

# 504 Loan Program

Presented By:

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# Our Goals Today

- ▶ Overview of the 504 Program and the Certified Development Company's (CDC) Role
- ▶ Why Use the Program?
- ▶ Who's Eligible?
- ▶ What's New?
  - ▶ Newly Enhanced 504 Refinance Component
- ▶ 504 Closing & Funding Process
- ▶ Real Life Examples
- ▶ Questions

The background features abstract, overlapping geometric shapes in various shades of blue, ranging from light sky blue to deep navy blue. These shapes are primarily located on the right side of the slide, creating a modern, dynamic feel.

# 504 Overview & Certified Development Company's Role

# 504 Loan Program

- ▶ Established to help businesses looking to acquire, expand, or construct owner occupied commercial real estate and / or equipment with lower down payment requirements than conventional financing to preserve working capital.
- ▶ Program goals include Job Creation and/or Public Policy & Local Development Goals
- ▶ A 504 loan reduces the risk to the participating lender through it's structure as second mortgage financing.
- ▶ 504 loans are funded through a sale of a Debenture that are guaranteed 100% by SBA
- ▶ Administered by SBA through Certified Development Companies like WBD and BLP
- ▶ Competitive, long term fixed-rate financing (10, 20, or 25 years)
- ▶ Lower down payment requirements than conventional financing

# 504 Lending - By the Numbers

- ▶ FYE 9/30/21 - In the State of WI:
  - ▶ 341 Loans for \$297,781,000, leveraging \$670,007,250 in Total Financing
  - ▶ WI represented 3.62% of the National 504 Approval Dollars
- ▶ YTD through 3/31/22 (6 months into FYE) - In the State of WI:
  - ▶ 192 Loans for \$161,687,000, leveraging \$363,795,750 in Total Financing
  - ▶ WI represented 3.01% of the National 504 Approval Dollars YTD 2022
  - ▶ 504 Lending up 40% (in terms of Dollars Approved) compared to this time last year
  - ▶ Midwest Region up 52% (in terms of Dollars Approved) compared to this time last year

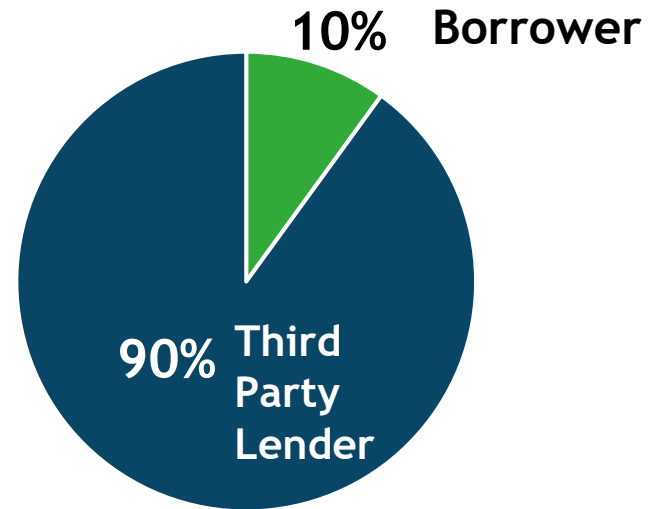
# Common Industries / Projects

- ▶ Manufacturing
- ▶ Professional Buildings
- ▶ Self-Storage Facilities
- ▶ Restaurants
- ▶ Retail
- ▶ Assisted Living (CBRF / RCAC)
- ▶ Hotels / Resorts / Campgrounds
- ▶ Business Acquisition including Real Estate

# Why use the program?

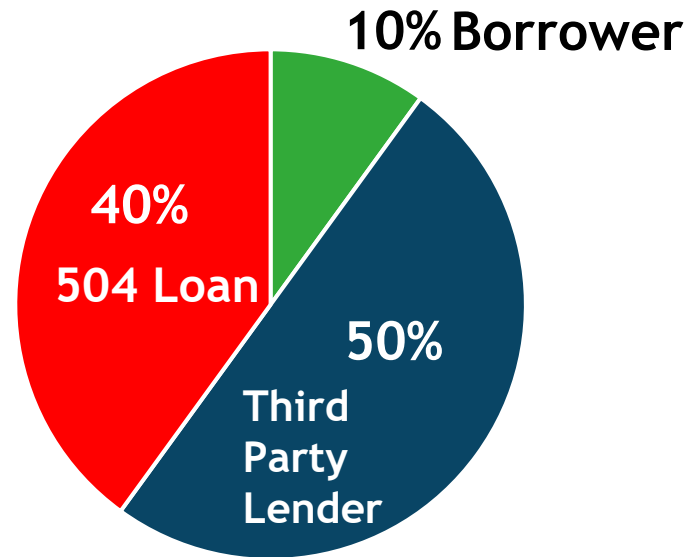
A great tool to help your customers in a volatile market

## Interim Financing



■ Borrower ■ Third Party Lender

## Permanent Financing: 50-40-10



■ Borrower ■ Third Party Lender ■ 504 Loan

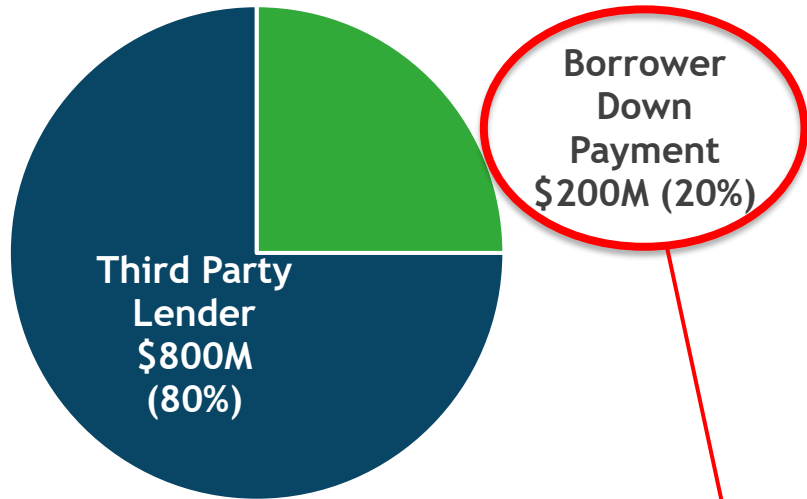
## Typical 504 Loan Structure

- Third Party Lender's (TPL) portion is a conventional loan
- TPL may take additional collateral during Interim
- 504 portion has 100% SBA guaranty

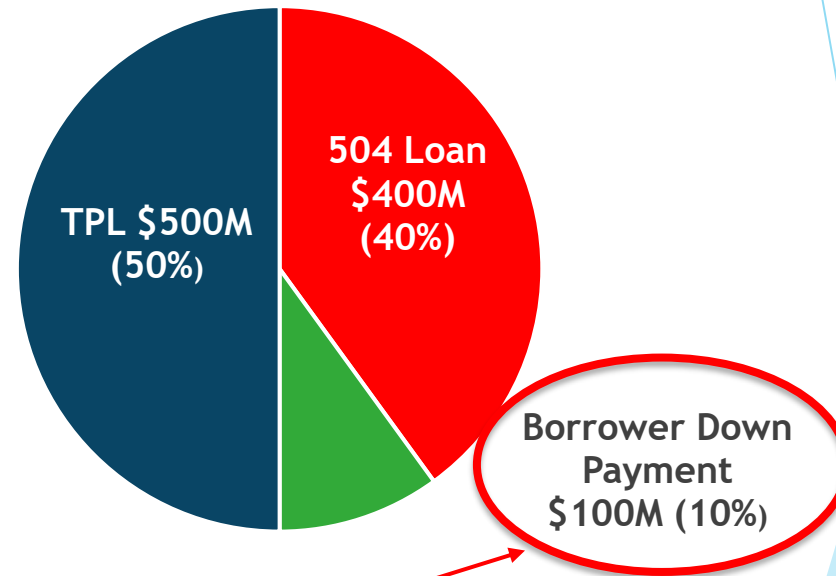


# Cash is King in a Volatile Market

Typical Conventional Structure  
\$1,000,000 Project



Typical 504 Structure  
\$1,000,000 Project



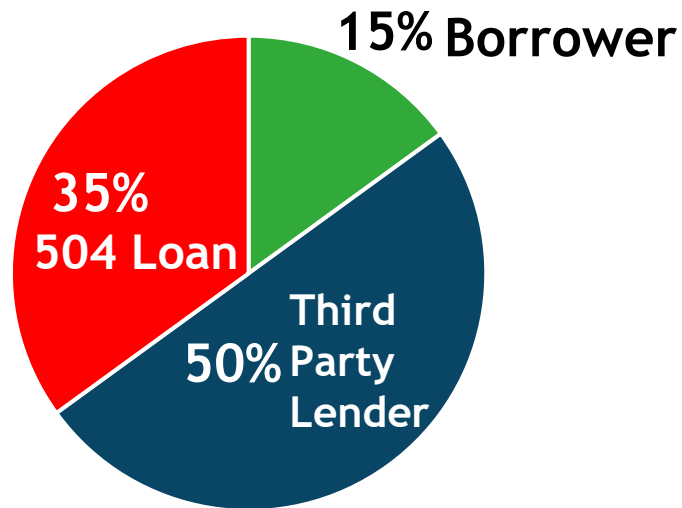
\$100,000 lower down payment = Improved Cash Position!

# Lower / Flexible Borrower Contribution

- As little as 10% down
- Owner's Personal Cash
- Cash from Business Operations
  - Interim interest
  - Down payments related to eligible project costs
- Proceeds from Seller, Municipal Loan, or TIF
  - Borrowed funds secured by project assets must have the same Term as the 504 debenture
  - Municipal loans with favorable terms may be granted an exception to this “same term” rule
  - If unsecured, no minimum term or percentage of project requirement
- Equity in Real Estate
  - “As Is” appraised value, less existing debt, if owned at least 2 years

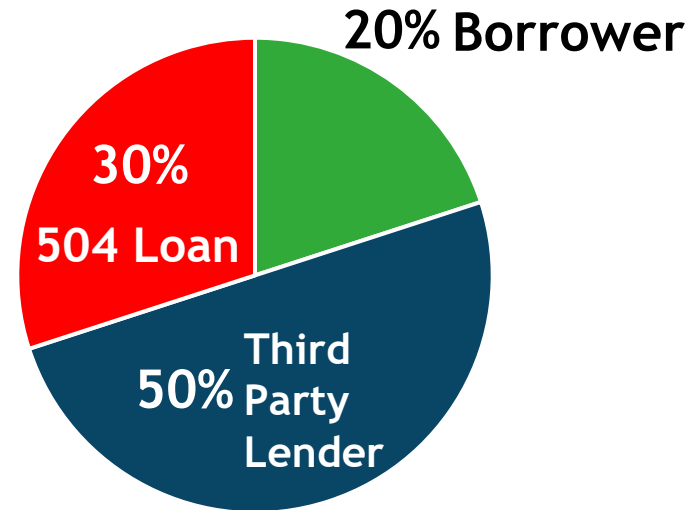
# Special 504 Loan Structures

Start-up **OR** Special Purpose R/E  
50-35-15



■ Borrower ■ Third Party Lender ■ 504 Loan

Start-up **AND** Special Purpose R/E  
50-30-20



■ Borrower ■ Third Party Lender ■ 504 Loan

- Third Party Lender must be at 50% participation in both scenarios
- If a borrower (including affiliates) has an outstanding debenture for a Project that is a limited or special use asset, the borrower must contribute 20% for each project after the first one.

# Long-Term Financing Commitments

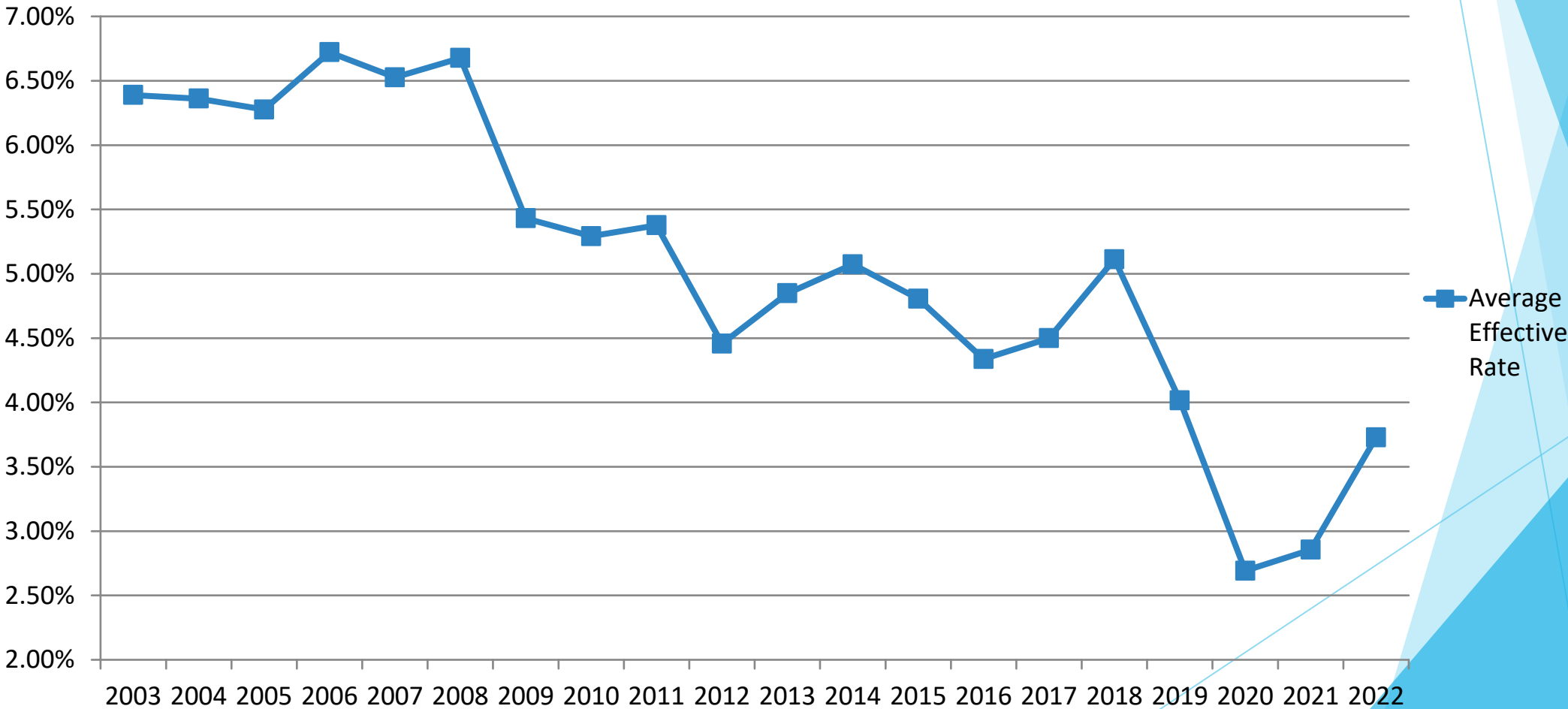
- ▶ **25-Year or 20-Year Debenture (Real Estate):**
  - Third Party Lender's loan must have at least a 10 year maturity
  - Combined real estate & equipment projects (mixed-use) are possible based on concentration of equipment
  - Declining Voluntary Prepayment Penalty applies for 10 years
- ▶ **10-Year Debenture (Equipment):**
  - Third Party Lender's loan must have at least a 7 year maturity
  - Equipment project may be financed with a 20 year or a 25 year Debenture based on the equipment's certified useful life
  - Declining Voluntary Prepayment Penalty applies for first 5 years
- ▶ **Amortization of Third Party Lender's loan does not have to match the SBA 504 Debenture**

# Competitive Long-Term Fixed Rate

- ▶ **Current Effective 504 Fixed Interest Rates:**
  - ▶ 25 Year - 4.68% (April 2022)
  - ▶ 20 Year - 4.62% (April 2022)
  - ▶ 10 Year - 3.82% (March 2022)

# Rate History - 20 Year Effective Rate

## Average 20 Year Effective Rate



# Key Takeaways

- ▶ Provides an affordable payment structure, with long term financing commitments
- ▶ Borrower hedges interest rate risk on up to 40% of the financing structure
- ▶ Helps your customers preserve working capital with lower down payment requirements than conventional financial
- ▶ Very comfortable post debenture funding LTV position (typically 50%)
- ▶ Reduced Audit Scrutiny
- ▶ Third Party Lender's loan is not subject to annual SBA loan servicing fees
- ▶ Lender does not have to perform monthly SBA loan reporting on its Third Party Lender loan

# Who's Eligible?

High Level 504 Eligibility



# What's the 504 “Sweet Spot”?



# Eligible Businesses - Lots of them!

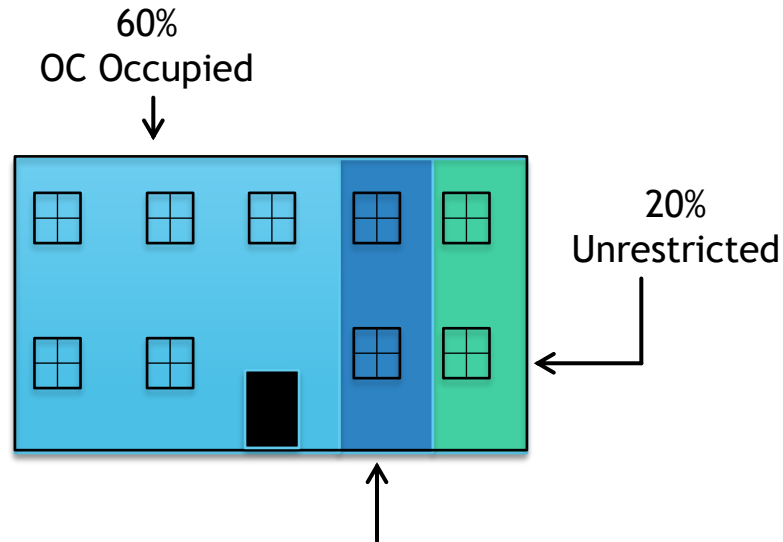
- ✓ Must be organized **for profit**
- ✓ Can be either a **new or existing** business
- ✓ Must be 'small' per SBA 504 size standard (including Affiliates)
  - ✓ Tangible **Net Worth ≤ \$15MM** and
  - ✓ 2-year **Average Net Income ≤ \$5MM**
- ✓ Or must be 'small' per SBA 7(a) size standard (including Affiliates)
  - ✓ Maximum Revenue or Employment
  - ✓ Determined by NAICS Code
- ✓ **Ineligible** business types include:
  - ✓ Non-profits; Real estate investment properties; gambling; etc.

# Eligibility - Eligible Use of Funds

- ▶ Eligible Use of Funds
  - Owner Occupied Commercial Real Estate
  - Equipment
  - Project Related Eligible Soft Costs
    - Professional Fees
    - Cost of Appraisal & Environmental Reports
    - Interim Interest
  - Refinance w/ Expansion - Up to 100% of expansion costs
  - Permanent Refinance Program - Discussed Later
- ▶ **Ineligible 504 Project Costs**
  - Working Capital; Inventory; Other Current Assets
  - “Goodwill”; Other Intangible Assets

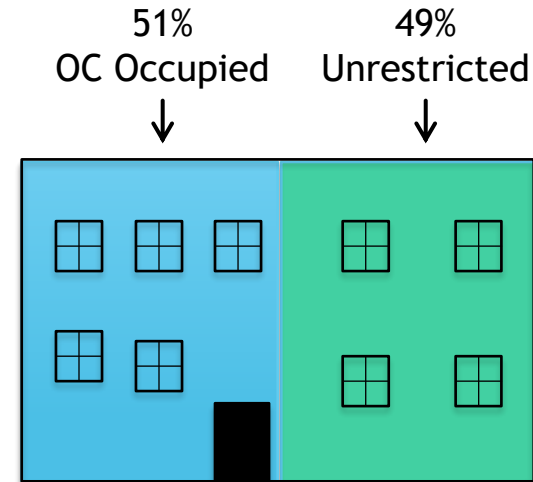
# Eligibility - Occupancy Rules

## New Construction



20% - Short Term Lease  
Borrower must begin occupying this space in  
Year 3 and occupy it by Year 10

## Existing Real Estate



Rentable Property in both cases may also include exterior space, not including parking, used by the business; e.g. storage yard for contractors, trucking companies, landscapers, etc.

# Eligibility - Maximum Loan Size & Funding Limits

- ▶ **\$5 million maximum loan in all eligible cases**
  - ▶ Represents total exposure available to Borrowers and their Affiliates
  - ▶ Includes loan being applied for plus any existing 504 or 7(a) loans
- ▶ **\$5.5 million per project for eligible small manufacturers**
  - NAICS codes beginning with 31, 32, or 33
  - Must create/retain one job per \$100,000 in SBA financing, or meet a SBA policy goal
- ▶ **\$5.5 million per project for projects (capped at \$16.5MM in aggregate exposure)**
  - That reduce energy consumption by at least 10%
  - That generate 15% of energy used by the project location

# 504 Refinance Component - What's New?

# What's New - Some Hurdles Removed

- ▶ Reduces *Qualified Debt* seasoning period to **6 months** from 2 years
  - ▶ (Note: business still needs to be operating at least 2 years at application date)
- ▶ 12-month payment **currency** - **now a credit decision**
  - ▶ No longer does a past due payment automatically disqualify a refinance opportunity.
- ▶ **Refinance of existing government guaranteed debt (SBA 504 loans, 7a loans, etc.) now allowed!**

# What is a Qualified Debt?\*\*\*

- ✓ Loan(s) was incurred at least 6 months prior to application date
- ✓ No modifications within the past 6 months
- ✓ At least 85% of original use of proceeds being refinanced was used to acquire a 504 eligible asset which will secure the proposed 504 refinance project
- ✓ Other Items:
  - ✓ Copy of note(s) being refinanced and corresponding collateral documents must be provided
  - ✓ SBA still requires a loan history / transcript of account for the prior 12 months - Payment currency is now a credit decision vs. an eligibility determination

**\*\* All Refi Loans Must include Qualified Debt**



# REFI of SBA 7(a) and 504 loans - YES!

- ▶ Subject to the following requirements:
  - ▶ 504:
    - ▶ Both the Third Party Lender (1<sup>st</sup> REM) and 504 loan (2<sup>nd</sup> REM) are being refinanced
  - ▶ 7(a):
    - ▶ CDC needs written verification that current lender is either unwilling or unable to modify the current payment schedule.
    - ▶ Same institution 7(a) debt refinance - eligible if the lender is unable to modify the terms of the existing loan because a secondary market investor will not modify terms
  - ▶ 504 and 7a -
    - ▶ Must demonstrate a 10% cash flow savings (cash out excluded from calculation)

# Understanding LTV Limitations

- ▶ **Straight Refinance of Qualified Debt - 90% LTV**, based on a current appraisal
- ▶ **Refinance of Qualified Debt with Cash Out - 85% LTV**, based on current appraisal;
  - ▶ Cash out amount cannot exceed 20% of the appraised value
- ▶ **Structure Based Updated Appraised Value** - even if borrower has owned the property for less than 2 years. (assuming all other 504 REFI criteria are met)

# Cash Out for Business Expenses

- ▶ **Eligible Business Expenses = operating expenses of an eligible Operating Company:**
  - ▶ Payoff / pay down an operating LOC - Borrower needs to certify funds were not used for capital expenditures
  - ▶ expenses such as salaries, rent, utilities, inventory, etc.
  - ▶ credit card debt on card in the name of the business; certify business purpose
  - ▶ expenses incurred but not paid prior to the date of SBA application
  - ▶ expenses that will come due within 18 months of application date
- ▶ **Ineligible Business Expenses include**
  - ▶ Partner buyout
  - ▶ paying off existing loans
  - ▶ expand footprint of building
  - ▶ purchase additional fixed assets
  - ▶ expenses incurred for "upkeep and maintenance" of Project Property, such as new roof, repaving parking lot, flooring, redecorating, etc.
  - ▶ business acquisition

# 504 Refinance - Other Key Requirements

- Third Party Lender loan amount is at least the same amount, or greater, than the SBA 504 loan amount
- SBA 504 loan amount is not greater than 40% of the appraised value (35% if special use property, 30% if second-time 504 special use)
- Current environmental report dated within 12 months of the application date is required
- Current appraisal report dated within 12 months of the application date is required
- Lien positions on Eligible Fixed Assets securing loan must be a 1<sup>st</sup> for Lender and 2<sup>nd</sup> for SBA (other assets offered as collateral may have existing priority liens)
- All loans must be funded by the sale of the debenture within 9 months of approval. An extension can be requested from the SBA- Sacramento Loan Processing Center

# 504 Expansion with Refinance Update



# 504 Expansion with REFI?

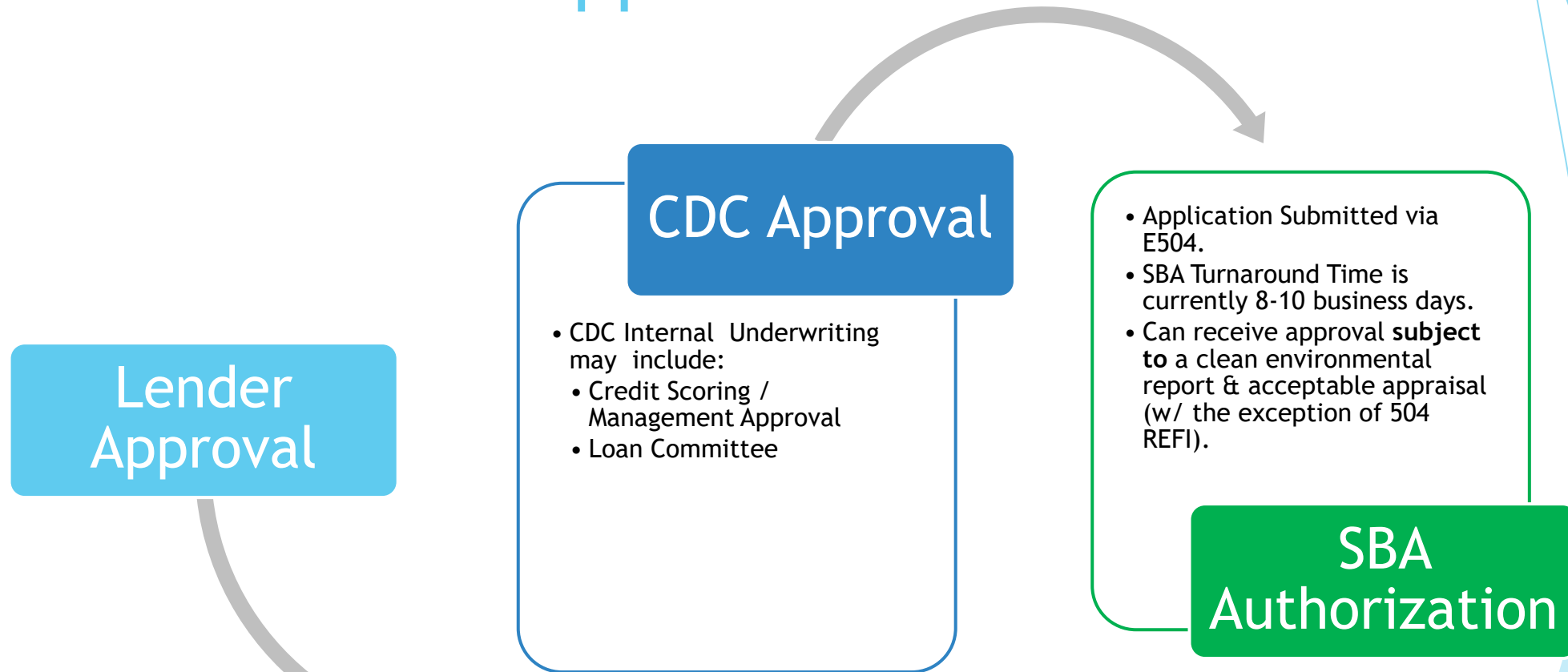
- ▶ Part of traditional SBA 504 Loan Program
- ▶ Allows a limited amount of debt refi when a 504 Project involves Expansion
- ▶ **\*\*\*Eligible debt refi amount is now limited to 100% of new expansion costs (up from 50%)\*\*\***
- ▶ Applicant must still be current on all payments due for 12 months preceding SBA application date
- ▶ “Expansion” - defined at 13 CFR 120.882(f):
  - ▶ Any Project involving acquisition, construction or improvement of land, building or equipment for use by the small business concern (SBC)

# Expansion Debt Eligibility

## Eligible Debt Refinance

- ▶ Existing debt that does not exceed 100% of the expansion costs - no requirement for age of debt
- ▶ 85% of the original use of proceeds on the note(s) to be refinanced have been used for a 504 eligible purpose
- ▶ If the existing debt exceeds the expansion cost, the difference can be added to the TPL's front-end loan

# SBA 504 Loan Approval Process



Currently 4-5 Weeks with a Complete Application Package



# Credit Underwriting - Items of Note

- ▶ CDC's and SBA emphasize management & cash flow in underwriting. We recognize that 504 projects are leveraged & that the CDC/SBA portion is under-secured.
- ▶ Unlike the 7(a) program, we are NOT required to take all available business & personal collateral available if under-secured based on project assets.
- ▶ 2020 results are discounted due to Pandemic
- ▶ Debt service Coverages calculated without Pandemic Relief \$
- ▶ 2021 Debt Service Coverage weighted heavily in underwriting

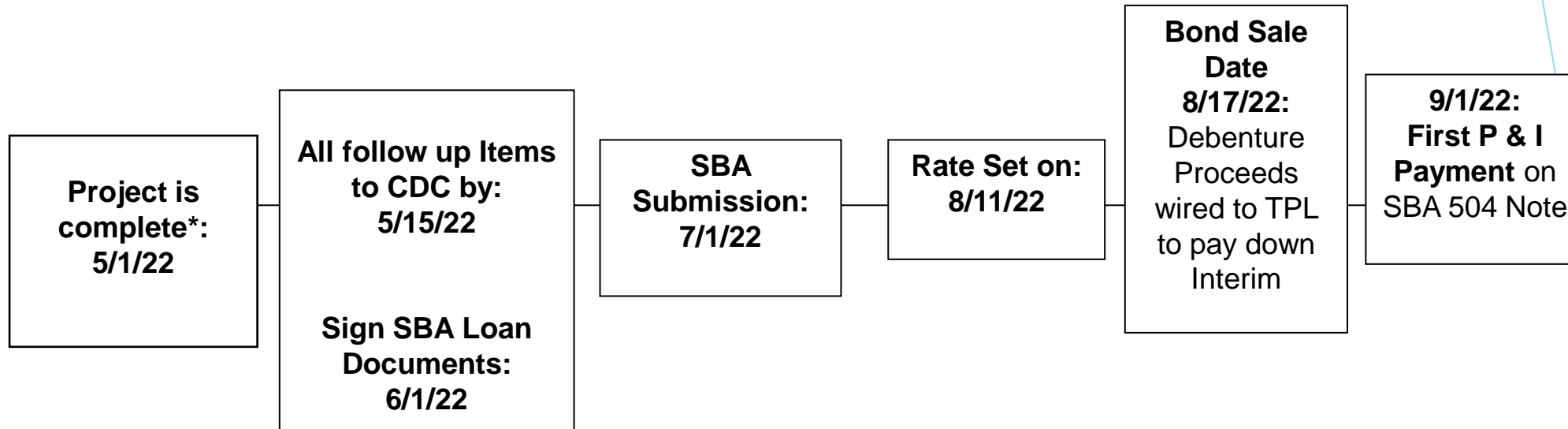
# Other Considerations - Get your CDC involved Early on in the Process

- ▶ Franchise, Dealer, or Supply Agreements
- ▶ Development Agreements
- ▶ Third Party Management Agreements
- ▶ Affiliation - Reviewed for Size Standards and Global Cash Flow
- ▶ EPC (aka Real Estate Holding Company) & OC Lease Requirements

# 504 Closing & Funding Process

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# Example 504 Funding Timeline



## \*Definition of a complete project:

- ▶ Straight Real Estate Purchase / Refinance:
  - ▶ Third Party Lender closes on the purchase or refinance
- ▶ Construction Project:
  - ▶ Construction is complete and final draw has been disbursed
  - ▶ Certificate of Substantial Completion is signed off on by the General Contractor
  - ▶ Clean Occupancy Permit (if applicable) has been issued by municipality

Real Life Examples - Join us for the  
Case Study Session for More!

# #1 - Real Estate Purchase: Basics

## ▶ **Business Background & Current Situation:**

- ▶ Established architectural and civil engineering firm founded in 1989
- ▶ In 2017, the operating company was sold to four long term employees via a stock sale
- ▶ Current owners lease the office building from the prior owner and are looking to purchase the building to complete the buy-out

## ▶ **Preliminary Borrower Financing Request:**

- ▶ Purchase Price of Building - \$1,390,000

# #1 - Real Estate Purchase: Structure

504 Uses of Funds:		504 Sources of Funds:		
Purchase Land & Building	\$1,390,000	Third Party Lender	\$700,000	50.00%
Soft Costs	\$10,000	SBA 504	\$560,000	40.00%
		Borrower Contribution	\$140,000	10.00%
Total	\$1,400,000	Total	\$1,400,000	100.00%

## ▶ Project Considerations:

- ▶ Considered an existing business and the property is not considered a Special Purpose Property by SBA; therefore, the required Borrower Contribution is 10%
- ▶ Seller of the real estate was related to one of the owners of the operating company, therefore, this wasn't considered an arms length transaction. Thus, the appraisal was required prior to submitting an application to SBA for approval.
- ▶ Building is 5,000 square feet, of which, 900 square feet was leased to an un-related third party tenant. A couple of considerations:
  - ▶ Owner Occupied test was met, as 51% or more was leased by the OC
  - ▶ Lease to un-related third party tenant was required to be a sub-lease from the OC to the tenant to meet SBA requirements
- ▶ Rent replacement provided a monthly savings of \$1,400 (rent vs P&I payments)

# #2 - Refinance with Cash Out: Basics

- ▶ **Business Background & Current Situation:**
  - ▶ Long established agricultural equipment dealer
  - ▶ Company operates under several dealer agreements
  - ▶ 2<sup>nd</sup> generation involved in the management of the company and are the future succession of the company
  - ▶ Business concerned about interest rate risk and potential slow down in the economy, so they asked their current lender about fixed rate solutions
  
- ▶ **Current Debt Schedule:**
  - ▶ Real Estate Note - \$545,000
  - ▶ Revolving LOC Balance - \$1,230,000 (commitment of \$1.9MM)



## #2 - Refinance with Cash Out: Structure

504 Use of Funds		504 Source of Funds		
Real Estate Equity	\$ 567,000.00	Third Party Lender	\$ 414,000.00	29.7%
Refinance Real Estate Debt	\$ 545,000.00	SBA 504 Debenture	\$ 414,000.00	29.7%
Cash Out - Paydown RLOC	\$ 279,000.00	Real Estate Equity	\$ 567,000.00	40.6%
Soft Costs	\$ 4,000.00			
	\$ 1,395,000.00		\$1,395,000.00	100.0%

### ▶ Project Considerations:

- ▶ Real Estate Note met qualified debt criteria
- ▶ Original mortgage debt goes back many years and several lenders ago, making documenting original use of proceeds difficult\*
  - \*CDC had the borrower certify that 85% of the original use of proceeds was for fixed asset purposes
- ▶ Appraisal on the real estate came in at \$1,395,000
- ▶ Max LTV when including cash out for business expenses is 85%, however, the cash out portion cannot exceed 20% of the appraised value

# Summary

- ▶ Fixed Asset Request > \$350M? Think 504!
- ▶ Provides an affordable payment structure, with long term financing commitments
- ▶ Borrower hedges interest rate risk on up to 40% of the financing structure
- ▶ Helps your customers preserve working capital with lower down payment requirements than conventional financial
- ▶ Very comfortable post debenture funding LTV position (typically 50%)
- ▶ Contact your CDC early on in the process!

Questions?

# Presenter Contact Information



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