Four Ways Your Company Can Use SBA Credit

SBA loans are a practical solution for the financial needs of many business leaders. Fifth Third Bank Vice President and National SBA Director Dave Jackson explains how this financial resource can be used in a variety of situations businesses face each year.

Purchasing real estate
Buying the property your company needs to operate can be a prudent financial move. The SBA offers the 504 loan program specifically for purchasing property. The borrower must occupy at least 51 percent of the property and use it for its business headquarters or related operations. The 504 program loan cannot be used to purchase investment property for lease.

Under the 504 program, the borrower gets a low interest rate and must put down just 10 percent of the value of the property. Jackson provides the following example. A business buys a $1 million building with the bank lending $500,000 toward the purchase and taking a first lien on the property. That means the bank gets first priority for repayment if the borrower defaults. The SBA lends $400,000 and takes a second lien, while the borrower comes up with $100,000 to fund the purchase. This structure allows a business to own a $1 million asset, lower its fixed overhead expense by eliminating leasing costs and put up only 10 percent of the cash to make the purchase.

Buying a business
SBA loans are frequently used by established business owners who are buying out their competitors in an effort to grow into new regions, add product lines or take on new customer accounts. The SBA loans address a common challenge faced by businesses seeking to acquire another company with traditional financing.
Jackson explains. With a typical business acquisition loan, the business leader can struggle to put up the full collateral requested by the bank because the inventory, equipment and other “hard” assets the business leader is purchasing do not add up to the full amount of the loan needed to buy the business. What’s left that pushes the typical purchase price higher? Something less tangible but just as important: the “good will” the company has earned over the years. That means its reputation, its client loyalty and its brand name. “Those intangibles represent real value, but they aren’t hard assets that can be converted to cash by a lender looking for collateral,” Jackson explains. “Using a 7(a) loan, the person making a business acquisition can utilize a government guarantee to close the collateral gap.”

Refinancing existing debt
Conventional debt is often renegotiated after three to five years, even if the term is much longer. In some cases businesses face adjustable-rate loans that have balloon payments — repayment of a total loan amount — that come due after three to five years. In both cases, an SBA loan can be a good resource. “You can use an SBA loan to extend the remaining debt over the 20 years remaining on the loan term,” Jackson explains. “An SBA loan can also give you certainty that you won’t have to face huge one-time payments since SBA loans do not have any balloon payments.”

Starting a new business
New businesses typically do not own assets such as accounts receivable, real property or equipment that are typical loan collateral items. Through the use of SBA loan programs, Fifth Third will consider startup entrepreneurs if they have lots of experience in the industry or if they have strong managerial experience and ample capital. “Oftentimes, we get applications from a retired CEO or company president who wants to open a franchise. Or we have a borrower who brings in a lot of cash in retirement funds,” Jackson says. “The more experience they have, the less cash we’re going to require them to keep in reserve to fund working capital during the start-up phase.” There’s a balancing act that loan officers must keep in mind between requiring business leaders to invest in their companies and making sure they have enough cash to carry their operations for the six months or a year it typically takes to get sales flowing.