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How to Obtain Financing with Assistance from the SBA

Three different programs offer you options to grow your business

By The BizQuest Staff

One of the Small Business Administration's primary objectives is to help small businesses obtain financing. Although the SBA itself does not make direct loans, it has set up a number of loan programs to assist small businesses. In connection with most of these programs, the SBA provides guarantees to the private sector lenders who actually make the loans. With this guaranty in place, these lenders will generally make loans they would not otherwise make.

The discussion below focuses on those programs that are most commonly used by buyers in connection with financing the purchase of a small business.

Section 7(a) Program

The Section 7(a) Loan Guaranty Program is one of the SBA's most important and widely used lending programs. Loans may be used for a wide variety of business purposes, including to purchase real estate and most other types of assets. Although in most cases, there is no limit on the size of the loan which can be requested from the lender, there is a limit on the amount of the loan that the SBA will guaranty. Generally the SBA will guaranty up to $1,500,000 and 75% of the loan. Thus, a $2,000,000 loan would be the largest fully guaranteed SBA loan under the Section 7(a) program.

Eligibility for this type of loan guaranty is dependent on a number of factors. The business must be operated for profit, do business in the United States, and have a reasonable amount of equity invested by the owner. Note that all owners of 20% or more of the business must personally guaranty the loan. The size of the business must also be below certain size limits established by the SBA. These size limits vary by industry and are tied to either annual receipts or number of employees. Additional considerations include the business's cash flow, and the owner's character, management capability, and equity contribution.

Other details include:

- Loan Maturities - Term is based on the ability to repay, the loan purpose, and the useful life of the assets financed. Longer terms are encouraged, and the maximum maturities are (i) the shorter of 25 years or the useful life for most hard assets and (ii) 7 years for working capital.
- Principal Repayments - Loan principal is structured to amortize over the period of the loan. Thus there is no "balloon" balance owing on the loan's maturity date.
- Interest Rates - Interest rates can be either fixed or floating, and are negotiated between the borrower and the lender. Fixed rates may not exceed Prime plus 2.25% for terms less than 7 years or Prime plus 2.75% for terms of 7 years or more. Loans of under $50,000 have slightly higher maximums.
- Collateral - Loans must generally be secured by the assets which are acquired with the loan proceeds.
- Business Acquisitions - The SBA generally requires the borrower to put up at least 30% equity in the case of a purchase of a business, and at least 33% equity in the case of a new start up.
- Fees - Origination and related fees that can be charged in connection with SBA loans are sharply restricted.

504 Certified Development Company (CDC) Program

This program provides existing businesses long-term fixed rate financing for major fixed assets, including land and buildings. The program is intended to help small businesses create and retain jobs, and thus one job must be created or retained for every $50,000 provided under this program. The loan structure generally includes 50% senior financing from a private sector lender, 40% SBA backed financing from a CDC, and 10% equity from the borrower. Maturities are generally 10 or 20 years and interest rates are at a spread over 5 or 10 year U.S. Treasuries. A business may not have over $7,000,000 in net worth or average net income in excess of $2,500,000 after taxes for the last two years to qualify for the program. Most of the other terms are similar to the Section 7(a) program.

To learn more, the financing portion of the SBA's website contains additional information on the foregoing programs as well as additional lending programs, or you can contact the SBA at 800-827-5722.

The Small Business Investment Company (SBIC) Program

A related resource for buyers is the SBIC Program. SBIC's are privately organized and managed investment firms that invest in small businesses. One of the ways an SBIC can increase its pool of investment capital is by issuing SBA guaranteed debentures. This gives the SBIC additional funds to make available to qualifying small businesses. An SBIC can provide both debt and equity funds to a small business. Find out more about the SBICs.