Small Business Real Estate Financing: Why Small Businesses and Banks Should Utilize SBA 504 Loans

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I. INTRODUCTION

In the United States, many small businesses start from practically nothing and develop into very successful companies. Small businesses aiming to have similar success often have difficulty obtaining the necessary financing to facilitate growth. Without adequate financing, small businesses struggle to acquire real estate—an essential way for small businesses to grow. Fresh on the heels of the subprime mortgage crisis, increasing loans to underqualified borrowers for real estate acquisitions appears to be a recipe for generating a sequel to the 2008 financial crisis. Accordingly, the Small

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1. Darren Dahl, Top Companies Started During a Recession, HUFF POST SMALL BUS. (May 10, 2010, 6:37 PM), http://www.huffingtonpost.com/2010/05/10/top-companies-started-during-a-recession_n_923853.html (providing examples of notable companies like Microsoft and Disney that started as small businesses during a recession and have since grown into the large corporations they are today).


4. See e.g., Danielle Lundquist, Small Business Lending Still Depressed Five Years After the Collapse of Lehman Brothers, According to New Survey, REUTERS (Sep. 11, 2013, 12:02 PM), http://www.reuters.com/article/2013/09/11/ny-merchant-cash-idUSnBwl16053a+100+BSW20130911 (establishing that even though the economy is improving, small business are still having difficulty obtaining capital in order to hire and grow).

Business Administration\(^6\) (SBA) attempts to mitigate banks’ concerns by providing a loan program that lowers banks’ risk on subprime real estate loans to a specific class of under qualified borrowers—small businesses.\(^7\)

This Note discusses whether the SBA successfully mitigates banks’ risk regarding small business real estate loans, and whether loans to small businesses for real estate acquisitions are a viable option or too similar to the subprime mortgages that helped fuel the 2008 financial crisis. Specifically, this Note analyzes the SBA’s Certified Development Company (CDC)\(^8\)/504 loan program, which has been designed to aid small businesses’ real estate financing needs and alleviate banks’ lending risks.\(^9\) When considering the benefits and risks of real estate financing through the CDC/504 loan program, it is apparent that 504 loans\(^10\) are beneficial for all parties involved and are not nearly as unjustifiable as the subprime home loans that contributed to the 2008 financial crisis.

This Note proceeds in seven parts. Part II provides an overview of subprime lending and the subprime mortgage crisis that led to the 2008 financial crisis.\(^11\) Part III discusses several attempts by Congress to increase small business financing in the wake of the 2008 financial crisis.\(^12\) Part IV provides information regarding eligibility requirements, use of proceeds restrictions, and terms on 504 loans.\(^13\) Part V discusses why many banks find small business financing unappealing.\(^14\) Part VI analyzes why SBA 504 loans are a viable option for small businesses, banks, and the U.S. economy.\(^15\) Finally, Part VII

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6. Congress created the SBA on July 30, 1953, for the purpose to assist small businesses. See id. The SBA “has delivered millions of loans, loan guarantees, contracts, counseling sessions and other forms of assistance to small businesses.” Id.

7. Throughout the entirety of this Note, the term “bank” will be used instead of referring to various other types of lending institutions.

8. See infra Part IV.


10. The loan that a small business receives through the CDC/504 loan program is referred to as a 504 loan. See Use of CDC/504 Loan Proceeds, SBA.gov, http://www.sba.gov/content/use-cdc504-loan-proceeds (last visited Jan. 6, 2014).

11. See infra Part II.

12. See infra Part III.

13. See infra Part IV.

14. See infra Part V.

15. See infra Part VI.
concludes and recommends that banks and small businesses take advantage of the CDC/504 loan program.\footnote{16}{See infra Part VII.}

II. OVERVIEW OF THE SUBPRIME MORTGAGE CRISIS

Subprime lending occurs when credit is extended to borrowers who otherwise would not qualify under traditional lending standards.\footnote{17}{LISSA L. BROOME & JERRY W. MARKHAM, 441 (4th ed. 2011), REGULATION OF BANK FINANCIAL SERVICE ACTIVITIES; see Richard D. Marsico, Subprime Lending, Predatory Lending, and the Community Reinvestment Act Obligations of Banks, 46 N.Y.L. SCH. L. REV. 735 (2003) (" Broadly defined, subprime loans are loans available on more expensive terms to borrowers who have weak credit histories or repayment abilities.").} Banks serve the subprime market because they can provide funds at a higher interest rate than they can on prime loans\footnote{18}{Prime loans are loans provided to creditworthy borrowers and carry an interest rate that is typically “announced and printed in the press every business day.” ALVIN L. ARNOLD & MARSHALL E. TRACHT, CONSTRUCTION AND DEVELOPMENT FINANCING (3rd ed. 2011), available at https://a.next.westlaw.com/Document/14d34852ba61211d9b404dcedcc2e8ef6/View/FullText.html?listSource=Foldering&originationContext=clientid&transitionType=MyResearchHistoryItem&contextData=%28oc.DocLink%29&VR=3.0&RS=cblt1.0.} because of the higher risk of default.\footnote{19}{See Gerald Komgold, Legal and Policy Choices in the Aftermath of the Subprime and Mortgage Financing Crisis, 60 S.C. L. Rev. 727, 728 (2009).} When the interest rate is increased to a rate that exceeds a bank’s incurred risk, the subprime lender is participating in what is referred to as predatory lending.\footnote{20}{BROOME & MARKHAM, supra note 17.}

Subprime home mortgage lending was popular between 2004 and 2007.\footnote{21}{Id.; see Marsico, supra note 17 ("Predatory loans are characterized as loans with abusive terms, deceptive practices, and the inability of a borrower to repay the loan.").} During this time period, subprime lenders originated a multitude of high risk mortgages.\footnote{22}{DEPARTMENT OF STAT. AND OPERATIONS RES., SUBPRIME MORTGAGE CRISIS 8 (Jan. 13, 2008), available at http://www.stat.unc.edu/faculty/cji/fys/2012/Subprime%20mortgage%20crisis.pdf.} Subprime lending was fueled by an increased demand for housing and increased the number of home-owners in the United States.\footnote{23}{Id. at 1.}

As of March 2007, $7.5 million first-lien subprime mortgages, out of the estimated $1.3 trillion U.S. subprime mortgages, were outstanding.\footnote{24}{Id. at 5.} As the number of mortgages increased, mortgage-
backed securities\textsuperscript{26} (MBS) also substantially increased.\textsuperscript{27} MBS enabled major global financial institutions to invest in the U.S. housing market\textsuperscript{28} and encouraged subprime lending by offering lenders the opportunity to lower their risks with various credit enhancements to the MBS.\textsuperscript{29}

The popularity of subprime lending in the United States contributed to a 124\% increase in home values from 1997 to 2006.\textsuperscript{30} During the same time period, consumers began to spend and borrow much more than they saved.\textsuperscript{31} Eventually the substantial number of homes led to "a surplus of unsold homes, which caused U.S. housing prices to peak and begin declining in mid-2006."\textsuperscript{32}

Dramatic increases in default and foreclosure ensued in 2006 and 2007 when housing values decreased simultaneously with initial mortgage terms expiring and ARM rates\textsuperscript{33} resetting at higher rates.\textsuperscript{34} As a result, major global financial institutions, which had borrowed and invested substantial amounts of money into the U.S. housing market, suffered significant losses because of the decline in mortgage

\textsuperscript{26} "Mortgage-backed securities (MBS) are debt obligations that represent claims to the cash flows from pools of mortgage loans, most commonly on residential property. Mortgage loans are purchased from banks, mortgage companies, and other originators and then assembled into pools by a governmental, quasi-governmental, or private entity. The entity then issues securities that represent claims on the principal and interest payments made by borrowers on the loans in the pool, a process known as securitization." \textit{Mortgage-Backed Securities}, U.S. SEC. AND EXCHANGE COMMISSION, http://www.sec.gov/answers/mortgagesecurities.htm (last modified July 23, 2010).

\textsuperscript{27} DEPARTMENT OF STAT. AND OPERATIONS RES., supra note 22, at 6; see Korngold, supra note 19, at 729-30.

\textsuperscript{28} DEPARTMENT OF STAT. AND OPERATIONS RES., supra note 22, at 2.


\textsuperscript{31} DEPARTMENT OF STAT. AND OPERATIONS RES., supra note 22, at 6.

\textsuperscript{32} \textit{Id.}; see Bianco, supra note 30, at 12 ("The prevalence of subprime loans contributed to a 31-percent spike in foreclosure filings in the first half of 2006.").

\textsuperscript{33} An adjustable-rate mortgage ("ARM") has an interest rate that typically fluctuates with an index, and therefore, differs from a fixed-rate mortgage because the interest rate does not remain the same for the life of the loan. \textit{Consumer Handbook on Adjustable-Rate Mortgages}, THE FED. RES. BOARD 4, http://files.consumerfinance.gov/f/201204_CFPB_ARMs-brochure.pdf (last visited Jan. 9, 2014).

\textsuperscript{34} DEPARTMENT OF STAT. AND OPERATIONS RES., supra note 22, at 2; see Korngold, supra note 19, at 730-31.
By September 2010, the underlying mortgages of 23% of the homes in the United States were worth more than the market value of those homes.\textsuperscript{36} With home values worth less than the underlying mortgage, many borrowers defaulted rather than pay off an underwater mortgage.\textsuperscript{37} Accordingly, the subprime mortgage crisis was a key contributor to the 2008 financial crisis because it resulted in consumers losing wealth, and consequently, the deterioration of banking institutions.\textsuperscript{38}

While this is, admittedly, a broad overview of the subprime mortgage crisis, it demonstrates the contributions that subprime real estate financing played in the 2008 financial crisis.\textsuperscript{39} At first glance, it is surprising that the SBA continues to actively encourage subprime lending to small businesses when subprime financing for residential properties had such a negative impact on the economy.\textsuperscript{40} However, this Note explains why financing real estate loans for small businesses are worth the risk and essential to the viability of the U.S. economy.\textsuperscript{41}

III. ATTEMPTS TO INCREASE SMALL BUSINESSES FINANCING IN THE WAKE OF THE FINANCIAL CRISIS

As a result of banks' tighter lending standards following the 2008 financial crisis, small businesses find it more difficult to secure financing.\textsuperscript{42} Bank lending to small businesses increased from $308 billion in June 1994 to $659 billion in June 2008.\textsuperscript{43} However, lending

\textsuperscript{35} DEPARTMENT OF STAT. AND OPERATIONS RES., supra note 22, at 2; see Korngold, supra note 19, at 728.

\textsuperscript{36} DEPARTMENT OF STAT. AND OPERATIONS RES., supra note 22, at 7.

\textsuperscript{37} Id.

\textsuperscript{38} Id. at 1.

\textsuperscript{39} See Id. at 1–2, 24.

\textsuperscript{40} Id. at 1 (establishing that sub-prime home loans had a negative impact on the economy).


\textsuperscript{43} REBEL A. COLE, HOW DID THE FINANCIAL CRISIS AFFECT SMALL BUSINESS LENDING IN THE UNITED STATES? i (2012), available at
to small businesses fell during the financial crisis to $543 billion by June 2011—a decline of almost 18%,\textsuperscript{44} while bank lending to all businesses declined from $2.14 trillion in June 2008 to $1.96 trillion in June 2011—a decline of almost 9%.\textsuperscript{45} As illustrated by the statistics cited above, the decline in bank lending to small businesses was more drastic than for larger businesses.\textsuperscript{46}

Access to capital for small businesses is crucial for the U.S. economy because small businesses account for 55% of all U.S. employment.\textsuperscript{47} Moreover, small businesses occupy approximately 30 to 50% of all commercial space in the United States.\textsuperscript{48} As of 2010 there were more than 23 million nonfarm sole proprietorships, approximately 2.5 million partnerships with fewer than $1 million in total assets, and over 5 million corporations with fewer than $1 million in total assets.\textsuperscript{49}

Appreciating the importance of small businesses, Congress attempted to encourage banks to extend loans to small businesses by implementing the Troubled Assets Relief Program (TARP)\textsuperscript{50} and the Small Business Jobs Act of 2010 (SBJA of 2010).\textsuperscript{51}

A. TARP: Capital Purchase Program

Congress attempted to create stability and prevent the U.S. economy and financial system from collapsing by enacting TARP in

\begin{enumerate}
\item http://www.sba.gov/sites/default/files/files/rs399tot.pdf.
\item Id.
\item Id.
\item Id.
\item Id. (providing also that “[t]he 600,000 plus franchised small businesses in the U.S. account for 40% of all retail sales and provide jobs for some 8 million people.”).
\end{enumerate}
2008. Through the Capital Purchase Program (CPP), as a part of TARP, "the [U.S.] Treasury injected more than $200 billion of capital into more than 700 U.S. banking organizations to stabilize their subsidiary banks and promote lending, especially lending to small businesses." Congress may have intended for banks to lend TARP funds to businesses and consumers, but TARP did not explicitly require banks to utilize the capital in any particular way. While the CPP was intended to increase bank lending to small businesses, evidence shows that lending from CPP participating banks decreased by more than nonparticipating CPP banks.

B. 2010 Small Business Jobs Act

Because TARP’s CPP did not result in increased small business lending, Congress enacted the SBJA of 2010 to provide “critical resources to help small businesses continue to drive economic recovery and create jobs.” One provision in the SBJA of 2010 created a $30 billion Small Business Lending Fund (SBLF) that was allocated to banks with assets of no more than $10 billion. Unlike CPP participating banks, three-quarters of SBLF participating banks

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55. Press Release, U.S. Dep’t of the Treasury, Statement by Sec’y Henry M. Paulson, Jr. on Actions to Protect the U.S. Economy (Oct. 14, 2008), http://www.treasury.gov/press-center/press-releases/Pages/hp1205.aspx (providing Secretary Henry Paulson’s statement that the Treasury’s goal for the CPP “is to see a wide array of healthy institutions sell preferred shares to the Treasury, and raise additional private capital, so that they can make more loans to businesses and consumers across the nation.”).
57. Id.
"increased small business lending by 10% or more."\textsuperscript{60}

The SBJA of 2010 also amended provisions of the Small Business Investment Act of 1958 (SBIA of 1958).\textsuperscript{61} Among other changes, the SBJA of 2010 amended the SBIA of 1958 to permit the SBA to increase maximum loan amounts on 504 loans,\textsuperscript{62} provide services to more businesses by increasing size standards,\textsuperscript{63} and create more jobs through tax incentives.\textsuperscript{64} The SBJA of 2010 also permitted a 504 loan refinancing program until September 27, 2012, which allowed small businesses to refinance assets that qualified under normal 504 loan standards.\textsuperscript{65} This Note will not discuss the 504 loan refinancing program in detail since it is no longer available, but it should be noted that the many individuals in the 504 loan industry hope Congress will reinstate the program because of its success.\textsuperscript{66}

The CDC/504 loan program, which will be explained in further detail in Part IV, does not give funds directly to banks like the CPP and SBLF. Rather, the CDC/504 loan program provides a less risky way for banks to extend real estate loans to small businesses by only requiring the bank to extend a portion of the loan rather than the entire loan.\textsuperscript{67} The other portion of the loan is extended by SBA-certified nonprofit organizations referred to as CDCs.\textsuperscript{68}

\textsuperscript{60.} Press Release, Statement by Sec’y Henry M. Paulson, Jr. on Actions to Protect the U.S. Economy, supra note 55.

\textsuperscript{61.} See \S 1112, 124 Stat. at 2508.

\textsuperscript{62.} Id. (providing that the maximum loan amounts provided in the Small Business Act of 1958 are increased); see 15 U.S.C. \S 696 (2012); Small Business Jobs Act of 2010, supra note 58.

\textsuperscript{63.} \S 1116, 124 Stat. at 2509 (providing that an applicant cannot have a tangible net worth exceeding $15,000,000 or have an “average net income after Federal income taxes... of the applicant for the 2 full fiscal years before the date of the application is not more than $5,000,000.”); Small Business Jobs Act of 2010, supra note 58.

\textsuperscript{64.} 124 Stat. at 2504; Small Business Jobs Act of 2010, supra note 58.


\textsuperscript{68.} Id.
IV. CDC/504 Loan Program: Eligibility, Use of Proceeds, and Terms

To increase banks’ confidence in lending to small businesses, the SBA offers loan programs that are attractive to both lenders and small business borrowers. The four types of loans available to qualified borrowers through the SBA are the 7(a) loan, the microloan, the 504 loan, and the disaster loan. Small businesses attempting to finance large assets, like real estate and equipment, are advised to apply for the 504 loan.

A. Overview of the SBA 504 Loan Program

The purpose of the CDC/504 loan program is “to foster economic development, create or preserve job opportunities, and stimulate growth, expansion, and modernization of small businesses.” The SBA facilitates a partnership between a CDC and a bank to provide favorable financing to qualified small businesses for major fixed assets and real property.

For a bank to extend a 504 loan to a small business borrower, the bank must first partner with a CDC. There are currently 270 CDCs in the United States, with each responsible for a specific geographic region. In addition to providing a portion of the 504 loan, CDCs also market the CDC/504 loan program, approve at least two 504 loans a year, and maintain a portfolio that reflects one job opportunity

69. See id. at 1; see also SBA Loan Programs, SBA.gov, http://www.sba.gov/loanprograms (last visited Jan. 6, 2014).

70. SBA Loan Programs, supra note 69.


72. 13 C.F.R. § 120.800 (2013).


74. Id.; “Certified Development Companies (CDCs) are nonprofit corporations certified and regulated by the SBA, that work with participating lenders to provide financing to small businesses.” SBA Certified Development Companies, SBA.gov, http://www.sba.gov/tools/local-assistance/cdc (last visited Jan. 7, 2014).

75. SBA Certified Development Companies, supra note 74.
for every $65 thousand of 504 loans.\textsuperscript{76}

Once a partnership is formed, both the CDC and bank may provide a loan to a small business that qualifies under the SBA’s eligibility requirements.\textsuperscript{77} The bank’s loan typically covers 50\% of the project cost and is secured with a first-lien position\textsuperscript{78} on the property purchased.\textsuperscript{79} The CDC’s loan covers 40\% of the project cost and is secured with a second-lien position.\textsuperscript{80} What differentiates the CDC’s loan from the bank’s loan, other than the 10\% loan amount difference and lien position, is that 100\% of the CDC’s loan is guaranteed by the SBA.\textsuperscript{81} Accordingly, the borrower may only be required to provide equity worth 10\% of the project cost.\textsuperscript{82}

There are instances, however, where the borrower may be required to provide a larger down payment.\textsuperscript{83} For instance, a small business is required to provide 15\% of the project cost as a down payment when it has only been in existence for two years or less\textsuperscript{84} or when the 504 loan is for a special purpose facility.\textsuperscript{85} If both of these conditions are met, the borrower is required to provide a down payment of 20\% of the project cost.\textsuperscript{86} Regardless of any changes in down payment amount, the bank is still required to provide at least 50\% of the project cost.\textsuperscript{87} The rationale behind requiring an increased down payment for businesses less than two years old is likely because there is

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{76} CDC/504 Loan Program, SBA.gov, http://www.sba.gov/content/cdc504-loan-program-0 (last visited Oct. 24, 2013).
\item \textsuperscript{77} OFF. OF THE COMPTROLLER OF THE CURRENCY, supra note 73, at 2.
\item \textsuperscript{78} A lien is defined as a “[a] legal right or interest that a creditor has in another’s property . . . until a debt or duty that it secures is satisfied.” BLACK’S LAW DICTIONARY 1006 (9th ed. 2009).
\item \textsuperscript{80} OFF. OF THE COMPTROLLER OF THE CURRENCY, supra note 73, at 1.
\item \textsuperscript{81} See id.; 13 C.F.R. § 120.920(b) (2013) (providing that the SBA cannot guarantee any part of the third party lender’s loan).
\item \textsuperscript{82} See OFF. OF THE COMPTROLLER OF THE CURRENCY, supra note 73.
\item \textsuperscript{83} See 15 U.S.C. § 696(3)(C)(iv).
\item \textsuperscript{84} Id. at § 696(3)(C)(i).
\item \textsuperscript{85} 15 U.S.C. § 696(3)(C)(ii) (2012); see Buying Your Building: An Upside in a Downturn, MERRILL LYNCH: WEALTH MANAGEMENT, http://www.totalmerrill.com/TotalMerrill/Pages/perspective.aspx?Title=buying-your-building-an-upside-in-a-downturn&referrer=Perspectives (last visited Sep. 30, 2013) (providing that a higher down payment is required when the loan is for the purchase of a special purpose facility like a gas station or bowling alley).
\item \textsuperscript{86} 15 U.S.C. § 696(3)(C)(iii).
\item \textsuperscript{87} Id. § 696(3)(B)(ii).
\end{itemize}
\end{footnotesize}
a higher probability that newer small businesses will fail, and consequently, the 504 loan is riskier for the bank and SBA. Likewise, special purpose facilities require a higher down payment because special purpose facilities are subpar collateral due to the difficulty in liquidating such assets in the event of default. Because the collateral has a limited resale value, the loan is riskier and requires a higher down payment to accommodate for the risk.

B. Eligibility

The SBA provides a detailed list of eligibility requirements for a business to be considered for a 504 loan. Some of the eligibility requirements are non-discretionary, whereas other requirements are at the discretion of the SBA.

1. Requirements for Small Businesses Borrowers

To be eligible for a 504 loan, a business must meet the following requirements: (1) function as a for-profit company; (2) conduct or plan to conduct business in the United States or its territories; (3) obtain an average net income of less than $5 million for the past two years and a net worth of less than $15 million; (4) project


89. See Buying Your Building: An Upside in a Downturn, supra note 85 (providing that special purpose facilities have “limited resale value” and require a higher down payment than other types of assets that are purchased using 504 loans).

90. See id.

91. CDC/504 Loan Program Eligibility, SBA.GOV, http://www.sba.gov/content/cdc504-loan-program-eligibility (last visited Jan. 6, 2014).

92. See id.

93. Id.; U.S. SMALL BUS. ADMIN. & OFFICE OF FIN. ASSISTANCE, SOP 50 105(E): LENDER AND DEVELOPMENT COMPANY LOAN PROGRAMS 272 (June 1, 2012), [hereinafter LENDER AND DEVELOPMENT COMPANY LOAN PROGRAMS], available at http://www.sba.gov/sites/default/files/SOP%2050%20105(E)%20(5-16-2012)%20clean.pdf (establishing that partnership agreements, tax returns, articles of organization, and articles of incorporation are some types of documents that are helpful in determining for-profit status).

94. CDC/504 Loan Program Eligibility, supra note 91.

operating cash flows that will enable the business to repay the loan amount; (5) conduct business that does not involve speculation or investing in income-producing real estate; (6) utilize alternative financial resources that are available; (7) have no capital available from other sources; and (8) demonstrate good character, a viable business plan, and relevant management expertise.

2. Special Considerations Applied by the SBA

In the event that a business does not satisfy the eligibility requirements, the SBA may still decide that the business is eligible if it meets certain special considerations. Businesses that are eligible for a 504 loan under special considerations include: (1) franchises where the franchisee has the right to profit and control operations; (2) recreational facilities and clubs that are open to the general public or do not restrict membership to particular groups; (3) farm and agricultural businesses if they have first explored the Farm Service Agency for a loan; (4) fishing vessels; (5) medical facilities; (6) an Eligible

96. CDC/504 Loan Program Eligibility, supra note 91; SBA Financial Assistance Eligibility, supra note 95.

97. CDC/504 Loan Program Eligibility, supra note 91; SBA Financial Assistance Eligibility, supra note 95.

98. CDC/504 Loan Program Eligibility, supra note 91; see 13 C.F.R. § 120.102(a) (2013) (providing that the applicant cannot have the desired funds available through “the personal resources of 20 percent or more equity of the applicant”); LENDER AND DEVELOPMENT COMPANY LOAN PROGRAMS, supra note 93 at 285 (establishing that any owner subject to utilizing personal resources is still subject to that rule even if the ownership interest falls below 20 percent when the percentage change occurred within six months of the loan application); CDC/504 Loan Program Eligibility, supra note 91 (“SBA does not extend financial assistance to businesses when the financial strength of the individual owners or the company itself is sufficient to provide all or part of the financing.”).

99. 13 C.F.R. § 120.101 (establishing that the CDC or bank must show that the borrower is not capable of securing financing “on reasonable terms and conditions from non-Federal sources without SBA assistance, taking into consideration the prevailing rates and terms in the community in or near where the applicant conducts business, for similar purposes and periods of time.”); CDC/504 Loan Program Eligibility, supra note 91; see SBA Financial Assistance Eligibility, supra note 95.

100. CDC/504 Loan Program Eligibility, supra note 91; SBA Financial Assistance Eligibility, supra note 95.

101. See 13 C.F.R. § 120.110 (providing a list of all the various types of businesses that are ineligible to receive SBA business loans).

102. See SBA Financial Assistance Eligibility, supra note 95.

103. See Farm Loan Programs, U.S. DEP’T OF AGRIC.: FARM SERV. AGENCY, http://www.fsa.usda.gov/FSA/webapp?area=home&subject=fmnp&topic=landing (last visited Jan. 7, 2014) (providing several different farm loan programs that are available for
Passive Company that does not engage in regular business activity but uses the loan for real estate that it leases to an operating company, businesses changing ownership to develop or preserve the existence of the business; and (8) businesses owned by legal aliens. Businesses that are not permitted to participate in the CDC/504 program “include those engaged in illegal activities, loan packaging, speculation, multi-sales distribution, gambling, investment or lending, or where the owner is on parole.”

C. Use of Proceeds

Proceeds from a 504 loan may be used to finance land or building purchases, improvements, construction or renovation of facilities, and long-term equipment. Improvements that can be financed with a 504 loan include street restoration, grading, landscaping, utilities, and parking lot repair or formation. A 504 loan cannot be used for investment or speculation in income-producing real estate, debt financing, working capital, and inventory consolidation. However, as aforementioned, the SBJA of 2010 did temporarily authorize a 504 refinance program that permitted small businesses to refinance property without requiring expansion. The 504 refinance program ended on September 27, 2012, and even though legislation has been proposed to extend the program, it has not been extended to date.

104. Note that fishing vessels “seeking funds for the construction or reconditioning of vessels with a cargo capacity of five tons or more must first request financing from the National Marine Fisheries Service.” SBA Financial Assistance Eligibility, supra note 95.

105. SBA Financial Assistance Eligibility, supra note 95 (“An Eligible Passive Company is a small entity that does not engage in regular and continuous business activity.”).

106. SBA Financial Assistance Eligibility, supra note 95; LENDER AND DEVELOPMENT COMPANY LOAN PROGRAMS, supra note 93, at 298 (providing that businesses with persons who are not citizens from the United States, but are lawfully in the United States, may be provided an SBA loan if those persons own at least 51% of the business).

107. SBA Financial Assistance Eligibility, supra note 95.

108. Use of CDC/504 Loan Proceeds, supra note 10.

109. Id.

110. Id.

111. 504 Loan Refinancing Program, supra note 65.

112. Legislation Introduced to Extend SBA 504 Debt Refinancing Program, FFCF.COM
D. Terms of 504 Loan

A small business that receives a 504 loan is required to pay fees and interest, secure the loan with collateral, and borrow an amount permitted by the SBA.113

1. Fees and Interest Associated with a 504 Loan

The SBA, CDC, and bank may each charge the borrower fees on the services provided.114 For guaranteeing the CDC’s portion of the loan, the SBA charges the borrower a fee of 0.5% of the debenture.115 The CDC is permitted to charge the borrower a processing fee, closing fee, servicing fee, late fee, and assumption fee.116 Finally, borrowers are typically charged a fee of 1 to 1.5% by the bank for the first-lien mortgage loan.117 According to the SBA website, fees are about 3% of the total loan and can be included in the financing.118

While the fees for a 504 loan are somewhat predictable,119 the interest rates associated with a 504 loan can vary depending on the benchmark used.120 The CDC portion of the loan carries a maturity of ten or twenty years and has a fixed interest rate that is set at “an increment above the current market rate for five-year and ten-year U.S.

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113. **CDC/504 Loan Amounts, Interest Rates & Fees**, supra note 93, at 350-51.
114. **See LENDER AND DEVELOPMENT COMPANY LOAN PROGRAMS**, supra note 93, at 350-51.
116. **See id.** § 120.971(a).
118. **Use of CDC/504 Loan Proceeds**, supra note 10; contra **SBA 504 Term Loan**, WELLS FARGO, https://www.wellsfargo.com/biz/loans_lines/sba/504_term_loan/ (last visited Jan. 7, 2014) (establishing that that the fees may be higher than anticipated by the SBA by providing that Wells Fargo’s fees on 504 loans are generally 3.5% of the SBA debenture amount).
119. **See LENDER AND DEVELOPMENT COMPANY LOAN PROGRAMS**, supra note 93, at 350-51.
Treasury issues."121 However, small businesses will not know the interest rate for the CDC’s portion of the loan at closing.122 Instead, the borrower will learn the interest rate after the SBA packages the debenture in a national pool with other CDC debentures and sells the pool to underwriters.123 The debenture pool is attractive to investors because it is guaranteed by the U.S. Treasury.124 A portion of the small business’s fee includes a loan loss subsidy fee which helps reduce costs to taxpayers when the U.S. Treasury is required to pay on losses incurred from 504 loans.125 Once the SBA sells the CDC debentures, the interest rate is fixed and will not fluctuate with the market.126 To not leave small businesses totally in the dark on what the interest rate for the CDC’s portion of the loan will be, CDCs provide borrowers with historical interest rates as a guide.127

The bank’s portion of the 504 loan must be at least a seven-year term on a ten-year CDC loan and at least a ten-year term on a twenty-year CDC loan.128 A bank may provide a variable or a fixed interest rate on its portion of the 504 loan.129 Like CDCs, banks typically use treasury rates and other common indexes as benchmarks to set interest rates on loans.130 A spread of 1.5 to 3.5% is typically pegged to the benchmark rate by the bank, depending on the borrower’s credit.131 Moreover, because the pools of SBA debentures, discussed above, are not sold for thirty to sixty days, banks provide interim financing during this time period.132 The interim loan provides an additional opportunity

121. CDC/504 Loan Amounts, Interest Rates & Fees, supra note 113; see OFF. OF THE COMPTROLLER OF THE CURRENCY, supra note 67, at 11.
123. Id. at 9 n. 22 (explaining that the national pool of CDC debentures is sold on a monthly basis and “investors purchase interests in debenture pools and receive certificates representing ownership of all or part of a debenture pool.”).
125. See id.
127. See id. at 9.
128. See id. at 13.
129. See SBA 504 Term Loan, supra note 118 (providing that the interest rate may be fixed or variable depending on the negotiations between the borrower and the bank); OFF. OF THE COMPTROLLER OF THE CURRENCY, supra note 67, at 13.
130. See CDC/504 Loan Amounts, Interest Rates & Fees, supra note 113.
131. Id.
for banks to earn fees and interest.\textsuperscript{133} Banks, however, do not have full discretion on the amount of interest to charge.\textsuperscript{134} To protect borrowers from unreasonable interest rates, the SBA requires banks to sign third-party lender agreements.\textsuperscript{135} The third-party lender agreements provide that the bank’s loan must have a reasonable interest rate that “does not and will not exceed the maximum interest rate for Third Party Loans from commercial financial institutions as published periodically by the SBA in the Federal Register and in effect as of the date of this Agreement.”\textsuperscript{136}

3. Collateral Required to Secure a 504 Loan

To mitigate risks, the project’s assets generally secure 504 loans\textsuperscript{137} and the CDC typically takes a second-lien position.\textsuperscript{138} The SBA also may require additional collateral in the event that protection of the government’s interests requires additional security.\textsuperscript{139} The SBA or bank may also require the principals of the small business to personally guarantee payment of the loan.\textsuperscript{140} By personally guaranteeing the loan, the principals give lenders permission to access their cars, homes, savings accounts, and other personal assets in the event of default.\textsuperscript{141}

\begin{itemize}
\item \textsuperscript{134} See CDC/504 Loan Amounts, Interest Rates & Fees, supra note 113.
\item \textsuperscript{135} See OFF. OF THE COMPTROLLER OF THE CURRENCY, supra note 67, at 9 (establishing that a bank enters into a third-party agreement with a CDC when it originates a 504 loan); Third Party Lender Agreement, SBA.GOV 2, http://www.sba.gov/sites/default/files/SBA%20Form%202287.pdf (last visited Jan. 7, 2014) (providing restrictions on the interest rate that a bank may charge a borrower).
\item \textsuperscript{136} Third Party Lender Agreement, supra note 135, at 3..
\item \textsuperscript{137} See 13 C.F.R. § 120.934 (2013) (providing that it would be rare for the SBA to allow other collateral to be substituted for the property for which the loan was issued).
\item \textsuperscript{139} 15 U.S.C. § 696(3)(E)(i).
\item \textsuperscript{140} See id.; CDC/504 Loan Amounts, Interest Rates & Fees, supra note 113; see also SBA 504 Term Loan, supra note 118 (establishing that Wells Fargo requires the borrower to provide 20% or more personal guarantee, business or personal collateral, and hazard insurance to secure the 504 loan).
\item \textsuperscript{141} James R. Coughlin, Advising Small Business Clients on Personal Guarantee Negotiations, ACCOUNTINGWEB (Feb. 8, 2013), http://www.accountingweb.com/article/advising-small-business-clients-personal-guarantee-
4. Maximum and Minimum Loan Amount Permitted

The maximum loan amount is determined by the SBA and is based upon how the funds will be utilized, whereas the minimum loan amount is fixed at $25 thousand. Job creation, public policy, and small manufacturing are the three categories that the SBA uses to determine the maximum loan amount for small business. Small businesses that have goals in place to utilize SBA funds for job creation can obtain a maximum loan of $5 million. Eligible small businesses, except for small manufactures, typically have to create one new job for every $65 thousand provided.

Small businesses that meet public policy goals may be eligible for between $5 million and $5.5 million. The SBA provides a list of the types of public policy goals that qualify under this category, including business district revitalization; export expansion; minority business expansion; rural development; productivity and competition growth; restructuring caused by federally mandated policies or standards; necessary changes caused by federal budget cuts; veteran-owned and-controlled business expansion; and woman-owned and-controlled business expansion.

Small manufacturers may obtain a maximum loan of $5.5 million. SBA defines a small manufacturer as a company with its "primary business classified in sector 31, 32, or 33 of the North American Industrial Classification System (NAICS) and all of its production facilities located in the [U.S.]" Additionally, a small manufacturer must either create or retain one job for every $100 thousand guaranteed by the SBA or satisfy public policy goals or

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142. CDC/504 Loan Amounts, Interest Rates & Fees, supra note 113.
143. 13 C.F.R. § 120.930(b).
144. CDC/504 Loan Amounts, Interest Rates & Fees, supra note 113.
146. CDC/504 Loan Amounts, Interest Rates & Fees, supra note 113.
148. CDC/504 Loan Amounts, Interest Rates & Fees, supra note 113.
149. Id.
improve the local economy.\footnote{152}{CDC/504 Loan Amounts, Interest Rates & Fees, supra note 113.}

V. MANY BANKS REMAIN UNMOTIVATED TO PROVIDE REAL ESTATE FINANCING FOR SMALL BUSINESSES

Even though the U.S. economy’s viability depends on the success of small businesses, banks often shy away from extending credit to small businesses.\footnote{153}{See Robb Mandelbaum, The S.B.A. Wants to Encourage More Small Loans, N.Y. TIMES (Apr. 18, 2013, 7:00 AM), http://boss.blogs.nytimes.com/2013/04/18/the-s-b-a-wants-to-encourage-more-small-loans/?_r=0.}

Bank participation in the CDC/504 loan program is very uneven.\footnote{154}{OFF. OF THE COMPTROLLER OF THE CURRENCY, supra note 67, at 14.} Small businesses and banks in some states are not even aware that 504 loans exist.\footnote{155}{Id. at 10.} In 2010, SBA statistics indicated that 7,840 small businesses received 504 loans from approximately 3,500 banks.\footnote{156}{Id. (stating that 99% of bank lenders made fewer than ten loans).} However, two-thirds of the 3,500 participating banks only extended one 504 loan each.\footnote{157}{Id.} Most of the 504 loans were concentrated in seven states—Florida, Texas, Illinois, New York, Georgia, Wisconsin, and California.\footnote{158}{Id.} Remarkably, California originated 23% of the 504 loans extended in 2010.\footnote{159}{Id. at 10.} California’s high participation rate is likely due to the increased publicity of 504 loans because of a highly competitive CDC industry in California.\footnote{160}{OFF. OF THE COMPTROLLER OF THE CURRENCY, supra note 67, at 11.} While lack of exposure to the CDC/504 loan program is likely one reason for uneven participation across the country,\footnote{161}{See id. at 8.} other contributing factors include the small business failure rate, fees associated with 504 loans, and the perception that 504 loans require too much paper work.\footnote{162}{See Scott Shane, Why Small Businesses Have Trouble Getting Credit, SMALL BUS. TRENDS (May 27, 2013), http://smallbiztrends.com/2013/05/why-small-businesses-have-trouble-getting-credit.html; Mandelbaum, supra note 153.}

Since 2000, approximately $1.3 billion of loans extended through SBA loan programs have resulted in default.\footnote{163}{Lynn Hulsey & Ken McCall, Taxpayers Paid $1.3B for Loan Defaults, COLUMBUS DISPATCH (Apr. 14, 2013),}
and 2012, the average recovery rate for SBA loans discharged to the U.S. Treasury was 64%.\textsuperscript{164} Some of these losses occurred because lending institutions relied on inflated real estate values,\textsuperscript{165} which resulted in high levels of default because the underlying 504 loans were in excess of the asset being financed.\textsuperscript{166} While some of the losses were the result of inflated real estate values, other losses stemmed from lax lending standards and general disregard for SBA requirements.\textsuperscript{167} Larger businesses, on the other hand, have a lower failure rate than small businesses.\textsuperscript{168} Consequently, larger businesses often are more successful with securing loans.\textsuperscript{169} The SBA is mindful of the likelihood of default and has implemented a plan on how to proceed when a 504 loan is in default.\textsuperscript{170} This plan is provided to banks in their third-party lender agreement with the CDC.\textsuperscript{171}

In addition to wariness about the increased risk of default on small businesses loans, banks are also unmotivated to extend loans to small businesses because smaller loans are just as costly to originate as larger loans.\textsuperscript{172} Analysis on a borrower’s business metrics and ability to repay on a $25 thousand loan costs the same as analysis on a $100 million loan.\textsuperscript{173} Accordingly, banks would rather put resources towards loans that carry less risk than roll the dice on a high-risk borrower.\textsuperscript{174}

\begin{itemize}
  \item \textsuperscript{164} Id.
  \item \textsuperscript{165} Id.
  \item \textsuperscript{166} See Department of Stat. and Operations Res., \textit{supra} note 22, at 2 (establishing that during the 2008 financial crisis borrowers chose to default on their home mortgage rather than repay a mortgage that exceeded the home’s value).
  \item \textsuperscript{167} See Hulsey & McCall, \textit{supra} note 163.
  \item \textsuperscript{168} Board of Governors of the Fed. Res. Sys., \textit{Availability of Credit to Small Businesses} I (Sept. 2012), available at \url{http://www.federalreserve.gov/publications/other-reports/availability-of-credit/September-2012-Executive-Summary.htm}.
  \item \textsuperscript{169} Shane, \textit{supra} note 162.
  \item \textsuperscript{170} See Off. of the Comptroller of the Currency, \textit{supra} note 67, at 9 (providing that a 504 lender is required to notify the CDC and SBA when a borrower is thirty days late on payment, banks must work on debt restructuring with the borrower, and guidance has been provided on prudent commercial real estate loan workouts).
  \item \textsuperscript{171} Id.; \textit{Third Party Lender Agreement, supra} note 135.
  \item \textsuperscript{172} Shane, \textit{supra} note 162; see Mandelbaum, \textit{supra} note 153.
  \item \textsuperscript{173} Mandelbaum, \textit{supra} note 153.
  \item \textsuperscript{174} See id.
\end{itemize}
VI. 504 LOANS ARE A VIABLE OPTION FOR BANKS, SMALL BUSINESSES, AND THE UNITED STATES ECONOMY

Even with banks’ understandable uneasiness with extending credit to small businesses, 504 loans are a viable option for small businesses, and the U.S economy. There are significant risks and benefits for participants in the CDC/504 loan program, and why 504 loans should be utilized going forward.

A. Small Businesses

Qualified small businesses with real estate needs should bypass conventional loans and take advantage of 504 loans. Although 504 loans provide more favorable terms for small business borrowers, conventional loans are still most commonly utilized by small businesses. Two substantial factors that likely contribute to the utilization of conventional loans rather than 504 loans are the requirement that 504 loans cannot be used for income-producing real estate investments and the low level of awareness about the availability of 504 loans. Small businesses that are not in business to secure income-producing real estate investments are recommended to utilize 504 loans for real estate acquisitions because they allow for lower down payments and longer maturities than conventional loans.

A small business that utilizes a 504 loan is able to pay a small down payment, which in some cases can be as low as 10% of the project cost. Conventional financing, on the other hand, typically requires

175. See Shane, supra note 162.
182. See Lender Benefits, supra note 177.
183. HURN, supra note 176; The Benefits of SBA 504 Loans, supra note 179, at 4; OFF.
the borrower to pay a down payment of 30 to 40% of the project cost. The only instance where a 504 loan’s down payment gets even close to that of a conventional loan’s is when a 504 loan is extended for a special purpose facility or to a business that has operated less than two years. However, even under these circumstances, the 504 loan still only requires a 15 or 20% down payment. Accordingly, a borrower who takes advantage of a 504 loan will retain more cash for working capital.

Another advantage provided by 504 financing is that small businesses can secure a loan for ten or twenty years with the peace of mind that at least the CDC’s portion of the loan carries a fixed interest rate. While the CDC’s portion of the loan is the only portion of the loan that is guaranteed to carry a fixed interest rate, a bank may also elect to offer a fixed-rate on its portion of the loan. If small businesses are provided a fixed-rate mortgage from both the CDC and bank, small businesses can better develop long-term plans for growth without fear of interest rate fluctuations that could adversely affect loan payments. Moreover, since 504 loans offer banks first-lien loans, valued at 50% of the project cost, banks are more comfortable lending longer-term, which lowers the borrower’s monthly payments. As a result, access to longer term loans, like low down payments, enables small businesses to retain more cash per month to allocate towards working capital.

Conventional financing, on the other hand, is much more difficult for small businesses to secure at favorable terms because a portion of a conventional loan is not guaranteed by the SBA. With more risk exposure, banks prefer to lend to companies that have

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184. The Benefits of SBA 504 Loans, supra note 179, at 6.
186. Id.
187. HURN, supra note 176; The Benefits of SBA 504 Loans, supra note 179, at 6.
188. The Benefits of SBA 504 Loans, supra note 179, at 7.
190. See The Benefits of SBA 504 Loans, supra note 179, at 7.
191. See id.
193. See Conventional Loans, supra note 180.
valuable collateral and ability to pay-off the loan. The borrowers must have high FICO scores, a good business plan, and a reasonable debt to worth ratio to secure conventional financing. The attributes that a bank requires for conventional loans, are typically not found in small business borrowers.

Furthermore, conventional loans “typically finance a percentage of either the appraised value or the purchase price of the property, whichever is less.” On the other hand, 504 loans enable small businesses to finance closing costs, land and existing structures, construction of new facilities, renovations, utilities, grading, landscaping, equipment, and soft costs. Instead of having to pay these costs out of pocket, small businesses can roll these costs into the 504 loan.

Finally, small businesses should not be deterred by commonly held myths that SBA loans take forever to close, charge much higher fees than conventional loans, and include copious amounts of paperwork. In fact, most 504 loans are closed within thirty to sixty days involve similar application and approval processes as conventional loans, and only require fees totaling approximately

194. Id.
195. Id.
196. See id.
198. Stephen Umberger, U.S. Small Business Administration Loan Funds Available to Purchase Commercial Real Estate, SBA.GOV, http://www.sba.gov/content/u-s-small-business-administration-loan-funds-available-purchase-commercial-real-estate (last visited Jan. 7, 2014) (establishing that “architectural and legal fees, environmental studies, appraisals, and interest and fees on the construction and/or interim bank financing” are examples of soft costs).
199. BEST KEPT SECRET, supra note 197.
201. BEST KEPT SECRET, supra note 197.
202. Eckblad, supra note 200; BEST KEPT SECRET, supra note 197, at 25.
203. BEST KEPT SECRET, supra note 197, at 25; Eckblad, supra note 200 (providing that it typically take approximately six weeks to close on an SBA loan when the borrower is prepared).
204. BEST KEPT SECRET, supra note 197, at 25.
0.25% or 0.5% more than fees on a conventional loan. Accordingly, eligible small businesses should bypass conventional loans and pursue 504 loans for real estate acquisitions.

B. Banks

Banks, like small businesses, can also benefit through participating in the CDC/504 loan program. Banks utilizing 504 loans can mitigate credit risk, enlarge their customer base, strengthen core earnings, and obtain Community Reinvestment Act (CRA) credit in some cases. There are certainly risks associated with 504 loans, but banks face credit risks with all loans that they originate. Concerns that banks typically have with 504 loans are: (1) the loan is often secured by property that is difficult to liquidate; and, (2) the bank generally has to finance 90% of the project cost until the CDC portion of the loan arrives.

Much of the concern regarding the liquidity of the collateral securing 504 loans is because 504 loans are often secured by special purpose facilities like gas stations or bowling alleys. Liquidity of collateral securing 504 loans for special purpose facilities, however, should not deter banks from extending 504 loans because a bank’s

205. Id. (providing that the slightly higher fees should not deter small business borrowers because 504 loans allow for “longer-term, below-market, fixed-rate financing and the highest cash-on-cash return from their commercial property.”).

206. See Lender Benefits, supra note 177.

207. The Community Investment Act (“CRA”) was enacted by Congress in 1977 to encourage depository institutions to provide financing to their communities. Community Reinvestment Act (CRA), Bd. of Governors of the Fed. Res. Sys., http://www.federalreserve.gov/communitydev/cra_about.htm (last updated Aug. 12, 2013). A bank’s Federal regulator is required to “assess the institution’s record of meeting the credit needs of its entire community, including low- and moderate-income neighborhoods, consistent with the safe and sound operation of such institution.” 12 U.S.C. § 2903(a)(1). A CRA rating is determined by the bank’s regulator “based on an evaluation of its lending, investments, and services.” Broome & Markham, supra note 17; “CRA ratings range from Outstanding, Satisfactory (High and Low), Needs to Improve, to Substantial Noncompliance.” Id. Banks are encouraged to obtain a favorable CRA rating because it plays a key role in determining whether a bank can open a new branch or merge with another bank. Id.

208. Lender Benefits, supra note 177.


210. See id.

211. See id.

212. See id.
collateral risks are mitigated by having to finance only 50% of the project cost.\textsuperscript{213} Furthermore, a bank’s risk is reduced by borrowers providing a 15% down payment instead of the typical 10% down payment when the project asset is a special purpose facility.\textsuperscript{214}

Other limitations on a 504 loan’s collateral that may concern banks are the SBA’s default procedures.\textsuperscript{215} The SBA’s one year redemption period after a foreclosure sale is one default procedure that restricts the alienability of collateral because it is a cloud on title that limits the marketability of the property.\textsuperscript{216} Another default procedure that restricts a bank’s liquidation efforts are requirements to provide a thirty day written notice of default and sixty day written notice of foreclosure to the SBA and CDC.\textsuperscript{217} The SBA default procedures regarding collateral are not ideal for a bank,\textsuperscript{218} but the benefits from having first-lien position on a loan valued at 50% of the project cost outweigh the trouble caused by the less than ideal default procedures.\textsuperscript{219}

Likewise, a bank should not be apprehensive when asked to provide 90% of the project cost for thirty to sixty days until the CDC portion of the loan arrives.\textsuperscript{220} The interim loan does not present a substantial risk to a bank because the SBA guaranteed debenture provides certainty that the CDC will deliver the necessary funds.\textsuperscript{221} If anything, the interim loan benefits banks.\textsuperscript{222} By incurring additional risks through providing funds during the interim period, banks are able to strengthen their core earnings through additional fee and interest payments.\textsuperscript{223} Banks, therefore, should not be overly concerned with providing an interim loan to small business borrowers because earnings

\begin{itemize}
  \item \textsuperscript{213} See OFF. OF THE COMPTROLLER OF THE CURRENCY, supra note 73, at 2.
  \item \textsuperscript{214} See 15 U.S.C. § 696(3)(C)(iii) (2012); see also Buying Your Building: An Upside in a Downturn, supra note 85.
  \item \textsuperscript{216} Id.
  \item \textsuperscript{217} Id.
  \item \textsuperscript{218} See id.
  \item \textsuperscript{219} See The Benefits of SBA 504 Loans, supra note 179, at 7.
  \item \textsuperscript{220} OFF. OF THE COMPTROLLER OF THE CURRENCY, supra note 67, at 10.
  \item \textsuperscript{221} Id.
  \item \textsuperscript{222} Lender Benefits, supra note 177 (establishing that the interest and fees that are earned on an interim loan benefit the lender because the lender’s core earnings are strengthened).
  \item \textsuperscript{223} SBA 504 – Small Business Expansion Loans, supra note 133.
\end{itemize}
can be increased while only acquiring a small amount of risk.\textsuperscript{224} In addition to various safeguards provided by the SBA,\textsuperscript{225} banks’ concerns are also mitigated through their capability to strengthen earnings or reduce exposure to risks through the secondary market.\textsuperscript{226} By purchasing 504 loans from the originating bank, a bank can “generate income from the retained servicing activities of the portfolio.”\textsuperscript{227} Moreover, in lieu of buying 504 loans on the secondary market, a bank may elect to sell a 504 loan in the secondary market.\textsuperscript{228} By selling 504 loans in the secondary market, a bank can lower its risk exposure to zero and increase its non-interest income by earning income on the fees for originating the 504 loan.\textsuperscript{229}

While increased earnings from interim financing and the secondary market provide attractive benefits to banks,\textsuperscript{230} expansion of a bank’s customer base is an even more enduring benefit that 504 loans provide.\textsuperscript{231} Banks that extend 504 loans are able to lend to businesses that they otherwise would not lend to under conventional loan standards.\textsuperscript{232} As a result, banks diversify their customer base and strengthen earnings through cross-selling opportunities.\textsuperscript{233} Potential cross-selling opportunities might include construction loans and other financial products and services that the borrower may need if the small business grows.\textsuperscript{234} Thus, 504 loans enable a bank to learn more about a small business with minimal risk to determine if the small business borrower can be a worthwhile customer in the future.\textsuperscript{235}

While banks are helping both small businesses and the economy by extending 504 loans,\textsuperscript{236} banks also receive significant benefits by

\begin{itemize}
  \item \textsuperscript{224} See Off. of the Comptroller of the Currency, supra note 67, at 10.
  \item \textsuperscript{225} See 15 U.S.C. § 696(3)(C)(iii) (2012); see also Off. of the Comptroller of the Currency, supra note 67, at 10; see Lender Benefits, supra note 177.
  \item \textsuperscript{226} SBA 504 - Small Business Expansion Loans, supra note 133.
  \item \textsuperscript{227} Off. of the Comptroller of the Currency, supra note 67, at 7.
  \item \textsuperscript{228} See Lender Benefits, supra note 177.
  \item \textsuperscript{229} Id.
  \item \textsuperscript{230} Id.
  \item \textsuperscript{231} See Off. of the Comptroller of the Currency, supra note 73, at 2.
  \item \textsuperscript{232} Conventional Loans, supra note 180 (providing that banks are more careful when issuing conventional loans because there is no guarantee by the government).
  \item \textsuperscript{233} Off. of the Comptroller of the Currency, supra note 67, at 6.
  \item \textsuperscript{234} Id. at 7.
  \item \textsuperscript{235} See Off. of the Comptroller of the Currency, supra note 73, at 2.
  \item \textsuperscript{236} See Rep. Sam Graves, Small Business Helps Push The Economy Forward, THE HILL (02/29/12 02:09 AM ET), http://thehill.com/special-reports/jobs-february-2012/213185-small-business-helps-push-the-economy-forward (explaining how important
\end{itemize}
extending 504 loans.\textsuperscript{237}

C. \textit{The United States Economy}

According to the White House, “small businesses are the engine of job growth in our economy.”\textsuperscript{238} With small businesses accounting for half of the United States’ private-sector employment,\textsuperscript{239} the White House’s statement is not without merit. As reported in July 2013, small business borrowing increased to a six-year high.\textsuperscript{240} Increased small business borrowing is a positive sign for the U.S. economy, and greater participation in the CDC/504 loan program can ensure that more small businesses can obtain the necessary capital.\textsuperscript{241} The increased borrowing indicates that small businesses are acquiring real estate, and consequently, planning to hire more employees as their businesses grow.\textsuperscript{242}

For small businesses to hire additional employees, they need financing to facilitate necessary real estate acquisitions to accommodate the increased number of employees.\textsuperscript{243} For instance, Collision Authority, a small business in Las Vegas, opened its sixth location and hired eighteen additional employees after receiving $3.6 million in SBA 504 financing.\textsuperscript{244} Because Collision Authority was only required to contribute 10\% of the project cost, the business retained more cash to put towards other potential locations.\textsuperscript{245} The increased likelihood of additional locations, made possible by 504 loans, will likely result in further hiring by the business.\textsuperscript{246}

Collision Authority’s success with 504 loans is just one example, but demonstrates how real estate acquisitions can create jobs

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\textsuperscript{237} See Lender Benefits, supra note 177.


\textsuperscript{239} COLE, supra note 43, at 3.

\textsuperscript{240} Saphir, supra note 5.

\textsuperscript{241} See id.

\textsuperscript{242} See id.

\textsuperscript{243} See id.

\textsuperscript{244} Smith, supra note 178.

\textsuperscript{245} Id.

\textsuperscript{246} See id.
and facilitate small business success. In 2012, two million jobs were created as a result of $50 billion worth of SBA 504 loans. Accordingly, to assist with lowering the unemployment rate, efforts must be implemented to continue helping those that are best at creating jobs—small businesses.

In addition to creating jobs, small businesses can assist larger businesses by providing services that larger businesses are better off outsourcing. Without small businesses, larger businesses have to allocate capital towards projects that are not part of their primary business. Furthermore, if small businesses are not provided with some assistance, the United States could miss out on companies that could revolutionize certain industries. Many large companies, such as Ben & Jerry's, started out as small businesses and grew into large successful companies.

Appreciating the importance of small business real estate acquisitions, the 2013 budget allocates $6 billion towards covering losses incurred through the CDC/504 loan program. While taxpayer support ensures the continuance of the CDC/504 program for the current year, many individuals in the 504 loan industry submit that efforts need to be implemented to return the program to its historical zero-subsidy form. One suggested solution to return the CDC/504 loan program to zero-subsidy is to empower CDC's to recover on 504 loans rather than discharging the defaulted loan to the Treasury. The third-party collector that the Treasury relies on to recover the loan is not nearly as familiar with the borrower, the local real estate market, and SBA policies like the CDC. CDCs can be incentivized to actively pursue recovery efforts by the potential servicing fees on 504 loans that are put back on track. The recommendation further states that CDCs

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247. See id.
248. See id.
249. Graves, supra note 236.
250. Brown, supra note 41.
251. Id.
252. See id.
253. Id.
254. Supporting Small Businesses and Creating Jobs, supra note 238.
255. BUDGET REQUEST, supra note 66, at 2.
256. Id. at 3.
257. Id. at 2–3.
258. Id. at 3.
should only be reimbursed for their services if they are successful in collecting on delinquent loans, which would result in no cost to taxpayers. Accordingly, while the CDC/504 loan program is still beneficial to the U.S. economy in its current form of relying on government subsidies when losses cannot be recovered, the CDC/504 loan program can have an even greater impact on the U.S. economy if CDCs are empowered and incentivized to recover on 504 loans.

While gradually returning the CDC/504 loan program to its zero-subsidy form may initially reduce the size of the program, it will ensure longevity and provide future small businesses the opportunity to benefit from 504 loans.

Another suggestion to help return the CDC/504 loan program to its zero-subsidy form is to reinstate the 504 loan refinance program that the SBJA of 2010 temporarily allowed until September 27, 2012. The fees, which are higher on refinanced loans, would help offset future losses.

Regardless of who has the onus of collecting on defaulted 504 loans or whether refinancing is permitted under the program, there is no question that the U.S. economy benefits from the existence of 504 loans in their current state because they assist with decreasing the unemployment rate and increasing the odds of more success stories like Ben & Jerry’s.

VII. CONCLUSION

The SBA loan program has its fair share of skeptics because of

259. Id. at 4.
260. See id. at 2-5.
261. See Kent Hoover, Mercantile Capital CEO says SBA Should Outsource Debt Recovery, THE BUS. J. (March 30, 2012), http://www.bizjournals.com/bizjournals/washingtonbureau/2012/03/30/mercantile-capital-ceo-says-sba-should.html?page=all (providing Mercantile Capital's CEO's recommendation to empower CDCs to recover on 504 loans and that it is better for the CDC/504 loan program to reduce its size than to rely on taxpayer subsidies).
262. Frequently Asked Questions SBA 504 Loan Program, PIKES PEAK REGIONAL DEV. CORP., http://www.pprdc.com/sba-504-qas/ (last visited Oct. 24, 2013) (providing that if the CDC/504 loan program will have increased longevity by not being the victim of budgetary concerns).
263. BUDGET REQUEST, supra note 66, at 5–6.
264. Id. at 6.
265. See Smith supra note 178.
266. Brown, supra note 41.
the high risk of default that many of the loans carry, but the fact that a high percentage of the U.S. economy depends on small businesses cannot be overlooked. Banks, with assistance from CDCs and the SBA, must make capital available to small businesses for employment rates to rise and the economy to get back on track. While subprime mortgage loans and other high risk loans contributed substantially to the 2008 financial crisis, banks must not give up on all high-risk borrowers. Small businesses, specifically, are the class of high-risk borrowers that banks should take a chance on because SBA loans like the 504 loan substantially mitigate a bank’s risks. Moreover, 504 loans provide banks with ways to increase earnings and increase their customer base. If all CDCs can successfully implement their role of marketing the CDC/504 loan program, bank and small business participation across the nation will hopefully mirror California’s participation rate. Accordingly, this Note recommends that instead of requiring CDCs to only provide two 504 loans a year, CDCs should be required to provide a much higher number of 504 loans a year to incentivize adequate marketability of the program. In turn, the unemployment rate in the U.S. will likely decrease due to more small businesses being able to acquire the necessary real estate to grow. Without access to financing, small businesses will likely not be capable of increasing employment due to not having space or equipment available for additional employees.


268. See Small Business Trends, supra note 47 (providing statistics on how large of a cumulative impact that small businesses have on the U.S. economy).

269. See COLE, supra note 43, at 3 (establishing that increased lending to small businesses “will translate into more jobs and faster economic growth.”).

270. DEPARTMENT OF STAT. AND OPERATIONS RES., supra note 22, at 1.


272. SBA 504 – Small Business Expansion Loans, supra note 133.


274. CDC/504 Loan Program, supra note 76.


276. See CDC/504 Loan Program, supra note 76 (establishing that CDCs are only required to provide two 504 loans a year).

277. See Saphir, supra note 5.

278. See id.; see also Smith, supra note 178.
It is not a repetition of past mistakes to provide real estate financing to small businesses when banks utilize the CDC/504 loan program because 504 loans effectively mitigate the risks incurred by participating banks.\textsuperscript{279} Moreover, because the viability of the U.S. economy depends on the success of small businesses, the U.S. Government should continue supporting small businesses through the CDC/504 loan program.\textsuperscript{280}

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\textsuperscript{279} See generally \textsc{Off. of the Comptroller of the Currency}, \textit{supra} note 67 (establishing the various ways that banks' risks are mitigated through participating in the CDC/504 loan program).

\textsuperscript{280} See generally \textit{id.} (providing information on the benefits that the CDC/504 loan program has on the U.S. economy).