USDA and SBA: The Pros and Cons

Which one will help you grow your business?

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Two government-guaranteed loan programs, the **USDA** and **SBA** programs, are designed to help companies grow, including franchisee-owned businesses. In this white paper, we highlight the strengths of USDA loans and SBA loans when franchisees are either leasing retail space or purchasing real estate.

The graph below highlights the key differences between the 2 programs. Michael Oppel with Stone Bank explains the advantages of the USDA program, while Tricia Hoffman with Gulf Coast Small Business Lending describes the advantages of SBA loans. Both industry professionals have immense experience working with their respective loan programs over many years, helping numerous business owners and franchisees to secure funding needed to launch their new business or grow their existing business. Contact information for Tricia Hoffman, Michael Oppel and Paul Bosley's is listed in their respective bios on page 7. Please feel free to contact us with questions or comments you may have at your earliest convenience.

KEY DIFFERENCES between the SBA 7(a), 504 and the USDA programs.

	SBA 7(a)	SBA 504	USDA
Loan $ Amount - Upper Limit	$5,000,000	$10,000,000	$25,000,000
Loan $ Amount - Total $ Cap	$5,000,000	$10,000,000	No $ Cap
Minimum Equity Injection - Existing Company	10%	Varies by Lender	10%
Minimum Equity Injection - Startup	Varies by Lender	Varies by Lender	25%
Closing Costs - Estimate	5%	3%	4%
Repayment Term	up 25 years	10 - 25 years	up 30 years
Interest Only Period	Construction	Construction	Construction + Stabilization
Interest Rate Adjustment	Quarterly	CDC: Fixed; 1st MTG: Varies	Fixed or Adjusting
Interest Rate - Base Rate	Prime Rate	Prime Rate	Prime & CMT
Risk Premium Rate	Varies by Lender	Varies by Lender	Varies by Lender
Collateral Requirement	Real Estate; Equipment	Varies by Lender & Project	Real Estate
Personal Guarantee for Owners	Yes - 20% Ownership	Yes - 20% Ownership	Yes - 20% Ownership
Environmental Study Required?	Phase I	Phase I	Phase I & Others
Feasibility Study Required?	No	For Real Estate Only	Startup/Expansion
Use of Funds	All Uses	Real Estate & Equipment Only	All Uses
Geographic Limitations	No	No	Yes

Key Advantages of USDA Loans with Michael Oppel of Stone Bank

Upper Loan Limits

"$5 million is not what it used to be, especially the way inflation has been lately. The cost and size of projects have ballooned," says Oppel, in regards to getting the right amount of capital for franchisees to grow their businesses. "The USDA allows for $25 million loan maximum, per project. That's larger than what other government loan programs can offer. Franchisees need that efficiency to be more successful."

This is a key advantage to USDA loans because the SBA 504 loans cap at $10M and the SBA 7(a) loan program caps at $5M.

No Aggregate Loan Cap

"Let's say someone had a $5 million SBA loan, and they wanted to do something else," Oppel says. "They could not use the SBA going forward because they've reached the SBA loan limit. Once they've done that, they are no longer eligible for more." With the USDA program, he says, borrowers can access that program again and again.

"There are people out there with hundreds of millions of dollars in USDA loans," Oppel reports. He says he has one convenience store customer who has accessed $3

Key Advantages of SBA Loans with Tricia Hoffman of Gulf Coast Small Business Lending

Smaller Loan $ Amounts

Hoffman's bank is actively offering franchise lending nationwide across various industry segments, and she says the SBA 7(a) can fund any almost any size project for these businesses. "The SBA 7(a) loan can be relatively small; however, most banks prefer a minimum $300,000 loan size and can be as large as $5 million. Another consideration is that we look at these deals and they are often 'leasehold loans' which don't have much, if any, tangible collateral. Fortunately, the SBA loan program does not set minimum collateral requirements as long as we are making a 'prudent lending decision' so, in many cases, this lack of collateral isn't an obstacle to securing SBA financing. Each situation is unique and that's why we assess and structure a loan to best fit each borrower's needs."

USDA loans are typically real estate loans with improvements, so these loans are rarely less than $1M.

Loans NOT involving the Purchase of Real Estate

Hoffman says the SBA is beneficial for modest loan amounts because it doesn't always require real estate as collateral, which is perfect for franchises that are leasing their space. "The loan is based on cash flow, and there isn't a set, minimum collateral requirement," she said.

million or $4 million per store. "And they will come to us for more. They understand the program and integrate it into their growth plan.

This is another key advantage to a USDA loan because once a client has financed the maximum amount allowed by the SBA 504 or SBA 7(a) program, they are only allowed to finance the $ amount they have reduced their loan balance by making payments. For example, if someone closes a $5M SBA 7(a) loan and pays down the balance to $4M, they are eligible to apply for a $1M SBA loan.

Repayment Term

As long as the majority of the loan is real estate based, Oppel says a franchise operator will be able to have a repayment term of 30 years. "USDA loans have to be fully secured," he reports. "If you have a $1 million piece of property, we can lend you $800,000 on it. A lot of borrowers are getting creative and using local and state grants, subordinated or mezzanine debt to make their projects work. Creativity is at an all-time high right now."

SBA loans involving real estate offer a 25-year repayment term which is 5 years less offered by USDA loans. SBA loans are not restricted to real estate loans so SBA loans for home-based businesses or businesses leasing retail space have 10-year repayment terms.

USDA loans must be fully collateralized with real estate and improvements so loans that do not involve the purchase of real estate are ineligible.

Environmental & Feasibility Studies

"It is really project specific as to when we must require environmental and feasibility studies," Hoffman says. "Typically, when real estate is involved, these are a required part of the due diligence. But, per SBA guidelines, the environmental report requirement is based on the type of property, industry, and proposed use of the property. Basically, it varies by project, bank credit policy and SBA program." The requirement for a feasibility study varies by project and loan amount. Hoffman recommends speaking with an experienced SBA lender early on in the process to better understand the requirements for each specific, unique situation.

USDA loans always require feasibility and environmental studies that cost $25K - $30K. These studies must be completed before submitting the loan request to the USDA district or national office.

Geographic Limitations

"Gulf Coast Small Business Lending is a direct, nationwide, SBA Preferred Lender," reports Hoffman. "Some lenders have geographic limitations or industry concentrations, but most of the larger lenders in the franchise space don't. For instance, we lend in all 50 states, Puerto Rico and the Virgin Islands—

Interest Rate

Oppel reports the USDA interest rate is usually a little lower than the SBA's. "We are still at an index, prime or treasury, plus some variable," he says. "The going rate is usually 175 basis points and 2.5 over prime. The ability for the USDA to use a treasury rate is good right now. They move differently than prime does. We can adjust the treasury rate every year, and about 40% of my borrowers choose to do that."

SBA loans are all based upon the prime lending rate which varies based upon rates set by the Fed Board of Governors at their periodic meetings. The risk premium assigned to any given SBA lender will vary and is capped at 2.75% which is a fixed rate.

Interest-Only Period

Having an interest-only period, where the borrower pays only the interest on the loan, is "more prevalent for a start-up or new construction," Oppel says. "The USDA likes to see interest-only payments during construction. It is a little more forgiving than SBA. If it takes you 12 months to construct, it may take three, six, or 12 months after that to stabilize the business where interest only comes into play, too." He adds that these payments have to be supported by the franchisee's feasibility studies.

SBA loan payments typically begin 1 month after the loan closes. Borrowers can especially to franchises."

USDA loans are designed to encourage lending to rural areas. The property being financed must be in an approved USDA area. Click on the link **"https://eligibility.sc.egov.usda.gov/"** to enter your property address in the USDA map to see if your location is eligible.

Two-Step Approval Process

Hoffman's Gulf Coast Small Business Lending approaches franchise finance with a 2-step process. First, the bank prequalifies the franchisee for SBA eligibility, sometimes even before the franchisee signs their franchise agreement. "So, when the franchisee comes to us and says they are moving ahead with the franchise, they know they've been preapproved," she says. "We then are able to deliver a full commitment letter much more quickly."

She adds that her team uses a "high-side budget for what the franchisee needs. So, when we pre-approve them, we do it on that budget. If they come in over that, we'll figure it out with them." Their process, she says, helps franchisors, too, because they know they have a candidate that will be funded once they sign the franchise agreement.

All USDA loans must be approved by the USDA lender and then also approved by the USDA district or national office, so all USDA loans require a 2-step underwriting and approval process.

request interest only payments for the first 3 -6 months which can be approved at the discretion of the lender.

Oppel's key tip for franchisees wanting to access USDA funding:

"Be sure to tell your story when you present your business to the USDA: How will you impact your local community through jobs or the economy when you launch your franchise location? As a lender, that's the story I help curate for the borrower—the USDA wants to see how your business will benefit rural America."

Closing Costs

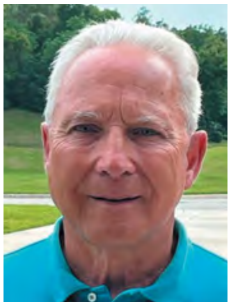
On a prorated share, closing costs are included in the loan itself, Hoffman says. And, for the SBA's fiscal year 2024, ending September 30, Hoffman says the SBA is not charging guarantee fees this year for loans under $1 million. For loans over that amount, they've also been reduced. "Those fees can be steep sometimes," she says, "so that's big savings." The fee is paid at closing, directly to the federal government.

All USDA loans have USDA fees associated with the loan that are included in the closing cost regardless of the loan $ amount.

Hoffman's final word on SBA-guaranteed financing

"It's worth noting that the SBA 7(a) program provides longer-term financing; we can go up to 10 years for leasehold and up to 25 years for real estate," she says. "And it is fully amortizing, with no balloons, resets, or maturities, which is truly a benefit to the borrower. And, the fact that we can budget in their interim interest, and the fact that the first payment is not due until 30 days after opening are all benefits you cannot get with a conventional loan. These benefits coupled with lower down payments and reduced collateral requirements make SBA 7(a) an ideal option for many franchisees."

About the Author



Paul Bosley, the founder of Business Finance Depot, is known for his expertise in financing franchises and RV parks and campgrounds. He has partnered with several national brands to assist new franchisees acquire the capital needed to launch their new businesses and to expand their current business. Paul is a regular speaker and writer for many industry conferences and online magazines. Paul serves as the finance instructor for the Outdoor Hospitality Industry's (OHI) National School & Perspective Owners Workshop. Paul has been a volunteer counselor for SCORE, a division of the SBA, for over a decade where he learned the value of SBA loans for funding new and existing businesses.

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Thank you to our contributors

Tricia Hoffman, Senior Vice President-Business Development Officer, Gulf Coast Small Business Lending, has been actively involved in SBA lending for over 25 years, serving as both a Business Development Officer and Portfolio Manager during her career. Tricia graduated with a degree in Economics and Accounting from the University of Tampa. After graduation, Tricia worked in banking as a commercial real estate loan officer, special assets manager, and private banker in the Tampa Bay area. In 1998 she joined with national SBA lender and began working with small business clients throughout the U.S. Since 1998 Tricia has provided financing for hundreds of borrowers across many industries.

Products and services offered by Gulf Coast Small Business Lending, a division of Gulf Coast Bank & Trust Co. Nothing herein shall be construed as a commitment to lend. All loans are subject to credit and collateral approval. Additional terms, restrictions and limitations may apply. Loans are only available to U.S. citizens and residents. Member FDIC - Equal Housing Lender.

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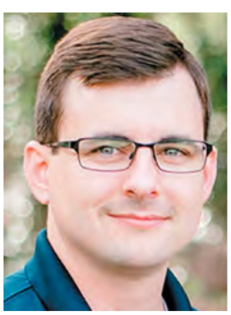

Michael Oppel Vice President of Government Guaranteed Lending, Stone Bank, has nearly 15 years of experience in loan origination, portfolio management, underwriting, and servicing USDA Business and Industry guaranteed loans. His expertise includes executive-level banking experience and a deep understanding of government-guaranteed loan programs, particularly in Rural Development. Michael is dedicated to serving rural communities and plays a vital role in assisting clients to access capital for expanding their businesses.

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Stone Bank is an Equal Housing Lender and Member FDIC. All loans are subject to credit approval and other bank and government loan program requirements. Other restrictions may apply. Please call (833) 253-2265 for details.

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Business Finance Depot (BFD) specializes in providing financing for new and existing franchisees, helping them to acquire the capital they need to launch or grow their business. They are experts in packaging SBA-guaranteed loans with their network of active lenders, and helping franchisees get that financing quickly so they can open their stores faster. Above all, BFD's attention to customer service which helps reduce the stress associated with applying for business financing.

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