BALTIMORE DISTRICT OFFICE
Stephen D. Umberger, District Director
10 S. Howard St., Ste. 6220, Baltimore, MD 21201
Phone: (410) 962-6195 * Fax: (410) 962-1805
www.sba.gov/md

U. S. Small Business Administration Loan Funds Available to Purchase Commercial Real Estate

by: Stephen Umberger, District Director

Small business owners thinking of purchasing or renovating commercial real estate or purchasing equipment to grow or expand their businesses should consider the **U.S. Small Business Administration's (SBA) 504 Loan Program.** The 504 loan provides small businesses access to the same type of long-term, fixed-rate financing enjoyed by larger firms. Interest rates are equivalent to favorable bond market rates.

Most Maryland businesses would be eligible for this loan program. The 504 Loan Program defines a business as small if its net worth is under $7 million and net profits, after taxes, are under $2.5 million. Almost any type of legitimate business is eligible for 504 financing, including manufacturing, wholesale, service, professional service or retail.

A 504 loan may be used to purchase fixed assets such as: land and improvements, including owner-occupied buildings, grading, street improvements, utilities, parking lots and landscaping; construction of new facilities, or to modernize, renovate or convert existing facilities; or to purchase long-term machinery and equipment with a useful life of at least 10 years. Soft costs like architectural and legal fees, environmental studies, appraisals, and interest and fees on the construction and/or interim bank financing can also be rolled into the loan. Financing for other needs such as working capital, inventory, debt consolidation or refinancing are eligible through a separate SBA 7(a) Loan Guaranty Program.

A typical 504 project is structured with fifty percent of the project costs provided through a private-sector lender. This senior loan is usually for a 10-year term at a fixed or variable rate, depending on the relationship with the lender. Forty percent of the project costs are financed with a fixed-rate debenture secured with a junior lien from a SBA Certified Development Company (CDC). The debenture is backed by a 100 percent SBA-guaranty. And the final 10 percent of the project cost is provided by the purchaser.

The low 10 percent down payment is the big attraction of this program. It is possible to require even less from the business if a city, town or the state trying to attract businesses to their community is willing to provide a small piece of the financing in a subordinate position. Because of the lower down payment required and the ability to finance the soft costs, the small business will realize upfront cash savings of approximately $100,000 on a $1 million project.

The maximum SBA debenture can be up to $2 million. Certain manufacturing entities are eligible for up to a $4 million debenture. This means that a CDC can work with you to put together financing for a $10 million project with the bank providing a $5 million first mortgage with a SBA 504 debenture of $4 million, and only 10 percent equity.

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Maturities of 10 or 20 years are available. Interest rates on 504 loans are pegged to an increment above the current market rate for five-year and ten-year U.S. Treasury issues. The rate on the 504 loan is fixed for the life of the loan and is set when the CDC sells the bond to fund the loan. Effective all-in rates, which include all fees and closing costs, on 20-year bonds vary monthly.

Consider the following advantages of the SBA 504 program versus conventional mortgage financing:

Advantages to the business:

- **Low down payment.** In most cases, the company is required to inject just 10 percent of the total project cost, which includes renovations and soft costs. This allows the business to preserve cash for working capital. (Ordinarily, banks require a 20 to 30 percent down payment on the purchase price.)
- **Fixed rate on the SBA 504 portion.** Small businesses don't have to worry about the prime lending rate going up and can calculate the exact amount of their mortgage payments for 20 years.
- **Long term.** 504 loans are for 10 or 20 years. Because the CDC is in second lien position, the lender doing the 50 percent first lien loan is willing to lend at a longer term. Longer terms reduce monthly payments
- **Low interest rate.** Even with fees and closing costs included in the rate, the 504 program offers a low fixed rate for a subordinate mortgage loan. The blended rate between the lender portion and the SBA's 504 portion makes the project very affordable, particularly for small businesses.

Advantages to the first mortgage lenders in a 504 project:

- The lender has less risk because the SBA 504 loan is in second position
- A lower loan to value ratio
- The first mortgage lender gets CRA credits
- Keep a growing customer happy

Advantages to the community:

The community gets the advantage of keeping or attracting a healthy, growing small business that will be creating jobs and contributing to the health of the local economy.

For more information:

To learn more about this program, call the SBA Baltimore District Office at 410-962-6195 or contact one of the following active Certified Development Companies serving Maryland.

- **Business Finance Group**, 621 Knollwood Rd., Severna Park, MD 21146, (410) 544-1994 * www.businessfinancegroup.org
- **Chesapeake Business Finance Corp**., 4606 Wedgewood Blvd., Frederick, MD 21703, (310) 668-1844 or (800) 453-0262 * www.chesapeake504.com
- **Mid-Atlantic Business Finance Company**, 1410 Crain Highway, Ste. 5B, PO Box 19815, Baltimore, MD 21225, (410) 863-1600 or (800) 730-0017 * www.mabfc.com
- **Prince George's Financial Services Corp (FSC First).,** 1100 Mercantile Lane, Ste. 115-A, Largo, MD 20774, (301) 883-6900 * www.fscfirst.com