The following reported article on 504 loans appeared in the June 15, 2017 issue of *The Alternative Lending Report*:

504 LOANS: KEEPING THE PIPELINE OPEN FOR COMMUNITY IMPACT

By Allen Taylor

The Small Business Administration is one of the most successful independent agencies of the U.S. federal government. Created by the Small Business Act of 1953, the agency takes its mission of helping America's small businesses succeed seriously. In 1958, the Small Business Investment Act initiated small business development loan opportunities that, over time, has evolved into the 504 program. The nexus of 504s are the 230 non-profit Certified Development Companies (CDC) that service the loans.

According to program chief Linda Reilly, 504 lending is on a growth trajectory. Last year, through June 9, the SBA approved 3,811 loans for a little more than $3.05 billion. As of the same date in FY 2017, the SBA has

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approved 4,385 loans totaling more than $3.57 billion, amounting to year-over-year growth of 16.8%.

This means more businesses are applying for 504 loans, and the SBA is approving them. To ensure this growth, and the success of the borrowing businesses, CDCs must operate efficiently. But what does that entail, exactly?

How the 504 Program Works

The 504 loan program is designed to provide gap fixed asset financing for small businesses. Borrowers are required to provide 10% of their own assets to purchase equipment or real estate. The first lien holder is a bank with 50% interest in the loan. The CDC fills the gap with a full guarantee from the SBA for the second lien.

"This allows the small business to have more leverage with the same collateral," Reilly said.

The process, from application to approval, takes four to six weeks, depending on the complexities of the borrower's situation. The CDC receives the loan application, analyzes the small business's financial condition, the applicant meets with the CDC board, and sends the paperwork to the SBA central processing office in Sacramento, California.

"Once it hits that level," Reilly said, "there's a three to five day turnaround."

The SBA has strict rules regarding what a loan can be provided for, and for the size of the businesses receiving the loans. They also approve CDC applications and oversee their training while providing technical assistance when necessary. But it's up to the CDCs themselves to manage their processes and keep the ball rolling on the loans. In that regard, Reilly does have a few suggestions to help CDCs become better portfolio managers.

Thinking Like a Bank, Acting Like a Community Resource

While CDCs are non-profit organizations, they're in the business of making loans. That requires a mindset similar to any other lender, such as a bank. Reilly said one of the biggest challenges many CDCs face is business concentration.

"If you're in a coastal area, for instance, and you loan to a lot of hotels, you still should have a diversified portfolio," she said.

Bill Manger, Associate Administrator for the Office of Capital Access at the SBA, said diversification means a stronger local economy and a healthier loan portfolio for the CDC. Both Manger and Reilly recommend that CDCs learn the local community well enough that they can become a community resource for small businesses and help economic development corporations establish a more diversified business environment. New businesses entering the local economy could potentially become CDC customers later when they qualify for a 504 loan.

The SBA provides a ton of resources to small businesses. This includes free business plan development, among other things. An effective CDC can steer small business loan applicants to SBA programs so they can run their businesses better. Many CDCs even lead small business owners to the right bank to apply for the initial loan.

How CDCs Impact Communities

CDC Small Business Finance has been in business since 1978 and has made more than 11,000 loans to small businesses providing almost $14 billion in total capital while creating 182,000 jobs. In the last year, they've managed $1 billion in public and private investment in California, Arizona, and Nevada. Chief Credit Officer and Director of Business Development Michael Owen said 504 loans are as much about the economic impact of a loan as deriving a profit from it.

"You have to understand the dynamics of a project and look at it from a credit perspective," he said. An effective CDC must employ staff that's knowledgeable about sound credit practices as well as economic development principles.

When assessing credit risk, he looks at a business's historical growth pattern and tries to align capital needs with future growth prospects. He wants to know if a business can meet its equipment and facility needs without outside capital. Rural CDCs can have as big an impact on their communities with 10 loan projects as a big urban CDC can with hundreds, he said. In the end, it's all about community impact.

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