

Finding the Money You Need

One key to a successful business start-up and expansion is your ability to obtain and secure appropriate financing. Raising capital is the most basic of all business activities. But as many new entrepreneurs quickly discover, raising capital may not be easy; in fact, it can be a complex and frustrating process. However, if you are informed and have planned effectively, raising money for your business will not be a painful experience.

This information summary focuses on ways a small business can raise money and explains how to prepare a loan proposal.

FINDING THE MONEY YOU NEED

There are several sources to consider when looking for financing. It is important to explore all of your options before making a decision.

- **Personal Savings:** The primary source of capital for most new businesses comes from savings and other forms of personal resources. While credit cards are often used to finance business needs, there may be better options available, even for very small loans.
- **Friends and Relatives:** Many entrepreneurs look to private sources such as friends and family when starting out in a business venture. Often, money is loaned interested free or at a low interest rate, which can be beneficial when getting started.
- **Banks and Credit Unions:** The most common source of funding, banks and credit unions, will provide a loan if you can show that your business proposal is sound.
- **Venture Capital Firms:** These firms help expanding companies grow in exchange for equity or partial ownership.

BORROWING MONEY

It is often said that small business people have a difficult time borrowing money. This is not necessarily true.

Banks make money by lending money. However, the inexperience of many small business owners in financial matters often prompts banks to deny loan requests.

Requesting a loan when you are not properly prepared sends a signal to your lender. That message is: High Risk!

To be successful in obtaining a loan, you must be prepared and organized. You must know exactly how much money you need, why you need it and how you will pay it back. You must be able to convince your lender that you are a good credit risk.

SBA LOAN MATURITIES

SBA loan programs are generally intended to encourage longer term small business financing, but actual loan maturities are based on the ability to repay, the purpose of the loan proceeds, and the useful life of the assets financed. However, maximum loan maturities have been established: 25 years for real estate; up to 10 years for equipment (depending on the useful life of the equipment); and generally up to seven years for working capital. Short-term loans are also available through the SBA to help small businesses meet their short-term and cyclical working capital needs.

TYPES OF BUSINESS LOANS

Terms of loans vary from lender to lender, but there are two basic types of loans: short-term and long-term.

Generally, a short-term loan has a maturity of up to one year. These include working-capital loans, accounts-receivable loans and lines of credit.

Long-term loans have maturities greater than one year but usually less than seven years. Real estate and equipment loans may have maturities of up to 25 years. Long-term loans are used for major business expenses such as purchasing real estate and facilities, construction, durable equipment, furniture and fixtures, vehicles, etc.

HOW TO WRITE A LOAN PROPOSAL

Approval of your loan request depends on how well you present yourself, your business and your financial needs to a lender. Remember, lenders want to make loans, but they must make loans they know will be repaid. The best way to improve your chances of obtaining a loan is to prepare a written proposal.

A good loan proposal will contain the following key elements:

General Information

- Business name, names of principals, Social Security number for each principal, and the business address.
- Purpose of the loan – exactly what the loan will be used for and why it is needed.
- Amount required – the exact amount you need to achieve your purpose.

Business Description

- History and nature of the business – details of what kind of business it is, its age, number of employees and current business assets.
- Ownership structure – details on your company's legal structure.

Management Profile

- Develop a short statement on each principal in your business; provide background, education, experience, skills and accomplishments.

Market Information

- Clearly define your company's products as well as your markets.
- Identify your competition and explain how your business competes in the marketplace.
- Profile your customers and explain how your business can satisfy their needs.

Financial Information

- Financial statements – balance sheets and income statements for the past three years. If you are starting out, provided a projected balance sheet and income statement for three years.

- Personal financial statements on yourself and other principal others of the business.
- Collateral you would pledge as security for the loan.

WHEN REVIEWING A LOAN REQUEST, THE LENDER IS PRIMARILY CONCERNED ABOUT REPAYMENT.

HOW YOUR REQUEST WILL BE REVIEWED

When reviewing a loan request, the lender is primarily concerned about repayment. To help determine this ability, many loan officers will order a copy of your business credit report from a credit-reporting agency. Therefore, you should work with these agencies to help them present an accurate picture of your business. Using the credit report and the information you have provided, the lending officer will consider the following issues:

- Have you invested savings or personal equity in your business totaling at least 25 percent to 50 percent of the loan you are requesting? (Remember, a lender or investor will not finance 100 percent of your business.)
- Do you have a sound record of credit-worthiness as indicated by your credit report, work history and letters of recommendation? This is very important.
- Do you have sufficient experience and training to operate a successful business?
- Have you prepared a loan proposal and business plan that demonstrate your understanding of and commitment to the success of the business?
- Does the business have sufficient cash flow to make the monthly payments?

SBA FINANCIAL PROGRAMS

The major concern for today's small business owners is access to capital and credit. The SBA's loan guaranty programs provide a key source of

financing for viable small businesses that have real potential, but cannot qualify for loans from traditional sources. SBA guaranties, provided through private lenders and nonprofit lending institutions, give small business owners access to the same kinds of reasonably priced, long-term financing available to large businesses by virtue of their size and economic clout.

Financing programs provided by SBA vary according to a borrower's financial need. SBA loans are made by private lenders and are guaranteed up to 85 percent. There are three principal players in an SBA-guaranteed loan – the small business borrower, the private lender and the SBA. First, the private lender determines whether a borrower's application is acceptable. If it is, the lender forwards the application and its credit analysis to the SBA. After SBA review and approval, the lender makes the loan and disburses the funds to the borrower to make payments to the lender. The following outlines major programs offered by the SBA.

7(a) LOAN GUARANTY PROGRAM

The 7(a) Loan Guaranty Program is the SBA's primary loan program. The SBA reduces risk to lenders by guaranteeing major portions of loans made to small businesses. This enables the lenders to provide financing to small businesses when funding is otherwise unavailable on reasonable terms.

The eligibility requirements and credit criteria of the program are very broad in order to accommodate a wide range of financing needs.

When a small business applies to a lending institution for a loan, the lender reviews the application and decides if it merits a loan on its own or if it requires additional support in the form of an SBA guaranty. SBA backing on the loan is then requested by the lender. In guaranteeing the loan, the SBA assures the lender that, in the event the borrower does not repay the loan, the government will reimburse the lending institution for a portion of its loss. By providing this guaranty, the SBA is able to help tens of thousands of small businesses every year get financing they would not otherwise obtain.

To qualify for an SBA guaranty, a small business must meet the 7(a) criteria, and the lender must certify that it could not provide funding on reasonable terms except with an SBA guaranty. The SBA can then guarantee as much as 85 percent on loans of up to \$150,000 and 75 percent on loans of

more than \$150,000. In most cases, the maximum guaranty is \$1 million. Exceptions are the International Trade, DELTA and 504 loan programs, which have higher loan limits. The maximum loan size under the 7(a) program is \$2 million.

How It Works

You submit a loan application to a lender for initial review. If the lender approves the loan subject to an SBA guaranty, a copy of the application and credit analysis are forwarded by the lender to the nearest SBA office. After SBA approval, the lending institution closes the loan and disburses the funds. You make monthly loan payments directly to the lender. As with any loan, you are responsible for repaying the full amount of the loan.

There are no balloon payments, application fees or points permitted with 7(a) loans. Prepayment fees are permitted on loans with maturities of 15 years or longer.

Use of Proceeds

You can use a 7(a) loan to: expand or renovate facilities; purchase machinery, equipment, fixtures and leasehold improvements; finance receivables and augment working capital; refinance existing debt with compelling reason; finance seasonal lines of credit; construct commercial buildings; and/or purchase land or buildings.

Terms, Interest Rates and Fees

The length of time for repayment depends on the use of the proceeds and the ability of your business to repay: usually five to 10 years for working capital and up to 25 years for fixed assets such as the purchase or major renovation of real estate or purchase of equipment (not to exceed the useful life of the equipment).

Both fixed and variable interest rates are available. Rates are pegged at no more than 2.25 percent over the lowest prime rate* for loans with maturities of less than seven years and up to 2.75 percent for seven years or longer. For loans under \$50,000, rates may be slightly higher.

The SBA charges the lender a nominal fee to provide a guaranty, and the lender may pass this charge on to you. The fee is based on the maturity of the loan and the dollar amount that the SBA guarantees. On any loan with a maturity of one year

or less, the fee is just 0.25 percent of the guaranteed portion of the loan. On loans with maturities of more than one year, the guaranty fee is 2 percent on loans up to \$150,000; 3 percent on loans over \$150,000 but not over \$700,000; and 3.5 percent on loans over \$700,000.

* All references to the prime rate refer to the lowest prime rate as published in the Wall Street Journal on the day the application is received by the SBA.

Collateral

You must pledge sufficient assets, to the extent that they are reasonably available, to adequately secure the loan. Personal guaranties are required from all the principal owners of the business. Liens on personal assets of the principals may be required. However, in most cases a loan will not be declined where insufficient collateral is the only unfavorable factor, if all available collateral has been pledged.

Eligibility

Your business generally must be operated for profit and fall within the size standards set by the SBA. The SBA determines if the business qualifies as a small business based on the average number of employees during the preceding 12 months or on sales averaged over the previous three years. Loans cannot be made to businesses engaged in speculation or investment. Maximum size standards:

- Manufacturing – from 500 to 1,500 employees
- Wholesaling – 100 employees
- Services – from \$2.5 million to \$21.5 million in annual receipts
- Retailing – from \$5 million to \$21 million
- General construction – from \$13.5 million to \$17 million
- Special trade construction – average annual receipts not to exceed \$7 million
- Agriculture – from \$0.5 million to \$9 million

What to Take to the Lender

Documentation requirements may vary; contact your lender for the information you must supply. Common requirements include the following:

- Purpose of the loan
- History of the business

- Financial statements for three years (existing businesses).
- Schedule of term debts (existing businesses).
- Aging of accounts receivable and payable (existing businesses).
- Projected opening-day balance sheet (new businesses).
- Lease details.
- Amount of investment in the business by the owner(s).
- Projections of income, expenses and cash flow.
- Signed personal financial statements.
- Personal resume(s).

What the SBA Looks for

- Good character.
- Management expertise and commitment necessary for success.
- Sufficient funds, including the SBA guaranteed loan, to operate the business on a sound financial basis (for new businesses, this includes the resources to meet start-up expenses and the initial operating phase).
- Feasible business plan.
- Adequate equity or investment in the business.
- Sufficient collateral.
- Ability to repay the loan on time from the projected operating cash flow.

Specialized Programs Under 7(a)

There are a number of special loan guaranty programs under the 7(a) program that address specific needs of start-up or established businesses. They are governed, for the most part, by the same rules, regulations, fees, interest rates, etc., as the regular 7(a) loan guaranty. Your lender can advise you of any variations.

PRE-QUALIFICATION LOAN PROGRAM

SBA Pre-Qualification Loan (Pre-Qual) Program was developed to provide substantive support and assistance in the small business loan application process to those segments of the small business community that traditionally may have been underserved by the lending community.

It was later expanded to include women, veteran and minority-owned businesses, as well as exporters,

rural markets and certain designated geographical areas and industries.

The Pre-Qual concept revolves around intermediaries who help market the SBA's loan programs and assist prospective borrowers in assembling a viable loan application package.

To be eligible, a prospective business must be 51 percent or more owned by veterans, women and/or minorities. Export eligible loans are those made with the intention of significantly expanding existing export markets or developing new export markets. With respect to rural markets and other specially designated geographical areas or industries, contact your local SBA office for specific requirements.

The maximum loan amount under this program is \$250,000. If a borrower currently has an SBA loan and the combined loans requested as a result of this program are more than \$250,000, the request is to be processed through the regular guaranty program.

The Pre-Qualification Loan Program is a (7a) loan program. Therefore, all other terms, conditions and requirements of the 7(a) program apply as prescribed by SBA's policies and regulations.

LOW DOCUMENTATION LOAN

LowDoc is one of the SBA's most popular programs. Once you have met your lender's requirements for credit, LowDoc offers a simple, one-page SBA application form and rapid turn-around on approvals for loans up to \$150,000 (for loans over \$50,000, you must also provide a copy of U.S. Income Tax Schedule C or the front page of the corporate or partnership returns for the past three years). The SBA will guarantee up to 85 percent of the loan amount. Completed applications are processed quickly by the SBA, usually within two or three business days. Proceeds may not be used to repay certain types of existing debt. Business start-ups, as well as businesses with average annual sales for the past three years not exceeding \$5 million and with 100 or fewer employees, including affiliates, are eligible.

SBA EXPRESS

SBAExpress is available for loans up to \$150,000. The program authorizes SBA preferred lenders to use mostly their own forms, analysis and procedures to process, service and liquidate SBA guaranteed loans.

The SBA guarantees up to 50 percent of an SBA Express loan. Loans under \$25,000 do not require collateral. Like most 7(a) loans, maturities are usually five to seven years for working capital and up to 25 years for real estate or equipment. Revolving lines of credit are allowed for a maximum of five years. For a list of approved lenders contact the Georgia District Office, 233 Peachtree Street, NE, Suite 1900, Atlanta, GA 30303, (404) 331-0100. Information may also be obtained on the SBA website <http://www.sba.gov>.

CAPLINES

This specialized umbrella loan program is designed to help small businesses meet their short-term and cyclical working capital needs. The CAPLines can be used to finance seasonal working capital needs; finance the direct costs of performing certain construction, service and supply contracts; finance the direct cost associated with commercial and residential construction performed on a speculative basis (without a firm commitment for purchase); finance operating capital by obtaining advances against existing inventory and accounts receivable; and consolidate short-term debt. SBA provides up to 85 percent guarantee.

There are several distinct programs under the CAPLine umbrella:

The Contract Loan Program – is used to finance material and labor needs for a specific contract or contracts. If used for one contract, it is generally not revolving; if used for more than one contract at a time, it can be revolving. The loan maturity is usually based on the length of the contract, but no more than five years.

The Seasonal Line of Credit Program – finances the short-term seasonal increases of accounts receivable and inventory. The business must have a definite established seasonal pattern and thus must have been in business for a period of 12 months in order to establish that pattern. The loan does not revolve during the season but may be used over again after a "clean-up" period of 30 days. These also may have a maturity of up to five years. The business may not have another seasonal line of credit outstanding but may have other lines for non-seasonal working capital needs.

The Small Asset-Based Line – can be used for revolving lines up to \$200,000 to purchase inventory, pay direct labor or finance accounts receivable and is advanced against existing inventory and accounts receivable. Repayment comes from the collection of accounts receivable, and this line of credit must revolve.

They do require periodic servicing and monitoring of the collateral for which service the lender can charge up to two percent annually to the borrower. These lines are generally used by businesses who provide credit to their customers.

The Standard Asset-Based Line – is similar to the Small Asset-Based Line, but for loan amounts over \$200,000. It does require stricter servicing and monitoring, and the lender may pass the costs along to the borrower.

EXPORT WORKING CAPITAL PROGRAM

The Export Working Capital Program (EWCP) provides pre- and post-export working capital financing for export sales. It is transaction-based and can be a revolving line of credit or structured for each purchase order, shipment or contract.

The loan funds may be used for pre-sold inventory, materials and labor and for financing foreign receivables, as well as standby letters of credit used for performance bonds, bid bonds or payment guarantees to foreign buyers. The loan may not be used for refinancing, fixed assets, marketing or setting up operations abroad.

The maturity is typically 12 months or less and SBA's fee is 0.25 of one percent of the loan guaranty extended to the lender (90 percent per loan and maximum of \$750,000 per business).

INTERNATIONAL TRADE LOAN

A combination of long-term, fixed-asset financing and the EWCP may exceed the usual limit of SBA's guaranty of \$1 million per business up to a total of \$1.25 million. Businesses preparing to export or to increase their export sales and companies adversely affected by import competition are eligible. The EWCP portion may not exceed the \$1 million SBA guaranty limit.

DEFENSE LOAN AND TECHNICAL ASSISTANCE (DELTA)

DELTA is a joint effort of the SBA and the Department of Defense to provide financial and technical assistance to defense-dependent small firms affected by defense reductions. The goal is to help affected small firms diversify into the commercial market while remaining a part of the defense industrial base. Reductions affecting business may be the result of any number of actions, such as cuts in defense spending, termination of defense contracts or the closure or realignment of military installations.

SBA may guarantee 75 percent of a loan up to \$1.25 million under the 7(a) program, or \$1 million under the 504 program. Technical assistance, including help in preparation of a business plan and loan application package, is available through Small Business Development Centers.

SBA 504 LOAN PROGRAM

The 504 is the SBA's economic development instrument that supports American small business growth and helps communities through business expansion and job creation. The SBA 504 loan program provides long-term, fixed-rate, subordinate mortgage financing for acquisition and/or renovation of capital assets including land, buildings and equipment. Virtually all types of for-profit small businesses are eligible for this program.

The SBA 504 loan is distinguished from other SBA loan programs in these ways:

- Lower down payment; allows a business to conserve valuable operating capital by injecting as little as 10 percent of total project cost.
- Fixed interest rate; borrower knows cost of occupancy for the next 20 years.
- Rate is usually below market rate.
- All project costs can be financed, including acquisition (land and building, land and construction of building, renovations, machinery and equipment) and soft costs such as title insurance, legal, appraisal, environmental and bridge loan fees. Closing costs may be financed.
- Collateral is typically assets-financed; allows other assets to be free of liens and available to secure other needed financing.

- Long-term; real estate loans are 20-year term, heavy equipment 10- or 20-year term and are self-amortizing.
- 504 program encourages banks and other lenders to make loans in first position on reasonable terms, helps them retain growing customers and provides Community Redevelopment Act credit.
- 504 program benefits the borrower's community through job creation and retention.

Businesses that receive 504 loans are:

- Small – net worth under \$6 million, net profit after taxes under \$2 million, or meet other SBA size standards.
- Organized as for-profit.
- Any type of business – retail, service, wholesale or manufacturing.

7(M) MICROLOAN PROGRAM

The Microloan Program provides small loans ranging from under \$500 to \$35,000. Under this program, the SBA makes funds available to nonprofit intermediaries that, in turn, make the loans directly to entrepreneurs. Proceeds can be used for typical business purposes such as working capital, machinery and equipment, inventory and leasehold improvements. Interest rates are negotiated between the borrower and the intermediary.

SMALL BUSINESS INVESTMENT COMPANY PROGRAM (SBIC)

There are a variety of alternatives to bank financing for small businesses, especially business start-ups. The Small Business Investment Company Program fills the gap between the availability of venture capital and the needs of small businesses that are either starting or growing. Licensed and regulated by the SBA, SBICs are privately owned and managed investment firms that make capital available to small businesses through investments or loans. They use their own funds plus funds obtained at favorable rates with SBA guaranties and/or by selling their preferred stock to the SBA. SBICs are for-profit firms whose incentive is to share in the success of a small business. In addition to equity capital and long-term loans, SBICs provide debt-

equity investments and management assistance. The SBIC Program provides funding to all types of manufacturing and service industries. Some investment companies specialize in certain fields, while others seek out small businesses with new products or services because of the strong growth potential. Most, however, consider a wide variety of investment opportunities.

ANGEL CAPITAL ELECTRONIC NETWORK

The Angel Capital Electronic Network (ACE-Net) is a nationwide Internet-based listing service that provides information to angel investors of small, dynamic, growing businesses seeking \$250,000 to \$5 million in equity financing. ACE-Net is a major effort to systematize and expand information available to investors on firms seeking equity financing. Once fully operational, ACE-Net will be run as a private, independent, nonprofit organization.

ACE-Net is not a matching service and does not serve as an investment advisor or broker-dealer. In addition, no securities trading takes place on ACE-Net.

Applications and more detailed information are available at the ACE-Net Internet site, ace-net.sr.unh.edu, which can be accessed directly, or at <http://www.sba.gov/ADVO>.

PREFERRED AND CERTIFIED LENDERS PROGRAM

The most active and expert lenders qualify for the SBA's Certified and Preferred Lenders Program. Participants are delegated partial or full authority to approve loans, which results in faster service. Preferred lenders are chosen from among the SBA's best lenders and enjoy full delegation of lending authority. This authority must be renewed at least every two years, and the lender's portfolio is examined by the SBA periodically. Certified lenders are those that have been heavily involved in regular SBA loan-guaranty processing and have met certain other criteria. They receive a partial delegation of authority and are given a three-day turnaround on their applications (they may also use regular processing).

GOVERNMENT GRANTS DATABASE

There is A Web site designed for easy research on government grants. Notices of Funding Availability (NOFA) are now in a database designed to allow expedient access in looking up grants by department, topic, or date. The listings are brief, but include contact information and a link to the fuller NOFA on the appropriate Department's Web site. See: <http://ocd.usda.gov/nofa.htm>.

SBA's MOST UTILIZED LOAN PROGRAMS

	7(a) Regular Business Loans	Low Doc	Development Company Loans (504)
WHO CAN APPLY	For profit businesses that qualify as small under SBA size standards and cannot borrow on reasonable terms from conventional lenders without government help.	For profit businesses that qualify as small under SBA size standards and cannot borrow on reasonable terms from conventional lenders without government help.	For profit businesses that qualify as small under SBA size standards and cannot borrow on reasonable terms from conventional lenders without government help.
PURPOSE	Fixed assets, working capital or to finance start-ups, some debt payment allowed.	Fixed assets, working capital or to finance start-ups, some debt payment allowed, but may not be used for lines of credit.	Fixed assets only – no working capital and no debt refinancing.
MAXIMUM PERCENTAGE OF GOV. GUARANTEE	Up to 85 percent of loans under \$150,000. Loans over \$150,000 may be guaranteed up to 75 percent.	85 percent	Up to 40 percent of total project cost.
MAXIMUM LOAN AMOUNT	\$2 million; however, SBA share is limited to lesser of 75 percent or \$1 million	\$150,000	Single project maximum: \$1 million (\$1.3 million for projects that meet certain Public Policy Goals.) Minimum: \$50,000
MATURITY	5 to 7 years for working capital, up to 10 years for equipment, and up to 25 years for real estate.	5 to 7 years for working capital, up to 10 years for equipment, and up to 25 years for	10 or 20 years
MAXIMUM INTEREST RATES	Prime plus 2.25% for maturities under 7 years. Prime plus 2.75% for maturities of 7 years or longer. SBA allows lenders to charge one additional percentage point in interest on loans over \$25,000, but not exceeding \$50,000. On loans of \$25,000 or less, lenders may charge two additional percentage points in interest.	Prime plus 2.25% for maturities under 7 years. Prime plus 2.75% for maturities of 7 years or longer. SBA allows lenders to charge one additional percentage point in interest on loans over \$25,000, but not exceeding \$50,000. On loans of \$25,000 or less, lenders may charge two additional percentage points in interest.	Based on current market rate for 5 and 10-year Treasury Bonds.
SPECIAL FEATURES AND/OR REQUIREMENTS	Loans cannot be made to businesses involved in speculation investment real estate. SBA generally requires that the owner(s) inject 1/3 to 1/2 of the total amount needed to launch a new business.	These loans focus on an applicant's character, credit and experience and provide a rapid response from SBA. Sales by the company and all affiliates cannot exceed \$5 million, and total employee count, including spouse's businesses cannot exceed 100.	Must create or retain one job for every \$35,000 guaranteed.