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SBA FUNDING FOR FRANCHISES: What to Expect

What you need to know about securing a loan from the Small Business Administration.

By Justin Lee and Lynne D. Shelton, Esq.

The Small Business Administration (SBA) offers financial support for franchises. This loan can be used by franchisors and franchisees for the initial startup expenses, such as real estate and equipment purchases. The two most common loans for franchise owners are the SBA 7(a) loans and the SBA 504 loans. The SBA 7(a) loan can go up to \$5 million, and franchisors and franchisees can use the loan for all expenses involved in starting a franchise. The SBA 504 loan is a fixed loan that is specific to large assets such as machinery and real estate. Along with other strict requirements, such as a higher credit score, the franchisor/franchisee must be listed in the SBA Franchise Directory to qualify for SBA loans.

THE SBA FRANCHISE TEAM REQUIRES APPLICANTS TO SUBMIT A BRAND APPLICATION TO BE LISTED ON THE SBA FRANCHISE DIRECTORY.

ting the proper forms to be reviewed to be eligible to apply for an SBA loan. Shelton Law & Associates also assists franchisees in applying for an SBA loan. This process ensures that the franchisor is listed on the

The SBA Franchise Team requires applicants to submit a brand application to be listed on the SBA Franchise Directory. Shelton Law & Associates, LLC, helps franchisors get listed on the SBA Franchise Directory by assisting in compiling the necessary documents and submit-

SBA Franchise Directory, assists with using a franchisee's 401(k) and IRA in connection with the SBA fund, and assists with the down payment required for SBA loans.

Over the last year, more than 3.7 million business have found relief through SBA loans to help save their businesses. More specifically, the SBA Economic Injury Disaster Loans have helped many business owners pay off debt on their businesses and have helped to rebuild as the world opens its doors again. As of October 8, 2021, the SBA began approving loans greater than \$500,000 with a loan term of up to 30 years.

GETTING THAT SBA LOAN

Although this may sound appealing to many small business owners, there are a handful of hurdles to jump through before applying



for the SBA loan. All business owners must fill out a personal financial statement, borrower information form, and be willing to provide tax transcripts. They may also need to include tax returns, balance sheets, and revenue/expenses for the business. Based on the franchisor's assets, they may secure collateral with the loan. In most cases, borrowers put up their homes as collateral. According to *Forbes*, applying for an SBA loan is not only a long process, but there is a very low approval rate. Large banks approve roughly 25% of their applicants. Smaller banks approve about 49% of their applicants.

The SBA has been criticized for having an SBA loan monitoring system that does not function as intended. The SBA continues to guarantee loans to high-risk franchises and does very little, if anything, to mitigate the risks involved. A study by the *Wall Street Journal* indicates that large franchises, such as Quiznos and Cold Stone Creamery, have defaulted on about thirty percent of the loans provided by the SBA.

KNOW THE RISKS

There are several important factors that must be considered by the borrower before taking out an SBA loan. First, borrowers may be personally liable if the business flops. That means the debt may be paid out of pocket. This could lead to extremely unstable financial hardships or bankruptcy. Take the steps to navigate the business' growth to ensure that loan payments will continuously be made. Look to the franchise disclosure document to see the outlined estimated costs involved in operating a franchise. Second, look to see if the business is relying heavily on loans to be functional. Multiple loans may negatively affect the borrower's credit score



and put the business in an unfortunate, financial situation. The business should be sufficiently capitalized to avoid the possibility of defaulting on the loan. Detailed research into the franchisor's business is crucial before applying for any type of loan.

THE GOOD NEWS

On the bright side, the International Franchise Association (IFA) has insisted that independent small businesses have a much higher failure rate than franchised small firms. A study by the IFA indicates that franchise businesses contributed to \$670 billion of economic output in 2020 and represents 3% of the total nominal gross domestic product. FRANData predicts that the economic damages from Covid could

be erased, and franchises are projected to open more than 26,000 locations and add nearly 800,000 new jobs. The overall franchising industry has maintained a high contribution throughout Covid and will continue to grow as the economy revives from pandemic damages. ►

Justin Lee is a 3L at the McGeorge School of Law. He is currently an extern at Shelton Law & Associates, LLC ("SLA"). He is learning the world of franchising and intellectual property as part of the SLA team, and he plans to pursue a career in entertainment law.

SLA additionally works with entrepreneurs buying franchises by assisting with business creation, industry evaluations, franchise disclosure document review, fairness factors, opinion letters, and negotiations. Further, SLA assists in navigating the SBA loans for franchisors and franchisees.

For more information or to schedule a customized consultation for your business, you can write to franchising@SLA.Law or call (866) 99-FRANCHISE.