

**IBI Credit Union Services, JR Bruno and Associates, Colorado
Lending Source, and The Liberty Group present**

Starting Your Own SBA Department

A Primer and White Paper for Credit Unions

By Tim Thomas

with Vern Hansen, Mike O'Donnell and Tucker Herring

The logo consists of the letters 'BI' in a large, bold, green serif font. The 'B' is slightly larger than the 'I'. The letters are set against a white background within a rectangular box.

CREDIT UNION SERVICES

A division of Isaak Bond Investments

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Chapter One: The Big Picture, by Tim Thomas

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Why does anyone bother doing SBA 7A or 504 loans? Two reasons: They are very profitable these days, especially if you take advantage of the red hot secondary market, and the SBA guarantee enables you to better meet the needs of your members (and those new members you are trying to recruit).

SBA lending has significant profit potential, as we shall see in about 2 minutes, and these business loans are products that many of your members, their families and friend, need. SBA will enable you to make some of those loans at a significant profit – we'll explore the numbers.

Some of the horror stories you have heard are true. If you originate some kinds of SBA loans, particularly on startups without extraordinary offsetting factors, get ready for an unacceptably high default rate. And if you are negligent *as an originator*, or commit fraud, SBA may deny your request to have them repurchase a badly or fraudulently originated transaction that is in default. That's famously called a Herndon (Virginia) denial named after SBA's repurchase headquarters.

So you need to follow the guidelines, set forth in the *Standard Operating Procedures* Bulletin, SOP 5010-C, as updated from time to time.

And on the other hand, some of the horror stories you have heard are NOT true. Suppose, like many credit unions, you purchase loan guarantees to supplement your production (and that's not a bad strategy because it insure you will hit your goals for growth in loans outstanding without principal risk). The SBA, and their rural cousins at USDA, has NEVER failed to honor their guarantee to a good faith secondary market holder (you). Not ever.

So, has your Board asked you to explore creating an SBA department? Have you started one already, only to see low production and continual customer service issues? In writing and editing this White Paper, we will be brief and blunt and brutally honest about the road to success. And we will share with you – without “selling” anything – our ideas about where to get the materials, and vendors, and people, involved. And we'll be candid about the math and accounting rules of selling the guaranteed portions of the loans on the secondary market – and the other strategy, buying.

Let's start with the P-word, PROFIT. In fiscal 2009, SBA guaranteed 10,171 7A and ARC loans totaling \$2.91 billion. That's an average loan of \$270,928. For 2010, the totals are 10,978 loans – about the same number – but for a dollar volume of \$4.05 billion. That's an average of \$368,920. Volume was up an astonishing 39%.

SBA guaranteed 1,369 504 SECOND mortgages (actually debentures) totaling \$803 MM in 2009 and 1,371 loans – again about the same number – in FY 2010 totaling \$751MM. So the average 504 loan, the second mortgage part, that is, was \$547,775. Now the 504 consists of a FIRST mortgage, which you usually keep in portfolio but, until 2011, you can actually SELL at a PREMIUM in the secondary market because more than a dozen POOLERS are creating mortgage securities, made up of a senior 85% guaranteed part – that are AAA and full faith and credit securities just like Ginnie Maes. So, last year, combining the FIRST LIEN and the SBA guaranteed SECOND, there was over \$1.88 billion, approximately, in SBA 504 financing for business last year.

We are going to ignore the SBA programs, like ARC, other than 7A and 504 because they carry more risk and/or a heavy paper burden (to you) and represent less volume. But there are, in fact, other programs you may eventually want to add, see www.sba.gov.

Now let's bring this down to earth with a real example. First let's talk about SBA 7A. Suppose you made ONE SBA 7A loan a month, averaging \$368,920. That's a paltry \$4,427,000 annually in 7A volume. The SBA guarantee on a 7A loan is 75%. (The highest guarantee available is 85% on small loan and community advantage. Express loans are typically 50% guaranteed.) So that means in this case you have \$3,320,280 in GUARANTEED loans on your books. The guaranteed part does not count against your commercial lending cap, just the UN guaranteed part. And you, cleverly, decide to SELL the guarantees in the SECONDARY market because the premiums are so attractive right now. Some people might even say, "outrageous." So, to be the hero of the day, or of 4th quarter, anyway, you SELL \$3,320,280 for a NINE POINT PREMIUM, earning \$298,825 in revenue you had not counted on before. Of course, there's the little matter of FASB 166, which we will ignore for the moment. AND there's the other not-so-little matter of SHARING that gain with the business developer (BDO in SBA circles) who originated the loan. So, there goes, let us say, 25% of that \$298,825 to the originator, but, no matter, you have \$224,119 left, that's a hefty revenue contribution on ONE loan a month. How much more would you make with a first class origination team? Hmmm.

And, what's more, you have a 1% servicing spread on guaranteed part of the loan, which we'll pretend is interest only, so cha-ching, that is another \$33,203 on the guaranteed part. AND you get a great interest rate on the UN guaranteed part of the loan, Prime plus 275, typically, so 6% x the \$1,106,750 you keep on the books, that adds another cha-ching, \$66,405 to earnings, so on ONE loan a month, you added \$224,119 + \$33,203 + \$66,405 to your revenues, that's \$323,727 you were not expecting to have when the year started and THAT, friends, is a great source of CEO bonus compensation, don't you think?

Let's go one more step toward that golden pathway of SBA prosperity. Suppose in the entire year you also do TWO SBA 504 first mortgages for \$547, 775 each. That's only one deal every 6 months. And let's assume ZERO compensation to you on the SECOND mortgage part of the 504, just the first. So, you have \$1,095,550 on the books, good 50% LTV commercial real estate secured owner occupied business loans. And since you are lucky enough to have read this paper, written in part by a secondary marketing specialist, you know that you can sell those loans, if you want, at a SIX point premium, keeping the junior 15% part yourself. So we have $\$1,095,550 \times 85\% \times 6\% = \$55,973$ in additional gain, revenue, yet another contributor to the CEO compensation plan.

OK let me add the piece d'Resistance. You promised the Board you would do not just 12 7A loans and 2 504 loans all YEAR, but that you would grow earning assets by \$10 million. Unfortunately for you, you only originated about \$5MM in our example, and, to make matters worse, you SOLD those guaranteed portions, so as to enhance the Executive Comp Plan. *So, end of the day, you only kept \$1,106,750 in 7A volume and a whopping \$164,333 of the 504 loans.* (If you lost me, reread the preceding 2 paragraphs).

Ergo:

\$10 Million Loan Growth Target

\$1.271 MM actually retained on the Books

\$8.73 MM Shortfall

What to do? Call your SBA-USDA loan desk manager (preferably the undersigned) and buy \$8.73 MM in USDA or SBA guaranteed loans. These don't yield as much (they trade at a large premium) but they will give you a very good spread over cost of funds, and particularly if you buy a 3 or 5 year hybrid -- and, unlike loans, they carry no principal or accrued interest risk. And, even though the individual guarantee can be counted upon just as you would a Ginnie Mae or FHLB guarantee, and is irrevocable, they are treated as loans in your portfolio from an accounting standpoint -- not securities. So you are growing loans with credits that let you sleep at night, quite soundly.

And, as they say in Manhattan, and even here in downtown Denver, here's the thing. If you buy SBA guarantees, or USDA guarantees, to supplement your production, you do take premium risk. *Premium risk is the risk that the loan pays off, usually due to default, before you have recaptured the 9-11 points you paid to own it. Now, the trick is, to use your SBA staff to review your PURCHASES too, so that you only buy the good loans, with some extra due diligence no one else bothers with, thereby mitigating principal risk by buying smartly not blindly.*

There are so many more questions about your member business lending plan with an SBA component. Here are a few samples:

Should we get started originating SBA guaranteed loans? What are the two basic SBA programs? What's the profit potential? What kind of people do we need to hire, what do the customarily get paid and how do we recruit them? What are the credit risks on these

loans, and how do we avoid them? Where can we get the training and education we need? The servicing standards are complex – who has servicing responsibility? What can we outsource? How do we get approved by SBA? What about loan requests that are outside our Field of Membership – or outside of our own lending standards? Can we sell the whole loan or do we need to keep the risk? What types of loans should we avoid? Where can we get good statistical information for loan committee? How do we report to and communicate with SBA? How does our lending policy need to be modified to allow for SBA originations? What happens if we don't hit our portfolio growth objectives – are there other ways to get there? What concerns are our examiners going to have if we add SBA to our product mix? What resources are there out in the market place to assist? What organizations should we consider belonging to? How do we sell our product on the secondary market? What goes in to an SBA package? What does the process look like and how long does it take? How can we insure good customer service? Where can we get all the SBA forms? What resource should we use for official SBA guidelines? How do all the numbers fit together?

We're going to show you how the numbers fit together and even provide a sample budget. And we'll give you the resources to answer these other questions and decide whether you should start a department, what you should outsource, whether you should sell on the Secondary, and whether you should buy the guaranteed portions of other lenders' loans to strengthen your balance sheet.

You'll need a guide in the jungle to explore the issues fully. In the end, your conclusion may be that you will start a small department with one SBA expert, who sources the business AND trains your other loan officers to source as well, combined with outside processing, servicing and secondary. Or, that you set up a larger, more comprehensive department and become a preferred lending partner of the SBA in a year or so. Or you might decide to package SBA loans, carry zero risk, and broker them to reputable wholesalers for a 1-2 point fee, only keeping the “creampuff” deals within your Field of Membership on the books. Or you can combine ORIGINATION with PURCHASING the guarantees obtained by others. If origination is short, step up purchasing; if origination is strong, reduce it – but, no matter what, hit your portfolio goals. And remember that loan guarantees you BUY from other lenders have an IRREVOCABLE guarantee that cannot be taken away.

Chapter Two: About the SBA 7A Program, by Mike O'Donnell

Mike O'Donnell is President and CEO of Colorado Lending Source, Colorado's largest SBA Certified Development Company and one of the top CDC's in the Nation. Colorado Lending Source not only funds and services SBA 504 transactions but processes SBA 7A and 504 loans for credit unions and banks. He can be reached at mike@coloradolendingsource.org.

For the borrower, 7A is a good thing. These loans offer long term fully amortized loans unavailable from conventional MBL programs or banks. The typical 7A deal is secured by the business' real estate, and usually, though not always, cross collateralized on the customers' house if they have enough equity. Terms are up to 25 years and loan amounts are now up to \$5MM. SBA loans can as well be unsecured or secured just by equipment, though most lenders (prudently) prefer real estate collateral.

There is currently a 75% SBA Guaranty as we mentioned earlier. The usual 7A is 25 due in 25, 5/3/1 prepay, P+2.75, no cap, adjusting every 3 months, payable monthly. But you can customize – and the successful originators do – by offering a 3 or 5 year fixed/ARM or other variations.

Lender Benefits:

For you as a lender, since 75% of the loan is government guaranteed, you can reduce loan risks without tightening credit standards and reducing available credit. As we have seen, you can increase profitability by selling loans in secondary market. And you will have increased liquidity as guaranteed portion doesn't count against your MBL legal lending limit.

When you start with SBA, you are a “CLP,” or Certified Lending Partner, lender. SBA approves the guarantee after you submit the request for authorization to the nearest processing center. There's one in Citrus Heights, and another in Kentucky. If all goes well, and you have the staff and ability, you can apply after a few months for PLP (preferred lending partner) status, a kind of delegated underwriting authority subject to annual review.

7A Use of Funds Summary:

- Purchase, construction or renovation of owner-occupied commercial real estate
- Purchase of machinery and equipment for business use
- Business Acquisition
- Business Expansion
- Debt Refinance (must meet SBA requirements, showing cash flow or term benefit)
- Working Capital (be careful with this)
- Business Start-Up (be sure you have an experienced operator and loads of real collateral)

7A Eligibility Requirements Summary:

- The business must be a for-profit
- It can't be too large and have a net worth of less than \$15MM and net profit of less than \$5MM calculated on a two year average
- The owner/user must occupy 51% of an existing building or 60% of new construction
- There must be a demonstrated need for the desired credit; you must meet the “credit elsewhere” test.

A Few Quirky SBA Rules You Need to Know

- **Franchises** must be approved by SBA because the affiliated companies (Shell Oil, for example) may be too close to the franchisee, effectively making the loan a “large business” loan not a “small business” one. Moreover, there are many provisions that need to be in the franchise agreement. Find out more, and who is approved, on www.franchiseregistry.com.
- **Persons** on whom the success of the company depends must have life insurance and it has to be assigned to the lender (you) at close. Start the life insurance process

- early. Mass Mutual and some others have a QUICK CLOSE life policy that suits SBA and good BDO's know this.
- **Sellers of a business or business building can carry back** some of the financing but the terms of the sellers note are strictly regulated. Sometimes seller notes can count as part of the buyers equity injection (another SBA term of art) if they have a standstill agreement with all of the required provisions.
 - **Want to count good will as part of the** cost of a business? What is good will worth? Does it have collateral value? The answer to the last question is, "no." Learn the Blue Sky rules.
 - **Mortgage brokers can package** SBA loans and submit them to you. Their maximum fee is \$2,500, and if they exceed this number, they have to document hour by hour and the customer has to acknowledge.

Responsibilities of 7(a) Lenders

- Submit complete applications for guaranty. Initially, whether you outsource or not, your loans will need approval by your loan committee and by the SBA, which operates two loan processing centers – the largest of which is in Citrus Heights, California, near Sacramento.
- Execute loan authorizations
- Close loans in accordance with SBA program requirements (SOP 5010 C and amendments)
- Maintain complete loan files
- Service loans in accordance with SBA program requirements. You can outsource this but you are responsible for your contractor in the eyes of the SBA.
- Liquidate loans in accordance with SBA program requirements. This is also typically outsourced.
- Comply with all SBA loan program requirements in effect at the time the action is taken

Interest Rate Maximums for 7A loans:

- Loans with maturities under 7 yrs (usually equipment loans) must price at less than or equal to PRIME/LIBOR Base Rate + 2.25%
- Maturities of 7 yrs or more must price at less than or equal to the PRIME/LIBOR Base Rate + 2.75%. This is the typical structure for most 7As we see.
- Loan amounts of \$25,000 or less cap out at an additional 2% above standard rate maximum
- Loan amounts of \$25,000-\$50,000 cap out at 1% above standard rate maximum

- The SBA also offers a new fully amortized fixed rate option, see www.sba.gov.

You can mix and match. That is, create your own loan program, provided the loan uses SBA approved indices, has the required prepay penalty, and is fully amortized with no balloon payment. For example, you may want to create a product with a 5 year fixed rate that adjusts every 5 years; or a 3 year fixed rate that adjusts quarterly starting month 37; or a 5 year fixed rate that adjusts quarterly starting month 61. And carry as well the standard P+2.75b (or P+2.5 of you fee generous) quarterly adjusting, monthly pay product.

You can also get fancy and create a construction loan that turns in to a 7A. 7A loans can build new buildings, or rehab old ones. SBA allows a combination construction + perm, typically 1 year interest only with draws, then 25 years fully amortized.

SBA Up-Front Guaranty Fees for 7A Loans:

- For loans with maturities of 12 months or less (hard to fathom why anyone would originate this) the fee is 0.25% of guaranteed portion (not eligible for fee waiver)
- For loans with maturities of 12 months or more by loan amount
 - For a loan size of \$150,000 or less, SBA charges 2% of the guaranteed portion (lender may retain 25% of fee)
 - For a loan size of \$150,001 to \$700,000, SBA charges 3% of the guaranteed portion
 - For a loan size of \$700,001 up to maximum of \$5 million SBA charges 3.5% of guaranteed portion up to \$1 million PLUS 3.75% of guaranteed portion above \$1 million

On-going Guaranty Fees:

- The maximum fee to SBA is set by statute at 55 basis points – and that fee is adjusted annually to keep 7(a) program at zero subsidies (effective 10/1/10)

So let us assume the borrower starts at \$1,000,000. The SBA guarantees \$750,000. The ongoing (deducted from the monthly P&I) fee to SBA is a maximum of .55% x \$750,000 = \$4,125, payable in monthly installments. This fee rate remains the same through the life of the loan.

SBA Prepayment Penalty:

There is a prepayment penalty if the term of the loan is 15 years or more AND the borrower voluntarily prepays more than 20% of the outstanding loan balance within any one of the first 3 years after disbursement. *SBA requires a 21 day written notice if you intend to prepay.*

Penalty Assessed:

- 1st year after disbursement 5% x amount of prepayment. SBA keeps this.

- 2nd year after disbursement 3% x amount of prepayment SBA keeps this.
- 3rd year after disbursement 1% x amount of prepayment. SBA keeps this.

Chapter 3: And Now, Meet the 504. By Mike O'Donnell

SBA 7A borrowers typically have a loan that floats 275 or so over Prime, with no ceiling. 504 borrowers, by contrast, end up with a TWENTY year fixed rate second mortgage, guaranteed by SBA, at a great rate (mid0Fives as I write this). And, typically, a 25 year fully amortized first mortgage, adjusting every 3 or 5 years, with a floor rate of around 6.25 (as of January 2011), at a spread of 350-425 over the 3 or 5 year Libor swap rate. In all, the 504 package offers long term relatively stable rates, most often a better choice for commercial real estate than the 7A.

The 504 can also be used for refinances, which is a new feature of the program – again, it's the highest loan to value you can get on owner occupied real estate such as an office or industrial condo, doctors office or business warehouse owned by the principals of an operating company and leased back by that operating company.

Commercial real estate and capital equipment financing for small business owners

- Up to 90% financing is available for existing businesses
- Borrowers will receive a long-term, fixed interest rate

Loan Structure:

Here is a typical SBA 504 deal.

Ace Engineering wants to buy its building. They only have \$100,000 to put down. Ace is owned by Joe Sample and his wife, Free Sample. Ace has been in business for 5 years and can afford the rent easily. Joe and Free are buying the building for \$1,000,000. They come to Rocky Road Credit Union for the loan.

Rocky Road approves a 50% loan to value, \$500,000, 25 year, fully amortizing first mortgage, adjusting every 5 years, starting at 6.5% and adjusting at 400 basis points over the 5 year SWAP rate every 5 years thereafter. Rocky Road charges a prepayment penalty of 5% flat on the first mortgage. In SBA parlance, this is a 504 FIRST LIEN. It is also called a 503 to distinguish it from the second loan which is the 504 debenture.

Rocky Road submits application and a complete package to their local SBA Certified Development Company (CDC), which coincidentally is Colorado Lending Source, the State's top CDC. Colorado Lending Source approves a \$400,000, 20 year fixed rate loan at 5.5%. The CDC loan has a bond-like prepayment penalty that lasts for the first 10 years.

Sample Financing

Project	\$1,000,000			
First		\$500,000	6.5% fixed 5 =	\$3,375 PI
Second		\$400,000	5.5% Fixed 20 =	\$2,751 PI
Down Pmt		\$100,000		

The payments on the loans together are \$6,126/month. Ace Engineering leases the property from its owners for \$6,126/month, plus any CPI increase, plus taxes, utilities, maintenance, and insurance. *Ace used to pay rent to outsiders – now the Samples are using their company's ability to pay rent to buy them a building. And because the maximum bank financing these days is 70% or \$700,000, the 504 has given the Samples the additional \$200,000 in leverage they needed.*

If you do 504 loans, you sometimes may have to fund the second along with the first, and then wait for the CDC to fund and pay off your second. Typically, you will need to approve a “swing loan” for \$400,000 for say 1-3 months at a floating rate just like any other MBL, and then pay yourself off when the CDC funds the second. CDCs pool their loans and sell bonds once a month to fund these second mortgages, so if the closing can't wait, you might need to accommodate.

.Other Things to Know

- The SBA 504 loan is available for up to 40% (90% combined) of the total project cost with a maximum of \$5MM and a minimum of \$25K. If you are outfitting a building, or putting in landscaping, for example, the construction, along with regular hard and soft costs, is a project cost. This maximum can be increased to \$5.5MM for manufacturers and businesses meeting the SBA's “green” (energy efficiency) public policy goal.
- The small business is required to put 10% down on the project and in some cases 15% (if the business is a start-up or if the business is purchasing a single purpose facility or 20% (if the business is a start-up AND is purchasing a single purpose facility, like a car wash, ice rink, or funeral parlor, for example.
 - The business must have a net worth of less than \$15MM and/or a net income (after taxes) of no more than \$5MM for the last two years.
 - The business must intend to occupy at least 51% of an existing structure or at least 60% of a newly constructed building.
 - Individuals owning 20% or more of the business must act as personal guarantors.
 - These owners may be required to inject additional funds in to the project if their personal liquidity, after contributing the required equity injection, exceeds the total financing request.

Interest Rates:

Interest rates tied to the SBA 504 portion of the loan are set once a month with the sale of a bond on the New York market. These rates are fully amortized over the life of the loan.

Rates on the second mortgage (called a debenture) are fixed for:

- 20-years for commercial real estate
- 10-years for capital equipment and machinery (*the ten-year bond sells only in odd numbered Months*)

Fees on the Debenture:

The borrower pays a onetime origination fee on the debenture of 0.65% in addition to attorney closing costs of around \$2,000, plus applicable recording and title costs. These are typically financed as part of the loan.

A prepayment penalty exists for the first half of the life of the loan.

Small Loan Advantage

- Small Loan Advantage is structured to encourage larger, existing SBA lenders to make lower-dollar loans, which often benefit businesses in underserved markets.
- Maximum Loan Size: \$250,000 • Guarantee: 85 percent for loans up to \$150,000 and 75 percent for those greater than \$150,000.
- Approval Times: Small Loan Advantage loans submitted electronically through the SBA's e-Tran will be approved within minutes. (You will learn about e-Tran through your NAGGL training or consultant). Other applications will be approved within one business day.
- Paperwork: Small Loan Advantage features streamlined paperwork, with a two-page application for borrowers.
- Lender Requirements: Small Loan Advantage is open to banks and credit unions participating in SBA's Preferred Lender Program (PLP).
- Time Frame: The Small Loan Advantage Program will be implemented on or before March 15, 2011.

Chapter Four: STEPS IN STARTING AN SBA PROGRAM AND DEPARTMENT, by Vern Hansen

Vern Hansen is a SBA and MBL Specialist with J.R. Bruno & Associates, the leading SBA and business lending consulting firm in the United States, with over 150 years of combined commercial lending experience

Your Credit Union is considering offering SBA loans, after looking at all the advantages it brings to your members and to your institution. After all, where else can you find a program that allows you to make individual \$100,000 Member Business Loans, with 85% SBA guarantees, and realize a first year return on your invested capital in excess of 55%? Now the question is, 'How do we start an SBA Program?' Senior management and Boards of credit unions need to carefully walk through the following planning and implementation process, making sure that all key elements are considered.

Assess your local market needs and competition. Consider such factors as:

- What types and sizes of business do you have in your local market? Don't forget the home-based business sector, which on a national basis are approximately 50% of all small businesses;
- What other lenders in your market are offering member business loans, and of those which ones are offering SBA loans? Knowing your competitors and their strengths and weaknesses can help you in designing a business development campaign to reach those members not being served by their present providers.

Next, look at who in your institution has member business lending skills, including business development officers or lending officers, loan operations, processing, and commercial loan documentation skills. *Please note, the SBA will require that you have 2 years of demonstrated business lending expertise. If not, you will be required to either hire personnel who have this 2 years of experience on their resume, or supplement your application with the submission of an agreement with an approved Lender Service Provider outsource in order to establish credibility and a track record of performance.*

- Do you have existing staff that can fulfill these areas? If so, you may need to identify training needs and resources to enhance their business lending expertise;
- If you do not have the staff on hand, what positions do you need to hire, and where will you find the talent? Do you know experienced personnel that you can hire from the outside? Or should you outsource certain key functions?

Contact your local SBA district office. Tell them you are interested in starting an SBA program, and meet with them to get an overview of:

- Types and terms of various SBA loans programs;
- How the SBA is structured and how the processing centers work;
- Various resources which the SBA has to assist you in developing marketing and business development programs, including training workshops offered by the SBA; and
- Understand the process for applying to be approved as an SBA lender.

You will then need to get approved by the SBA as a lender. Contact the local SBA field office in writing, to request approval as a participating lender. The application consists of a questionnaire, and documentation.

First, the documentation. The SBA requires the following documents:

1. A copy of your: a) Charter; b) Articles of Incorporation; and c) By-laws of the Credit Union including any amendments;
2. A copy of your NCUA insurance certificate;

3. A list of all current officers and directors;
4. A copy of the credit union board of directors resolution authorizing the application for SBA lender participation in the 7(a) Loan Program;
5. Copies of your most recent quarterly and year-end call report filings provided to NCUA; and
6. Signed SBA Form 750, *Loan Guaranty Agreement* and SBA Form 750B, *Loan Guaranty Agreement (Short Term)*.

The Questionnaire is simple as well. All you need do is provide the answers for questions such as:

1. Estimate the number and dollar amount of member business loans funded in the last three years. Make sure you include all loans to members for their business vehicles!
2. Describe your lending institution's organizational structure including your marketing area and branch office locations and the name of the person(s) who will have *overall responsibility* for your SBA Program.

*Lastly, you'll need a copy of your current **Credit Policy Manual**, which should include your MBA and SBA Lending policies. Look at your member business lending policy, and decide what needs to be supplemented to incorporate SBA lending. Make sure your policy covers such areas as: credit analysis and underwriting of business requests; loan approval authorities; proper use and review of 3rd party reports such as appraisers, environmental companies, and title companies; loan servicing, liquidations, and workouts, and accounting and management reporting responsibilities. If you need assistance with any of these areas, especially in formulating a prudent lending policy or assembling your application package, please let me know? J. R. Bruno has been helping credit unions get SBA licensed longer than anyone else, and a track record of successful lenders to prove it!*

Decide on the proper structure of your SBA department, and develop written procedures. In order to have an efficient lending department, you will need a standardized routine for loan origination and processing within the department. The loan process is a multi-step procedure, and you need to consider up-front how to organize your department in order to take account of each of the following functions. If you wish, some of these functions can be outsourced, but they all need to be considered as part of the procedures:

- Business development and sales calls, BDO/loan officer responsibilities;
- Pre-screening applications for eligibility per SBA Standard Operating procedures (also known as SOP's);
- Gathering all required application documents and underwriting materials from member;
- Completion of a quality credit analysis and underwriting memo;
- Approval procedures for credit decisions within the organization;
- Packaging and submittal of approved loans to the SBA;
- Proper review of all terms of the SBA authorization and proper communication of those conditions with the member and processing department;
- Proper preparation and pre-review of loan documents;

- Closing and funding responsibilities;
- Servicing the loans on an ongoing basis, gathering and analyzing ongoing financial information, monitoring the financial and credit health of the business and all guarantors. Who will be responsible for ongoing site visits to the customer?
- A process for handling workouts and liquidations;
- Handling of sales of the guaranteed portions of the loans into the secondary market; and
- Accounting and management reporting responsibilities.

Then, based on your work so far, come up with a budget for the department for the first year and perhaps years 1-3. For income projections, consider such factors as:

- What do you think your average size loan will be, and how many loans per month or quarter do you think you will do;
- Sources of income, such as interest income, premium income (in the event you sell the guaranteed portions), packaging fees, and servicing income;

On expenses, as business lending consultants, one of the questions we hear most often is also one of the toughest to answer definitively: what will it cost my credit union to get started? The two biggest variables that will influence your startup costs are: how much can you do with what you have, and, how much do you want to outsource? Each institution has different factors and approaches vary.

Our "best practices" suggestion is to outsource those things that are most expensive, and provide the least initial "bang for your buck." Look at four main areas: Sales & Marketing, Underwriting & Analysis, Operations and Documentation, and lastly, Servicing.

When it comes to Marketing, expect a minimum of \$5,000 for a basic marketing campaign, collateral materials and website updates. Overall, you can spend up to 25% of your overall budget on marketing. When it comes to Sales, we advise promoting or reassigning a current employee. If you're going to hire expect to pay anywhere from \$40,000 to \$100,000 BASE PAY per year (plus benefits), based upon experience, your local job market, and benefits packages.

Underwriting is the area that is hardest to "make do." There is simply no substitute for experience and training. Expect to spend anywhere from \$75,000 to \$200,000 for services, depending upon whether you hire a consultant, or hire an experienced lender.

Operations run the gamut from things such as complex computer systems to more mundane items such as filing cabinets and desks. Costs for this can range from next to nothing to hundreds of thousands of dollars.

Do you currently have the ability to close and document a commercial loan? If not, you can hire a note department and purchase software, to the tune of \$100,000 or more. Or, you can use a lawyer, but the price can be as high as \$5,000-\$10,000 per loan. Another option is to use a closing document provider. Edocs-Express, as well as several other firms,

offer closing documents on a per deal basis, with a minimal set-up fee in the \$5,000 range. For lenders getting started, this can be the most economical way to get going.

Overall, expect to spend at least \$100,000 the first year if you plan on building a long-term program. If you want to hire a whole department, and take the risks inherent with that procedure, expect to spend in the neighborhood of \$400,000+. Outsourcing some or most of these functions can be a cost effective way to minimize your up-front costs until the department and volume grows to a level to support itself, while at the same time providing valuable training and OJT experience as you build your staffing and procedures.

A critical element of a successful department is proper training and availability of reference materials. Make sure that all levels of your staff have training in their area of responsibility in marketing and selling SBA loans, and running and overseeing the department and processes. Of critical importance is training for your loan department in SBA's current SOP's and eligibility requirements, and to have a copy of the SOP, all relevant federal regulations, and Standard Industrial Classification Code Manuals on hand.

Finally, and very important, make sure you have a marketing and sales plan, covering at a minimum the first 12 months. Your member business loan marketing plan should cover direct marketing opportunities, community relations, media relations, advertising, sales materials, website exposure, how to generate and track leads and prospects, incentive programs, sales aids, and training for all employees who have customer contact, with varying levels of training depending on the involvement of the employee in the sale process. You should develop a plan to develop leads and sales from multiple sources, including external calls, referrals from existing members, networking, community involvement, and from all line and operational personnel within your credit union.

Thank you for your time and attention. If you have questions on any of these items, please contact me at vern@jrbrunoassoc.com I am available for a free consultation to go over your specific needs. **NOW, GO OUT AND START MAKING SBA LOANS!!**

Chapter Five: Real World Recruiting and Staffing, by Tucker Herring

Tucker Herring, C.P.C., is one of the Nation's leading SBA recruiters. Tucker is a Senior Director and Manager of the SBA/Banking Division at The Liberty Group. He can be reached at tuckerh@thelibertygroup.com.

We all know that having the right person for the job is the key to success in any organization. Even more important in today's market is having the right people that work well together. A business development officer can originate \$40MM in loans in any given year, but if he/she is not working in unison with the loan underwriter, processor, and closer, you could end up with a problem that you never saw coming.

This section will cover two of the most important employees you will hire in building out a successful SBA Department: The Business Development Officer (BDO) and the Credit Officer.

Business Development Officer – Skill Set

- Credit Training and/or underwriting experience to include:
 - Working knowledge of SBA business size and eligibility requirements
 - Understanding of utilizing SOP 5010-C as a reference
 - Working knowledge of balance sheet, P&L and corporate/partnership tax return analysis
 - Understanding of SBA packaging and credit requirements
 - Understanding of personal and business cash flow analysis
 - Understanding of the SBA approval process
- Ability to prospect for new clients and referral sources
- Ability to develop and execute marketing plan
- Aptitude for building new relationships with new clients and referral sources
- Ability to present clearly to internal customers and borrowers regarding products and services that will enhance existing relationships
- Present to and consult with management on business trends

Business Development Officer – What to Look For

Departments are usually set up one of two ways, or a combination of both. Many departments require their BDO's to self source their own deals utilizing an existing, external referral network. Other departments require their BDO to work with the branch lending staff in support of their customers SBA needs. Many of the national banks with significant SBA teams employ BDO's that source their own deals and work with the branches.

If you intend to hire BDO's that will source all of their own deals, you'll be looking for someone very different than those that work within a branch network. Successful BDO's who self source are typically very independent and the successful ones are highly self motivated. They typically prefer to work on their own and require little management from their supervisors. These BDO's are deal hunters....they are driven by the hunt of the deal.

If you intend to hire BDO's that work within a branch network, an additional skill set is needed. Quite often, programs set up with branches employ BDO's who see the bank's commercial staff as their primary customer. They spend a great deal of time educating the branch staff on how to spot a SBA deal and which customers are eligible for a SBA loan. The best BDO's in a branch network would usually not do well in a role where they are required to self source their own deals. They usually prefer to educate and market their services rather than hunt deals starting from scratch.

Business Development Officer - Compensation Plan

There are hundreds of SBA departments across the country with many different types of compensation plans....this section will highlight *three of the most popular*.

Lenders who sell SBA guaranteed loans on the secondary market usually employ a commission plan where incentive is earned by a BDO on each deal he/she closes and is

dependent on the fee income earned by the bank/lender when the asset is sold. This type of plan usually includes a base salary from \$55K to \$90K (depending on market) and has a tiered commission plan, such as the following:

<u>Loan Volume</u>	<u>% of Fee Income paid to BDO</u>
\$0 to \$3MM	15%
\$3MM to \$6MM	20%
\$6MM to \$10MM	25%
\$10MM+	30%

Quite often, tier bonuses are included with this type of plan. A BDO will receive a bonus when his/her production reaches certain tiers, such as the following:

<u>Loan Volume</u>	<u>Tier Bonus</u>
\$6MM	\$5,000
\$12MM	\$10,000
\$18MM	\$20,000

Lenders who book assets and hold those assets in their portfolio typically pay the BDO *as a percentage of the total loan amount*, such as the following:

<u>Loan Volume</u>	<u>Basis Points Paid as Commission</u>
\$0 to \$3MM	40 bps
\$3MM to \$6MM	75 bps
\$6MM to \$10MM	100 bps
\$10MM+	150 bps

Credit Officer – Skill Set

- Customer focused individual with expert knowledge of credit products and processes including thorough knowledge of SOP 50 10 10 5(C)
- Strong organizational, analytical, communication and interpersonal skills.
- Proven leadership abilities.
- Extensive knowledge of credit policy, procedures and Bank regulations.
- Thorough understanding of commercial credit structures, loan documentation, and related legal issues.
- Knowledge of SBA operating procedures and eligibility guidelines.

Credit Officer – What to Look For

You should be looking for someone who spends most of their time managing the responsibilities of determining eligibility, analyzing financial statements and tax returns, assessing and mitigating risks, and structuring loan requests while adhering to internal loan policies and procedures, SOP 50 10 10 5(C), SBA Policy Notices, and Code of Federal Regulations. Quite frequently, the Credit Officer is responsible for continuing education such as attending NAGGL training seminars, classes and events.

The Credit Officer typically works with internal and external customers on a daily basis, including senior management, business development officers, commercial bankers, underwriters, servicing and liquidation personnel, and the SBA.

Credit Officer – Compensation Plan

Compensation package for credit officers vary as widely as those for BDO's. You can expect the base salary for an experienced SBA Credit Officer in a high cost area (New York, LA) to be in the \$80K to \$150K range. In most areas, the range is closer to \$50K to \$80K per annum. The largest differences in the packages usually lie in the incentive compensation section. Organizations with a more conservative approach will usually provide bonus potential in the 10% to 20% range. More aggressive lenders will provide bonus potential in the 35% to 50% range and more often than not will get the performance they are looking for.

Annual bonus should be measured on quantitative objectives set by executive management. Those specific objectives should be evaluated annually as the department grows and changes.

Chapter Six: Some Typical Credit Guidelines, by Tim Thomas

SBA sets forth its guidelines in SOP 5010-C. Lenders typically will have rules which are, to say the least, tighter. Here are some suggestions from some of the most successful SBAS shops with the lowest delinquency.

Keep in mind the SBA has special rules for Franchises, goodwill, citizenship and immigration status, equity injection, freedom from felony and other background issues, life insurance, and other standards that your credit officers and SBA BDOs are expected to know. These are beyond the scope of this paper, but NAGGL and your SBA consultants offer training on the subject and the "rules" are contained in the SOP 5010C. The guidelines below are more conservative, generally speaking, than the SBA allows and you will need to decide whether or not you want to push the envelope on such things as business acquisitions, unsecured credit and the like. It is, after all, your credit union that is keeping the unguaranteed part of the loan.

Recommendations For Borrowers Buying a Business:

- At least 12 mos. of operations as evidenced by a Federal Tax Return (minimum DSCR 1.20x)
- Historical operations are sufficient to service the proposed debt with standard add-backs only: Interest, depreciation, non-recurring rent, owner salary
- Repayment in the latest FY is not reliant on either a reduction in Cost of Goods Sold % versus historical operations or on tenant income
- Stable or positive trends in gross sales, net income and DSC
- Nominal working capital requirement

- Look at CONCENTRATION – do just one or two customers make up most of accounts receivable?
- In the event that the enterprise value of the business exceeds available real property collateral, seller financing for a portion of the enterprise value is often a good idea to fill the gap because you want your loan to be collateralized by real value. Many bigger lenders will insist that the entire loan be collateralized by lendable equity in the commercial real estate and borrower residences. No “blue sky.”
- Seller financing can only count as part of the borrowers’ 25% minimum equity injection only if certain “standby” requirements are met in the sellers’ note.

At the time of loan submission, the borrower must demonstrate the ability to obtain the required licenses, certifications, franchise approvals, etc. The SBA has a franchise information and approval data website, www.franchiseregistry.com.

How About 51% + Owner Occupied Commercial Real Estate?

- The owner’s co must have at least 12 mos. of operations as evidenced by a Federal Tax Return
- Repayment does not rely on projected income but real numbers
- Existing tenant lease is at least 12 mos. old with three or more years remaining on the original term.
- Stable or positive trends in gross sales, net income and DSC
- Existing tenant income does not represent more than 20% of the required DSCR.
- Projection dependent loans must demonstrate the ability for historical operations to service the proposed debt at a minimum DSCR of 1.0x.

What about Startups?

- Borrower has SUCCESSFUL experience that is RECENT and in the SAME INDUSTRY
- CRE secured no blue sky
- Strong balance sheet and earnings history – guarantors

What Business Types Seem to Carry the Least Risk?

- Commercial Mfg. of Retail Products
- Commercial Bakeries
- Beer, Wine & Liquor Stores
- Building Material and Garden Equipment and Supplies Dealers
- Health & Personal Care Stores
- Packaging & Crating/Shipping
- Veterinarian
- Legal
- CPA, Tax Preparation

- Employment Placement Agencies and Executive Search Services
- Physicians
- Child Day Care Services
- Car Wash / Car Wash Equipment Sales
- Elderly Community Care Facilities
- Motels with good STAR ratings and proven cash flow

What types do many seasoned SBA lenders avoid or reduce LTV/LTC?

- Mining (Caution)
- Construction (Avoid)
- Agricultural / Textile Mfg.(Caution)
- Semiconductor / Electronic Component Mfg. (Caution)
- Metal & Mineral Wholesale Merchants (Caution)
- s (Caution)
- Motor Vehicle Dealers (Avoid)
- Grocery / Specialty Food Store (Avoid)
- Fuel Dealers (Avoid)
- Mobile Home Dealers (Avoid)
- Gasoline Stations (Avoid)
- Finance (Avoid)
- Arts & Entertainment (Caution)

Recommendations on Motels and Limited Service Hotels:

- Flagged Only
- Max \$5MM
- 7A Eligible
- Lease or other financing for FFE
- 11 to 13 Cap Rate 65 LTV
- Strong balance Sheet – Principals
- Strong income history (turnarounds a problem)
- STAR Report
- Client Mix (Tourist, Business, Other)

Recommendations Freestanding Restaurants (If you Must do then at all)

- 5+ Year History, DOCUMENT THE CASHFLOWS
- Outstanding Sponsorship
- Strong Ratings – Reviews
- CRE Secured
- 7A Eligible, Max \$5MM
- Understand client Mix

- Need to know number of tables, turnover (breakfast, lunch, dinner)
- Food and Liquor and Catering % Revenue
- Month by Month P&LS 2007 + 2008 + 2009 YTD to measure seasonality
- Location Location Location

A Word about “All Available Collateral”

When you make a 7A loan on a business, *SBA requires, with some exceptions, that you take a lien on all available collateral. No More Mister Nice Guy.* To see if collateral is “available” or not, you use the liquidation value minus existing debt.

Maximum liquidation rates as a percentage of FMV for SBA loan collateral types:

Single Family Residential, owner occupied (1)	80%
Single Family Residential, rental (1)	75%
Commercial Real Estate, general purpose (2)	85%
Commercial Real Estate: retail, condo’s, mixed use and metal buildings.	70%
Commercial Real Estate, special purpose	60%
New Manufactured Equipment	80%
Manufacturing Equipment	60%
All Machinery and Equipment	30%
All Accounts Receivables and Inventory	0%
All Goodwill, Furniture, Fixtures, Leaseholds	0%

(1) Liquidation rate may be increased 5% provided that value is determined
By a current appraisal or online evaluation (FAST Web)

Chapter 7: SBA Sam’s Personal Business Development Plan

SBA Sam, the new head of your credit union’s SBA department, uses SBA lending not only to service existing members, and their families, but to reach out to the business community and bring in NEW members, who join to take advantage of the new program and set up share draft accounts to make payments. Here is Sam’s business plan for “outside” new business.

“I pull the listings, whether it’s an office condo on Loop net, a veterinary practice off CraigsList, a small office building for sale off CoStar, or a printing business and building for sale by a business broker. I check eligibility, run the numbers for the broker or Realtor® that way I deliver an item of value and that can be the starting place for a long term referral relationship. Plus, I HAVE A PLAN. And I Work my Plan.

- Month 1 target office condo listings under \$2MM on Loop net
- Month 2 target industrial condo manufacturing building listings under \$2MM Loop net
- Month 3 target day care centers for Sale Loop net

- Month 4 Business Brokers (Google)
- Month 5 Liquor Stores for sale Loop net, Google
- Month 6 Bakeries for Sale Google
- Month 7 Packaging Stores and Printers for Sale Google
- Month 8 Veterinary Practices for Sale Google
- Month 9 Medical Practices for Sale Google
- Month 10 Chiropractor Practices for Sale Google
- Month 11 Law Practices for Sale
- Month 12 Small Manufacturing Companies for sale with sales under \$50 MM (Google)
- Review each Quick Quote before it goes
- I Make 30+ calls a day
- I Do 5 price sheets a day
- I Follow up with intro call to business broker or commercial realtor (you need to write a phone pitch)
- I call all incoming leads, interview the borrower
- I gather operating company tax returns and financials
- I gather sponsor tax returns and financials
- I collect the processing deposit

In all, a simple and straightforward and inexpensive plan.

Chapter 8: Notes on the Secondary Market, by Tim Thomas

To recap the secondary marketing math we discussed in the Introduction:

Loan	\$300,000
Guaranteed Portion	\$225,000
Un-Guaranteed Portion	75,000

Sell the guarantee for: \$22,500

Let's look at the \$225,000 guaranteed part (Pretend it's interest only the first year)

Coupon 2.75 over Prime	6.000% = \$13,500 paid by the borrower
SBA Fee	0.675 = \$ 1,519 goes to Colson Services who master services for SBA
You Service for	1.000 = \$2,250

The investor, who buys the guaranteed part, gets the rest: $6\% - 0.675\% - 1\% = 4.325\%$.

So your revenue on the guarantee is \$22,500 premium, plus your servicing revenue of \$2,250, less whatever you are paying your outside SBA servicer.

On the UN guaranteed part, which sits in your portfolio, your revenue is $6\% \times \$75,000 = \$4,500$ per annum if it were interest only.

So you have \$75,000 invested, which counts as an MBL loan, but year 1 you got back \$29,250, which is a handsome 39% return. After that, you earn servicing + interest, or \$6,750 a year on \$75,000, or 9%.

Credit unions who originate SBA loans often do so through their own CUSO, because for a CUSO, there is no field of membership restriction.

Whether you originate yourself or through your CUSO, the happy day will come when you sell your first guarantee. It's as easy as a phone call. Just gave your GP (guarantee) number, the loan write-up, and a copy of the Note handy.

Once you receive your Guarantee, you can sell the 75% (today it's up to 90%, but that will change) guaranteed portion of the 7A loan on the secondary market. Several market makers, including of course IBI Credit Union Services, price these assets and buy them as principal. Some, like IBI, can also act as your "one stop" agent to get you several bids. Premiums on 7A loans currently average about 10%.

Whomever you work with, be sure they can advise you on how to maximize the price you get through structuring the loan, pricing it correctly, making sure the asset is eligible to be placed in a pool if possible, and packaging the guarantee for delivery to the secondary market.

You can also sell the 504 first lien, if it is structured right, to one of more than a dozen poolers in the United States. These loans sell at premiums up to 6%. Bank of America is one of the most active poolers and their rate sheet and contact information is attached.

Your consultant (JR Bruno, for example) or secondary marketing service (IBI, for example) can assist you in establishing a working relationship with a 504 pooler to deliver your loans at a handsome gain. The pooling program goes away, under current legislation, at the end of 2011.

But what if you want to sell the WHOLE loan? Or what if you want to just package and broker it because it is out of your field of membership, or over your lending limit, or out of state? Can you just package SBA loans for a fee? Can you get a piece of the premium?

Yes. You can sell the whole loan – it's basically brokering, however, because the buyer (the wholesaler) does the loan on their own paper, and the process follows their guidelines. But the GOOD news is that you take zero risk, you do not put the asset on your books, and you get paid a premium of up to 2% for doing a complete package. So anything your Department does not want, that is of good quality (see my section on Credit), can be sent to a wholesaler.

Two of the larger wholesalers are Midwest Business Capital, whose agent is Horizon West (www.horizon-west.com), and Zion's Bank (One South Main, Salt Lake 84133). Your

consultants can assist you in training to originate for these wholesalers. Horizon West does 7A and 504 and Zion's concentrates mainly on 504. It's a great source of fee revenue without portfolio or credit risk.

Chapter 9: The Budget

Let's bring it all together and present a budget for Year 1. We'll pretend the new Department has one BDO and one processor, and that it plans to buy guaranteed loans in addition to producing its own loans. This hastens the breakeven point and helps profitability. Our other assumptions are shown below.

Liquidations (Prepayment CPR)	8.00%
Loan Guarantee Pct	25.00%
Initial Yield on Purchases	4.250%
Initial Yield on 7A or 504 Production	6.000%
Cost of Funds Assumption	1.000%
Actual Cost of Funds 90 Day	0.600%
Servicing Spread 7A	1.000%
Servicing Spread 504	0.375%
Cost of Servicing as Pct of Spread	70.000%
Premium on Sale	9.000%
Packaging Per Application	2,250.000
Pull through	75.00%
Gross Packaging	2,500.000
Outside Processing all in per application	1,900.000
Base Sal A	4,500.000
Base Sal B	3,500.000
Benefits Payroll Taxes Etc	25.000%
Comm. as Pct of Margin on Sales (only after hurdle)\	25.000%
Average Loan	250.000
Comm. Credit on Purchases of GGLs % Volume	0.100%
Comm. Credit on Originations % Volume	1.000%

Typical SBA Department Budget Year 1 Showing Combined Origination and Loan Purchasing Activity						
By Tim Thomas 303-656-3232						
Month	Jan	Feb	Mar	April	May	June
Applications	0	0	1	1	1	3
Closings	0	0	1	1	1	2
SBA 7A Originations In Field of Membership or from CUSO	0.000	0.000	250.000	250.000	250.000	500.000
SBA-USDA Guarantees Purchased For Portfolio	2,000.000	2,000.000	2,000.000	2,000.000	2,000.000	2,000.000
SBA 504 First Lien Originations in Field of Membership or from CUSO	0.000	0.000	0.000	0.000	0.000	0.000
Total Production & Purchase	2,000.000	2,000.000	2,250.000	2,250.000	2,250.000	2,500.000
SBA 7A Guarantee Sales (Gain is 3 Mo delay FAS 166)	0.000	0.000	0.000	187.500	187.500	187.500
SBA 504 First Lien Sales	0.000	0.000	0.000	0.000	0.000	0.000
Portfolio BNR	0.000	2,000.000	1,986.667	2,236.756	2,047.588	2,048.849
Gain to Portfolio from Production	2,000.000	2,000.000	2,250.000	2,250.000	2,250.000	2,500.000
Sales	0.000	0.000	0.000	-187.500	-187.500	-187.500
Liquidations	0.000	-13.333	-13.244	-14.912	-13.651	-13.659
ENR	2,000.000	1,986.667	2,236.756	2,047.588	2,048.849	2,298.841
ANR	1,000.000	1,993.333	2,111.711	2,142.172	2,048.219	2,173.845
Interest Income	4.271	8.513	9.019	9.149	8.748	9.284
Cost of Funds	-0.833	-1.661	-1.760	-1.785	-1.707	-1.812
Net Interest Income	3.438	6.852	7.259	7.364	7.041	7.473
Loan Serviced for Others BNR	0.000	0.000	0.000	0.000	187.500	360.000
Loan Servicing Portfolio Liquidations	0.000	0.000	0.000	0.000	-15.000	-28.800
Loan Servicing Portfolio Gain from New Secondary Sales	0.000	0.000	0.000	187.500	187.500	187.500
Loan Servicing Ending Net Receivables	0.000	0.000	0.000	187.500	360.000	518.700
Loan Servicing Average Net Receivables	0.000	0.000	0.000	93.750	273.750	439.350
Servicing Income	0.000	0.000	0.000	0.073	0.214	0.343
Less: Outside Servicing Contracted Services	0.000	0.000	0.000	-0.037	-0.107	-0.172
Net Servicing Income	0.000	0.000	0.000	0.037	0.107	0.172
Gross Packaging Fees	0.000	0.000	3.333	3.333	3.333	6.667
Packaging and Underwriting Cost from Outside Vendors	0.000	0.000	-2.533	-2.533	-2.533	-5.067
Net Packaging Fees	0.000	0.000	0.800	0.800	0.800	1.600
	0.000	0.000	0.000	0.000	0.000	0.000
	0.000	0.000	0.000	0.000	0.000	0.000
Gain on Sale taking into consideration FASB 166	0.000	0.000	0.000	0.000	0.000	0.000
Total Revenues from All Sources	3.438	6.852	8.059	8.200	7.948	9.244
Fixed HR All In Incl Taxes and Benefits	10.000	10.000	10.000	10.000	10.000	10.000
Commissions (None due until Comm exceeds total HR)	0.000	0.000	0.000	0.000	0.000	0.000
BTE and Marketing	1.500	1.500	1.500	1.500	1.500	1.500
Office Overhead including Software and Contingency	1.500	1.500	1.500	1.500	1.500	1.500
Organizational and Legal and Audit	10.000	0.500	0.500	0.500	0.500	0.500
Total Expenses from All Sources	23.000	13.500	13.500	13.500	13.500	13.500
P/L	-19.563	-6.648	-5.441	-5.300	-5.552	-4.256
Cumulative P/L	-19.563	-26.210	-31.651	-36.951	-42.503	-46.759
Total Capitalization	46.759					

Month	July	Aug	SEP	Oct	Nov	Dec	2011	2012 Forecast
Applications	5	5	7	8	8	8	48	96
Closings	4	4	5	6	6	6	36	72
								0.000
SBA 7A Originations In Field of Members	500.000	500.000	750.000	750.000	750.000	750.000	5,250.000	9,000.000
SBA-USDA Guarantees Purchased For F	2,000.000	2,000.000	2,000.000	2,000.000	2,000.000	2,000.000	24,000.000	24,000.000
SBA 504 First Lien Originations in Field of	500.000	500.000	500.000	750.000	750.000	750.000	3,750.000	9,000.000
Total Production & Purchase	3,000.000	3,000.000	3,250.000	3,500.000	3,500.000	3,500.000	33,000.000	42,000.000
SBA 7A Guarantee Sales (Gain is 3 Mo c	375.000	375.000	375.000	562.500	562.500	562.500	3,375.000	6,750.000
SBA 504 First Lien Sales	0.000	0.000	0.000	500.000	500.000	500.000	1,500.000	6,000.000
Portfolio BNR	2,298.841	2,609.674	2,607.602	2,857.616	2,918.449	2,918.044	26,530.086	35,016.524
Gain to Portfolio from Production	3,000.000	3,000.000	3,250.000	3,500.000	3,500.000	3,500.000	33,000.000	42,000.000
Sales	-375.000	-375.000	-375.000	-562.500	-562.500	-562.500	-3,375.000	-6,750.000
Liquidations	-15.326	-17.398	-17.384	-19.051	-19.456	-19.454	-176.867	-233.443
ENR	2,609.674	2,607.602	2,857.616	2,918.449	2,918.044	2,918.046	29,448.133	35,016.557
ANR	2,454.258	2,608.638	2,732.609	2,888.033	2,918.246	2,918.045	27,989.110	35,016.540
Interest Income	10.482	11.141	11.671	12.334	12.463	12.462	119.537	149.550
Cost of Funds	-2.045	-2.174	-2.277	-2.407	-2.432	-2.432	-23.324	-29.180
Net Interest Income	8.437	8.967	9.393	9.928	10.031	10.031	96.213	120.369
Loan Serviced for Others BNR	518.700	852.204	1,159.028	1,441.305	2,388.501	3,259.921	10,167.159	39,119.051
Loan Servicing Portfolio Liquidations	-41.496	-68.176	-92.722	-115.304	-191.080	-260.794	-813.373	-3,129.524
Loan Servicing Portfolio Gain from New S	375.000	375.000	375.000	1,062.500	1,062.500	1,062.500	4,875.000	12,750.000
Loan Servicing Ending Net Receivables	852.204	1,159.028	1,441.305	2,388.501	3,259.921	4,061.627	14,228.786	48,739.527
Loan Servicing Average Net Receivables	685.452	1,005.616	1,300.167	1,914.903	2,824.211	3,660.774	12,197.973	43,929.289
Servicing Income	0.536	0.786	1.016	1.496	2.206	2.860	9.530	34.320
Less: Outside Servicing Contracted Serv	-0.268	-0.393	-0.508	-0.748	-1.103	-1.430	-4.765	-17.160
Net Servicing Income	0.268	0.393	0.508	0.748	1.103	1.430	4.765	17.160
Gross Packaging Fees	13.333	13.333	16.667	20.000	20.000	20.000	120.000	240.000
Packaging and Underwriting Cost from C	-10.133	-10.133	-12.667	-15.200	-15.200	-15.200	-91.200	-182.400
Net Packaging Fees	3.200	3.200	4.000	4.800	4.800	4.800	28.800	57.600
	0	0.000	0.000	0.000	0.000	0.000	0.000	0.000
	0	0.000	0.000	0.000	0.000	0.000	0.000	0.000
Gain on Sale taking into consideration FA	16.875	16.875	16.875	33.750	33.750	33.750	151.875	405.000
Total Revenues from All Sources	28.779	29.436	30.776	49.226	49.685	50.011	281.652	600.129
Fixed HR All In Incl Taxes and Benefits	10.000	10.000	10.000	10.000	10.000	10.000	120.000	120.000
Commissions (None due until Comm exc	2.000	2.000	4.500	7.000	7.000	7.000	29.500	84.000
BTE and Marketing	1.500	1.500	1.500	1.500	1.500	1.500	18.000	18.000
Office Overhead including Software and	1.500	1.500	1.500	1.500	1.500	1.500	18.000	18.000
Organizational and Legal and Audit	0.500	0.500	0.500	0.500	0.500	0.500	15.500	6.000
Total Expenses from All Sources	15.500	15.500	18.000	20.500	20.500	20.500	201.000	246.000
	0							
P/L	13.279	13.935	12.776	28.726	29.185	29.511	80.652	354.129
Cumulative P/L	-33.480	-19.545	-6.769	21.957	51.142	80.652		434.782
Total Capitalization								

First year out, our Department takes 48 applications and generates 36 loans. We also buy \$24MM to build the “zero principal risk” guaranteed loan portfolio. After all, guarantees remain salable in the very active secondary market – they can’t be pledged, but they can be sold quickly. So the Department brings in over \$96,000 in Net Interest Income, \$4,765 in Servicing income, \$33,750 in Gain on Sale, and \$28,800 in loan packaging fees for \$281,652 in revenue. Expenses including startup are \$201,000 so our year 1 profit is \$80,652.

Second year out, we do 72 loans after processing 96 applications (we do not count those loans for which we do not issue application, the early rejects). Revenues including Gain on Sale are \$600,123. Overhead is \$246,000, for a net profit contribution of \$246,000.

Of course, we can change different variables in the spreadsheet to see what happens.

SBA loans are exempt from MBL loan to value restrictions and can give you a valuable new addition to your product line. The MBL rule generally governs commercial lending by federally insured credit unions and sets out several restrictions and limitations, including collateral and equity requirements. 12 C.F.R. Part 723. The rule applies to all federal credit unions and to federally insured, state chartered credit unions except for those in states that have adopted a comparable rule approved by the NCUA Board. 12 C.F.R. §§741.203(a), 723.20.

Although the rule establishes limits governing loan to value ratios, it provides an exception to those requirements for loans made pursuant to an SBA loan program:

The collateral and security requirements of §723.3 and §723.7 do not apply to member business loans made as part of a Small Business Administration guaranteed loan program.

But the bottom line is this: a well run and disciplined SBA department, supplemented with purchased guarantees to add to the portfolio, is a strategy worth considering and there are Industry experts at the ready to provide the advice and guidance you need to create your new Department.

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