you can borrow half the balance, up to \$50,000,

and pay it back over five years, usually at prime plus 1% to 2%, says Randy Carver, president of Carver Financial Services (bullmkt.com) in Mentor, Ohio.

TRY PRIVATE LENDING. Ryan Oliver used lendingclub.com, a website that arranges loans between individuals (see also prosper.com and zopa.com). Rates are higher than for home loans, and fees can be as much as 3%. **Also, says Gary Webb, a financial advisor in Bloomington, MN(webbfinancial.com), you can try friends and family, but "your relationship could be toast."** One way to guard against that is to use a service such as Circle-Lending— (circlelending.com), which manages the repayment of private loans.

SEEK GOVERNMENT LOANS. Many communities have programs to encourage small businesses. "I'd recommend speaking to the city economic-development person and say, 'I want to grow. What can the city do for me?'" says Randy Carver. He has referred several business-owner clients to the Mentor Economic Assistance Corp. (meacoweb.com), which has helped arrange loans for six businesses this year.