



Office of Financial Assistance
504 Loan Program
Presentation for Credit Unions

September 24, 2015

What is the 504 Loan Program?

The SBA 504 Loan program is a powerful economic development loan program that offers small businesses another avenue for business financing, while promoting business growth, and job creation. This program is a proven success and win-win-win for the small business, the community and participating lenders. SBA has no geographic restrictions on the 504 loan program.

Public/Private Partnership - The 504 Loan Program is an example of public/private partnerships in economic development. Banks provide 50% of project financing and the SBA 504 Loan Program can provide up to 40%. The minimum borrower injection is 10%.

Long-Term/Fixed-Rate Financing - The 504 Loan Program provides approved small businesses with long-term, fixed-rate financing used to acquire fixed assets for expansion or modernization.

Local Economic Development - 504 loans are made available through Certified Development Companies (CDCs), SBA's community based partners for providing 504 Loans.



504 Loan Eligibility

- ▶ **Small Business Size** - To be eligible for a 504 Loan, your business must be operated for profit and fall within the size standards set by the SBA. Under the 504 Program, a business qualifies if it has a tangible net worth not more than \$15 million, and an average net income of \$5 million or less after federal income taxes for the preceding two years prior to application.
- ▶ **For Profit/Not Passive or Speculative** - Loans cannot be made to businesses engaged in nonprofit, passive or speculative activities.
- ▶ **Job Creation/Retention Requirements** – 1 job per \$65,000/504 loan



504 Loans Help Small Businesses Leverage Capital

In a 504 Loan Project, the Bank has a first lien on project collateral and SBA has a second lien on project assets.

Example of Loan Project

- ▶ \$500,000 50% Bank
- ▶ **\$400,000 40% SBA/504**
- ▶ \$100,000, 10% Borrower (+5% start-up; +5% special purpose)

Total Project \$1,000,000 Job Creation/Retention = 7 jobs



Fixed Asset Financing in 504 Loan Project

504 Loan (up to 40% of Total Project) may be used for:

- ▶ Building Purchase
- ▶ Land
- ▶ Building Construction
- ▶ Renovation
- ▶ Equipment
- ▶ Furniture
- ▶ Soft Costs Directly Attributable to Project (ex: Architect Fees)

Interest Rate: Fixed rate for life of 504 loan

Terms: Land/Building – 20 years; Equipment – 10 years

Collateral - Generally, the project assets being financed are used as collateral.

Guarantees - Personal guaranties from owners of 20% or more are also required.



504 Loan Program Public Policy Goals

Maximum Loan Size - \$5 million unless project meets public policy goal of manufacturing or energy

Multiple \$5.5 million in 504 loans for projects that include either:

- ▶ Small manufacturers
- ▶ Energy Public Policy Projects:
 - Reduction of existing energy consumption by at least 10%
 - Plant, equipment and process upgrades of renewable energy sources such as: solar, wind, biodiesel, ethanol



504 Loan Program – Special Purpose Properties

Businesses with a Limited or Special Purpose Property also must inject 15%.
Examples of properties SBA considers Limited or Special Purpose Property:

- ▶ Amusement parks;
- ▶ Bowling alleys;
- ▶ Car wash properties;
- ▶ Cemeteries;
- ▶ Clubhouses;
- ▶ Dormitories;
- ▶ Farms, including dairy facilities;
- ▶ Funeral homes with crematoriums;
- ▶ Gas stations;
- ▶ Golf courses;
- ▶ Hotels, motels, and other lodging facilities;
- ▶ Marinas;
- ▶ Mines;
- ▶ Museums;
- ▶ Nursing homes, including assisted living facilities;
- ▶ Oil wells;
- ▶ Quarries, including gravel pits;
- ▶ Railroads;
- ▶ Sanitary landfills;
- ▶ Sports arenas;
- ▶ Swimming pools;
- ▶ Tennis clubs;
- ▶ Theaters; and
- ▶ Wineries
- ▶ Cold storage facilities where more than 50% of total square footage is equipped for refrigeration;
- ▶ Service centers (e.g., oil and lube, brake or transmission centers) with pits and in ground lifts; and
- ▶ Hospitals, surgery centers, urgent care centers and other health or medical facilities;



Third Party Lender Collateral Requirements

§120.920 Revised to allow Third Party Lender (TPL) to take additional collateral only if:

- ▶ TPL must first apply all proceeds from liquidation of additional collateral to balance due on the TPL loan
- ▶ Then TPL can apply proceeds from 504 Project Property
- ▶ Only for 504 loans



SBA 504 Funding Process

The Small Business Window to Wall Street

Frank Keane
Eagle Compliance LLC Fiscal Agent
September 24, 2015

SBA 504 Capital Markets Team

- ▶ **Fiscal Agent/Selling Agent** – *Eagle Compliance LLC*. Manage the funding process to obtain the best monthly debenture rate available for borrowers.
- ▶ **Underwriters** – *Credit Suisse and Bank of America*. Market, sell and trade DCPCs, take capital risk, pool debentures, product research.
- ▶ **Issuing Agent and Trustee** – *The Bank of New York Mellon*. Hold debentures issued by CDCs, issue DCPCs as SBA's agent, distribute P&I to DCPC holders, report outstanding pool statistics.
- ▶ **Central Servicing Agent** – *Wells Fargo Corporate Trust Services*. Process loans, report new pool statistics to DCF LLC, collect loan payments, pay out proceeds.
- ▶ **Legal Counsel** – *Morgan Lewis, LLP*. Program and transaction legal advisors to underwriters and DCF LLC.



SBAP Funding Process with deadlines for Sept. 2015 Sale

- ▶ July 23-August 1 – CDC submission of forms to Sacramento for No Adverse Change; then placed in legal folder for District Counsel review
- ▶ Thursday August 26 – **Cut-Off-Date** – Upon District Counsel approval, documents go to the CSA for review and resolution of **Loan Package errors**
- ▶ Monday August 30 – the CSA sends CDC Confirmation e mails to CDC's
- ▶ Friday Sept.4 - CSA provides FA with preliminary loan numbers
- ▶ Monday Sept. 7 – **Pulled Loan Deadline**. CSA and CDC's have resolved all loan documentation issues
- ▶ Tuesday Sept. 8 – **Announcement Date** with final numbers
- ▶ Thursday Sept. 10 – **Pricing Date**. Rates are set and pool is formed
- ▶ Wednesday September 16 – **Closing Date**, CSA distributes proceeds of sale to borrower or interim lender

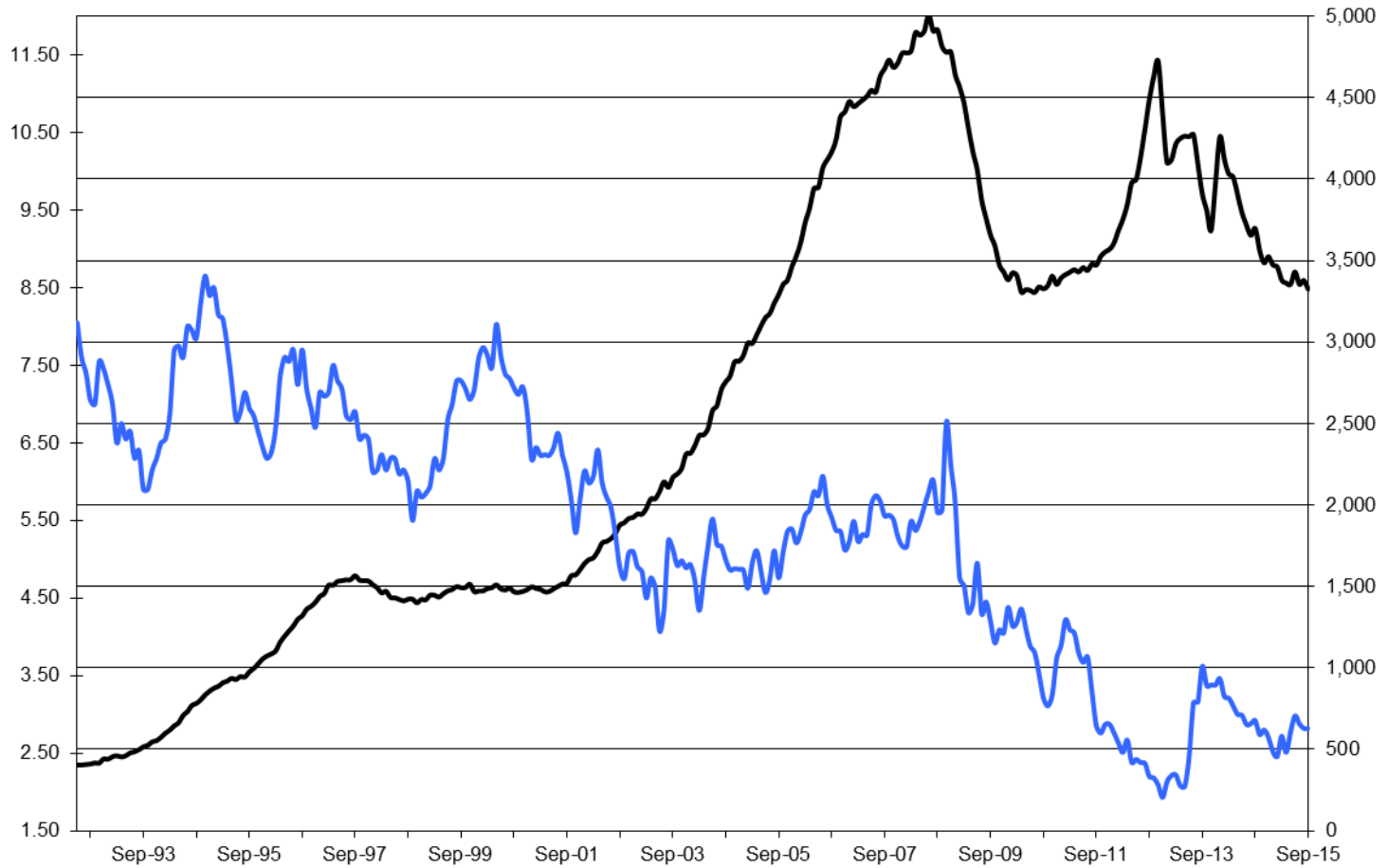


504 Always Funding Small Businesses

- ▶ Sections 503 (1958), 504 and 505 (1986) of the Small Business Investment Act provide for guarantee and pooling of CDC-issued debentures and guarantee and issuance of *Development Company Participation Certificates (DCPCs)*. *Loan/Note/Debenture/Certificate*
- ▶ Section 503 guarantees full and timely debenture payments. *Section 504 guarantees full and timely payments to DCPC holders.*
- ▶ Provides monthly access to fixed rate, long-term funding in the public capital markets not otherwise available to small business.
- ▶ Uses a proven securitization process to create appealing investments resulting in efficiently-priced fixed-rate funding for small business borrowers.
- ▶ 29 years of history have led to stable performance through multiple interest rate and economic cycles and through large crises. Over \$63 billion in certificates have been issued with \$26.8 billion outstanding.



**SBA-504 20 Yr. Debenture Rate (% , light, left scale)
and Amount Issued (rolling 12 mo. total, \$MM, heavy, right scale)**

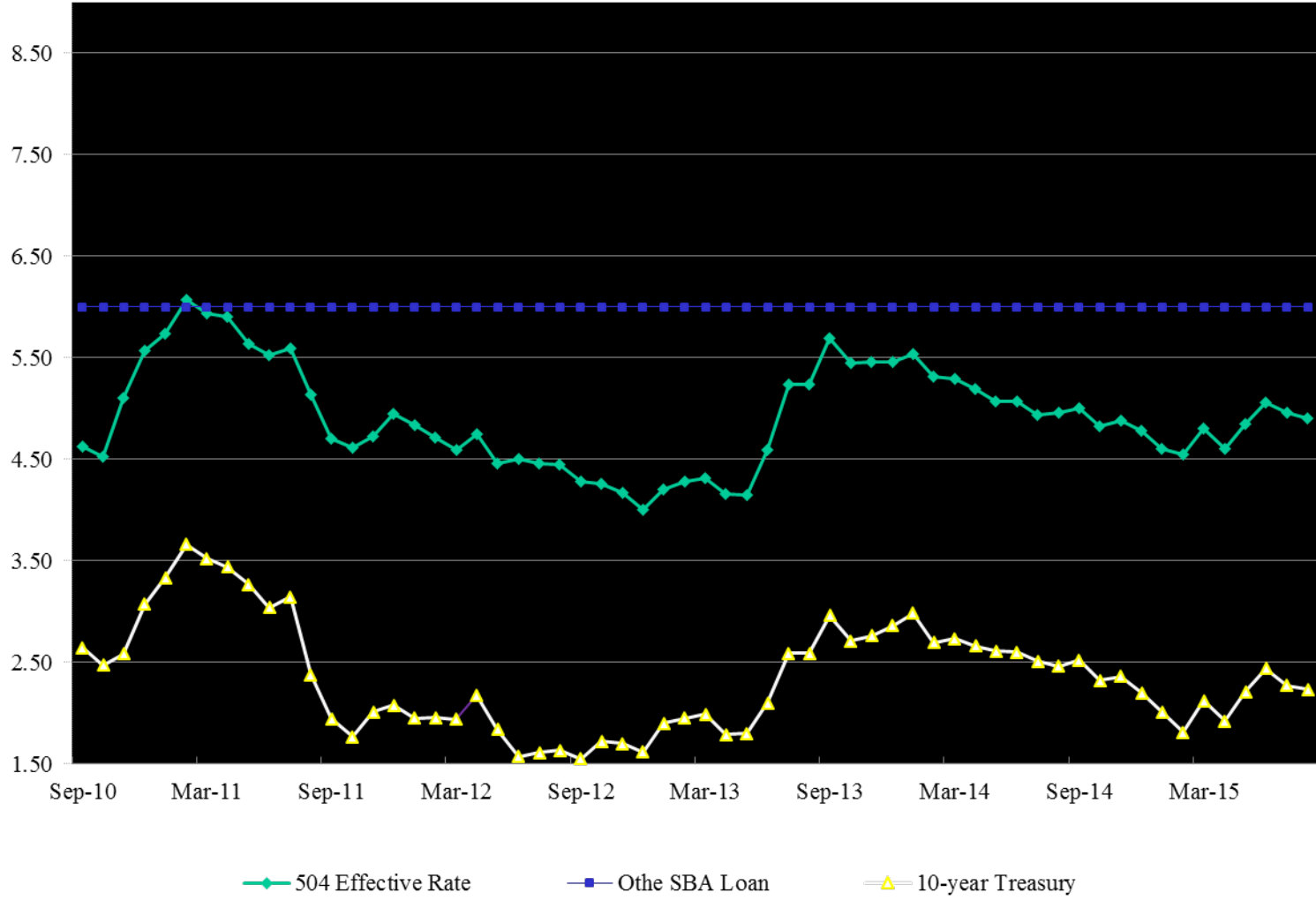


SBAP 2015-20I Effective Rate

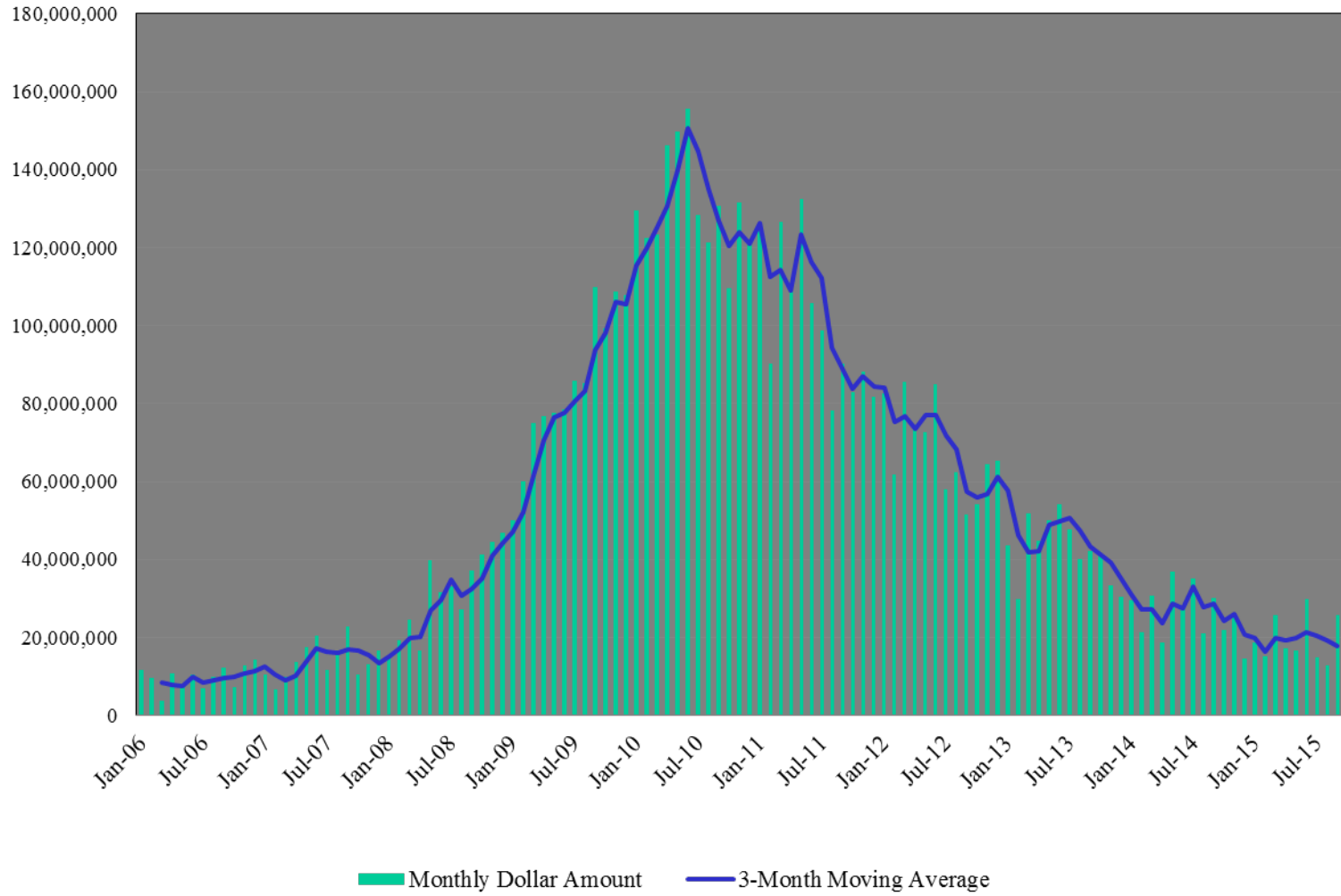
REQUIRED INPUTS IN BLUE			RESULTS IN GREEN	
Enter debenture rate and fees as decimal values (e.g. 5% as .05)				
			Estimated	Estimated
Debenture Rate	2.820%	<u>Term</u>	<u>Effective Rates</u>	<u>Monthly Pmts.</u>
Loan Amount	2,069,000	1st 5 Years	4.71%	14,204.72
CDC fee	0.625%	2nd 5 Years	4.80%	13,633.99
Borrower fee	0.938%	3rd 5 Years	5.01%	12,975.38
CSA fee	0.100%	<u>4th 5 Years</u>	<u>6.06%</u>	12,215.35
(CSA fee is fixed at 0.1%)		Full Term	4.89%	
Note Rate	2.86790%	Cumulative Effective Rate		
Ending Balance	0.00	1st 5 Years	4.71%	
		1st 10 Years	4.74%	
		1st 15 Years	4.80%	
		Full Term	4.89%	



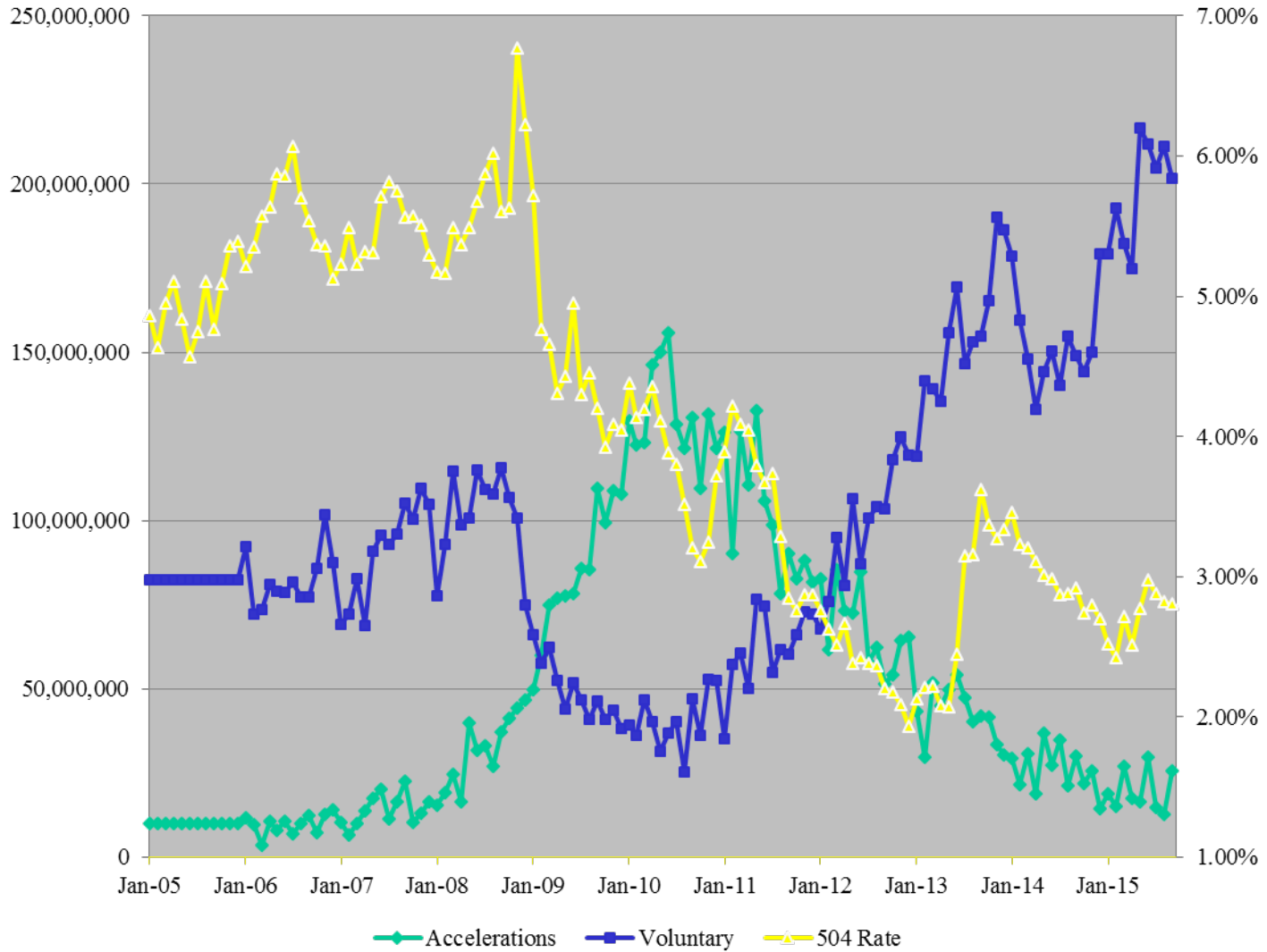
Comparative Loan Costs



SBA DCPC Monthly Accelerations (\$) September 2015



SBA 504 Pre-Payments



DCPC Characteristics

- DCPC's exactly match the full amortization, interest rate, maturity and prepayment penalty schedule of the pooled debentures. P&I is paid semiannually.
- *Prepayment penalty schedule* starts at 100%+debenture interest rate and declines ratably to par after 5 years (10-year maturity) or 10 years (20-year maturity) ; e.g. 2015-201, 2.82% 9/1/2035 has an initial prepayment price of 102.820. Prepayments are allocated on a *pro rata* basis
- Acceleration of principal upon loan default is at par.
- Obligation of the United States for **risk-weighting** by investors and federal income tax treatment
- Range of coupons: high 10.75% (10/87 20-yr), low 1.93% (12/20 20-yr). Original WAC 4.98%, outstanding WAC 4.65%.
- Projected average life on a new 20-year par pool is 8.08 years at 5% Constant Payment Rate (CPR)

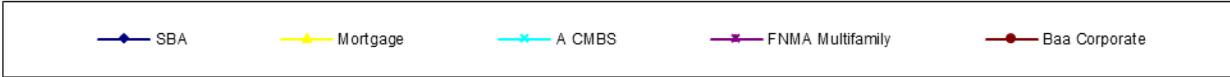
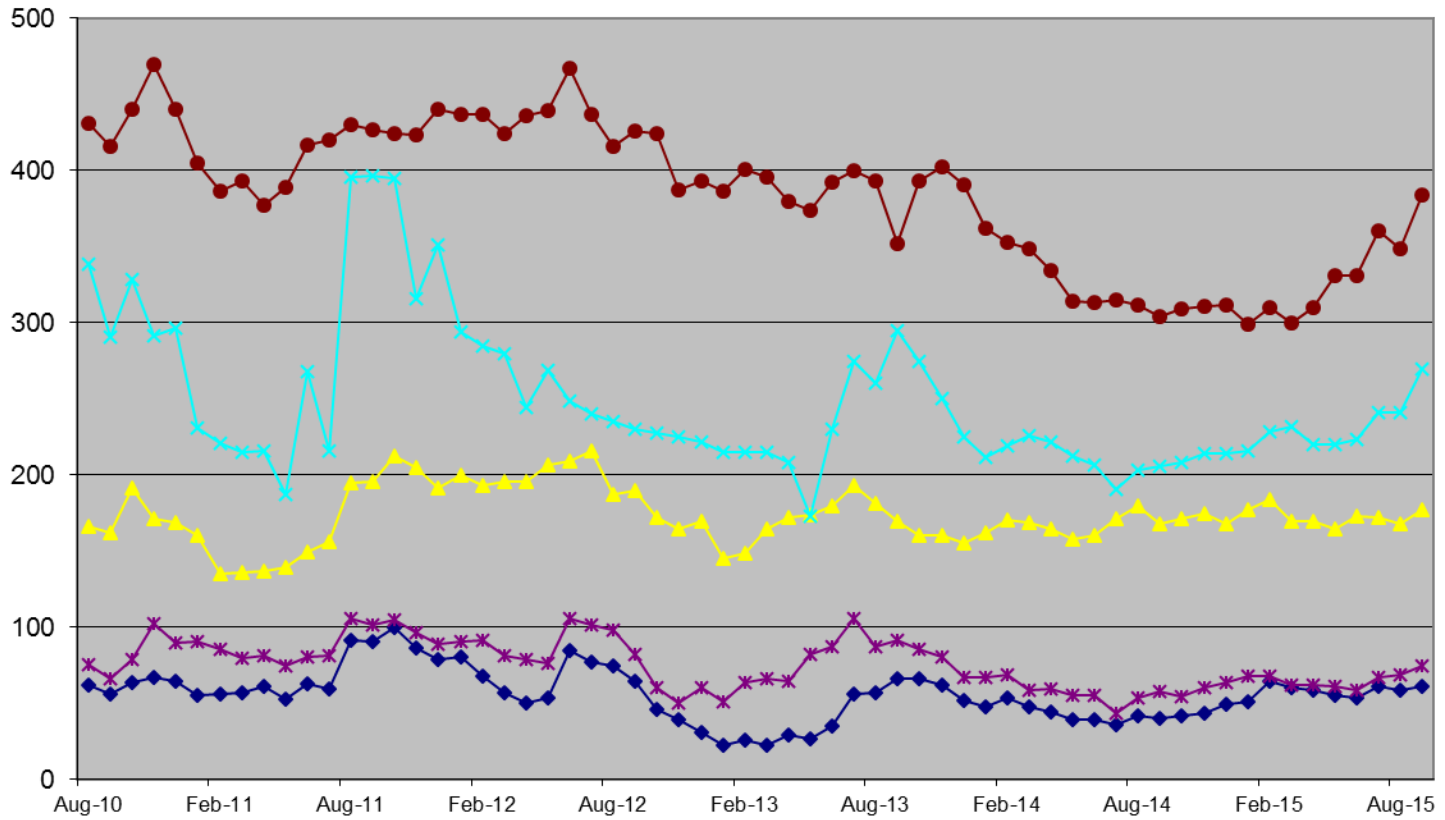


How is the Debenture Rate Determined? (continued)

- **Debenture Rate** = treasury rate + swap rate + spread to swap. 2015-201 2.21%+1bps+60bps=2.82%
- **Swap Rate** = treasury yield + swap spread. 20-year 504 loan uses *10-year swap rate*, 10-year 504 loan uses *5-year swap rate*.
- **Pricing.** Fiscal agent and underwriters agree on the rates; fiscal agent accepts the debenture rate and obtains approvals from Treasury and SBA.



Comparative Spreads to Treasury (BP)



Who Buys DCPCs?

- ▶ **Insurance companies** – yield, safety and government security status with yield very important to match their liabilities.
- ▶ **Bank Portfolios** – yield, safety, government security status; *zero risk weighting*. Held for sale or to maturity.
- ▶ **Money Managers** – on the behalf of other institutions and individuals. Relative value/spread buyers. Includes mutual funds, hedge funds.
- ▶ **Minimum original denomination** - \$25,000 with \$1,000 multiples thereafter.



Why Do Investors Buy DCPCs?

- ▶ Full faith and credit of the U.S. Highest quality.
- ▶ Absolute yield, 4.98% WAC over program life. Wide selection of coupons and prices.
- ▶ Spread over treasuries/swaps in compensation for the borrower prepayment option and lower liquidity.
- ▶ Monthly offering calendar.
- ▶ Well-supported secondary market.
- ▶ Reasonably predictable cash flows.
- ▶ Long history, rich prepayment/acceleration data.



What's Ahead

- ▶ Interest rates remain historically low - until wage growth improves and global economy strengthens Fed will remain cautious
- ▶ Cheap gas hasn't helped retail consumption, and strong \$ has hurt American exporters
- ▶ Europe needs to reduce unemployment and end deflation
- ▶ Grexit solved (?) but not China
- ▶ Federal Reserve needs to raise rates, but it will be gradual
- ▶ When rates do rise Banks reduce exposure to fixed-rate loans – an opportunity for 504 loans
- ▶ Congress needs to authorize reinstatement of Debt Refi, and possibly internal refinance within the program
- ▶ <http://www.nadco.org/page/DCFLLC> and www.eaglecompliance504.com as of 9/1/2015



Disclaimer

The information herein has been obtained from sources that we believe to be reliable, but we do not guarantee its accuracy or completeness.



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