by Beverly King
Weber State University
Small Business Development Center
801-626-7232
bking1@weber.edu

Let's talk business financing. This is a big topic and it will take more than one month's article to give complete coverage.

First, let's talk the Small Business Administration (SBA) Guaranteed loans referred to as 7(a) loans. Believe it or not, the U.S. Government does believe in small business. The 7(a) loan program is one of the primary ways they assist small businesses to start and grow.

First, it is important to understand that the SBA does not make loans, they only place a guarantee on loans made through the lending institutions. Second, it is important to accept that the lenders are businesses themselves and are not risk takers. They will only make loans when they feel very confident that they will be repaid. Helping someone to be independent and fulfill their dream is not part of the decision making process.

Typically, when a business seeks a loan from a lender they will find that they need to show three years of past history with adequate cash flows to make the monthly loan payment. This, of course, is impossible for a start up business or one that has just been through those rough startup years, hence the SBA 7(a) loan program.

With the loan guarantee, the lender is more willing to make loans to start-up businesses and businesses that cannot show a strong history. The guarantee is between the SBA and the bank only. Should the borrower default on the loan, the SBA guarantees, or covers a portion of the loss for the lender. The business, however, is held fully accountable. The SBA will try to fully recover their loss by liquidating all assets and personal collateral.

An SBA guaranteed loan can offer longer repayment terms than a typical commercial loan. Loan terms can range from five to 25 years. This does not mean that you can select how many years you have to repay. The terms will be set to match the items the loan is purchasing. Inventory, office equipment and working capital will generally be financed at five to seven years. Buildings and land generally go 20 or 25 years.

It is up to the bank to determine the interest rate, but the SBA does set a maximum on what they can charge. For loans of seven years or less, the max is 2.25% above prime. For loans over seven years, it goes up to 2.75% above prime. Today, the prime rate is 7.5%, so a typical SBA loan may run 9.75% to 10.25%. The loan will generally be a variable rate adjusted quarterly.

The lender will look at several things when deciding whether they are willing to make the loan. 1) Equity. For a start up business, this equates to down payment. You should plan on 20% or more. For an existing business, maintain your balance sheet! You need equity on that balance sheet or you will need to come up with that down payment. 2) Collateral. The lenders and the SBA wish to be fully covered on their loan. Be prepared to put up business assets and personal assets. Other things looking good, this element is the most flexible, but you must be willing to put up what you have. 3) Credit history. They will pull a credit score on all owners of 20% or more. 4) Management skills. These are the skills, education, training and experience that improve the odds of success. 5) Ability to repay. The lender will request three years of past tax returns, if applicable, and a two to three year financial forecast. The forecasts need to show realistic cash flows sufficient to repay the loan.

SBA 7(a) loan funds can be used for a wide variety of items including inventory, equipment, land, building, debt consolidation and working capital. The business must qualify as a small business, which is much larger than most people realize. The standards vary from business to business, but think millions of dollars of revenue or up to 500 employees.

It is sometimes easier to state what the loan funds cannot be used for. Not-for-profit entities are not eligible. The funds cannot be used towards rental property, either commercial or residential (sorry, this includes storage bays). They cannot be used for illegal purposes, so in Utah, they cannot fund gambling establishments. They cannot be used for speculation or investment purposes (this includes housing developments and home flipping). They cannot be used for flooring or for lending. There are other regulations, but those are some of the bigger ones. Check with the bank, the SBA or my office for specific details. The SBA's website, www.sba.gov has a great deal of information available.

Next month I'll discuss the SBA 504 loan program and possibly some other loan programs in the area. I'll also touch some on incentive programs. In March, I'll talk about grants and equity investors, both topics that need to be clarified a great deal.