Financing Business Start-ups Using an SBA 7(a) Loan

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First Business Bank

Nasdaq: FBIZ — $323 million Market Cap[1]

FBIZ Business Banking[2]
$3.5 Billion[3]
In Total Assets

FBIZ Private Wealth
$3.1 Billion[3]
In Assets Under Management & Administration

Headquarters: Madison, WI

Mission: Build long-term shareholder value as an entrepreneurial banking partner that drives success for businesses, investors, and our communities.

- Serving unique needs of business executives, entrepreneurs, and high net worth individuals through Business Banking, Private Wealth, and Bank Consulting
- Within Business Banking, our commercial banking offerings are focused on our attractive Midwest markets while Specialty Finance products and services have national reach
- Efficient and highly scalable model with limited branch network and exceptional digital capabilities

1. Market capitalization as of 1/25/2024
2. Consists of all on-balance sheet assets for First Business Financial Services, Inc. on a consolidated basis.
3. Date as of 12/31/2023

First Business Bank – Business Lines

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Definitions

Start-up

- The SBA defines a start-up business as a business that has been in operation (i.e. generating revenue from intended operations) for 1 year or less
  - These companies generally start with high costs and limited revenue

SBA 7(a) Loan Program

- Small Business Administration's primary program for providing financial assistance to small businesses.
- Financial institution lends money to a business; a portion of those dollars are guaranteed by the SBA, mitigating the bank's risk.
  - This makes the 7(a) program a great tool for getting banks more comfortable with start-up business loans.

Start-Up SBA Structure Enhancements

- **Longer loan amortizations** – The SBA standard without real estate is 10 years; if there is real estate it can be extended out to 25 years.
- **Flexible initial payment schedules** – Allows for flexibility during the "ramp up" phase of a start up.
- **SBA Guaranty** – Allows banks to get comfortable with a new business idea / concept that is unproven.
- **Equity Injections** - Flexible down payment requirements.

Equity Requirements

- Except for transactions for changes in ownership as stated below, the Lender's requirement for equity and equity injection must be consistent with its requirements for similarly sized, non-SBA-guaranteed commercial loans.
  - However, the Lender may use its discretion to reduce the amount of equity and/or equity injection required if it determines that the Applicant needs leverage that exceeds the Lender's conventional requirements.
- For 7(a) Small and SBA Express loans, the credit decision, including how much to factor in a past bankruptcy or whether to require an equity injection, is left to the business judgment of the Lender.
  - Also, if the Lender requires an equity injection and, as part of its standard processes for similarly sized, non-SBA-guaranteed commercial loans verifies the equity injection, it must do so for its 7(a) Small and SBA Express loans.
  - While the credit decision is left to the business judgment of the Lender, early loan defaults will be reviewed by SBA pursuant to SOP 50 57.
- Roll Over For Business Start-Up (ROBS) plans can also be used towards equity injections.

Underwriting Considerations of SBA Small Loans and Start-Ups

- The SBA defines a loan of less than $500,000 as an "SBA Small Loan."
  - Often times, start-up opportunities have a funding need of less than $500,000.
  - The maximum guaranty percentage for 7(a) Small Loans is:
    - 85% for loans of $150,000 or less
    - 75% for loans over $150,000
- This kicks off different underwriting criteria defined by the SBA to make the process more streamlined for lenders to complete.
  - All SBA Small Loan applications begin with a screening for a FICO Small Business Scoring Service (SBSS) score.
    - The SBSS score is calculated based on a combination of consumer credit bureau data, business bureau data, borrower financials, and application data.
      - The minimum acceptable SBSS score is 155.
    - If the applicant receives an acceptable SBSS score, then the lender may close and disburse the loan in accordance with procedures in SOP 50 57.
    - If the applicant does not receive an acceptable SBSS score, then PLP lenders may approve and override the unacceptable score and document their credit memo or non-delegated lenders would send the application via E-Tran with their credit memo for approval.

Where to Start?

- Before you even start the application process for an SBA loan to start a business, you need to have a business plan.
  - A business plan assists with defining what you want your business to do and how you want it to operate.
  - Often times, also includes a financial plan and projections.
- Understand how much funding you will need.
  - Important to know, in detail, how much money you will need to start and run the business.
  - List everything in detail, including cost projections for everything from equipment and materials to salaries and marketing costs.
  - The more detail you can provide, the more prepared you will be to apply for an SBA loan.
- Assemble your financing package
  - Includes business plan, projections, and other pertinent borrower information.

Franchise Start-Up Opportunities

- Franchise startups are a common use of SBA 7(a) funds.
  - The franchise model can help banks get more comfortable with startup loans as the franchise often provides support to their franchisees.
  - Depending on how long the franchise has been in existence, the franchise should have data in their FDD (Franchise Disclosure Document) which provides helpful data to franchisees and banks about typical project size, franchise performance, etc.
- Mature, established franchises usually have 50 or more units for a national franchise or at least 25 units for a regional franchise.
  - Any newer franchises will need more evidence or borrower enhancements to "prove" their franchise model or make the transaction stronger from a borrower standpoint.
- Franchise should ideally have less than a 5% charge-off rate based on recent SBA / Coleman data.
- Some applicants may have signed multi-unit development agreements with the franchise
  - Need to ensure applicant's subject location or other existing locations will not be adversely impacted if the borrower fails to meet the obligations under the agreement.

Other Considerations Of Start-Up Lending

- If start-up opportunity is with a franchise, it is helpful to understand the franchise fee and what the borrower is getting for the fee.
  - There are deviations from franchise to franchise in terms of fee and services provided for the fee.
- Ramp-up phase is the most critical phase to understand.
  - Working capital is often the largest use of start-up funds.
  - Important to understand when the business is expected to become profitable and how this is going to be achieved.
- Industry experience is key.
  - Can overcome this obstacle with specific training in start-up franchise opportunities, however if no franchise is involved. then direct industry experience is very important.

SBA Micro-Loans

- Maximum loan amount is $50,000
- Interest rates typically vary between 8% to 13%
- Typical uses for micro loans include:
  - Working capital
  - Inventory
  - Supplies
  - Furniture & Fixtures
  - Machinery
  - Equipment
- This loan product is geared towards start-ups and underserved businesses

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Case Study #1

Non-Franchise Day-Care Start-up

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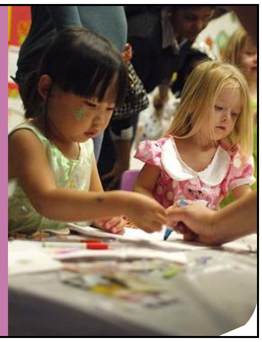

Structure:

$650,000 Real Estate Purchase Price
$45,000 Pre-opening Startup Costs
$75,000 Working Capital
$30,000 Closing costs / SBA Gty Fee
$800,000 Total Project
- $200,000 Cash Equity (~25%)
$600,000 SBA 7a Loan

Strengths:

- Borrowers have industry experience
- Real estate secured and partially leased out and generating additional income
- Borrowers connected in the community
- Sufficient outside income to assist with personal expenses

Risks:

- Unproven management and no historical financial history

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Case Study #2

Start-up Franchise Restaurant

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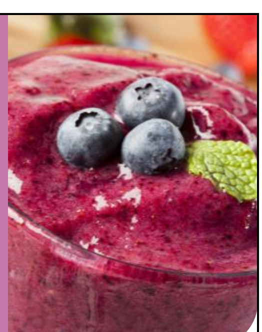

Structure:

$565,000 Construction costs and reserves / contingencies

$200,000 Furniture and Fixtures

$152,000 Franchise fees & pre / post opening working capital

$26,000 Closing Costs & SBA Gty Fee

$943,000 Total Project

- $95,000 Cash Equity (~10%)

$848,000 SBA Loan

Strengths:

- Very low franchise SBA charge-off rates for the subject franchise
- 1 of the 3 Guarantors has direct industry experience and own two existing franchise locations
- Support & strength of the subject franchise

Risks:

- Collateral shortfall of ¾ of the loan amount
- Primary operators do not have significant industry experience
- Borrower has signed multiple franchise agreements for existing and future stores (multi-unit development agreement)

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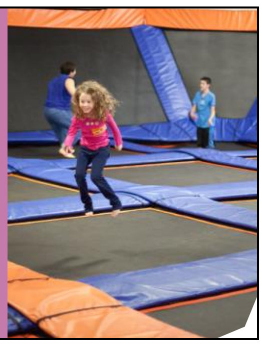
Case Study #3

Start-up Trampoline Park Franchise



Structure:

$1,298,000 Leasehold Improvements & Reserves/Contingencies

$1,372,000 Equipment & Fixtures

$328,000 Franchise Fees & Pre/Post Opening Working Capital

$87,000 Closing Costs & SBA Guaranty Fee

$3,085,000 Total Project

- $675,000 Borrower Equity (~21.86%)

$2,411,000 SBA Loan

Strengths:

- Guarantor experience with the franchise / industry (opening 3rd franchise location)
- Strong liquidity position of guarantors
- Strong projections / business plan based on actual performance of nearby franchise locations

Risks:

- Franchise location is near a former failed franchise location
- Large collateral shortfall (~$1.8MM)

Thank You!

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