

Finance Your Hotel with an SBA 504 Loan

The SBA 504 loan is a popular method of financing the acquisition or construction of hotels around the country. It requires as little as 15 percent borrower equity, provides up to a 20 year fixed interest rate, and insulates the primary lender from virtually all credit risk. Following is a general description of the program, its benefits and requirements, and how you can apply for a 504 loan.

What are 504 Loans?

The 504 loan, a program of the U.S. Small Business Administration (SBA) introduced in the 1980s, is incentive financing for small and medium sized businesses wanting to own fixed assets. The essence of the program is to make available long-term, low down payment, reasonably priced financing by providing second mortgages subordinated to conventional first mortgages from traditional lenders. Following is a typical 504 loan structure for a hypothetical \$2 million hotel project.

504 Loan Structure for \$2,000,000 Hotel Project				
	Amount	Percent	Collateral	Term
1st Mortgage Lender	\$1,000,000	50%	1st Mortgage	10 to 25 Yrs.
Your Local CDC	\$700,000	35%	2nd Mortgage	10 or 20 Yrs.
Borrower Equity	<u>\$300,000</u>	15%		
	\$2,000,000			

The 504 loan program is administered by a certified development company (CDC) rather than the SBA. There are about 250 CDCs across the country that are licensed by the SBA to deliver 504 loans to specific geographic territories.

What is the Maximum Size 504 Loan?

The maximum size 504 loan is \$1.5 million, but that amount can increase to \$2.0 million if the project meets one of the SBA's public policy objectives, such as a female or minority owned enterprise. Moreover, there is no size restriction to the overall project.

What are the Benefits of a 504 Loan?

From the borrower's perspective, the primary advantages of a 504 loan are (1) fifteen percent minimum down payment for hotels; (2) low, long-term fixed interest rate; and (3) the ability to include soft costs in the project. Pass-through

companies formed to hold real estate for tax purposes are allowed under the program.

From the lender's perspective, the 504 loan all but eliminates credit risk because of a first lien on project assets with a loan-to-cost value ratio typically at 50 percent. In addition, it provides an excellent source of core earnings. Most importantly, the 504 loan makes local long-term financing possible.

Are 504 Loan Requirements Different than Conventional Loans?

The underwriting requirements for 504 loans are similar to those of traditional lenders. In general, the company applying for the loan, together with its closely related affiliates, must be profitable, show positive net worth and its primary principals must be of good character and credit worthy. Newly formed companies are eligible for 504 financing but need to inject 20 percent equity into the project.

The 504 loan does have size restrictions and job creation requirements. For example, the company owning the hotel, together with its closely related affiliates, must have a combined net worth of less than \$7 million and profit after taxes of less than \$2.5 million. In addition, both the principal owners of the hotel and the principals of the company operating the hotel must personally guarantee the 504 loan.

Generally, the hotel project should also create at least one job for every \$50,000 lent. Women, veteran, or minority-owned businesses; businesses located in rural areas; and businesses located in redevelopment areas are examples of projects that can qualify for a 504 loan without meeting the jobs creation goal.

How Much Will I Pay in Loan Fees?

Fees generally run about 1.5 percent of total project costs – about \$30,000 in the \$2 million hypothetical example. One of the big advantages of a 504 loan is that all fees and soft costs are financed in the loan rather than out of pocket. Soft costs include accrued interest during the interim or construction period, and fees for survey, appraisal, environmental study, title insurance, deed recording, etc.

How Long Does it Take to Process a 504 Loan Application?

It generally takes 3 to 4 weeks for your local CDC and the SBA to process a 504 loan application. Once approved, the SBA will issue an authorization (commitment letter) for debenture guarantee, which sets forth the conditions upon which the SBA will guarantee the 504 loan. Funding of the permanent 504 loan takes place through the sale of bonds in the open capital markets, a process which takes an additional 60 days.

How do I Apply?

For more information regarding 504 loans, click www.hbcloans.com.

Heartland Business Capital (HBC) seeks to foster economic development by originating and packaging loans that fit the financing needs of small and medium-sized businesses. The HBC is licensed by the Small Business Administration to deliver the 504 loan to businesses located in the State of Kansas and nine counties in the State of Missouri (Jackson, Clay, Platte, Cass, Clinton, Lafayette, Ray, Caldwell, and Bates).