

504 Loans

If you're buying a fixed-asset like land, buildings or long-term equipment, look into a 504 loan.

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What It Is: Established in 1980, the 504 Loan Program provides long-term, fixed-rate financing for major fixed assets, such as real estate, facilities construction or expansion, or other fixed-asset needs. 504 loans are made through Certified Development Companies (CDCs).

Appropriate for: Businesses that fall into SBA-size ranges and whose owners are interested in reducing the costs of real estate and equipment loans.

Best Use: Proceeds from these loans must be used for fixed-asset projects, such as purchasing land and improvements, including fixing up existing buildings, grading, making street improvements, upgrading utilities, adding parking lots and landscaping; construction of new facilities; or modernizing, renovating or converting existing facilities; or purchasing long-term machinery and equipment.

Cost and Funds Typically Available: Interest rates on 504 loans are tied to an increment above the current market rate for five- and 10-year U.S. Treasury issues. Fees total approximately 3 percent of the loan amount and may be financed by the loan. Generally, project assets are used as collateral and personal guarantees from the principal owners are required. The range of funds is typically \$50,000 to \$750,000 for up to 10 years on equipment and 20 years for real estate. The maximum amount may increase to \$1 million under certain circumstances. The private-lender contribution is unlimited.

Ease of Acquisition: Challenging. Federal regulation combined with several parties involved in the transaction make for a complex application process.

First Steps

Typically, 504 loan requests are initiated by a private lender. So if you think this is a viable option for your financing needs, it is in your best interest to find a banker familiar with 504 financings.

As is the case with all small-business loans, borrowers should have three years' worth of financial statements, plus personal financial statements for company principals. This is in addition to other qualitative information concerning management, the company, the market and usage of loan proceeds.

Once a banker is convinced of the loan's viability and the company's creditworthiness, the bank may recommend the loan as a candidate for 504 financing. And, in fact, banks have real incentive to recommend this program. First, since the bank's portion of the loan is 50 percent, its exposure is lower. Also, since its investment is less than that of traditional

financing, it can spread its investments out over a number of projects, reducing the bank's financial exposure, increasing its customer base and stimulating the local economy through job creation. Finally, this program gives the bank a senior lien position on 100 percent of the assets being financed. Thus, the 504 program offers benefits to both borrower and banker.

Once the bank has given preliminary approval on a 504 request, the prospective borrower is turned over to a local CDC, which works with the applicant on a true management level. The CDC may, for example, offer financial and technical assistance, or help businesses obtain such assistance from other sources. This is in addition to assisting the borrowers with the preparation of the application and the closing documentation.

The CDC then recommends the package to the SBA for approval (unless it is a PCLP and has approval authority). SBA approval means that the administration guarantees the CDC portion of the loan (roughly 40 percent). Funds are then raised through a monthly debenture sale and are guaranteed 100 percent by the SBA.

When the loan is approved, the funding process begins. A hypothetical example makes this process easier to understand. Assume there is a \$1 million project, with proceeds to go toward purchasing land and constructing a building. The bank provides \$500,000 and assumes a first mortgage. The CDC takes a second mortgage for \$400,000. The remaining \$100,000 comes from the borrower. Depending on the terms of the loan, in most cases the bank for an interim period actually assumes \$900,000 (its \$500,000, plus the CDC's \$400,000). This period may extend from one month—if no construction is involved and the wait is just until the next debenture sale—up to six or eight months if there is construction. Longer interim terms are possible given extenuating circumstances. (Remember, these loans provide permanent financing and do not cover construction. But construction loans are not permanent, either. At some point they must be replaced with a longer-term vehicle, such as a CDC loan.)

Once the debentures are sold, funds are wired to the bank. It receives its \$400,000 and retains its senior lien on the \$500,000. Of course, this is not the end, and most CDCs remain involved with their loan customers, providing valuable and ongoing consultation even after the loan closes.

To find a CDC in your area, consult the 504 loan program area on the SBA Web site.

How to Raise Money for Your Business

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