

# MOUNTAIN WEST SMALL BUSINESS FINANCE MASTERS IN 504 LENDING

- Eligibility 101



# MOUNTAIN WEST SMALL BUSINESS FINANCE MASTERS IN 504 LENDING

- Welcome to the fourth session of the Masters in 504 Lending Series, presented by Mountain West Small Business Finance
- Next Month (deep dive into eligibility)
- We will not necessarily cover refinance eligibility as that will be discussed when debt refinance is presented (conventional refi / refinance with expansion)
- We appreciate your taking the time to visit with us today, and throughout this series
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# MOUNTAIN WEST SMALL BUSINESS FINANCE MASTERS IN 504 LENDING

*Eligibility – We miss Mike Vanchiere, but his expertise of the SOP lives on in Jeff Vanchiere*

**We've learned a thing or two over the last 42 years and are constantly learning as SBA changes the SOP**

- No, Mike's not dead, just retired
- Curtis Singleton has a little Vanchiere in him and he'll be doing the deep dive into the eligibility next month
- 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

# MOUNTAIN WEST SMALL BUSINESS FINANCE MASTERS IN 504 LENDING

## *Why does SBA care about ELIGIBILITY and why should you?*

- We care about the 5 Cs of credit too, but we have an “E” to deal with
- Eligibility is crucial to the SBA’s mission and to an approval of a 504 loan
- Sometimes a loan seems like a “slam dunk” in a conventional scenario but may not be eligible regardless (i.e. too much cash)
- Please contact us early so we can address any eligibility oddities or pain points.

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## *Public Policy*

- One job created or retained for every \$75,000 in SBA money borrowed (or one job created or retained for every \$120,000 for a small manufacturer – based on NAICS code)
- ***And...at least one of the following:***
  - Community Development
  - Women owned business
  - Minority owned business
  - Veteran owned business
  - “Green”
  - Opportunity Zone
  - Rural Community
  - Others (improve strengthen community, for example)

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## *Eligible Uses of Proceeds/Funds*

### **A Borrower may use loan proceeds from any SBA Loan to:**

- Purchase one or more existing buildings;
- Convert, expand, or renovate one or more existing buildings (already owned);
- Construct one or more new buildings;
- Acquire and install fixed assets (including machinery and equipment);
- Refinance certain outstanding business debts; and/or refinance existing debt and take “cash out” for Eligible Business Expenses (EBE);
- Finance a Lender’s Other Real Estate Owned (OREO):
- Make approved energy saving improvements to an existing property or as part of a construction project;
- Acquire land as part of an eligible project; Improve a site (e.g., grading, streets, parking lots, landscaping) including up to 5 percent for community improvements such as curbs and sidewalks, etc. (part of a construction project)
- Certain Soft Costs (Appraisal & environmental, title & recording taxes and fees, interim interest and contingency (for construction loans), interim loan fees (TPL fees for construction loans or interim loans)

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## *What Are Not Eligible Uses of Funds?*

- A CDC may not use 504 loan proceeds to pay any creditor in a position to sustain a loss causing a shift to SBA of all or part of a potential loss from an existing debt.
- Third-Party Loan fees (commitment, broker, finders, origination, processing fees of permanent financing).
- Ancillary business expenses, such as:
  - Working capital;
  - Counseling or management services fees;
  - Incorporation/organization costs;
  - Franchise fees; and
  - Advertising
- Fixed-asset Project components, such as:
  - Short-term equipment, furniture, and furnishings (unless essential to and a minor portion of the Project);
  - Automobiles, trucks, and airplanes; and
  - Construction equipment (except for heavy duty construction equipment and/or manufacturing equipment integral to the business' operations with a remaining useful life of a minimum of 10 years).

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## *Eligible Companies:*

- Legal Entity type: Corporation, Partnership, Sole-proprietorship, Limited Liability Company
- Located in the United States
- Net worth under \$15MM and net profits under \$5MM (including any affiliates)
- Owner-user of the project being financed must occupy at least 51% of the property for an existing building or 60% of a newly constructed building. Two or more unrelated small businesses can receive an SBA 504 loan if they combine to meet occupancy requirements

## **Must also:**

- Economic development goals must be achieved through the project financing (from public policy list)
- Have participation by another lender that provides up to 50% of project cost



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## *Ineligible Companies:*

- **A not for profit** (for profit subsidiaries may be eligible)
- **Engaged in Lending:**
  - i.e. Banks,, finance/factoring companies, investment companies, bail bond companies, other businesses whose stock in trade is money
    - ❖ There are limited circumstances under which certain businesses engaged in lending may be eligible (pawn shop, mortgage servicing company, check cashing, etc.)
- **Any Business, or guarantor that has had Prior Loss to the Government or Delinquent Federal Debt**
- **Life Insurance Companies** (however, a life insurance agency is eligible)
- **Passive Businesses:**
  - i.e. businesses primarily engaged in owning or purchasing real estate and leasing it, land leases for cell towers/solar panels/billboards, apartment buildings, residential facilities not licensed as nursing homes or assisted living facilities, mobile home parks
    - ❖ Certain business engaged in leasing and renting may be eligible (hotels/motels, RV parks, marinas, campgrounds, nursing homes or assisted living facilities, leasing equipment/household goods, barber shops, hair salons or similar services
- **Businesses located in a foreign country or owned by Non-U.S. citizens or individuals with out permanent residence status** (or specific renewing Visas – Legal Permanent Resident ok)

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## *Ineligible Companies (Continued):*

- **Businesses Engaged in any of the following:**
  - **Illegal Activity** (no marijuana based or related, direct/indirect)
  - **Businesses That Restrict Patronage or Have Discriminatory Hiring Practices**
  - **Speculative Businesses or Legal Gambling**
  - **Is a government-owned entity** (exception for Native American tribes)
  - **Religious Activity**
  - **Consumer and marketing cooperatives / Pyramid (MLM)**
  - **Provides prurient sexual material**
  - **Engaged in political or lobbying activities**
  - **Engages in SBA Loan Packaging or Small Business Lending Company, Equity interest by lender, CDC or associates in applicant concern**
  - **Owned by persons of poor character** (i.e. certain felonies...background check, misdemeanors/traffic violations ok)

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## *Eligible Projects (project size)*

### *How big can the project be?*

- No limit to the size of a project...however a CDC can only lend up to 40% of the project costs with a dollar cap of \$5,000,000 depending on the type of project
  - The regular program has a \$5,000,000 max, this number could also potentially be reduced by any outstanding 7a debt.
- Can go up to \$5,500,000 of 504 lending for eligible manufacturing projects and for projects that incorporate energy saving technologies for sustainable design
  - “Green” projects – up to 3 are eligible

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### *Credit Elsewhere (Basic)*

#### ■ What is “Credit Elsewhere”...

- It's a way to determine why a government loan is necessary or why a bank/borrower needs a 504 loan
  - ❖ LTV – loan not available from a traditional lender at an LTV at or around 90%
  - ❖ Risk of industry – Perceived risk by traditional lenders
  - ❖ Startup – Perceived risk by traditional lending institutions
  - ❖ Limited cash pre or post injection – need cash for operations
  - ❖ Long-term, fixed rate terms that are fully amortizing – not available from most traditional lenders

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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
- Borrower must meet occupancy requirement in EACH condo unit they are purchasing, if there are multiple units or property Tax ID numbers
- New Construction
  - Must be at least 60% upon completion of construction and 80% within 10 years

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## *EPC (Eligible Passive Company – “holding company”)/OC (Operating Company) Rules*

### **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, not the holding company (EPC)
    - ❖ The tenant will pay rent to the OC not the EPC
- Borrower cannot allow the EPC to collect “excess rents”
  - This means income reported by the EPC cannot be much greater than the combined loan payments, taxes, and other minor expenses (i.e. repairs/maintenance, insurance, etc.)

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### *Cash Flow*

#### **We can only use cash flow derived from the Operating Company in our analysis of cash flow**

- Cannot count lease income from the property (from any tenant/s)
- Cannot count outside income from borrower or spouse if not derived from the OC
  - We can include cash flow from the borrower's personal income if derived from the OC and we can illustrate that there is "excess" income available to add to business and/or global cash flow after all personal obligations are met (personal debt, taxes)
- Our "acceptable" DSCR may differ from yours...
  - Please don't assume that if your global cash flow works, that ours will also. If cash flow on the OC is tight on a stand-alone basis, let's chat before you develop a global cash flow

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## *Prior Government Financing*

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*

- An appropriate environmental report is required. Sometimes a Phase I or II may be required based off of the industry of the OC or previous occupant of the property (if an existing building).
  - Must have a reliance letter and the environmental professional's insurance

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### *Appraisal*

#### **An appraisal is required and must meet the following criteria:**

- Must list the U.S. Small Business Administration as an intended user
- Must include two methods of valuation
- Must have an “as-is” value (and an “as complete” value if it includes construction, remodel, etc.)
  - We cannot use “as stabilized” to determine value.
- Must address occupancy
- Must state remaining economic life of property is equal to or greater than the SBA loan term

#### **When not required:**

- Total project costs or estimated value of the property less than \$500,000, do not require an appraisal.

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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, through their legal department which handles franchise eligibility.

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## *Loan Documentation*

### ■ Financials

- Last two years filed tax returns (sometimes three years are needed)
- Current Interim financials (P&L and Balance Sheet) no older than 120 days
  - ❖ This includes EPC, OC and Affiliates

### ■ Other

- Signed application
  - ❖ This allows us to pull credit and request Previous Government Financing report

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***What if a loan gets declined for an eligibility issue is it dead?***

- **NO**
- **Maybe**
- **Yes**

# MOUNTAIN WEST SMALL BUSINESS FINANCE MASTERS IN 504 LENDING

## **Please join us for our next Masters in 504 Lending Session**

- June 23, 2022 at 11:00am
- Topic: Eligibility – Deep Dive...in case you still have brain space for more
- 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 deep dark secrets of SBA eligibility



**THANK YOU!**

**Mountain West Small Business Finance  
Masters of 504 Lending**