

Lender's Guide
SBA 504 LOAN PROGRAM
(Updated 11/2022)



Prepared by:

Capital Matrix, Inc.

(208) 383-3473

(800) 568-9363

FAX(208) 383-9404

E-mail: sba504@capitalmatrix.org
www.capitalmatrix.org

TABLE OF CONTENTS

Overview of 504 Program.....	3
Benefits of SBA 504 Loan.....	4
Features of SBA 504 Loan	
Use of Loan Proceeds	5
Refinance with Expansion	6
Refinance without Expansion	7
Project Size	8
Maximum Loan Amount.....	9
Down Payment Requirement.....	9
Personal Guaranties.....	10
Terms	10
Interest Rate.....	10
Fees	10
Appraisal & Environmental Requirements.....	11
Eligibility	
Size Standard.....	12
Occupancy Requirement	12
Ownership of Project Assets.....	12
Job Creation Requirements	13
Application	14
Closing and Funding	15
Servicing.....	17
Appendix A (Sample Bank Commitment Letter).....	18
Appendix B (Checklist for Construction Related Costs).....	19
Appendix C (Environmental Information).....	20-26
Questions.....	27

OVERVIEW OF SBA 504 PROGRAM

Congress established the SBA 504 loan program in order to promote the growth of small businesses by expanding their access to favorable long-term **fixed asset financing**. Borrowers and lenders can access 504 financing through a certified development company that is certified and regulated by the Small Business Administration to make 504 loans.

Capital Matrix, Inc., a certified development company, serves Idaho, Montana, Southeastern Oregon (counties of Harney and Malheur), and Eastern Washington (counties of Asotin, Spokane, Pend Oreille, and Whitman). Capital Matrix, Inc. has been providing 504 loans to borrowers since 1984 and has funded almost 1,500 loans totaling over \$500 million.

Capital Matrix' goal is to provide **quality, timely** loan processing for you and your customer. The responsibilities of Capital Matrix include:

- Providing information about the 504 program to lenders and prospective borrowers
- Assessing eligibility of borrowers and projects
- Completing all SBA application forms
- Underwriting, processing, closing, and servicing 504 loans.

504 financing can provide up to 90% financing to existing businesses with a successful track record. More equity will be required for start-ups, businesses with irregular profitability, lack of historical debt capacity, special purpose facilities, etc. Financing for a 504 loan comes from three different sources: a lender, Capital Matrix, and the borrower. The percentage of the funding is typically as follows:

- 50% - from the lender through a conventional real estate loan
- 40% - from Capital Matrix through the issuance of debentures*
- 10% - from the borrower

* The debentures, which are guaranteed by the SBA, are pooled nationally and sold monthly. The debentures bear the going market rate, which usually results in more favorable interest rates to the business.

BENEFITS OF SBA 504 LOANS

Benefits to Lender

- With a 50% loan-to-value ratio, the lender is able to reduce the risk of lending to small businesses.
- Through participation in 504 financing, the lender is able to demonstrate CRA compliance and involvement in community lending and development.
- There are no fee or interest rate restrictions on the lender's portion of the 504 loan.
- Lenders faced with loan limit restrictions can spread capital among more small business borrowers.
- Because of their high quality (low loan to value), 504 loans can be sold in the secondary market. (Contact Capital Matrix for more information on accessing secondary market.)
- Since the 504 loan package is prepared by Capital Matrix, the lender saves on time and labor costs.
- Lenders build stronger banking relationships by providing their customers the benefits of 504 loans.

Benefits to Borrower

- The 504 program provides below-market, long-term, fixed-rate funds which enhance the cash flow and profitability of small businesses.
- The lower down payment requirement enables small businesses to conserve valuable working capital for future growth.
- Increase return on equity/investment.
- Fully amortized loans (no balloon payment) with terms of 10, 20 or 25 years.

Benefits to Community

- 504 loans permit viable businesses to expand at an accelerated rate, thereby creating jobs, generating taxes, and stimulating the overall economy.

FEATURES OF SBA 504 LOANS

Financing on a Typical \$1,000,000 Project

<u>Entity</u>	<u>Loan Amount</u>	<u>% of Project</u>	<u>Security</u>
Lender	\$ 500,000	50%	1 st DOT
Capital Matrix	\$ 400,000 + fees	40%	2 nd DOT
Business	\$ 100,000	10%	
Total	\$1,000,000	100%	

Use of Loan Proceeds

The 504 program provides loans to businesses for fixed-asset acquisition or expansion including the following:

- Purchase land and construct new buildings.
- Purchase an existing building and make necessary renovations.
- Acquire and install machinery/equipment.
- Construct or remodel buildings on leased land (where the lease is as long as the term of the 504 loan).
- Other costs associated with a project are also eligible for financing, e.g., architects and engineering fees, appraisals, environmental reports, interim interest, interim loan fees, title insurance, and impact fees.
- Refinance of existing debt with Expansion (details on page 6)
- Refinance of existing Debt without expansion (details on page 7-8)

Costs incurred directly attributable towards a project are generally eligible project costs.

SBA 504 loans are for permanent financing. The lender must provide interim financing of up to 90% of the project costs to cover the cost of construction, the purchase of a building, and/or the purchase of equipment. Upon completion of the project and funding of the debenture, the SBA 504 loan proceeds are applied to the interim loan, reducing the lender's loan-to-value to 50%.

Refinance of existing debt with Expansion

The project must involve the EXPANSION of a small business:

“Expansion” is broadly defined to include any project that involves the acquisition, construction or improvement of land, building or equipment for use by the small business.

New project (*expansion*) can include:

- Purchase of land or land & building
- Construction/remodeling
- Purchase/install equipment or fixtures
- Professional fees
- Other expenses

Existing debt cannot exceed 100% of the new project (expansion or cost)

Example:

Renovations	\$ 450,000
Professional fees	\$ 50,000
Total Cost of Expansion	\$ 500,000
<i>Refinanced Debt</i>	<i>\$ 500,000 (does not exceed 100% of expansion)</i>
Total Project	\$1,000,000

All the following debt refinancing requirements must be met:

1. Existing debt used for 504 eligible assets (85% or more)
2. Existing debt incurred for the benefit of the small business
3. Existing debt collateralized by the fixed assets
4. Refinancing will provide a substantial benefit to borrower (better terms or rates, including prepayment penalties, financing fees and other financing costs)

Using existing equity as required injection:

For example, \$500,000 is needed in new financing for an addition to a facility and there is an existing \$500,000 mortgage. The required 10% injection will come from equity in existing land and building. The project cost is increased by 10% for the required injection or to \$1,111,111. An appraisal will be required to verify equity of \$111,111.

If the refinanced portion of the project does not meet the eligibility requirements (exceeds 100% of expansion cost), the lender may still consolidate an existing mortgage on the project real estate with new debt related to construction or remodeling of a building. In such cases, part of the existing debt will be added to the lender's loan but is not considered part of the 504 project.

Example:

\$500,000 in new financing for an addition to a facility and existing mortgage is \$600,000 (only \$500,000 of existing debt is eligible as 504 eligible cost)

Lender Loan	\$ 555,556	(50% of 504 project)	Including remaining debt	\$ 655,556 (+remaining debt)
Capital Matrix	\$ 444,444	(40% of 504 project)		\$ 444,444
Borrower	<u>\$ 111,111**</u>	(10% injection from equity)		<u>\$ 111,111**</u>
	\$1,111,111	Total Financing		\$1,211,111

(**assumes borrower has equity in land & bldg. of at least the 10% required down payment)

Refinance of Existing Debt without expansion

Refinance of existing debt without expansion will be in effect only in any fiscal year in which the subsidy cost is zero. Refinance projects will be limited to 50% of approved CDC (Capital Matrix) loans during the previous fiscal year.

All the following debt refinancing requirements must be met:

1. Borrower has to be in operation for at least two years from the date of application
2. Borrower has to meet all 504 loan program requirements
3. Borrower must satisfy the job creation and job retention requirements
4. Refinance under the 504 program must include Qualified Debt
5. Refinance project may include a combination of two or more loans
6. Refinance project may include eligible business operating expenses

Qualified Debt

1. Substantially all (85% or more) of the proceeds were used to acquire 504 eligible assets
2. Debt incurred no less than 6 months prior to the application date
3. Refinance of the existing debt has to benefit the small business

Refinance of qualified debt secured by eligible 504 fixed assets can be financed up to 90% of appraised value (85% of appraised value for special use projects).

If the project will include eligible business operating expenses(cash out), financing is limited to 85% of the appraised value.

Eligible Operating Expenses

1. Business expenses including salaries, rent, utilities, inventory, or other obligations of the business that were incurred but not paid prior to the loan application or that will become due for payment within 18 months after the date of the application.
2. Business operating expenses are limited to 20% of the value of the fixed asset securing the qualified debt.

Example:

Refinance \$300K existing qualified debt plus \$160K for business operating expenses. Property is appraised at \$800K.

Appraised Value = Project	\$800K
Qualified debt	\$300K
Bus. Expenses	\$160K (20% of appraised value)
Total Financing	\$460K (57.5% LTV)
Third Party Loan	\$230K (28.8% of project or 50% total financing needed)
SBA 504 Loan	\$230K (28.8% of project or 50% total financing needed)
Borrower Equity	\$340K (42.5% of project)

Project Size

Minimum project size is \$100,000; there is no upper limit on project size.

Maximum Loan Amount (Gross Debenture)

Capital Matrix' portion of the 504 financing is limited to 40% of total eligible project costs or the maximum debenture, whichever is less.

Maximum Debenture cannot exceed:

1. \$5,000,000 for regular 504 loans and borrowers (this is the max cumulative SBA eligibility per borrower, incl. all affiliate businesses, not a per loan limit).
2. \$5,500,000 ** for a manufacturing company or businesses who can provide a reduction in energy consumption by at least 10%.
3. \$5,500,000 ** if project generates 15% of the energy used by renewable energy or renewable fuels, such as biodiesel or ethanol production.

** On a \$5,500,000 debenture the maximum loan amount applies to each PROJECT, rather than per borrower (the max accumulate SBA eligibility per borrower is \$16,500,000).

Please note, as SBA loan fees are included in the debenture, the net loan proceeds of a \$5,000,000 debenture is \$4,867,500; the net proceeds of a \$5,500,000 debenture is \$5,354,250.

Down Payment Requirement

If the borrower is an established business, the typical down payment requirement is 10%. When financing is requested by a business that has been in operation less than 2 years or for the purpose of purchasing or constructing a special purpose facility, an additional five percent (5%) down payment is required, and the Capital Matrix financing would be reduced to 35% of project costs. Lender financing has to be at 50%.

If the business is less than two years old and the project is special purpose, a 20% down payment would be required, and Capital Matrix financing would be reduced to 30%.

In some circumstances, the down payment/equity can be in the form of subordinated debt or equity in the real estate to be improved/expanded. To determine value of equity, real estate owned two years or more will be valued at current market value as determined by an appraisal; real estate owned less than two years will be valued at cost.

SBA allows for seller carry back as part of the required down payment. An appraisal is required with the application. Seller carry back has to mirror the terms of the SBA 504 loan if secured with 3rd lien on the project property.

Personal Guaranties

Owners of 20% or more of the small business or the eligible passive company (real estate holding company or other entity which is to own project assets) are required to guarantee the loan. SBA may require owners with less than 20% ownership to guarantee to strengthen the project.

Term of the Loan

The Capital Matrix portion of the financing is funded through an SBA-guaranteed debenture sold for a term of either 10, 20 or 25 years. Equipment financed through a separate SBA loan must have at least a 10-year economic life.

The lender must provide a minimum 10-year maturity when there is a 20 or 25 year 504 loan; any amortization of 10 years or longer is acceptable. The interest rate may be adjusted periodically. When the SBA provides a 10-year loan, the lender must provide a minimum term of 7-years.

Interest Rate

Capital Matrix' portion of the financing is a fully amortized, fixed-rate loan. The rate is established when the project has been completed, the SBA loan has been closed, and the debenture sold. (Visit us at www.capitalmatrix.org for current rate information).

The lender independently negotiates the rate and fees on its portion of the financing.

Capital Matrix quotes an effective interest rate each month, which includes servicing fees of approx. 1.6%.

Fees

One-time loan fees on a 504 loan are approximately 2.15% of the financing provided by Capital Matrix (i.e., up to 40% of the project cost). These fees are financed in the SBA loan.

The lender may charge fees on its portion of the financing. The SBA charges the lender a one-time fee of 0.5% of their permanent loan amount. This fee is due at the time the SBA loan is closed.

SBA regulations require that an attorney reviews and certifies Capital Matrix' closing documents. The typical charge for this legal review is between \$800 and \$1,000. This expense is passed on to the borrower. These fees can be financed as part of the closing costs.

Prior to submitting an application to the SBA, Capital Matrix requires a deposit of up to \$2,500 from the borrower. If the SBA declines the application the deposit will be refunded. If the application is approved, the deposit will be credited towards the SBA loan closing cost. Once the application is approved by the SBA, the borrower will be required to pay a refundable 1% processing fee on the SBA loan. The processing fee will be refunded once the SBA loan funds. If the application is withdrawn after SBA approval, the processing fee will not be refunded.

Appraisal & Environmental Requirements

SBA requires appraisals and environmental assessments on real property financed with SBA 504 loan proceeds.

SBA requires an appraisal based on ***total project cost*** as follows:

- Under \$500M Tax Assessment, bank internal, or realtor valuation
- \$500M & Above Appraisal Required

Appraisals must address the SBA as an intended user and include 2 approaches. The appraisal must always have the sales approach method of valuation. Reports may be either self-contained or summary format. SBA does not accept restricted reports.

SBA's environmental requirement will be based on the size of the SBA loan, an acceptable questionnaire and the NAICS code of current or past occupants of the property. The SBA requires that the environmental questionnaire provided includes the current and past uses of the subject property and adjacent properties. See Exhibit C for a flow chart of environmental requirements, NAICS list of environmentally sensitive industries, and environmental questionnaire.

ELIGIBILITY CONSIDERATIONS

Size of Businesses That May Be Assisted

In order to meet size eligibility requirements of the 504 program, the small business (and its affiliates) must be a for-profit firm with a tangible net worth of less than \$15,000,000 and an average net profit after taxes of less than \$5,000,000 for the preceding two years. If a business exceeds either of these two standards, it may still qualify based on SBA's industry-specific size standards (7A size standards).

Occupancy Requirements

The business may sublease a portion of the building being financed. However, the business must be able to support the entire debt service requirement without relying on rental income. The specific occupancy requirements are as follows:

- **Purchase of an existing building** - The business must occupy at least 51%. It may sublease up to 49% of the building.
- **Construction a new building** - The business must immediately occupy at least 60%. It may sublease up to 40% of the building but must intend to occupy some of the additional space within three years and occupy at least 80% of the space in 10 years. The remaining 20% may be subleased permanently.

Ownership of Project Assets

The SBA allows the ownership of the project assets to differ from ownership of the operating company. The assets may be owned by an "*eligible passive company*"(EPC) and leased back to the operating company. An "*eligible passive company*" may be any legal organizational structure (i.e. individual, corporation, partnership, Limited Liability Corporation, proprietorship, trust, etc.). The term of the lease must be at least as long as the term of the 504 loan. SBA requires the EPC to only hold real estate leased to the operating company.

The operating company as well as individuals owning 20% or more of the "eligible passive company" or the operating company are required to guaranty the loan.

504 Job Creation Requirements and Exceptions

Because the 504 is a loan program designed to help small businesses expand and to promote economic development, the SBA requires that projects financed by the program result in the creation or retention of jobs. One job must be saved or created, within two years of project completion, for each \$75,000 in financing provided by the SBA. For manufacturers the requirement is one job saved or created for each \$120,000 in financing provided by the SBA.

The job creation requirement can be waived under certain circumstances. Please contact Capital Matrix for details.

WHAT IS NEEDED FOR A 504 APPLICATION

- _____ Tax returns & financial statements for past two fiscal years on the business
- _____ Current financial statement on the business (less than 90 days old) with details of any existing debt and matching A/R and A/P aging
- _____ Tax returns (past two years) and current financial statements of other businesses owned (50% or more) or controlled by the small business owner(s)
- _____ Projected month to month profit & loss statement for two (2) years with assumptions (on start-ups or businesses which do not demonstrate ability to service proposed debt from historical earnings)
- _____ Current personal financial statements (less than 60 days old) and last year's tax return of owners of 20% or more of the business
- _____ Purchase and Sale Agreement for land or building acquisition
- _____ Cost estimates or bids from contractors & suppliers of equipment, fixtures, etc.
- _____ Itemization of all known and anticipated project costs
- _____ Overview of the business, its operations, and management.

At the time the application is submitted to the SBA, these additional items will be needed

- _____ A copy of the lender's interim and permanent loan commitment letter (see Sample Letter Appendix A)
- _____ Good faith deposit up to \$2,500.00
- _____ Corporate Documents (By-laws and Operating Agreements)
- _____ Appraisal
- _____ Environmental report

Capital Matrix underwrites the application. If found to meet Capital Matrix and SBA credit and eligibility criteria, the application will be packaged and submitted to the SBA for approval. SBA approval generally takes from 10 to 15 working days. Upon approval, the SBA will issue an Authorization and Guaranty Debenture documents which detail the terms of their approval. This document will be provided to the borrower and lender for review.

LOAN CLOSING AND FUNDING

After the SBA loan is approved (for purchase of real estate) or approximately 30-45 days before completion of construction, Capital Matrix will contact both the lender and the borrower to begin collecting information needed for closing the 504 loan.

Information typically needed from the borrower (as applicable) includes:

- List of final project costs (construction)
- List of equipment purchased with serial numbers of major items
- Evidence of down payment (canceled checks and invoices)
- Copy of certified settlement sheet from title company (for purchase)
- Copy of insurance policy for liability and hazard coverage
- Copy of insurance policy of life insurance policy and original acknowledged collateral assignment
- Certificate of occupancy (construction)
- Certificate of completion from general contractor (construction)
- Updated financial statement of the operating company (less than 90 days old)
- Lease agreement between operating company and the borrower

Information typically needed from the lender

- Copy of the interim note, term note, modifications, and recorded deeds of trust
- A letter which includes various assurances and certifications described in the Authorization and Debenture Guaranty (third party lender agreement and interim certification)
- Disbursement of construction loan (cancelled checks and invoices)
- Wire Instructions
- Bank participation fee of .5% on Term Loan amount
- Copy of title policy

Once this and other relevant information has been provided, Capital Matrix will coordinate with the borrower and lender to close the 504 loan. The lender's construction loan or interim loan would then be paid from the proceeds of the lender's term loan and the 504 loan at the time the 504 loan is funded. However, the lender may choose to fund its term loan and reduce the interim loan prior to the 504 funding. The proceeds of the 504 loan would then pay the balance of the interim financing.

Funding of the 504 Loan

After the SBA loan is closed, the closing documents must be reviewed by Capital Matrix' attorney and then submitted to the SBA for funding. The SBA reviews the documents and the opinion of the attorney before approving the loan to be included in the next available debenture sale.

The SBA issues a schedule of monthly deadlines for submission of closed loans to meet specific funding dates. Contact Capital Matrix for information about debenture funding dates.

AFTER THE LOAN IS FUNDED

Loan Servicing

Capital Matrix is responsible for servicing SBA 504 loans after funding.

Annual financial statements will be requested from all 504 borrowers as per the terms of the loan approval. The financial statements will be reviewed, and if appropriate, Capital Matrix will contact the lender to review the financial performance of the borrower.

All requests for changes in the loan, e.g., subordinations, collateral release/substitution, payment deferrals, etc. must be directed to Capital Matrix. Capital Matrix will gather and evaluate relevant information and make recommendations to SBA's Fresno servicing office for action.

504 Loan Assumption

SBA 504 loans may be assumed with the SBA's approval. Call Capital Matrix loan officers or servicing specialists for more details.

Prepayment Penalty

There is a prepayment penalty on a 504 loan. For a 10 year SBA loan, there is a prepayment is for the first 5 years. For a 20 and a 25 year SBA loan, there is a prepayment penalty for the first 10 years. This prepayment penalty is a *declining percentage* of the debenture interest rate times the principal balance at the time of prepayment.

No extra payments or partial prepayments can be made during the term of the loan.

APPENDIX A

Sample Bank Letter of Commitment SBA 504 program

Date

Name of CDC contact
Title of CDC contact
Name of CDC
Address of CDC
City, State Zip Code

RE: Name
Address, City, State

Dear ***[name of CDC contact]:***

[Insert Name of Lender] has reviewed the borrower's application for a \$ ***[insert total project amount]*** loan for full project financing for the ***[insert project components such as purchase, improvements, construction]*** of the ***[real estate and/or equipment]*** located at ***[insert address, city, state]***. This Bank is not in a position to meet the borrower's request for full project financing at this time as ***[insert reason, such as, "the loan maturity exceeds our credit policy"]***. To the best of our knowledge, financing of the total project cost is not available at interest rates and terms prevalent in our community.

[Insert Name of Lender], however, is willing to participate with ***[insert name of CDC]*** in the SBA 504 loan program to benefit ***[Insert Name of applicant]***. In this connection, the Bank's \$***[insert amount of TPL loan]*** ***[insert % of Project Cost]*** would have an interest rate of ***[insert complete interest rate, not just the initial rate]***. The note will be for a term of ***[insert term]*** to be amortized over ***[insert amortization period]***.

The project is located at ***[physical address of project property]***. The bank commitment is contingent upon the collateral and guarantors listed below:

List third party lender collateral requirements
List guarantors for third party lender loan

In addition, ***[Insert Name of Lender]***, is willing to provide an interim loan in the amount of \$ ***[insert amount of interim loan]*** ***[insert % of the Project Cost]*** to be repaid from the proceeds of the debenture sale. This interim loan is to be secured by a ***[insert lien position]*** on the subject real estate. In addition, the SBA approval of this loan is conditioned upon the receipt by SBA from Bank of a one-time participation fee equal to one-half of one percent of the principal amount of the Bank loan attributable to the 504 project that is senior to SBA. ***[Optional: This is conditioned on the final Bank approval as well as the approval by the Small Business Administration.]***

Sincerely,

Name of Lending Official

APPENDIX B

Checklist For Construction Related Costs

The following cost categories include items which may not be included in a construction cost breakdown. A review of the items on this checklist will help ensure that both hard and soft costs are included for an accurate cost breakdown for your construction projects. The list is not intended to be all inclusive but rather to include items that may not be part of a standard construction contract but still necessary for completion of the project. The list is as follows:

-Land Cost	\$ _____
-Construction Estimate	\$ _____
-Plans & Specs	\$ _____
-Architect and Engineering Fees	\$ _____
-Survey	\$ _____
-Building Permits	\$ _____
-Impact Fees	\$ _____
-Water Meter and Sewer Hookups	\$ _____
-Idaho Power Fees	\$ _____
-Material Testing Fees	\$ _____
-Site Preparation	\$ _____
-Landscaping	\$ _____
-Equipment/Fixtures & Installation	\$ _____
-Interest on Construction Loan	\$ _____
-Title Insurance/Escrow Fees	\$ _____
-Legal	\$ _____
-Loan Fees	\$ _____
-Appraisal/Appraisal Recertification	\$ _____
-Environmental Report & Costs	\$ _____
-Contingency (5-10% of const. est.)	\$ _____
-Bonding	\$ _____
-Irrigation	\$ _____
TOTAL	\$ _____

HAVE ANY QUESTIONS?

If you need more information or want to discuss your project,
contact us below

<u>Staff</u>	<u>Titles</u>	<u>E-mail/Direct Line</u>
Ann Munroe	President	amunroe@capitalmatrix.org (208) 789-2605
Paulette Hudson	Sr. Loan Officer, V.P.	phudson@capitalmatrix.org (208) 789-2601
Donna Upson	MT Loan Officer	donna@capitalmatrix.org (406) 210-1144
Jorene Batali	Servicing Specialist	jorene@capitalmatrix.org (208) 789-2604
Nancy Tamayo	Loan Closing Assistant	nancy@capitalmatrix.org (208) 789-2606
Cheryl Bluma	Sr. Loan Closing Specialist	cheryl@capitalmatrix.org (208) 789-2608
Austin Heindel	Sr. Credit Analyst	aheindel@capitalmatrix.org (208) 789-2609
Michael Peeler	Credit Analyst	mike@capitalmatrix.org (208) 789-2602
Daniel Moore	Credit Analyst	daniel@capitalmatrix.org (208) 789-2600

Visit our website at www.capitalmatrix.org