Explore Your Options

Many Alternative and Supplemental Financing Sources Exist for Business

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So, you're looking for financing for your business to allow it to remain viable through these difficult and volatile economic times. But you find that all your traditional sources of financing have dried up. What can you do, and where can you look for such needed funding?

There are several non-traditional avenues of obtaining needed business capital that can be complementary to any existing financing that you may already have in place for your business. These alternative sources may include quasi-public bond financing, several federal and state tax-credit programs, and private financing. They each have certain advantages, but in order to receive them, you must relinquish something in return.

In the area of quasi-public bond financing, the Mass. Development Finance Agency (MassDevelopment) has a number of available programs that can be utilized to provide financing for both for-profit and not-for-profit business entities. For example, tax-exempt bonds, which are exempt from federal taxes and, in certain cases, state taxes, can provide the lowest-interest-rate option for certain types of projects, including real-estate development and new equipment purchases. In better economic times, these bonds were traditionally bundled into large-denomination packages and sold on Wall Street to institutional investors.

The more likely scenario in today's marketplace is that such bonds would be purchased directly by your company's current bank or possibly another area financial institution. The fact that the interest income received by the holders of these bonds is exempt from federal and (in many cases) state tax allows for a lower-than-market interest rate to be offered, which, depending on the amount of such bonds, can provide a substantial savings over the life of the bond.

According to information contained on MassDevelopment's Web site, such financing must be eligible for tax-exempt financing under the federal tax code, which can include 501(c)3 nonprofit real estate and equipment, affordable rental housing, assisted living and long-term-care facilities, public infrastructure projects, manufacturing facilities and equipment, municipal and governmental projects, and solid-waste recovery and recycling projects.

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Additionally, MassDevelopment has other available loan and guaranty programs, as well as specialty programs, that include financing for companies that either currently export or will be exporting their products or services internationally, and technology companies that may be commencing or expanding their business operations in Massachusetts; visit the Web site for further information.

A second alternative source of non-traditional financing is in the area of available federal and/or state tax-credit programs, which are available for certain projects and industries. For example, Low-income Housing Tax Credits (LIHTC) are dollar-for-dollar tax credits benefiting developers undertaking affordable-housing investments. This program was created under the Tax Reform Act of 1986, which provided incentives for the utilization of private equity in the development of affordable housing aimed at low-income Americans, and it accounts for the majority of all affordable rental housing created in the U.S. today. Tax credits are more attractive than tax deductions because they provide a dollar-for-dollar reduction in a company's federal income tax, whereas a tax deduction provides only a reduction in its taxable income. In Massachusetts, LIHTCs are administered by the state Department of Housing & Community Development.

A second type of tax-credit program that has seen increased activity over the past several years is the New Markets Tax Credit (NMTC) Program, which was established in 2000 as part of the Community Renewal Tax Relief Act of 2000. The goal of this tax-credit program is to spur revitalization efforts of low-income and impoverished communities across the U.S. The NMTC initiative provides tax-credit incentives to business investors for equity investments in certified Community Development Entities, which have a primary mission of investing in projects located in low-income communities. The scope of the NMTC program can include the development of projects that could provide funding for project components, including real-property acquisition, building construction, and machinery and equipment purchases.

A third type of tax-credit program, which has provided fertile ground for available alternative financing, is the Federal Historic Preservation Tax Incentives program, which has been the largest, most successful, and most cost-effective federal community-revitalization program in recent memory. It seeks to preserve historic buildings, stimulate private investment, create jobs, and revitalize communities. This program has leveraged more than $58 billion in private investment to preserve and reuse more than 37,000 historic properties nationwide since 1976. This program is administered by the National Park Service and the Internal Revenue Service in conjunction with the Mass. Historical Commission.

Each of the above programs can provide either needed alternative financing or real incentives that will attract the necessary funding to undertake various types of projects. These projects, by their very nature, will generate activity for a multitude of allied businesses, such as general contractors, subcontractors, equipment vendors, insurance agents, accountants, attorneys, appraisers, and so on.

Finally, a company can seek the infusion

of private capital, which will generally be provided as a mezzanine-type loan or equity investment. Depending on the nature of your business, you can seek out and, in many instances, obtain a private investor or group of investors that will provide what is essentially a commercial business loan normally secured by a junior lien position on certain specific collateral behind the company's primary senior lender. Since taking a junior position results in a greater degree of risk for such investors, the rates of interest charged on such credit facilities is generally higher than a commercial business loan from a conventional bank lender, and any applicable financial covenants are more stringent.

Alternatively, such a private investor may elect to contribute its funds by way of an equity injection into your company so as to provide additional working capital, in return for which the investor will require an equity/ownership interest in the company. This equity interest may require certain perquisites, such as a preferential return on its investment to be made prior to any distribution to the holders of non-preferential equity interests; or perhaps take the form of a stock option, which will allow the investor, in its discretion, to convert such options to an equity/ownership interest at a future date; or an option whereby the investor has the right to require the company to repurchase its equity/ownership interest at a time of its choosing, based on an agreed-upon repurchase price formula.

The bottom line in undertaking such private financing is that it traditionally results in your relinquishing a certain degree of sovereignty in your control of your company.

One final suggestion is that, while it behooves you to research and fully evaluate any number of possible sources of alternative financing, once you have determined which you feel would be most beneficial for your company, you need to ask for it. Many times, business owners are reluctant to initiate a request for credit based on what they perceive are insurmountable obstacles to obtaining a favorable response, when in fact many such alleged obstacles may be able to be satisfactorily addressed and overcome by working in concert with professional advisers who can provide you with sophisticated counsel and bring both creative and fiscally responsible alternatives to the table. ■

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