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Growing Small Businesses: The SBA 504 Loan Program

The Small Business Administration (SBA) 504 Loan Program provides an alternative to conventional financing for small businesses that may have issues qualifying for a traditional loan. SBA 504 Loans provide long-term financing for the acquisition or refinance of major fixed assets, such as owner-occupied real estate and long-term machinery and equipment. Though a slightly more involved and complex process than a conventional loan, this program provides small businesses the opportunity to receive up to 90% financing from outside sources. There are three instrumental players to the SBA 504 Loans: the borrower, the lender and the certified development company (CDC). The typical structure of a SBA 504 loan is 10% down by the Borrower, 40% financing from the CDC and 50% financing from a certified Lender.

The Players

The Borrower

SBA 504 Loans are only available to a certain type of company. In order to be eligible for a SBA 504 Loan, a business must be a for-profit company with a tangible net worth of less than $15,000,000.00 and an average net income of less than $5,000,000.00 after taxes for the preceding two years. While exclusions exist, SBA 504 Loans are generally available to a legitimate business involved in manufacturing, wholesale, service, professional service or retail located in the United States. While these businesses must not have funds available from other sources, such as individual owners or the company itself, they must be able to repay the loan on time from the projected operating cash flow of the business.

SBA 504 Loans are only available for specific purposes, including the purchase of land and existing buildings, the purchase of improvements, such as landscaping or utilities, the construction of new or modernization of existing facilities, or the purchase of long-term machinery and equipment. Historically, an SBA 504 Loan has not been permitted for use as working capital or refinancing of existing debt; however, recent changes to the program allow cash out for future operational needs as well as refinancing of existing debt.

Since the SBA lending program is designed to improve local communities, eligible borrowers must qualify under a specified public policy goal. Borrowers must either create or retain one job for every $65,000.00 guaranteed by the SBA, or further a public policy goal such as expanding minority-owned, woman-owned or veteran-owned business development or revitalizing a business district of a community with a written revitalization plan.

The Lender

Like any loan, a SBA 504 Loan originates with a traditional lender. The lender will evaluate whether the Borrower is a candidate for a 504 loan. If so, lenders are typically attracted to these deals for several reasons. SBA 504 Loans can retain and attract customers, assist in risk and liquidity management and provide fee and interest income at lesser risk than typical loans. Since the Lender only finances up to 50% of the loan, the loan-to-value ratio does not exceed fifty percent. While the Lender has limited credit risk, it still maintains a first lien on the property securing the loan.

Lenders have the potential for increased risk associated with a SBA 504 Loan, however, since they typically provide the bridge financing for the delay between the funding of the bank loan and the funding of the CDC loan. While the lender maintains a 90% loan to value ratio during this time, lender banks are generally unconcerned since this exposure is typically only for an average of 45 days.

The Certified Development Company

A Certified Development Company (CDC) is typically a nonprofit organization certified by the SBA to provide funding for small businesses under this program. The CDC provides up to 40% of the financing for this loan. It works closely with the Borrower to process, approve, close and service the loan. CDCs generate the funds to support the loans by issuing 10- or 20-year debenture bonds that are sold to investors. While this structure provides long-term, low, fixed interest rates to small businesses, it is attractive to investors since the bonds are backed by the SBA and fully guaranteed by the U.S. Treasury. New Jersey has 5 CDCs located in Central and North Jersey.

The Process

The SBA 504 Loan application process is slightly more involved than an application for traditional financing. In addition to completing the SBA 504 Loan Application, the Borrower must provide a statement of personal history and a personal financial statement from the principal(s) of the Borrower, in addition to business financial statements, projected financial statements and profit & loss statements. In addition, the Borrower must provide a list of names and addresses of any subsidiaries and affiliates, resumes for each principal and a brief history of the business and its challenges, which includes an explanation for why the SBA 504 Loan is necessary. This process requires further documentation as well, including copies of income tax returns, business leases, business certificates and licenses and the loan application history of the Borrower.

While the process may be difficult, SBA 504 Loans are an excellent opportunity for small businesses that may lack the liquidity to qualify for a traditional loan. By only requiring 10% down, SBA 504 Loans allow small businesses to get the financing they need to expand. ■

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