Black Hills Community Economic Development

SBA 504 Loan Information Guide

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"Economic Growth through Community Cooperation"

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Previous Editions are obsolete
A Certified Development Company

SBA 504 LOAN PROGRAM

ADVANTAGES

By using the Small Business Administration (SBA) 504 Loan Program, which is administered by the Certified Development Company (CDC), small businesses realize the following advantages:

1. Low Down Payment (10%-20%)
2. Long Maturities (up to 20 years)
3. Fixed Interest Rate (typically below market)
4. Collateral incentives for bank participation

QUALIFYING PROJECTS

Generally, any project involving the purchase, construction or improvement of fixed assets is eligible. Examples include:

1. Land & Building Acquisition
2. Construction or Renovation
3. Purchase of Durable Machinery or Equipment
   (useful life of 10 years)

Furniture, fixtures and soft costs such as professional fees and interest during construction are eligible with a few exceptions. <u>Investment, residential properties, and refinancing are not eligible.</u>

ELIGIBILITY REQUIREMENT

Many types of businesses are eligible: manufacturing, distributing, retailing, service companies and others. Start-ups as well as existing businesses may participate in the program.

Businesses must address each of the following requirements to apply for a 504 loan:

1. Property must be owner-occupied. If purchasing an existing building, the small business must occupy at least 51%. If constructing a new building, the business must OCCUPY at least 60%.

2. The project must, according to SBA guidelines, promote

economic development. This includes one of the following: Creation of jobs; location in a distressed area; or promotion of Minority-owned, woman-owned, or veteran owned business development. To meet job creation requirements, reasonable projections must show that one full-time equivalent job will be created over the next two years for every $50,000 the CDC lends.

3. The business must be for-profit and must average less than $3 million in profits and less than $8.5 million in tangible net worth to qualify.

4. The SBA may fund up to 40% or $50,000 - $1,500,000 in the form of a debenture to any approved project (special circumstances may allow a maximum debenture up to $2,000,000).

HOW THE PROGRAM WORKS

Each 504 Loan Package is typically structured with three elements as follows:

1. The Certified Development Company (CDC) loans *up to* a maximum of 40% of the total project costs, while meeting the job creation requirements mentioned above.

2. A Third Party Lender, usually a bank, finances 50%, of the remaining portion of the project's total cost.

3. The borrower must provide *at least* 10% equity in the project. There are occasions when the borrower may be required to come up with additional equity.

    → <u>New Business Ownership</u>: SBA defines a new business as a start-up, a business with less than two years of historical operation. The purchase of an existing business, no matter how long in operation, is always considered "new business ownership" by SBA. New businesses/ownership are required to inject an additional 5% equity.
    → <u>Single-Use vs. Multi-Use</u>: A Single-Use facility will require an additional 5% equity. SBA maintains a list of single-use properties.
    → <u>If a borrower happens to meet both of the above, they will be required to come up with a total of 20% equity.</u>

The Third Party Lender will be in first collateral position; the CDC will accept a subordinated collateral position.

The SBA 504 program provides **permanent financing**. An interim lender (usually the same as the Third Party Lender) provides interim financing during the construction phase or for the purchase of property. Once the transaction has taken place, construction, if any, has completed, and the business occupies the space, the CDC closes and funds the SBA loan. There is an approximate 60 day span between “closing” and “funding” of the SBA loan.

Time Frame
From the time the CDC receives the completed application, it typically takes 15-30 days to receive approval.

INTEREST RATE

The interest rate on the SBA’s percentage of the loan is fixed, and is based on the 10-year Treasury note plus fees (see below for details). The maturity is 10 or 20 years depending on the assets being purchased. The interest rate on the bank loan is negotiated by the borrower.

This possible combination of fixed and variable financing provides an effective hedge against interest rate fluctuation. If rates increase, the borrower is locked in with the relatively low CDC rate on its 40% portion of the financing. If rates decrease, the bank's rate decreases with their 50% portion of the loan.

***The CDC disburses its loan after the project is complete (construction is finished/business is purchased). The interest rate is determined at this time and is fixed for the life at the CDC loan.

FEES

Application/Origination Fees

The program has some fees that the borrower must consider when applying to use government funding. The Application/Origination fee on the loan is approximately 2.15% of the SBA loan, which is a combination of three separate fees.
The following is a breakdown of the Application/Origination Fee:

1. <u>CDC origination Fee</u>: 1.5% of the SBA loan. This fee is paid to the CDC for packaging your loan and preparing the extensive application for the SBA to review.

2. <u>Underwriting Fee</u>: 0.40% of the SBA loan. Covers expenses of pooling & underwriting 504 debentures paid directly to Merrill Lynch.

3. Funding Fee: 0.25% of the SBA loan. This fee is paid to the Central Servicing Agent (Colson Services)

The above 3 fees are added together to give a total Application/Origination fee of approximately 2.15%. These fees are financed into the SBA loan.

Closing Fees

A $2,500 CDC attorney fee is charged for closing each loan. This fee is also financed into the SBA loan.

Ongoing Servicing Fees

The program has 2 ongoing servicing fees that are included in the fixed interest rate, based on the 10-year Treasury bill. As discussed earlier your interest rate is based on a monthly debenture sale and fees are added back onto the debenture rate to come up with the final fixed rate.
The following is a break down of the ongoing servicing fees.

1. CDC Ongoing Fee: The annual servicing fee is approximately 0.625% of the outstanding balance and is paid over the life of the loan. This fee is automatically added to the borrower's monthly payment, which is fixed for the life of the loan.

2. Colson Services Ongoing Fee: The annual servicing fee for Colson is 0.100% of the loan. Once again this fee is added to the treasury yield to determine in your final interest rate.

Please talk with your CDC representative to get the recent rates with all fees on both the 10-year and 20-year bonds.

PREPAYMENT

The 504 loan may be prepaid; however, it must be paid in full. A prepayment penalty is assessed during the first half of the loan term. The fee declines over time beginning at one year's interest. There is no penalty if prepayment occurs in the second half of the term.

In any prepayment, but borrower must pay the sum of all of the following amounts due and owing through the date of the next semi-annual Debenture payment:
Principal balance
Interest
Fees
Expenses incurred by CDC for which borrower is responsible, and
Any prepayment premium

The bank loan can generally be prepaid according to terms negotiated between the bank and the borrower.

Please talk with your CDC representative for more details on the Prepayment of a 504 loan.

COLLATERAL

Personal guarantees are required. Additional collateral (other than the assets to be purchased with loan proceeds) may be required and could include personal assets and life insurance.

CASE EXAMPLE

A manufacturer wants to purchase a 25,000 square foot building and equipment to expand the business. The financing requirements would be as follows:

Purchase of Building	$450,000
Purchase of Equipment	$40,000
Professional Fees	$10,000
TOTAL	$500,000

If a bank was willing to finance the project conventionally, it would typically lend 80% of market value of project costs ($500,000 x 80% = $400,000) at a variable interest rate such as 2% over the prime rate for ten years. Assume that prime rate is 10%.

However, with the 504 program the borrower could finance 90%, (500,000 X 90% = 450,000). The bank would lend fifty percent at prime rate plus 2% variable for ten years and the CDC would lend forty percent at 10% fixed for 20 years (see table below).

The advantages to 504 financing are:

1) Down payment is $50,000 lower.

2) $2,664 less annual debt service while financing an additional $50,000.

	Conventional Bank Loan	504 Program
Bank	$400,000 (10 years)	$250,000 (10 - 15years)
CDC	$0	$200,000 (20 years)
Small Business	$100,000	$50,000

* Assuming that at least six jobs are created.

FOR FURTHER INFORMATION

Call Black Hills Community Economic Development at (605) 381-2591.

Legal Representative
The borrower may be represented by an attorney during the closing process. The CDC and its legal counsel prepare all the closing documents in participation with the borrower's attorney.

NOTICE

IMPORTANT INFORMATION ABOUT IDENTIFICATION PROCEDURES WHEN OBTAINING A 504 LOAN

To help the government fight the funding of terrorism and money laundering activities, Federal law requires all Certified Development Companies to obtain, verify, and record information that identifies each person who applies for a 504 Loan.

What this means for you: When you apply for a 504 Loan, we will ask for your name, address, date of birth, and other information that will allow us to identify you. We may also ask to see your driver's license or other identifying documents.