

## COMMERCIAL LENDING E-ALERT SEPTEMBER 2010

### JOBS ACT EXTENDS AND EXPANDS SBA LENDING: WHEN DOES SMALL = MIDDLE?

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On September 27, with one stroke of his pen, President Obama transformed the “SMALL” (as in the Small Business Administration “SBA”) into a MIDDLE MARKET lender. The enactment of the “Small Business Jobs Act” will dramatically increased the size and scope of the two major SBA Programs (the 7(a) and 504 Programs) and will allow borrowers and private sector lenders to finance significantly larger “middle market” transactions.

#### 504 PROGRAM

SBA’s 504 Program provides assistance to small businesses acquiring real property or equipment by offering 90% financing: The SBA finances 40% of the cost to acquire real property or equipment with a long-term, fixed-rate loan (20 years for real property and 10 years for equipment), secured by a second mortgage/personal property lien, combined with 50% financing provided by a first mortgage/personal property lien lender, thus requiring only 10% equity contribution by the borrower. Previously, the maximum size of the SBA portion was approximately \$2 million, so a typical TOTAL project cost, using the maximum SBA financing, was \$5 million (the bank lent \$2.5 million (50%), SBA’s portion was \$2 million (40%), and the borrower injected \$500,000 – 10%). The borrower paid fees to SBA amounting to approximately 2.5 “points” on the SBA portion. The February 2009 Stimulus Bill eliminated the borrower’s obligation to pay the 2.5 “points” on the SBA portion and, thus, created a large number of acquisitions when virtually no other financing was available. The 2010 Jobs Bill temporarily extends the SBA “points” waiver to December 31, 2010, and makes a PERMANENT INCREASE in the amount of the SBA portion to **\$5 million**, meaning that the borrower can, in the typical 50%–40%–10% structure now finance a \$12.5 million acquisition, with its lender making a \$6.25 million loan, SBA contributing \$5 million, and the borrower injecting \$1.25 million. Note that even larger projects may be financed, as long as the borrower always injects 10% and SBA’s share is capped at \$5 million. For example, the borrower could purchase a building for \$15 million, with its Bank providing \$8.5 million, SBA \$5 million, and borrower equity injection of \$1.5 million.

#### 7(A) PROGRAM

SBA offers “credit enhancement” to bank and non-bank lenders through its 7(a) Program in which SBA guarantees repayment of 75% of the outstanding balance of principal and interest

due in the event of default. 7(a) loans may be used for a broad range of business financing needs, including business acquisition, real and personal property acquisition, working capital, and debt refinance. Previously, the amount of SBA Guaranty was capped at \$1.5 million, so historically the biggest loan that could be made using the maximum amount of SBA Guaranty was \$2 million. The borrower is required to pay to SBA a “Guaranty Fee” – basically a “user fee” – in the range of 2% – 3% of the SBA Guaranty. The February 2009 Stimulus Bill (i) increased the percentage of the loan guaranteed to 90% (allowing the lender to make a \$1.566 million loan using the maximum 90% SBA Guaranty), and (ii) eliminated the borrower’s obligation to pay the Guaranty Fee. The 2010 Jobs Bill temporarily extends the SBA Guaranty Fee waiver and the 90% guaranty to December 31, 2010, and makes a PERMANENT INCREASE in the amount of the SBA Guaranty to \$3.75 million, meaning that the lender can now make a \$5 million loan using the SBA 7(a) Program.

## SIZE STANDARDS

SBA is modifying the size standards to allow many more businesses to qualify as “SMALL” – up to \$15 million of tangible net worth and a 2-year average net income after federal income taxes of \$5 million.

## ENCOURAGING ECONOMIC ACTIVITY

Real economic activity occurs through the use of the SBA 7(a) and 504 Programs, as thousands and thousands of transactions would not go forward unless the private sector lender has the assistance of SBA financing. This was especially true after passage of the 2009 Stimulus Bill, and the provisions of the Small Business Jobs Act are expected to continue to greatly stimulate small and now middle market lending as we continue to recover from this recession.

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