

INTERIM LENDER'S GUIDE TO CLOSING THE 504 LOAN

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Following are steps that an interim lender can take to facilitate a smooth transition into the SBA 504 permanent loans.

1. **Structure of Interim Loan.** We recommend that you structure the interim loan with two notes and a separate set of security documents securing each note. In addition, if construction is involved, separate mortgagee title policies should be obtained for each loan.

- **Loan One** - the first note and security documents will evidence and secure the bank's permanent loan.
 1. **Amount of note** - the amount of the note should be the amount stated in the Authorization as the "Third-Party Lender Loan."
 2. **Payment terms** - the payment terms should be the same as set forth in the Authorization. However, please be aware of the following:
 - i. SBA rules prohibit early call features or demand language unless the loan is in default.
 - ii. Balloon payments require prior SBA approval, and the term of the balloon payment provision must be at least 10 years.
 - iii. The term of your loan must be at least seven years when the SBA loan is for ten years, and ten years when the SBA loan is for twenty years.

We often see a combination "draw note" and "term note" that calls for payments of interest only during the construction period, and converts into a term note with the above terms upon the occurrence of a named event (e.g. the passage of time, or the completion of construction).

3. Interest rate - the interest rate charged should be the amount stated in the bank's commitment letter.
4. Forms - the standard forms used by the bank in its non-SBA loans can be used to evidence its permanent loan under the 504 loan program.
5. Priority of liens securing the note - the liens securing the note should be in the priority set forth in the Authorization for the bank's Third-Party Lender Loan.

➤ **Loan Two** - the second note and security documents will evidence the loan that will be refinanced by the SBA loan.

1. Amount of note - the amount of the note should be the amount stated in the Authorization as "the CDC Share of Project Costs."
2. Payment terms - the note may not call for payments of principal, but may call for interest payments.
3. Interest rate - the interest rate charged should be the amount agreed to in the bank's commitment letter
4. Forms - the standard forms used by the bank in its non-SBA loans can be used to evidence this loan.
5. Priority of liens securing the note - the liens securing the note should be in the priority set forth in the Authorization for the SBA's permanent loan.

2. Read the Authorization for Debenture Guaranty to make sure it correctly reflects your understanding of the deal when the project was put together. Among other things, the Authorization states what the priorities of the liens must be on the various pieces of real and personal property collateral before the SBA will authorize the funding of the SBA loan.

Is the bank willing to be subordinate to the SBA in certain collateral if the Authorization requires it? If not, it will be necessary to amend the Authorization before the permanent loan can close.

3. First Mortgage Fee. In all 504 loans approved by the SBA since October 1, 1996, there is a requirement for the permanent lender to pay the SBA a one time fee equal to one-half of 1 percent (½ of 1%) of the bank's permanent loan amount. The fee is due at the time of the permanent loan closing.

4. Survey. A survey showing all improvements will be required. If construction is involved, a survey prepared after the completion of the improvements will be necessary to identify all improvements constructed as a part of the project.
5. Appraisals. An appraisal of the collateral is usually required. If the Bank obtains an Appraisal subject to the completion of the improvements, a "Satisfactory Completion Certificate" must be signed by the appraiser that states that the conditions set forth in the appraisal have been satisfied.
6. Flood Insurance. If the collateral for the loan is located in a special flood hazard area, make sure the Borrower purchases flood insurance.
7. Make sure the borrower starts working on any life insurance requirements early on in the process so that these conditions can be satisfied by the time the project is complete.
8. Environmental Inspections/Phase I Environmental Audits. On-site environmental inspections must be performed on all "primary" real property collateral to determine if there is a potential for environmental contamination.

In addition to the on-site inspections, Phase I Environmental Audits are required under the following circumstances:

- The on-site inspections do not satisfy the SBA as to the absence of the potential for environmental contamination;
 - The borrower or a prior occupant of the property is a member of a frequently polluting business sector;
 - The property is located in an area known to have a pollution problem.
9. Line up someone to sign the Earthquake Certification. If the project involves the construction of a new building or an addition to an existing building, and even though Texas is in a no-earthquake zone, we must obtain certifications that the construction meets or exceeds earthquake standards set by congress.

We normally do this by getting a licensed building architect, construction engineer, or similar professional to state that the improvements: were built in accordance with one or more of the following building codes that set forth these standards:

- 1991 Uniform Building Code of the International Congress of Building Officials (ICBO);
- 1992 A supplement to the Building Officials and Code Administrators (BOCA) National Building Code

- 1992 Amendments to the Southern Building Code Congress (SBCC) Standard Building Code.

The other option is to ask a state, county, or local governmental official to state either of the following:

- The improvements are built in an area in which a Certificate of Occupancy is required. In order to receive a Certificate of Occupancy, the improvements must demonstrate conformity with building codes that contain Seismic Standards that are substantially equivalent to the NEHRP Provisions;
- the improvements are built in an area in which there are no applicable codes and standards. However, seismic regulations are inapplicable because the area does not experience earthquakes.

10. Make copies of all draw requests and other evidence of the project costs to deliver to the CDC after the project is complete. For a number of reasons, the SBA requires the CDC to verify the amount and eligibility of project costs. We do this by reviewing the draw requests and other invoices and checks provided by you and your borrower. Most interim lenders prefer to do make these copies as the project progresses rather than waiting until all the work is done.
11. Borrower as Contractor. As a general rule, the Borrower should not act as contractor in a 504 project without the SBA's prior approval. The SBA may permit it if the project is small compared to the financial resources of the Borrower, or the Borrower is a qualified contractor.
12. Third Party Leasehold Improvements. If any tenants (other than the "Operating Company") will occupy space in the building occupied by our borrower, make sure that none of your loan proceeds are used to finance improvements to the space occupied by the third party tenants.
13. Tenant Subordinations. Please advise your borrowers that if their property is subject to leases, it will be necessary for the tenant's in those leases to subordinate their leasehold estates to the loan documents.

14. Restrictive Covenants. Make sure you review the restrictive covenants affecting the property prior to the interim loan closing. Also, please forward a copy of the restrictions to the CDC for their prior approval.

Pay particular attention to the limitations that are placed on the types of businesses that may be conducted on the property. If the types of businesses are restricted too greatly, the SBA may decide that the property is either:

- a 'limited or single-purpose property' - which may require a larger injection

by the borrower; or

- not adequate collateral for the loan - which may prompt the SBA to refuse to fund the permanent loan unless the restriction is removed.

15. **Assessment Liens.** If the property is subject to assessment liens payable to a property owners association, please make sure that (1) the liens will be subordinate to the SBA's second lien, or (2) the property owner's association will be willing to subordinate them to the SBA's lien.

16. **Mineral Interests.** If the property is subject to outstanding mineral interests, please satisfy yourself that there is no danger of damage to the property from drilling or mining activities.

17. **Interim Lender's Representations.** At the time of the permanent loan dosing, a representative of the interim lender will be asked to make the following representations:

- Interim Lender has no knowledge of any unremedied substantial adverse change in the financial condition of Borrower or Operating Company since the date of Borrower's loan application to Interim Lender;
- The Interim Loan was disbursed in reasonable compliance with the Authorization;
- The Project is complete. Without limiting the generality of the foregoing: (1) if any buildings, structures, or other improvements were constructed as a part of the Project, all the construction has been completed, all the bills have been paid, and all of the improvements have been built in accordance with the plans and specifications which formed the basis for the appraisal used in the application; and (2) if any equipment was purchased as a part of the Project, all of the equipment has been ordered, paid for, delivered, assembled, tested, and accepted by the Borrower;
- All proceeds of the Interim Note either paid Project Costs, or refinanced monies used to pay Project Costs. None of the proceeds of the Interim Note either paid the costs of renovating space occupied by anyone other than the Borrower or Operating Company, or refinanced monies used to pay the costs of renovating space occupied by anyone other than the Borrower or Operating Company.