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Term Loans, Lines of Credit Can Finance Business Expenses

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When a business needs to buy expensive equipment and doesn't have the operating cash to buy it outright — or doesn't want to commit liquid assets to such a big-ticket item — the owner will often approach a bank for financing. The same is true when a business has cash flow shortfalls because its inflows and outflows are out of sync.

Most banks have commercial lending departments that can offer the business a loan to finance equipment purchases or cover short-term obligations. Two of the most common loan types are term loans and revolving lines of credit. An experienced commercial banker can help the business decide which loan is most appropriate for its situation.

Term Loans

With term loans, the bank advances a specific amount of money and requires the business to pay it back over a defined period. Such a loan is typically structured with the bank contributing 75 percent of the cost and the business committing 25 percent, though the percentages can vary depending on the type of equipment being purchased.

The bank sets the maximum repayment schedule to be slightly less than the useful life of the equipment. For example, if the business wanted a new machine that should last for seven years, the bank may offer a five-year term to ensure the loan is paid off before the collateral has zero value.

Rates and fees for a term loan can vary depending on the business's relationship with the bank and the financial strength of the company. A company is likely to secure better interest and repayment terms with a bank where it maintains a checking and savings account or has previously borrowed money than it will from a bank it has never done business with.

Revolving Lines

Companies use revolving lines of credit to fund working capital needs when their revenues and expenses are on different schedules. For example, a company's income could be operating on a 60-day cycle, but the business might have bills to pay every week or month.

Banks typically secure revolving lines of credit with a lien on the business's assets; this is called a UCC (Uniform Commercial Code) filing. A UCC filing can be taken on the business's equipment, furniture, fixtures, equipment, inventory, accounts receivable, intangibles or other assets.

Unlike a term loan, a revolving line of credit is not paid back over a specified period but is drawn on and paid back under loan terms that accommodate the business's cash flows. A business might draw on a line of credit to fund its accounts payable and payroll obligations while it is waiting for a receivable to be paid. Once the receivable arrives, the business uses the funds to pay off or pay down the line of credit.

Lines of credit should not be used to finance long-term working capital or equipment purchases. If they were, businesses would find themselves continuing to pay for equipment that is obsolete or useless.

While term loans and revolving lines of credits are among the more common types of commercial loans, most banks can tailor financing to a business' specific needs. For more information about business loans, visit http://lanb.com/Business-Banking.aspx.

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