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A Comparative Analysis of the SBA and USDA Small Business Loan Guarantee Programs

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ABSTRACT

The last few years have been good to hotel investors in terms of the financing climate. The sources and amount of capital available for lending on hotel projects has increased. Franchiser conduit programs, insurance companies, local banks, nonbank lenders, seller financing, and venture capital have all been on the upswing. However, the small-hotel owner has always been perceived to be at a disadvantage when it comes to procuring funds for hotel development or acquisition. Commercial lenders are hesitant to make long-term loans on projects that have insufficient collateral, require longer-than-normal repayment terms, or have been in business for less than three years.

The Small Business Administration (SBA) was established in 1953 to "aid, counsel, and protect the interests of the Nation's small business community." This mission is accomplished partly by working with intermediaries, banks, and other lending institutions to provide loans and venture capital financing to small businesses that are not able to secure financing through the normal lending channels. In the past 10 years nearly 6,000 hotels and motels have been financed with $2.9 billion using SBA's loan guarantee program.

The U.S. Department of Agriculture (USDA) has had a Rural Development Program for many years. However, its Business and Industrial Guaranteed Loan Program is relatively new. Started in December 1996, the program has a design and purpose similar to the SBA.

The Business and Industrial Guaranteed Loan Program guarantees loans by eligible local lenders to businesses (including hotels, motels, and restaurants) to benefit rural areas. A rural area is defined as a city with a population under 50,000. Eligible borrowers include individuals, public, and private organizations and federally recognized Indian tribal groups.

The purpose of this paper is to do a side-by-side comparison of the philosophies, purposes, terms, eligibility criteria, loan guarantee limits, and other significant factors of both of these vital programs (SBA and USDA). While most of us are familiar with SBA programs, many are not familiar with the new USDA programs. While philosophically similar, as both the programs are intended to serve as guarantors and thereby facilitating financing, they differ in their primary intentions. The SBA focuses on small businesses

regardless of location, while the USDA focuses on location (rural areas) regardless of size.

This paper will primarily examine the following areas for both of the programs:

- Brief description, philosophy, and purpose
- Eligibility criteria
- How to participate in the programs
- Types and descriptions of programs
  - ⇒ Collateral
  - ⇒ Loan to appraised value ratios
  - ⇒ Maximum repayment terms
  - ⇒ Ineligible loan purpose
  - ⇒ Fees and costs
  - ⇒ Interest rate
- Guarantee amounts

Comparison of USDA and SBA Loan Guarantee Programs

FEATURES	**USDA**	**SBA**
Maximum Loan Size	$25,000,000	$750,000
Guaranteed Percentage	60% to 80%	75% to 80%
Fees	2%	2% to 3.875%
Maximum Length of Loan	30 years	25 years
Interest Rate	Negotiated	Negotiated
Equity Contribution	10% Existing hotel 20% New hotel development	15% to 20%
Restrictions	Rural location (population 50,000)	Small business ($5 million annual revenue)