



SBA 504 loans can be useful growth tool

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By Bradley Vear

Small businesses make up 97 percent of all business in New Hampshire, according to the N.H. Small Business Development Center, and a common goal of most small businesses is to grow in size and revenue. This growth usually translates into more space — a bigger facility is required. Financing this growth can be made easier or less costly by an SBA 504 loan offered by the U.S. Small Business Administration, a federal agency chartered to provide financial, educational and marketing assistance to small businesses.

The SBA 504 loan program provides financing for fixed-asset acquisitions and allows business owners to obtain 20-year loans to buy real estate, to build, expand or improve their buildings and to finance the purchase of equipment or machinery.

If your company is looking to buy a property, the SBA 504 loan should be considered as a financing option. Why? The No. 1 reason is that it allows you to borrow 90 percent of the money you need. Only 10 percent down payment is required vs. the 25 percent to 40 percent down payment that most banks will require. It also gives you a fixed rate for 20 years vs. the shorter five-, seven- or 10-year fixed rates that banks offer. Locking in today's rates may be advisable, given interest rate trends over the long term.

With the current slowdown in many industries, we have seen lenders become more cautious towards financing business expansions. The 504 loan is structured to remove much of the risk from the lender resulting in a much more willing and cooperative attitude from your loan officer. In fact, if your business qualifies within the program guidelines, most banks will aggressively pursue a SBA 504 loan.

Here's how it works. You apply through your bank for up to 90 percent of the money you need to finance your expansion. If your bank says that they do not participate in the SBA 504 program, find another lender. Fifty percent of your funding requirements come from the participating bank. Forty percent is loaned through a certified development company (CDC) by the sale of a debenture that is guaranteed by the SBA. Your banker will contact the CDC office to set up the loan. The SBA-guaranteed portion is subordinated to the bank's collateral, translating into a low risk loan to the bank.

The 40 percent loan from the CDC can be as large as \$1.3 million, which together with the bank's 50 percent gives a maximum loan value of \$2.925 million. Minimum loan value is \$125,000. The September 2001 rates for the SBA portion of the loan were at 7.75 percent, including a servicing fee, fixed for 20 years. The bank's rates will vary, but you can probably figure on 7.5 percent currently, with some movement downward in the next three to six months. Typically, the bank will fix the rate for only five years with a 20-year amortization; the loan term must be for a minimum of 10 years.

There are eligibility requirements for the 504 program. Your business must occupy at least 51 percent of the building that it buys or 75 percent of a new building it builds. The tangible net worth of your company cannot exceed \$6 million with net profits after taxes of no more than \$2 million. You should have been in business for at least one year, preferably three or more. And, of course, you have to have the cash flow from your business to adequately cover the debt service within certain ratios.

A useful tool

What is the downside? Probably the biggest negative of this financing is the additional fees and the additional paperwork. The fees for the SBA-guaranteed portion of the loan are approximately 2.75 percent, which is split between the CDC, the SBA and the fiscal agent servicing the loan. These fees are financed and added to the principal amount so your down payment can remain at 10 percent. The additional paperwork is required by the SBA in order to qualify your business – so polish up your business plan. The bank also may charge some fees or points for their part of the loan, but it's a competitive market for these loans. Other loan costs, such as appraisals and legal fees, are pretty much the same as conventional financing. Another downside is the high prepayment penalties of the SBA-guaranteed portion over the first 10 years of the loan. However, these penalties can be avoided if the loan is assumed by a buyer when the property is transferred or sold during this time.

To build your personal wealth, or for retirement planning, your financial adviser may recommend that you, or you and several of your company principals, purchase the property through a limited liability company (LLC) of which you are a member. Then the LLC would lease the property to your company long term and you would build equity while enjoying certain tax benefits. That will work within the framework of the 504 program.

New construction also can be funded through a 504 loan program, but you will need a construction or interim lender to finance the renovation or construction, because the 504 loan is only an end loan. Usually the bank that provides the end loan (50 percent portion) also will provide the construction loan. Once an occupancy permit is obtained, the SBA will fund its 40 percent portion and you will then have two separate amortizing loans, one with the CDC and one with the bank.

The SBA 504 program is an effective and popular financing vehicle that can give you the resources to grow and expand your business. Over the past year there have been approximately 130 SBA 504 transactions in New Hampshire totaling more than \$33 million in guaranteed financing. It is an important economic stimulus to the local economy, and it is a useful tool for business planning that allows real estate to be acquired without depleting large cash reserves.

With the recent drop in interest rates, it may be an especially good time to consider this option and lock in to some low cost money.

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