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Aggressive Lenders Redrawing SBA Turf

SPECIAL REPORT: Overall volume off but targeted programs clicking
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Hawthorne businessman Robert Ivanov was looking for a quick way to get start-up cash for his fledgling children's uniform company. After scouring local banks, he turned to a source he had not anticipated: the Small Business Administration.

In four days, he had the \$15,000 he needed.

Meanwhile, in the San Fernando Valley, the owners of a family Italian restaurant received notice of a huge rent increase and decided to buy their own building in Valley Glen. The Monteleone family was steered towards an SBA program geared to make real estate loans.

Four months later, they had the \$950,000 they needed.

Welcome to the new world of SBA lending. Once the province of small businesses that typically got quarter-million-dollar loans to purchase equipment, it has been transformed in recent years by new regulations and lenders that have come into the market offering both smaller and larger loans to businesses for a wider variety of uses.

"It's become a much more aggressive, much more competitive business," said Roberto Barragan, president of the Valley Economic Development Center, which packages SBA loans for business clients.

Some of the changes have been driven by market forces, especially the proliferation of community banks that have turned to the SBA as a profitable niche to get off the ground. Other changes have come from the SBA itself as it has sought to diversify its loans and make it easier for lenders to participate.

The changes have not come without controversy, though, especially to the SBA's flagship 7(a) guaranteed loan program, which until recently had handled the lion's share of loans to small businesses.

Two years ago, Congress and the Bush administration restructured the program to make it self-sufficient so that it wouldn't continue running out of government funds. Fees were raised as up to 50

percent, to as much as 3.75 percent of the loan value. This discouraged many businesses from applying.

However, the SBA is no longer the staid monopoly of regional banks that made the majority of SBA loans a couple of decades ago – banks that were swallowed up in the wave of mergers and consolidations that swept through the industry in the 1990s.

Today, smaller ethnic and community banks have emerged to fill in the void, especially those catering to small and mid-sized businesses. More than half-a-dozen have formed in the last couple years, including California Business Bank, 1st Century Bank and Promerica Bank.

The end result: heightened competition and greater access than ever by businesses to the totality of SBA loan offerings.

“The idea of more choices and more products for both businesses and lenders is the key to what has happened here,” said Alberto Alvarado, director of the SBA’s Los Angeles District, the largest in the country as measured by dollar volume of loans.

Heightened competition

Most of these new banks immediately offered SBA loan products, in part because the government guarantees on SBA loans allow them to be easily sold on the secondary market to generate working capital for banks. On the traditional 7(a) loan, the federal government guarantees that 75 percent of the loan will be paid if the borrower defaults; other SBA loan products have 50 percent loan guarantees.

Indeed, competition is so keen among banks to offer SBA loans that officers with experience in the often-arcane world of SBA lending regulations are hard to come by. When a new bank opens, it often poaches SBA loan officers from other banks, whose SBA lending operations are then disrupted, sometimes for months.

That’s one factor behind some of the precipitous SBA loan drops at some financial institutions, according to the Valley Economic Development Center’s Barragan. Nonetheless, new players have continued to enter the lucrative market.

“We think it’s a good part of the lending business to be in,” said Robert Franko, chief executive officer of Beach Business Bank, which not only started offering SBA loans upon opening last year but immediately sought and received “preferred lender status” with the SBA. This is a program begun several years ago to speed up loan processing. Preferred lenders can send their loans directly to the SBA’s main state processing center in Sacramento, saving days or even weeks.

Also, because SBA loans are meant to serve businesses that otherwise wouldn't meet bank lending criteria, it's a way to establish relationships with businesses that will likely turn to the same bank for future loan products and services. That's what drew lending giant Washington Mutual to SBA lending.

"We've been trying to go after more business customers, because business loans are foundational. Once you make a loan to a business, you can develop relationships with the owners, the employees and even the customers of that business," said Gene Perez, small business relationship manager and vice president with Washington Mutual.

The Seattle-based lender didn't go after the traditional 7(a) loans, but instead chose the SBA Express Loan program. The SBA has pushed this program in recent years as an alternative to 7(a) loans; it allows banks greater latitude to make smaller loans, but only provides a 50 percent loan guarantee. It also involves less paperwork, as the name implies.

"We use this Express Loan program as a counter-offer product for our business loans," Perez said. If a borrower doesn't meet the standard for a conventional loan, especially the requirement to have been running the business for at least two years, Perez said the bank comes back with a counteroffer for an SBA Express Loan.

Other banks that had primarily focused on the 7(a) program, such as Banco Popular North America, have found they could make more small loans through the Express program.

"We didn't want to do \$50,000 loans under the SBA 7(a) program; it was just too much paperwork," said Gloria Miller, western region sales manager for Banco Popular. "By streamlining the process, the Express Loan program makes it less costly for lenders, which is especially important on smaller loans."

That's precisely what the SBA intended. "We're on a trajectory to empower lenders so that they would be more willing to make these loans," said SBA District Director Alvarado.

The program has proven so attractive for lenders that it has even drawn institutions like credit card issuer Capital One Bank, which conducts virtually all of its SBA Express Loan business online.

For the Express Loan borrower, there are not as many hoops and the fees are lower than for the 7(a) program. That suited children's uniform business owner Ivanov. Earlier this year, his company, Kids Unlimited, was gearing up for its busy summer season and an expected flurry of orders.

"We needed the ability to order more merchandise but didn't have the funds to do so," Ivanov said. "We took the fastest loan we could get, which turned out to be the SBA Express Loan. In four days, we had our \$15,000 and were able to buy the merchandise."

In other instances, the Express Loan program allows the business borrowers to obtain a larger loan than they might through conventional loans. That is because it is based upon credit worthiness, as opposed to the ability to put up assets as collateral.

“If through our standard loan screening process we find you qualify for a loan of \$40,000, we might be able to get you \$50,000 or \$60,000 through the SBA Express Loan program. And we can do this in a matter of hours in many cases,” said David Bartram, president of U.S. Bancorp’s SBA lending division and chairman of the board of the National Association of Government Guaranteed Lenders.

Real Estate Loans

Equally dramatic changes have taken place at the other end of the spectrum for larger loans. The SBA long had the 504 loan program for real estate loans and major equipment purchases; often community development corporations packaged the loans as part of economic development deals. But traditional banks preferred the 7(a) loan program because of its higher federal loan guarantee of 75 percent as opposed to the 50 percent for the 504 program.

But with the 7(a) program constantly running out of money, Congress and the SBA overhauled it in 2005, raising the fees. As a result, many borrowers shied away from the program; 2006 loan figures from some of the county’s participating SBA lenders seem to bear this out. Many traditional SBA lenders experienced sharp drops in both the number and dollar volume of SBA loans over the past year.

Indeed, the rise in 7(a) fees has been so great that some banks, such as Koreatown-based Center Bank, saw their SBA lending fall by more than 50 percent for the federal fiscal year ending Sept. 30. This is one reason why there’s a movement afoot to restore the federal subsidies for the 7(a) loan program and lower the fees.

Instead, the SBA began encouraging businesses seeking to buy property and/or buildings to use the 504 loan program, emphasizing its lower fees.

The SBA also liberalized rules for participating community development corporations. Until recently, these non-profit economic development organizations could only package and contribute to 504 loans that were within their service area; now, community development corporations can make loans anywhere in their home state.

That’s just what San Diego-based CDC Small Business Finance Corp. has done. Two years ago, this lending arm of a community development organization opened an office in Pasadena; it’s now the sixth largest underwriter of SBA loans in the Los Angeles region.

“We’ve migrated as a company to focus primarily as a 504 entity,” said Mike Owen, executive vice president with CDC Small Business Finance who oversees the L.A. area.

The timing for this change couldn't have been better, especially in Southern California. As real estate values have skyrocketed here since 2000, fewer businesses can now buy their own buildings for less than \$2 million, which is the current loan cap under the 7(a) program.

But even for those business owners who do fall under that \$2 million cap, the 504 program's lower fees are a big draw. "We were also going for a 504 loan, since the interest rates and fees are lower than the 7(a) program," said Barone's Famous Italian Restaurant co-owner Monteleone.

While the SBA proudly touts these two programs, critics say the agency can do much more to help small businesses, especially in minority communities. The SBA does have a program called Community Express aimed primarily at minority and women-owned businesses, but only in the last couple years have banks started picking up this product, most notably Oakland-based Innovative Bank.

"We've not had good leadership at the SBA in terms of providing a small measure of support to small and medium-sized businesses, especially those in minority communities," said Jorge Corralejo, head of the Latin Business Association's government relations committee and owner of Macondo Leasing Inc., an L.A.-based equipment leasing and finance company.

The SBA's Alvarado readily admits that there are communities the agency can serve better, something it is trying to do. He said the agency has stepped up its outreach to minority businesses, and not just for the guaranteed loan programs. The agency frequently holds forums in minority communities, introducing them to SBA loan products, explaining how to bid on federal government contracts and advice on how to prepare sound business plans.

"The biggest challenge we have, despite how many new banks come in, is making sure that we reach certain pockets of the market that have been neglected," he said.