SBA Loan Basics

What is SBA?

SBA is an independent federal agency created by congress in 1953 to assist in the commencement, expansion, growth, and prosperity of most types of small businesses. SBA has numerous programs, including the Small Business Development Center, SCORE, Pro-Net, disaster assistance, export assistance, women's and minority business initiatives, and the guaranteed loan program, to name but a few. This publication will deal primarily with the various SBA guaranteed loan programs.

Who is eligible?

Most types of businesses are eligible for SBA loans. Listed below are some of the exceptions:

- Non-profit organizations or 501(c)(3) corporations
- Companies engaged primarily in lending or investing
- Schools that teach academic subjects
- Organizations involved in speculative business ventures (financing real property to be held for investment)
- Floor plan financing
- Monopolies
- Pyramid sales distribution plans
- Persons on probation or parole, or persons who have criminal cases pending.

Contrary to popular belief, SBA is often referred to as "the lender of last resort." If you are able to secure financing on reasonable terms from a bank, generally, you are ineligible for SBA financing assistance.

Types of Loans

Direct Loans

In rare instances, the US Small Business Administration may loan money directly to businesses or individuals. These loans are intended for those economically affected by the disaster, and are available at below-market interest rates to compensate for the loss of revenues or profits. Typically, these loans follow a disaster declaration by the President of the United States and an appropriation of funds by the Congress. *SBA does not budget funds for disaster assistance.* If you think you may be eligible for a low-interest disaster loan, please check the SBA web site at http://www.sba.gov/disaster/updates.html.

Guaranteed Loans

Guaranteed loans are made by private lending institutions, primarily commercial banks, and may be guaranteed at up to 85% by the US Small Business Administration. Most SBA loans are made under the guarantee program, and SBA may elect to guarantee up to $1,000,000 of a private sector loan. Generally, there are three parties to an SBA loan: SBA, the small business borrower, and the private lender. In many cases, the private lender (and SBA) may request a business plan to accompany the loan request or application from the small business borrower. If the lender finds the business plan and financial projections acceptable, the lender will then complete a credit analysis, and the borrower and lender will complete the SBA application. Once the SBA application is forwarded to the nearest SBA office and SBA issues an approval, the lender will close the loan and disburse the funds. The borrower will then make monthly payments directly to the lender. There are two major types of SBA loans available in our area: the 7(A) loan, and the 504 loan. Although there are other loan programs, most lenders are not eligible to participate or elect not to participate in these programs due to complexity of the loan process. For a complete listing of the types of SBA loans available, check the SBA website at http://www.sba.gov/financing/indexloans.html.

7(A) Loans

The 7(A) loan guaranty program is one of SBA's primary lending programs. It provides funding to businesses that are unable to secure financing on reasonable terms through normal lending channels. The program operates through private sector lenders, typically commercial banks, and the loans are guaranteed by SBA. SBA does not fund direct lending programs or grants.

Most lenders are somewhat familiar with SBA lending programs; so interested applicants should contact their banks for specific information and assistance in the SBA lending process. (Information on SBA loan programs, as well as management consulting and training programs are also available from your local Small Business Development Center.) To participate in the 7(A) loan program, you must have a willing lender, as SBA does not accept loan applications from individuals or business applicants.

A maximum loan amount of $2,000,000 has been established for loans under the regular 7(A) loan program, although the SBA limits its guaranty amount to $1,000,000. For loans less the $150,000, the maximum guaranty is 85%, and for loans above that amount, the guaranty is limited to 75%. Repayment ability from the cash flow of the business is the primary consideration in the SBA loan decision process, but character, management capabilities, collateral, and overall economic conditions also merit consideration. All owners holding more than 20% of the applicant firm's ownership are required to personally guarantee the debt, and their personal credit history is reviewed. *Even if a business is incorporated, a poor personal credit history usually results in loan denial.*

The 7(A) loan program is less restrictive than most other SBA programs regarding the use of the loan proceeds. Eligible uses include most asset acquisition, working capital needs, accounts receivable financing, debt refinance (subject to strict limitations), and most other uses.

The majority of businesses are eligible for SBA assistance, although the firm must operate for a profit; be engaged in, or propose to do business in, the United States or its possessions; have reasonable owner equity to invest; and use alternative financial resources first, including personal assets. Please see above for a summary listing of ineligible businesses. The size of the applicant firm is also a consideration, although SBA has developed size standards according to SIC codes. Again, the majority of businesses in the US are "small."

The 7(A) loan process is quite involved and requires much paperwork. In many instances, the lender may refer the applicant to a third party such as a Certified Development Company or Small Business Development Center to "package" the loan request. Although the SBDC usually does not charge fees for the packaging, many other third-party processors will charge a small percentage of the loan amount for this service.

Loan maturities may vary according to the use of the proceeds, but general guidelines apply. Loans for working capital purposes will not exceed seven years, and the terms of loans used for asset acquisition will not be longer than the useful life of the asset. Real estate loans are limited to a maximum term of 25 years. Interest rates may be either fixed or variable, and are negotiated between the lender and borrower, subject to SBA limits shown below:

Loans less than $25,000 with less than 7 year maturities:	Prime + 4.25%
Loans less than $25,000 with more than 7 year maturities:	Prime + 4.75%
Loans from $25,001-$50,000 with less than 7 year maturities:	Prime + 3.25%
Loans from $25,001-$50,000 with more than 7 year maturities:	Prime + 3.75%
Loans greater than $50,000 with less than 7 year maturities:	Prime + 2.25%
Loans greater than $50,000 with more than 7 year maturities:	Prime + 2.75%

Fees may also be charged for SBA loans. SBA charges the lender a guaranty and servicing fee for each loan approved, and these fees may be passed on to the borrower. The amounts of the loan fees are determined according to the guaranteed amount of the loan, and will be determined upon approval. Lenders or packagers may share more information with you about the fees. Also, a new regulation is that loans may be subject to a prepayment penalty of up to 5% of the amount of prepayment. Additionally, lenders usually require life insurance in the same amount as the loan, in the event of the borrower's untimely death.

Certified Development Company (504) Loan Program

The (504) Certified Development Company (CDC) loan program provides long-term, fixed-rate financing for businesses for fixed asset acquisition. A CDC is a nonprofit corporation set up to contribute to the economic development of its community, and the 504 loan program is one of the ways to accomplish its goal. CDC's work with SBA and private sector lenders to provide financing for real estate, buildings, and durable machinery and equipment.

Typically, a 504 loan includes a loan secured by a first lien from a private sector lender for up to 50% of the project cost. Additionally, the CDC will make another loan with a second lien position (and backed by a 100% SBA-guaranteed debenture) covering up to 40% of the project cost. For existing businesses, the owners should be prepared to inject 10% equity into the project, while start-ups should inject a minimum of 15%. The maximum SBA debenture is $1,000,000, and the borrower is required to create or retain one job for each $35,000 provided by SBA. For meeting a public policy goal, the maximum SBA debenture is $1,300,000. Public policy goals are listed below:

Business district revitalization
Expansion of Exports
Expansion of minority-, veteran-, or female-owned business development
Rural development
Enhanced economic competition

The funds from the 504 loan must be used for fixed asset projects such as purchasing land and buildings for expansion, construction of new facilities, or purchasing long-term machinery and capital equipment. Interest rates are pegged to an interest rate above the current market rate for 5 and 10-year US Treasury maturities, and the term may be for either 10 or 20 years. Fees total approximately 3% of the debenture, and may be financed with the loan.