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Common 7(a) Questions

When business-owner clients ask about this SBA program, know how to respond

By **Harlan A. Friedman,** president, Lightning Commercial Funding Inc.

Recently, a prospective client asked about financing an upcoming business acquisition. I immediately asked whether the business opportunity also came with real estate or if it was the purchase of a business consisting only of furniture, fixtures and equipment, a work-in-progress and the client list. He said that it was a business acquisition with two five-year lease options.

The scene was set for a typical U.S. Small Business Administration (SBA) 7(a) loan. "Typical" is probably not the best word, however, because each 7(a) loan is different. The only similarities between the range of 7(a) products are that they are SBA-guaranteed and that they are required to be collateralized as much as possible.

Most businesses that are sold for less than $2 million are situated in a leased facility and sold without the real estate. The 7(a) is the only SBA program that allows for the purchase of a business without the accompanying real estate. The SBA does require that the business have a lease agreement in place for the length of the loan term, however, or at the very least, additional option periods to cover the term.

When discussing the basics of the SBA 7(a) program with your clients, it's always a good idea to start by discussing the "four Cs and E" — credit, collateral, contribution, character and experience. After that, your clients will inevitably have several questions. Let's address common questions that prospective borrowers often ask about the 7(a).

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1. Doesn't the SBA take forever to close transactions?

A professionally prepared 7(a) loan-submission package often funds within 45 to 60 days from its submission to the underwriter. The reason for this closing time frame is likely the level of preparation that goes into packaging the loan. That leads into the next question.

2. What type of information will be required?

A properly prepared package should address the following inquiries:

- **Does the business in question have a positive cash flow that is supported by historical documentation?** This can be answered by including the appropriate financial statements and tax returns.
- **Can the business support additional debt?**
- **Are the borrowers qualified to run this business?** This can be answered by including the current résumé and any additional supporting documentation.
- **Do the prospective purchasers have a marketing and business plan to demonstrate their business knowledge, as well as their plans for repayment and future growth?**
- **What are the projected revenues for the new business?**
- **What is the current financial situation of the borrowers?**

A professionally prepared package that answers the above questions can make the approval — and ultimately the closing — go faster.

3. How much experience should borrowers have?

As a matter of practical application, most business-owners selling their business will offer a few months of training to their successors. They will often extend the training time on a continuing consulting basis if needed. An agreement for training, however, may not be enough to satisfy the lender's requirements for business experience. If you were the lender, after all, would you lend your hard-earned money to an individual who has little or no experience running a business?

Many new clients are so excited about the idea of running their own business after many years of being an employee that they exaggerate their abilities. The borrowers must take a hard look at themselves, though, and be sure there is a true potential for success in running the new venture.

4. What kind of financial history is required?

Borrowers often wonder why their past financial condition should matter if they have a proper down payment. Again, put on the lender's hat, and ask yourself: Would you lend money to an individual who has no experience making money in the past?

Lenders want to feel confident that the new owners will be successful. Their primary means of measuring that potential is to review borrowers' financial history through financial

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Common 7(a) Questions

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statements, bank accounts and tax returns.

5. Will the assets of the business cover the collateral requirement?

Borrowers tend to believe that their business assets should be valued for collateral purposes at fair-market value. Nothing is further from the truth. Lenders will treat all collateral as if it was liquidated at an auction and discount it.

Typically, your clients will want to know what they must do if securing the business assets with a Uniform Commercial Code 1 filing statement (which allows the bank to take immediate ownership of the business assets and liquidate them to recoup their investment in the event of default) is not enough security. Do they need to pledge their home? The answer is often yes. This is simply another precautionary step lenders take to ensure they are secured by more than just the assets of the business.

6. If the lender will require my home as collateral, why not just take a home equity line of credit (HELOC)?

The SBA has better rates and terms and a longer amortization period than a traditional HELOC, which is a loan using the current equity of one's home.

But there is more to it than that. By going through the SBA process, borrowers will get some of the best due diligence available. Lenders and brokers working on behalf of their clients will delve into every aspect of the new business. There will be no stone unturned in the scrutiny of: the sellers' current financial statements; interim financial statement; historical tax returns; lease; uniform franchise-offering circular (if it's a franchise); and other matters related to the purchase.

Also, once loan approval is granted, a business evaluation will be ordered to determine that the price is fair and that it adequately represents the market. As part of the business evaluation, a complete financial analysis will again be performed looking for validation of the purchase price.

Now tell me, where else can prospective buyers get such a thorough look at a business they are planning to purchase? Of course, they could hire attorneys, certified public accountants and other specialists to perform the same analysis, but it will be expensive and the result won't be the same.

If the prospective buyers decided to just tap into their home equity to purchase a business, they would miss out on the due diligence they would get with the SBA 7(a) program.

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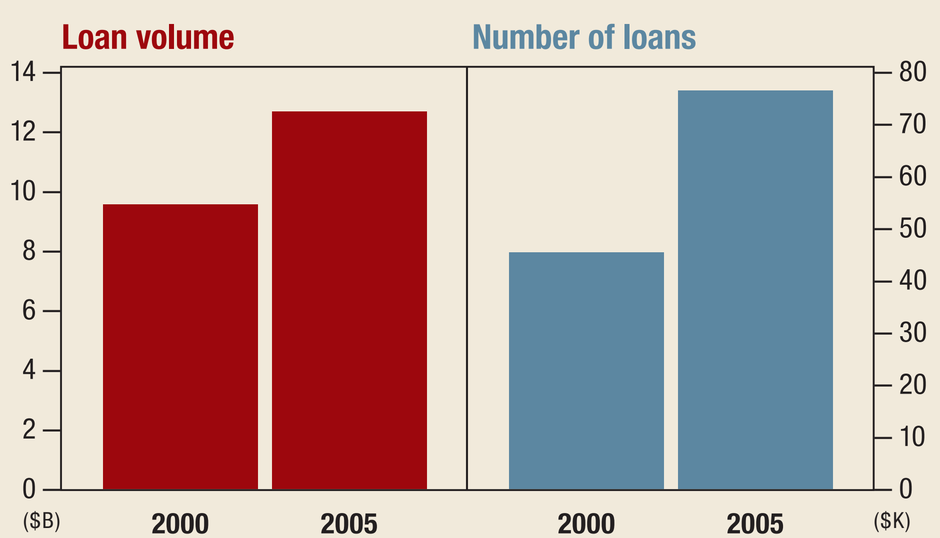
Indeed, every negative that a prospective client raises about the SBA loan program can and should be turned into a positive response, one that you can close on.

SBA 7(a) Loans



Source: Small Business Administration