

CHAPTER 1 - LOAN PROCESSING

When a lender is approached by a small business to extend credit for the business's financial needs, the lender may choose to approve the request, decline the request, or approve the request contingent on receiving an SBA guaranty. A typical reason for a lender to approve a loan only with SBA's guaranty is that the loan term the small business needs to finance its operations and to repay the loan in a timely manner exceeds the lender's own policies. For example, the small business may need a five-year working capital loan but the lender's internal policies do not permit a working capital loan beyond three years. Another typical reason is that the business is a start-up where an analysis of repayment is based solely on projections.

When a lender accepts SBA's guaranty on a loan, the lender also accepts certain responsibilities in order to maintain the guaranty. These responsibilities include a determination that the borrower, the use of the loan proceeds, and the loan structure meet SBA's requirements. In addition, all the lender's actions when approving, closing, disbursing, and servicing the loan (including liquidation activity) must meet prudent lending standards and comply with applicable SBA policies and procedures. A lender risks an alteration of SBA's guaranty (including full denial of liability) if these requirements are not met.

7(A) Loan Submission Processes

The 7(a) Loan Program has several different processes by which a lender may obtain an SBA guaranty for its qualified borrowers. Depending on the process, the maximum guaranty percentage, the maximum loan amount, and the turn-around time vary. The following is a chart of the different methods available to a 7(a) Lender to obtain an SBA guaranty for its small business borrower (Chart No. 1).

METHODS LENDERS USE TO OBTAIN AN SBA GUARANTY - Chart #1

Process	Standard 7(a) Guaranty	Certified Lenders Program (CLP)	Preferred Lenders Program (PLP)	LowDoc	SBAExpress
Attributes					
Submission to SBA and SBA's level of review	Lender submits standard SBA application including all required exhibits to SBA for its review. SBA fully re-analyzes Lender's analysis for eligibility and credit.	Lender submits standard SBA application including all required exhibits to SBA for its review. SBA reviews Lender's analysis.	Lender submits an eligibility checklist for SBA's review. Credit decision delegated to Lender. Standard application is completed by borrower and Lender but not submitted.	Lender submits a two-page summary of credit and eligibility for SBA's review.	Lender submits the same eligibility checklist as PLP for SBA's review EXCEPT for those Lenders with delegated eligibility-determination authority who are not required to submit the checklist.
Lender requirements	Lender completes and submits in-depth analysis of repayment ability, collateral, management, and credit history. Specific type of financial statement analysis required by SBA. SBA determines if the borrower meets SBA's eligibility requirements. SBA prepares loan authorization.	Same as for Standard 7(a) PLUS Lender provides draft loan authorization using SBA-approved boilerplate.	Lender completes but does not submit in-depth credit analysis using SBA forms. Lender initially determines eligibility prior to completing checklist. Lender prepares authorization using SBA-approved authorization boilerplate but does not submit to SBA for its review.	Lender completes and submits summarized credit and eligibility analysis. Lender initially determines eligibility prior to completing forms. SBA prepares loan authorization.	Lender completes but does not submit credit and eligibility analysis using its own procedures. Lender initially determines eligibility prior to completing checklist. Lender is not required to use SBA authorization boilerplate.
Required documentation prepared by Lender	Application includes SBA Form 4 with all required attachments and SBA Form 4-I with all required attachments and analysis.	Same as Standard 7(a) PLUS draft loan authorization using SBA-approved boilerplate.	Same as Standard 7(a) PLUS eligibility checklist PLUS loan authorization (not reviewed by SBA) using SBA-approved boilerplate.	Lender uses own application forms. Completes 2-page submission to SBA.	Lender uses own forms. Lender uses own loan authorization. Lender completes eligibility checklist in some cases.
SBA's loan approval role	SBA determines eligibility and credit risk. SBA prepares and finalizes the loan authorization.	SBA determines eligibility and credit risk. SBA finalizes the authorization.	SBA makes eligibility determination based on completed checklist submitted by Lender.	SBA determines eligibility and credit risk. SBA prepares and finalizes the loan authorization.	Same as PLP
Size Standard	Regular size standard	Regular size standard	Regular size standard	Special size standard	Regular size standard
Target Proc. time	13 business days	3 business days	1 day	1.5 days	1 Day
Maximum loan amounts	General rule is gross loan amount limited to \$2,000,000 SBA guaranty amount limited To \$1,500,000 . (Chart 2 for exceptions.)	Same as Standard 7(a)	Same as Standard 7(a)	Limited to \$150,000 (gross)	Limited To \$2,000,000 (gross)
Percent of Guaranty	85% for loans of \$150,000 or less. 75% for loans over \$150,000 .	Same as Standard 7(a)	Same as Standard 7(a)	Same As Standard 7(a)	50%
Use of Proceeds	Refer to Chart 2 which describes the various programs and their limitations.	Same as Standard 7(a)	No refinancing of Same Institution Debt (SID) permitted.	SID refinancing limited to 25% of loan.	No refinancing of SID permitted.
Maturity	Depends on use of proceeds and which loan program used. Maximum of 25 years reserved for fixed assets including real estate.	Same as Standard 7(a)	Same as Standard 7(a)	Same as Standard 7(a)	Maximum of 7 years.
Interest Rates	Prime + 2.25% for loans with maturities under 7 years . Prime + 2.75% for 7 years or more . Special exception for loan amounts of \$50,000 or less : rates can be higher.	Same as Standard 7(a)	Same as Standard 7(a)	Same as Standard 7(a)	Loans \$50,000 or less: Prime + 6.5%. Over \$50,000: Prime +4.5%
Guaranty Fees (Multiply percentage times guaranteed amount, not gross amount.)	Maturity of 12 months or less = 0.25% On maturities over 12 Months Gross loan: \$150,000 or less = 1% Gross loan \$150,001 - \$700,000 = 2.5% ;Over \$700,000 = 3.5% ; Additional .25% of the guaranteed portion which exceeds \$1,000,000.	Same as standard 7(a)	Same as Standard 7(a)	Same as Standard 7(a)	Same as Standard 7(a)

Maximum Loan Maturities

The specific maturity of a loan is determined by:

- use of proceeds
- ability to repay
- useful life of the assets being financed

The maximum maturities permitted by SBA are the following:

For **long term working capital**, 10 years;

For **fixed assets**, the economic life of those assets up to 25 years. (The 25-year maximum maturity normally applies only to the acquisition of land and buildings or the refinancing of debt incurred in the acquisition or construction of land and buildings. If the 7(a) loan covers the construction period, the 25-year maximum would be **in addition to** the time needed to complete construction.) Generally equipment loans are limited to 10 years or less.

When the loan proceeds are to be used for **varied purposes**, the maximum maturity and resulting amortization is a **weighted average of the uses of the proceeds**.

For loans to franchises, the term of the loan is generally no longer than the term of the franchise agreement.

A summary of the various loan programs is found in Chart No. 2 and includes the different uses of proceeds, maturities, collateral, and qualifications.

SBA LOAN PROGRAMS REFERENCE GUIDE – Chart #2

Program	Use of Proceeds	Special Features	Maturity	Collateral	Who Qualifies
Basic 7(a) Loan (See "C" below.)	Acquisition or construction of buildings (including land); machinery and equipment; furniture and fixtures; leasehold improvements; short or long-term working capital; refinancing.	The most flexible. Adaptable to a variety of loan structures for a variety of loan purposes. There are general (government) restrictions on what the proceeds can be used for and the types of businesses that can receive financial assistance from SBA.	Working Capital up to 10 years. Fixed Assets including Real Estate up to 25 years. Maturities combine 1) use of proceeds and 2) business's ability to repay in a timely manner.	The goal is to take available collateral (valued at the liquidation value) equal the loan amount. Collateral may include all assets financed with loan proceed; other business assets; and personal assets of principals. If all available collateral does not fully secure the loan, that is acceptable BUT it is not acceptable if the loan is not secured by all available collateral.	Must be eligible incl. being a for-profit business that meets certain size standards; cannot obtain loan proceeds for an ineligible purpose; owners must be of good character. Must be creditworthy including reasonably demonstrate that the loan (along with all other obligations) can be repaid from the operations of the business in a timely manner.
International Trade Loan Program (See "B" below.)	Finances fixed assets including improvements that will be located in the U.S. and used to produce goods/services to be exported. No refinancing allowed	When made in conjunction with a working capital loan, the two loans together can have a SBA guaranteed share up to \$1,250,000	Based on the assets being financed. Generally between 10 and 25 years	Must be secured by a first lien on the assets acquired with the loan proceeds.	Same as Basic 7(a) PLUS the applicant must have been in operations for at least 12 months at the time of application..
Export Working Capital Program (EWCP) (See "B" below.)	Finances the short term working capital needs of a exporting business on either a revolving or non-revolving basis	Prequalification by SBA available prior to small business applying to Lender. SBA provides a 90% repayment guarantee up to \$1 million. Only program with a provision for a Standby Letter of Credit to offset risk.	Generally 12 months or less, with annual reissuances for a maximum of 3 years.	First on the assets being financed.	Same as Basic 7(a) PLUS the applicant must have a prior (12 month minimum) history of demonstrated export expertise
Seasonal CAPLines (See "A" below.)	Finance the seasonal working capital needs. New businesses ineligible.	Mandated zero balance at season's end prior to future season draws.	Maximum of 5 years	First on the assets being financed.	Same as Basic 7(a) PLUS business in operation for at least one year with a definite seasonal pattern to sales/expenses
Contract CAPLines (See "A" below.)	Finance the direct costs needed to perform on an assignable contract	Can provide loan funds prior to start of work.	Maximum of 5 years	Assignment of the proceeds from the contract(s) being performed.	Same as Basic 7(a) PLUS business must have demonstrated, historical experience in performing on same type contract.
Builders CAPLines (See "A" below.)	Finance the Contractors cost to build or renovate commercial or residential property to be resold to a third party upon completion	The only SBA program that allows a business to buy a building or home for the purpose of being resold.	Maximum of 5 years	First on the assets being financed.	Only available to businesses in the building and construction trades.
Small Asset Based CAPLines (See "A" below.)	Provides working capital based on eligible accounts receivable and inventory. Limit of \$200,000	Required review of a monthly borrowing base by lender to ensure that borrowing does not exceed qualified assets.	Maximum of 5 years	First on the assets being financed.	Same as Basic 7(a) PLUS designed for businesses who sell on credit and who have a need to obtain funds from existing receivables and inventory prior to receipt of funds from customers
Standard Asset Based CAPLines (See "A" below.)	Provides working capital based on eligible accounts receivable and inventory.	Borrowing base review by Lender with each request for disbursement. No restriction on servicing fee charges by lender subject to full disclosure	Maximum of 5 years	First on the assets being financed	Same as Small Asset Based Caplines.
Energy Loan Program (See "A" below.)	Provides financing to develop, build, install and/or service an energy savings device.	The only SBA loan program that permits loan proceeds to be used for Research & Development (up to 30%)	Same as Basic 7(a)	Same as Basic 7(a)	Same as Basic 7(a) PLUS business has to make, build, improve, install or service the energy savings device. (See pages 232 to 234 of SOP 50-10(4).) This program is not for the end user of the energy device or measure.
Employee Stock Ownership Plan (ESOP) Loans (See "A" below.)	Provides funds to ESOP to purchase or increase the ESOP's ownership in the business that employs its owners.	The loan is made to the trust, not the business. Other special requirements are on pages 242 to 249 of SOP 50-10(4).	Same as Basic 7(a)	Same as Basic 7(a) BUT the ESOP Trust is not required to guaranty.	A qualified Employee Trust organized under IRS or Department of Labor Requirements.

A - Can be processed only under Standard 7(a).

B – Can be processed under Standard 7(a) or PLP.

C – Can be processed under all methods. (See Chart No. 1 for methods.)

Fees

GUARANTY FEES

(SOP 50-10(4), Sub B, Ch 1, ¶ 15, Pages 214 to 221-6)

Guaranty fees are paid to SBA to support the cost of the program resulting from SBA's honoring its guaranty when a 7(a) borrower fails.

One-Time Guaranty Fee (13 CFR 120.220)

The lender pays a one-time fee when the loan is approved. It is a flat fee based on the size of the loan, the amount guaranteed by SBA, and the term of the loan.

For loans with a maturity of 12 months or less, the guaranty fee is .25 of 1 percent of the guaranteed amount.

For loans with a maturity exceeding 12 months, the guaranty fee is as follows:

Gross Loan Size:	\$150,000 or less	= 1.0% of guaranteed amount
	Over \$150,000 to \$700,000	= 2.5% of guaranteed amount
	Over \$700,000 to \$2,000,000	= 3.5% of guaranteed amount*

*There is an additional up-front guarantee fee equal to 0.25 percent of the amount by which the guaranteed portion exceeds \$1,000,000.

Lenders can charge the fee to the Borrower AFTER the Lender pays it and AFTER the loan is closed and disbursed.

Combination Loan Financing

If the commercial lender has a senior credit position to the 7(a) loan, a one-time fee equal to **0.7 percent of the amount of the commercial loan** is to be paid to SBA.

This fee shall be paid by the SBA participating lender, and must be remitted when the up-front guarantee fee is paid. This fee may not be passed on to the borrower.

If the commercial loan is in a shared lien (sometimes known as pari passu) or subordinate lien position to the 7(a) guaranteed loan, this one time fee does NOT apply.

On-Going Guaranty Fee (13 CFR 120.220 (f))

The Lender pays SBA an annual servicing fee equal to 0.36% of the outstanding principal balance of the guaranteed portion of the loan. Unlike the flat fee, Lenders are not permitted to pass this fee onto the Borrower.

Subsidy Recoupment Fee Payable to SBA by Borrower (13 CFR 120.223)

For loans with a maturity of 15 years or more, a subsidy recoupment fee is assessed of the borrower when the borrower voluntarily prepays 25% or more of its loan in any one year during the first three years. The fee is 5% of the prepayment amount during the first year, 3% during the second year, and 1% during the third year.

OTHER FEES

Fees a Lender May Collect (13 CFR 120.221): (SOP 50-10, Sub B, Ch 1, ¶ 16, Page 222)

Packaging Fees: The Lender may charge an applicant reasonable fees that are customary for similar services provided by lenders in the geographic area where the loan is being made. SBA may review these fees at any time. The Lender must refund any such fee considered unreasonable by SBA.

Closing expenses: The Lender may collect from the applicant necessary out-of-pocket expenses such as the costs associated with surveys, title reports, appraisals, filing and recording fees, photocopy and delivery charges, and other direct charges related to the closing. The Lender or a Lender's associate may not charge the Borrower for legal services, unless they are hourly charges for requested services actually rendered.

Extraordinary servicing: Subject to prior written SBA approval, if all or part of a loan will have extraordinary servicing needs, the Lender may charge the applicant a servicing fee not to exceed 2 percent per year on the outstanding balance of the part requiring special servicing. Examples are 7(a) loans that cover the construction period which would include field inspections, monitoring of draw schedules, title reports, etc.; or asset based lending secured by accounts receivable and/or inventory that require frequent monitoring and inspections of that collateral.

Fees a Lender May Not Collect (13 CFR 120.222) (SOP 50-10, Sub B, Ch 1, ¶ 17, Pages 222 to 226)

Application fees: Processing fees, origination fees, application fees, points, brokerage fees, bonus points, add-on interest, commissions, referral or similar fees which the Lender might charge an applicant on a commercial loan are not permitted for a 7(a) loan.

Premiums: The Lender or its Associate may not share any premium received from the sale of a 7(a) loan in the secondary market with any other entity or individual not directly compensated by the lender.

Prepayment Fee: The Lender may not charge a fee for full or partial prepayment of a loan.

Fees for goods or Services such as Insurance: The Lender is prohibited from collecting fees for goods or services, including insurance, as a condition of obtaining an SBA guaranteed loan.

Interest Rates

Variable Rate Loans

The initial interest rate for a variable rate loan is based on the prime rate printed in the Wall Street Journal on the date SBA receives the loan application. This date is identified in the loan authorization.

The percentage above the prime rate must not exceed:

- 2.25%—If Loan is more than \$50,000 and matures in less than 7 years.
- 2.75%—If Loan is more than \$50,000 and matures in 7 years or more.
- 3.25%—If Loan is for \$25,001-\$50,000 and matures in less than 7 years.
- 3.75%—If Loan is for \$25,001-\$50,000 and matures in 7 years or more.
- 4.25%—If Loan is \$25,000 and under and matures in less than 7 years.
- 4.75%—If Loan is \$25,000 and under and matures in 7 years or more.
(Refer to Chart #1 for SBAExpress interest rates)

A Lender is prohibited from increasing the initial interest rate until the first day of the first fluctuation month occurring after initial disbursement.

There is no requirement that the loan payment amount change at the same frequency as interest rate changes. However, the Lender must adjust the payment amount **at least annually** to ensure that the principal amortizes over the remaining term of the loan.

Ceilings and Floors

A Lender may establish interest rate ceilings and floors, however,

1. Both the ceiling and floor must be stated in the Note, and
2. The difference between the stated rate in the Note and the floor must be equal to or greater than the difference between the stated rate in the note and the ceiling. For example: if the rate is 10% and the ceiling is 12%, then the floor must be 8% or lower.

Eligibility

Once a Lender has initially reviewed the application and determined that the Lender's policies do not permit it to approve this loan without SBA's guaranty, the Lender then must determine if the applicant is eligible to receive SBA financial assistance. There are five basic factors to consider when determining eligibility.

1. Size and affiliation
2. Type of Business
3. Use of Proceeds
4. Credit Elsewhere
5. Special Eligibility Factors:
 - Eligible Passive Company (EPC)
 - Change of Ownership
 - Foreign-Owned Businesses or Businesses Owned by Non-U.S. Citizens
 - Farms and Agricultural Businesses, and Medical Facilities
 - Litigation, Bankruptcy, Probation or Parole
 - Combination Financing (sometimes referred to as Piggyback Financing)

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SIZE AND AFFILIATION

(SOP 50-10(4), Sub A, Ch 3, Pages 71 to 80-1)

Size

SBA can only guaranty loans made to small businesses. To determine whether a business is small, SBA uses the North American Industry Classification System (NAICS). SBA has posted the Table of Small Business Size Standards from the NAICS manual on its website at www.sba.gov/size.

Under NAICS, the standard for an industry is based on **either the number of employees** (calculated by averaging the total number of employees for each pay period during the most recently completed 12 calendar months) **or** average **annual receipts** for the most recently completed 3 fiscal years. A synopsis of SBA's basic Size Standards follows.

<u>Industry</u>	<u>Size Range</u>
Retail and Service	\$1.5 to \$24.0 million
Construction	\$12.0 to \$28.5 million
Agriculture	\$0.75 to \$10.5 million
Wholesale	No more than 100 employees
Manufacturing	500 to 1,500 employees

A business that meets SBA's size standards at the time of application is eligible even if the loan proceeds will result in an increase beyond those standards.

Affiliation (SOP 50-10(4), Sub A, Ch 3, ¶ 3, Pages 71 to 75)

Size is determined based on the combined operations of an applicant and all its affiliates. (Concerns are affiliates of each other when one concern controls or has the power to control the other, or a third party or parties controls or has the power to control both.) Businesses that have common ownership, common management, or contractual relationships may be affiliates. When affiliation exists between companies, two separate size standard tests must be met. The applicant must not exceed the size standard for the industry in which:

1. The applicant and its affiliates are primarily engaged
2. The applicant alone is primarily engaged.

When two or more businesses are affiliated and they each conduct different business activities (for example manufacturer and wholesaler), the primary business activity must be determined.

Where the affiliates are engaged in several industries, the size standard is that of the primary industry of all the related concerns taken as a whole.

If the business or its affiliate already has an SBA guaranty loan outstanding, the dollar amount of any subsequent SBA loan request is added to the outstanding amount of all SBA loans to ensure that the combined loans do not exceed SBA maximums to one borrower (including affiliates).

Franchises (SOP 50-10(4), Sub 3, Ch 3 ¶ 3e, Page 75)

If the applicant is a franchisee, a special determination of whether the franchisee is affiliated with the franchisor needs to be made. If affiliation is determined, the franchisee is not eligible to apply by itself. Affiliation may arise through common ownership, common management or excessive restrictions imposed by the franchise agreement.

To streamline the determination of whether affiliation exists between selected franchisees and franchisors or licensees and licensors, SBA has established a Franchise Registry, www.franchiseregistry.com. This Registry lists those franchises that have paid to have their agreements reviewed **and** that SBA has determined have an agreement that does not create an affiliation between the franchisor and the franchisee. Participation in the Registry by any given franchise is voluntary. A fee is paid by the franchisor in anticipation of being listed so that when one of their existing or potential franchisee operations applies for SBA financing the determination of one of the more involved aspects of SBA eligibility can already be completed.

If a franchise is not listed on the Registry, an eligibility review must be performed. If the loan is processed by SBA, SBA is responsible for the review. If a loan is submitted under delegated authority, the lender is responsible for reviewing the franchise documents and

making the eligibility determination. Appendix 1-A of this guide is a checklist for use in determining whether a franchise is eligible.

(Note: a determination that the franchise is eligible does not address all aspects of eligibility, but rather only the issue of whether the franchise relationship between the Borrower and its franchisor creates an affiliation that would affect the Borrower's small business size status and, therefore, eligibility for SBA-guaranteed financing.) For franchises listed on the Registry, the Lender only needs to obtain a "Certification of No Change or Non-Material Change on Behalf of Registered Franchisor" signed by the franchisor. If the franchise is not listed, a written determination of eligibility opinion must be made.

Some of the criteria that SBA reviews are the following:

- Franchise Fee and other fees are not excessive.
- Franchisee has control of money & accounts – deposits and withdrawals. (Franchisor may prescribe accounting method and due dates for fee payment, but may not control accounts.)
- Franchisee manages daily operations (except in case of illness or disability).
- Franchisee controls, hires and fires employees. (Franchisor can require employee training.)
- Agreement specifies: 1) events of default; 2) what written notice of default will be provided; 3) events that may lead to termination; 4) events that cause automatic termination; and 5) time to cure provided for other defaults.
- Franchisee has the right to transfer its interest in the franchised business.
- Franchisor allows transfer to qualified transferee. (Qualifications must be specified in Agreement or otherwise set forth in writing.)
- Franchisor prior written consent will not be unreasonably withheld or delayed.
- Franchisor does not control sale price or appraisal method.
- Terms and conditions of leases and/or other franchise related documents do not lead to excessive Franchisor control.

TYPE OF BUSINESS

(SOP 50-10(4), Sub A, Ch 2, ¶ 8, Pages 28 to 44)

Most types of businesses **are eligible** for financial assistance from SBA. To be eligible a small business must be:

- Organized for profit.
- Open to the public on a non-discriminatory basis.
- Located in the United States or its possessions.

The following are **not eligible for SBA financial assistance**:

- Non-Profit Businesses

- Businesses Primarily Engaged in Lending
- Passive Holder of Real/Personal Property: Entities that exist to passively hold real or personal property principally to collect the rental income from such properties are not eligible for SBA financing.
- Life Insurance Companies: Life insurance agencies, however, may be eligible for SBA financial assistance provided they are considered independent contractors and have no affiliation with the companies they represent.
- Businesses Located in a Foreign Country
- Businesses Selling Through a Pyramid Plan
- Businesses Engaged in Gambling: Businesses deriving more than one-third of gross annual revenues from legal gambling activities are not eligible for SBA financing. Businesses generating 33% or less from legal gambling are eligible if the activity is licensed and supervised by the appropriate state authority.
- Illegal Businesses: Businesses that directly engage in illegal activities and businesses that knowingly sell, service, or distribute legal products specifically used in support of illegal activities.
- Businesses Which Restrict Patronage: Businesses that restrict membership or patronage for any reason other than capacity (e.g. based on ethnicity, religion, gender, etc.).
- Government Owned Entities (Excluding Native American Tribes): SBA financing to assist municipalities or other political sub-divisions is prohibited as financial assistance from other Federal agencies is available to such entities. While Native American tribes are considered government entities, tribally-owned small businesses may be eligible for SBA assistance. Such businesses must establish legal distinction from the tribe, and lenders should ensure that the tribe has the authority to establish the applicant and that appropriate provisions are made to ensure collectability of the debt (e.g., waiver of sovereign immunity).
- Businesses Engaged in Promoting Religion: Businesses principally engaged in teaching, instructing, counseling or indoctrinating religion or religious beliefs. Businesses that primarily offer tangible religious items, broadcast religious music, publish religious periodicals or develop religious software may be eligible despite the religious aspect of the enterprise. Also, while non-profit religious entities are ineligible for SBA assistance, their for-profit subsidiaries may be eligible.
- Consumer or Marketing Co-operatives: Producer co-operatives, however, may be eligible. Eligibility requires the co-operative to be engaged in a business activity and to be organized for the financial benefit of both the co-operative and the member businesses, all of which must be considered small.
- Businesses Engaged in Loan Packaging: Loan packagers deriving more than one-third of their gross revenue from packaging SBA loans are ineligible for SBA financial assistance.

- Businesses Providing Prurient Sexual Material
- Businesses That Have Previously Defaulted on a Federally Assisted Financing Resulting in a Loss to the Government: This includes businesses owned or controlled by an applicant or any of its Associates (“Associate” is defined in 13 CFR Section 120.10) which previously owned, operated, or controlled a business which defaulted on a Federal loan (or guaranteed a loan which defaulted) and caused the Federal government to sustain a loss in any of its programs (for purposes of this section, a compromise agreement shall also be considered a loss).
- Businesses Primarily Engaged in Political or Lobbying Activities. This includes businesses where 50% or more of the applicant’s revenues or time are related to such activities.
- Speculation: SBA financial assistance is prohibited if the applicant business is principally engaged in speculation in any kind of property (real, personal or intangible).

USE OF LOAN PROCEEDS

(SOP 50-10(4), Sub A, Ch 2, ¶ 10, Pages 51 to 60)

SBA 7(a) loans may be used for most business purposes that benefit the small business including:

(SOP 50-10(4), Sub A, Ch 2, ¶ 10, Page 51)

- Acquisition, construction or renovation of buildings
- Purchase of equipment, fixtures or inventory
- Working capital
- Refinancing of existing debt
- Purchase of existing businesses

SBA loan proceeds **must not** be used for any of the following purposes: (SOP 50-10(4), Sub A, Ch 2, ¶ 11, Pages 52 & 53)

- Finance floorplan needs
- Purchase real estate where the participant has issued a forward commitment to the builder/developer
- Pay delinquent withholding taxes, sales tax or similar funds held in trust for a purpose other than use by the business
- Make payments to an Associate or principal of the business
- To acquire real estate that will be held primarily for investment purposes (exception is for Eligible Passive Companies discussed later).

Debt Refinancing Restrictions: (SOP 50-10(4), Sub A, Ch 2, ¶ 12, Pages 54 to 60)

To be eligible for refinancing by SBA, existing debt must not be on reasonable terms AND the refinancing must provide a substantial benefit to the small business. SBA has four basic rules pertaining to debt refinancing:

1. Refinancing cannot be used to provide an extension of credit for a purpose which is not otherwise eligible: The original purpose of the debt being refinanced had to have been eligible for SBA financing when originally made or the ineligibility has to have been eliminated prior to the approval of a refinancing.

2. Refinancing must provide the business with a substantial benefit: SBA measures the benefit by comparing the dollar amount of the monthly payment of a debt prior to being refinanced to the dollar amount of the monthly payment after refinancing. SBA requires at least a 20% reduction in the amount of the loan payment for any amortized debt with regularly scheduled principal and interest payments and a maturity over 12 months.

There are exceptions to the 20% test. SBA considers the following types of refinancing requests to be beneficial to the business even though the 20% test is not met:

- Debt structured with a maturity of 12 months or less requiring just interest only payments until maturity.
- A business related credit card debt that does not require a minimum payment to bring all interest current through the date paid plus reduces the principal that was owing at the time of billing by at least 5%. SBA will consider refinancing credit card debt if the applicant documents that the use of the credit card was business related. The application must include documentation to support that the debt was business related.
- Trade payables classified as short-term debts. Working capital proceeds can be used by an eligible small business to reduce or pay off that business's accounts payable and not be subject to either the substantial benefits or unreasonable terms test.
- Debt amortized with a balloon payment.

3. The debt being refinanced must be on unreasonable terms prior to refinancing. The principal test for how reasonable the terms of the existing debt are is whether the existing cash flow of the business is adequate to meet these obligations. If the payments are in excess of what an analysis of repayment and cash flow determines the business can reasonably pay, then the debt can be classified as being on unreasonable terms.

4. SBA prohibits loan proceeds from being used to pay a creditor who is in a position to sustain a loss. In such cases, refinancing would cause a shift to SBA of all or part of a potential loss from an existing debt.

On all debt refinancing, the following is required:

- Copies of all original and renewal notes.

- An explanation of what the original proceeds were used for and what collateral was given to secure the debt.
- Maturity tied to the original purpose of the loan.

Refinancing Participant's Own Non-SBA Debt: (SOP 50-10(4), Sub A, Ch 2, ¶ 12(c), Page 58)

For all debt refinancing, the lender must:

Certify in writing that subject debt is and has always been current for the entire period the loan has been outstanding up to 36 months, whichever is greater. Current means that a required payment has not remained unpaid for more than 29 days. (A loan that includes a payment unpaid for 30 days that subsequently was deferred is considered not current on that 30th day and is therefore not eligible for refinancing.)

Provide a transcript of the borrower's account with the application showing that the loan to be refinanced is current and has been current for at least the last 36 months.

Refinancing Non- Participant SBA Debt: (SOP 50-10(4), Sub A, Ch 2, ¶ 12(a) & (b), Pages 54 to 57)

A Lender can refinance existing SBA debt held by another lender ONLY if the Lender is able to demonstrate that the debt is eligible for refinancing AND the current lender is unwilling or unable to modify the terms to accommodate the borrower's current needs and repayment ability.

Refinancing Participant SBA Debt: (SOP 50-10(4), Sub A, Ch 2, ¶ 12(d), Page 59)

SBA will not consider a request to refinance a participant's SBA debt with one exception: If in order to assist the borrower, the loan needs to be reamortized AND the loan has been sold in the secondary market AND the purchaser (investor) will not permit a renegotiation of the terms, SBA may consider the request to refinance.

CREDIT ELSEWHERE TEST

(SOP 50-10(4), Sub A, Ch 2, ¶ 3 and 4, Pages 11 to 23)

SBA cannot provide financial assistance to small businesses that have the ability to obtain the financing without federal assistance. This means that funds must not be available on reasonable terms from any of these sources:

The lending institution: If a lending institution can provide the credit to the small business applicant on reasonable terms without SBA's guaranty, then the requested financing is not eligible for SBA consideration. In order to be eligible, the loan documentation must identify a reason why the loan request does not meet the lender's established policies or

regulatory restrictions.

The internal resources of the applicant concern: SBA requires that borrowed funds be unobtainable through the disposal, at a fair price, of assets owned by the applicant business, if these assets are not needed by the business to conduct its operation or not reasonably necessary for healthy growth.

The external resources of the applicant concern: SBA also requires that borrowed funds must be unobtainable through the disposal, at a fair price, of assets owned by any of an applicant's affiliates, that are not needed by the affiliate for its operation or that are not reasonably necessary for the affiliate's healthy growth.

The personal resources of the owners of the applicant concern: SBA requires the use of personal resources from any 20% or more owner as an injection to reduce the SBA funded portion of the total financing package. When the total financing package:

1. Is \$250,000 or less, each 20% owner of the applicant must inject any personal liquid assets which are in excess of two times the total financing package or \$100,000, whichever is greater; or
2. Is between \$250,001 and \$500,000, each 20% owner of the applicant must inject any personal liquid assets which are in excess of one and one-half times the total financing package or \$500,000, whichever is greater; or
3. Exceeds \$500,000, each 20% owner of the applicant must inject any personal liquid assets which are in excess of one times the total financing package or \$750,000, whichever is greater.

Requirements of the rule are:

1. Only individuals (not businesses) who own 20% or more of the small business concern or the eligible passive company are subject to this rule. (Spouses and any dependent children with a combined ownership interest of 20% or more in the applicant or eligible passive company are subject to the rule.)
2. The exemption thresholds are based on the total financing package, not just the loan that SBA guarantees.
3. Only liquid assets are subject to the rule.

There are no additional exemptions. This means there are no exemptions for education, retirement funds not subject to withdrawal restrictions or other penalties, medical reserve fund, business contingency, or any other type of exemption that originates from a personal desire.

SPECIAL ELIGIBILITY FACTORS

(Various locations within SOP 50-10(4), Subpart A)

In addition to the standard eligibility issues of size, type of business, use of proceeds, and credit elsewhere, there are also some other special factors that impact eligibility.

Eligible Passive Concerns (EPC) (SOP 50-10(4), Sub A, Ch 2, ¶ 9, Pages 45 to 50)

As previously stated SBA is prohibited from providing financial assistance to businesses owned by developers or landlords. SBA allows one exception—a loan structure where the Borrower is a passive owner of the assets to be financed with the loan proceeds and leases the assets to an Operating Company (OC). The Borrower in these cases is an Eligible Passive Company (EPC). SBA has several special requirements that must be met when the loan has an EPC/OC structure:

- The OC must be an eligible small business, and the proposed use of the proceeds must be an eligible use as if the OC were obtaining the financing directly.
- The EPC and the OC each must be small under the appropriate size standards. When determining size, the EPC is not combined with the OC unless an affiliation exists. The fact that the EPC is leasing the project property to the OC does not in and of itself create an affiliation.
- There can be multiple OCs but only one EPC.
- All parties must be liable:
 - EPC as Borrower
 - OC as either a Guarantor or Co-Borrower
 - All 20% or more owners of both the EPC and OC must guarantee the loan in full.
- OC MUST be a Co-Borrower when:
 - Any assets purchased with loan proceeds will be directly owned by the OC and appear on the OC's balance sheet
 - Use of proceeds includes working capital
- There must be a written lease for 100% of the property financed with loan proceeds from the EPC to the OC and:
 - Lender must obtain a perfected assignment of rents paid under the lease between the EPC and the OC.
 - Term of the lease, with options to renew, must be equal to or exceed the term of the loan.
 - Lease payments must not exceed the amount necessary to cover the amortization of the SBA 7(a) loan plus any expenses related to maintaining the property as well as paying property taxes and insurance. Lease payments cannot include a profit margin to the EPC.

Change of Ownership (SOP 50-10(4), Sub B, Ch 3, Pages 193 to 199)

Loan proceeds may be used to accomplish a change in ownership of a small business where:

- The transaction will result in the Borrower acquiring/owning 100% of the business;
- The buyer(s) and seller(s) are involved in an arms-length transaction, and the price to be paid represents the fair market value of the business; and
- There is a reasonable need for the change in ownership, e.g., the change in ownership will promote the sound development of the small business, or will preserve the existence of the small business.

Acquisition of a Existing Business

Issues that the Lender should consider when presented with a loan request that will result in the change of ownership of a going concern include:

- Are the parties related?
- How did the parties arrive at the fair market value for the business; e.g., was an independent appraiser, or other acceptable method of evaluating a business used?
- What is the justification for the change of ownership? Will it benefit the small business?
- Is the repayment ability based, at least in part, on the historical performance of the business being acquired?

Asset Acquisition versus Stock Purchase

Where the change of ownership involves the acquisition of assets, the buyer does not assume the liabilities. Through a stock purchase, the buyer purchases the assets and assumes the liabilities. In both cases, the value of the business, including the value of the assets being acquired, must be established by an independent appraiser.

Partial Change in Ownership

When 7(a) loan proceeds are used for a change of ownership, the borrower must acquire 100 percent of the business. A partial change of ownership where the end result is that the borrower owns less than 100 percent of the business is not permitted.

Transactions Involving Family Members

Loan proceeds may be used in transactions between family members; however, the Lender must closely examine the business valuation, the company's historical performance documentation, and tax returns for accuracy.

Foreign-Owned Businesses or Non-U.S. Citizen-Owned Businesses

Foreign-owned Businesses (SOP 50-10(4), Sub A, Ch 2, ¶ 8(e), Page 31)

To be eligible, a foreign-owned applicant business must:

- Be located in the U.S.;
- Operate primarily in the U.S.
- Be authorized to operate in the state where it seeks SBA financial assistance;
- Pay taxes to the U.S.;
- Use loan proceeds exclusively for the benefit of the domestic operations.

Businesses Owned by Non-U.S. Citizens (SOP 50-10, Sub A, Ch 2, ¶ 15(h), Pages 70 & 70-1)

SBA can, in many cases, provide financial assistance to businesses owned by persons who are not U.S. citizens. SBA Form 912, “Statement of Personal History” identifies whether the owners and managers of the business are U.S. citizens. If they are not, they must provide documentation that includes their alien registration number. An alien registration number indicates that the person is in the U.S. legally. In addition, the Lender must:

1. **Obtain a photocopy of their INS documentation.** Lenders must place a photocopy of the individual’s documentation in the case file.
2. **Verify the status of the documentation with the INS.** INS verification must be done as part of the loan application with the findings submitted with the application package. The lender must submit an INS Form G-845 , “Document Verification Request”, with supporting information to the nearest INS office. The response from the INS generally takes 6 weeks.

INS releases information about the status of an alien to lenders or other non-governmental entities ONLY when a signed and dated authorization from the alien is attached to and submitted with the Form G-845 on that alien. INS requires that authorizations provide the person’s name, address, and date of birth. INS accepts either of the following authorization statements:

“I authorize the Immigration and Naturalization Service to release information regarding my immigration status to [name of lender], because I am applying for a U.S. Small Business Administration loan.” OR

“I authorize the Immigration and Naturalization Service to release alien verification information about me to [name of lender], because I am applying for a U.S. Small Business Administration loan.”

Without this additional language, INS will not respond to the Lender. It is also important not to abbreviate U.S. Small Business Administration. Individuals should submit the request on personal stationery, not SBA or lender letterhead. INS requires an original signature. Therefore, the Form G-845 and the statement authorizing INS to release the status information to the lender should never be faxed to an INS office.

3. **Determine if they are eligible based on their status.** For questions regarding status, Lenders should contact INS directly. A list of INS offices and sub-offices can be found at www.immigration.gov/graphics/fieldoffices/index.htm.

Legal Permanent Residents (LPR) are persons who may live and work in the U.S. for life unless the INS revokes this status through an administrative hearing. LPRs are eligible for SBA assistance. The primary document acceptable as evidence of LPR status is INS Form I-551 (551). INS has two versions of the 551. One is titled "Resident Alien Card". The other is titled "Permanent Resident Card". The latter is the most recent version of the 551. INS requires replacement of the 551 every 10 years to update the photograph. SBA requires that the 551 or an acceptable substitute must be current at the time it is submitted with an application.

INS revokes LPR status and deports aliens when they are convicted of criminal activity, normally a felony. Therefore, LPRs with felony convictions are not eligible unless:

- INS provides written documentation identifying the specific criminal activity stating that the LPR status is in good standing in spite of the specific documented activity, AND
- AA/FA or designee authorizes processing of this application.

Businesses owned by other documented aliens may be eligible. They must have current/valid INS documentation permitting them to reside in the U.S. legally. The documentation/status of each alien must be verified with INS.

4. **Determine if they will need to comply with the "Additional Requirements for Businesses owned by Foreign Nationals, Foreign Entities, and Non-Immigrant Aliens residing in the U.S." discussed below:**

Businesses at least 51% owned by individuals who have verified LPR Status from the INS and control the management and daily operations of the business can obtain financial assistance from SBA without complying with the "Additional Requirements" outlined in this section. Without verified LPR status, all businesses with foreign elements must also:

- Provide evidence that separate continual and consistent management (in addition to the owners) exists and will continue indefinitely.
- Have management that has U.S. citizenship or verified LPR status.
- Have management that has operated the business for at least 1 year prior to the application date.

- Pledge collateral within the jurisdiction of the U.S. sufficient to pay the loan in full any time during its life.

Miscellaneous Types of Businesses

Farms and Agricultural Businesses (SOP 50 1-(4), Sub A, Ch 2, ¶ 5, Page 22)

Farms and agricultural businesses are eligible for SBA business loan assistance but the Agency is not the primary maker or guarantor of loans to farms within the Federal government. Applications from businesses involved in raising crops or raising animals should first be referred to Rural Development (formerly Farmers Home Administration) programs, particularly if the applicant has a prior or existing relationship with that agency.

Medical Facilities (SOP 50 10(4), Sub A, Ch 2, ¶ 15(d), Page 68)

For profit hospitals, clinics, emergency outpatient facilities, medical and dental laboratories are eligible. Convalescent and nursing homes, i.e. Adult Living Facilities (ALF), **are eligible if** they are primarily involved in providing services, not just providing room and board, and they are licensed by the state where they will be located.

Litigation, Bankruptcy, Probation or Parole

Litigation (From Question 9 on SBA Form 4)

If a loan application discloses pending litigation, Lender should have the Borrower furnish the following:

- A copy of the complaint and answer that has been filed.
- An explanation from the Borrower's counsel as to the nature and potential effect of the litigation on Borrower's business.

Bankruptcy (From Question 10 on SBA Form 4)

If a loan application discloses a prior bankruptcy or that the applicant is currently in bankruptcy, Lender should have the Borrower furnish the following:

- An explanation from the Borrower as to the circumstances that caused the bankruptcy.
- If completed, a copy of the discharge.
- If ongoing, a copy of the plan, if any.

Probation or Parole (SOP 50-10(4), Sub A, Ch 2, ¶ 8(n), Pages 38 & 39)

Applications **will not** be accepted from businesses where a principal (any one of those required to submit an SBA Form 912, "Statement of Personal History"):

- is currently incarcerated, on parole, or on probation; or
- is a defendant in a criminal proceeding; or
- whose probation or parole is lifted expressly because it prohibits an SBA loan.

Affirmative response to Questions 7 or 8 on SBA Form 912: Eligibility judgments are made on a case-by-case evaluation of the nature, frequency, and timing of the offenses. An affirmative response does not necessarily preclude a loan to a business.

If yes to Question 7, the applicant must:

- Furnish details in a separate exhibit, including dates, location, fines, sentences, etc., whether misdemeanor or felony, dates of parole/probation, unpaid fines or penalties, names under which charged, and any other pertinent information.
- Complete a "Supplemental Affidavit to SBA Form 912, Statement of Personal History."

If yes to Question 8, the applicant must also furnish Fingerprint cards, Form FD 258 (available from the local SBA office) to be processed.

Fingerprint cards need to be submitted as soon as the requirement is identified to expedite loan processing.

The FBI will not process fingerprint cards with highlighted fields or fingerprint cards that have been perforated with any type of hole-puncher.

Combination Financing (sometimes referred to as Piggyback Financing) (SOP 50-10(4), Sub A, Ch 2, ¶ 4(g), Pages 20 to 23)- Amended by SBA Policy Notice 0000-1727.

Combination Financing occurs when a conventional non-SBA guaranteed commercial loan and a 7(a) loan are made to a single borrower at or about the same time and for the same or a similar purpose.

The SBA limits on the size of loans only applies to the 7(a) guaranteed loan. Therefore, the Combination Financing structure enables a lender to consider larger projects than could be considered with the 7(a) \$2,000,000 limit alone.

The legislation provides that Combination Financings must meet the following requirements:

- The financing must be comprised of both a loan guaranteed under the 7(a) loan program and a commercial loan which is not guaranteed by the federal government.
- The commercial loan may be made by the same participating lender that is making the 7(a) loan or by a different lender.

- The commercial loan may be made by a PLP lender.
- The commercial loan amount must not exceed the gross amount of the 7(a) loan.

If a PLP lender is making both the commercial loan and the 7(a) loan in a Combination Financing, the lender must submit the 7(a) loan to the SBA District Office, not the PLP Processing Center, for processing and approval.

Requirements Imposed on the Lender in the Senior Lien Position:

The lender must waive any provisions in its note or loan documents that:

1. Allow future advances except advances made for the reasonable costs of collection, maintenance, and protection of lender's senior lien.
2. Cross-collateralize the loan with other non-SBA financings provided by lender to borrower.
3. Have an early call feature.
4. Cause the note to be payable on demand unless the lender's note is in default.

In addition, if the note contains a default interest rate, a late payment charge, or a prepayment penalty, these must be subordinate to SBA's lien position on the collateral.

Note: If the commercial loan has a senior credit position to the 7(a) loan, a one-time fee equal to 0.7 percent of the amount of the commercial loan is to be paid to SBA. (See previous section on Fees.)

Other Requirements for Combination Financing

In addition to the items above, SBA has established the following requirements for Combination Loans:

- The term of the first lien note must be similar to the term of the SBA guaranteed loan, but no less than half the maturity of the SBA guaranteed loan.
- The first lien note must be fully amortizing and may not include a balloon payment.
- The interest rate of the first lien note may be no higher than the interest rate of the SBA guaranteed loan.
- A default interest rate on the first lien note is not permitted.
- No additional fees triggered by a default on the first lien note will be permitted.
- At least 75% of the proceeds of a Combination Financing must be used for real estate and long-term, fixed assets.

- The lien position for the SBA guaranteed loan may be no lower than second position.
- For the purpose of determining the size of the SBA loan, the “project” shall be defined as the total amount financed. It will not include the borrower’s down payment or any other items.
- The first lien note must be for a purpose that would be eligible for SBA financing.
- The lender cannot foreclose on the first lien note without foreclosing on the SBA note; therefore, there must be a cross default provision in both loan notes to ensure they are treated as one loan.
- Each of these items must be documented in the loan file to expedite review of the case.
- Please refer to SOP 50 10 (4) (E), Chapter 2 (Business Loan Eligibility), Paragraph 4 (Utilization of Personal Resources) (d) (3) through (9).

When the Combination Financing involves refinancing, the proceeds of both the guaranteed and non-guaranteed loans must both be eligible for SBA refinancing.

Once a Lender determines that the 7(a) applicant is eligible for SBA financial assistance, the next step is to determine if the applicant meets the credit standards of SBA.

Creditworthiness

Credit Analysis (SOP 50-10(4), Sub A, Ch 4, Pages 81 to 96)

SBA assumes that the Lender's decision to seek SBA's guaranty is made after the lender has conducted a thorough credit analysis of the applicant's request for financial assistance in accordance with prudent lending practices. **No loan can be guaranteed by SBA unless there is the reasonable assurance of repayment in a timely manner.**

The Lender's written credit analysis must demonstrate at a minimum a thorough assessment of 1) repayment ability; 2) financial statement analysis including ratio, trend, and pro forma analysis; 3) management capabilities; 4) collateral coverage; and 5) lender's experience with the applicant.

Collateral

Collateral is never a substitute for a full assessment by the Lender of the borrower's ability to repay the loan in a timely manner. If the Lender's analysis determines that the borrower lacks reasonable assurance of timely repayment from the earnings of the business, the loan request must be declined and not submitted to SBA for its guaranty.

In addition to a reasonable demonstration by the Lender of the applicant's ability to repay the loan timely, SBA has certain minimum collateral requirements. A 7(a) loan must be fully secured (or secured to the extent possible) with available collateral (both business and personal).

A loan is considered to meet SBA's collateral requirements if 1) the Lender obtains security interests in the available assets (business and personal) with a combined liquidation value that equals 100% of the loan approval (the Lender is not required to take liens on more collateral than is needed to secure 100% of the loan) or 2) the Lender obtains security interests in all available assets which together represents less than 100% of the loan amount. (Liquidation value of an asset means the amount expected to be realized if the lender sold the asset after conducting a reasonable search for a buyer and after deducting the costs of taking possession of the asset, preserving the asset and marketing the asset.) Although personal guaranties are not considered collateral, assets securing such guaranties are considered collateral.

When considering all assets available, the Lender should first consider assets acquired with the loan proceeds, then liens on other business assets, and then personal assets.

When loan proceeds will be used to buy business assets, the acquired assets must be pledged as collateral. When SBA refinances secured debts, SBA expects to have at least the same security as the original loan.

Commercial Real Property Collateral (SOP 50-10(4), Sub A, Ch 5, ¶ 3, Page 101)

If the purpose of the 7(a) loan is to acquire commercial real property, an appraisal for that property by a state licensed or certified appraiser is required when the approved loan amount (gross amount) exceeds \$250,000.

Appraisals are generally not required on secondary collateral.

Environmental Investigation and Mitigating Risk of Environmental Contamination
(SOP 50-10, Sub A, Ch 5, ¶ 7, Pages 115 to 128)

If the 7(a) loan is secured by commercial real estate, an environmental assessment in compliance with SBA’s environmental policy must be done to determine any risk of liability for environmental contamination.

The Authorization must contain terms and conditions complying with the SOP requirement of an adequate and prudent investigation of the environmental risk (the “Environmental Investigation”) on all Primary Collateral offered as security for any SBA-guaranteed loan. “Primary Collateral” is any business real property acquired or improved with loan proceeds or business real property pledged that represents over 50% of the value of all collateral securing the loan. If the Environmental Investigation determines potential existence of contamination, Lender must take adequate and prudent steps to mitigate the risks of contamination or Lender must decline the loan.

On 7(a) loans, SBA is responsible for determining the adequacy of the Environmental Investigation and the risk mitigation efforts. On PLP and *SBAExpress* loans, this responsibility falls upon the Lender. In addition to the SOP provisions, Lender’s due diligence and risk mitigation are subject to normal prudent lending and commercially reasonable standards.

Although SOP 50-10 (4) addresses performance of environmental analysis prior to “disbursement,” conducting the investigation and taking risk mitigation efforts can be time-consuming. SBA strongly advises Lenders to investigate and resolve environmental concerns early on, well before loan closing. For example, if an indemnification agreement is required from the seller, lengthy negotiations can occur, and the seller will be far more likely to provide indemnification prior to execution of sale documents at the closing.

Under the SOP’s Environmental Procedures, the Lender (in PLP and *SBAExpress* loans) or SBA (all other 7(a) loans) must take the following steps:

1. Insert as necessary the certifications set forth in the Additional Conditions Section, paragraph 9 in the Boilerplate 7(a) Loan Authorization.

2. Insert the relevant environmental terms and conditions in the Loan Authorization (see Additional Conditions Section, paragraph 2 in Boilerplate 7(a) Loan Authorization).
3. Perform an adequate and prudent Environmental Investigation on all Primary Collateral.

The Environmental Investigation must consist of one or more of the following:

- A Transaction Screening Analysis (TSA). The SOP generally requires, at a minimum, performance of a TSA, which includes:
 - (1) Completion of Environmental Questionnaire (EQ) asking questions about past use of the property of seller and/or current operator and signed by seller or current operator; Lenders can use the American Society of Testing and Materials (ASTM) version or its own questionnaire if it is more expansive than the SBA questionnaire in SOP 50-10 (4).
 - (2) Site inspection by lender or lender's agent (not by seller or seller's agent);
 - (3) An Environmental Records Review (See Pars. 7.b (14), 7.d(2)), which includes:
 - (a) review of regulatory agency files to minimum search distances from site
 - (b) review of historical records showing past use of site
 - (c) Lender's recommendation regarding the need for further investigation
- For loans of under \$25,000 or other limited exceptions, only an EQ is needed (See Par. 7d). The limited exceptions are:
 - (1) Site is vacant land with no prior business or agricultural use; or
 - (2) R/E collateral is only part of a multi-unit building; or
 - (3) Phase I done within 1 year from date of loan application, and:
 - (a) No risk of contamination at site, or
 - (b) Contamination found but no remediation required or remediation has been completed and "no further action" letter has been issued; or
 - (4) Lender has affirmative knowledge or belief (based on prudent lending standards) that property is not contaminated (Lender cannot rely upon the EQ to obtain this knowledge).
- A Phase I Environmental Site Assessment (ESA) performed by an environmental professional is required if lending experience or other information suggests a reasonable likelihood that the past uses of the site or adjacent sites are subject to potential contamination. A Phase I ESA includes:

- (1) Visual inspection of site and adjacent sites by environmental contractor.
 - (2) An Environmental Records Review (see above).
 - (3) Interviews with current owner and operators, neighboring sites, etc.
 - (4) Environmental contractor's recommendation re: need for further investigation.
4. Verify that the risk from any adverse findings is sufficiently mitigated to allow disbursement to occur. Disbursement is only justified if one of the following exists:
- The contamination does not exceed state action levels (Par. 7.g).
 - If more significant contamination has occurred, that the responsible governmental agency overseeing any cleanup has issued a "no-further action" letter (Par. 7.g).
 - If neither of the above applies, the seller or responsible party executes an indemnification agreement and can demonstrate that it has financial resources to complete the clean-up (Par. 7h). SOP 50-10 (4) contains a standard SBA indemnification agreement, which lenders can use without SBA approval. Deviations from this agreement require approval of the SBA's Office of Litigation, Office of General Counsel. TIP: SBA has negotiated indemnification agreements with a number of large companies, including many oil companies. Lenders should check with their local District or Branch office if a seller is not willing to sign the standard SBA form.
 - If indemnification is not available, the loan can only go forward if allowed under the risk mitigation factors outlined in SOP 50-10 (4), par. 7i. TIP: Generally, if remediation is ongoing and the amount of contamination is other than negligible, disbursement is discouraged unless there is either environmental insurance or escrow of funds from the sale of the property to cover reasonably anticipated clean-up costs.
5. Lender must document its decision-making and the actions it took to address environmental concerns and to justify approval and disbursement for the loan and retain these documents in the loan file.

SBAExpress loans: An *SBAExpress* lender may not request an *SBAExpress* loan number for a loan that will have Primary Collateral that will not meet SBA's environmental requirements or that will require use of a non-standard indemnification agreement.