

How Business Owners Go From Tenants to Owners with SBA 504 Financing

We've been stuck in a slow moving economy for quite a while now. There's growing concern over the tremendous size of the government deficit, unemployment is a concern and banks haven't exactly made things any easier for business owners. Small to medium sized business owners (smb's) are concerned about the future and rightly so. Things have been pretty lousy for the past few years (albeit with some bright spots such as low interest rates) so business owners are biting at the bit for things to improve.

But very successful business people are also aware that the right time to buy is precisely when no one else thinks it's the right time to buy. As Warren Buffet once famously quipped - try to be fearful when others are greedy and greedy when others are fearful. Are today's bargain real estate values and historically low interest rates a supreme buying opportunity? We think so. Maybe not over a 3 year period. But with a 5 - 10 year outlook, we believe today's real estate buyers will see substantial appreciation.

One major factor for our view is the availability of funds backed by U.S. Small Business Administration (SBA). Commercial property owners and potential buyers that are aware of the recent changes to the SBA 504 program can take advantage of high loan to value financing at extremely affordable interest rates. In addition, a new refinancing provision can help owners that have balloons coming due in the near future.

High Loan to Value Financing (and low rates too!)

Most commercial mortgage financing today requires down payments of at 25% or more. A few lenders are expanding their lending parameters by offering 80% financing but typically only on multi family properties and only on loans in excess of \$1,500,000.

But what about small-business owners that are tired of renting and want to purchase a commercial property so that their business can be an owner rather than a renter? In many parts of the country, mortgage payments along with taxes and insurance could be even less than renting thanks to today's low interest rates and depreciated properties. Well, if this sounds interesting to you, you need to learn about the SBA 504 program. The SBA 504 is a financing tool that is designed to conserve capital for the business owner while still allowing him to turn their business from a renter to an owner. The 504 program allows a borrower to finance up to 90% for the purchase and renovation of most commercial property. Not only does the program allow for a low down payment, but it also provides the borrower with below-market, fixed-rates for the duration of the loan. And while most commercial mortgages come with 5 or 10 year balloons, the SBA 504 borrower gets a 20-year amortizing loan with no balloon payments and no adjustments to the interest rate for the entire loan!

The SBA 504 is structured a bit differently from typical commercial mortgages. Rather than one big mortgage, it is actually made up of 2 separate loans that are then tied together. Typically, the first 50% of the desired loan amount is provided by a lender. Then a CDC or "certified development company" injects the additional 40%. They can do this because the SBA guarantees that loan in case of default. The buyer then adds their 10% down payment and there you have it - 90% financing on commercial property. Because each loan may come with somewhat different interest rates, the borrower pays on what is called a "blended" rate. The blended rates of most SBA loans today (October 2011) fall somewhere in the mid 5% range.

"Small Businesses" Not So Small Anymore

The Small Business Jobs Act of 2010 expanded what is consider a "small business". As a result, SBA financing can now be used by businesses that too big to qualify in the past. Today, projects of more than \$20 million can be financed because there is no longer a cap on the amount of the first mortgage loan that is provided by lender in first position. And the second mortgage cap has been increased from \$2 million to \$5 million (even more for manufacturing and green-energy projects which allows for secondary financing as high as \$5.5 million). Now, if you remember, the first mortgage lender typically will loan 50% of the project. But the SBA actually allows the first mortgage to go as high as 65 percent loan to value (LTV), as long as a lender is willing to do so. In this way, a business owner can actually acquire a \$15 million to \$20 million property with just 10 percent down.

In the past, the SBA also required caps on the amount of revenue a company was able to generate and still be considered a small business. That is no longer the case. The new ruling is that in order to be able to access SBA guaranteed funds, the business should have a net worth of no more than \$15 million and their **net income** should average no more than \$5 million over the past 2 years.

SBA Refinancing Rules

A major problem that many business owners face are that their business property has declined in value over the past few years. Since many of these business owners financed with mortgages that came with balloon payments, they now are in need of refinancing their debt. Once again, 90% SBA financing can save the day.

Take the example of a business owner that purchased his property 4 years ago for \$3,000,000. At the time, he probably financed 75% of the price which left him with a mortgage of \$2,250,000. Because rates are so low, he is looking into refinancing now, a full year before the balloon comes due. But his property has declined in value. Instead of being worth the \$3,000,000 he paid for it, it is now only \$2,700,000, just a 10% decline but 10% is substantial at these amounts.

His lender has told him that they would be willing to refinance his debt but at no more than 75% of his value. He has amortized his loan down to \$2,128,826. (Based on a rate of 6% and 30 year amortization). In order to refinance now, his property would need to appraise at \$2,838,434. If the appraisal only comes in at \$2,700,000 as stated earlier, he will only get a new mortgage in the amount of \$2,025,000. and of course some business owners will find their properties have depreciated even more than 10%. In any case, this particular situation leaves this business owner with having to come out of pocket to the tune of \$103,826 PLUS closing costs. \$120,000 or so is substantial outlay and possibly not one the owner can handle at the present time. Thank goodness for SBA financing.

With SBA financing, the mortgage loan amount could be as high as \$2,430,000 so financing out of his balloon of \$2,128,826 plus covering his closing costs out of the proceeds of the loan will be handled with minimal stress. And it's great to know that he can get approved for his new loan without having to pay for an appraisal until prior to closing.

Please keep in mind that these new provisions for the SBA 504 program is set to expire September of 2012. It's our view that there has never been a better time for company owners to actively pursue commercial property ownership. Switching from being a tenant to becoming an owner may pay dividends far in excess of the effort it will take to get you to that point. And SBA financing is the perfect vehicle to do it with.

Ron Borg is the President of Mortgage One, a progressive originator of commercial mortgages since 1997. Mr. Borg has many years of experience in the business and welcomes your inquiries. He may be reached at 347-RON-BORG (766-2674)

Balance of existing debt	\$3,750,000
Current appraised value	\$4,250,000
90% of appraised value	\$3,825,000

Source of funds:

Bank loan	\$2,125,000 (50%)
SBA 504 loan	\$1,625,000 (38%) Borrower
equity	\$500,000 (12%)
Total	\$4,250,000