Taking the Mystery out of Loans

by J. Tol Broome, Jr.

One of the most frustrating aspects of running a small business is the difficulty in getting capital to meet day-to-day working expenses. This is especially true as companies struggle to rebound from the recession that ushered in the '90s.

But help may be in sight. In recent years, the Small Business Administration's (SBA) guaranteed loan program has become an attractive solution to business owners facing a capital crunch. Since its inception in 1953, the SBA has guaranteed more than 480,000 loans totaling over $60 billion. In fiscal 1993 alone, the SBA guaranteed over 25,000 small business loans worth nearly $5.2 billion, including over $25 million to firms involved in construction.

Many small business owners, however, have little knowledge of the program's advantages; others believe the SBA loan process is too complicated. While an SBA guaranteed loan may not be right for every small business owner, it can offer help to the capital shortfall problems faced by many business owners in today's volatile economic environment. Here's a plain English explanation of how the program works.

The SBA Advantage

In the guaranteed loan program, a bank actually extends the loan, and the SBA guarantees repayment for between 75% and 90% of the loan amount. Because the SBA assumes most of the credit risk, commercial banks are more willing to consider loans that under normal conditions would not be "bankable." About 25% of all SBA loans, for example, are to start-up entities, which are generally considered "hands off" by conventional commercial banks.

The SBA program offers three key advantages: favorable repayment terms, few qualification restrictions, and low-cost financing.

Repayment terms. SBA terms of repayment are usually more favorable than those offered by conventional financing. The term can be as high as 25 years for real estate loans, for example, giving business owners who need extra space an alternative to the higher payments required by a conventional commercial loan. For equipment loans, the repayment term may be as long as ten years, depending on the useful life of the asset being purchased. And for working capital loans, including those used to finance inventory, the borrower may take as long as seven years to repay the loan. These terms compare favorably to typical maximum terms of seven years for equipment and four years for working capital offered by conventional loans.

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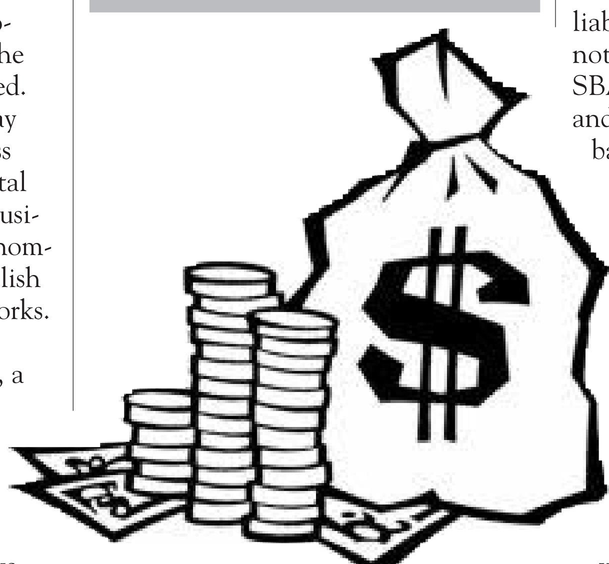

Qualification. While there are some restrictions to how a small business is defined, the SBA estimates that 98% of all businesses in the United States qualify for SBA financing. There is no minimum loan amount (although many banks set internal minimums of $25,000 to $50,000 for SBA loans), and a maximum guaranty amount of $750,000.

Low-cost financing. The third advantage of the SBA guaranty program is the low cost of financing. The SBA charges a 2% guaranty fee for term loans — on a 90% guaranteed loan of $50,000, for example, the fee would be $900. The maximum variable rate the SBA can charge is prime plus 2.25% for loans of less than seven years, and prime plus 2.75% for loans of seven years or more. Many banks also give fixed-rate SBA guaranteed loans.

Basic Requirements

For existing companies, the SBA looks for a debt-to-worth ratio — total liabilities divided by total assets — of not more than 3:1. In addition, the SBA looks very closely at both past and projected cash flow, as well as the background and competence of management.

The red tape involved in getting an SBA loan is not nearly as excessive as many small business owners believe. The program is actually quite "user friendly," and bankers are very cooperative in helping business owners apply for a loan.

Finding a banker. The first step in applying for an SBA loan is to call a loan officer at your current bank to see if the bank has any SBA lending experience. You can also ask your accountant and attorney if they know which banks are actively involved with the SBA. If all else fails, call the regional SBA office directly to see which local lenders are "SBA literate."

Finding the right banker is important for several reasons.
A banker with no experience in dealing with SBA guaranteed loans can often slow down the process signifi-

cantly. Also, a lender with an understanding of the inner workings of the program is more likely to have a feel for the "hot buttons" that lead to co-approval by the SBA.

Preparing for the SBA

Before going to the bank with a loan request, you should prepare several documents that will help expedite the process.

Business plan. You will need a narrative business plan that includes a company history, resumes of key personnel, and an explanation of the purpose for the loan. It is not necessary to write a novel: The business plan may only be a few pages long. But you should write a plan that demonstrates to the banker and the SBA that the business is founded on sound principles and that you have thoroughly considered the obstacles the business may face in the future.

Financial statements. Before going to the bank, prepare at least three years of historical financial statements on the company, as well as current personal financial statements on all owners. Also include profit-loss projections for the next three years. The projections should list the description and value of the collateral you will offer to secure the loan.

Applying for a Loan

Your banker will help you to apply for the SBA loan. The SBA promises a verbal answer in three to ten business days, once they receive all of the proper documentation. To avoid delays — and to avoid putting approval in jeopardy — make sure you have prepared all required information before making formal application for the loan. If approved, the loan usually takes a couple of weeks before closing.

The SBA guaranteed loan program is one of the best kept secrets in the intricate world of financing. For many small business owners, however, the SBA program can provide the push needed to clear the hurdle of raising money. ■

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