Refinancing SBA Loans

Help business-owners who wish to move out of their prime-based SBA loans

By **Gregory J. Malanos,** president, C&T Funding Inc.

The U.S. Small Business Administration (SBA) 7(a) program helps hundreds of thousands of small-business-owners start or purchase a new business venture, expand an existing business or refinance previous debt.

The economy would be significantly smaller if not for the 7(a) and many of its innovative, business-friendly sister programs under the auspices of the U.S. Department of Agriculture. The longer amortization schedules of these loans help fledgling and expanding businesses flourish by allowing more cash-flow dollars to stay in the business, rather than going into monthly mortgage obligations. The more-liberal credit criteria can help new and existing businesses qualify for more capital.

There is one catch to these loans, however. Under the 7(a) program, the SBA uses the prime rate as the index to establish its prevailing monthly interest rate. In an increasing-rate environment, it can be costly to have a loan originated as a prime-based, floating-rate transaction.

The burden of carrying a loan tied to a floating index can present substantial cash-flow concerns during the first years of a new business. Business-owners who closed on an SBA loan in June of 2003 (when prime was 4 percent) with pricing of prime-plus-2.5 percent now have an interest rate of 10.75 percent.

Many business-owners are discovering that the financing structure they initially retained to start a new business may not be suitable for the long-term. But you can help qualified businesses with SBA-loan balances (secured by real estate) find more-favorable terms through a refinance.

Talking to clients

Most SBA borrowers facing higher mortgage payments are eager to explore exiting their financing. They shouldn't be difficult to solicit, seeing as how they are faced with escalating monthly payments and a need for capital.

Explain to them what influences interest rates and that when the Federal Reserve sees the economy growing at a robust pace, its goal is to prolong the economic growth cycle. More specifically, it aims to increase the discount rate enough to prevent the growth cycle from burning out too soon. Conversely, when the economy is weak, the Fed often will lower the discount rate, making credit more readily available.

The discount rate impacts the credit-lending policies banks make to borrowers. Higher rates slow down the injection of credit into the economy, while lower rates stimulate more-aggressive lending decisions.

Although increasing rates may have the immediate effect of increasing a business's monthly mortgage obligation, the big picture is that they provide for the overall continued health of the business cycle.

Knowing the complexities

After you find clients who want to refinance, you must learn how to restructure all the ancillary collateral typically wrapped in these loans. Refinancing an SBA loan can be complex. It commonly include elements of equipment, accounts receivable, second-mortgage positions on additional real estate and — to a lesser extent — inventory, works-in-process and other pledged assets.

Refinancing an existing SBA-loan transaction can often involve several different capital sources working together, often closing simultaneously. Although some conventional lenders may have the discretion to use equipment or accounts receivable as additional collateral sources, their criteria may require unrealistic credit-scoring or valuations that are below industry norms.

For a successful transaction, you must have experienced and knowledgeable sources and contacts to consult with throughout the process. Further, you must learn how to unravel the myriad SBA liens and cross-collateralizations.

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As interest rates continue to increase and impact refinance business, it is essential to search for niches and developing sectors in the commercial market. The SBA refinance market is just one of those sectors.

Brokers who successfully service these types of sectors can continue to thrive.

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