SMALL BUSINESS LOANS 101

Live Oak Bank's guide serves as a comprehensive outline on the various types of small business loans.

To learn more, visit liveoakbank.com/small-business-loans

DEDICATED TO THE DOERS™

Whether you're just launching your business venture, or you are in expansion mode, it's highly likely that you'll need financing to support your business objectives. Many owners turn to small business loans as a solution for capital without losing equity or stake in their company. Small business loans enable entrepreneurs to get off the ground and remain in control of their company. Within this guide, we'll break down different types of loans, which type of loan might be the best fit for you and how these loans can be used to strengthen your business. We're highlighting the following elements of a loan for each type:

- **Down Payment** – A sum of money the borrower must pay towards the project - represents a percentage of the project costs.
- **Loan Terms** – The specific conditions involved when borrowing money, including the interest rate and the repayment period.
- **Working Capital** – A type of small business loan that can be used to fund every day, operational needs.
- **Financial Covenants** – Agreement between borrower and lender with certain restrictions for the borrower while paying on the loan.
- **Personal Guarantees** – The borrower agrees, in conjunction with the business, to be 100% personally responsible for repaying the loan in full.
- **Choosing the Right Lender** – Our general guidance on how to select a lender.

Why Live Oak

Service
We strive to provide unmatched service and an unwavering dedication to your success.

Know-How
We'll take you where you need to go with our deep industry and product expertise.

Efficiency
Our commitment to efficiency and transparency helps you avoid costly mistakes.

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SBA 7(a) LOANS

The Small Business Administration (SBA) is a government agency that serves as the main resource for government-backed business loans. A portion of SBA loans is guaranteed by the government and these loans allow small business owners to obtain capital with less equity than a conventional loan requires. To clarify, the federal government does not lend you the money, the bank does. The SBA just guarantees a percentage in the event of a default on the loan. The most common SBA loan program is 7(a). These loans can be used to set up a new business but can also assist in an acquisition or expansion of an established business. There are many benefits of an SBA loan and the specific terms can be negotiated between the borrower and an SBA-approved lender.

Down Payment

Typically, most conventional bank loans require around a 25% - 35% down payment. SBA loans are based on a cash flow analysis and require less of a down payment. This allows a borrower to get started with less money down and opens the doors to new owners seeking financing. For a new business purchase, the SBA requires at least a 10% down payment but this can vary depending on the transaction.

Loan Terms

SBA 7(a) loans are long-term loans, with the average term around 10 to 25 years. The interest rate varies depending upon the lending institution. The maximum loan amount for an SBA 7(a) loan is $5 million.

Working Capital

Working capital can be rolled into an SBA 7(a) loan. A working capital reserve can help bridge the financial gap until the business becomes stabilized.

Financial Covenants

SBA 7(a) loans do not have restrictive financial covenants that you may find in conventional loans, such as loan to value or debt service coverage ratio covenants.

Personal Guarantees

SBA loans require a personal guarantee from individuals who own 20% or more of the business applying for the loan.

Choosing the Right Lender

Working with an SBA-preferred lender should make the experience less time consuming. Typically, a lender is what makes the difference in whether the transaction is smooth or not. When choosing a financial institution, make sure that the lender has a proven track record of helping small to medium-sized businesses succeed. PLP lenders have the ability to make credit decisions without SBA review, expediting the loan approval process.

SBA 504 LOANS

Another common program from the SBA is a 504 loan, but this product is geared toward small businesses looking to finance commercial real estate or large equipment to use in their operations. Additionally, a 504 loan can be used to finance land acquisition, ground-up construction or improvements/expansion to an existing building. Think of 504 loans as funding tangible assets. The business net worth cannot exceed $15 million.

SBA 504 loans are structured differently than other SBA loan programs and it's important to understand that 504 loans are composed of three distinct parts — the lender, Certified Development Company (CDC) and a borrower. In most cases, SBA 504 loans are structured in a 50-40-10 model. First is the bank loan, which is 50% of the total amount. Second is a Certified Development Company (CDC) who provides 40% of the total loan amount. And third is the borrower who provides a 10% down payment.

Down Payment

Like a 7(a) loan, the SBA requires at least a 10% equity to put toward the down payment for a 504 loan. In most scenarios, the down payment will be 10-20%.

Loan Terms

The interest rate varies depending upon the lending institution. No outside collateral is required. Funding amounts vary per loan but can be up to $15 million.

Financial Covenants

There are no financial covenants for SBA 504 loans.

Personal Guarantees

SBA loans require a personal guarantee from individuals who own 20% or more of the business applying for the loan.

Choosing the Right Lender

Again, it's best to work with an SBA-preferred lender who can help you decide if a 7(a) or 504 loan will work for you. Not only do the banks in the SBA's Preferred Lenders Program (PLP) have clear knowledge of the loan programs, but they have the ability to streamline the process and make the final credit decision. Non-preferred lenders must submit loans into the SBA for approval which can slow down the process.

CONVENTIONAL LOANS

Conventional loans are exactly what you might expect — fairly standard and formularized. They are often predictable and typically have fixed or floating interest rates and repayment terms. In general, these loans are better suited for businesses with an established operating history, so projection-based and startup companies will typically face more of a challenge getting a conventional loan. Conventional loans can be used for the construction, purchase or improvement of real estate or a business.

Down Payment

Larger business loans will require a down payment, but the exact amount will be dependent upon the borrower's credit history and collateral.

Loan Terms

Conventional loans can be structured in a variety of ways, with different terms and either floating or fixed rates. Depending on what's decided between the borrower and the bank, payment schedules can range from monthly to quarterly to even annual payments.

Financial Covenants

Conventional small business loans must adhere to covenants throughout the life of the loan. Be sure you have a full understanding of all covenants to avoid any surprises.

Choosing the Right Lender

If you have good credit and are seeking a higher amount of funding, seek out either an online lender or a bank for your conventional loan. Typically, online lenders can provide funding much faster than banks. Terms and costs can vary.

BUSINESS LINE OF CREDIT

A line of credit allows you flexible access to a pool of money when you need it most. You can use it to cover business expenses, buy inventory and ultimately, enjoy improved cash flow month-to-month. Whether you're experiencing rapid growth or a bump in the road, a line of credit can help you address the needs of your business. The benefits of a line of credit include only paying interest on the money you use, quickly accessing capital when the need arises and repeatedly drawing funds once you've repaid them. Just remember that the amount of funding available and repayment terms will depend upon the health and history of your small business. Generally speaking, business lines of credit often work better for owners who have cash flow issues, where an SBA or conventional loan make more sense for one-off purchases or investments. Ultimately, the flexible nature of a line of credit is the most attractive feature for small business owners.

Down Payment

There is no down payment required for a business line of credit.

Loan Terms

While there are several different types of business lines of credit (short, medium or long-term), the exact terms will depend on the revenue, credit score, and general history of your small business. If you cannot qualify for a long-term line of credit, a short-term line of credit is a great place to start and establish a good credit score. Secured lines of credit require collateral while unsecured lines of credit do not.

Financial Covenants

Specific covenants can vary across different lending scenarios, but several examples of financial covenants include net worth, interest ratio, debt ratio and material change covenants. Be sure to ask your lender any questions you may have regarding financial covenants required for your business line of credit.

Choosing the Right Lender

When it comes to seeking out a lender for a business line of credit, there are various options. It really just depends on how much money you want to borrow, ease of application process and the terms you're willing to accept. Do your due diligence and research and compare several options to discover which lender is the best fit for your needs.

WHAT IS THE PROCESS?

Stage	ROLE	RESPONSIBILITY
Connect & Pre-Qualification	Lender	Connects with borrower to discuss long-term business goals and current challenges in order to create a tailored loan package.
	Borrower	Provides all pre-qualification due diligence documents for the lender to review.
	Lender	After review, the lender will issue a letter of interest which states how much the customer is eligible to borrow and outlines next steps.
Underwriting	Borrower	Provides letter of intent or purchase contract to the lender.
	Lender	Reviews the borrower's documents to validate that we have the necessary information to get an approval decision.
Credit Review	Credit Team	After receiving documents from borrower, the bank's credit team reviews the loan package to ensure that it aligns with our credit philosophy. Note that it may be somewhat repetitive in nature to the connect/prequalify stage, but it's necessary for the credit team to understand the full scope of the loan.
	Lender	After approval, a formal commitment letter is issued to the borrower.
Closing	Borrower	After the borrower executes the commitment letter, the closing process affectionately known as the "great paper chase" starts. This is where the lender and borrower are working to gather all required documents needed to close and fund the loan.
	Lender	Once the lender has received all closing documents from the borrower, the loan is closed and the project gets funded.
Servicing	Business Analyst	Once your loan closes you are assigned a Business Analyst who checks in each quarter to provide insight and business guidance.

Every loan from Live Oak Bank is unique. While this process is a general road map for what our borrowers can expect, it's not a guarantee for every single loan. Some deviations from this process may occur.

HOW DO SMALL BUSINESS LOANS WORK?

A small business loan gives you access to capital so you can invest it into your business. The funds can be used for many different purposes including working capital or improvements including renovations, technology and staffing, business acquisitions, real estate purchases and more. When a bank is assessing if you are eligible for a loan and how much debt your business can afford, they look at many different factors such as the condition of your business, the available collateral, your cash flow and your character. Depending on what type of loan product you are applying for, the requirements and terms can vary so be sure your lender explains what they will need from you in order to qualify.

Am I Eligible?

What's required once you initiate a small business loan transaction will largely depend on the lender you choose and the type of loan you are applying for. Regardless of lender, there are some essential items that you must provide, including:

1. Time in business
2. Personal and business credit score
3. Annual revenue (or monthly sales)
4. Bank statements
5. Personal and business tax returns
6. Purpose of a loan
7. Personal background and character
8. Business plan with projections
9. Collateral
10. Legal documents relevant to your business (business licenses, franchise agreements, leases for commercial real estate, etc.)

As a small business owner, you have options when it comes to finding the right financial solutions. Terms, rates, and qualifications can vary by lender and loan product and every situation has advantages and challenges. Base your decision on the specific goals and needs of your small business and start the process with as much qualifying documentation to help your lender identify the best fit.

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