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SBA Lending – A Way to Expand Commercial Lending

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In today's competitive commercial lending market, a middle-market commercial lender faces the challenge of maintaining prudent credit standards while building its commercial loan portfolio. One way to achieve that balance is to share the risk with the U.S. government by participating in the loan programs administered by the U.S. Small Business Administration (SBA). Because many of the SBA loan programs promote loans to small businesses, SBA lending also helps middle-market lenders establish relationships with newer businesses as borrowers.

The federal Small Business Act and the regulations that implement the Act authorize a number of loan programs administered by the SBA. Financial institutions are primarily involved in the 7(a) Loan Guaranty Program (the SBA's primary business lending program) and the 504 Certified Development Company Program.

The 7(a) loan program is a multi-purpose business loan program administered as a "deferred participation" program, where the SBA effectively guarantees a portion of a qualifying loan made by a lender by agreeing to purchase an undivided interest in a defaulted loan. The lender initiates the loan to a small business and, if the SBA agrees to guarantee the loan, the lender funds and services the loan. In the event the loan goes into default, the lender conducts the workout or liquidation efforts and the lender and the SBA share in the loss, if any, in accordance with the percentage guaranteed by the SBA.

Federally regulated and certain non-federally regulated institutions are eligible to participate with the SBA as a 7(a) lender. These institutions include state or federally-chartered commercial banks, savings banks, savings and loan associations and credit unions, although when a state-chartered credit union applies to the SBA to become a participating lender, it will undergo an additional level of scrutiny by the SBA field office.

A financial institution wishing to participate in the SBA 7(a) loan guaranty program would request to be a participant lender through the SBA field office serving the geographical area where the lender's principal office is located. Upon the receipt of a request from a financial institution, the SBA field office will determine whether the lender meets the general requirements for a participating SBA lender. Once the SBA field office determines that the lender meets the requirements for a participating lender, the field office and the lender will sign SBA Form 750, "Loan Guaranty Agreement (Deferred Participation)," or SBA Form 750B, "Loan Guaranty Agreement (Deferred Participation) for Short Term Loans" (loans with a maturity of 12 months or less). Once the SBA Form 750 is executed, the SBA field office will add the lender to the SBA Partner Information Management System (PIMS) which identifies the lender as a SBA participating lender.

The 504 Certified Development Company (CDC) loan program provides businesses with long-term, fixed-rate financing for major fixed assets, such as land and buildings. Typically, a 504 loan transaction includes a loan made by a private-sector lender covering up to 50 percent of the project cost and secured by a first-priority lien on the assets financed, combined with a loan made by a CDC covering up to 40 percent of the project cost and secured by a second-priority lien on the assets financed. The CDC loan (but not the private-sector lender's loan) is backed by a 100 percent SBA guaranteed debenture. The objectives of the program include job creation (generally, a business must create or retain one job for every $50,000 provided by the SBA) and community development.

The SBA has no specific requirements for the financial institutions that participate in a 504 loan either as private-sector lenders or interim lenders. Unlike the lender participating in the 7(a) loan program, a lender may participate in a 504 loan without the prior approval or authorization of the SBA.

Of course, participating in SBA does not come without a cost or risk. In addition to the guarantee fee that must be paid to the SBA, a lender must carefully document and close an SBA loan. Under the 7(a) loan program, the SBA issues a loan authorization that outlines all of the documentation and loan term requirements for each loan approved by the SBA. If the participating lender fails to follow the authorization precisely, the lender risks losing or reducing the SBA guarantee. The terms of loans under both the 7(a) loan program and the 504 loan program are limited by regulation. For example, the only default permitted under these programs is a monetary default.

SBA lending can be a great tool for growing an institution's commercial loan portfolio, but lenders should not participate in SBA lending casually. A successful SBA lender maintains prudent lending standards and comprehensive documentation and closing procedures.

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