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## Government-guaranteed loans often overlooked and misunderstood

**T**here are many financing vehicles available for your business or franchise: bank loans, personal savings, and equity investors. However, there is another highly advantageous source of financing that is often overlooked and frequently misunderstood: the Canada Small Business Financing Program (CSBF). Loans made under the CSBF are guaranteed by the Canadian government. They are available for most new and existing small businesses and franchises across Canada. Since 1961, thousands of small businesses have used this program to obtain financing that might otherwise have been unavailable to them. The following are some tips to help you better understand the CSBF and decide if it is the best financing vehicle for your franchise.

So, what exactly is the Canada Small Business Financing Program? Do not let the long name intimidate you. Under the Canada Small Business Financing Act (CSBFA), the government encourages your financial institution to provide small businesses with a business loan that is partially guaranteed by one or more principals of the business and partially guaranteed by the government.

Under a CSBF loan, personal liability is limited to only 25% of the original loan amount. If your business received a conventional bank loan, you would typically be required to personally guarantee 100% of it. A CSBF loan allows you to put fewer of your personal assets at risk.

From the financial institution's point of view, it is willing to take a smaller personal guarantee in the CSBF program because the government may reimburse some of its eligible losses. Of course, this government guarantee comes at a price, and there are some other factors you need to take into account when considering this type of loan for your business.

### Is the CSBF loan for you?

The CSBF program is designed to help small business owners like yourself expand, renovate, and improve. The CSBF may be a good option if you are:

- ▶ **Purchasing a new franchise**, including the equipment, building, leaseholds, and property;
- ▶ **Improving existing leaseholds**. For example, renovating the kitchen or storefront;
- ▶ **Purchasing equipment**, such as new refrigerators for restaurant franchises or new display units for retail stores.

Keep in mind the CSBF program does not assist your franchise with the financing of:

- ▶ Working capital;
- ▶ Franchise fees;
- ▶ Appraisal and legal costs;
- ▶ Goodwill and most other types of intangible assets; and
- ▶ Inventory.

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### How much money is available to you?

You can receive up to 90% of the cost of eligible assets you are purchasing, with a maximum value of \$250,000. In other words, you may only need to provide 10% of these purchase costs from the business. This low equity requirement is one of the major benefits of the program. With conventional loans, lenders usually require a higher percentage of down payment.

### Does your franchise business qualify?

Most franchise systems will qualify for the program. However, there are some government restrictions<sup>1</sup> including:

- ▶ Your annual gross revenue must be less than \$5 million in the year you apply;
- ▶ You are or will be operating in Canada;
- ▶ The assets you purchased or improved are used in your business; and
- ▶ Your business is not a farm, charity, or religious enterprise.

### How many years do you have to pay it back?

Repayment is related to the life expectancy of your asset, which is up to a maximum of 10 years, subject to other criteria. For example, if you use a CSBF loan to purchase an oven for your pizza franchise and the oven is expected to last five years, you will have five years to repay the loan. On the other hand, if you use a CSBF loan to purchase a new building for your store and expect to operate in the building for 20 years, you have a maximum of 10 years to repay the loan. Your financial institution can arrange a monthly payment plan for you.

### What is the interest rate?

Similar to other types of bank loans, CSBF allows you to choose between a floating and fixed interest rate.

**Floating rate.** Under this option, the standard interest rate is prime plus 3%, of which 1.25% is for insurance paid to the government and the remaining is interest charged by the lenders. This option allows you to repay the loan at any time without penalty. However, your interest rate may change periodically depending on your lender's prime rate. In an increasing interest rate environment, you may end up with a higher interest rate than you had originally planned for.

**Fixed rate.** Under this option, your interest rate is set by your lender at a fixed rate, depending on the type of security and repayment term. With this option, you will always know how

much interest you are paying. However, you may be limited in your ability to repay early.

Some lenders allow you to switch between these two rate options. Make sure you consult prospective lenders about their interest rate options and service plans.

### Are there any hidden costs?

The government charges a one-time loan registration fee, which is 2% of the total loan amount. You can pay the fee up front or include it in your loan amount, provided you do not exceed the maximum of \$250,000. For example, if you borrow \$100,000, your fee will be \$2,000. You can choose to either pay the \$2,000 up front or repay \$102,000 over the amortization period.

### Are there any other security requirements?

Besides the personal and government guarantee, the lender may take security in the property, equipment, or leasehold being financed (similar to other types of business loans). If applicable, lenders may require a copy of the franchise agreement.

### Where do I get a CSBF loan?

Many banks, credit unions, and leasing companies offer CSBF loans. However, not all of them are equally experienced in the process. Look for a lender who has small business banking and/or franchise banking specialists to help you ensure your application process goes smoothly and comfortably. You should also consider a lender with experience in financing your franchise system.

### How do you get the loan?

The approval process for a CSBF loan is similar to the approval process for other types of loans. You will need to provide the lender with personal information, business documents, and franchise information, such as: personal income, historical financial statements or business projections, letter of incorporation, and any franchise agreements.

After your lender approves the loan, funding will be provided based on the presentation of invoices. Upon receiving the completed documentation/invoice, the lender can process the funds in one of three ways:

- ▶ Payment made directly to the supplier;
- ▶ Payment in trust to a solicitor; or
- ▶ Reimbursement of an invoice previously paid by you.

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In the latter situation, you need to provide proof that you have paid the invoice. Examples of proof include a credit card statement or a copy of a cancelled cheque.

#### Are there disadvantages to this program?

Some critics believe the CSBF program has three major disadvantages. Firstly, a CSBF loan usually costs more than a conventional loan. With the government guarantee, you are paying a one-time 2% fee and sometimes a higher interest rate. Secondly, there are strict documentation requirements, such as providing detailed invoices in acceptable formats. Any mistake in documentation and invoice could hinder the lender's ability to claim a loss. Finally, not all financial institutions have the expertise in or are willing to provide CSBF loans. Your neighbourhood financial institution may not be able to provide you with the services you require. Make sure you do your homework before choosing a lender.

To help your CSBF application and funding processes go smoothly, keep the following tips in mind.

- ▶ Ensure that all your franchising documents are accurate. Inaccuracies in the franchise agreement, business-incorporation papers, or invoices can prolong the CSBF loan application and funding process. Consider this: Mr. Smith purchased a new franchise and signed the franchise agreement under his personal name. However, he later decided to incorporate a business and received a CSBF loan under the business name, ABC Inc. Consequently, all of the leases and invoices were signed under ABC Inc. In this case, Mr. Smith must change the franchise agreement to ensure the borrower's name, ABC Inc., is on it. He can also execute an assignment agreement that assigns the franchise agreement to the corporation ABC Inc. This may take a long time, depending on the franchisor's or solicitor's process, and it may ultimately delay funding.
- ▶ Ensure that all your invoices are accurate and contain the required information. The invoices must be in the name of the borrowing business, including its full address. The invoices must also include a detailed listing of the items being

purchased, the number of items, the serial numbers, and/or any services provided. Any missing information or errors will have to be corrected by your suppliers, thereby prolonging the funding process.

- ▶ Remember, items such as the franchise fee, goods and services tax (GST), transaction per second (TPS), share purchase, legal fee, goodwill, appraisal fee, inventory/supplies, and permits and licences are not eligible under the program. Therefore, when you purchase a franchise, you must pay for these fees and costs with other funds.
- ▶ Some franchise systems require payments on a turnkey basis. This will reduce the number of advances required. Make sure your lender is aware of any turnkey requirement.
- ▶ The 180-day rule: When determining the total loan amount, you can include all your eligible costs made within 180 days prior to the day on which the loan is approved.

For more information, contact your Small Business Advisor, or call Industry Canada at (888) 576-4444 or (866) 959-1699 or visit its website at [www.ic.gc.ca](http://www.ic.gc.ca). ●

1 Additional government requirements exist.

*For all your small business banking needs, please visit your local branch or [www.tdcanadatrust.com/smallbusiness](http://www.tdcanadatrust.com/smallbusiness)*

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