Contract CAPLine Program

7A LOAN GUARANTY PROGRAM
Flexible financing for your small business customers

Tennessee & West Virginia District Offices
March 13, 2018

Presenter – Bill Reed
Topics for Today’s Discussion

I. Contract CAPLine Financing
II. General Requirements
III. Ineligible Use of Proceeds
IV. Eligibility Requirements
V. Documentation
VI. Establishing Loan Amount
VII. Disbursements and Repayments
Topics for Today’s Discussion

VIII. Collateral
IX. Assignment of Contract Proceeds
X. Exception to Assignment of Contract Proceed
XI. Prime and Sub-Contractor Contracts
XII. Purchase Orders and Contracts with Performance Bonds
XIII. Application Process
I. Contract CAPLine Financing

- Provides financing in anticipation of what will be created

- Provides financing against “What Will Be”

- It is not financing against existing receivables
I. Contract CAPLine Financing

- A Line of Credit type financing used to cover both the Direct and Indirect Costs of one or more specific contract(s)

- Contract CAPLine proceeds may be used to finance materials, labor, overhead, and general & administrative costs, attributable to the contract(s) being financed

- Cannot include any mark-up or profit

- Cannot include G&A and Overhead not associated with the contract(s) being financed
I. Contract CAPLine Financing

The Danger of Financing G&A and Overhead

- Does the applicant know how to determine the right amount of G&A and Overhead associated with just the contract(s) being financed?

- Do the Lenders know how to check the applicant’s calculations?

- What is going to be the Borrower’s temptation to get proceeds to cover more G&A and Overhead than is needed for just the contracts being financed?
II. General Requirements

- The applicant must qualify under Regular 7(a) requirements, Plus be a business performing contracts, sub-contracts, or purchase orders for third parties

- Maximum line amount $5,000,000.00

- Maximum guaranty amount limited to $3,750,000 to any one borrower and its affiliates
II. General Requirements

- Maximum interest rate is the same as Regular 7(a)

- Maximum maturity is 10 years but generally tied to the receipt of the final payment for any contract financed

- Maximum guaranty percentage is 75% for loans over $150,000 and 85% for loans of $150,000 or less
<table>
<thead>
<tr>
<th>Gross Loan Size</th>
<th>FEES</th>
<th>NOTES</th>
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<tbody>
<tr>
<td>Loans of $150,000 or less (See Note 1)</td>
<td>2% of guaranteed portion</td>
<td>Maturities that exceed 12 months.</td>
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<td>Lender is authorized to</td>
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<td>retain 25% of the fee.</td>
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<tr>
<td>$150,001 to $700,000</td>
<td>3% of guaranteed portion</td>
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<tr>
<td>$700,001 to $5,000,000</td>
<td>3.5% of guaranteed portion up to $1,000,000 PLUS 3.75% of the guaranteed portion over $1,000,000</td>
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<tr>
<td>(See Note 2 )</td>
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<tr>
<td>Short Term Loans – up to $5 million</td>
<td>0.25% of the guaranteed portion</td>
<td>Maturities of 12 months or less</td>
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II. General Requirements (cont.)

- May be revolving or non-revolving, between Contracts and within Contracts

- The funding of multiple contracts requires the use of a master note with multiple sub-notes for each contract being financed

- Recommend the proceeds from the contract receivable be assigned to the lender
II. General Requirements (cont.)

- Interest only payments for any period exceeding the borrower’s contract final date, or project completion date are not permitted

- An extraordinary servicing fee charged by the lender cannot exceed two percent

- The Contract CAPLine must have an exit strategy – Zero Balance by maturity
III. Ineligible Use of Proceeds

Contract CAPLine Proceeds may not be used for:

- Permanent working capital;
- To acquire fixed assets;
- To pay delinquent taxes or similar funds held in trust;
III. Ineligible Use of Proceeds (cont.)

Contract CAPLine proceeds may not be use for:

- To refinance existing debt;
- To finance a contract in which significant performance has already begun;
- For change in ownership or floor plan financing;
- To cover any mark-up or profit
III. Ineligible Use of Proceeds (cont.)

Contract CAPLine proceeds may not be use for:

- Advances identified for one contract under a master note agreement cannot be used for another

- Progress payments received under a master note agreement for one contract cannot be used for another
IV. Eligibility Requirements

Applicants must have developed an adequate track record to assess its short-term working capital needs

- Possess the overall ability to bid accurately project costs, and perform the specific type of work required by the contract

- Have the financial capacity and technical expertise to complete the contract on time and at a profit
IV. Eligibility Requirements

Applicants must have developed an adequate track record to assess its short-term working capital needs (cont.)

- Be able to demonstrate an ability to operate profitably based upon the prior completion of similar contracts

- The Contract CAPLine is not intended for start-ups
V. Documentation

Prior to approval, you should obtain from applicant:

- A project cost schedule depicting all direct material, labor, and overhead attributable to the contract to be financed. (Profit may not be included.) The schedule must illustrate each cost by line item a/k/a Bid Sheets

- A month-to-month cash flow projection(s) covering the term of each contract, subcontract, or purchase order to determine appropriate disbursement and repayment timeframe
Prior to initial disbursement on each contract, subcontract, or purchase order:

- Obtain copy of the executed Contract, Subcontract, or Purchase Order;

- Perfect all liens and verify that the required lien positions have been obtained;

- Obtain copy of the executed assignment of the contract proceeds (if applicable);

- Obtain written acknowledgment of this assignment from the third party (if applicable);

- If contract assignment is not required, document the conditions specified in SOP 50 10 that justify no assignment
VI. Establishing Loan Amount

A Contract CAPLine LOC may be Used to Fund Either a Single or Multiple Contracts

- For single contract financing … The loan amount is equal to the sum of the amounts identified in the project cost schedule as being needed to meet project cost requirements (excluding profit)

- For multiple contract financing … The master note loan amount is equal to the sum of the costs for all contracts as evidenced by the project cost schedule for each specific contract sub-note

- Sub-Notes must not conflict with the conditions of the master note except for variances in repayment schedule
VI. Establishing Loan Amount (cont.)

How to address future projects when using an SBA approved Master Note Agreement

- Lender may advance against additional contracts without SBA approval as long as the borrower and lender are in compliance with all terms of the authorization.

- Lender will need to follow all previously outlined requirements per SOP 50 10 which includes obtaining a project cost schedule, annual income statement review, confirmation of cash flow, copy of the contract, and month-to-month cash flow projections.
VII. Disbursements and Repayments

- Disbursements are made, when needed, to pay for the costs on a specific contract.

- Month-to-Month cash flow projections for each Contract, Subcontract, or Purchase Order are used to determine appropriate disbursement and repayment timeframe.

- Progress payments are applied first to interest due on the CAPLine, with the remainder applied to the CAPLine balance until the balance is paid in full.
VII. Disbursements and Repayments

If the Line is Structured so proceeds only cover select costs, like Direct Costs:

- The lender must establish which costs will be financed and then establish the percentage of each payment to be applied to the loan balance and the percentage to be returned to the business, so they can cover what the loan did not
### VII. Disbursements (cont.)

<table>
<thead>
<tr>
<th>Scenarios</th>
<th>Assignment of Proceeds</th>
<th>Use of Proceeds</th>
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</table>
| Option 1  | Yes                    | Proceeds finance all costs  
|           |                        | • Apply each payment 1st to interest and the balance to principle |
| Option 2  | Yes                    | Proceeds finance select costs  
|           |                        | • Identify cost being financed and retain a % of each payment received |
| Option 3  | No                     | Interest only with principle paid at contract final payment date  
|           |                        | • Full amount of principal must be fully repaid by final payment date |
| Option 4  | No                     | Proceeds finance all costs  
|           |                        | • Borrower remits all payments to lender |
| Option 5  | No                     | Proceeds finance select costs  
|           |                        | • Borrower remits required % of each payment received to lender |
VIII. Collateral

- First lien position on the contract(s) and the proceeds of the contract(s), by assignment to the participating lender and proper UCC filing

- Liens must be perfected prior to the initial disbursement for each contract or project

- The lender may take additional collateral in accordance with its policies and procedures governing its similarly size, non-SBA guaranteed commercial line of credit

- The requirements for personal guaranties are the same as for any other 7(a) program
IX. Assignment of Contract Proceeds

Assignment of Contract Proceeds:

- Before recommending a Decision, Lender should ascertain if an Assignment of Contract Proceeds is Available

- Lender then Decides if they Want that Structure

- Prior to initial disbursement on any Contract CAPLine … The entity the borrower has entered into the contract with must be advised in writing, by both the lender and borrower, that an assignment of the contract proceeds is required
Assignment of Contract Proceeds:

- Such assignment must be in place before any disbursement for a particular contract is made and include a provision for the lender’s right to receive all payments from the third party.

- The lender must receive written acknowledgement from the third party.

- A government contract assignment of contract proceeds can be accomplished in the System for Award Management (SAM).
X. Exception to Assignment of Contract Proceeds

An assignment is not required by SBA if at least two of the following conditions are met:

1. The term of the contract being financed is 12 months or less

2. A successful track record between the borrower and the contracting authority exists relative to the same or reasonably similar contracts

3. Financial analysis of historical income statements and/or tax returns and pro-forma financial statements show that the applicant has a Debt Service Coverage ratio that exceeds 1:1

4. All contract proceeds are paid directly to the lender by the contracting authority or, in the instance where a performance bond is in place, a Funds Control (or escrow of third party servicer) procedure is implemented

5. Other available and worthwhile collateral is pledged to secure the line
A contract between a Prime and Subcontractor is eligible to be financed if at least two of the following conditions are met:

1. Both the Prime and the Subcontractor have favorable credit ratings based on an acceptable rating agency (e.g., Builders Industry Credit Association “BICA”);

2. There is a successful track record between the Prime contractor and the Subcontractor (borrower);

3. There is a successful track record between the Prime contractor and the contracting authority;
XI. Prime and Subcontractor Contracts

A contract between a Prime and Subcontractor is eligible to be financed if at least two of the following conditions are met (cont.):

4. The Contract CAPLine amount is less than $300,000;

5. The term of the contract is 12 months or less;

6. The financial analysis of historical income statements and/or tax returns and pro-forma financial statements show that the applicant has a Debt Service Coverage ratio that exceeds 1:1; or

7. There is other available and worthwhile collateral pledged by either the borrower or any owner/guarantor.
XII. Purchase Orders and Contracts with Performance Bonds

Purchase Orders (PO) may be substituted for a formal contract, provided the following conditions exist:

- The PO is issued to the borrower under a Master Agreement; and

- The combination of the PO and the Master Agreement constitute a binding agreement
A contract requiring a Surety’s performance bond may be eligible for a Contract CAPLine provided the lender perfects a UCC security interest in the contract proceeds.

- The lender’s perfected UCC security interest in the contract proceeds will be subordinate to the cost reimbursement claim of the Surety; and

- The Surety may require that a funds control facility be executed. The funds control facility would disburse directly to suppliers and laborers. The contracting authority will remit contract proceeds directly to the funds control facility, which will remit payment to the lender.
XIII. Application Process

- Lender Agreements must include SBA Form 750B (Short-Term Loans) and SBA Form 750. PLP lenders must have Supplemental Guaranty Agreement for PLP

- Lender has the option of using their own note and guaranty agreements rather than SBA’s versions (SBA Forms 147, 148 and 148L)
For Non-delegated – use Regular 7(a) application forms

- Include a project cost schedule by line item
- Include a copy of the contract being financed
- Include a month-to-month cash flow projections for each contract and another for all contract work

For PLP – use SBA Forms 1919 and 1920

The lender should also use their own documents including the Credit Memorandum. Use these in place of Regular 7(a) application forms used for other PLP loans. E-Tran submission for SBA approval is required
Open Discussion

“Of course it’s only one dollar... It’s a small business loan.”
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