

CHAPTER 4 - LOAN SERVICING

LENDER SERVICING RESPONSIBILITIES

Loan servicing is the responsibility of the Lender. Lenders must service all SBA-guaranteed loans using generally accepted commercial lending standards employed by prudent Lenders and comply with SBA policies and procedures concerning loan servicing actions (see Appendix 4-A for specific references to SOP 50 50 4, which governs servicing). Lenders must use the same standards for servicing SBA-guaranteed loans as they would for other loans in their portfolio of similar size and type.

SERVICING REGULAR BUSINESS LOANS

SBA recognizes three classifications of loans in servicing:

Approval Status: Loans in “approval status” are loans that have been approved by SBA but either the funds have not been fully disbursed to the borrower or the guaranty fee has not been paid by the Lender. Modification actions for loans in “Approval” Status are governed by the Standard Operating Procedures (SOP 50 10 4), “Loan Processing,” or by the Supplemental Guide for a specific program such as an *Express* Loan Program. (Note: Express includes *SBAExpress*, *CommunityExpress* and *ExportExpress*.) For those loans approved at an SBA Processing Center (Hazard, KY or Sacramento, CA), the requests for approval or acknowledgement of a Lender’s unilateral action are to be sent to the SBA Commercial Loan Servicing Center (CLSC) that covers the geographic area in which the business is located. For loans approved at the local district office, the modifications while in approval status are to be sent to the local office.

Regular Servicing Status: Loans are transferred to “regular servicing” status after all disbursements have been made and after the guaranty fee has been paid. Servicing actions for loans in “Regular Servicing” status are governed by SBA’s SOP 50 50 4, “Loan Servicing.” Requests for approval or acknowledgement of a Lender’s unilateral servicing action are to be sent to the CLSC that covers the geographic area in which the business is located (see next section of this chapter).

Workouts : In the event of an adverse situation affecting the borrower’s ability to repay the loan, all Lenders are required to initiate an effort to determine if the loan can be repaid through an alternative repayment approach. Servicing actions for loans in a workout situation are initiated while the loan is in “Regular Servicing” status and are governed by SBA’s SOP 50 50 4. The requests for approval or acknowledgement of a Lender’s unilateral servicing action are to be sent to the CLSC that covers the geographic area in which the business is located.

LOAN SERVICING CENTERS

SBA loan servicing is conducted at two centralized loan servicing centers specializing in commercial loans.

SBA CLSC East
2120 Riverfront Dr., Ste 100
Little Rock, AR 72202

SBA CLSC West
2719 N. Air Fresno Dr., Ste 107
Fresno, CA 93727

(501) 324-5871, x303
lrservicing@sba.gov

(559) 487-5650
fsc.servicing@sba.gov

The Little Rock CLSC serves borrowers located in the states encompassed by SBA Regions I, II, III, IV and VI (excluding Louisiana and New Mexico).

The Fresno CLSC serves borrowers located in the states encompassed by SBA Regions V, VII, VIII, IX, X and also Louisiana and New Mexico.

LOAN SERVICING REQUEST GUIDELINES

Elements of a servicing request

SOP 50 50 4, Ch. 4

A clear and concise cover letter drawn from information in the Lender's internal credit memorandum generally suffices as the servicing request to SBA. If the cover letter addresses the request and describes the supporting analysis, Lender does not need to submit additional information. SBA may request additional information as individual circumstances require. When submitting requests that involve complex credit or collateral issues, Lender should include its internal credit memorandum with the servicing request but should not submit copies of financial statements, appraisals or other documents related to collateral unless requested. Lenders are encouraged to submit requests for servicing by e-mail.

In general, servicing requests must address a common set of elements, which allow Lender and SBA to quickly understand the request, the status of the SBA loan(s), the condition of the borrower's business, and other factors important to the decision. The servicing request may require all or a portion of the following items:

- Statement of the proposed action, identification of obligor and a brief description of what makes the request necessary.
- Status of the SBA loan (date and amount funded, current balance and status).
- Summary of the analysis of the business, including analysis of financial statements.

- Summary of prior servicing experience with the borrower, e.g., loan modifications and/or issues pertinent to the request.
- Identification of guarantors/co-makers and a statement as to whether Lender has or will obtain their consent for the action.
- Summary of the impact/benefit of the action on the business.
 - Will the proposed action address the needs or solve the problems of the business?
 - Will the action protect the interest of the Lender and SBA?
- For loans sold in the secondary market, a statement as to whether Lender has given or will give Colson notification of proposed changes to loan terms and whether the secondary market holder has approved the changes.

Additional requirements for actions concerning loan collateral

SOP 50 50 4, Ch. 4, ¶ 6

Lender must protect SBA’s interest by maintaining responsible control over collateral items pledged to secure the loan. Lender should fully review the benefits and risks of any loan collateral adjustments.

For actions affecting collateral, Lender must address the following items in addition to those listed above:

- Summary of prior collateral actions approved by the Lender unilaterally and/or by SBA, and
- Summary analysis of collateral before and after the requested change.

Valuation of collateral: Lender is responsible for proper valuation of collateral. The following are general SBA guidelines:

- Appraisals. A recent appraisal prepared by a qualified appraiser must indicate the fair market value of the collateral. If an appraisal is not available, Lender must identify the alternative form of valuation (such as net book value, property tax assessment, internal valuation, etc.).
- Valuation of collateral. Generally, Lender should calculate the net realizable value of collateral by applying the following liquidation percentages to the fair market value (Lender should justify any alternative liquidation values used):

Real Property:	
Commercial – RE	75%
Residential - RE	80%
Unimproved Land.	50%

Business Assets (net of depreciation):	
Machinery/Equipment.	50%
Furniture/Fixtures	10%
Accounts Receivable/Inventory. . .	20%
Leasehold Improvements	5%

AUTHORITY DELEGATED AND NOT DELEGATED TO LENDERS

To help streamline delivery of its financial services to small businesses, SBA places increased reliance on its private sector lending partners. The SBA encourages its lending partners to utilize “unilateral/delegated authority” (i.e., without prior written consent of SBA) whenever possible. As a result, in the various regulations and SOPs, SBA has delegated to Lenders with certain levels of unilateral authority. Also, under supplemental loan guaranty agreements that SBA signs with Lenders in the PLP and Express loan programs along with the regulations, SOPs, and/or program guides for such programs, SBA has delegated to such Lenders a broad range of authority for actions taken on loans processed under their delegated authority that are in Approval and Regular Servicing status. In SOP 50 50 4, SBA has delegated to Lenders similar authority for loans processed under LowDoc that are in “regular servicing” status. SBA also specifies which actions it has NOT delegated to such Lenders (“non-delegated actions”). For Lenders operating under the standard loan guaranty agreement (SBA Form 750) and not under any supplemental agreement, SBA has granted, limited unilateral authority (in regulations and SOPs) to take certain servicing actions without prior SBA approval when the loan is in Regular Servicing or Liquidation status. All other servicing actions, for which SBA has not specifically granted unilateral authority, require prior written SBA approval.

SBA expects Lender to perform delegated or unilateral servicing actions without concurrence by or notification to SBA. Lenders must retain documentation regarding the action in its loan file. The exception to the rule is that Lenders must notify the appropriate field office or CLSC in writing when it makes delegated/unilateral changes that will require SBA to make changes to the SBA loans database or accounting records (e.g., interest rate, maturity date, etc.). SBA does not consider changes Lenders make on the 1502 report to be notification to SBA.

It is important for the Lender to recognize that they must NOT exercise “unilateral/delegated authority” indiscriminately. (SOP 50 50 4, Ch. 4, ¶ 12)

- Prudent lending/credit practices must always be used.
- Unilateral actions can be taken only when they:
 - Assist the small business in solving a problem;
 - Assist in its ability to repay the loan;
 - Will not adversely affect the interest of the Lender/SBA; and
 - Are in compliance with all applicable laws and regulations.

Remember that certain terms and conditions were placed in the loan and agreed to by all parties (borrower, Lender/SBA):

- To ensure repayment ability and success of the small business; and
- As a condition to the approval of the loan.

Non-delegated actions for PLP and Express Lenders and for LowDoc loans

13 CFR 120.453, 120.432, and 120.513;

SOP 50 50 4, Ch. 6, ¶ 5(c)(4); 6(2); 7(b)(2);

SOP 70 50 3, Ch. 6

SBA Form 1086 (emergency repurchase from secondary market)

SBA delegates to PLP and Express Lenders, and to other Lenders for LowDoc loans, authority to take all necessary routine “loan servicing” actions without prior SBA approval, **except**:

- Any action that would create a conflict of interest or confer any preference on the Lender in collection or lien position with respect to SBA’s position or the shared SBA/Lender position on the guaranteed loan.
- Compromise with any obligor of the principal loan balance outstanding for less than the full amount due. Lender can adjust accrued interest, if justified, without prior written SBA approval.
- If a loan is delinquent or liquidation is contemplated or underway, prior SBA approval is required to release a guarantor for less than the principal balance owed even if actual demand has not yet been made on the guarantor.
- Title property in the name of the SBA.
- Acquisition of title (in Lender’s name or the Agency’s) to environmentally impaired property (property which exceeds the minimum action levels established by relevant regulatory agencies).
- Transfer of a loan to another Lender.
- Sell or pledge more than 90% of a loan.
- Increase the loan amount or change the percentage of the SBA guaranty.
- Make an emergency repurchase from the secondary market (*See SBA Form 1086*).
- Handle non-routine litigation or litigation involving legal costs exceeding \$5,000.

Unilateral authority for all other Lenders

13 CFR 120.10 (“Preference”) and 120.513 (actions requiring SBA prior consent); SOP 50 50 4, Ch. 4, ¶ 10 and 13

All other Lenders have limited unilateral authority to make certain adjustments in the terms and conditions of a loan if SBA does not consider the action to be “substantial” and the action does not confer preference on the Lender. “Preference” would include but not be limited to a release or subordination of collateral to secure another loan made to the borrower by the same Lender.

Certain actions require the loan to be seasoned for the Lender to be able to exercise their unilateral authority. The term “seasoned” loan applies to a borrower’s loan that has demonstrated excellent repayment history over a period of time. For this reason, servicing requirements should generally be less stringent for “seasoned” loans. However, the Lender must exercise care to avoid abuse of the classification. If the Lender takes an action based on the “seasoned” loan classification, the Lender must document this in the borrower’s file. “Seasoned” loans are those loans which meet the following criteria:

- At least 4 years have elapsed since the loan was funded, or for loans under 7 years, where the original principal balance has been reduced at least 25%.
- The loan has been paid “as agreed” for the past 12 months.
- Collateral is at or near “approval” levels, subject to any approved modifications.
- The financial statements are favorable.
- The loan is satisfactory in all other respects.

The following is a listing of allowable unilateral actions such Lenders may take without SBA’s prior consent (subject to the restrictions and requirements in SOP 50 50 4, Chapter 4, paragraph 13). This is not all inclusive, but rather a compilation of the most frequently occurring loan servicing actions:

For any of the actions below to be considered as unilateral, it is important for the Lender to read paragraph 13, in Chapter 4 of SOP 50 50 4. Paragraph 13 identifies the policy and procedure for each of the categories below that must be considered for the action to be considered as unilateral.

- Correct obvious typographical errors in the Authorization.
- Provide pay off figures to the borrower.
- Modify financial statement requirements.
- Deferral of principal and/or interest payments.
- Release of collateral.
- Substitution of collateral.
- Subordination to senior liens.

- Changes to life insurance or hazard insurance requirements.
- Adjustments to the installment amount.
- Make loans to the borrower that do not affect the collateral.
- Approve a borrower's change in form of organization (assumption).
- Adjustments to management covenants.
- Accept prepayments.

SERVICING CONCERNS

Initial Interest Rate on Variable Rate Loans (*13 CFR 120.214(a), SOP 50 10(4), Subpart B, Chapter 1, ¶10.a.*): Every 7(a) Loan Authorization (“Authorization”) establishes the initial interest rate. SBA establishes the initial interest rate at the time it receives the application from the Lender. It is based on the prime rate in effect at that time. Once that rate is established, Lender cannot change it prior to closing regardless of the prime rate in effect. Lender **MUST** close the loan at the initial interest rate stated in the Authorization. After the initial disbursement, the Lender may change the interest rate on the first calendar day of the month following the date of the initial disbursement, providing this day coincides with the first day of a month designated as an adjustment month (e.g., monthly, quarterly, etc.). All other rate changes **MUST** be made on the first calendar day of the adjustment interval as stated in the Note (e.g., monthly, quarterly, etc.) following the rate change as reported in the Wall Street Journal.

Interest Rate Basis (*13 CFR 120.214(c), SOP 50 10(4), Subpart B, Ch. 1, ¶ 10.c.*): Lender must establish an interest rate basis before the date of first disbursement and must disclose it on the first SBA Form 1050, Settlement Sheet. SBA policy permits 30/360 (every month is treated as if it has 30 days regardless of the number of days in that month), actual/360 (not permitted for secondary market loans) or actual/365.

Reamortization of Payments: When the prime rate changes and Lender makes a change in the interest rate on a variable rate loan, Lender may reamortize the loan balance for the remaining number of months on the Note. The Lender must notify the Borrower, in writing, of the new payment amount. This will prevent the possibility of a balloon payment at maturity (SBA policy does not permit balloon payments).

Payment Application: For loans in “Regular Servicing” status, Lender **MUST** apply payments first to interest, up to the date it receives payment; then, the balance (if any) to principal. This is true of all SBA Notes regardless of the payment type (e.g., principal and interest, principal + interest, etc.).

SERVICE CHARGES / FEES

Cancellation of SBA Guaranty for Non-Payment of the Guaranty Fee (*13 CFR 120.524(7), SOP 50 10(4), Subpart B, Ch. 1, ¶ 15.f.*): SBA will automatically cancel its guaranty if Lender does not pay the guaranty fee as required. The Lender must pay the fee within 90 days of loan approval – even if the Lender has not closed the loan with the borrower.

On-going Servicing Fee (*13 CFR 120.220(f)(1&2), SOP 50 50 4, Ch. 3, ¶7.*): Lenders are required to pay SBA $\frac{1}{2}$ of 1% of the outstanding (guaranteed portion) of the principal balance on all loans approved after October 12, 1995 through September 30, 2002. The fee was reduced to $\frac{1}{4}$ of 1% effective October 1, 2002 for loans approved through September 30, 2004. The fee is paid monthly only when Lender has collected interest from the Borrower during that month. Lender CANNOT charge this fee to the Borrower.

Late Payment Fee (*13 CFR 120.221(d), SOP 50 50 4, Ch. 3, ¶ 8.a.*): Lenders may charge a late payment fee not to exceed 5% of the regular loan payment if Lender receives a payment more than 10 days after its due date. The late fee is optional and may be less than 5%. It is the Lender's responsibility to collect the late fee in addition to the regularly scheduled payment. The late fee is the property of the Lender and does not have to be shared with the investor if the Lender has sold the loan in the secondary market. Lender MUST NOT add late fees to the principal balance of the loan under any circumstances. Lender must not add the fees to the transcript of account submitted to SBA when Lender requests SBA's purchase of the guaranty nor can Lender deduct them from liquidation proceeds. SBA will not be responsible for paying late fees at any time under any circumstances. If SBA purchases a loan guaranty, SBA will permit the Lender to collect late charges from the borrower which were owed at the time of purchase, but only after SBA has been paid in full.

Out-Of-Pocket Expenses (*13 CFR 120.221(c), SOP 50 50 4, Ch. 3, ¶ 8.a.*): The Lender may collect from the Borrower necessary out-of-pocket expenses such as filing or recording fees for renewing security interests.

Assumption Fee: The Lender may charge an assumption fee consistent with the Lender's assumption fee on its non-SBA guaranteed loans but must not exceed 1 percent of the total outstanding principal balance of the loan being assumed. This fee may be paid by the seller or the assumptor.

Lender Prepayment Fees (*13 CFR 120.221(e), SOP 50 50 4, Ch. 3, ¶8.a.*): A Lender may not charge a *penalty* for full or partial prepayment of a loan.

However, as stated in the Note, the borrower may prepay. Borrower may prepay 20% or less of the unpaid principal balance at any time without notice. If borrower prepays more than 20% and the loan has been sold on the secondary market, borrower must:

- a. Give Lender written notice;

- b. Pay all accrued interest; and
- c. If the prepayment is received less than 21 days from the date Lender receives the notice, pay an amount equal to 21 days' interest from the date Lender receives the notice, less any interest accrued during the 21 days and paid under subparagraph b., above.

If Borrower does not prepay within 30 days from the date Lender receives the notice, Borrower must give Lender a new notice.

Subsidy Recoupment Fee (13 CFR 120.223):

For all 7(a) loans where the applications were received by the Lender ON, OR AFTER, December 22, 2000, a new prepayment charge, paid by the borrower to SBA ("subsidy recoupment fee"), has been added for those loans that meet certain criteria. Refer to 13 CFR 120.223 to determine when a loan meets the criteria for this fee. For a prepayment to be determined to be involuntary and therefore not eligible for the fee, the Lender must submit a request to the SBA office servicing the portfolio, which is required to obtain a decision from the Associate Administrator for Financial Assistance (AA/FA) or designee.

Lenders are instructed to report and remit all prepayments along with prepayment fees within 2 business days of receipt to Colson Services Corp.'s Section 7(a) Loan Payoff Department.

Regardless of the secondary market status of the loans, Lenders must report the prepayment and the prepayment fee on SBA Form 1502. Please indicate below the "SBA GP Number" that the subject 1502 remittance is for repayment and prepayment fee. Prepayment fee amount should be reported on the "Remittance Penalty" section of the 1502. The "prepayment amount" does not include accrued interest. It refers only to the principal amount being prepaid. Further information about 1502 reporting can be found at the end of this Loan Servicing chapter.

Servicing Fees on Purchased Loans: If a Lender continues to service a loan after purchase by SBA, the Lender may deduct a service fee on all regular payments collected. Within fifteen days of receipt by the Lender, SBA's share of the payments must be remitted to SBA, Denver, CO 80259-0001 using SBA Form 172. Instructions for computing the service fee are included on SBA Form 172. The Lender must compute the fee based on SBA's participation in the loan and the number of days of interest collected. However, a Lender must NOT collect a servicing fee from principal received (i.e., payments from liquidation proceeds).

COLSON 1502 REPORT

SBA Form 1502 is used by Lenders each month to report 7(a) loan balances, payments, the ongoing servicing fees and status information. This form is mandatory for all Lenders who have SBA guaranteed loans outstanding in their portfolios. Colson Services

Corp. (Colson), SBA's Fiscal Transfer Agent ("FTA"), has been designated as the collection agent for guaranty loan balances, status information, payments related to secondary market loans, as well as the ongoing servicing fees.

Colson does not identify the loans for a Lender to report on each month. It is the Lender's responsibility to generate the SBA Form 1502, identify the loans, indicate their status correctly, and forward it to Colson, together with all remittances, by the third calendar day of each month (or the next business day if the third calendar day is not a business day). The form may be in a hard-copy format. However, use of electronic media is strongly encouraged. Funds may also be remitted by wire transfer.

Lenders can use Colson's 1502 template, which is in Excel and Lotus spreadsheet formats. Lenders may remit the 1502 information to Colson on a diskette or via e-mail. The template can be downloaded, at no charge, by accessing the Colson website at www.colsonservices.com (select "Program Forms & Resources") or by calling Colson at 877-245-6159.

Complete the report very carefully. Please double check the status codes entered on the form.

Only report loans as "paid in full" when such loans actually have been paid in full. Do not report the following as paid in full:

- A loan that is being transferred to another Lender; use the status for transfer of the loan.
- A revolving loan with a balance that is paid to zero but which the Lender expects the borrower to continue to use as a revolver in the future; show the loan with a zero balance.

Any time a loan is mistakenly reported as paid in full, it is automatically deleted from SBA's computer system, the SBA guaranty is cancelled, and the loan file is sent to the Federal Records Center. A Lender can request reinstatement of the guaranty, however, if an adverse circumstance occurs while the guaranty is not in effect, SBA will likely not approve reinstatement and the Lender will have no guaranty for the loan.

Colson's website (www.colsonservices.com) contains all the information Lenders need to know about 1502 reporting. It includes field descriptions, FAQs, template instructions, fee calculator, Online User Guide, and much more. Lender also can contact Colson Customer Service at 877-245-6159.