

SBA RESPONSES TO Q&A - 504 Debt Refinance
May 25, 2016 – July 21, 2016

Eligibility

- 1) Would a Fannie Mae or Freddie Mac loan be considered a loan subject to guarantee by a Federal agency or department? In other words can you refinance a Fannie Mae or Freddie Mac loan?

These are federally guaranteed loans and are not eligible for the 504 Refinancing program. Furthermore, these are housing loans which would be considered personal expenses and not business expenses.

- 2) Are loans that originated with SBA or USDA, but have been refinanced into conventional loans, eligible for the 504-Refinancing Program? There is a 2 year requirement on qualified debt. Does this mean the loan must have been non-federal for 2 years prior to application before it can be eligible to be refinanced by the 504-Refinancing Program?

Yes. The loan must have been non-federally backed for at least 2 years.

- 3) If a loan which was in place for 10 years was renewed last year, would it be eligible for SBA 504 refinancing?

Yes, if it meets the requirements for a Qualified Debt. The renewal within the last year would not make it ineligible as long as the loan is current on all payments due. CDCs will need to document in the credit memorandum that any renewal during the previous 24 months did not involve an increase in the amount of debt.

- 4) Would a residential mortgage being used on a home that is has recently been converted for a commercial business be considered a “commercial loan” and eligible for refinance? For example: would a borrower who operates a bedroom residential care home that is secured by a residential mortgage be eligible?

The loan is a residential mortgage and is not eligible for refinance under this program as it is not an existing commercial loan.

- 5) Is a loan eligible if the current note has not existed for two years, however, the loan is the refinance of a loan which was funded prior to the two year requirement for Qualified Debts. For example: A small business purchased a building 6 years ago. The bank approved a loan with a 5-year balloon payment, then refinanced that loan last year when it matured. The loan will mature in approximately 4 years. The current note has not existed for two years, but this loan was funded 6 years ago.

This is not an eligible project since the existing loan has not been in existence for more than two years.

- 6) **Small business debts often change over time and applicants may keep less than a complete record of documentation. Are CDCs allowed to obtain a certification of missing documents from the applicant in these situations?**

No. According to the current Form 1244 (Exhibit 2), the borrower and the CDC must certify that the debt is eligible.

- 7) **There is a new requirement for the 504 Debt Refinancing Program to confirm that the applicant has not changed ownership (even partially) in the 2-year period prior to application. Would a change in type of business entity that did not change of ownership have to have occurred 2 years prior to application (Simple example being the incorporation of a sole proprietorship.)**

If there has been no change in the ownership, a change in business type of business entity would not impact eligibility.

- 8) **If an LLC of a multi- member LLC extended a small ownership interest to a former manager within the last two years, but the debt and collateral are the LLC's, is this now considered ineligible under the 504 Debt Refinance program? If it is ineligible, could it become eligible in the future under the Qualified Debt time limit?**

The small business would need to wait to apply until at least two years from the change of ownership before the project is eligible. SBA requirements depend on ownership at the time of application. Guarantees must be provided in accordance with 120.160(a).

- 9) **Can the Energy Public Policy Goal ("Green loan)" 504 be worked into a 504 debt refinancing project so borrower have access to an additional \$5MM of SBA funds?**

No.

- 10) **Can personal residence be used to cover the shortfall of collateral?**

In the case of collateral shortfall for meeting the 90% LTV, a personal residence may be added. This is not allowed for any collateral shortfall associated with the Business Operating Expenses requirement of 75% LTV.

“Other Secured Debt”

- 1) “Other Secured Debt” must have been incurred 2 or more years ago and secured by the “same Eligible Fixed Assets” securing the Qualified Debt. May the “other” debt be secured with additional assets provided it is secured with the Eligible Fixed Assets?

Yes, the “other secured debt” is eligible if it has been secured by the Eligible Fixed Asset for at least two years.

- 2) Please confirm the following. If a commercial real estate expansion loan was made more than 2 years ago, but secured only by a mortgage on an unrelated piece of real estate, it is not “other secured debt.”

It is not “Qualified Debt” or “Other Secured Debt” since both must have been secured by eligible fixed assets for at least 2 years.

- 3) If that same loan had instead been secured with a junior mortgage on the improved real estate (the Eligible Fixed Asset), it would be “other secured debt.”

Yes, depending on the use of funds that the second mortgage represents, it could be “Qualified Debt” or “Other Secured Debt.”

- 4) Is the difference in the LTV criteria apply based on the collateral of the debt or the purpose of the debt?

LTV is based on the purpose of the debt. If the purpose of the funds is for refinancing Qualified and other secured debt, LTV is 90% LTV; if there are any business operating expenses, the LTV is 75%.

- 5) In a case where the Qualified Debt is commercial real estate more than 2 years old and a lender secured a working capital line of credit both with a mortgage on that commercial real estate (Eligible Fixed Asset) and a lien on current assets, is the working capital line “other secured debt” on those facts?

If the working capital line of credit is secured with the Eligible Fixed Assets securing the Qualified Debt, it would be classified as “other Secured Debt.” Additional collateral taken would not impact that determination.

“Business Operating Expense”

- 1) For “Business Operating Expenses”, are rent payments limited to unrelated parties?

Rent for the premises or equipment may be an eligible Business Operating Expense.

Payments to associates of the Borrower are not authorized except for ordinary compensation for services rendered. An associate of the Borrower is defined in 13 CFR §120.10(2) as:

- (i) An officer, director, owner of more than 20 percent of the equity, or key employee of the small business;
 - (ii) Any entity in which one or more individuals referred to in paragraphs (2)(i) of this definition owns or controls at least 20 percent; and
 - (iii) Any individual or entity in control of or controlled by the small business (except a Small Business Investment Company (“SBIC”) licensed by SBA
- 2) If the loan includes “Business Operating Expenses”, what will SBA require for documentation post loan funding to show the payment of those stated eligible expenditures and what party retains the documentation?

If the Borrower is requesting that the refinancing include Eligible Business Expenses, the application must include a specific description of the Eligible Business Expenses and an itemization of the amount of each expense, with the Form 1244 certification of the accuracy of this information.

Both the CDC and the Borrower must certify in the application that the funds will be used to cover eligible business expenses. 13 CFR 120.882(g)(6)(ii) states: “Borrower must, upon request, substantiate the use of funds provided for business expenses through, for example, bank statements, invoices marked “paid”, cleared checks, or any other documents that demonstrate that a business obligation was satisfied with the funds provided.”

- 3) Can a line of credit or other debt be paid down or paid off as a Business Operating Expense?

Yes. This limits the LTV to a maximum of 75%

- 4) Are prepayment penalties eligible projects costs under the 504 Debt Refinancing program?

Yes.

- 5) May closing costs, appraisals, and environmental costs be included in a 504 Refinancing Program project? Are they included as Business Operating Expenses which triggers the 75%/25% requirements? Was this the intent not to include closing costs?

Closing costs and professional fees may be included in the 504 Refinancing Program in the same way and limits as they are currently included in the 504 loan program. They are not considered “Business Operating Expenses.” If there are no Business

Operating Expenses, closing costs may be included to the extent that the project does not exceed the 90% LTV limitation.

Closing/Funding Time Frames

- 1) Must all loans be closed and funded within 6 months, as required with the temporary debt refinance program, or is it the same time frame as “traditional” 504 loans?

Yes. Under 13 CFR 120.882(g) (12), all loans must be disbursed within 6 months after loan approval. The Director of the Office of Financial Assistance or his or her designee may approve an extension of the disbursement period for good cause.

Escrow

- 1) Why was the escrow closing established for same institution debt in the 504 Debt Refinancing program?

The rationale was that there is no need for interim financing with same institution debt and that the use of the escrow should reduce costs for the Borrower since the Lender could modify the existing loan documents (Note, Deed of Trust or Mortgage, etc.) rather than require the Borrower to execute and record all new documents.

- 2) Please provide a summary of the Escrow Account requirements for 504 debt refinancing program.

Escrow Closing (No Interim Financing) for Refinancing of Same Institution Debt under the 504 Debt Refinancing Program:

The project will not require interim financing. The following will be required for an escrow closing:

(a) Escrow Account:

(i) SBA must approve the escrow agreement. Escrow agent must be approved by CDC and SBA and follow escrow instructions provided by CDC and SBA. Approval by the District Counsel at closing constitutes approval of the agreement and disbursement upon receipt of the net debenture proceeds.

(ii) Debenture sale funds must be wired directly into the escrow account.

(iii) The funds in escrow may not be distributed and the escrow account may not be dissolved until CDC is satisfied that all collateral documents have been

properly filed, lien positions properly perfected, and a final title policy (or other evidence of title if no title policy is required) issued showing required title and lien position.

(iv) The escrow must close no later than 6 months from the date of loan approval, which is the Approval Date on the first page of the Authorization for Debenture Guaranty. If it does not, the escrow funds will be used to pay off the Debenture in full.

(v) Borrower must deposit its cash contribution to Refinancing Project, if any, in the Escrow Account.

(b) SBA Form 2416 - Third Party Lender must execute and submit to the CDC at the time of closing SBA Form 2416, Lender Certification for Refinanced Loan.

3) Will SBA provide a template for the escrow agreement?

No. The Agreement must provide that the escrow will be funded by the Borrower's contribution and the net debenture proceeds. The Escrow Agreement must be executed by the Borrower, the Third Party Lender, the Escrow Agent and the CDC. The account may be held by the CDC attorney, Title Company or other party approved by SBA District Counsel.

4) In a case of an Escrow closing, net debenture proceeds are wired to the Escrow Account set up earlier. Funds may be released from this account "only upon written approval by CDC and SBA". What are the logistics for receiving written approval from SBA for release of funds after debenture proceeds are wired to the escrow account? Who is "SBA" for these purposes? Does the earlier approval of the loan package by the SBA District Counsel act as SBA written approval – though provided prior to funding of the account?

At closing, the District Counsel will be able to determine if SBA has the required lien positions on the collateral and should have evidence that the Borrower has deposited its contribution into the escrow account.

5) Please provide a more detailed example of how the escrow account will work.

Example: The 504 Debt Refinancing loan is for \$600,000 and it includes same institution debt. CDC counsel delivers a proposed escrow agreement to District Counsel for review and approval. At the time of the 504 loan closing, Borrower deposits its contribution, if any, in the escrow account and evidence of same is provided to District Counsel. After sale of the debenture, the net debenture proceeds will be wired to the escrow account. The net debenture proceeds and the Borrower's contribution may then be wired to the Lender.

- 6) Policy Notice 5000-1382 states that if a refinance of same institution debt, no Interim Lender may be used and an escrow account is required. Under the Jobs Act version of refinance exceptions could be requested. Will exceptions continue to be available, and if so, at which SBA level will it be granted?

There are some circumstances under which the use of an interim loan may be more advantageous to the Borrower. For example, if multiple loans are being refinanced, the CDC may request an exception to policy. SLPC will assist the CDC in obtaining the exception on an as needed basis if the CDC can explain how closing the loan without using an escrow would be more advantageous to the Borrower.

TPL

- 1) Policy Notice 5000-1382 references that the Third Party Lender (TPL) must certify in its commitment letter that it has no reason to believe that the debt is not eligible. If we have a letter of intent from TPL instead of a commitment letter, will this be acceptable if we have similar language contained in the LOI?

Yes.

- 2) What is required of the TPL in terms of certification?

See Part D of SBA Form 1244, Instructions for Third Party Lender Certifications for loans made for debt refinancing.

- 3) Does the TPL need to certify anything related to eligible business expenses if these are included in the project?

No.

Job creation/retention, public policy and community development objectives

- 1) Will public policy and community development objectives be allowed when a project does not meet the 1 job per \$65,000 job creation and retention requirement (1 to \$100,000 for manufacturing)?

Yes, the public policy and community development goals may be utilized if the applicant can show that the refinancing serves one of these goals. Please note that none of the Energy Public Policy Goals (see p. 271 of SOP 50 10 H) may be utilized for projects under this program.

- 2) The Jobs Act had an alternative jobs retention goal. Why was this eliminated? How can a project document job creation/retention under the 504 debt refinance program now?

The elimination of the alternative job retention goal was a statutory change. CDCs may consider whether they can reasonably show that the Project will result in the creation or retention of jobs. Please refer to SOP 50 10 5 (H), page 271 for the job creation/retention requirements a CDC must document for the 504 program. If the CDC submits the project under a public policy goal, the CDC should be aware they still need to meet their job creation and retention requirements for their overall portfolio.

Documentation

- 1) Please provide more specific direction on the documentation requirements for the credit memorandum that states “CDC must provide an analysis in its credit memorandum that the proposed debt refinancing satisfies each of the requirements of the 504 Debt Refinancing Program.”

The CDC’s credit memorandum must address all issues that would be required of a prudent lender. For all Qualified/Other Secured Debt, SBA would expect that, the credit memorandum must include, but is not limited to, the following:

- Description of how the debt meets the requirements for Qualified Debt or Other Secured Debt
- Lender Name;
- Original Loan Amount:
- Original Date:
- Maturity Date:
- Payment amount/frequency:
- Payment Due Date:
- Current Balance to be refinanced:

- Borrower(s):
- All guarantors:
- Use of Proceeds:
- All Collateral:

- Identify the Borrower or Operating Company for whose benefit the proceeds were used:

In addition, the credit memorandum must contain an analysis of the transcript(s) with due date, actual payment date, and payment amount for each of the previous 12

months, indicating that the loan has been current and therefore eligible for refinance. This should be supported by the actual transcripts in the application. Any/all late fees private lenders charge prior to a 30 day delinquency must be addressed.

Any forbearance or similar agreement(s) that might have been in place prior to the 12-month period when the loan payments became current must be addressed in full including the circumstances surrounding the agreement(s). The agreement(s) must be included with the application.

- 2) Why are appraisals not required at time of application, since the appraisal defines the 504 Debt Refinancing project?

Until there is a loan approval many businesses would not want to move forward with the expense of an appraisal and/or an environmental assessment. If the amount of the Refinancing Project was based on an estimate, then prior to loan closing the SLPC will determine, based on the appraisal, whether the amount of the Refinancing Project needs to be revised and the refinancing restructured. However, if a current appraisal is available, SLPC strongly encourages submission with the application.

General/Misc.

- 1) Why is there a small premium on the 504 refinancing program annual guarantee fee when there is no current subsidy?

The statute authorizing the Program requires an additional fee to cover any additional costs attributable to the refinancing. The CFO subsidy modeling team has calculated the additional costs for FY 2016.

- 2) In SEC.521 (a) (2), is the “50 percent of the dollars loaned” the dollars as approved by SBA in the preceding fiscal year, or the dollar amount of loans funded in the fiscal year?

The 50% is based on dollar amount of loan approvals and not disbursements.

- 3) May we also continue to rely upon SBA Policy Notices issued during the Jobs Act Temporary Debt Refinancing Program?

No. Policy Notice 5000-1382 and Information Notice 5000-1383 are effective now. The notices issued during the Jobs Act are expired and the Jobs Act refinance program has sunset. Although some of the requirements are similar to the Jobs Act, there were statutory changes in the Omnibus Act that are reflected in the current Policy and Information notices. SBA will be updating the SOP to include guidance for this program.