Introduction to SBA Lending

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SBA Intro – What we will cover today

- How the SBA Guaranty Works
- Fees and Fee Waivers
- Interest Rates, Maturities, Eligibility and Uses of Proceeds
- Credit Standards
- Collateral Policy
- 7a Loans
- 504 Program
- Equity Requirements and acceptable sources of Injection
- Changes of Ownership
- Real Estate Lending
- Start Up Financing
- Servicing Actions
- Liquidation
- Guaranty Repurchase
- Resources

What is SBA Lending?

- Small Business Administration (SBA) Lending is a government backed lending program where a Lender will utilize a set of rules established by the SBA to fund transactions that the typical lender would not make due to elevated risk. This set of rules is written in the Standard Operating Procedures (SOP) and establishes the minimum requirements of the loan.
- The SBA will offer a “guaranty” for loan repayment between 50% and 90% of the loan balance. This means the lender would generally have 10% - 50% of the loan at risk.
- SBA loans allow the lender to generally offer lower down payments, longer terms, and loans that would have inadequate collateral, or other types of loans outside of standard bank policy including start-up financing and changes of ownership.
- SBA Loans can also be sold on the secondary market to free up bank liquidity

How SBA Loan Guaranty Program Works

- Commercial LO decide they need an SBA guaranty. Lender must certify that, without the SBA guaranty, they would not be able to make the loan.
- Lender completes their underwriting and then decides what SBA loan program to use.
- Depending on the loan program used, either the lender will use their *delegated authority* to approve the loan or, for non-delegated loans, SBA will make the final decision.
- A Loan Authorization is prepared which outlines the terms of guaranty. Lender then closes and disburses loan per Authorization.
- If borrower defaults, lender may submit the loan origination package to the SBA requesting that SBA honor its guaranty. The Lender is required, at a minimum, to liquidate all business assets prior to submitting the request (unless there is a compelling reason not to do so).
- After purchase, Lender is required to liquidate any remaining collateral and share the proceeds with SBA based on the guaranty percentage. SBA will likewise share any recoveries realized after purchase with the lender.

Basic SBA Loan Types

- 7(a) Loan Program

Includes SBA Express & Export Express

- 504 Loan Program

Fixed Assets

7(a) Loans

Standard 7(a) Loan Guaranty Program – $5,000,000 (flagship program)

- Loan proceeds generally used for real estate, construction, change of ownership, inventory, equipment, and working capital
- SBA will guaranty a portion of the loan balance
- Loans can be made as a Preferred Lender (PLP) or submitted to the SBA for approval.
- Special programs authorized by the SBA can allow for increased loan amounts.
  - Currently, the SBA is seeking Govt approval to increase loan maximum to $10MM for small manufacturers

SBAExpress – up to $500,000

- Lender must apply to be an Express Lender
- Term and revolving products available
- The program reduces the number of government mandated forms and procedures, streamlines the processing, and reduces the cost of smaller, less complex SBA loans. The program allows Lenders to utilize, to the maximum extent practicable, their respective loan analyses, procedures, and documentation. In return for the expanded authority and autonomy provided by the program, Lenders agree to accept a maximum SBA guaranty of 50%.

Guaranty Percentages

Standard 7(a) Program	
• Loans up to $150,000	85%
• Loans over $150,000	75%
SBAExpress Loans	50%
Export Express	
• Loans up to $350,000	90%
• Loans over $350,000	75%
• Export W/C and International Trade	90%

*The maximum dollar amount outstanding of SBA's guaranty to any one business and its affiliates must not exceed $3,750,000

SBA 7(a) Loan Fees

<u>Guaranty fee</u> – Bank pays fee then is reimbursed by borrower. May be passed on to Borrower within the loan proceeds.

- The Guaranty fee is the heartbeat of the SBA loan program. The entire loan program runs on the guaranty fee and annual servicing fee so that taxpayer dollars are not used.
  - At least annually, the SBA will adjust the fee amount based on economic outlook. This includes expected defaults and loan fundings.
- Fees are based on the guaranty portion of the loan and have tiers based on loan amounts.
- Fees are adjusted frequently by the SBA to ensure the program maintains financial stability. Currently fees have a range from 2% - 3.75% depending on the loan/guaranty amount
- Lender may charge a packaging fee (origination fee) but must itemize to the SBA the extent of those expenses. In no way can those expenses exceed 5% on loans up to $150,000 or 3% on loans over $150,000 OR the maximum of $30,000. The SBA has the right to audio those fees and charge back the lender in the event the fees were deemed unreasonable.
- The lender may also pass on third party fees such as appraisal, environmental, attorney, etc.

<u>Annual Service Fee :</u> Paid by lenders annually based on outstanding loan balance. Currently the fee is 0.55% and cannot be passed on to the borrower

Interest Rates

- The SBA allows lenders to set the rates offered to borrower.
- It is a common misconception that all rates for SBA loans are the same.
- Loans may be fixed or variable.
- Default rates are not allowed
- SBA will update the maximum allowable fixed rate monthly. For example, the maximum fixed rate for a loan over $250,000 is 12.5% as of 10/1/25

Product **Standard 7(a) Loans**	**Interest Rate** **The published maximum allowable fixed rate or if variable:**
Loans $50,000 or less	Cannot exceed Prime or SBA Optional Peg Rate + 6.5%
Loans $50,001 up to and including $250,000	Cannot exceed Prime or SBA Optional Peg Rate + 6.0%
Loans $250,001 up to and including $350,000	Cannot exceed Prime or SBA Optional Peg Rate + 4.5%
Loans $350,001 and greater	Cannot exceed Prime or SBA Optional Peg Rate + 3.0%

**Base Rate options:*

1. *Prime Rate***
2. *SBA Peg Rate – Accessible through the SBA website*
3. *LIBOR*

Loan Maturities

- Working capital or inventory loans and the financing of intangible assets (including goodwill) must not exceed 10 years
- Real estate up to 25 years
- Generally, equipment, fixtures, or furniture loans should not exceed 10 years (term may be up to 15 years if IRS asset class useful life supports the term. Lender must document justification in credit memo)
- Just about everything else – 10 years
- Mixed Proceeds: What are the lender's options when considering an application with Real Estate and Equipment? Under this circumstance, the lender has 3 options:
    1. Use a weighted average to determine loan term. If CRE assets are the majority proceeds, maturity can be 25 years.
    2. Offer 2 loans. One for the CRE with a 25 year maturity and the other for the equipment with a 10 year maturity.
    3. Offer one loan with a 25 year maturity and a weighted loan payment in the first 10 years to account for the equipment asset value to be paid off early.
- **NOTE:** Balloon and demand features are prohibited

Eligibility

Determining whether an Applicant is eligible for a loan guarantee is one of the most critical steps in the lending process. Program eligibility should be determined as early as possible in the application process and properly documented.

- Must be a for-profit business open to the general public
- Must be located in the United States
- Must be "small" including affiliates
  - SBA has set benchmarks for size standards based on NAICS codes
- Demonstrate the need for desired credit
- Must have a sound business purpose

Eligibility Cont.

<u>Ineligible businesses/uses of proceeds</u> (not complete list)

- Businesses involved in lending or speculation
- To acquire real estate that will be held primarily for investment purposes
- Pyramid-type businesses (Fortune Hi-Tech Marketing)
- Businesses deriving more than 1/3 of their revenue from legal gambling activities (e.g. lottery sales)
- No payments allowed to owners, or to pay delinquent withholding, sales or similar funds held in trust
- **Mini-warehouses ARE eligible**
- Prior loss to the Government:
  - Small Business Applicant that incurred Delinquent Federal Debt or caused Prior Loss (either directly or as a guarantor);
  - Any business owned, operated or controlled by Small Business Applicant or an Associate of Small Business Applicant that incurred Delinquent Federal Debt or caused Prior Loss (either directly or as a guarantor); and
  - For Delinquent Federal Debt only, any guarantor who has a Delinquent Federal Debt.

Credit Standards

- SBA Express – follow general bank guidelines for credit standards
- 7a - $350,000 or less
  - Lender is required to obtain an SBSS (Small Business Service Score). This score encompasses all business and personal credit reports and reported financial data. If above the SBA established maximum, the lender can provide a limited detailed credit memo and use all bank documents to fund and close the loan. If score is not met, standard underwriting is required.
- 7a Greater than $350,000
  - Credit history of the applicant (and the Operating Company if applicable), its Associates, and guarantors, including historical performance as well as the potential for long term success (character and reputation will be determined through the appropriate questions on SBA Form 1919);
  - Strength of the business;
  - Past earnings, projected cash flow, and future prospects; and
  - Applicant's ability to repay the loan with earnings from the business.
    - Historical debt service coverage must be at least 1.15 to 1 or greater on a historical and/or projected basis and at least 1:1 globally
    - Projections are required for start-up, change of ownership, and any time the loan repayment is deemed reliant on future earnings.

Collateral Requirements

One of the primary reasons lenders use the SBA-guaranteed program is for those Small Business Applicants that demonstrate repayment ability but lack adequate collateral to fully repay the loan if the loan defaults. However, SBA does not permit its guaranty to be used as a substitute for available collateral.

- For loans of **$50,000** or less, lenders are not required to take collateral;
- For loans over **$50,000**, up to and including **$350,000**, lender must follow the collateral policies and procedures that it has established and implemented for its similarly-sized non-SBA-guaranteed commercial loans. Lender may secure applicant's trading assets (using a 10% current book value for the calculation) if it does so for similarly sized non-SBA-guaranteed commercial loans.
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Collateral Requirements Cont.

- For loans in excess of $350,000, lender must collateralize the loan to the maximum extent possible up to the loan amount.

  If fixed assets do not fully secure the loan, the lender must take available equity in the personal real estate of the principals as collateral.

  Note: SBA does not require a lender to collateralize a loan with personal real estate to meet the "fully secured" definition when the equity in the real estate is less than 25% of the property's fair market value.

Collateral Quiz

1. For a 7a loan for $45,000 is the lender required to take a lien on business assets?

2. Can a lender take a lien on personally owned real estate on a loan for $1,000,000?

3. For a 7a loan of $300,000 used to finance a change of ownership, what is the required collateral?

Collateral Quiz - Answers

1. For a 7a loan for $45,000 is the lender required to take a lien on business assets?
   - No – For all loans up to $50,000 lender is not required to take a lien on any business or personal assets
2. Can a lender take a lien on personally owned real estate on a loan for $1,000,000?
   - Yes – if the business assets do not fully secure the loan, the lender MUST secure the personal residence of the business owners (20% or greater) if there is more than 25% equity in the home.

3. For a 7a loan of $300,000 used to finance a change of ownership, what is the required collateral?
   - Nothing is required. The SBA says you can follow your own bank guidelines.
   - What would your bank require?

Personal Guaranty

- For all loans, all owners of 20% or greater must personally guaranty the loan regardless of their role in the company. Spouse and Children’s ownership must be combined to determine guaranty requirement.
- When deemed necessary for credit or other reasons, SBA or, for a loan processed on a delegated basis, Lender, may require other appropriate individuals to provide full or limited guaranties of loan without regard to percentage of their ownership interests, if any. For example, an individual with a minority ownership or no ownership interest in Applicant or OC who is critical to operation of business may be required to provide a personal guaranty

Equity Requirements

- Per the SBA -
  - Lender must determine there is sufficient invested equity. They must determine if equity position and pro forma debt-to-worth are acceptable based on the factors related to that type of business, experience of the management and the level of competition in the market area. Lender must also include a detailed written analysis of its Equity requirement/position of the company it its credit memo
- Equity Requirements
  - For loans of <u>$350,000 or less</u>, the lender must follow the requirements for its non-guaranteed loans of similar size. However, ultimately the decision is left up to the lender
  - For loans <u>over $350,000</u> except for transactions for changes in ownership and start-up businesses, Lender's requirement for equity and equity injection must be consistent with its requirements for similarly-sized, non-SBA guaranteed commercial loans. However, the Lender may use its discretion to reduce the amount of equity and/or equity injection required if it determines that the Applicant needs leverage that exceeds the Lender's conventional requirements.
    - Start up and change of ownership, the SBA requires 10% minimum equity to the finance project.
    - This means the SBA will allow 100% financing on all other types of financing including, but not limited to CRE, equipment, and other capital investment
    - Remember that the SBA sets minimum requirements. Lenders will often set their own parameters that are more conservative.

Equity Requirements Cont.

Changes of ownership – Promotes the sound development and/or preserve the existence of a small business through an asset or stock purchase. The loan cannot be made solely to an individual. The business must be either a borrower or co-borrower.

- Resulting in a new owner: Minimum of at least 10 percent of the total project costs. Project costs can include any other eligible loan proceed per the SBA. Seller debt may not be considered as part of the equity injection unless:
  - It is on full standby for the life of the loan, and cannot exceed half of the required equity – 5% buyer/5% seller

- 100% financing is allowed if when an existing business is buying the assets of another business within the same NAICS code. Think of this as the competitor buy-out.

- Partner buy-out: Change of ownership between existing owners ("partner buyout"). This can include change for all current owners, or can bring someone from outside .

  - SBA can allow up to 100% financing in this scenario with certain balance sheet requirements, or 10% buyer equity in the project is required.
  - This transaction is great for continuing management or ownership to reduce customer attrition.

Equity Requirements Cont.

- For loans of all sizes and types, 100% financing is available for assets such as working capital, CRE, equipment, building improvements. The applicant must be an existing business with sufficient “equity” per the lender.

SBAExpress and Export Express programs:

- Credit decision, including how much to factor in a past bankruptcy or whether to require an equity injection, is left to the business judgement of the Lender.
- If Lender requires an equity injection and, as part of its standard processes for similarly-sized non-SBA guaranteed loans verifies the equity injection, it must do so for SBA Express and Export Express

Business Acquisition Example

Bill and Tammy Smith wish to buy a shoe manufacturing company that has been in existence for 10 years. The selling price is $750,000 and includes all equipment ($100,000), inventory (50,000), and goodwill ($600,000). Business cash and liabilities are not transferred to the buyer.

Project Costs

- Business Asset Purchase - $750,000
- Working Capital - $100,000
- SBA Fee and Closing Costs - $35,000

Total Project Costs = $885,000

- Equity Injection - $88,500 (10%)
- Loan Amount - $796,500
- Loan Term – 10 years

Collateral:

- UCC on all business assets

Borrower/Guarantor: The owner will establish a new operating company to run the business and will be the borrower on the note. The business is owned 50/50 by Bill and Tammy Smith and they both must personally guaranty the loan.

An Express Line of Credit may be added to the project if the buyer and lender deem it necessary for business operations. The amount of this LOC does not impact the Total Project Costs in regards to the equity injection requirements because the SBA deems it to be used for ongoing operations, and not the actual change of ownership.

Real Estate Purchase Example

Meat, Inc is an existing butcher shop looking to expand their business by moving out of their 5,000 SF facility into a 12,000 SF facility. They will be creating a new entity to hold the CRE (Knife Holdings, LLC). Loan funds include CRE purchase, Construction/Improvements, and Equipment. The business balance sheet shows strong working capital and net worth, due to owner's lack of distributions.

Project Costs

- CRE Purchase - $1,000,000
- Construction - $500,000
- Construction Soft Costs – $75,000
  - Contingency (10%), interest reserve, A&E, permitting, etc.
- SBA Fee and Closing Costs - $50,000

Total Project Costs = $1,625,000

- Equity Injection - $0
- Loan Amount - $1,625,000
- Loan Term – 25 years

Collateral:

- 1st Lien (PMSI) on equipment
- 1st Mtg on CRE

Borrower/Guarantor:

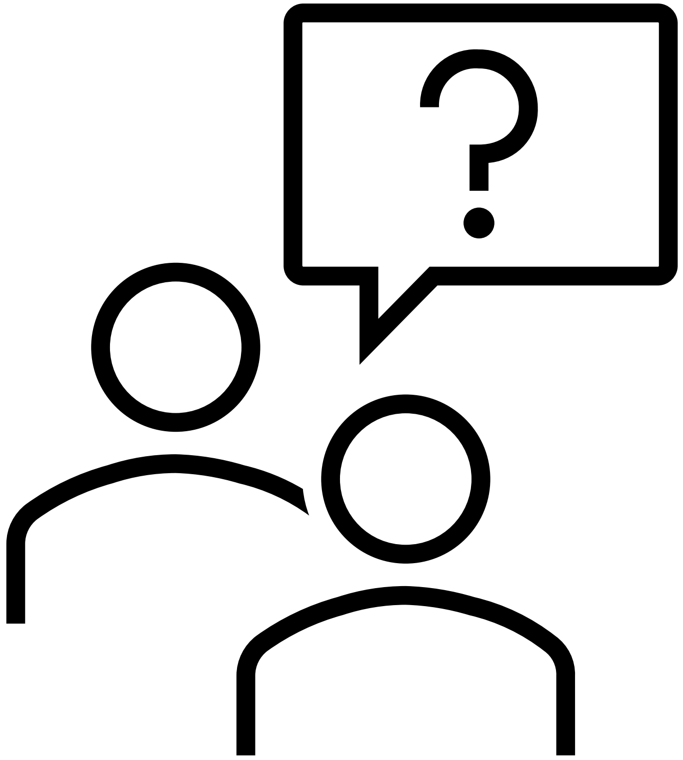
- Borrower – Meat, Inc
- Co-borrower – Knife, LLC
- Guarantor – All owners 20% or greater of the borrower and co-borrower. Ownership in these companies are not required to be the same.

Real Estate Purchase Example - Cont.

Loan Funding:

- Lender is required to get an “as-is” and “as-complete” appraisal to support both the initial purchase price and construction improvements.
- Loan can be set up with interest only term during construction and interest reserve for loan payments may be included in the loan. When construction is involved in the transaction, the loan term can exceed the SBA maximum, only for the construction term.
- During the interest only period, the lender must follow the SBA rules for construction disbursements. Money cannot be given to the borrower to use at their own discretion.
- Once construction is complete, the interest only period should be done and the loan convert to P&I

SBA 7(a) Lending Questions?



504 Fixed Asset Loan Program

- A financing tool which provides long-term, fixed-rate financing to small businesses to acquire commercial real estate (including construction) and/or heavy machinery and equipment. Working capital assets are not allowed, but can be done in conjunction with a 7a loan.
- Requires partnership with a Certified Development Companies (CDC), which are nonprofit corporations set up to contribute to the economic development of their communities, work with the SBA and private-sector lenders to provide financing to small businesses
- Important note: The lender in this situation does not have an SBA guaranty. Only the CDC will have a guaranty from the SBA.

How Does it Work?

- Combination Financing of generally:
  - 50% Lender financing with no government guaranty (1st lien position)
  - 40% Government Financing through SBA-approved CDC (2nd lien position)
  - 10% Owner's Equity
    - Add 5% to equity if business is less than two years old
    - Add additional 5% to equity if limited-use building as defined by the SBA
- SBA portion offers long-term, fixed rate financing
  - Maturity – 10, 20 or 25 years depending on use of proceeds
  - Interest rate: Standardized rate among all CDC lenders and are normally funded at a rate lower than that of the bank.
  - Bank Portion of the loan may have a balloon (minimum term of half the debenture) or fully amortized.
  - No rate restrictions on the Bank portion.
  - Generally, the Bank loan can look and act like a traditional conventional loan.

Maximum Debenture (2nd mtg.)

- \$5,000,000 when meeting:
  - – job creation criteria of one job per \$75,000 of CDC/SBA portion of the financing
  - – or by meeting one of 15 Public Policy or Community Development goals.
- \$5,500,000 for "Small Manufacturers" (NAICS beginning with 31, 32 or 33) and certain energy projects

COMMON PUBLIC POLICY GOALS

- Business district revitalization
- Rural development
- Minority business development
- Veteran-owned businesses
- Women-owned businesses
- Energy projects

Eligible Businesses

- The business must be operated for profit and fall within the size standards set by the SBA.
- Small =
  - Maximum tangible net worth is $15 million or less; <u>and</u>
  - Average net income after Federal income taxes (excluding any carry-over losses) for 2 full fiscal years before date of application is $5 million or less.
- Loans cannot be made to businesses engaged in speculation or investment in rental real estate.

Eligible Project Costs

- Fixed asset projects such as:
  - purchasing land and improvements
    - existing buildings, grading, street improvements, utilities, parking lots and landscaping;
    - construction of new facilities
    - modernizing, renovating or converting existing facilities;
    - purchasing long-term machinery and equipment.
  - Professional Fees – directly attributable and essential to the project incurred in closing the Interim and Third Party Loans. Examples include: title insurance, title searches and abstract costs, surveys and zoning matters.
  - Lender may charge an origination fee (Interim Loan Fee), of which 0.50% of the debenture must be paid to the CDC.
- The 504 Program <u>cannot</u> be used for working capital or inventory; however, you may use 7(a) programs for these financing needs.

Collateral and Guaranties

- Normally the project assets being financed are the only collateral required.
  - Lender will be in 1st Lien
  - SBA will be in 2nd lien position.
- Personal guaranties of the principal owners are required.
  - Principal owners are those who own <u>20% or more</u> of the business.
- It is very uncommon for the CDC to require any personal collateral to secure their loan, however life insurance can sometimes be required on its owner(s) and/or key employees.

504 Loan Process

- Lender will contact a local CDC to discuss opportunity and general eligibility of the project
- Once general terms are agreed upon, both the lender and CDC will seek approval for their loans individually. Ultimately, both loan approvals must match the SBA Loan Authorization issued by the SBA.
- Lender will initially provide two (2) loans at origination.
  - 1^{st} Mtg usually at 50% project costs. Referred to as the "permanent loan"
    - 1^{st} lien on asset financed (50% LTV)
  - 2^{nd} Mtg usually at 40% of the project costs. Referred to as the "bridge loan or Debenture"
    - 2^{nd} lien on asset financed (90% LTV)
- Once project is fully funded, the CDC will seek a debenture sale in the secondary market to then use to pay off the 2^{nd} mortgage. They will provide a low fixed rate for the life of the loan. Timing of this "take-out" can take a minimum of 45 days once loan is fully funded.
- During the time the lender has both loans outstanding, there is no SBA guaranty and LTVs are typically above bank standards. Additional collateral (personal or business) is often used to lower risk during this time.
- Once the bridge loan is paid off, Lender will typically have a 50% LTV 1^{st} mortgage, while the CDC will have a 90% LTV 2^{nd} mortgage and a 100% guaranty from the SBA.

Real Estate Purchase Example

Buckets, Inc is an existing manufacturer of buckets. They have the opportunity to purchase the manufacturing facility they currently operate from and will hold the CRE in Lids, LLC.

Project Costs

- CRE Purchase - $5,000,000
- Interim Loan Fee and Closing Costs - $100,000

Total Project Costs = $5,100,000

  - Equity Injection (10%) - $510,000
  - Senior Loan Amount (50%) – 2,550,000
  - Bridge Loan Amount (40%) - $2,040,000
  - Sr Loan Term – 25 years
  - Bridge Loan Term – 3 months
  - SBA Participation fee (0.5% of 1st) – $12,750

Collateral:

  - Sr Loan – 1st Mtg on CRE
  - Bridge Loan – 2nd Mtg on CRE

- Borrower – Lids, LLC
- Guarantor – Buckets, Inc and all owners 20% or greater of the borrower and co-borrower

Once both loans are funded, the CDC will begin their process to fund the bridge loan through a debenture sale. This process can take a minimum of 45 days. The CDC will pay off the bridge loan and provide a 25 year term loan. The SBA Participation fee is paid from the lender’s origination fee (interim loan fee).

Recap of 504 Loan Program

- Up to 90% LTV financing available
- Financing includes both hard and soft costs
- Up to 25 year fully amortizing for 504 portion
- 50% LTV for bank
- Project costs upwards of $10MM-$12MM
- Generally, below market rate on SBA portion

504 Lending Questions?

SBA Loan Servicing

- **504 Loans** – Follow bank established guidelines. Any modifications to the note should be cleared with the CDC to ensure they continue to have an eligible loan.
- **SBA 7a Loans** – The SBA has established rules and regulations on how to properly service an SBA loan. This includes financial monitoring and loan modification requests from the borrower.
  - Sets out the SBA standard operating policies and procedures for the administration of 7(a) Loans that are in "regular servicing” and "liquidation" status.
  - An SBA loan:
    - Moves into regular servicing status when fully disbursed:
    - Term loans are considered fully disbursed when loan has been closed and final loan disbursement has been made.
    - Revolving lines of credit are considered fully disbursed when loan has been closed and initial loan disbursement has been made.
    - Moves from "regular servicing” status to "liquidation” status if the loan is in default

Reporting Requirements

- Lenders are required to report borrowers of SBA-guaranteed loans to the commercial credit reporting agencies after initial disbursement. Reporting of guarantors is not required.
- Lenders should continue to report information concerning the extension of credit, including servicing, liquidation, and charge-off activities throughout life-cycle of loan.

Financial Reporting Covenant

- The only financial covenant allowed on an SBA loan is the submission of annual financial statements (TR and PFS) for all borrowers and guarantors. If borrower does not provide financials, lender cannot put loan into default.
- Lender is required to request statements annually and should keep record of requests in the event of default. If your bank allows it, you can charge the borrower fees for missing financials.
- If financial statements are received, lender should perform a financial review and upgrade internal risk grading accordingly. If financials provided indicate significant financial deterioration, lender is encouraged to reach out to the borrower for assistance. If payments continue to be made, lender <u>cannot</u> default the loan.

Servicing Actions

SBA has developed a Servicing and Liquidation Action Matrix for 7(a) loans which outlines actions that:

- **Do not require notification to or approval by SBA** (“unilateral authority”);
  - Cancel SBA Guaranty
  - Extend Maturity
  - Borrower name change
  - Adding a guarantor
  - Collateral swaps
- **Require notification to SBA but <u>not</u> approval by SBA**;
  - Change borrower/guarantor SSN/TIN
  - Change interest rate
- **Require SBA approval**
  - Change in ownership of the business
  - Release of borrower/guarantor
  - Loan assumption
  - Reinstatement of SBA Guaranty
  - Liquidation Plans, including sale of collateral and forbearance agreements/offer and compromise

Servicing Actions Cont.

- The most common servicing action is a collateral swap. Remember, the SBA allows loans to be undersecured, however you must still follow the rules for business and personal collateral. The lender must evaluate the collateral position prior to the servicing action, and if similar collateral in type and value can be provided, the lender is permitted to swap.
  - Ex: Business owner pledged their primary residence which provides $100,000 in collateral coverage on the $500,000 loan and the property is being sold. The sale of the home is allowed, however new collateral with the same value must be provided, or the proceeds from the sale must be used to paydown the loan. The borrower can use the proceeds (with bank approval) to purchase a new home and the SBA Lender will file a lien behind the primary mortgage holder. In no circumstances can any cash from the sale of an asset be delivered back to the business or owner if the loan is not fully secured with other assets.

Servicing Actions Cont.

Interest Rate Adjustments

- After loan approval, the lender may change the initial Note rate, including the base rate, the spread over the base rate, or from a fixed rate to a variable rate or from a variable rate to a fixed rate, provided the new interest rate does not exceed the maximum allowable interest rate at the time of the loan application. The lender Must obtain the Borrower's written agreement and Must notify the SBA of the change.
  - In the event the loan is sold on the secondary market, the lender must get the investor to approve the rate change. If the investor denies the change, the lender must petition to the SBA the ability to buy the note back from the investor.

Liquidation and Collecting the Guaranty

- 7(a) Loans Must Be Classified in Liquidation Status when the Note is accelerated.
- When the Note Should Be Accelerated
  - Lenders with Non-SBA Loan Portfolios may decide whether to accelerate the Note based on their own policies and procedures for similarly-sized non-SBA guaranteed commercial loans.
  - Lenders without Non-SBA Loan Portfolios should accelerate whenever there has been an event of default on the Note and it is clear to a prudent lender that the Obligor(s) cannot, or will not, keep the loan current through regularly scheduled payments.
  - Loans sold on the secondary market **must be** immediately repurchased by the lender or must request that SBA purchase it.
- The term ‘Prudent’ is now included in the Definitions Chapter.
- It emphasizes lenders must service their SBA portfolios in a commercially reasonable manner and complete the resolution of SBA loans within 24 months of guaranty purchase. This deadline may be extended with approval by the SBA

Charge Off

<u>When Charge Off is Appropriate</u>

- SBA charge-off is appropriate when SBA has received a Lender Wrap-up Report that identifies:
  - All reasonable efforts have been exhausted to achieve recovery from: (1) voluntary payments on Note; (2) compromise with Obligors; (3) liquidation of collateral; and (4) enforced collection; and
  - Further collection efforts are not cost effective or practical; and
  - Remaining legally obligated Obligors cannot be located, are unable to pay loan balance, or are unwilling to pay loan balance; or
  - Loan balance is uncollectible due to discharge in bankruptcy (i.e., release of debtor from any further personal liability for pre-bankruptcy debts), expiration of statute of limitations (i.e., passing of deadline for suing), or existence of another defense available to remaining Obligors under state or federal law.

When and How to Request a Guaranty Purchase

WHEN TO REQUEST:

- For loans approved on or after May 14, 2007, lenders must liquidate <u>business personal property</u> securing a loan <u>prior to</u> requesting SBA to purchase the guaranteed portion of the loan.
  - Exception: lender may request purchase if there is a bankruptcy, judicial foreclosure, litigation or other unusual liquidation circumstance that is likely to extend the liquidation process more than 90 days past the earliest date that the lender could request purchase.

HOW TO REQUEST:

- Provide the SBA with a Purchase Demand Kit which includes all loan origination documents supplied by the applicant and used for credit underwriting and closing. Key items of note are SBA eligibility forms, equity injection documentation, tax verifications, and loan servicing documents.
- Submit the loan Wrap-Up report detailing liquidation, and amount remaining to be paid from the guaranty

Denial and Repayment of Guaranty

- SBA may be released from liability on its guarantee, in full or in part, for any reason set out in 13 CFR 120.524(a); and may recover funds already paid in connection with a guaranty purchase.
- Generally, SBA only denies liability when Lender's actions or omissions caused, or could cause, a material loss on the loan BUT…
- SBA may deny liability on a guarantee in the absence of a material loss if Lender's misconduct is deemed material to the soundness and integrity of the Loan Program, e.g., if
    - Loan was ineligible for SBA financing
    - Lender failed to disclose or misrepresented a material fact to SBA
    - Lender breached SBA's conflict of interest regulations
- Partial Denial of Liability = Lender's actions or omissions caused, or could cause, a material, but less than total, or near total, loss on the loan AND lender <u>does not agree</u> to a repair
- Full Denial of Liability = SBA's determination that Lender's acts or omissions are so serious as to warrant non-payment of guaranty

Guaranty Repair - agreement between SBA and lender as to a specific dollar amount that will be deducted from purchase amount to fully compensate SBA for the actual or anticipated loss caused by the lender

Top Reasons for Repair and Denial

- **Lien and Collateral Issues that Result in Missed Recoveries (Generally a Repair)**
  - Failure to obtain required lien position
  - Failure to properly perfect security interest
  - Failure to fully collateralize loan at origination when additional collateral was available (in rare cases)
- **Unauthorized Use of Proceeds**
  - Proceeds disbursed for purpose(s) inconsistent with the loan authorization or subsequent modifications without a business justification. (Could be a Denial if early default and improper use of proceeds caused the failure of the business)
  - Same lender Non-SBA loan paid with PLP loan proceeds (preference)
- **Liquidation Deficiencies (Generally a Repair unless harm is the full value of the outstanding balance)**
  - Failure to conduct Site Visit which resulted in missed recoveries
  - Improper safeguarding or disposition of collateral which resulted in missed recoveries
  - Misapplication of recoveries to lender's loan when SBA-guaranteed loan has lien priority

Top Reasons for Repair and Denial

- **Undocumented Servicing Actions (Generally a Repair)**
  - Liens not properly renewed during servicing on worthwhile collateral
  - Release or subordination of collateral without documented business justification
  - Allowing hazard insurance to lapse on major collateral and collateral was subsequently destroyed
  - Failure to maintain life insurance on principal and principal subsequently dies
- **Early Defaults (Denial if determined to be reason for business failure)**
  - Missing or unsupported documentation of verification of borrower financial information with IRS when financial information was relied on in lender's credit analysis
- **SBA Loan Eligibility (Denial)**
  - Ineligible franchise
  - Ineligible loan purpose
  - Ineligible loan recipient (loan to an associate of lender)
- **Release of Guarantors without SBA's Permission**
- **Failure to File Proof of Claim**

SBA Lending Recap

SBA Lending provides banks the ability to broaden their lending tool box with products they wouldn't normally offer due to inherent risks

SBA Lending offers:

- Low equity requirements. Sometimes 100% financing
- Multiple uses of proceeds in one loan
- Long term with matching amortization – No balloon notes
    - Non-real estate – 10 years
    - Real Estate – 25 years
- Collateral Shortfalls
    - SBA Guaranty will cover a portion of this
- Riskier transactions such as start-up and change of ownership
- Riskier industries
- Term and revolving loan products
- Loan Servicing is less intensive due to lack of financial covenants

QUESTIONS

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