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The Middle Market Meets the SBA

SBA Size Standard Update and Changes to 504 Loan Program Expand Reach to Middle Market Companies.

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Effective March 18, 2024, the Small Business Association (SBA) implemented a new final rule that revised the alternative size standards for businesses eligible under the 7(a) and 504 loan programs.

The new final rule expands the pool of eligible businesses by increasing the standards previously in effect by 25%. A business is now eligible if it has a tangible net worth that does not exceed $20 million (previously $15 million) and its average net income after taxes does not exceed $6.5 million (previously $5 million), each as determined in accordance with SBA regulations. Even if a business exceeds these size standards, they may still qualify under specific industry size standards and should consult an attorney to determine eligibility.

This revision follows recent updates to the affiliation standards, which were effective August 1, 2023, moving the evaluation solely to ownership and no longer on "control" for purposes of determining whether affiliates were to be considered as a single borrower under the size standard.

These revisions have significantly expanded the pool of applicants who may be eligible for SBA financing into the traditional middle market. This is especially true for businesses who now fit within the new size standard that are considering purchasing commercial real estate or long-term equipment. Under the SBA 504 loan program, which isn't as well known as the 7(a) loan program, these borrowers could see significant benefits.

The SBA 504 loan program is a public-private partnership that leverages traditional lending institutions and Certified Development Corporations (CDCs) to provide financing for approved projects that typically break down as:

- 50% project-cost financing by a traditional lender
- 40% project-cost financing by a CDC backed by a 100% SBA-guaranteed debenture
- 10% project-cost financing through borrower equity

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These loans are differentiated by low down-payment/equity injection costs and carry fixed interest rates for much longer terms (from 10 years for fixed equipment, up to 25 years for real estate) than would be available without the SBA guaranty.

Loans made under the 504 program are not subject to an overall project-size limitation, rather the only limitation is that the CDC portion that benefits from the SBA-guaranteed debenture not exceed $5.5 million per project. Additionally, a manufacturing borrower may obtain multiple 504 loans so long as the aggregate amount is below $16.5 million. This is significantly higher than the traditional 7(a) SBA limitation of $5 million per borrower. To make this loan program even more attractive for borrowers who are looking to finance energy public policy projects, the $16.5 million aggregate cap on 504 loans was removed effective May 30, 2024. This means that for any borrower who now qualifies under the expanded alternative size standards and operates in the clean energy space, they have the opportunity to secure as many 504 loans for which they would otherwise qualify, subject only to the $5.5 million limitation on the CDC-backed portion of each project.

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