BMO Bank of Montreal

Understanding the Canada Small Business Financing Act

While there are numerous loan products available in the financial marketplace today, one of the most popular forms of assistance continues to be through the Canada Small Business Financing Program (CSBF). Established over 40 years ago, its main purpose is to increase the availability of financing for establishing, expanding and/or modernizing small businesses. Over the years this program has provided the necessary financing that many businesses may not have been able to access otherwise.

For new &/or existing businesses, this program is actually easy to access. Application is made through the local bank or credit union of choice, in much the same way one would apply for any business loan. Having an existing business or personal banking arrangement with a financial institution would be to the applicant's advantage, assuming there was a favourable history of dealings, but this is definitely not mandatory.

The CSBF Program is ideal for many franchise systems due to the nature and extent of financing most often required. Business owners may sometimes find it challenging to finance capital outlays for items such as signage, leaseholds and premises improvements. These expenditures generally represent less value to the banks for lending purposes than more tangible items such as equipment and vehicles. Nevertheless they are often just as important to the business.

While it stands to reason that there are some rules and qualification parameters to access this program, the process is not as cumbersome as some would believe. The following is an overview of the primary requirements and conditions:

- The business must be a start-up or currently operating in Canada, with estimated annual gross revenues/sales not exceeding $5 million during the fiscal year in which they apply.
- Sole proprietors, partnerships and incorporated companies qualify, however farming and charitable or religious organizations are not eligible.
- Business assets/purchases that qualify for financing include equipment (new or used), signage, furniture & fixtures, new leasehold improvements, real property and vehicles.
- For qualifying purposes, the loan amount can be up to 90% of the cost of eligible purchases.
- The maximum loan amount a small business can access under the program is $500,000, of which up to $350,000 can be used to finance the purchase or improvement of equipment, signage, furniture & fixtures, vehicles and new leasehold improvements. For land and building purposes, the maximum amount available is $500,000. Items such as inventory, franchise fee and goodwill are not eligible for financing.
- Financing can be arranged for a period of up to 10 years. The loan interest rate cannot be more than 3 percent above the lender's prime lending rate. Fixed rate loans are also available.
- Importantly, the loan interest rate includes a 1.25% on-going CSBF Program administration fee. Also, at time of registration and loan access, all applicants must pay a one-time 2% registration fee. These fees, payable to the federal government, are intended to help cover the costs of administering the CSBF Program.

The CSBF Program provides significant benefits for all concerned. First, small business owners gain access to financing which might not otherwise be available through more traditional financing arrangements. Repayment terms can also be established over a longer period of time to ease annual debt servicing obligations.

Secondly, lending institutions have the opportunity to use this financing arrangement as a means of expanding their customer base and product offerings. From a national, economic perspective, the CSBF Program helps stimulate business growth, competition and employment.

This program is often referred to as the "government guaranteed loans program." Consequently business owners often have a perspective which conflicts with that of the bank concerning qualification criteria, application requirements, security, business viability, etc. There is a perception by some that the loan is guaranteed so there should be no concern by the bank regarding the prospects of the business. If the business fails, the bank can just claim from the government. This perception is incorrect and an important point of clarification is necessary in this regard.

Firstly, under the Canada Small Business Financing Act, the business owner is expected to provide their personal guarantee in support of business borrowings. However, the maximum amount of their guarantee cannot exceed 25% of the initial amount of financing provided. This is a very important consideration for any business owner as it provides a limit to their potential liability should the business not succeed.

Secondly, the government guarantee is only for 85% of the outstanding loan. Consequently, if the business fails, the bank may claim on this guarantee but only after all other attempts by the bank to recover the debt from the sale of any business assets and/or from the guarantors (usually the business owners) have been exhausted.

While all lending institutions (the banks) are encouraged by the federal government to make and administer CSBF loans under the Act, it is also understood that the banks should and will apply the same care, scrutiny, due diligence and prudent lending practices as they would in granting any other loan facility. In other words, just because the loan would be supported by a government guarantee does not mean that the lender should bend or change the rules associated with good lending practices. The initial application will still need to be supported by a business plan and financial forecasts. Periodically thereafter, the bank will also conduct a review of credit facilities provided to the business to ensure financial performance remains in order.

As previously mentioned, the CSBF Program has and continues to represent a very popular source of financing. However, it is not the only loan program or financing facility available. Alternatives including other bank loan products, private funding or equity partners may be available but will vary in terms of qualification parameters, repayment terms, interest rates, security, etc. To some business owners, the various conditions and/or loan criteria for some of these alternative financing facilities may represent a better option than the CSBF Program. Others may view their respective criteria as less attractive. Either way, when financing is needed, it is important that business owners take the time to investigate as many financing options as possible and to evaluate each to determine which is the most appropriate financing structure for their business.

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