



# **SMALL BUSINESS JOBS ACT:**

## **Temporary 504 LOAN PROGRAM DEBT REFINANCING**

### **FINAL PROGRAM REVISIONS**

Columbus District Office



# Jobs Act – 504 Debt Refinance Program

## Background

- On September 27, 2010, the Small Business Jobs Act of 2010, P.L. 111-240 (Jobs Act) was signed into law
- The Jobs Act temporarily authorizes the 504 program to allow refinance without business expansion
- The Administration had proposed that the refinance program be targeted to just refinancing of existing mortgages to “ration” program authority to the most needy
- Interim Final Rule published February 17, 2011 and implemented through Policy Notices 5000-1197 and 5000-1204 and Procedural Notice 5000-1212.



## Jobs Act – 504 Debt Refinance Program

- At the industry's request, Congress authorized that the program could also finance other business debt and expenses
  - Most comments to the interim final rule asked SBA to allow this
  - Jobs Act listening tour identified critical need for working capital
  - Sufficient program authority is available
  - It will strengthen more small business and may increase employment
- SBA Information Notice 5000-1223, dated September 30, 2011 provided FY12 fees for program
- Final Rule published October 12, 2011
- Policy Notice 5000-1225, dated October 19, 2011



Jobs Act – 504 Debt Refinance Program

# **JOBS ACT 504 DEBT REFINANCE PROJECT EXAMPLES**

# Comparisons

## Initial Program – Does not Qualify

|                             |             |
|-----------------------------|-------------|
| Appraised value of Property | \$5,000,000 |
| Outstanding Balance of Debt | \$2,000,000 |

- Third Party Loan \$2,000,000
- SBA 504 Loan \$ 0
- Borrower Contribution \$3,000,000

Under the current rules this business has no eligibility for refinance.

**New provisions in Final Rule gives this businesses access to the program.**

## TPL Less than 50% - Now Qualifies

|                             |             |
|-----------------------------|-------------|
| Appraised value of Property | \$5,000,000 |
| Outstanding Balance of Debt | \$2,000,000 |

- Third Party Loan \$1,000,000
- SBA 504 Loan \$1,000,000
- Borrower Equity Contribution \$3,000,000

- ✓ Quality lower LTV projects will now be included in the portfolio.
- ✓ Borrower benefits from access to the program.
- ✓ Equity is available for working capital

# Comparisons

## Initial Program – TPL @ 50%

|                             |              |
|-----------------------------|--------------|
| Appraised value of Property | \$10,000,000 |
| Outstanding Balance of Debt | \$ 5,500,000 |

- Third Party Loan \$5,000,000
- SBA 504 Loan \$ 500,000
- Borrower Contribution \$4,500,000

SBA in second position to a very large TPL loan which could potentially impact recovery.

## TPL Less than 50%

|                             |              |
|-----------------------------|--------------|
| Appraised value of Property | \$10,000,000 |
| Outstanding Balance of Debt | \$ 5,500,000 |

- Third Party Loan \$2,750,000
- SBA 504 Loan \$2,750,000
- Borrower Equity Contribution \$4,500,000

- ✓ Quality lower LTV projects will now be included in the portfolio.
- ✓ Borrower benefits from a larger SBA portion of the project financed at a fixed rate.
- ✓ SBA benefits with more recovery for each dollar of debenture at risk.

**New provisions in Final Rule give businesses the ability to obtain a larger SBA share.**

# Comparisons

## Initial Program – TPL @ 50%

|                             |             |
|-----------------------------|-------------|
| Appraised value of Property | \$1,400,000 |
| Outstanding Balance of Debt | \$1,000,000 |
| 90% LTV                     | \$1,260,000 |

- Third Party Loan \$700,000
- SBA 504 Loan \$300,000
- Borrower Contribution \$400,000
- Excess equity \$300,000

## Maximum Debenture – Lowest Debt

|                             |             |
|-----------------------------|-------------|
| Appraised value of Property | \$1,400,000 |
| Outstanding Balance of Debt | \$1,000,000 |
| 80% LTV                     | \$1,120,000 |

- Third Party Loan \$560,000
- SBA 504 Loan \$560,000
- Borrower Equity Contribution \$280,000
- Available for Working Capital \$120,000

- ✓ Borrower benefits from lower cost working capital and more debt at long-term fixed rates
- ✓ Borrower is trying to minimize their total indebtedness and still take out equity

**New provisions in Final Rule  
give businesses access to  
their excess equity**

# Comparisons

## Initial Program

|                             |             |
|-----------------------------|-------------|
| Appraised value of Property | \$1,400,000 |
| Outstanding Balance of Debt | \$1,000,000 |
| 90% LTV                     | \$1,260,000 |

- Third Party Loan \$700,000
- SBA 504 Loan \$300,000
- Borrower Contribution \$400,000
- Excess equity \$300,000

## Maximum Working Capital

|                             |             |
|-----------------------------|-------------|
| Appraised value of Property | \$1,400,000 |
| Outstanding Balance of Debt | \$1,000,000 |
| 90% LTV                     | \$1,260,000 |

- Third Party Loan \$700,000
- SBA 504 Loan \$560,000
- Borrower Equity Contribution \$140,000
- Available for Working Capital \$260,000

- ✓ Borrower benefits from lower cost working capital and more debt at long-term fixed rates

**New provisions in Final Rule give businesses access to their excess equity**



### Occupancy Examples

#### **Example 1:**

A business constructed a new building five years ago. It has always occupied 55% of the building and leased out the remaining. Note had a five year call and is now coming due. Clearly the business did not meet the occupancy requirements for new construction (60% immediate) and under the current rule would be ineligible for refinance assistance.

The change allows the business to meet the occupancy requirements for an existing building (51%) at the time of application. In this case the business meets this requirement and the financing can move forward.

#### **Example 2:**

A business purchased a building 7 years ago, occupying 20% and leasing out the balance. Over the years the business has grown and they now occupy 75% of the space. Although they initially did not meet the occupancy requirement, they would now be eligible as they currently occupy more than 51% of the building.



## Jobs Act – 504 Debt Refinance Program

### **Eligible Project Costs**

504 loan proceeds are to be used to refinance the Qualified Debt and any Eligible Business Expenses and other eligible costs permitted for 504 loans under 13 CFR § 120.882 (c) and (d) and 120.883 (see Job Documentation Addendum).

### **Loan Structure & Conditions**

Funding for the Refinancing Project must come from three (3) sources:

- 1.) Third Party Lender - *not less than SBA 504 loan amount*
- 2.) SBA 504 Loan - *not more than 40%*
- 3.) Borrower - *not less than 10%*



## Jobs Act – 504 Debt Refinance Program

### **ELIGIBILITY (cont.)**

- More than one loan may be combined and refinanced. As a clarification, the Qualified Debt that is being refinanced may consist of a combination of two or more commercial loans provided that the primary loan satisfies the statutory and regulatory requirements
- Debt must have been incurred not less than two (2) years prior to the date the application is received by SBA
- Short extensions of the primary loan that are less than 2 years old qualify as long as the entire indebtedness for the qualifying asset has been more than two years
- Small business concern must have been in business for two years prior to the submission of the application



## Jobs Act – 504 Debt Refinance Program

### **Eligibility - Current on All Payments Due for the Last 12 Months**

- Original definition of “current” did not include loans where the payment terms had been modified (including deferments)
- New definition is:
  - No payments more than 30 days past due according to original or modified terms (including deferments)
  - Any modification must have been entered into in writing prior to the publication of the Final Rule in the Federal Register.
- SBA reserves the right to determine if a modified payment schedule would preclude refinancing under this program (e.g. adversely affects creditworthiness)



## Jobs Act – 504 Debt Refinance Program

### Eligibility - Amount of Third Party Loan and 504 Loan

The initial program limited the total amount of refinancing to no more than the outstanding commercial mortgage

### Now

The Third Party loan and the 504 loan **combined** may not be more than 90% of the fair market value of all the fixed assets securing the loan

**This provision allows for the financing of other business expenses and debt**



### Application Requirements for Business Expenses

- Must include a specific description and itemization of Eligible Business Expenses
- **Eligible Business Expenses** means the business expenses of the Borrower:
  - Such as rent, utilities, inventory, or other obligations
  - Incurred but not paid prior to the date of the application or that will come due within 18 months of the date of the application
- Borrower and CDC must certify in the application that funds will be used for eligible business expenses
- CDC must conduct such review and inquiry of Borrower's request so as to be able to certify in the application that the funds will be used to cover eligible business expenses



## Documentation for Eligible Business Expenses

To guide the CDC's review of business expenses the business should provide documentation of past related expenses that are indicative of the level and timing of projected expenses.

### **Examples:**

- Past invoices to predict future expenses
- Past payroll documentation to predict future salary expenses
- Lease agreements
- Prior utility bills to predict future utility expenses
- Contracts
- Records of debt obligations for the small business
- Estimates from vendors

**Funds cannot be used to expand the business to another location or to acquire another business**



### **Business Expenses Verification**

- If application is approved and funds are disbursed, Borrower must be able to substantiate the use of funds provided for business expenses through its business records
- Borrower must be able to provide evidence such as
  - Bank statements
  - Cleared checks
  - Paid invoices
- Documentation must be available to SBA and CDC upon request



### CHANGES TO QUALIFIED DEBT CRITERIA

- Interim Final Rule provided that debt would meet definition of “Qualified Debt” if:
  - “substantially all (85% or more)” of the debt was for the acquisition of an eligible fixed asset, and
  - the remaining 15% was used for the benefit of the small business
- Revisions: The existing debt may qualify if the loan that originally financed the Eligible Fixed Asset satisfies the 85/15 criteria **AND** the current commercial loan is the most recent refinancing of that original loan



## CHANGES TO QUALIFIED DEBT CRITERIA (cont.)

**“Substantially All” certifications at application:**

By Borrower and CDC that debt satisfies the applicable requirements including:

Either :

- (a) **If the original loan is the current loan:** substantially all (85% or more) of the proceeds of the indebtedness being refinanced was used to acquire an Eligible Fixed Asset (e.g., land, including a building situated thereon, to construct a building thereon, or to purchase equipment) and the remaining amount (15% or less) was incurred for the benefit of the small business seeking the refinancing; or
- (b) **If the original loan has been refinanced:** The loan that originally financed the Eligible Fixed Asset must satisfy the 85/15 criteria **AND** the current commercial loan is the most recent refinancing of that original loan



### Other Qualified Debt Criteria

- Borrower and CDC certify that all of the proceeds of the indebtedness being refinanced were used for the benefit of the small business.
- Third Party Lender certifies in its commitment letter that it has no reason to believe that the existing debt does not satisfy the requirements of the program.
- Where the indebtedness being refinanced is debt of the Third Party Lender, or any of its affiliates, (Same Institution Debt), the Third Party Lender must certify in its commitment letter as follows:

**The Third Party Lender is not in a position to sustain a loss on the Refinancing Project Amount causing a shift to SBA of all or part of a potential loss from the existing debt. (Similar to language in 7 (a) refinancing SOP)**



### Changes to Qualified Debt Criteria (continued)

- Random audit: Borrower and Third Party Lender may be requested to present documentation to support certifications
  - If they cannot, both Borrower and Lender must certify that they have made a diligent search and that the documents are not in their possession
  - SBA will not cancel an approved loan before disbursement on this basis (unless the documentation shows the 85%/15% standard was not reached)
  - Original lenders are expected to be able to produce documentation



## Jobs Act – 504 Debt Refinance Program

### **Borrower's Contribution**

#### **Can be satisfied by:**

- ✓ Cash contribution,
- ✓ Equity in the Eligible Fixed Asset(s) serving as collateral for the Refinancing Project **and/or**
- ✓ Equity in any other pledged fixed assets that are acceptable to SBA as collateral

An **independent appraisal** of the fair market value of the project assets and any additional assets offered as additional collateral must be provided



## Jobs Act – 504 Debt Refinance Program

### Appraisal Requirements

- The **independent appraisal** must be submitted by the CDC and be dated within six (6) months of the date of submission.
- Appraisals are not required at the time of application. The application may contain an estimate of the value of the collateral
- Prior to closing, the CDC must submit the independent appraisal of the fixed assets in the refinancing project and any other fixed assets offered as collateral (whether commercial or residential).
- The qualifications of the appraiser and requirements of the report are outlined in SOP 50-10-5.



## Jobs Act – 504 Debt Refinance Program

### Same Institution Debt

- When the loan being refinanced is Same Institution Debt, either an escrow account or an Interim Lender may be used. If an escrow account is used, then the requirements outlined in Policy Notice 5000-1204 must be followed
- When the debt being refinanced is same institution debt, the Third Party Loan cannot be sold on the secondary market as part of a pool of guaranteed loans as per 13 CFR 120, Subpart J



## Jobs Act – 504 Debt Refinance Program

### **Same Institution Debt – Underwater Collateral**

If the amount of the refinance is not sufficient to repay the entire outstanding debt, the CDC must disclose how the balance of the debt will be handled, as noted below

The lender of the Qualified Debt may:

- a) forgive all or part of the deficiency (which may have tax consequences for the Borrower)
- b) accept payment from the Borrower for all or part of the deficiency
- c) accept a new Note for the balance which will be subordinate to the liens of the Third Party Lender and SBA

If 'c' is chosen, SBA may require the third lien note to remain on standstill for some period of time



## Jobs Act – 504 Debt Refinance Program

### Lien Positions

Lien positions on the Eligible Fixed Assets securing the Refinancing Project **MUST BE** first and second for the Third Party Lender and SBA, respectively. Any other lien must be junior in priority to these lien positions.

When other fixed assets are offered as collateral, the SBA and Third Party Lender liens may be junior to any previously existing liens on that collateral.

SBA has listed fixed assets that may serve as acceptable collateral as land, buildings, machinery, equipment , other commercial property or a personal residence.



## Jobs Act – 504 Debt Refinance Program

### Restrictions

- No refinancing of loans with an existing federal guaranty. (e.g. a 7(a) loan or USDA loan)
- No refinancing of debt if it is to:
  - An Associate of the Borrower
  - An SBIC
  - A New Market Ventures Capital Company (NMVCC)
- No refinancing of loans which is already part of an existing 504 project



## Jobs Act – 504 Debt Refinance Program

### Restrictions (cont.)

- No Jobs Act 504 Debt Refinance program loans may be processed under PCLP authority. All loans must go to SLPC for approval.
- No refinancing where the creditor on the debt to be refinanced is in a position to sustain a loss causing a shift to SBA or all or a portion of a potential loss from an existing debt.
- Under the regulations for the Temporary Debt Refinancing Program, 504 loans must be disbursed within 6 months after loan approval
  - **The SLPC Center Director may approve a request for an extension of the disbursement period up to an additional 3 months for good cause.**



## Jobs Act – 504 Debt Refinance Program

### Other Things to Know!

- All loans must be funded by the sale of the debenture within six (6) months of approval. Loans will be cancelled by SBA if not funded during this period.
- The CDC must report any delinquency to SBA after loan approval but before loan funding as an adverse change. It may or may not prevent closing
- The borrower must pay an ongoing guarantee fee of **1.103%** on the total unpaid balance of the debenture



## Jobs Act – 504 Debt Refinance Program

**QUESTIONS?**



# Contacts

**For more information about the Jobs Act 504 Debt Refinance Program contact:**

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