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# SBA Loan Program Gives Owners the Edge

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**BANKS AND SMALL-BUSINESS OWNERS ARE DISCOVERING A LOAN PROGRAM THAT KEEPS THEM COMPETITIVE AND MITIGATES RISK.**

**W**e all know how tough these economic times are. Let's face it: Banks are handling a heavy load of problems and are more selective about extending credit.

Small-business owners know what they're up against too. Two of the most recognized hurdles facing business owners are preservation of capital (Will a large down payment strain my cash flow?) and the ability to find appropriate financing (What types of financing are best for me? Will I qualify for real estate financing?). It has become increasingly difficult for small-business owners to get a conventional loan because of more stringent loan terms and higher credit standards.

Wouldn't it be nice if you could use a program that would benefit both the banker and the borrower - that would make both more competitive in their respective markets? A program that would provide the borrower with 90% financing on the acquisition loan and slash the lender's risk to half of the project cost? How? Through a program many people don't even know about. The SBA 504 Loan Program.

The 504 Loan Program, established by the U.S. Small Business Administration, was designed to promote economic development and is structured to be a win-win situation for both banks and business owners. Small-business owners are able to use up to 90% financing to acquire/remodel their commercial property. Lending institutions benefit by being able to extend financing to companies in a way that may not otherwise be available, and the bank gets first lien position on the assets financed. The bank sets the interest rate for its portion of the loan, and by

participating with the SBA, it also meets economic development and community reinvestment goals.

The program works in conjunction with local banks to allow business owners to receive up to 90% financing for the acquisition, construction, improvement or expansion of commercial property or for acquiring heavy machinery or equipment. The program essentially consists of three key elements: 50% of the project's total cost is provided by a lending institution, usually a bank; 40% is provided through the 504 Loan Program; and 10% equity is provided by the borrower. (Startup businesses and single-purpose facilities require a slightly higher equity contribution.)

Most types of businesses are eligible to receive 504 financing. Businesses with a successful track record and growth potential can generally qualify for the program, as can startup companies if they are for-profit and average less than \$3 million in after-tax profits and \$8.5 million in net worth. Qualifying projects should involve the purchase, construction or improvement of fixed assets such as land and buildings and/or the purchase of heavy machinery or equipment. Projects that qualify must, according to SBA guidelines, promote economic development, which generally means the creation or retention of jobs.

There is no limit on the size of the deal, but the SBA participation is limited to \$1.5 million. This amount is increased to \$2 million for projects that fulfill public policy goals, such as expansion projects for minority, female or veteran business owners. For manufacturing companies, the SBA participation amount is increased to \$4 million.

Another nice feature of the program is that some furniture, fixtures and small equipment can be added to the 20-year loan. For example, a hotel that would cost \$2 million to construct may have \$300,000 in furniture and equipment. Rather than having a short-term five-year loan on the \$300,000, the business owner can add this amount to the total project and have it financed

over the 20-year term. This increases the cash flow of the borrower as well as the borrower's ability to be successful.

Overall, the benefits of the 504 program include:

#### **Benefits to Borrowers:**

- There is a low down payment (10% in most cases), which helps preserve working capital.
- There is a low, fixed interest rate, which avoids future rate fluctuations.
- The loan term is long, which brings debt service in line with cash flow generated by the business.
- Loans are advanced based upon project costs and not appraised value.
- Other assets are prevented from becoming encumbered.
- The borrower has an option to refinance debt related to fixed assets if also looking to borrow more money to finance a real estate or equipment purchase.

#### **Benefits to Lenders:**

- There is reduced risk with 50% loan-to-value (LTV) ratio.
- The bank has first lien.
- It expands the lender's customer base - if you're on the fence about whether to approve a deal, with a 50% LTV, your risk is substantially reduced.
- Overall lending limits are managed.
- There is a fixed or variable rate option on the bank loan - and banks set their own rates.
- There are higher customer deposits at the bank.
- The program meets economic development and community reinvestment goals.

To gauge the effects the 504 Loan Program has had on individual businesses, the National Association of Development Companies completed an economic impact study in late 2007. More than 75 percent of the businesses polled reported increasing revenue within two years of their 504 loans, and 62 percent reported job growth.\*

The SBA authorizes Certified Development Companies (CDCs) to administer SBA 504 loans throughout the United States. The various roles of a CDC include assisting businesses and lenders in qualifying projects for 504 financing and preparing/processing a complete application, obtaining approval from the SBA, and closing the 504 loan.

With 504 rates at just over 5% for a 20-year fixed mortgage, the 504 Loan Program is promoting economic development while providing numerous benefits to banks and business owners. And in today's tough economic environment, using the 504 Loan Program is vital to gaining the competitive edge in small-business financing. ■

*Clay Lindhorst is vice president of Small Business Growth Corp., a Certified Development Company. His company focuses exclusively on providing SBA 504 loans, and he is an expert in assisting small businesses and lenders with 504 financing. Contact him at 314-292-9531 or read about the program at [www.growthcorp.com](http://www.growthcorp.com).*

*\*Data taken from the National Association of Development Companies SBA 504 "Growing Small Businesses, Jobs, Communities" 2008 Economic Impact Study. To read the report in its entirety, go to [www.nadco.org](http://www.nadco.org).*