



SBA A to Z: How SBA Lending Compliments Your Conventional Loan Portfolio

How Can Community Banks Can Make Safe, Sound, Secure and Profitable
Commercial Loans in a Competitive and Difficult Credit Climate and Uncertain
Economic Environment?

Presented By: Michael Ryan

Presentation Objectives



Role of Community Banks & Small Business Lending

The SBA 7(a) Loan Program

SBA 7(a) Loan Profitability

SBA 7(a) Loan Program - Loan Process Overview

Outsourcing Solution – The Lender Service Provider

Recap – Community Bank's use of the SBA 7(a) Program

Role of Community Banks

U.S. Small Businesses

- Represent 99% of all employer firms
- Employ half our nation's workers
- Created 70% of all new jobs over the past decade
- Struggle to obtain capital in challenging lending markets

Community Banks

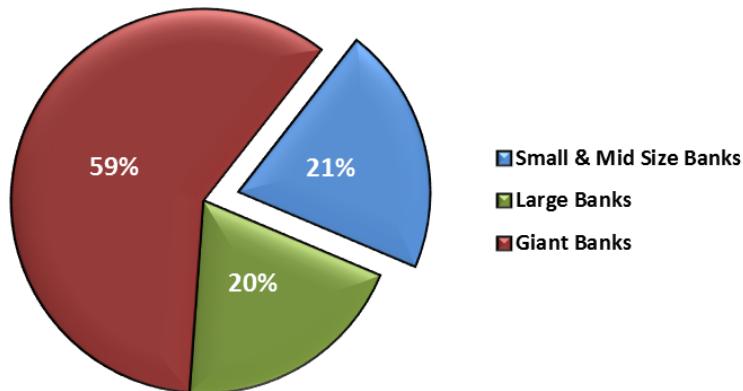
- Loans to small business owners represents only 12% of all community bank assets in the U.S.
- Provide in excess of 20% of all Small Business Loans
- **Historically:** Focused on Commercial Real Estate Lending (85% of Commercial Loan Portfolio)
- **Recently:** Increase in C&I Lending

Role of Community Banks

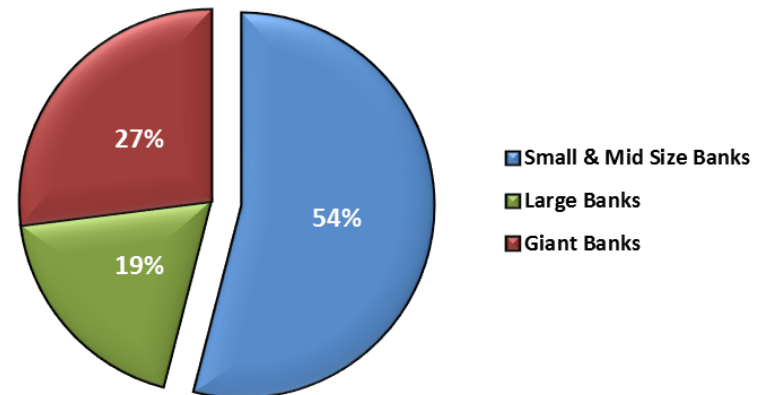
Small & Mid Size Banks

- Represent 21%* of Total Bank Assets
- Account for 54% of all Small Business Loans

Share of Total Bank Assets



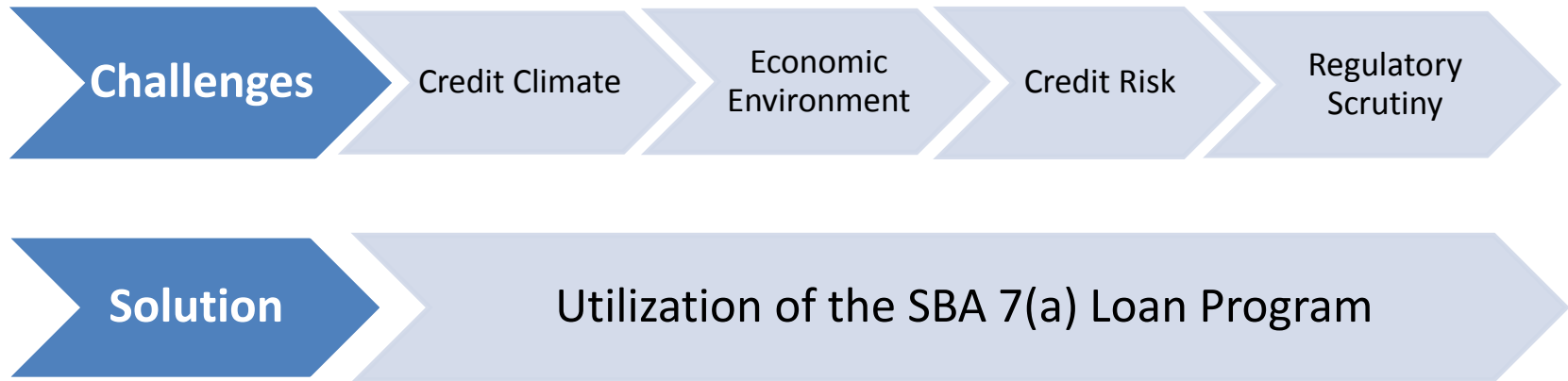
Share of Total Small Business Loans



*Community Banks included in "Small & Mid Size Bank" Category
Source: Federal Deposit Corporation Data, 4th Quarter 2015

SBA 7(a) Loan Program

How can Community Banks Increase Lending to Small Businesses and make sound, safe, secure and profitable commercial loans?



Use Of Loan Proceeds

- Refinance Debt
- Permanent W/C
- Business Acquisition
- FFM&E Financing
- R/E Acquisition, Refi, Expansion

SBA 7(a) Loan Program Summary

SBA 7(a) Loans

Eligible Business	For Profit
Eligibility Criteria	Industry: Sales & Employee Limits by Industry Financial: Net Worth < \$15 Million, NIAT < \$5.0 Million
Loan Guarantee	75% / Maximum of \$3.750 Million
Interest Rate	Negotiable to NYP + 2.75% or 1 Mo. LIBOR + 300bps +2.75%
Maximum Loan Term	25 Years
Fees	2%-3.75% of the Guaranteed Portion

Conventional Loans vs. SBA 7(a) Loans

	Conventional Loan	SBA 7(a) Loan
Interest Rate	Variable or Fixed Rate	Primary Rate based on NYP or LIBOR
Term Maturity	FFM&E: 5-7 Year Term Real Estate: 5-10 Year Term with Balloon	Working Capital: Up to a 10 Year Term FFM&E: Useful Life or Up to a 10 Year Term Real Estate: Up to a 25 Year Term with no Balloon
Amortization	FFM&E: Typically fully amortizing Real Estate: 15-25 years amortization	FFM&E & Real Estate: Fully amortizing (No Balloons)
Collateral	Typically fully collateralized based on discounted collateral values	Absence of full collateral coverage based on discounted collateral value is acceptable. Loan guarantee covers collateral shortfall.
Covenants	Typical for C&I and Commercial Real Estate transactions	SBA: Acceptable based on lender approval USDA: May require certain covenants
Fees	Varies based on Loan Type and Competitive Factors	Agency Loan Guarantee Fee
Profitability	Measured primarily by: <ul style="list-style-type: none"> ➤ Net Interest Margin & Fee Income ➤ Deposits 	Measured primarily by: <ul style="list-style-type: none"> ➤ Net Interest Margin (Retained Portion of loan) ➤ Non Interest Fee Income (Secondary Market Sale) ➤ Loan Servicing Income & Deposits

SBA 7(a) Loan Program

Benefits to Lender

- U.S. Government Guarantee for up to 75% of Loan Amount (↑Yield & ↓Risk)
- Reduced Reliance on Participations while Maximizing Fee Income. Guaranteed Portion of Loan is not subject to the Bank's Legal Lending Limit or Reserve Requirements
- Expand Market Share / Increase Asset Quality / Reduce Loan Portfolio Credit Risk
- Increased Liquidity & Portfolio Profitability through Secondary Market Sales
- Substantial "Non-Interest" Fee Income in Year 1 & Annual Servicing Income provides Significant Yield on Invested Funds

SBA 7(a) Loan Program

Benefits to Borrower

SBA 7(a) Program

- Longer Term Financing:
 - Up to 10 Years for Working Capital
 - 10 Years or Useful Life for FFM&E
 - 25 Years for Real Estate
- No Balloon Provisions
- Reduced Equity and Collateral Requirements
- Consolidated Loan Components
 - Lower Monthly Payments
 - Improved Cash Flow

SBA 7(a) Loan Program

Lender Categories & Obstacles

Lender Categories

- **Not Interested**
- **Interested:** Not sure how to proceed
- **Interested:** Infrequent Use
- **Committed:** Frequent Use

Some Common Obstacles

- Cost to hire additional staff
- Lack Industry Knowledge & Expertise
- Considered Cumbersome & Time Consuming
- Adherence to Specific Program Guidelines and Requirements that differ from Conventional Lending Parameters

Loan Profitability Profitability Comparison

SBA 7(a) vs. Conventional

Government Guarantee, permits Lender
to increase loan production by 4x

Total Profitability over 5 years – 2.5x more profitable

Higher profitability, compensates Lender for increased risk

Loan Profitability

SBA 7(a) Loan Sale Illustration

SBA 7(a) Loan

Loan Assumptions

Gross Loan Amount	\$ 1,000,000
Guaranteed Portion Sold (75%)	\$ 750,000
Non-Guaranteed Retained Portion	\$ 250,000
New York Prime	3.50%
Interest Rate Spread	2.75%
Loan Term	25 Years

Secondary Market Assumptions

Full Coupon Price	110.00
Gross Premium at Full Coupon	\$ 75,000
Servicing Retained by Lender	1.00%

Estimated Income Year 1 and On-Going:

Servicing Income on Sold Portion	1.00%	on	\$ 750,000	\$	7,500
Interest Income On Retained Portion	6.25%	on	\$ 250,000	\$	15,625
Ongoing Annual Income				\$	23,125
Premium Income First Year Only				\$	75,000
First Year Total Income				\$	98,125

Approximate Yield on Retained Loan Balance:

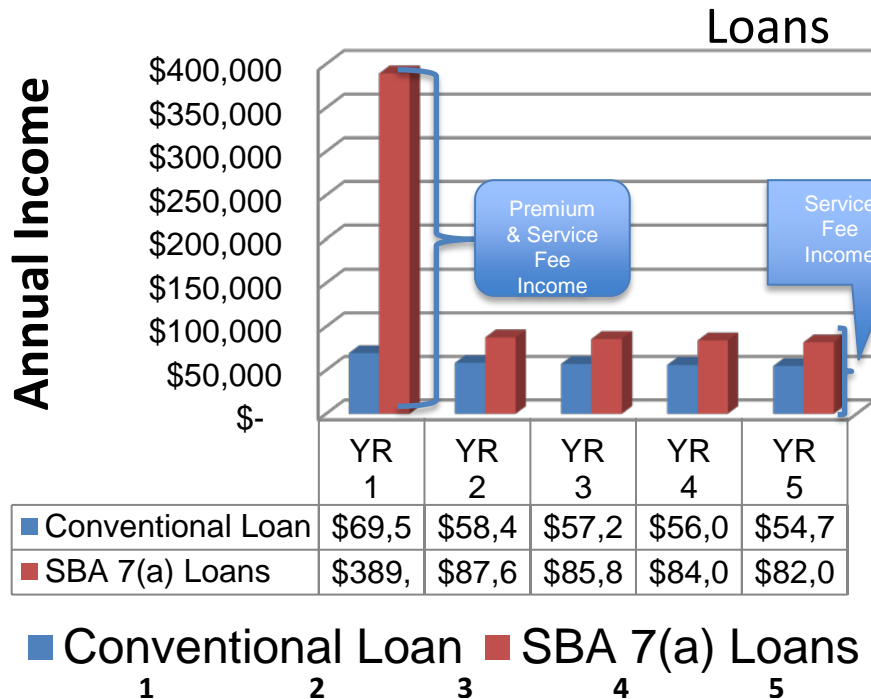
<i>First Year</i>	\$ 97,500	/	\$ 250,000	= Prime +	35.75%
<i>Ongoing Subsequent Years'</i>	\$ 22,500	/	\$ 250,000	= Prime +	5.75%

Loan Profitability

SBA 7(a) vs. Conventional - 5 Yr. - Income Comparison

Conventional Loan: 1x \$1 Million @ 6%

SBA 7(a) Loans: 4x sold \$1 Million SBA 7(a) 75% Guaranteed Loans @ 6% with 110 Premium and 1% Servicing Income on Sold



- 4x Loan Volume
- Year 1 = Premium Income
- Annual = Servicing Fee Income
- 7(a) Income 2.5x > Conventional Loan

**Upon loan sale, the Lender's exposure decreases to 25%. Four sold \$1MM SBA Loans = \$1MM total exposure.*

SBA 7(a) Loan Program Overview

Utilizing a Lender Service Provider

- **Lender & Lender Service Provider (LSP) Relationship:** Development and implementation of an SBA 7(a) Loan Program.
 - **SBA Loan Programs & Banking Expertise:** LSP provides in-depth knowledge, experience and resources in:
 - i. SBA Lending
 - ii. Banking & Finance
 - iii. Loan Compliance
 - **Variable vs. Fixed Costs:** Utilizing an LSP allows the Lender to offer SBA 7(a) loans, without the cost of hiring lending and support staff.
 - **Referral Source for New Loans:** No referral fees paid on LSP referrals.
- **Loan Origination Process:** Clearly defined process and allocation of responsibilities → Reduces the time required by the Lender to manage its SBA loan program through a strategic alliance with an approved SBA LSP.
- **New Loan Production:** Increase quality C&I loan opportunities.

SBA 7(a) Lending Loan Process Overview

- **New Loan Prospects:** Sourced by both Lender & LSP
- **Key Stages of SBA 7(a) Loan Process:**
 - Initial Eligibility Assessment (IEA):** Lender or LSP completes the Preliminary Assessment Documents and collects limited documentation for completion of the IEA = **Assessment Stage**
 - Underwriting (UW):** LPS verifies eligibility & completes credit analysis and UW = **Evaluation Stage**
 - Loan Approval:** Lender approves the SBA compliant credit request = **Lender Approval Stage**
 - SBA Application Processing:** LSP completes and submits the SBA Application = **SBA Approval Stage**
 - Loan Closing:** Lender's counsel documents the loan pursuant to SBA program guidelines = **Loan Closing Stage**

Assessment Stage

IEA - By Lender

- **New Loan Prospects:** Lender and LSP source new loan opportunities. Each is classified as:
 - **Pass on Loan Prospect:** Does not meet minimum credit standards.
 - **Conventional Loan Prospect:** Meets conventional credit standards.
 - **SBA 7(a) Loan Prospect:** Does not meet conventional credit standards and further evaluation required to meet SBA eligibility and UW guidelines.
- **SBA 7(a) Loan Prospect:**
 - **Initial Eligibility Assessment (IEA):** Lender responsible for the following:
 - i) Prelim Assessment Docs** → Provides and overview of financing request:
 - **Loan Parties:** Borrower(s) / Guarantor(s) / Affiliate(s).
 - **Financing Request:** Use of Proceeds (by primary Use Category).
 - **Debt Refinance:** Need terms of prior debt and understand original use of loan proceeds.
 - **Collateral:** Description of anticipated collateral.
 - **Credit & Character:** Identify issues that could impact SBA eligibility.
 - **Financial Condition:** General understanding of recent financial performance and trends.
 - ii) Assemble Required Borrower Financial Information & Documentation**

Assessment Stage

IEA Part 2 - By LSP

Initial Eligibility Assessment: LSP is responsible for the following:

- i) **Review all IEA Documentation Submitted** → Review Prelim Assessment Docs and related financial information to begin eligibility assessment.
 - **Financing Request:** Discuss questions / clarifications with Lender
 - **Initial Documents Submitted:** Determine if initial documents submitted provide sufficient support for completion of the Prelim Assessment Docs.
- ii) **Evaluate**
 - **Eligibility:** Type of Business / Use of Proceeds.
 - **Credit Worthiness:** Historical or Projected Cash Flow to repay debt.
 - **Loan Structure:** Borrowers / Guarantors / Terms / Collateral / Other Considerations.
 - **Engagement:** Discuss preliminary loan terms with Bank and Borrower.

Evaluation Stage

Analysis & Underwriting

Analysis & Underwriting: LSP evaluates the Preliminary Assessment Docs, including all supporting financial and related information, and proceeds as follows:

- i) **Program Eligibility:** Program Eligibility & Credit Worthiness of the Applicant is completed based on review of the Prelim Assessment Docs.
- ii) **Applicant Engagement:** Analysis and Underwriting commences upon Applicant engagement.
- iii) **Comprehensive Documentation Checklist:** Prepared based on scope of the financing request. Checklist is sent directly to the Borrower.
- iv) **Financial Analysis:** LSP completes a comprehensive credit analysis and UW of the financing request.
- v) **Credit Approval Document:** The Credit Approval Document, in the Lender's approved format, is saved and safely secured by the LSP for Lender to access.

Lender Approval Stage

Lender Credit Evaluation

Lender Approval: Lender completes its credit review and evaluation of the Applicant Financing Package prepared by LSP.

- i) **Documentation Review:** Lender reviews all the related information and supporting documentation.
- ii) **Eligibility & Credit Worthiness:** Lender separately reviews all SBA loan program guidelines to ensure the Applicant's credit request is eligible and credit worthy in order to establish a reasonable expectation of the Borrower's ability to repay the loan.
- iii) **Credit Approval:** Once the credit request has been approved by the Lender, the SBA Loan Application is completed.

SBA Approval Stage

SBA Application Process

SBA Application: LSP prepares the SBA Application.

- i) **SBA Application (Draft):** Concurrent with the Lender's Approval Stage, LSP begins to prepare the SBA Application (Full Draft).
- ii) **SBA Application (Final):** Upon the Lender's Approval, LSP submits final SBA Application according to the terms approved by the Bank and conforms with all SBA program requirements.
- iii) **Agency Processing:** Throughout the SBA Agency Processing, LSP serves as the primary contact to SBA to address questions regarding the SBA Application.

Closing Stage

SBA Loan Documentation & Closing

SBA Loan Documentation: Lender or Lender's counsel is responsible for preparation of all required loan closing documentation.

- i) **Third Party Reports:** Orders placed at the time of the SBA Application submission. The timing to prepare reports coincides with the general timeframe for SBA Application Processing.
- ii) **Preliminary Loan Closing Checklist:** LSP prepares a preliminary loan closing checklist for Applicant to begin to organize loan closing documents.
- iii) **Initial Documentation Review:** Applicant forwards the required closing documents to the LSP. LSP reviews and organizes all files for review by the Lender's attorney.
- iv) **Legal Documentation Review:** Lender and LSP review all legal documents prepared by Lender's counsel to ensure compliance with the SBA Loan Authorization.

Outsourcing Solution

Advantages to Community Banks

Primary Considerations:

Cost Effective

- Uncertain Loan Volume
- Outsourcing = Variable Cost (No Fixed Overhead)

Easy to Implement

- No Learning Curve
- Established Processes & Procedures on Day One

Industry Expertise

- Strategic Alliance = Industry Expertise on Day One
- Ensured Compliance = Reduced Risk to Bank

Outsourcing Solution

Evaluation of Lender Service Provider

Lender Service Provider (LSP) Relationship Allows Lender to:

- Acquire program expertise vs. employing the same staff directly
- Carefully manage cost to offer GGLs (No Fixed Overhead!)
- Increase relationship profitability

The Lender should evaluate the LSP to ensure the LSP can:

- Define Lender's Commercial Lending Strategy: Loan Size, Loan Type, Industries Served, Market Area
- Evaluate LSP's:
 - Knowledge & Expertise
 - Services & Value = Cost
 - Flexibility = Adapt to Lender's Requirements: Understand the Lender's Credit Culture & Policies

Recap

Community Bank's use of the SBA 7(a) Program

Advantages Offered by the SBA 7(a) Loan Program

- Expand Lender's commercial loan product offerings
- Expand commercial loan portfolio / market share
- Increase asset quality & reduce portfolio risk
- Preserve liquidity & enhance profitability

Obstacles

- Technical and Specific Requirements
- Knowledge and Expertise
- Uncertain Loan Volume
- Fixed Overhead = Staffing Expenses

Outsourcing Solution

- Cost Effective = Variable Fee Structure
- Industry Expertise = Reduced Compliance Risk
- Easy Implementation

Contact Information

Michael D. Ryan, President & CEO

Office: (610) 228-4654 Ext. 101

Cell: (610) 733-9955

Direct/ Fax: (484) 485-2756

E Mail: mryan@InnovFS.net

Joe Herbst, SVP

Office: (610) 228-4654 Ext. 107

Cell: (484) 432-3332

Fax: (484) 485-2757

E Mail: jherbst@innovFS.net

Website: www.InnovativeFinancingSolutions.net