

## U.S. Small Business Administration

*The U.S. Small Business Administration (SBA) and its partners help millions of existing and prospective small business owners start, grow and succeed. SBA and its partners can help entrepreneurs with SBA guaranteed loans, counseling and training and contracting opportunities. SBA also helps businesses and families recover from disasters with loans and serves as a voice for small business, helping reduce regulatory impact on small firms.*

*Each month, this The Daily Transcript section will provide information on programs to help start, expand, and manage small business.*

### **Credit factors a potential borrower should know**

To qualify for SBA loans, you need to understand credit factors. Every successful application needs credit merits, the factors a lender analyzes before approving loans and seeking SBA's guaranty.

**Equity Investment:** Loan applicants must have a reasonable investment in their business to ensure that, when combined with borrowed funds, the business can operate soundly. Debt-to-worth ratio will compare the loan to owner(s) investment. Owners invest assets applicable to business operation and/or cash for acquiring such assets. Invested asset value should be substantiated by invoices, appraisals for startups, or financial statements for existing businesses.

Strong equity with manageable debt provide resiliency to weather adversity. Minimal equity makes firms susceptible to miscalculation and default. Strong equity ensures owner(s) commitment, particularly for new business. Weak equity makes lenders reluctant. Somewhat low equity can be overcome with other strong credit factors. Appropriateness of debt to equity requires expected earnings analysis and viability. Stronger profit support increases loan likelihood. High debt, low equity and unsupported projections mean loan denial.

**Earnings Requirements:** Financial obligations are paid with cash, not profits. When cash outflow consistently exceeds inflow, businesses cannot continue. Cash management is crucial. To support operations, sufficient cash must be timely available. Companies must meet all debt payments, not just loan payments. Applicants should report on when income becomes cash and when expenses are paid; e.g., monthly cash flow projection, covering the first annual period after loan receipt.

When projections are for new or existing business with significant differences in performance, applicants should provide assumptions used in revenue/expense projections. Loans must demonstrate repayment ability from business operation. For existing businesses buying a building where mortgage payments won't exceed historical rent, the process is relatively easy. Previous rent funds now can pay the mortgage. For a new or expanding business with increased revenues and expenses, lenders must understand revenue assumptions.

**Working Capital:** Working capital is excess of current assets over liabilities. Current assets are most liquid and convertible to cash. Current liabilities are obligations due within one year. Working capital measures what is available to pay current debts and represents protection margin companies give short-term creditors. Working capital is essential to meet continuous operational needs. Its adequacy influences ability to meet trade and short-term debt obligations, and remain financially viable.

**Collateral:** When assets are available, collateral is required to secure SBA loans. However, SBA will generally not decline loans where collateral inadequacy is the only unfavorable factor. Collateral can be usable business and personal assets. Borrowers can assume that all assets financed with borrowed funds will collateralize the loan. Depending on how much equity contributed toward asset acquisition, lenders may require other business asset collateral.

For SBA loans, personal guarantees are required of every 20 percent (or more) owner, plus other key management individuals. Whether a guarantee will be secured by personal assets depends on the value of assets already pledged and of assets personally owned versus loan amount. If real estate collateral is

used, lenders must obtain third-party valuation on real estate-related transactions of \$50,000 or more. Certified appraisals are required for loans of \$100,000 or more. SBA may require professional appraisals of business and personal assets, plus surveys and/or feasibility study. Owner-occupied residences generally become collateral when: 1) Lender requires residence as collateral; 2) Equity in residence is substantial and other credit factors are weak; 3) Collateral is necessary to assure principal(s) remain committed to venture's success; 4) Applicant operates business at residence or building located on same land.

Resource Management: Ability to manage business resources is prime in loan approval. Managerial capacity is important, involving education, experience and motivation.

Mathematical calculations on historical/projected financials form ratios providing insight into previous resource management. No ratio provides all insight, but several ratios together provide an overall management picture. Most lenders review: debt to worth, working capital, rate income is received after being earned, rate debt is paid after being due, and rate product/service moves from business to customers.

### **Small Business Success**

Anthony Baechler was a law enforcement officer, struck by a truck on the job. In 1988, he opened Baechler Investigative Services, for Insurance, Corporate and Business Investigations. Services include investigation of internal theft, pre-employment screening, traffic collisions, business matters, litigation, insurance fraud and surveillance.

In 1993, Baechler received an SBA 7(a) Loan to purchase a building, after leasing two prior offices. "In investigations, you need adequate space for evidence storage and stability of your own office and forensic facilities," said Baechler. "This would not have been possible without SBA arranging for the building loan." The company has grown from a single person startup to offering statewide services, with investigators in all major California cities. Baechler and his Investigative Services are recorded with the Library of Congress in the 2004-2005 National Register's Who's Who in Executives and Professionals.