



Debt Consolidation & Reorganization

HOW TO STRENGTHEN
YOUR BUSINESS THROUGH
SBA'S 7(A) PROGRAMS

*By Milton Talkington, Contributing Editor and
Michael J. Gordan, Omni-Funding*

In today's economy it is important to manage debt appropriately in order to conserve or increase cash flow which can be used to put back into a business for future growth. All too often business owners abruptly jump into debt simply because they have to. In this article we will discuss when consolidating and reorganizing is the right choice and which types of debt should be consolidated. We will also discuss ways to achieve that consolidation and reorganization through effective avenues such as the SBA's 7(a) programs.

When thinking about consolidating or reorganizing debt, there are a few key questions to ask yourself:

- What are my current rates and terms?
- What savings will I realize?
- How much will my monthly cash flow increase?

- What types of debt should I consolidate?
- When does it make sense to lengthen the term on a debt?

It is important to manage debt in order to conserve or increase cash flow to put back into a business for future growth.

- What is the proper term at which to consolidate particular assets or debts?
- Are there currently any prepayment penalties on the loans I wish to consolidate?
- Is there a balloon payment coming due on my commercial mortgage in the near future?

All of these questions should play a role in making the proper decision for your particular situation and will now be discussed in more detail.

WHEN DOES CONSOLIDATING AND REORGANIZING DEBT MAKE SENSE FROM A SAVINGS STANDPOINT?

The general rule of thumb is that a business owner should realize 10%-20% savings over their current debt outlay or expenditure. For example, if your

the old must create a cash flow savings of at least 10%. In the past this rule was set at 20% but has been temporarily lowered by recent programs. Currently it is uncertain if or when the percentage may increase again. There are also other situations, such as balloon payments or adjustable rate mortgage situations, which would supersede the savings rule and make any loan qualify. Consolidating and reorganizing should make sense from a dollars and cents perspective, and the analysis of this is a key first step in deciding the advantages of doing so.

WHICH TYPES OF DEBTS MAKE SENSE TO CONSOLIDATE, AND WHAT IS THE PROPER TERM TO CREATE ON THOSE DEBTS?

We are going to concentrate on three different types of debt for this topic. The first will be Mortgages, Real Estate Loans and Seller held Notes; the second will be Equipment Loans and Leases; and the third will be Loans or Lines which were used for Operating or Working Capital. All, one, or a variation thereof can be included in any successful plan of consolidation and reorganization.

Mortgages, Real Estate Loans, and Seller Held Notes are the most commonly refinanced debt and the anchor for most major consolidations and reorganizations. It is generally advantageous to refinance them due to the long-term nature of the assets associated with these types of financings such as Commercial

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current monthly debt payments total \$10,000.00, you would want to lower the outlay to between \$8,000.00-\$9,000.00 per month, possibly lower. Meeting this minimum savings will not only insure your time and cost of consolidating is not wasted by giving you a quick return on your investment but will also qualify you for one of the many programs the SBA has to offer. When using an SBA program to consolidate debt, the SBA has certain savings requirements that must be met. The current requirement is that the debt taken on to consolidate



Real Estate, Buildings, Land and Business Acquisitions. By putting a long-term solution in place, you are likely to better your position from a cash flow standpoint, not only by reducing rates and getting a proper term, but by avoiding the future expenses of refinancing due to balloon payments that usually coincide with non-SBA type mortgages or debts.

use of funds should play a major role in that decision. For example, if a line were used for improvements to a long-term asset such as a building or large piece of equipment, it makes sense to extend the term on that note to the length for which the asset may be used. On the other hand, if the monies were used for general operating expenses which were

bank loans. What this means is that we can structure the SBA Loan in a way which makes sense for all of your different types of debts. For example, in a blended term situation we are able to put your Mortgages, Real Estate Loans, and Seller Held Notes in one bucket at a 25-year term, while taking your equipment at a 10-year term and your other

WHEN DOES IT MAKE SENSE TO CONSOLIDATE AN EQUIPMENT LEASE OR LOAN?

The answer to this topic is much the same as the previous. There are a few added mitigating factors such as the effective life of the equipment and whether or not if a lease, that lease can be terminated at a discount. Generally you should not extend the term of financing on a piece of equipment past its probable useful life. If you can reduce rate and create a favorable term based on the life of the equipment, then it makes sense to consolidate and reorganize barring any outside factors such as prepayment penalties.

WHEN DOES IT MAKE SENSE TO REFINANCE LINES AND LOANS WHICH WERE USED FOR OPERATING AND WORKING CAPITAL?

Generally it makes sense to refinance any debt if there is a rate reduction, but that line becomes less clear when discussing the proper term at which to consolidate. When discussing the proper term, the

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short-term such as payroll, supplies, office expenses, etc., it may not make sense to extend terms.

There is one factor for which it would make sense to extend terms on such a debt. In the case of a high interest credit card or interest payment only line of credit, if your current cash flow only affords you the opportunity to make the minimal payment and term will most likely be indefinite, it does make sense to group these debts into the consolidation process. If the rate is more favorable, this will force you to terminate those debts which may remain forever if not put into a term.

The advantage of using an SBA 7(a) program when discussing the consolidation and reorganization of the previous three types of debts for any business is that they allow you to create a blended term and include all your debts into one pool creating one loan. This is not typically the case with traditional

outlying debt from Lines and Credit Cards at a 5-10 year term, depending on their uses. This insures that you are not extending debts to terms they should not be extended to and that you are making the proper decision for your business. We are able to accomplish this while simultaneously providing one monthly payment to one bank, therefore minimizing your administrative duties with regards to paying multiple different payments to multiple different lenders/creditors.



TWO ACTUAL EXAMPLES WHICH INCLUDE ALL ASPECTS OF WHAT WE HAVE SHARED THUS FAR:

Example 1

Center for Arthritis, an arthritis clinic specializing in Rheumatoid Arthritis Treatment came to us with an important question, "We have \$30,000.00 plus going out in debt service per month which is creating an inability for us to grow and may even put us out of business. Can you help?" The answer was yes. First let's go over the general makeup of their debt.

They had \$449,250 mortgage with a balloon payment due and rate of 8.5%, various lines of credit and credit cards totaling around \$78,000 with rates ranging from 9%-24%, an equipment loan for an X-Ray machine of \$208,000 at 11%, and a vendor held note of approximately \$340,000 at 15%, bringing the total amount to be consolidated to \$1,075,250 with monthly payments in excess of \$30,000. We were able to reorganize and consolidate all of these debts in to one SBA 7(a), include all fees, and give them \$60,000 in working capital for a loan totaling \$1,150,000, all while reducing their monthly payments to \$7,234.72.

With a reduction in cash outlay of over \$22,000.00 per month they were able to add to their bottom line, grow the business, hire more employees, pay down the debt more quickly, and create many more great opportunities for their business.

Example 2

A Medical Spa came to us with a similar situation. The owner had years ago purchased a building. She had wanted to do some improvements to the property at the time of purchase, but at that time the business cash flow would not support the additional funds needed. Consequently, the bank would not help, but she took the mortgage and building anyway, determined to make it work. Over the next few years she ended up taking out both a second and third mortgage on the property to obtain a Line of Credit and eventually started using credit cards to make the improvements. While the first mortgage of \$660,000 had a great rate for that time, at about 7%, the subsequent lines and credit cards had rates ranging from 11% up to 29%, totaling \$576,000. The combined payments on all these debts were around \$20,000 per month. She came to us hesitantly as she had several dealings with lenders prior to talking with us and all went negatively. When I saw the transaction and put the numbers together, I could not understand why. The cash flow was there, the assets/collateral were there, the business was growing, everything a bank looks for, right? The problem was not the numbers but the way they were packaged, presented, and explained to the bank. While she was knowledgeable at running her business and doing what she does best, she lacked experience in financing, accounting, etc. Sometimes when a business owner does not have the experience or the time to deal with these situations correctly, it makes sense to
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EXAMPLE 2 (CONT'D)

bring in an outside professional to help. We deal with these situations on a daily basis, just like you deal with your business on a daily basis. We were able to put together a concise, well thought-out package with a great write-up and explanations for the bank and put a bank offer in front of her within 48. The end result was a loan for \$1,250,000 at a payment of \$7,863.83, a savings of over \$12,000.00 per month. Now this client, unlike the first, was still operating comfortably and did not really have a dire need to reorganize and consolidate, but why wouldn't she? \$12,000.00 per month or \$144,000 per year is a lot of money, which if used properly can create tremendous opportunity.

She could have increased advertising, hired more employees and grown; she could have stayed the same size and paid off the debt more quickly as there was no prepayment penalty; she could have increased benefits and salaries for employees, and so on.

While both these situations seem uncommon and an immense savings, these types of scenarios occur more often than most would think. It is quite common to reduce payment by 20%-50% and in fact seems to be the norm in our business society today.

These are just two of thousands of great examples out there of how often business owners can take on debt during the course of business and create problems in the future. These actions, however, are completely understandable. A business owner today has to do whatever it takes to stay in business, succeed, and grow. Many times this means sometimes taking on debt that does not make sense due to a lack of capital and worrying about it later. The lesson here is that, even when this occurs or when debt is forced upon a company to gain assets or items they need, those effects are reversible through effective analysis and good future planning.

All too often we focus on sales and expenses but not the debt we take on and the way it can be organized to both better our cash position and balance sheet while making our business both be stronger and look stronger for future growth. Every business, large or small, owes it to itself to do an analysis or contact a professional that can help with an analysis to see what positive effects a debt reorganization and consolidation may have on them. The time it takes to do so is minimal compared to the advantages and savings that can be accomplished for many years to come. If it does not make sense to consolidate or reorganize, at least you have the confidence in knowing you are currently in the best position possible for your business. **TTI**



About the Author

Michael J. Gordon has been an Operations Manager for Omni-Funding for three years and specializes in the consultative services for SBA and USDA programs developed to meet the needs of today's businesses. Mr. Gordon is also Managing Partner in Leader Capital Group, a partner of Omni-Funding specifically developed to provide services for clients with regards to Government Loan Programs. Mr. Gordon previously worked at US Bank for six years as a Business Banking Officer specializing in Commercial Financing, SBA, and USDA. Mr. Gordon graduated in 2000 from The Ohio State University with a Major in Finance and a Minor in Accounting. You can contact him directly at mgordon@omni-funding.com