EVALUATING REPAYMENT ABILITY FOR AN SBA LOAN APPLICATION

By Bruce Hurta

The primary definitions of the word "lend" include giving (money) to someone with the intention of getting it back. The U.S. Small Business Administration government guaranteed 7(a) loan program fits the definitions. It is not a government grant, nor is it a gift or charity. Actually, the 7(a) loan program is not even funded by the government. It is funded by privately-owned, or publicly-owned, financial institutions who loan their own funds with partial reliance on the U.S. government agency guaranty. This allows the SBA lender to offer more relaxed underwriting guidelines and approval parameters.

The lending institutions who participate in the SBA 7(a) loan program need to be repaid with interest. They are lending money as a business, and they expect a return. The typical government guaranty is 75% of the loan amount, so a loan default due to the small business borrower's inability to repay the loan will result in a loss for the lending institution. Not only will the lender experience a loss of as much as 25% of the money they lent, but they will also lose the interest income they should have earned. Additionally, if too many defaults cause the lender to rely upon the SBA government guaranty, that lender will lose their privilege to grant SBA loans to small business borrowers. Repayment ability is, therefore, the number one criterion the SBA lender wants to satisfy when evaluating a new SBA loan application.

What Are a Lenders Considerations When Evaluating Repayment Ability for an SBA Loan Application?

What are the sources for repayment that will be considered on an SBA loan application? Since the loan program was designed to help small businesses grow, thrive, and create jobs, the primary source for repayment should be the income from the small business applying for the loan. It is the lender's responsibility to study the track record of the business to evaluate repayment ability. Traditionally, this is done by reviewing the business and personal tax returns, plus current interim financial statements, to detect growth trends, profit stability, expansion opportunities, or problems with any of the aforementioned criteria for measuring business success. Significant aberrations in the financial trends, or ratios that appear out of line for the industry, will cause the lender to dig deeper for underlying symptoms of business decline. The aberrations may be a red flag, or they may be satisfactorily explained or justified by the loan applicant. The applicant's business plan and financial projections should provide explanations and solutions for any weaknesses in the historical financial performance of the small business, and they should highlight future business opportunities.

In the cases of businesses with unstable track records, the lender will need to assure himself of, and document the file to demonstrate, the borrower's grasp of the situation and their plans to implement strategies to correct the problems. A business turnaround loan request is one of the most difficult types of small business loan requests to accommodate. Lenders rely heavily upon "track records" as indications of how a small business will perform in the future. Documenting an expected successful turnaround business plan needs to be accomplished carefully and precisely with as much market and industry data as possible.

The same business plan and financial projections information is required for new business startups. Fortunately, a startup business will not have a negative track record to detract from their success expectations. Startup businesses, however, can be even more challenging. Lenders understand that most people learn from their mistakes. To evaluate repayment ability with a startup business requires multiple realistic assumptions to prove that financial projections are achievable. Once again, these assumptions should be documented based upon market research, industry statistics, industry experience, and management backgrounds with the expertise to execute the business plan. A lender does not want to be the last one holding the bag because the borrower did not have the experience, facts, statistics, market research, etc. to achieve success with the new business.

The SBA requires that the small business qualifying for the loan will ultimately have the capacity on its own to repay the loan. There are, however, other sources of repayment that a lender can rely upon to strengthen the loan application. Secondary and tertiary means of loan repayment will not allow a small business to qualify for SBA financing without primary business repayment ability at some point in the near future, but they can minimize the risk to the lender in the meantime. These other sources of repayment may include, but are not limited to, spouse's outside income from other employment, rental real estate income, stock portfolio income, other business interests, etc.

IT IS THE LENDER'S RESPONSIBILITY to study the track record of the business to evaluate repayment ability.

Being able to add a personal guarantor with good credit, strong collateral, and/or a proven track record of success in the industry may also help strengthen the loan application.

In summary, the small business borrower is required to have done their homework when submitting an SBA loan application. The process of approving business loan requests is not always consistent, but as a practice, it will always involve the basics described above.

A well-prepared loan application package, which includes reliable research, facts and statistics, will best prove repayment ability to the lender seeking to approve the SBA loan application. N

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