McCombs Career Webinar



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What Makes Real Estate Eligible for SBA Government-Backed Financing?







by Bruce Hurta, BBA '75

Why am I qualified to tell you about small business real estate financing with the SBA government-back loan programs?

- I have specialized in small business lending for 30 years with over half that time specializing in SBA lending.
- I am currently the Business Lending Manager, and one of the founding associates, of the SBA lending department at Members Choice Credit Union in Houston, TX. With a team of three people, and only three years in business, we have been among the top 10 SBA lenders in the 32 county Houston SBA district the last two years, moving from the #10 position last year to the #9 position this year.
- I am the 2013 president of the Houston Association of Government Guaranteed Lenders, the SBA professional trade organization for the Houston SBA district. www.haggl.com

What is an SBA loan?

There are two government-backed loan programs offered through the U.S. Small Business Administration:

SBA 7(a) Loan Program

- Most commonly used
- The participating lender uses their own cash to fund a small business loan
- They receive a partial government guaranty which allows them to take on more credit risk than a conventional bank lender.

SBA 504 Loan Program

- Requires two participating lenders
- No government guaranty on the loan.
- Participating "bank" lender lends its own funds, and receives a first lien on business real estate or equipment.
- A participating SBA Certified Development Company raises funds through a government-backed debenture to fund up to 40% of the project cost and accepts a second lien position.

What loan amounts and terms are available with SBA loans?

The SBA 7(a) loan program

- Available up to \$5 million per business owner, in one or more loans
- Real estate loans have a 25 year repayment term and maturity
- Non real estate loans have a 10 year repayment and maturity.

SBA 504 loan program

- Can finance business equipment and real estate transactions generally up to \$13 million in one or more loans
- The repayment term is generally 20 years for real estate and 10 years for equipment.



Can SBA loans be used for other purposes besides financing small business real estate?

- The SBA 7(a) loan program can be used to finance any legitimate small business expense or cost.
- The SBA 504 loan program can be used only to finance business fixed assets real estate and equipment.



Why take advantage of SBA Financing?

For business owners who are purchasing, constructing, or refinancing their owner-occupied business real estate, SBA financing provides:

- Lower down payment requirements
- Longer repayment terms
- Easier qualifying criteria than conventional bank loans.

Not all commercial real estate transactions are eligible for SBA financing. Investment real estate is not eligible for SBA financing, because it is not occupied and used by a small business.



How does an SBA loan work for financing business real estate?

- SBA loan programs are actually business loans, rather than real estate loans. The loan request is qualified by the lender based upon the ability of the business to repay the loan, rather than based upon the income from tenants to repay the loan.
- Only owner-occupied small business real estate is eligible for SBA financing.



Ineligible Real Estate for SBA Financing

Ineligible Real Estate is property that is not used and owner-occupied by a small business, including:

Undeveloped raw land

Investor property held for rental income such as:

- Apartments
- Multi-tenant office buildings
- Mobile home parks
- Single tenant buildings
- Multi-tenant retail strip centers.

Occupancy Requirements for SBA Real Estate Financing

- A small business is eligible to purchase or construct a new building with SBA financing, even though they have some rental income from tenants in the property.
- The SBA rule that dictates eligibility requires the small business purchaser of an existing property to immediately occupy at least 51% of the square footage under roof.
- For new construction, the small business must immediately occupy at least 60% of the square footage under roof.



Examples, Eligible Real Estate for SBA Financing

Following are some examples of real estate which is eligible for SBA financing:

- Office/warehouse property
- Manufacturing facility
- Child daycare facility
- Medical, dental, chiropractic or veterinary clinic
- Restaurant or catering facility
- Hotel
- RV park or campground
- Assisted living facility
- Drycleaner or Laundromat
- Self storage facility
- Salon
- Attorney, CPA, insurance agency or other professional office building

- Gas station, convenience store or carwash
- Auto repair facility
- Wholesale or manufacturer's rep business
- Oilfield or other service business
- Antiques mall
- Auto, motorcycle, boat or equipment dealer
- Retail store
- Bottling plant
- Machine shop

SBA Financing vs. Conventional Bank Financing

Because many businesses have a track record and good relationship with a conventional bank lender, SBA financing may not be appropriate for them.

When should a small business owner consider SBA financing for their real estate instead of conventional bank financing?

- When a business owner has lost its long term banking relationship.
- Banks may require a large down payment (roughly 30%)
- Bank may require excess collateral for the loan
- Bank may offer only short term financing instead of a 25 year loan offered through the SBA program.

SBA Financing vs. Conventional Bank Financing

- Most SBA loans have a variable rate of interest tied to changes in the Wall Street Journal Prime Rate
- Some borrowers will fear the interest rate risk. What they do not contemplate is that the conventional bank loan is typically a short term loan for 3 – 5 years, and they will once again have interest rate risk at that time.



Short Term Bank Loans - Renewal Risks

Short term bank loan renewal is not guaranteed. Reasons a loan may not be renewed include:

- The business is experiencing declining trends in revenue at the time for renewal, they might be denied for credit risk
- The bank changes ownership or management, they might be denied for new policy reasons
- The bank was taken over by the FDIC, there may no longer be a bank to discuss renewal terms.

The typical SBA real estate borrower is one who justifies the interest rate risk with other advantages in the loan structure. These include factoring in changes in the interest rate to feel confident the payments are manageable even with interest rate increases.

Advantages of SBA Government Backed Loans

The business owner can take comfort knowing that:

- An SBA government backed loan got them into property ownership with much less down payment (preserves cash for the business)
- The loan will stay in place for 25 years if needed
- The borrower can enjoy ownership while establishing
- a payment track record (could help qualify for more attractive refinancing terms after 2 – 3 years)
- SBA 7(a) loan has prepayment penalties only for the first three years. The business owner can still pay ahead on the loan principal up to 25% of the loan balance in each of the first three years while prepayment penalties exist, without incurring the penalty.



Advantages of SBA Government backed loans

Other advantages on an SBA real estate loan include the ability to finance loan closing costs & and other business needs:

- working capital
- new business equipment
- debt consolidation.

Because this is a business loan, rather than a pure real estate loan, the use of loan proceeds can be flexible.



Business owners needing to borrow up to \$5 million for small business real estate should investigate all options including SBA financing.

What about SBA loans for new construction?

SBA construction financing offers advantages over conventional bank financing:

- Interim construction and permanent financing can be accommodated in only one loan, with only one closing, and one set of closing costs
- Typically 6-9 months is added to the term and maturity of the loan for the interim construction period
- No payments are due on the loan while construction is in progress. Interest that
 accrues during construction is treated as part of the construction costs which are
 funded with loan proceeds
- SBA lender typically hires a construction management firm (CMF) to qualify the contractor and the contract. The CMF will monitor the job and control disbursements to the contractor according to a pre-established draw schedule
- The CMF retains 10% of each draw from the contractor until the job is completed according to the borrower's and the lender's satisfaction
- Interim construction financing is available only with the SBA 7(a) loan program.



Thank you! What questions do you have?

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Thanks Again!

 The recording of today's presentation, along with the PowerPoint slides, will be available on our Career Resources web page by early next week:

http://www.mccombs.utexas.edu/Alumni/Career.aspx

