



Small Business Administration
Guaranteed Loan Program
White Paper

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SBA's Role

SBA does not make direct loans to small businesses. Rather, SBA sets the guidelines for loans, which are then made by its partners (lenders, community development organizations, and microlending institutions). SBA guarantees that these loans will be repaid, thus eliminating some of the risk to the lending partners. So when a business applies for an SBA loan, it is actually applying for a commercial loan, structured according to SBA requirements with an SBA guaranty.

SBA-guaranteed loans may not be made to a small business if the borrower has access to other financing on reasonable terms.

SBA loan guaranty requirements and practices can change as the Government alters its fiscal policy and priorities to meet current economic conditions. Therefore, you can't rely on past policy when seeking assistance in today's market.

SBA Loan Programs

Banks and other lending institutions offer a number of SBA guaranteed loan programs to assist small businesses. While SBA itself does not make loans, it does guarantee loans made to small businesses by private and other institutions.

Below is an overview of SBA's guaranteed loan programs.

For more information, click on the name of the program.

[7\(a\) Loan Program:](#)

This is SBA's primary and most flexible loan program, with financing guaranteed for a variety of general business purposes. It is designed for start-up and existing small businesses, and is delivered through commercial lending institutions.

The major types of 7(a) loans are:

- [Express Programs](#)
- [Export Loan Programs](#)
- [Rural Lender Advantage Program](#)
- [Special Purpose Loans Program](#)

[CDC/504 Loan Program:](#)

This program provides long-term, fixed-rate financing to acquire fixed assets (such as real estate or equipment) for expansion or modernization. It is designed for small businesses requiring "brick and mortar" financing, and is delivered by CDCs (Certified Development Companies)—private, non-profit corporations set up to contribute to the economic development of their communities.

[Microloan Program:](#)

This program provides small (up to \$35,000) short-term loans for working capital or the purchase of inventory, supplies, furniture, fixtures, machinery and/or equipment. It is designed for small businesses and not-for-profit child-care centers needing small-scale financing and technical assistance for start-up or expansion, and is delivered through specially designated intermediary lenders (nonprofit organizations with experience in lending and technical assistance).

[Disaster Assistance Loan Program:](#)

This program provides low-interest loans to homeowners, renters, businesses of all sizes and most private non-profit organizations to repair or replace real estate, personal property, machinery and equipment, inventory and business assets that have been damaged or destroyed in a declared disaster.

SBA Guaranteed Loan Credit Factors

Before beginning to assemble a business loan application, you should first understand some basic credit factors that apply to all loan requests. Every application needs positive credit merits to be approved. This section explores the credit factors a lender will review and analyze before deciding whether to internally approve your loan application, seek a guaranty from SBA to support their loan to you, or decline your application all together.

Equity Investment

Business loan applicants must have a reasonable amount of capital invested in their business. This ensures that, when combined with borrowed funds, the business can operate on a sound basis. Lenders will expect you to contribute your own assets and to undertake personal financial risk to establish the business before asking them to commit any funding. If you have a significant personal investment in the business, you are more likely to do everything in your power to make the business successful.

A lender will make a careful examination of the debt-to-worth ratio of the applicant to determine how much money it is being asked to loan (debt) in relation to how much the owner(s) have invested (worth). Owners invest either assets that are applicable to the operation of the business and/or cash that can be used to acquire such assets. The value of your invested assets should be substantiated by either invoices or appraisals (for start-up businesses) or current financial statements (for existing businesses).

Positive equity with a manageable level of debt provide financial resilience to help a firm weather periods of operational adversity. Positive equity also ensures that the owner(s) remains committed to the business. Minimal or non-existent equity makes a business susceptible to miscalculation, and increases the risk of default (failing to repay) on borrowed funds.

Sufficient equity is particularly important for new businesses. Weak equity makes a lender more hesitant to provide any financial assistance. However, low (but not non-existent) equity in relation to existing and projected debt—the loan—can be overcome with a strong showing in all the other credit factors.

Determining whether a company's level of debt is appropriate in relation to its equity requires analysis of the company's expected earnings and the viability and variability of these earnings. The stronger the support for projected profits, the greater the likelihood the loan will be approved. Applications with high debt, low equity, and unsupported projections are prime candidates for loan denial.

Earnings Requirements

Financial obligations are paid with cash, not profits. When cash outflow exceeds cash inflow for an extended period of time, a business cannot continue to operate. As a result, cash management is extremely important. In order to adequately support a company's operation, cash must be at the

right place, at the right time and in the right amount.

A company must be able to meet all its debt payments, not just its loan payments, as they come due. All SBA loans require that the borrower be able to reasonably demonstrate the ability to repay the intended obligation from the business operation. The lender will consider the cash flow from the business, the timing of the repayment, and the probability of successful repayment of the loan. Payment history on existing credit relationships (personal and commercial) is considered an indicator of future payment performance. Lenders will also want to know about your contingent sources of repayment.

Applicants are generally required to provide a report on when their income will become cash and when their expenses must be paid. This report is usually in the form of a cash flow projection, broken down on a monthly basis, and covering the first annual period after the loan is received. When the projections are for a new business or an expanding business with anticipated revenues and expenses exceeding past performance by a significant amount (20 percent plus), a critical factor in loan approval is having the lender understand all the assumptions on how these revenues will be generated.

Working Capital

Working capital is defined as the excess of current assets over current liabilities.

Of all assets, current assets are the most liquid and most easily convertible to cash. Current liabilities are obligations due within one year. Therefore, working capital measures what is available to pay a company's current debts. It also represents the cushion or margin of protection a company can give their short-term creditors.

Working capital is essential for a company to meet its continuous operational needs. The availability of working capital influences the firm's ability to meet its trade and short-term debt obligations, as well as to remain financially viable.

Collateral

To the extent that worthwhile assets are available, adequate collateral is required as security on all SBA loans. However, SBA will generally not decline a loan where inadequacy of collateral is the only unfavorable factor.

Collateral is an additional form of security to show a lender that you have a second source of loan repayment. Assets such as equipment, buildings, accounts receivable, and in some cases, inventory, are considered possible sources of repayment if they are sold by the bank for cash. Collateral can consist of assets that are usable in the business as well as personal assets that remain outside the business.

Borrowers can assume that all assets financed with borrowed funds will collateralize the loan. Depending on how much equity was contributed toward the acquisition of these assets, the lender is likely to require other business assets as collateral.

For all SBA loans, personal guaranties are required of every owner of 20 percent or more of the

business, plus other individuals who hold key management positions. Whether a guaranty will be secured by personal assets is based on the value of the assets already pledged and the value of the assets personally owned compared to the amount borrowed.

Certified appraisals are required for loans greater than \$250,000 secured by commercial real estate. SBA may require professional appraisals of both business and personal assets, plus any necessary survey and/or feasibility study. When real estate is being used as collateral, banks and other regulated lenders are required by law to obtain third-party valuation on transactions of \$50,000 or more.

Owner-occupied residences generally become collateral when:

- The lender requires the residence as collateral;
- The equity in the residence is substantial and other credit factors are weak;
- Such collateral is necessary to assure that the principal(s) remain committed to the success of the venture for which the loan is being made;
- The applicant operates the business out of the residence or other buildings located on the same parcel of land.

Resource Management

The proven positive ability of individuals to manage the resources of their business is a prime consideration when determining whether or not a loan will be made.

Character and Managerial Capacity

Character is the personal impression you make on the potential lender or investor. The lender decides subjectively whether or not you are sufficiently trustworthy to repay the loan or generate a return on funds invested in your company.

Managerial capacity is an important factor, and your educational background and experience in business and in your industry will be reviewed. The quality of your references and the background and experience of your employees will also be considered.

Key Ratios

Mathematical calculations on historical and projected financial statements form ratios that provide insight into how resources have been managed in the past. It is important to understand that no single ratio provides all this insight, but the use of several ratios in conjunction with one another can give an overall picture of management performance. Some key ratios all lenders review are:

- Debt to worth;
- Working capital;
- The rate at which income is received after it is earned;
- The rate at which debt is paid after becoming due;
- The rate at which the service or product moves from the business to the customer.

How to Apply

While the standards for SBA-qualifying loans are more flexible than those for other types of loans, *lenders still require extensive documentation to evaluate your loan request*. You want to make the best possible presentation in your initial loan submission, since you may not get a second opportunity.

Check with the bank in which you currently have a relationship with to see if they offer SBA Guaranteed loans. To locate SBA Approved lenders, contact the [SBA District Office](#) nearest you.

There are many different formats you can use for a loan proposal. You may want to contact the lender you are approaching to determine which format is best for you. When writing your proposal, don't assume the lender is familiar with your industry or your individual business. Always include industry-specific details so the lender can understand how your particular business is run and what industry trends affect it.

In addition to consulting the information in this section, you can take a **free online course** on [How to Prepare a Loan Package](#).

SBA Forms

Your loan application must include certain SBA Forms. The primary forms for the Basic 7(a) program include:

- [Form 4](#): Application for Business Loan
- [Form 4-a](#): Schedule of Collateral - Schedule A
- [Form 413](#): Personal Financial Statement
- [Form 912](#): Statement of Personal History
- [Form 1624](#): Certification Regarding Debarment, Suspension, Ineligibility and Voluntary Exclusion Lower Tier Covered Transactions
- [Form 1846](#): Statement Regarding Lobbying

Loan Documents

While you need to check the specific requirements of your lender, a loan application usually includes these elements.

Executive Summary

Begin your proposal with a simple and direct cover letter or executive summary. Clearly and briefly explain who you are, your business background, the nature of your business, the amount and purpose of your loan request, your requested terms of repayment, how the funds will benefit your business, and how you will repay the loan.

Business Profile

Provide a written description of the history of your business, including:

- Type of business

- Location
- Product or service
- Brief history (including length of time in business and ownership)
- Annual sales
- Number of employees
- Proposed future operation
- Competition
- Customers
- Suppliers
- Date of information

Management Experience

Include resumes of each owner and key member of management.

Loan Request: SBA Form 4

This description of how the loan funds will be used should include purpose, amount and type of loan.

Loan Repayment

Provide a brief statement indicating how the loan will be repaid, including repayment sources and time requirements. Cash-flow schedules, budgets, and other appropriate information should support this statement.

Collateral: SBA Form 4-a

List real property and other assets to be held as collateral. Few financial institutions will provide non-collateral-based loans. All loans should have at least two identifiable sources of repayment. The first source is ordinarily cash flow generated from profitable operations of the business. The second source is usually collateral pledged to secure the loan.

Personal Financial Statement: SBA Form 413

SBA requires financial statements for all owners, partners, officers and stockholders owning 20 percent or more of the business. These statements (listing all personal assets, liabilities and monthly payments) should not be more than 90 days old. Federal income tax returns for the past three years must also be submitted.

Business Financial Statements

Provide complete financial statements for the last three years (including balance sheets, income statements, and a reconciliation of net worth) plus a current (no more than 90 days old) interim financial statement. Also include a schedule of term debt and aging of accounts payable and accounts receivable (broken into 30-, 60-, 90-, and past-90-day-old categories). If you are just starting out, provide a projected balance sheet and income statement. The strength and accuracy of your financial statements will be the primary basis for the lending decision, so be sure that yours are carefully prepared and up-to-date. (Formats for constructing a balance sheet, income statement, and cash flow statement can be found in [Forms](#).)

Proposed Business

Provide a pro-forma balance sheet reflecting sources and uses of both equity and borrowed funds.

Projections

Provide a projection of future operations for at least one year or until positive cash flow can be shown. Include earnings, expenses, and reasoning for these estimates. The projections should be in profit and loss format. Explain the assumptions you use if they are different from trend or industry standards and support your projected figures with clear, documentable explanations.

Other Items (as They Apply)

- Lease (copies of proposal)
- Franchise agreement
- Purchase agreement
- Articles of incorporation
- Plans, specifications
- Copies of licenses
- Letters of reference
- Letters of intent
- Contracts
- Partnership agreement

If you have any questions or need any further information, contact the [SBA District Office](#) nearest you.

Source: [Small Business Administration](#)