Working Capital: Using an SBA Line of Credit

Businesses often have a need for cyclical or short-term access to working capital to keep cash flowing. A line of credit can work in these instances by helping a business operate smoothly during a busy season, finance a construction project or fulfill a large contract. Under the 7(a) loan program, the SBA offers general working capital lines of credit that are underwritten and funded by SBA-preferred lenders like Fifth Third Bank.
Dave Jackson, Fifth Third Bank's expert on SBA lending, explains some ways businesses can use SBA loans as a solution to their working capital needs.

Capital when you need it

One of the popular working capital solutions offered under the SBA guarantee program is an asset-based revolving line of credit. It is typically used by businesses experiencing very fast growth. Borrowers repay the lender by converting short-term assets into cash that is used for repayment purposes. Frequently, this kind of working capital line is used by companies that provide credit to their customers and experience a gap between delivering a product or service and getting paid for it. Businesses continually draw from this line of credit, based on existing assets, and repay it as their cash cycle dictates.
For example, a company might have a $1 million working capital line. It has a receivable of $250,000 that is due in 30 days, but it needs that cash to fund another order, so it draws the $250,000 from its SBA line of credit. Once their customer pays them $250,000, the company is required to use that money to pay the working capital line down, Jackson says.

Longer terms and fewer rules

As with all SBA-guaranteed loans, banks that make them must grant some benefit to the business owner in return for the backing of the government. One example of this is the extension of the period of time between renewals. Under the SBA program, the bank can extend credit for up to 10 years without going through the renewal process. "This saves the time and expense of having to renew that line every year, which can be a long process," Jackson explains.

SBA-backed credit lines also carry fewer covenants, which means that the rules and restrictions a bank normally writes into its lending contracts are not as strict for SBA-guaranteed lines of credit. However, there are some restrictions on what the money can be used for. The SBA will not allow an owner to borrow money to cash out of a business, unless the owner is selling all ownership. "If an owner wants to sell 20 percent of his business and wants to liquidate that part of his interest in the company, he can't use the SBA to convert some of his ownership to cash," Jackson explains.

Improve your chances of securing an SBA credit line

When new businesses apply for working capital, banks like Fifth Third Bank are looking for evidence that the business owner has gotten good advice and sought out expertise. One program Jackson recommends is SCORE counseling, www.score.org. "We like to have somebody who is experienced help a newer business owner put together their business plan. SCORE offers free help with business planning, so if somebody has seen a SCORE counselor, we look favorably on that," he says. Gathering information on key customers and their repayment history can also help. "If you can evidence the quality of your customers by showing they are well-known, or publicly traded, that's great. This means they have a public financial history that the bank can examine if we're giving you a loan against those receivables," Jackson says. Even if your customers are not large brands, if you can show they have a prompt repayment history, the bank will be more comfortable lending against those receivables.