SBA Policy Notice

TO:	All SBA Employees	**CONTROL NO.:**	5000-1197
SUBJECT:	Changes to 504 Certified Development Company Loan Program Regarding Debt Refinancing Authorized by the Jobs Act	**EFFECTIVE:**	2/17/2011

On September 27, 2010, the Small Business Jobs Act of 2010, P.L. 111-240 (Jobs Act) was signed into law. Section 1122 of the Jobs Act temporarily expands the ability of a small business to use the 504 Certified Development Company Loan Program (504 Program) to refinance certain qualifying existing debt. Prior to the Jobs Act, in a typical 504 project with a refinancing component, the small business was required to use a significant portion of the loan proceeds for expansion of the business. The temporary Jobs Act program authorizes the refinancing of debt where there is no expansion of the small business. This authority is for two years only, and is available for loan applications approved by SBA through September 27, 2012. SBA has amended its regulations to implement the new law [*See* *Federal Register:* February 17, 2011 (Volume 76, Number 33, Pages 9213-9219)]. The Sacramento Loan Processing Center will begin accepting applications effective Monday, February 28, 2011. Lenders are encouraged to carefully review this Policy Notice to ensure that applications are complete upon submission so that actions on the applications are not delayed.

This Policy Notice provides further guidance on the implementation of the debt refinancing provisions of the Jobs Act and is effective immediately.

(1) In its loan analysis submitted with the application to SBA, the CDC must include a conclusion that the proposed debt refinancing satisfies all the requirements and conditions that apply to this debt refinancing program, with supporting analysis and documentation.
(2) The loan applications for debt refinancing under the Jobs Act must be processed by SBA and may not be approved by CDCs under PCLP authority.
(3) The CDC must state that the Refinancing Project does not involve an expansion of the small business, *i.e.*, none of the funds provided will be used for the acquisition, construction or improvement of land, buildings or equipment for use by the small business applicant.
(4) The small business has been in operation for not less than two years prior to the date of application (as defined in ¶ 17 below), as evidenced by the financial statements submitted at the time of application.
(5) The debt that is being refinanced is a “Qualified Debt”, which is a commercial loan:
    (a) incurred not less than 2 years prior to the date of application;
    (b) for the benefit of the small business seeking the refinancing;

(c) Substantially all (85% or more) of the proceeds of which must have been used for 504 eligible purposes (to acquire, construct or improve long-term fixed assets), and the remaining amount of the proceeds (15% or less) must also have been incurred for the benefit of the small business seeking the refinancing;

(i) at application, the Borrower and CDC must certify that the debt meets this standard (See Exhibit 2 of SBA Form 1244) and the Third Party Lender must certify in its commitment letter that it has no reason to believe that the debt does not meet this standard (Exhibit 19 of SBA Form 1244) as instructed in SBA Form 1244 Part D;

(ii) SBA will require, on a random basis, that the Third Party Lender and/or Borrower submit further documentation to support the certifications; and

d) that is maturing on or before December 31, 2012. This date may be extended by Notice in the *Federal Register* if SBA determines that changes in the available resources and market conditions warrant an extension. In addition, SBA will monitor the use of the program capacity of SBA and the CDC industry to handle the demand for this program and market conditions to determine whether SBA should also allow a debt to be refinanced if it is not maturing within the set timeframe but the refinancing would provide a "substantial benefit" to the Borrower as defined in 13 CFR §120.882(e)(5). If SBA determines to allow such refinancing, the Agency will announce such determination through a Notice published in the *Federal Register*.

(6) The Qualified Debt is secured by Eligible Fixed Assets (as defined in ¶ 17 below).

(7) The Borrower has been current on the Qualified Debt (no payment was either deferred or more than 30 days past due) for not less than one year prior to the date of application. The CDC must submit a transcript of account, or similar documentation from the lender whose debt is being refinanced, that contains a complete payment history to demonstrate compliance with this requirement.

(8) Same Institution Debt. For debt held by the Third Party Lender or its affiliates (same institution debt), the CDC must submit the Transcript of Account covering the entire history of the loan for review and consideration by SBA in determining the creditworthiness of the Borrower. The CDC must also certify that no creditor whose debt is being refinanced is in a position to sustain a loss causing a shift of any part of a potential loss to SBA (*i.e.*, the CDC has no knowledge of a default by Borrower and has no knowledge or information that indicates a default is likely). In addition, the

Third Party Lender must certify to the CDC and SBA that it has no knowledge of a default by the Borrower and has no knowledge or information that indicates a default by the Borrower is likely. This certification must be made as instructed in SBA Form1244 Part D and included in the Third Party Lender's commitment letter (Exhibit 19 of SBA Form 1244). This will satisfy the requirement that the Third Party Lender must certify that it is not in a position to sustain a loss causing a shift to SBA of all or part of a potential loss from an existing debt. Also, for same institution debt refinancing, the Third Party Loan cannot be sold on the secondary market as a part of a pool guaranteed under Subpart J of Part 120 of 13 CFR.

(9) Appraisal. The CDC must submit an independent appraisal at application supporting the fair market value of the fixed assets being refinanced and any other fixed assets offered as collateral (whether commercial or residential). Please refer to SOP 50 10 5 (C), Subpart C, Chapter 3, ¶ II, with regard to the qualifications of the appraiser and requirements of the appraisal report. The appraisal must be dated within 6 months of the date of the application.

(10) Alternative Job Retention Goal. A debt may be refinanced under the Jobs Act if it does not meet the job creation or other economic development objectives set forth in 13 CFR § 120.861 or § 120.862. In such case, the 504 loan may not exceed the product obtained by multiplying the number of employees of the Borrower by $65,000 (not to exceed the maximum 504 loan amounts set forth in the Small Business Investment Act). The number of employees of the Borrower is equal to:

(a) the number of full-time employees of Borrower on the date of application, plus

(b) the product obtained by multiplying:

(i) the number of part-time employees of the Borrower on the date of application, by
(ii) the quotient obtained by dividing the average number of hours each part time employee of the Borrower works each week by 40.

Example: 30 full-time employees and 35 part-time employees working 20 hours per week is calculated as follows: 30 + (35 x (20/40)) = 47.5. The maximum amount available for the 504 loan is 47.5 multiplied by $65,000, or $3,087,500.

(11) Eligible Project Costs. The Project costs which may be paid with the proceeds of the 504 loan are the amount used to refinance the Qualified Debt and other eligible costs permitted for 504 loans under 13 CFR §§120.882(c) and (d) and 120.883

(12) Loan Structure and Conditions. Consistent with 504 Program requirements, the funding for the Refinancing Project must come from three sources based on the current fair market value of the fixed assets serving as collateral for the Refinancing Project, including not less than 50% from the Third Party Lender, not less than 10% from the Borrower, and not more than 40% from the 504 loan. The Third Party Lender must state in its commitment letter that it would not make the loan without the assistance provided by SBA under this debt refinancing program

(a) Amount of Third Party Loan and 504 Loan. The portion of the Refinancing Project provided by the Third Party Loan and the 504 loan may be no more than 90% of the fair market value of the fixed assets securing the loans, but in no event may it exceed the outstanding principal balance of the Qualified Debt. If the amount of the refinancing is not sufficient to repay the entire amount owed on the Qualified Debt, the CDC must disclose how the balance of the debt (the deficiency) is being handled. The lender of the Qualified Debt being refinanced may forgive all or part of the deficiency, accept payment from the Borrower for all or part of the deficiency, or accept a new Note for the balance which will be subordinate to the liens securing the Third Party Loan and the 504 loan. SBA will determine what effect, if any, the disposition of the deficiency has on the Borrower's creditworthiness and may place additional restrictions on any remaining debt, such as requiring that it be placed on standby during the term of the 504 loan.

(b) Borrower's Contribution. In addition to a cash contribution, the Borrower's 10% contribution may be satisfied by its equity in the Eligible Fixed Asset(s) serving as collateral for the Refinancing Project as set forth in 13 CFR § 120.910, or by the equity in any other fixed assets that are acceptable to SBA as collateral for the Refinancing Project, provided that there is an independent appraisal of the fair market value of the asset.

(i) When the fixed asset serving as collateral is a limited or special purpose building, the Borrower will not be required to increase its contribution amount to 15-20% (as would be required in a non-refinancing 504 project) because the sole purpose of the loan is refinancing existing debt.

(ii) In the event that the outstanding principal balance on the existing loan is more than 90% of the current fair market value of the Eligible Fixed Assets securing the loan being refinanced, SBA will also permit the Borrower to contribute the equity in other fixed assets acceptable to SBA as collateral to increase the amount of the Refinancing Project. Acceptable fixed assets may be any other 504-eligible fixed assets, other commercial property, or a personal residence. As provided in ¶ (12)(a) above, the Third

Party Loan and the 504 loan will not exceed 90% of the fair market value of all of the fixed assets serving as collateral for the Refinancing Project.

(c) Lien Positions. The lien positions on the Eligible Fixed Assets securing the Refinancing Project must be first and second for the Third Party Loan and the 504 loan, respectively, and any other lien must be junior in priority to these lien positions. In cases in which other fixed assets are offered as collateral, the liens securing the Third Party Loan and the 504 loan may be junior to any previously existing liens on that collateral.

(d) Examples. The following examples illustrate the loan structures for the refinancing under different scenarios where the refinancing is over-collateralized, slightly over-collateralized, and under-collateralized:

<u>Example 1 – Over-collateralized</u>. The fair market value of the Eligible Fixed Assets securing the Refinancing Project based on an independent appraisal is $600,000 and the outstanding principal balance of the existing indebtedness is $500,000.

- In this example, the value of the collateral securing the Refinancing Project ($600,000) exceeds the outstanding principal balance of the existing indebtedness ($500,000). Accordingly, the portion of the Refinancing Project that is funded by the 504 loan and the Third Party Loan may not exceed the outstanding principal balance of the existing debt, or $500,000.

- The contributions are calculated based on the fair market value of the Eligible Fixed Assets securing the Refinancing Project. Accordingly, the Third Party Lender must contribute at least 50% of $600,000, or $300,000, and the Borrower must contribute at least 10% of $600,000, or $60,000.

- The 504 loan would provide $200,000, for a total of $500,000 in cash to pay off the existing indebtedness.

- The Borrower’s contribution may be satisfied with the Borrower’s $100,000 equity in the Eligible Fixed Assets securing the Refinancing Project. With the contribution of this equity, the Borrower’s participation is equal to 16.7% of the Refinancing Project.

<u>Example 2 – Slightly over-collateralized (Borrower has less than 10% equity in the Eligible Fixed Assets)</u>. The fair market value of the Eligible Fixed Assets securing the loan based on an independent appraisal is $540,000 and the outstanding principal balance of the existing indebtedness is $500,000.

- In this example, the value of the collateral securing the Refinancing Project ($540,000) slightly exceeds the outstanding principal balance of the existing indebtedness ($500,000). Accordingly, the portion of the Refinancing Project that is funded by the 504 loan and the Third Party Loan may not exceed 90% of the fair market value of the Eligible Fixed Assets, or $486,000.

- The contributions are calculated based on the fair market value of the Eligible Fixed Assets securing the Refinancing Project. Accordingly, the Third Party Lender's loan must be 50% of the fair market value, or $270,000; the Borrower's contribution must be 10% of the fair market value, or $54,000; and the 504 loan would be 40% of the fair market value, or $216,000.

- In this case, $40,000 of the Borrower's contribution could be the equity in the property. The remaining $14,000 would have to be cash or equity in other fixed assets acceptable to SBA. To the extent that the Borrower's cash contribution is not sufficient to pay the Qualified Debt in full, one of the following two alternatives, or some combination thereof, must be implemented:

    A. Additional Collateral to Increase Amount of Refinancing Project. The Borrower may contribute the equity in other fixed assets acceptable to SBA as collateral to increase the amount of the Refinancing Project, provided that there is an independent appraisal of the fair market value of the additional asset(s). The loan structure would be calculated based upon the new amount. (For example, if the collateral securing the Refinancing Project totaled $555,555.56, cash from the Third Party Loan and the 504 loan would be sufficient to pay the Qualified Debt in full.)

    B. Action by Lender of the Debt Being Refinanced. The lender of the debt being refinanced must take one of the following actions, or some combination thereof, to address the deficiency between $500,000 and the total amount of cash that the lender receives from the Third Party Loan, the 504 loan, and the Borrower's cash contribution:

        i. forgiveness of all or part of the deficiency,

        ii. acceptance of payment by the Borrower, or

        iii. requiring the Borrower to execute a Note for the balance, or any portion of the balance. This Note must be subordinate to the 504 loan if secured by any of the same collateral and is subject to any other restrictions that SBA may establish, including a requirement that the loan be on standby for not less than three years.

Example 3 – Under-collateralized. The fair market value of the Eligible Fixed Assets securing the loan based on an independent appraisal is $600,000 and the outstanding principal balance of the existing indebtedness is $800,000.

- In this example, the value of the Eligible Fixed Assets securing the Refinancing Project ($600,000) is less than the outstanding principal balance of the existing indebtedness ($800,000). Accordingly, the portion of the Refinancing Project that is funded by the 504 loan and the Third Party Loan may not exceed 90% of the fair market value of the Eligible Fixed Assets securing the loan ($600,000), or $540,000.

- The Third Party Lender must contribute at least 50% of the fair market value of the Eligible Fixed Assets securing the loan, or $300,000, the Borrower must contribute at least 10% of the fair market value of the Eligible Fixed Assets securing the loan, or $60,000, and the 504 loan would contribute at most $240,000, for a total of $600,000.

- With the total amount of the refinancing being equal to the fair market value of the fixed assets securing the refinancing and insufficient to pay the Qualified Debt in full, one of the following two alternatives, or some combination thereof, must be implemented:

    A. Additional Collateral to Increase Amount of Refinancing Project. The Borrower may contribute the equity in other fixed assets acceptable to SBA as collateral to increase the amount of the Refinancing Project, provided that there is an independent appraisal of the fair market value of the additional asset(s). The loan structure would be calculated based upon the new amount.

    B. Action by Lender of the Debt Being Refinanced. The lender of the Qualified Debt must take one of the following actions, or some combination thereof, to address the deficiency between $800,000 and the total amount of cash that the lender receives from the Third Party Loan, the 504 loan, and the Borrower's cash contribution:

        i. forgiveness of all or part of the deficiency,

        ii. acceptance of payment by the Borrower, or

iii. requiring the Borrower to execute a Note for the balance, or any portion of the balance. This Note must be subordinate to the 504 loan if secured by any of the same collateral and is subject to any other restrictions that SBA may establish, including a requirement that the loan be on standby for not less than three years.

Note: These examples do not include other eligible project and administrative costs.

(13) A loan application is not eligible for refinancing if:

(a) the loan to be refinanced has a federal guarantee (*e.g.*, a 7(a) loan or a USDA loan);

(b) the loan is a Third Party Loan which is part of an existing 504 Project;

(c) the debt being refinanced is owed to an Associate of the Borrower or to a Small Business Investment Company or a New Markets Venture Capital Company; or

(d) the creditor of the debt to be refinanced is in a position to sustain a loss causing a shift to SBA of all or a portion of a potential loss from an existing debt (*i.e.*, neither the CDC nor the Third Party Lender has any knowledge of a default by Borrower or has any knowledge or information that indicates a default is likely).

(14) CDCs must report any delinquency after loan approval but before loan funding to SBA as an adverse change. At the time the Interim Loan is closed, the CDC must ensure that the Lender whose debt is being refinanced signs SBA Form 2416, Lender Certification for Refinanced Loan.

(15) All loans approved under this program must be funded by the sale of a debenture within 6 months of approval. If a loan is not funded during that period, SBA will cancel the loan number.

(16) For loans approved during Fiscal Year 2011, the total annual guarantee fee is 1.043% (104.3 basis points) on the unpaid principal balance of the debenture. This fee amount includes the guarantee fee assessed under 13 CFR § 120.971(d)(2) and the supplemental guarantee fee authorized by the Jobs Act. The CDC should follow the drafting instructions on the Authorization for Debenture Guaranty to ensure that the correct fee amount is input. SBA will review this fee to determine whether it needs to be changed for loans approved during FY 2012 and, if so, SBA will publish a Notice in the *Federal Register* of any change in the fee.

(17) For purposes of this Notice, the following terms shall have the meanings set forth below:

(a) "Date of application" means the date the complete application is received by SBA.

(b) "Eligible Fixed Assets" means one or more long-term fixed assets (such as land, buildings, machinery, and equipment) acquired, constructed, or improved by a small business for use in its business operations.

(c) "Refinancing Project" means the fair market value of the Eligible Fixed Asset(s) securing the Qualified Debt and any other fixed assets acceptable to SBA.

(18) SBA will continue to consider the most efficient and effective way in which to implement the Section 1122(a)(C)(ii)(I) (collateral value less than 125% of refinancing) and Section 1122 (a)(C)(iii) (business expenses) of the Jobs Act. Questions regarding this notice should be directed to the lender relations specialist in the local SBA field office.

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Karen G. Mills
Administrator