

The Recovery Act and the Small Business Administration:

Changes in Regulations to Help Small Businesses

⚙ Background

In the past ten years, small businesses have accounted for approximately 70% of the job growth in the United States. While many of these small businesses require loans to grow, access to capital has become increasingly difficult to obtain in recent months. In order to stabilize and enable small businesses to continue to thrive, the American Recovery and Reinvestment Act (the "Recovery Act") has granted the Small Business Administration (the "SBA") hundreds of millions in additional funds and has developed programs, opportunities, and tax incentives to free up the credit market for small businesses and provide temporary financial relief. The following information highlights where much of this money will be distributed and how it can help small businesses.

⚙ Changes to 7(a) Loans

Under the 7(a) loan program, the SBA guarantees a portion of loans issued by private lenders in situations where the small business might not otherwise qualify for a loan. The two significant changes to the 7(a) loans are an increase in the amount the SBA will guarantee in a loan, and a temporary elimination of guaranty fees.

Prior to the implementation of the Recovery Act, the SBA guaranteed between 75% and 85% of private loans. Under the new guidelines, the SBA may guarantee a loan for up to 90%. The 7(a) loan program may be used for loans up to \$2,000,000.

Under the traditional 7(a) loan program, the SBA charged a fee of up to 3.75% of the loan. These fees increased the cost of borrowing for small businesses and made it more difficult

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for borrowers to access the credit they needed to expand or make new investments. To reduce the cost of obtaining loans, the SBA is temporarily eliminating these up-front fees. This temporary elimination of fees is expected to last at least through the end of 2009.

In connection with the SBA's changes to the 7(a) loan program, the Treasury Department is purchasing securities backed by guaranteed portions of 7(a) loans and will continue to do so through December 31, 2009. This will both directly encourage banks to lend to companies applying for SBA backing, and will also help free up the secondary market for these types of loans. Therefore, any entity that has not applied for a 7(a) loan in the past is strongly encouraged to do so, since the environment for such loans is unusually favorable right now.

Eligibility Requirements for a 7(a) Loan

Approval for a 7(a) loan is determined by the lending institution to which the borrower applies. However, the SBA does have several general eligibility requirements to obtain a 7(a) loan. Specifically, the business must meet SBA size standards, be for profit, may not already have the internal resources to provide the financing, and must be able to demonstrate repayment.

To be considered a small business under the SBA guidelines, the following apply:

- The business must be independently owned and operated and cannot be dominant in its field
- Wholesale suppliers may not have more than 100 employees
- Retail or service companies may not have more than \$21 million in annual revenue
- Manufacturers may not have not more than 500 employees
- Construction companies may not have average annual sales greater than \$17.5 million

In addition to the original requirements for qualification under a 7(a) loan, the Recovery Act requires that the borrower file a report that it will only hire U.S. citizens and those otherwise authorized to legally work in the United States. Any business with a history of knowingly hiring unauthorized aliens will be barred from participating in the 7(a) program.

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Obtaining an SBA Loan Guarantee

To obtain 7(a) loans, borrowers apply directly with private lending institutions. The SBA works with thousands of small and large lenders nationwide. Those who qualify for such SBA-backed loans are usually companies with a strong business idea, management ability, and sound financial projects, but may have a shortfall in collateral to secure a loan or equity to put into the business. In addition, SBA-backed loans are three to five times more likely to be made to minority and women owned businesses than conventional small business loans.

Anyone who is interested in obtaining such loans should speak to lenders who have been approved to participate in SBA lending programs. SBA District Offices provide a list of approved participants in a borrower's area. A list of SBA District Offices can be found at the following website:

<http://www.sba.gov/localresources/index.html>

As an SBA-backed loan is made through a lending institution, each institution has its own set of application requirements. Lending institutions commonly require the following as part of their application process:

- purpose of the loan
- history of the business
- financial statements for up to three years
- schedule of term debts
- lease details
- amount of investment in the business by the owner
- projections of income
- expenses and cash flow
- signed personal financial statements
- personal resumes

Business Stabilization Program

In addition to the changes to the 7(a) loans, the SBA has allocated a \$255 million emergency loan program called the Business Stabilization Program ("BSP") loan. It will offer loans of up to \$35,000 that are essentially interest-free. These loans will only be available to companies

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that already have bank-issued business loans, and such loans need not have been made through the 7(a) loan program.

Funds from a BSP loan are used to pay off up to six months worth of payments on existing loans. Loans under the BSP carry no interest, have no fees, and may accept secondary liens as collateral. These loans must be repaid within five years. Effectively, they allow a company to free up cash in a currently tight business and credit market.

To qualify for these loans, a borrower should contact the entity through which they currently have their loan. The SBA guarantees the loan on behalf of the small business, and switching to another lending institution is not required. These loans terminate the sooner of an exhaustion of the funds allocated to the program or September 30, 2010.

Tax Incentives

In addition to the programs listed above, the Recovery Act has also included several tax incentives for small businesses. Several of these incentives are listed below, but you should speak with your tax advisor for a more detailed explanation:

Five Year Carryback Provision: Under the Recovery Act, small businesses will be allowed to carry back their 2008 net operating losses for up to five years, resulting in a rebate on past taxes.

Capital Gains Reduction for Small Business Investors: Investors who acquire stock in qualified small businesses and who hold their stock for at least five years will be able to exclude 75% of their capital gains from such investments.

Accelerated Equipment Write-Off: Small businesses will be able to immediately write off up to \$250,000 worth of qualified equipment purchased in 2009.

More Information

Carr & Ferrell has additional information on government funding and other alternative funding sources, and continually updates its materials on these opportunities. If we can be of assistance in any of your funding or other corporate needs, please contact Barry Carr, Jill Fishbein or Robert Keller of Carr & Ferrell's Corporate Group at 650-812-3400.