

SBA CHANGES: BORROWER LIQUIDITY FACTORS

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Major SBA Update from George B. Heaslip, the "SBA Loans Professor"

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If a loan applicant has a suitable credit score, management experience, and a sufficient down payment, the law changes make this the best time to apply for a loan. The guarantee fee is waived through December 31, 2010, and might come back, nobody knows! This saves the borrower up to 3.5% of the SBA guaranteed portion of the loan. Remember, the SBA does not lend money; it is an "insurance agency."

What follows are the new law facts that commercial realtors, business brokers and loan applicants will need to know about. Then comes a few paragraphs on "liquidity" which, along with poor credit scores and lack of directly related management experience, cause underwriters to kill loans.

The New Law, HR 5297

• Larger 7(a) and 504 loans

The 7(a) loan maximum gross loan size increases to \$5 million and the maximum net 7 (a) loan increases to \$3.75 million. Larger projects are now eligible for 504 loans and borrowers who already have loans with the SBA can now return for additional funding.

• Temporary 90% Loan Guarantee

To encourage fast action by banks, the legislation temporarily allows a 90% guarantee on a \$5 million loan. This means that the SBA (an "insurance agency") will insure 90% of the loan amount. Previously only 75% of the loan was insured and many "nervous" banks curtailed lending.

Although this provision is now scheduled to expire on December 31, 2010, it is an attractive incentive for lenders who seize the opportunity for making loans in the 4th quarter. The extension mean the authority for 504 and 7(a) fee reductions and the 90% 7(a) guarantees are through December 31st only, or until \$505 million in appropriations to support them is used. The \$505 million has been allocated to fund SBA loan fees through December 31, 2010 saving borrowers many thousands of dollars. On a large loan, the fee was up to 3.5% of the SBA guaranteed portion of the loan. This fee is paid by the bank to the government, but is passed on to the borrower.

For loan applicants early filing is recommended since there is no guaranty that the "90%" will be extended into year 2011. "Get logged in," is my advice.

• One year Increase in SBA Express maximum loan size

The maximum loan size for an SBA Express loan is temporarily increased to \$1 million.

• **Maximum Loan Amounts** - - - permanently increases the loan maximum on 504 loans, including public policy loans, to \$5 million, except small manufacturer loans and energy loans are increased to \$5.5 million. Also increases the maximum amount of 7(a) loans to \$5 million gross and \$3.75 million net (or guaranteed amount).

• **Alternative Size Standard** - - - pending SBA establishment of an alternative applicable to both 504 and 7(a), establishes a standard of maximum tangible net worth of \$15 million and 2-year average net income after Federal income tax of \$5 million, which will apply to both programs.

• **Debt Refinancing** - - - establishes a temporary 2-year program of business debt refinancing through the 504 program independent of the usually required job creation/preservation goals of one job per \$65,000 borrowed. This enables 504 to be used for refinancing of qualified existing debt without business expansion.

• Business Size Standard For SBA 504 Loans

There was also an increase in the business size standard to be eligible for an SBA 504 loan. 504 Loans are for land, building(s), equipment, construction, and soft costs. Working capital is not permitted. Businesses with a tangible net worth of \$15 million and 2-year average net income after Federal income tax of \$5 million, are now be eligible to apply for SBA 504 financing opening the door to many more small business owners across the country.

SBA 504 loans are typically used by small businesses needing more operating space or by businesses that have lost their leases and decide to invest in their own facilities. Still others want to construct or retrofit facilities to incorporate energy efficient technologies to decrease operating expenses. Businesses needing to invest in capital-intensive equipment and machinery also look to the SBA 504 loan for funding. Small business owners definitely see the advantage of the low down payment which is typically only 10%, or 14% depending on the type of business.

Importance of Personal Liquidity

Each bank or non-bank SBA lender has a personal liquidity rule.

Banks need to know what, after loan closing, how much cash reserve the applicant has, in case of a "business bump."

Liquidity means how fast the loan holder can convert his or her assets into cash in case of a business emergency. Liquidity is an emergency cash fund.

Cash equivalent assets that comprise liquidity include:

- > Money market funds
- > Bank savings
- > Checking accounts
- > Home equity line of credit
- > Treasury Bills
- > Listed Stocks
- > US Savings Bonds
- > Short-term Bonds
- > CD's
- > Annuities
- > Accounts Receivable
- > Note receivable
- > Life Insurance

Real estate and many types of collectibles generally have poor liquidity. This includes art work, and raw land.

Financial experts have long held that liquid assets equal to two to six months of usual living expenses is an adequate amount for most people.

What Is The Liquidity Ratio That Banks Use?

The Basic Liquidity Ratio is: Liquid Assets/Monthly Expenses. Another ratio is Liquid Assets + Other Financial Assets/Monthly Expenses. Many banks look for at least a recommended value of six months for this ratio.

Example: If the applicant (and family) have \$12,000 in cash assets, and monthly expenses of \$4,000, the liquidity ratio is 3.0.

Believe it or not, there are banks out there now that want to see a liquidity ratio of 12, or enough to cash in to maintain a similar life style for 12 months.

Summary: To capture a loan, the applicant must have a credit score of 680 or higher, relative management experience, a rock-solid business plan and cash flow projections (He is where I help), and depending on the lender, a satisfactory liquidity ratio. Also DTI is critical, information is at www.sbafacts.com.

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