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Taking on Debt for All the Right Reasons

Borrowing Money can be a Smart Solution

Many of us who grew up in the 1960's and 1970's were taught not to rely on credit, but rather to pay cash whenever possible. Certainly, avoiding debt can be good advice, however, borrowing money can also be a smart solution under the right circumstances and for appropriate reasons. It can even help pull an organization through a tough financial situation.

When Does Borrowing Make Sense?

Emergencies and unforeseen problems happen. Roofs leak, donors pull away, fund-raisers are canceled and grant money can take weeks or months to arrive. A loan can be a quick source of cash for handling these types of unanticipated situations.

Borrowing for short periods can also stabilize cash flow and help keep your organization running smoothly. Frequently, nonprofits must bridge the gap between a project's startup and its ongoing program revenues. Other times, an organization's need for funding may not match a funders' grant schedules. Still other organizations require a line of credit in order to assure a steady source of cash between billing and collection.

Taking Advantage of Opportunities

A capital purchase is another situation when borrowing money may be justified. For example, in the case of a major equipment breakdown, taking on a loan for "big ticket" capital purchase can provide an immediate source of cash that can be repaid over time. It avoids the time and cost involved in writing and waiting for a grant and it keeps you from depleting your carefully built cash reserves.

Non-profits also occasionally need to take advantage of an opportunity. A local food pantry, for example, has an opportunity to start a hot lunch program and will receive funding based upon the number of meals served. However, to meet health department requirements, the pantry must purchase a commercial stove. This could be an opportunity of a lifetime that could expand the organization's income and diversify its services. Financing can make it all possible.

Obtaining Financing

Banks are still the primary source of loans for nonprofits, so it's always a good idea to build a relationship with a banker who understands your industry. And in larger banks you're apt to find associates who specialize in services to nonprofits.

However, you may also be able to find a low- or even no-interest short-term loan program in places other than banks. Some community-based foundations provide funds that allow nonprofits to continue operating until they receive contract monies. The Cash Flow Loan Program, created in 1976 by the Fund for the City of New York, is the granddaddy of them all, but there are many others.

How Can You Secure a Loan?

Applying for a loan doesn't require any more time or skills than writing a grant or contract proposal. In fact, it may be easier. But you must demonstrate your ability to repay.

First, apply at the right time: Your chances of negotiating are better when you're in a position of financial strength. Consider establishing a line of credit with a local bank when you *don't* need to draw on the funds.

When talking to the banker, be specific about how the loan will be used. Thoroughly describe the proposed project, your readiness to launch the project and its timing. Be prepared to specify the amount you need to borrow and the date by which you'll need the loan.

What Will You Need to Provide?

Come prepared for your meeting with the lender. Be ready to present your organization's budget, a current and accurate statement of financial position, prior statements of activities, cash flow projections and an annual report if you have one. Bring resumes or biographies of your executives and board members so that the bank officer can judge the management strength of your organization.

To protect their interests, banks may expect you to secure the loan with collateral, which is generally based on contracts and accounts receivable. But they also may require assets such as unencumbered real estate, automobiles or equipment. You may need to produce cash collateral from board members, supporters or constituents, and ask them to place money into a special interest-bearing account, which is then pledged to the bank. Alternatively, the bank may ask you to have a co-signer or guarantor for the loan.

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If you have any questions, please feel free to contact your Seiler professional at (650) 365-4646 or email info@seiler.com. We would be happy to discuss appropriate courses of action for your particular circumstance.

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