

SBA 504 Loans and Commercial Real Estate Could Be a Good Fit

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The effects of the financial crisis of 2008-2009 rippled throughout the U.S. economy like a pebble hitting a still lake. The commercial real estate market was hit hard, of course, and unemployment soared, especially in industries tied to real estate.

Credit to finance commercial real estate all but vanished. While the credit markets are finally starting to thaw, it can still be difficult for business owners to secure the financing they need to purchase or renovate commercial property.

Small Business Administration (or SBA) loans are one option that can help many business owners who are struggling to obtain financing. SBA loans are made through regular banks, but the SBA guarantees repayment of a portion of the loan, which helps reduce the bank's risk.

There are several different types of SBA loans — including the SBA 504 loan, which is often used to finance commercial real estate. SBA 504 loans are available to for-profit small businesses for the acquisition and improvement of owner-occupied commercial property. They offer fixed-rate, long-term financing with 90 percent loan-to-value and a 10- or 20-year amortization schedule.

Here's how 504 loans work: The bank provides 50 percent of the financing and the SBA 40 percent, while the business owner kicks in the remaining 10 percent. This can provide a huge cash flow advantage compared to a traditional commercial mortgage, which might require a down payment of 20 to 30 percent or more.

For example, with a \$500,000 piece of commercial property, the down payment on a 504 loan would be just \$50,000, compared to \$150,000 or more with a traditional commercial mortgage.

Some changes were made to the SBA loan program by the Small Business Jobs and Credit Act that make it even more attractive. The Act increased the SBA 504 loan limit to \$5 million and it expanded the definition of a small business for the purpose of applying for an SBA loan. Any business with a tangible net worth of under \$15 million and average net income over the past two years of under \$5 million can now apply for an SBA 504 loan.

There's a wide range of latitude when it comes to how the proceeds from a 504 loan can be used. These include: finance the purchase of land and existing owner-occupied buildings, construction of new facilities, grading, street improvements, utilities, parking lots, and landscaping, as well as modernizing, renovating or converting existing facilities. Soft costs like architectural and legal fees, environmental studies, appraisals, interest and fees can also be rolled into the 504 loan.

Keep in mind that not all banks are created equally when it comes to SBA lending. Be sure to look for a bank that is designated as an “SBA Preferred Lender.” These banks follow a streamlined method of underwriting SBA loans, which usually enables them to process SBA loan applications faster than banks that aren’t SBA Preferred Lenders.

Also, just because a loan is “SBA-guaranteed” doesn’t mean the bank will be any less diligent in its loan underwriting process. You’ll need to prepare the same kind of thorough loan application package for an SBA 504 loan as you would for a traditional commercial mortgage.

SBA 504 loans aren’t a panacea that cures all the ills of the commercial real estate credit crunch. But in the right circumstances, they could help you get the financing you need for a commercial real estate project.

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