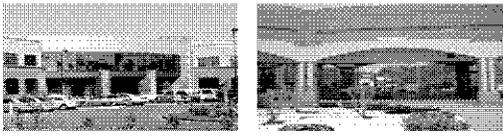


U.S. Small Business Administration

SBA

Your Small Business Resource

Standard 7 (a) Loan Guaranty Processing Centers



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The CAPLines Program

- CAP Lines consists of five separate sub-programs which are designed to meet particular credit needs of businesses by financing short-term, revolving and non-revolving, working capital.

The CAPLines Umbrella Encompasses:

- Seasonal
- Contract
- Builder
- Standard Asset Based
- Small Asset Based

Credit Concepts

- The purpose of the Seasonal, Contract and Builder CAPLines is to provide working capital in order to **CREATE** new current assets (What Will Be).
- The purpose of the Standard and Small Asset Based CAPLines is to provide financing against **EXISTING** current assets (What Is).

The “What Will Be” Financing

- Seasonal CAPLine
 - ❖ finances the seasonal build-up of accounts receivable or inventory
- Contract CAPLine
 - ❖ finances labor and material to complete contract(s)
- Builder CAPLine
 - ❖ Finances labor and material to construct or rehabilitate real property

The “What Is” Financing

- Standard Asset Based CAPLine
 - ❖ finances working capital needs (over \$200,000) on a revolving basis over a period of years
- Small Asset Based CAPLine
 - ❖ finances working capital needs (\$200,000 or less) on a revolving basis over a period of years

Characteristics Unique to All SBA CAPLines

- Can be revolving
- Allows for use of master and sub notes, if necessary
- Can finance creation of current assets or financing existing current assets
- Cash collections must repay the loan
- Repayment is based on cash cycle instead of cash flow

SBA CAPLines Characteristics

- Does not require an annual clean-up period (except seasonal)
- Loan amount may be increased once up to one-third the original loan amount
- Cannot be sold into secondary market
- Cannot be processed PLP, CLP, Express, or any pilot program
- Maximum 2% servicing fee allowed (except Standard Asset Based)

* Servicing fee is unlimited on Standard Asset Based and is the only CAPLine that requires SBA approval for participation (SBA Form SAB-159A is required – it describes anticipated services to be provided and fees to be charged in connection with a Standard Asset Based CAPLine)

Seasonal CAPLines

- Applicant must qualify under the regular 7(a) requirements
- Have been in operation for at least 12 calendar months; and be able to demonstrate a definite pattern of seasonal activity
- Finances only the seasonal increases to inventory, accounts receivable, labor, and materials.

* It does not provide financing for the permanent level of activity, only the seasonal increase.

Features of Seasonal CAPLines

- Finances working capital needs down to the low point of the business cycle.
- ❖ Seasonal Use of Funds
 - Inventory
 - Accounts Receivable
 - Labor
 - Materials
(To perform Seasonal Activities)
- Can revolve between seasons and can have multiple seasons within a year.

Other Features of Seasonal CAPLines

- Must be repaid as soon as funds are collected from sale of inventory or collection of accounts receivable
- The loan amount needs to be sufficient to cover the full financing of the increases to seasonal needs.
- Required to be zeroed out for at least 30 days after each season.
- Borrower is required to provide a monthly reconciliation report of accounts receivable and/or inventory.

Maturity of Seasonal CAPLines

- Overall maturity of the line is 5 years
- Can finance a single or multiple seasons
- A Single Season Loan
 - ❖ Can have multiple seasons in one year
 - ❖ Maturity is at the end of a season, but not to exceed 11 months (The duration of a single seasonal cycle cannot exceed 11 months from the date of first disbursement since a 30 day clean up must occur after each cycle)
- Multiple Season
 - ❖ Maturity is 5 years overall with each season limited to 11 months

Seasonal CAPLines are Self-Liquidating Loans

- Repayment comes from normal sale of current assets (self-liquidation of current assets that had not yet been created at the time the loan was disbursed)
- Sell-down usually occurs without immediate replacement
- Repayment *is not* from profits

Borrower Issues

- Must have demonstrable seasonality in past financial statements.
- Loan requires a clean-up period.
- Collateral will be all current assets

Lender Issues

- Lender needs to carefully monitor the seasonal activity of the borrower
- Lender needs to reconcile asset balances to loan balance
(normally accomplished with a borrowing base certificate)

Contract CAPLines Eligibility

- Contractors and subcontractors in construction, manufacturing and service industries who
 - ❖ Qualify under the regular 7(a) requirements
 - ❖ Are able to demonstrate an ability to operate profitably
 - ❖ Possess the overall ability to bid accurately, project costs and perform the specific type of work required by the contract(s)
 - ❖ Have the financial capacity & technical expertise to complete the contract on time & at a profit

Features of Contract CAPLines

- May involve one or multiple contracts
 - ❖ Loan can be revolving or non-revolving
 - A contractor can have more than one Contract CAPLine outstanding at the same time
 - Repaid from contract proceeds assigned to Lender
 - ❖ Assignment of contract proceeds to lender is required and must be acknowledged by grantor of contract
 - Contract must allow this assignment
- *BUT**
- **Lender does not normally retain 100% of the contract proceeds for application against the loan's balance**

(A portion of each collection should be generally be transferred to the borrower to cover overhead and administrative expenses)

Maturity of Contract CAPLines

- Single contract
 - ❖ must be based upon the timing of receipt of final payment after completion of contract
- Multiple contracts
 - ❖ master note for overall lending need is SBA Note
 - Sub note for each individual contract is the lender document
 - ❖ maximum maturity of master note is 5 years; but maturity of each contract is upon receipt of final payment after completion of each contract

Use of Funds for Contract CAPLines

- To finance labor and materials required to perform contract
- Bulk inventory purchases are allowed
- Advances for labor must match billings

How is the Contract Loan Amount Determined?

- Single contract: based on the cash needs for performance on the individual contract
- Multiple contracts: based on cumulative cash needs for performance of the overall work to be performed by applicant either sequentially or simultaneously, as applicable
 - ❖ 100% of direct labor and material costs
 - ❖ Maximum amount is determined by method of contract payments
 - Progress payments
 - Lump sum at completion
 - Retainage

Cash Flow Statements Required

- Cash Flow specific to the contract
(One should project the full contract period for the specific contract)
- Cash Flow for the entire business activity
(The other should detail all the contract work to be performed by the applicant, including the contract being financed, for the same time period)

Contract CAPLines Repayment

- Lender must receive contract payments directly from contracting entity
 - ❖ Lender must inform contractor in writing of the percentage of each check that will be retained per contract
- A previously agreed upon percentage (no less than the percentage advanced) must be kept from the contract proceeds received and applied to outstanding loan balance by lender

Borrower Issues

- Proper bidding essential
- Past performance a good indicator
- Financial capacity
- Technical expertise
- Ability to complete on time and at a profit

Lender Issues

- Lender monitoring is critical
- Surety bond does not help lender; it only assures completion for grantor of contract
- And recall: Lender must pre-advise borrower of payment application to loan balance

Builder CAPLines

- Used for construction contractors or developers to construct or rehabilitate residential or commercial property
- Must be construction for resale
- Only SBA program which allows “spec builders” to apply
 - ❖ speculative businesses are otherwise not eligible for SBA term loans

Features of Builder CAPLines

- Finances construction or rehabilitation of residential or commercial property
 - ❖ Any construction contractors with applicable NAICS codes (renovations must be “prompt & significant” – equal or exceed one-third (1/3) of the purchase price of the property)
- Repayment is from final sale of each individual construction project when sold
- Final sale must be to unaffiliated third party

Parameters of Builders Financing

- Loan may be revolving or non-revolving
- Single line of credit may be used to fund multiple projects
 - ❖ Maximum term is up to 5 years (Master Note), plus up to 36 months after completion of project (allow for sale)
- If used to finance a single project,
 - ❖ borrower can have multiple sub-program loans outstanding at the same time
- A business may have more than one Builder CAPLine outstanding at the same time
- Repayment is from final sale of each individual construction Project when sold

Builder Use of Proceeds

- Direct expenses related to construction or renovation
- Labor, material, supplies and related equipment rental
- Direct fees
- Up to 5% for development costs
- Not more than 20% for land acquisition
- No purchase of vacant land for future development

Collateral

- 1st Lien on Project Property is required

Unless

- 1st Lien was used to Acquire Property, then 2nd Lien

Builder CAPLines Application Requirements

- Projected twelve month cash flow for entire business activity
- For each individual project:
 - ❖ Month to month cash flow
 - ❖ Mortgage availability letter
 - ❖ Realtor's marketability letter
 - ❖ Inspection agreement with appropriate technical specialist

Lender and Borrower Issues

- Lender must always maintain an awareness of loan advances, project progress, and repayment ability
- Loan advances must always be concluded in sufficient time for repayment to occur by maturity date

"What Is" CAPLines (Asset Based Lending)

- Term used in financial industry
- Describes lending against existing current assets
- Repayment is tied to the cash cycle
- Outstanding balance is related to current assets on-hand
- Balance always revolves

Features of Asset Based Lending

- It is a secured (collateralized) loan
- The collateral is the firm's working assets (inventory and accounts receivable)
- Active monitoring is extremely important
- It is typically more expensive to a borrower than a traditional loan

SBA Asset Based CAPLines Sub-Programs

➤ Two distinct sub-programs based upon size of loan

- ❖ Standard asset based - up to \$2,000,000
 - Lenders must complete the Lender Qualification Survey Form (LQS-2) and be approved by the Standard 7(a) Guaranty Processing Center for processing.
- ❖ Small asset based - \$200,000 or less
 - Must demonstrate the ability to repay the requested amount using internally generated cash flow over no more than 7 years or operates the same as the Standard asset based.

(this is typical term loan repayment analysis)

Lender Responsibilities in Asset Based Lending

- Determine what is the gap in financing
- Identify the risk exposure
- Analyze whether the borrower has performance capability
- Judge the quality of receivables generated from the customers
- Control of funds for repayment

Asset Based Terms

- The analyst need to be familiar with these terms
 - ❖ **Eligible** Receivables/Inventory (work in progress is typically not eligible)
 - ❖ **Advance Rates**
 - Lender determines the Advance Rates for Accounts Receivable (Industry ranges 50-80%) and Inventory (up to 50%.)
 - ❖ **The Borrowing Base**
 - ❖ **Borrowing Base Certificate**
 - ❖ **Reconciliation of the BBC**

Eligible Accounts Receivable and Inventory

- A lender making an asset based loan is interested in the business A/R level
 - ❖ advances are made against levels of A/R on hand at that moment in time
 - ❖ the A/R balance also serves as an estimate of the collateral value on-hand
- But the borrower may have A/R that are not acceptable to the lender
- Lender also reviews inventory to determine the likelihood of collection, considering
 - ❖ Type of goods, location of goods and product liability

The Borrowing Base

A sum of all eligible receivables and eligible inventory

times

the respective advance rates

Borrowing Base Certificate & Report to Lender

- This is a written listing periodically prepared by borrower
- Identifies values and changes in values of assets pledged (A/R and inventory)
- It is certified correct by the business owner and submitted to lender
- Sample forms
 - ❖ See 50-10 (5)b Appendix 7 (page 366-369) for BBC formats
 - ❖ Lender may use its own form instead

Lender Reconciles the BBC

- The reconciliation section adds the element of the loan balance to the borrowing base information
- Each asset category and the loan balance information must reconcile from one period to next
- In this manner the lender “verifies” the accuracy of the values

Use of the BBC

- After confirmation of content, the lender uses it to determine whether any repayment on the loan should occur at that time
- It also identifies if any additional advances can be made
- Comparison from one period to the next is vital
- The BBC determines AVAILABILITY of funds to borrower based solely on available borrowing base value (collateral value) regardless of business need

SBA Asset Based CAPLines Application Requirements

- Standard Asset Based
 - ❖ SBA Form 4 and 4i Application
 - ❖ SBA Form AB-4 & AB-4i
 - ❖ SBA Form SAB-159B
 - ❖ Month-to-Month cash flow projection for 12 months
- Small Asset Based
 - ❖ SBA Form 4 and 4i Application
 - ❖ SBA Form AB-4 & AB-4i
 - ❖ Month-to-Month cash flow projection for 12 months

Control is Very Important in Asset Based Lending

- There are a variety of controls and reporting required
 - Field examinations
 - Collateral monitoring
 - Control of cash collections
 - Periodic financial statements
 - Periodic reporting schedules like agings and borrowing base certificates

Methods of Control

- ▶ Field exam prior to disbursement
- ▶ Legal assignment of assets
- ▶ Filing of financing statements
- ▶ Periodic field exams
- ▶ Periodic collateral reconciliation
- ▶ Periodic financial statements

Control of Accounts Receivable Payments

- Collections into and lender payments from business operating account
- Direct deposit or trust account
- Controlled account
- Lock box

Repayment of Asset Based CAPLines

- Payment is derived from orderly liquidation of current assets
 - ❖ For asset based CAPLines, final disbursement must occur far enough in advance of maturity so that a sufficient amount of time is available for the assets acquired with the proceeds to be converted back to cash and available to make final payment at maturity

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