

# SBA 101 - Introduction to SBA Lending

WPASGL 2013 Quality Circle

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# PURPOSE OF SBA FINANCIAL ASSISTANCE

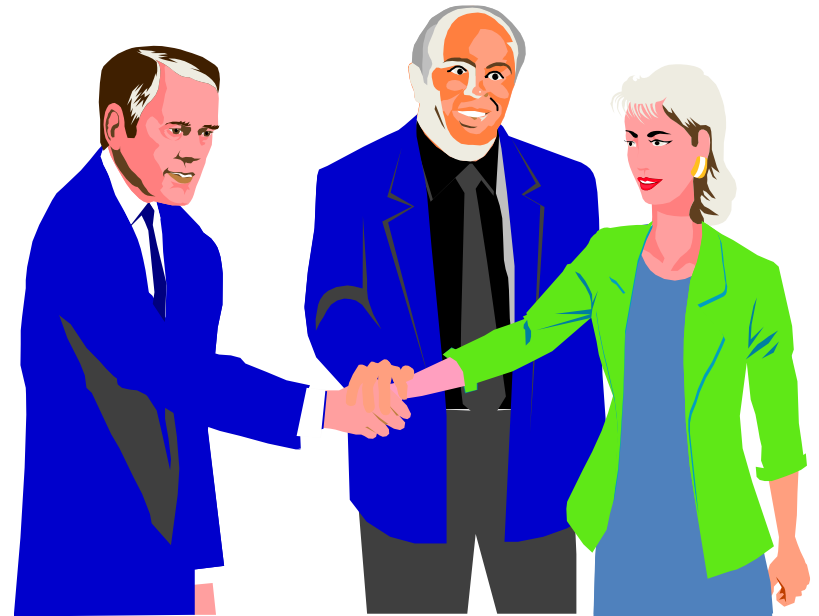
- The purpose of SBA financial assistance is not to encourage banks to make bad loans.
- SBA's purpose is to help businesses with a reasonable chance of succeeding obtain financing needed on reasonable terms.
  - “SBA will not make a bad loan good, but will make a good loan possible”

# Who is SBA?

- SBA is a Federal Government Agency
  - Uses Taxpayer Dollars to Expand the Breadth of Small Business Lending by the Private Sector
- SBA Headquarters – Washington D.C.
  - Makes and Implements Policy
- Centers Delivery Programs
  - SBA Regular Guaranty Processing Center – Citrus Heights, CA
  - PLP & SBA Express Processing Center – Sacramento, CA
  - Loan Servicing Center – Little Rock, AR
  - National Guaranty Purchase Center – Herndon, VA
- SBA Pittsburgh District Office
  - Serves as liaison between Centers and Lenders
  - Marketing & Outreach of SBA Programs

# THREE PRINCIPALS IN AN SBA GUARANTEED LOAN

- Small Business
- Bank
- SBA



# BENEFITS TO SMALL BUSINESS

- Gives small businesses a flexible financing alternative when funding is not otherwise available on reasonable terms.
- Allows for longer terms and lower payments than traditional loans
- Equity/Downpayment requirements may be more flexible than traditional financing

# Situations Where an SBA Guaranty May Be Necessary

- Startup Businesses
- Lack of Collateral
- Lower Than Normal Downpayment/Equity
- Longer Term/Lower Payments Required to Meet Debt Coverage Requirements
- Riskier Industries  
(Entertainment, High-Tech, Service, Retail)
- Uneven Historical Revenues or Profits
- Tighter Than Normal Debt Coverage
- Change of Ownership/Management
- Lending Limits
- Reliance on Projections

# Benefits of SBA Lending

- Increase Your Loan Portfolio
  - Eliminate missed opportunities
  - Small Business has highest growth potential
- Improve Risk Management
  - SBA Lending Has an Inverse Relationship to Economy
- Broaden Your Customer Base
- Provide Better Service
  - Longer terms, lower monthly payments
  - Lower Downpayments
- SBA Loans Meet CRA Requirements
- Allows your bank to be more competitive

# Benefits of SBA Lending (cont.)

- Increase Profitability - SBA Loans can provide good return on pricing
- Relationship Building and Cross Sale Opportunities
- Opens a source of cash to your bank
  - Secondary Market (Premium & Servicing Income)
- Career Building Opportunities
  - Niche Lending
  - Experienced SBA Lenders are in Demand
- Offer Specialty Loan Programs



# How Does SBA Work with Lenders?

- Loan Guaranties – SBA 7(a) Loan Program Umbrella
  - SBA Guarantees or Insures a percentage of the risk to the Bank
    - Pursuant to Eligibility, Underwriting, Closing and Servicing Requirements
    - In accordance with the SBA Loan Authorization
    - Assumes a Prudent Lending Standard
  - In the event of a default, once primary assets are liquidated, Lender can request that SBA honor or “purchase” its guaranty
    - SBA reimburses the approved percentage of loss to the Bank
    - 50% to 90% Guaranty Depending on Program
- Gap Financing – SBA 504 Program
  - SBA guaranties subordinate lien financing to a Bank Loan
    - Certified Development Companies act as SBA’s Agent
    - Only Available for Fixed Asset Financing
    - Provide 30% to 40% of Project Financing in subordinate lien position to primary lender
    - Bank provides a conventional first mortgage/first lien loan at 50% of cost/value of fixed asset financed

# SBA Lending Authority

- 750 Agreement Provides the Basis for SBA Guarantee
- Regular 7(a) Lender
  - SBA Performs Complete and Independent Eligibility Review & Credit Analysis
- CLP Lender
  - SBA Performs a Credit Review of Lender's credit analysis
  - Lender Prepares Draft of SBA Loan Authorization
  - SBA Relies Heavily on Lender's Analysis and Recommendation
- PLP Lender
  - SBA Performs only a brief eligibility review
  - Credit Decision is delegated to the lender
  - Lender executes SBA Loan Authorization on behalf of SBA
  - Immediate approval thru SBA E-Tran system
  - Contract & Working Capital Caplines now available thru PLP

# ELIGIBILITY

- When Should Eligibility Be Determined?  
**AS SOON AS POSSIBLE**
- Determination of Eligibility of the Business Size, Type, and Use of Proceeds Should Be the First Consideration in the SBA Loan Making Process.
- May Eligibility Be Considered Prior to Formal Application? **YES!**
- You Are Encouraged to Contact the District Office When Unclear About the Eligibility of a Particular Business or Transaction
  - Saves Time and Effort

# Eligibility

- Credit Elsewhere Criteria
  - SBA provides business loan assistance only to applicants for whom the desired credit is not otherwise available on reasonable terms from non-Federal sources.
  - Lender's signature on the SBA loan application constitutes certification that credit is not available elsewhere (conventionally).
  - Lender's file must be documented to explain the factors that prevent the financing from being accomplished without SBA support.

# Size Standards

- How Small is a Small Business?
  - Size Standards are Based on NAICS Codes
    - [www.sba.gov/size](http://www.sba.gov/size)
  - Typically Based on Number of Employees or Annual Receipts
    - Retail - \$7 Million (3 year average)
    - Manufacturing - 500 Employees
    - Wholesale - 100 Employees
    - Service - \$7 Million (3 year average)
  - Alternate Size Standard
    - Tangible Net Worth <\$15MM
    - Average 2 Year Net Income < \$5MM
  - Size Is Based on the Combined Operations of an Applicant and All Its Affiliates
    - Affiliates are businesses that have common ownership, common management or contractual relationships

# Ineligible Businesses

- Non-Profits
- Passive Holder of Real Estate (Landlords)
- Businesses Located in a Foreign Country
- Businesses Engaged in Gambling
  - < 1/3 of annual gross sales from legal gambling eligible
  - Criteria for lottery income is based on commission
- Businesses Which Restrict Patronage for other than capacity
- Businesses with an Associate on parole, probation or incarcerated
- Businesses Engaged in Promoting Religion
- Cooperatives
- Equity Interest by Lender
- Businesses Providing Prurient Sexual Material
- Business or Associate which defaulted on a Federal loan resulting in a loss to the government
  - Includes Government Guaranteed Student Loans
  - Does not include tax obligations
- Speculative businesses

# Eligibility (Cont.)

- Utilization of Personal Resources
  - Applies to all 20% or more owners
  - Limitations on liquid assets
    - < or = \$250,000: 2X Financing Package or \$100,000, whichever is greater
    - \$250,001 to \$500,000: 1.5XFP or \$500,000, whichever is greater
    - > \$500,000: 1XFP or \$750,000, whichever is greater
  - Liquid assets in excess of these limits must be injected and reduce the requested SBA financing accordingly
  - Liquid Assets include: cash, CD's, marketable securities, unassigned CVLI
  - Does not include: closely held stock, retirement accounts, real estate, pledged as collateral >6 months.
  - Liquid Assets cannot be pledged as collateral in lieu of injection

# Eligible Passive Company

- Formerly “Alter Ego” Rule
- Exception to Restriction on Passive Concerns
- Operating Company Must be Ultimate Beneficiary of the Financial Assistance
- EPC Rule No Longer Requires Commonality of Ownership Between the Passive and Operating Companies
- EPC Must Use Loan Proceeds to Acquire or Lease, and/or Improve or Renovate Real or Personal Property that It Leases to the Operating Company
- EPC and OC Must Meet Size Standards
- Lease Must Be In Writing
  - Term of lease must at least equal term of loan
  - Assignment of rents required



# Franchises

- Franchisee must have the right to profit from their efforts
- Franchisor must not have undue control over the operation of the business
- Franchise Agreements and FTC disclosures must be reviewed by SBA or Bank depending on program used
- Consult SBA Franchise Findings List
  - [www.sba.gov/content/franchise-findings](http://www.sba.gov/content/franchise-findings)
- All franchises are listed on [www.franchiseregistry.com](http://www.franchiseregistry.com)
  - Must first determine SBA eligibility
  - If eligible, must have appropriate certifications from franchisor

# Franchise Registry

Franchise Registry - Windows Internet Explorer

http://www.franchiseregistry.com/lenders/view\_underwriting\_sba/?corporate\_id=8695&folder\_id=5461

File Edit View Favorites Tools Help

☆ Favorites | ☆ Suggested Sites | Free Hotmail | Web Slice Gallery

Franchise Registry Franchise Registry x

Home RSS Print Page Safety Tools >>

## Firehouse Subs FRN#: 11398

Franchising Status: Active

Underwriting SBA Eligibility

### STEP #1: CHOOSE AGREEMENT DATE

Enter the year of your agreement:   or [Choose from Available Years](#)

### STEP #2: PRINT CERTIFICATE

Print certificate, read & follow eligibility notes, if applicable.

### STEP #3: PRINT ADDENDUMS

Print addendums and other documents referenced in eligibility notes, if applicable.

Agreement Name	Approved Date	Click to View
Firehouse Subs 2012 FDD	Approved 05/25/2012	<a href="#">AGREEMENT II ADDENDUM</a>
Conditional Assignment of Telephone Numbers	Approved 12/07/2012	<a href="#">AGREEMENT</a>

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### STEP #4: Get Signature

Submit certificate to franchisor for signature, prior to loan approval

Contact:   
Title:   
Phone:   
Email:

### STEP #5: SUBMIT TO SBA

For loan approval:

- Delegated Authority - You must document your loan file with the executed certificate, prior to submitting your request to SBA.
- Non-delegated Authority - You must submit the executed certificate as well as copies of the franchise agreement, the addendum & any other required documents (executed or not executed) to the appropriate center for approval.

Internet 75%

# Other Eligibility Issues

- Prior Criminal Convictions
  - Must be disclosed on SBA Form 912 Personal History Statement
    - Single or remote in time minor offenses can be cleared by SBA District Office
    - Felonies will require fingerprint check and clearance only by SBA Headquarters
- Non-US Citizens
  - Must be permanent resident aliens OR
  - Management must have citizenship or permanent resident status and operated business for at least 1 year AND
  - Loan must be 100% collateralized by assets in the U.S.
- CAIVRS – Credit Alert Verification Reporting System
  - Now REQUIRED to be used for loans processed under delegated authority to identify delinquent federal debt or prior loss to government

# Loan Proceeds Eligibility

- Eligible Uses of Proceeds
  - Real Estate
    - Acquire land and/or buildings
    - Construction, Renovation or Improvements
  - Purchase of Fixed Assets (M&E,F/F)
  - Inventory
  - Working Capital
- Ineligible Proceeds Use
  - Payment to an Associate
    - Officer, director or owner of more than 20%
  - Floor Plan Financing
  - Payment of Delinquent Taxes

# Debt Refinancing

- SBA does not refinance debt that is on reasonable terms.
- Must justify unreasonable terms to refinance existing debt with SBA
  - Balloon notes, demand notes, and business credit card debt are all considered by SBA to be on unreasonable terms
- Lender must evidence at least a 10% improvement in cash flow (i.e. reduction in debt service) thru the proposed refinance
- You can refinance your own institution's debt if on unreasonable terms and has been current for last 36 months.
- All debt to be refinanced must be documented and verified as business related
  - Home Equity Loans used for business purposes are again eligible for SBA refinancing

# Real Estate Financing with SBA

- SBA Financing is only for “Owner Occupied” Real Estate
  - For acquisitions and refinances, 51% of total square footage must be owner occupied
    - SBA now allows exterior space actively used in business to be included in the calculation
  - For construction, must be at least 60% immediate owner occupancy, and 80% long term owner occupancy
  - No SBA Loan Proceeds can improve leased space
    - Common improvements are allowed

# Financing Changes of Ownership

- Asset Purchases or Treasury Stock Purchases Only
  - Underlying concept is that a business not individual must be beneficiary of SBA loan proceeds.
  - Must be a complete buyout of the departing or selling owner
  - Must provide a benefit to the business
  - Business Valuation must be completed by Lender or Third Party depending on size of transaction and level of goodwill
    - If amount financed less appraised value of fixed assets < \$250k, then Lender may perform its own valuation
    - If amount financed less appraised value of fixed assets > \$250k or if close relationship between buyer and seller, third party valuation by qualified professional will be required
    - If goodwill/intangible assets > \$500k, then Borrower must have a 25% equity injection for PLP submission

# SBA's Lending Criteria

- Character, Reputation and Credit History of Applicant
- Experience and Depth of Management
- Strength of the Business
  - Proforma Balance Sheet
  - Working Capital Adequacy
- Past Earnings, Projected Cash Flow and Future Prospects
  - Note trends in revenue and cash flow
- **Ability to Repay Loan with Earnings from the Business Operations**



# Proforma Balance Sheet

- Reverse Side of Lender Application (4-I)
- Use Latest Balance Sheet as basis
- Adjustments for Debits/Credits
  - Writeup/Writedown of Asset Values
  - Removal of Intangibles
  - Effect of proposed loan
  - Standby agreements/Shareholder loans
- Ratios calculated: Debt/Worth, Current Ratio, Working Capital, Days Payable/Receivable

# Lending Criteria (Cont.)

- Sufficient Invested Equity to Operate on a Sound Financial Basis
  - Generally will not provide 100% financing for a new business or business purchase
  - Debt/Worth is primarily tool for determining adequacy of equity
  - Adverse Equity Ratio Can Be Offset By:
    - Pledge of outside collateral
    - Experienced Management
    - Standby Debt
  - Personal Debt May Be Considered Equity:
    - On Full Standby
    - Outside Income/Repayment Source Outside of the Business Present and Sufficient to Service the Debt

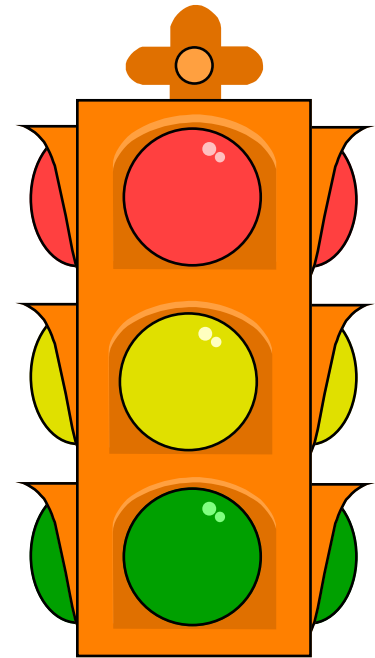
# Maximum % of SBA Guaranty

- 7(a) Term Loans, Caplines & Small Loan Advantage
  - 85% on loans up to \$150,000.
  - 75% on loans over \$150,000.
- SBA Express
  - 50% Guaranty
- International Trade & EWCP
  - 90% Guaranty



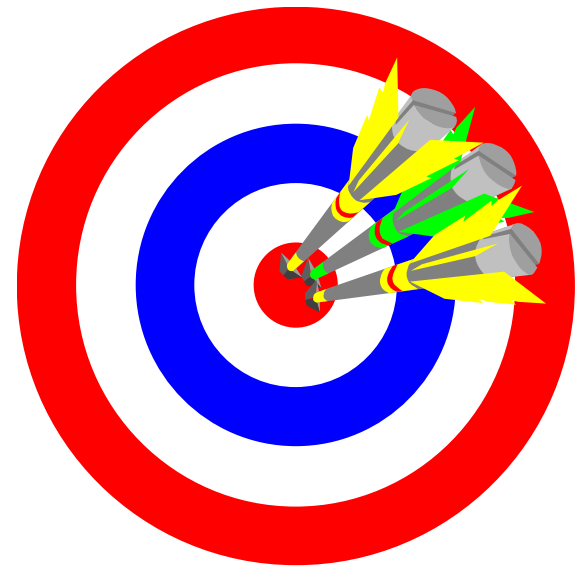
# Maximum Loan Amount

- 7(a) Term Loans & Caplines
  - SBA combined exposure is limited to maximum of \$3,750,000.
  - Can be one loan or numerous loans up to \$3,750,000 limit.
  - Gross Loan Limit is \$5,000,000
- SBA Express
  - \$350,000 except
  - Patriot & Export Express \$500,000
- Small Loan Advantage
  - \$350,000 Maximum
- 504
  - \$5,000,000 Debenture Limit



# Maturity of Loans

- 7 to 10 years for working capital.
- Up to 10 years for equipment.
- Up to 25 years for real estate.
- SBA will blend maturity for multiple uses of proceeds OR
- Use maximum maturity for asset comprising the largest percentage of the loan



# Maximum Interest Rates

- Must use SBA approved Index
  - Wall Street Journal Prime Rate
  - LIBOR Base Rate
  - SBA Optional Peg Rate
- Prime plus 2-1/4% for maturities under 7 years.
- Prime plus 2-3/4% for maturities of 7 years or longer.
- Exceptions for smaller loans: (Up to \$50,000)
  - May charge 1% more on loans between \$25,000 and \$50,000; and,
  - 2% more on loans under \$25,000.
- Express Loans & Small Loan Advantage can be priced up to 6.5% over WSJ Prime
- Lenders should compensate for 55 basis point servicing fee in pricing.

# Guaranty Fee Changes

- Simplified structure, previous tiered structure has been eliminated.
- If total loan is \$150,000 or less: Fee is 2% of SBA guaranteed portion.
  - Lenders may retain 25% or 50 basis points of the guaranty fee on small loans.
- If total loan is between \$150m and \$700m: Fee is 3% of SBA guaranteed portion.
- If total loan is more than \$700m: Fee is 3.5% of SBA guaranteed portion.
- Guaranteed portions of loan in excess of \$1MM are charged at 3.75%
- If Loan is 12 months or less in term, fee is only  $\frac{1}{4}$  of 1% of SBA Guaranteed Portion
- Guaranty Fee Due to SBA within 90 days of approval if longer term loan > 12 months
- Guaranty Fee Due to SBA within 10 days of approval of short term loans of 12 months or less

# Guaranty Fee Examples

- \$100,000 Loan
  - 85% guaranty (\$85,000)
  - 2% fee (\$1,700)
- \$140,000 Loan
  - 85% guaranty (\$119,000)
  - 2% fee (\$2,380)
- \$500,000 Loan
  - 75% guaranty (\$375,000)
  - 3% fee (\$11,250)
- \$800,000 Loan
  - 75% guaranty (\$600,000)
  - 3.5% fee (\$21,000)



# Packaging & Broker Fees

- SBA now permits brokerage and packaging fees to be based on a percentage of the loan amount
  - Fees must be reasonable and customary
  - Cap of 3% on loans of \$50,000 and less
  - Cap of 2% on first \$1MM and ¼% thereafter
  - Maximum fee of \$30,000
  - Must still be disclosed on SBA Form 159

# The SBA 7(a) & Caplines Application

- SBA Form 4-I Lender's Loan Application
- SBA Form 4 – Borrower's Loan Application
- SBA Form 4a – Collateral Schedule
- SBA Form 159 – Compensation Agreement
- SBA Form 912 – Personal History Statement
- SBA Form 1624 – Debarment Form
- IRS Form 4506 – Request for Tax Transcript
- SBA Form 601 – Agreement of Compliance (if applicable)
- SBA Form 1846 – Statement Regarding Lobbying

# SBA Express

- Reduced SBA Guaranty of 50%
- Bank uses own documentation and underwriting process
  - SBA Form 1919 only customer form
  - Eligibility checklist submitted to SBA Sacramento
- Can charge fees reasonable and customary for conventional loans of same size and type
- Can use for revolving lines of credit

# The SBA Express Application

- SBA Form 1919 – Borrower Information Form
- IRS Form 4506 – Request for Tax Transcript
- SBA Form 159 – Compensation Agreement (if applicable)
- SBA Form 601 – Agreement of Compliance (if applicable)
- SBA Form 1920 B & C – Supplemental Information Sheet and Eligibility Checklist
  - Are completed by lender not borrower

# Small Loan Advantage

- Available to all SBA participating lenders
- Maximum Loan Size of \$350,000
- Term loans only, no revolving lines
- Electronic application submission
- Credit Scored by SBA prior to loan approval
  - Proprietary Small Business Predictive Score
  - If acceptable score, no further underwriting by SBA
- Lenders can use their own notes and guaranties

# Caplines

- Contract Caplines
  - Funds all contract costs as contract is completed
  - No longer requires assignment of contract in all cases
- Seasonal Caplines
  - Finance seasonal increases in accounts receivable and inventory
- Builder's Capline
  - Funds construction or substantial renovation of residential or commercial buildings for resale
- Working Capital Caplines
  - Fund short term working capital needs
  - Up to 10 year maturity
  - Governed by a borrowing base certificate or must be fully collateralized on a 1:1 collateral ratio

# TYPICAL 504 PROJECT

- Private-sector lender - 50% of project cost - first mortgage on assets being acquired.
- CDC - maximum of 40% of project cost - from sale of SBA guaranteed Debentures - second mortgage on assets being acquired.
- Borrower - at least 10% of project cost - up to 20% injection may be required.

# 504 Loan Program

- Purpose: Fixed Assets Only - No working capital or debt refinancing.
- Maximum SBA participation is \$5,000,000
  - \$5.5MM for Manufacturers & Energy Efficient Projects.
- Minimum SBA participation is \$50,000.
- Maturity for Debenture is 10 or 20 years.
- Must create or retain one job for every \$65,000 guaranteed or meet SBA public policy goals.



# BENEFITS OF 504 LOAN

- For Borrower - Receives long-term, fixed-rate financing at favorable interest rate.
  - Most recent 20 year 504 bond APR was 4.3%  
Fixed for 20 years
- For Banker - Finances only 50% of project costs, while getting a first lien on all the assets.

# SBA Lending Resources

- [WWW.SBA.GOV/FOR-LENDERS](http://WWW.SBA.GOV/FOR-LENDERS)
- [WWW.NAGGL.ORG](http://WWW.NAGGL.ORG)
- [WWW.WPASGL.ORG](http://WWW.WPASGL.ORG)
- [WWW.NADCO.ORG](http://WWW.NADCO.ORG)