SBA 504 Loan Program More Attractive Then Ever for Banks and Borrowers

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The Small Business Administration (SBA) 504 Loan program deserves serious consideration when small business owners arrive looking for financing to expand current facilities, purchase commercial real estate or refinance an existing loan. This government-guarantee, loan program is designed to make job creation and economic development possible by providing long-term, fixed rate financing to small business owners who are investing in their companies and adding staff.

A small business that is investing in a permanent facility is often entering into its largest business-related loan, and in many cases, an SBA 504 loan becomes the basis for an entire banking relationship. Lenders have an opportunity to cultivate additional accounts and receive additional interest income from various sources. More importantly, by participating in SBA 504 loans, banks can mitigate credit risk, manage overall lending limits, and manage liquidity, while strengthening core earnings.

Since 504 loan size is linked to job creation, in general, a small business can borrow $65,000 in SBA 504 loan funds for each job created and/or retained within two years. As growing businesses are typically adding staff as they expand and move to larger facilities, they are excellent candidates for 504 loans.

Most small businesses are eligible for 504 loans. In fact, business size was recently increased late last year to allow even more small businesses to quality. An eligible small business must be operating a for-profit company that has a tangible net worth of less than $15 million and profit after taxes of less than $5 million. Also, the business must occupy at least 51% of its property for existing buildings and 60% initially of a newly constructed facility - increasing to 80% occupancy within two years. Two or more small businesses can receive an SBA 504 loan if they combine to create a real estate holding company to meet occupancy requirements. This provision works especially well for professional office buildings.

There is no limit to the total project cost for an SBA 504 loan; however, the SBA-guaranteed portion is limited to 40% of the project cost with a dollar cap of $5,000,000 depending on the type of project. 504 loans can go as high as $5,500,000 for eligible manufacturing projects and for projects that incorporate energy saving technologies for sustainable design. Project costs can also include certain soft costs including architect/engineering fees, interim interest and appraisal/feasibility studies. The 504 loan program will now allow for total projects in the range of $10 to $20 million for purchase price or construction costs for small business borrowers.

Take a look at an article published by the Office of the Comptroller of the Currency in May of 2010, "*Small Business Administration 504 Loan Program: Small Businesses' Window to Wall Street*." It provides an excellent overview of the program.

SBA 504 for Refinancing Existing Debt

SBA 504 loans can include a limited amount of debt refinancing, and recent legislation provides additional authority for qualified debt refinance and provides capital to pay business debts through September 2012. SBA guidelines are currently pending; however, this may be a free-standing financing and need not be a part of a regular SBA 504 expansion project. Based on the language in the recent legislation, to qualify for this new refinancing provision, the existing debt must:

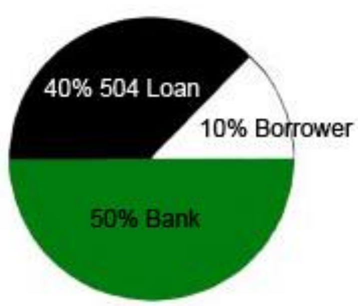
- Have been incurred not less than two years prior to the date of the refinance application;
- Be a commercial loan and not subject to any Federal guarantee;
- Have been used to acquire fixed assets which would have been eligible for financing under the regular 504 program and these assets provided to the lender as collateral; and
- Have been current for at least the past year before applying for refinancing.

The new financing may not be more than 90% of the value of the collateral securing the loan, subject to additional borrower contributions if necessary to attain the LTV. Also, the borrower must have at least a 2-year business history and the amount of the financing is limited to an amount equal to $65,000 per employee or the borrower must meet the usual job creation/protection rule.

In addition to debt refinancing, the borrower may also use specified and itemized amounts to pay business expenses, but no part of the financing may be used for non-business purposes.

Financing Structure

The SBA 504 loan program structure is straightforward. A bank or third party lender is in a first lien position and provides 50% of the project cost. The SBA – through a Certified Development Company (CDC) – is in a subordinate lien position and provides up to 40% of the project cost. The small business borrower injection is between 10-20% depending on loan specifics.



If the project involves a special purpose building or if the borrower is a startup company, the down payment increases by 5% increments. For example, if a loan is for a single-purpose building and the company is a startup, the borrower injection rises to 20%. Collateral is typically project specific which leaves working assets available for future credit needs.

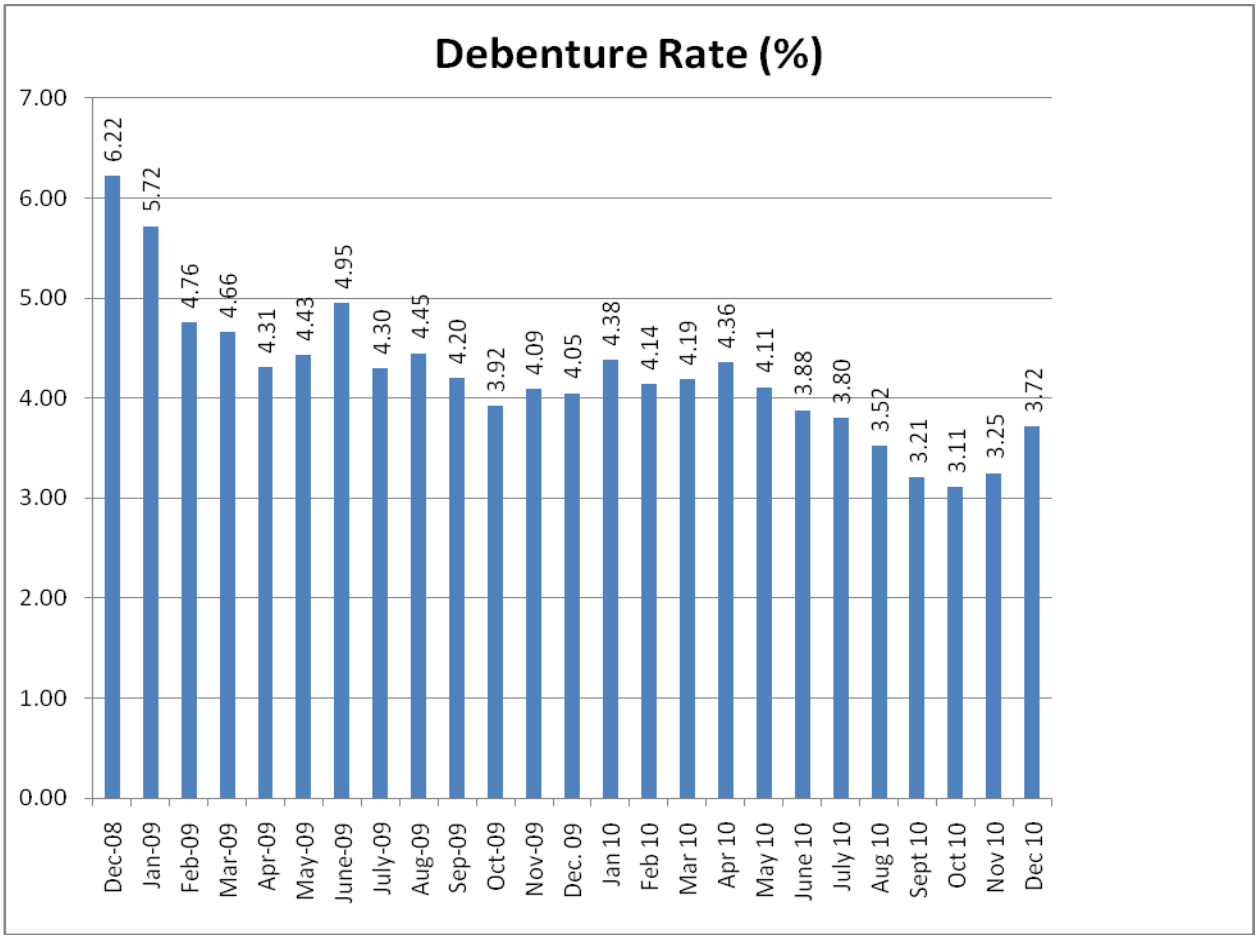
There are virtually no restrictions on the bank's loan with respect to structure or pricing. Rates can be fixed or floating. In fact, the pricing on the interim or bridge loan can be structured to reflect the greater risk during the construction phase. The only stipulation as part of 504 project financing, is that the bank's loan must be for at least 7 years for a 10-year 504 equipment loan and at least 10 years for a 504 real estate loan. The bank does its own underwriting and sets its own terms, interest rates and fees. There is a one-time fee of 0.5% of the bank loan that is paid to SBA as a program participation fee.

Once a 504 loan is approved by a lender, the application must be approved by the CDC's board of directors or its credit committee and submitted to the SBA. Once the loan is approved by the SBA, (usually in a few days) the bank receives a commitment, subject to specified conditions, to provide the takeout 504 loan.

During construction the bank funds the entire project balance minus the borrower's injection, however, within 30 to 60 days of project completion, the 504 loan will provide takeout financing thereby reducing the bank's exposure to 50% in the event of default. For equipment purchases, the takeout loan is paid based on delivery and installation. In most cases, the SBA can only collect on its 504 loan collateral after the lender is paid in full.

The CDC works with the small business borrower to process, approve, close and service the 504 loan. 504 loans are funded by monthly bond (debenture) sales to investors on Wall Street. The SBA's Central Servicing Agent wires the proceeds to the banks taking out the 504 loans and provides amortization schedules to all borrowers within a week.

When reviewing the debenture sales for the bonds sold to fund SBA 504 loans, you will see that the rates dropped into the low 4% range in 2009, fell to a record low of 3.11% in October 2010 and had an uptick in November and December to end 2010 at 3.72%.



The actual interest rate the borrower pays is calculated based on the debenture rate for the month the loan funded, a CDC fee of .625%, the Central Servicing Agent fee of 1% and the SBA Borrower Fee that changes each year. You can see that the SBA 504 loan offers extremely attractive interest rates for 20-year financing. When added to the bank's interest rate on their first lien, the blended rate and 20 year term offers real advantages to the borrower.

Benefits for Banks

If a project looks good but there are lending limits to consider, a credit enhancement is required, or the customer only wants to pledge the asset being financed, a 504 loan can be the solution. Banks advance only

50% of a project cost at the beginning of permanent financing and this 50% interest can be liquid if needed thus providing excellent flexibility for managing a bank's balance sheet. Since the bank will have to manage risk during the interim construction loan, adequate care must be taken to address all issues of security positions and any related concerns at closing.

Also, with 504, smaller banks can handle larger projects and larger banks can limit their exposure to certain industries and/or to a particular borrower. The reduction of CRE loan concentration on the balance sheet also reduces regulatory concerns. Ninety percent financing also means that more of the customer's funds remain on deposit. The bank is able to earn fees and interest on the interim loan, and generate fee income from sale premiums and loan fees if it chooses to sell the first mortgage loan in the secondary market. Banks that participate in SBA 504 loans are eligible for Community Reinvestment Act (CRA) credit on most projects.

Benefits for Borrowers

The small business owner not only gets the tax benefits and appreciation on the real estate, but also locks in occupancy costs for the long term with financing tailored to the owner's needs. In addition, with financing available for up to 90% of the project cost, SBA 504 loans offer an affordable down payment, enabling businesses to conserve working capital and retain liquidity to meet operating needs. The 504 program fees are also financed in the loan and therefore do not represent out-of-pocket expenses for the borrower.

SBA 504 loans are long-term, fully amortized financing. This enables a small business owner to avoid risky loan call provisions while enjoying lower monthly loan payments. In fact, current effective interest rates are coming in below 5% which is an extremely attractive rate for long-term commercial money. CDCs handle all of the Small Business Administration paperwork and are always available to answer all technical or programmatic questions.

Benefits to the Community

The National Association of Development Companies (NADCO), the trade association representing the Certified Development Company (CDC) industry, commissioned the first formal assessment of the SBA 504 loan program's economic impact at the national level in 2007. The study, which was conducted by Applied Development Economics, Inc. and California State University, Chico, found that the 504 Loan Program very clearly provides a cost effective means by which to generate new business activity for the national economy**.**

As an example, applying the survey results to the more than 15,000 businesses who received 504 loans nationally during the two year study period (2003-2005), the program supported the net growth of 54,000 jobs and about $4.6 billion in added labor income. Economic multiplier effects from the increase in direct economic activity contributed to the addition of another 66,000 jobs and $4.5 billion in wages and salaries. In addition to significant business generation, the study found a corresponding increase in federal, state and local tax revenues that were many times greater than the funding required to administer the program.

The study concluded that in actual dollars invested, the financing provided to small businesses by the 504 loan program through CDCs represented a ***$94.00 return per dollar of program cost*** – an exceptional return on investment. The complete SBA 504 Economic Impact Study and additional information on the SBA 504 loan program are available on the NADCO website: www.nadco.org.

The SBA 504 loan program is a win-win scenario for the bank, the small business borrower and the community.