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IS SBA FINANCING RIGHT FOR YOUR BUSINESS?

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There are many financing options to consider as a small business owner, including the use of a traditional commercial loan versus a Small Business Administration Loan (referred to as a SBA Loan).

The U.S. Small Business Administration (SBA) was founded via the Small Business Act of July 30, 1953, with the purpose to "*aid, counsel, assist and protect, insofar as possible, the interests of small business concerns*." The size standard for qualifying as a "small business" under the SBA is specific to each industry and based upon average annual receipts or total number of employees. For instance, the size standard for employment placement companies is defined as receipts less than $27,000,000, while the size standard for administrative companies is defined as receipts less than $7,500,000.

The SBA satisfies its purpose by setting guidelines and guarantying loans made by approved participating lenders to eligible small businesses applicants. These SBA guarantees significantly reduce lender risk which ultimately result in loans to applicants who would not otherwise have access to traditional commercial funding. **The four main types of SBA loan programs are as follows:**

- Standard 7(a) Loan Program
- Certified Development Company (CDC) 504 Loan Program
- Microloan Program
- Disaster Loans

Standard 7(a) Loan Program:
The Standard 7(a) Loan Program is a general purpose loan program which is predominately used by small businesses to do any of the following:

- Increase short and long-term working capital
- Fund construction and/or repairs of existing capital
- Purchase real estate properties, franchise units, equipment, machinery, supplies or materials
- Refinance existing debt

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The Standard 7(a) Loan Program consists of a single loan from an SBA approved lender such as a bank, credit union, or specialized lender, which is guaranteed by the SBA as follows:

- 85% of loans up to $150,000; and
- 75% of loans up to a maximum loan amount of $5,000,000 (for a maximum guarantee of $3,750,000)

As a result of the increased lender confidence due to the SBA guarantee, the Standard 7(a) Loan Program is typically able to offer longer financing terms than traditional commercial loans, potentially lower down payments and variable interest rates which can be negotiated by lenders and applicants. Balloon payments and call provisions are prohibited.

Certified Development Company (CDC) 504 Loan Program:
Certified Development Companies (CDCs) are non-profit corporations regulated by the SBA. They work with participating lenders, both private sector and non-profit, to promote economic development within their communities by offering long-term fixed rate financing for major fixed assets, such as commercial real estate, buildings, equipment and machinery. The CDC 504 Loan Program can also be used to refinance certain existing commercial mortgages to a lower interest rate through its Debt Refinancing Program.

- The CDC 504 Loan Program consists of a third-party traditional commercial loan and a CDC debenture, which must be structured as follows:
- A third-party lender must provide a traditional commercial loan funding at least 50% of the total project costs;
- The participating CDC will then provide up to 40% of the remaining costs through a CDC debenture generally guaranteed by the SBA up to $5,000,000; and
- The borrower must then provide the remaining financing costs (a minimum of 10%).

The current repayment terms under the CDC Loan Program are 20 years for real estate and 10 years for machinery and equipment. The repayment term for the third-party commercial loan must be at least seven years if the CDC 504 Loan is 10 years and at least 10 years if the CDC 504 Loan is 20 years. Interest rates for the CDC Loan are fixed in correlation with the current market rate for 5-year and 10-year U.S. Treasury issue, and third-party lender interest rates are required to be reasonable and published in the Federal Register. Like the Standard 7(a) Loan Program, balloon payments and call provisions are prohibited.

The Microloan Program:
The Microloan Program specifically assists minority business owners (including women and veterans) and small businesses suffering from lack of credit, in the start-up of new or growing small businesses. It does this through the offering of small-scale loans for increased working capital or for the purchase of materials, supplies and equipment.

The SBA does not guarantee loans made through the Microloan Program in the same way as the Standard 7(a) Loan and CDC 504 Loan Programs. Rather, the SBA distributes funds directly to qualified and experienced community-based non-profit lenders (referred to as Micro-lender Intermediaries), who then administer the Microloans. While the maximum amount of the microloans are set by the SBA at $50,000, with a maximum repayment term of six years, eligibility determinations are made at the discretion of each Micro-lender Intermediary. Interest rates are generally set between 8 to 13 percent.

Disaster Loan Program:
The Disaster Loan Program assists small business owners affected by natural disasters and other emergencies, after insurance and funding from the Federal Emergency Management Agency (FEMA) prove insufficient. Loans under this program, which are offered directly through the SBA, have a maximum loan amount of $2,000,000 and a maximum repayment term of 30 years. Interest rates are fixed for the term of the loan and dependent upon whether the applicant has the ability to borrow from any other non-government sources.

Eligibility Requirements for all SBA Loans:
It is no surprise that applicants seeking financing through an SBA program must overcome stringent eligibility requirements. For instance, at a minimum, all borrowers must:

- Be a for-profit business with limited exceptions;
- Conduct business in the United States;
- Have invested equity (time and money) into the business;
- Evidence strong business plans and relevant management experience;
- Evidence an ability to pay; and
- Have exhausted all other financing options.

In assessing whether SBA financing is appropriate for your business, one must certainly keep in mind the pros and cons of the SBA programs. While an SBA loan may seem very attractive, especially when no other options are available, the approval and closing process can be extremely grueling, time-consuming and expensive to say the least. In addition, the SBA guarantee fees can get quite expensive as the loan amounts increase.

The following will provide some using guidance in assessing the pros and cons when contemplating SBA financing:

Pros:

- Provides financing when no other financing source is available
- Increased lender ability and willingness to finance soft costs
- Typically longer repayment terms than traditional commercial loans
- Generally lower down payments than traditional commercial loans
- Accommodation of diverse small business needs, including opportunities for woman and veterans
- Limits competition for certain contracts to small businesses, referred to as "small business set-asides," which help small businesses compete for and win federal contracts

Cons:

- Personal guaranties from all owners owning more than 20% of the eligible small businesses are generally required
- Exposure of borrower's affiliate and/or subsidiary companies as guarantors
- Borrowers must evidence very strong personal and/or business credit, as well as a very strong business plan and management experience when limited operating history may pose a difficulty
- Borrowers may be prevented from taking out any other loans
- More paperwork and eligibility requirements than conventional loans
- Generally much longer approval periods than traditional conventional loans requiring updates as the approval process continues, especially as to financial statements
- More expense associated with closing fees, guarantee fees and third party professionals

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About Becker LLC

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For more information, call (973) 422-1100, or visit www.becker.legal