DON'T LET THAT EQUIPMENT DEAL GET AWAY!

By: **Michael D. Ryan**

Small and mid-sized businesses often struggle to find financing sources for a myriad of borrowing needs including the financing of machinery and equipment (M&E) to modernize or expand their business. These businesses operate in numerous capital-intensive industries including (but not limited to) manufacturing, construction, transportation, and distribution. And it's not only capital-intensive businesses that need equipment – the services sector is in constant need of technology and other less durable equipment. For many of these businesses, the ability to acquire and finance equipment can determine their ability to successfully compete in today's economy. Most often, companies seek financing for M&E from traditional lending sources such as community or regional banks or credit unions; and in some cases they can also attain financing from the equipment manufacturer, distributor or reseller via a vendor finance program – offering both loans and leases as financing options.

But what happens when your prospective borrower does not qualify for conventional financing or financing from any of these sources – **including your own lender?** What are your options as a lender to provide financing to borrowers with "storied credits" seeking financing for machinery and equipment?

For many established businesses that do not qualify for conventional financing, such as startups or in situations where there is a collateral shortfall, the solution can be a loan backed by the Small Business Administration (SBA) – which offers excellent programs for machinery and equipment acquisitions. This solution allows lenders of all sizes to keep these "storied loans" in their portfolio as earning assets – avoiding an otherwise lost opportunity for portfolio growth. The lender also retains control over the underwriting and funding of the transaction. The SBA's involvement includes reviewing the loan application submitted by the lender to ensure the loan request meets the SBA's eligibility and credit standards, and the SBA provides critical loan guarantees to the lender – in essence guaranteeing the repayment of a percentage of the loan in cases where the borrower runs into problems.

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SBA 7(A) GUARANTEED LOAN PROGRAM

The SBA 7(a) Loan Program is by far the SBA's most popular and flexible lending program. Loans typically range from $25,000 to $5 million. For new machinery and equipment, the 7(a) program does not require an equity injection from the business owner(s) and often allows for 100% financing of the equipment (depending on the strength of the company's cash flow and whether or not it is a start-up operation).

Under this program, the SBA provides an 85% guarantee for loans of $150,000 or less, and a 75% guarantee for larger loans – with a maximum loan guarantee of $3.75 million. In some cases, if the request assists with establishing infrastructure to increase international trade, the guarantee percentage can be up to 90% of the loan amount. The 7(a) loan program is highly effective for the financing of machinery and equipment acquisitions; but it's also available for debt refinances, business sales and purchases, working capital, and real estate acquisitions, construction, expansion and refinancing. The term of the loan is dependent upon the usage of the loan proceeds – which typically range from 5 to 25 years. Machinery and equipment loans will generally qualify for a term of 10 (ten) years, up to the remaining useful life of the equipment.

ELIGIBILITY REQUIREMENTS

The basic criteria to qualify for an SBA loan is that the loan must demonstrate the ability to be repaid on a timely basis from historic or projected cash flow, however, the SBA also reviews additional credit underwriting factors such as industry experience, collateral for the loan, equity contributions from the business owner, and of course a full personal credit history – because these loans require the personal guaranty of those maintaining a 20% or greater ownership interest.

Additionally, to qualify, a business must be a "For Profit" entity, operate profitably and typically provide a business plan demonstrating three to five years of financial projections and a full understanding of the competitive landscape for the business. Of course, as is required for all SBA loans, the borrower must be a domestic company located in the U.S. (and its territories). The borrower must also meet the business size standards which include maintaining a positive tangible net worth that is less than $15 million, and the business must demonstrate an average net income of less than $5 million for the preceding two years.

BENEFITS OF THE SBA 7(A) LOAN PROGRAM TO LENDERS

- **Retain and serve existing borrower relationships and acquire new customers –** the program enables lenders to provide financing to businesses that typically do not meet conventional credit underwriting criteria. As a result, lenders can expand their customer base significantly.
- **Risk mitigation –** as a result of the guarantee provided by the SBA to the lender, overall lending risk is mitigated.
- **Limits lender's capital requirements –** utilization of the 7(a) guarantee lowers a lender's risk weighting for meeting capital requirements because the risk weight of a guaranteed loan for capital purposes is lower than for unguaranteed loans.
- **Assists in managing legal lending limits –** the guaranteed portion of a 7(a) loan may not count against a bank's legal lending limit. As a result, the lender can make 7(a) loans in amounts above the lender's legal lending limit.

Today, small and medium-sized businesses have more options than ever to find financing for their equipment needs, but the options can be expensive and in many cases, requests for loans can be rejected for any number of reasons. The SBA 7(a) Loan program solves this problem for thousands of businesses annually throughout the U.S. and enables lenders that would typically need to walk away from a "storied credit" to book earning assets with support from the U.S. government.

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