What is a SBA Guaranteed Loan?

The U.S. Small Business Administration:
does **NOT make LOANS**
does **NOT have GRANTS** for small businesses.

The U.S. Small Business Administration:
GUARANTEES loans that have been submitted by financial institutions.

To come to a credit decision on a loan request, the SBA evaluates a business in the same way a bank does. However, if a bank is hesitant about lending to a business because there is insufficient collateral or there is risk inherent in the particular industry or the age of the business, then the bank will turn to the SBA to obtain a loan guarantee.

The SBA guarantees loans up to 85% of the loan value if the loans are $150,000 or less, and up to 75% if the loans are over $150,000. Maximum application amount is $2,000,000.

SBA loans are not "cheap" loans. Interest rates are at, or above, typical rates for commercial loans (interest rate cannot be more than 2.25 – 2.75% over prime for SBA participation). In addition there is a one time guarantee fee based on the dollar amount of the guaranteed portion of the loan.

SBA loans offer a longer amortization rate than most commercial loans.

Working Capital Loans:	up to 7 years
Fixed Asset Loans	up to 10 years
Real Estate or Construction of Building	up to 25 years

SBA loans can be used to acquire land (purchase or lease); improve a site; purchase, convert or construct one or more existing buildings; acquire and install fixed assets; inventory; supplies; raw material; working capital; export financing; contract financing; and refinancing in certain cases.

Refer to the Quick Reference to SBA Loan Programs (attached) for additional information.

Does Your Business Qualify for a SBA Loan?

Like a lending institution, the SBA wants to lend to businesses that they believe will repay a loan. Both the lending institution and the SBA are evaluating a loan request on the same criteria.

To qualify for a SBA loan guarantee, the following criteria must be met:

1. The business must show its ability to repay the loan through historical financial statements and/or financial projections and supporting documents.
2. The business must show the capacity to carry more debt (*pro forma* debt to net worth usually cannot be more than 5:1). If it is a new business, at least 25-30% owner equity is required.
3. The business or owner(s) must have some collateral to secure the loan plus a personal injection into the business, though they do not have to have 100% collateral coverage. Lack of collateral cannot be the sole reason to decline a package, but this factor is not ignored.
4. Personal credit must be good or if there have been credit problems, there has to be a reasonable justification for these problems and proof that there has been an attempt to rectify previous problems.
5. The business and the owner cannot have delinquent taxes.
6. The business cannot obtain credit elsewhere without the SBA guarantee.
7. The business must meet the size and eligibility criteria of the SBA as described below,

Size Criteria:

The size criteria of the SBA specify the size of business that is eligible to obtain SBA financing. Size criteria vary by the industry (e.g. manufacturing, service, construction, etc.). Size standards are based on the average number of employees for the proceeding 12 months or on the sales volume averaged over a three-year period. You can look up the specific size standards for your industry on the SBA's Website (www.sba.gov).

Eligibility Criteria:

There are some businesses that cannot obtain SBA financing given the nature of the business. Examples of businesses that cannot obtain financing are lending institutions, real estate held for speculation, investment or rental (building has to be over 51% owner occupied), non-profits and religious institutions. Check out the SBA's Website (www.sba.gov) for a complete list of ineligible businesses.

Interest Rates

Interest rates are negotiated between the borrower and the lender but are subject to SBA maximums, which are pegged to the Prime Rate.

Interest rates may be fixed or variable. Fixed rate loans of $50,000 or more must not exceed Prime Plus 2. 25 percent if the maturity is less than 7 years, and Prime Plus 2.75 percent if the maturity is 7 years or more.

For loans between $25,000 and $50.000, maximum rates must not exceed Prime Plus 3.25 percent if the maturity is less than 7 years, and Prime Plus 3.75 percent if the maturity is 7 years or more.

For loans of $25,000 or less, the maximum interest rate must not exceed Prime Plus 4.25 percent if the maturity is less than 7 years, and Prime Plus 4.75 percent, if the maturity is 7 years or more.

Guarantee Fees:

1.0% if guaranteed portion is $150,000 or less
3.0% over $150,000 up to and including $700,000
3.5% for loans greater than $700,000

Financing Existing Debt:

In order to qualify for financing, the loan request must show that credit is not available elsewhere without a SBA guarantee and the refinancing must result in a substantial benefit to the small business. Specifically, the small business must obtain at least 20% improvement in the debt service payments when comparing the existing principal and interest payments to the new payments. In addition, if more than one debt is being refinanced, each debt has to obtain at least 10% improvement in the debt service payments for a cumulative total of at least 20%.

Injection of Personal Resources:

The applicant for a business loan must show that the desired funds are not available from personal resources of any owner of the business (any one who owns 20% or more of the business). SBA has a formula to determine the personal resources to be injected. Personal resources are considered to be cash, savings accounts, marketable stocks, cash surrender value of life insurance and equity in a home (in some instances).

If you have further questions about SBA loans you can call the Business Resource Center at (816) 235-6675 or visit the SBA Website at www.sba.gov or the SCORE Website at www.scorekc.org.

How Business Loans Are Evaluated

To simplify applying for a small business loan, prepare answers to the following basic questions.

Seeking a business loan can be easier if you know how loan requests are evaluated. Typically, business loans are evaluated in much the same way by lenders, non-bank lenders and the SBA. To simplify the procedure, before you talk to a lender, prepare answers and provide written information as backup. All lenders ask the following questions to evaluate a business loan request.

Question 1: How much money do you need to start the business and make it profitable? In the case of existing business, how much do you need to expand and/or refinance your operation?

Most businesses need money to provide working capital, including inventory, purchase machinery, equipment, furniture and fixtures, purchase land and buildings, and refinance existing debt. Specify your needs by category and dollar amount.

Question 2: How much of this money are you contributing?

Actually, cash investment is needed. State where your money is coming from and how you plan to use it. Equipment, machinery, and other assets that you now own could be used as an investment. State what such equipment cost at the time of purchase.
Existing businesses generally present balance sheets to demonstrate how much was invested and how the money was spent. This information will be scrutinized to determine how much actual cash investment remains after paying out expenses and providing a living for yourself and family. Money invested from unencumbered resources is called equity capital. Borrowed money is not viewed as equity capital. Be prepared to prove the source and uses of your equity capital.

Question 3: How much money are you trying to borrow and what is the specific purpose of the loan?

Back up the cost of purchases with written bids and estimates from the supplier or contractor. Describe inventory by categories and dollar costs for each group. The answers to questions 1, 2 and 3 will be evaluated to determine if the amount of equity capital is reasonable to assure that the business operates soundly; that the debt burden does not place unreasonable demands on the profits of the business to repay debt and provide for replacement of fixed assets and your personal living requirements; and that you have enough capital at risk to keep you committed to the success of your operation.

Many ask, “How much down payment do I need?” If you are well prepared, you will be able to determine the answer. There is no predetermination formula or ratio for every situation. The amount varies with the risk and other credit factors. Most start up businesses should be prepared to put in up to one third or half of the money needed to start the business. Few, if any, lenders will lend 100% of the money needed to start a business. The most frequently used measure to begin formulating an opinion is the debt to worth ratio. This ratio is figured by dividing the total debt by the total equity. The higher the number, the greater the risk for the lender. This is compared with national figures for similar businesses.

Question 4: How and when will you repay the loan?

This is your chance to convince the lender your earnings will reasonably assure repayment of the loan. Your tools for this task will include industry and market research data and demography important for business start-ups and expansions; historical operating statements to demonstrate prior sales, expenses and profits (especially important for buy outs and existing businesses); projection of sales, expenses and profits for the 2 or 3 years to follow; and a monthly projection for the next 12 months of cash expected from sales and other sources (cash in), including cash needed to pay for monthly expenses, debts and living expenses (cash out). Find a financial analyst, certified public accountant or business consultant who is familiar with key business ratios and market research to test your projections.

This information will be tested by the lender to reasonably assure that the loan can be repaid from the cash flow of the business and that your working capital is adequate. Lenders use various key business ratios to test projected profits, the adequacy of working capital and the debt to worth ratio. The most frequently used reference, RMA Annual Statement Studies by Robert Morris Associates can be found in most public libraries. Other sources include Industry Norms & Key Business Ratios by Dun & Bradstreet and Almanac of Business & Industrial Financial Ratios by Prentice Hall. Industry and market data and demographics are used to test the expected sales volume. Joining industry associations can make valuable market research available to you for a small price. Use it to determine the market size for your area and how much of the market you may expect to capture. Also, libraries have directories of national associations and other local sources can freely provide demographics for a given area.

Question 5: What qualifications and experience do you have to operate this business?

Provide a resume of prior employment and job duties along with appropriate dates. Present you business plan. Lenders must be convinced that you have a solid understanding of financial record keeping, business credit, the importance of accounts receivable collection and turnover, inventory control and turnover, and marketing your product or service. Your credit history will be one way to check what you say about your ability to control your finances and what you do.

Question 6: If the business fails, how will the lender recover the money?

Lenders want collateral as a secondary source of repayment but only as a last resort. Provide a detailed list of collateral; include its original cost and current market value. Show how much it has depreciated on your tax returns. An applicant without enough collateral to pledge or cash to invest will have to scale back their borrowing needs and make do with less. The amount of a business loan for which you can qualify is not evaluated alone on the value of collateral pledged. It is not a matter of "here's my collateral, how much can I borrow?" Offer your personal guarantee and include your personal financial statements.

Borrowing is a matter of convincing the lender that you have the capital needed to succeed, capacity to repay, character and skill to implement the plan, and collateral to serve as backup.

One final tip: First talk to the lender with whom you have had experience. Seek out someone who can refer you to a lender. Ask them to call ahead and introduce you. Telephone the lender for an appointment. It is never a good idea to just drop in. Once a relationship has been established and you have explained your business operations and anticipated needs, it becomes far easier to approach a lender when a loan is needed. Keep the lender updated on your company's progress. Discuss problems and solutions you think will work. Once you establish credibility and trust, your lender's knowledge will help ensure continued success of your business.

For further information, call the Business Resource Center at (816) 235-6675.

Kansas City SCORE Chapter 19 offers its popular Minding Your Business Seminar on the second Saturday of each month. This seminar is held at 4747 Troost Avenue, Kansas City, MO. The seminar covers the basics of starting and growing a business. The cost is $40.00. For registration, call (816) 235-6675.

SCORE volunteers offer free business counseling at the SBA/SCORE Business Resource Center. Feel free to call and speak with a counselor at (816) 235-6675, or call and make an appointment to come into the office at 4747 Troost, Kansas City, Missouri. SCORE members are available five days a week to answer your questions regarding business start-up and/or expansion. For 45 years, SCORE has helped entrepreneurs start or expand their businesses. Remember, there are three peak periods in the life a business when entrepreneurs are most likely to seek assistance:

1. When thinking about starting a business.
2. When a business is ready to expand.
3. When there are problem areas in a business.

INFORMATION IS THE KEY TO SUCCESS

Don't miss your target….

SCORE with SCORE!

(816) 235-6675