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Restoring the flow of credit to entrepreneurs

A Treasury Department program aims to make it easier for lenders to find buyers for the loans they make.

By Cyndia Zwahlen
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The credit crunch looks like an espresso machine.

At least it does to Michael McDonald, who is trying to open a coffee shop near UC Santa Barbara next month but just heard that his funding had evaporated for an equipment leasing deal. McDonald needs the espresso maker and other gear in place in two weeks so he can train the first employees for the Zizzo's Coffee franchise.

"If I don't get my funding, those are 15 or 20 people who are not going to have work," said the Goleta resident, recounting his third brush with the credit crisis.

McDonald was squeezed this year when his bank cut off the home equity credit line he was using to help fund his start-up. He had looked into a conventional business loan but found most banks weren't interested in new businesses, requiring at least two years of operations. And the cost of the money was too high, he said, despite his good credit.

McDonald is just the kind of borrower the federal government hopes to help by its announcement last week that it would make loans more plentiful for small-business owners.

The program, part of the \$800-billion credit-loosening initiative unveiled Tuesday by Treasury Secretary Henry M. Paulson, covers certain loans backed by the Small Business Administration, as well as consumer borrowing such as credit cards, auto loans and student loans.

Paulson said \$20 billion would be used as credit protection for as much as \$200 billion in federal lending.

The program, which will launch around February, wouldn't lend money directly to small-business owners or consumers. Instead it would help cover loans the Federal Reserve Bank of New York could make to investors who buy securities backed by the consumer and small-business loans.

The Treasury Department offered few details but said the deal applied only to investors who held newly issued, Triple-A rated assets.

Loans guaranteed by the Small Business Administration have dropped sharply in the last year. Small-business operators have seen other cash sources dry up, including home-equity loans, conventional business loans and even credit cards.

One expert didn't dispute the need to unlock the secondary market for such loans but said it was unclear how, and whether, that would work.

"There is not enough detail on the program yet to really know how much impact it's going to have and whether it will result in freeing up more capital," said Kurt Chilcott, chief executive of CDC Small Business Finance Corp. in San Diego. His company makes SBA real estate loans and sells them on the secondary market.

That market has suffered as investors find higher interest rates in other markets, said Chilcott, whose company ranked fifth among SBA lenders in the Los Angeles district in the 2008 fiscal year that ended Sept. 30.

As a board member for two government-backed asset-lending organizations, Chilcott said he was working on the problem from another angle: the cost of capital.

He is putting together a proposal for the incoming administration recommending legislation to subsidize the interest rates on SBA loans and reduce loan fees.

Whether his plan -- parts of which have been suggested by others -- or the Treasury's move will make it easier for small-business owners to find the capital they need is unclear in today's uncertain economy and financial markets.

Small-business owner Earlena Morris hopes it will. She needs a loan to expand her Bakersfield personal concierge service, Time Ave. Morris would like to lease a vehicle, pay for more training for herself and buy some client management software.

To prepare to apply for a loan, Morris is taking a business workshop at the Kern County Black Chamber of Commerce, which is run by her husband, Ali, to help her write a business plan and learn about lending requirements. She's not sure there will be money available to borrow when she's done, especially for entrepreneurs like her who don't have stellar credit.

"It's definitely a scary time and something to be concerned about -- if it's going to be possible to even get a loan to become a bigger business," she said.

The SBA, which recently changed an interest rate policy to make SBA lending more attractive to banks, expects the new federal plan to smooth the way for Morris and other small-business owners.

The agency said in a news release last week that the Treasury program would make it easier for lenders to find buyers for the loans they made "and use the proceeds of those sales to make new loans."

Acting Administrator Sandy K. Baruah called the approach "a significant and important breakthrough in our efforts to help unclog the secondary market and to help restore the flow of credit and credit products to normal levels."

It may come too late to help McDonald open his doors without tapping more of his own reserves: After his first line of credit was yanked, the small-business owner tapped an additional line of credit he had on a second property and stashed it in a money market account. It was a cushion he didn't want to use to pay for equipment, but he would if he had to.

He struck a positive note Friday about his chances of succeeding despite his tangles with the credit freeze.

"There couldn't be a worse time to open a business as now," McDonald said.

"But I'm still confident in our concept, and as far as the challenges, it makes me stronger."

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