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Financing Your Small Business *How to Borrow Money from People You Know*

By SCORE and Circle Lending

The national SCORE Association is a nonprofit organization dedicated to entrepreneur education and the formation, growth and success of small business nationwide. SCORE Portland is one of 389 chapters throughout the United States, with over 11,000 volunteers nationwide. SCORE is a resource partner of the U.S. Small Business Administration.

SCORE Portland Maine <http://www.scoremaine.com>



Financing Your Small Business

Second Edition



How to Borrow Money from
People You Know



SCORE[®]
Counselors to America's Small Business

**Circle
Lending**SM

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About CircleLending

CircleLending provides a full range of services for reducing the financial risks, administrative hassles, and emotional pitfalls of interpersonal loans between relatives, friends, and other private parties. Based in Waltham, Massachusetts and serving clients nationwide, the company is widely regarded as a pioneer in the financial services industry for its innovative work in private lending.

CircleLending provides everything needed to agree on terms, close the deal and repay the loan. This includes document preparation services, customized repayment schedules, and electronic billing and payment collection. We also provide year-end tax statements, UCC filing, real estate closing services, escrow administration, loan restructuring, and web-enabled payment tracking. CircleLending handles a wide variety of private loan types for its clients, including personal loans, business loans, private mortgages, and seller-financing transactions.



About Score

SCORE-"Counselors to America's Small Business"-is a source of free and confidential small business advice to help build businesses, from idea to start-up to success. Headquartered in Washington, D.C., SCORE is a nonprofit association dedicated to entrepreneurial education and the formation, growth and success of small businesses nationwide. SCORE staff and volunteers provide the following services for entrepreneurs: a resource-rich website, face-to-face small business counseling, and low-cost workshops at 389 chapter offices around the country.

About This Guide

This guide has been written by CircleLending, Inc. with the intent of providing useful information, tips, and strategies to individuals who are considering a private business loan. The guide assumes a basic level of understanding of the terms, processes and documents involved in business financing, and generally does not attempt to define or explain these items.

Raising business capital from family, friends and associates is an entrepreneurial tradition shared by the smallest home-based business owner and the most successful corporate superstar. Here's why: by borrowing from people you know you can access a source of business capital that is affordable, available, flexible, and that doesn't require a credit check. Certainly, there are emotional pitfalls to these transactions, as well as financial risks and administrative requirements. But that's why we're here.

To maximize its value to you, we have tried to ensure that this guide is not a sales brochure for CircleLending. However, we have also not been shy about pointing out the benefits of involving specialists to ensure that your private business loan is a success.

For more information, read on, visit: www.circlelending.com or call **800.805.2472**

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Table of Content

Title	Page
Why a Private Business Loan?	1
Approaching Potential Lenders	4
Formalizing the Loan	7
Addressing Common Borrowers' Concerns	11
Frequently Asked Questions	12

DISCLAIMER:

Significant time and effort has been put into making this guide as accurate as possible. However, there may be mistakes both typographical and in content. The materials in this guide should therefore be used for general guidance and informational purposes only. Every transaction is unique and may have circumstances that are not addressed by the materials in this guide. Any questions about your specific loan transaction, its unique circumstances or any recent changes to the laws of your state that might affect your loan should be directed to a licensed legal or real estate professional in your state. CircleLending is not a law firm and does not provide legal advice or tax advice. Use of these materials to formalize your loan does not guarantee that the outcome of your loan will meet your individual needs and expectations. The information contained herein is the sole property of CircleLending, Inc., and may not be reproduced or redistributed for any purpose without the express written consent of CircleLending, Inc. All Rights Reserved. Copyright © 2006.



Why a Private Business Loan?

Before you dive into asking people you know for money its worth taking a few minutes to make sure you're clear about what you're doing and why you're doing it.

A Private Loan and Your Business

A loan from someone you know can fill a critical gap in the financial life of your small business. Private loans often come into play after you have invested personal resources in your business, but before strangers are willing to take a chance on you. Typically, you will need to prove that your business can make money before people external to the business, particularly banks, will lend to you.

So how do you earn those first few dollars, obtain your first customers or secure your first contracts? Often, these milestones are accomplished with the funds that you personally put into the business and from the gifts, loans and investments that your loyal supporters — your family, friends and associates — risk on your idea.

These folks represent a real and serious source of business capital for you - one that deserves more than a cocktail napkin proposal and a handshake to seal the deal. The next two sections will detail how to approach potential lenders, and how to formalize the deal. But before we do that, let's get specific about what's in it for you, and for your lender.



[continued on next page](#)

Learn more...

...where does a private loan fit in the financial life of my business?

Stage of Business	Common Funding	Source of Money
Research Start-up	Personal funds, gift, loan or equity investment	Savings, salary, credit cards, line of credit, home equity line, retirement funds
Start-up Early growth Small and profitable business	External gift, loan, equity investment Extension of trade credit, equity investment	Friends, family, associates Suppliers, angel investors
Growing business	Commercial loan Equity investment	Institutional lenders, such as banks Institutional investors, such as venture capital



Why a Private Business Loan? (continued)

Benefits for the Borrower

A private loan usually means business capital that is:

- **Affordable.** Once you have used as much of your personal resources (savings, salary) as you are willing, you'll start looking for other sources of money, and when you use other people's money, you have to pay. For example, if you pay business expenses with your credit card, you'll likely encounter interest rates in the high teens and low 20s. If you pass muster at a small business lending program, you may pay 8% or more to borrow from them. Nationwide, even established small businesses with good credit pay 9% on average when they borrow money. The median rate for private loans managed by Circlelending is 7% (and lower if you get money from relatives), and the rate for your loan can be whatever amount you and your lender agree upon.
- **Available.** For some, affordability is not even an issue, because the capital is simply not available. When a business has no revenue and no history, financial institutions look at the entrepreneur's credit, and unless yours is stellar, your application may be denied. However, private lenders don't usually run a credit check; they rely on the relationship and what they know about you to decide if they want to make a loan or not.
- **Flexible.** The payment schedule for a private loan can be customized to accommodate the cash needs of your growing business. For example, the first payment can be deferred for several months, payments can be interest-only for a period of time, can be graduated so they increase on a regular schedule over the term of the loan, or they can even vary by season to accommodate the changing revenue patterns of a seasonal business.

[continued on next page](#)

Learn more...

...are there alternatives to loans?

Yes. Although this guide is geared exclusively to private lending, entrepreneurs also can receive gifts and equity investments from people they know when raising business capital.

The person can make a gift to you (or your business.) According to the IRS, individuals may gift up to \$11,000 per person, per year without tax consequences (this figure is expected to increase to \$12,000 soon.) This means that you can receive up to \$22,000 each year from your parents, and, if you have a spouse, that number is \$44,000. Thanks to the flexibility inherent in private lending, a lender can also make a gift of loan payments. For example, once a loan is set up, the lender can, for any reason, decide to forgive one or more payments. The giver simply needs to write a letter notifying the borrower of his or her intention to forgive the specified payments. In this way, a lender can make significant gifts to a family member in the shape of a loan to their business.

The person can become an equity investor. As long as your business is formed as a corporation, LLC or partnership, you can raise business capital by selling shares in your business to others. To do this you'll need a business attorney who can guide you through the process of complying with securities laws and preparing the right legal agreements. While the occasional superstar can attract venture capital, if you're looking for equity capital you have a much better chance of raising it from people you know who are wealthy and experienced entrepreneurs, and from private angel investors.

For an exhaustive discussion of how to raise business capital from family, friends and associates, look for our book released in February 2006 *Investors in Your Backyard*, publication information at www.circlelending.com.



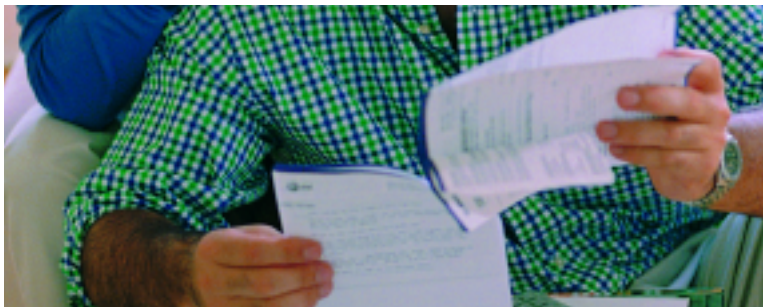
Why a Private Business Loan? (continued)

Benefits for the Lender

Making a private loan provides a return to the lender that is both financial, in the form of interest, and emotional, in terms of the support provided to the borrower. Lenders are typically in it to:

- **Earn Income.** Offer to pay your lender a reasonable rate of interest. Chances are you can agree on a rate that is better than your lender might be earning on a short term financial instrument, such as a 5-year CD (currently about 4%) but less than you would have to pay a bank or your credit card company. If you need to, and your business plan supports it, you can offer a higher interest rate as additional incentive for your lender.
- **Be Supportive.** Over 80% of our customers say private lenders do it because they want to help out the borrower. Some lenders are older relatives who want to support the younger generation; some are themselves successful entrepreneurs and want to support other startup businesses. Many private lenders have some dose of altruism motivating the decision to make a private loan.
- **Meet Own Needs.** At the same time, private lenders often also are motivated by self-interest. A private loan is a financial opportunity, especially if you offer a competitive interest rate and the loan management services of CircleLending. With a private loan, a lender can get involved in an exciting and growing business, and play the role of mentor. A private loan can be offered by a vendor to help a potential client get started. A private loan can also be structured in a way to transfer funds to relatives without exceeding IRS gifting limits.

To get started setting up your private loan today, visit: www.circlelending.com or call **800.805.2472**



Real People. Real Profiles.

Brothers Kyle and Aaron Campos decided to open a juice and smoothie shop in their new hometown of Verrado, AZ. When they realized that their own savings wouldn't be enough to launch the business, they did what most entrepreneurs do, they asked for support from family and friends. They sent an email describing their plans and offering to send a business plan to anyone who was interested in taking part in their new venture.

Old friend James Rohl received one of those emails. "I took advantage of the opportunity when they offered... more so to say that I believe in them than the actual financial part of it. I came up with an amount I could do, from there Kyle suggested an interest rate and payment schedule, and I just chose one." Kyle and Aaron rounded up seven loans from friends and family; three were for \$5,000 each and four were for lesser amounts. They had CircleLending document all seven loans, and then service the three largest ones.

"The funds from friends and family was our first round of financing and let us get the first phase of our business in place; if we hadn't had that money we couldn't have gotten started," remarks Kyle. "We used it for the deposit on the location and a consulting service to get things going; the money played a large role getting the ball rolling and definitely was a huge part of getting us where we are now."

Both parties say they appreciate the convenience of the electronic debits and credits provided by CircleLending. Rohl notes "the process has been so easy; CircleLending has taken care of logistics I did not even think to ask about. At the time we setup the loan I didn't know how things should work, I got spoiled because CircleLending took care of everything. Knowing what I know now I can't think of any way of doing it without CircleLending."





Approaching Potential Lenders

While some entrepreneurs know exactly how much money they need and who to get it from, most need to spend time fundraising. This includes identifying potential lenders, putting a request in writing and making a pitch.

Identify Lenders in Your Circle

You probably have heard of Wal-Mart, MoTown Records, Subway and The Limited, but did you know that their founders got started with money from family and friends?

- Sam Walton, founder of Wal-Mart, borrowed from his father-in-law \$20,000 of the \$25,000 he needed to buy his first retail store in 1945 (the other \$5,000 came from his own savings.) Wal*Mart is now the world's largest retailer.
- Berry Gordy borrowed \$800 from family members in 1959 to start his business in the music recording industry, and soon after launched Motown Records, which grew into one of the largest black-owned businesses in US history.
- Fred DeLuca, lacking the money to go to college, was handed a check for \$1,000 from a family friend who decided to help the teen launch a sandwich shop. Today Subway is the world's largest submarine chain with more than 21,000 restaurants in 75 countries.
- Leslie Wexner borrowed \$5,000 from his aunt (after an argument with his father about how to run the family clothing shop) to open a small women's retail shop called Leslie's Limited. The Limited now operates 5,600 stores in the US and earns \$10 billion a year.

So, how do you identify the potential lenders you know? Take these three easy steps:

- 1. Brainstorm a list.** Write down the names of relatives, friends, business associates, even contacts from previous jobs and schools. Look at your holiday card list, review your email and cell phone address books, and even pull out old school yearbooks. While half of private loans come from family and friends, the other half come from more distant contacts, so be creative and open-minded when you brainstorm your initial list.
- 2. Narrow the List.** The four characteristics of someone who is most likely to make a private loan to you include: trusts you, has money, has business experience and has no relationship problems or baggage with you. Review your brainstormed list and circle the names with at least two of these characteristics.

Learn more...

...3 dos and 3 don'ts when raising business money from people you know.

Do ask for referrals. The quickest and most effective way to expand your circle is to get the names of three referrals from each of your best bet prospects. Getting a few names of others you can approach can be just as valuable as a loan.

Do let the lender pick the final amount.

Instead of guessing that your grandmother could lend you \$8,000, put her on your list for \$5,000 - \$10,000. Then let her nail down the exact dollar figure. To some lenders it just plain feels better to suggest the amount of the investment themselves.

Do be sensitive to family issues. If the loan is between family members, be sensitive that it might raise some emotional issues for other family members, such as jealousy. The best approach is to be open about the loan as appropriate, and make sure the same opportunity - possibly even at the same terms - is available to other family members.

Don't change the way you behave when you ask for money. Be yourself. This even includes dressing like yourself: Showing up in a suit for a restaurant lunch with your mother will probably make her anxious (unless that's normally how you visit with her).

Don't ask for it all from one person. Unless you are fairly confident that a particular person wants to make you a loan, don't put all your eggs in one basket. Have a list of others who you're ready to ask.

Don't choose a lender out of desperation. Although you need the money, don't take it from people you don't trust or like. One entrepreneur says, "I avoid people who only seem interested in the money part, and not in what it takes to grow the business, people who say they can't wait to tell 'their people' about the deal, or people who are pushy. It's a gut feeling ..."

continued on next page



Approaching Potential Lenders (continued)

3. Determine an Amount. Determine how much you need to raise for your business. If you're raising money to launch the business, refer to financial projections in your business plan or use one of the start-up costs calculators found online. If your business is already in operation, chances are you need a specific amount to buy a new piece of equipment, or for working capital. Create a table where you list the names of your top prospects and a range for how much you plan to request from each that adds up to the total needed

Putting Your Plans Into Writing

To increase your chance of success when raising business capital from your circle of contacts, take the time to prepare your request in the following three ways:

- **Put your business plan in writing.** If you haven't already, take the time to prepare a business plan. Although some friends and relatives may have no interest in a business plan, anyone with business experience will probably want to see it before they agree to make a loan to you. Also, the exercise of creating the plan will help you to think carefully about all the critical elements. Two of the best sources of free business planning information are the Small Business Administration (SBA) and SCORE, available online at www.sba.gov and www.score.org.
- **Plan your loan, and options.** Think ahead to the details of your ideal loan. Before you ask for money, you should be prepared to say not only how much you need, but also, what rate of interest you will pay, how long it will take you to pay it back, how often you will make payments, and how the payments will be made to the lender. In addition, be ready to vary these details of your loan proposal depending on the lender and what it will take to make him or her feel comfortable making the loan. For example, you may need to offer to pay a higher rate of interest to a business associate (who's considering the loan to make some money) than to a family member (who's considering the loan to help you out.)
- **Prepare a letter for your lender.** Even if you're talking about your business idea at the family reunion picnic and a wealthy uncle says on the spot that he'll loan you whatever you need, it's a good idea to follow up with a letter. A lender letter should summarize key business highlights and your proposed loan terms in a tone that is professional and friendly. In the letter you can also describe how the loan would be repaid, specifically, how you will set it up and then make — and keep track of — payments. Lender letters can be used to open your fundraising discussion, for example, you can send one with a copy of your business plan to someone who has expressed interest. Or, you can use a lender letter to confirm loan terms discussed in a successful kitchen table pitch.



Real People. Real Profiles.

While some business owners stumble on an opportunity, others plan for years. "To own my own business — a creative business — has been my dream from a fairly young age" notes Rob. But when it came time to raise funds to finally launch his gallery, he felt he couldn't go to a bank, and so he turned to his family. "I think it's a good way of borrowing money — getting capital — to get past some sort of financial obstacle, without going through a bank, which can be a lot of paperwork and possibly end in rejection" he adds.

Rob approached his older sister with his loan request. To prove to her that he was serious about paying her back, he created a formal loan request and a comfortable repayment schedule. She agreed to give him the money then asked CircleLending to document and service the loan. "Where Rob is concerned, my head said uh-oh, don't do this, but, my heart said, he's my brother. So, with CircleLending I was able to bridge the conflict between my heart and my mind."

Loaning to family is a gamble, but she says he has a special kind of collateral. "I won't be happy if he defaults on the loan, I really don't expect it, but it's not like I will kick myself for loaning my brother money, I love him and was able to help him and it's all good karma."

Rob made good on his promise and had a reliable repayment record. Due to the good experience the pair had with the loan, Rob later requested and received a second loan from his sister. The first loan is now fully repaid, the second is well on its way, and Rob's new gallery in Boston's South End is open.



Approaching Potential Lenders (continued)

Your Kitchen Table Pitch

Here at CircleLending we use the phrase “kitchen table pitch” to describe the way to approach friends, family, and other potential private lenders with a request for business capital. In contrast to the anonymous and often aggressive approach embodied in the “elevator pitch”, your pitch should be warm, informal, and in keeping with the relationship that you have already built with the person. Here are three ways to do that successfully:

- **Make it comfortable.** Pick a time and a location that suit the relationship you already have with the person. If you see the person regularly, such as a parent or friend, you may be able to just bring up your request in conversation at one of those times. For some people it may be more appropriate to schedule an informal meeting, for example over lunch or a cup of coffee.
- **Make it compelling.** This is the time to communicate what it is that most excites you about your business plan. Show your passion for the work you have ahead of you, and be able to say why you think you'll succeed. While you don't need to have a full length business plan on hand (because the meeting should be informal) do bring along a carefully chosen item, such as a sample product, a printout of your web page, or a mock-up of your brochure and new logo that will impress your potential lender.
- **Guide it to an agreement.** While you want to keep the tone friendly and informal, you are there to ask for money and will need to guide the meeting to that request. A natural sequence is:
 1. Tell him or her about your business idea and gauge interest and support.
 2. Bring up your need for money, and what your financing options are.
 3. Ask if the person might be interested, and why you thought of him or her.
 4. Talk generally about what you have in mind, and then ask if you can send a letter outlining the loan terms and repayment details. You may also offer to send a copy of your business plan.

The two greatest concerns of private lenders are: 1) that the loan will jeopardize the relationship, and 2) that the money might be lost. The best way to alleviate these concerns is to have CircleLending set up and service the loan. Some clients say that just hearing about the involvement of a professional loan servicing company like CircleLending is what convinced their lender to go ahead and make the loan.

To get started setting up your private loan today, visit:
www.circlelending.com or call **800.805.2472**

800.805.2472
www.circlelending.com

How we can help

CircleLending can create a fundraising package for you.

Put your potential lenders at ease by presenting them with a professional loan proposal that highlights the core strengths of your business and CircleLending's seamless system for documenting and managing private party loans. You will receive three loan request portfolios and each will include:

- A custom fundraising letter written by our expert staff
- Three loan option sheets that describe the loan options you're offering
- A letter of intent so that you can walk away from your meeting with a commitment
- A brochure describing CircleLending's loan set-up and management system

Fundraiser clients also receive discounted setup of their first private loan at CircleLending.

Learn more online at www.circlelending.com/fundraiser or call a Private Loan Specialist at 800.805.2472.



Formalizing the Loan

Once a lender has decided to make a private loan, the next steps are to:

1. **Agree on terms,**
2. **Close the deal, and**
3. **Begin repayment.**

1. Agree on terms

Set the stage for a successful loan by preparing a promissory note as a bank would for a loan to a stranger. A promissory note is a borrower's promise to repay a debt according to specific terms spelled out in the note. Promissory notes can be used to formalize any kind of loan, including mortgage loans, business loans and personal loans.

Many people mistakenly assume that it is offensive or inappropriate to ask for formal documentation when arranging to transfer funds between relatives. In fact, formal documentation is perhaps one of the most appropriate things that can be done. Not only does it protect both parties financially, but it also preserves the personal relationship. It can do this by preventing confusion over repayment start dates, interest rates, repayment schedules, grace periods, and other terms of the loan.

To prepare the note, the parties will need to agree on several financial details of the loan, including:

- **The interest rate.** The promissory note must state the interest rate to be charged. The lender and borrower should agree on a rate based on several factors, including the opportunity cost (how much the same amount of money could earn in alternative similar investment), the need for an incentive (how much the borrower needs to pay the lender to attract their money), and IRS private loan regulations. See... How do I pick an interest rate?
- **If the loan will be secured or unsecured.** When a loan is secured, the borrower signs over to the lender the designated asset, such as a piece of equipment or a vehicle, in case the borrower is unable to make payment on the loan. To do this a few additional legal items are required, such as a security clause in the promissory note, a separate security agreement and a UCC filing. Offering to secure a private business loan is another way a borrower can make a lender feel more comfortable.



Learn more...

...how do I pick an interest rate?

When setting your interest rate, consider the following factors:

Recognize the opportunity cost. The money loaned would most likely be earning a return if invested elsewhere (i.e. a savings account or CD). Consider that alternative and pick a rate that both the borrower and the lender feel is fair given alternative uses of the money.

Create an incentive. Offering a generous interest rate is one way to persuade a buyer or seller who is on the fence.

Respect usury laws in your state. Usury laws were originally instituted to protect people from unreasonably high "predatory" interest charges, and most states have instituted specific limits on the maximum interest rates that lenders could charge. Different states have different usury laws, and if the state laws are violated, the promissory note may be unenforceable if brought to court.

Look up the applicable federal rate (AFR). In order for a transfer of private money of more than \$11,000 (soon to rise) to be considered a loan and not a gift, the lender must charge an interest rate at no lower than a minimum rate required by the federal government, called the AFR. If you charge less than the AFR, the IRS may view the lender's forgone interest as income (what the seller would have earned charging the AFR) as a gift.

You can look up current AFR rates at www.circlelending.com/afr, or call a Private Loan Specialist at 1.800.805.2472.

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Formalizing the Loan (continued)

• **Type of repayment.** The schedule of loan repayments you will make is determined by a section of the promissory note which states how much will be due on which dates. Traditional bank loans are amortized; the borrower pays the same amount every month for the life of the loan. But there are a wide variety of options you can consider to create a repayment schedule that suits the cash needs of your business. For example, consider using a graduated schedule if you have a low level of income now but expect it to increase with time. You might choose a seasonal loan if the your income is dependent on a business that is seasonal and fluctuates on a predictable pattern throughout the year. See... What are my options for structuring repayment of my private loan?"

You will also need a plan for managing the repayment of the loan. In our experience, setting up and servicing private loans for clients across 48 states, we have found that using a 3rd party like CircleLending to manage the process reduces the default rate from 14% to less than 5% on these loans. Most parties to a private loan use one of the following two options:

You can do it yourself. You can send a check every period by the due date specified in your promissory note. Unfortunately, over a third of self-administered payments by check are late or missed entirely, and this tends to be a significant cause of strained relationships and misunderstandings. Missing or late payments on a family loan have a way of haunting holiday gatherings that can be unpleasant for everyone.

You can hire a neutral 3rd party such as CircleLending to manage the repayment. A professional can administer your loan, keep track of payments and create year-end reports for tax purposes. Having a third party involved ensures that the loan is handled in a business-like manner, and is a resource in case there is a need to restructure the loan or handle collections.

2. Close the Deal

To close the loan, two things need to happen, the borrower needs to sign a promissory note, and the lender needs to disburse the funds.

Borrower signs the promissory note. Prepare a draft promissory note based on the terms agreed to informally by both parties to the loan. Once the lender approves the draft, prepare a final document and have the borrower sign it. Creating a legally binding agreement is one of the most important things you can do when handling a private loan transaction. Knowing that the loan is made legal with a promissory note can be a great comfort to most lenders, enough to give them the confidence to make the loan.

Learn more...

...what are my options for structuring repayment of my private loan?

As you probably know, standard types of loan repayment schedules include:

Amortized - the repayment schedule consists of payments that are always the same dollar amount and are due at regular payment dates (monthly, quarterly, or annually) for the life of the loan.

Graduated - the repayment schedule starts with lower payments initially (monthly, quarterly, or annually) but they gradually increase over the life of the loan.

Seasonal - the repayment schedule comprised of both principal and interest payments are lower during some months of the year and higher in other months of the year (typically used for situations where a borrower's income is different at different times of the year).

There are also different repayment tools you can use to further customize your repayment schedule. These include:

Add a deferment period at any point - this is a period during which no payments come due, commonly at the beginning for anywhere from one to 12 months.

Make a period interest-only - this is a period where only interest (no principal) is paid. When an entire loan is "interest-only," all payments include only the interest portion of the payment until the end, when the principal is repaid in one lump sum payment, often called a "balloon."

Achieve fixed payments - some borrowers like to back into their payment schedules by fixing the maximum payment amount they are able to pay each period. If the loan term is also limited, the schedule may then require a balloon to fully repay the loan by a certain date.

Finally, although payment schedules are typically monthly, you can also make quarterly or annual payments.

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Formalizing the Loan (continued)

Lender disburses the funds. This can be done in person, by mail, or electronically using cash, a personal check, cashier's check, or wire transfer. If a personal check is used, note that the clearing period may be longer than usual due to the large amount.

3. Begin repayment

After the promissory note is signed, your job as a borrower is relatively straightforward. Know when payments are due, and make them on time. If you hit a stretch where you have difficulty repaying, there are ways to adjust the repayment schedule, as long as your lender agrees.

If all goes well, you repay the loan according to the terms set out in the note. To do this:

- **Know what the promissory note says.** The note will state not only the loan amount and interest rate, but also other clauses describing the rights and responsibilities of each party. You'd be surprised at how few parties to a loan ever read the promissory note.
- **Create a repayment schedule.** Plug the terms in the note into a loan calculator to determine the due date and amount of each and every payment. The borrower should keep the schedule handy to avoid late or missed payments.
- **Pay on time.** It is your responsibility to pay on time. The note will usually state a grace period during which late payments are accepted. Payments received beyond the grace period, usually incur a late fee and if they occur frequently, test the lender's patience.
- **Create year-end reports.** Both parties to the loan will want year-end reports to track progress on repayment of the loan, as well as for accounting and tax purposes.

Remember, CircleLending offers a complete private loan setup and administration service to reduce the hassle of handling the loan yourself. Our clients prefer to leave the business of payment collection to an experienced third party, so the loan doesn't have to become a topic at the dinner table or the holidays.

Learn more...

...repaying a private loan can improve your credit score

Your credit score is a single number which sums up your history of repaying your debts. Although this score represents your past experiences, it is relied on by institutional lenders and suppliers of credit as an indicator of how well you will do in the future with new debts. Your personal credit can be a huge help or a huge problem when you are looking for money to start or grow your business.

Here are a few tips that should help:

- 1. Forget big banks as sources of funding.** In the past, obtaining bank financing was based on the four Cs of credit: credit history, cash flows, collateral and character. Today, this is no longer true for most large financial institutions; they tend to focus purely on your personal credit history in making lending decisions.
- 2. Differentiate your business credit.** Smaller community lenders and business-friendly banks will focus on a combination of your personal credit score, business credit score and other factors associated with the viability of your business. Your business credit score is linked to the tax ID for your business, not your Social Security number. This is an important distinction. If your personal credit score is damaged, get a separate tax ID number for your business as soon as possible — whether you are incorporated or not.
- 3. Build your business's credit score.** Once you have a tax ID number and a legal identity for your business, you can start building your business's credit to qualify for trade and credit lines from suppliers and sources of capital. If you are able to make your payments from your business account on time, you can establish a strong credit rating for your business. Especially if you do not have strong personal credit, you should pay special attention to ensuring that you build a good business credit history.

CircleLending has a new optional service called CreditBuilder which will report data on private loans to credit bureaus. Check www.circlelending.com/creditreporting to see latest developments with the service. Learn more online at www.circlelending.com or call a Private Loan Specialist at 800.805.2472.

[continued on next page](#)



Formalizing the Loan (continued)

If you hit a bumpy patch, communicate with your lender. One of the primary benefits of private loans is the flexibility — the contract is between the two individuals, and can be changed as long as both parties agree. Following are some of the most common ways to resolve repayment difficulties:

- **Forgive the payment.** The lender can choose to forgive the payment entirely so the borrower's only concern is the next payment.
- **Skip a payment.** The lender can agree that the borrower will skip the payment in question, but add it to the end of the loan, extending the term by one additional payment period.
- **Spread out the payment.** The lender can agree to spread out the payment across several subsequent payments.
- **Restructure the loan.** If there is no chance that the borrower can catch up or keep up with the repayment schedule set out in the promissory note, it's time to create a new promissory note with a payment schedule that the borrower can keep.

To get started setting up your private loan today, visit: www.circlelending.com or call **800.805.2472**

How we can help...

...formalizing a private loan using Small Business Builder

In addition to drafting and finalizing a customized promissory note, CircleLending will:

- Create a repayment schedule in our secure computer system
- Create CircleLending accounts for both parties in our secure computer system
- Set up electronic payments (payment can also be received via check or money order)
- Set up web tracking so that both parties can view the schedule and payment status/history online.

When it comes to the ongoing business of keeping the borrower and lender on track per the terms of the loan, CircleLending will:

- Send a reminder email to the borrower before each payment comes due
- Debit the borrower's bank account on a monthly basis (or receive payment via check)
- Credit an account designated by the lender once the payment has cleared
- Send a confirmation email to the lender once the electronic deposit has been completed
- Provide 24/7 online access to payment status and history
- Furnish both parties with year end tax summary statements that detail the interest and principal paid during that year

Learn more online at www.circlelending.com/businessbuilder or call a Private Loan Specialist at 800.805.2472.

Real People. Real Profiles.

Dale Stoddard needed three new trucks for his fast-growing kitchen remodeling business in Sacramento. He found a dealer with the trucks he wanted, at the price he wanted. Based on Dale's established business, solid revenue, and good credit, the dealer's financing program offered him a rate of 7.2% for a \$66,000 loan, to be secured by the new trucks.

Dale could afford the loan — 7.2% wasn't at all unreasonable. But he got to thinking about how much he would pay the company in interest on top of the price tag for the three new trucks, and wondered whether there were any alternatives.

A few days later, Dale visited his mother, who happened to mention that her CD investments were earning barely 4%. She asked whether Dale knew of any investments that would be secure but would earn her a higher return.

That night, Dale drew up two lender letters, one to his mother and one to his grandmother (Dale knew that she, too, had a portion of her retirement assets in low-interest CDs). Dale prepared the requests so that they offered the same terms as the dealer-financing program had offered him: 7.2% interest for a secured loan of \$33,000. Dale's main objective was to make the loans work for his family. He felt confident that, in case of problems, his family would gain the right to sell his trucks. Dale offered to retain CircleLending to service the loan, "so we wouldn't have to talk about the loans over the supper table."

Dale's mother and grandmother were both pleasantly surprised by his offer, and hearing that CircleLending could set up and service the loans offered a level of confidence that made the deal even more attractive to them. He also told each upfront that he'd already been approved for financing at the same rate by the dealer, so that they wouldn't feel under any pressure to say yes — he had, after all, other options.

Both loans are currently in active repayment. "There's just no sense in paying 7.2% to the dealer when I could be paying it to my family," Dale notes.



Addressing Common Borrower Concerns

Below are some of the leading concerns borrowers express as they consider asking for private loans. Each one is followed by the best practical means in our experience to address these concerns.



If you're worried that: "I don't want to disappoint my lender if I'm unable to keep up with the payments I promised."

Be sure to: Carefully watch your cash flow situation, and communicate problems to your lenders as soon as you're aware of them. Generally, when you borrow from friends and family, they will be flexible if they think it will help you succeed in the long term. If you are having difficulty making payments, be upfront with your lender about your situation, and suggest an alternative repayment plan that works for both of you. In most cases, your lender will appreciate your proactive response and accommodate your request — which should ultimately allow you to get your business back on its feet.

If you're worried that: "My lender will constantly be anxious about the possibility of my business failing and hate me forever if it does."

Be sure to: Yes, lenders may worry, and business failure at this early stage is a risk you are responsible for making clear to them. If a particular lender ranks high on the worried scale, but might be more willing to make the loan with some protection against the risk, you can offer to secure the loan with collateral. Collateral significantly reduces your lender's risk, because if you default on the loan, your lender will be entitled to receive and sell the item of collateral (such as a vehicle or office equipment) in lieu of being repaid. If you do have troubles, as long as you are honest and open about the situation, your lenders are highly unlikely to hate you.

If you're worried that: "Even after I pay my lender back, what if my lender still feels as though he or she did me a favor, and that I owe something."

Be sure to: Pay your lender a fair interest rate from the get-go. Even better, pay the lender more than he or she would have earned putting the money in a similar investment. If yours is a three-year loan, make sure to pay more than a three-year CD would earn. When you set up the loan, point out why you picked the rate that you did. That should help satisfy the lender that you owe him or her nothing after the loan has been repaid. Also, by using a formal loan request to ask for the money, and then a legally binding promissory note (your promise to repay the loan) to formalize the deal, you will make it clear that this is a business transaction, not a favor.

If you're worried that: "My lenders will meddle in how I run my business."

Be sure to: If you want someone who made you a loan to keep a distance, formalize the loan with proper documentation, to make clear that this is indeed a loan, not a favor. Seeing that you are serious about treating the loan in a businesslike manner should help your lender understand that his or her role does not extend beyond that of a lender and that you don't owe him or her anything more than timely payments.

If you're worried that: "What if my lender scrutinizes everything I spend money on that isn't related to my business. What if I buy a new coat or take a vacation—will he or she wonder whether I'm doing it with his or her money?"

Be sure to: If you've set up a mutually agreed upon repayment plan, your lender will always know if you are current on your obligations to him or her. Of course, if your business is hobbling along on other peoples' money, it's not wise financially or personally to make extravagant purchases. Your lender does have a right to know how his or her money is being used, especially if you are missing payments. The best way to keep your lenders out of your business is stick to your repayment schedule.



Frequently Asked Questions

Q: I'm making a loan to my sister so that she can purchase a computer for her graphics design business. Why can't I simply download a free promissory note?

A: You can, but you'll still have to keep track of the repayment schedule yourself, which can be much more trying than it appears. Payments could be neglected; agreements and promissory notes can be stashed in a drawer or closet so that the terms are forgotten or ignored. By managing the entire repayment process of your loan, including payment processing, online accounts, and proven methods of payment collection, CircleLending relieves you of having to manage your loan and alleviates any stress to the lender and borrower's personal relationship. In other words, CircleLending can provide a buffer, allowing you to keep your loan separate — and on track — from your personal relationship.

Q: What happens if my borrower can't make a payment?

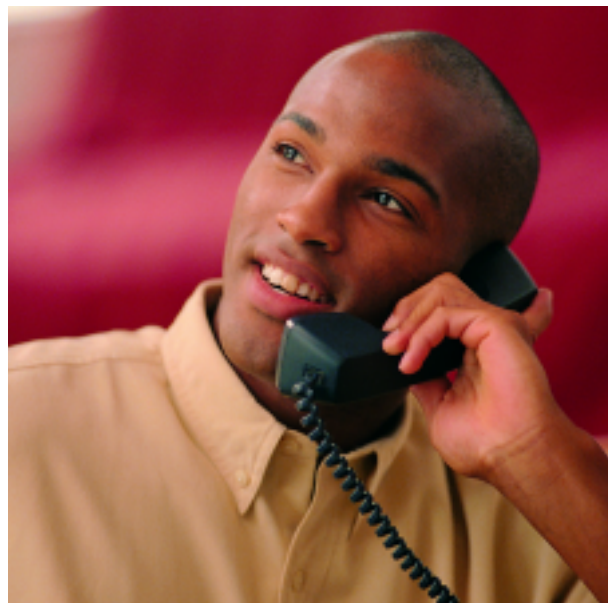
A: There is any number of reasons that a borrower may miss a payment. The borrower may experience a cash flow crunch, an unexpected business cost, or a personal financial situation that impacts the business. For example, if the borrower loses a job or has a major car repair, it may impact his or her ability to keep up with their payment schedule. In response, depending on your situation, you can choose to forgive the missed payments, spread them out over the course of the loan, or add them to the end of the term with the balloon payment. CircleLending specializes in different types of loan restructuring options while keeping the initial terms of the agreement intact, to help lessen the chance of default.

Q: What will other relatives say about this loan?

A: If you are a parent setting up a loan with one child, and you are worried about another child becoming resentful, sit down and have a discussion with each of your children. Explain your reasoning to both of them, and also explain that you are structuring a business investment for both you and your borrower, not gifting money arbitrarily. Don't play favorites or give special treatment, but do keep in mind that certain adult children of yours may need more or less support based on individual situations.

Q: Can a private loan improve my credit standing?

A: CircleLending can report payment performance on personal and business loans to national credit reporting agencies. CircleLending's reporting allows you to build your credit history even for private loans that would normally go unreported. (Check www.circlelending.com/creditreporting/ for latest details.) Many banks and other lenders use credit history information obtained from one or more of the credit bureaus as an indication of your risk when making future credit decisions. Banks incorporate this data into their automated underwriting models. Borrowers — whether businesses or individuals — with a strong, documented history of making on-time payments can often qualify for larger amounts of credit at better rates.





Concluding Comments

We hope that you have found this guide helpful and that we have demonstrated the benefits of working with CircleLending for your private loan transaction. Do not hesitate to contact us if you have additional questions or if you have suggestions for future editions of this guide.



Get a Free Phone Consultation

Discuss your situation with one of CircleLending's private loan specialists who can help you structure a small business loan that best fits your needs

Call 800.805.2472

Hours of operation are M-F: 9AM–7PM EST

OR **Visit: www.circlelending.com**