Should Your Nonprofit Get a Bank Loan or Line of Credit?

It's a tough time for many, and nonprofits organizations are no exception. Even nonprofits that have been around for decades are struggling right now with so many new challenges and an uncertain future. Nonprofits are often able to predict and plan out their yearly cash inflows based on past history but throw in a pandemic, a recession, and political uncertainty and it is hard to know if your cash forecasting will be accurate, it's probably likely to be your least accurate forecast yet.

Many nonprofits never considered a loan or a line of credit from a bank but now might be the time to consider that option based on a few important factors. Let's discuss what a loan or line of credit might do for you, what you would need to be approved, and what loan options your nonprofit might have.

A Loan or a Line of Credit Buys You Time

Many nonprofits that have been around for a long time have had to weather many storms. Businesses have used financing in times of crisis to help them get through those uncertain periods, but nonprofits often have been reluctant to use this important tool.

First, what is the Difference Between a Term Loan and a Line of Credit?

There are two categories of loans a nonprofit might want to consider, depending on their circumstances. A term loan and a line of credit.

Term Loan

A term loan is a fixed amount of money that is paid back monthly over a few years. A term loan is often a larger sum of money than a credit line and is often used for purchasing equipment, making renovations, or expanding programs. In other words, its secured by some specific tangible asset(s)

Line of Credit

A line of credit is a preapproved amount of money that you can have access to when needed. The only time you pay interest/fees on a credit line is when you use your line. This differs from a term loan which has a fixed monthly payment, interest, and fees. A line of credit is used as a cash back up plan for emergencies or new opportunities. A credit line is often used for a short period of time (i.e. weeks or months) and most often used to address a temporary cash-flow issue. With nonprofits a line of credit is most often used when reimbursements, donations or grants are delayed and when important bills, like payroll, must be paid on time.

What Will a Traditional Bank Look for To Approve a Nonprofit loan

A traditional bank is often the first place any nonprofit (or business) turns to for a loan, but most organizations don't realize how hard it is to be approved. Banks have three main standards they use to determine if your nonprofit will be approved. Let's cover those three things but please continue reading. It is easy to get discouraged thinking that your nonprofit will never be approved with a traditional bank. There are now new lending options for many nonprofits.

Banks Want You to Have Collateral

Banks want businesses or nonprofits to pledge some type of collateral (called security) that the bank can use in case of default. Collateral can be equipment, owned real estate, or any other tangible asset. In the case of a nonprofit, you can also ask a donor or board member to pledge their own personal collateral to support the bank loan

Banks Want a Personal Guarantee (PG)
Banks want the person signing the loan contract to personally guarantee the loan in case of default. This is often one of the biggest hurdles for nonprofits to be approved for a loan. Banks also usually want the person signing the contract to have a 680 or better personal credit score.

Banks Want to See That You Can Pay the Loan Back
Banks want to see, from history, that you will be able to pay the loan back and that the reason you are getting the loan makes sense. For example, if your nonprofit is going to be expanding, a bank will want to see that you have a solid plan that will pay back the monies borrowed.

Banks Are Not Always the Cheapest Loan or Line of Credit Option
Banks are often thought of as the cheapest place to get financing however there are exceptions. Regardless of whether you are setting up a term loan or a line of credit, a bank is going to charge an initial application fee from $1,000-$5,000 based on the size of the loan along with yearly renewal fees in the cases of a credit line. For nonprofits that may only use their credit line as an emergency backup plan, that may make a bank line of credit an expensive option.

Another Option: Financing Solutions Nonprofit Line of Credit Program

Financing Solutions, an A+ and 5 stars rated BBB company has been a leading provider of lines of credit to nonprofits since 2012. Its Line of Credit product is a very good option for many nonprofits that just want an emergency cash backup plan. In order to qualify, a nonprofit needs to be doing at least $200,000 per year in revenue.

Unlike a bank, Financing Solutions does not require collateral or a personal guarantee. The credit line offered by Financing Solutions costs nothing to set up, nothing until used, and is inexpensive when needed. The nonprofit line of credit is a cashback plan that most nonprofits use for emergencies or new opportunities. It is usually set up in advance by a nonprofit and it is renewed yearly. There is no requirement to use it.

Why can Financing Solutions provide lines of credit to nonprofits without collateral or personal guarantees? Unlike a bank, which is lending out depositors and government money, Financing Solutions is using private funds and therefore is not required by the government to have collateral to back up a loan. Financing Solutions has learned over the years that nonprofits are honest clients who pay their lines of credit back. Visit our website to learn more or apply today.

This article was written by Financing Solutions Managing Partner Stephen Halasnik.