Responses to On-Line Questions from SBA 504 Teleseminar

#1
Q: How are we assured that Zion's does not share their/our portfolio information with the competition?

A: We operate entirely independent from all our affiliate banks. We do not share info outside our Zions National Real Estate Department. Our reputation is more important to us than a loan(s).

#2
Q: How can the average LTV be 54% when I thought the maximum could be 50%?

A: The banks portion cannot be less than the 504 – but can be more than 50% - as long as the required borrower injection is met. There may be cases where the CDC has met there legal limit on a larger project – leaving the bank to do much more than 50%. For example – if this were a $6 million project that did not meet the public policy goals. The borrower would have a 10% down payment ($600,000) the CDC would be limited to $1,500,000 (25%) and the bank would do the remainder, or, $3,900,000 (65%).

#3
Q: What would cause Zions to fail or refuse to perform under the Master Purchase Agreement?

A: If we issue a commitment letter to fund after construction, problem situations sometimes arise where the project is not completed. Examples of this might include a deceased borrower or filed bankruptcy. In the Master Purchase Agreement the note Seller represents and warrants that the Note and Mortgage are valid and enforceable. If fraud is involved, or the documents are deemed invalid or unenforceable, that would be a problem.

#4
Q: Can 504 finance agricultural facilities (i.e. farm production, etc)?

A: Yes – we have financed dairy facilities with the 504. Generally it is difficult to meet the job creation formula – but they are often qualified as rural.

#5

Q: How do some of the specialty properties such as hotels/assisted living fit under the owner-occupied criteria that are required?

A: They are in the business of providing short term needs. If the agreement were long term – they would be apartments and not qualified. Also, you generally need to look to "value added" services so that it is not just investment property. For example - generally we cannot finance mini-warehouse facilities, but can finance warehouse facilities that provide services in addition to space (i.e. – cold storage units that also provide shipping and fork lift services). There must be a substantial amount of services as in an example of a residential care facilities such as nursing homes providing substantial services in addition to room and board (such as 24-hour attendance and supervision of daily living)

#6

Q: Can the SBA 504 program be used on international projects (outside of US) by a US small business owner/ Co.?

A: No, but Puerto Rico, Guam and Virgin Islands are permissible.

#7

Q: Please give an example of loan with a larger than 50% LTV. I have run into situations where the SBA does not feel certain costs should be included in the project costs and will not lend on them, such as good will or FF&E. Could the bank lend on this?

A: The program cannot allow the first mortgage to include non-eligible project costs like goodwill. So goodwill cannot be included in the first mortgage – but the bank could lend that part of the purchase price in a third position behind the 504 – or could lend it directly to the principals.

#8

Q: Can the amortization be longer than the SBA?

A: Yes

#9

Q: Is existing debt eligible to be refinanced under the 504 program?

A: No, the 504 loan cannot refinance any existing debt. The bank can roll an existing mortgage into their new mortgage that is part of the 504 loan as long as the appraisal will validate adequate collateral.

In addition to its share of Project cost, a Third-Party Loan may include consolidation of existing debt on the Project Property. The consolidation must not improve the lien position of the Lender on the pre-existing debt, unless the debt is a previous Third-Party Loan (as part of a 504 project).

You can consider the refinancing of any previous financing of the land (only) as an eligible 504 project cost if you determine that the intent of small business was to finance the purchase on a "short-term" (interim) basis until the entire project was completed.

#10

Q: In what circumstances can you finance leaseholds?

A: In cases where you lease the land but construct and own the building improvements. If the leaseholds will be capitalized and the underlying lease is longer than the loans – we may finance them. For example: a restaurant in a leased facility where we are financing the equipment and also need to finance the leasehold improvements. If the lease were for 20 years and our loan was for 10 and if there was outside collateral to support the loan (since leaseholds have little value) then we might go forward.

#11

Q: Can you address the rationality of 504 loan volume/growth, with higher lender participation and growth rates on the coasts as compared to the middle of the country?

A: High growth states such as California and Florida are the biggest users of the 504 program.

#12

Q: Does the SBA portion for public policy loans have a dollar limit requirement?

A: Yes, if the project meets a public policy goal, the maximum 504 loan is $2,000,000.

#13

Q: Can you use a CDC outside of the state where the project is located?

A: Only if the CDC is authorized to do business in that state. Please check the NADCO website - select the state you are interested in and it will provide a list of all CDC's authorized to do business in that state.

#14

Q: Is the 504 commitment letter from the CDC/SBA adequate for a legal lending limit exemption?

A: No. While this letter represents a commitment to lend/take-out, there is an adverse change stipulation that can allow the CDC/SBA to back out, therefore it is not an "unconditional commitment to lend" as required by the lending limit regulation. It is rare that the CDC/SBA will back-out. However, banks should not advance funds or approve interim commitments to lend that exceed their lending limit. Several options are available to the bank. First, a bank may participate a portion of the interim commitment or loan to another financial institution to reduce its exposure below its lending limit. Second, a bank can refer the transaction to a secondary market bank with a larger lending limit, while retaining its customer relationship.

#15

Q: Please explain the small manufacturer limit of $4MM.

A: If the small manufacturer is classified as NAICS code 31, 32, or 33, then the 504 loan can be as much as $4MM.

#16

Q: Slide 36 mentions .5% fee. Are there ongoing fees to SBA under 504 program?

A: Any additional fees are built into the effective rate that the borrower pays. No ongoing fees paid by first mortgage lender.

#17

Q: What are Colson and CDC fees?

A: The current total of up front fees is 2.65%. This includes the fees for the reserve, the funding fee, the CDC processing fee, the underwriter's fee. This changes each year when the program determines the necessary subsidy rate to keep this program operating without any line item budget. Additionally individual CDC's may allow the borrower to fund the closing costs as part of the debenture.

#18

Q: Could environmental insurance replace the requirement for a Phase I provided it covers both the 1st and 2nd liens? The insurance may be cheaper than the cost of the Phase I.

A: No. This is not permitted.

#19

Q: The CRE guidance exemption on owner-occupied property was vague in the final guidance publication. Has something changed in this area and, if so, where can this be referenced?

A: Small business must occupy > 50% of existing building, > 60% on new construction. www.nadco.org or, www.sba.gov. The final CRE guidance explicitly exempts loans secured by commercial property where the primary source of repayment is the cash flow from ongoing operations and activities conducted by the party, or affiliate of the party, who owns the property. It also states that loans secured by real estate wherein 50 percent or more of the source of repayment is derived from third party, nonaffiliated, rental income, or proceeds from the sale, refinancing or permanent financing of the property are to be included as CRE loans, notwithstanding that an owner may operate or occupy a portion of the facility for non-real estate business purposes.

#20

Q: When you sell your portion of a 504 loan in the secondary market, does the originating bank continue to service loan?

A: Servicing retained is an option; however 95% of sellers do not retain servicing.

#21
Q: Any chance that the debenture does not sell?

A: That risk does exist, but not frequently enough to be overly concerned (1 of 400-500)

#22
Q: In Zion's experience, what percentage of 504 loans are a gateway to a broader banking relationship and what percentage are stand-alone deals?

A: Depends entirely on the lender, my guess is approximately 50% develop into a relationship.

#23
Q: Assume that the 504 must be in the assessment area of a bank?

A: No, can be in any of the 50 states. A 504 loan does not necessarily need to be within a bank's traditional market area for regular business purposes. However, for CRA consideration, it should be within the bank's defined assessment area.

#24
Q: Regarding occupancy - on new construction, I heard that after 3 years the borrower must occupy 80%, is that true?

A: In new construction that is correct. They must occupy 60% at the time of closing and can temporarily lease up to 20% and permanently lease up to 20%. So, at the 3 year period they are supposed to occupy 80% of the new building.

In existing buildings they can permanently lease up to 49%...must occupy 51% at the time of closing.

#25
Q: Could you provide an estimated rate for what the SBA portion of the 504 is closing at today?

A: Based on loans funded in January 2007, the 20 year rate was 6.29% and the 10 year rate was 6.44%.

#26
Q: Please address CDC underwriting criteria?

A: The CDC will perform its own underwriting of the loan, just as the bank does. Generally, in addition to making sure the loan meets all of the eligibility requirements – the CDC will determine the anticipated cash flow coverage, review and analyze the projections and other normal underwriting activities. The CDC will prepare a credit memo for review by their loan committee or board for approval before it is submitted to the SBA.

#27
Q: Are we required to be an SBA approved lender to participate in this program?

A: No.

#28
Q: Are the job creation requirements reduced in any targeted areas?

A: If the loan meets any of the public policy goals, then the job creation requirement is waived if the CDC's overall portfolio of 504 loans, including the subject loan, meets or exceeds the CDC's required Job Opportunity average.

The public policy goals are included on slide # 32.

#29
Q: Is it typically required for the 504 borrower to personally guarantee the first mortgage loan?

A: Generally yes, because they also guaranty the 2nd lien, but it's not mandatory on the 1st.

#30
Q: The 504 program focuses on project cost. Appraisals commonly resolve cost, comparable sales and income approaches, resulting in a fair market value below cost. How does Zions Bank address this in the appraisal ordering and review process?

A: If the current “as is” or the prospective market value is less than project costs, it may or may not require the total financing to be reduced. If the 1st mortgage is now 55% LTV that’s generally not a problem. However, if the appraised value is less than the combined financing, the CDC and SBA may object and require more equity, reduce the total financing or take additional collateral.

#31
Q: What are some characteristics of the markets that this program has been successful in? Which markets are seen as underserved?

A: Industrial, commercial, and hotels in urban areas have seen much success. Underserved may be rural areas.

#32
Q: Are we allowed to go above our legal lending limit while waiting for the SBA portion to fund?

A: No. The SBA/CDC debenture commitment is not legally unconditional. In a potential lending limit exception situation, the bank should consider participating a portion of the credit with another institution, or refer the customer to a larger secondary market 504 lender or purchaser.

#33
Q: What are the preferred loan structures and/or rate structures to enhance marketability in the secondary market for the first mortgage loan?

A: Higher spreads, with repricing at least every 5 years, and as strong a pre-payment penalty as possible (e.g. flat 10% for 10 yrs, or declining 10, 9%...1% over 10 years pay the highest premiums) typical are 5 year penalties. Rates indexed to prime, LIBOR, or Fed Home Loan Bank of Seattle work very well.

#34
Q: If a customer is currently leasing and wants to build, does there still need to be new job creation? (i.e. 1 employee per $50,000 financed)

A: If the company does not meet a public policy goal, then it must meet the job creation formula. However, it includes not only job creation – but also job retention (which often can be supported with statements from the borrower).

#35

Q: If we are in the midst of a construction period in which our loan-to-value approaches the 85% limit and the OCC comes in for an exam, how will this loan be evaluated? Would this be an example of a 504 which is not subject to the supervisory guidance?

A: The loan is subject to our Supervisory Loan-to-Value (SLTV) limits based on the commitment to lend, and depending on the phase it is in. During construction, any commitment that exceeds 80% loan-to-value (LTV) should be reported as a SLTV exception. Once the project is completed and term financing is committed, it becomes an improved property loan, and would be subject to an 85% SLTV limit. In this situation, any LTV over 85% should be reported as a SLTV exception until the second lien take-out occurs.

Finally, our guidance considers transactions that may be structured to include the development, construction and long term financing phases of a project. If the loan is structured in this way, and converts to a term loan upon completion of construction per the loan agreement, the SLTV limit is the one associated with the final phase of the transaction. In this case, the final phase would be considered improved property, so any commitment to lend or term financing that exceeds 85% LTV would be reported as a SLTV exception until the second lien take-out occurs.

#36

Q: How is seller financing considered in the entire package? Can it be considered as part of the downpayment? How about the seller rate and term?

A: Yes, seller financing can be part of the downpayment – but it will need to be in a subordinate position to the SBA loan and for a term equal to or longer- than the 504 loan and generally will be required to be on “stand by” for a period of time. This will also be considered when the loan is underwritten – i.e. this may cause the leverage to be very high, or may stress the cash flow coverage.

#37

Q: In regards to credit concentration, does the OCC give favorable treatment if the bank has a concentration in a certain industry such as hotel/motel?

A: The OCC does not encourage or discourage concentrations in specific industries. Rather, we expect a bank to exhibit appropriate expertise and risk management given the nature of its concentrations. Our risk management expectations vary depending on the size and nature of the concentration.

#38

Q: Some of our customers request 80%+ financing, however, we would prefer to keep the lion share of the loan (70-75%). Would the CDC accept a smaller portion (75/15/10) and your fees (of 2.75%) are based on the second mortgage?

A: Yes, a CDC can finance less than 40%. However, you want to be putting the best possible structure in front of your customer. If you aren't – your competition might.

#39

Q: Are start-up loans acceptable as long as the borrower meets the downpayment criteria?

A: Yes. With a start-up loan the minimum down payment is 15% of the total project costs.

#40

Q: Page 18 of the presentation refers to the SBA 504 debentures receiving a 2.75% origination fee. Can you please go over this, as this was not addressed?

A: The standard fee – that is included in the debenture – is currently 2.65%. This includes the reserve, funding fee, processing fee, and the underwriter's fee. Some CDC's will also allow the borrower to fund any closing costs through this mechanism. This fee changes each year based on the calculated subsidy rate.

#41

Q: Must the project create jobs, or is job retention also a consideration?

A: Job retention – if supported – can also be considered.

#42

Q: What is the level of risk and can you give examples where a CDC is unwilling to purchase their share of a project

A: The authorization includes a clause which would allow the SBA to not fund if there is "unremedied adverse change." The likelihood of this being used is actually very small. There was one example where a borrower was charged with attempted murder of the general manager. This was likely an unremedied adverse change.

#43
Q: The fee for the first loan held by the bank paid to SBA at .5%, can this fee be financed/charged to the borrower in the first loan by the bank or is it paid/included in the fees when the second loan is taken out by SBA?

A: This fee can be included as an eligible "project cost" if assessed as an interim loan fee on the interim 2^{nd} mortgage; otherwise paid in cash by borrower.

#44
Q: Please discuss when refinancing may be an option through the 504 program. A recent land contract holder said that a CDC approved a refinance as long as it was within 12 months.

A: There is a 9 month look back period for costs to be included in the 504 project without being considered refinancing.

Expenditures within 9 months of the date of the application, including land, building, and/or equipment, can be included in the project costs and be reimbursed by the interim lender net of the equity requirement. Costs incurred prior to that date may be included solely at the SBA field office's discretion. Additional information can be obtained from your SBA district office or local CDC.

#45
Q: Please give us an example of an asset based company acquisition.

A: If the acquisition was structured as an asset purchase rather than a stock purchase – then you could determine the allocation of purchase price to eligible fixed assets. Those assets could then be purchased through the 504 program

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#46
Q: What is the range of rates you are seeing for the first mortgages on real estate 20 year loans?

A: They range currently from 7% to 10%.

#47
Q: If the borrower wants to construct a building that will cost approximately $2.5 million and the building will be a single purpose building and the land is paid for, will the land ($375,000) be considered as the borrower's 15% equity into the project?

A: Yes. And actually if the land was owned for more than 2 years – it could be injected at the appraised value rather than the original cost.

The project may include land, no matter how long it has been held. The value of the land will be at cost if acquired within two years of application. If the land was acquired prior to that time, the value also will be at cost unless the small business submits a professional appraisal acceptable to SBA establishing a different value. The appraisal should include the sales history of the property during the last five years. The appraisal must be conducted by a party other than the borrower, its associates, or the present mortgagee.

#48
Q: Is the gas station/convenience store a single purpose facility, and, if so, how is the borrower's equity % defined as a % of the total construction project? Can equipment be included in the cost?

A: Yes. A gas station is a single purpose facility. Equipment can be included in the cost. The total eligible project would need to be defined (land building and equipment) and the borrower would need to inject 15% of the total. The bank would need to finance 50% and the 504 program would fund 35%. Note that if it is also a start-up, the borrower would need to inject an additional 5% for a total equity contribution of 20%.

#49
Q: Are there banks which sell these types of loans to other banks for CRA purposes? If so, who are some of the larger sellers?

A: There might be, but we are not aware of any.

#50

Q: If the bank is working with an expanding company, what proforma cash requirements are considered for underwriting?

A: We will generally look at company prepared projections for a 2 year period. Part of the normal underwriting would look at whether the company had adequate working capital for the projected growth.