U. S. Department of the Interior
Assistant Secretary—Indian Affairs
Office of Indian Energy and Economic Development
Division of Economic Development

Tribal Economic Development Principles at a Glance Series

Financing a Tribal or Native-owned Business

This is the seventh in a series of economic development primers produced by the Division of Economic Development (DED), Office of Indian Energy and Economic Development (IEED), to offer answers to fundamental questions about creating jobs and expanding economies in Native communities.

If you would like to discuss in more detail ways to obtain capital, please contact the Division of Economic Development at (202) 208-0740.

As a tribal business person, why must I know something about financing?

Many businesses, both large and small, need to borrow money to sustain or expand their operations. It is important to know about financing before making a decision to borrow money.

What precautions should I take before seeking financing?

Borrowing unwisely or from the wrong source can result in debt repayment terms that can cripple a business or even cause it to collapse.

What are the advantages of financing?

Prudent financing allows a business to meet the demand for its products or services, hire needed employees, obtain office or retail space, and purchase needed equipment. Additionally, the interest paid on debt financing is potentially tax deductible.

What are the disadvantages of financing?

The costs of debt repayment add to a business's monthly expenses. Financing to meet a market demand may become a serious liability if demand unexpectedly falls and monthly debt payments are still required.

Where should I go for financing?

It is recommended that you contact your local bank, Community Development Financial Institution (CDFI), or credit union.

What is a CDFI?

A Community Development Financial Institution (CDFI) is a locally-controlled private sector financial institution (sometimes funded by the U.S. Department of the Treasury) that focuses on personal lending and business development in poor and urban communities whose citizens lack access to traditional lending institutions. Since the goal of a CDFI is to promote local economic growth, its lending practices are often less stringent compared to other financial institutions. Some CDFIs are certified by the U.S. Department of Treasury as "Native CDFIs," meaning that at least half of the CDFI's activities are directed toward serving Native Americans, Alaska Natives and/or Native Hawaiians. At this writing, there are 968 CDFIs, 70 of which are Native. For a current list of CDFIs, please consult: https://www.cdfifund.gov/programs-training/certification/Pages/default.aspx

How should I prepare for my visit to a bank, CDFI, or credit union?

Arrange for a meeting with a loan officer at one of these lending institutions. Be prepared to document your company's profits during the time your business has been in operation. If your business is not profitable, you will have to describe what steps you are taking to achieve profitability. If your business is a start-up, you should provide the officer with a business plan demonstrating how your business will succeed. Bring your personal and business credit history, tax returns from previous years, cash flow projections for the upcoming year, and relevant financial and bank statements. Be prepared to forecast your future earnings and demonstrate that your plan for using the loan will benefit your business.

What are principal and interest?

Principal is the amount of money your business wishes to borrow that you will repay over an agreed upon period of time. Interest is the amount of money you will pay the lender for borrowing its money over this period.

What is the interest rate?

The interest rate is the amount charged, expressed as a percentage of the principal, by a lender to a borrower for the use of its funds. Interest rates are usually figured on an annual basis, known as the annual percentage rate (APR).

What is collateral?

Collateral describes assets such as real estate, savings, equipment or other items of value that the lender can use as a secondary source of repayment if the borrower is unable to repay the loan. Collateral reduces the lender's risk of being unable to recover the money it lent to the borrower. Be careful about pledging personal assets (your home, cash, or investments) as collateral because you could lose them if the loan is not repaid.

What is a secured loan?

A secured loan involves collateral that the lender can recover in the event that your business does not pay back the loan. Secured loans usually involve higher credit amounts (the amount of money the lender is willing to lend) and lower interest rates because they pose less risk to the lender.

What factors will the lender take into consideration in deciding whether to approve the loan?

The lender will try to determine whether your cash flow will be sufficient to timely pay back the loan, whether you are the kind of person who can be trusted to timely pay back the loan, and what kind of collateral or security the lender can receive in case you do not pay back the loan. Generally, you must be able to demonstrate that your business has been profitable over the past three years in order to obtain a bank loan. The lender will want to know your credit score. A low score may disqualify you from receiving a loan unless you can identify a source of collateral to secure the loan. The lender will examine your total current debt. In addition, it will look to the diversification of your business's income streams to determine whether your business is too dependent on one particular income source. The lender may ask whether you are contributing any of your own funds to the business and will consider it a negative if you are depending solely on financing to start or sustain your business. The lender will also want to make sure that there are no liens against your business's assets or lawsuits or tax liabilities that could threaten your business's solvency.

What is a line of credit?

A line of credit (also called "revolving credit" or "working capital") is an account a lender makes available from which you can draw funds when needed, which provides flexibility. You can borrow money up to a pre-determined limit and must pay interest on the money you actually withdraw.

What is an equipment loan?

An equipment loan is used to fund the purchase of a particular vehicle, machine, or other device used in your business. These loans have fixed interest rates and terms. You should consider whether it makes more sense to lease equipment than to finance its purchase.

What is receivables financing?

Receivables financing describes a loan obtained based upon expected payments owed to you by a third party for your goods or services. This is a kind of short-term, secured loan.

What is equity financing?

Equity financing (also called "venture capital") describes the sale of a portion or shares of your business in return for an immediate cash infusion. Keep in mind that it is possible to sell so much of your company that you may no longer be able to take advantage of Native American procurement set-asides and preferences because the company is no longer majority owned by a Native American. You could also lose your eligibility to obtain an Indian Affairs Loan Guarantee, which requires companies receiving the guarantee to be at least 51 percent Native owned (see discussion of the Indian Affairs Loan Guarantee on pages 6 - 10 herein).

Do any special financing issues apply to tribal (as opposed to private, Native- owned) businesses?

Yes. When a lender deals with a private, Native-owned business, it can seek to resolve contract disputes with the borrower through litigation, arbitration or other means. However, tribally owned businesses enjoy sovereign immunity. These businesses must first grant their permission before any such dispute can be resolved in court, arbitration, or other venue. Indian Reorganization Act (IRA) Section 17 corporations and businesses created by tribal resolution are explicit arms of the tribe that have sovereign immunity. However, if the tribal resolution establishing a business provides that the business can "sue and be sued," the business is likely a separate legal entity from the tribe and cannot claim sovereign immunity. To learn more about tribal business structures that preserve a tribe's sovereign immunity, please consult the DED primer, "Choosing a Tribal Business Structure" by clicking **here**.

Can a tribal business waive its sovereign immunity?

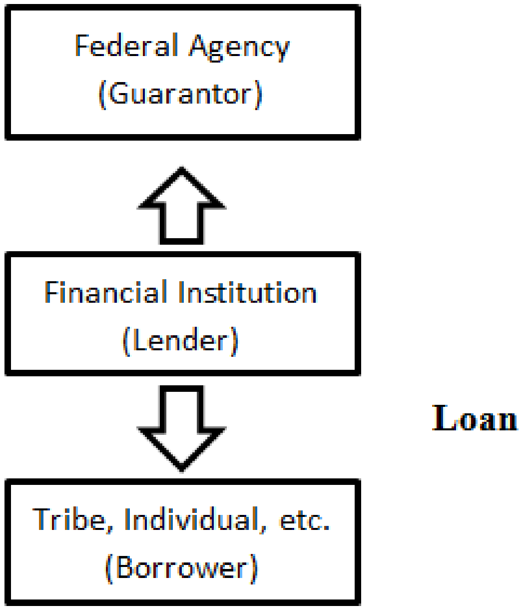
Yes. This is called "a limited waiver of sovereign immunity" and it has become a common feature of lending transactions involving tribal owned businesses.

Also, while a private, Native-owned business may pledge land it owns as collateral for a loan, tribal owned businesses may not pledge Indian trust lands as collateral.[1] However, some lenders have taken leasehold mortgage interests as collateral, and others have taken equipment that a tribe has purchased through the loan.

What is a federal loan guarantee and why should I be interested in one?

A federal loan guarantee is not a direct loan. Rather, it is a promise by the federal government to pay back a certain percentage of the loan's principal in the event the borrower defaults. This kind of guarantee reduces the risk to the lender, enabling the lender to approve a loan that would otherwise not have been approved or to offer it on better terms to the borrower, such as a reduced interest rate or a longer repayment term.

[1] 25 U.S.C. § 177



What is the Indian Affairs Loan Guarantee and Insurance Program?

Congress established the Indian Affairs Loan Guarantee and Insurance Program by way of the Indian Financing Act of 1974, 25 U.S.C. §1481 et seq. to furnish tribal members with business and commercial capital not otherwise available to them. The Indian Affairs Loan Guarantee was intended to enable American Indian and Native Alaskan borrowers to obtain financing for which they would otherwise not qualify.

Who operates the Indian Affairs Loan Guarantee and Insurance Program?

The Office of Indian Energy and Economic Development's Division of Capital Investment (DCI) operates the program. DCI can guarantee up to 90 percent of the unpaid principal and accrued interest due on a loan for terms up to 30 years.

The program has enabled roughly $1.4 billion of lending to take place in Indian Country that would not have occurred otherwise. At any given time, it has between 500 and 600 guaranteed and insured loans outstanding.

How can I obtain an Indian Affairs Loan Guarantee?

It is actually your lender – a bank, CDFI, or non-bank lender – that would apply for an Indian Affairs Loan Guarantee and it is the lender that must comply with a loan insurance agreement under the program.

Who is eligible for an Indian Affairs Loan Guarantee?

To be eligible for an Indian Affairs Loan Guarantee, you must be able to show that your business is at least 51% Indian owned. You must also be able to demonstrate that the loan will contribute to the economy of a reservation or Bureau of Indian Affairs service area. Additionally, you must be able to identify a 20% equity position in the business being financed. Loans cannot have as their primary purpose gaming or tobacco-related endeavors, or anything that violates the law. The premium for a loan guarantee is 2% of the portion of the original loan principal amount that DCI guarantees.

When DCI evaluates the lender's application for an Indian Affairs Loan Guarantee, what will be the determining factor?

The most important factor DCI will take into consideration when evaluating the lender's application for an Indian Affairs Loan Guarantee is the reasonable prospect of loan repayment from the borrower's cash flow or liquidation of assets.

What kinds of assets will fulfill the 20% equity requirement?

The borrower is required to have at least 20% equity in the business being financed, immediately after the loan is funded. Property, equipment, inventory, and accounts receivable will all qualify as assets for this requirement. If a substantial portion of the loan is for construction or renovation, the borrower's equity may be calculated based upon the reasonable estimated value of the borrower's assets after the construction or renovation is completed.

Can the Indian Affairs Loan Guarantee be used to refinance an existing loan?

Yes. However, the borrower must not be in default on the loan sought to be refinanced.

Is there a limit to the amount of money I can borrow for a loan backed by the Indian Affairs Loan Guarantee?

If the borrower is an individual Indian or Native Alaskan, the limit for a loan backed by the Indian Affairs Loan Guarantee is $500,000. However, there is no statutory limit on the amount of a loan that can be guaranteed for an Indian or Native Alaskan business, tribal business, or tribal enterprise involving two or more persons. In FY 2015, the average Indian Affairs Loan Guarantee was for $3.3 million.

What is considered a non-bank lender?

A non-bank lender is a lender that is not a bank or a CDFI but regularly engages in the business of making loans and is capable of evaluating and servicing loans in accordance with reasonable and prudent industry standards.

What kinds of lenders are not eligible to apply for an Indian Affairs Loan Guarantee?

Ineligible lenders include: agencies or instrumentalities of the federal government; lenders that borrow money from any federal government source, other than the Federal Reserve Bank System, for purposes of relending; lenders that do not include the interest on loans they make in gross income, for purposes of chapter 1, title 26 of the United States Code; and lenders that do not keep any ownership interest in loans they originate. Credit unions, except those that are CDFIs, are not eligible to apply for an Indian Affairs Loan Guarantee.

What must be included in an Indian Affairs Loan Guarantee application?

To apply for an Indian Affairs Loan Guarantee, an eligible lender must submit to DCI a loan guarantee application request form, together with a written explanation of why it needs the guarantee, and the minimum loan guarantee percentage it will accept; a copy of the borrower's complete loan application; a description of the borrower's equity in the business being financed; a copy of the lender's independent credit analysis of the borrower's business, repayment ability, and loan collateral (including insurance); a credit report dated within the prior 90 days; a copy of the lender's loan commitment letter to the borrower, showing at a minimum the proposed loan amount, purpose, interest rate, schedule of payments, and security (including insurance requirements), and the lender's terms and conditions for funding; and the lender's good faith estimate of any loan-related fees and costs it will charge the borrower. If the loan guarantee will be used refinance an existing debt, the application must also include a clear description of all loans being paid off, and a comparison that identifies the advantages of the new loan over the loan(s) being paid off.

DCI also offers loan insurance. What is that?

Loan insurance is designed to appeal to lenders wishing to finance smaller Indian-owned business transactions, typically less than $250,000. Loan insurance agreements can be between the Department and any Federal or State bank, CDFI, or non-bank lender that meets specified criteria.

Like loan guarantees, loan insurance is available only when the borrower can demonstrate 20% equity in the business being financed, and a purpose that will aid the economy of a reservation or tribal service area. Loans being insured cannot have as their primary purpose gaming or tobacco -related endeavors, or anything that violates law. Unlike loan guarantees, loan amounts to be insured under $250,000 require no prior review by DCI. The premium for insured loans is 1% of the insured loan amount. In the event of default, insured lenders must liquidate collateral before making an insurance claim for any remaining deficiency.

Whom should I contact for questions about the Indian Affairs Loan Guarantee and Insurance Program?

David Johnson -Acting Chief of DCI. He can be reached by email at Davidb.Johnson@bia.gov or by phone at (202) 208-3026.

What other federal agencies offer loan guarantees for Native American business owners?

Various federal agencies offer loan guarantee programs including the U.S. Small Business Administration (SBA), the U.S. Department of Agriculture (USDA), and the U.S. Department of Energy (DOE). The U.S. Export-Import Bank also offers a program.

For more information about SBA loan guarantee programs, please visit: https://www.sba.gov/loans-grants/see-what-sba-offers/sba-loan-programs/7a-loan-program

For more information about USDA's program, please visit: http://www.rd.usda.gov/programs-services/business-industry-loan-guarantees

For more information about DOE's loan guarantee program, please visit: http://energy.gov/lpo/title-xvii-faqs

For more information about the U.S. Export-Import Bank's loan guarantee program, please visit: http://www.exim.gov/what-we-do/working-capital

[2] Readers may also consult the USDA's "Business & Industry Loan Guarantee" fact sheet, Rural Development, Rural-Business Cooperative Service, January 2015.

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1951 Constitution Ave, N.W. MS-20-SIB
Washington, D.C.   20245

Phone: (202) 208-0740