SBA RESPONSES TO Q&A - 504 Debt Refinance
May 25, 2016 – November 17, 2016

Eligibility

1) **Would a Fannie Mae or Freddie Mac loan be considered a loan subject to guarantee by a Federal agency or department? In other words can you refinance a Fannie Mae or Freddie Mac loan through the 504 Debt Refinancing Program?**

These are federally guaranteed loans and are not eligible for the 504 Refinancing program. Furthermore, these are housing loans which would be considered personal expenses and not business expenses.

2) **Are loans that originated with SBA or USDA, but have been refinanced into conventional loans, eligible for the 504-Refinancing Program? There is a 2 year requirement on qualified debt. Does this mean the loan must have been non-federal for 2 years prior to application before it can be eligible to be refinanced by the 504-Refinancing Program?**

Yes. These loans may be eligible if they have been non-federally backed for at least 2 years.

3) **Would a residential mortgage being used on a home that has recently been converted for a commercial business be considered a "commercial loan" and eligible for refinance? For example: would a borrower who operates a residential care home that is secured by a residential mortgage be eligible?**

The loan is a residential mortgage and is not eligible for refinance under this program as it is not an existing commercial loan.

4) **Is a loan eligible if the current note has not existed for two years, however, the loan is the refinance of a loan which was originally funded at least two years prior to the date of application, as required for Qualified Debts? For example: A small business purchased a building 6 years ago. The bank approved a loan with a 5-year balloon payment, and then refinanced that loan last year when it matured. The loan will mature in approximately 4 years. The current note has not existed for two years, but this loan was funded 6 years ago.**

This is not an eligible project since the existing loan (current note) has not been in existence for more than two years.

5) **Small business debts often change over time and applicants may keep less than a complete record of documentation. Are CDCs allowed to obtain a certification of missing documents from the applicant in these situations?**

No. In accordance with the current Form 1244 (Exhibit 2), the borrower and the CDC must both certify that the debt is eligible.

6) **Would a change in type of business entity that did not change ownership need to have occurred 2 years prior to application (Simple example being the incorporation of a sole proprietorship.)**

A change in type of business entity would not impact eligibility.

7) **Can the Energy Public Policy Goal ("Green loan") be worked into a 504 debt refinancing project so a borrower would have access to an additional $5MM of SBA funds?**

No.

8) **Can personal residence be used to cover the shortfall of collateral?**

In addition to the project property, other fixed assets acceptable to SBA, including a personal residence, may be added to meet the 90% LTV that applies to projects that refinance Qualified Debt and Other Secured Debt, but may not be added to meet the 85% LTV that applies to projects that include the financing of Business Operating Expenses.

9) **If a debt was acquired 10 years ago but has been refinanced a number of times and the last refinance to the debt was 3 years ago, would this be a qualified debt?**

If an existing debt was refinanced multiple times, the most recent Note will need to have been in place for at least 2 years before an applicant can qualify for this program.

10) **Business is owned by two individuals. Six months ago Owner A sold their portion to Owner B. Would this applicant be eligible for the program?**

As long as the borrower has been in operation for at least a consecutive two-year period ending on the date of the application AND the change of ownership does not result in a new business, the loan would be eligible. Please see "new business" guidance in SOP 50 10 5(H), page 236, to determine if your borrower is considered a "new business":

> **New Business is a business that is 2 years old or less at the time the loan is approved. A business that is more than 2 years old at the time the loan is approved may be considered a New Business if it is a change of ownership that will result in new, unproven ownership/management and increased debt unrelated to business operations. * * ***

11) **Does it make a difference if the ownership change was just in the Operating Company and not the EPC?**

It would make a difference only if the Operating Company is a co-Borrower, in which case any change of ownership in the Operating Company must not result in a new business.

12) **If a property was purchased using a residential loan but for commercial use, can a residential mortgage be refinanced under this program?**

No, only eligible commercial loans can be refinanced under this program.

13) **If Business Operating Expenses are included in the project, what is the LTV requirement?**

LTV for financing of Business Operating Expenses is 85%.

<u>"Other Secured Debt"</u>

1) **"Other Secured Debt" must have been incurred 2 or more years prior to the date of the application and secured by the "same Eligible Fixed Assets" securing the Qualified Debt. May the "other" debt be secured with additional assets provided it is secured with the Eligible Fixed Assets?**

Yes.

2) **Please confirm the following: If a commercial real estate expansion loan was made more than 2 years ago, but is secured only by a mortgage on an unrelated piece of real estate, it is not "other secured debt."**

The statement is correct. It is not "Other Secured Debt" since it must have been secured for at least 2 years by the same eligible fixed assets securing the Qualified Debt.

3) **If that same loan had instead been secured with a junior mortgage on the improved real estate (the Eligible Fixed Asset), would it be "other secured debt?"**

Yes.

4) **Is the difference in the LTV criteria based on the collateral of the debt or the purpose of the debt?**

LTV is based on the purpose of the debt. If the purpose of the funds is for refinancing only Qualified and Other Secured Debt, LTV is 90%; if the Borrower is also financing any business operating expenses, the LTV is 85%.

5) **In a case where the Qualified Debt is commercial real estate more than 2 years old and a lender secured a working capital line of credit both with a mortgage on that commercial real estate (Eligible Fixed Asset) and a lien on current assets, is the working capital line "other secured debt" on those facts?**

If the working capital line of credit is secured with the Eligible Fixed Asset(s) securing the Qualified Debt, it would qualify as "Other Secured Debt." The fact that additional collateral may be taken would not impact that determination.

"Business Operating Expense"

1) **For "Business Operating Expenses," are rent payments limited to unrelated parties?**

Rent for the premises or equipment may be an eligible Business Operating Expense and may be approved if the amount of the rent satisfies prudent lending standards. Note that loan proceeds may not be used to make payments to Associates of the Borrower (except for ordinary compensation for services rendered). See 13 CFR 120.130(a).

2) **If the loan includes "Business Operating Expenses," what will SBA require for documentation post loan funding to show the payment of those stated eligible expenditures and what party retains the documentation?**

If the Borrower is requesting that the refinancing include Eligible Business Expenses, the application must include a specific description of the Eligible Business Expenses and an itemization of the amount of each expense, with the Form 1244 certification of the accuracy of this information.

Both the CDC and the Borrower must certify in the application that the funds will be used to cover eligible business expenses. 13 CFR 120.882(g)(6)(ii) states: "Borrower must, upon request, substantiate the use of funds provided for business expenses through, for example, bank statements, invoices marked "paid," cleared checks, or any other documents that demonstrate that a business obligation was satisfied with the funds provided."

3) **Can a line of credit or other debt be paid down or paid off as a Business Operating Expense?**

Yes, and the financing of a line of credit limits the LTV to a maximum of 85%.

4) **Are prepayment penalties eligible project costs under the 504 Debt Refinancing program?**

Yes.

5) **May closing costs, appraisals, and environmental costs be included in a 504 Refinancing Program project? Are they included as Business Operating Expenses which triggers the 85%/25% requirements? Was this the intent not to include closing costs?**

Closing costs and professional fees may be included in the 504 Refinancing Program in the same way and under the same criteria as they are currently included in the 504 loan program. They are not considered "Business Operating Expenses." If there are no Business Operating Expenses, closing costs may be included to the extent that the project does not exceed the 90% LTV limitation.

6) **Can Business Operating Expenses include a business line of credit that was recently paid off?**

No, Business Operating Expenses that were paid off prior to the date of the application are not eligible.

Closing/Funding Time Frames

1) **Must all loans be closed and funded within 6 months, as required with the temporary debt refinance program, or is it the same time frame as "traditional" 504 loans?**

Yes. Under 13 CFR 120.882(g) (12), all loans must be disbursed within 6 months after loan approval. The Director of the Office of Financial Assistance or his or her designee may approve an extension of the disbursement period for good cause.

Escrow

1) **If the debt being refinanced is same institution debt, is an Escrow Account required?**

No, in accordance with Policy Notice 5000-1939, either an Escrow Account or an Interim Loan may be used.

2) **Please provide a summary of the Escrow Account requirements for 504 debt refinancing program.**

The following will be required for an escrow closing:

(a) Escrow Account:

(i) SBA must approve the escrow agreement. Escrow agent must be approved by CDC and SBA and follow escrow instructions provided by CDC and SBA. Approval by the District Counsel at closing constitutes approval of the agreement and disbursement upon receipt of the net debenture proceeds.

(ii) Debenture sale funds must be wired directly into the escrow account.

(iii) The funds in escrow may not be distributed and the escrow account may not be dissolved until CDC is satisfied that all collateral documents have been properly filed, lien positions properly perfected, and a final title policy (or other evidence of title if no title policy is required) is issued showing required title and lien position.

(iv) The escrow must close no later than 6 months from the date of loan approval, which is the Approval Date on the first page of the Authorization for Debenture Guaranty. If it does not, the escrow funds will be used to pay off the Debenture in full.

(v) Borrower must deposit its cash contribution to Refinancing Project, if any, in the Escrow Account.

(b) SBA Form 2416 - Third Party Lender must execute and submit to the CDC at the time of closing SBA Form 2416, Lender Certification for Refinanced Loan.

3) **Will SBA provide a template for the escrow agreement?**

No. You must ensure that the Escrow Agreement provides that the escrow will be funded by the Borrower's contribution and the net debenture proceeds, and the Escrow Agreement must be executed by the Borrower, the Third Party Lender, the Escrow Agent and the CDC. The Agreement must also provide that the escrow account may be held by the CDC attorney, Title Company or other party approved by SBA District Counsel.

4) **In a case of an Escrow closing, net debenture proceeds are wired to the Escrow Account set up earlier. Funds may be released from this account "only upon written approval by CDC and SBA". What are the logistics for receiving written approval from SBA for release of funds after debenture proceeds are wired to the escrow account? Who is "SBA" for these purposes? Does the earlier approval of the loan package by the SBA District Counsel act as SBA written approval – though provided prior to funding of the account?**

At closing, the District Counsel will be able to determine if SBA has the required lien positions on the collateral and should have evidence that the Borrower has deposited its contribution into the escrow account. The approval of the loan package for funding constitutes "written approval by SBA."

5) **Please provide a more detailed example of how the escrow account will work.**

Example: The 504 Debt Refinancing loan is for $600,000 and it includes same institution debt. CDC counsel delivers a proposed escrow agreement to District Counsel for review and approval. At the time of the 504 loan closing, Borrower deposits its contribution, if any, in the escrow account and evidence of same is provided to District Counsel. After sale of the debenture, the net debenture proceeds will be wired to the escrow account. The net debenture proceeds and the Borrower's contribution may then be wired or otherwise transferred to the Lender.

TPL

1) **Policy Notice 5000-1382 references that the Third Party Lender (TPL) must certify in its commitment letter that it has no reason to believe that the debt is not eligible. If we have a letter of intent from TPL instead of a commitment letter, will this be acceptable if we have similar language contained in the LOI?**

Yes.

2) **What is required of the TPL in terms of certification?**

See Part D of SBA Form 1244, Instructions for Third Party Lender Certifications for loans made for debt refinancing.

3) **Does the TPL need to certify anything related to eligible business expenses if these are included in the project?**

No.

Job creation/retention, public policy and community development objectives

1) **If applicant will not be able to create any additional jobs, then can they qualify using one of the Public Policy goals?**

All projects must adhere to the 504 Program job creation and retention requirements. However, the Project may also be eligible if the small business qualifies under a Public Policy/Community Development goal, excluding the Energy Public Policy goals (see page 271 of SOP 50 10 5(H)).

Documentation

1) **Please provide more specific direction on the documentation requirements for the credit memorandum that states "CDC must provide an analysis in its credit memorandum that the proposed debt refinancing satisfies each of the requirements of the 504 Debt Refinancing Program."**

The CDC's credit memorandum must address all issues that would be required of a prudent lender. For all Qualified/Other Secured Debt, SBA would expect that the credit memorandum include, but not be limited to, the following:

- **Description of how the debt meets the requirements for Qualified Debt or Other Secured Debt;**
- **Lender Name;**
- **Original Loan Amount;**
- **Original Date;**
- **Maturity Date;**
- **Payment amount/frequency;**
- **Payment Due Date;**
- **Current Balance to be refinanced;**
- **Borrower(s);**
- **All guarantors;**
- **Use of Proceeds;**
- **All Collateral; and**
- **Identify the Borrower or Operating Company for whose benefit the proceeds were used.**

In addition, the credit memorandum must contain an analysis of the transcript(s) with due date, actual payment date, and payment amount for each of the 12 months preceding the date of application indicating that the loan has been current and is therefore eligible for refinance. This should be supported by the actual transcripts in the application. Any/all late fees that private lenders charge prior to a 30 day delinquency must be addressed.

Any forbearance or similar agreement(s) that might have been in place prior to the 12-month period when the loan payments became current must be addressed in full, including the circumstances surrounding the agreement(s). The agreement(s) must be included with the application.

2) Can appraisal reports be dated 6 months prior to the date of approval of the application?

Yes, appraisals must be dated no earlier than 1 year prior to the date the application was approved, and must otherwise comply with the requirements for appraisals set forth in SOP 50 10 5 (H). Appraisals are not required at time of application, but must be submitted to and approved by the SLPC prior to closing.

3) **Why are appraisals not required at time of application, since the appraisal defines the 504 Debt Refinancing project?**

Until there is a loan approval, many businesses would not want to move forward with the expense of an appraisal and/or an environmental assessment. If the amount of the Refinancing Project was based on an estimate, then prior to loan closing, the SLPC will determine, based on the appraisal, whether the amount of the Refinancing Project needs to be revised and the refinancing restructured. However, if a current appraisal is available, SLPC strongly encourages submission with the application.

4) **If borrower can't provide the loan transcript to show they are current, can they provide canceled checks and copies of bank statements?**

A loan transcript is required to show that the loan has been in good standing for the past 12 months. If there is no means of obtaining one, then SBA will consider a consolidation of canceled checks that correspond with each monthly loan stub along with an analysis.

General/Misc.

1) **What is the annual guarantee fee for the 504 Debt Refinancing Program during FY 2017?**

For loans approved under the 504 Debt Refinancing Program during FY 2017, the total annual guarantee fee is 0.731% (73.1 basis points).

2) **Why is there a small premium on the 504 refinancing program annual guarantee fee when there is no current subsidy?**

The statute authorizing the Program requires an additional fee to cover any additional costs attributable to the refinancing. The CFO subsidy modeling team has calculated the additional costs for FY 2016.

3) **In the statute reauthorizing the Debt Refinancing Program, each CDC must limit the financings made under the program to"50 percent of the dollars loaned" during the previous fiscal year. Does this phrase refer to the dollars approved by SBA in the preceding fiscal year or the dollar amount of loans funded in the fiscal year?**

The 50% is based on the dollar amount of loan approvals and not disbursements.

4) **May we also continue to rely upon SBA Policy Notices issued during the Jobs Act Temporary Debt Refinancing Program?**

No. Policy Notices 5000-1382 and 5000-1939 and Information Notice 5000-1383 are effective now. The notices issued during the Jobs Act are expired and the Jobs Act refinance program has sunset. Although some of the requirements are similar to the Jobs Act, there were statutory changes made to the Debt Refinancing Program that are reflected in the current Policies and Information Notices. SBA will be updating the SOP to include guidance for this program.

5) **Can we use this program to refinance a qualified debt that was financed by the Seller?**

Yes, as long as the applicant can provide all the security instruments as a regular commercial loan (Note, Deed of Trust, etc.)

Waiver Guidance

1) **What is the guidance for waivers of the rule that CDC's new financings under the 504 Debt Refinancing Program during any fiscal year cannot exceed 50% of the dollars the CDC loaned under the 504 Loan Program during the previous fiscal year?**

The Act requires that each CDC's new financings under the 504 Debt Refinancing Program during any fiscal year cannot exceed 50% of the dollars the CDC loaned under the 504 Loan Program during the previous fiscal year, but allows this limitation to be waived for good cause. In making this good cause determination, SBA will consider such factors as:

- **Whether the borrower has access to other sources of financing, including other CDCs that have not exceeded their 50% cap; and**
- **Whether the CDC has an existing 504 loan with the Borrower that is in current status.**