

MOUNTAIN WEST SMALL BUSINESS FINANCE

MASTERS IN 504 LENDING

- Best Practices



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MASTERS IN 504 LENDING

- Welcome to the third session of the Masters in 504 Lending Series, presented by Mountain West Small Business Finance
- We appreciate your taking the time to visit with us today, and throughout this series
- Presenter:
 - Spencer Davis
 - VP, Senior Lending Officer
 - Mountain West Small Business Finance
 - sdavis@mwsbf.com
 - 801.412.3769 (Office)
 - 435.669.4622 (Cell)

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Best Practices from MWSBF

- We've learned a thing or two over the last 42 years
 - Number 1 SBA 504 lender in Utah
 - Number 1 SBA 504 lender in our SBA Region
 - Top 10 SBA 504 lender in the nation
 - We are leaders and teachers in our industry
 - We do hundreds of loans each year
 - We train other CDCs

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Our Goal is to Get the Loans We Work On Approved and Funded Quickly

- Meet deadlines
- Simple and efficient as possible
- Avoid surprises
- We want you and your customer to be happy
- We want to be your number 1 CDC

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Communication is Key

- We need to have as much information as possible upfront
 - We want to communicate with you as early as possible.
 - What is the correct information to communicate up front?
 - This presentation will cover the information that we want to know up front.

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Tell Us About the Project

- Straight purchase
- Construction
- Equipment
- Refinance without expansion
- Refinance with expansion
- Partner buyout
- Timing and deadlines
- Why?
 - This helps us know what kind of information we need to collect for the loan, what eligibility items we need to cover, and timing expectations.

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Tell Us About the Project Costs

- Discuss the estimated project costs associated with the loan
 - Hard costs
 - Soft costs
 - Estimated interest rate and term for both the Lender and SBA loans
 - SBA has asked us to round the total project cost up to the nearest hundredth
 - Why?
 - This helps us know the kind of information we need to collect for the loan and it also helps us both get on the same page

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Let's Discuss Structure

- How long have they been in business?
- Is the building general or special purpose?
- What is the source of their injection?
- Why?
 - We want to be on the same page with you from the beginning on structure and we want to make sure the borrower has sufficient funds for the injection.

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Sources and Uses

- Once we understand the type of project, the estimated project costs, the structure and the estimated interest rates and terms, we can create a Sources and Uses document for you.
- Why?
 - It is an excellent visual representation of how the loan works
 - It creates an easy guide to help explain this type of loan to your borrower
 - It gives your borrower an estimate of loan fees as well as monthly and annual payments for both loans

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Tell Us About the Business

- What entities are involved?
 - Who is the Operating Company?
 - Will there be an EPC?
 - Are these entities owned personally or with a pass thru entity?
- What does the OC do and what is their story?
- Why do they want/need this loan?
- Why?
 - This helps us to know what kind of information to collect for the loan, who our guarantors will be and the history of their business

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Credit Worthiness

- Give us a heads up on the strength of the borrower
- It would be good for us to know if repayment is strong, acceptable or needs projections
- Let us know if you are aware of any unusual circumstances with their ability to repay the loan
- Let us know if you are aware of any significant issues on their personal credit
- Why?
 - We will of course do our own underwriting on the project but a heads up of any of the above gives us a better start on the loan and let's us know what to expect.
 - We can pre-screen a loan and give you a quick “Yes or No” on a borderline project

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Let's Discuss Eligibility

- Occupancy
- EPC/OC rules
- Prior SBA loan history
- Environmental
- Franchise
- Historical property
- Credit elsewhere
- Bridge financing

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Occupancy

- Occupancy expectations for straight purchase, refinance and new construction
- The borrower's occupancy will be confirmed at two points during the origination process:
 - At application - SBA reviews the appraisal
 - At closing - we collect any third-party leases at closing
- All tenants must sign a Subordination and Non-Disclosure Agreement (SNDA)
 - Let's collect these together
- Borrower must meet occupancy requirement in EACH condo unit they are purchasing

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EPC/OC Rules

- The EPC cannot be involved in any other business operations aside from leasing the building to the OC
- The EPC must lease 100% of the building to the OC
 - The OC can then turn around and sublease to third party tenants
 - This means that the lease for any third-party tenant is between the OC and the tenant
 - The tenant will pay rent to the OC
- The rent payment between an OC and EPC cannot be considered excessive
 - SBA has not defined what “excessive” means but we have found that in most cases, a rent payment that is 20% above the debt service payment is acceptable
 - We have also found that SBA is willing to hear out reasons why a rent payment needs to be higher than 20% on a case-by-case basis (Property Taxes)
 - We are running into a lot of issues for repeat borrowers where they are not in compliance with these EPC/OC rules
 - The SBA views them as being in technical default and won’t approve a loan for them until they come back into compliance
 - Often, the borrower is required to provide SBA with updated leases to prove they are back in compliance

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Prior SBA Loan History

- Do they have any other SBA loans?
- Have they ever defaulted on a prior SBA or government loan?
 - If so they are not eligible for a new SBA loan
 - The earlier we know this the better
- How can we know if they have defaulted on an SBA loan?
 - When the borrower signs our application, they give us permission to collect prior SBA loan history data from our local SBA District Office.
 - We do this on every loan

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Environmental Report

- Discuss upfront what kind of environmental report is needed and who is going to order it.
- We want to avoid getting all the way to the point where SBA has approved the loan and we realize we forgot to order the environmental report.
- We are not going to tell you who you should or should not order environmental reports from, but please be aware that we experience a high % of problems with RSRAs that are done by VeraCheck.
 - Low Risk Level Two or Higher
 - Even with follow up information back to VeraCheck, they seem hesitant to update report.
 - This will at minimum cause time delays with SBA and at worst, create the need for a Phase I.

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Franchise

- We want to know right away if the project business has a:
 - Franchise Agreement, License Agreement, Distributor Agreement, Membership Agreement, Jobber/Fuel Supply Agreement
- Any of the above meet the FTC definition of a franchise which means they need to be on the SBA Franchise Directory.
- If the agreement has not already been pre-screened by SBA, it can be a very slow and frustrating process to get the agreement approved.
- We need to know this ASAP so that we get this process going if needed.
- We are not able to submit the loan to SBA for approval until the relevant agreement has been approved by SBA.

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Historical Property

- If a property is 100 years old or more, resides in a historical district or is itself already determined to be historical, we have to work with SBA to clear this property for SBA approval.
- This process involves providing information to local State Historic Preservation Office (SHPO)
 - Once reviewed, the local SHPO provides us with a “No Adverse Effect” letter
 - This letter is then provided to our local SBA District Office to be reviewed by legal counsel
 - After the local counsel reviews, they make a recommendation that is then sent to SBA’s Office of General Counsel
 - Finally, SBA’s Office of General Counsel will state that “No Further Section 106 Review” is required
 - We cannot submit to SBA until we know that No Further Section 106 Review is required
- The sooner we can get this process started the better. It will prevent delays with our ability to submit the loan.

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Credit Elsewhere

- We must demonstrate to SBA why the borrower needs a government guaranteed loan.
- It is helpful if we understand from you, the lender, why our assistance is needed/wanted.
- We have had loans declined in instances where SBA determined that the borrower had sufficient liquid asset to qualify for conventional financing.
- It is very helpful if we can have a conversation up front about Credit Elsewhere. We can strategize the best way to overcome a potential issue.

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Bridge Financing

- Everyone please pay close attention to the following slides.
- Bridge financing is when the lender makes an interim loan before the loan has been approved by SBA. It can really help or it can really hurt.
- Due to the slowness of SBA and the demand of sellers to close on a property in a hot real estate market, we have seen a large uptick in bridge financing.
- Examples of Bridge Financing:
 - Short term note to purchase land
 - Short term note for a building
 - We typically see this done by a conventional lender, hard money lender or seller carryback

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Bridge Financing Continued

- For bridge financing to be considered eligible, it must be short term.
 - A term of three years or less is considered short term by the SBA.
 - Three years or more is considered long term by the SBA.
 - They will NOT make an exception for even a note that is three years and one day.
- When bridge financing is short term and eligible, we include the cost of paying off that bridge note as part of our regular 504 loan.
- When bridge financing is long term, we can usually transition the loan into one of SBA's refinance products, but not always. We have had deals die due to bridge financing not being done properly.

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Bridge Financing Continued

- A common problem we see is when a lender does bridge financing with two notes:
 - One is a long-term note meant to be the Lender's perm note.
 - The second is short term, meant to be the interim loan eventually to be paid off by the debenture.
 - The long-term note will be considered ineligible bridge financing and could cause delays and major problems with the loan.
- We do have a solution, but it is much easier to avoid this scenario.

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Bridge Financing Continued

- A common problem we see is when a Lender does a bridge note for a loan we are trying to refinance.
- SBA requires that any loan we refinance be seasoned for six months.
- When a lender does a bridge note for an existing loan, it will start over this six-month period.
- Bridge financing is **NOT** allowed on refinance without expansion loans.

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Loan Documentation

- MWSBF has started requiring all borrowers to fill out our 504 Loan Application
- We have updated our application to best suit our back office processors and we have found that a loan goes through our system faster if we have our application.
- What is needed to get our loans into processing and underwriting?
 - Prescreen?
- Our forms will help us detect if there is:
 - Lawsuit, bankruptcy, citizenship, or arrest issues
 - All of these require additional documentation or information from the borrower
- Why?
 - Knowing about these early avoids potential credit and eligibility issues.

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Closing Best Practices- Certificate of Occupancy

- If renovations/construction require a permit, this means the project has to have a Certificate of Occupancy
- Our closing attorney requires us to contact the city to verify if there are any outstanding permits
- Our closing attorney won't prepare closing docs without the CO
- Our SBA attorneys won't allow us to close with a temporary CO

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Closing Best Practices- Project Costs

- The closing process will be faster and smoother if the Lender makes sure that their loan amount(s) match exactly the numbers that are in the Authorization.
- We often see Notes from a Lender with different loan amounts than what was on the Authorization.
- Why?
 - Even the slightest change can result in us needing to make an amendment to our Authorization. Depending on how busy SBA is, this may take one week to one month.

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In Closing

- Communication is Key
- There are certain aspect of the project that we should be discussing upfront on every loan.
- We need our application on every loan that we work on
- Doing these things will make for a better experience for you and your borrower

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Please join us for our next Masters in 504 Lending Session

- May 26th at 11:00am
- Topic: Eligibility 101
- Please invite all of those in your offices who have any present or potential future, role in 504 lending to attend
- This is a very important topic that will help you understand the basics of SBA eligibility



THANK YOU

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