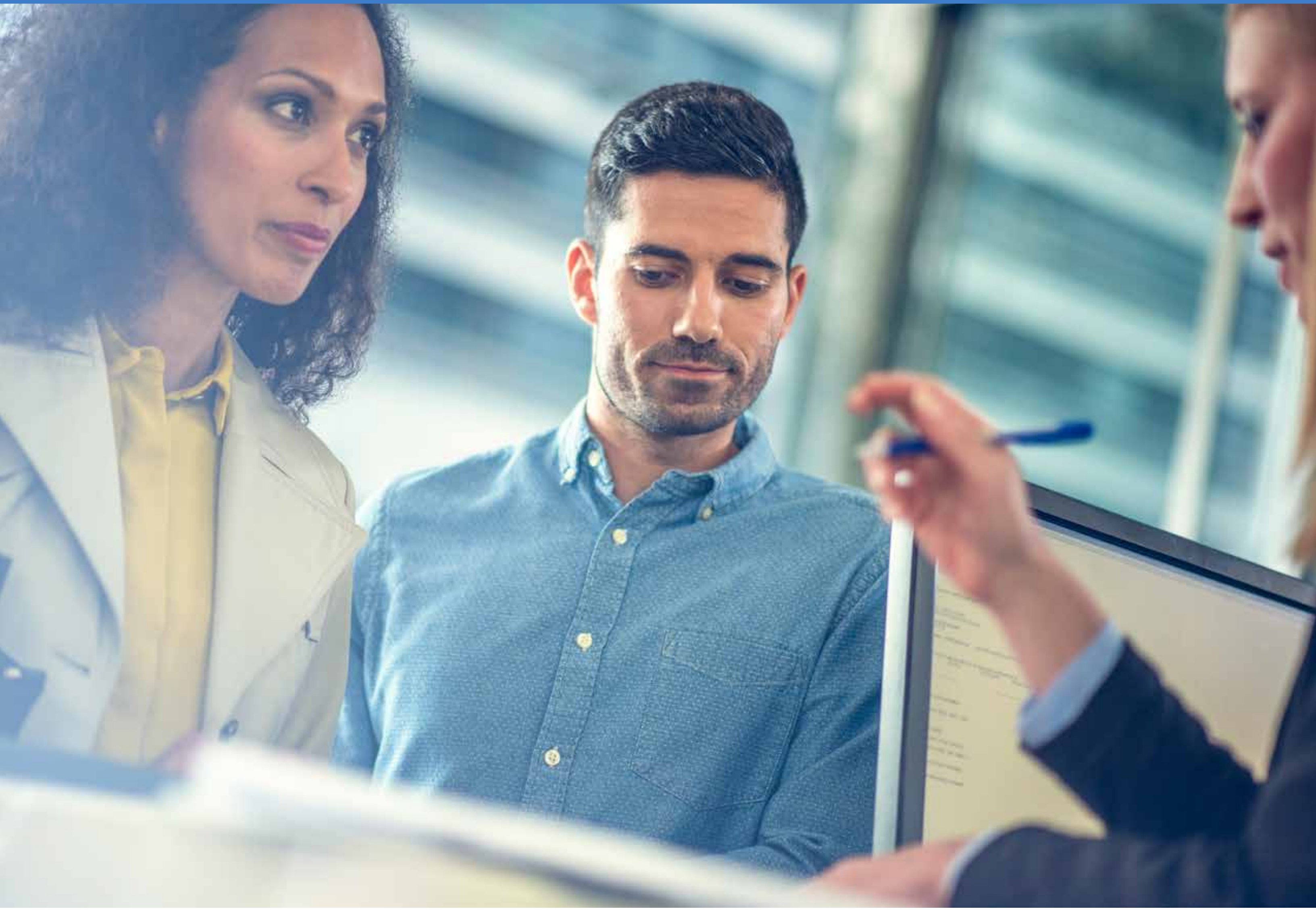

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SBA 504 Loans: Basics Businesses Should Know

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The Small Business Administration (SBA), in partnership with financial institutions, offers a number of loan programs to help organizations start, build or grow their businesses. One of these is the SBA 504, which can be used to finance fixed assets like commercial real estate and industrial equipment.

This guide outlines the basics of the SBA 504: its primary uses, how these loans are structured, the benefits to business owners, eligibility requirements and the importance of choosing the right lender.

HOW SBA 504 LOANS CAN BE USED

Proceeds from SBA 504 loans must be used for fixed assets (and certain soft costs), including:

- The purchase of existing buildings.
- The purchase of land and land improvements, including grading, street improvements, utilities, parking lots and landscaping.
- The construction of new facilities, or modernizing, renovating or converting existing facilities.
- The purchase of long-term machinery.
- The refinancing of debt in connection with an expansion of the business through new or renovated facilities or equipment.
- Refinance of a qualified project debt unrelated to an expansion

An SBA 504 loan **cannot** be used for working capital or inventory, consolidating or repaying debt.

HOW SBA 504 LOANS WORK

- The SBA 504 loan is structured differently than conventional loans. A typical SBA 504 project has a 50-40-10 structure: the bank finances up to 50% of the total project cost on a conventional loan in a first lien position; a second loan for 40% of the total project cost is the government-guaranteed SBA 504 portion, which is in second lien position (this is the portion of the loan that the rate and terms are locked in for the full term of up to 20 years); the final 10% is equity from the borrower.

SBA 504 Loans

- This structure is designed to make it easier for small business owners to own commercial real estate with less money down, and with longer-term fixed interest rates than conventional financing.
- The project assets being financed are used as collateral.
- Personal guarantees from owners of 20% or more of the company are also required.
- Because the SBA portion is guaranteed with third-party bonds, there are prepayment penalties.

A Certified Development Company (CDC) is a nonprofit corporation that promotes economic development within its community through SBA 504 loans. CDCs are certified and regulated by the SBA, and work with the SBA and participating lenders (typically banks) to provide financing to small businesses.

SBA 504 LOAN EXAMPLE[1]

Total SBA 504 project costs for a $1,000,000 project may include the following (eligibility requirements apply to both the 504 portion of the project and the participating lending portion):

- Current finances
- Building purchase
- Land
- Renovation
- Furniture and equipment
- Soft costs

LOAN STRUCTURE

- $500,000: 1st lien with bank (loan obtained from a private sector lender covering up to 50% of the total project cost).
- $400,000: 2nd lien with SBA 504 loan, 20-year, fixed-rate (loan obtained through a Certified Development Company [CDC], funded through an SBA-guaranteed debenture, covering up to 40% of the total project cost).
- $100,000: borrower contribution (contribution from the borrower of at least 10% of the total project cost).

[1] SBA.gov

BENEFITS OF SBA 504 LOANS

- A benefit of the SBA 504 loan that's most appealing to business owners is that it requires as low as 10% equity down, compared to 25% or 30% typically required for conventional financing.

- Another reason so many small businesses take advantage of the 504 loan for buildings and equipment is because of the **interest rate protection**. With a long-term (up to 25 years on real estate and 10 years for equipment) below-market fixed rate on up to 40% of the debt, borrowers are protected against rising interest rates, giving business owners more control over long-term interest expenses.

- Longer loan amortization means **smaller monthly payments**, helping protect the company's cash flow.

HOW TO QUALIFY FOR AN SBA 504 LOAN

A number of criteria must be met in order to qualify for SBA 504 financing:

- The business must be an eligible for-profit, non-publicly traded company

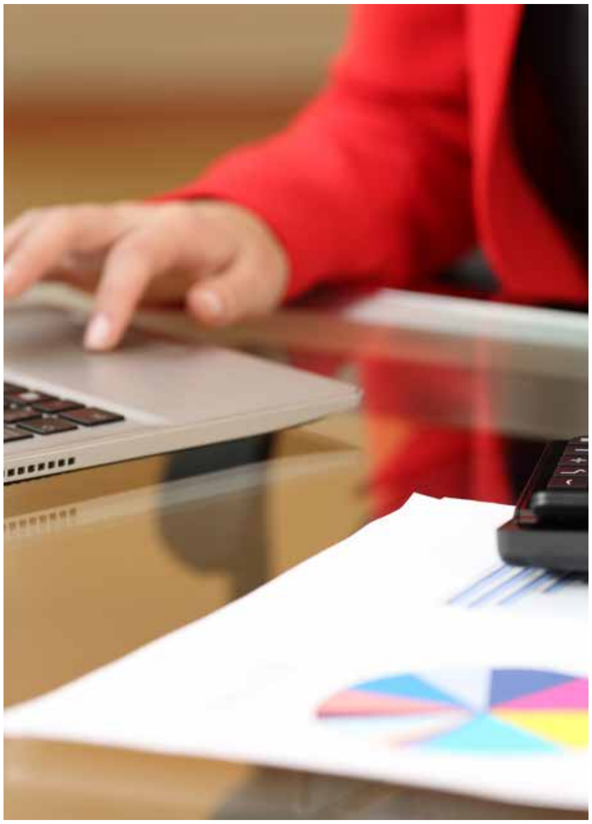
- The business must be small under SBA size requirements for the business' primary industry

- At least 51% of business ownership must be controlled by U.S. citizens or lawful permanent residents with green cards

- The company must do business in the United States or its possessions

- The small business must be a sole proprietorship, partnership, limited liability company or corporation

- The operating company of the owner-occupied real estate must occupy at least 51% of the space to be bought on day one; or 60% on day one for ground-up construction projects



SBA 504 LOAN RESTRICTIONS

There are a few restrictions regarding the use of SBA 504 loan proceeds.

- An SBA 504 loan cannot be used by a business to purchase inventory, infuse general working capital or fund goodwill and other intangibles.
- Established businesses and their affiliates must have a tangible net worth of less than $15 million, and an average net income of less than $5 million after taxes (excluding any carry-over losses) for the preceding two years.
- Loans cannot be made to businesses engaged in speculation or investment in rental real estate.
- The SBA does not extend financial assistance to businesses when the financial strength of the individual owners or the company itself is sufficient to provide all or part of the financing; both business and personal financial resources are reviewed as part of the eligibility criteria.

Both established and startup businesses must also demonstrate the ability to repay the loan based on projected operating cash flow. Startups must show evidence of relevant management experience and a sound business plan that indicates growth potential.

HOW SBA 504 LOANS COMPARE TO OTHERS

The chart below summarizes the important differences between the SBA 504, the SBA 7(a), the SBA CAP Line and Conventional financing.

	SBA 504	SBA 7a	SBA CAP Line	Conventional
Uses	• Existing building • New construction • Building expansion • Building improvements • Equipment	• Equipment • Working capital • Business acquisition • Real estate • Leasehold improvements • Inventory	Short-term working capital/operating needs	For business purposes
Loan Limit	Max: Up to $5 million (504 portion)	Max: $5 million	$5 million	Based on limits of financial institution
Interest Rate	Fixed (once debenture is sold)	Variable (tied to Prime), with some fixed-rate options	Variable (tied to Prime)	Varies by lender
Term	25 years for real estate 10 years for equipment	• Up to 25 years for real estate • Up to 10 years for business acquisition and equipment • Up to 10 years for working capital	Up to 10 years but a shorter initial maturity may be established	Usually 3-5 years with amortizations up to 25 years
Collateral/ Guarantees	• Generally, project assets are used as collateral • Personal guarantees of principal owners of 20% or more	• Subject assets acquired by loan proceeds • Pledge of personal residence (if collateral shortfall) • Personal guarantees of principal owners of 20% or more	Holders of at least 20% ownership in the business are required to guarantee the loan	Business and personal assets
Down Payment	Minimum of 10%	Minimum of 10%		Varies

CHOOSING THE RIGHT LENDER

An SBA 504 loan might be the most practical choice for your small business, but before making a decision, discuss your needs, goals and options with a business banker. He or she will leverage their experience and insights to guide you toward the loan that aligns most closely with your needs. Because it's an integral part of the business environment in your area, a community bank is often the best choice. The familiarity of their bankers with your business and market results in more informed guidance.

As you can see, the SBA 504 loan offers many advantages that aren't available with conventional commercial financing, and small businesses that want to own commercial property in order to grow should consider this type of financing. It's important to seek the input of an experienced SBA lender, and often a community bank is a wise choice. Because they're owned and operated locally, community banks are acutely aware of the importance of funding businesses in their communities, and can leverage their knowledge of your market's challenges and opportunities to provide valuable insights that can help grow your business.

Reach out to Investors Community Bank to learn more about the best loan choice for your specific business needs.

Appleton: (920) 739-2660
Green Bay: (920) 884-1166
Manitowoc: (920) 686-9998
Stevens Point: (715) 254-3400
Sheboygan (Loan Production Office): (920)-451-0200
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