



# Self-storage Financing Through the SBA 504 Loan Program

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While the mega players don't need the SBA to finance property purchases, the independent mini storage or self-storage operator will not find a loan that beats the SBA 504.

For facilities that are greater than 2-years-old, borrowers can take advantage of all the many benefits that come with the SBA 504 program: 85% loan-to-value financing, a low fixed-rate and up to 25-year terms.

# Anatomy of an SBA 504 Loan



To illustrate an SBA 504 loan, we will use a hypothetical self-storage facility in Illinois selling for \$4.2MM. In seeking out SBA 504 financing, the borrower wants to know where the funds will come from and how much money he will need to come up with out-of-pocket for the down payment. A simple calculation can make sense of the financing structure of an SBA 504 loan:  $50\% + 35\% + 15\% = 100\%$ . Let's break down that formula and associate the major players involved in loan funding and approval.

**Conventional Lender (50%)** - The first 50% in financing comes from a financial institution like a bank or specialty SBA lender in the form of a conventional loan. The first-lien loan is usually a fixed rate loan amortized over 25 to 30 years. It's important to pick a lender that has a staff who understands SBA loan regulations and can hold your hand through the process. After reviewing the loan package, an experienced SBA lender should ask the right questions up front, anticipate problems and help the borrower get around any roadblocks that might come up.

In our example, this means that the first-lien lender will commit \$2.1MM toward the total financing of the deal.

**Certified Development Company (35%)** - The next 35% of financing is a second-lien loan from an organization known as a Certified Development Company (CDC). A CDC is an SBA-regulated non-profit organization with a mission to

promote the SBA 504 loan program. There are over 260 CDCs across the country and each has a specific coverage area. The SBA assumes the risk on the CDC's second-lien loan through its guarantee. If the borrower defaults, the government will pay the loan off. The second-lien loan is a 20-year fixed rate loan.

This means that our hypothetical self-storage buyer will secure a second-lien loan in the amount of \$1,470,000 from the CDC, guaranteed by the SBA.

**Borrower (15%)** - The final 15% comes in the form of a down payment from the borrower. In comparison, most conventional loans require a minimum 25% down payment. The savings a borrower realizes with an SBA 504 loan can be used toward much-needed costs to operate his business.

For the acquisition deal in Illinois we are using as an example, the borrower will have to provide a down payment of \$630,000.

**Small Business Administration (SBA)** - The final player is the SBA itself. The SBA will review loan documents to make sure everything has been done according to its loan requirements and Standard Operating Procedures have been followed. Once the SBA is satisfied, it will approve the loan.

# Benefits of an SBA 504 loan



In 2010, the SBA deemed some businesses with rental income – also called passive income – eligible for its programs. This gave self-storage operators the opportunity to take advantage of the SBA 504 loan's many benefits. 85% LTV – The SBA 504 is a high leverage loan, which is one of its most attractive features. A borrower only needs to come to the table with a 15% down payment toward the purchase of the facility, fixed equipment and allowable soft costs, giving the borrower more money to put toward working capital. Most conventional loans require 25 percent or more out of the borrower's pocket for a down payment.

**Low rates** – The SBA sets the interest rate on the second-lien (CDC) portion of the loan ensuring that rates are competitive. Because the government-guaranteed loan assumes most or all of the default risk, a conventional lender can offer a

low rate on the first-lien loan.

**Fixed rate** – An important feature of the SBA 504 loan is the fixed rate. Right now, rates are still at historic lows, but current economic forecasts show this will not last forever. Locking in a long-term fixed rate will reduce the uncertainty that comes with an adjustable rate loan, helping facility owners better manage their cash-flow.

**Refinancing available** – In 2016, the SBA introduced new rules that enabled borrowers to refinance a conventional loan on self-storage properties into an SBA 504 loan. A self-storage facility is eligible for refinancing as long as the property has been operating under the same ownership for at least two years.

# Qualifying for a 504



Like any loan, the SBA 504 program has specific guidelines to qualify for financing. A lender or CDC will outline the qualifications in detail to make sure you and your property are eligible.

**Personal guarantee** – The SBA 504 is a full recourse loan. No matter the credit rating of the borrower or health of the business, the SBA will require a personal guarantee.

**Cash flow** – Net operating income (NOI) is the income that your facility will generate after expenses. NOI has to cover the property's debt service coverage ratio (DSCR), the proportion of available cash to mortgage debt, at 1.2 times.

**Seasoning** – The facility has to have a minimum of two-year operating history before it is eligible for SBA 504 financing.

# *The right choice for self-storage property owners.*

The SBA 504 program is far superior to any other financing for self-storage property owners and should be at the top of the list of options.

SBA 504 loans can be quick to close.  
An expert lender with a knowledgeable  
and well-trained staff  
will help put all the pieces together  
and guide a borrower through  
the loan process quickly and efficiently.



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