

small business resource associates



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Introduction to Small Business Administration Lending

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I. Overview and History of the US Small Business Administration (SBA)

1. Founded in 1953 under administration of President Eisenhower
2. Philosophy and mission began years earlier in a number of predecessor agencies in response to the Great Depression and WWII.
3. Various initiatives were formed to help small businesses that were being hurt by big business in the production of war goods. They were dominating the market in many areas pushing out the small business man.
4. As these dwindled over the years, President Eisenhower saw a need to continue to help the small business owner and proposed the creation of the SBA.
5. SBA Act of 1953 was passed with the described function, "to aid, counsel, assist and protect, insofar as possible, the interest of the small business concerns."

II. Primary Function of the SBA Today

- 1- Still provides access to loans for small businesses through various loan guarantee programs, which guarantees repayment of a loan offered by a participating bank- 75% to 85% guarantees apply. SBA does not make direct loans to businesses in its main program types. This guarantee encourages banks to lend money to small companies that may not necessarily qualify otherwise. What are some examples of this?
- 2- SBA provides education to business owners through various training programs, which offer both financial understanding and technical assistance. Business plans assistance, etc. from SBDC.
- 3- While less publicized, the SBA also provides advocacy for the small business owner in an effort to battle some obstacles faced from big business. Similar to the programs offered after the Great Depression and WWII.
- 4- The SBA has strong representation in the federal government and this helps to offset an imbalance of power between big business and small business. This has been beneficial in providing support for small business companies of the last several decades. The head of the SBA is not holds a seat in the president's cabinet.
5. Why is advocacy so important to small businesses? Top 10 reasons: 10. Small businesses make up more than 99.7% of all employers. 9. Small businesses create more than 50 percent of the nonfarm private gross domestic product (GDP).8. Small patenting firms produce 13 to 14 times more patents per employee than large patenting firms.7. The 22.9 million small businesses in the United States are located in virtually every neighborhood.6. Small businesses employ about 50 percent of all private sector workers.5. Home-based businesses account for 53 percent of all small businesses.4. Small businesses make up 97

percent of exporters and produce 29 percent of all export value.³ Small businesses with employees start-up at a rate of over 500,000 per year.² Four years after start-up, half of all small businesses with employees remain open.¹ The latest figures show that small businesses create 75 percent of the net new jobs in our economy.

III. SBA Loan Programs

1. SBA offers a variety of loans through its 3 main loan programs: (1) 7(a) Loan Program, (2) 504 Loan Program, (3) Micro Loan Program. The SBA also at times will offer Disaster Relief Loans in the event of various catastrophic events such as hurricanes, floods, drought, etc.

2. The 7(a) Loan Program is the most common type of SBA loan generally made by banks. However the 504 Loan Program has recently grown in popularity with banks and business owners with many recently added benefits. See attached SBA information for more details on the 504 Loan Program. The Microloan Program provides small, short-term loans to small business concerns and certain types of not-for-profit child-care centers. The SBA makes funds available to specially designated intermediary lenders, which are nonprofit community-based organizations with experience in lending as well as management and technical assistance. These intermediaries make loans to eligible borrowers. The maximum loan amount is \$50,000, but the average microloan is about \$13,000.

3. The 7(a) Loan Program contains several different types of loans including the Special Purpose Loan Program, the Export Loan Program, Rural Business Loans, Advantage Loan Initiatives, Community Advantage Approved Lender Loan Program and Express & Pilot Loan Programs. For a detailed discussion on these different types of loan please refer to the following SBA link:

<http://www.sba.gov/category/navigation-structure/loans-grants/small-business-loans/sba-loan-programs/7a-loan-program>

4. This introduction to SBA lending will focus on the regular 7(a) loan program.

IV- Why Banks Should Make SBA Loans?

1. Reduced risk to the bank with SBA guaranty- **75% guaranty on loans over \$150,000**; 85% on loans under \$150,000.
2. Excellent source of premium income- **guaranteed portion can be sold in the secondary market.**
3. Ongoing servicing income
4. Reduced reserve requirements- **Balance sheet management.**
5. Increased liquidity/existing debt refinance opportunities
6. Increased product offering

7. Retains and attracts customers
8. Loan types that may not be allowed by the bank's loan policy- **Collateral shortage, longer terms, etc.**

V. Eligibility Requirements for SBA Loans

1. SBA 7(a) loan proceeds may be used to finance:

- Working Capital
- Furniture & Fixtures
- Machinery & Equipment
- Purchase of Land & Building
 - Including construction and/or renovations
- Business Acquisition
- Refinancing of Existing eligible debt

2. The small business must:

- Be an operating business; or can be a new business- business plan required.
- **Be organized for profit;**
- Be located in the United States (includes territories and possessions);
- Be small (as defined by SBA); and
- Demonstrate a need for the desired credit.
- The small business must not be able to obtain the loan “reasonable” terms elsewhere.
- The small business applicant must show that the funds are not available from alternative sources, including personal resources of the principals.

3. Ineligible Types Of Businesses

- Non-profit businesses
- For profit subsidiaries are eligible
- Businesses Engaged in Lending
 - Banks,
 - Finance Companies;
 - Factors;
 - Investment Companies;
 - Bail Bond Companies; and
 - Other businesses whose stock in trade is money and which are engaged in financing.
- Passive Businesses
 - Apartments
 - office suites
 - shopping centers/flea markets
 - mobile home parks
- Life Insurance Companies (but not independent agents)
- Business Located in a Foreign Country or Owned by

Undocumented (Illegal) Aliens

- Businesses Selling Through a Pyramid Plan
- Businesses Engaged in Gambling
- Businesses Engaged in any Illegal Activity
- Businesses Which Restrict Patronage
- Government-Owned Entities, Excluding Native American Tribes
- Businesses Engaged in Promoting Religion
- Cooperatives
- Businesses Engaged in Loan Packaging
- Businesses Owned by Persons of Poor Character or on Probation or Parole
- Equity Interest by Lender or Associates in Applicant Concern
- Businesses Providing Prurient Sexual Material
- Prior Loss to the Government
- Businesses primarily engaged in political or lobbying activities
- Businesses engaged in speculative nature

4. SBA is a Cash Flow Lender

- Repayment must be documented
 - Historical
 - Projected
- Collateral must “fully secure” the loan on a liquidated basis
 - Additional collateral is required, if it is available
- Personal Guarantees required for all 20% or more owners
 - Key personnel or others can be added
- SBA does not require a specific equity injection, BUT the credit decision must be “prudent” and comply with internal bank guidelines.

5. SBA credit administration procedures stress practices that are “generally accepted commercial banking standards employ by prudent lenders”

- Lenders must analyze each application in a commercially reasonable manner, consistent with prudent lending standards.
- SBA expects lender to service and liquidate their SBA portfolio under the same processes and procedures they use to administer their conventional commercial loan portfolio.
- Specific actions may require prior SBA approval, depending on the level of delegated authority extended to the lender participant.
- **The Lender risks impairment of the Guaranty, including full denial if these requirements are not met.**

VI- Summary- SBA does not make a bad loan good, it makes a good loan better

