



# **SBA 504 Non Bank Business Model**

Presented by Sok Cordell

# CH Capital Partners LLC (SBA Non Bank Lending Program)

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# SBA 504 Non-Bank Lender Program

- General Description Of SBA 504 Loan Program

- The SBA 504 loan program is a long-term financing tool for economic development within a community
- The 504 Program provides growing businesses with long-term, fixed-rate financing for major fixed assets, such as land and buildings
- A Certified Development Company is a nonprofit corporation set up to contribute to the economic development of its community
- CDCs are licensed by the SBA as the sole funding source for the SBA 504 second lien Debenture
- Only owner occupied commercial real estate properties are eligible, SBA defines owner occupancy as the small business borrower occupying at least 51% or more of the subject property
- Businesses must be determined to be 'small' per SBA standards. That equates to a maximum \$8.5MM business net worth and a maximum \$3.5MM average net income over the prior two years

# SBA 504 Non Bank Loan Program

- A Typical 504 Project Includes
  - A loan secured with a senior lien from a private-sector lender covering typically 50% of the project cost
  - A loan secured with a junior lien from a CDC (backed by a 100 percent SBA-guaranteed Debenture) covering 30% to 35% of the project costs for special purposes properties, such as hotels.
  - A contribution of at least 15% (existing business) to 20% (new business) equity from the small business applicant
  - The first mortgage lender must also make a 90 day (plus) second mortgage interim loan to allow for CDC/SBA funding
  - SBA pays off this interim loan at the time of CDC/SBA funding (normally 90 days after escrow closing)

# SBA 504 Non Bank Loan Program

- Use Of Funds
  - Real estate and fixed asset acquisition
  - Ground up construction, including plans, interest, contingency, offsite improvements, permits, landscaping, minor FF&E
  - Tenant improvements
  - Minor FF&E when purchasing a special purpose property
- Proceeds Can Not Be Used For
  - Working capital
  - Goodwill (of a special purpose property purchase)
  - Cash out
  - Complete refinance (unless special legislation occurs) which has with the **New SBA Bill**

# SBA 504 Non Bank Loan Program

- Typical SBA 504 Loan Structure
  - Purchase Price of \$7,000,000.00
    - Investor First Lien \$3,500,000 (50%)
    - SBA Second Lien \$2,100,000 (30%)
    - Borrower \$1,400,000 (20%)
    - Total \$7,000,000
- First Lien Parameters
  - Fixed or adjustable
  - Fully amortizing or balloons
  - Can be protected from early payoff by prepayment penalties
  - Maximum rate on first lien is NY Prime + 6.00%, regardless if the loan is fixed or adjustable

# SBA 504 Non Bank Loan Program

- Other Key Factors

- The SBA second lien is always fixed for life, usually for 20 years
- The SBA loan rate is well below market, currently 5.50%
- Personal guarantees are always required on the first mortgage and SBA second lien for any owners owning 20% or more of the small business or the real estate holding entity
- Personal net worth and personal net income are not included in the calculation of small business eligibility
- Each personal guarantor is able to access up to \$2MM in SBA funds
- Special 'Green' qualifications for the subject collateral allow up to \$4MM in SBA financing, and manufacturers also benefit from the higher SBA allocation
- The standard down payment is 10% for multi purpose properties
- SBA requires a down payment of 15% for existing special purpose property purchases, increasing to 20% if the business is considered a start up

# SBA 504 Non Bank Loan Program

## The American Recovery & Reinvestment Act of 2009 (AKA The Stimulus Bill) Provides A One Time Opportunity

- ARRA mandated that SBA create a First Lien Mortgage Pool (FLMP Program) to provide guarantees on pools of eligible first mortgages where the SBA second lien funded between 2/2009 and 2/2011
- The CDC industry is working on extending this time frame
- SBA will guarantee 80% of eligible pools
- A pool is defined as two or more loans, either fixed or adjustable, with similar interest rate indices
- There is a ready market for SBA guaranteed paper
- This guarantee can be sold for a premium with and/or servicing income
- SBA does not charge for more for different property types; special purpose properties (such as a hotels or gas stations) will obtain the same guarantee from the SBA as a multi purpose properties
- Similarly, SBA does not charge a differential for the type of business, the historical debt service coverage, or for turn-around situations
- This business plan seeks to use the government guarantee to simultaneously enhance yields and reduce risk for the participating non-bank lender.



# SBA 504 Non Bank Loan Program

- High Dollar Loans Provide The Best Opportunity For Return On Investment
  - The business plan should focus on high dollar loans from \$3.5MM to \$7.0MM made to borrowers that require projected income to qualify
  - There is less competition from community banks for larger loans, and less competition from large banks for projected income loans
  - One high dollar loan generates the same return as 5 or 6 average size loans without the cost of origination multiple loans
  - Larger loan applicants have a more realistic view of the cost of credit as compared to small loan applicants
  - Hospitality property loans will be a major focus due to the lack of competition from banks and other non-bank lenders for this property type
  - Hospitality loans are considered to be unattractive by mainstream banks
  - The CMBS market, which used to be the primary financing option for medium and larger hotel acquisitions, is non-existent
  - There are very few, if any traditional lenders, willing to fund hotel transactions between \$5MM and \$15MM
  - This lack of liquidity has driven the cost of borrowing higher which equates to a larger return on investment for the non-bank lender

## SBA 504 Non Bank Loan Program

- The Blended Rate Is Still Very Appealing To Borrowers
  - Consider the previous example and applicable rates:
  - First Lien (50%)\$3,500,000 90 Day Adj.\*6.84%%
  - SBA Lien (30%)\$2,100,000 20 Yr Fixed5.50%
  - Total Debt\$5,600,000 Blended Rate6.34%
  - 90 Day LIBOR + 6.25%, adjusting quarterly
  - A combined rate in the 6's is very attractive to projected income borrowers
  - The borrower and the non-bank lender benefit by having a large portion of the financing at long term fixed rate
  - Prepayment penalties protect against early payoff
  - Fixed rates first mortgages will also be considered

# SBA 504 Non Bank Loan Program

- Benefits To The Non-Bank Lender
  - Low loan-value-ratio, reduces risk
  - By funding new acquisitions versus refinances, loans will be made on already discounted values
  - Geographic diversity
  - Diversification of project risk by partnering with SBA on both the first lien and the second lien
  - Superior returns versus conventional lending
  - Unlike a bank or publicly traded entity, a private non-bank lender can benefit from excess servicing
  - Much lower cost structure than distressed debt acquisition

# SBA 504 Non Bank Loan Program

## • Non-Bank Lender

- Reviews and approves every transaction
- Funds 15% -100% of each first mortgage transaction, depending on transaction characteristics and participating Pool Originator requirements
- Funds 0% to 100% of interim second mortgage (non-bank lender choice)
- Can draw loan docs and fund, or can table fund another parties' loan documents
- Responsible for liquidation activity related to any loan that is more than 30 days past due (liquidation may be outsourced to the participating Pool Originator)
- Average IRR target is 20% to non-bank lender for all program loans
- Non-bank lender can team with retail agent for outsourcing of loan generation, underwriting, and funding

# SBA 504 Non Bank Loan Program

- Pool Originator
  - Since a private lender is not eligible to be a Pool Originator, a third party Pool Originator must be part of the funding structure
  - Pool Originator purchases 85% of each loan from non-bank lender, normally at the close of escrow
  - Pool Originator must retain 5% of the loan pool for the life of the pool
  - Structures eligible pools for sale
  - Functions as loan servicer including collection of payments, prepayments, servicing action, late payment collection, monthly statements, annual statements, etc.
  - Is paid an annual servicing fee from portion of the servicing fee paid to non-bank lender

## SBA 504 Non Bank Loan Program

- CH Capital Partners assist with it's affiliates and other pooling relationship can provide a business model
  - Assists the Pool Originator in structuring individual loans and loan pools
  - Will help the Pool Originator compile a conforming package
  - Provides latest information or changes to SBA FMLP program
  - Confirms eligibility of 504 loan applications
  - Assists with obtaining CDC/SBA approval on SBA second lien (if necessary)
  - Commits or obtains commitment prior to loan funding for purchase of guaranteed portion of all loans comprising a loan pool
  - Will assist in the generation of new loans from referrals from national network of CDC's

# SBA 504 Non Bank Loan Program

- Suggested Loan Underwriting Criteria
  - Loan amount target of \$3.5MM to \$7.0MM
  - Consider all property types including multi purpose, hospitality, other special purpose, and gas stations (subject to non-bank lender concurrence)
  - Suggested maximum 65% LTV on multi purpose properties, 60% LTV on hospitality properties, and 55% LTV on other special purpose properties including gas stations
  - Current appraisal required on all properties
  - Environmental reports required on all properties (clean environmental report is a condition of SBA funding)
  - No ground up or heavy tenant improvement construction should be considered due to the short term nature of the program
  - Light TI and PIP construction should be considered on a case by case basis only if the SBA Debenture can fund by February, 2011 or the program is extended past February of 2011

# SBA 504 Non Bank Loan Program

- Borrower/Guarantor
  - For hospitality properties, only existing hospitality owners that can document profitable operation of existing hotel businesses should be considered
  - Personal guarantees required from all 20% or more owners of business or real estate holding entity
  - Personal credit history should be good with no current derogatory credit (significant items), recent foreclosures (less than 5 years), or unpaid judgments
  - Verification and documentation of down payment will be required by SBA
  - Adequate personal draw calculation should be calculated and deducted from business cash flow
  - Individuals with excessive revolving credit will not be considered
- All transactions will require CDC/SBA approval on the second mortgage, this insures a secondary opinion of credit



# SBA 504 Non Bank Loan Program

## • First mortgage

- Suggested average 1.50% net origination fee on first mortgage
- Any SBA required fees should be added to the 1.50% required first mortgage fee
- Up to 1% should be reserved to pay as a referral fees to real estate or mortgage brokers
- 25 year amortization
- 90 day adjustable loans should be the norm, 5 year fixed converting to 90 day adjustable should be offered on a limited basis
- Pricing should be LIBOR or LIBOR Swap + 6.25% (subject to first mortgage party rate of NY Prime + 6.00% as allowed by SBA)
- Prepayment penalties should be charged as follows:
  - 90 Day Adjustable: 5,4,3,2,1
  - 5 Year Fixed: 5,5,5,5,5
- Payment reserve should be required on all first mortgages covering period from escrow closing to SBA debenture funding to insure that all first mortgage payments are kept current until pooling

# SBA 504 Non Bank Loan Program

- Second Mortgage
  - For those non-bank lenders that choose to fund interim second mortgage loan
  - 1% loan fee
  - A referral fee is not normally expected on the second mortgage
  - 9% rate is the current market rate
  - Typical 60 day term for projects involving no construction
  - If light construction is required, borrower to expect to pay a construction loan fee plus fund control and inspections
  - Loan to be paid off by CDC/SBA loan

# SBA 504 Non Bank Loan Program

- Loan Approval & Funding Process
  - Non-bank lender receives loan application request
  - CDC Direct Capital pre-screens transaction for 504 and FMLP eligibility
  - If transaction passes pre-screening, a letter of interest to be issued by non-bank lender (or retail agent)
  - If accepted by applicant, letter is executed and returned with requested deposit for appraisal and environmental report
  - The loan package is reviewed by non-bank lender (or retail agent) and Pool Originator with a resulting letter issued requesting any missing information
  - Once the package is considered complete, non-bank lender (or retail agent) completes underwriting memorandum

## SBA 504 Non Bank Loan Program

- Loan Approval & Funding Process cont.
  - Upon completion of written analysis, the package is sent on-line to Pool Originator (and non-bank lender if complete by retail agent)
  - Non-bank lender and Pool Originator approves or denies the application
  - If approved, non-bank lender (or retail agent) issues commitment letter noting conditions of funding
  - Once all conditions have been satisfied, CDC DC works with non-bank lender and Pool Originator to facilitate funding of first mortgage through escrow
  - Non-bank lender funds interim second mortgage or works with third party lender with CDC Direct Capital assistance
  - Property purchase is complete

# SBA 504 Non Bank Loan Program

- Loan Sale & Servicing
  - Non-bank lender funds 15% to 100% of first mortgage and 0% to 100% of interim second mortgage
  - Pool Originator purchases 85% of each loan from non-bank lender
  - Once at least two loans have funded to form an eligible loan pool, Pool Originator applies to SBA for pool creation
  - Pool Originator works with CDC Direct Capital to purchase the guaranteed portion of each pool
  - Pool Originator sells guaranteed portion for a combination of premium (paid to Pool Originator) and servicing (paid to non-bank lender)



- Loan Sale & Servicing

- Non-bank lender receives interest income on retained portion of each loan (15%) plus servicing income on sold portion of each loan (85%)
- Non-bank lender simultaneously agrees to pay Pool Originator an on-going servicing fee
- Pool Originator provides on-going servicing
- Non-bank lender and Pool Originator determine who takes the lead in any liquidation

# SBA 504 Non Bank Loan Program

## Projected Yield & IRR

| Sample Transaction                               |                  |
|--|------------------|
| Loan Amount                                      | \$5,000,000      |
| Non-Bank Lender Portion (15%)                    | \$ 750,000       |
| Pool Originator Portion (85%)                    | \$4,250,000      |
| Funding Rate (90 Day LIBOR + 6.25%)              | 6.84%            |
| Loan Pool Sale (Months)                          | 3                |
| Average Expected Loan Life (Months)              | 72               |
| Projected Servicing Spread                       | 3.05%            |
| Interest Income On Residual (\$750M * 6.84%) **  | \$51,300         |
| Projected Servicing Income (\$4,250M * 3.05%) ** | <u>\$129,625</u> |
| Combined Annual Income                           | \$180,925        |
| Annual Yield (Income/Residual)                   | 24%              |
| Internal Rate Of Return                          | 20%              |
| ** Not considering amortization                  |                  |



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## SBA 504 Non Bank Loan Program

- CH Capital Partners LLC with all the affiliated lending partners and CDC relationships have over 5 billion in loan service.
- CH Capital Partners have exclusive relationships with various CDC's throughout the country, make markets in the SBA 504 loan programs
- As Bank consultants we educate, package and syndicate the loans through various broker dealers in the country.