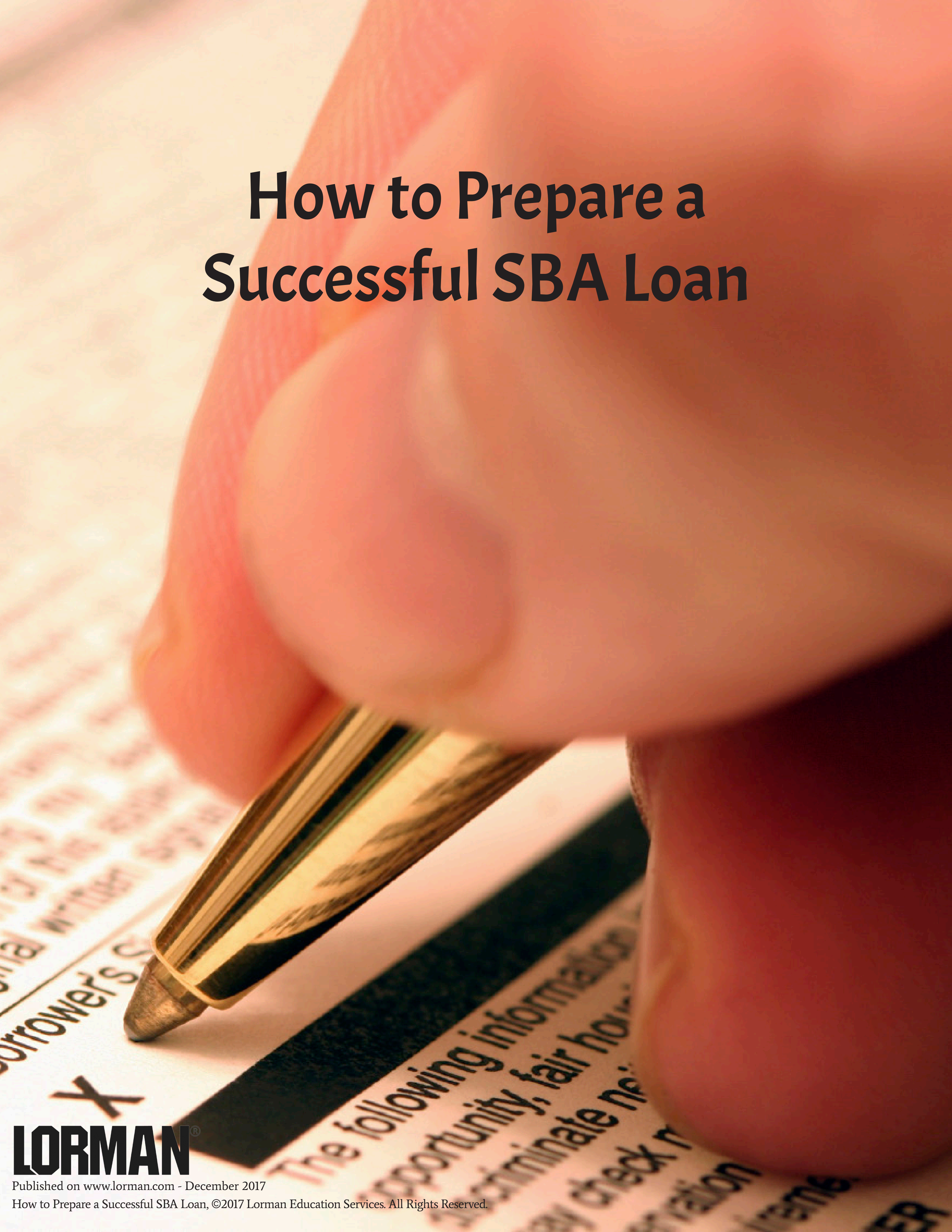

How to Prepare a Successful SBA Loan

LORMAN

Published on www.lorman.com - December 2017

The Mission of the Small Business Administration

The U.S. Small Business Administration was founded in 1953 with the purpose of supporting and encouraging the growth of small businesses in the United States. The SBA is primarily known for the millions of loans and loan guarantees that it has been responsible for but its work covers many other areas, including counseling, contracting and other types of assistance to small businesses.

For most small businesses, finding adequate financing is often a challenge. To help meet this need, the SBA has established a series of programs that provide or guarantee loans under a variety of circumstances. Before considering the SBA as a source of financing, it is helpful to understand the types of loans that are available and the requirements that pertain to each.

The SBA makes several key points to all prospective borrowers. Before you start the earnest effort to secure a SBA-guaranteed loan, it is worth taking time to review these basic insights. These include the following:

1. Equity is required. No business should expect 100 percent financing. Both sweat and financial equity must be evident in an applicant company.

2. Credit histories of the business and owners are key elements. Review these histories and clean up any issues before submitting an application.

3. Be prepared for all owners to provide personal guarantees for any loan, even for an incorporated business.

4. There are no free grants or free money from the government. Loans are made on basic business principles expecting full repayment.

5. Remember that you are dealing with a private lender in all but disaster loan situations. The government does not provide funds; it guarantees loans from SBA-approved lenders.

Types of SBA Loans

Since its founding, ongoing legislation and regulations have added various funding and financing programs to the collection of SBA tools for small business owners. Each loan program is designed for a specific set of circumstances and applicants must meet the requirements for the program to which they apply. An overview of those primary programs includes the following:

GENERAL SMALL BUSINESS LOANS. The most common of all SBA loan programs is referred to as the 7(a) Loan Program and provides assistance to businesses under certain stringent requirements.

General Requirements

The first thing to understand is that a 7(a) loan is made to a business based on factors pertaining to the business, not on the individual or individuals that own it. A few of these factors and characteristics include that the applicant business:

- Operate to make a profit
- Meet SBA definition of a small business
- Operate in the United States or its territories
- Show a reasonable lever of equity invested by the owners
- Be able to show a need and sound business use of any loan proceeds
- Not be delinquent on any obligations to the U.S. government

There are also a number of other eligibility and disqualifying characteristics for any applicant business to carefully evaluate.

Use of Proceeds

The proposed use of proceeds from a SBA 7(a) loan can be used for a number of business purposes. There are a number of restrictions, however, including the reimbursement of an owner for any money they have put into the business. Examples of approved uses include:

- Providing long-term working capital for normal business operating expenses and inventory
- Providing short-term working capital for seasonal financing purposes, construction financing and compliance with contracts
- Revolving financing for inventory and receivables
- Purchase of needed furniture, equipment, machinery and other supplies
- Purchase of real estate, which includes land and buildings
- Use in an acquisition or establishing a new business
- Under certain circumstances, refinancing existing business debt

As noted, there are certain restrictions to the use of 7(a) loan proceeds. These include any use that is not considered for a sound business purpose, to repay delinquent taxes or other escrow funds, as well as other restrictions.

Repayment of Loan

The basic philosophy of SBA lending is focused on longer-term needs and loans. The actual structure of any loan is based on 1) the ability of a business to repay, 2) purpose of the loan and use of proceeds, and 3) the use of proceeds of any assets financed. The basic guidelines include a maximum maturity depending on purpose: up to 10 years for equipment, 25 years for real estate and seven years for working capital. As indicated in approved uses, maturity periods for loans for short-term financing such as cyclical and seasonal needs, are based on specific circumstances.

Amortization of loans is generally based on monthly payments that include both principal and interest. Both fixed-rate and variable-rate loans are made based on the lenders terms. It is not uncommon to have interest only payments during an initial start-up or expansion period of the business. For standard 7 (a) loans, no balloon or call provisions by the lender are allowed. Likewise, there are no prepayment penalties except if paid in the first three years of any loan with a maturity of 15 years or more.

The collateral for a 7 (a) loan is expected to fully secure the total amount of the loan, including personal guarantees of the owners. There is some leeway concerning insufficient collateral if all collateral is otherwise offered and secured.

Loan Amounts and Other Terms

The actual terms of any 7 (a) loan are negotiated between the borrower and the SBA-lender actually advancing the funds. However, the maximum of such a loan is $5 million. There is no actual minimum for a loan but the average loan as of 2012 was over $337,000. There are guarantee fees associated with SBA loans, ranging from 2 to 3.5 percent based on the amount of the loan.

The SBA establishes maximums for the interest charged on both fixed and variable loans. The actual amount is subject to negotiations between the borrower and lender, subject to the SBA rate structures. The actual rate is includes two parts, the base rate and the allowable spread. The base rate is selected from three acceptable options and the allowable spreads range between 2.25 and 2.75 percent. The actual amount of the loan guaranteed by the SBA will range from a maximum of 85 percent on loans of up to $150,000, 75 percent on loans over $150,000, and a maximum SBA exposure on any loan of $3,750,000. There is a maximum 50 percent guarantee on SBA Express Loans.

Loan Application Checklist and Processing Times

The details of the loan application process and checklist are discussed below. It is essential to allow time to collect and assemble all required documents for the application. Processing time that can be expected depends on the process option selected. There is a SBAExpress option that is limited to a loan of no more than $350,000 and a guarantee of no more than 50 percent. While the SBA standards for a 7 (a) loan apply, the lender has more options relative to collateral and procedures followed. A response to an Express application is provided within 36 hours.

There are special purpose loans made under the 7 (a) Loan Program. They are designed to address issues such as ESOPs, impact of NAFTA and other special circumstances. These specialty loans include:

- CAPLines
- SBA Export Loans
- Advantage Loans
- Community Advantage Loans
- Rural Business Loans
- Patriot Express Loans

Not all banks or financial institutions are SBA-approved lenders. When all information is evaluated and a general plan is developed, the SBA can provide information on local approved lenders to approach for submission of an application. However, as discussed below, there are other steps to follow before the application is submitted to any lender.

MICROLOAN PROGRAM. This program is designed to provide loans with a maximum of $50,000, while the average loan is $13,000. They are made for small businesses and not-for-profit childcare centers. These funds are provided by the SBA to certain selected and designated intermediary lenders. These community-based nonprofit lenders must have experience in lending, technical assistance, and management. Administration of the Microloan program is handled by these intermediary organizations. Any Microloan must be used for approved purposes, such as working capital and purchase of inventory or equipment. The details of a loan’s repayment terms, interest, and fees are set by the intermediary following SBA guidelines. These intermediaries handle and process applications and may require training and planning training by the applicant.

REAL ESTATE & EQUIPMENT LOANS – CDC/504 Loans. A separate loan program exists to provide for the financing of the purchase of fixed assets such as machinery, equipment and real estate, including land.

Program Eligibility

Many of the requirements for this loan program are the same as those for the 7 (a) Program. Other requirements for the business include:

- Having a net worth less than $15 million and net income less than $5 million after taxes for past two years
- Not be involved in speculation or investment in real estate that is for rentals
- Planning for investment in fixed assets
- Not having access to needed funds from other sources
- Good character of principals of the business as evidenced by a Statement of Personal History
- Appropriate management expertise
  Viable business plan

Use of Proceeds

The proceeds from a 504 loan are provided for:

- Purchas of land and existing buildings
- Improvements such as utilities, parking lots, grading, and street improvements
- Construction of new facilities
- Renovation or conversion of existing structures

Proceeds cannot be used for working capital, consolidation of or paying off debt, or speculation in real estate.

Loan Amounts and Other Items

The use of funds and the goal they will support determine the maximum loan amounts that can be guaranteed. The amounts will range from $ 4 million to $5 million. These goals are defined as 1) Job Creation, 2) Public Policy support (such as expansion of exports, rural development, and other defined objectives), and 3) Small Manufacturing as defined by SBA guidelines.

Application Process

The steps and documentation required for this loan program are the same as those for the 7 (a) Program.

DISASTER LOANS – CDC/504 Loans. Special low-interest loans are available under specific circumstances to renters, homeowners, businesses and private nonprofit organizations. These loans are intended to be used for the repair or replacement of certain items that a declared disaster destroys or damages. These qualified items include: personal property, machinery, equipment, real estate, inventory, and other business assets.

These loans are low-interest and long-term to allow recipients to deal with physical and economic losses as a result of a declared disaster. This includes home, business and economic injury loans. Eligible small businesses can also qualify for Military Reservist Economic Injury Loans.

Program Eligibility

The individual or business must be located in an area covered by a federal disaster declaration. There are specific forms and application processes and documents. Drought victims may qualify for assistance under the Economic Injury Disaster Loan Program.

Use of Proceeds

There are specific guidelines that detail what disaster loan proceeds can be used for. There is a limit of $2 million for disaster loans, covering both categories of physical damage and economic injury assistance. There are detailed requirements and restrictions, including how insurance and uninsured losses are to be handled.

Other loan programs of the SBA include Export Assistance Loans, Veteran and Military Community Loans and Special Purpose Loans.

Successfully Applying for a SBA Loan

There are four elements to a successful application. The information above deals with the first step, determining the right loan program and eligibility. Secondly, carefully study all the materials and resources that provide guidance on preparing a successful application. As the third element, a complete and accurate loan package must be prepared. The fourth element is related to the first three. Understand how your application is going to be evaluated. With this insight, you can prepare your application knowing what components will be important to ensure a successful application.

With this basic overview, the first step is to determine what type of loan is appropriate for specific circumstances. By reviewing the detailed requirements and qualifications, a potential applicant can save a lot of time and expense before starting the detailed application process. If it appears that there is a specific loan program that can be utilized, it is often wise to approach a local SBA-approved lender for an initial discussion. The actual application is so detailed there are CPAs and other professionals that consult with business owners to prepare an acceptable application. Ask the potential lender if they have any local recommendations that have worked on successful applications.

Completing the Application

The SBA provides its lenders with specific guidelines for an application package. The impression you make with a potential lender begins with a well-prepared and comprehensive application that follows those guidelines in all details. Every requested document and report must be provided with the application. Each requested item meets a specific purpose and will be evaluated against a detailed checklist.

Evaluating credit histories of the owners and the business is a first step in the evaluation process. Make every attempt to ensure that those credit reports are as clean and positive as possible. If there are any specific credit issues that will show up, include an explanatory letter with the application. It may be worthwhile to explore any potentially disqualifying aspects of credit history before beginning the time-consuming application process.

While the application itself follows a specific outline, the very first step for any business owner is to prepare for the process by answering some basic questions for themselves in detail. This begins with a very specific amount and use of funds. In other words, there must be a business justification that can be clearly explained for the money that is being sought for the business. The second component of this pre-assessment is determining a realistic plan for repaying the loan. Lastly, consider what might be called a "disaster scenario." What is your plan if and when the business is unable to repay the borrowed funds?

These issues are actually part of a well-prepared business plan. Having an up-to-date and detailed business plan will prove invaluable in completing the loan application.

With this clear picture in mind, the actual application can be dealt with. The SBA provides a general checklist that serves as a good starting point. The Application for Business Loan, SBA Form 4, must be completed. The actual lender will provide a format for a loan proposal that includes these items and others that they require. Before starting the application process, it is very productive to take the time to review the following list and evaluate the elements of completing what will have a chance at being a successful application.

*The updated **SBA Loan Application Checklist** should be checked and followed for the final application.*

- Overall reason for requesting the loan.
    - What is the need for the loan and how will the proceeds be used?
    - How does this debt fit into the overall financial picture and can it realistically be repaid?
    - How is management qualified and prepared to properly use the funds and work to see it repaid?
- Resumes and detailed personal information for owners and key managers, including full disclosure of all credit histories, criminal records, previous work history, etc. (SBA Forms 912 and 413).
- Business Plan. There are countless resources that detail how to prepare a good business plan, including on the SBA website. While the final form of the plan can follow any of a number of outlines, the basic information it must address includes:
    - Strategic factors. What the business does to be successful, competitive advantages, competition.
    - Management and Structure. All key management, owners, professional advisors such as lawyers and accountants, and the business legal form and ownership.
    - Marketing. How the business markets its products and how they compare with the competition.
    - Operations/Administration. How does the business function, information technology used, etc.
    - Finances. This section will receive detailed scrutiny. It should include a management discussion of the information provided in at least two previous years and two forecast years for:
        - Profit and Loss Statements
        - Balance Sheet
        - Cash Flow and Changes in Cash Position
- Current Accounts Payable and Accounts Receivable ledgers. A current aging and discussion of any significant elements or issues.
- Income Tax Returns. Three years of returns from both the business and owners.
- Collateral. Depending on the loan program, this is a key component. Include a schedule of the collateral that will secure the loan, especially for a 7 (a) loan.
- Legal Documents. All documents presented should be organized and easy to access. Remember that all items submitted in this application must be true and accurate. Any misleading or false information will disqualify an application. Depending on the loan and business type, documents needed include:
    - Articles of Incorporation
    - All relevant business licenses, permits, authorizations and related documents
    - Copies of significant contracts
    - Leases on all property

Actual Lender Steps and Resources in SBA 7 (a) Program Lending

With the 7 (a) loan being the most significant SBA lending platform, a standardized process is followed with approved lenders for processing and dealing with applicants and borrowers. Since the SBA does not actually provide the funds for the loans, lenders provide all proceeds to approved borrowers. Government funds are provided only in the event of default and then to the extent of the guarantee on the loan not covered by proceeds from liquidating collateral. The steps involved are similar to normal loan processing with the addition of SBA requirements and guarantee procedures. These include:

- Application submission/review. The SBA checklist/documentation requirements are to be followed.
- Approval/authorization. Loan package templates, evaluation criteria, and eligibility information is provided.
- Closing. The SBA provides a full loan closing checklist with a best practices guideline.
- Servicing. There are a number of items in the servicing package, including agreements, checklists and restatements of the SBA Guaranty
- Liquidation. The SBA provides specific guidelines and procedures for any liquidation process. These include issues related to liquidation submission and all items dealing with collateral.
- Litigation. There are established policies, pleadings and legal fee guidelines to include in a litigation plan that involves outside counsel.
- Guaranty Purchase. When circumstances call for the SBA to purchase a guaranty, there are specific guidelines, documents and processes to request the honoring of the guarantee. Issues relative to a denial of liability and repairs are also discussed.
- Terms and Conditions of a 7 (a) Loan. Specific SBA conditions exist relative to the lender and applicant relationship. The lender negotiates the details of the loan subject to these conditions.
- Eligibility for a 7 (a) Loan. A detailed listing of the requirements for being eligible for the loan and items that will disqualify an applicant.

There are separate steps that follow these general items when processing CDC and 504 Loans. A successful SBA loan application is a process that requires a significant level of effort. If a business qualifies for one of the SBA loan programs, it will find access to financing that might not be available from any other sources.