



The Benefits of SBA 504 Loans...

Found that perfect building, but the banker says the borrower needs 30% down? Can't afford 30%?

Plus pay for renovations and soft costs and still have enough working capital left over for the expansion? Well, a 504 certified development company can help by making a loan to buy that building through the SBA 504 loan program. Only 10%* down by borrower. All project costs are included-land, building, renovation and soft costs. The loans are long term and provide a low fixed interest rate. The SBA 504 loan program can even finance the machinery for the project. Interested?

*Please Note: Equity of 15-20% is required for start-ups and businesses with irregular profitability, lack of historical debt service ability, a short track record or for single purpose properties.

- The borrower often need only 10%* down
- Lets the borrower keep more of their cash for working capital during their expansion
- Long term -- low fixed interest rate
- Finances soft costs including accountant fees, title, insurance, attorney closing fees, etc.

The Role of Community Capital Development Corporation

Community Capital Development Corporation (CCDC) is a regional economic development organization that is licensed by the U.S. Small Business Administration (SBA). CCDC covers the entire state of Ohio. CCDC makes loans under the SBA 504 loan program to assist small business. In addition, CCDC makes loans under the State of Ohio Regional 166 Program and the City of Columbus Economic Development Loan Programs. CCDC processes, approves, closes and services the loans. Funding is arranged by the CCDC issuing a bond, and in all ways, the CDC is the direct lender for the SBA 504 loan program.

Eligibility for SBA 504 Loans:

- Organized as a for-profit business. The only not-for-profit companies eligible for SBA 504 loans are sheltered workshops.

- Legal entity-corporation, partnership, sole proprietor, limited liability company.
- Any type of legitimate business- manufacturing, wholesale, service, professional service or retail.
- Located in, or planning to, locate in any area of the United States.
- Small business - either: net worth under \$7 million & net profits after taxes under \$2.5 million or meet SBA's other size standards (by sales or number of employees depending on NAICS code).
- Planning to use the loan proceeds for capital investment (land, building, leasehold improvements, renovation, construction, machinery & associated soft costs). The SBA 504 loan program is not a working capital program. See uses of loan proceeds section for more details.
- Another lender must be willing to participate in the financing. The SBA 504 loan finances up to 40% of the total project cost and the other lender finances 50%. The business or its owner typically puts in 10%. Economic development goals must be achieved through the project being financed. See section on economic development requirements.
- Owner-user of the project being financed (51% occupancy if existing building; 60% occupancy if new construction) Two or more unrelated small businesses may receive a 504 loan to buy or construct a building as long as they, together, will occupy at least 51% an existing building or 60% of new construction.

Companies that are not eligible for SBA 504 loans are:

Not-for-profit businesses (except sheltered workshops); businesses engaged in lending (such as banks, finance companies); passive holders of real estate and/or personal property; life insurance companies -- however an insurance agency is eligible;) businesses located in a foreign country or owned by aliens; businesses selling through a pyramid plan; illegal businesses; businesses which restrict patronage; government owned entities (excluding Native American Tribes); businesses engaged in promoting religion; consumer and marketing cooperatives (producer cooperatives are eligible); businesses engaged in loan packaging; businesses owned by persons of poor character; equity interest by lender, CDC or associates in applicant concern; businesses providing prurient sexual material; businesses that have previously defaulted on a Federal loan; businesses engaged in political or lobbying activities; and speculative businesses.

What are the Permitted Uses of 504 Loan Proceeds?

- Acquisition of vacant land for construction of a building
- Acquisition of land and building
- Leasehold improvements

- Renovation of building; addition to building
- Construction of a building
- Acquisition of a commercial fishing vessel or party boat
- Acquisition of heavy duty machinery & equipment (such as printing press)
- Associated soft costs: Title searches & insurance; attorneys fees; appraisals; environmental reports; architects; permits; surveys; installation of machinery; points on bridge loans, small amount of furniture and fixtures, etc.
- Not permitted are mortgage broker fees; points on permanent financing; moving expenses.
- Refinancing is not permitted except to take out financing on property acquired within last 9 months with interim funds.

Economic Development Requirements

SBA 504 is a community lending program designed to improve the locality. Eligibility requires either:

1) Job creation or retention (one job per every \$50,000 borrowed from CDC under SBA 504)

OR

2) One of the following public policy goals to:

- Revitalize a business district of a community with a written revitalization or development plan
- Expand exports
- Expand minority business development (owned 51% or more by minority business person)
- Aiding rural development
- Change necessitated by federal budget cutbacks
- Change required by mandated standard re health, safety, environment
- Increase productivity & competitiveness (retooling, robotics, or modernization)
- Expand woman-owned business development
- Expand veteran-owned business development

One of the following community development goals to:

- Help to improve, diversify or stabilize the economy of the locality
- Stimulate other business development in the community
- Bring new income into the community
- Assist manufacturing firms
- Assist businesses in a labor surplus area.

SBA 504 is not a real estate investment tool. It exists to help the community by helping small business have an impact on the community-by creating jobs or in other ways benefiting the community.

Deal Structure -- Financing

The borrower determines the total project cost (hard and soft costs). A bank or other financial institution finances 50% of the cost and takes a first mortgage (lien) position on the assets financed. CCDC, through the SBA 504, finances 40% of the project cost up to a cap and takes a second mortgage position. The borrower can put in as little as 10% equity.

Typical Project:

Cost

Acquisition of building	\$800,000
Renovations	\$100,000
Machinery	\$50,000
Soft costs	<u>\$50,000</u>
Total	\$1,000,000

Financing

Bank - first mortgage	\$500,000 permanent loan
CCDC/SBA 504 (2nd)	\$400,000 permanent loan
Equity	<u>\$100,000</u>
Total	\$1,000,000

Note: the seller can provide the 50% permanent financing but, under current regulations, the seller must be co-equal to or subordinate to the SBA 504 loan. The 50% can come from a variety of non-federal sources such as banks, non-bank institutions, government agencies.

Amount of 504 Loan

The CDC can lend up to 40% of the project cost with a dollar cap of \$1,500,000. CCDC can exceed \$1,500,000 and go up to \$2,000,000 of SBA 504 financing under the following conditions:

- the project will help revitalize a business community with a written revitalization plan or
- the project will help the company to expand its exporting or
- the company is 51% or more minority, woman or veteran owned or
- the company is locating in a rural area or
- the project will increase productivity and competitiveness by retooling, modernization or assistance in competing with imports, or
- the business was affected by federal budget cutbacks (such as defense downsizing).

CCDCs can also lend up to \$4,000,000 for eligible manufacturing projects.

Rates and Terms

The rate on the SBA 504 portion is set when CCDC sells the bond to fund the loan. The rate is then fixed for the loan term. SBA 504 bonds are amortized

securities. For comparable rates, look at treasury rates. The SBA 504 rates can be found in the "About DCFC" Section of the NADCO.org web site. The effective rate (APR) will include program fees and a loan loss subsidy.

Loans are ten or twenty years; self liquidating. In order for the CCDC to do a 20-year loan, the lender doing the 50% permanent first mortgage must have at least a ten year term. That lender can have a longer pay-out. Typically, lenders will lend with a 15-20 year term and 20-year payout. For a CDC to do a ten-year loan, the 50% lender must have a term of at least 7 years. Many lenders will match CDC's ten year term.

Principals (owners)

Owners must be US citizens or registered aliens with green card.

Owners cannot be convicted felons currently on probation.

Anyone who owns 20% or more of the operating company must personally guarantee (unsecured general guarantee).

Liquid assets of the principals are taken into account in determining eligibility. Too much liquid assets owned by a principal could disqualify the loan because it will be deemed that the project could be financed by the principal without SBA 504 assistance.

Collateral

CCDC takes a subordinate (second mortgage) to secure its 40% portion of the financing, and the CDC takes a security interest in assets financed. Key Person life insurance is generally not required unless there is no succession of management. Other assets of the business or principals are generally not required. (unless the company is a startup or the credit is unusually risky, or the asset being financed is considered a single purpose asset or doesn't appraise high enough).

Fees and Payments

All of the fees on the SBA 504 loan are added to the loan amount so that the borrower can amortize their cost over the loan term. The borrower will sign a note for the 40% of project cost plus the fees. Fees are based on the 40% of project cost: 1.5% of the 40% goes to CDC as its processing fee; 1/4 of 1% of the 40% is a funding fee; loan loss coverage fee; various closing costs will be included; an amount for CCDCs recording fees and title insurance can not be added to the loan. In addition, when the loan closes, the borrower's monthly payment will include servicing fees based on the declining balance of the SBA 504 loan: 0.5% to CDC; 0.125% to SBA; 0.10% to central servicing agent.

Payments on the SBA 504 loan are made by ACH debit to the borrowers designated checking account on the first of each month after the loan closes. Payments on the 504 loan are separate from the borrower payments on the 50% first mortgage loan.

Special Notes

There is a prepayment penalty for the first half of the loan term on the SBA 504 loan. In start up situations or single purpose buildings being financed, an equity injection of 15% is required.

CCDC is a permanent lender only. This means the 50% first mortgage lender will have to bridge the Certified Lender's 504 loan portion until the project is complete. CCDC will sell its bond and fund its loan when the certificate of occupancy is issued. Interest and fees on the bridge loan can be included in the project costs to be financed.

Process

The process begins either with a call to one of CCDC's experienced loan officers or to the borrower's bank of account to see if the bank wants to participate by doing the permanent first mortgage and bridge loan. It is recommended that the prospective borrower meet with a CCDC loan officer to help structure the deal. Materials submitted to CCDC consists basically of the same materials the borrower will submit to their bank. Basic application materials include:

- 3 years of financial statements and federal tax returns on the company (if in existence for 3 years);
- if there is no historical cash flow ability to service the proposed new debt, submit 2-3 years financial projections;
- personal financial statement (assets and liabilities) on the owners of the company;
- written history of the business, reasons for expansion, plans;
- copy of contract of sale;
- personal history statement of principals indicating citizenship status, etc.

CCDC's staff will investigate and evaluate the borrower and their company. CCDC will draw credit reports, do supplier, bank and trade checks, visit the existing and proposed operations/facilities; assess the borrowers credit ability and character. Once the bank or other 50% first lien lender has indicated an interest in financing the 50%, CCDC staff prepares a loan memorandum and presents it to CCDC's Board and Loan Review Committee which meets at least once per week. Once the board approves the project, CCDC presents the application to the SBA to acquire its agreement to guarantee the CDC's bond. This generally takes a five to seven days. CCDC then issues a commitment and the

borrower's bank closes its first mortgage loan and bridge loan. The borrower takes the bank's funds to complete the project. When the project is complete, the borrower closes with CCDC and CCDC wires its money to the bridge lender. The borrower then pays CCDC back for the SBA 504 loan. CCDC services the loan for its life.

Advantages of SBA 504 over Conventional Financing

Low down payment. Just 10%. Lets the borrower preserve their cash for working capital. Most banks will lend only 60-70% of the appraised value of the project leaving the borrower to sink in 30-40% plus the cost of renovations, plus the soft costs.

Fixed rate on the SBA 504 portion. The borrower doesn't have to worry about the prime lending rate going up. They can plan because they know the amount of their mortgage payments for the next 20 years.

Long term. CCDC 504 loans are for 10 or 20 years. Because CCDC is in second lien position, the bank or other lender doing the 50% first lien loan are willing to lend at a longer term. Longer terms make the borrower monthly payments lower.

Low interest rate. Even with all the fees and closing costs included in the rate, it is still a low rate for a subordinate mortgage loan, particularly for small business. The blended rate between the bank portion and the Certified Lender's 504 portion makes the project affordable for borrower.

For the banker wishing to participate as the 50% lender here are the advantages:

- they lend at a lower loan to value ratio;
- they keep a growing customer happy;
- they have lower risk because the SBA 504 loan is in second position behind CCDC
- they get CRA credits;

The community gets the advantage of keeping or attracting a

healthy, growing small business that will be creating jobs and doing other wonderful things in the community.

Borrowers and Bankers may also wish to visit the SBA website at:

www.sba.gov/financing/sbaloan/cdc504.html

SBA 504 Loans are a Win-Win for Everyone!