

Benefits of SBA Lending

Presented by Brian Carlson

- Presenter's background
- 30 years of SBA lending experience running SBA lending groups
- EVP and SBA manager for First Bank, the 34th largest SBA lender in FYE 2017.
- President & CEO of SBA Complete, Inc.
- Teaches SBA lending at the Graduate School of Banking at the University of Colorado, in Boulder, CO

Benefits of SBA Lending

- Why is SBA important for your Bank?
- How to start an SBA lending department.
- What are the costs?
- How do you market SBA loans?
- What is the SBA loan process?
- What are some “Red Flags” to consider?



SBA lending allows a financial institution to help more clients.



How do you correctly process and document SBA loans.



What are the financial considerations for the lender?

SBA Loan Submission Categories



General Program (GP)

- Initial designation for new lender
- Loans completely underwritten by an SBA underwriter



Certified Lender Program (CLP)

- High priority underwriting
- Loans still underwritten by an SBA underwriter
- Soon to be eliminated



Preferred Lender Program (PLP)

- Proficient in SBA lending
- Allows lender to effectively approve own loans
- Must show expertise in staff and submit 5 loans to obtain status

Keys to Success

- Efficient, integrated process
- PLP status
- Experienced team

Referral sources want:

- A quick decision: yes or no
- Knowledgeable staff that can close a loan efficiently and set proper expectations
- A reasonable, understandable and consistent credit box

The SBA Loan Process



UNDERWRITING & PROCESSING

- Proper application
- Compliant loan structure
- Credit Analysis
- Submission of files per program criteria

CLOSING

- Documentation prep
- Closing coordination
- Loan note guaranty development.

LOAN SALES

- Guaranty sale
- Investor coordination
- Post-sale accounting and reporting

SERVICING

- Collections and distributions
- 1502 reporting
- Portfolio reviews

Cost of Doing Business

The basic steps to get any loan from start to finish are Loan Acquisition, Underwriting, Processing, Closing and Servicing. Each of these steps has a cost and for SBA they are generally as follows:

- Loan Acquisition – 2.5%
- Underwriting, Processing and Closing – 2.0%
- Servicing – 0.50%

7(a) Loan Guaranty Sale

One of the most interesting aspects of SBA lending is that the guaranty on the loan can be sold in an active secondary market and earn a premium.

- Currently, if a bank makes a \$1,000,000 SBA loan at Prime + 2.75% for 25 years, they can sell the 75% guaranteed portion of that loan and generate a premium of approximately 17.0%.
- However, the SBA requires the bank to split any portion of the premium over 10.0% with the SBA. So the net premium in this example would be 13.5.
- In addition, when the investor buys the guaranty, they don't get the 6.0% note rate, they actually get a 5.0% rate, and the 1.0% difference is allocated to the bank to cover the cost of servicing.

Accretive to Capital

A key advantage to making SBA loans is that the guaranty is sold, the loans **increase** capital instead of depleting capital.

	CONVENTIONAL	SBA
Loan Amount	\$1,000,000	\$1,000,000
Risk Based Capital Required	\$100,000 (10%)	\$25,000
Provision for Loan Losses	\$20,000 (2%)	\$5,000
Guaranteed Portion		\$750,000
Unguaranteed Portion		\$250,000

Lender increases its capital by \$60,000

Net gain on sale of guaranty \$90,000

Starting An SBA Lending Department

- Credit Department buy-in
- Clear policy on acceptable loans and SBA credit parameters
- Front-line staff awareness on SBA vs. conventional
- Risk tolerance and integration with bank credit models

SMALL BUSINESS LENDING

RISK RATING GUIDE

<i>Borrower:</i>							<i>BDO:</i>		
RISK ATTRIBUTE	1	2	3	4	5	6	Equated Attributed	Weight	Rating
DEBT COVERAGE RATIO (1)	DCR 1.76 or greater	DCR 1.41 to 1.75	DCR 1.11 to 1.40	DCR 1.00 to 1.10	DCR .76 to .99 or projection based	DCR below .76		20%	0
COLLATERAL (2) <small>Multi- purpose, SFR</small>	60% or less LTV	61% to 70% LTV	71% to 85% LTV	86% to 90% LTV	91% to 100% LTV	Over 100% LTV, or no collateral		15%	0
<small>Single purpose</small>	40% or less	41% to 59%	60% to 80%	81% to 90%	91% to 100%	Over 100%			
<small>Land</small>	30% or less	31% to 45%	46% to 60%	61% to 70%	71% to 85%	Over 85%			
AGE of PROPERTY IMPROVEMENTS								5%	0
<small>Multi-purpose / SFR</small>	10 years or less	20 years or less	35 years or less	40 years or less	45 years or less	over 45 years			
<small>Single purpose</small>	5 years or less	10 years or less	20 years or less	25 years or less	30 years or less	over 30 years			
CREDIT HISTORY								15%	0
<small>CRE</small>	FICO over 800	FICO 721 to 800	FICO 650 to 720	FICO 600 to 649	FICO 550 to 599	FICO below 550			
<small>No CRE</small>	Over 824	775 to 824	725 to 774	675 to 724	625 to 674	FICO below 625			
INDUSTRY EXPERIENCE	15 yrs or more in subject industry	10 to 15 yrs in subject industry	5 to 10 yrs in subject industry	3 to 5 yrs in subject industry	1 to 3 yrs in subject industry	Less than 1 yr in subject industry		10%	0
SMALL BUSINESS OWNERSHIP EXPERIENCE	> 10 years	5 - 10 years	3 - 5 years	2 - 3 years	1 - 2 years	< 1 year		10%	0
PERSONAL FINANCIAL STRENGTH (3)	Adjusted personal net worth exceeding 100% of the loan request	Adjusted personal net worth between 80% and 99% of the loan request	Adjusted personal net worth between 60% and 79% of the loan request	Adjusted personal net worth between 40% and 59% of the loan request	Adjusted personal net worth between 20% and 39% of the loan request	Adjusted personal net worth less than 20% of the loan request		10%	0
POST-CLOSE LIQUIDITY (4)	> 12 months of proposed total business debt service	6 - 12 months of proposed total business debt service	3 - 6 months of proposed total business debt service	2 - 3 months of proposed total business debt service	1 - 2 months of proposed total business debt service	< 1 month of proposed total business debt service		15%	0

(1) For last fiscal year and unless two years' are required per policy, then take the average of the last two fiscal year ends.

(2) Non-Real Estate Collateral may be included using the appropriate liquidation value in the calculation. 100% of the appraised real estate value may be used.

(3) Adjusted net worth includes proposed injection.

(4) Includes business and personal liquidity.

RATING

0

Default Rates

NAIC	Year									
	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Full-Service Restaurants	3.87%	3.62%	2.55%	3.49%	3.51%	7.04%	9.20%	8.79%	2.92%	4.65%
Fitness and Recreational Sports Centers	2.14%	1.93%	2.47%	2.13%	2.38%	3.94%	12.65%	9.08%	6.63%	3.73%
Drinking Places (Alcoholic Beverages)	3.67%	2.42%	2.29%	2.65%	3.62%	5.25%	7.95%	8.97%	4.07%	4.60%
Automotive Oil Change and Lubrication Shops	2.01%	2.61%	2.40%	5.10%	4.67%	6.94%	3.13%	9.62%	6.07%	2.80%
Car Washes	2.12%	1.90%	1.72%	2.55%	2.37%	7.28%	9.00%	9.21%	3.18%	3.48%
Bowling Centers	3.47%	4.56%	5.68%	3.32%	2.49%	3.66%	4.81%	6.07%	1.37%	7.17%
Drycleaning and Laundry Services (except Coin-Operated)	2.18%	1.39%	2.04%	4.07%	2.98%	5.73%	4.30%	9.72%	3.77%	4.75%
Gasoline Stations with Convenience Stores	4.36%	2.97%	2.04%	2.41%	2.57%	4.14%	6.55%	7.55%	3.83%	4.04%
Limited-Service Restaurants	2.65%	2.80%	2.40%	3.58%	2.13%	3.86%	7.37%	8.16%	2.54%	3.27%
Supermarkets and Other Grocery (except Convenience) Stores	3.90%	1.73%	2.71%	1.73%	2.65%	5.00%	6.76%	6.74%	4.35%	3.12%
Other Gasoline Stations	6.57%	4.11%	4.32%	3.28%	2.35%	5.33%	4.24%	4.04%	2.04%	1.52%
All Other Specialty Trade Contractors	0.00%	0.00%	3.85%	1.91%	0.00%	2.52%	9.81%	8.72%	5.66%	2.73%
Hotels (except Casino Hotels) and Motels	2.61%	2.13%	1.85%	1.99%	1.75%	3.45%	5.03%	7.91%	3.31%	3.00%
Automotive Body, Paint, and Interior Repair and Maintenance	0.74%	2.39%	1.11%	2.79%	0.82%	2.36%	5.33%	6.66%	2.74%	3.26%
Coin-Operated Laundries and Drycleaners	1.27%	1.61%	3.63%	1.50%	1.85%	4.42%	3.96%	2.87%	1.89%	5.08%
Child Day Care Services	2.30%	1.71%	2.05%	1.68%	1.60%	3.05%	3.77%	5.91%	1.96%	3.42%
Convenience Stores	3.21%	2.15%	1.66%	2.10%	1.44%	2.00%	4.23%	5.37%	2.45%	2.66%
Offices of Chiropractors	0.38%	1.52%	1.73%	2.82%	2.02%	3.27%	6.16%	4.87%	0.77%	3.38%
Beauty Salons	0.96%	1.60%	0.60%	1.53%	0.86%	2.88%	6.62%	6.32%	2.14%	1.02%
Machine Shops	2.39%	3.23%	0.93%	1.56%	1.22%	3.59%	4.09%	3.29%	2.03%	1.32%
General Automotive Repair	1.62%	1.40%	1.38%	1.32%	1.90%	2.40%	4.26%	4.30%	2.53%	2.52%
Lessors of Nonresidential Buildings (except Miniwarehouses)	1.74%	0.98%	0.75%	1.17%	0.97%	2.99%	6.20%	3.96%	2.53%	2.00%
Theater Companies and Dinner Theaters	2.79%	2.57%	1.98%	2.78%	1.33%	1.96%	3.65%	2.50%	1.14%	0.48%
Beer, Wine, and Liquor Stores	1.78%	0.44%	1.14%	0.87%	1.38%	1.32%	3.02%	5.43%	2.11%	1.95%
Offices of Physicians (except Mental Health Specialists)	0.57%	1.08%	1.18%	1.34%	1.03%	1.72%	3.68%	3.31%	2.07%	1.83%
Offices of Dentists	0.31%	0.52%	0.41%	0.94%	0.84%	2.28%	4.13%	3.60%	1.50%	1.77%
Funeral Homes and Funeral Services	1.33%	0.50%	0.83%	2.08%	0.60%	1.30%	2.92%	3.93%	1.44%	0.90%
Offices of Lawyers	0.52%	0.77%	0.32%	0.82%	0.60%	1.89%	1.89%	4.13%	2.14%	0.66%
Veterinary Services	0.26%	0.87%	0.54%	0.53%	0.40%	2.56%	2.07%	3.19%	1.47%	1.37%
Broilers and Other Meat Type Chicken Production	0.59%	0.49%	0.18%	0.58%	0.23%	0.70%	1.95%	0.63%	1.15%	0.41%

Marketing SBA Loans



SUPPORT

What is your approach to the market? Once you have identified the types of loans that you want, how do you generate that business?

- Trade Associations, Conferences and target groups
- Industry/Vertical marketing
- Use of technology, email generating inbound leads
- Loan Brokers, Scotsman Guide, Loan portfolio
- Call Center
- Market direct to borrowers or use referral

SBA Sales Staffing



SUPPORT

How should you approach development of your SBA sales staff?

OPTION 1

Train Existing Lenders

- Lower cost
- Longer “spin up” period
- Lower initial volumes
- Often better awareness of local opportunities
- Better connection with local retail teams

OPTION 2

Hire Seasoned SBA Lenders

- Higher initial cost
- Faster “spin up” period
- Higher volumes
- Possibly less awareness of local opportunities
- Potentially less connection with local retail teams

Refinancing Existing Loans

The SBA now allows you to refinance your bank's existing performing loans into SBA loans.

- Reduce real estate concentrations.
- Restructure loans where a borrower may need a longer amortization.
- Reduce exposure to any one borrower.
- Generate fee income.

Refinancing Example

One of our banks had a concentration in mini-storage facilities and the FDIC was pressuring them to reduce the concentration.

They decided to use the SBA 7a program to refinance some of the mini-storage loans that they had in their portfolio.

The first loan that we refinanced was for \$1,600,000.

Refinancing Example

- The bank was able to sell the 75% or \$1,200,000 portion of the loan and show the FDIC that they were working to reduce their concentration.
- The bank made \$133,000 in premium on the sale of the guaranteed portion.
- They were able to keep the customer happy and retain a good client.

Why Outsource?

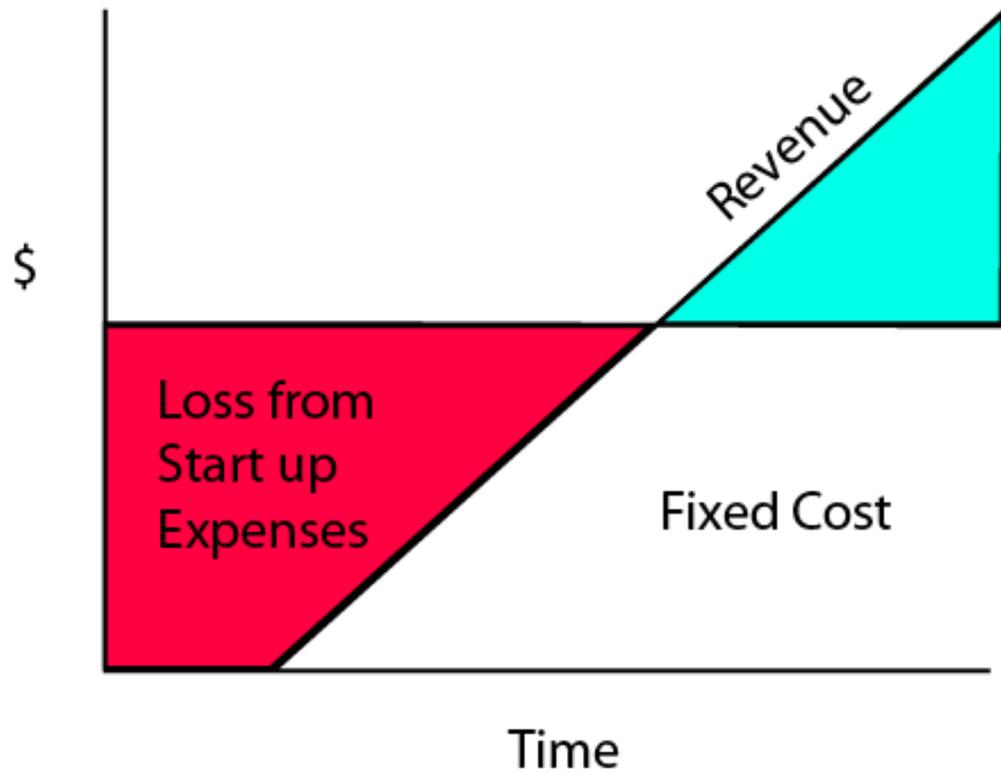
Several firms provide an outsourced solution for handling the evaluation, underwriting, SBA application package, loan documentation & closing and servicing.

The advantages to using an outsource provider are:

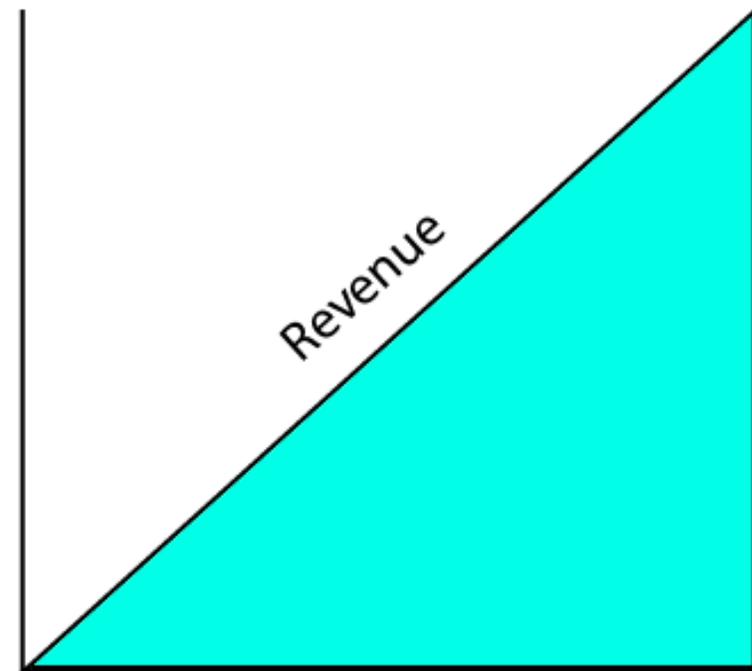
- Ongoing training & support for your existing staff to help you generate SBA loans.
- Quick access to an experienced team, so you can get your program running immediately and the loan process is executed much more quickly for the borrower.
- Less overhead. It is a variable cost and it is cheaper than hiring staff.
- Warranty on the work performed.

Why Outsource?

Internal SBA Department



Outsourced Department



All costs are variable

We don't charge if the loan doesn't close

SBA Lending Benefit

Bank example:

- A \$250,000,000 asset size bank that is making \$1,800,000 in after tax income.
- The bank has \$3,000,000 shares of common stock outstanding, with an earnings per share of \$0.60 and a stock price of \$6.00.

SBA Lending Benefit

Bank example:

- Add an SBA department and produce \$50 million in new loans.
- Based on the costs outlined, a bank will make at least \$500,000 on \$10 million in loans, so \$50 million in production should make our sample bank \$2,500,000.
- Assuming a tax rate of 35% the after tax income is \$1,625,000.

SBA Lending Benefit

Bank example:

- Now add the bank's profits of \$1,800,000, plus the SBA profit of \$1,625,000 = \$3,425,000.
- Based on the bank's \$3,000,000 shares of common stock outstanding, the new earnings per share of \$1.14 and a stock price of \$11.40.

Mitigating Risk

- **Credit Risk** – The financial institution determines whether it is comfortable with the credit risk. **What credit risks can be mitigated with the guaranty?**
- **Guarantee Risk** – One way to reduce this risk is to submit the loan directly to SBA for their approval. Some lenders have Preferred Lending status, which allows them to approve loans on their own – this increases the risk that SBA could come back and potentially repair the guaranty in the event of default.
- **Documentation Risk** – According to SBA, documentation errors are one of the top three reasons for guaranty repair.
- **Servicing Risk** – Every time someone touches an SBA file, they potentially put the guarantee at risk. The bank must have experienced staff to properly maintain the loan portfolio and enable the institution to stay in compliance.

SBA Compliance Red Flags

As senior bank managers, what are things to watch for in an SBA department?

- Is their adequate staff to Underwrite, Process, Close, Sell and service the SBA loans? Make sure that you have staff in place to handle all of these roles.
- Who is managing the SBA dept.? Is it a sales person?
- Does the bank have a recent SBA audit and what were the findings?

SBA Compliance Red Flags

- Does the bank hire an outside audit firm to evaluate their SBA loan portfolio?
- Is the bank sourcing all of their loans through brokers?
- What is the level of start up loans, projection loans and under secured business acquisition loans?

Brian Carlson, CEO

SBA Complete, Inc.

550 Continental Blvd., Suite 120

El Segundo, CA 90245

(310) 775-2571

bcarlson@sbacomplete.com