TOLL FREE CUSTOMER CARE 1-800-880-0349
CUSTOMERCARE@GARRTECH-GROUP.COM
WWW.GARRTECH-GROUP.COM/FUNDING

GARRTECH FUNDING – YOUR EQUIPMENTS LOAN APPLICATION CHEAT SHEET

No matter what industry you're in, you'll probably need to purchase equipment regularly—whether that's office furniture, commercial gas stoves, or heavy-duty machinery. Maybe you're expanding your business, or maybe your computer is malfunctioning and needs to be replaced.

New equipment costs money, and although it might bring you more cash in the long run, it can be impossible for many small businesses to afford upfront purchases of equipment just when they need it. And trying to run a business without up-to-date or functional equipment is a disaster waiting to happen for your customer loyalty, making it difficult to increase revenue—a classic case of needing money to make money.

Luckily, most lenders offer some type of equipment financing—a specific financial offering where the equipment you need to purchase is used as its own collateral. A lender usually makes the purchase on your behalf, then lets you use that equipment even before you've fully paid for it. This usage can take the form of a lease, meaning that you don't own the equipment, or a loan, meaning that you do. Both have their upsides and downsides, and the right choice for your business depends on your specific equipment needs.

The application process for equipment financing is actually easier than the one for traditional loans—and we'll explain why in a minute—but we'll take you through it anyway, explaining all the requirements you might run into and what you can expect from your application.

What Is Equipment Financing?

First, let's figure out what exactly equipment financing is, and whether this kind of financing is right for your business.

Loans vs. Leases

When it comes to equipment financing, the major difference you need to understand is between loans and leases.

A **loan** is a lot like a traditional small business loan, except that you're using the borrowed equipment as collateral—instead of a personal asset, like your house or retirement fund.

A **lease**, on the other hand, is pretty much no-strings-attached. In terms of the equipment you've secured: you use it and lose it. (Unless you then decide to buy it, which is also an option.)

An equipment loan application is a little more complicated than an equipment lease application. The lender might ask you to make a down payment of a certain percentage of the loan's value, or they might want to file a blanket lien against your property to secure the loan. (Remember that a lien is a legal contract allowing a lender to seize some portion of your assets in the case of default. Blanket liens are liens that don't target a specific asset, which gives a lot more protection to lenders than to borrowers.) Alternative lenders are much less likely to place liens on your property than traditional banks are in the case of equipment loans, though!

At the end of term for a loan, you'll own the equipment, which can be a positive or a negative—depending on whether or not you still want that specific piece of equipment. At the end of a leasing term, you won't own the equipment at all— you've just been paying for the privilege to use it.

For both loans and leases, you'll end up spending more over the long term than you would if you were able to just buy the equipment upfront, because of that interest you'll have to pay. For example, if the equipment you'd like to purchase costs $10,000 and you've taken on an equipment loan at 12% APR for a term of three years, you'll wind up paying $11,957.15 over those three years instead of just the $10,000 right away. On the flipside, you can afford more or better equipment sooner than you'd be able to otherwise—and, ideally, the payoff would more than make up for the interest payments you'll be making.

When deciding whether to take on a loan or to lease equipment, there are two main questions you should consider:

1. How long will you be using this equipment for?

A lot of equipment, especially technology, isn't going to be useful for more than a few years. Think about computers—do you really want to have the same computer around ten years from now? If the type of equipment you're dealing with upgrades often, a lease might be a better option. The worst-case scenario for an equipment loan is if the equipment becomes useless and outdated before you've finished paying for it, which will get you stuck making monthly payments for something you no longer want or need.

Another consideration to think about: if you'll need the equipment in the long term. Equipment that's only necessary for a short-term project should be leased, not bought. For example, if you want to take on five temporary employees for a project and you have to give them desks, chairs, and computers, you don't want to end up owning that equipment unless you're planning to use it again in the future. That would be like buying a car instead of taking a taxi.

William G. Sutton, the president of the Equipment Leasing and Finance Association, suggests in IMPO magazine that the maximum term for a lease should be about 36 months. If you lease for longer, you may as well just have taken out a loan, at the rate you'll be paying.

The exception is for loans with trade-in options. These loans let you trade in that equipment for the newest model after a certain amount of time has passed. You're really leasing the utility of the equipment, not the piece of equipment itself—and that can be a big difference to your business.

2. How's your business's cash flow?

Equipment loans often require a down payment, so if you're a brand new business with a tight cash flow, leasing might be your preferred option. Leases will also often cover part of the "soft costs" like taxes, delivery, and installation.

Credit scores matter... But less than usual

Compared to traditional term loans, equipment loans are much easier for business owners with fair to okay credit scores to secure. Because the equipment itself acts as collateral, lenders aren't as concerned with how "risky" of a borrower you are. Asset-based lenders look to the future—what you can get from that equipment—instead of the past—how you've acted as a borrower before.

The specific requirements depend on the lender, but generally speaking, lower interest rates get paired with higher credit scores and annual revenues—just like with traditional term loans.

Plus, equipment loans are a good way for businesses with low credit to increase their scores and for all businesses to increase their net worth. In other words, taking on an equipment loan and then paying it off will make it easier for you to get financing down the line, whether that's a line of credit, a term loan, or another equipment loan.

The best term length for an equipment loan

Bruce Morse, Regional Director of the Wyoming Entrepreneur Small Business Development Center, suggests that you should match the length of your term to the length of time that you'll be using that equipment. If you try to pay off the loan sooner, your payments could become too high and tie up your cash flow. On the other hand, if you take too long, the equipment could become outdated, leaving you in that sticky worst-case scenario of spending money for obsolete equipment.

Equipment loan terms usually fall between 6 months and 10 years, depending on the type and life span of the equipment.

Payment schedules

Lots of alternative lenders offer flexible repayment schedules for equipment loans, which is a great opportunity to make sure that you don't run into any cash flow problems. You can sometimes opt to push off your first payment for 90 days, so if your finances stumble a little from your temporary lack of equipment, you'll have time to recover.

You can also choose how often to make your payments—for example, monthly or quarterly—and every payment will be the same, making it simple to work these loans into your budget.

Tax benefits

There's a secret bonus to taking out equipment loans: they often have pretty great tax benefits!

Payments for an equipment loan are usually tax-deductible as operating costs, according to Section 179 of the IRS Tax Code, which states that a business can deduct the full purchase price of financed or leased equipment as long as it's being put to use during the year of the deduction. The amount you end up saving in taxes can be a significant help to your cash flow and might make those loan payments much more manageable.

You should check in with both your lender and your tax accountant about whether or not your equipment loan would qualify for this deduction. (And for true leases, you can claim the entire lease payment as a tax deduction!)

The Application Process

Now that you understand a little more about equipment loans, let's talk about the application process.

For most business loan applications, you need to assemble a mountain of paperwork to convince the lender that you're a safe bet. Personal and business credit reports, income tax returns from the past few years, and bank statements are almost always non-negotiable, and depending on the loan, the lender might require even more documents: articles of incorporation, business licenses, personal resume, business plan, collateral documentation, and more.

Of course, as a responsible business owner, you should have all of this ready to go. It'll make your life—and your tax accountants and lawyer's lives—much easier if you're in the habit of keeping neat, up-to-date statements and records on file.

Still, if your pizza oven breaks and you're trying to serve a crowded restaurant full of hungry customers using a microwave, you need that loan fast. And assembling a picture-perfect loan application isn't always easy to do in a short time span.

SBA Equipment Loans

An SBA equipment loan through the CDC/504 Loan Program offers some of the best interest rates around—just slightly above the US Treasury market rate, so think single digits—but they also require the most paperwork and highest credit scores. You'll have to demonstrate a solid cash flow, present statements explaining your personal history and your business plan, include a resume that shows off your business expertise, and detail your financial history.

Because SBA loans are a governmental program, they require the most exhaustive and thorough documentation—it's a time-consuming process. This can be pretty frustrating if you need that new equipment as soon as possible.

The Alternative Advantage

Fortunately, many alternative and online lenders don't require you to submit that much paperwork in order to receive equipment financing. Since the equipment itself acts as collateral for your loan, they're not too concerned with how trustworthy of a borrower you are or how impeccable your credit score is. If you default on your loan, they'll simply take the equipment back. (The exception to this is if the equipment has depreciated in value since you first borrowed it, in which case you might have to pay the difference between the remaining principal of your loan and the current value of the equipment.)

Alternative lenders like Funding Circle, for example, offer similar rates but require even less documentation. Some alternative lenders only require your business's bank statements and details about the price of the equipment. Others might ask for tax returns.

However, your business finances still need to be pretty solid, much like for an SBA loan. Business owners applying for an equipment loan through Funding Circle need to have a credit score of at least 620, and must have been in business for two years, to qualify.

Personal Guarantees

In general, assume that even alternative lenders will want you to sign a personal guarantee. A personal guarantee will let your lender chase after your personal assets if you can't pay off the loan and if taking back the collateralized equipment itself won't cover the full amount you owe.

Banks offering equipment financing will probably file a blanket lien on your business, but alternative lenders are much less likely to do so. That's the advantage of the equipment itself: it makes the lender feel a lot more secure about that loan.

Exploring Other Options

If you need funding right away, or if your credit score isn't so rosy, you can apply for a working capital loan instead of an equipment loan. Some alternative lenders, like OnDeck and CAN Capital, don't offer equipment financing—but their working capital loans can be used for equipment. Their requirements are looser than those of banks and other lenders offering equipment financing: OnDeck, for example, requires a credit score of only 500 and a time in business of greater than one year. The application process for a loan through OnDeck is much shorter and simpler than the process for other lenders, needing much less personal and financial information, and the funding can be ready for you in as little as one day.

These types of quick, accessible loans can be great options, but be aware that fast money is usually expensive money. Interest rates can be very high—so if you have more time to spare and a solid business history, this isn't the way you want to go. Loans like these are best for small equipment purchases that can get paid off pretty quickly so you'll only need a make a few high-interest payments.

In general, expect your interest rates from an alternative lender to range from 15% to 30% for an equipment loan.

If you default

Unlike with other loans, you often won't need to put up any extra collateral for an equipment loan—so defaulting won't be catastrophic for your finances. You're not going to lose your personal assets or be forced to work out a high-stakes payment plan unless there's a significant difference between the current value of the equipment and the amount remaining to be paid on the loan.

The exception here: if the lender placed a blanket lien on your assets, in which case they are legally allowed to chase after your assets to recoup the full value of the loan. That's why it's best to comb through the fine print of your loan agreement and seek professional advice if necessary when taking out a loan!

On the other hand, as with all loans, the default will show up on your credit report and your score will drop. Even if defaulting on an equipment loan might not be as destructive as defaulting on a traditional term loan, it's still far from ideal—take pains not to enter into loan agreements that you won't be able to honor.

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If the reason your small business needs a loan is to purchase new equipment, then you're in luck, because equipment loans are some of the safest and easiest loans to get. They're also highly likely to make your business more profitable, so those monthly payments won't be such a squeeze—and don't forget that they're tax-deductible!

Consider the ideal amount and length of your equipment loan when you're comparing options, and make sure to have a clear picture of your business's finances so that you can find the best option for you.