

The SBA 504 Loan Program

Tuesday, April 24 – 11:00 a.m. Eastern

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Thank you!



U.S. Small Business Administration

West Virginia District Office

The SBA 504 Loan Program

Presented by
West Virginia District Office



Today's Presenters

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&

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ACKNOWLEDGMENT

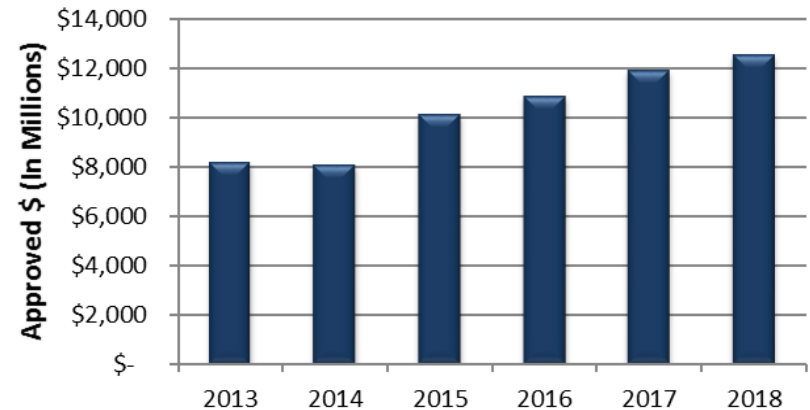
We would like to thank Rebecca and Beth for their time and providing information regarding their experience in lending and working on SBA loans from their perspective. All opinions, conclusions, and/or recommendations expressed herein are those of the presenter(s) and do not necessarily reflect the views of the SBA.



YTD Activity – Total 7(a) and 504

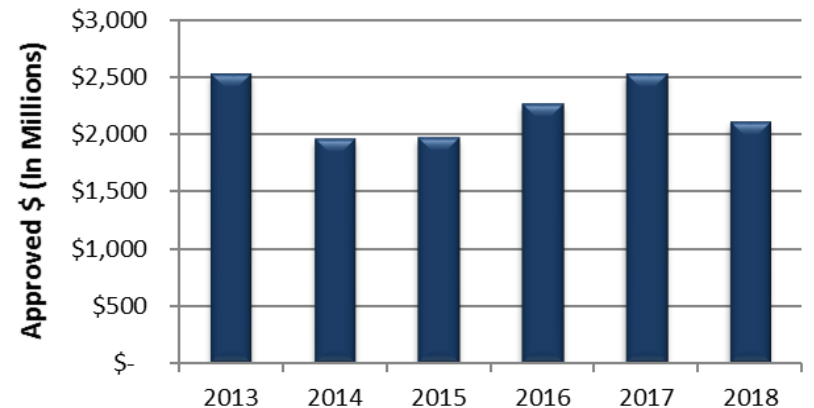
7(a) Lending Activity

Fiscal Year	Approved Loans	Approved Dollars
2018	29,512	\$ 12,568,238,800
2017	28,645	\$ 11,968,061,900
2016	30,127	\$ 10,910,298,500
2015	27,952	\$ 10,135,525,300
2014	22,384	\$ 8,099,996,400
2013	21,490	\$ 8,220,871,300



504 Lending Activity

Fiscal Year	Approved Loans	Approved Dollars
2018	2,664	\$ 2,106,567,000
2017	3,082	\$ 2,517,433,000
2016	2,754	\$ 2,264,727,000
2015	2,752	\$ 1,962,315,000
2014	2,786	\$ 1,956,729,000
2013	3,753	\$ 2,522,111,000



OFA Updates

➤ Charge-Off Rates

- 7(a) – 0.80%
- 504 – 0.41%

➤ Purchase Rates

- 7(a) – 0.79%
- 504 Regular Loans – 0.67%

➤ SBA Policy Notice 5000-17057

- Credit Elsewhere
- Minimum equity requirements
- Business engaged in any Illegal Activity (Marijuana/Hemp)

Credit Elsewhere

Clarified Lenders must include the reason/need for desired credit (13 CFR § 120.101) in credit memo.



SBA has increased the minimum percentage ownership at which owners are subject to personal liquidity consideration from 10% to **20%**.

As a reminder, the liquidity of the owner includes the liquid assets of the owner's spouse and any minor children. Spouses must sign the SBA Form 413 or Banks Personal Financial Statement (PFS) even if they are a non-owner of the business. **Signing of the PFS does not obligate spouse for any responsibility of the loan.**

Minimum Equity Requirements

For a change of ownership transaction between existing owners (“partner buyout”) on 7(a) loans :

- (1) the remaining owner(s) must certify that he/she has been actively participating in the business operation and held the same ownership interest in the business for at **least the past 24 months** ; and
- (2) the business balance sheets for the most recent completed fiscal year and current quarter must reflect a **debt-to-worth ratio** of no greater than **9:1** prior to the change in ownership.

In the event the Lender is unable to document that both (1) and (2) above are satisfied, the remaining owner(s) must contribute cash in the amount of at least **10%** of the purchase price of the business, as reflected in the purchase and sale agreement.

25 Year Debenture - Overview

Launch date – April 2, 2018; Federal Register Notice and Information Notice will announce program change officially and provide start date.

- SBA Information Notice 5000-17058 was released on April 5, 2018.
- 25 year debenture will provide small business borrowers with more choice in financing their long term capital projects.
- 25 year debenture will provide longer repayment term and lower borrower's monthly loan payments.
- 20 year 504 loan cannot be converted to 25 year 504 loan after loan approval.
- Program forms and the Wizard and SBA systems have been updated.

No Regulatory Change on TPL Term

13 CFR § 120.921 also notes:

“A Third Party Loan (TPL) must have at least 7 years when the 504 loan is for a term of 10 years and 10 years when the 504 loan is for 20 years.” SBA will use the 10 year minimum maturity for a TPL to a 504 loan with a stated 25 year maturity.

What is a “504” Loan?

- The SBA 504 Loan Program is used to finance fixed assets for small business enterprises at below market rates and is funded by Wall Street Bonds.
- A Certified Development Company (CDC) is an economic development organization that has been authorized by the SBA to make loans under the SBA 504 Loan Program.
- The CDC works in partnership with the lender and small business to process, approve, close and service the SBA 504 loan.

What is a “504” Loan?

- Available to for-profit, privately held companies based in the U.S.
- For primarily Owner-Occupied real estate:
 - *51% for acquisition; 60%/80% for new construction.*
- For Machinery & Equipment:
 - *Must have a ≥ 10 year useful life.*
- Job creation/retention required or achievement of one of SBA’s 15 Community Development or Public Policy Goals.
- “Small” under the SBA’s size standards:
 - *TNW – not more than \$15 million & NIT – not more than \$5 million (average of last 2 years), or the alternative 7a definition may be used (revenues or employees, based on NAICS code).*

What is Eligible?

Fixed assets with a useful life of at least 10 years:

- Land and new building construction.
- Existing building acquisition.
- Building renovation.
- Machinery and equipment and any related installation costs.
- Asset-based company acquisitions.
- Limited term loan & mortgage refinancing in the original SBA 504 Loan Program ($\leq 50\%$ of “expansion costs”).
- Plus, all related soft project costs.

Eligible 504 Project Costs

- Acquisition-related legal expenses & closing costs.
- Construction contingency up to 10%.
- Interest carry expense on the interim loan.
- Appraisal & environmental reports.
- Title insurance.
- Flood insurance.
- Surveys/Architectural fees.
- Equipment Installation costs.
- Any costs associated with Bank's Bridge Loan, including points and filing fees.

What is NOT Eligible?

- Non-profit businesses.
- Investment real estate & passive businesses.
- Rolling stock.
- Working capital, goodwill, inventory, liquor licenses & franchise fees.
- Speculative businesses.
- Strip clubs and businesses that restrict patronage.
- Businesses engaged in gambling, lending or promoting religion.
- Businesses located in foreign countries or owned by undocumented aliens.
- Businesses owned by individuals with poor character.
- Prior loss to the government & delinquent Federal debt.

504 Loan Limits

- Projects range from \$200K to \$15M
- \$5,000,000 for most transactions
- \$5,500,000 for Manufacturing projects, Energy Efficient projects and Renewable Energy projects
- No limit on project size

Typical Structure



■ Lender 50% ■ SBA 40% ■ Borrower 10% ■

Start-up or Special Purpose



■ Lender 50% ■ SBA 35% ■ Borrower 15% ■

Start-up & Special Purpose



■ Lender 50% ■ SBA 30% ■ Borrower 20% ■

Project Example

Use of Funds:

Building Purchase \$ 700,000

Improvements \$ 200,000

FF&E \$ 75,000

Related Fees

Appraisal & Environ. \$7,500

Architect \$2,500

Transfer Tax \$8,000

Title Insurance \$5,000

Interim Interest \$2,000

\$ 25,000

Total Project Cost

\$1,000,000

Typical 504 Structure - 50/40/10:

Bank:	\$ 500,000
SBA:	\$ 400,000
Equity:	<u>\$ 100,000</u>
TOTAL	\$1,000,000

Special Purpose or Start-up Structure - 50/35/15:

Bank:	\$ 500,000
SBA:	\$ 350,000
Equity:	<u>\$ 150,000</u>
TOTAL	\$1,000,000

Special Purpose and Start-up Structure - 50/30/20:

Bank:	\$ 500,000
SBA:	\$ 300,000
Equity:	<u>\$ 200,000</u>
TOTAL	\$1,000,000

SBA 504 Process

- The SBA 504 loan is “take-out” financing.
- The SBA will issue an up-front commitment.
- The Lender funds the interim financing, typically 90% of the project.
- The SBA 504 loan will close when all funds are fully disbursed and the project is complete.
- Funds are wired to the Bank to payoff the SBA’s portion of the project, thus reducing the Bank’s LTV to 50%.

504 Interest Rates

- Established at the time of the bond sale after the project is complete.
- Typically lower than conventional financing:
 - 5.03% for 20 year debenture (April 2018)
 - *Requires a Bank term of at least 10 years*
 - 5.11% for 10 years (March 2018)
 - *Requires a Bank term of at least 7 years*
- NEW!! 25 year debenture (1st funding in July 2018)
- RATES ARE FIXED FOR THE LIFE OF THE LOAN

(Note: Debenture funding occurs approximately 45-60 days after completion of a “504” project)

SBA 504 Fees

504 Fees (Capitalized into the 504 loan)

CDC Processing Fee	1.50%
SBA Guarantee Fee	0.00%
Funding Fee	0.25%
Bond Underwriter Fee	<u>0.40%</u>
TOTAL	2.65%

Bank Fee

Third Party Lender Fee of 0.50% is based on the 1st Trust amount and may be passed on to the Borrower. Bank is permitted to charge other commitment fees on the permanent and interim loans.

Common SBA 504 Projects

- Manufacturing/Industrial/Commercial buildings
- Hotels/Motels
- Personal care and nursing home facilities
- Day care facilities
- Automobile and motorcycle dealerships
- Gas Station/Convenience Stores
- Fitness Centers
- Restaurants/Bars
- Franchises (i.e. Meineke, Dunkin Donuts, etc.)
- Funeral Homes/Crematoriums
- Car Washes
- Self-Storage Facilities
- Office Buildings/Medical Offices
- Any Equipment with a useful life of at least 10 years

Debt Refinancing - 2 Programs



504 Debt Refi with Expansion

- All new expansion costs
- Plus existing debt not to exceed 50% of new expansion costs



504 Debt Refi without Expansion

- Max 90% LTV without Cash-Out
- Max 85% LTV with Cash-Out

504 Expansion Debt Refinance

When Appropriate

- Existing debt on property 1
 - Major renovation/addition at property 1, and/or
 - Expansion to another location (property 2)
 - Can use existing equity in property 1 to purchase property 2
- Existing debt
 - Conventional
 - Existing SBA 7(a) or 504

Eligible Use of Proceeds

- All new expansion costs
- Existing debt
 - Capped at 50% of new costs
 - If existing debt exceeds cap, overage added to Third Party Loan AFTER 504 project structured

Example 1 – 504 Expansion Debt Refinance

USES OF FUNDS		SOURCES OF FUNDS		
As-Is Equity	300,000	Third Party Loan	1,500,000	50%
Existing Debt	700,000	SBA 504 Loan	1,200,000	40%
New Construction	1,400,000	Borrower Contribution	300,000	10%
Equipment	300,000	TOTAL SOURCES	3,000,000	100%
Soft Costs -		ASSUMPTIONS		
settlement costs	50,000	<ul style="list-style-type: none"> As-Is Appraised Value = \$1,000,000 Existing Debt = \$700,000 * As-Is Equity = \$300,000 New Costs = \$2,000,000 		
appraisal	5,000			
environmental	5,000			
contingencies @10%	140,000	NOTES		
interest carry	100,000	<ul style="list-style-type: none"> * Existing Debt is <u>less than 50% of new costs</u> 		
TOTAL USES	3,000,000	<ul style="list-style-type: none"> Entire amount is added to 504 project costs 		

Example 2 – 504 Expansion Debt Refinance

USES OF FUNDS		SOURCES OF FUNDS		
As-Is Equity	200,000	Third Party Loan ²	1,000,000	50%
Existing Debt ¹	600,000	SBA 504 Loan	800,000	40%
		Borrower		
New Construction	900,000	Contribution	200,000	10%
Equipment	100,000	TOTAL SOURCES	2,000,000	100%
Soft Costs -		<u>ASSUMPTIONS</u>		
settlement costs	50,000	As-Is Appraised Value = \$1,000,000		
appraisal & enviro	10,000	As-Is Equity = \$200,000		
contingencies		<u>Existing Debt = \$800,000 ¹</u>		
@10%	70,000	New Costs \$1,200,000		
interest carry	70,000	<u>NOTES</u>		
TOTAL USES	2,000,000	* <u>Existing debt exceeds 50% of New Costs</u>		
		¹ Amount added to 504 Project capped at \$600,000 (<u>50% of New Costs</u>)		
		² Remaining balance of Existing Debt (\$200,000) added to Third Party Loan after 504 project split – <u>Final TPL Loan = \$1,200,000</u>		

504 Permanent Debt Refinance without Expansion

- **Eligibility Requirements:**

- Borrower operating for minimum of 2 years
- “Note” to be refinanced must be 2 years old
- Borrower meets all 504 Program eligibility requirements (i.e. 51% owner occupancy)

- **Loan (LTV) Guidelines:**

- No Cash-out → **MAX 90% of Appraised Value**
 - Existing Debt refi + Closing Costs
 - **Max 85%** for “Special Use Properties”
 - Other fixed asset collateral can be added if appraisal shortfall on project property
- With Cash-Out → **MAX 85% of Appraised Value**
 - Cash-out limited to **20% LTV**
 - Cash-out can be used for expenses incurred but not paid or expenses due within next 18 months
 - Only other eligible business debt that can be paid is business credit card balances



- **No Longer Eligible:**

- “Other Secured Debt” - Non-purchase money business debt secured by same fixed assets as “Qualified Debt”

Example 1 – 504 Permanent Debt Refi without Cash-Out

USES OF FUNDS	\$	SOURCES OF FUNDS	\$	%
Existing Equity	500,000	Third Party Loan	2,500,000	50%
Existing Debt Refinance	4,400,000	SBA 504 Loan	2,000,000	40%
Closing Costs	100,000	Borrower Contribution	500,000	10%
TOTAL PROJECT COSTS	5,000,000	TOTAL SOURCES	5,000,000	100%

ASSUMPTIONS

- **As-Is Appraised Value = \$5,000,000**
- **Existing Debt = 4,400,000**
- **Closing Costs = \$100,000**
- Additional collateral can be taken if existing debt exceeds 90% LTV on project property alone

Example 2 – 504 Permanent Debt Refi with Cash-Out

<u>ASSUMPTIONS</u>		<u>SBA REQUIREMENTS</u>		
As-Is Appraised Value	\$1,500,000	Total Financing = max 85% LTV	\$1,275,000	85%
Existing Debt	\$1,000,000	Cash-Out = max 20% LTV	\$275,000	18.33%
USE OF FUNDS	\$	SOURCE OF FUNDS	\$	%
Existing Equity	225,000	Third Party Loan	675,000	45%
Refinance Existing Debt	1,000,000	SBA 504 Loan	600,000	40%
Cash-Out (*)	275,000	Borrower Contribution	225,000	15%
TOTAL USES	1,500,000	TOTAL SOURCES	1,500,000	100%

* CASH-OUT – for Eligible Business Expenses

- Utility Bills, Rent Expense, Inventory, Salaries, Minor FF&E Purchases, Minor Renovations, etc.
- Billed but not paid **OR** future items due within **18 months** of 504 application

Application Package / Approval Timing

Needed from Borrower

- **Essentially same as any commercial lender:**
 - ☑ Business Tax returns
 - ☑ Projections, if start-up business
 - ☑ Personal financial statement and tax returns for owners
 - ☑ History/description of business / owners' resumes
 - ☑ Cost Documentation – Purchase Contract or Letter of Intent, construction/renovation estimates
- **Application Checklist or Apply Online**
- **How long does it take? With complete application package –**
 - 10-15 business days approval (depending on complexity of transaction)
 - 5 business days for SBA approval
 - 15-20 business days TOTAL**

Needed from Bank Partner

- Meet with Client early
- Be a 504 1st trust lender
 - Annual awards based on activity
- Refer to CDC
 - Educate and refer colleagues
- Contact CDC with questions

Dispelling Myths About SBA 504 Loans

- The 504 Loan Program is not the “Lender of Last Resort”—it should be used for strong, established companies, not just marginal deals or start-ups.
- SBA approval turn-around is about 10 business days or less.
- The Borrower and the Banker will not be overwhelmed with paperwork—the CDC completes the application.
- The fees are capitalized into the project and can be amortized over 20 years.

Advantages to the Bank

- Offers a competitive advantage against variable rate loans.
- Loan-to-value ratio of 50%.
- May tolerate higher default risk and increase Bank's comfort level with certain industries.
- Ability to finance larger and/or multiple projects .
- Obtain or maintain customer relationship and deposits.
- Community Reinvestment Act (CRA) Credit.
- The Bank does not have to obtain an SBA guaranty, as in SBA 7(a) lending.
- CDC handles all SBA documents.
- In case of default, Bank does not have to interface with SBA.
- Appraisal can be as low as 95% of the total project costs.

Advantages to the Borrower

- Below-market fixed interest rates.
- Low down payment preserves working capital (usually 10%).
- Offsets interest rate risk.
- Extended amortization provides lower monthly payment.
- Improved cash flow coverage.
- Borrower can finance most closing fees.
- Lower fees compared to 7A program for similar sized projects.
- Collateral is typically limited to project assets, and the SBA permits flexibility with appraisal shortfalls (up to 105% LTV w/o additional collateral)

Successful Bank Strategies

- Develop a “relationship” with your CDC.
- CDC loan officers can accompany you on customer calls to answer technical questions.
- Bank and CDC share information to expedite processing and to minimize the need the for customers to duplicate information.
- Agree on structure before you get approvals in place.
- Use the 504 for your best customers, not just the marginal deals—it helps build customer loyalty!!
- Offer a “504” as a structuring advantage before your competition does—it can help you win deals!

Questions



Contact Information

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