

Advantages of SBA Lending

Member Business Lending can be one of the most profitable segments of a Credit Union's business. It carries, however, some significant risks along with those rewards. SBA Lending is great tool for Credit Unions, of any size, to mitigate those risks, and add some additional rewards. We have detailed here some of these benefits.

The first benefit is **Decreased Risk**. Risk mitigation can be broken down into two subcategories: Credit Risk and Portfolio Risk.

Credit Risk: Business loans are inherently more risky than consumer loans. They require a different set of underwriting skills, and regular, annual analysis. Every SBA loan that your Credit Union makes carries a US government backed guarantee on a portion of the principle. That guarantee can be 50%, 75% or 85% of the principle. This greatly reduces your overall risk in writing these credits. Should the business liquidate, the SBA guarantees (assuming you filed your packaging correctly) that you will only lose the portion of that debt that is not recoupable through the combination of liquidation sales, and SBA guarantees. In liquidation of SBA loans, most lenders do not end up with significant losses.

Portfolio Risk:

Diversification: According to regulations, Credit Unions may only lend 12.25% of their total asset value in business loans. SBA loans, because they are government secured (that is, a portion of the principle is guaranteed by the US Gov't) are not included in calculating the amount of MBL's outstanding. This allows you to make more loans, and lower your risk through portfolio diversification.

The other benefits of incorporating SBA into your MBL program are diversified income streams and increase capacity.

Secondary Market Sales: The guaranteed portion of SBA loans can be sold, much like securitized mortgages, in the secondary market. There is an established secondary market for the guaranteed portions where Credit Unions can receive between 7 to 12 premium points for those guarantees. This allows Credit Unions to essentially "front-load" their income streams.

Float Income: If you choose to sell the guaranteed portion of your SBA loans, you gain the opportunity to capture "float income." There is a transfer agent that is responsible for sending monies to the *purchaser* of your guaranteed portion every month. You can (legally) require loan payments from your members on 1st of every month, and pass the required portion of those payments along to the Transfer Agent on the 31st of the same month. This allows you to hold on to the interest income from the entire portfolio for thirty days. This can be a sizeable amount as your portfolio grows.

Increased Capacity: As we mentioned earlier, the guaranteed portion of SBA loans do not count against your 12.25% lending cap. Additionally, any non-guaranteed portion of less than \$50,000 does not count against your cap. A Credit Union could make literally *hundreds* of \$199,000 loans and never impact their business lending cap by a single dollar.

Lastly, SBA loans carry some unique benefits to your Members. Most important is the ability to obtain long term financing.

Long Term Financing: The maximum term on an SBA loan is 25 years. For business owners buying a building or starting a new business, this is a major advantage. If the business owner is buying inventory or machinery, the terms can be between 7 to 15 years. This really maximizes the owner's ability to succeed and plan his business growth. Most businesses fail in part, due to under capitalization. A long term SBA loan can help business owners get the full capital they require, and still have affordable payments.

Riskier credits: Some business ventures are inherently more risky than others. Startups and business purchases, to name two, historically carry more risk. By taking advantage of the SBA's guarantees, however, you limit your risk, and can offer these types of loans to your members. Most banks will not make these loans. To be blunt, they are more interested in high dollar, low risk loans, than they are in serving the community. Credit Unions can fill that niche.

All things considered, SBA loans can help round out your Member Business Lending program. They can reduce your risk, increase your capacity and allow you to better serve your members.