

# Economic Development Foundation - Certified SBA 504 Loan Program

## SBA 504 Objective:

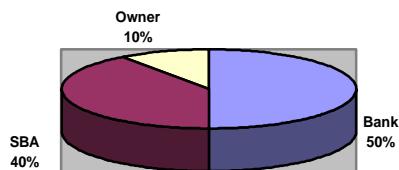
To achieve community economic development through job creation and retention by providing long-term fixed asset financing to businesses.

## Economic Development Foundation:

Economic Development Foundation – Certified is a Michigan non-profit corporation. The board is comprised of individuals representing; private sector lending institutions, community organizations, business organizations, and government. The Foundation is licensed to administer the 504 Loan Program and was created under the auspices of the Small Business Administration to foster economic growth in urban and rural areas.

## SBA 504 Partnership:

A complete 504 financial package is a combination of at least three sources: Small Business Administration (SBA), financial institution and the small business.



- § The business is required to inject at least 10% of the total funds for any project.
- § The SBA may guarantee up to 40% in the form of a debenture to any approved project. The maximum SBA 504 loan is \$1,500,000 for most projects. For projects that meet a public policy goal, the maximum is \$2,000,000. For SBA 504 loans to manufacturing businesses, the maximum is \$4,000,000. The SBA 504 loan combined with any other federal funds may not exceed 50% of the total financing for the project.
- § The financial institution must provide the remaining percentage of the SBA 504 financial package (in this example, 50%).

## Security:

The financial institution has the security of a first lien on the land, the building and equipment

being financed. The SBA is secured by a second lien.

## Debentures:

The SBA 504 loan is a debenture – a type of bond. Debentures, pooled through a certificate mechanism, are sold publicly to investors (e.g., pension funds, insurance companies, or private individuals). Each debenture is issued in connection with the making of a loan by the EDF to a company. Each loan must be approved by the SBA. Debentures are 100% guaranteed by the SBA. If a default occurs, the SBA is responsible for timely payment of the debenture to the investors.

## Terms/Rates:

The term for machinery and equipment is 10 years and term on real estate is 20 years.

## Collateral:

All debentures guaranteed under the 504 Program must be secured to ensure repayment. Collateral may include: a mortgage on the land and the building being financed, liens on machinery, equipment, and fixtures; lease assignments; and personal guarantees from all individuals with 20 percent or more ownership.

## Interim Financing:

Loan repayment begins on the first day of the month following funding. Only a completed project can ensure the operating capacity needed to make payments, so interim financing will be needed for all projects. The financial institution provides the needed capital at project start and is repaid from debenture proceeds.

## Project Eligibility:

SBA 504 loans are for financing fixed assets: plant acquisition, construction, renovation, or expansion, including the acquisition of land. Proceeds may also be used for land and site improvements (e.g., grading, streets, parking lots, utilities, or landscaping); the acquisition and installation of machinery and equipment; and the interest on interim financing. Additionally, project costs may include professional fees directly attributable and essential to the project (e.g., surveying, engineering, or architectural).

### **Debenture Prepayment:**

There is a prepayment premium for the first 10 years of a 20 year loan and a premium on the first 5 years of a 10 year loan. The loan must be prepaid in full, not in part. The prepayment premium is calculated by taking the outstanding principal balance of the debenture multiplied by the interest rate on the face of the debenture multiplied by a factor for the applicable year. For a twenty year loan, the factor begins at 1.00 in the first year and decreases by a tenth each year so that after 10 years, no prepayment premium is due. For a ten year loan, the factor begins at 1.00 for the first year and decreases by .20 each year until after the fifth year when it is zero.

Example: After 6 years of a 20 year loan, the business elects to prepay their debenture. The current balance of the loan is \$300,000 and the debenture rate is 5%. The prepayment premium would be  $\$300,000 * .05 * .50 = \$7,500$ .

### **Personal Resource Test of Principals**

Each individual which owns 20% or more of the business must meet a personal resource test. The SBA requires that excess personal resources be injected to reduce the SBA 504 loan. The personal resource test is a measure of liquid assets in comparison to the total financing package.

For a project of \$250,000 or less, personal liquid assets must be injected if over 2 times the project amount or \$100,000, whichever is greater.

For a project of \$250,001 to \$500,000, personal liquid assets must be injected if over 1.5 times the project amount or \$500,000, whichever is greater.

For a project above \$500,000, personal liquid assets must be injected if over 1 times the project amount or \$750,000, whichever is greater.

### **Ineligibility:**

The following types of businesses are ineligible for 504 financing; non-profit organizations; investment companies; gambling facilities; lending institutions.

### **Eligibility:**

A company must meet the following criteria to qualify for an SBA 504 loan:

- § Its net worth must not exceed \$7 million and its average net income after taxes for the proceeding two years must not exceed \$2.5 million.
- § It must be creditworthy.
- § Its project must demonstrate a significant economic impact on the community in which it is located, primarily through job creation or retention.

### **How to Proceed:**

Interested parties should make appointments with a loan officer of a bank or at the EDF. The following documents should be prepared for an initial meeting:

- § A description of the project.
- § An estimate of total project costs including new construction, renovation, machinery, or equipment.
- § Product description and product literature.
- § Financial statements for the past 3 years.

### **Contacting EDF:**

EDF is a fully operational development company headquartered in Grand Rapids and serving all of Michigan. Give us a call. We will guide you from start to finish.

#### **Economic Development Foundation - Certified**

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