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Creative Use of SBA Loans

By Dennis Monroe

Over the last three years, restaurant businesses have been privy to numerous loan programs and government benefits, several administered in conjunction with the Small Business Administration (SBA). The importance of the SBA as a central part of financing the restaurant community has never been more relevant. In 2021, SBA loans totaled $36.5 billion, up significantly from $22.5 billion in 2020. Most of the SBA loans are made under the 7(a) program, but there are many other interesting options.

For some additional insights into the SBA loan process, I spoke with John Kimball, senior vice president and head of the SBA lending group at Alerus Financial in Minneapolis. Kimball focuses on all aspects of small-business lending, including the restaurant space. As Kimball observed, the economic headwinds and general financing issues have allowed the SBA to provide key lending programs which have greatly benefited the restaurant industry.

The breadth of SBA financing for restaurants surprised me. SBA loans have been used to finance improvements, such as outdoor patio upgrades, dining-room remodels, point-of-sale equipment, as well as other kinds of in-store improvements. Traditionally, these types of uses required cash or equipment leasing, but SBA loans now are able to be used for the restaurant remodel made necessary by the pandemic.

Kimball made it clear the SBA is not a collateral lender, but rather a cash-flow lender, with outside support from personal guarantees. This cash-flow approach recognizes seasonality and is flexible with all types of amortizations. SBA loans can be combined with conventional bank lines of credit. Additionally, SBA loans can provide draws of up to 18 months on the original loan amount, then provide for an amortizing term loan. This is a way to facilitate new restaurant development and provide the necessary flexibility to grow a concept.

Normally the typical restaurant loan would be a five year amortization (if you can get a conventional loan), but the SBA allows for up to a 10-year amortization. The right lender group, Kimball pointed out, is going to look at blending the SBA product with conventional lending. This may entail a first lien for the conventional loan and an SBA product for financing new equipment and new assets.

Another unique option is the use of SBA financing for management buyouts or acquisitions. The seller can be involved with a seller note. There are issues of subordination, but if the seller carries a note back on the transaction, that seller note can count toward the down payment, allowing up to a $10 million loan from the SBA.

A key requirement is the SBA requires a valuation from an independent expert. The business value has to cover the SBA loan. If you have a seller note, all you have to cover with valuation is the SBA loan. Also, when it comes to the issues of EBITDA and proformas, the lender is normally working with historical numbers. While this can be challenging, there is flexibility, such as a weighted average approach to EBITDA which can help to normalize EBITDA for underwriting purposes.

A couple of other points: The SBA has low document loans which have quick SBA approval for loans under $500,000, so this can benefit early startup concepts. It should also be noted in loans up to $1 million, SBA fees are normally waived.

The bottom line is SBA lending, particularly for under $10 million, can be a viable option. At a time when working together isn't always the norm, it's reassuring to see SBA loans and conventional loans pairing together to present a world of options. The key is to find a bank and lender that has that kind of creativity.

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