SBA's International Trade Loan Gathers Renewed Attention!

by

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The Small Business Jobs Act of 2010 did several things to improve SBA's loan programs, among them was making the **International Trade Loan** worthy of a second look! Originally introduced by the Omnibus Trade and Competitiveness Act of 1988, the International Trade Loan has gone through various iterations of attractiveness, disuse, and a bit of confusion over the past twenty-five years. However, the SBJA changed the ITL to allow a full 90% guarantee on loans up to $5 million. Suddenly there was a significant advantage for lenders to take a second look at the applicant's export plans—an advantage of up to an additional $750,000 in guarantee coverage when at the maximum loan amount ($4.5 million vs. $3.75 million for a standard 7(a) loan). Several lenders already have shown that they like what they have seen: In the first ten months of FY2013, ITL loans numbers increased 150% to 110 loans, while dollar volume increased 175% to $190 million.

At the time of the enabling legislation in 1988, there was Congressional concern about the growing imports coming into this country, primarily from Asia, as well as a recognized need to expand small business exports. As a result, the eligibility criteria were designed to address both concerns. *Those eligibility requirements have not changed as a result of the SBJA.*

They are:

1. That the loan proceeds will help the Small Business Applicant expand existing export markets or develop new export markets. To establish this, the Small Business Applicant must submit an **export business plan**, including historical data, projections and a narrative rationale that contains enough information to reasonably support the likelihood of expanded export sales. SBA does not specify the structure or length of such a business plan, but at a minimum it should identify existing and targeted export markets, projected sales into those markets, historical sales in the prior year, if any, competition, a discussion of plans and strategies for expansion/entry into existing/new markets, and how the loan will help finance that activity.
   OR
2. That the Small Business Applicant has been adversely affected by import competition. The Small Business Applicant must demonstrate injury attributable to increased foreign competition in the domestic market. A narrative explanation and financial statements which can demonstrate that directly competitive, imported products or services have contributed significantly to a decline in the Applicant's competitive position are required. Alternatively, the Small Business Applicant can submit a finding of injury by the International Trade Commission or the Secretary of Commerce pursuant to Chapter 3 of Title II of the Trade Act of 1974 (19 U.S.C. 2341 et seq.),
   AND

3. In addition to either 1 or 2 above, the Small Business Applicant and the loan officer's report must be able to demonstrate that the loan will allow the Small Business Applicant to improve its competitive position.

Four other clarifying points:

1. Indirect exports are considered exports for purposes of determining eligibility. The term "indirect exports" applies to situations where, although the Borrower's direct customer is located in the United States, that customer will be exporting the items/services it purchased from the Borrower to a foreign buyer. Suppliers to Boeing or Caterpillar, or to an Export Trading Company, are good examples of firms that are a part of the supply chain for major exporters. In this case, the borrower must provide a certification from the exporter-of-record to the lender (typically in the form of a letter, invoice, order or contract) that the goods or services are being exported;

2. For all of the Borrower's exports (including indirect exports), the lender must determine if U.S. companies are authorized to conduct business with the country to which the goods or services will be shipped, pursuant to the Ex-Im Bank's Country Limitation Schedule (found at www.exim.gov). A loan may not be made to a business that exports to a foreign country which is listed as a prohibited country (Note # 7) on the Country Limitation Schedule (currently Burma, Cuba, Iran, North Korea, Sudan and Syria);

3. International Trade Loan proceeds may be used for (a) acquiring, constructing, renovating, modernizing, improving or expanding facilities and equipment to be used in the United States to produce goods or services involved in international trade and to develop and penetrate foreign markets; (b) working capital; and (c) the refinancing of any debt that is not structured with reasonable terms and conditions, including any debt that qualifies for refinancing under Standard 7(a), while also meeting the eligibility criteria above. And,

4. The lender is required to take a first lien on the assets financed with the ITL proceeds or other assets of the Borrower. An ITL can be secured by a second lien position on the property or equipment financed by the ITL or on other assets of the Borrower, if the SBA determines that the second lien provides adequate assurance of repayment of the loan.

In recent discussions with SBA's Loan Guaranty Processing Center, we have been made aware of several issues of concern to Lenders.

1) **How detailed does the export business plan have to be?** As stated above, while there is no prescribed format, the export business plan should be sound, descriptive and grounded in fact. This is not an academic exercise that says, "I know exporting will help my company. I've done some research and, if I get a loan, I'm going to start exporting to maybe two or three countries." Rather, it is a definitive plan that directly ties the loan proceeds to increased export sales. If the applicant is an early stage exporter, it would require a review of the competition, an analysis of targeted markets, market entry

strategies, including any barriers to trade and required product adjustments, any pending or signed distribution agreements or orders, and sound sales projections —at a minimum—plus an explanation of how loan proceeds will be used to support this export initiative. For current exporters, a discussion of markets, distribution, and historic and projected export sales should be provided, as well as an explanation of how the funds will support the sales expansion.

2) **What percentage of sales should an applicant's export sales represent to qualify?** There is no statutory threshold, although SBA's regulations require that the loan proceeds will be used to significantly expand an existing export market or develop new export markets. In fact, a business could have no export sales and use an ITL to start exporting. Lenders are expected to exercise good judgment when reviewing an application. If an applicant with $3 million in annual sales is requesting a $1 million loan for plant and equipment expansion to support export sales that will grow from $5,000 to $10,000 over the next three years, clearly the loan would be used overwhelmingly to support domestic operations and would not qualify as an ITL. On the other hand, if the business plan shows a need for specialized production equipment to meet metric standards in the U.K. and other European markets and funding for an aggressive international marketing campaign that will grow exports from $100k to $200k in two years with projections for $350k in export sales in four years, it would likely pass the reasonable test, even if this final figure might not represent a high percentage of total sales.

3) **Here are some other examples:** XYZ Corporation manufactures industrial controls. They attach a spreadsheet which shows exports to China increased from $150k to $300k in the past three years. Their Chinese distributor advises that he has $375k worth of orders in hand for the current year, with a projection of $450k in orders for the coming year. In order to meet this increase, the Small Business Applicant will need additional production equipment. The applicant also is requesting permanent working capital to purchase Gold Keys (matchmaking appointments offered by the U.S. Department of Commerce) and funding for travel to meet potential distributors in Indonesia and Malaysia. This company has a business plan that proactively demonstrates its commitment to expanding its export sales and would meet the ITL standard.

   Another example of financing that would meet the ITL standard: ABC Corporation manufactures industrial packaging equipment but does not currently export. They have identified a potential for growth in international markets, but discovered that, in order to compete in the international marketplace, they need to modify their production line and produce to metric standards. They have lined up distributors in both the United Kingdom and Mexico that project first year sales of $200k and potential third year sales of $400k if their product can be produced to metric standards. The company anticipates costs of $200,000 in order to retool to make products that will conform to metric standards. This new equipment will ensure that they have adequate production capacity to be able to produce the quality and quantity of products needed in order to stay competitive in these overseas markets. Although new-to-export, they have distributors in place and firm projections of future export sales volume.

Another example of financing that would meet the ITL standard: Acme Corporation manufactures components for high-end sound systems. The Chinese market for these systems has exploded, and Acme has received a purchase order from the High-End Sound Corporation of Dayton, Ohio, for components that will be incorporated into High-End Sound Systems going to China. The Acme Corporation has the ability to manufacture the components, but the additional volume will strain their cash flow. They have an existing term loan that was used to purchase initial production equipment, but the note has a three-year amortization. They are requesting a seven-year loan to refinance this note in order to free up monthly cash flow. They anticipate indirect export sales of $150,000 in the next 12 months, with additional export sales growth anticipated by their customer as it expands into the Taiwan and Hong Kong markets. Refinancing is an acceptable use of funds, as long as all other eligibility criteria are met.

The International Trade Loan offers lenders an attractively revised program to use to help their customers expand their export sales. For more details, please feel free to contact your SBA District Office or an SBA Trade Finance Specialist located at one of 19 U.S. Export Assistance Centers across the country. For a list of contacts, please go to: http://www.sba.gov/content/us-exports-assistance-centers.

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