

The SBA 504 Loan Program

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For technical assistance, contact the AT&T
Helpdesk at 888-796-6118 - Thank you!



U.S. Small Business Administration

ACKNOWLEDGMENT

We would like to thank Beth Wilson & Rebecca MacBlane for their time and providing information regarding their experience in lending and working on SBA 504 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.



Growing Small Businesses, Jobs & Communities

What is 504?

ECONOMIC DEVELOPMENT FINANCING TOOL

- Finances fixed assets for healthy, expanding businesses
- Low down payment to preserve cash to fund growth

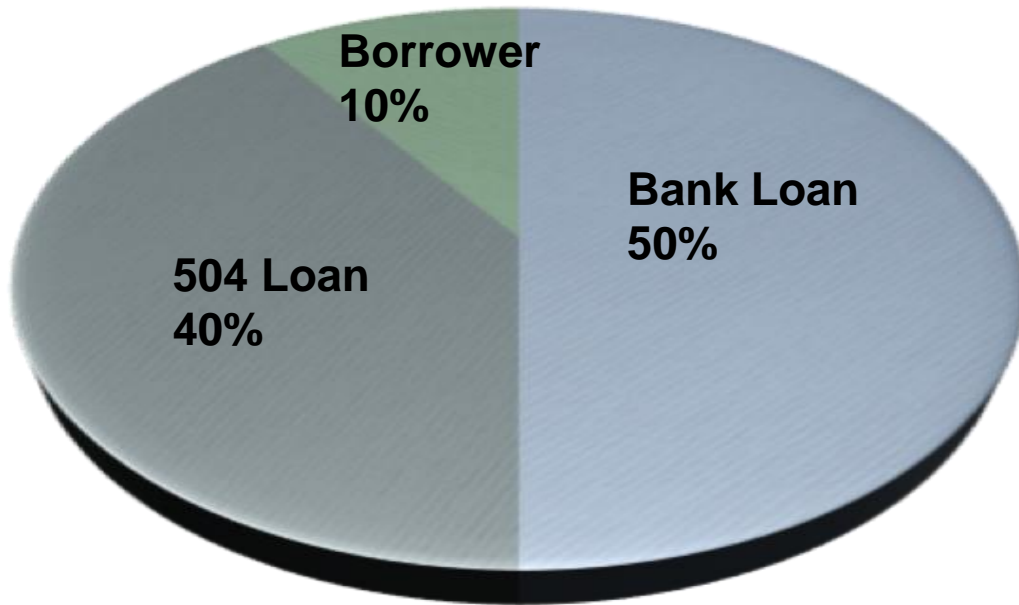
COMMUNITY BENEFITS

- Jobs created and/or retained
- Increased tax base

DELIVERY SYSTEM

- Delivered by nationwide network of 260 CDCs – typically non-profits with an economic development mission

Typical 504 Structure



**Total Project Costs
\$1,000,000**

● \$500,000	10 Year Maturity. Negotiable Rate
● \$400,000	20 Year Fully Amortized Fixed Rate Bond Market
● \$100,000	Borrower Contribution

504 Source of Funds

- Bonds sold on Wall Street to institutional investors
 - Life insurance companies
 - Pension plans
 - Mutual funds
- Interest Rate is based on 10 year treasury rate
 - Plus spread to bond investor
 - Plus servicing fees to SBA, CDC, and SBA's bookkeeping contractor

Interest Rate

4.827%

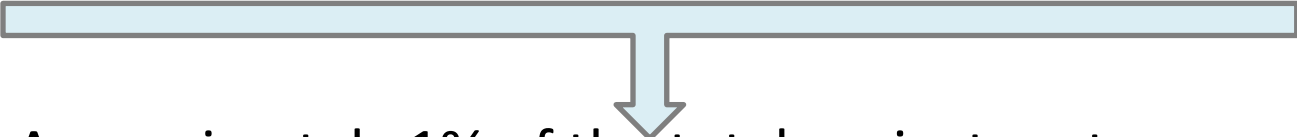
All-in-fixed for 20years

March 2017

Bond Sale

Fees- Bond Sale Costs

CDC Processing Fee	1.50%
SBA Guarantee Fee	0.50%
Funding Corp Fee	0.25%
Bond Broker Fee	<u>0.40%</u>
TOTAL	2.65%

- 
- Approximately 1% of the total project costs
 - Fees are added to the 40% 504 portion and financed over 20 years
 - Adds approximately 25 basis points (0.25%) to the 504 interest rate on an “APR” basis
 - Bank pays 0.5% fee on 1st trust loan amount,

Prepayment Penalty

- Prepayment penalty declines during first 10 years to 0% →
- Loan is assumable and prepayment penalty does not apply

<u>Year</u>	<u>%</u>
1	3.00%
2	2.70%
3	2.40%
4	2.10%
5	1.80%
6	1.50%
7	1.20%
8	0.90%
9	0.60%
10	0.30%
11-20	0.00%

Business Eligibility

- ✓ For-Profit & Privately Held
- ✓ “Small”
 - Net Worth < \$15.0 million
 - After Tax Income < \$5.0 million (2 year average)
- ✓ Creates or Retains Jobs*
- ✓ Or meets a public policy or community development goal of SBA

**1 job per \$65,000 in 504 loan dollars*

Eligible Project Costs

Real Estate (owner occupied)

- Existing Buildings
- Addition/Major Renovation
- Land/Building Construction

Machinery and Equipment

- Minimum 10 Year Life
- Printing Press or Manufacturing Equipment

Soft Costs

- Appraisal & Environmental
- Title & Recording Taxes
- Closing Costs, Bank Points

Refinancing

- Permanent 504 Refinance Program – Expansion costs and existing debt (up to 50% of New Costs in Expansion)

Project Eligibility

Occupancy

Existing Building 51%

New Construction 60%

- *20% permanently leased*
- *20% to be occupied in 10 years*

Down Payment

Typical 10%

Start-up 15%

Special Use 15%

Both 20%

Project Size

Min = \$200,000

Max = No max project size

Max 504 Loan:

- *\$5,000,000 for most loans*
- *\$5,500,000 for manufacturers & certain energy efficient projects*

Bank Loan can exceed 50%

Projects could be as large as \$20+ million

504 Loan vs. Conventional Loan

<u>Eligible Project Costs</u>		<u>504 Financing Structure</u>		
Land/Building	500,000	Third Party Lender	\$ 500,000	50%
Renovation	400,000	504 portion	\$ 400,000	40%
Equipment	50,000	Borrower Contribution	\$ 100,000	10%
Soft Costs:		TOTAL SOURCES	\$ 1,000,000	100%
Title Charges	3,500			
Recording Taxes	15,000	<u>Conventional Financing</u>		
Appraisal	3,500	20% of hard costs	\$ 190,000	
Environmental	3,000	Soft Costs	\$ 50,000	
Architect / Engineer	15,000	Borrower Contribution	\$ 240,000	
Bank points	10,000			
TOTAL PROJECT COSTS	\$ 1,000,000	BORROWER SAVINGS WITH 504	\$ 140,000	

Application Items Needed

Essentially same information any commercial lender requires:

- Tax returns on the business
- Projections, if start-up business
- Personal financial statement and tax returns for owners
- Brief History/description of business and owners' resumes
- Purchase Contract or Letter of Intent, construction/renovation estimates

How long does it take?

Working with us, 10 days for our approval;

Up to 5 days for SBA approval

Credit Underwriting Considerations

<u>CASH FLOW ANALYSIS</u>	<u>12/31/2011</u>
Revenues	\$2,734
Pre-tax earnings	\$1,122
plus depreciation	\$16
plus interest expense	\$0
plus rent savings	\$169
plus officers comp. expense	\$249
CASH FLOW AVAILABLE	\$1,557
Existing Debt Service	\$21
Proposed Debt Service	\$308
Officers' Comp. needed (40% personal D/I ratio)	\$385
CASH FLOW NEEDED	\$714
CASH FLOW MARGIN	\$843
CASH FLOW COVERAGE	2.18

- Proven Management
- Cash Flow Coverage
 - Minimum 1:1 cash flow coverage based on historical operations or projections (if start-up business or rapidly growing business)
 - ← Example of how we calculate cash flow coverage
- **NOTE** – bank requirements may vary

Credit Underwriting Considerations

- Acceptable Collateral Coverage
- Appraisals must have minimum 2 approaches to value

<u>PROJECT COSTS</u>		<u>MINIMUM APPRAISAL CALCULATION</u>	
Land Purchase	700,000	Total Project Costs	2,800,000
New Construction	1,500,000	less Equipment	300,000
Equipment	300,000	Minimum Required R/E Value	2,500,000
Soft Costs -			
settlement costs	50,000	If needed, SBA allows for a 10% tolerance without changing loan amounts	2,500,000
appraisal & environmental contingencies @10%	10,000		(250,000)
interest carry	150,000	Minimum Acceptable R/E Value	2,250,000
	90,000		
TOTAL PROJECT COSTS	2,800,000		

504 REFINANCE LOAN WITH EXPANSION

When is this appropriate?

- Business has existing debt on property and needs a major renovation or expansion

- 504 Project can include all new costs and existing debt (subject to limitations)
 - Existing debt to be rolled into 504 structure is limited to 50% of new costs
 - If existing debt exceeds 50% of new costs, the overage is added to the bank loan AFTER the 504 project is structured

Example 1 – Refinance with Expansion

Appraised Value of Property As-Is \$1,000,000
 Pre-Existing Debt \$700,000
 New Costs \$2,000,000

<u>Use of Funds</u>		<u>Sources of Funds</u>		
Existing Equity	300,000	Third Party Loan	1,500,000	50%
Pre-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 -				
settlement costs	50,000			
appraisal & environmental	10,000			
contingencies @10%	140,000			
interest carry	100,000			
TOTAL USES	3,000,000			

Note: Existing debt is less than 50% of new costs and is added back to 504 project entirely before the split.

Example 2 – Refinance with Expansion

Appraised Value of Property As-Is	\$1,000,000
Pre-Existing Debt	\$ 800,000 *
New Costs	\$1,200,000

<u>Use of Funds</u>		<u>Sources of Funds</u>		
Existing Equity	200,000	Third Party Loan *	1,200,000	50%
Pre-Existing Debt *	600,000	SBA 504 Loan	600,000	40%
New Construction	900,000	Borrower Contribution	200,000	10%
Equipment	100,000	TOTAL SOURCES	2,000,000	100%
Soft Costs -				
settlement costs	50,000			
appraisal & environ.	10,000			
contingencies @10%	70,000			
interest carry	70,000			
TOTAL USES	2,000,000			

***Note:** Pre-Existing debt exceeds 50% of new costs. So, pre-existing debt added to eligible 504 project cost is limited to \$600,000 (50% of new costs). The remaining \$200,000 in pre-existing debt is added to the bank's 50% loan after the split to create a combined bank loan of \$1,200,000.

504 DEBT REFINANCING PROGRAM

SBA 504 Debt Refinance Program

- The SBA 504 Debt Refinance Program was originally enacted as part of the Small Business Jobs Act of 2010. Although it was a temporary program (expired in Sept. 2012), it was used to assist over 2,700 businesses refinance nearly \$7 billion in old, expensive debt and unleash capital to reinvest into their businesses to create and retain jobs.
- In December of 2015, Section 521 of Division E of the Consolidated Appropriations Act reauthorized it as a **permanent part of the 504 Loan Program**. The SBA began accepting applications in June, 2016.
- The program will be available during years when there is a **Zero Subsidy** for both Regular 504 & Refi programs.
- 504 Refinance volume for each CDC will be limited to **50% of CDC's prior FY \$\$ loaned** (waivers may be granted for just cause).

Basic Program Details

- Like the regular 504 program, the purpose of the original loan being refinanced must have been for the **purchase or improvement of eligible fixed assets** such as land & building acquisition, ground-up construction, building renovation or equipment.
- The Project is based on the **Fair Market Value of the Eligible Fixed Assets** securing the Qualified Debt and any other fixed assets acceptable to the SBA if a shortfall in collateral exists.
- The Borrower may rely on **equity in assets** being refinanced as its equity contribution (real estate OR equipment). If equity is insufficient, additional fixed assets or cash may be pledged.

Basic Program Details

- 51% Owner-Occupancy is required **at SBA application date.**
- The debt being refinanced may consist of **one or more commercial loans** originally used for real estate or long-term equipment.
- The Small Business must be **in operation for at least 2 yrs.** prior to the date of the application. If ownership has changed during the last 2 yrs., the CDC must follow “new business guidance” in the SOP.
- Refinanced loans must be secured by 504-eligible fixed assets.
- “Same Institution Debt” can be refinanced using an **interim loan OR an escrow account.**

New Fee Structure

For loans approved under the 504 Debt Refinance Program during FY 2017, an additional fee of .34% will be added to the effective rate. The SBA will review the increase to the guaranty fee annually and issue notices of any change.

- March 2017 Twenty yr. Refi rate: 4.869%
- March 2017 Ten yr. Refi rate: 4.867%

Ineligible Debt

- A loan with a **Federal Guarantee** (SBA 504, SBA 7(a), USDA, tax-exempt bond financing).
- A first mortgage in an **existing 504** project.
- Debt owed to an associate of the Borrower (**shareholder debt**).
- Debt owed to a Venture Capital Company or a Small Business Investment Company (SBIC).
- The existing creditor is in a position to sustain a loss and refinancing would shift all or part of the **potential loss to SBA**.
- Paying off a loan that was used for commercial purposes, but secured by **personal collateral**.

Eligibility Factors

“Qualified Debt”:

- Incurred not less than **2 yrs.** before application date.
- Not subject to a guaranty by a Federal Agency.
- Proceeds were used to acquire **eligible fixed assets.**
- A commercial loan(s) incurred for the benefit of a small business.
- The loan must be **secured by eligible fixed assets** (real estate or equipment).
- The borrower has to have been **current** for at least **1 year** prior to application.
- May consist of **multiple** commercial loans.

Eligibility Factors

“Other Secured Debt”:

- Debt that has been secured for at least 2 years prior to application by the **SAME** Eligible Fixed Assets securing the Qualified Debt and for which the borrower has been current for not less than 1 year.

“Business Operating Expenses”:

- Expenses other than “Qualified Debt” or “Other Secured Debt”, including salaries, rent, utilities, inventory or other obligations of the business that were **incurred but not paid** prior to application, or that will **become due within 18 months** after the application date.

“Substantially All (85% or more)” Requirement

- The **ORIGINAL** loan being refinanced must have originated at least two years prior to application. The project must meet the “**Substantially All**” requirement, which is defined as follows:
 - **85% or more of the original** use of loan proceeds must have been for 504-eligible purposes (i.e.: to acquire land, buildings, renovations or long-term equipment).
 - The remainder of the debt (up to 15%) must have been used for **business purposes**.
 - Equity may have been used in subsequent refinancing for **non-504-eligible** purposes.

Structuring Considerations

- Project amount is based on the **fair market value** of the 504-eligible assets established by a current appraisal which is no more than 1 year old.
- The Bank and 504 loans **cannot exceed 90%** of the appraised value if project includes the refinance of Qualified Debt and Other Secured Debt.
- If project includes Business Operating Expenses, **LTV may not exceed 85%, AND**
- Business Operating Expenses must be **≤ 25% of the appraised value of the assets.**
- The Third Party Loan must be **at least as much as** the 504 Net Debenture proceeds and the SBA 504 Loan **may not be more than 40%** of the entire project.
- Borrower must contribute at least 10% equity in the form of **assets, cash or other collateral.**

Financing Business Operating Expenses

- Business expenses which are **INELIGIBLE** to include in a 504 Refi structure include:
 - Monies used to acquire a new business.
 - Monies used to acquire a new property.
 - Change of ownership with buy-out of co-owner.
 - Pay-off of shareholder debt.
 - Paying an owner's personal expenses.
- If the appraised value is insufficient and LTV exceeds 85%, additional fixed assets or cash may **NOT** be pledged to provide funding for Business Operating Expenses.

Example 1: No Cash Out

Request: Refinance \$200K in Qualified Debt & \$700K in Other Secured Debt borrowed several years ago for other business purposes.

Property appraised at \$1,000,000.

Final Structure: This is an acceptable structure. LTV is 90%.

Appraised Value	\$1,000,000
Qualified Debt	\$ 200,000
Other Secured Debt	<u>\$ 700,000</u>
Total Financing	\$ 900,000
Third Party Loan	\$ 500,000
504 Net Debenture	\$ 400,000
Land Equity	<u>\$ 100,000</u>
Total Project	\$1,000,000

Example 2: Cash Out

Request: Refinance \$500K in Qualified Debt & \$400K in Business Operating Expenses (BOE). Property appraised at \$1,000,000.

Final Structure: Only \$250K of the BOE can be included due to LTV requirements of 85% and the need for BOE \leq 25% of appraisal.

Appraised Value	\$1,000,000
Qualified Debt	\$ 500,000
Business Op. Expenses	<u>\$ 250,000</u>
Total Financing	\$ 750,000
Third Party Loan	\$ 375,000
504 Net Debenture	\$ 375,000
Land Equity	<u>\$ 250,000</u>
Total Project	\$1,000,000

Example 3: Insufficient Equity

Request: Refinance three Qualified Debts totaling \$1,250K. Property appraised at \$1,000,000.

Final Structures: Borrower must offer \$350K in cash **OR** offer other eligible fixed assets to increase the project to \$1,389K.

With \$350K in Cash

Appraised Value	\$1,000,000
Qualified Debt	\$ 900,000
Third Party Loan	\$ 500,000 (50%)
504 Net Debenture	\$ 400,000 (40%)
Equity Contribution	\$ 100,000 (10%)

With Additional Fixed Asset Collateral

Appraised Value	\$1,389,000
Qualified Debt	\$1,250,000
Third Party Loan	\$ 694,500 (50%)
504 Net Debenture	\$ 555,500 (40%)
Equity Contribution	\$ 139,000 (10%)

Target Markets for 504 Debt Refinance Program

- Businesses that own and occupy at least 51% of their building. Reach out to existing customers with conventional loans to take advantage of historic low 504 interest rates.
- Contact title companies and commercial real estate brokers to get lists of companies that purchased commercial real estate over 2 years ago.
- Contact occupants in local industrial parks or office condominiums.
- Look for businesses with high annual cap-ex requirements. Equipment term loans can be restructured into low fixed-rate loans.

Benefits to the Bank

- Use the program as a competitive advantage—offer an SBA 504 Refinance loan before your competitor does!
- Reduce industry concentrations in your bank's portfolio by refinancing Same Institution Debt.
- Facing restrictions due to legal lending limits? Don't risk losing your great customers to another institution—recommend an SBA 504 Refinance loan!

Questions?



CDC's in WV

- **Regional Development Funding Corporation**
 - Statewide
 - Rebecca MacBlane – rmacblane@rdfc.net
 - 877-832-6504 X101
- **Business Finance Group**
 - 4 counties (Berkeley, Jefferson, Hampshire, Morgan)
 - Beth Wilson – ewilson@businessfinancegroup.org
– 800-434-9427

WV Lender Relations Contacts

Rick Haney
304-623-7449

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Or contact your local Lender Relations
Specialist – www.sba.gov