

Banking Relationship

From "Know Your Numbers,
Unlocking Financial Success for Small Business",
Developed by the Northland SBDC of MN

Develop a relationship with your bank and or banker. Always be honest and open about the financial position of your company. Provide them with the information they want on a timely basis. They will be more responsive to someone who is upfront with them.

Line of Credit or LOC is used as a short-term borrowing to purchase inventory or pay for new employees. A Line of Credit should never be used to purchase fixed assets such as equipment, buildings, and renovations. It is understood that an LOC is to be at zero borrowed for 30 days of a calendar year. Those 30 days do not have to be consecutive.

If you need to purchase inventory in September for sales in November and December, this would be a good use of an LOC. If you are hiring a new employee and sales are expected to go up as a result of that hire, this would also be a good use of an LOC.

General Guidelines When Borrowing

A bank likes to see 20% or better of owner equity when looking at financing a project. If you want to purchase \$100,000 of equipment the bank would like to see you put down \$20,000, and they finance \$80,000 of the total amount. This is not written in concrete but is generally the case. There are all kinds of different scenarios which can change the assumption.

Types of Loans

Conventional Loans

The bank makes the credit decision and is solely responsible for the loan. This is usually the least expensive lending with less fees and lower interest rate.

SBA Loans

SBA loans, or Small Business Administration loans, are financial assistance programs offered by the United States Small Business Administration (SBA) to help small businesses access funding for various purposes, including startup capital, working capital, equipment purchases, and more. The SBA doesn't directly lend money to small businesses but partners with banks, credit unions, and other financial institutions to provide loan guarantees, reducing the risk for lenders and making it easier for small businesses to secure loans.

Types of SBA Loans

- **7(a) Loan Program:** The most common SBA loan program, the 7(a) program, offers loans for various business purposes, including working capital, equipment purchase, expansion, and more. The bank receives a guarantee of 75% to 85% of the loan amount.
- **504 Loan Program:** This program is designed to provide financing for purchasing real estate, machinery, and other fixed assets. This loan is split up between the bank and a Community Development lender. The bank lends 50% of the loan and the other lender lends 40% therefore the borrower equity is only 10%. This is for an existing business. If it is a start-up business the percentages change to 50% bank, 35% Community lender, and 15% equity for the borrower. These types of loans make good sense for projects not needing working capital. Owner equity requirements vary for special use buildings.

Types of SBA Loans continued . . .

- Microloan Program: Microloans are smaller loans (up to \$50,000) targeted at startup businesses and small businesses in need of short-term working capital.
- SBA Express Loans: This is similar to an SBA 7(a) loan except the lender only gets a 50% guarantee if the loan defaults. There is also less paperwork that the bank must file. SBA Express loans generally can be originated more quickly than through the 7(a) program.
- Disaster Loans: The SBA provides disaster loans to businesses affected by natural disasters, such as hurricanes or floods.

Benefits of SBA Loans

- Lower Interest Rates: SBA loans often offer lower interest rates compared to conventional loans, making them more affordable for small businesses.
- Longer Repayment Terms: SBA loans typically have longer repayment terms, which can help lower monthly payments and improve cash flow.
- Lower Down Payments: SBA loans often require smaller down payments, making it easier for businesses to access funding with less capital upfront.
- Flexible Use of Funds: Depending on the loan program, SBA loans can be used for various business purposes, providing flexibility to business owners.

Eligibility and Application

- Eligibility criteria for SBA loans vary depending on the specific loan program and lender. Generally, small businesses that meet size standards defined by the SBA, have a sound business purpose, and demonstrate the ability to repay the loan are eligible.
- To apply for an SBA loan, business owners typically need to work with an SBA-approved lender. The application process involves submitting financial documents, a business plan, and other relevant information.

SBA Loan Guarantees

- SBA loans are considered less risky for lenders because the SBA guarantees a portion of the loan amount. If the borrower defaults, the SBA pays the guaranteed portion to the lender, reducing the lender's losses.

Loan Terms and Amounts

- Loan terms and amounts vary based on the specific loan program and the purpose of the loan. For example, 7(a) loans can be as large as \$5 million with repayment terms ranging from 7 to 25 years, depending on the use of the funds.

Repayment

- Borrowers are typically required to make regular payments to repay the loan, including principal and interest. SBA loans may have fixed or variable interest rates, depending on the loan program and lender.

Use of Funds

- The use of funds can vary depending on the loan program but may include working capital, purchasing equipment, real estate acquisition, debt refinancing, and more. Specific restrictions and allowable uses are determined by the loan program guidelines.

The SBA steps in and gives the bank a guarantee from 75% to 90% of the loan value if the loan defaults. There are fees associated with this and they are passed on to the customer. The loan still has to pass financial scrutiny. In essence the SBA is giving the bank an insurance policy in case of default. SBA loans take more time to process usually 90 days as opposed to a conventional loan. They do, however, give the bank a green light to make the loan where without the guarantee, the bank would not lend.

In summary, SBA loans are government-backed financial products designed to help small businesses access funding and support their growth and development. These loans offer favorable terms and lower risk for lenders, making them an attractive financing option for small business owners. However, eligibility requirements, loan terms, and the application process can vary, so it's important for small business owners to work with SBA-approved lenders and understand the specific details of the loan program they are interested in.

Bank Loan Checklist

This is an example of the items required for a bank loan.

1. Business Plan
2. Sources & Uses
3. Current Business Debt Schedule (Existing Businesses Only)
4. Three Years Company Tax Returns & Financial Statements
5. Company In-House Interim Statements for year to date
6. Three Years Projections, Cash Flow & Assumptions
7. Copy of the Purchase Agreement
8. List of Collateral & Estimated Values
9. Personal Financial Statement (All 20% Owners)
10. Three Years Personal Tax Returns (All 20% Owners)
11. Personal Resume (All 20% Owners)
12. Affiliated Company Information (All 20% Owners)
13. Franchise Agreement (If Applicable)
14. Company Articles, By-Laws & Registration Documents
15. Copy of Drivers Licenses & List of Previous Gov't Loans (For SBA Loans)
16. Copy of Leases (If Applicable)

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