

Benefits of Using SBA 504 Financing

Benefits to Small Business Owners

There are at least five significant reasons why the SBA 504 Loan Program can be beneficial for a business owner.

- 1. The interest rate on the SBA 504 portion of the project financing is set in the private capital market and is FIXED for the life (typically 20 years) of the loan.**

Why is this important? The fixed interest rate and the certainty of predictable payments / debt service over a period as long as twenty years, offers a considerable advantage to a business owner who is planning future growth and cash flow requirements.

- 2. The equity injection by the business is typically only 10% of the total project cost.**

Under the SBA 504 Program the typical financing structure is for a private sector lender to provide 50% of the total project financing and Economic Development Foundation (EDF) to provide 40%. It is almost impossible for a small business to be able to secure 90% financing on a project without the participation of the SBA 504 Loan Program.

It is worth noting, too, that although this required 10% injection is usually in the form of cash from either inside or outside the business, it is also possible to count existing equity in project land or equity in an existing facility (in the case of an expansion or renovation project) as part, or all, of the required equity contribution to a specific project.

On a technical note, regulations governing the SBA 504 Loan Program provide that the minimum contribution from an existing business be 10%. However, if the business is a “startup” business (and the SBA defines a startup business as one less than two years old), OR, if the project property has a specialized, single-purpose use (for example, a gas station), then the minimum equity contribution must be 15% and the maximum SBA 504 Loan portion is 35%.

If the project involves both a startup business AND a specialized, single-purpose property, the minimum equity contribution from the business entity must be 20% and the maximum SBA 504 Loan portion is 30%.

- 3. For the purposes of calculating the total project cost, it is permitted, under SBA 504 Loan program guidelines, to include associated “soft costs” in the total financing package.**

Businesses will often have to pay for related project costs (sometimes known as “soft costs”) such as site plans, zoning, engineering fees, appraisals, etc., out of available working capital reserves or credit lines, sometimes making it hard to keep the business operating smoothly. The SBA 504 Program allows all of these costs to be counted and actually included in the total project cost calculation for the purposes of financing allocations.

This means that a business can include these costs in the total financing package and typically finance 90% of all these costs over the life of the project loans.

- 4. The SBA 504 Loan can stay with the project property – it is assumable!**

If somewhere down the line, a business receives an offer it can't refuse for a facility financed under the SBA 504 Loan Program, or the business simply grows so much that it needs to move to a bigger building somewhere else, then the SBA 504 Loan portion of the project facility is something that can stay with that facility and be assumed by the future buyer, if that buyer wishes to do so.

The ability for a business to provide partial “seller financing” using an existing SBA 504 Loan, could be a real plus for both the seller and a prospective business buyer.

- 5. The loan terms available under the SBA 504 Program (either 10 or 20 years) usually better matches the life of a project asset than the 7 or 15 year terms that otherwise might be available from private sector lenders.**

It makes sense, from both a management planning and accounting viewpoint, to match financing with the anticipated useful life of the asset being financed.

The SBA 504 Program generally provides 20 year financing on all real estate projects and 10 year financing on all equipment / machinery projects.

Benefits to Commercial Lender

There are at least two significant reasons why the SBA 504 Loan Program can be beneficial for a commercial lender.

- 1. Because the SBA 504 portion is a second mortgage and subordinate to the bank, risks to the bank and the bank's portfolio are minimized, allowing the bank to more competitively position its own market terms and rates on SBA 504 Loan projects.**
- 2. The SBA 504 Loan Program can help cement a long term (20 years!) relationship between the commercial lender and the small business client.**

Commercial lenders in business for the long term, will always have the best interests of their business clients in mind. And while the SBA 504 Loan Program won't necessarily be the best option in every instance where fixed asset financing is sought, it is certainly a viable option that deserves to be reviewed or discussed as a partnership option for a business to consider.

Benefits to a Local Community

When a business can gain access to, usually, less-expensive, longer-term financing, it typically frees working capital for other uses, including growth and expansion purposes. When a business expands and spends more money / hires more people / makes more profits, the whole community benefits.

There is also the multiplier effect associated with this infusion of capital (SBA 504 Loan Proceeds) into a local economy from outside that community, effectively increasing the available money supply and accelerating growth within that local economy.