



SBA 504 Loan 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” or “CDC” that is certified and regulated by the Small Business Administration to make 504 loans.

South Central Kansas Economic Development District, Inc. (“SCKEDD”), an SBA certified development company, services a 14-county region in South Central Kansas including the Butler, Chautauqua, Cowley, Elk, Greenwood, Harper, Harvey, Kingman, Marion, McPherson, Reno, Rice, Sedgwick and Sumner counties. SCKEDD has been providing 504 loans to borrowers since 1984 when the loan program began.

SBA 504 loans are for permanent financing. Typically, the lender provides interim financing of up to 90% of the project costs. Upon completion of the project debenture funding, the SBA 504 loan proceeds are applied to the interim loan reducing the lender’s loan to 50% of the project. Financing for a 504 loan comes from three different sources: a lender, SCKEDD and the borrower.

Eligibility Considerations

- **Size of Business**
 - Must be a for-profit company;
 - Maximum tangible net worth of \$15,000,000; **and**
 - Average net income after Federal income taxes (excluding any carry-over losses) of \$5,000,000 or less for the 2 full fiscal years before the date of the 504 application.
- **Occupancy Requirements**
 - **Purchase of an existing building** – the business must occupy at least 51% and may lease up to 49% of the building.
 - **Construction of a new building** – the business must immediately occupy at least 60% and may lease 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 leased out permanently.
- **Ownership of Project Assets**
 - SBA allows the ownership of the project assets to differ from the ownership of the operating company.
 - Property owner must lease the property to the operating company with a term as long as the 504 loan.
- **Availability of Personal Resources**
 - “Excess liquid assets” must be applied towards the project costs.
 - The SBA would reduce the amount of its financing accordingly.
- **Job Creation Requirements and Exceptions**
 - One job must be saved or created, within three years of project completion, for each \$65,000 (Small Manufacturers-for each \$100,000) in financing provided by SCKEDD; or
 - Meet public policy goal or community development goals.
- **Franchise/License/Dealer/Jobber or similar agreement**
 - If the Franchise is not listed on SBA’s Franchise Registry SBA approval of the Franchise Agreement is required before we can submit the loan application.

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Projects Financed

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

- Purchase land and construct new building(s).
- Purchase an existing building and make necessary renovation.
- Acquire and install machinery/equipment.
- Construct or remodel building on leased land (where the lease is as long as the term of the 504 loan).
- Refinance qualified asset-backed debt up to a maximum of 50% of the new project.
- Other costs associated with a project are also eligible for financing, e.g. architects/engineering fees, appraisals, environmental reports, interim interest, interim loan fees, title insurance, etc.

504 Loan Amount– The minimum 504 debenture amount is \$25,000.

\$5,000,000

- Regular 504 or Public Policy Projects.

\$5,500,000

- Small Manufacturer;
- Project borrower’s energy consumption reduced by 10%; or
- Project generates renewable energy or renewable fuels

(Energy Policy defined as NAICS Code beginning with 31, 32 or 33 with all production facilities in U.S.)

Interest Rate

- Low, fixed-rate based on a debenture bond sale.
- Debenture bond sales occur monthly for 20-year loans and every other month for 10-year loans.

Sample 504 Structures (Based on \$3.0MM project)

	Existing Business	Start-up Business <u>OR</u> Special Purpose Building	Start-up Business <u>AND</u> Special Purpose Building
Lender (Third Party Lender)*	50% - \$1.5MM	50% - \$1.5MM	50% - \$1.5MM
SCKEDD (SBA 504 Loan)	40% - \$1.2MM	35% - \$1.05MM	30% - \$900M
Borrower	10% - \$300M	15% - \$450M	20% - \$600M
Total Project	100% - \$3.0MM	100% - \$3.0MM	100% - \$3.0MM

*The bank must finance a minimum of 50% of the project cost if the Borrower is a new business or the Project Property is Limited or Special Use.

More equity injection is required for start-ups (less than two years of operating history), businesses with irregular profitability, lack of historical debt capacity, or utilize a special purpose facility.

Repayment

- Real estate will be fully amortized for 20 years (i.e., 20-year debenture).
- 504 loans specifically for equipment are limited to the 10-year debenture, and equipment must have at least a 10-year economic life.
- 504 loans for real estate will be fully amortized for 20 years (i.e., 20-year debenture).

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- The lender must provide a minimum 10-year maturity when there is a 20-year 504 loan; amortization may be up to 30 years. The interest rate may be adjusted periodically.
- When the SBA provides a 10-year loan and either equipment or leasehold improvements are being financed, the lender must provide a minimum of 7-year maturity with no calls.

Collateral

- The 504 loan is typically secured with a subordinate lien to the bank on project assets. The bank will have a first lien position and SBA will have a second lien position. SBA can recognize existing prior liens in the case of building expansions and renovations.
- SBA requires that the 504 loan must have a security interest in all project assets.
- Personal guarantees of all principals owning 20% or more of the operating company or “eligible passive company” are required.
- Key Man life insurance is typically required.

Appraisal Requirements

SBA requires appraisals on real property financed with SBA 504 loan proceeds. For equipment only deals, new equipment may be financed on the basis of cost, but used equipment must be appraised. Appraisal reports must be prepared in compliance with USPAP. The report must be for the use of the US Small Business Administration, and may also be for your lender’s use. Restricted reports are unacceptable. SBA requires an appraisal based on the total project cost as follows:

- | | |
|--------------------|---|
| • Under \$250M | Tax assessment, bank internal or realtor valuation |
| • \$250M - \$1.0MM | 2 approaches to value; self contained or summary format |
| • \$1.0MM or more | 3 approaches to value; self contained or summary format |

Appraisals must always include the sales approach method of valuation. If there is any business value (“value in use” / “blue sky” / “good will”) included in the appraisal, it must be plainly stated so that we can deduct it from the project-it is not eligible for 504 financing. Additional “upon completion” appraisals are required for projects that involve new construction or remodeling of more than 40% of the project costs. (See *Appraisal Standards for SBA 504 Loans* for more information)

Environmental Requirements

SBA requires that an environmental investigation be performed on every project we finance, but the level of investigation varies according to the historic use of the project real estate. This mostly comes down to NAICS codes, but the rules regarding this are lengthy and somewhat complex. Please contact SCKEDD at the start of your project so we can help determine the level of investigation that may be needed. (See *Environmental Guidelines for SBA 504 Loans* for more information)

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