

SBA Solutions

Small-business owners can benefit from 504 loan program.

By Christopher G. Hurn, Commercial Investment Real Estate, CIRE Magazine

In the hyper-competitive commercial real estate marketplace, successful brokers and agents can utilize a relatively little-known yet highly effective financing source to help clients secure the ideal property for their needs. The Small Business Administration 504 loan program represents one of the best possible options for small-business owners to acquire and enhance their own facilities. For many commercial real estate professionals, it is one of their top strategies for helping clients obtain and afford their first-choice business properties.

The SBA 504 loan program has increased nearly 100 percent since 2003, due in part to the foundering residential market and rising commercial lease rates. In fact, office rents are skyrocketing across the nation due to a lack of space in some markets, along with a new breed of landlords who are holding out for premium tenants, according to a Reis research report. Office rents jumped an average of 3.1 percent nationwide during 2Q07, which was the largest quarterly rise in seven years.

In many markets, small and midsize business owners are finding that the rising commercial lease rates combined with the diminishing returns and increased risk in their residential real estate investments are making buying rather than leasing their business spaces a very appealing investment option. Savvy developers are bringing new properties aimed at owner-occupied small businesses to the market, and smart commercial brokers are helping to steer clients toward ownership options.

For instance, Marc Young, a broker with Marcus & Millichap in Orlando, Fla., helped a client sell its Dairy Queen property and business, including all of the equipment in the store, to a buyer who was only able to afford the monthly payments with the terms provided by the 504 program. The \$1.05 million sale of the property together with the business would have been difficult without the 504 financing, as the loan terms and rates that were available through conventional financing for even the most qualified buyers would have made it very difficult to turn a profit.

By informing the buyer about the 504 option, Young was able to help his client close the deal, and the buyer is now profitably operating the 3,000-square-foot ice cream shop in an Orlando suburb.

Using 504 Financing

The 504 program offers financing that covers 90 percent of a project's total cost, as opposed to the 70 percent to 80 percent offered with most conventional commercial loans. The typical breakdown of the funds in a 504 loan is 50 percent from a bank or other private lender, 40 percent from the SBA, and 10 percent from the borrower.

Business owners can reduce their initial capital outlay by as much as \$1 million in some circumstances by leveraging the 504 program's 90 percent loan-to-cost financing. In many cases, this lower down payment requirement is what makes it possible for business owners to afford the initial capital outlay for their acquisitions or construction projects without disrupting their operations. In addition, the 504 program enables borrowers to include renovation, closing, and other soft costs along with furniture, fixtures, and equipment into the financing package.

The portion of the 504 loan that is funded by the SBA represents the least expensive financing available in the commercial mortgage industry for small businesses — 6.03 percent fixed for 20 years as of December 2007. The blended rates for the entire loan are often significantly lower than those of conventional loans and can be fixed for the duration of the 20-year to 25-year amortizations. In addition, borrowing from the SBA 504 program does not preclude business owners from also applying for funding from the SBA 7(a) program for working capital, inventory, and other needs.

By forgoing the 504 loan program and real estate ownership, business owners would be disregarding one of their best options for preserving capital, improving cash flow, and maximizing profits. Initially they benefit

from the lower down payment requirement, but as business owners reach retirement age, they can sell their business while retaining and leasing the real estate as a continuing income source.

Loan Qualifications

SBA 504 loans are available to almost any type of for-profit small to midsize business in the U.S. with the exception of financial services providers, passive real estate investors, companies having a tangible business net worth greater than \$7 million, or companies with net profits after taxes that averaged more than \$2.5 million during the past two years.

As an SBA lending program, 504 loans require applicants to demonstrate job creation, export potential, or other economic development or public policy goals, which are met easily for the majority of applicants. The funds must be used for capital expenses, including land, buildings, construction, and equipment. Owner occupancy requirements are 51 percent of the total square footage for acquisition loans and 60 percent for new-construction financing.

In addition, multiple businesses may be able to jointly pool 504 financing if they meet occupancy requirements together. The loans require the same amount of documentation and due diligence as ordinary commercial loans, and approval processes also are comparable to conventional loan processing.

For commercial brokers who represent clients who wish to own rather than lease space and equipment, the SBA 504 loan program is an effective tool for closing deals. These brokers also are providing added value to their clients by informing them of one of the least-known programs for property financing.