Obtaining Loans Through the SBA

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EXECUTIVE SUMMARY

- The Small Business Administration (SBA) may offer the only way for new or small businesses to obtain financing in today's tough banking climate. The SBA's sole mission is to help people get into business and to stay in business.
- Besides guaranteeing loans, the SBA provides business development assistance since many new businesses fail within a few years of inception. Marketplace survival skills are also taught by the SBA.
- Small businesses should know what they need the money for, how much they need, and how they intend to pay back the loan before approaching the SBA.

How do new or small businesses obtain a long-term commercial loan in a time when there is both a tough banking climate and business environment? The Small Business Administration (SBA) may offer the only way for a small or new business to obtain financing. Small loans are very often overlooked by lenders as unprofitable owing to their high overhead and other administrative considerations.

In addition, many small businesses need "term" loans of up to twenty-five years, but find most commercial lenders limit their lending to short-term loans. In a time of tight bank policies, many entrepreneurs are not able to qualify for traditional financing. The bottom line is that bankers prefer to lend to stable, profitable businesses rather than to those without sufficient capital. While entrepreneurs are happy to take calculated risks, bankers are taught to avoid financial risks. The SBA's sole mission is to help people get into business and stay in business. The SBA is an independent federal agency created by Congress in 1953 to stimulate and foster economic development through small businesses. It provides financial and business development assistance programs to small firms and helps new businesses get started and established businesses to grow. Since its inception, the SBA has helped more than ten million firms.

Financial Assistance. The SBA primarily provides financial assistance. The agency offers a variety of financing options for small businesses, but it rarely makes direct loans to a company. Instead, the SBA acts as a guarantor; it guarantees loans made by banks and other private lenders to small business clients.

The SBA-approved lenders are delegated authority to make credit decisions that result in faster service to borrowers. The lender will also check with the SBA before formal application for feasibility of the project. Effective January 1, 1995, and as of April 1, 1995, the SBA guarantees up to 90 percent of loans under $155,000 and up to 85 percent of loans between $155,000 to $500,000.

The primary goal of this program is to reduce the risk to banks and increase the

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chances that banks will do more to assist young businesses. Statistically, a small business is an extremely high-risk investment for banks. Roughly half of new ventures do not survive the first five years, but when the SBA steps in and assumes the risk on behalf of the bank by guaranteeing loan repayment, it allows banks to extend credit lines to businesses with little collateral or above-average risk.

Financial Counseling. The SBA also provides business development assistance since most new businesses fail within a few years of starting. While there may be a number of reasons why this occurs, the major cause is poor planning and management.

Many small businesses are not sure what they want and are not sure what to ask for in terms of loans. The SBA attempts to reduce this problem though its management assistance efforts. It sponsors courses and conferences, provides counseling, prepares and distributes information booklets, and conducts research into the management problems of small businesses. The SBA will teach small business owners marketplace survival skills, bookkeeping, marketing, cash flow management, and business development plans.

Preparation. Small business owners must be precise in what they need the money for, how much they need, and how they intend to pay the loan back before approaching an SBA lender. It is advisable that a small business owner retain an experienced attorney who is familiar with SBA loans and their requirements. Depending on the size of the loan and the collateral involved, the transaction can be complicated and a counsel with a lending background can be a substantial benefit to the company. The company may also want to bring an accountant to the initial meeting with the bank. To combat a banker's skepticism, the accountant should:

- ☐ Ensure that the company's financial statements are in order.
- ☐ Be fully prepared to discuss how the loan is to be repaid, the history of the business, and its past earnings.
- ☐ Be prepared to answer questions beyond those on the loan application. Try to present as full a picture of the company as possible by including product samples, promotional literature, consumer testimonials, and press clippings with the loan application.

Eligibility Requirements. To be eligible for an SBA loan, business owners must be able to meet the formal requirements of the SBA (see the accompanying sidebar, entitled "SBA Eligibility Requirement Checklist," for more information). An SBA-approved lender will usually require detailed plans that project sales, marketing goals, staffing, income, cash flow, and growth over the previous three years. While there is no requirement to show denial of a prior loan, all loans must be reviewed and approved by the SBA. Generally, SBA approval is obtained within ten – twenty business days on receipt of a completed application.

The SBA will not provide assistance to businesses that are based on creating or distributing ideas or opinions, including:

- Most non-profit organizations
- Newspapers and magazines
- Radio and television stations
- Book publishers
- Film, record, and tape distributors
- Musicians
- Gambling establishments
- Businesses that own property solely for sale or investment

Loan Details. In an SBA loan, there are three principal parties: The SBA, the small business borrower, and the SBA-approved private lender. The lender plays the center role. The small business will submit a loan application to the SBA lender for an initial review. If the lender finds the application acceptable, it forwards the application and its credits analysis to the SBA for approval. On approval, the SBA lender chooses the loan and disburses the funds. The private lender is actually the bank and not the SBA. The borrower will make loan payments directly to the SBA lender.

The maximum loan amount offered by the SBA as of April 1, 1995, is $500,000. The products offered by the SBA have interest rates calculated at 2.25 percent to 2.75 percent over the prime rate as listed in *The Wall Street Journal.* The interest rates generally are adjusted quarterly. Loan terms vary depending on the use of the proceeds and the ability of the business to repay. Working capital loans generally have maturities of seven years. While the maximum maturity is twenty-five years for the purchase of business premises, longer maturities are available depending on the SBA lender. There are no adjustment caps, no floor, and no ceiling. The principal is amortized over the term of the loan with no balloon payments. There are no prepayment penalties. Most lenders will not loan less than $50,000. The loan proceeds can be used to finance increased receivables, augment working capital, staff a new business, purchase machinery, fixtures, inventory, or equipment or leasehold improvements, business-related real estate improvements expansion, and modernization, purchase business related land and buildings, or construct new commercial buildings. The proceeds can also be used to expand, hire employees, or to refinance existing debt.

Typical closing costs consist of an appraisal and environmental report if the loan is to be secured by real property, a credit report, a processing fee, a guaranty fee of 1.57 to 2 percent of the amount guaranteed by the SBA, and the lender's legal fees.

Collateral. The SBA will approve the lender's request to provide a guaranteed loan by issuing an authorization and loan agreement. This agreement is similar to a loan commitment and outlines the loan terms and the collateral to be taken to secure the loan. Most loans will require the following:

- ☐ Mortgages on commercial and personally owned real property;
- ☐ Security interests in machinery, equipment, furniture, fixtures, inventory, contracts rights, and receivables;

SBA Eligibility Requirement Checklist

Requirement	*Satisfied*
1. Has the individual business owner invested at least 30 percent of his own capital into the company?	☐
2. Does the company have a net worth of less than $6 million?	☐
3. Does the company have an average net profit of less than $2 million for the prior two years?	☐
4. If a retail or service firm, does the company have less than $3.5 million in annual sales?	☐
5. If a construction firm, does the company have average receipts of less than $17 million for the previous three years.	☐
6. If a wholesale distributor or manufacturer, does the company have less than 500 employees?	☐
7. If a farmer, does the company have average annual receipts of less than $500,000 for the previous three years?	☐
8. Is the company independently owned and operated?	☐
9. Can the company show that the requested financing will be used for specific business purposes?	☐
10. Can the company show that it cannot obtain financing from resources of the business, personal resources of the company's owners, or through ordinary commercial lenders without undue hardship?	☐

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- ☐ The assignment of life insurance policies issued to the principal borrower in the amount of the loan; and
- ☐ The personal guarantees of each individual business owner who owns over 20 percent of the business.

HELPING TO CREATE JOBS

Small businesses are a significant force in national and state economics. Some twenty million independently owned and operated small businesses exist nationwide; small businesses represent 99 percent of all firms, contribute 42 percent of all sales in the country, and are responsible for nearly half of the gross national product. Small businesses employ six of every ten people, provide half of all new jobs, contribute 40 percent of all new high-technology jobs, and provide two of every three workers with their first job.

From 1953 to 1990, the SBA has made 597,833 business loans and, since its inception, it has created 24 million jobs. The SBA has approximately 100 offices and more than 3,700 employees throughout the nation.

By providing jobs, generating sales revenues and payrolls, and pumping tax dollars into federal, state, and local government coffers, small businesses using the SBA-guaranteed loan program are infusing the economy with revenues at a rate far exceeding any costs associated with the program. The default rate of SBA loans was 5.7 percent.

CONCLUSION

Businesses that have received SBA loans include doctors, dentists, manufacturers, architects, veterinarians, franchises, service businesses, retailers, wholesalers, motels, restaurants, marinas, car service companies, and automobile repair shops. The SBA's goal is to provide small businesses with financing and guidance. If your business has had difficulty in obtaining a loan, try an SBA-guaranteed loan and see if it can help you. Success stories like Nike and Apple Computers did. ■