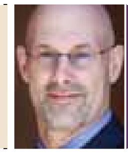

By Jordan Blanchard
Executive vice president and manager
CDC Direct Capital

New Opportunities in SBA Lending

Loan-program changes could mean big business

The Small Business Jobs Act, signed into law this past September, was a somewhat controversial bill primarily because it created the $30 billion Small Business Lending Fund for community banks — which was accused of being another bailout.

The fund represents a source of low-cost capital for community banks. It's intended to increase their small-business lending. Although it remains to be seen what impact that portion of the Small Business Jobs Act will have, one thing is certain: The U.S. Small Business Administration (SBA) provisions contained in the bill likely will increase opportunities for mortgage brokers.

There are two primary types of SBA loans involved in commercial real estate: 7(a) and 504. The SBA 7(a) loan program can be used for general business purposes such as financing startups, expansions or acquisitions; working capital; equipment; and real estate purchase or construction. The SBA 504 program, on the other hand, may only be used to finance real estate acquisition or construction and to purchase long-life equipment.

Both programs offer real estate financing of as much as 90 percent of the purchase price or construction cost on the subject property — or more with additional collateral. They also require the property to be owner-occupied, defined as at least 51 percent of the net rentable square footage for acquisitions and 60 percent for new construction.

Eligible property types include multipurpose, hospitality and special-purpose properties along with gas stations, restaurants, contractor yards, automobile dealerships and campgrounds. Ministorage facilities are recently eligible, though not related to the bill.

The definition of a small business historically has been different for each loan program — and even by industry — based on sales, revenues, business net worth or business income. One of the provisions of the Small Business Jobs Act is to amend and increase the maximum-size definition for small businesses and use the same standard for the 7(a) and 504 programs regardless of industry.

The updated definition of a small business includes those with as much as $15 million in business net worth and as much as $5 million in average net profit in the preceding two years. Personal income and personal net worth don't enter the equation. This change will greatly expand the number of businesses eligible for SBA financing.

Changes to SBA loans

SBA loans have been the primary source of small-balance, owner-occupied commercial real estate loans for many years. The Small Business Jobs Act has several provisions that make SBA lending even more attractive.

The following changes are among the most critical to the 7(a) program:

- **Permanent increases to the maximum loan amount,** from $2 million to $5 million
- **Increases to the SBA guarantee** available to banks, from 75 percent to 90 percent, through the end of this year
- **Origination-fee waivers** through the end of this year, pending sufficient funding

The SBA 504 loan program has several important changes, as well. They include:

- **Permanent increases to second-mortgage debenture,** from $2 million to $5 million ($5.5 million for manufacturers and projects meeting a green designation); and
- **SBA origination-fee waivers** through the end of this year, pending sufficient funding.

In addition, the 504 changes also allow:

- **For 85 percent of each first mortgage to be sold** to a pool originator, who retains 5 percent of the loan amount and sells 80 percent with a federal guarantee; and
- **Refinances of conventional owner-occupied debt** up to a 90 percent loan-to-value ratio (LTV) on the subject property or 125 percent LTV with additional collateral.

Both of these changes expire in September 2012.

The 504 debenture is a second-mortgage, subordinate-debt instrument. Because of the increase in the maximum debenture amount, it may be common to see total project amounts — purchase price or construction cost — range from $10 million to $20 million. In the past, projects this large were anomalies; going forward, however, larger loan sizes will be common.

Incentive to lend

The provision that will have the greatest

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Jordan Blanchard is executive vice president and manager of CDC Direct Capital, a wholly owned subsidiary of CDC Small Business Finance Corp., the nation's largest certified development company. CDC Direct Capital facilitates the sale of 85 percent of first mortgages from bank and nonbank lenders to pool originators. CDC Direct Capital collaborated with Bank of America/Merrill Lynch to issue the first pool under the 504 first-mortgage loan-pool program. Reach Blanchard at jblanchard@cdcloans.com.

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impact on the SBA 504 market is the temporary program that allows for 85 percent of the first mortgage to be sold into a secondary market. Referred to as the first-mortgage loan-pool program by SBA, it was originally introduced in February 2009 as part of the American Recovery and Reinvestment Act.

It was to expire this coming February. Because of the time it took to implement the program, however, the Senate introduced language into the Small Business Jobs Act to extend the program for two years from the date of the first-pool issuance. The first pools were issued this past September, so the program has been extended to September 2012.

The program gives banks an incentive to increase SBA 504 lending by providing them:

- **Liquidity and capital relief;**
- **Commercial real estate concentration reduction;**
- **Premium income;** and
- **Long-term servicing income.**

The loan-pool program also is available to nonbank lenders and mortgage bankers. To make a SBA 7(a) loan, a nonbank lender must hold one of the few Small Business Lending Company licenses. The cost of these licenses, if one is for sale, can approach $1 million. There is no special licensing requirement for the first-mortgage lender of an SBA 504 loan transaction. A private financial company can make the first-mortgage loan.

Historically, few nonbank first-mortgage lenders would consider funding the first because of the relatively low return caused by the inability to sell the whole loan or to participate in a securitization or syndication. The loan-pool program changes that and provides the leverage necessary to achieve a rate of return economically viable for a nonbank lender.

Refinancing with SBA

Although the increase in loan amounts and potential lenders is important, the ability to use SBA 504 loans to refinance existing debt will provide an even larger opportunity to mortgage brokers.

A number of small-business owners have loans that will mature in the near future at LTVs that are greater than what a conventional lender will approve. The reduction in property values has created a population of borrowers who have no viable option other than default if the current lender is unwilling to extend the loan.

The ability to fund as much as 90 percent of a property's existing value, or 125 percent with additional collateral, will be a welcome solution for many borrowers.

The specific refinance provisions in the Small Business Jobs Act are:

- **The debt must have been incurred at least two years before** application.
- **The business must have been operating continually** for at least the preceding two years.
- **Payments must have been current** for at least the preceding 12 months.
- **Only non-federally guaranteed debts are eligible.** This rules out refinancing existing SBA loans.
- **Property must be owner-occupied,** per the definition above.
- **The original debt must have been for eligible fixed assets initially,** which would rule out financing debt that was not used to finance owner-occupied real estate or long-life equipment.

The refinance language contained in the actual bill is general. The traditional process to translate a bill to a functioning or amended loan program involves the SBA issuing standard operating procedures to interpret and clarify program guidelines.

What remains to be seen is if SBA inserts any additional parameters, such as minimum LTVs, payment savings, maturity dates, etc.

Mortgage professionals likely will never see a better time to be involved in SBA lending. SBA loans can now reach more applicants, with more dollars and with a higher approval rate. But various aspects of this opportunity are time-sensitive, so brokers must be aware of when elements of the program expire and take advantage while they can.