SOP 50-10(4) EXECUTIVE SUMMARY

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INTRODUCTION

WHAT IS THE PURPOSE OF THIS SOP?

This standard operating procedure (SOP) stipulates the policy and procedures for the processing of all requests for financial assistance under the Agency's business loan programs. This SOP also provides the text of the rules of 13 Code of Federal Regulations (CFR) which correspond to making SBA business loans. The rules of 13 CFR govern the U.S. Small Business Administration (SBA). The rules are written in small bold text, and the policy is written in standard text. This SOP is written to and for the SBA field personnel engaged in the processing of business loans, including both the recommending and approving officials.

The business loan programs include: general business, microloan demonstration and development company loans. General business loans are described in section 7(a) of the Small Business Act while microloans are described in section 7(m) of this same Act. Development company loans are described in sections 503 and 504 of the Small Business Investment Act and referenced in Section 7(a)(13) of the Small Business Act. The statutory requirements of the business loan programs are Congressionally mandated and cannot be altered or waived by the Agency. The regulations pertaining to these three programs are primarily located in section (denoted by the symbol .) 120 of 13 CFR. However, the business loan programs are also governed by other sections of 13 CFR including but not limited to sections: 101, 112, 113, 117, 121, 136, 140, 142, 145, and 146.

Section 120 of 13 CFR is divided into nine parts including an introduction and eight subparts. This SOP will cover the introduction and the five subparts associated with processing business loans. These subparts include: A, B, C, D and H. The other three subparts cover post approval requirements and are discussed in separate SOPs.

Unless specified within the body of the rule, the regulatory requirements of the business loan programs cannot be altered or waived by the Agency. The policy and procedures of the business loan program are divided between the policies directly associated with statutory or regulatory provisions of the law or regulation and those promulgated, i.e., established under the authority provided the Agency to maintain both prudent and quality lending practices. Policies directly associated with law or regulation cannot be waived unless the law or regulation specifically permits a waiver. Procedures for obtaining a waiver are detailed in appendix 11 of this SOP.

This SOP is to be used in conjunction with its companion SOP 50-11 which provides technical support and guidance on credit analysis to be used during the processing function.

SUBPART A - POLICIES APPLYING TO ALL BUSINESS LOANS

WHAT IS THE PURPOSE OF THIS SUBPART?

This subpart contains the policies and procedures which govern all SBA business loans - Section 7(a) loans, Development Company (504) loans, and Section 7(m) Microloans.

CHAPTER 1 - GENERAL PROVISIONS

1. WHAT DOES THIS SUBPART COVER?

.120.1 Which loan programs does this part cover?
This Part regulates SBA's financial assistance to small businesses under its general business loan programs ("7(a) loans") authorized by section 7(a) of the Small Business Act ("the Act"), 15 U.S.C. 636(a), its microloan demonstration loan program ("Microloans") authorized by section 7(m) of the Act, 15 U.S.C. 636(m), and its development company program ("504 loans") authorized by Title V of the Small Business Investment Act, 15 U.S.C. 695 to 697f ("Title V"). These three programs constitute the business loan programs of the SBA.

2. DESCRIPTIONS OF THE BUSINESS LOAN PROGRAMS

.120.2 Descriptions of the business loan programs.

(a) 7(a) loans.

(1) 7(a) loans provide financing for general business purposes and may be:
(i) A direct loan by SBA;
(ii) An immediate participation loan by a Lender and SBA; or
(iii) A guaranteed loan (deferred participation) by which SBA guarantees a portion of a loan made by a Lender.

(2) A guaranteed loan is initiated by a Lender agreeing to make an SBA guaranteed loan to a small business and applying to SBA for SBA's guarantee under a blanket guarantee agreement (participation agreement) between SBA and the Lender. If SBA agrees to guarantee (authorizes) a portion of the loan, the Lender funds and services the loan. If the small business defaults on the loan, SBA's guarantee requires SBA to purchase its portion of the outstanding balance, upon demand by the Lender and subject to specific conditions. Regulations specific to 7(a) loans are found in subpart B of this part.

a. The 7(a) Program

The SBA has legislative authority to provide 7(a) loans to eligible small businesses through direct, immediate participation, or deferred participation (guaranteed). However, the ability of the Agency to provide 7(a) financial assistance depends upon the availability of congressionally authorized and appropriated funding.

Remember, a 7(a) guaranteed loan is actually a lender loan approved and funded by a participant (qualified lender), guaranteed by SBA, and subject to the regulations and policies applicable to all 7(a) loans. Even though commonly called an SBA loan, it is

actually a lender's loan with an SBA guaranty.

b. The Microloan Demonstration Project

(b) Microloans. SBA makes loans and loan guarantees to non-profit Intermediaries that make short-term loans up to $25,000 to eligible small businesses for general business purposes, except payment of personal debts. SBA also makes grants to Intermediaries for use in providing management assistance and counseling to small businesses. Regulations specific to these loans are found in subpart G of this part.

All loans to intermediaries are processed and approved at the Office of Financial Assistance (OFA) in Headquarters. See subpart D for discussion of the microloan demonstration project.

c. The Development Company Loan Program

(c) 504 loans. Projects involving 504 loans require long-term fixed-asset financing for small businesses. A Certified Development Company (CDC) provides the final portion of this financing with a 504 loan made from the proceeds of a Debenture issued by the CDC, guaranteed 100 percent by SBA (with the full faith and credit of the United States), and sold to investors. The regulations specific to these loans are found in subpart H of this part.

See Subpart H for discussion of the 504 Loan Program.

d. Pilot Loan Programs

.120.3 Pilot programs.
The Administrator may from time to time suspend, modify, or waive rules for a limited period of time to test new programs or ideas. The Administrator shall publish a document in the Federal Register explaining the reasons for these actions.

Public Law 105-208 enacted September 30, 1996, limited SBA's authority to conduct pilot programs. Under this law, the number of loans under any pilot initiated after the date of enactment must not exceed 10 percent of the total number of loans guaranteed during a year.

3. DEFINITIONS USED IN THE BUSINESS LOAN PROGRAMS

.120.10 Definitions.
The following terms have the same meaning wherever they are used in this part. Defined terms are capitalized wherever they appear.

Associate

(1) An Associate of a Lender or CDC is:

(i) An officer, director, key employee, or holder of 20 percent or more of the value of the Lender's or CDC's stock or debt instruments, or an agent involved in the loan process;

(ii) Any entity in which one or more individuals referred to in paragraphs (1)(i) of this definition or a Close Relative of any such individual owns or controls at least 20 percent.

(2) An Associate of a small business is:

(i) An officer, director, owner of more than 20 percent of the equity, or key employee of the small business;

(ii) Any entity in which one or more individuals referred to in paragraphs (2)(i) of this definition owns or controls at least 20 percent; and

(iii) Any individual or entity in control of or controlled by the small business (except a Small Business Investment Company ("SBIC") licensed by SBA).

(3) For purposes of this definition, the time during which an Associate relationship exists commences six months before the following dates and continues as long as the certification, participation agreement, or loan is outstanding:

(i) For a CDC, the date of certification by SBA;

(ii) For a Lender, the date of application for a loan guarantee on behalf of an applicant; or

(iii) For a small business, the date of the loan application to SBA, the CDC, the Intermediary, or the Lender.

Reference subpart A, chapter 2, paragraph 4.m. for further guidance on how a change of ownership impacts changes to the associate relationship.

Authorization is SBA's written agreement providing the terms and conditions under which SBA will make or guarantee business loans. It is not a contract to make a loan.

Borrower is the obligor of an SBA business loan.

Certified Development Company ("CDC") is an entity authorized by SBA to deliver 504 financing to small businesses.

Close Relative is a spouse; a parent; or a child or sibling, or the spouse of any such person.

Eligible Passive Company is a small entity or trust which does not engage in regular and continuous business activity, which leases real or personal property to an Operating Company for use in the Operating Company's business, and which complies with the conditions set forth in .120.111.

Immediate Family Unit - Two married spouses and all dependent children

Intermediary is the entity in the Microloan program that receives SBA financial assistance and makes loans to small businesses in amounts up to $25,000.

Lender is an institution that has executed a participation agreement with SBA under the guaranteed loan program.

Loan Instruments are the Authorization, note, instruments of hypothecation, and all other agreements and documents related to a loan.

Operating Company is an eligible small business actively involved in conducting business operations now or about to be located on real property owned by an Eligible Passive Company, or using or about to use in its business operations personal property owned by an Eligible Passive Company.

Preference is any arrangement giving a Lender or a CDC a preferred position compared to SBA relating to the making, servicing, or liquidation of a business loan with respect to such things as repayment, collateral, guarantees, control, maintenance of a compensating balance, purchase of a Certificate of deposit or acceptance of a separate or companion loan, without SBA's consent.

Principal is a term that does not have a single definition. However, there is a standard definition that shall be used if no further definition is provided. The standard definition of principal includes the following: sole proprietors; general partners; limited partners owning 20 percent or more of the equity of the business; and all owners of 20 percent or more of the equity of a corporation. This definition shall be used when ever the term principal is used unless a different definition is provided.

Principal may also include corporate officers with between 5 - 20 percent ownership of a corporation, all guarantors, and other key employees. These additional entities will be added to the standard definition of principal in those instances where needed.

Principal can also mean a married couple where both own some interest in the applicant and together they own at least 20 percent.

Rentable Property is the total square footage of all buildings or facilities used for business operations. By Policy, "Rentable Space" is only "Interior Space"

Rural Area is a political subdivision or unincorporated area in a non-metropolitan county (as defined by the Department of Agriculture), or, if in a metropolitan county, any such subdivision or area with a resident population under 20,000 which is designated by SBA as rural.

Service Provider is an entity that contracts with a Lender or CDC to perform management, marketing, legal or other services.

CHAPTER 2 - BUSINESS LOAN ELIGIBILITY

1. REGULATIONS AND POLICES APPLICABLE TO ALL LOANS

The regulatory requirements applicable to all business loans are described in subpart A of 13 CFR .120 (120.100 through 120.199). The policies and procedures for all business loans are described in chapters 2 through 4 of this SOP.

Subpart A . Policies Applying to All Business Loans

The following SBA eligibility requirements apply to all SBA business loan programs - 7(a) loans, microloans, and 504 loans. An applicant must be in compliance with the rules and policies of SBA at the time of application to be eligible for financial assistance from this Agency.

a. When Should Eligibility Be Determined?

The determination of eligibility of every applicant should be made as soon as possible in the loan making process. You can often make a preliminary determination during the applicant's or the lender's first contact with the Agency. If the business is complex or unique, you should recommend to the applicant or lender to request a formal eligibility determination prior to applying. You should advise the applicant or lender as soon as an application is determined to be ineligible or when eligibility problems appear likely. This prevents unnecessary expense and frustration in the preparation of an SBA application. When advising the applicant or lender about eligibility, make clear that credit has not yet been analyzed.

The field office determines final eligibility based on the information provided at the time of application.

b. May Eligibility Be Considered Prior To Formal Application?

Yes. At times a case may come to the attention of the processing office before actual application is made which has eligibility questions associated with it. The SBA may accept a written request from either a lender or applicant requesting a formal eligibility determination prior to receipt of the application. The letter should be addressed to the approving official and include sufficient information for a adequate determination on the relevant eligibility factors. Counsel may be consulted as necessary.

c. Who Has Authority to Make Eligibility Determinations?

Officials with authority to take final action on the assistance requested also have the authority to make the ultimate eligibility determinations about the application. The loan

officer generally makes a recommendation regarding eligibility, and the approving authority takes final action. If there is a question about eligibility, like an unusual or complex situation or one without a clear precedent, the approving official must consult SBA field counsel for a legal opinion.

If there is a difference of opinion between the Finance Division (FD) and field counsel, every effort should be made to reach an accord. If one cannot be reached, each must prepare a memorandum summarizing his or her position and forward it through the district director (DD) to the Associate Administrator for Financial Assistance (AA/FA) or their designee. The AA/FA must consult with the Office of General Counsel (OGC) for legal advice. If the AA/FA and General Counsel do not agree on the determination, they will submit the eligibility issue to the Administrator for final decision.

2. ELIGIBILITY REQUIREMENTS FOR BUSINESS LOANS

.120.100 What are the basic eligibility requirements for all applicants for SBA business loans? To be eligible for an SBA business loan, a small business applicant must:

(1) Be an operating business (except for loans to Eligible Passive Companies);

a. Impact of the Form of Business Entity on Eligibility

Any legal form is eligible so long as it is for profit. If the entity is a joint venture, no more than 49 percent of the joint venture may be foreign business entities.

b. May Businesses Restrict to Whom They Sell or Provide Service?

The products and services of the small business must be available to the general public. The small business may not discriminate with regard to goods, services, or accommodations offered or provided, because of:

1 race 3 color 5 age
2 religion 4 sex 6 disability, and or
7 ethnic or national origin of a person.

The small business must accept a person on a non-segregated basis as a patient, student, visitor, guest, customer, passenger, or patron.

c. Can One Loan Be Used To Assist More Than One Business?

Yes. SBA can guaranty a single loan that provides financial assistance to multiple businesses. These businesses can either be affiliated or unaffiliated. This arrangement can be accomplished under either 7(a) or 504 program rules. The loan must be structured so the multiple businesses are co-borrowers when no Eligible Passive Concern (EPC) is involved. When the borrower is an EPC, the multiple operating companies (OCs) can be either co-borrowers or guarantors. For additional information on EPC see Subpart "A", Chapter 2, paragraph 9.

In addition, if the borrower is an EPC, there can only be one EPC borrower. SBA has no provision to permit one loan to multiple EPCs under any circumstances. For additional information on EPC refer to Subpart A, Chapter 2, paragraph 9.

(2) Be organized for profit;

All recipients of SBA business loan assistance must be organized for-profit. The only exception is for loans made under section 7(a)(10)(handicapped assistance for sheltered workshops) and this exception can only be evoked if, and only if, funds are specifically appropriated for 7(a)(10) loans.

d. Is a For-Profit Business Owned By a Non-Profit Entity Eligible?

Yes, such businesses are eligible if they meet SBA's other eligibility requirements.

(3) Be located in the United States;

e. May Money be Borrowed for Operations in Another Country?

No, financial assistance is only available for the domestic operations of businesses. Export Working Capital Program (EWCP) and International Trade (IT) loans are for domestic operations, even though some or all of the EWCP funds are for the purpose of accessing foreign markets.

(4) Be small under the size requirements of Part 121 of this chapter (including affiliates). See subpart H of this part for the size standards of Part 121 of this chapter which apply only to 504 loans; and

f. Size Requirements

See subpart A, chapter 3 for the basic size requirements.

(5) Be able to demonstrate a need for the desired credit.

g. How is the Need for a Loan Demonstrated?

An applicant demonstrates need if it is unable to obtain the desired credit from non-Federal lending sources, i.e., banks, savings & loans, small business lending companies, etc., on reasonable terms for valid business purposes.

An applicant must use assets owned by it or its affiliates not needed for the operation of the business before it may qualify for SBA financial assistance. A financing need exists when the desired capital is not available through the operations of the applicant or its affiliates.

h. Start Up Businesses?

Applicants that have not yet commenced operation shall have the eligibility criteria associated with .120.120 through .120.131 considered based on what the business intends to do rather than on what it is doing on the day of application. As such, a business that projects to generate 50 percent of its annual income from gambling would not be eligible since gambling income is restricted to no more than one third of an applicant concern's annual income.

3. SBA'S CREDIT ELSEWHERE CRITERIA

As a Federal Agency that relies upon Federal taxpayer dollars to support its lending programs, SBA cannot provide financial assistance to small businesses that have the ability to obtain the financing on reasonable terms without Federal assistance. Therefore SBA has a "credit elsewhere test" to which all business loan applicants are subject. The regulatory rules of this "test" are detailed in .120.101:

.120.101 Credit not available elsewhere.
SBA provides business loan assistance only to applicants for whom the desired credit is not otherwise available on reasonable terms from non-Federal sources. SBA requires the Lender or CDC to certify or otherwise show that the desired credit is unavailable to the applicant on reasonable terms and conditions from non-Federal sources without SBA assistance, taking into consideration the prevailing rates and terms in the community in or near where the applicant conducts business, for similar purposes and periods of time. Submission of an application to SBA by a Lender or CDC constitutes certification by the Lender or CDC that it has examined the availability of credit to the applicant, has based its certification upon that examination, and has substantiation in its file to support the certification.

a. The Credit Elsewhere "Test":

Credit Elsewhere is an eligibility factor that must be determined prior to assessing the credit factors of a loan request. The purpose of Credit Elsewhere is to determine if the applicant concern along with its affiliates and principals has the ability to obtain some or all of the requested loan funds from alternative sources without causing undue hardship to the applicant, its affiliate(s), or principal(s). These alternative sources include:

(1) The lending institution;

(2) The internal resources of the applicant concern;

(3) The external resources of the applicant concern;

(4) The personal resources of the principals of the applicant concern.

If the financial assistance applied for is otherwise available on reasonable terms from any of these sources, the application must be denied.

b. The Lending Institution as an Alternative Source:

Lending institutions are a source of credit for small businesses. If a lending institution will provide the credit to the small business applicant, on reasonable terms, without SBA support, the requested financing is not eligible for SBA consideration. As part of the Credit Elsewhere Test, every lender who applies to SBA for a guaranty of a loan they propose to make to a small business must signify that they could not make the proposed loan without SBA support. Lenders have to substantiate their compliance with the credit elsewhere rules.

c. Lender Substantiation of Compliance with Credit Elsewhere Rules

504 third-party lenders and 7(a) lenders must explain to SBA the factors that prevent the financing from being accomplished without SBA support. The CDC or 7(a) lender must retain the explanation in the applicant's file. The CDC may use this information to satisfy the requirements of Exhibit #19 of the Application for 502/504 Loan (SBA Form 1244), Part A, when it applies for a 504 loan. Microloan intermediaries (microlenders) must have a letter of decline from an institutional lender such as a bank for loans of $15,000 or more in the applicant's file. Substantiation is not required for microloans of less than $15,000.

d. What Factors Are Acceptable as Substantiation?

Acceptable factors are those that demonstrate an identifiable weakness in the credit or exceed policy limits of the lender. These factors include, among others:

(1) The business needs a longer maturity than the lender's policy permits (for example, the business needs a loan that is not on a demand basis);

(2) The requested loan exceeds either the lender's legal limit or policy limit regarding the amount that it can loan to 1 customer;

(3) The lender's liquidity depends upon selling the guaranteed portion of the loan on the secondary market;

(4) The collateral does not meet the lender's policy requirements because of its uniqueness or low value;

(5) The lender's policy normally does not allow loans to new ventures or businesses in the applicant's industry; and/or

(6) Any other factors relating to the credit that, in the lender's opinion, cannot be overcome except for the guaranty.

e. What Factors Are Not Acceptable Substantiation?

Any factors related solely to a lender's choice to obtain a guaranty without any identifiable weakness in the credit or failure of the credit to meet the lender's established policies or regulatory restrictions are unacceptable. Typical examples are when SBA's guaranty is sought for unacceptable reasons:

(1) Substantiate Community Reinvestment Act (CRA) compliance;

(2) Improve the lender's collateral lien position;

(3) Refinance debt already on reasonable terms; or

(4) Comply with the requirement for small business lending companies (SBLCs) that SBA guarantee all loans.

f. What is the Certification Process Under Credit Elsewhere?

For 7(a) loans, the lender must certify that credit is not otherwise available by signing the Lender Official block on the appropriate application form. The lender's certification is

"I approve this application to SBA subject to the terms and conditions outlined above. Without the participation of SBA to the extent applied for we would not be willing to make this loan, and in our opinion the financial assistance applied for is not otherwise available on reasonable terms. I certify that none of the Lender's employees, officers, directors or substantial stockholders (more than 10 percent) have a financial interest in the applicant.

A certification requirement does not exist for microlenders.

For 504 loans, the third-party lender must send a written explanation to the CDC stating the reasons it will not finance the project without SBA support. The CDC must also write an explanation stating why the financing is not otherwise available.

g. Must Consideration of Prevailing Rates and Terms Be Documented?

No, except as noted above for microlenders, the SBA assumes the lender has considered the prevailing rates and term in its market. Just because the lender knows what may be available on an isolated basis does not require a referral of the credit to another lender.

h. The Importance of Providing Credit on Reasonable Terms

All debt guaranteed by SBA is on reasonable terms when made. Lenders certify this when they request SBA to guaranty the loan they propose to make to their applicant. SBA does not refinance debt that is already on reasonable terms. Therefore, it is important to understand how SBA determines if a debt's terms and conditions are reasonable or why they are no longer reasonable in order to confirm that the lender's certification was correct and to know whether one of the refinancing eligibility factors has been satisfied.

i. Guidelines to Determine if Credit Terms are Reasonable

Generally, structuring debt in accordance with the need being financed and within the repayment ability of the borrower is reasonable and prudent financial management. We do not encourage small businesses to finance fixed asset purchases with demand notes or revolving lines of credit. We also find that loans have unreasonable credit terms if they require a debt service burden that is in excess of debt service ability.

Another reason existing terms can be deemed unreasonable is when they do not allow the applicant concern the ability to accumulate equity in the assets being financed for a prolonged period of time (such as a 10 year interest only debt due in full at maturity) or when the loan is clearly for the benefit of an individual (such as a seller take back note amortized over 35 years).

j. How is the Availability of Credit on Reasonable Terms Determined?

When evaluating whether loans available from non-Federal sources are on reasonable terms, consider if the loan amounts, interest rates, maturities, payment schedules, and loan conditions from these sources can be reasonably accommodated from the cash flow of the small business. Although a small business may be able to obtain a loan from a non-Federal source, the terms or conditions may not meet its needs, and therefore be classified as unreasonable.

If the business is unable to get financial assistance from non-Federal sources on terms and conditions that meets its business needs, SBA has determined that the desired credit is deemed to be not available on reasonable terms.

Q1. What are some examples of the circumstances that create situations where the "needs" of a business are not reasonably met because of the terms or conditions of a loan being provided from a non-Federal source?

A1. An analysis of cash flow available to service all proposed debt compared to the debt service requirement must be performed to determine whether the debt is on reasonable terms. If anticipated cash flow covers all proposed debt service, the terms may be considered to be reasonable. However, if the margin of difference between the two is so small as to leave too little room for error or growth or other needs as they may arise, the terms may be considered to be not on reasonable terms.

Another example would be where a lender has secured a loan with so much collateral, that the business has no collateral to offer on any other loan and therefore has a limited or non-existent ability for additional borrowings. A method to evaluate if an overabundance of collateral has been required would be to compare what SBA would require to secure the same loan. If the lender has required assets in addition to what SBA would require, this could be considered an overabundance, rendering the loan's collateral term unreasonable, and eligible for refinancing.

Q2. If SBA generally requires that the collateral securing any loan being refinanced to also secure the new loan that provides the refinancing and if an overabundance of collateral is used to substantiate that the original debt was not on reasonable terms, isn't the same unreasonable terms issue (an overabundance of collateral) continued, because the new loan is secured by the same collateral as the original loan?

A2. Maybe. It will depend on whether the new loan is strictly to refinance the one loan that had the overabundance of collateral or if the new loan also includes new money which will be used to acquire assets that will have a value that is less than the amount of the new money. When refinancing a debt that was over secured, consideration can be given to securing the new loan with less collateral, providing the loan is fully secured based on the way SBA values collateral. In the latter case, the new money could be used for working capital or leasehold improvements (as examples) which have minimal collateral value. The new loan will only be fully secured if the overabundance from the original loan is used to not only cover the refinanced debt but also the debt associated with the new money.

When a non-SBA loan has collateral with a value (based on SBA's way of assigning value) that exceeds the amount of the loan, the loan is considered to be over collateralized. SBA wants to make sure that when a loan that has an overabundance of collateral is refinanced, that a sufficient amount of these assets secure the new loan so that the new loan is fully collateralized, e.g., has an SBA collateral value equal to no less than the value of the loan.

Q3. Can an overabundance of collateral be created through the appreciation of the value of assets which secure a loan or a decrease in the amount of debt in relation to the amount of collateral securing that debt?

A3. No. A loan that did not have an overabundance of collateral when originally made can not be reclassified as having an overabundance just because the principal balance decreases and/or the value of the assets securing the loan appreciates. An overabundance of collateral can not be created through the process of making normal payments on a collateralized loan just because the equity in the collateral may have increased over the duration of that loan.

Q4. What renders a loan's terms unreasonable?

A4. For loans providing new money, SBA considers whether the business can meet the debt service requirements of the proposed loan plus any other term debt(s) existing or to be created as part of the financing from its available cash flow, and whether these payments are predictable for the borrower over the loan's term.

A loan with an interest rate that is variable and subject to continual fluctuations could be reasonable as long as the basis for change is understood at origination and not alterable without borrower consent.

When refinancing existing debt, the reasonableness test starts with an analysis of whether the present cash flow is adequate to service this existing debt. See subpart A, chapter 2, paragraph 11.

k. Is Credit Card Debt Considered Reasonable?

Only if the credit needed by the small business is short term in nature might credit card debt be on reasonable terms, depending on the rate of interest and other terms of the credit card debt.

l. Are Balloon Notes Considered Reasonable?

No. Many businesses find the stability provided by fully amortized long-term debt preferable to shorter maturities with a long amortization (balloon notes), even though interest rates may be lower on the latter. The following are concerns about balloon notes:

(1) Condition and willingness of the lender to refinance;
(2) Interest rate changes;
(2) Prevalent market conditions in the future; and
(4) Renewal fees.

Small businesses need to be able to match the maturity of the loan to the expected economic life of the assets being financed. Notes with balloons frequently hinder small businesses from planning effectively.

For eligibility purposes we consider notes with balloons to be on unreasonable terms.

m. Are Demand Notes Considered Reasonable?

No. Demand notes put a business in a position where its debt financing is uncertain and is at the discretion of the lender. If the note is called, which may occur for any reason, the business may not be able to obtain other financing. This unduly jeopardizes the continued existence of the business.

n. Are Interest Only Notes Considered Reasonable?

Maybe. The determination has to be made on a case by case basis.

Intermediate and long-term debt that requires only interest payments until the debt matures is not reasonable. Such a structure may be used for seller take back financing of a business but the purchaser could just as easily be paying rent. The unreasonableness here is that such a loan does not allow the business to accumulate any equity in the assets being acquired rather than the inability of the borrower to be able to repay the loan.

Lines of Credit that accept either interest only or principal and interest payments until a stated maturity or demand is made may be considered reasonable if the borrower properly maintains their line.

Seasonal lines that require interest only payments for a specified period and then principal and interest for the reciprocal period are generally reasonable.

o. Internal Resources as an Alternative Source:

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

In addition to considering the internal resources of the applicant concern as a source of credit at the time of application, the internal resources of the applicant concern after disbursement have to be considered a potential source.

Consider an existing printing company with three printing presses that desires to replace its oldest press. Proceeds can be authorized to acquire and install the new press as well as to remove the old press. If the old press is no longer needed by the applicant, it can be sold. Under such circumstances the proceeds from the sale are to be applied against the loans outstanding balance.

p. External Resources as an Alternative Source:

SBA also requires that the 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.

q. Personal Resources as an Alternative Source:

Reference paragraph 4 of this chapter.

4. UTILIZATION OF PERSONAL RESOURCES

As part of its credit elsewhere test, SBA requires the personal assets of all owners of 20 percent or more of the applicant firm (or operating company) be reviewed and subject to injection in lieu of loan proceeds. This regulation is commonly known as the "utilization of personal resources test." a/k/a "UPR"

.120.102 Funds not available from alternative sources, including personal resources of principals.

The standard definition of "Principal" shall apply to .120.102

Policy applicable to the "utilization of personal resources test" follows.

a. What is the Purpose of the Personal Resources Rule?

Utilization of personal resources is a matter of eligibility for both the 7(a) and 504 programs and is required by authorizing legislation. The purpose is to restrict the use of Government-backed funding, when that funding, or a portion of it, is available from the personal resources of those individuals who stand to benefit most from the funding.

(a) An applicant for a business loan must show that the desired funds are not available from the personal resources of any owner of 20 percent or more of the equity of the applicant. SBA will require the use of personal resources from any such owner as an injection to reduce the SBA funded portion of the total financing package (i.e., any SBA loans and any other financing, including loans from any other source) when that owner's liquid assets exceed the amounts specified in paragraphs (a)(1)-(3) of this section. When the total financing package:

(1) Is $250,000 or less, each 20 percent 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;

(2) Is between $250,001 and $500,000, each 20 percent 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;

(3) Exceeds $500,000, each 20 percent 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;

b. To Whom Does Personal Resource Rule Apply?

The Rule applies to each person that is at least a 20 percent owner as a matter of eligibility. The rule also applies to each person who owns less than 20 percent when that person is married to another owner and/or has dependent children who are owners when the combined ownership of the spouses and/or dependent children is 20 percent or more. The utilization of the personal resources rule does not apply to the business resources of an associate or affiliated business.

c. Personal Resources of Spouses

The SBA's lending programs qualify as a "Special-Purpose Credit Program" under the Federal Reserve's Regulation B relating to the Equal Credit Opportunity Act (ECOA). This regulation stipulates that information pertaining to the applicant's marital status, sources of personal income, alimony, child support, and spouse's financial resources can be obtained and considered in determining program eligibility. Therefore, the lender has the right to obtain the signature of an applicant's spouse (whether an owner of the business or not) or other person on an application or credit instrument relating to a special-purpose program if it is required by Federal or State law.

Credit instruments as used here refers to mortgages, personal guarantees (limited to the persons interest in the collateral), or similar documents.

Unless there is some legal impediment to access the personal resources of the spouse such as those held by an independent trustee of an irrevocable trust, the applicant is presumed to have access to the personal resources of his/her spouse and minor children. As a matter of policy, the personal resources of close relatives (excluding spouse and dependent children), including children above the age of majority, living in the household are not considered to be available to the applicant for injection into the business.

As a credit matter, SBA cannot require the injection of the spouse's personal resources, but can determine that the applicant is ineligible because of access to personal resources. The SBA can require injection of the available personal resources of the individual's minor children.

Q. A husband and wife each own 15 percent of the same business. Are they to be treated as one entity and subject to the utilization of personal resources test or are they to be treated as separate entities and exempt.

A. In this case, both spouses are owners of the same business, so they have a marital community of interest. As such, their individual ownership parts are to be added together and treated as a single block. ECOA is not applicable in this case because this law is designed to protect a spouse who, among other things, is not an applicant or involved in the applicant's operation.

d. The Utilization of Personal Resources Rule

The utilization of personal resources rule was modified on March 31, 1996, with the publications of new regulations on this subject. The modifications altered the use of personal resources requirements in at least five ways.

(1) Only individuals (not businesses) who own 20 percent or more of the small business concern (SBC) or the eligible passive company (EPC) are subject to this rule. Officers, directors, and key management owning less than 20 percent of the SBC or EPC who may otherwise be considered a principal or associate will not be subject to this rule.

(2) The exemption thresholds are based on the total financing package, not just the loan which SBA guarantees.

(3) Only liquid assets are subject to the rule.

(4) 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.

(5) Spouses (and any dependent children) with a combined ownership interest of 20 percent or more in the applicant (or EPC) will be subject to the rule.

Once it is determined that an individual owner is subject to the utilization of personal resources rule, their percentage of ownership has no effect on the amount of their required injection. If a 20 percent owner has personal liquid assets of $1,000,000 and the 80 percent owner has personal liquid assets of $200,000, SBA will not give consideration to allowing the 20 percent owner to be anything but fully subject to the utilization rules. The owners must resolve among themselves any issues of fairness arising because of different ownership percentages.

The exemption is determined as of the date of application. You must carefully consider whether the requested loan amount is appropriate for the business. This will lessen the possibility that an applicant could inflate its loan request to increase its exemption and later request a decrease in the loan.

e. How is the Amount of the Personal Exemption Determined?

Lenders and CDCs use the following procedures to make a written determination which they must keep in the file, available for SBA's review:

(1) Determine the overall dollar value of the allowable exemption on the basis of the "total financing package," using the definition of total financing package found in subparagraph "g." of this paragraph and the requirements of .120.102(a);

(2) Carefully review the personal financial statements required from the owners of 20 percent or more of the equity of the business (including the resources of spouse and dependent children [immediate family unit]);

(3) Determine the value of the liquid assets subject to the rule for each individual; and

(4) Subtract the exemption from the liquid assets of each individual (including their immediate family unit), subject to the rule;

Q1. Can a husband and wife who are subject to the utilization of personal resources rule receive a greater exemption?

A1. No. There is only one exemption for each immediate family unit. In situations where 1 owner is married to another owner and/or is responsible for a dependent child (children) who is also an owner and their combined ownership equals or exceeds 20 percent, only 1 exemption is provided.

(b) Any liquid assets in excess of the applicable amount set forth in subsection (a) of this section must be used to reduce the SBA portion of the total financing package. These funds must be injected prior to the disbursement of the proceeds of any SBA financing.

f. Requirements Imposed on the Excess Liquid Assets

The amount by which the value of the liquid assets exceeds the value of the allowable exemption must be injected into the business, reducing the amount of the SBA loan requested.

g. The "Total Financing Package"

(1) Financing Package For 7(a) loans:

The total financing package includes the SBA loan, together with any other

loans, equity injection, or business funds used or arranged for at the same general time for the same project/need/goal as the SBA loan. This includes the total non-SBA financing in a 7(a) piggyback arrangement.

EXAMPLE: A business applies for a $100,000 7(a) loan as a start-up. It also gets a $50,000 line of credit from another lender; uses $50,000 of its own funds to buy equipment, borrows $20,000 from a relative to purchase inventory; and gets financing totaling $15,000 from suppliers.

The total financing package is $220,000. The SBA loan, the line of credit, the injection by the applicant, the loan from a relative and the funds of the business make up the financing package in this example. The $15,000 of supplier debt is not part of the financing package because it is part of the normal operations of the business.

(2) Financing Package for 504 loans:

The total financing package includes all elements of financing for the project (the permanent third party senior loan, the 504 debenture, and the applicant injection/contribution) and any other loans or injection made at the same time as the 504 loan, such as for working capital to accomplish the project/need/goal.

EXAMPLE: A small business proposes a piggyback structure to purchase a larger building with a $500,000 permanent senior loan, a $400,000 SBA loan, and a $100,000 injection. As part of its move it also gets junior financing of $250,000 from another source for inventory and an injection of $50,000 for working capital. The total financing package is $1,300,000. Include all listed sources of financing as part of the financing package.

(3) Piggyback Financing:

Piggyback financing occurs when one or more lender(s) provides more than one loan(s) to a single borrower at or about the same time, financing the same or similar purpose, and where SBA guarantees the loan secured with a junior lien position. A piggyback structure exists regardless of whether the different loans are made by the same lender or different lenders. As a matter of policy, piggybacks are eligible for SBA financing.

Both lien position and commonality of purpose determines whether a piggyback structure exists. When SBA is in a junior lien position to a non-SBA loan that finances similar or related items and the multiple financings are approved at or near the same time, the loans are considered to be structured as piggyback loans. Examples of when two loans are not considered to be in a piggyback financing arrangement:

(a) The SBA second mortgage loan for building improvements, made 3 years after another loan financed the same real estate's purchase;

(b) The SBA second mortgage loan for working capital, made at the same time the lender is financing the purchase of real estate;

(c) The SBA working capital loan, under a Line of Credit program, secured by both a first position on current assets and second on real property. A remote exception to this example would be when the line of credit was used to finance long term assets.

(4) What are the Underlying Reasons for a Piggyback Structure?

A large financing need may lead the lender to consider a piggyback structure in order to obtain the best possible collateral and guaranty position.

If a $1,500,000 funding was required, a lender could request a maximum guarantee of $750,000 with a 50 percent guaranty percentage which would leave an unguaranteed exposure of another $750,000. On the other hand, a piggyback with a $500,000 first and a $1,000,000 SBA guaranteed second would result in an exposure of $250,000 in a second and $500,000 in a first.

The lender's exposure is still $750,000, but it's risk is reduced or possibly eliminated because of its senior position on the collateral. In this case a larger first would also reduce SBA's guaranty fee. In short, a piggyback structure generally reduces a lender's risk.

(5) Are there any Eligibility Concerns in a Piggyback?

Yes. When the piggyback financing involves refinancing, the purposes of the piggyback loans must be the same or similar. The proceeds of both the guaranteed and non-guaranteed loans must both be eligible for SBA refinancing, as a matter of policy. If the intended use of proceeds for the first position loan are not eligible for SBA refinancing, they are not eligible for refinancing in a senior position loan within a piggyback structure.

Example - Two debts are to be refinanced. The SBA is asked to guarantee a loan in second position where the proceeds will refinance a debt that is eligible for refinancing under SBA policy and the lender will refinance in a senior position another debt that does not meet the 20 percent cashflow requirement for refinancing. This proposed structure would not be eligible.

(6) How Does SBA View Piggyback Financing?

The Agency has always been able to participate in a portion of the overall financing when there are two loans, only 1 of which will be guaranteed. Thorough credit and risk analysis and the exercise of prudent credit judgment are very important in these instances.

(7) What Characteristics Are Important?

Piggyback financing may help applicants obtain the additional credit they need. It also complies with the intent of the credit elsewhere policy. However, SBA's collateral position is weaker when it has a junior lien position, particularly if additional collateral is not available.

The terms of the non-guaranteed loan may have a significant impact on the ability of the borrower to repay the guaranteed loan, particularly when balloon or call provisions are imposed.

(8) Credit Criteria Used When Processing Piggyback Loans

(a) The piggyback arrangement must make sense as a financing tool.

Analyze each piggyback application on a cash flow basis. Do not use a set formula to determine the amount of credit to be guaranteed in relation to the amount unguaranteed.

(b) To perform an appropriate analysis you must obtain a copy of the non-guaranteed loan commitment letter stating all the terms and conditions of that loan. The non-guaranteed loan may be secured by a superior lien position on available collateral.

(c) Repayment ability is essential to protect SBA's interests. Satisfy yourself that the terms and conditions of all loans in the piggyback arrangement are appropriate.

(d) Clear justification must exist when the proposed interest rate for the non-guaranteed loan is significantly higher and/or the proposed maturity is significantly shorter than the SBA loan.

(e) Thoroughly analyze both proposed financings and determine whether the borrower's cash flow is sufficient to repay both the guaranteed and non-guaranteed loans, as well as any other debt, under the terms and conditions proposed for both loans.

(f) Loans involving a piggyback arrangement must not be processed under the preferred lenders program (PLP), LowDoc program, or SBA Express procedures when the superior lien position is held by the participant.

(9) Requirements Imposed on the First Position Lender

For its participation in a piggyback structure, the SBA requires that the lender agree to certain terms and conditions. If the first position lender does not agree, the piggyback second position loan can not be authorized. This is the case regardless of whether the first and second position lenders are the same or different.

(a) The first position lender must waive any provisions in its note or loan documents that:

(i) Allow future advances except advances made for the reasonable costs of collection, maintenance, and protection of lender's senior lien.

(ii) Cross-collateralize the loan with other non-SBA financings provided by lender to borrower.

(iii) Have an early call feature.

(iv) Are payable on demand unless the lender's note is in default.

(v) Contain a default interest rate, a late payment charge, or a prepayment penalty which is not subordinate to the lender's position on this loan.

(b) The first position lender will subordinate any senior lien prepayment penalties, late payment charges, or increased default interest to this loan. Any advances made for reasonable costs of collection, maintenance, and protection of lender's senior lien need not be subordinated. If such subordinated amounts are paid to lender through purchase of the senior lien, foreclosure, or consensual sale, lender agrees to apply such funds to this Loan.

(c) For purposes of this section, liquid assets means cash or cash equivalent, including savi ngs accounts, Cds, stocks, bonds, or other similar assets. Equity in real estate holdings and other fixed assets are not to be considered liquid assets.

h. Which Assets Are Not Considered "Liquid Assets?"

"Liquid assets" do not include: Closely held non-marketable stocks; individual retirement accounts (IRAs), 401K, Keogh, or other established retirement accounts subject to withdrawal restrictions or penalties; and other similar assets. All other liquid assets are subject to the rule. You should consider carefully the transfer of assets or other actions of the applicant to avoid compliance with the intent of this provision. At a minimum, liquid assets transferred by applicants within 6 months of application for SBA assistance will not be exempt.

i. Cash Surrender Values of Life Insurance

For purposes of the personal resources "test", the cash surrender value (CSV) of life insurance is a liquid asset unless the policy has been assigned as part of the requested financing or assigned to an existing loan. Under such circumstances, an individual's total personal liquid asset (including CSV) can be reduced by the lesser of the cash surrender value pledged to secure a debt or the amount of the debt. If CSVs were not considered liquid assets, an applicant might be able to circumvent the personal resource requirement by using liquid assets to purchase a life insurance policy with this feature.

j. Additional Exemption for Pledged Liquid Assets

For purposes of the personal resources "test", the liquid assets that serve as security on other debt (obtained over 6 months from date of application) may be exempted from the calculation of total available personal liquid assets. However, the dollar value of the liquid assets that can be exempted must be no greater than the lesser of the amount of the debt or the amount of the face value of the liquid assets securing the debt.

Examples #1: Applicant wants to acquire $325,000 in assets, borrow $250,000 via an SBA guaranty loan, and inject $75,000 from their own resources. The "total financing package" is $325,000. Therefore each person subject to the UPR rule has an exemption equal to the higher of $487,500 ($325,000 times 1.5) or $500,000 [per .120.102(a)]. Assume one of the principals has liquid assets of $700,000. If none of these liquid assets are pledged to secure other loans, this principal is required to inject $200,000, reducing the financing from $325,000 to $125,000.

Example #2: If the principal in example #1 had an existing loan with a balance of $100,000 and this loan was secured with $200,000 of their personal marketable securities, the amount of total liquid assets subject to UPR would be reduced by $100,000 (the amount of the debt). If none of the principal's other liquid assets serve as security for any other loans, this principal would be considered to have $600,000 in non-exempt liquid assets and would be required to inject $100,000 ($600,000 available less $500,000 exemption), reducing the total financing from $325,000 to $225,000.

Example #3: If the existing loan in example #2 was secured with $50,000 in marketable securities plus a 2nd mortgage on the principal's personal residence, the amount of total liquid assets subject to UPR would be reduced by $50,000 (the amount of liquid assets securing a debt). If none of the other liquid assets serve as security for any other loans, this principal would have $650,000 in non-exempt liquid assets and would be required to inject $150,000 ($650,000 available less $500,000 exemption), reducing the total financing from $325,000 to $175,000.

The source of the injection would be the unpledged liquid assets.

Q1. Can a person's liquid assets be exempt from being available for UPR consideration if they may be needed to cover a contingent liability the individual may be obligated to pay?

A1. No. Neither the amount of the contingent liability or the amount of the liquid assets which could be used to pay a contingent liability may be exempted from the determination of total available liquid assets for UPR purposes.

Q2. Does it make any difference whether the loan that a person's personal liquid assets as security is a personal or business related loan?

A2. No. Personal liquid assets that secure either a personal or business debt are exempt from the calculation of total liquid assets (up to the dollar amount of the debt).

Q3. Does it make any difference when the loan (that is secured by personal liquid assets) was obtained?

A3. Yes. Personal liquid assets that secure any debt obtained within 6 months of an application for guaranty to SBA are not exempt from the total liquid assets available under UPR.

k. Pledging Liquid Assets Rather Than Injecting Liquid Assets

Liquid assets required to be injected into the business under the utilization of personal resources rule can not be pledged as an alternative to injection.

l. Do Personnel Resource Limits Affect Capitalization Requirements?

The personal resource limits do not restrict the Agency's ability to require additional capitalization beyond that required by the personal resources policy if additional capitalization is necessary to make a loan credit worthy. Availability of personal resources must be considered when evaluating any change to the original loan amount.

m. Reducing Ownership Interest

Q. How does SBA view the practice of a person reducing their ownership interests to avoid being subject to SBA's personal resources, character, and/or personal guaranty requirements?

A. Per 13 CFR .120.10(3), the time during which an associate relationship exists commences 6 months before the date SBA receives an application for business loan assistance. The definition of associate includes all individuals who own 20 percent or more of the applicant concern. These individuals are subject to: the utilization of personal resources rule; character evaluation via the SBA Form 912 process, and the requirement to personally guarantee the debt.

Under the regulation, if an individual who owns 20 percent or more of the applicant firm changes their ownership percentage to less than 20 percent within six months of applying for SBA business loan assistance, that individual is still subject to the requirements for personal resource utilization, good character, and personal guarantee execution.

The only exception to the 6 month associate rule would be when owners of 20 percent or more of the applicant concern (individual and/or entity) completely divests their interest. Complete divestiture is not only divestiture of all ownership interest but total removal from the applicant concern (and any associated EPC) in any capacity, including being an employee (paid or unpaid).

Since credit elsewhere and character are factors of eligibility and eligibility is determined at the time an application is received, the individual or entity must be completely divested prior to application submission in order to not be subject to:

(1) ¸120.102 - The utilization of personal resources rule;

(2) ¸120.110(n) - The determination that the principals are of good character (includes reviewing the statement of personal history)

Since the requirements of ¸120.160(a) - personal guarantees are factors of collateral, SBA will permit a loan to be authorized without requiring an individual or affiliate who would otherwise be required to guarantee, to be omitted from having to guarantee, if, and only if, they are completely divested prior to initial disbursement.

5. ELIGIBILITY OF FARM ENTERPRISES

.120.103 Are farm enterprises eligible?
Federal financial assistance to agricultural enterprises is generally made by the United States Department of Agriculture (USDA), but may be made by SBA under the terms of a Memorandum of Understanding between SBA and USDA. Farm-related businesses which are not agricultural enterprises are eligible businesses under SBA's business loan programs.

For purposes of SBA business loan lending, the term "farm enterprises" represents all for-profit businesses engaged in agriculture, whether actually engaged in the production of farm products or engaged in activities in connection with this production. All farm enterprises are eligible for SBA financial assistance and are to be treated the same as any other applicant except as provided in this paragraph.

Financial assistance under the 504 loan program is only available for facility enhancement such as fencing; diking; construction of silos, barns, and hog and dairy facilities; and farm machinery and equipment with the required economic life span. All farm enterprises are subject to the same eligibility rules as other applicants.

Agricultural Enterprises include businesses engaged in the cultivation of soil, producing crops, and raising livestock.

Farm-Related Businesses are those which supply goods and services primarily used in connection with farming.

a. Which Agency Handles Applications from Farm Enterprises?

Lending to agricultural enterprises generally requires special understandings of the credit factors unique to these types of businesses. The SBA processing personnel should be generally familiar with the U.S. Department of Agriculture (USDA) loan programs and eligibility requirements. SBA personnel should not refer applicants back and forth between USDA and SBA, particularly applicants clearly ineligible for USDA assistance. However, SBA does not want to accept and process cases where the applicant is already borrowing through USDA.

As a general rule applications from agricultural enterprises should apply to USDA first. If the application is declined or found to be ineligible, an application can be accepted by SBA. These type of businesses should be encouraged to contact the appropriate USDA office for assistance.

All applications from agricultural enterprises should include an explanation of the outcome of the contact with USDA. Applications from farm-related businesses should

be accepted by SBA with out any indication of contact with USDA.

b. Referrals to USDA

Applicants normally should not apply to two Federal agencies to borrow funds for a single purpose. Therefore, if either Agency can make the entire loan, it must not refer the applicant to the other agency for part of the needed funds.
Applicants who are denied USDA assistance for any reason, including lack of USDA funding, may contact SBA for assistance. However, applicants denied by USDA for credit reasons are rarely found credit worthy for SBA's loan program.

c. Use of Proceeds for Farm Enterprises

Loan proceeds for both 504 and 7(a) programs may be used for:

1. The purchase of land, buildings, and land improvements (fencing, irrigation systems, construction of dikes, silos, barns, cranberry bogs, hog, and dairy facilities, etc.);

2. Construction, renovation, or improvement (including water systems) of farm buildings other than residences; and

3. The purchase of farm machinery and equipment.

In addition, loan proceeds may also be used in the 7(a) program for:

4. Operating expenses directly related to the farming operation, excluding personal or family living expenses;

5. The purchase of seed and the acquisition of animals; and

6. Refinancing of debt related to the farming operation, excluding personal or family debt, providing the refinancing meets Agency policy regarding refinancing.

6. ELIGIBILITY OF BUSINESSES FINANCED BY A SBIC

.120.104 Are businesses financed by SBICs eligible?
SBA may make or guarantee loans to a business financed by an SBIC if SBA's collateral position will be superior to that of the SBIC. SBA may also make or guarantee a loan to an otherwise eligible small business which temporarily is owned or controlled by an SBIC under the regulations in part 107 of this chapter. SBA neither guarantees SBIC loans nor makes loans jointly with SBICs.

a. What Consideration is Given to Businesses with SBIC Financing?

Since a small business investment corporation (SBIC) may supply either loans or equity capital, an SBIC may be a source of part or all of an applicant's needs. Referral to an SBIC is appropriate when the applicant's financial need is likely to be met by the SBIC program. The SBA may approve a loan subject to a condition that the applicant obtain junior financing from an SBIC. Carefully consider the total financial requirements of the business and the protection of the Government's interests.

b. Applicants Controlled By SBIC's

Q. What Must Be Considered When Making a Loan to an SBC Temporarily Owned or Controlled by an SBIC?

A. The SBA may make or guarantee a loan to an otherwise eligible small business temporarily controlled by an SBIC if:

The SBIC assumed control under provisions related to its financing of the business; and

The SBIC filed a control certification with the Associate Administrator/Investment Division.

If an SBIC owns 20 percent or more of the small business, the SBIC must guarantee the SBA loan unless the loan is made under EWCP.

7. SPECIAL CONSIDERATION FOR VETERANS

.120.105 Special consideration for veterans. - SBA will give special consideration to a small business owned by a veteran or, if the veteran chooses not to apply, to a business owned or controlled by one of the veteran's dependents. If the veteran is deceased or permanently disabled, SBA will give special consideration to one survivor or dependent. SBA will process the application of a business owned or controlled by a veteran or dependent promptly, resolve close questions in the applicant's favor, and pay particular attention to maximum loan maturity. For SBA loans, a veteran is a person honorably discharged from active military service.

What Special Consideration is Given Veterans by SBA?

(1) The SBA will provide in-depth management counseling on the first interview.

(2) The SBA will provide prompt processing of the application of a business owned or controlled by a veteran or dependent.

(3) Each SBA field office will designate at least one staff person as their veterans representative.

(4) The SBA must resolve close questions in the applicant's favor.

(5) The SBA must consider allowing maximum loan maturity for repayment.

8. INELIGIBLE TYPES OF BUSINESSES FOR BUSINESS LOANS

.120.110 What businesses are ineligible for SBA business loans?

By statutory provisions in the Act, regulatory provisions in 13 CFR and policy, some types of businesses are not eligible to receive business loan assistance from SBA.

How Does SBA Determine Whether a Business is Ineligible by Its Type of Business?

First, decide the primary business activity of the applicant. This is normally based on what the SBC sells and to whom it sells it. For example, it may be a retail, manufacturing, wholesale or service business. Second, determine whether it is one of the types of business deemed ineligible by SBA regulations and policy. SBA may not make a loan to an SBC for the benefit of an ineligible affiliated business.

The following types of businesses are ineligible:

The SBA may not provide financial assistance to any businesses engaged in the following activities.

a. Non-Profit Businesses

(a) Non-profit businesses (for-profit subsidiaries are eligible);

Section 2(a) of the Small Business Act directs the Agency to assist businesses which preserve free, competitive enterprise. Therefore, the Agency may not make loans to charitable institutions or other non-profit enterprises.

Q. Is there an exception to this rule?

A. Section 7(a)(10) of the Small Business Act authorizes SBA to make loans to any public or private organization qualifying as a sheltered workshop under the DAL-1 program (see subpart C for a discussion of the DAL program). However, funding for this program currently is not available.

b. Businesses Engaged in Lending

(b) Financial businesses primarily engaged in the business of lending, such as banks, finance companies, and factors (pawn shops, although engaged in lending, may qualify in some circumstances);

(1) Lenders create and hold interest-bearing notes. The act of holding such notes for their potential investment income is counter to SBA's philosophy that a small business should occupy the time, attention, and labor of the owners/operators in the continual task of providing goods and services and not with enterprises which merely hold property.

The SBA must not make loans to provide funds to enterprises primarily engaged in lending or investment, nor to an otherwise eligible enterprise for the purpose of financing investment not related or essential to the enterprise. This prohibits loans to banks, life insurance companies, finance companies, factors, investment companies, and other businesses whose stock in trade is money and which are engaged in financing. This also prohibits a loan to finance the construction, acquisition, conversion or maintenance of any property, real or personal, tangible or intangible, which is held by the owner for the income that it may produce.

(2) The following are exceptions to this regulation.

(a) A pawn shop or an otherwise eligible business which provides financing can be deemed eligible if more than 50 percent of its income for the previous year was from the sale of merchandise rather than from interest on loans.

(b) An otherwise eligible business that provides financing in the regular course of its business (like a business that finances credit sales or a franchisor that provides financial help to its franchisees) is eligible provided its income is not solely or primarily from financing conditional sales contracts. A financing subsidiary established by an eligible business is not eligible.

(c) A mortgage lender that creates investments such as interest bearing notes by the act of lending may be eligible, if they immediately sell the notes for a fee and receive absolutely no interest income.

(d) A check cashing business, although dealing exclusively with cash and near cash inventory, can be deemed eligible because the business uses the cash to provide a service.

c. Passive Holder of Real and/or Personal Property

(c) Passive businesses owned by developers and landlords that do not actively use or occupy the assets acquired or improved with the loan proceeds (except Eligible Passive Companies under .120.111);

The nature of the business makes it active or passive. An ineligible passive SBC holds real and/or personal property to receive rent or lease income and does not provide sufficient services in its business activity to deem it an active rather than a passive business. Whether the revenue is called rent or whether a portion of its space is leased out is not relevant to the determination of whether the business has sufficient services to be considered active.

Examples of active eligible businesses are:

(1) Hotels, motels, trailer parks (i.e. RV parks), campgrounds, or similar types of business deriving 50 percent or more of their gross annual income from transients who stay for 30 days or less at a time;

(2) Residential care facilities such as nursing homes providing substantial services in addition to room and board (such as 24-hour attendance and supervision of daily living) (See Chapter 2, paragraph 15.d of this Subpart);

(3) Equipment rental businesses, unless they have long-term leases without providing any significant services during the lease term (such as leasing trailers for months or years at a time);

(4) Antique malls, office suites, marinas, and equestrian centers if they provide sufficient services.

Mini-warehouses, shopping centers, flea markets, mobile home parks, and most parking lot operations are normally not eligible because they ordinarily do not provide sufficient services . This does not preclude financing the construction of a parking lot for use by employees and customers of an otherwise eligible business when the parking lot spaces are not for rent or lease. Apartment buildings are not eligible.

The basic test between eligibility and ineligibility becomes whether the applicant has a real estate operation where some services are provided (ineligible), or a service business with some real estate component (eligible).

An ineligible passive business cannot obtain an SBA loan for any purpose, including to purchase or construct a building for its own use.

d. Life Insurance Companies

(d) Life insurance companies;

Life insurance companies are not eligible because they are actively engaged in the business of investing. They invest their premium income to maintain a predictable, ready contingent cash reserve.

The SBA may provide financial assistance to life insurance agencies that qualify as independent contractors, even if they write insurance for only 1 company. See Opinion Digest (O.D.) 154 O.D. 203 at page 2278 for the standards to use to determine whether an insurance agent who works for 1 company qualifies as an independent contractor. Life insurance brokerages are ineligible because they assume the risk of policy coverage until the life insurance is placed.

Casualty companies are eligible only to acquire or renovate fixed assets. SBA financial assistance may not be used to enable such companies to increase their capacity to write additional business.

e. Business Located in a Foreign Country or Owned by Aliens

(e) Businesses located in a foreign country (businesses in the U.S. owned by aliens may qualify);

Analysts must be concerned with a number of issues when considering loans that could in anyway involve a "foreign" element. This paragraph addresses some of these issues. Paragraph 15h and 15i in this subpart and chapter address related issues.

A business located in a foreign country with no activities in the United States is ineligible for SBA financial assistance. Businesses with both domestic and foreign locations/operations can not use SBA loan proceeds to benefit the foreign location/operation. Foreign-owned businesses that operate in the U.S. are subject to other special requirements. Businesses owned by illegal aliens are ineligible. Businesses involved in international trade are subject to U.S. trade restrictions.

To be eligible an applicant must have a place of business located in the U.S.; must operate primarily in the U.S.and be authorized to operate in the state where they seek SBA financial assistance; pay taxes to the U.S.; use American products, materials, and labor; and the proceeds must be used exclusively for the benefit of the domestic operations. As a result the business and its employees are subject to U.S. and local taxes.

The "United States" includes the 50 states, the District of Columbia, the Commonwealth of Puerto Rico, the Territories and Possessions, and the Trust Territory of the Pacific Islands.

The following restrictions are placed on businesses with "foreign" elements. These restrictions can render an application ineligible or at least cause it to be re-structured. Analyst should be familiar with these restrictions.

(1) Restriction on Foreign Located Businesses

An applicant with no place of business in the United States is not eligible. An American subsidiary of a foreign-owned business is not ineligible if it is authorized to operate in the state or territory where it intends to conduct its operations.

(2) Restrictions on Domestic Businesses with Foreign Operations

U.S. owned businesses that conduct operations in both the U.S. and elsewhere can not receive loan proceeds that benefit the foreign operations. This means the proceeds must be used exclusively for the benefit of the domestic operations. 13 CFR .121.105 also addresses this issue.

(3) Small Businesses Owned by Foreign Nationals or Foreign Entities

A small business owned by a foreign national or a foreign entity must have a place of business located in the United States and must comply with the other requirements of subparagraph (e).

In addition, businesses owned by foreign nationals or foreign entities are subject to the same requirements as those imposed on businesses owned by persons with temporary visas as specified in Subpart A, Chapter 2, paragraph 15h.

(4) Restrictions On Businesses Owned By Undocumented (Illegal) Aliens:

Section 2(i) of the Small Business Act prohibits providing business loan funds to individuals not lawfully within the United States. Also, SBA must not make loans to businesses owned by individuals not lawfully in the United States. The SBA may consider financial assistance to legal alien applicants. Subpart A, Chapter 2, paragraph 15h, provides more information on loans to aliens.

Determining the eligibility and establishing the terms and conditions of loans to business owned by aliens requires extra care to ensure compliance with SBA's rules and policies in addition to various laws. Lenders and CDCs must verify the INS status of all aliens and all naturalized citizens who control or own 20% or more of any small business applicant. Paragraph 15h of this Subpart provides more details on the verification process.

(5) Restrictions on Businesses Involved in International Trade

Businesses that trade internationally are subject to the trade restrictions imposed by the U. S. Government. SBA can not provide financial assistance to any business that conducts prohibited commercial activity with a country identified by the U.S. Government, even if the proceeds would only benefit domestic operations. Subpart A, Chapter 2, paragraph 15i, provides more information on this subject.

f. Businesses Selling Through a Pyramid Plan

(f) Pyramid sale distribution plans;

Pyramid sales distribution plans are ineligible for SBA assistance. Many multilevel sales distribution plans (MSDP) resemble pyramids in many respects but may still be eligible. They are ineligible if all of the following factors are found in the MSDP.

(1) The recruitment of a continuous chain of subdistributors with little or no territory protection. The plans often provide payment for the mere act of recruitment.

(2)* The use of multilevel distributors, with levels of distribution related to recruitment of subdistributors, and with higher-level distributors receiving bonuses, commissions, discounts, or other benefits not available to lower-level distributors but derived from the efforts (sales) of lower-level distributors.

(3) The door-to-door sale of products, "house parties," sales meetings, or seminars rather than retail store locations.

(4) The sale or purchase of distributorships involving a substantial investment, with part of the purchase price being payment for a substantial initial non-returnable product inventory.

(5) The use of exaggerated promises or claims of income for a distributor.

An MSDP which includes some but not all of the above elements may be eligible or ineligible You must consider eligibility carefully and address it thoroughly in the loan officer's report. You must include in the credit investigation, an examination of the experience of the applicant with such sales efforts, the potential ability of the applicant to sell the distributor's product in the applicant's sales territory and the success or failure of existing subdistributors in selling of the distributor's product. If the applicant is the primary distributor or the franchiser, thoroughly investigate sales to ultimate consumers of the product and, if possible, determine whether consumers make repeat sales or purchases.

***** If factors like those in item (2) above are present in an applicant's plan, such as compensation that flows to higher-level distributors from the sales of an extensive chain of subdistributors, the case is most likely ineligible.

g. Businesses Engaged in Gambling

(g) Businesses deriving more than one-third of gross annual revenue from legal gambling activities;

Otherwise eligible small businesses that obtain one-third or less of their annual gross income from legal gambling activities may be eligible if the income is derived from:

(1) Official State lottery ticket sales under a State license; or

(2) Gambling activities licensed and supervised by state authority in those states where the activities are legal.

For purposes of this section, gross annual revenue from legal gambling activities includes rental income from gambling activities.

The income attributable to an SBC from the sale of official state lottery tickets under a state license is only the commissions from those sales, not the purchase price. Lottery ticket sales are funds collected for the state by the SBC. The SBC only benefits from the commissions on the sales.

If the purpose of the business is gambling, such as a pari-mutuel betting racetrack or a gambling casino, it is considered to derive all of its income from gambling and is not eligible, regardless of the percentage of gross income derived from gambling.

h. Illegal Businesses

(h) Businesses engaged in any illegal activity;

The SBA must not approve loans to borrowers that are engaged in an illegal activity. The SBA must not also make loans to borrowers that make, sell, service, or distribute otherwise legal products or services when these products or services will be specifically used in connection with an illegal activity, unless such use can be shown to be completely outside of the borrower's intended market. Loans to firms that sell drug paraphernalia in areas where they are not legal, as well as businesses that illegally dispense drugs, dispense illegal drugs, or operate a hotel or motel that permits illegal prostitution are ineligible. Exercise prudent judgment and primarily consider whether the use of taxpayers' funds is proper to finance the enterprise.

Q. Does this mean we can not make a loan to a company that manufactures surgical needles because these same needles may be used for illegal activity?

A. No, this type of business would not be prohibited from receiving a loan based on this regulation unless the firm knowingly permitted the distribution of this product for illegal purposes.

i. Businesses Which Restrict Patronage

(i) Private clubs and businesses which limit the number of memberships for reasons other than capacity;

Any business that uses exclusionary devices that result in selective memberships or patronage is ineligible. While a business may limit the number of people using a facility at any given time to comply with health and safety requirements, memberships quotas, or limitations are not allowable. For example, a men's only or women's only health club is not eligible. Separate facilities may be provided for men and women in health clubs, provided the arrangements are based strictly on privacy concerns.

j. Government-Owned Entities, Excluding Native American Tribes

(j) Government-owned entities (except for businesses owned or controlled by a Native American tribe);

(1) Restrictions On Government-Owned Entities

To avoid duplication of services, SBA may not provide business loans to assist municipalities or other political subdivisions, either directly or indirectly, since financial assistance is available to such entities from other Federal agencies.

(2) Special Requirements Applicable to Native American Businesses

A small business owned in whole or in part by a Native American tribe may be eligible despite its tribal ownership, provided it meets all other SBA requirements for loan applicants. The tribe itself is a Governmental entity and is not eligible.

The small business must establish that it is a separate legal entity from the tribe and must submit the document that authorizes its existence. It can be a State-chartered corporation or an enterprise established by tribal charter, ordinance, or resolution.

For an entity chartered or otherwise created by a tribe, examine the tribe's constitution, articles of incorporation, bylaws, ordinances, and resolutions to ensure:

(a) The tribe has authority to establish the applicant; and

(b) The tribe waives sovereign immunity with respect to the collateral for the loan and collection of the loan from the borrower, OR agrees to a "sue and be sued" clause specifically naming U.S. Federal courts as "courts of competent jurisdiction."

Subpart A, chapter 2, paragraph 14.f. provides more information on loans to Native Americans.

k. Businesses Engaged in Promoting Religion

(k) Businesses principally engaged in teaching, instructing, counseling or indoctrinating religion or religious beliefs, whether in a religious or secular setting;

The SBA shall not provide financing to businesses whose principal activities are teaching, instructing, counseling, or indoctrinating religion or religious beliefs. Otherwise eligible small businesses are not ineligible merely because they offer religious books, music, ceremonial items and other religious articles for sale or provide services that encourage moral and ethical values. To determine if the business is so principally engaged, the overall activities and business environment must be considered.

For-profit concerns owned by non-profit religious entities or their affiliates may be eligible for SBA financial assistance is they are otherwise eligible for-profit concerns (such as grocery stores or gift stores) and these for-profit businesses are not principally engaged in teaching, instructing, counseling or indoctrinating religion or religious beliefs.

Q1. What types of business are generally eligible under this rule?

A1. The following for-profit entities are generally eligible provided the business is not affiliated with a religious organization and its activity is not so influenced by religion or religious belief that it rises to the level of religious teaching, instructing, counseling or indoctrination activities:

(1) Stores which limit their activities to the sale of tangible products like religious books, music, artifacts, gifts, or other like items;

(2) Broadcasters which play religious music;

(3) Publishers of religious newspapers, journals, or other religious publications; and

(4) Developers and marketers of religious computer software.

Q2. How do we process loan applications which appear to involve teaching, instructing, counseling or indoctrination of religion or religious beliefs?

A2. Refer such applications to District or Branch Counsel for review and a legal opinion as to eligibility. If necessary, counsel should make a factual inquiry.

Q3. What will counsel consider?

A3. (1) The nature, extent, and overall effect of the religious activity;
(2) Whether the business is connected or affiliated with a religious organization.

If District or Branch Counsel makes a preliminary determination that the applicant is ineligible, forward the case file and all applicable information through the Director, Office of Loan Programs (D/OLP) to the Office of Litigation/OGC. The General Counsel or designee makes the final Agency determination as to legal eligibility under this rule. The final decision as to program eligibility remains with OFA program officials with delegated authority.

l. Cooperatives

(l) Consumer and marketing cooperatives (producer cooperatives are eligible);

Q1. Why are consumer and marketing cooperative ineligible?

A1. SBA's business loan programs were established to assist small business entities, not individuals in their capacity as consumers. Consumer and marketing cooperatives are established for the benefit of their members as individuals, since the members can obtain lower prices for items which they personally consume. Since a consumer or marketing cooperative does not benefit the actual co-op entity or the members in a business capacity, it is ineligible.

Q2. When is a producer cooperative eligible?

A2. A producer cooperative may be eligible for SBA financial assistance because the financial benefit the cooperative receives goes to the members who are producers and, therefore, business entities. A producer cooperative is eligible for business loan assistance if:

(1) It is engaged in a business activity; AND

(2) The purpose of the cooperative is to obtain financial benefit for itself as an entity AND its members in their capacity as businesses.

Note: Each member of the cooperative must be small.

m. Businesses Engaged in Loan Packaging

(m) Loan packagers earning more than one third of their gross annual revenue from packaging SBA loans;

Q. Does this prohibition also apply to businesses doing essentially the same thing even if they call themselves something other than "loan packagers"?

A. Yes, eligibility is based on the business activity, not the title under which the business operates.

n. Businesses Owned by Persons of Poor Character

(n) Businesses with an Associate who is incarcerated, on probation, on parole, or has been indicted for a felony or a crime of moral turpitude;

Q1. How are these applications treated by SBA?

A1. The SBA will not knowingly accept these applications for processing. Good character is a requisite for SBA assistance. In addition, repayment ability is uncertain since probation or parole can be revoked.

Q2. May we accept an application when parole or probation is lifted solely because it is an impediment to obtaining an SBA loan?

A2. No, the character issue still remains and there is no evidence of rehabilitation.

Q3. May we accept an application when an individual was, but is no longer, under indictment for a felony or a crime of moral turpitude?

A3. Yes, if the individual was acquitted or the indictment was dismissed and they are not incarcerated, on probation or on parole for such an offense.

Q4. Is an application eligible if an associate of the business is on some form of pre-trial diversion?

A4. No, the risk is the same as if the individual had been convicted and is on probation or parole. A violation could cause the individual to be incarcerated, jeopardizing repayment ability.

Q5. What does "moral turpitude" mean?

A5. Moral turpitude is conduct contrary to justice, honesty, modesty, or good morals. Court decisions have included convictions for tax evasion, vandalism, making a false statement, indecent exposure, bribery, and burglary, among others. For SBA purposes, financial crimes such as embezzlement are included. It is not necessary for the act to be a felony. It can be a misdemeanor under local statute.

o. Equity Interest by Lender, CDC, or Associates In Applicant Concern

(o) Businesses in which the Lender or CDC, or any of its Associates owns an equity interest;

Neither a lender, a CDC, nor any of their associates may obtain an equity position, either directly or indirectly, in the applicant firm. The only exception is where the associate of the lender or CDC is an SBIC, in which case the requirements of .120.104 apply. See 13 CFR .120.140 for a list of ethical requirements that apply to participants.

p. Businesses Providing Prurient Sexual Material

(p) Businesses which:

(1) Present live performances of a prurient sexual nature; or
(2) Derive directly or indirectly more than de minimis gross revenue through the sale of products or services, or the presentation of any depictions or displays, of a prurient sexual nature;

Q1. What is the procedure for applications when the business appears to have a prurient sexual component?

A1. You must refer all loan applications by businesses whose activities appear to involve the sale of products or services, or the presentation of performances, depictions, or displays that appeal to a prurient sexual interest to field counsel. Field counsel will review these applications and provide a legal opinion on the eligibility of the business.

Q2. When is a business not eligible because of prurient sexual component?

A2. A business is not eligible for SBA assistance if it presents live performances of a prurient sexual nature or it derives more than a de minimis gross revenue, directly or indirectly, through the sale of products or services or the presentation of any depictions or displays of a prurient sexual nature.

Q3. Why are these businesses ineligible?

A3. By law SBA must consider the public interest in granting or denying financial assistance. The SBA has determined that financing lawful activities of an obscene or prurient sexual nature is not in the public interest.

Q4. What will field counsel consider to determine if the application is eligible?

A4. Field counsel must consider:

(1) Whether the nature and extent of the sexual component causes it, in view of community standards, to be prurient; and

(2) Whether the business receives more than a de minimis gross revenue from the sexual component.

Q5. What happens if I do not agree with field counsel.s opinion?

A5. Field counsel must give a legal opinion as to the impact of the prurient sexual component on eligibility. If you disagree with that opinion, make every effort to reach an accord. If an accord can not be reached, present the issue to the DD who will render the final decision.

Q6. What is meant by the term "de minimis"?

A6. For the purposes of this policy, "de minimis" means the business derives such a small portion of its revenue from the specified activity or activities that it has no significant impact on its operations.

Under Section 4(e) of the Small Business Act, SBA may not provide any assistance to any business or person engaged in the production or distribution of any product or service that has been determined by a court to be obscene.

q. Prior Loss to the Government

(q) Unless waived by SBA for good cause, businesses that have previously defaulted on a Federal loan or Federally assisted financing, resulting in the Federal government or any of its agencies or Departments sustaining a loss in any of its programs, and businesses owned or controlled by an applicant or any of its Associates which previously owned, operated, or controlled a business which defaulted on a Federal loan (or guaranteed a loan which was defaulted) and caused the Federal government or any of its agencies or Departments to sustain a loss in any of its programs. For purposes of this section, a compromise agreement shall also be considered a loss;

For purposes of this regulation, "Federal loans or Federally assisted financing" is defined as any financial obligation requiring repayment which was provided by an agency of the Federal Government and which requires a loss to be reported in the Government-wide delinquent debt collection reporting system known as the Credit Alert Interactive Voice Response System (CAIVRS). This includes any loan made directly or guaranteed/insured by any Federal agency as well as any unreimbursed advance payments under 8(a) or similar programs by any Federal agency. It also includes Federal Government backed student loans and disaster loans (excluding any amount forgiven as a condition of the loan at the time of origination).

Q1. How is "loss" defined?

A1. For purposes of this regulation, "loss" means the dollar amount of any deficiency which has been incurred and recognized by a Federal agency after it has concluded its write-off and/or close-out procedures for the particular account. Such procedures include the following:

(1) The sale or other disposition of collateral acquired after default;
(2) Compromise, i.e., resolution or settlement of a loan balance for less than the full amount due;
(3) Bankruptcy by a borrower and/or any guarantors; and
(4) Any unreimbursed advance payments by a Federal agency.

Q2. What obligations to SBA are subject to this rule?

A2. Any obligation under the 7(a) loan program, 504 loan program, 7(m) microloan demonstration program, 7(b) disaster loan program; or created as the result of a note receivable, through the establishment of a COLPUR (collateral purchased), 8(a) advance, or otherwise.

Q3. What are the procedures for obtaining a waiver of this regulation?

A3. The AA/FA or designee has the authority to waive the application of this regulation when it can be shown that there is "good cause." When there are compelling circumstances, the district office shall prepare a recommendation and forward it Headquarters, along with the district's justification for concluding that "good cause" has been shown by the applicant. The request must be submitted from the Senior Economic Development Supervisor level or higher.

Use the 327 format to detail the cause for the action, the background of the case, with particular focus on the details of the circumstances surrounding the prior loss from the financial assistance previously provided. Also include a clear explanation of the connection between the personnel associated with the prior loss and the personnel requesting the new assistance. District Counsel comments are to be included.

Q4. How does this rule apply?

A4. This rule applies to the applicant or a predecessor, to any business in which a principal of the applicant was also a principal in an entity on which a loss occurred or to any business controlled by the same person(s) who controlled an entity on which a loss occurred.

Q5. What are the definitions of "principal" and "predecessor" in this rule?

A5. "Principal" means any person who has at least a 20 percent ownership interest in a business concern, whether direct or indirect. "Predecessor" means any business entity controlled by the same person(s) who controls the applicant.

Q6. Are unpaid/delinquent taxes covered under the prior loss rule?

A6. No. The Internal Revenue Service (IRS) does not provide financial assistance. Debt due under the Internal Revenue Code of 1986 is exempt.

Q7. Is the loss which Federal Deposit Insurance Corporation (FDIC) incurs when they sell a loan off for a discount covered by the prior loss rule?

A7. No. When FDIC sells off a failed lenders portfolio, the buyer pays less than the face value of the notes but the obligors are still responsible for the full debt.

Q8. Under what circumstances have waivers been granted?

A8. When it can be shown that the individual associated with the business that caused the loss had become disassociated from the business before circumstances developed leading to the loss suffered by the Government.

Q9. Does it make any difference that the prior debt, which is the loss, was compromised and no one ever told the effected person that they would be barred from obtaining future Federal financial assistance?

A9. No, when a compromise is accepted, pursuit of collections on the debt compromised ends, and the case is closed. However, a loss has occurred. A new loan is a new matter and is prohibited under .120.110(q). The fact that no notice was given is immaterial.

Q10. Do we need a waiver of the prior loss rule from the AA/FA if the debt that was the source of the prior loss is paid in full?

A10. No. If the debt is fully satisfied, you may process the application without a waiver from the AA/FA. Consideration of past delinquencies on Federal debt is part of the loan analysis process and does reflect on the applicant's character.

r. Political or Lobbying Activities

(r) Businesses primarily engaged in political or lobbying activities; and

Q. What does "primarily" mean?

A. For purposes of this rule, "primarily" means the business spends over 50 percent of its business activity time on such activities or derives over 50 percent of its gross annual revenue from such activities.

s. Speculation

(s) Speculative businesses (such as oil wildcatting).

Q1. How is this rule applied?

A1. The SBA may not provide financial assistance that will finance speculation in any kind of property - real or personal, tangible or intangible, directly or indirectly. This prohibits loans to an enterprise:

(1) Engaged in a financially risky business for the chance of an unusually large profit;

(2) Profiting from fluctuations in price rather than from the usual course of trade; or

(3) Having inadequate assurance of an ability to repay a loan from the earnings of the business.

Q2. What are some examples of speculative businesses?

A2. Speculative businesses include:

(1) Wildcatting in oil;

(2) Dealing in commodity futures;

(3) Mining gold or silver in other than established fields; and

(4) Building homes for future sale.

Note: Construction of homes for future sale with no sales contract in place (spec homes) is eligible under the Builder's CAPline program.

Q3. What are some examples of non-speculative businesses?

A3. Non-speculative businesses include:

(1) A business, such as a grain elevator, that hedges in futures commodity trading in the course of ordinary operations to protect itself from price fluctuations;

(2) A farmer who hedges his production of grain by buying futures to protect the price he or she will get at market;

(3) A business engaged in drilling for oil in established fields; and

(4) A business engaged in building a home under contract with an identified purchaser.

Q. Do the eligibility criteria specified in .120.110 through .120.131 apply only at the time of application, or are they also applicable over the term of the loan?

A. Eligibility is determined at the time of application. Once determined, eligibility must remain in effect through final disbursement, otherwise there would be an adverse change. However, if the operation of an eligible concern changes after final disbursement so that if they applied for further financing they would be deemed ineligible, there is no impact upon the current loan.

9. THE ELIGIBLE PASSIVE COMPANY (EPC) RULE

.120.111 What conditions must an Eligible Passive Company satisfy?
An Eligible Passive Company must use loan proceeds to acquire or lease, and/or improve or renovate real or personal property (including eligible refinancing) that it leases to one or more Operating Companies for conducting the Operating Company's business (references to Operating Company in paragraphs (a) and (b) of this section mean each Operating Company).
(a) Conditions that apply to all legal forms:
(1) The Operating Company must be an eligible small business, and the proposed use of the proceeds must be an eligible use if the Operating Company were obtaining the financing directly;
(2) The Eligible Passive Company (with the exception of a trust) and the Operating Company each must be small under the appropriate size standards in part 121 of this chapter;

(3) The lease between the Eligible Passive Company and the Operating Company must be in writing and must be subordinated to SBA's mortgage, trust deed lien, or security interest on the property. Also, the Eligible Passive Company (as landlord) must furnish as collateral for the loan an assignment of all rents paid under the lease;
(4) The lease between the Eligible Passive Company and the Operating Company, including options to renew exercisable solely by the Operating Company, must have a remaining term at least equal to the term of the loan;
(5) The Operating Company must be a guarantor or a co-borrower (with the Eligible Passive Company) of the loan (in a 7(a) loan including working capital, the Operating Company must be a co-borrower); and
(6) Each holder of an ownership interest constituting at least 20 percent of the Eligible Passive Company and the Operating Company must guarantee the loan (the trustee shall execute the guarantee on behalf of any trust).

(b) Additional conditions that apply to trusts.
The eligibility status of the trustor will determine trust eligibility. All donors to the trust will be deemed to have trustor status for eligibility purposes. A trust qualifying as an Eligible Passive Company may

engage in other activities as authorized by its trust agreement. The trustee must warrant and certify that the trust will not be revoked or substantially amended for the term of the loan without the consent of SBA. The trustor must guarantee the loan. For purposes of this section, the trustee shall certify to SBA that:
(1) The trustee has authority to act;
(2) The trust has the authority to borrow funds, pledge trust assets, and lease the property to the Operating Company;
(3) The trustee has provided accurate, pertinent language from the trust agreement confirming the above; and
(4) The trustee has provided and will continue to provide SBA with a true and complete list of all trustors and donors.

.120.111 changes what was previously known as the "alter ego" rule. The new name is the "Eligible Passive Company" (EPC) rule. Like "alter ego," the EPC rule is an exception, because it details the requirements for allowing exceptions to SBA's regulations which prohibit the Agency from financing assets which are held for their passive income [.120.110 (c)]. Under both "alter ego" and EPC, the entity that receives SBA financial assistance is not the operating small business, although the "Operating Company" is the ultimate beneficiary. However, previously under "alter ego," there had to be a specific commonality of ownership between the passive and operating companies. The EPC rule no longer requires commonality of ownership.

Q1. Should the size factor of the EPC be combined with the size factor of the Operating Company (OC) when determining size?

A1. The answer depends on whether affiliation exists. If the EPC is affiliated with the OC, then the two companies are combined. If there is no affiliation between the OC and EPC, each entity must be considered under the size requirement for its particular industry.

The fact that the EPC is leasing the project property to the OC does not in and of itself create an affiliation, even if the EPC and the OC are co-borrowers. (Please refer to Part 121 of 13 CFR for definitions of affiliation. Some include common ownership, common management, and contractual relationships.)

Q2. How does SBA determine the size standard for the EPC?

A2. The EPC, just like the OC, must be eligible as to size and type of business except for being allowed to be passive.

(1) Determine its primary industry, including any affiliates. An EPC may engage in business activity other than leasing property to the OC.

(2) Determine the maximum size standard for the loan program. The 7(a) and 504 loan programs have different size standards.

Note: Some EPCs may be owned by individuals who have no affiliation (control over) with any particular defined business. In these cases, the size standard (for both 7(a) and 504) shall be based on a Standard Industrial Classification (SIC) Code of 6512 which is for an entity that owns and leases commercial buildings.

Q3. Must the EPC assign the lease between the EPC and the OC?

A3. By regulation, only an assignment of rents for each OC is required. However, an assignment of lease for each OC is required if it:

(1) Is necessary to perfect the assignment of rents under state law, or

(2) Is necessary for collateral purposes to enable SBA to exercise the tenant's rights upon default.

Q4. Can an EPC charge its OC lease payments that are higher than the loan payments?

A4. No - with the minor exception that the lease payment or rent can include an additional amount to cover the EPC's expenses of holding the property, such as maintenance, insurance and property taxes. To permit the EPC to charge a rate of rent in excess of the loan payment (market rent) would qualify the property as investment real estate which is prohibited by 13 CFR 120.110(c)

For loans to multiple OCs, the total of the lease payments must comply with the above statement.

Q5. A franchiser wants the EPC to lease the property to the franchiser; the franchiser will then sublease the property to the OC. Is this eligible?

A5. No. The lease from the EPC must be directly to the OC. There can be no intervening entity. (Note: The OC is permitted to enter into a lease/leaseback with the franchiser so long as it is economic in nature with no prohibited control factors and no intervening lease agreement between the EPC and OC.)

Q6. Can the land just be leased from a third party and not purchased?

A6. Yes, as long as the term of the lease, including options to renew is the same or greater than the SBA-guaranteed loan or debenture.

Q7. Who decides whether the OC is a guarantor or co-borrower?

A7. The OC, not the district office, chooses whether it wants to be a guarantor or co-borrower except in those situations where the OC will have ownership of some of the assets acquired from the loan; and the value of these assets should be reported on the OC's business balance sheet. In these instances, the OC must be a co-borrower. Examples of when the co-borrower structure must be used include:

1. When there is a fixed asset component for the EPC and a working capital component for the OC [only allowed under 7(a)]; or

2. When the EPC and OC are both acquiring only fixed assets (different ones) like L&B for the EPC and M&E for the OC, and there is no working capital in the loan. [This can be under either 7(a) or 504.]

Q8. Who must guarantee this type of loan?

A8. Each 20 percent or more owner of the EPC and each 20 percent or more owner of each OC must guaranty the loan. Since the EPC rules are an exception to the general prohibition against financing passive businesses, there are no allowances for waivers of the personal guarantee requirements.

NOTE: Each 20 percent owner of the EPC and each 20 percent owner of each OC must comply with the personal resources test.

Q9. Regarding ownership guaranties, there are established "exceptions to policy" allowing a waiver of a guaranty under certain circumstances. Can exceptions to policy be processed if the SBA loan is to the EPC?

A9. No. If there is a 20 percent or more owner of either the EPC or any of the OCs that cannot or will not guaranty the loan, then the applicant for financial assistance cannot be an EPC. An example is an Employee Stock Ownership Plan (ESOP). If an ESOP's trust agreement prohibits it from being a guarantor or co-borrower, then it cannot use the EPC form of borrowing.

Q10. Are there special considerations regarding trusts?

A10. The following have been identified:

(1) If the trustor - creator of the trust - is a type of business not eligible for SBA assistance (for example, it is a casino or it is large by SBA size standards), the trust is not eligible as an EPC.

(2) The trust, as an EPC, is not limited to the activity of only leasing. It may engage in a number of activities. The trust, itself, does not have to be small by SBA size standards.

(3) To be an eligible trust:

(i) The trustee must warrant and certify that the trust will not be revoked or substantially amended for the term of the loan without SBA's consent;

(ii) The trustor (all donors) must guarantee the loan; and

(iii) The eligibility status of the trustor will determine trust eligibility.

(4) Beneficiaries usually do not have any control over the actions of the trust and, therefore, do not have to meet the guaranty and personal resource requirements.

Q11. Can two or more separately owned businesses be operating companies which receive assistance from 1 loan to an EPC?

A11. Yes, provided the complete application was received by SBA on or after January 13, 1999.

Q12. Can an eligible EPC participate in multiple financings?

A12. Yes, provided that SBA's aggregate exposure to the EPC, including its affiliates, does not exceed allowable Agency limits. For example, an EPC could lease properties in separate transactions to three unaffiliated businesses as long as the total SBA share to the EPC does not exceed statutory limits.

Note: The SBA exposure to one borrower applies to both the EPC and the OC, whether the OC co-borrowed or guaranteed. In other words, if the project is a 504 project that meets a public policy goal and the SBA debenture was $1,000,000, neither the EPC nor OC could borrow again, or be an affiliate of another business applying for SBA financing, until the sum of the outstanding SBA exposure plus the proposed exposure under the new request is less than or equal to the SBA limit when the new loan is closed and disbursed.

Q13. Must the EPC have any particular legal structure (e.g. proprietorship, partnership, corporation)?

A13. No. As long as state law authorizes it, the EPC can take any legal form, including individuals owning the real estate as tenants in common or limited liability companies.

Q14. After the loan or debenture is closed and fully disbursed, can the EPC sell the property or can there be a change of ownership?

A14. Yes, with SBA's concurrence. There is no difference between EPC and non-EPC loans regarding sale of the property or change of ownership. EPC is an eligibility rule applicable at the inception of financing. Servicing after closing has different considerations.

Q15. Should the EPC's or OC's SIC Code be used to identify the loan in the Agency's database?

A15. Use the same SIC code as was used to determine size. If there is only 1 OC, use the OC's SIC code. It there are multiple unaffiliated OC's, use SIC Code 6512 (Reference Subpart "A" , Chapter 2, Paragraph 9).

Q16. What SIC Code should be used when there are multiple OCs and they are affiliated?

A16. Utilize the rules detailed in 13 CFR .121.107 for determining the primary industry of affiliated businesses. The SIC Code of the primary industry of the OC shall be the identifying SIC Code.

Q17. How is the size of the applicant concern determined when there are multiple unaffiliated OCs?

A17. The size of each unaffiliated OC must be independently established and must be classified as small, based on SBA Size Standards.

Q18. Can an OC lease some of the space in the property to a third-party or does it have to occupy all the space itself?

A18. OCs must lease 100 percent of the property from the EPC, but it can sublease a portion of the property under the rules governing occupancy requirements with which all SBA borrowers must comply.

Q19. Is the alter ego rule still applicable?

A19. The alter ego rule applies to applications filed before March 1, 1996. It was replaced by the EPC rule. The EPC rule applies only to applications submitted to SBA on or after March 1, 1996.

Q20. Who has to submit Financial Statements when the loan will have an EPC structure?

A20. Both the EPC and each OC. The EPC is required to have a legal structure recognized by the State wherein it operates. The statements of the EPC are required to verify the viability of the EPC. The regular requirement for an Aging of receivables and payables are waived for EPC's. The complete financial statements of each OC are needed because the OC represents the source of repayment. These are the statements subject to tax verification.

A21. If the EPC is being formed as part of acquiring an SBA loan and will consist of the person who owns the OC, can their personal financial statement be used in lieu of any other financial statement requirement?

A21. No. SBA requires no less than an opening day balance sheet on the EPC. This will reflect the assets of the EPC, including those being leased to the OC, and the corresponding liabilities of the EPC, plus the equity.

Q22. Can two or more separately owned EPCs receive assistance from one loan?

A22. No. SBA has always limited the EPC (formerly alter ego) rule to assisting one EPC and one OC. The changes to the regulations and policies that now permit loans to multiple OCs do not permit loans to multiple EPCs. No more than one EPC per loan is allowed.

10. ELIGIBLE USES FOR BUSINESS LOAN PROCEEDS

.120.120 What are eligible uses of proceeds?
A small business must use an SBA business loan for sound business purposes. The uses of proceeds are prescribed in each loan's Authorization.
(a) A Borrower may use loan proceeds from any SBA loan to:

(1) Acquire land (by purchase or lease);

(2) Improve a site (e.g., grading, streets, parking lots, landscaping), including up to 5 percent for community improvements such as curbs and sidewalks;

Q. On what part of the loan is the 5 percent for community improvements calculated?

A. The 5 percent is based on the portion of the loan for construction and/or improvements to each specific site. The other costs of construction and/or improvements on a site comprise 95 percent of the total of the loan proceeds eligible for developing the site. Dividing that amount by .95 will provide the total amount of loan proceeds which may be used to develop the site. The difference is the amount which is eligible for community improvements.

EXAMPLE: $190,000 is authorized for grading the site, construction of a building, onsite plumbing, and parking lot construction. $190,000/.95 = $200,000 $200,000 - $190,000 = $10,000 for community improvements.

(3) Purchase one or more existing buildings;
(4) Convert, expand or renovate one or more existing buildings;
(5) Construct one or more new buildings;
(6) Acquire (by purchase or lease) and install fixed assets (for a 504 loan, these assets must have a useful life of at least 10 years and be at a fixed location, although short-term financing for equipment, furniture, and furnishings may be permitted where essential to and a minor portion of the 504 Project).

Subpart H more fully addresses the financing of equipment, furniture and furnishings of a short-term nature which are essential to and a minor portion of a 504 Project.

(b) A Borrower may also use 7(a) and microloan proceeds for:

(1) Inventory;
(2) Supplies;
(3) Raw materials; and
(4) Working capital (if the Operating Company is a co-Borrower with an Eligible Passive Company, part of the loan proceeds may be applied for working capital if used for that purpose only by the Operating Company).

(c) A Borrower may use 7(a) loan proceeds for refinancing certain outstandi ng debts.

The approved "Use of Proceeds" for all loans shall be input as part of the funding process according to the instructions in appendix 2.

11. BUSINESS LOAN PROCEEDS RESTRICTIONS

.120.130 Restrictions on uses of proceeds.
SBA will not authorize nor may a Borrower use loan proceeds for the following purposes (including the replacement of funds used for any such purpose):

a. Payment to an Associate

(a) Payments, distributions or loans to Associates of the applicant (except for ordinary compensation for services rendered);

The SBA loan proceeds cannot be used to make payment to any associate of the borrower other than to reimburse the associate for services actually rendered, and then at a fair and reasonable rate. An example would be a lawyer who owns 30 percent of the borrowing entity who also gets paid by this small business concern as their attorney.

Loan proceeds can be used to repay an interim construction loan financed by an associate. Such a use of proceeds is not classified as a distribution to an associate.

b. Refinancing Debt Owed to an SBIC

(b) Refinancing a debt owed to a Small Business Investment Company ("SBIC");

See subpart A, chapter 2, paragraph 6, this SOP for more information on providing financing to a borrower when an SBIC is involved.

c. Floor Plan Financing

(c) Floor plan financing or other revolving line credit, except under .120.390

The SBA loan proceeds cannot be used for floor plan financing or any other revolving line credit, except under the CAPline program, or as otherwise specifically authorized.

d. Purchase of Stock

(d) Investments in real or personal property acquired and held primarily for sale, lease, or investment (except for a loan to an Eligible Passive Company or to a small contractor under .120.310)

Purchase of shares of stock in a corporation to experience an appreciation in their value is an ineligible use of loan proceeds.

e. For the Benefit of Other Than the Applicant Business

(e) A purpose which does not benefit the small business;

The SBA supported loan proceeds can only be used to benefit the small business borrower. This provision restricts proceeds going to the owner(s) of an applicant concern.

A loan (7(a) only) made to more than 1 small business, even if all of the proceeds do not benefit each business, is eligible if:

(1) All of the proceeds benefit at least 1 of the small businesses;

(2) Each small business individually meets eligibility requirements; and,

(3) All of the small businesses concerned are jointly and severally liable for the loan.

f. Payment of Delinquent Taxes

Loan proceeds must not be used to pay delinquent IRS withholding taxes, sales taxes or similar funds held in trust since SBA would be replacing funds that were unlawfully converted. We may consider payment of delinquent income taxes, on a case-by-case basis the same as other delinquent accounts. However, the willful failure of principals to pay income taxes is a character issue for consideration.

12. POLICIES REGARDING DEBT REFINANCING

a. Refinancing Existing Debt

(f) Any use restricted by .120.201-120.203 and 120.884 (specific to 7(a) loans and 504 loans respectively).

NOTE: 13 CFR does not have a .120.203 as of the writing of this SOP

Only 7(a) proceeds may be used to refinance existing debt, whether private or institutional, including credit card debt related to the business. 504 proceeds can not be used for general refinancing but can be used to term out debt obtained in anticipation of the 504 project which would have been eligible for initial 504 financing. Reference subpart H, chapter 11, paragraphs 7 and 8.

To be eligible for refinancing with 7(a) proceeds, the existing debt must not presently be on reasonable terms and the refinancing must provide a substantial benefit to the small business. In addition SBA can not approve a loan that would pay a creditor in a position to sustain a loss, thereby causing a shift to SBA of all or part of a potential loss from an existing debt if SBA would assume all or part of that same position. See Subpart B for restrictions on paying creditor in a position to sustain a loss.

To be eligible for refinancing with 7(a) proceeds, the existing debt, regardless of who the lender is or whether the debt is guaranteed, must not presently be on reasonable terms AND the refinancing must provide a substantial benefit to the small business. For purposes of refinancing, an analysis of both the reasonableness of the terms of the existing debt as well as the existing capability of the company to meet those terms at the time of refinancing must be performed. The principle test for how reasonable the terms of the existing debt are is whether the existing cash flow is adequate to meet these obligations. If a company is found to have obtained credit on reasonable terms, but is now unable to meet those terms, it may technically be eligible for refinancing. However, its inability to meet terms that once were reasonable would generally indicate a serious credit risk.

(1) Refinancing Long-Term Debt

When refinancing long term debt, the business must receive a permanent

substantial benefit. This is defined as at least a 20 percent improvement to the company's cash flow as measured by the changes in the debt service requirements between the existing and new debt structures of the debt being refinanced that remains in effect over the terms of the refinanced debt. This means the new installment amount for the portion of the loan refinancing the debt must be at least 20 percent less than the existing installment amount. The comparison does not have to be based on similar methods of amortization. As such, principal plus interest can be compared to principal and interest.

The need for the business to receive a lower debt service requirement must be justified and available for SBA analysis when processed under procedures where SBA conducts a review or separate analysis or it must be in the lender's file for follow-up review when processed under procedures where SBA delegates approval to the lender. This benefit must be used to: finance increased accounts receivable or other business assets; increase inventory or improve the operations of the business; or to counter diminishing debt service ability with improved debt coverage. The benefits of refinancing must not simply provide additional funds for distribution to the owners.

When computing the cash flow change to be derived from refinancing, compare the current debt service requirement of the debt to be refinanced (this equals the installment amount) to the proposed debt service requirement (this equals the anticipated installment amount) of the same amount. Compare the total installments due in the next 12 months on the debt to be refinanced to the total amount due for the first 12 months after the same amount is refinanced under the proposed term
Example: If a $200,000 loan request includes $100,000 for refinancing, compare the payment amount of the existing $100,000 before refinancing to the payment amount of an equivalent $100,000 made under the terms of the proposed $200,000 loan.

If refinancing involves more than 1 debt, the combined debt service on all the debts must satisfy the substantial benefit test of a 20 percent improvement in cash flow.

When refinancing multiple debts, the change in debt service burden (case flow requirement) of each debt must be determined. No debt being refinanced is permitted to have a higher debt service requirement after debt refinancing than prior to refinancing, unless waived by the AA/FA or designee.

Debt being discounted can be refinanced, provided there is a 20 percent improvement to cash flow, not just a 20 percent discount in the outstanding balance of the debt. The refinancing requirements apply equally to loans held by institutional lenders or by private individuals.

(2) Refinancing Short-Term Debt

For a business wanting to refinance a revolving line of credit, the substantial benefit lies in the ability for the business to continue to borrow once its existing line matures or its ability to stretch the payments over a longer maturity, thereby retaining its working capital for a longer period of time. This "terming out" will frequently benefit companies experiencing significant growth and is an acceptable type of refinancing if reasonably justified.

Refinancing short term debt (including credit card debt) is not subject to the 20 percent improvement to cash flow test as is required when refinancing term debt. Paying off eligible credit card debt is similar to using working capital to pay off accounts payable.

The only short term or credit card debt eligible for refinancing is that which the business can document to have been used for legitimate business purposes of the applicant. Debt due a principal of the applicant business cannot be refinanced with SBA financial assistance regardless of the principal's percentage of ownership.

(3) Refinancing Balloon Payment Notes

Debt amortized with a balloon payment is not deemed reasonable (Subpart A, Chapter 2, paragraph 3.l.). In addition, the substantial benefits which a debtor must receive when refinancing their debt with SBA can not be measured by the traditional 20 percent cash flow improvement test. Instead, the benefit is received by having the debt amortized with standard principal and interest payments. Therefore, debt with balloon payments are not subject to the 20 percent improvement test.

(4) Refinancing Interest Only Debt

There are numerous types of debt that allow a business to only have to make interest payments rather than principal and interest (P&I). Seasonal term loans or seasonal lines of credit may only require interest payments during the low end of the seasonal cycle and full P&I at the high end. Lines of credit generally allow the borrower the ability to manage their own borrowings and do not require more than interest payments until either the lender makes demand or a pre-stated maturity is reached. These types of debts can be considered as short term debts and as stated in subparagraph (2) above are not subject to the 20 percent improvement to cash flow test.

b. Loan Officer's Report Contents When Refinancing is Requested

The loan officer's report must address the following when refinancing debt:

(1) Why was the debt incurred?

(2) Has over-obligated or imprudent debt scheduling necessitated a major restructuring of the debt?

(3) Is the present debt already on reasonable terms?

(4) How will the new loan improve the financial condition of the firm?

(5) What benefit will the refinancing give the applicant?

(6) Does the refunding include payments to creditors in a position to sustain a loss due to either an inadequate collateral position or low or deficit net worth?

(7) Would SBA be likely to sustain part or all of the same loss by refinancing the debt or will additional collateral or altered terms protect the interest of the Agency?

(8) What portion of the total loan does the refinancing constitute?

(9) If credit card debt, for what business purpose was the credit card debt incurred?

c. When May We Refinance a Participant's Debt?

If the requirements of 12a. and 12b. above are met, SBA may consider refinancing a participating lender's debt as well as the debt(s) of another lender. When a lender seeks to have SBA proceeds used to refinance their own debt, the following additional requirements apply.

(1) The lender must certify in writing, on the 4-I or otherwise, that its debt to be refinanced is, and has been, current for at least the last 36 months. Current means that a required payment has not remained unpaid for more than 29 days. A loan which includes a payment unpaid for 30 days, subsequently deferred, was not current on that 30th day and is not eligible for refinancing.

Similarly, a loan that has matured and not been paid within 29 days of the maturity date is not current and is not eligible for refinancing. A debt may be eligible for refinancing if we receive the guaranty request before the loan is 30 days past due or if the lender approved a deferment of payment for the loan before it was 30 days past due. If a lender wants to refinance debt that has not always been current, approval of the AA/FA or designee is required.

(2) The lender must 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.

(3) When a major part of the loan proceeds is for debt repayment, the lender must fully explain how and why the debt accumulated.

(4) Exercise caution and prudent judgment when a loan is for 100 percent refinancing of participant debt. Provide a full justification in the file.

d. May We Refinance An SBA Loan?

No, except under very narrow circumstances. SBA believes its appropriated funds should be used to assist as many small businesses as possible and that the capital needs of businesses already supported by existing SBA loans should be accommodated through cooperation between the borrower, lender, and SBA by altering the existing terms rather than refinance for ease or convenience.

Refinancing an existing SBA debt is permissible providing all the conditions of subparagraph 12a., 12b., and 12c. (if appropriate) of this paragraph are satisfied plus the following:

(1) Procedure to Refinance an SBA Loan Through a New Lender

Contact the lender holding the existing SBA loan and verify that the lender has declined to approve a second loan and the lender is either unwilling or unable (because of the reluctance of a secondary market investor or regulatory restriction) to modify the current payment schedule in such a way that a new lender could approve a loan without SBA's guaranty.

Document the conversation in the case file, recording the date, time and person with whom you spoke, along with a short summary of the conversation.

(2) Lender's Ability to Refinance its Own Existing SBA Guarantee Loan

A lender may refinance a loan on which it holds an SBA guaranty only if the sole reason the lender is unable to modify the terms of the existing loan is that the loan had been sold in the secondary market. Existing lenders and SBA field offices are expected to cooperate in adjusting the terms of the new loan and, if necessary, the terms of existing SBA guaranteed debt so the pro forma debt structure can be handled by the expected cash flow.

(3) May PLP or PCLP Procedures be used to Refinance or Pay Off An Existing SBA Loan?

No. Loans to refinance or repay an existing SBA guaranteed loan must only be processed under standard procedures [Subpart D, Chapter 3, paragraph 7(4)(c)]. Since 504 can only refinance bridge financing [reference Subpart H, Chapter 11, paragraph 10], no 504 processing method can be used to refinance existing SBA debt.

e. Paying Off Seller Debt is Not Refinancing to Effect a Change of Ownership
SBA does not classify the act of a seller using the funds they receive from a purchaser to pay off some or all of the existing debt of the sellers business as refinancing, providing the purchaser is financing a complete change of ownership. A loan for this purpose is considered to be for the purchase of a business, not the refinancing of any existing debts.

However, if it is known that the debts of the business being sold include existing SBA debt, the loan can not be processed under any of the Agency's expedited loan processing programs. In such cases, the application must be processed under standard procedures. In addition, the option to assume the existing SBA debt should be offered the buyer. This is recommended so that the Agency's limited appropriations are not unnecessarily used.

f. Limits on Expedited Processing for Refinancing:

No existing SBA debt (direct or guaranteed) can be refinanced under any expeditious loan processing procedure (PLP, CLP, LowDoc, or SBA*Express*).

Applications processed under Preferred Lenders Program (PLP) or Certified Lenders Program (CLP) procedures may include the refinancing of debts due other non-affiliated lenders. They must not include the refinancing of any same institution debt (SID), including debt owed an affiliates.

Applications processed under SBA*Express* procedures may include the refinancing of debts due other non-affiliated lenders as well as debt owed to the participating lender (SID) which has always been current.

Applications processed under LowDoc procedures may include proceeds for debt refinancing except any SBA debt. No more than a maximum of 25 percent of the total loan amount may be used to refinance debt owed to the same institution (SID) or its affiliates, regardless of the percentage guaranteed. 100 percent of the proceeds of a 7(a) loan processed under LowDoc procedures can be used to refinance debts due other non-affiliated lender.

g. What Other Conditions Apply to Debt Refinancing?

(1) The 7(a) program will not refinance a debt owed to an SBIC.

(2) Loan maturities are based on the ability of the business to repay the debt and on the original use of proceeds of the debt being refinanced. See subpart B regarding SBA's maximum maturities for 7(a) loans.

(3) For 504 loans, the third party lender may refinance existing debts under limited circumstances, on assets that are to be part of the project. See subpart H for applicable procedures.

(4) The third party financing for an existing 504 project can not be refinanced with a 7(a) loan as long as the debenture remains outstanding, without the approval of the AA/FA. SBA holds, per .120.930, that no more than 50 percent of an eligible project cost can come from Federal sources. By policy, SBA requires that the 50 percent maximum remain in effect through the entire term of the debenture, unless the ultimate viability of the borrowing concern is in jeopardy without refinancing of the third party lender's loan.

h. How Do We Treat Interim Loans and Trade Payables?

The SBA loan proceeds may be used to reimburse interim advances made by a lender or an affiliate of the lender as long as the interim disbursements reasonably comply with the terms of the final authorization. You must notify the lender of the loan terms and conditions as soon as possible. The lender makes interim advances at its own risk, including the risk of decline by SBA, the risks associated with the authorization's "adverse change" clause, and potential policy changes impacting permitted use of loan proceeds. SBA's credit standards must not be relaxed because interim advances were made. The lender does not have to notify SBA of an interim loan.

The payment of trade payables is not considered to be debt repayment. It is considered to be working capital, generally permitting additional inventory purchases. Since 504 financing is "take-out" financing, most 504 projects will involve interim loans. Subpart H addresses the applicable procedures for interim loans relating to 504 projects.

i. How Is Debt Repayment Identified in the Authorization?

The authorization must include an itemization of all debts being repaid by loan proceeds when the individual creditor is to be paid $10,000 or more. It must also include the loan number and dollar amount of any existing SBA debt refinancing.

13. LEASING PART OF A BUILDING ACQUIRED WITH LOAN PROCEEDS

.120.131 Leasing part of new construction or existing building to another business.
(a) If the SBA business loan involves the construction of a new building, a Borrower may lease up to 33% of the Rentable Property for a short term to any third party if reasonable growth projections show that the Borrower will need additional space within three years and will use all of the additional space within ten years. If the Borrower is an Eligible Passive Company leasing 100 percent of the Project space to one or more Operating Company, the Operating Company, or Operating Companies together, may sublease up to 33 percent of the Rentable Property to a third party under the same conditions. (See .120.870(c) for an exception with respect to 504 Projects.)

a. What Does "Under the Same Conditions" Mean?

Like any other borrower that subleases space, an OC will need to use and occupy some of the additional space on a permanent basis within 3 years and all of the additional space within 10 years.

b. What Does "Rentable Property" Mean?

By regulation, "Rentable Property" is the total square footage of all buildings or facilities used for business operations. (Reference .120.10)

When a business purchases, renovates, or constructs a building or buildings for its use, the total project generally includes external elements such as the grounds and parking lot area in addition to the building. The building itself is comprised of three distinct elements: Vertical Penetrations (stairways, elevators, and mechanical areas that are designed to transfer people or services vertically between floors); Common Areas (lobbies, passageways, vestibules, and bathrooms); and the Usable Square Footage (the total interior square footage minus all vertical penetrations and common areas).

For the purpose of determining what portion of the available square footage a borrower may lease, SBA's policy more specifically defines "rentable property" as the interior Usable Square Footage plus the interior Common Areas. The key concept of this definition is that rentable property excludes all outside areas.

SBA includes the interior common areas as part of its definition of rentable property in order to increase the overall square footage that can be leased.

Only the AA/FA or designee can classify outside areas as usable square footage or common area. All exception to this policy must be referred to the Director, LPD.

Q1. Will SBA require every applicant that intends to use SBA proceeds to acquire either an existing or new structure to figure out its allowable rentable property by computing the total interior square footage of the structure(s) and then deduct the square footage of all the vertical penetrations?

A1. "Yes", when any of the acquired space will be leased and "No" when the borrower or its EPC will occupy the entire space. Computing the interior square footage of a structure and the square footage of all vertical penetrations should be done as part of an appraisal or architect's drawings.

Q2. Does SBA intend to exclude all out-of-doors areas from the determination of rentable property, even space like the covered area above gas pumps at a service station?

A2. Yes. Only the Usable Square Footage and Common Areas that are contained within a building can count towards the calculation of Rentable Property.

Q3. Can There be Waivers?

A3. Yes, but the loan must be processed under standard processing procedures (non-expidited), and the waiver (which can only be approved by OFA) must be submitted from a District.

Q4. What are some situations where a waiver could be considered?

A4. It is anticipated that some businesses will endeavor to justify that some or all of their outside area should be included in the common area calculation in order that the business can rent or lease more of their walled space to an unaffiliated business. Such cases can be submitted to OFA for consideration, but each case will be evaluated on its own merits.

One example likely to receive positive consideration would be for a short haul moving & storage company that needs to dedicate a specified amount of its outside space to park trailers that are loaded with stored items which are waiting for authorized movement. Such space would otherwise be needed inside the building, but the process of unloading and reloading the trailer within a short term (like one week) period is not economically practicable so the items are stored outside in the trailer. The outside space that counts towards the rentable property calculation would be the average, not the maximum needed. No allowances for the tractor would be made because this piece of machinery is not normally kept inside a building.

(b) If the SBA business loan involves the acquisition, renovation, or reconstruction of an existing building, the Borrower may lease up to 49 percent of the Rentable Property long term. If the borrower is an Eligible Passive Company leasing 100 percent of the Project space to one or more Operating Companies, the Operating Company, or Operating Companies together may sublease up to 49 percent of its Rentable Property to a third party under the same conditions. (For 504 loans, see Sec. .120.871.)

c. May Proceeds Be Used to Remodel or Convert Rental Space?

No, except remodeling or conversion expenses required for space occupied by the small business which incidentally improve the rental space (such as replacing a roof or a heating system for a whole building) are acceptable if the benefit to the rental space is reasonable and can not be avoided.

d. Must the SBC Meet Occupancy Requirements Immediately?

Circumstances may justify allowing the SBC a period of time after closing of the SBA loan to comply with the above occupancy requirements. For example, a pre-existing lease may have a few more months to run. SBA may judge what is a reasonable time for the small business to meet the occupancy requirements given the circumstances of the business and real estate conditions in the community. In no case may the small business have more than 1 year to meet occupancy requirements.

e. Leasing Restrictions When Renovation Cost Exceeds Purchase Cost

Occasionally a business may purchase a building and spend more to renovate it than it originally cost or make so many changes that it does not resemble the acquired structure. Generally, improvements made to a standing building, without significant addition of new space will not be considered "new construction" but rather "renovations."

However, when new space is added, load bearing walls are moved, or renovations costing significantly more than the building are made, and the business does not intend to occupy all the space within 10 years, questions have to be raised as to whether the building was right for the borrowers needs.

While the rules may permit a business that acquires an existing structure to lease up to 49 percent forever, it is not the intent of the Agency to finance (some or all) significant renovations to an existing structure and have just a simple majority (over 50 percent) of space occupied by the borrower.

f. Proceeds to Acquire, Build, or Renovate Residential Space

(1) Loan proceeds may be used for the purchase of an existing combined residential or rental space and business building, provided:

(a) Such residential and/or rental space is 49 or less percent of the total space; and

(b) The location is appropriate and conducive to the success of the business and alternative facilities that do not contain residential nor rental space are not reasonably available.

(2) Loan proceeds may not be used for the construction of any combined residential or rental space and business type building, except in the following cases.

(a) Where the owner or the business manager resides in the same building because of the nature or location of the business. In this case, residential space of up to 33 percent of the total can be allowed.

(b) Where a reasonable projection of business growth indicates the need for additional space in the near future, and where later additions are not feasible due to the nature of the construction. In this case, commercial rental space of up to 33 percent of the total is permitted.

g. Rental Income As a Source of Repayment

SBA has a prohibition against providing loans to businesses whose primary activity is to obtain income through passive means [.120.110(c)]. SBA will not make a loan to a business whose primary activity is to own and lease property that they do not actively occupy, but rather who chooses to rent or sub-lease the premises to a third party. Operating an apartment building is the classic example of the type of business activity where SBA does not provide financial assistance.

When SBA approves a loan to a business that will buy an existing structure, it permits the business to lease out up to 49 percent of the acquired space forever. When the loan's purpose is to construct a new building, the business receiving the loan can rent or lease up to 33 percent of the space for up to 10 years. Additionally, on 504 projects for new construction, the business receiving the loan may permanently lease up to 20 percent of the space.

We therefore have rules that control the amount of space a business may own and lease to others. When we analyze the repayment ability of a business that receives passive income, we want the different sources of repayment separated so that we can concentrate on whether the business's operational income is sufficient to repay the loan before we consider whether the passive income will be necessary to reasonably demonstrate repayment. The Agency does not want the analysis of repayment to be unknowingly biased by combining the different sources without justifying the likelihood for achievement of repayment from each separate source.

Therefore, the documented determination of repayment, that is required as part of every loan's analysis, must be based on the existing and/or projected cash flow of the primary business activity, without the benefit of any rental income.

When the anticipated cash flow from the applicant's primary business activity is insufficient to demonstrate repayment of the proposed loan and other debt obligations, the analyst may add the anticipated cash flow of the projected rental income to make a case for repayment ability. However, the validity of the projected rental income must be independently substantiated. It is insufficient to justify the receipt of rental income just because the space is available.

Examples of items that can be reviewed and commented on to substantiate rental income include, but are not limited to: The longevity of existing rental agreements that will transfer with the purchase of an existing building; or an appropriate Real Estate Association Report on the need and desirability for the type of space that the applicant will be able to offer for lease.

14. ETHICAL REQUIREMENTS PLACED ON A LENDER

.120.140 What ethical requirements apply to participants?
Lenders, Intermediaries, CDCs, and Associate Development Companies ("ADCs") (in this section, collectively referred to as "Participants"), must act ethically and exhibit good character. Ethical indiscretion of an Associate of a Participant or a member of a CDC will be attributed to the Participant. A Participant must promptly notify SBA if it obtains information concerning the unethical behavior of an Associate. The following are examples of such unethical behavior. A Participant may not:
(a) Self-deal;
(b) Have a real or apparent conflict of interest with a small business with which it is dealing (including any of its Associates or an Associate's Close Relatives) or SBA;

a. Conflicts of Interest

Conflicts of interest or the appearance of conflicts of interest involving a participant or its associate(s) and a small business or its associate(s) must be avoided. You should also be aware that conflicts of interest or the appearance of conflicts of interest among SBA employees, participants and applicants may exist and must also be avoided. (See Part 105, 13 CFR.)

(1) Circumstances that Preclude SBA Loans

Exercise care and judgment in determining whether a conflict of interest exists. Document the file in detail. The SBA will not guarantee a loan if the participant, its associate, or a close relative or a partner:

(a) Has a significant direct or indirect financial or other interest in the applicant;

(b) Had such interest within 6 months prior to the date of application; or

(c) Acquires such interest at any time thereafter while the loan is outstanding.

A significant interest is one that may result in preferential treatment by the lender or the loss of independent, impartial, objective judgment, or corrective actions or the appearance of such.

For example, in addition to the physical relationship identified above, a lender may have a financial relationship that could affect, or appear to affect, its objectivity. This financial interest may include securities, with or without voting

or conversion rights or warrants.

A community organization (except state and local development companies) its officers or its directors have a significant financial interest in the applicant unless the organization has been inactive in packaging SBA loans for at least two years prior to the date of the application.

(2) Conflict of Interest Determinations Regarding Lenders and Businesses

The SBA may guarantee a loan if it determines that no conflict of interest exists, based on the facts of the case.

Example:

Situation: A loan officer of a bank is a 25 percent owner of a business applying for a 504 loan. The bank officer.s employer will be the interim lender as well as the first mortgage lender in the 504 project. Is this a conflict (or appearance of a conflict) of interest?

Answer: The SBA field office reviewing a request for approval must determine whether an actual or apparent conflict of interest exists because of actual or apparent preferential treatment or the loss of independent, impartial and objective judgment. It must determine what corrective action, if any, will eliminate the actual or apparent conflict of interest to allow processing of the loan application to continue. These circumstances require a close look. The initial reaction is that an actual or apparent conflict may exist. Under certain circumstances a finding of eligibility may be possible. If the loan officer will have no influence over the loan decision or servicing of the loan, and collateral values are supported by independent appraisal, a determination that the application is eligible may be possible. If the loan officer has also been a major stockholder in the bank or could reasonably be expected to influence the loan decision or future servicing, the application would not be eligible. Carefully consider all factors to making a correct eligibility determination.

(3) Who Makes Conflict of Interest Determinations Involving SBA Employees or Certain Third Parties Having an Interest in the Applicant?

(a) The determination must be made by the district director of another district office selected by the D/OLP makes the determination when:

(i) Employees, not officers or directors, of community organizations such as certified development companies and microlenders or members of their household, have a significant financial interest in the applicant. The selected DD should consider:

- The employee's relationship with the community organization;
- The organization's relationship with SBA;
- The employee's relationship with SBA; and
- Any additional information which might bear on a possible conflict of interest.

(ii) Close relatives that are not members of the household of SBA employees, other than those of the district director or regional administrator, who have a significant financial interest in the applicant.

(b) The determination must be made by the Standards of Conduct Committee at Headquarters, when:

(i) An SBA employee, their close relative, or other member of their household, has any financial interest in the applicant;

(ii) A former SBA employee, separated from SBA less than 1 year, has any financial interest in the applicant.

(iii) Individuals currently involved in the Small Business Institute (SBI) or Small Business Development Company (SBDC) Programs (coordinator, instructor, student, director, etc.) or members of their household have a significant financial interest in the applicant;

(iv) A member of Congress or a member of his/her household, is an officer, director or shareholder with 10 percent or more interest in the applicant; and

(v) An appointed official or employee of the legislative or judicial branch of the Federal Government, a member or employee of a Small Business Advisory Council, a SCORE or ACE Volunteer, or a close relative, is a sole proprietor, partner, officer, director, or shareholder with an interest or 20 percent

or more.

The application should be processed and may be conditionally approved by the appropriate field office under its delegation of authority. The file will be sent to the Standards of Conduct Committee with a recommendation from the district director of another district office selected by the D/OLP concerning the question of a conflict of interest.

(c) The determination must be made by the Office of Loan Programs when close relatives of the district director or regional administrator, even though they are not members of his/her household, have a significant interest in the applicant. The loan officer should process the application thoroughly. It should include the recommendations of all appropriate field officials and a statement from the district director or regional administrator concerning the relationship and the manner in which the conflict will be avoided. The Loan Policy Branch takes final action.

(4) Appearance of Conflicts

The SBA employees must disqualify themselves from deciding or even participating in the consideration of a request for SBA financial assistance when their participation raises or may raise questions of impropriety. They must do this even when no actual conflict exists if the appearance of a conflict reasonably could be perceived. Examples include, but are not limited to, the following.

(a) Loan to a personal friend;

(b) A loan to a former supervisor or similar person;

(c) Where an SBA employee is considering a business or commercial transaction with an applicant or recipient of SBA assistance; or

(d) Where an SBA employee is involved in business negotiations with an applicant or a recipient of SBA assistance.

In cases where an "appearance" of conflict exists, official action can not be taken by the field office until written approval is obtained from the appropriate SBA Standards of Conduct Counselor or from the SBA Standards of Conduct Committee. (See 13 CFR Part 105.)

(5) Other Government Employees

An applicant must submit a statement of no objection from the pertinent department or military service if an associate or a member of an associate.s household is an employee of another Federal Government department and is a GS-13, (or its equivalent) or higher, or holds the rank of Major or Lieutenant Commander (or their equivalent) or higher.

(c) Own an equity interest in a business that has received or is applying to receive SBA financing (during the term of the loan or within 6 months prior to the loan application);
(d) Be incarcerated, on parole, or on probation;
(e) Knowingly misrepresent or make a false statement to SBA;
(f) Engage in conduct reflecting a lack of business integrity or honesty;
(g) Be a convicted felon, or have an adverse final civil judgment (in a case involving fraud, breach of trust, or other conduct) that would cause the public to question the Participant's business integrity, taking into consideration such factors as the magnitude, repetition, harm caused, and remoteness in time of the activity or activities in question;
(h) Accept funding from any source that restricts, prioritized, or conditions the types of small businesses that the Participant may assist under an SBA program or that imposes any conditions or requirements upon recipients of SBA assistance inconsistent with SBA's loan programs or regulations;
(i) Fail to disclose to SBA all relationships between the small business and its Associates (including Close Relatives of Associates), the Participant, and/or the lenders financing the Project of which it is aware or should be aware;
(j) Fail to disclose to SBA whether the loan will:
(1) Reduce the exposure of a Participant or an Associate of a Participant in a position to sustain a loss;
(2) Directly or indirectly finance the purchase of real estate, personal property or services (including insurance) from the Participant or an Associate of the Participant;
(3) Repay or refinance a debt due a Participant or an Associate of a Participant; or
(4) Require the small business, or an Associate (including Close Relatives of Associates), to invest in the Participant (except for institutions which require an investment from all members as a condition of membership, such as a Production Credit Association);
(k) Issue a real estate forward commitment to a builder or developer;

b. What is a Forward Commitment?

A forward commitment exists when a lender issues a commitment to a builder or developer to finance future sales of real estate. The SBA will not guarantee loans made by the lender to small businesses to purchase such real estate. This is a potential conflict of interest for the lender because of its predisposition to make SBA loans in order to honor their prior agreement with the builder or developer. Such loans are ineligible for SBA's guarantee regardless of whether the lender gets a fee for issuing the commitment.

There have been situations where developers, brokers or lenders have created the impression that SBA financing is readily available for new purchases in a development. The SBA and participants must be careful to avoid any perception of forward commitments. Developers and brokers should not use the availability of SBA financing in their marketing.

(l) Engage in any activity which taints its objective judgment in evaluating the loan.

15. SPECIAL REQUIREMENTS FOR PARTICULAR TYPES OF LOANS

a. National Register of Historic Places

If loan proceeds will in any way affect properties included or eligible to be included in the National Register of Historic Places, the authorization must require that the undertaking be reviewed by the Advisory Counsel of Historic Preservation before SBA loan funds are disbursed. Follow the procedures set forth in 36 CFR, chapter VIII, Part 800. (Consult SBA counsel for further information.)

b. Business Relocations

Financing the relocation of an applicant's business is permitted only when it will accomplish a sound business purpose. Do not approve a loan if it finances a move that:

(1) Will cause serious unemployment in the present location;

(2) Will nullify a labor union contract or a commitment to negotiate a collective bargaining agreement; or

(3) Will involve substantial loss or expense to either party to an outstanding lease.

If there are doubts regarding the legal effect of a relocation, require applicant's counsel to provide a statement of all obligations or commitments which would be affected by the relocation.

c. Fishing and Shore Operations

Financial assistance request from applicants involved in commercial fishing activities may need to be referred to the Department of Commerce's National Marine Fisheries Service (NMFS) before being eligible for consideration by SBA. If the proceeds will be used to purchase or recondition fishing vessels of 5 tons or more, the NMFS can finance such activities through its Fisheries Obligation Guarantee Program, and such requests must be evaluated by the NMFS before they can be considered by SBA. If the request is to provide operating capital; for shore operations only; or for the actual construction of a fishing vessel, SBA may process the application without consulting NMFS. Otherwise, prior to SBA consideration, SBA must have a decline letter from NMFS stating:

(1) The applicant is ineligible for assistance under NMFS programs;

(2) Funds are unavailable for lending under NMFS programs; or

(3) The loan has been considered and declined by NMFS.

The NMFS also evaluates the request to determine if it is a wise use of fishery resources. The NMFS's letter must state that it has no objection to SBA providing the requested assistance. The NMFS has advised SBA that, because of over-fishing, it is no longer financing the construction of new fishing vessels for new ventures and it is reluctant to finance a new fishing vessel for an existing business. It has taken the position that economic prospects are not favorable for new vessels trying to get into commercial fishing unless the species of fish to be harvested is currently under utilized.

The NMFS has also advised that the act of giving a junior lien on a vessel creates an automatic default on an NMFS loan, and has requested that SBA advise it by letter, identifying the vessel, if SBA intends to file a junior lien on any vessel already pledged under the NMFS loan program.

Contact the nearest NMFS regional office to obtain permission for SBA to accept an application unless the applicant has already secured the needed written documentation.

The NMFS regional financial assistance divisions are located at:

1 Blackburn Drive Gloucester, MA 01930 (508) 281-9203	7600 Sand Point Way, N.E. Seattle, WA 98115 (206) 526-6140
9721 Executive Center Dr. St. Petersburg, FL 33702 (813) 570-5312	501 W. Ocean Blvd., Suite 4200 Long Beach, CA 90802 (310) 980-4000

d. Loans to Medical Facilities

Privately owned for-profit hospitals and medical and dental laboratories are eligible for SBA financing. Convalescent and nursing homes are eligible if they are properly licensed by the appropriate Government agency and provide services beyond room and board. (See subpart A, chapter 2, paragraph 8c(2) about Passive Businesses.) All medical facilities must meet the standards generally accepted for their type of institution. When licensing is required by state, county, or local agencies, the facilities must have a license in good standing or the licensing agency must indicate that a license will be issued subsequent to SBA financing.

e. Loans to Mines

Generally, an application for a mining loan must include, at the applicant.s own expense, an appraisal and engineering study evaluating the feasibility of the operation prepared by a qualified mining engineer. If the loan is approved, loan proceeds may pay for the appraisal but not the evaluation of the feasibility of the operation. Mining loan applications must also contain the applicant's completed SBA Form 4, SBA Form 4 Schedule A, and SBA Form 4B, "Essential Information Required for Loans to Producers of Minerals, Metals, fuel Except Oil, and Gas (Mining Loans)," unless:

(1) The loan proceeds will be used to remove sand and gravel from a pit or open cut by conventional earth removing equipment; or

(2) The lender has independent expertise in mining operations and a personal knowledge of borrower's operation, the lender and SBA may mutually decide that an engineering study is unnecessary.

Before a loan can be granted to any coal mining operation, the loan officer must contact a recommendation coordinator from the Office of Surface Mining Reclamation and Enforcement (OSM), Lexington, KY, (800)643-9748 and request an applicant violator check. The OSM responds by telephone usually within 24 hours, to whether the applicant mine is in compliance with the Surface Mining Control and Reclamation Act (SMCRA), 30 U.S.C. 1201 et. seq., and will provide a written response by mail or fax if one is requested.

Document the conversation, including the identity of the recommendation coordinator, in the loan report. No loan may be granted to an applicant who is not in compliance with the SMCRA. Applicants not in compliance should be referred to the local OSM office.

f. Native Americans Loans Collateralized by Indian Lands Held in Trust

Procedures for processing applications from Native Americans are the same as other applications.

If a loan is collateralized by an individually-owned trust or restricted land, the following specific requirements apply.

(1) The Secretary of the Interior or authorized representative must issue a commitment to approve or must approve a mortgage before we can accept the land as collateral for the loan.

(2) If only a commitment is issued, the owner of the land must get approval from the above authority before it can pledge the land.

(3) If the owner cannot get approval for a lien on the property, you may consider requiring an assignment of a lease instead. The assignment of lease also has to be approved by the Secretary of the Interior or his or her authorized representative.

Field offices may seek the advice and assistance of the Bureau of Indian Affairs (BIA) personnel when dealing with loans collateralized by Indian lands held in trust. For example, BIA can provide general information about:

(1) The manner in which security interests can be perfected on Indian lands;

(2) The applicant's title to or interest in Indian lands; and

(3)***** Official records filed with the Department of the Interior showing the status of the trust or restricted Indian lands.

g. Environmental Protection Agency (EPA) Requirements

Borrowers of direct Federal funds more than $100,000 must comply with the Clean Air Act and the Water Pollution Control Act by executing an agreement to abide by Executive Order 11738, which is part of the "Statements Required By Executive Orders" SBA Form 1261. If an applicant's facilities are on the list of violating facilities published by the Environmental Protection Agency (EPA), direct loan funds are prohibited unless the proceeds are for the principal purpose of complying with Federal, state or local laws. If the listing is based on a Federal criminal conviction under either Act, the applicant is ineligible for an SBA loan. Field offices have the responsibility of reporting, through channels, to Headquarters any instance of non-compliance with these Acts which comes to their attention.

h. Businesses Owned by Persons Not Citizens of the United States

SBA can provide financial assistance to businesses that are owned by persons who are not citizens of the United States. However, the processing procedures and the terms & conditions will vary, depending upon the status of the owners assigned by the Immigration and Naturalization Service (INS).

(1) Definitions of Immigration and Naturalization Service (INS) Statuses:

(a) Naturalized Citizens are persons of foreign birth who have been granted citizenship in the United States (U.S.). These individuals are not subject to any special restrictions or requirements beyond providing evidence of their citizenship status.

(b) Legal Permanent Resident (LPR or immigrant) (also known as Permanent Resident Aliens) are persons who may live and work in the U.S. for life unless INS revokes this status through an administrative hearing.

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

(i) 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

(ii) AA/FA or designee authorizes processing of the application.

(c) Asylees and Refugees are persons considered political offenders by their country or are fleeing war or similar conflict who receive temporary refuge in the United States. Asylees and refugees do not automatically receive LPR status. They must apply for this status like any other alien.

(d) Non-Immigrant (Documented) Aliens are persons who are admitted to the U.S. for a specific purpose(s) and for a temporary period of time with a current/valid INS document such as a visa.

(e) Undocumented Aliens are persons in the U.S. illegally.

(f) Foreign Nationals are non-citizens of the U.S. who reside outside the U.S. and do not have an express right, via INS documentation such as a visa, to physically be within U.S. boundaries.

(g) Foreign Entities are businesses, organizations, associations, *etc*. based in another country.

(2) INS Documentation to Evidence an Alien's Status

SBA Form 912, "Statement of Personal History," requires that aliens provide their alien registration number. An alien registration number indicates that the person is in the U.S. legally. It is not evidence of INS status or eligibility for SBA's programs.

Any alien who must complete SBA Form 912 or who owns 20 percent or more of the applicant business must provide current/valid INS documents to lenders or CDCs to determine eligibility.

The INS publication titled "A Guide to Selected U.S. Travel/Identity Documents for Law Enforcement Officers" provides color photographs and facts about the most commonly used authorization documents but is not comprehensive. All SBA field offices and processing and servicing centers should obtain a copy of this publication from the nearest INS office or telephone 800-870-3676. A list of INS offices and suboffices can be found at www.ins.usdoj.gov/graphics/fieldoffices/index.htm.

SBA, lenders, and CDCs must place a photo copy of the individual's documentation in the case file.

(3) Verification of INS Status

Because fraudulent INS documents are a serious problem, lenders and CDCs must verify the INS status of each alien, including LPRs who are required to submit INS documents. You must document the findings in the application package. This applies in all cases, regardless of the processing method or loan programs.

The lender or CDC submits an INS Form G-845 (845), "Document Verification Request," with supporting information to the nearest INS office. 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 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:

(a) I authorize the Immigration and Naturalization Service to release information regarding my immigration status to [name of lender].

(b) I authorize the Immigration and Naturalization Service to release alien verification information about me to [name of lender].

(4) Legal Permanent Resident-Owned Small Businesses

Immigrants (LPRs) are the **ONLY** class of aliens residing in the U.S. eligible to obtain financial assistance from SBA without complying with the requirements stated in the paragraph titled "Additional Requirements for Small Businesses in Subparagraphs (5) and (6) of This Paragraph."

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 and security measures. Replacement may also be necessary if the 551 is lost, the individual changes name, *etc*. LPR status does not lapse and is not in jeopardy merely because the 551 document lapses.

Replacement may take more than a year. Acceptable forms of evidence when the 551 has been submitted to INS for replacement or has an expired date include the following:

* A temporary stamp by INS on the individual's passport that says, "Processed for I-551 - Temporary Evidence of Lawful Permanent Residence;"

* INS Form I-327, "Re-entry Permit," issued to LPRs in lieu of passports, which is valid for only 2 years.

* INS Form I-797, "Notice of Action," a receipt issued to an alien when the 551 is lost or surrendered for renewal or changes (e.g., a name change because of marriage or divorce).

Conviction of criminal activity of a felony nature is the primary basis for termination of LPR status and/or deportation. INS holds administrative hearings to determine whether to impose termination of LPR status and/or deportation.

NOTE: SBA requires that the 551 or an acceptable substitute must be current at the time it is submitted with an application. SBA will return the application without accepting it for processing if the INS documentation is not currently in force.

(5) Small Businesses Owned by Foreign Nationals or Foreign Entities

To be eligible an applicant small business owned by a foreign national or a foreign entity must have a place of business located in the U.S.; operate primarily within the U.S.; pay taxes to the U.S.; and use American products, materials, and labor.

As a result of this, the business and its employees are subject to U.S. and local taxes.

(6) Businesses Owned by Non-immigrant Aliens Residing in the U.S.

Businesses owned by 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. Aliens must comply with the requirements stated in the subparagraph titled "Additional Requirements for Small Businesses in Subparagraphs (5) and (6) of This Paragraph" and meet SBA's other credit and eligibility criteria.

Businesses owned by undocumented (illegal) aliens are not eligible for SBA assistance.

Businesses owned by aliens who are subject to the Immigration Reform and Control Act of 1986 (IRCA) might be eligible under limited circumstances. IRCA invests INS with the authority to grant illegal aliens lawful temporary resident status under its provisions. Some aliens already enjoy this status. INS can grant it to others in accordance with the provisions of IRCA.

IRCA prohibits financial assistance to businesses owned 20 percent or more by such individuals for a period of 5 years after INS grants the alien lawful status.

This disqualification does not apply to Cuban or Haitian entrants or alien entrants subject to IRCA who are aged, blind, or disabled. The definition of blind or disabled is equivalent to SBA's criteria for determining eligibility for assistance to any small business owned by disabled individuals.

All applicants self-certify that they are eligible under IRCA by certifying that they have received and read SBA Form 1261, "Statements Required by Law and Executive Orders." This form includes a certification that IRCA does not apply to them.

(7) Additional Requirements for Small Businesses in Subparagraphs (5) and (6) of This Paragraph

Businesses and their owner(s) in this category must comply with Appendix 3, "Restrictions on Foreign Controlled Enterprises," of this SOP. They **MUST** also meet the following:

(a) Provide evidence that separate continual and consistent management (in addition to the owners) exists and will continue indefinitely. The management must have U.S. citizenship or **verified** LPR status. The potential for absentee ownership is much greater for businesses in this category. Management must have operated the business for at least 1 year prior to the application date. The application must contain assurance that management is expected to continue in place indefinitely.

This requirement prevents financial assistance to "start-up" businesses owned by aliens who do not have LPR status.

The personal guarantee of management must be considered as a loan condition and if not required, the loan report must explain why.

(b) Pledge collateral within the jurisdiction of the U.S. sufficient to pay the loan any time during its life (based on SBA's definition of collateral in SUBPART "A", Chapter 4, para. 1h). This requirement is mandatory for reasons of eligibility for these types of businesses for the life of the loan.

However, the credit decision on these applications must be based primarily on repayment ability and other credit factors, not collateral.

All Authorizations for loans to alien (other than LPR)-owned and foreign-owned small businesses must include this requirement. Lenders participating in expedited loan programs (e.g., PLPs, SBA*Express*, CLPs, LowDoc, *etc.*); CDCs (including PCLPs); and SBA personnel must comply with this requirement for the entire life of the loan.

i. Restrictions on Businesses Involved in International Trade

Whenever an applicant indicates that they conduct international trade, the lender or CDC must verify that the U.S. Government does not restrict trade with any country where the applicant does business. Verification consists of reviewing the Export-Import Bank's current "Country Limitation Schedule" (CLS). When an applicant conducts commercial trade in a country that the list identifies as unlawful with which to trade (referenced on the CLS as footnote #7), the application is not eligible and cannot be accepted for processing, even if the purpose of the proceeds is to finance a transaction to a non restricted country.

This schedule lists all countries with which commercial activity is unlawful. If the lender tells SBA orally instead of in writing, you must document the oral statement in the case file. The CLS is made available by Ex-Im Bank and is updated as needed or annually. A current schedule can be obtained via the internet address: http://www.exim.gov/country/cntlimit.html.

CHAPTER 3 - SIZE

1. SIZE STANDARDS

.121.101 What are SBA size standards?
SBA's size standards define whether a business entity is small and, thus, eligible for Government programs and preferences reserved for "small business" concerns. Size standards have been established for types of economic activity, or industry, generally under the Standard Industrial Classification (SIC) System. . . . A full table matching a size standard with each four-digit SIC code is also published annually by SBA in the Federal Register.

The current size standards can be found via SBA's home page at http://www.sba.gov.

2. ESTABLISHMENT OF SBA SIZE STANDARDS

.121.102 How does SBA establish size standards?

(a) SBA considers economic characteristics comprising the structure of an industry, including degree of competition, average firm size, start-up costs and entry barriers, and distribution of firms by size. It also considers technological changes, competition from other industries, growth trends, historical activity within an industry, unique factors occurring in the industry which may distinguish small firms from other firms, and the objectives of its programs and the impact on those programs of different size standard levels.

(b) As part of its review of a size standard, SBA will investigate if any concern at or below a particular standard would be dominant in the industry. SBA will take into consideration market share of a concern and other appropriate factors which may allow a concern to exercise a major controlling influence on a national basis in which a number of business concerns are engaged. Size standards seek to ensure that a concern that meets a specific size standard is not dominant in its field of operation.
(c) Please address any requests to change existing size standards or establish new ones for emerging industries to the Assistant Administrator for Size Standards, Small Business Administration, 409 3rd Street, S.W., Washington, D.C. 20416.

3. AFFILIATION

.121.103 What is affiliation?

(a) General Principles of Affiliation.

(1) 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.

(2) SBA considers factors such as ownership, management, previous relationships with or ties to another concern, and contractual relationships, in determining whether affiliation exists.

(3) Individuals or firms that have identical or substantially identical business or economic interests, such as family members, persons with common investments, or firms that are economically dependent through contractual or other relationships, may be treated as one party with such interests aggregated.

(4) SBA counts the receipts or employees of the concern whose size is at issue and those of all its domestic and foreign affiliates, regardless of whether the affiliates are organized for profit, in determining the concern's size.

(b) Exclusions from affiliation

(1) Business concerns owned in whole or substantial part by investment companies licensed, or development companies qualifying, under the Small Business Investment Act of 1958, as amended, are not considered affiliates of such investment companies or development companies.

(2) Business concerns owned and controlled by Indian Tribes, Alaska Regional or Village Corporations organized pursuant to the Alaska Native Claims Settlement Act (43 U.S.C. 1601), Native Hawaiian Organizations, or Community Development Corporations authorized by 42 U.S.C. 9805 are not considered affiliates of such entities, or with other concerns owned by these entities solely because of their common ownership.

(3) Business concerns which are part of an SBA approved pool of concerns for a joint program of research and development as authorized by the Small Business Act are not affiliates of one another because of the pool.

(4) Business concerns which lease employees from concerns primarily engaged in leasing employees to other businesses are not affiliated with the leasing company solely on the basis of a leasing agreement.

(5) For financial, management or technical assistance under the Small Business Investment Company program, an applicant concern is not affiliated with the investors listed in paragraphs (b)(5)(i) through (vi) of this section if the investors do not control the concern except under those circumstances set forth in .107.865(c) or (d) of this chapter. For purposes of this paragraph (b)(5), "control" is determined under .107.865 of this chapter.

(i) Venture capital operating companies, as defined in the U.S. Department of Labor regulations found at 29 CFR 2510.3-101(d);

(ii) Employee benefit or pension plans established and maintained by the Federal government or any state, or their political subdivisions, or any agency or instrumentality thereof, for the benefit of employees;

(iii) Employee benefit or pension plans within the meaning of the Employee Retirement Income Security Act of 1974, as amended (29 U.S.C. 1001, et seq.);

(iv) Charitable trusts, foundations, endowments, or similar organizations exempt from Federal income taxation under section 501(c) of the Internal Revenue Code of 1986, as amended (26 U.S.C. 501(c));

(v) Investment companies registered under the Investment Company Act of 1940, as amended (1940 Act) (15 U.S.C. 80a-1, et seq.); and

(vi) Investment companies, as defined under the 1940 Act, which are not registered under the 1940 Act because they are beneficially owned by less than 100 persons, if the company's sales literature or organizational documents indicate that its principal purpose is investment in securities rather than the operation of commercial enterprises.

(6) A protégé firm is not an affiliate of a mentor firm solely because the protégé firm receives assistance from the mentor firm under Federal Mentor-Protégé programs.

(c) Affiliation based on stock ownership.

(1) A person is an affiliate of a concern if the person owns or controls, or has the power to control 50 percent or more of its voting stock, or a block of stock which affords control because it is large compared to other outstanding blocks of stock.

(2) If two or more persons each owns, controls or has the power to control less than 50 percent of the voting stock of a concern, with minority holdings that are equal or approximately equal in size, but the aggregate of these minority holdings is large as compared with any other stock holding, each such person is presumed to be an affiliate of the concern.

(d) Affiliation arising under stock options, convertible debentures, and agreements to merge. Since stock options, convertible debentures, and agreements to merge (including agreements in principle) affect the power to control a concern, SBA treats them as though the rights granted have been exercised (except that an affiliate can not use them to appear to terminate control over another concern before it actually does so). SBA gives present effect to an agreement to merge or sell stock whether such agreement is unconditional, conditional, or finalized but unexecuted. Agreements to open or continue negotiations towards the possibility of a merger or a sale of stock at some later date are not considered "agreements in principle" and, thus, are not given present effect.

(e) Affiliation based on common management. Affiliation arises where one or more officers, directors or general partners controls the board of directors and/or the management of another concern.

(f) Affiliation based on joint venture arrangements.

(1) Parties to a joint venture are affiliates if any one of them seeks SBA financial assistance for use in connection with the joint venture.

(2) Concerns bidding on a particular procurement or property sale as joint venturers are affiliated with each other with regard to performance of that contract.

(3) A contractor and subcontractor are treated as joint venturers if the ostensible subcontractor will perform primary and vital requirements of a contract or if the prime contractor is unusually reliant upon the ostensible subcontractor. All requirements of the contract are considered in reviewing such relationship, including contract management, technical responsibilities, and the percentage of subcontracted work.

(4) For size purposes, a concern must include in its revenues its proportionate share of joint venture receipts.

(g) Affiliation based on franchise and license agreements. The restraints imposed on a franchisee or licensee by its franchise or license agreement relating to standardized quality, advertising, accounting format and other similar provisions, generally will not be considered in determining whether the franchisor or licensor is affiliated with the franchisee or licensee provided the franchisee or licensee has the right to profit from its efforts and bears the risk of loss commensurate with ownership. Affiliation may arise, however, through other means, such as common ownership, common management or excessive restrictions upon the sale of the franchise interest.

a. Do Affiliates Affect Size Standard Eligibility?

Size is determined based on the combined operations of an applicant and all its affiliates. Businesses that have common ownership, common management, or contractual relationships may be affiliates. The applicant, along with its affiliates, may be eligible under SBA's size standards if the entire group as a unit is eligible using the size standard for the group's primary industry. The applicant itself must also meet the size standard for its business.

b. What Else Must Be Considered When Affiliates Are Involved?

Even if the business including its affiliates is small, you must use the group's financial statements to answer the following questions.

(1) Do all the outstanding SBA loans to the business and its affiliates limit the amount of the loan you can approve?

(2) Do the affiliates have liquid assets (outside resources) to inject into the business?

(3) Will the loan replenish funds used for an ineligible purpose?

(4) How do the affiliates' operations affect cash flow? Do they add strength to repayment ability? Do they allow the principals to draw less from the business?

c. Businesses Owned by Close Family Members

SBA presumes that close family members, such as spouses, have an identity of interest and should be treated as one person for affiliation purposes. The applicant can rebut this presumption by showing:

(1) That there has been a clear fracture between the family members in question;

(2) That the family members are not closely involved in each other's businesses; or

(3) That other factors exist that would make the presumption unjust or inequitable under the circumstances.

(See subpart A, chapter 6, paragraph g(2) for Equal Credit Opportunity Act rules.)

d. How Are Complicated Affiliation Questions to be Handled?

In most ways, affiliation determinations are handled the same as other eligibility determinations. Where the issue is not clear, the SBA loan officer consults SBA field counsel. If there is a difference of opinion between FD and counsel, procedures are followed to obtain a decision from the AA/FA or designee. (See subpart A, chapter 2, paragraphs 1.a., b., and c.)

However, there is an additional option available. At any point during the eligibility determination, the applicant for assistance or the SBA official with authority to take final action on the assistance requested may request a determination on affiliation from the appropriate Government Contracting Area Office (GCAO). [See 13 CFR

.121.1001(b)(1).] If that request is made, the responsible Government Contracting Area Director or designee will make the decision, not a recommendation. [See 13 CFR .121.1002.] The Office of Hearings and Appeals (OHA) may, at its sole discretion, review the GCAO determination based on a request filed under the procedures set forth in 13 CFR Part 134.

e. Affiliation of Licensees/Franchisees with their Licensor/Franchisors

The following provisions in franchise agreements have been found to either give the franchisor so much control over the operations of the franchisee or to so restrict the opportunity of the franchisee to have the benefit of profits or the risk of loss from the operations, that the franchisees and franchisor were considered affiliates:

(1) A franchise fee equal to 52 percent of gross profits;

(2) A provision that allowed the franchisor to terminate the franchise at any time without cause;

(3) A provision that allowed the franchisor to terminate the franchise whenever the franchisor opened a new retail store in the franchisee's primary zip code;

(4) A provision that a franchisee could not transfer its interest in the franchise without the prior written consent of the franchisor, which could be withheld for any reason in the exercise of the franchisor.s sole subjective judgment;

(5) A provision that the franchisor has the option to purchase the franchisee's assets upon expiration or breach of the franchise, where the franchisor has the ability to control the price at the time of purchase

(i) by the franchisor unilaterally determining "fair market value"; and

(ii) by the franchisor unilaterally selecting an appraiser for the assets.

(6) A temporary personnel service where the employees recruited by the franchisee are hired on the franchisor's payroll; the franchisor handles all billing activities for the franchisee; and the franchisor shares losses with the franchisee on the same basis as the sharing of gross profits (40 to 60 percent).

4. CALCULATION OF ANNUAL RECEIPTS

.121.104 How does SBA calculate annual receipts?
(a) Definitions. In determining annual receipts of a concern:

(1) Receipts means "total income" (or in the case of a sole proprietorship, "gross income")

plus the "cost of goods sold" as these terms are defined or reported on Internal Revenue Service (IRS) Federal tax return forms (Form 1120 for corporations; Form 1120S for Subchapter S corporations; Form 1065 for partnerships; and Form 1040, Schedule F for farm or Schedule C for other sole proprietorships). However, the term receipts excludes net capital gains or losses, taxes collected for and remitted to a taxing authority if included in gross or total income, proceeds from the transactions between a concern and its domestic or foreign affiliates (if also excluded from gross or total income on a consolidated return filed with the IRS), and amounts collected for another by a travel agent, real estate agent, advertising agent, or conference management service provider.

Q. What is Meant by "Defined or Reported"?

A. If tax returns have not been filed (reported), SBA will calculate annual receipts as if they were filed because that is how receipts are defined. For example, if tax returns were filed in 1993, 1994, and 1995, but not for 1996 yet, although the fiscal/tax year has ended at the time the application is filed in 1996, use the last three completed years, i.e., 1994, 1995 and 1996. This requires a determination of how receipts for 1996 will be reported because that is how they are "defined."

(2) Completed fiscal year means a taxable year including any short period. Taxable year and short period have the meaning attributed to them by the IRS.
(3) Unless otherwise defined in this section, all terms shall have the meaning attributed to them by the IRS.

(b) Period of measurement.
(1) Annual receipts of a concern which has been in business for 3 or more completed fiscal years means the receipts of the concern over its last 3 completed fiscal years divided by three.
(2) Annual receipts of a concern which has been in business for less than 3 complete fiscal years means the receipts for the period the concern has been in business divided by the number of weeks in business, multiplied by 52.
(3) Annual receipts of a concern which has been in business 3 or more complete fiscal years but has a short year as one of those years means the receipts for the short year and the two full fiscal years divided by the number of weeks in the short year and the two full fiscal years, multiplied by 52.

(c) Use of information other than the Federal tax return. Where other information gives SBA reason to regard Federal Income Tax returns as false, SBA may base its size determination on such other information.

(d) Annual receipts of affiliates.
(1) If a concern has acquired an affiliate or been acquired as an affiliate during the applicable averaging period or before small business self-certification, the annual receipts in determining size status include the receipts of both firms. Furthermore, this aggregation applies for the entire applicable period used in computing size rather than only for the period after the affiliation arose. Receipts are determined for the concern and its affiliates in accordance with paragraph (b) of this section even though this may result in different periods being used to calculate annual receipts.
(2) The annual receipts of a former affiliate are not included as annual receipts if affiliation ceased before the date used for determining size. This exclusion of annual receipts of a former

affiliate applies during the entire period used in computing size, rather than only for the period after which the affiliation ceased.

5. DEFINITION OF "BUSINESS CONCERN OR CONCERN"

.121.105 How does SBA define "business concern or concern"?

(a) A business concern eligible for assistance from SBA as a small business is a business entity organized for profit, with a place of business located in the United States, and which operates primarily within the United States or which makes a significant contribution to the U.S. economy through payment of taxes or use of American products, materials or labor.

(b) A business concern may be in the legal form of an individual proprietorship, partnership, limited liability company, corporation, joint venture, association, trust or cooperative, except that where the form is a joint venture there can be no more than 49 percent participation by foreign business entities in the joint venture.

(c) A firm will not be treated as a separate business concern if a substantial portion of its assets and/or liabilities are the same as those of a predecessor entity. In such a case, the annual receipts and employees of the predecessor will be taken into account in determining size.

6. SBA'S CALCULATION OF NUMBER OF EMPLOYEES

.121.106 How does SBA calculate number of employees?

(a) Employees counted in determining size include all individuals employed on a full-time, part-time, temporary, or other basis. SBA will consider the totality of the circumstances, including factors relevant for tax purposes, in determining whether individuals are employees of the concern in question.

(b) Where the size standard is number of employees, the method for determining a concern's size includes the following principles:

(1) The average number of employees of the concern is used (including the employees of its domestic and foreign affiliates) based upon numbers of employees for each of the pay periods for the preceding completed 12 calendar months.

(2) Part-time and temporary employees are counted the same as full-time employees.

(3) If a concern has not been in business for 12 months, the average number of

employees is used for each of the pay periods during which it has been in business.

(4) The treatment of employees of former affiliates or recently acquired affiliates is the same as for size determinations using annual receipts in .121.104(d).

7. DETERMINATION OF A CONCERN'S "PRIMARY INDUSTRY"

.121.107 How does SBA determine a concern's "primary industry"?
In determining the primary industry in which a concern or a concern combined with its affiliates is engaged, SBA considers the distribution of receipts, employees and costs of doing business among the different industries in which business operations occurred for the most recently completed fiscal year. SBA may also consider other factors, such as the distribution of patents, contract awards, and assets.

Which Size Standard is Used When a Business is in More Than One Activity?

If a concern without affiliates is engaged in activity in more than one industry with different size standards, use the size standard for the concern's primary industry.

8. PENALTIES FOR MISREPRESENTATION OF SIZE STATUS

.121.108 What are the penalties for misrepresentation of size status?
In addition to other laws which may be applicable, section 16(d) of the Small Business Act, 15 U.S.C. 645(d), provides severe criminal penalties for knowingly misrepresenting the small business size status of a concern in connection with procurement programs. Section 16(a) of the Act also provides, in part, for criminal penalties for knowingly making false statements or misrepresentations to SBA for the purpose of influencing in any way the actions of the Agency.

9. SIZE STANDARDS ARE IDENTIFIED BY SIC CODES

.121.201 What size standards has SBA identified by Standard Industrial Classification codes?
The size standards described in this section apply to all SBA programs unless otherwise specified. The size standards themselves are expressed either in number of employees or annual receipts in millions of dollars, unless otherwise specified. The number of employees or annual receipts indicates the maximum allowed for a concern and its affiliates to be considered small. . . .

The SIC Code Alternatives

The Office of Management and Budget (OMB) is responsible for publishing the Standard Industrial Classification Codes while the Department of Commerce develops the actual breakout of the different classifications. The Department of Commerce has revamped the industrial classification system to coordinate efforts with Canada and Mexico, as well as to expand the breakout of industries from 4 to 6 digits. The North American Industry Classification System (NAICS) became effective 01/01/98. SBA did not convert to the six digit system at that time. If SBA converts to this new system, revisions will be made to existing requirements and forms.

10. SIZE STANDARDS APPLICABLE TO FINANCIAL ASSISTANCE

.121.301 of the regulation reads as follows:

(a) For Business Loans and Disaster Loans (other than physical disaster loans), an applicant must not exceed the size standard for the industry in which:
(1) The applicant combined with its affiliates is primarily engaged; and
(2) The applicant alone is primarily engaged.

(b) For Development Company programs, an applicant must meet one of the following standards:
(1) Including its affiliates, tangible net worth not in excess of $6 million, and average net income after Federal income taxes (excluding any carry-over losses) for the preceding two completed fiscal years not in excess of $2 million; or
(2) The same standards applicable under paragraph (a) of this section. . . .

(c) The applicable size standards for the purpose of all SBA financial assistance programs, excluding the Surety Bond Guarantee assistance program, are increased by 25 percent whenever the applicant agrees to use the assistance within a labor surplus area. Labor surplus areas are listed monthly in the Department of Labor publication called "Area Trends."

Q. What are general size standards that apply to most businesses?

A. For most retail businesses, the applicant and its affiliates cannot exceed $5.0 million in gross sales averaged over the last 3 fiscal years.

For most wholesale businesses, the applicant and its affiliates cannot have more than 100 employees.

For most manufacturing businesses, the applicant and its affiliates cannot have more than 500 employees.

11. WHEN SIZE STATUS OF AN APPLICANT IS DETERMINED

.121.302 When does SBA determine the size status of an applicant?
(a) The size of an applicant for SBA financial assistance is determined as of the date the application for such financial assistance is accepted for processing by SBA, except for the Disaster Loan and Preferred Lenders programs.
(b) For the Preferred Lenders program, size is determined as of the date of approval of the loan by the Preferred Lender.
(c) For disaster loan assistance (other than physical disaster loans), size status is determined as of the date the disaster commenced, as set forth in the Disaster Declaration.
(d) Changes in size subsequent to the applicable date when size is determined will not disqualify an applicant for assistance.

a. How Does Post Approval Growth Impact Size?

SBA can assist an existing business that is small as of the date the application is accepted for processing by SBA, even if the financing results in the business exceeding the size standard.

b. How Does the Acquisition of a Business Impact Size?

By policy, the business to be acquired must be eligible (including by size) at the time of application, even though the actual acquisition does not occur until the loan is disbursed. If the applicant already owns one business and is using at least part of the proposed loan proceeds to acquire a new business, the sizes of the two businesses are combined to determine if the application is size eligible.

12. SIZE PROCEDURES BEFORE A FORMAL DETERMINATION

.121.303 What size procedures are used by SBA before it makes a formal size determination?
(a) A concern that submits an application for financial assistance is deemed to have certified that it is small under the applicable size standard. SBA may question the concern's status based on information supplied in the application or from any other source. . . .

(b) A small business investment company, a development company, a surety bond company, or a preferred lender may accept as true the size information provided by an applicant, unless credible evidence to the contrary is apparent.

(c) Size is initially considered by the individual with final financial assistance authority. This is not a formal size determination. A formal determination may be requested prior to a denial of eligibility based on size.

(d) An applicant may request a formal size determination when assistance has been denied for size ineligibility. Except for disaster loan eligibility, a request for a formal size determination must be made to the Government Contracting Area Director serving the area in which the headquarters of the applicant is located, regardless of the location of the parent company or affiliates. For disaster loan assistance, the request for a size determination must be made to the Area Director for the Disaster Area Office which denied the assistance.

(e) There are no time limitations for making a formal size determination for purposes of financial assistance. The official making the formal size determination must provide a copy of the determination to the applicant, to the requesting SBA official, and to other interested SBA program officials.

13. SIZE REQUIREMENTS FOR REFINANCING AN SBA LOAN

.121.304 What are the size requirements for refinancing an existing SBA loan?

(a) A concern that applies to refinance an existing SBA loan or guarantee will be considered small for the refinancing even though its size has increased since the date of the original financing to exceed its applicable size standard, provided that:

(1) The increase in size is due to natural growth (as distinguished from merger, acquisition or similar management action); and

(2) SBA determines that refinancing is necessary to protect the Government's financial interest.

(b) If a concern's size has increased other than by natural growth, the concern and its affiliates must be small at the time the application for refinancing is accepted for processing by SBA.

14. SIZE REQUIREMENTS FOR LOANS RELATED TO PROCUREMENT

.121.305 What size eligibility requirements exist for obtaining business loans relating to particular procurement?

A concern qualified as small for a particular procurement, including an 8(a) subcontract, is small for financial assistance directly and primarily relating to the performance of the particular procurement.

See 13 CFR 121 for all rules pertaining to small business size regulations.

CHAPTER 4 - CREDIT

1. SBA'S LENDING CRITERIA

.120.150 What are SBA's lending criteria?
The applicant (including an Operating Company) must be credit worthy. Loans must be so sound as to reasonably assure repayment. SBA will consider:
(a) Character, reputation, and credit history of the applicant (and the Operating Company, if applicable), its Associates, and guarantors:

a. Consideration of Character

Have the principals historically shown the willingness and ability to pay their debts? Have they abided by the laws of their community? While the lender will normally be more knowledgeable about the strength of a principal's character, the loan officer must be attentive to information contained in the credit file which may have an impact on this issue. Adverse information on the "Statement of Personal History," SBA Form 912, may indicate character issues that need to be addressed. See Subpart A, chapter 6, paragraph 4(d).

(b) Experience and depth of management;

b. Consideration of Management

In assessing management ability, consider such factors as education, experience and motivation. While the opinion of the lender or the business development officer must be considered, you must independently assess and evaluate the applicant's management ability or potential. You may comment briefly in the loan report when management skill is clearly satisfactory. Otherwise, address any weaknesses and identify ways to improve deficient areas. You may consider requiring training, SCORE, or other assistance as a prerequisite to disbursement.

(c) Strength of the business

c. Consideration of Business Strength

We judge the financial strength of a business by analysis and consideration of:

(1) Balance Sheets - Understanding past operations is necessary to know where the firm is headed. Balance sheets allow you to chart the history of where a firm has been and where it is as of the current statement. The pro forma balance sheet shows you where it is headed. In analyzing the pro forma you must do the following.

(a) Evaluate the balance sheet and make any necessary adjustments by deleting intangibles, such as goodwill not associated with the purchase of a going concern, old accounts receivable, non-business assets and other items as appropriate. Note: goodwill in the purchase of a going concern may be a legitimate value, albeit a soft value, which may add support to an otherwise well-leveraged capital position.

(b) Adjust inflated asset values and excessive depreciation and evaluate questionable items.

(c) Perform sufficient ratio analysis to understand past operations and trends and to assure that resources are adequate for the business's needs. You must also analyze the factors that make up the ratios and their impact on the financial condition of the business.

(2) Working Capital Adequacy

Adequate working capital is of major importance to most SBA borrowers. Many firms have failed before reaching their potential due solely to inadequate working capital. The working capital analysis format in SOP 50-11 is an excellent tool and should be regularly utilized. The analysis allows you to construct the relevant balance sheet components of the applicant based only on projected sales and Robert Morris Association (RMA) industry averages. It reveals the dollar amount of cash, accounts receivable, inventory and accounts payable that the average firm would have at the projected sales level. Comparison to the pro forma balance sheet of the applicant allows for a direct comparison of working capital adequacy.

If necessary, as in the case for most start-ups, you may also require the applicant to provide a detailed cash flow projection. Consider increasing the loan amount if the request does not provide for sufficient working capital. Do not reduce a needed working capital portion of a loan merely to improve the debt to net worth ratio or to reduce a collateral shortage. Also, be aware of the additional costs which might result from SBA or lender imposed conditions.

(3) Asset Revaluation = A Caution

The revaluation of assets to increase net worth occasionally has merit but often does not. Revaluations are frequently cosmetic intended simply to improve the balance sheet. Before accepting them, carefully evaluate the following.

(a) The focus of appreciation claims is usually real estate. Other assets rarely appreciate. Revaluation may have validity if the real estate has been held for a long period and market values have increased.

(b) Claims of appreciation of newly purchased assets are seldom valid. The purchase price of such assets is usually a better test of value for analysis purposes.

(c) If you increase the pro forma net worth by means of asset revaluation, the entry must be justified in the loan report and supported by a written appraisal.

(d) Past earnings, projected cash flow, and future prospects;

d. How Should Repayment Ability Be Evaluated?

Historical earnings and cash flow are the best bases upon which to gauge repayment ability. Projections are to be considered the basis for determining repayment when there is a change in the circumstances affecting the business or a lack of historical financial data. Regardless of whether historical or projected performance is the basis for repayment, all expenses (e.g., operating expenses, owners withdrawals, salaries, dividends, etc.) must be considered when evaluating repayment ability.

(1) Historical Cash Flow

The best evidence of repayment ability is sufficient cash flow from prior operations to retire the anticipated annual fixed obligations of the business. Always note any trends in revenues and cash flows.

Interim operating statements may not be a reliable basis for loan approvals, particularly where the interim results are inconsistent with the prior operating results. Interim statements for seasonal businesses can be especially misleading.

(2) Projected Cash Flow

If historical cash flow does not demonstrate repayment ability, a realistic projection of future earnings must be used. The projections must be tested against industry averages and historical operations to assess feasibility. You must explain any significant variations.

(e) Ability to repay the loan with earnings from the business;

e. Consideration of Repayment Ability

(1) Business Earnings Vs. Collateral

The ability to repay a loan from the cash flow of the business is the most important consideration in SBA's loan making process. All SBA loans must be of such sound value or so secured as to reasonably assure repayment. Sound value contemplates such factors as good character, earnings, collateral, management ability and financial condition. The object is not to obtain sufficient collateral to completely liquidate loans under future conditions. The SBA does not make loans based upon the liquidation value of collateral. This would be a disservice to the borrower. If you do not believe a firm can repay the loan from the cash flow of its operations, you must decline the loan application.

(2) Annual Fixed Obligations

The pro forma schedule of annual fixed obligations, which you must fully complete in the loan report, is a very important element in analyzing the ability to repay. Annual fixed obligations, including the proposed loan, are generally shown as the total principal obligation of term debt. Sometimes it may be difficult to break down an existing fixed obligation into principal and interest. You should comment in your report if interest is included as part of the fixed obligation amount.

(3) Compensation of Owners/Principals

You must consider the effect that owner compensation may have on repayment ability. Answer the following questions and any others which may be relevant.

(a) What personal obligations and expenses does each owner have?
(b) How much compensation, including bonuses, perks, and benefits, is the business really paying each owner?

(c) Are company "assets" benefiting the company or any owner?

(d) How do these practices impact the cash flow and repayment ability?

(e) Do the balance sheets show increases in "Loan(s) Receivable-Officer(s) or Partner(s)" accounts? Increases in these accounts usually indicate funds being paid to the officers/partners in addition to their normal compensation listed on the income statement for that year. This conceals the impact on net profits and net worth and causes the traditional rule of thumb cash flow calculation to be inflated.

(4) Actual Cash Flow vs. Rule of Thumb Cash Flow

Analysis of actual cash flow is preferred over "rule of thumb" cash flow for analyzing repayment ability. "Rule of thumb" cash flow can be distorted easily by ownership and management through their accounting practices and reporting. Net profits do not usually equate to cash available to service debt. Expenses for depreciation may be distorted as a result of management's method of allocation and may be short-term in nature. "Rule of thumb" cash flow often may indicate repayment ability when actual cash flow is insufficient or even negative. It may also incorrectly indicate an inability to repay when substantial cash flow is actually available to repay the loan. A company's actual cash flow should always be analyzed when there have been significant changes in its operations.

(5) Importance of Analyzing the Source of the Cash Flow

The presence of a positive actual cash flow is not necessarily an indication of repayment ability. If the source of the cash flow is mostly or entirely from the occurrence of debt, equity injection or sale of company assets, repayment ability may not exist.

(f) Sufficient invested equity to operate on a sound financial basis;

f. Equity Investment Policy

(1) Adequacy of Equity

SBA generally will not provide 100 percent financing for a firm. Financing of more than 90 percent of the cost of real estate is not eligible under PLP. See subpart D. You must decide whether equity is adequate on a case-by-case

basis. This is particularly important for new businesses where a pattern of earnings has not been established. A solid equity position reduces the need for debt, provides an incentive for the principals to remain committed, provides a cushion which helps the business endure economic slumps, and improves the value of the collateral as security for the loan. Excessive debt can place unreasonable demands on a firm's ability to develop sufficient cash flows to service it.

(2) Debt to Equity Ratio

This ratio should be calculated on a tangible basis, generally discounting such soft values as organization costs, goodwill, patents, and research and development costs. Although these assets may have little or no tangible value, they may well provide an indication of strength in the business. For example, goodwill may represent a realistic valuation of a company's good name and reputation when the business is being sold.

The debt to equity ratio varies considerably between industries making it difficult to establish a minimum acceptable ratio. However, generally you will not be able to justify approving a loan to an insolvent firm when the insolvency is due to operating losses, unless such losses were beyond the control of management.

(3) Impact of other Favorable Factors

Other favorable factors may help offset an adverse equity ratio. These could include the pledge of outside assets as collateral, the continuity of experienced management that has produced solid and consistent earnings, education and knowledge in a specialized field such as medicine or law or other factors. You may consider the value of the education of some professionals such as lawyers, doctors, and accountants to offset the lack of equity investment in terms of money or assets.

(4) Value of Assets other than Cash Injected as Equity

You must carefully evaluate the value of assets other than cash which are

injected by owners or principals because an applicant may overvalue assets either through an honest misjudgment or an attempt to embellish his or her financial investment in the new business. Applicants may also undervalue their assets. Therefore, an appraisal or other valuation by a third party may be desirable.

(5) Standby Debt

Generally, standby debt from non-owners is not acceptable as the entire net worth of an applicant, especially when it occurs in new business and change of ownership loans.

(6) Can Personal Debt be used for Equity Injection?

Funds borrowed through the use of personal credit for injection into the business should normally be treated as debt financing, not equity injection. A lender must disclose any loan made to an individual for the purpose of providing an equity injection into the business. Its loan analysis should address the impact on the personal and business balance sheets and sources of repayment for such side loans. On a case-by-case basis you may be able to justify such funds as equity injection based on the analysis.

If the lender of the borrowed funds agrees to a formal standby of payment of the principal and interest until the SBA loan is paid in full, the borrowed funds may be deemed to be equity for loan purposes.

The other instance in which borrowed funds may be deemed equity is if the applicant can demonstrate repayment ability from a source other than the cash flow of the business or from reasonable withdrawals or salary, and excessive withdrawals or salary are not required to service the side loan. "Reasonable" withdrawals or salary means an amount comparable to that paid to someone employed to perform the same functions and duties with the same level of responsibility and authority.

(7) Impact of Debt

Simply stated, the greater the debt in comparison to the net worth, the lower the chances for success.

(g) Potential for long term success;

g. Consideration of Long Term Success

Many factors affect the prospects for the survival of a business. You must evaluate the financial issues, as well as many other factors. The more you know about the factors affecting the business, the better you can assess the prospects and the risks.

(1) Factors Affecting the Business and the Industry

(a) Is the borrower in a growth, mature, or declining industry?

(b) Does the firm have a good location for its type of business?

(c) Will local demographic factors benefit or harm the firm?

(d) What is SBA's experience with other businesses in the same industry?

(2) The SBA's Experience in a Specific Industry

The SBA's database provides information about SBA's loan experience by SIC Code, by office, region, and nationally for the past 10 years. Procedures for obtaining this information can be found in Appendix 2.

(h) Nature and value of collateral (although collateral will not be the sole reason for denial of a loan request); and

h. What is SBA's Policy Regarding Collateral For 7(a) Loans?

The Agency is a cashflow lender and does not apply loan-to-value criteria in deciding whether to approve or decline loan or loan guaranty requests. It has been a long-standing policy not to decline a loan where inadequacy of collateral is the only unfavorable factor. However, this does not mean that collateral is to be ignored as a credit factor, nor does it mean the analysis of collateral adequacy ends with obtaining the assets being financed or refinanced with loan proceeds. To the extent that worthwhile assets (both those financed with loan proceeds and those available from other sources) are available from either the applicants or the principals of the applicant, adequate collateral is to be required. This policy is to be applied consistently across program lines, unless specific guidance to the contrary is established by Headquarters.

While cash flow is the primary consideration in our analysis of repayment ability, it is important, nonetheless, to accurately calculate the real value of the collateral assets providing the secondary source of repayment, as this valuation will help identify the overall level of risk associated with the loan.

The SBA loans must be secured as fully as possible with whatever worthwhile assets are available to be pledged. Collateral and personal guarantees of the principals provide a secondary means of repayment if the borrower is unable to repay the debt from its cash flow. However, you must not decline a loan if the only weakness in the application is the value of collateral in relation to the loan amount, provided all assets available to the business and its principals have been pledged. Assets securing personal guarantees will generally be limited to those contributing the most significant collateral value such as investment real estate, residences, and occasionally investment interests.

A loan is considered fully secured if SBA has security interests in assets with a combined "collateral" value that equals or exceeds the loan balance. For SBA, the "Collateral" value of an asset means the amount expected to be realized if the lender took possession after a loan default and sold the asset after conducting a reasonable search for a buyer and after deducting the costs of taking possession, preserving and marketing the asset, less the value of any existing liens. Each loan analysis is to contain the market value of each asset taken as collateral and its "collateral value" using the above definition. Collateral coverage is to be based on "Collateral Value" and not market value.

While the mortgage industry has historically used a "loan to value" ratio to help assume an acceptable level of collateral protection, the use of SBA's "collateral" value on a case by case basis will provide room for considering experiences of individual lenders and local market conditions. The result is a tailored collateral valuation for each transaction. To preserve this level of discretion on each case, we have not provided a matrix of valuation ranges for given types of collateral assets. However, it is very important that the collateral value established in each case be fully justified in each transaction.

These valuations will assist in identifying the degree of collateral coverage. When the coverage is not equal to the loan amount, the need to obtain other assets which may be available in order to fully secure the loan must be explored. If coverage is not full and worthwhile assets are available, they must be pledged, or the loan must be declined. However if the loan is not fully covered and there are no additional assets to be pledged (either business or personal) the loan shall not be declined solely for lack of collateral.

The analysis of all other credit factors which impact the applicant's ability to service its debts determines whether the loan will be made or not. The impact of collateral is not significant until the business operation has failed. Again, the inadequacy of collateral itself is no reason to decline the loan, provided all available assets have been offered.

(1) Collateral for Psychological Value

You should not take a lien on assets with little or no value merely for "psychological value." This practice costs the borrower for collateral filings, but does not measurably improve SBA's position on the loan.

(2) Collateral Normally Required

When loan proceeds will be used to buy assets, you must obtain a first security interest in these assets as collateral for the loan, unless otherwise justified. When SBA refinances secured debts, we expect to have at least the same security for the new debt, unless the debt being refinanced was classified as unreasonable because it was secured by too much collateral. Reference Subpart A, Chapter 2, paragraph 3a, Q&A number 1. The first source of collateral is the assets of the business. Since most SBA loans are long term, look first at fixed assets - real estate and machinery and equipment. You should consider taking working assets as collateral only if short term credit is not needed. If a collateral shortfall exists, look to the personal assets of the principals to secure their guarantees - first to investment properties and then to the personal residence.

(3) Personal Residences

A personal residence is taken as collateral when:

(a) The participant lender requires it; or

(b) Other collateral offered is weak and the equity equals or exceeds 25 percent of the property's fair market value.

Since collateral is never a substitute for repayment ability, the liquidation of a residence should not be relied upon as a source of repayment. When a borrower lacks reasonable assurance of repayment from the earnings of the business, you must decline the loan.

Unless State law prevents it, owner-occupied residences may always be required as collateral where the applicant operates out of the residence or other buildings located on the same parcel of land. Residential properties and other buildings leased or rented to others may always be required as collateral. When an owner-occupied residence is taken as collateral, no representations are to be made limiting the possibility of foreclosure in the event of default.

(4) The SBA Collateral Requirements vs. Lender's Requirements

When submitting a loan request to SBA, the lender recommends the loan structure and various terms and conditions, including the collateral. If you disagree with the lender about any of the proposed loan conditions, including the collateral requirements, you must resolve the disagreement(s) before you recommend approval of the loan. If a lender is proposing to take collateral which does not fully secure the loan and other collateral is available to be pledged, SBA may decline the loan due to inadequate collateral.

(5) Assignments of Lease and Landlord's Waivers

(a) An assignment of lease and landlord's waiver should be obtained when a substantial part of the loan proceeds are to be used for leasehold improvements or a substantial portion of the collateral consists of leasehold improvements, fixtures, machinery, or equipment that is attached to leased real estate.

Personal assets or other assets are acceptable, and possibly preferable, alternative collateral in place of, or in addition to, leasehold improvements. The length of the lease and renewal options must, at a

minimum, equal the term of the loan. The assignment of lease should require the lessor to provide a 60-day written notice of default to lender/SBA with option to cure default. This does not mean the term of the lease must exactly match the term of the loan (e.g., a 20 year lease that has 19.5 years to go when you are considering a 20 year loan would be satisfactory).

If the loan proceeds are to be used to finance improvements on a leasehold interest in the land, the underlying ground lease should include, at a minimum, detailed clauses addressing the following:

(1) Tenant's right to encumber leasehold estate;

(2) No modification or cancellation of lease without lender's or assignee's approval;

(3) Lender's or assignee's right to acquire the leasehold at foreclosure sale or by assignment and unqualified right of reassignment of the leasehold estate (along with right to exercise any options) by lender or successors;

(4) Lender's or assignee's right to sublease;

(5) Lender's or assignee's rights upon default of the tenant or termination of the lease. This would include notice, extended time to cure (at least 90 days), time allotted for foreclosure and sale, and procedures for non-monetary defaults;

(6) Lender's or assignee's rights to hazard insurance proceeds resulting from damage to improvements;

(7) Lender's or assignee's first right to share in condemnation proceeds.

(b) There are special problems when financing leasehold improvements. Ordinarily improvements that are attached substantially to real property become part of the real property and hence the property of the landlord. In making the credit decision, the SBA Finance Division should consider the following:

(1) Additional tangible assets of the small business that may be

available for collateral;

(2) Additional collateral from guarantors; and/or

(3) Requiring the lease on the project to be substantially longer than the term of the SBA guaranteed loan. The reason for this is that in a liquidation, property with a short amount of time left on the lease will have little or no value to a potential buyer.

(c) When a landlord's waiver and assignment of lease cannot be obtained, you must reconsider the applicant's credit factors to determine if approval is warranted. Approval without the waiver and assignment may be feasible where:

(1) Other collateral or secured guarantees are available in sufficient amount to reasonably protect the Agency's interest; or

(2) A profitable business with established, sufficient cash flow to repay the proposed SBA loan and other fixed obligations is expanding.

You must consider reluctance on the part of a landlord to grant a lease assignment or to waive his rights to assets on the leased premises when determining whether the applicant has pledged all available assets.

If it is not possible for SBA to obtain a recorded lien against a leasehold estate because of a Federal, State, or tribal law or regulation, the lender must obtain from the applicant other collateral sufficient in value to reasonably protect the interests of the Government.

(6) Value of Fixtures as Collateral

Fixtures attached to real property generally become a part of the realty. If SBA does not have a lien on the real estate, recovery on the fixtures is unlikely. There is no problem in perfecting a lien when both the real estate and fixtures are to be taken as collateral.

Where a chattel of substantial value is affixed to leased real estate or to real estate subject to a prior lien, consult with counsel regarding the effect of an SBA lien on the property.

(7) Current Assets as Collateral

Blanket liens on current assets such as inventory and accounts receivable, generally offer little value at liquidation. Inventory is usually sold off to meet other expenses or to meet debts. Accounts receivable are hard to collect if a business fails. Encumbering these assets may hurt the ability of the borrower to obtain short-term financing for seasonal needs. You might consider, after discussing with the lender, leaving part of these assets unencumbered for this purpose.

Also, firms that regularly get performance bonds could have difficulty if we claim these assets. Such needs of the applicant should be addressed in the loan report. If field warehouse receipts or assignments of government contract proceeds are involved, consult counsel about how to perfect the necessary liens.

(8) Insurance as Collateral

You should require life or disability insurance only to protect SBA's interests in the event of the death or disability of a key person(s) critical to the success of the business or whose continued earning power is being relied upon in making the loan. Life or disability insurance may not be necessary where the collateral is sufficient or there is adequate depth and experience of management. Coverage should be set at the minimum amount and type necessary to protect the loan. Consider the impact of the cost of the insurance (whether whole life, term, or some other form) on the working capital and cash flow. Assignment of existing insurance coverage is acceptable.

(9) Amounts in Which to Take Liens on Collateral

All liens on collateral must be taken/secured for the "Full" amount of the loan to protect the Government's interest or the maximum permitted by appropriate State law.

(i) The effect any affiliates (as defined in part 121 of this chapter) may have on the ultimate repayment ability of the applicant.

i. How Are Affiliates Evaluated In Repayment Analysis?

The financial condition of affiliates can be a major credit factor. Realistic analysis of the borrower requires that you consider the affiliates carefully and thoroughly. Issues to consider include the following:

(1) How do they interact?

(2) Are there intercompany transactions?

(3) Is the affiliate generating excess cash that could help our borrower?

(4) Is the affiliate in need of cash and may drain funds from our borrower or in a position to support the borrower in a pinch?

(5) Consolidation of the financial statements of all of the affiliates is a beneficial practice in most cases where affiliates exist.

2. MAXIMUM SBA EXPOSURE

.120.151 What is the statutory limit for total loans to a Borrower?
The aggregate amount of the SBA portions of all loans to a single Borrower, including the Borrower's affiliates as defined in part 121 of this chapter, may not exceed a guarantee amount of $750,000, except as otherwise authorized by statute for a specific loan program. The amount of any loan received by an Eligible Passive Company applies to the loan limit of both the Eligible Passive Company and the Operating Company.

a. General Maximums for SBA's Loan Programs

(1) Regular 7(a)

The SBA's maximum guaranty on regular 7(a) loans is normally $750,000 but can be as high as $1,000,000 for Pollution loans and as high as $1,250,000 for International Trade loans under certain circumstances.

(2) SBAExpress (Formerly FA$TRAK)

SBAExpress loans are limited to $150,000 with a 50 percent ($75,000) maximum guaranty per loan. SBA does not restrict the number of SBAExpress loans which a borrower may obtain, but the total SBA guaranteed amount must not exceed $750,000.

(3) LowDoc

LowDoc loans are limited to a maximum total amount of $150,000, including the balance of all outstanding SBA business loans. The maximum guaranty percentage is 80 percent for loans that total $100,000 or less and the maximum guaranty percentage is 75 percent for loans that total more than $100,000. A borrower may have more than one loan processed under LowDoc procedures, providing the gross amount of all SBA loans (excluding disaster) is not more than $150,000.

(4) DELTA

The maximum gross loan amount for a DELTA 7(a) loan is $1,250,000 with a 75 percent guarantee. The maximum SBA loan amount for a DELTA 504 is $1,000,000. The maximum gross loan amount for combined DELTA 7(a) and 504 financing is $1,250,000. To determine the aggregate loan for a combination of DELTA 7(a) and 504 financing, add the 7(a) gross loan amount to the 504 debenture guarantee amount. The combined total may not exceed $1,250,000. For example, a DELTA 504 loan with a $1,000,000 SBA-guaranteed debenture can be combined with a $250,000 7(a) DELTA loan guaranteed by SBA at 75 percent.

(5) Certified Development Company (504)

The maximum exposure on 504 loans is normally $750,000 but can be as high as $1,000,000 under specific conditions discussed in subpart H.

(6) Other Maximums

Maximum loan amounts and SBA exposure for other programs, such as the microloan program, are addressed in the sections covering the specific program.

b. Loans to Affiliates

You must determine whether control exists to determine whether affiliation exists. If affiliation exists, SBA's loan or guarantee maximums apply to the affiliated group as if it were a single business. See subpart A, chapter 3 for further discussion.

c. Approving Multiple Loans from Different Programs with Different Maximums

When an applicant applies for any combination of 7(a), 7(a) DELTA, 504 and 504 DELTA loans, the order in which you fund the loans determines the maximum loan and guaranty amounts available. Fund the loan subject to the lowest maximum first and fund the subsequent loans in the order of the next higher maximum loan exposure amounts, such as in the following examples:

7(a) SBAExpress, then regular 7(a), then 504, or 504 DELTA;
or
7(a) DELTA, then 504, or 504 DELTA

The maximum amount to any one borrower or group of borrowers must never exceed the highest maximum amount for loan programs.

CHAPTER 5 - LOAN CONDITIONS

1. BASIC LOAN CONDITIONS:

.120.160 Loan conditions.

SBA Headquarters establishes the wording for all 7(a) and 504 standard authorization conditions. These conditions reflect the policies and procedures in effect at the time the National Authorization Boilerplates are issued and can be found in SOP 50-10 and 50-50 [as revised] and in appropriate Headquarters policy and procedure notices. The current edition of the National Authorization can be found at www://sba.gov.banking.

The authorizations for any 7(a) loan approved after June 1, 1998, and the authorizations for any 504 loan approved after August 15, 1998, must only use pre-approved conditions that are found in the National Boilerplate.

Q1. Who Determines Terms and Conditions For Any Given Loan?

A1. The participant sets the terms and conditions for extending their credit. SBA establishes the terms and conditions for its loan or debenture guaranty. SBA must agree to any term or condition proposed by the participant with are not SBA pre-approved conditions before approval of the guaranty.

Q2. Who prepares the Authorization?

A2. It depends upon the method of delivery program under which the loan was processed. For all loans processed under.

a. Standard 7(a) or 504 procedures: SBA is responsible for initiation and finalization of the authorization utilizing pre-approved SBA conditions.

b. CLP procedures: The lender is responsible for preparing a draft authorization, utilizing pre-approved SBA conditions, and SBA is responsible for finalization of the authorization.

c. PLP or PCLP procedures; The lender or PCLP CDC is responsible for finalization of the authorization utilizing pre-approved SBA conditions.

d1. LowDoc procedures at the LowDoc Processing Center (LDPC): The center is responsible for finalization of the Authorization utilizing pre-approved SBA conditions. Reference paragraph 8d in Appendix 5, for additional information.

d2. LowDoc Reconsideration procedures at a district or branch office: Responsibility for finalizing the authorization is up to the local office, using pre-approved boilerplate conditions. Field offices must follow the same procedures

as used by the LDPC concerning authorizations when reconsidering an application under LowDoc procedures.

e. Pilot procedures: Use the instructions for the particular pilot program.

Q3. What Authorizations Are Field Counsel Required To Review?

A3. SBA Counsel must review any 7(a) or 504 loan authorization that proposes to use non-approved National Boilerplate language except for those loans processed under PLP or Premier Certified Lenders Program (PCLP) procedures.

Q4. What is the Procedure for Handling Unusual Terms and Conditions?

A4. Field offices that process requests for financial assistance may develop authorization conditions that are not pre-approved in the National Boilerplates. These conditions can be used on a case by case basis without Headquarters approval providing they have been cleared by counsel for that office. Once a condition that is not pre-approved has been used, it must be "E-Mailed" to the appropriate [7(a) or 504] E-Mail Authorization Q&A for follow-up by the authorization committee. An explanation of the circumstances surrounding the case and reasons for developing and using the condition must accompany the text of the actual condition.

Q5. What Procedure Do PLP or PCLP Lenders Follow for Handling Unusual Terms and Conditions?

A5. Lenders with PLP and PCLP authority may develop authorization conditions that are not pre-approved in the National Boilerplates and use them without prior SBA approval, providing they are only used one time. Conditions to be used on multiple loans must be approved by SBA prior to being used as a condition on more than one loan. Whenever a PLP or PCLP lender develops and uses a non-standard condition, an explanation for its development must be sent to the PLP Center. If the condition will be used more than one time, it must be cleared by Center Counsel and "E-Mailed" to the appropriate [7(a) or 504] E-Mail Authorization Q&A for follow-up by the authorization committee.

Q6. Why Does the Borrower Not Sign the Authorization?

A6. Under SBA regulations, the authorization is not an agreement to lend money (ref: 13 CFR .120.10) or an agreement between the SBA and the borrower. It is an agreement between SBA and the participant/CDC which details the terms and conditions under which SBA will guaranty a loan or debenture.

Q7. What is a Loan Agreement?

A7. A loan agreement is the document between the lender and borrower specifying the terms and conditions under which the lender agrees to provide credit. SBA does not require that the lender use a loan agreement. An example of a loan agreement and borrower's certification is located in the National Authorization Boilerplate appendix.

Q8. Where can someone obtain the current National Authorization Boilerplates?

A8. Copies of the most recent 7(a) and 504 boilerplate authorization from the following SBA web site.

SBA Personnel http://yes.sba.gov/loans
Participants http://www.sba.gov/banking

2. PERSONAL GUARANTEES

The following requirements are normally required by SBA for all business loans:
(a) Personal Guarantees.
Holders of at least a 20% ownership interest generally must guarantee the loan. SBA, in its discretion, consulting with the Participating Lender, may require other appropriate individuals to guarantee the loan as well, except SBA will not require personal guarantees from those owning less than 5% ownership.

SBA generally requires the personal guaranty of any person owning 20 percent or more of the applicant business, regardless of the form of ownership. At your discretion, you can require other appropriate individuals to guarantee a loan. You should discuss this with the participating lender prior to imposing such requirements.

For instance, when a key management person would be vital to repayment ability, you may require a guaranty, either limited or total, regardless of stock ownership. However, you must only require managers or officers of a business who have no ownership interest to guarantee a loan in exceptional circumstances such as when the guarantee of the owners is weak and repayment ability is particularly dependent upon the key management person. You must also consider owners of less than 20 percent of the stock for limited or total guarantees. If a limited guarantee is used, you will have to choose one of seven payment limitation options in SBA Form 148L (Unconditional Limited Guarantee) and then specify the option in the authorization. Where legal and appropriate, you may require the guaranty of a spouse. When necessary to secure a collateral position, you must require the signature of the spouse on the appropriate collateral documents and, when necessary, the spouse's guaranty to the extent of the spouse's interest in the collateral. Whether you secure personal guaranties with liens on personal assets is a credit decision, but you should not take such action solely for the "psychological" value. Assets taken should have sufficient monetary value to qualify as worthy for collateral purposes.

a. Guaranty Considerations

A guaranty may be either secured or unsecured, but unsecured guarantees are generally of little value. You must get a personal financial statement from all individuals guaranteeing the loan. When the guaranty of the owner(s)/principal(s) is weak, you may require a guaranty from someone else. This may be the spouse if the spouse volunteers. But, neither the lender nor SBA may specifically require a non-owner spouse to be an obligor, co-obligor or guarantor except where state law allows or requires this to perfect a lien where spousal interest is involved. See subpart A, chapter 2, paragraph 4g(2), for more information on spousal guarantees under the Equal Credit Opportunity Act.

b. Waiver of Guarantee

Only the AA/FA or designee can approve a waiver of the requirement that holders of at least 20 percent ownership of the applicant concern (or its affiliates) must personally guarantee the loan. The declination of such requests is to be finalized by the office processing the application. The first reconsideration of such requests must also be finalized locally when the decision is a declination. Second reconsiderations, even if recommended for decline, must be finalized by the AA/FA or designee. An example of when a waiver might be considered is if the holder is an SBIC which may be prohibited by statute or regulation from increasing its exposure or liability to the small business, even though it is only contingent as a guarantor.

Q1. Are there any circumstances where SBA's Personal Guarantee requirements can be waived by the processing office?

A1. Yes, under the very narrow circumstance of cases involving ESOP or ERISA Trust where the trust owns at least 20 percent of the applicant.

Q2. What conditions must be met before a waiver of the requirement for providing a personal guarantee to a Trust owner of an ESOP formed under either U.S. Treasury or Department of Labor requirements can be given?

A2. The Trust must request a waiver from the lender or SBA, as appropriate, on the grounds that the ESOP Trust would suffer significant economic hardship or is prohibited from providing its guarantee, because of a law or ruling (such as an IRS prohibition). Under such circumstances, Counsel for the Trust must provide participant with correspondence that cites the specific tax code section and ESOP trust agreement provision which covers this restriction.

SBA Counsel must provide a written opinion as to the validity of the circumstances as presented by Counsel for the Trust and the legitimacy for a waiver of the requirement for personal guarantee by the Trust.
In addition the owners of the non-trust portion of the ESOP would be subject to .120.160(a).

Q3. Are there further restrictions to consider when deciding to approve a waiver of the requirement for personal guarantee for an ESOP Trust?

A3. Yes, if the ESOP is also an Eligible Passive Concern, no waiver may be provided. (Reference Q&A numbers 8 & 9 in Subpart A, Chapter 2, paragraph 9)

A completely divested associate is not subject to the requirement to guarantee [reference Subpart A, Chapter 2, paragraph 4(m)].

3. APPRAISAL REQUIREMENTS:

(b) Appraisals.
SBA may require professional appraisals of the applicant's and principals' assets, a survey, or a feasibility study.

For purposes of this regulation, the definition of "principal" will include the standard definition plus all guarantors. SBA's appraisal policy pertains to the assessment of value of real estate, and the building(s) situated or to be built upon this real property.

An appraisal is a written statement independently prepared by a qualified appraiser, indicating the appraiser's opinion of the market or liquidation value of adequately described property, at a specific date, supported by the presentation of relevant market information. Appraisals may be either COMPLETE which details the three methods of valuation (cost, income, and comparable sales) or LIMITED which does not. When you permit a limited appraisal, valuation must be based on the comparable sales method, unless another method is justified by the participant.

a. Acceptable Appraisal Reports

To be acceptable, an appraisal must contain sufficient information to allow someone not familiar with the property to understand the basis for the determined value. An appraisal must clearly and accurately describe any extraordinary assumptions or limiting conditions that directly affect the appraisal and must indicate their impact on the value.

According to Uniform Standards of Professional Appraisal Practice (USPAP), every real property appraisal report must be prepared under one of the following three options and must clearly state which option was used.

(1) SELF-CONTAINED APPRAISAL REPORTS must:

(a) Identify and describe the real estate being appraised;

(b) State the real property interest being appraised, including legal description and known encumbrances;

(c) State the purpose and intended use of the appraisal;

(d) Define the value (cost, income, or comparable sales) to be estimated;

(e) State the dates of the appraisal and the report;

(f) State all assumptions and limiting conditions that affect the analysis, opinions, and conclusions;

(g) State the extent of the process of collecting, confirming, and reporting data;

(h) Describe the information considered, the procedures followed, and the reasoning that supports the analysis, opinions, and conclusion;

(i) Describe the appraiser's opinion of the highest and best use of the real estate, when such an opinion is necessary and appropriate;

(j) Explain and support the exclusion of any of the usual valuation approaches;

(k) Describe any additional information that may be appropriate and explain any departures; and

(l) Have a signed certification by the appraiser.

(2) SUMMARY APPRAISAL REPORTS must include all of the items required in a SELF-CONTAINED APPRAISAL REPORT, except the level of presentation can be less detailed or summarized for items (a), (f), (h), (i) and (k), listed above.

(3) RESTRICTED APPRAISAL REPORT must also include all of the items required in a SELF-CONTAINED APPRAISAL REPORT with some minor modifications. The restricted appraisal is intended for use only by the client. Therefore you must not accept restricted appraisals for SBA loan processing transactions. A RESTRICTED APPRAISAL REPORT is not acceptable for any request for financial assistance.

b. What Are Evaluation Reports, and When Are They Acceptable?

A formal opinion of market value prepared by a state licensed or certified appraiser is not always necessary. An evaluation, which is an estimate of real estate market value, is acceptable when the real estate transaction is $100,000 or less, if it conforms to the standards of the interagency appraisal and evaluation guidelines of the regulators.

This means the evaluation must:

(1) Be in writing and dated;

(2) Include the name, address, and signature of the preparer;

(3) Describe the real estate including its current and projected use;

(4) Provide the sources of the information used in the analysis;

(5) Describe the analysis and supporting information; and

(6) Provide an estimate of the market value and reference any limiting conditions. Individuals who prepare evaluations must have real estate related training or experience and knowledge of the market relevant to the subject property.

c. What Determines the Type of Appraisal to Require?

The OMB requires an appraisal prepared by a State licensed or certified appraiser consistent with the requirements of USPAP for all Federal agency credit transactions involving real estate financing more than $100,000. Therefore an Evaluation Report is not acceptable for any loan where the real estate transaction portion of that loan is more than $100,000.

d. SBA's Policy on Appraisals

Whether, and what type of appraisal, SBA requires is based on the amount authorized in the financing package for real estate transactions. A financing package is defined in subpart A, chapter 2, paragraph 4(e). Examples of a financing package include the combination of 504 debenture, third party financing, and equity in a 504 project, and the combination of a 7(a) and participant non-SBA financing plus equity under a piggyback structure.

Real estate transactions include the acquisition, construction, and improvement to land and buildings. You must require appraisals for all 7(a) and 504 financing packages where more than $100,000 of the authorized loan proceeds will be used for real estate transactions:

(1) All appraisals must be consistent with USPAP as established by the Appraisal Standards Board of the Appraisal Foundation.

(2) All appraisals must be performed by either a State certified or State licensed appraiser except when the real estate transaction is over $1,000,000, in which case the appraisal must be performed by a State certified appraiser.

(3) Requests involving real estate transactions over $100,000 or requests where real estate is the primary collateral and this collateral has an estimated value over $100,000, may be processed to conclusion without the presence of an appraisal, providing the following three items occur:

(a) An estimation of the value of the real estate is established at the time of loan processing;

(b) This estimated value is stated in the loan authorization;

(c) The authorization requires the receipt of an appraisal before initial disbursement.

(4) Disbursements on loans where the primary real estate collateral or the real estate transaction has a value in excess of $100,000 can not occur without SBA concurrence unless the final appraised value is not more than 10 percent less than the estimated value. When the appraised value is more than 10 percent less than the estimated value, the lender must make a written recommendation on whether to disburse the loan to the SBA office that processed the request. The justification must provide a sufficient understanding into the reasons for the differences in values between the estimated and actual values so that SBA can make a determination on whether the collateral offered adequately protects the interest of the Government.

When the justification for disbursement is based on obtaining additional collateral, the lender must detail the values of the additional collateral including a reference on the basis (Fair Market, Liquidation, Replacement, etc.) for determining its value.

SBA will respond in writing to the lender

PLP and PCLP lenders must place and retain the written justification for why they disbursed a loan where the appraised value was more than 10 percent less than the estimated value in the loan file for review by SBA.

When the real estate transaction is over $1,000,000, or the estimated value of the real estate collateral is over $1,000,000, the appraisal received must be a "Complete Appraisal."

(5) The SBA does not require an appraisal for real estate that is used as collateral when the real estate is not being financed as a part of the SBA loan, unless the real estate is the "primary" collateral for the loan. This generally occurs with working capital and fixed asset acquisition loans where real estate is required as additional collateral. Real estate is "primary" collateral if, in your (or the lender's) opinion, the assets being financed provide less than 50 percent collateral coverage (based on reasonably estimated liquidation values) for the total amount of the loan. In this case only, the amount of the loan, not the amount of the real estate transaction, is the basis for determining the type of appraisal or evaluation to be conducted.

(6) For any real estate transactions over $1 million or when the proceeds will be used for either construction or construction take out financing, the appraisal must be a COMPLETE APPRAISAL, reporting all three accepted methods of valuation (comparable sales, cost, and income). However, SBA can concur with a lender that a LIMITED APPRAISAL is satisfactory for the final verification of value either because all three valuation methods are not needed or an existing COMPLETE APPRAISAL, which is no more than 6 months old, only needs updating.

Q. Does this mean a loan will have to be processed under standard processing procedures if the lender wants to use a Limited Appraisal on a project more than $1 million or for permanent financing on a construction project in order that SBA can concur with this decision?

A. Partially. When a Complete Appraisal is required, and the lender chooses to rely upon a limited appraisal, the loan has to be processed under standard procedure so SBA can concur with the lender's decision. The PLP lenders are not bound by this requirement for loans processed under PLP procedures, providing justification for choosing other than the required type of appraisal is on file.

(7) In addition to the 12 factors in subparagraph a(1) of this paragraph which must be covered per USPAP, SBA requires the appraiser to disclose any involvement with the owner (past, current, and/or anticipated).

e. What Standards Must Appraisers Meet?

The selected appraiser must be independent and have no direct or indirect, financial or other interest in the property or the transaction. Appraisers must be capable of rendering an unbiased opinion. The appraiser's client must be the lender, not the borrower or the seller. The lender should order and pay for the appraisal and pass the cost on to the applicant or borrower. A lender may accept an appraisal prepared for another lender or agent of a lender, if the appraiser operated independently.

f. How Important Are Appraisals for Loan Processing?

Appraisals are only one factor used in the decision-making process. They provide independent confirmation of estimated values, but are not a substitute for prudent analysis and sound judgment.

g. How is the Value of Non-Real Property to be Determined?

When SBA proceeds are to be used in connection with the acquisition of a going concern, a determination of the value of what is being acquired shall be conducted and based on generally accepted valuation methods used for the industry in which the business operates. Five acceptable valuation methods include: the gross revenue multiplier; adjusted book value; discounted future earnings; capitalized adjusted earnings; and cash flow valuation. Other generally accepted valuation methods may also be employed.

The analysis can be performed by the lender loan officer or an independent person qualified, in the opinion of SBA, to perform business valuations.

4. SBA POLICIES REGARDING HAZARD INSURANCE:

(c) Hazard Insurance. SBA requires hazard insurance on all collateral.

a. On What Assets is Hazard Insurance Required?

Hazard insurance is generally required on all pledged assets. If you do not require hazard insurance, you must document the loan file on the reason for this decision.

b. How Much Coverage Should be Required?

Since most insurance policies on business property are written subject to a co-insurance clause, you should require that the assets be insured with full replacement cost coverage, if available, or to the maximum insurable value. The assets must be covered for at least the amount required by the co-insurance clause (usually 80 percent). Under a co-insurance clause the insurance company pays only a portion of the loss, leaving the policyholder or some other party to cover the difference.

c. May Coverage be Limited to The Amount of The Loan?

Generally, you should not require coverage based on the amount of a loan unless this amount is equal to the value of the property. Full replacement coverage is preferable. Generally, you determine the amount of coverage but, when appropriate, you may defer to the lender.

d. Who Should be Listed as Loss Payee or Mortgagee?

Generally, SBA and the lender or CDC must be listed as the mortgagee on real estate and fixtures and as the loss payee on chattels. Consult an insurance agent on the relative benefits of being listed as a mortgagee versus a loss payee. The distinction may mean the difference between being paid in events of arson or other illegal acts by borrowers or suffering a loss.

5. TAXES - LOAN PROCEEDS RESTRICTIONS:

(d) Taxes. The applicant may not use any of the proceeds to pay past-due Federal and state payroll taxes.

Loan proceeds must not be used to repay delinquent IRS withholding taxes, sales taxes, or similar funds held in trust, or to replenish funds used for such purpose, since SBA would be replacing funds that were unlawfully converted. You may consider payment of delinquent income taxes on a case-by-case basis the same as other delinquent accounts. Additionally consider whether a willful failure to pay income taxes is a character issue.

6. OTHER REQUIRED TERMS AND CONDITIONS:

a. Financial Statement Requirements

The participant shall require the borrower (or operating company when an EPC structure is utilized) to submit a signed and dated balance sheet and profit & loss statement at least annually for all loans over $150,000. Participants can require statements more frequently on particularly large or complex loan transactions. For loans of $150,000 or less, the participant should require post approval financial statements of all SBA loans to no less of a degree than on their non-SBA loans. The standard of quality for financial statements used to process a loan will usually suffice to service the loan. You must only require audited statements when it would be imprudent to do otherwise, such as when the loan is large and is primarily collateralized with inventory or accounts receivable or both and the financial data must be of particularly good quality.

b. Flood Insurance Requirements

(1) All SBA borrowers located in special hazard areas [as determined by the Federal Insurance Administration (FIA)] must purchase flood insurance prior to first disbursement. This includes areas subject to flooding, mud slides and erosion. (FIA maps designate flood prone areas as A or V zones. M zones are subject to mud slides and E zones to erosion.) You must require flood insurance coverage in the following situations:

(a) Loan proceeds will be used to purchase or improve land and buildings, M&E, F&F or inventory that is, or is to be located in a special hazard area. The Federal Emergency Management Agency (FEMA) has ruled that a lender is not mandated to obtain flood insurance on contents if the building is not also taken as collateral. Thus, this position overrules the opinion in Opinion Digest 155 at page 2340. SBA now has the discretion to require that flood insurance be obtained on contents when the real property is not also to serve as collateral. Generally, when contents are located on the ground floor, insurance will be required. When contents are located on levels above any likely flood damage, insurance need not be required.

(b) Any portion of SBA collateral consists of improved real estate located in a special hazard area.

(c) The SBA collateral includes a guaranty secured by improved real estate located in a special hazard area.

(d) A new loan, regardless of purpose, is made to a borrower who has an outstanding SBA loan where proceeds were used for the purchase or improvement of real estate located in a special hazard area and such real estate secures the existing loan or will secure the new loan.

(2) The FIA special hazard maps and lists of communities participating in the flood hazard insurance program are available in SBA's field offices. A community has one year after the effective date of an issued FIA Flood Hazard Boundary Map to become a participant in the National Flood Insurance Program (NFIP). During this year, SBA may approve applications without community participation in the NFIP. After that,

SBA cannot approve applications where assets of the applicant are located in designated special hazard areas unless the community becomes a participant in the NFIP. The SBA may not approve loans in communities suspended from the NFIP, effective the date of suspension, unless the applicant's assets are outside designated special hazard areas. Use coded reason for decline 15, "The required flood insurance is not available."

(3) Coverage is available in two layers. The first layer generally has a subsidized rate with limited coverage amounts available. The other layer has an actuarial rate with higher coverage amounts available. After issuance of the initial FIA map the community becomes eligible for the "emergency" program which allows first layer coverage only. After the final Flood Insurance Rate Map is published, second layer coverage becomes available to participating communities.

(4) The following condition must be included in all 7(a) and 504 loan authorizations and may only be modified by the Director, Office of Loan Programs or designee:

> **"Flood Insurance"** If FEMA Form 81-93 reveals that any portion of the collateral is located in a special flood hazard zone, Lender must require Borrower to obtain Federal flood insurance or other appropriate special hazard insurance in an amount equal to the lesser of the insurable value of the property or the maximum limit of coverage available. (Borrower will be ineligible for any future SBA disaster assistance or business loan assistance if Borrower does not maintain flood insurance for the entire term of the loan.)

If [lender or servicer (for guaranteed loans)] [CDC (for 504 loans)] [SBA (for direct loans)] determines during the term of a loan that the borrower has insufficient flood insurance, it will notify the borrower to obtain the necessary coverage within 45 days. If the borrower fails to act, the [lender, servicer, CDC or SBA] shall purchase such insurance and charge the borrower for the cost of premiums and fees incurred. This lender cost shall be reimbursed from the borrower.

(5) The required insurance must be in the amount set forth above and must not be limited to the amount of the SBA guarantee. Such limitation would be contrary to the intent of NFIP legislation and regulations.

(6) You must consider, on a case-by-case basis, whether prudent credit judgment dictates that you require other business assets to be covered by special flood hazard insurance as a means to assure business continuance.

(7) The SBA is not required to determine whether the property or any collateral is, or will be, located in a special flood hazard area. That determination must be made by the lender or CDC based on evidence described above.

(8) The NFIP offers flood insurance for co-ops through the General Property Form (GP). The GP is a commercial policy with a maximum amount of building coverage of $250,000. A co-op cannot be insured under the residential condominium building association policy.

(9) The National Flood Insurance Reform Act of 1994 (Reform Act) requires regulators of lending institutions (including insured banks, savings associations, and credit unions) to expand and revise their flood insurance rules. The Reform Act also explicitly requires lenders subject to regulation by these regulators to force place flood insurance on borrowers. The regulators have decided that the Reform Act provisions on the forced placement of insurance are effective without the issuance of regulations. As a credit consideration, SBA imposes these same forced placement of flood insurance requirements on small business lending companies (SBLC) with respect to their 7(a) lending.

Consequently, if at the time of origination or at any time during the term of a loan, an SBLC determines that any property securing the loan lacks adequate flood insurance coverage, the SBLC must notify the borrower of the borrower's responsibility to obtain coverage at the borrower's expense.

(10) If the borrower fails to purchase flood insurance within 45 days after that notification, the SBLC must purchase the insurance on the borrower's behalf, and may pass the cost of the insurance --premiums and fees-- on to the borrower.

(11) The National Flood Insurance Reform Act of 1994 requires a lender to notify the Director of the FEMA of the identity of the servicer of a loan subject to flood insurance requirements and of the identity of the new servicer if there is a change.

(12) The FEMA requests that all notices be sent to the insurance carrier that issued the flood policy or to the insurance agent of record to endorse the flood policy to change the mortgagee or servicer. **To comply with this, the following condition must be used in all business loans and may only be modified by the AA/FA or designee:**

> "The servicer of record of the subject loan, whether [lender][CDC] or SBA shall notify the issuing insurance carrier or its agent of record in writing within 60 days of any change of the service of record of the loan to endorse the flood policy to change the mortgagee or servicer. The notification shall include the borrower's full name; the policy number; the property address (including city and State); the name of the lender or servicer reporting the change; the name and telephone number of a contact person; and the name, address, and contact person of the new mortgagee or servicer."

c. Fixed Asset and Salary Limitation Requirements

Occasionally, you may wish to impose salary or withdrawal limits when there is reason to believe that a principal may withdraw excessive funds from the business. At other times, you may impose fixed asset limits if the over-purchase of such assets appears likely. You should use these conditions only when necessary for the protection of SBA. A history of excessive salaries or withdrawals may indicate the need for the salary limitation. A history of excessive asset acquisition may indicate a need for a fixed asset limitation. Do not impose these conditions unless the lender and applicant have been advised that they are in the loan authorization and understand what is expected.

d. Assignment of Lease Requirements

Where a substantial portion of the loan proceeds will be used for leasehold improvements or where leasehold improvements are relied upon for collateral, you should generally require an assignment of the lease. The term of the lease should be no less than the term of the loan. (See subpart A, chapter 4, paragraph 1h.)

e. Construction Loan Provision Requirements

(1) Construction loan provisions are primarily designed to minimize lender and borrower exposure in case allocated funds are inadequate to complete the planned project ("cost over-runs"), or the completed project is unsuitable for the borrower's needs. Substandard construction can also adversely effect the collateral value.

(2) Generally, you must not allow "do-it-yourself" construction or installation of machinery and equipment, or the borrower acting as the contractor unless the project is small compared to the financial resources of the borrower or the applicant is a qualified contractor.

(3) When loan proceeds of $10,000 or more are used for construction, the applicant and the contractor must sign SBA Form 601, "Agreement of Compliance," prior to or at loan closing. Construction includes rehabilitation, alteration, conversion or repair of buildings or other improvements to real property. This form is not necessary when the SBA loan is for take-out purposes under the 504 program or a 7(a) loan where none of the loan proceeds are used to directly finance construction.

(4) Mortgages must be recorded prior to the beginning of construction. Inspections should be made by a qualified engineer or appraiser, at borrower's expense, prior to progress disbursements. If the SBA loan is used to improve buildings on leased land, you must obtain an assignment of the lease. The lease term should be at least equal to the term of the loan.

(5) If proceeds for construction exceed $125,000, you must require the following loan conditions, unless specifically waived in the loan file:

(a) A requirement for a 100 percent payment and performance bond naming borrower as obligee;

(b) A requirement for borrower-furnished builders risks and workman's compensation insurance;

(c) If applicant is injecting funds into the construction project, a requirement that these funds should be used prior to first disbursement of our loan;

(d) A requirement that one complete set of plans and specifications of the proposed construction be submitted to the participant;

(e) A requirement that the borrower furnish a firm construction contract from an acceptable contractor at a specified price, including a provision that no material changes are to be made without the prior written consent of lender/SBA; and

(f) A requirement that, prior to any disbursement, lien waivers be obtained from all contractors, subcontractors, independent workers, and suppliers of material connected with the project.

(6) Most of these terms and conditions do not apply to 504 loans or to those 7(a) loans used only to provide permanent financing after the construction is complete. However, some evidence is needed prior to any disbursement that no liens, particularly material or mechanic's liens, intervene and preclude acquiring the lien position required by the authorization. An ALTA loan title insurance policy (American Land Title Association) is one form of acceptable evidence. Lien waivers from all contractors, subcontractors, suppliers of material, and independent workers are also acceptable.

f. Special Requirements for Franchise Businesses

(1) Franchises have special size criteria. See subpart A, chapter 3, paragraph 3e.

(2) The terms of the franchise agreement and the terms of any lease or sublease of the premises of the franchise business from the franchisor (or any of their affiliates) including options to renew exercisable by the franchisee, needs to generally be for the same time period as the term of the loan.

Q. A Franchise Agreement for 20 years was signed ten months before we approved a 20 year loan for the franchisor. Is this satisfactory?

A. Yes, the time periods of the agreement and loan are compatible. If the franchise agreement was for only 15 years, a 20 year loan would be inappropriate.

(3) When the franchisor is subleasing the real estate to the franchisee, it is desirable for the underlying lease to contain an option for the franchisee to lease directly from the owner of the real estate if the franchisor defaults and the franchisee cures the default. The loan report should address this issue, and indicate whether the landlord is agreeable to such a provision if it is not already in the lease.

(4) When the franchisor provides billing and collection services, controls receivables, accepts payments from customers of the franchisee or third party payors, or services the franchisee's accounts, the franchisor must provide the franchisee and lender or CDC and SBA with access to its pertinent books and records during regular business hours upon request.

(5) Authorizations for franchise business applicants should contain a provision which requires the franchisor to defer the payment of royalties and fees when the loan is in default or during any period for which the SBA or lender, as SBA's agent, has granted a deferment. Without such a provision, the franchisor continues to benefit from the borrower's operation during the period of deferment. Such continued payment to a franchisor, but not the lender who provided the financing to make the franchisee operational, is usually not desirable.

(6) The loan should be conditioned to require the franchisor to give the lender or CDC and SBA, during the term of the loan, the same notice and opportunity to cure any default under the franchise or lease agreement that is given the franchisee under the same agreements. The credit implications of a franchisor's

refusal must also be considered.

(7) The franchisor must supply the franchisee with an FTC- required disclosure report on its franchise operations. This report contains information that could be useful in evaluating the loan request. You must evaluate it to determine its effect on repayment ability.

(8) Use discretion in determining whether to retain the entire disclosure statement after the application has been processed. At a minimum, you must include the cover sheet in the case file.

(9) A credit report should be obtained on the franchisor whenever its financial responsibility and reputation are unknown. In evaluating an application, you must consider any experience SBA has had with other franchises with the same franchisor as indicated by the PMEI system. Appendix 2 provides the guidelines on how to access the PMEI system.

(10) The owner of any eligible franchise must have the right to profit from their efforts that are commensurate with their ownership interest, and the franchisor must not have the power to control this franchise.

g. Life Insurance

(1) Life insurance and/or disability insurance provides lenders with a hedge against the loss of key management personnel which could adversely impact repayment. Life insurance should be required when there is concern for the continuation of adequate management due to a lack of depth and experience. Life insurance is not required for all loans as a matter of policy, but rather is preferred when management hinges on the knowledge and skills of a single person or limited group who would be difficult to replace.

(2) When life insurance is deemed necessary, impacted individuals may offer an assignment of their existing policy (of any satisfactory type), or choose to acquire new insurance. SBA does not want to impose unnecessarily costly insurance premiums on the applicant or individual. Likewise SBA will make the decision on the use of any proceeds from a life insurance claim at the time of claim. Therefore neither credit life insurance nor whole life insurance are to be required. SBA will accept acquisition of decreasing term or universal life insurance.

h. Disbursement Periods

The disbursement of 7(a) loans should occur as close to approval as is prudently possible, considering the applicant's needs for the funds and the requirements to meets the terms and conditions specified in the Authorization. As a matter of policy, the initial disbursement must occur within 6 months of approval. The only exception is when the proceeds will provide the permanent financing for an interim construction project that will take more than 6 months from approval of the SBA loan to complete.

If any loan can not be initially disbursed within 6 months of approval, the initial disbursement period may be extended by the local processing or servicing office, providing there is specific justification that relates to the circumstances of the individual case. SBA must process all requests for extensions of the disbursement periods, except for loans originally processed under delegated authority (e.g., PLP and SBA*Express*, PCLP, etc), and SBA must be notified whenever an extension is approved, regardless of the authority of the lender.

When the initial disbursement period exceeds 6 months, the justification must include a written request from the applicant. If the request for extension past six months does not include a written request from the applicant, the request is ineligible for approval.

The final disbursement period must never exceed 12 months from approval except when the proceeds are for construction or renovation.

The initial disbursement for all 504 loans (which is also the final disbursement) shall be within 12 months of approval, unless SBA agrees to an extension in writing. The requirements for extension to the disbursement period for any 504 loan is detailed in Subpart H, Chapter 20. paragraph 4.

Recordation of disbursement periods are needed by the Agency to track the obligation of funds and initiation of any necessary cancellation of guarantees. As such, no lender or CDC is authorized to establish or extend the disbursement periods (initial or final) with out notification to the SBA office which approved the application. Lenders who process loans under their delegated authority must notify the Commercial Loan Servicing Center of all extensions to the disbursement periods. All lenders are required to notify SBA of any Loan Cancellation.

For additional guidance, see Subpart A, Chapter 6, paragraph 3b.

7. ENVIRONMENTAL CONSIDERATIONS:

Disbursement of loans approved prior to the effective date of this SOP may follow either the policies detailed herein or the policies from Notice 5000-494. SBA requires an investigation and assessment of the environmental risk on all primary collateral offered as security for any loan or debenture that the Agency is asked to guaranty in order that the risks of environmental contamination can be assessed and addressed. A lender may require its own environmental investigation of any additional collateral at its discretion.

a. What Are The Risks of Environmental Contamination?

(1) The costs of remediation could impair the borrower.s ability to repay the loan.

(2) The value and marketability of the property could be diminished. If the borrower defaults, SBA might have to abandon the property to avoid liability or accept a lower than expected price.

(3) The SBA potentially could be liable for environmental clean-up costs and third-party damage claims arising from environmental contamination if it takes title to contaminated property as a result of foreclosure proceedings or if it exercises operational control over the site.

(4) If a government agency cleans a site, it may be able to file a lien for recovery of its costs which may be superior to SBA's lien.

b. Definitions

(1) Environmental Investigation - An investigation to help ascertain whether and the degree to which a property is subject to environmental contamination. An Environmental Investigation may include one or more of the following: an Environmental Questionnaire, Transactional Screen Analysis, Phase I Audit, and Phase II Audit, as these terms are defined below.

(2) Environmental Questionnaire - A written form asking specific environmentally-related questions about the property which requires a visual inspection to complete the form. The lender or its agent must fill it out after conducting an interview with the current owner or operator of the site and the current owner or operator of the site must sign it. The lender may use SBA's form or its own

form if it includes all of the information included in SBA's questionnaire.

Use of an environmental questionnaire consistent with the standard issued by the American Society for Testing and Materials is satisfactory to SBA.

(3) Environmental Records Review - A review of the files of the regulatory agency (defined below) related to environmental permits, reported contamination, and the storage, generation, transportation, use, or release of environmentally harmful substances at the site or at nearby properties. These records may be available from the appropriate governmental agencies, and there are commercial services available to obtain this information, including several on the Internet. The Environmental Records Review must include, at a minimum, the following databases and minimum search distances to the subject property:

Governmental Record	Approximate Minimum Search Distance
Federal NPL site list	property and 1.0 miles
Federal CERCLIS list	property and .5 miles
Federal RCRA TSD facilities list	property and 1.0 miles
Federal RCRA generators list	property and adjoining properties
Federal ERNS list	property
State equivalent of NPL list	property and 1.0 miles
State equivalent to CERCLIS list	property and 1.0 miles
State landfill and solid waste disposal site list	property and .5 miles
State leaking underground storage tanks list	property and .5 miles
State registered underground storage tanks list	property and adjoining properties

(4) Historical Records - A second component of the Environmental Records Review consist of such items as: Aerial Photographs that show the development and activities on the subject property and surrounding areas; Fire Insurance Maps that indicate the uses of the subject property and surrounding areas; local fire, health, or environmental departments public records that show the uses of the subject property and surrounding areas; and any other records which could provide insight into the uses of the subject property and surrounding areas such as zoning records, building permits, property tax reports, and land title records.

(5) Lender - refers to banks, non-bank lenders, and certified development

companies.

(6) Monitoring - A physical sampling of soil or groundwater to determine the continued presence or quantity of environmental contamination.

(7) No Further Action Letter - A statement issued by the regulatory agency declaring that no further remediation or monitoring of contamination previously found is required.

(8) Phase I Audit - An investigation and written report by an environmental professional or contractor (see sub-paragraph l of this paragraph), regarding the history and use of the property, which determines the potential existence of environmental contaminants. At a minimum, a Phase I Audit must contain all of the following elements:

(a) A visual inspection of the site and adjacent properties;

(b) An Environmental Records Review;

(c) On-site review of available environmental records and interviews with the current owner and (if different) operator of the site and others with knowledge about operations on the site and on adjacent sites, such as the previous owner and (if different) operator of the site, and owners or operators of neighboring sites; and

(d) A conclusion by the contractor that performs the audit either: (i) that the risk of contamination at the site is so minimal that no further investigation is warranted; or (ii) that there is risk sufficient to warrant additional investigation.

(9) Phase II Audit - An investigation and written report conducted by an environmental professional involving testing for actual contamination which relies on laboratory testing of samples extracted from potentially contaminated locations (buildings, soil or groundwater) to determine whether and to what extent actual contamination exists.

(10) Primary Collateral

(a) The project site that is acquired or improved through the loan proceeds; or

(b) Any business real property to be taken as collateral when it represents over 50 percent of the total collateral value.

(11) Reasonable and Prudent Belief That There Is No Risk of Contamination
A belief based on existing information and prudent lending standards that past business or agricultural operations at the Primary Collateral site or on adjacent sites are unlikely to have resulted in contamination at the site. Such a determination would not be reasonable if:

(a) There is insufficient knowledge about past or current business or agricultural operations at the site or adjacent sites to be able to reach such conclusion; or

(b) Past or current business or agricultural operations at the site or adjacent sites are likely to have involved the use of (i) chemicals in such quantities as would be subject to regulation by environmental authorities or (ii) aboveground or underground storage tanks. Likelihood of contamination may arise from the known business operations at the site or typical industry practices of any business which operated at the site or adjacent sites.

(12) Regulatory Agency - The local, State, or Federal agency with authority to enforce environmental laws regarding use of hazardous materials or cleanup of environmental contamination at the primary collateral site.

(13) Remediation - Any action to clean-up or remove contamination from soil at a site or groundwater under a site.

(14) Transactional Screening Analysis ("TSA") - A review and written report which includes the following.

(a) A visual inspection of the site being offered as collateral by a person trained to determine whether conditions at a site are indicative of potential environmental contamination or adverse environmental conditions. The person conducting this inspection may be an employee of the lender or its agent, but cannot be an employee of, or under contract with, the seller, the borrower or any other party that will benefit financially from the loan. The lender must use prudent lender standards in choosing or accepting the qualifications of the person conducting the inspection.

(b) The completion of an Environmental Questionnaire.

(c) An Environmental Records Review.

(d) A recommendation by the lender or its agent either: (i) that the risk of contamination at the site is so minimal that no further investigation is warranted; or (ii) that there is risk sufficient to warrant additional investigation.

c. Environmental Investigation Requirements

Environmental investigation is part of the due diligence required of lenders.

(1) Except for loans of $25,000 or less, there must be an Environmental Investigation for all business loan applications secured by Primary Collateral. The results of this Environmental Investigation must be sent to SBA.

(2) Due diligence and prudent lending practice require a lender to pursue more in depth investigation when an investigation method indicates a risk of environmental contamination. The type of Environmental Investigation to be performed varies with the amount of the risks described in sub-paragraph A of this paragraph which might result from any contamination that might be present. The greater the risk, the more in depth should be the investigation.

(3) If a loan application is for $25,000 or less, no Environmental Investigation is required if the borrower certifies in writing that he or she has no knowledge of any past or present contamination at the site and lender has no information to the contrary.

d. The Steps of An Environmental Investigation

Depending on the circumstances, the Environmental Investigation can begin with an Environmental Questionnaire, Transactional Screening Analysis, Phase I Audit or Phase II Audit.

(1) The Environmental Investigation may begin with an Environmental Questionnaire when any of the following five conditions exists:

(a) There have been no business or agricultural operations on the property;

(b) The collateral is part of a multi-unit building or complex;

(c) A Phase I Audit has been completed within 1 year of the loan application indicating that the risk of contamination at the site is so minimal that no further investigation is warranted;

(d) A Phase I Audit has been completed within one year indicating the presence of contamination and: (i) the Regulatory Agency has determined that no remediation or monitoring is necessary, or that remediation and monitoring has been completed; or (ii) an adequate indemnification agreement exists; or

(e) There is a "Reasonable and Prudent Belief That There Is No Risk of Contamination" as specifically defined in subparagraph b.(11) of this paragraph. If this belief does not exist, a TSA would be appropriate [see sub-paragraph d.(2) of this paragraph].

If the Environmental Questionnaire or other information available indicates a risk of environmental contamination, the loan can not be disbursed. Therefore, further investigation such as a TSA or Phase I Audit will be required.

(2) The Environmental Investigation may begin with a TSA when the lender, or CDC for 504 loans, is unable to conclude that there is a Reasonable and Prudent Belief That There Is No Risk of Contamination, based on the due-diligence it has already completed.

If the TSA indicates a risk of environmental contamination, the lender should

either decline the loan or require a Phase I Audit prior to any disbursement.

(3) The Environmental Investigation may begin with a Phase I Audit when the lender, or CDC for 504 loans, has a reasonable belief that, based on existing information and prudent lending standards, the Primary Collateral site is likely to have been contaminated from past business operations at the site or adjacent sites. The likelihood of such contamination may arise from the known business operations at the site or adjacent sites, or from the typical industry practices of the business(es) which operated at the site or adjacent sites.

If the Phase I Audit indicates more than minimal risk of environmental contamination, the loan officer must either decline the loan or require a Phase II Audit to determine whether there is actual contamination.

(4) A Phase II Audit may be used when:

(a) A Phase I Audit reveals more than a minimal risk of environmental contamination; and/or

(b) A Phase II Audit will ultimately be needed and the Phase I Audit would be an unnecessary expense.

If an applicant cannot or will not obtain a Phase I or II audit when one is required, you may not approve or disburse the loan.

If a Phase II Audit indicates that contamination exists, the Audit must state: (i) whether the quantity exceeds the reportable or actionable levels for that contaminant established by the responsible Regulatory Agency; (ii) whether environmental remediation or monitoring of conditions will be necessary; and (iii) a general estimate of the remediation or monitoring costs.

e. What is the Timing for the Environmental Investigation?

A lender should initiate an Environmental Investigation as soon as it receives any application to be secured by Primary Collateral. The lender should get an understanding of the environmental issues surrounding any Primary Collateral before it applies to SBA for a guarantee. The lender must submit the results of its Environmental Investigation to the SBA office processing the application, prior to disbursement. SBA will approve disbursement based on the results of the Investigation it receives.

f. Legal Responsibilities

The SBA loan processing personnel must obtain field counsel concurrence in their determination of the adequacy of an Environmental Investigation and whether the risk from contamination is sufficiently minimized to allow disbursement.

g. What Actions Can Be Taken When Contamination is Present?

If the Environmental Investigation indicates potential contamination, the lender should attempt to minimize the risks discussed in paragraph A from any such contamination before submitting the guarantee request to SBA. The processing office may approve the loan, with appropriate conditions, if it determines that the risk from potential environmental contamination is sufficiently minimized so that disbursement would be appropriate relying upon the factors below and in sub-paragraphs 7h and 7i of this paragraph.

If the lender cannot minimize such risks sufficiently before it applies to SBA, the processing office may approve the loan, with appropriate conditions, if there is a reasonable expectation that the risks can be minimized sufficiently under the guidelines and relying upon the factors below and in sub-paragraphs 7h and 7i of this paragraph.

A lender must submit documentation with its guarantee request of the actions taken and factors relied upon to minimize any such risk. If a lender does not submit this documentation with the guarantee request, it must do so prior to disbursement. In either case, the SBA processing office must concur that the risks have been sufficiently minimized. (PLP lenders & PCLP CDCs do not have to submit such documentation or obtain SBA's concurrence - see sub-paragraph k of this paragraph).

The SBA processing office may approve disbursement if the contamination issue is resolved in any of the following ways:

(1) The amount of contamination present is less than the minimum "state action levels" set by the Regulatory Agencies and no remediation will be necessary under law;

(2) The Regulatory Agency has issued a "No Further Action" letter;

(3) There is adequate indemnification as discussed in this paragraph 7h; or

(4) Guided by the factors discussed in this paragraph 7i, disbursement is appropriate before completion of any necessary remediation or monitoring.

h. Indemnification Agreements

A loan may be disburse if the seller (or another party) possesses sufficient financial resources to cover the cost of completing remediation and signs an indemnification agreement which provides adequate protection to SBA and the lender. A standard indemnification agreement that field offices and lenders may use without authorization from Headquarters is included in appendix 7. If the indemnifying party will not sign this standard agreement, but is willing to negotiate a different agreement, the processing office must refer the matter to the AA/FA who will consult with the Associate General Counsel for Litigation in determining its acceptability.

Attempt to obtain an indemnification agreement before considering the factors in this paragraph 7i.

i. Disbursement Before Completion of Clean-Up

The SBA office which processed and approved the loan considers and provides approval for the initial disbursement of this loan prior to the completion of remediation or monitoring (in the absence of a "no further action" letter or indemnification agreement) if, and only if, it is satisfied that the risks from any contamination or potential contamination as detailed in sub-paragraph A of this paragraph have been sufficiently minimized. The SBA will rely upon one or more of the following factors when deciding to disburse before completion of remediation or monitoring:

(1) If the Regulatory Agency has affirmed in writing that remediation is complete but additional monitoring is required, approval may be granted after obtaining the monitoring results for the first year and a written opinion from a qualified environmental professional that the results show no unacceptable increase in contamination since remediation.

(2) Federal statutes limit the liability of lenders for contamination if the lender does not participate in the management of the site and moves promptly to sell the property after foreclosure. However, state law may hold the lender liable. If state law does limit environmental liability of lenders, field counsel should consult with the Associate General Counsel for Litigation in making the determination that the law adequately protects SBA. In order to do so, state law should:

(a) Protect private lenders and governmental entities;

(b) Apply to the contaminants found at the site;

(c) Allow a lender to foreclose without creating liability; and/or

(d) Define specific circumstances under which a lender would be liable (for example a precise explanation of "not participating in management").

(3) If there is a satisfactory agreement or "comfort letter" from the Regulatory Agency stipulating that lender, SBA, and future purchasers would not be liable for specified contamination at the site, disbursement may be appropriate. This letter or agreement must be approved by an official authorized to bind the Regulatory Agency to its content.

(4) If the extent of contamination and cost of remediation is minimal in relation to the value of the property and/or the resources of the party responsible for remediation, approval, or disbursement may be considered if remediation is projected to be completed within a year. A discussion of the reliability of the remediation estimates and projected completion date should include the contractor's experience, the lender's confidence in or past experience with the contractor, and the nature of the contamination. This factor would be more appropriate for contamination affecting the soil, given the complexities of groundwater contamination.

(5) If the State in which the site is located has a fund to reimburse remediation costs and SBA is adequately protected, approval or disbursement may be considered. Any conditions of remediation that might preclude reimbursement, and the financial capability of the fund should be addressed. Written assurance from the responsible Regulatory Agency that the fund will apply to the specific site may be necessary.

(6) If an escrow account is available which equals 110 percent of the total estimated cost (in the bid or contract) of required remediation, controlled by the 7(a) lender or first mortgage holder in a 504 loan as trustee, approval or disbursement may be justified. The lender's role as trustee of this account is not to control or manage the property to be remediated, but solely to release funds from the escrow account upon the satisfactory completion of work by the contractor performing the remediation and/or monitoring.

The authorization must ensure that funds will only be used for costs of cleanup and remediation until the appropriate "No Further Action" letter is received. The Regulatory Agency must concur with the scope of remediation and the cost estimate should be reviewed for reasonableness including a discussion of the contractor's experience.

(7) If the borrower obtains a bond or insurance equal to 110 percent of the total

estimated cost (in the bid or contract) of remediation, approval or disbursement may be considered. You must be satisfied that the borrower's cash flow is sufficient to complete the remediation and repay outstanding debt. The Regulatory Agency must concur with the scope of remediation and the cost estimate should be reviewed for reasonableness including a discussion of the contractor's experience.

(8) If groundwater contamination on the site is shown to have come from nearby property, approval may be considered if:

(a) Another party with sufficient resources is performing remediation and is willing to provide indemnification and the Regulatory Agency concurs with the remedial action;

(b) The State has a written policy that it will not hold an owner or operator of property responsible for contamination from another site; or

(c) The Regulatory Agency provides satisfactory written assurance that it will not hold the borrower, lender, SBA, or any future purchaser liable for the contamination.

(9) Additional or substitute collateral, or equity contribution, sufficient to overcome the potential loss due to contamination is available.

The lender must consider the six information items referenced in paragraph K when making a recommendation under this paragraph for approval or initial disbursement. lenders should forward their justification for approval and/or disbursement to the SBA processing office responsible for making the approval/declination decision on the request for financial assistance.

j. Submission of Environmental Investigation to SBA

When SBA approves a loan with the condition that initial disbursement can not occur without SBA's approval, the results of the lender's Environmental Investigation must be reviewed by the SBA office which processed the application. The lender must submit sufficient justification for disbursement to SBA, based upon one or more of the factors referenced in sub-paragraphs 7g, 7h, or 7i of this paragraph. Upon SBA approval, the lender may disburse the loan.

k. Responsibilities of the Processing Office to Approve Initial Disbursement

The SBA processing office makes the determination for initial disbursement in the absence of a no further action letter or indemnification agreement, based upon the

results of an Environmental Investigation which has justification based on one or more of the nine factors referenced in paragraph 7I above. The SBA will consider:

(1) How the factors of this paragraph 7i relied upon sufficiently protect SBA from the risks resulting from contamination;

NOTE: There may be factors other than the nine referenced above which can be acceptable to SBA, but reliance upon any such factor not previously referenced requires clearance from the AA/FA (this includes PLP and PCLP/CDC lenders).

(2) Nature and extent of contamination present (referring to relevant pages in the Phase I or Phase II Audit);

(3) The status of remediation and monitoring;

(4) Relevant environmental reports;

(5) Correspondence from the Regulatory Agency regarding current conditions at the site; and

(6) Amount of loan.

If a processing office has any questions regarding the application of any of the factors the lender chooses to use in a specific case, it should consult with SBA field counsel or the Associate General Counsel for Litigation. If the processing office is not sure that disbursement is appropriate in a particular case, based upon the justification provided by the lender, it should submit a recommendation regarding disbursement to the AA/FA, who will make a decision with the concurrence of the Associate General Counsel for Litigation.
The processing office's recommendation shall include the supportive documentation of the six items referenced above, and analysis of same plus other relevant information and the recommendation of SBA field counsel.

l. Criteria for Selecting an Environmental Professional/Contractor

(1) Environmental audits must be performed or approved by contractor personnel with adequate expertise and independence. Such expertise is evidenced by:
(a) A license to conduct such an audit by the State in which the audit will take place;

(b) At least 5 years experience in conducting environmental audits;

(c) An advanced degree in engineering, environmental sciences, or geology

and at least 2 years of direct experience in conducting environmental audits; or

(d) Sufficient prior, satisfactory experience with the 7(a) lender or first mortgage holder on a 504 in conducting reliable and technically sound audits.

(2) In addition, a Phase I or II Audit must be conducted by a firm that is impartial, with no conflict of interest in the transaction. Lender must obtain the responses from the auditor to the following information:

(a) Name and address of the contractor;

(b) Name and title of the person performing the audit plus a statement of how long the person has been performing environmental assessments and the education and training the person has received;

(c) The recognized environmental standards to be used in the audit;

(d) Any present or prior affiliation of the contractor with the seller or purchaser of the property;

(e) A description of the contractor's liability insurance; and

(f) A certification under 18 U.S.C. . 1001 that the information provided is true and correct.

The lender must include the responses to these questions made by the contractor when submitting a Phase I or Phase II audit as part of the justification for approval or disbursement.

m. PLP And PCLP Authority

(1) The PLP lenders and PCLP/CDCs are delegated the authority to internally make the decisions regarding environmental risk which are reserved for the processing SBA office. Therefore, these Lenders may not disburse any loan unless the Environmental Investigation has been performed in accordance with this paragraph and, if there is a risk of environmental contamination, disbursement can be justified under the guidelines detained in paragraphs 7H,

7I, and/or 7G.

(2) These lenders are subject to the same Environmental Investigation requirements as all other Lenders.

(3) Lenders must retain all documentation utilized to justify their approval and disbursement decisions in their file for review or audit by SBA.

(4) The PLP lenders and PCLP CDCs may consult with SBA field counsel regarding state or local environmental laws.

n. Environmental Loan Authorization Conditions

The following loan authorization conditions are required for both 7(a) and 504 loans that will be secured by primary collateral to address the risk associated with Environmental Issues.

(1) For Loans Over $25,000

For 7(a) loans, insert "Lender may not disburse this loan" and for 504 loans insert "CDC may not issue debenture to fund this loan" until it has:

(a) Completed the review for potential environmental contamination required in this SOP (Environmental Investigation) on each business real property site that is:

(i) acquired or improved with proceeds from this loan, or

(ii) taken as collateral if the site represents over 50 percent of the value of all collateral securing this loan; **and**

(b) Sufficiently minimized the risk from any adverse environmental findings discovered in the Environmental Investigation, or otherwise, in accordance with Subpart A, Chapter 5, paragraph 7 (Environmental Conditions) of this SOP.

(2) Use the Following Paragraph When Lender has not Completed the Environmental Investigation Prior to Issuance of Authorization

The lender must submit the results of the Environmental Investigation to the SBA field office for SBA approval prior to disbursement. If the lender or SBA determines from the Environmental Investigation that there is potential environmental contamination, [for 7(a) loans, insert] "Lender may not disburse the loan", and [for 504 loans insert] "CDC may not issue debenture to fund a loan" until SBA is satisfied that the risk has been sufficiently minimized. Adverse environmental findings may lead to [For 7(a) insert] cancellation of the SBA guaranty, [for 504 insert] "withdrawal of a 504 authorization."

OPEN OPTION: If the Environmental Investigation submitted with the application reveals risks of environmental contamination, and approval is still appropriate, the loan officer should add authorization conditions in accordance with the Agency's Environmental Policy per this SOP in consultation with counsel.

(3) For Loans $25,000 or Less

Lender may disburse the loan without an Environmental Investigation under this SOP if:

(a) Borrower certifies in writing that the borrower has no knowledge of any past or present contamination at the site; and
(b) Lender has no information to the contrary.

(4) For All Loans

The SBA will hold Lender responsible for any losses or liability caused by failure to comply with SBA environmental requirements.

o. Questions on SBA's Environmental Policy

Questions on SBA's Environmental Policy for the Office of Financial Assistance should be E-Mailed, not phoned, to "SOP-5010" with the subject heading of "Environmental". Since the issues surrounding environmental risk assessment can be complicated, it is best to provide a best time for a discussion and the appropriate phone number of inquirer.

CHAPTER 6 - LOAN PROCESSING CONSIDERATIONS

1. REQUIREMENTS IMPOSED BY LAW AND EXECUTIVE ORDERS

.120.170 Flood insurance.
Under the Flood Disaster Protection Act of 1973 (Sec. 205(b) of Pub. L. 93-234; 87 Stat. 983 (42 U.S.C. 4000 et seq.)), a loan recipient must obtain flood insurance if any building (including mobile homes), machinery, or equipment acquired, installed, improved, constructed, or renovated with the proceeds of SBA financial assistance is located in a special flood hazard area. The requirement applies also to any inventory (business loan program), fixtures or furnishings contained or to be contained in the building. Mobile homes on a foundation are buildings. SBA, Lenders, CDCs, and Intermediaries must notify Borrowers that flood insurance must be maintained.

a. Provisions Related to Flood Insurance

See subpart A, chapter 5, paragraph 6b for more information on SBA's policy regarding flood insurance.

.120.171 Compliance with child support obligations.
Any holder of 50% or more of the ownership interest in the recipient of an SBA loan must certify that he or she is not more than 60 days delinquent on any obligation to pay child support arising under:
(a) An administrative order;
(b) A court order;
(c) A repayment agreement between the holder and a custodial parent; or
(d) A repayment agreement between the holder and a State agency providing child support enforcement services.

b. Provisions Related to Child Support Compliance

All 7(a) and 504 loan authorizations must include the following condition:

All 7(a) and 504 authorizations require the Lender and CDC to have the Borrower certify that "No principal who owns at least 50 percent of the ownership or voting interest of the company is delinquent more than 60 days under the terms of any (1) administrative order, (2) court order, or (3) repayment agreement that requires payment of child support.

.120.172 Flood-plain and wetlands management.
(a) All loans must conform to requirements of Executive Orders 11988, "Flood Plain Management" (3 CFR, 1977 Comp., p. 117) and 11990, "Protection of Wetlands" (3 CFR, 1977 Comp., p. 121). Lenders, Intermediaries, CDCs, and SBA must comply with requirements applicable to them. Applicants must show:

(1) Whether the location for which financial assistance is proposed is in a floodplain or wetland;
(2) If it is in a floodplain, that the assistance is in compliance with local land use plans; and
(3) That any necessary construction or use permits will be issued.

(b) Generally, there is an 8-step decision making process with respect to:
(1) Construction or acquisition of anything, other than a building;
(2) Repair and restoration equal to more than 50% of the market value of a building; or
(3) Replacement of destroyed structures.

(c) SBA may determine for the following types of actions, on a case-by-case basis, that the full 8-step process is not warranted and that only the first step (determining if a proposed action is in the base floodplain) need be completed:
(1) Actions located outside the base floodplain;
(2) Repairs, other than to buildings, that are less than 50% of the market value;
(3) Replacement of building contents, materials, and equipment;
(4) Hazard mitigation measures;
(5) Working capital loans; or
(6) SBA loan assistance of $1,500,000 or less.

c. Provisions Related to Flood-Plain and Wetland Management

(1) Executive Order 11990 requires the avoidance, to the extent possible, of adverse impacts through the destruction or modification of wetlands and the avoidance of direct or indirect support of new construction in wetlands wherever there is a practical alternative. Wetlands are those areas inundated by surface or ground water that, under normal circumstances, do or would support a prevalence of vegetative or aquatic life that requires saturated or seasonally saturated soil conditions for growth and reproduction. These include swamps, marshes, bogs and similar areas such as sloughs, wet meadows, river overflows, mud flats and natural ponds. New construction includes draining, dredging, channeling, filling, diking, impounding and related activities and any new structures and facilities.

(2) Executive Order 11988 requires SBA to minimize the risk of flood loss and to preserve the beneficial values served by floodplains. SBA must evaluate the potential effects of any actions it finances on floodplains (as defined by the U.S. Department of Housing and Urban Development [HUD] floodplain maps). The SBA must:

(a) Identify flood hazards and evaluate the potential effects of any projects or construction actions SBA may be requested to finance in a floodplain or wetlands;

(b) Determine whether structures to be built, repaired or restored will fully comply with the Flood Insurance Protection Act;

(c) Require the acquisition of flood insurance and its maintenance during the life of the loan, and advise applicants that failure to comply fully precludes future Federal disaster assistance; and

(d) Give early public notice and full information to allow public input on decisions affecting floodplains and wetlands.

(3) The following actions are exempt from the requirements of Executive Orders 11988 and 11990:

(a) The SBA loan assistance of $500,000 or less;

(b) Actions outside of a base floodplain (any area subject to a one percent or less chance of flooding in any given year);

(c) Repairs to damaged facilities, the costs of which are less than 50 percent of the fair market value of the facility prior to the damage;

(d) Replacement of building contents, materials and equipment depending upon the facility in which they are located. For instance, liquid gas storage facilities might require the full determination process where non-degrading inventory and materials would not; and

(e) Actions taken by an applicant to mitigate natural hazards, including safe land-use and construction practices.

(4) Non-exempt actions include:

(a) Construction or acquisition of new facilities under the 7(a), DELTA, or 504 loan programs;

(b) Repair and restoration of damaged structures, the costs of which, as determined immediately before the repairs, are equal to or greater than 50 percent of the market value of the structure prior to the damage; and

(c) Replacement of destroyed structures.

(5) The decision-making process for SBA loan processors include the following:

(a) Determine whether a proposed action is in a base floodplain or in wetlands; the percentage probability of flooding; and the possible consequences of a larger-than-normal flood on the economics and

safety of the proposed floodplain action.

(b) Identify and evaluate alternatives to locating in a base floodplain or wetlands.

(c) Conduct an early public review of the requirements in Executive Orders 11988 and 11990.

(d) Identify positive and negative, direct and indirect, concentrated and dispersed, and short-term and long-term impacts on lives and property and floodplain values, as well as their source.

(e) Consider ways to minimize harm to lives and property and to restore and preserve floodplain and wetlands values.

(f) Re-evaluate the alternatives - including "no action."

(g) Prepare a statement of SBA's "Findings and Explanation" for public issuance.

(h) Implement the action, with comments in the loan report on the above areas, and insuring that the action complies with Executive Orders 11988 and 11990.

d. Lead-Based Paint

.120.173 Lead-based paint.
If loan proceeds are for the construction or rehabilitation of a residential structure, lead-based paint may not be used on any interior surface, or on any exterior surface that is readily accessible to children under the age of seven years.

e. Earthquake Hazards

.120.174 Earthquake Hazards.
When loan proceeds are used to construct a new building or an addition to an existing building, the construction must conform with the "National Earthquake Hazards Reduction Program ("NEHRP") Recommended Provisions for the Development of Seismic Regulations for New Buildings" (which can be obtained from the Federal Emergency Management Agency, Publications Office, Washington, DC) or a code identified by SBA as being substantially equivalent.

Executive Order 12699, "Seismic Safety of Federal and Federally Assisted or Regulated New Building Construction," applies to the Agency's 7(a) loan program. As a matter of policy, SBA extends the requirement to the 504 program. The Executive Order contains no exception. Its provisions must be followed even in areas which traditionally do not have earthquake activity.

(1) The following language must appear in all 7(a) and 504 authorizations where the loan is for the construction of a new building or an addition to an existing building.

"Building Standards: In the construction of a new building or an addition to an existing building, the construction must conform with the "National Earthquake Hazards Reduction Program Recommended Provisions for the Development of Seismic Regulations for New Buildings" (NEHRP), or a building code that SBA has identified with substantially equivalent provisions. Lender must obtain from evidence of compliance with these requirements from the borrower. The evidence must be either a certificate issued by a licensed building architect, construction engineer or similar professional, or a letter from a state or local government agency stating that an occupancy permit is required and that the local building codes upon which the permit is based include the Seismic standards."

(2) The following building codes have been identified as being substantially equivalent to the National Earthquake Hazards Reduction Program (NEHRP) Provisions:

(a) 1991 Uniform Building Code of the International Congress of Building Officials (ICBO);

(b) 1992 Supplement to the Building Officials and Code Administrators (BOCA) National Building Code; and

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

f. Coastal Barrier Protection

.120.175 Coastal Barrier Islands.
SBA and Intermediaries may not make or guarantee any loan within the Coastal Barrier Resource System.

(1) General

The Coastal Barrier Resources Act prohibits Federal expenditures or financial assistance to projects located on undeveloped Atlantic and Gulf of Mexico coastal barriers and undeveloped wetlands in the Great Lakes. The purpose is to prevent ecological damage and wasteful expenditures. A specific set of maps identifying the original areas has been adopted and distributed to the appropriate field offices. Maps identifying new areas will be distributed accordingly.

(2) Prohibited Lending

This Act prohibits 7(a) lending to projects located in the defined coastal barrier and wetland areas. Loans to purchase or improve structures or facilities, such as buildings, roads, bridges, boat landings, or upgrading of water treatment systems, are specifically prohibited.

(3) Exceptions

There are several exceptions to the prohibition, one of which could affect SBA lending. Facilities necessary for the exploration, extraction (mining) or transportation of energy resources may qualify as an exception. The SBA assistance can be considered when the Secretary of the Interior or designee authorizes in writing the granting of financial aid for such purposes. You must consult with the Department of Interior since that Department is charged with primary responsibility for administering the Act.

(4) Affected States

The following states contain areas covered by the Act: Maine, Massachusetts, Rhode Island, New York, Connecticut, Delaware, Virginia, North Carolina, South Carolina, Georgia, Florida, Alabama, Mississippi, Texas, Louisiana, Illinois, Minnesota, Wisconsin, Michigan, Ohio, Indiana, and Pennsylvania. When making loans in these States, be alert to ensure that the loans do not violate provisions of this Act.

g. Compliance with Other Laws

.120.176 Compliance with Other Laws
All SBA loans are subject to all applicable laws, including (without limitation) the civil rights laws (see Parts 112, 113, 117 and 136 of this chapter), prohibiting discrimination on the grounds of race, color, national origin, religion, sex, marital status, disability or age. SBA requests agreements or evidence to support or document compliance with these laws, including reports required by applicable statutes or the regulations in this chapter.

(1) Discrimination

13 CFR Parts 112 and 113 prohibit discrimination by recipients of Federal financial assistance in the delivery of services to the public, in employment practices, or in the membership policy of private, civic or fraternal organizations. SBA regulations, 13 CFR Part 117, states that no person shall, on the basis of age, be excluded from participation in, be denied the benefits of, or be subject to discrimination under any business or activity receiving Federal financial assistance. The Equal Credit Opportunity Act (ECOA) also prohibits discrimination against any applicant in a credit transaction.

You must immediately forward to SBA's Office of Equal Employment Opportunity and Civil Rights Compliance, complaints alleging discriminatory treatment based on race, color, religion, age, sex, marital status, disability, or national origin, whether the allegation is from the public, an SBA employee, an SBA program officer, an SBA recipient, or any other source. The Office of Civil Rights Compliance will investigate and dispose of the complaints.

(2) Equal Credit Opportunity Act

(a) General

The ECOA prohibits discrimination against any applicant with respect to any aspect of a credit transaction on the basis of race, color, marital status, sex, religion, national origin, age, receipt of income from any public assistance program, or the fact that the applicant has, in good faith, exercised a right under the Consumer Credit Protection Act or under State law.

(b) Marital Status

(i) We cannot determine if a spouse's signature is needed for eligibility purposes without knowing if there is a spouse.

Therefore, we may request and consider the applicant's marital status; alimony, child support and separate maintenance income; and the spouse's financial resources. "Marital status" means the state of being unmarried, married, or separated as defined by applicable State law. A person who is divorced or widowed is "unmarried" for the purpose of this Act.

(ii) You cannot ask the applicant for further information if they say they are "unmarried". Asking if an applicant is divorced, has never been married or is widowed is a direct violation of the ECOA.

(iii) An applicant cannot be required to use a title such as Mr., Mrs., Ms. or Miss on the application form. The SBA must collect statistics on loans made to women. We may require an indication of the gender of the applicant for statistical purposes only.

(c) Repayment Ability

(i) You may ask an applicant about the source of income to be used for repayment of the loan. You may consider a spouse's income as a basis for repayment only when it is volunteered. You must not ask that the spouse's income be used for repayment. You may then ask questions about the spouse and consider the spouse.s income to the extent that it is likely to be consistent. You may not otherwise request information about a spouse's income.

(ii) A creditor may ask and consider the extent of an applicant's obligation to make alimony, child support, or maintenance payments in order to establish repayment ability (how much the principal must draw from the business to meet personal expenses).

(iii) We cannot discount or exclude from consideration income of the applicant or applicant's spouse because it is derived from part-time employment or is a retirement benefit. However, you may consider the amount and probable continuance in evaluating the applicant's credit worthiness.

(iv) We may consider an applicant's age (presuming the applicant has the capacity to contract) or receipt of income from a public assistance program only for the purpose of determining a pertinent element of credit worthiness. For example, you may consider whether payment from a public assistance program will continue after a loan is approved, how long the applicant has been receiving benefits, the status of dependents, or how long the applicant intends to remain in the jurisdiction to ascertain whether the benefits will continue. Concerning age, SBA may consider such factors as occupation and length of time until retirement to determine whether applicant's income, including retirement income, will support the extension of credit until its maturity.

(v) Permanent resident or immigration status may be considered only as a means of determining our rights and remedies regarding repayment.

(d) Collateral

(i) The general rule is that when a married or separated applicant requests secured credit, we may require the signature of the spouse on necessary documents under applicable state laws which we reasonably believe to be necessary or under applicable state law to create a valid lien, pass title, waive inchoate rights to property, or assign earnings.

(ii) We may not ask a spouse to sign a note, guaranty or other document solely because of marital status. However, if the spouse is a co-applicant on whose income or property we are relying to establish repayment ability or counsel indicates that state property, statutory or decisional law makes the spouse's signature necessary (such as state law giving the spouse present ownership rights in the business), we may request the spouse to sign the note. A spouse, like any other co-owner, can be asked to sign all documents covering property in both names which is required to ensure access to the property but does not impose personal liability unless necessary under state law.

(iii) Any principal, partner, or official of the borrower may be asked to sign any document because of the person's official position, even if that person is the spouse of another signer, without violating the ECOA.

(iv) Collateral documents for loans approved in one of the twelve community property states will not automatically require a spouse's signature. However, the spouse (regardless of ownership interest) is not exempt from providing application information and should sign the personal financial statement in those States unless the applicant indicates that the personal financial data is not part of the community property. This does not obligate the spouse or automatically require the spouse to execute the loan documents. It does make the spouse aware that community assets may be required as collateral. Consult counsel before requiring a spouse to sign.

(v) A guarantee on an extension of credit is part of a credit transaction and is subject to ECOA. Therefore, creditors are barred from requiring the signature of a guarantor's spouse just as they are barred from requiring the signature of an applicant's spouse. An evaluation of the financial circumstances may indicate that an additional signature is necessary. The spouse may sign but cannot be required to sign.

(e) Prohibited and Adverse Information

(i) Whenever SBA receives adverse information on any principal, owner or officer of a business, such information can be considered in evaluating the credit risk. However, we cannot consider adverse information which concerns the arrest/conviction record or character of a non-owner spouse not active in the business.

(ii) Whenever we receive adverse credit reports of an applicant or principal, the applicant must be given the opportunity to prove that the adverse information applies to some other party, such as a spouse or former spouse, and does not reflect accurately the applicant's willingness or ability to repay.

(iii) The fact that we may have prohibited information in prior files or may have prohibited information received from other sources in a current file is not a violation of the ECOA. However, such information may not affect the decision on the current request for credit.

(f) Other Areas of ECOA Impact

Forms

(i) SBA Form 413, "Personal Financial Statement," or any other personal financial statement, must include the assets and liabilities of the applicant or principal and their immediate family unit (see subpart A, chapter 2, paragraph 4d. This is needed to determine eligibility based on the utilization of personal assets.

(ii) SBA Form 912, "Statement of Personal History," will be accepted without the name of the spouse, although you may request marital status when a business loan application is presented.

(g) Utilization of Personal Resources

When establishing whether personal credit or resources are available to be used in lieu of an SBA loan with regard to the eligibility of the applicant, you can consider the personal resources of a non-owner spouse. Unless a legal impediment such as an irrevocable trust exists, the spouse's personal resources are presumed to be available to an owner or principal of the applicant business.

(h) Size Standards

(i) When an applicant applies for credit under SBA programs, you may request financial information about a non-owner spouse when determining whether the applicant is "small" and whether personal resources are available to invest to reduce or eliminate the need for an SBA guaranteed loan. You can only use the information, when affiliates exist, to establish the primary activity of the group of affiliates to determine the applicant's eligibility as to size.

(ii) Concerns owned by spouses are presumed to be affiliated but this presumption can be rebutted. (See subpart A, Chapter 2, paragraph b) When each spouse applies for loans separately, we may not total the individual loans for the purpose of determining loan ceilings unless the concerns are affiliates.

(i) Miscellaneous

(i) Whenever SBA declines, withdraws, or screens out an application, a copy of the ECOA notice must be provided to the applicant by the lender. This notice is included on "Statements Required by Law and Executive Orders." Proper distribution and retention of either a signed copy or a signed certification of receipt is an important matter on all applications, including declines, withdrawals, and screenouts.

(ii) The SBA will continue to request and record data on age, sex, race and national origin according to existing instructions. This information cannot be considered in connection with the decision to grant financial assistance. SBA must compile this data to have evidence of compliance with various anti-discrimination laws. SBA also must submit periodic reports to the Justice Department on our compliance statistics.

(iii) The SBA is not liable for a participant's violation of ECOA unless SBA is aware of the violation. However, if there is reason to believe a lender is in violation, a clarification should be requested.

(iv) Under ECOA, "A creditor shall not refuse to extend credit and shall not terminate an account because credit life, health, accident, disability, or other credit-related insurance is not available because of the applicant's age."

(3) Right to Financial Privacy Act of 1978

(a) General

This Act is intended to protect individuals from unwarranted intrusions into their financial affairs by Government authorities, including SBA. Certain applicants and their principals must be notified that SBA has the right to access financial records and information necessary to process, service, or foreclose a loan or loan guaranty.

(b) Exclusions

The Act specifically excludes or is silent regarding certain exchanges of information:

(i) Financial records of corporations are not included. However, individual financial records of officers, shareholders and directors are included. Financial records of partnerships having six or more partners are excluded but not information concerning the partners as individuals.

(ii) Personal financial information supplied by individuals directly to SBA is not covered. Requests for financial institutions to verify information are covered.

(iii) Information received from non-financial institutions is excluded. Exchange of information between financial institutions is not covered.

(c) Implementation

(i) All applicants are notified of their rights under the Financial Privacy Act of 1978 through the "Statements Required by Laws and Executive Orders." The form providing this information must be signed by each individual identified on the form. For more on the requirements of the "Statements" form see subpart A, chapter 6, paragraph 4(c).

(ii) Telephone verification of financial information on individuals involved in any way with a loan application is considered an exchange of information and must be preceded by written certification.

(iii) The law with regard to the exchange of credit information between SBA and the IRS or any other Federal authority is complex. Therefore, all such exchanges must be referred to counsel.

2. IMPACT OF RULE CHANGES ON EXISTING LOANS

.120.180 Are rules enforceable if they are changed later?
Regulations and contractual provisions in effect at the time of a transaction govern an SBA loan financing transaction, notwithstanding subsequent rule or contract changes. SBA may conduct an enforcement action regarding any violation of provisions of regulations or contracts applicable at the time, but no longer in effect or in use.

3. APPLICATION FILING LOCATION

.120.190 Where does an applicant apply for a loan?
An applicant for a business loan should apply to:
(a) A Lender for a guaranteed or immediate participation loan;
(b) A CDC for a 504 loan;
(c) An Intermediary for a Microloan; or
(d) SBA for a direct loan.

a. Which SBA Office Processes Applications

(1) Lenders should generally file 7(a) loan applications with the SBA office located in the territory where the business has its headquarters. The CDCs should generally file 504 applications with the SBA office located in the territory where the project is located. If the participant is in another territory, the offices involved must work out a satisfactory arrangement, provided the lender has servicing capacity where the business is located. In any event, the lender must satisfy SBA that it can service the account prudently. If it can not, the applicant must select another participant. Lenders may not assess additional fees because

servicing costs increase as a result of their distance from the borrower.

(2) If two district offices cannot agree on which office will process and/or service the loan, the matter will be referred to the Director, Office of Loan Programs at Headquarters.

(3) You must render assistance to applicants filing applications in SBA offices outside the territory your office serves. This includes counseling, reviewing an application for completeness, and forwarding the application to the appropriate field office for formal acceptance and processing.

b. Processing Two Applications From Two Lenders

Once SBA accepts an application for processing, you cannot accept another lender's application for the same loan until final action has been taken on the first request. After we have authorized a loan, we cannot accept another request for the same loan until the first loan's initial disbursement period has expired without any disbursements on the loan. Exceptions may occur when the participant provides written permission to:

(1) Transfer the SBA loan authorization to another lender so long as the second lender also provides written notice of its willingness to take responsibility for the loan; or

(2) Cancel its loan.

Our responsibilities to our lending partners and to small business applicants make this policy necessary. These procedures are intended to restrict applicants or packagers from simultaneously shopping their credit request with multiple lenders and the submission of multiple applications to one or more SBA offices under one or more loan delivery programs. This practice causes redundant and unnecessary work for both the lender and SBA personnel.

However, lenders must not be able to prevent applicants from obtaining financing from other lenders for an extended period. For this reason, the establishment of the initial disbursement period is important.

The initial disbursement must occur within 3 months of the Authorization/Approval date. Final disbursement must occur within 12 months of approval. One exception to these parameters would be where the loan's purpose is to provide permanent financing to a construction project that is incomplete at time of application and where more time is needed before the interim construction loan can be paid off.

No lender can approve an extension to the initial disbursement period past 6 months or final disbursement period past 12 months without the concurrence of the applicant and notification to SBA. To allow unilateral extensions could unfairly prevent applicants from being able to go to alternative lenders after a reasonable time to arrange a workable solution (between the applicant and their lender) has lapsed. All lenders must obtain SBA concurrence to any request for an extension to the disbursement process except extensions provided on loans originally processed under PLP or equivalent procedures. When an extension is provided on a loan processed under PLP or equivalent procedures, the lender (or CDC) must inform SBA of the extension within 10 business days. All lenders must maintain a copy of the applicants request for any disbursement period extensions in their files.

Extension of the initial disbursement period does not automatically extend the final disbursement period. This policy applies whether the issued Authorization is under the 504 Loan program or the 7(a) loan program.

For additional information on disbursement periods, see Subpart A, Chapter 5, Paragraph 6h.

4. CONTENTS OF BUSINESS LOAN APPLICATIONS

.120.191 The contents of a business loan application.
For most business loans, SBA requires that an application for a business loan contain, among other things, a description of the history and nature of the business, the amount and purpose of the loan, the collateral offered for the loan, current financial statements, historical financial statements (or tax returns if appropriate) for the past three years, IRS tax verification, and a business plan, when applicable. Personal histories and financial statements will be required from principals of the applicant (and the Operating Company, if applicable).

Use the standard definition of "Principal," plus all guarantors, for these forms, unless otherwise specified.

Field offices must keep one copy of each application and all supporting documents. Each application must be complete and stand on its own. SBA does not use the applicant's information from existing loan files to process new loan requests. The application and all supporting exhibits must be signed and dated. SBA does not need loan documents with original signatures to process loan applications.

Lenders must retain one set of application documents with original signatures. These documents must be available for review by SBA upon request and must be provided whenever SBA takes over servicing. The following forms/information should be included:

a. SBA Form 4 and 4-I for 7(a) OR SBA Form 1244, Parts A, B, & C For 504

Except for special programs where use of different form(s) is specifically authorized, all 7(a) applications must be submitted on SBA Form 4, "Application for Business Loan," and SBA Form 4-I, "Lender's Application for Guaranty or Participation." All 504 applications must be submitted on SBA Form 1244, "Application for Section 502/504 Loan."

You must work with participants to make sure that they know how to appropriately complete page two of SBA Form 4-I. If the lender properly analyzes the loan, you only have to complete the recommendation block. If a participant has difficulty properly completing page two of Form 4-I, you must not recommend it for the Certified Lender Program (CLP) or the Preferred Lender Program (PLP).

Applicants should also be given SBA Form 641, "Request for Counseling," but execution and return of this form is optional.

b. SBA Form 4, Schedule A 7(a) (Use of SBA Form Optional)

When the collateral for a 7(a) loan consists of: (a) Land & Building; (b) Machinery & Equipment; (c) Furniture & Fixtures; (d) Accounts Receivables; (e) Inventory; (f) or Other Assets, the applicant must provide an itemized list that contains serial and identification numbers for all articles that had an original value greater than $500.00. The SBA Form 4 Schedule A, "Schedule of Collateral" is an acceptable format to provide this information. The applicant may use this form or any other format that will provide the equivalent amount of information.

If an applicant requests a change in the collateral prior to disbursement of an approved loan and the lender is agreeable, the lender should immediately submit the request to SBA. The request must include justification for the change and pertinent data on any substitute collateral being offered.

c. Statements Required By Laws and Executive Orders

You must not accept an application for processing without proper execution of the "Statements Required by Laws and Executive Orders" form which is part of Form 4 for 7 (a) loans processed under Standard, CLP and PLP procedures, Form 4-L for 7(a) loans processed under LowDoc procedures, Form 1919 for 7(a) loans processed under SBA*Express* procedures, and Form 1244 for loans processed under 504 procedures. The principals of the business, as well as every guarantor must sign this form and receive a copy for their files. The participant must obtain and provide to SBA the appropriate certification that the form has been received and read. This procedure must be followed even if the loan is screened out or declined. The use of SBA forms is required for compliance with this paragraph.

Required signatories includes the key individuals connected with the applicant firm such as: the proprietor, each general partner, each limited partner owning 20 percent or more of the business, and each guarantor, corporate officer, director, stockholders with 20 percent or more ownership of the applicant and their respective owner spouses. The participant shall retain a copy of the fully executed "Statements" form.

d. SBA Form 912, "Statement of Personal History" (SBA Form Required)

(1) Definitions:

(a) "Subject Individuals": The persons who must complete an SBA Form 912 are described within the Form. Subject individuals include: The proprietor if the applicant concern is a sole proprietorship; Each partner if the applicant concern is a partnership; and if the applicant concern is a Corporation - Each officer, director, and holder of 20 percent of more of the voting stock. In addition any person who can speak for and/or commit the applicant concern must complete an SBA Form 912

Note: "Officers" include the president, first tier vice presidents, secretary, and treasurer or chief financial officer.

(b) "Single Offense": Any **one** criminal arrest or conviction.

(c) "Minor Offense": Any criminal offense classified as a misdemeanor according to local law or by the jurisdiction authorized to judge it.

(d) "Remote in Time": The occurrence of the offense and all related activity (e.g., payment of fines, related probation, parole, *etc*.) concluded more than 10 years prior to the date of the SBA application.

(e) "Several Minor Offenses": No more than three criminal misdemeanor arrests or convictions (whether at one time or separately).

(f) "912": The SBA Form 912, a/k/a "Statement of Personal History" form and any other SBA form which ask the loan applicants who apply under non-standard procedures the same three character questions they would be asked if they completed a Form 912. Examples include Section D of SBA Form 4-L, "Application for SBA LowDoc Loan," and questions 1 through 3 on the SBA Form 1919, "SBA*Express* Borrower Information Form."

(g) "Character Evaluation": a/k/a Name Check - The process of determining if the Federal Bureau of Investigations (FBI) has any record of criminal activity on an individual. This process does not include any criminal background check with state or local authorities.

A character evaluation/name check is the minimum requirement that must be met any time there is any affirmative response to a character question, regardless of when the offense took place and even if the 912 has been cleared for processing by a field office or LDPC.

A character evaluation/name check is requested by waiving the fingerprint requirement and submitting the 912 to OIG/OSO with the box requesting a character evaluation checked.

(h) "Fingerprint Check": The process of determining if an individual has any criminal record with Federal, state and local law enforcement officials.

A fingerprint check is mandatory for any felony, regardless of when the offense occurred. To conduct a fingerprint check, the subject individual must complete a Fingerprint Card, FD 258 (FD 258).

(i) "Character/Name Check Review": The review made after the information from a character evaluation/name check is received to determine whether to: obtain additional information (as can be done with a Fingerprint check); put a loan that was cleared for processing on hold; continue to maintain a loan that was already on hold status; or permit processing and disbursement to continue.

(j) "Formal Character Determination:" The determination by OFA after it has received the results of the fingerprint check to either permit or prevent a loan that should already be on hold status to be processed or disbursed. It is also the determination made by OFA, after it receives any additional information from the field on whether, to permanently prevent any further disbursements of a loan put on hold by OFA as a result of a character evaluation/name check. This determination is made after reviewing information provided by the subject on their 912 and from the data gathered during the fingerprint check.

(k) "Local Clearance Official:" The highest ranking official of the financing or economic development function within the processing district office, and for loans processed under LowDoc procedures, the LowDoc Processing Center's (LDPC) Director. This person must also have supervisory responsibility over the personnel who recommend action on request for financial assistance. This person is usually referred to as the Assistant District Director for Economic Development (ADD/ED) or Supervisory Economic Development Specialist (Supervisory EDS).

The local clearance official is not necessarily synonymous with approving official. It does not refer to anyone who may have authority to approve loans such as Team Leaders or Supervisory Loan Specialists, unless these persons also have supervisory responsibility.

Persons acting for the ADD/ED or Supervisory EDS may perform the functions of the Local Clearance Official providing they perform the Clearance Official's role only while officially serving in an acting capacity.

(l) "The three character questions:" Questions which every subject individual must answer:

(1) Are you presently under indictment, on parole or probation?

(2) Have you ever been charged with or arrested for any criminal offenses, other than minor motor vehicle violations?

(3) Have you ever been convicted, placed in a pretrial diversion, or placed on any form of probation, including adjudication withheld pending probation, for any criminal offense, other than minor motor vehicle violations?

These three questions are sometimes referred to as the character questions or as questions 6, 7, and 8 of the 912. This is because: (1) they are the key character questions SBA ask of each subject individual, and (2) on the SBA Form 912 they appear as questions 6, 7, and 8.

(m) "OIG/OSO" The Office of Inspector General, Office of Security Operations (OIG/OSO), Small Business Administration, 409 3rd Street, SW, Suite 5600, Washington, DC 20416.

(2) The Agency requires that every individual who is subject to the 912 requirements be of good character. Loan processors must reasonably confirm an applicant's honesty, responsibility, and determination to succeed.

(3) The completion of an SBA Form 912 by each subject individual is part of the character determination process. Every subject individual is required to complete the 912, which includes the answering of the three character questions.

(4) SBA uses the responses from these questions to help make the character determination. These questions provide information on an individual's background. They reveal data about employment, criminal activity, and Government involvement.

Everyone completing a 912 must answer each question fully, giving all details about any affirmative response. **An affirmative response is required even when the record is supposedly sealed, expunged or otherwise unavailable**. The 912 information is private and confidential. **Exceptions to or waivers of this policy are not permitted**

(5) If every subject individual answers each of the three character questions with a negative response, processing may commence.

(6) If at least one subject individual answers at least one of the three character questions with a positive response, the following series of actions has to occur:

(a) The existence of an affirmative response must be brought to the attention of the Clearance Official before processing commences.

(b) A complete understanding of the reason(s) for the affirmative response must be obtained (if not already provided). When necessary for a clear understanding, the loan officer must obtain additional written clarification. The loan officer must not accept or rely upon verbal information.

(c) A Character Evaluation, a/k/a name check must be ordered; and

(d) The applications must not be processed under PLP, CLP, SBA*Express*, ALP, or PCLP procedures.

(7) Decisions Available to the Local Clearance Official When Handling An Affirmative 912:

(a) Clear the 912 to permit processing, which also means the loan is cleared to be approved and disbursed. This can only be done if the requirements of subparagraph 4.d.(10) of this paragraph are complied with;

(b) Place the processing of the application on hold for further investigation; or

(c) Decline the application citing, "Lack of reasonable assurance that applicant will comply with the terms of the loan agreement."

(8) When Choosing Paragraph 7(a) above:

(a) It is understood that the subject individual's reason for providing an affirmative response was for other than a felony.

(b) The Local Clearance Official understands that processing could lead to approval, and approval could lead to disbursement. Clearing an application with an affirmative 912 for processing is the same as clearing an application with an affirmative 912 for disbursement.

(c) A Character Evaluation/name check must be requested. This means the processing office must send a copy of the 912 OIG/OSO. The original 912 must be kept in the loan case files.

(d) The requirement for a fingerprint check must be waived by the Clearance Official.

To waive fingerprints, make the appropriate notation in blocks #10 and 11 on the SBA Form 912 or block D5V on SBA Form 4-L.

(e) When the field office clears the 912 and the FBI Name Check corroborates the information on the 912, OIG/OSO will advise the field office that no new information was received from the FBI. OIG/OSO will not advise the field office of the finding if referring the matter to the AA/FA or designee. The AA/FA or designee will make all notifications except those indicated above. OIG/OSO sends information to the AA/FA or designee when **(1)** the FBI Name Check results contradict what the individual disclosed on the 912 regarding criminal history, or **(2)** the disclosed criminal history raises a question about the character of the individual, even when corroborated by the FBI Name Check. The AA/FA or designee can overrule the clearance by the field office in either situation.

(f) When the field office clears the 912 but the name check discloses a contradiction from the information on the 912, OIG/OSO refers the matter to the AA/FA or designee for a decision on the continuance of processing and disbursement, i.e., the AA/FA or designee can overrule the clearance by the field office. The AA/FA or designee has sole discretion in requiring suspension of loan processing or disbursement and in requiring a fingerprint check of the involved individual.

(9) When Choosing Paragraph 7(b) above:

(a) A fingerprint check must be required meaning the subject individual who answered at least one of the character questions in the affirmative must complete an FD 258 form; or

(b) A Character Evaluation/Name Check must be required - follow the instructions specified in paragraph 8(c).

(10) Limitations on Clearing a 912 for Processing:

The Local Clearance Official may only clear the 912 for processing and waive the fingerprint requirement when the subject's affirmative activity meets the following situations:

(a) A Single Minor Offense within the last 10 years; or

(b) Several Minor Offenses Remote in Time; or

(c) A Prior Offense that was cleared by the AA/FA or designee on a previous application where no other offenses has occurred since the previous application was cleared by the AA/FA or designee.

NOTE Only the AA/FA or Designee may authorize the field to process and subsequently disburse a loan when the Form 912 is not cleared by the field office.

(11) Ramifications of Requesting a Character Evaluation/Name Check:

When a 912 is sent to the OIG/OSO for a Character Evaluation/Name Check, the application may have been either cleared for processing (and disbursement) or placed on hold pending the outcome of the Evaluation/Name Check. The FBI will provide OIG/OSO with their findings. For 912s cleared by a field office, OIG/OSO will notify the appropriate field office when no new findings were received from the FBI, or they will forward any findings that are **contradictory to the disclosed criminal history** to the AA/FA or designee for disposition. OIG/OSO will also refer any 912 to the AA/FA or designee when the criminal history raises a question about the individual's character, or the 912 was not cleared by the field office.

If additional criminal activity is uncovered, it will be provided to the AA/FA or designee who will notify the processing office that an adverse condition exists. As such, if processing was on hold it shall remain on hold and a fingerprint check shall be required. If the loan was already processed and approved so that it is now in a position to be disbursed, the lender shall be notified of the adverse change and told to cease disbursement of the loan.

If the loan is either partially or fully disbursed by the time the lender is told to cease disbursements, a report on the status of the loan shall be sent to the AA/FA from the Local Clearance Official. For loans that are partially disbursed, the report will include an opinion and recommendation from the lender and processing office on the likelihood of ultimate repayment if further disbursements are not permitted.

(12) When the lender or CDC (as appropriate) has not already done so, the field office must submit two copies of all 912s with an "AFFIRMATIVE" response to Office of Inspector General, Office of Security Operations (OIG/OSO), Small Business Administration, 409 3rd Street, SW, Suite 5600, Washington, DC 20416. The originals must be kept in the loan case files.

(13) Form FD 258 must be completed and submitted by the individual when a fingerprint check is required. Local law enforcement agencies will usually assist the individual with the fingerprinting. The individual is responsible for providing a legible set of fingerprints.

(14) When a 912 is sent to the OIG/OSO, SBA and lender personnel must not make a statement of any kind to anyone outside the SBA or the lender about action being taken regarding the information submitted. Exceptions are permitted only to comply with the provisions of the Privacy Act. (See SOP 40 04).

Q1. When must a loan officer submit a SBA Form 912 and a fingerprint card, FD 258, for clearance?

A1. Immediately upon receipt of both documents, pages 2 and 3 of the appropriate 912 with an affirmative response and related FD 258s (unless waived) must be submitted to the OIG/OSO. Clearance for processing, approval, and disbursement or waiver of fingerprints does not void this requirement.

When a FD 258 is submitted or a name check and character evaluation is requested, processing or disbursement must stop until the AA/FA or designee authorizes continuance. FD 258 forms are available from SBA field offices.

The individual must supply legible prints acceptable to the FBI on a form FD 258. The appropriate office identification code number and the name of the business applicant must be written on the back of the card ("SBA Office ID 1234" and "The XYZ Company, Inc.").

Note in block # 10 of the SBA Form 912 and the copies forwarded to OIG/OSO that "Fingerprint card forwarded to OIG/OSO on (date)."

Q2. Why must the SBA Form 912 and FD 258s be submitted for clearance?

A2. These forms must be submitted to assist in the character determination. They provide the necessary information and authorization to investigate past and current criminal activity through police agencies such as the FBI.

Q3. What would be an appropriate way to handle a case where an individual discloses that he or she was arrested and charged with a crime, but the charges were subsequently dropped?

A3. The local clearance official could clear the loan for processing and require a character evaluation which is the same as an FBI Name Check. Since the name check is usually completed in less than two weeks, the results would most likely be known before any disbursement would occur. If the name check turned up any additional criminal activities, an adverse condition would exist and disbursement would have to be halted.

Q4. Is clearance of the 912 to enable processing of an application required as a condition to waive the fingerprint requirement?

A4. No, the fingerprint requirement may be waived for a misdemeanor without clearing the 912. The approving official may do this on a case-by-case basis when criminal activity other than a felony is reported but must exercise prudent discretion.

The approving official **MUST NOT** clear a 912 or waive the FD-258 fingerprint requirement when a felony is reported.

Q5. What should be done when the accuracy of the responses are suspect?

A5. The loan officer must require completion of FD 258 and submit it to OIG/OSO with the 912 for a determination.

Q6. What if the loan officer receives adverse information from sources other than the 912?

A6. Send a memo with the 912 to the OIG/OSO.

Q7. How soon should 912s and FD 258s be submitted?

A7. As soon as a 912 with a positive response is received, SBA field offices must send the 912 and related FD 258 (if not waived) to the OIG/OSO. This minimizes delays in processing, making the credit decision, and disbursing loan proceeds.

Q8. How do you waive the fingerprint requirement?

A8. Make the appropriate notation in blocks #10 and #11 on the SBA Form 912 or check block D5V on SBA Form 4-L.

e. Business Financial Statements (Required, Applicant Uses Own Forms)

All SBA loan applications require financial statements on the applicant firm, including the balance sheets, reconciliation of net worth, and profit and loss statements for the 3 most recently completed fiscal years. In addition, these statements need to be current to within 90 days of the date of application. Therefore, if the most recent fiscal year end is more than 90 days from SBA's application receipt date, interim statements have to be prepared. A business that has not commenced operations is exempt from this requirement. In addition, a debt schedule and an aging of accounts receivable and accounts payable must accompany the application. Agings are summaries of the status of the accounts rather than a detailed status of each individual account.

Upon receipt of a loan package, the loan specialist shall evaluate the quality of the financial statements. You must not rely on poor quality statements (such as statements with inaccuracies or which you believe unreliable), especially when the loan request is large (more than $150,000). Also, see SOP 50-11. To determine the applicant's financial condition, require that the applicant:

(1) Submit one or more income tax returns to confirm the veracity of statements submitted; or

(2) Obtain verification (from independent accountants or appraisers) of any questionable items prior to disbursement; or

(3) Submit statements by an independent public accountant before processing the package.

All financial statements must be signed and dated by the proprietor, a partner, or an authorized officer of the applicant unless they are prepared by an outside accountant and properly certified. Qualified statements are not considered properly certified. It is not necessary for every page to be signed and dated.

Accurate credit analysis depends upon accurate financial statements. When the existing statements are questionable, you may require that their quality be upgraded. This upgrade can range from Compiled, Reviewed, or Audited statements, depending upon the business and credit needs under review.

Note In order for you to properly analyze this data, all financial statements must be as of the same date as the balance sheet(s) used to perform the financial analysis and to develop the pro forma balance sheet.

All current financial data should be as of the same date.

Additional financial data, such as earnings projections and/or cash flow statements, may be necessary for certain applications. This is especially true for new businesses just starting or existing businesses planning major changes in their operations as well as for applicants applying for a Contract CAPLines loan. In addition, the depreciation schedule from an applicant's tax returns may be useful in determining fixed asset values.

Selected financial statements are also required from the seller of assets or a business to the applicant when the analysis of repayment is dependent on how well these assets or this business preformed for the seller. Financial statements from the seller of assets to the applicant are not required when the analysis of repayment for the proposed loan is not dependent on historical performance.

When the applicant is acquiring assets that transfers the operation associated with the assets from the seller to the applicant, repayment will be either fully or partially be dependent on how well these assets historically performed for the seller. Under such circumstances, the financial statements (balance sheet and profit and loss) on these operations while under the control of the seller need to be included as part of the application submission. If the applicant is acquiring assets and there will be no transfer of the operation associated with the assets or business, no financial statements will not be required from the seller. Further discussion of these factors can be found in Subpart B, Chapter 1, Paragraph 3.

f. Tax Return Requirements - Including Verification

It is SBA's policy to require historical financial statements on all applications from existing businesses. Federal tax returns are acceptable financial statements, unless they are from a sole proprietor, in which case a balance sheet will also need to be prepared. However, submission of photocopies of Federal income tax returns is not an Agency requirement.

The financial information submitted will be relied upon for the credit analysis of the application. Whether the type of financial statements submitted are compiled, reviewed, audited, or Federal income tax returns, their accuracy is essential to the quality of analysis provided the application. Therefore, SBA has established policy that the financial statements of the applicant concern shall be verified. The process of conducting this verification is known as the tax verification process. Its purpose is to verify the accuracy of the financial information, not necessarily the tax returns, being submitted with each application.

Q1. Why was this policy initiated?

A1. Discrepancies between tax returns and financial statements submitted with loan applications led to the establishment of this policy in order to detect and deter the submission of fraudulent financial data. The verification process gives us information on the extent of this problem while allowing us to verify the financial information being submitted.

Q2. Is this policy mandatory?

A2. Yes, the accuracy of the annual financial statements relied upon in making a credit decision that repayment exist must be verified through the tax verification process. This means that the annual financial statements of all existing small business applicants and the financial statements from applicants who will use loan proceeds to acquire a going concern as part of a change of ownership situation must be verified. See Subpart B, chapter 1, paragraph 3(c)(1) for more information on the acquisition of a going concern.

The tax verification process is not applicable for new businesses, since there are no historical financial statements, or when proceeds are used to acquire assets from another businesses where the prior performance of these assets will not be relied upon to demonstrate repayment. However, the financial statements of the seller have to be verified when these statements will be relied upon to demonstrate repayment.

Q3. Are tax returns required?

A3. Tax returns are not required to be submitted with every loan application. However, they are an acceptable format for the required profit & loss statements. As with the analysis of any financial data, consideration must first be given to the perceived accuracy of the data being analyzed. If submitted information is significantly out of line with industry norms, the company's own operating history, or the personal experience of the analyst, the data itself must be questioned.

Care must always be taken in ensure the veracity of submitted data. SBA expects participants and loan packagers to exercise the same prudent behavior that we use in assessing the financial risk of each loan application. The IRS income tax return transcripts must be obtained for all requests for SBA financial assistance to verify the financial information submitted except:

1. When the applicant is for a start-up business, since there are no business tax returns to verify.

2. When a substantial (20 percent or more) portion of the proceeds will be used to acquire assets from another business AND the operations of the selling business are not altered PLUS the repayment of the loan is not based on the historical performance of these assets, financial statements from the selling business are not required and these statements do not need to be verified.

   In these cases, the value of the assets will be determined by an appraisal rather than a review of the historical performance of the business.

Q4. How will we verify the financial data through IRS?

A4. The IRS is ordinarily prohibited from disclosing information on individuals or businesses. Access to a limited amount of information is available to SBA because loan applicants are required to execute "Request for Copy or Transcript of Tax Form," IRS Form 4506 (or such other form as IRS may designate). Using this form, the lender requests a transcript, **NOT A COPY** of the tax form. For sole proprietorships IRS provides a computer-generated transcript of these returns (1040 and related schedules).

A transcript is a line by line summary of a tax return, reflecting data from the IRS Form 1040, Schedule C, and other schedules. For partnerships and corporations IRS sends a form letter which contains certain limited financial data on the business concern.

Q5. What is the IRS verification procedure?

A5. Lenders must require an applicant to execute an IRS Form 4506 (which should be noted **"SBA"** at the top center of the form) as soon as the applicant appears likely to submit a loan application. The lender must immediately send this form to the appropriate IRS office with instructions in a cover letter to return the requested information to the lender. IRS tries to respond within 10 business days.

Lenders must compare responses in the financial statements submitted in support of the application prior to any disbursement. If a significant discrepancy exists, the lender must notify SBA and not disburse any loan proceeds until the discrepancy is resolved. The lender may inform the applicant that SBA halted disbursement pending its investigation of an adverse change but may not refer to the IRS verification.

Without notifying the applicant, SBA must refer significant discrepancies to the Office of Inspector General (OIG) with a copy to the D/OLP. If a discrepancy is not resolved, the loan must be canceled due to an adverse change. The cancellation letter must clearly state that the reason for cancellation is the appearance of discrepancies between financial data submitted with the application and that received from IRS. The field office may, at the discretion of the supervisor of the finance function, inform the applicant that the matter has been referred to the OIG for evaluation. Data received from the IRS becomes part of the loan case file.

Q6. What happens if a lender disburses a loan before receiving a response or, after receiving a response, before a discrepancy is resolved without prior approval from SBA?

A6. The lender runs the risk that SBA may deny liability on its guarantee.

Q7. Is an exception to or waiver of the policy possible?

A7. The AA/FA or designee may grant either, but a full explanation of the circumstances is necessary.

Q8. To where do lenders submit IRS 4506s for sole proprietorships?

A8. Photocopy Units at IRS Service Centers provide data from the IRS Form 1040 and related schedules for sole proprietorships for specific geographic areas based on the location of the business.

Q9. To where do lenders submit IRS Form 4506s for partnerships and corporations?

A9. The IRS district offices provide information on these types of business organizations according to the geographic location of the business.

Q10. May I disclose any of the tax return information to other parties?

A10. You may discuss tax return information with the lender or anyone else only for loan analysis purposes or any other official business. The SBA employees and lenders are subject to criminal and civil penalties for willful, unauthorized disclosure of tax return information.

Q11. Is there any cost associated with obtaining a transcript from IRS?

A11. No.

Q12. How does one refer discrepancies to the Office of Inspector General (OIG)?

A12. Call the OIG FRAUD LINE at 1(800) 767-0385 (Toll Free) or mail complaints or fraud cases to:

Small Business Administration
Office of Inspector General
Investigations Division
Mail Code: 4113
409 3rd Street, SW
Washington, DC 20416

g. Personal Financial Statement (Required, Use of SBA Form Optional)

"Principal" in this section does not include officers with less than 5 percent ownership.

Personal financial statements are required from a proprietor, each general partner, each limited partner owning 20 percent or more of a business, each owner of 20 percent or more of a business, each officer, and each guarantor. We may require financial statements from owners of less than 20 percent if we will require their guaranty. Since the use of personal resources may not be waived for owners of 20 percent or more of a business (except for an SBIC if it is prohibited by SBA rules and policies from increasing its investment in that business), the requirement for who must submit personal financial statements cannot be waived. SBA Form 413, "Personal Financial Statement," is generally used for this purpose, but other forms are acceptable if they are current (within 90 days of the application) and provide adequate information. All personal financial statements must be signed and dated.

Q1. Do personal financial statements or tax returns have to be verified?

A1. No. The verification process assist the analyst to know the accuracy of the financial data to be relied upon for showing repayment. Since repayment does not come form the personal resources of the principals, their financial statements do not need to be verified.

h. Representatives Fees and Compensation (SBA Form 159 Required)

The applicant must furnish SBA the names of all representatives engaged in connection with obtaining financial assistance. Applicants must report all fees of these representatives on SBA Form 159 "Compensation Agreement".

An applicant does not have to employ an outside representative in connection with a loan application. However, if an applicant employs a representative, the fee paid must bear a reasonable relationship to the services actually performed. The SBA does not allow contingency fees (fees paid only if the loan is approved) or charges for services which are not reasonably necessary in connection with an application. The SBA also does not permit fees for the use or attempted use of influence to obtain an SBA loan, or fees based on a percentage of the approved loan, unless the percentage results in a fee that generally would be acceptable. The SBA allows referral fees when an applicant employs or contracts with a referral agent. A lender may not collect a referral fee payable by it to a third party from the applicant. A CDC may collect a referral fee on a 504 loan from the third party lender if it **secures** the lender for the small business concern under a written contract. The small business concern cannot pay this fee. (Refer to 13 CFR .120.926.) If a complaint is made regarding fees, the FD Chief or designee determines whether the fee is reasonable (except for legal fees which are referred to District Counsel for a determination).

i. Certification Regarding Debarment (SBA Form 1623/1624 Required)

Executive Order 12549 requires agencies in the executive branch of the Federal Government to participate in a Government-wide system for "non-procurement debarment and suspension." Debarment or suspension of a person or entity by any participating agency or executive department in connection with a non-procurement transaction or under non-procurement debarment regulations precludes financial and non-financial assistance from SBA. Debarment regulations are included in 13 CFR Part 145. Debarment language is included in SBA Form 1244C, part of the 504 loan application.

A participating agency, including SBA, may impose debarment for such offenses as fraud, price fixing, bid rigging, illegal allocation of customers, embezzlement, theft, bribery, falsification of records, making false statements or claims, receiving stolen property, or commission of an offense indicating a lack of business integrity. Report information concerning a cause for SBA to debar or suspend through channels to the AA/FA who is the debarment official.

(1) Definition of Participants

(i) Primary-Tier participants are those dealing directly with SBA such as participating lenders and direct loan applicants. The field office must retain an executed SBA Form 1623, "Certification Regarding Debarment, Suspension, and Other Responsibility Matters - Primary Covered Transactions," in each existing lender's file. New lenders must submit an executed SBA Form 1623 at the time they submit the blanket guaranty form. This is a one-time submission. When a participant is re-certified for any particular program (from CLP to PLP for instance), a new SBA Form 1623 is not needed unless there has been an ownership reorganization since the last 1623 was submitted. Applicants for direct loans must submit an SBA Form 1623 with the application package.

(ii) Lower-Tier participants are those dealing indirectly with SBA in transactions arising out of a primary-tier transaction, such as applicants of SBA guarantee loans. Loan applicants must submit an SBA Form 1624 (Lower Tier Covered Transactions) to the participant with the loan application. The SBA has no obligation to receive copies of these forms. However, a field office may request copies of the form if there is reason to believe that a lower-tier participant has been debarred or suspended.

Employees of participants are generally not covered by the rule. However, principals of a business are covered by the certification submitted by that business.

Required SBA Forms 1623 and 1624 must be obtained from CDCs, participants and applicants. Other lower-tier contractors, such as appraisers, consultants, accountants and packagers, are not required to submit certification forms.

(2) Checking the Non-Procurement List

The names of all primary tier participants shall be checked to make sure they are eligible to conduct business with the Federal Government. The General Services Administration (GSA) maintains a list of non-eligible individuals and entities. The Lists of Parties Excluded from Federal Procurement and Non-procurement Programs is electronically available through SBA's Home Page at http//www.arnet.gov/epls/.

(3) Action Where a Debarred or Suspended Person or Entity is Involved

If an applicant, an associate, an agent, or any other party to the application is debarred or suspended, return the application promptly with a letter advising the applicant that regulations prohibit our acceptance of applications involving a debarred or suspended entity or person. This action will be a screen-out rather than a formal decline.

(4) Retention of Certification Forms by SBA Field Offices

File all primary-tier certification forms (SBA Form 1623) from lenders with the loan guaranty agreement (SBA Form 750) in each district office. If the participant is re-certified under the CLP or PLP programs, file the SBA Form 1623 with SBA Form 1186 (CLP) or SBA Form 1347 (PLP). Keep primary-tier certifications by direct loan applicants in the individual loan file, directly under Form 4. File lower-tier certifications in the appropriate loan file, also under SBA Form 4.

j. Lobbying and Influence Peddling (Forms Required as Noted)

Section 319 of Public Law 101-121 prohibits SBA loan beneficiaries from using loan proceeds to pay any person to influence or attempt to influence a Federal Government employee in connection with a specific contract, grant, loan, cooperative agreement, or the extension, continuation, renewal, amendment, or modification of any of these transactions. The loan recipients must disclose any activity of this type undertaken with their own funds.

For Guaranty Loans: All participating lenders must complete SBA Form 1846 "Statement for Loan Guarantees and Loan Insurance" for each loan submitted, whether they internally keep it on file or provide a copy to SBA.

Direct Loans: For direct loans more than $150,000, the applicant must complete SBA Form 1711 "Certification for Contracts, Grants, Loans and Cooperative Agreements".

Participating lenders and direct loans applicants (for loans more than $150,000 only) who have undertaken any lobbying activities outlined above must execute Standard Form LLL, "Disclosure of Lobbying Activities."
The lobbying language is included in SBA Form 1244C, part of the 504 loan application.

5. LOAN DECISION

.120.192 Approval or denial.
Applicants receive notice of approval or denial by the Lender, CDC, Intermediary, or SBA, as appropriate. Notice of denial will include the reasons. If a loan is approved, an Authorization will be issued.

a. Approvals/Declines

(1) Procedure for SBA Loan Officers to Recommend Approval of Loans

(i) Sign and date the loan report.

(ii) For regular applications, prepare a draft of the proposed loan authorization to accompany the loan report. CLP packages should contain a draft Authorization from the lender. (Encourage lenders, especially CLP lenders, to submit proposed authorizations in their packages.) Review the lender's draft for accuracy and completeness and for any changes which you deem appropriate.

(iii) Discuss any changes to the proposed terms and conditions with the lender and the applicant. Make clear that the discussion does not represent a loan commitment nor an indication that the loan will be approved. Determine whether third parties agree to any conditions to be imposed which will require their agreement.

(iv) Route the file to the appropriate reviewer(s).

(2) Role and Responsibilities of Reviewers

(i) The official taking final action certifies, by signature, that the loan meets SBA lending criteria and all credit factors are adequately covered in your loan report.

(ii) The reviewer(s) must support any variation from your recommendations and provide the rationale in the review comments.

(iii) Reviewers must sign and date the report in the space set aside for this purpose.

(iv) Officials taking final action must review the authorization for accuracy and completeness.

(v) All final actions are subject to the availability of funds. A loan is not approved until it is funded. Individual recommendations are not to be disclosed to lenders or applicants. The decision to approve or decline is an Agency decision.

(3) The Procedure When Decline of a Loan Is Recommended

(i) To comply with the Equal Credit Opportunity Act, if SBA withdraws or screens out a loan, you must return the application with a letter explaining in terms the applicant can understand why the loan cannot be approved. If the loan is declined, do not return the application or supporting documents.

(ii) You must use a formal decline letter on all declines, signed by the individual having authority to approve or decline the loan. Authority to sign screen out and withdrawal letters may be delegated. These do not constitute a decline. You must use one or more of the standard coded reasons for decline, without substantial changes in the wording, in the decline letter.

(iii) In addition, you must explain the standard reasons in terms that the applicant can understand so that it will know what needs to be overcome for any reconsideration. Otherwise, under provisions of the Freedom of Information Act, the applicant may be entitled to a copy of the entire loan report.

(iv) You should not make reference in the decline letter to any document which the Agency does not choose to disclose. An incorporated reference could be considered public information, forcing SBA to disclose the entire document to which the reference is made. Reconsideration rights need to be stated.

(v) If, because of "splits" or other reasons, the final decision must be made by another office, the office which first processes the application will usually use only the coded reasons for decline to advise the second office. Explanations are not to be provided to avoid influencing the review and analysis of the other office.

Q. Who writes the decline letter?

A. The processing office will write the decline letter in conformity with the above instructions.

(4) Coded Reasons for Decline

The SBA has established 16 specific reasons for declining a loan application. Reason 15 (Policy) can include any reason for which policy not specified in any of the other reasons was the reason for the declination. When an application is declined, applicants shall be provided a written explanation, identifying all of the stated reasons which apply. These reasons are to be further explained as they apply to the individual application. This letter shall also advise the applicant of their right to reconsideration and must be signed by the official taking the decline action.

Code Number	Reasons for Decline
01.	Collateral, considered along with other factors, is not deemed sufficient to protect the interest of the Government. Note: See Coded Reason 16 also.
02.	Lack of reasonable assurance of ability to repay loan (and other obligations) from earnings. Note: Use for existing businesses.
03.	Lack of reasonable assurance that the business can be operated at a rate of profit sufficient to repay the loan (and other obligations) from earnings. Note: Only use for new businesses.
04.	Disproportion of (loan requested and of) debts to (tangible) net worth before and after the loan.
05.	Inadequate working capital after loan.
06.	The result of granting the financial assistance requested would be to

replenish funds distributed to the owner, partners, or shareholders.

07. Lack of satisfactory evidence that the funds required are not obtainable without undue hardship through utilization of personal credit or resources of the (owner) (partners) (shareholders).

08. The (major portion of the) loan requested would be to refinance existing indebtedness presently financed (on terms not considered unreasonable) (through normal lending channels).
Note: Only use on direct and immediate participation loans.

09. Credit commensurate with applicant's tangible net worth is already being provided on terms considered reasonable.

10. Gross disproportion between owner's actual investment and the loan requested.

11. Lack of reasonable assurance that applicant will comply with the terms of the loan agreement.

12. Unsatisfactory experience on existing loan.

13. Economic or physical injury not substantiated.

14. Not eligible - because of size.

15. Not eligible - because of policy reasons.

16. For loan purposes, after taking into consideration prior liens and considered along with other credit factors, the net value of the collateral offered as security is not sufficient to protect the interests of the Government.

b. Who Has The Authority to Approve or Decline Loans?

Only those individuals with the requisite experience, training, and other qualifications as determined by the AA/FA or designee may approve or decline loans. Depending on the personnel structure of an office, this may include non-supervisory individuals, such as team leaders. Certification of loan approval authority can be issued only by the AA/FA or designee.

(1) The Rule of Two

A loan may be approved or declined, on the basis of two concurring opinions of personnel who are appropriately trained, subject to statutory and administrative authority.

(2) Changes by the Reviewing Official

If the reviewing official changes the maturity, loan amount, or terms and conditions, the case must be treated as a split, unless both are in agreement with the change.

(3) Decisions on Splits

Forward the application through the normal chain of command, including acting personnel when necessary, until two concurring opinions are obtained.

c. Training Required for Authority to Take Official Action

(1) Authority to Take Official Action

Authority to recommend actions is a matter of policy. Only individuals with the appropriate knowledge, skills, and abilities necessary to carry out the duties and responsibilities of a qualified loan processor will be given the authority to recommend. Completion of the appropriate training required by SBA is necessary to recommend action on loans.

This section details the training requirements SBA personnel must satisfactorily complete before being able to officially make recommendations or take final action on requests for financial assistance for the Agency's 7(a) and 504 business loan programs.

Officials taking final action must have completed the appropriate training for the authority to recommend and approve loans at the branch or district office level unless the AA/FA or designee waives training requirements.

The regulations provide the general authority to recommend or approve loans. The AA/FA or designee delegates specific authority to individual officials to act on finance matters by issuance of a "Certificate of Delegation". Authority to

recommend or approve loans depends upon the position occupied **AND** the training levels of Commercial Credit Analysis (CCA) successfully completed.

The following table lists the authority which normally attends each level of training:

Training Level Completed:	Authorized Authority For Type Of Action:
Level One - Basic (Basic analysis applied to less complex cases)	Recommend and approve amounts up to $250,000 under the regular business, DAL II, Veterans and 7(a)11 loan programs
Level Two - Intermediate (Basic analysis applied to complex cases)	Recommend and approve loan amounts up to the dollar maximums permitted, under the regular business, DAL II, Veterans and 7(a) 11 loan programs.
Level Three - Senior (Analysis of special program loans & COCs)	Recommend and approve loan amounts up to the dollar maximums permitted, under all SBA loan programs.

(2) Authority to Take Official Action When CCA Training Has Not Been Completed.

Branch managers, deputy district directors, and other senior supervisory personnel who **HAVE NOT** completed the required training may not take formal action on loans unless they agree with the senior ED supervisor in the field office who took official action.
If they do not agree with the senior ED supervisor taking official action in the field office, they should pass them to the next level of authority with their comments. Senior ED supervisors include deputy district directors, and branch managers who **HAVE** successfully completed the required training courses.

d. Authority of District Directors to Take Final Action

District directors, including acting Dds, have authority to approve loans as follows:

(1) District directors who HAVE NOT successfully completed any of the three undergraduate levels of training may take final action to resolve splits only if they agree with the recommendation of a trained ED supervisor who, acting within the normal chain of command, has taken official action on the case. If they do not agree, they must refer the case to the AA/FA or designee with their comments and recommendation.

(2) They may not take official action as the first time reviewer with no intervening supervisory review.

(3) District directors who HAVE successfully completed Level One (Basic) training may take final action to resolve splits within the normal chain of command, choosing among any of the differing recommendations.

(4) District directors who HAVE successfully completed all levels of undergraduate training (Levels One, Two and Three) may take official action, where warranted, as the first-time reviewer with no other intervening supervisory review.

e. May I Process a Loan Which Exceeds My Authority?

You may participate in processing a loan that exceeds your authority. However, a person who is appropriately qualified must recommend the official action.

f. Who is Authorized to Screen Out or Decline Loans?

The same level of authority to approve loans has the authority to screen out or formally decline loans.

g. Can Recommending and/or Approval Authority Be Waived?

Unexpected personnel changes or shortages may necessitate a temporary extension of authority outside of the rules in this paragraph. In such cases, the supervisor in the affected field office will forward a written request, in memo or letter form, with appropriate justification for a waiver to the Office of Financial Assistance, Office of Loan Programs. Requests must be fully justified in all cases.

h. What Information Is Needed When a Waiver is Requested?

The request should address the following:

(1) The level of training you are requesting be waived.

(2) The employee's capabilities in performing the processing function to the level requested. This should include references to the processing already being performed on applications of the type for which the waiver will permit which are now being reviewed an concurred with by other qualified staff.

(3) Overall time the employee has been in processing, including the time and experience gained by pre-processing loans to the level for which the waiver is sought.

(4) A synopsis of actual performance while in an understudy position, processing cases which are similar to the type of cases that will be processed once a waiver is provided.

(5) The justification for the requested waiver, including the number of equivalent processing staff with the same level of authority as is being sought.

i. Who Conducts CCA Training?

The OFA and Office of Training Services (OTS) presently conduct CCA courses.

This training is held across the country to continue the Agency's efforts to enhance the financial knowledge of the processing and approving staff and to promote consistent and knowledgeable processing.

Upon satisfactory completion, you will be considered to have met the training requirements detailed in this paragraph. This permits you to be a recommending or approving official under the Agency's "Rule of Two" provision, when combined with appropriate classification and job description.

j. May All Employees Take This Training?

Considering the budgetary restrictions placed on training, training cannot be provide to under-qualified employees who are not prepared and inhibit the abilities of the qualified employees in attendance. First priority is given to supervisors and individuals assigned to the processing function. Others ED personnel have the next priority at the discretion of the

Director, OLP.

Nominations of personnel in other divisions to attend receive consideration at the discretion of the Director, OLP. The needs of each field office are weighed against those of the other offices to which a training session is offered.

k. Can The Courses Be Completed Quickly?

The general schedule of the CCA courses is one per year. Loan officers and management personnel should incorporate the lessons of each course into your loan analysis and decision making for a period of approximately one year before taking the next course. This gives you the opportunity to assimilate the concepts and to become comfortable with their application before taking the next course.

The practice of individuals taking these three courses on a "crash" basis is not desirable and should be avoided except in very unusual circumstances. Send requests and justifications for accelerated training to the Chief, Loan Policy Branch, for final decisions.

l. What is the Training for New Employees?

The CCA course series is not designed to initiate an employee's loan processing education. New personnel in the Finance Division or personnel in other divisions, particularly those with limited experience or training in accounting or credit analysis, should review SOP 50-10 and 50-11 and receive direction from the supervisor or an experienced senior loan officer for approximately 6 to 12 months prior to attending Level I. Development and appropriate supervision of individuals in the financing function is the responsibility of the supervisory personnel of each field office, especially for persons new to the financing function or in other functions.

During this time less complex loan applications should be analyzed with a senior loan officer, having the appropriate level of training and authority as cited above, making official recommendations.

m. Additional Qualifications Are Needed to Process Loans

Those persons designated to take final action on loan requests must assure that all personnel involved in the processing of business loan applications are adequately trained, experienced, and qualified.

n. Additional Qualifications Needed to Recommend/Decide Actions

Each course represents a milestone in an employee's progressive development towards full

proficiency. While satisfactory completion of the training courses is part of the requirement for obtaining the authority to recommend and approve actions, it is not the only requirement. In addition to appropriate SBA training, personnel making recommendations on requests for financial assistance must be designated to perform these functions by personnel action. This designation must be for an employee under a general schedule series being classified as an economic development specialist with no less than 25 percent of their duties officially designated to loan underwriting or a loan specialist involved in the finance function.

o. Authority Needed to Take Final Action on Loans

The authority to take final actions on requests for financial assistance is a regulatory matter, as described in the regulations. The delegations of authority detailed in these regulations are presently under review, but remain as described in the 1996 revision of 13 CFR.

p. Responsibility of Officials Taking Final Action on Credit Decisions

Any inadequacy in the loan analysis or incorrect conditions in the loan authorization of an approved loan is the responsibility of the official taking final action, as well as the recommending official. Therefore, supervisors should not place personnel into a position with recommendation authority unless they have a full understanding of the consequences of this action.

6. RECONSIDERATION AFTER DENIAL

.120.193 Reconsideration after denial.
An applicant or borrower may request reconsideration of a declined loan or loan modification request within 6 months of denial. Applicants declined due to an adverse size determination can appeal that determination under part 121 of this chapter. All others must be submitted to the office that denied the original request. To prevail, the applicant must demonstrate that it has overcome all legitimate reasons for denial. Six months after denial, a new application is required. If the reconsideration is declined, a second and final reconsideration may be considered by the Associate Administrator for Financial Assistance (AA/FA), whose decision is final.

The letter which advises the applicant of the decline of the original application must advise the applicant of the right to a reconsideration and the procedure for requesting one.

a. Information Needed with Request for Reconsideration

The applicant must supply the following for reconsideration of their request:

(1) The request must be in writing and, for guaranty loan applications, through the lender with the lender's concurrence in writing to let SBA know of its continued willingness to make the loan.

(2) All necessary information up to date, including a current financial statement which is less than 90 days old.

(3) A justification for why the decline should be reconsidered.

Use the "Loan Officer's Report on Reconsideration" (SBA Form 134A) for reconsideration or SBA Form 4-I if the decline was an informal "screenout" of a guaranty loan.

b. Who May Take Final Action on Reconsiderations?

Officials authorized to take final action to decline a loan application take final action on a reconsideration to approve the loan request. If the decline is to be affirmed, officials at the next higher level of authority must take final action.

c. Notify Declinee of Second Reconsideration Rights

The letter which advises the applicant of the decline of the first reconsideration must advise the applicant of the right to a second reconsideration and the procedure for requesting one.

d. What Are The Procedures for Second Reconsiderations?

The applicant must request a second reconsideration, through the participant, in writing to the office which declined the loan and the first reconsideration. The declining office will advise the D/OLP of the second reconsideration request and forward the case file to another field office selected by the D/OLP for analysis on a priority basis. Upon completion, the second field office will forward the case file with its analysis and recommendation to the D/OLP for final disposition.

e. Who Notifies Applicant When Second Reconsiderations Are Declined?

The original field office prepares and issues the letter of decline using the coded reasons cited by the D/OLP.

f. Who Prepares The Authorization if Second Reconsideration Approved?

If the field office doing the analysis recommends approval, it will submit a draft authorization to the D/OLP. The D/OLP, after making any appropriate revisions to the draft, will forward it to the original field office which will issue the final authorization.

7. MODIFICATION OF AUTHORIZATIONS

a. Which Division Modifies the Authorization When Needed?

Responsibility for a loan's administration rests with the Processing or Finance Division (FD) until the loan is fully disbursed. After final disbursement responsibility shifts to the Servicing Division. Therefore, until final disbursement, the Finance Division of Economic Development (ED) processes any modifications to the terms and conditions of the authorization. Portfolio Management Division (PMD) acts on modifications only on fully disbursed loans. You can use either an SBA Form 327 "Modification or Administrative Action," or the 327 stamp method providing the incoming letter is not ambiguous on the action requested or resulting action taken. Notify the lender in writing of any modification action taken by SBA.

Q. Since a revolving loan is not counted as fully disbursed until right before maturity, does its servicing stays with the Processing Division to maturity?

A. It depends on the time until maturity. If maturity is 12 months or less, the loan can remain assigned to Processing or be sent to the appropriate service center. Administration of loans with a maturity over 12 months shall be serviced where all other loans approved by the office are sent.

b. What is the Procedure When the 327 Stamp Method is Used?

If the 327 stamp is used, obtain a written request from the lender that states clearly and specifically the action it is requesting. Stamp the front of the lender's letter for recommendation, approval, comments, signatures, and dates. Send a copy of this letter with the approval stamp on it to the lender as notification of the action taken and file the original in SBA's file.

c. Can a Lender's Percentages of Participation on a Loan be Changed?

On undisbursed loans, SBA may consider an increase or decrease to the percentage of guaranty upon receipt of written justification from the lender (including PLP lenders). Such changes must comply with Agency policy and program constraints.

On disbursed loans, only decreases to the applicable percentage of guaranty may be approved. After initial disbursement, the processing office is locked out from making alterations. Such requests should be made to CFO Denver. Requests should include a copy of the executed 327 action. These changes must comply with SBA policy and program constraints.

Q. Does the percentage of guaranty change when a loan is increased from $100,000 or less to an amount that is more than $100,000?

A. Most likely. Reference Subpart A, Chapter 6, paragraph 10, Q&A #6.

d. Can Disbursement Periods Be Extended?

You can extend the disbursement period as many times as necessary, if the loan is not fully disbursed. The borrower must provide, through the lender, satisfactory justification and evidence that he needs an extension. You must ensure that no adverse change has occurred, by reviewing current, updated financial statements. Use the concurrence stamp SBA Form 327 to extend the disbursement period. Extension of the initial disbursement period does not automatically extend the final disbursement date, which must be extended separately.

e. May the Due Date of the Guaranty Fee be Extended?

No, the lender must pay the guaranty fee within 90 days of approval, regardless of whether the loan has been disbursed or not. The lender is prohibited from obtaining reimbursement

from the applicant/borrower until the initial disbursement has been made. For certain loans, the guaranty fee must accompany the application. The lender may pass this fee through to the borrower after the loan is disbursed.

NOTE: The amount initially disbursed must be substantially more than that needed to cover the guaranty fee.

f. May The Guaranty Fee Be Rebated to The Lender?

The SBA can rebate the guaranty fee when a lender requests in writing cancellation of the loan and return of the fee while the loan remains fully undisbursed. The guaranty fee may only go to the lender since the fee can not be charged to borrowers until after the first disbursement.

The SBA will not rebate the guaranty fee on loans for lines of credit (approvals using SBA Form 750B) which are approved on the terms submitted by the lender. If approval terms are substantially modified by SBA, a rebate is permitted upon a written request received within 30 days of approval to cancel the guaranty and return the fee.

8. LOAN CLOSING FOR LOAN OFFICERS

a. Who Has Responsibility for Loan Closings?

The SBA counsel monitors the closing and disbursement of all loans through the final disbursement.

Participating lenders close 7(a) guaranty loans. The SBA counsel gives guidance to lenders on loan closing problems.

The CDCs close 504 loans. The SBA counsel and CDC counsel work together to close 504 loans as discussed more fully below in subpart H.

b. What Is The ED Loan Officer's Role in Loan Closings?

You should have a general knowledge of SBA loan closing requirements and be able to answer procedural questions from banks, CDCs, and other lenders about loan closings. You must refer substantive or legal questions to SBA counsel.

From time to time you will be called on to modify the authorization, review financial statements for no adverse change determinations and to otherwise assist counsel in the closing process. The ED loan officers handle actions on loans through the final disbursement. After final disbursement, responsibility shifts to servicing loan officers.

c. What Are The General Requirements for Closing a Loan?

The required documentation to close a 504 loan is covered in subpart H.

The basic documentation required to close a 7(a) loan is:

(1) The note (SBA form 147)

(2) The personal guaranty (SBA form 148)

(3) The security agreement and UCC financing statements if personal property is being taken as collateral.

(4) The real estate mortgage or deed of trust or other lien instrument if real estate is being taken as collateral.

(5) A resolution of the board of directors if the borrower is a corporation, or a certificate as to partners if the borrower is a partnership.

(6) The SBA form 159, Compensation Agreement, this document discloses fees paid to borrowers' agents for services in connection with the application for and the closing of the SBA loan. Agents must itemize fees exceeding $1,000.00, showing the number of hours worked and the hourly rate charged.

Record searches of the Universal Commercial Code (UCC) filings and real estate filings are necessary to establish that SBA.s security interest has the proper lien position.

Prudent lending practice generally requires legal opinions and, when appropriate, title insurance when real estate is taken as collateral for the loan. Depending on the specific loan situation or legal practice in your area, prudent lending practice may require hazardous waste opinions, UCC filing opinions and other opinions. If in doubt, consult with or refer the question to counsel.

d. Closing Requirements for 7(a) Guaranty Loans

Lenders must use reasonable care in closing SBA guaranteed loans, and must ensure that the loan funds are disbursed to the correct person and for the authorized purpose. They must act as reasonably prudent lenders and close SBA guaranteed loans with the same degree of care they use in closing their own independent loans.

After the closing, if it occurs within 90 days of the date of approval, the lender sends the guaranty fee directly to the SBA Denver fiscal office and notifies SBA counsel of the date and the amount of the first disbursement. The lender submits to SBA copies of the SBA 159 forms and supporting itemization if the fees reported are more than $1,000.00. After the loan's final disbursement, the lender notifies SBA counsel of the date of the final disbursement.

Note: The lender must remit the guaranty fee to SBA within 90 days, whether disbursements have taken place or not. No authority exists to modify this rule or to extend the due date.

The SBA discourages the use of "escrow" or "controlled" accounts to disburse SBA loans. The use of these accounts can lead to a borrower paying substantial interest on funds to which it doesn't have access. Use of an escrow of limited duration (not more than 5 business days) to facilitate closing is acceptable. A lender must submit to SBA and SBA must approve in writing a lender.s request to use escrow or controlled accounts of any longer duration.

e. What Are The Closing Procedures for a 504 Loan?

This is addressed in subpart H.

f. Use of Escrow Accounts for 504 Loans

If a relatively minor portion of the project remains to be completed and delay of the debenture sale is not warranted, use of an escrow account is permitted. The escrow must have controls to assure proper use of the loan proceeds and must provide that funds not disbursed after one year will be applied to pay down the first mortgage loan. Subpart H addresses this in more detail.

9. CANCELLATION AND REINSTATEMENT OF COMMITMENT

a. What Is The Procedure for Canceling Loans?

Upon receipt of a written request from the participant, SBA may cancel an approved loan in accordance with the delegation of authority and the rule of two. If the field office initiates cancellation, it should notify the applicant by certified mail, return receipt requested, at least two weeks prior to the proposed cancellation or expiration of the disbursement period. Cancellation is warranted if:

(1) The applicant or lender has indicated that it does not intend to utilize the proceeds;

(2) Extensions are not justified or desirable; or

(3) There has been an adverse change.

SBA can approve the cancellation of the guaranty on an undisbursed loan based on a request from the applicant if the request is accompanied by a request to cancel from the participant or more than 6 months has lapsed since approval.

b. Can Canceled Loans Be Reinstated?

The approving official or designee that canceled the loan, may reinstate the same loan if there has been no adverse change. The reinstatement must be within six months of the date of cancellation. Updated financial statements may be needed to make this determination.

10. INCREASES OR ADDITIONAL LOANS

a. What Are The Guidelines For Loan Increases?

Only 7(a) loans, under certain conditions. Increases to existing loans require the use of authorized funds. The Agency earns an additional guaranty fee when an increase is approved. The additional guaranty fee for any increase is based on the rules for determining the fee which were in effect at the time the loan was originally funded, even though the actual funds used to accomplish the increase will be from the time of funding. When changes are made to the method of computing the guaranty fee, and because the fee to be received is based on prior rules, the Agency may be receiving a fee other than what was intended for the particular appropriation from which the increase was funded.

Increases to 7(a) loans (regardless of the disbursement status) are subject to statutory, administrative, and program maximums. Increases can only be made up to a maximum of 18 months after approval or 1 year after initial disbursement, which ever comes first. Applicants must submit written requests to their lenders for transmission to SBA.

Q1. Who processes requests for increases after approval?

A1. The SBA office where the loan is physically located when the lender requests the increase. Branch and district offices generally hold a case file until a loan is fully disbursed before they send it to the Commercial Loan Servicing Center (CLSC). The LowDoc and PLP Processing Centers send their case files to the CLSC within 7 days of approval. The lenders should send their requests for increases to the office that has responsibility for the loan at the time the lender makes the request.

Q2. Are there any dollar limits on increases?

A2. Increases to term loans are limited to 20 percent over the original loan amount regardless of disbursement status. Increases to revolving loans are limited to a one time increase which shall not exceed 33.3 percent.

Q3. Is a new application necessary to process a loan increase?

A3. A new application is not necessary for accomplishing an increase, but an SBA Form 327 is required. You may use the rubber-stamped 327 method if adequate justification is provided.

Q4. What additional requirements must be met to process these requests?

A4. You must base your decision on current financial statements in all cases. Increases to outstanding loans and additional loans are subject to the same credit standards as the original loan.

Q5. Do increases affect the guaranty fee or percent of the guarantee?

A5. There will almost always be an increase in the guaranty fee when a loan is increased, because there will almost always be an increase in the size of the SBA share. However, in cases where the maximum SBA share has already been provided, there will be no additional fee for increasing only the gross amount.

Consider the case where a loan was of the type that can have a maximum SBA share of $750,000 and the gross loan amount is $1,000,000. This loan would have a 75 percent guaranty. What would happen if this loan was increased to $1,500,000? The fee would not increase because the SBA share would remain the same even though the percentage of guaranty on the loan would be reduced to 50 percent.

Another case where there could be an increase to the loan but no additional fee would be when the gross loan amount is at or near a threshold for establishing an effective percentage of guaranty and after the increase the loan has a different guaranty percentage.

Consider the case where a loan for $100,000 with an 80 percent guaranty is increased to $105,000. In this case, the guaranty percentage would have to be decreased to 75 percent and the resulting SBA share would actually be less, so the guaranty fee would be less. The lender would only be entitled to a rebate of the difference between the fees if there had been no disbursement and the maturity of the loan was for more than 12 months.

Q6. If a $100,000 loan, with an 80 percent guaranty is increased, is the percentage of guarantee changed.

A6. Yes. An increase in the dollar amount of a loan originally approved for $100,000 with an 80 percent guaranty must result in the lowering of the guaranty percentage to 75 percent.

Q7. If the $100,000 loan with an 80 percent guaranty referenced above was sold into the secondary market before the increase was requested, could the increase be made without altering the guaranty percentage?

A7. No. If the guaranty percentage can not be lowered from 80 percent to 75 percent when a $100,000 loan is increased, the increase can not be approved regardless of disbursement status. Under these circumstances a new loan will be required.

Q8. Is there a time limitation on increases?

A8. Yes. Any increase to a 7(a) non-revolving loan must be made within 12 months from initial disbursement. Increases on 504 loans can only be made prior to the time the debenture is sold (initial disbursement).

Q9. When is the additional guaranty fee associated with an increase due?

A9. The additional guaranty fee must be submitted by the lender with the request to increase the loan. The request will not be processed without the additional fee.

NOTE: The dollar amount of a 504 loan can not be altered after funding.

b. What Are The Guidelines for Processing Additional Loans?

When you process applications for second loans to SBA borrowers, establish repayment ability independently for each loan. Do not make second loans for the primary purpose of protecting existing SBA exposure.

Consult the Portfolio Management Division or the appropriate Service Center if the applicant is a present or former SBA borrower and include the written comments and recommendation of the PM Chief or designee in the loan case file.

11. USE OF COMPUTER GENERATED FORMS

.120.194 Use of computer forms.
Any applicant or lender may use computer generated SBA application forms, closing forms, and other forms designated by SBA if the forms are exact reproductions of SBA forms.

The SBA does not approve or endorse specific software. The applicant or the lender, whichever is dealing directly with SBA is responsible for ensuring that computer generated forms are exact reproductions of SBA forms. The SBA reserves the right to take any action authorized by its rules and policies or available to it under law against either party if it suffers a loss as the result of the use of computer generated forms which are not exact reproductions.

Q. What is the meaning of "exact reproductions"?

A. In general reproduction of SBA forms may contain different fonts, spacing and other variations from the specifications of our forms. It is the language of the forms which must be exactly the same.

12. DISCLOSURE OF FEES

.120.195 Disclosure of fees.
An Applicant for a business loan must identify to SBA the name of each Agent as defined in part 103 of this chapter that helped the applicant obtain the loan, describing the services performed, and disclosing the amount of each fee paid or to be paid by the applicant to the Agent in conjunction with the performance of those services.

SBA requires the disclosure of all fees which an Applicant pays to or is charged by the lender or any Agent for services in connection with applying for and closing the SBA loan. Since the applicant is the party being charged, it is responsible for reporting these fees.

a. How Does An Applicant Disclose Their Fees?

An applicant must use SBA Form 159, "Compensation Agreement", to document the fees it has been or will be charged by any agent. The agent charging the fee must also sign the SBA Form 159. A separate SBA Form 159 must be executed for each agent

b. What Rules Apply to Agents And Disclosure of Fees?

13 CFR 103 governs the activities of agents and the disclosure of fees.

13. REGULATIONS REGARDING AGENTS

.103.1 Key Definitions.
(a) Agent means an authorized representative, including an attorney, accountant, consultant, packager, lender service provider, or any other person representing an applicant, or participant by conducting business with SBA.

a. Definitions Of An Agent

The regulation defining an Agent is found in 13 CFR .120.103.1

b. Does This Include Loan Referral Agents?

Yes, personnel or businesses that provide loan referral services are classified as agents, as they fall into the category of other person representing an applicant, or participant regardless of whether the applicant or the lender compensates them for their loan referral service. Loan referral agents are subject to the requirement to complete an SBA Form 159 when compensated by the applicant.

When the referral agent is compensated by the lender, the use of the 159 is not required. However, this form (when next revised) will provide notification to applicants that there may be an existing relation between referral agents and lenders.

c. Must Agents Reveal What Fees Are Paid by Whom?

Each packager and referral agent must disclose the name of its customer and all fees charged in connection with the SBA loan transaction.

d. Are Development Companies Agents?

For purposes of this rule, neither the development company nor its employees is an agent for a 504 loan application in which the CDC is involved. An Associate Development Company (ADC) providing services to a CDC is considered a lender service provider or LSP.

For 7(a) loans, if the employee performs packaging or loan referral services within the scope of their CDC employment, both the CDC and the employee are agents. If the employee packages or acts as a loan referral agent outside the scope of their CDC employment, they are the agent, but the CDC is not.

(b) The term conduct business with SBA means:
(1) preparing or submitting on behalf of an applicant an application for financial assistance of any kind, the referral of an application to a Lender, or any assistance from the Investment Division of SBA, or assistance in procurement and technical matters;

e. Does This Include the Referral of an Application?

Yes.

(2) preparing or processing, on behalf of a lender or a participant in any of SBA's programs, an application for federal financial assistance;
(3) participating with or communicating in any way with officers or employees of SBA on an applicant's, participant's, or lender's behalf;

f. Agents and Privacy Act Considerations

Q. Can private information about a loan be discussed with anyone who claims to be an agent for an applicant, participant, or lender?

A. No, SBA requires evidence of representation from an agent of any of the above before discussing with the agent anything regarding an applicant. Proprietary information is protected by the Right to Financial Privacy Act and the Privacy Act. Without proper authorization, SBA may not discuss private information with even a spouse or other close relative.

(4) acting as a lender service provider; and
(5) such other activity as SBA reasonably shall determine.
(c) Applicant means any person, firm, concern, corporation, partnership, cooperative or other business enterprise applying for any type of assistance from SBA.
(d) Lender Service Provider means an Agent who carries out lender functions in originating, disbursing, servicing, or liquidating a specific SBA business loan or loan portfolio for compensation from the lender. SBA determines whether or not one is a "Lender Service Provider" on a loan-by-loan basis.

g. Employment of Agent Initiated by Applicant

(1) An agent may bill and be paid by the applicant for providing their packaging services;

(2) An agent who works for an applicant as a packager may also work as a referral agent for the applicant and receive a referral fee from the applicant;

(3) An agent may be a referral agent for a lender and receive a fee from the lender to which the loan application is submitted, providing both the applicant and the lender are aware of both relationships, and the agent does not receive a referral fee from both the applicant and the lender;

(4) An agent who works for an applicant only as their referral agent can also work for a lender as the LSP on the same loan. Therefore, an agent can receive a referral fee from an applicant and a LSP fee from the lender, **providing** the agent discloses this relationship to both the applicant and the lender; and

(4) An agent who works for an applicant as a packager may not serve as the LSP on the same loan, but this agent may serve as a LSP on all other loans of the lender.

h. Employment of Agent Required by Lender

(1) An agent may serve as packager and LSP on the same loan, providing their

employment was initiated after the loan has been approved by the lender and the terms and conditions for the loan already established;

(2) An agent must bill and be paid by the lender for all services and the lender may not pass there charges through to the applicant.

i. Employment of Agent Initiated by Lender

When an agents employment is initiated by the lender at the request of the applicant or the applicant provides their voluntary acceptance of the lender's offer of service:

(1) An agent may serve as a packager and LSP on the same loan, providing their employment was initiated after the loan was approved by the lender and the terms & conditions for the loan already established; and

(2) An agent may charge either the lender or the applicant the cost of providing their packaging services, but not both;

(3) If an agent is engaged prior to the requested financial assistance approval and establishment of the terms & conditions by the lender, the agent may not serve as the lender's LSP on this case.

(e) Packager means an agent who is employed and compensated by an applicant or lender to prepare the applicant's application for financial assistance from SBA. SBA determines whether or not one is a "Packager" on a loan-by-loan basis.
(f) Referral Agent means a person or entity who identifies and refers an applicant to a lender or a lender to an applicant. The referral agent may be employed and compensated by either an applicant or a lender.
(g) Participant means a person or entity that is participating in any of the financial, investment, or business development programs authorized by the Small Business Act or Small Business Investment Act of 1958.

j. Who Does This Include?

A participant can be an applicant, a lender, a certified development company, Microloan intermediary, or an agent.

k. What is SBA's Definition of a Lender?

Lender means a participating lender in an SBA loan program. For 7(a) loans a Lender may be a bank or a non-bank lender or a small business lending company (SBLC). For 504 debentures the lender is a Certified Development Company. For Microloans the lender is

an intermediary licensed by the Agency.

l. What is a Non-bank Lender?

A non-bank lender is a lender regulated by a State or Federal regulatory body, not in banking, which is eligible to be a participant with SBA, such as savings & loans, credit unions, and production credit associations.

m. What Is a Small Business Lending Company (SBLC)?

It is an entity organized to make loans in participation with SBA which is licensed and regulated by SBA. Licenses for new SBLCs are not currently being issued. Accordingly, any organization wanting to establish an SBLC can only do so if acceptable to SBA and able to negotiate purchase of an existing license. The SBA's approval must be obtained for any transfer of an SBLC license to be effective. SBA's field offices should advise applicants as to any SBLCs operating in their area.

n. "Identify" An Applicant or Lender for Referral?

The term "identifies" means that the person or entity was responsible for creating the opportunity for the lender to do business with the applicant or vice versa, i.e., generated the lead through marketing or other business development activity. This does not include merely responding to a request to provide the name of a lender (or applicant) who might be interested in doing business with the entity being referred.

14. WHO MAY CONDUCT BUSINESS WITH THE SBA

.103.2 WHO MAY CONDUCT BUSINESS WITH THE SBA?
(a) If you are an applicant, a participant, a partner of an applicant or participant partnership, or serve as an officer of an applicant, participant corporation, or limited liability company, you may conduct business with the SBA without a representative.

a. May a Lender Require the Use of a Packager?

Yes, but the lender must pay the packager's fee and not pass it through to the applicant.

b. Must an Applicant Use an Agent?

Emphasize to lenders and agents that they must clearly inform the applicant that SBA does not require the use of an agent for packaging or referring a loan application. A lender may require the use of an agent in packaging a loan if the lender pays any related charges and does not pass them through to the applicant/borrower. Otherwise, the election to use or not use an agent is the applicant's/borrower's option.

(b) If you are an agent, you may conduct business with SBA on behalf of an applicant, participant or lender, unless representation is otherwise prohibited by law or by the regulations in this or any other part of Title 13. For example, persons debarred under the SBA or Government-wide debarment regulations may not conduct business with SBA. SBA may request that any agent supply written evidence of his or her authority to act on behalf of an applicant, participant, or lender as a condition of revealing any information about the applicant's, participant's, or lender's current or prior dealings with the SBA.

15. SUSPENSION OR REVOCATION OF AN AGENT'S PRIVILEGE

.103.3 MAY SBA SUSPEND OR REVOKE AN AGENT'S PRIVILEGE?
The Administrator of SBA or designee may, for good cause, suspend or revoke the privilege of an agent to conduct business with SBA. Part 134 of this chapter states the procedure for appealing the decision to suspend or revoke the privilege. The suspension or revocation remains in effect during the pendency of any administrative proceedings under Part 134 of this chapter.

a. What Is The Procedure for Suspension Or Revocation?

The field office makes an initial determination of whether good cause exists for suspension or revocation of an agent's privilege. It provides detailed justification and recommends the action it deems appropriate by a memorandum, through the Assistant District Director for Economic Development (ADD/ED) and District Director to the Director, Office of Loan Programs (D/OLP).

Generally, suspensions are for agents who repeatedly commit minor infractions after being cautioned or serious infractions but are deemed worthy of a second chance. Revocations are for agents who commit more serious infractions, repeat offenses, or illegal activities.

b. How Long Does a Suspension Last?

The D/OLP may suspend an agent from 6 months up to 5 years. In extreme cases, action may be initiated to debar an agent permanently in accordance with the procedures in 13 CFR.

16. SUSPENSION OR REVOCATION FOR "GOOD CAUSE"

.103.4 WHAT IS "GOOD CAUSE" FOR SUSPENSION OR REVOCATION?
Any unlawful or unethical activity is good cause for suspension or revocation of the privilege to conduct business. This includes:
(a) attempting to influence any employee of SBA or a lender, by gifts, bribes or other unlawful or unethical activity, with respect to any matter involving SBA assistance.

a. What is an Example of Other Unethical Activity?

Unethical activity between an agent and an SBA employee includes an undisclosed relationship between the agent and the SBA employee; or other unethical activity described in 13 CFR 105 - Standards of Conduct for SBA Employees.

(b) Soliciting for the provision of services to an applicant by another entity when there is an undisclosed business relationship between the two parties.

b. What is the Agent's Responsibility?

The agent must always inform any participant (applicant and lender) involved of any past, current, or known future relationship between the agent and any lender involved in the application or the agent and the applicant.

(c) Violating ethical guidelines which govern the profession or business of the agent or which are published at any time by SBA.
(d) Implying or stating that the work to be performed for an Applicant will include use of political or other special influence with SBA. Examples include indicating that the entity is affiliated with or paid, endorsed or employed by SBA, advertising using the words "Small Business Administration" or "SBA" in a manner that implies SBA's endorsement or sponsorship, use of SBA's seal or symbol, and giving a "guaranty" to an applicant that the application will be approved.
(e) Charging or proposing to charge any fee that does not bear a necessary and reasonable relationship to the services actually rendered or expenses actually incurred in connection with a matter before SBA or which is materially inconsistent with the provisions of an applicable compensation agreement or lender service provider agreement. A fee based solely on a percentage of a loan or guarantee amount can be reasonable, depending on the circumstances of a case and the services actually rendered.

c. What Types of Fees Are Reasonable?

Flat, hourly or percentage of loan fees are reasonable if they meet the criteria stated above.

(f) Engaging in any conduct indicating a lack of business integrity or business honesty, including a debarment, criminal conviction, or civil judgment within the last seven years for fraud, embezzlement, theft, forgery, bribery, falsification or destruction of records, false statements, conspiracy, receiving stolen property, false claims, or obstruction of justice.

d. Are Other Unethical Practices Covered by This Rule?

Yes, services which are not customary for the work being performed or charging for services not performed are just two examples. Unethical practices are too numerous to cover here. Consult counsel if you question any agent practice.

(g) Acting as both a lender service provider or a referral agent and a packager for an applicant on the same SBA business loan and receiving compensation for such activity from both the applicant and lender. A limited exception to this "two master" prohibition exists when an agent acts as a packager and is compensated by the applicant for packaging services; also acts as a referral agent and is compensated by the lender for those activities; discloses the referral activities to the Applicant; and discloses the packaging activities to the Lender.

e. Capacities an Agent May Work for an Applicant or Lender

An agent who works for the applicant as a packager may also work as a referral agent for the applicant. An agent who works for the applicant as a packager may also be a referral agent for the lender on the same loan if both the applicant and the lender are aware of both relationships. An agent who works for and is paid by an applicant as a packager on a loan may not work for the lender as an LSP on that loan, except as noted in paragraph 4-20g(4). An agent who works for an applicant as a referral agent on a loan may work for the lender as an LSP on that loan.

A packager compensated by the lender and not the applicant to engage in the packaging of the loan may also act as an LSP or Referral Agent on that loan for compensation from the lender. The lender may charge a packaging fee to the borrower that reimburses the lender for the cost of hiring an outside packager if the borrower requested this service or voluntarily accepted the lender's offer of the service.

(h) Violating materially the terms of any compensation agreement or lender service provider agreement provided for in section 103.5.
(i) Violating or assisting in the violation of any SBA regulations, policies, or procedures of which the applicant has been made aware.

f. How Thoroughly Must Allegations Be Investigated?

You must gather as much information as possible on the agent's activities, services, and fees for the applications or loans on which they worked from all available sources. Note that agents, by executing the "Code of Ethics", have agreed to provide you with any assistance in your investigation. Illegal activity must be reported to the SBA's Office of the Inspector General. The Agency does not want to subject agents to unnecessary investigations.

Substantiation of any allegations which would violate this rule is essential to protect the rights of agents as well as the interests of the SBA.

g. For What Activities Does SBA Investigate Agents?

Investigate agents for the following two purposes:

(1) Unreasonable fees charged to an applicant by an agent. Fees charged by an agent to a lender are usually not investigated by SBA as both parties are experienced and informed. The SBA is concerned that applicants, not being knowledgeable and experienced, may occasionally be taken advantage of when they hire packagers or referral agents.

Therefore fees paid to agents by the applicant will be more closely monitored. You must investigate the agent's services and fee structure to determine if the fees are necessary and reasonable when the SBA Form 159 shows what appears to be excessive fees, there is an indication from other participants that an agent's fees might be excessive or when an applicant complains about the fees charged by an agent. Reasonable fees are those which bear a reasonable relationship for appropriate services charged and that the total fees for the service charged are comparable to those charged by other agents in that geographical area.

Appropriate services are those which are customary and timely for the work being completed (packaging or loan referral), and do not include unusual or excessive extra expenses.

Reasonable relationship means that the fees bear a relationship (flat fee, hourly fee, or percentage of loan) that is normal for that service in the geographic area (city, State, or region) for either SBA programs or for private sector lending.

You must decide if the fees are reasonable or not and make the recommendation (along with any recommendation that an agent refund a proportion of their fees) through the ADD/ED to the Director, OLP. You should reiterate to the agents the importance of not overcharging applicants for services. Continued charging of excessive or unreasonable fees by an agent is good cause for the SBA to suspend or revoke an agent's privileges.

(2) Suspension or revocation of an Agent under 13 CFR 103.3. The Administrator of SBA or designee may, for 'good cause' suspend or revoke the privilege of any Agent to conduct business with SBA. Title 13 CFR Part 134 states the procedures for appealing the decision to suspend or revoke the privilege. The suspension or revocation remains in effect during the pendency of any administrative proceedings under Part 134.

17. SBA REGULATION OF AGENTS FEES AND SERVICES

.103.5 HOW DOES SBA REGULATE AN AGENT'S FEES AND PROVISION OF SERVICE?
(a) Any applicant, agent, or packager must execute and provide to SBA a compensation agreement, and any lender service provider must execute and provide to SBA a lender service provider agreement. Each agreement governs the compensation charged for services rendered or to be rendered to the Applicant or Lender in any matter involving SBA assistance. SBA provides the form of compensation agreement and a suggested form of lender service provider agreement to be used by agents. Along with the lender service provider agreement, the lender should provide a LSP registration Form for each individual who works for the Lender as an Agent.

a. Compensation Agreements for the Applicant and Agent or Packager

SBA Form 159, Compensation Agreement. You must make sure that each application submitted to SBA has a completed and executed SBA 159.

b. What Purpose Does This Form Serve?

It discloses the fees paid to the agent and by whom, is a source document for the registration of agents, and is the agreement by the agent (packager or referral agent) that, in cases where SBA deems the compensation unreasonable, SBA determines the reasonableness of the fees charged in relation to the work performed. Information on this form will be used to monitor the Agents, fees charged by Agents, and the relationship between agents and lenders. You must make sure that all of the appropriate data fields on SBA Form 159 are entered correctly into the computer.

SBA Form 159 is the form agents must use for compensation agreements. The Form 159 executed by an agent--such as an attorney, accountant or financial consultant--who provides substantial services to an applicant of independent value need only reflect the portion of the compensation paid, and/or to be paid, by the applicant for services directly intended to assist in preparation of the SBA application package.

In the case of a fee not readily divisible among activities directly related to the SBA loan package and other activities, the agent may disclose on the Form 159 only the portion of the fee which is attributable to activities directly relating to preparation of the SBA application, based on a reasonable good faith estimate by the agent. However, the agent must maintain records of the services provided with respect to such fees and make them available to SBA upon request for the Agency's review.

c. What Causes SBA to Review An Agent's Fees?

The SBA will generally only review an agent's fees when an applicant files a complaint with the Agency. However, an applicant should be aware of the reasonableness of the terms of any contract executed with an agent at the time the document is signed.

d. What Happens If SBA Determines The Fees Are Excessive?

The agent must reduce the charge to an amount SBA deems reasonable, refund any sum in excess of that amount to the applicant, and refrain from charging or collecting from the applicant, directly or indirectly, any funds, goods, or services with a value in excess of the amount SBA deems reasonable.

e. Lender Complaints About Fees Charged By Agents

Lenders are presumed to be competent to negotiate the fees they pay to agents and in the best position to determine whether a fee is appropriate for the work or service performed. The SBA will not review fees paid by lenders and will not intervene between a lender and an agent.

f. What is an LSP Agreement?

Lender Service Provider Agreements are two party agreements between a lender and an agent which performs specified duties on behalf of the lender.

g. Is the LSP Agreement an SBA Form?

No, but each agreement must include the following elements:

(1) Lender and LSP agree not to engage in any sharing of secondary market premiums;

(2) An accurate description of the services to be provided;

(3) The LSP may not assume a portion of the risk of the unguaranteed portion of any loan;

(4) Provision that the fees of the LSP will not be directly charged to applicants or borrowers except that the LSP when the LSP packages a loan after the lender has approved the loan and set the terms and conditions;

(5) Disclosure of the fee structure for the services rendered;

(6) The agreement is binding on the affiliates and predecessors of the LSP and the lender;

(7) Disclosure of any prior or existing relationship other than the contractual one created by the agreement; and

(8) The Agreement shall be subject to all applicable laws and regulations, including SBA rules.

Subject to the split premium prohibition, lenders have reasonable discretion in setting compensation for LSPs. Submission of financial statements of LSPs shall not be required across the board but may be required on a case-by-case basis.

h. How Will LSP Agents Be Registered?

Each professional/technical employee of the LSP must complete an LSP registration form and submit it to the SBA along with the LSP agreement within 10 days of employment with the LSP. This Registration Form is to enable the SBA to monitor the activity of individuals working for agents. Make sure that the lender and the LSP know that all agents hired under the LSP agreement submit an LSP registration form. Also make sure the data on these forms is accurately entered into the client server data base.

i. Where Are LSP Agreements Submitted?

They are submitted to the field office which serves the lender for which the LSP is an agent. The elements which must be included in LSP agreements are cited in this section. The SBA Form 159 identifies the existence of an LSP to alert you to check the database.

j. How Does the SBA Monitor and Regulate an Agent's Activities?

You review information on agents in the database for each application in which an agent is involved. In addition, monitor the following sources of information on agents and decide which agents need to be more fully investigated.

(1) Investigate any complaint by an applicant, borrower, or any other participant in an SBA program, concerning the activity, services completed, or fees charged by any agent. It is better if complaints are submitted in writing.

(2) Information on the database or year-end reports completed by Headquarters on the activities, fees, and relationships of the agents should highlight agents who: are working without completing training, have patterns of excessive fees, or have

unusual relationships (such as an LSP that also does extensive packaging compensated by applicants). Agents whose activity seems inappropriate or unusual should be investigated.

(3) Review all SBA Form 159s for completeness and correctness and follow up with agents who repeatedly submit improper forms. Be alert for indications from any source of any agent who commits any unethical or illegal act and investigate such allegations.

SUBPART B - POLICIES SPECIFIC TO 7(a) LOANS

PURPOSE OF THIS SUBPART:

This subpart covers the regulations, policies, and procedures that are applicable to loans processed and approved under the 7(a) program.

CHAPTER 1 - PROVISIONS FOR 7(a) LOANS

1. WHAT ARE SBA's BONDING REQUIREMENTS?

. 120.200 What bonding requirements exist during construction?

On 7(a) loans which finance construction, the Borrower must supply a 100 percent payment and performance bond and builder's risk insurance, unless waived by SBA.

A payment and performance bond protects the entity paying for construction if the contractor fails to complete the required construction in accordance with plans, specifications, and applicable building codes. In such instances the surety is responsible for completing the contract. The SBA and participating lender benefit by having the bond in place because they are assured that the structure will be completed and therefore obtain its approximate collateral value.

a. Performance Bond

Proceeds from 7(a) loans may be authorized for construction and/or renovation of real property. In such cases, a 100 percent payment and performance bond, and builder's risk insurance is required. These requirements are not necessary when SBA supported proceeds are used for the permanent take-out financing or refinancing of an actual construction loan made on a non-guaranteed basis. Proceeds from 504 loans are not used for construction and/or renovation, but rather are used for permanent financing and can be used to take out the interim construction debt.

b. Bond Waiver (Blanket)

SBA has granted a blanket waiver on requirement "a." above when the proceeds for construction and/or renovation are for $125,000 or less. This waiver relieves smaller borrowers of the higher costs imposed by the bonding requirements while increasing access to credit for smaller projects from those participating lenders that view bonding requirements as burdensome.

c. Bond Waiver Consideration Factors

SBA can consider waiving its requirements for a performance bond when SBA proceeds are authorized to construct and/or renovate real property that is more than $125,000, if proper documentation and tight control of the disbursement of the proceeds can avoid undue construction related risks.

(1) Construction mortgages, lien waivers, and related legal documentation are required to provide adequate priority of claim to precede suppliers, contractors, subcontractors and workmen.

(2) Borrower's equity contribution is to be used to fund the early stages of construction, and be documented as to their purpose to make sure they actually were used towards the overall construction. Strict adherence to a feasible draw schedule and establishing reasonable retainage along with the above cited documentation and oversight by the appropriate permit authority often mitigate some of the risk addressed by bonding.

d. Bond Requirements for Take-Out Financing

When SBA proceeds are authorized to refinance interim construction debt (take-out financing) which is not guaranteed by SBA, the Agency does not require a payment and performance bond or builder's risk insurance since the risk which the bond and insurance covers is eliminated before the SBA proceeds are disbursed.

2. SPECIAL LIMITATIONS ON 7(a) PROCEEDS?

In addition to the limitations on loan proceeds referenced in .120.131 there are two additional limitations that apply only to the 7(a) program. These are detailed in . 120.201 and . 120.202.

. 120.201 Refinancing unsecured or undersecured loans
A Borrower may not use 7(a) loan proceeds to pay any creditor in a position to sustain a loss causing a shift to SBA of all or part of a potential loss from an existing debt.

a. Refinancing When SBA is in a Position to Sustain a Loss

To determine if proceeds can be used to refinance existing debt, you must first determine if the lender is in a position to sustain a loss.

(1) If a loan is fully collateralized, using reasonable liquidation values of the collateral assets, the lender would not normally be considered to be in a position to sustain a loss. The opposite is not true. Just because a loan is not fully collateralized does

not necessarily mean that the lender is in a position to sustain a loss. It only means the lender cannot expect full repayment through the liquidation of the available collateral.

(2) If the present operation can be analyzed to reasonably demonstrate repayment ability, the lender is not in a position to sustain a loss (regardless of the extent of any collateral coverage shortfall). See subpart A on repayment ability.

If repayment cannot be reasonably demonstrated and collateral coverage is determined not to be adequate, the creditor can be judged to be in a position to sustain a loss. However, just because you find that the lender is likely to sustain a loss does not, in and of itself, preclude SBA financing.

b. SBA Cannot Take Over A Lender's Loss

If SBA can determine that as a result of refinancing, the new terms and conditions will provide reasonable assurance of repayment or additional assets can be acquired so the loan becomes fully collateralized, then SBA can conclude that it would not be in a position to sustain part or all of the same loss by refinancing the debt and the refinancing would be eligible.

While the situation described may result in an eligible refinancing since a loss would not likely result, repayment must be evident through the cash flow of the business.

3. RESTRICTIONS ON CHANGE OF OWNERSHIP SITUATION

. 120.202 Restrictions on loans for changes in ownership.
A Borrower may not use 7(a) loan proceeds to purchase a portion of a business or a portion of another owner's interest. One or more current owners may use loan proceeds to purchase the entire interest of another current owner, or a Borrower can purchase ownership of an entire business.

By policy, the term "Borrower" in this regulation will always be a business entity, not an individual. By policy, if existing owners are trying to acquire the ownership interest of other existing owners, the loan shall be made to the business for purposes of acquiring the ownership interest of the other owner(s).

a. Change in Ownership

7(a) loans are eligible to accomplish a total change of ownership between two parties conducting an arm's length transaction providing there is a reasonable need for the change of ownership. Examples of reasonable needs are:

(1) The change of ownership will promote the sound development of a small business; and

(2) The change of ownership will preserve the existence of a small business.

Justification for any change of ownership must be documented in the loan officer's report, and concurred with by the approving official.

b. Change Of Ownership Considerations

(1) Arm's-Length Transaction

Loan proceeds may only be used to effect a change of ownership that is an arm's-length transaction. A transaction is at arm's length if it is a reasonable representation of the fair market value, the price which an independent buyer would be willing to pay.

The seller should receive no other benefit than the funds obtained from the sale, including interest in the event there is seller financing and the purchaser should receive no other benefit than the right to own and operate the business and receive a profit commensurate with this operation.

(2) Analysis of Value

To determine whether the change of ownership qualifies as arm's-length, a determination of the value of what is being acquired must be performed. When the change of ownership involves the acquisition of a going concern, the determination must be based on a generally accepted valuation method used for the industry in which the business operates. Five acceptable valuation methods include: the gross revenue multiplier; adjusted book value; discounted future earnings; capitalized adjusted earnings; and cash flow valuation, are taught in Commercial Credit Analysis - Level II. Other generally accepted valuation methods may also be employed. The analysis can be performed by the loan officer or an independent person qualified, in the opinion of SBA, to perform business valuations.

If the lender's loan officer is selected on a guaranty loan request, the lender must perform the analysis and a synopsis of the determination must be provided SBA as part of the application - including PLP or Fa$trak applications. A formal valuation performed by an independent and qualified person, is always required when the change of ownership occurs between close family members.

(3) Reasons for The Sale

The loan analysis should clearly explain the reasons for the sale. Is it to permit the current owner to retire or leave because of poor health? Is it really to avoid something adverse such as a new competitor about to open or highway construction that will severely restrict access to the business?

Careful analysis of the financial statements needs to be conducted. Note any trends and consider local conditions. Is the area growing or decaying? Is the buyer presently an employee of the firm who already knows the market or is the buyer an inexperienced newcomer?

c. Documentation for a Change in Ownership Case

In order to process a change of ownership application, the proposed instruments of conveyance (generally the buy/sell agreement) must be present and they must be analyzed. The pro forma balance sheet shall be prepared to reflect what the business will look like on the date ownership transfer occurs. The selling price must be compared to the value of the business after the value has been determined from an independent third party. Said valuation must be obtained prior to approval or disbursement. The fact that the purchasing and selling parties have agreed to a selling price is not adequate justification that the business is worth that much. The price must be substantiated by recognized methods of value determination.

Financial statements of the business or division being purchased are required whenever the demonstration of repayment is based in part or in full upon the historical performance of this business, regardless of how the actual change of ownership will be accomplished. Consult with field counsel whenever there are complex questions associated with any application involving a change of ownership situation.

(1) Acquire A Going Concern

When a change of ownership involves the acquisition of a going concern, the

applicant's repayment ability will be based, at least in part, on the historical performance of the former company, regardless of whether the actual change is accomplished via a stock purchase or asset purchase.

When repayment is based on the historical performance of the whole company, business operation, or the collection of assets acquired with loan proceeds, the historical financial statements from the seller, for no less than the last 3 complete fiscal years plus interim statements, which are no older than 90 days from receipt of application, will be required.

(2) Acquire Assets

When a change of ownership involves the acquisition of another business' assets without affecting a change in the operation status of the selling business and the repayment ability of the loan will be based in full on the performance (historical and/or projected) of the buyer, rather than in any part on the historical performance of the seller, the need to obtain or verify the seller's historical financial statements is not necessary.

The value of the assets needs to be substantiated. Therefore, a valuation conducted by an independent third party must be obtained prior to approval or prior to disbursement.

Note: When the purpose of the loan is to acquire the assets of another business and repayment will not be based on how well these assets performed for the seller, the historical financial statements of the business that is selling the assets do not have to be part of the application submission and do not have to be IRS verified.

d. Additional Consideration for Changes Between Family

SBA can finance a change of ownership when there is a close relationship between the buyer and seller, such as close family members, but these situations require extra caution.

You must be sure that the transaction is arm's-length. The value of the business must be clearly substantiated. The purchase price must be based on an independent third party valuation and you must closely evaluate current and historical financial statements and tax returns to insure they are accurate.
Change of ownership loans between close family members require the determination of the value of what is to be acquired (assets or going concern) to be independently valued. An independent third party appraisal or valuation is needed. For this type of loan the appraisal must be completed prior to processing. A change of ownership between close family members can not be approved on a "subject to" appraised value or independent valuation. This requirement can not be waived.

e. Partial Change in Ownership

The allowable structures for permitting a change of ownership of an existing business depends upon the relationship of the buyer and seller to the business whose ownership is scheduled to change when the sales contract is consummated. Under no circumstances can proceeds be used to finance a borrower's purchase of only a portion of the ownership interests of the present owners.

If the buyer is presently an owner (any percentage) of the company whose ownership interest is being sold, loan proceeds can only be used to purchase 100 percent of the ownership interest of that owner, partner, or shareholder, providing this change of ownership will result in the sound development or preservation of the business and the loan is made to the company. This can be accomplished through redemption of stock by a corporation or through the purchase of a partner's interest by the partnership. There can be no purchase directly by a partner, shareholder, or an unrelated third party in this situation.

If the buyer is not an owner of the company being sold, the loan proceeds must be used to purchase 100 percent of the ownership interest of all owner(s), partner(s), or shareholder(s), and the change of ownership must result in the sound development or preservation of the business. In this case, there can be no purchase directly by an existing partner or shareholder.

(1) When a change of ownership occurs between existing owners, the proceeds must be lent to the business in order for the entity to either redeem (acquire) the stock of the selling shareholder for a corporation, or acquire the selling partner's interest for the partnership. No proceeds can be provided to any one or group of stockholders or partners to acquire any other stockholder or partner interest directly.

(2) When a change of ownership occurs between unaffiliated parties, the loan is made to the business entity of the acquiring party and the proceeds must be used to purchase the entire ownership interest of all the partners or shareholder(s) of the company being acquired.

In either case, the purchase must result in the sound development or preservation of the business.

The following chart outlines scenarios of eligible and non-eligible partial changes of ownership. These examples all involve proposed exchanges in ownership interest in order to try to accomplish a change in the ownership of the applicant concern.

Proposed Action	Buyer Affiliated with Seller	Buyer Not Affiliated with

		Seller
Individual wants to buy all of an existing SBC,	Loan must be to a SBC. All other owners must sell 100 percent of their interest. Proceeds to redeem full ownership interest of each selling owner.	Loan to buyer or entity established by buyer. Proceeds used to buy 100 percent of each existing owner's interest.
Individual wants to increase their ownership in an existing SBC.	Loan must be to an SBC. At least one owner must be selling full interest. Proceeds to redeem full ownership interest of each selling owner. All remaining owners will have a new ownership interest that is in the same proportion to each other as existed before the loan.	N/A
Individual wants to buy out one of any number of owners and increase just his interest to a greater share in relation to the other owners.	Not Permitted - SBA does not finance "Creeping Control."	N/A
Company with more than one owner wants to allow the non-owner manager a chance to buy a retiring owners interest and let the other owners remain status quo.	Not Permitted - Under SBA rules, when a non-owner will become an owner, all (100 percent) existing owners have to sell their interest.	Not Permitted
Individual wants to buy out one of any multiple number of owners in a company he does not own.	Not Permitted - Under SBA rules, when a non-owner will become an owner, all (100 percent) existing owners have to sell their interest.	Not Permitted - Because an unaffiliated buyer can only acquire all of an SBC, not any portion.
Sole proprietor wants to form a new partnership and take on a partner who has worked for his company.	N/A	Not Permitted - An owner can not give up a portion of his/her owner-ship to a non-owner.
Existing owner wants to use SBA proceeds to acquire one half of another owners interest.	Not Permitted - SBA does not finance "Creeping Control."	N/A

Q1. Other than as noted above, is there any structure where a non-owner can become an owner and some or all of the current owners remain?

A1. No, not if the business's existing legal structure remains.

f. 100 Percent Purchase of Corporate Stock

A change of ownership may be financed through the purchase of 100 percent of the capital stock. This policy applies whether:

(1) The acquiring party is a current owner(s) of the business buying out 100 percent of the interests of one or more of the shareholders, or

(2) The acquiring party owns no stock of the business being acquired and is purchasing 100 percent of the capital stock of the corporation from the existing owner(s), as long as the result of the loan is that the acquiring entity owns 100 percent of the business. The acquiring party may be an individual or any other legal entity.

If a change of ownership is to be accomplished through the purchase of corporate stock, the existing company must buy all of the stock of the departing shareholders or a third party must purchase 100 percent of the stock from all the existing shareholders. In either case, both the purchaser(s) of the stock and the new corporation must sign the note with joint and several liability for the parties. The requirement for personal guarantees and utilization of personal resources will only apply to the principals of the acquiring entity, not the principals of the selling entity.

A corporation may also change its ownership by repurchasing (a/k/a/redeeming) 100 percent of the shares of stock of one or more of its shareholders. If counsel determines it is required under state law, the authorization will contain a provision requiring an opinion of lender's or borrower's counsel that the stock repurchase will not violate applicable state law (such as by rendering the corporation insolvent).

In each case, the note must be executed on a joint and several basis by both the individual who acquires the stock and the corporate entity being acquired. Both should represent to SBA that the proceeds of the loan will be used in connection with the operation of the business itself. The requirement for personal guarantees applies only to principals of the acquiring entity, not to principals of the corporate entity being acquired, even though the corporate entity being acquired will be a co-borrower.

g. Legal Considerations

To protect against the possibility that the corporation may deny its joint and several liability with the acquiring party based on an alleged failure of consideration, the purpose of the acquisition must be to enable the acquiring party to operate the business in corporate form.

If SBA field counsel determines that there is risk that a corporation will deny liability for its joint and several liability with the acquiring party based on an alleged failure of consideration, add an Authorization provision acceptable to field counsel:

(1) Requiring a satisfactory opinion from the borrower's or lender's counsel that the corporation has no basis for denying liability for the debt for failure of consideration; or

(2) Requiring a waiver of the corporation of any right to deny liability for the debt for failure of consideration.

4. MAXIMUM DOLLAR AMOUNTS FOR GUARANTY LOAN

a. Total Dollar Limits On Guaranty Loans

There is no limit on the total dollar amount of an 7(a) loan, except one approved under the Defense Loan and Technical Assistance Program (DELTA) which has a limit of $1,250,000 gross amount.

b. SBA Dollar Limits On Guaranty Loans

The maximum dollar amount of SBA's guaranty (a/k/a SBA share, guaranty portion, or guaranty exposure) to any one business (including affiliates) either approved, committed, or in combination shall not be more than $750,000, except when the loan is under a program which specifically permits higher amounts. (See subpart C)

5. MAXIMUM PERCENTAGES OF GUARANTY FOR 7(a) LOANS

. 120.210 What percentage of a loan may SBA guarantee?
SBA's guarantee percentage must not exceed the applicable percentage established in section 7(a) of the Act. The maximum allowable guarantee percentage on a loan will be determined by the loan amount. As of October 12, 1995, the percentages are: Loans of $100,000 or less may receive a maximum guarantee of 80 percent. All other loans may receive a maximum guarantee of 75 percent, not to exceed $750,000, unless otherwise authorized by SBA.

a. Relationship Between Guaranty Percentage And Dollar Limits

The SBA guarantees a percentage of every loan it approves under the 7(a) program. This percentage equals SBA's pro rata share of the risk SBA assumes on each guaranty loan. The dollar amount of SBA's share of any approved loan equals the outstanding balance times the percentage of guaranty. The percentage remains the same through out the term of the loan, while the outstanding balance and corresponding dollar amount of the percentage guaranteed declines. The maximum dollar amount the SBA guaranty can support to any one business (including affiliates) can not be more than $750,000, unless specifically exempted by statutory provision.

b. Maximum Guaranty Percentage for Loans Over $100,000

The maximum SBA guaranty percentage for all 7(a) loans over $100,000 is 75 percent, except for EWCP loans (see Subpart C, Chapter 6).

c. Maximum Guaranty Percentage for Loans of $100,000 or Less

The maximum guaranty percentage for 7(a) loans of $100,000 or less is 80 percent, unless the percentage is being computed on a subsequent SBA loan to the same borrower (or its affiliates) and the subsequent loan is filed within 90 days of the receipt or approval date of the other loan. In this case the gross dollar amounts of the loans are combined. If the combined gross amount exceed $100,000, the percentage of guaranty on the combined loans shall not be more than 75 percent (subject to the $750,000 limit).

Q1. If a business receives an 80 percent guaranty on a loan of $100,000 or less, and a second application (for an amount which, when combined with the amount of the first loan, is more than $100,000) for this same business (or its affiliate) is received within 90 days of the first loan's approval, does the percentage of guaranty on the first loan have to be reduced from 80 percent to 75 percent to comply with this requirement?

A1. The answer depends upon the disbursement and secondary market status of the first loan. If this loan is undisbursed, its percentage of guaranty can be lowered to 75 percent and the second loan would get a 75 percent guaranty If the first loan is initially or fully disbursed and not sold on the secondary market, its guaranty percentage can be lowered to 75 percent and the second loan can receive a 75 percent guaranty. However if the first loan is sold into the secondary market, the adjustment in the percentage of guaranty will have to be born solely by the subsequent loan.

In the latter case, the effective percentage of guaranty for the subsequent loan would equal the percentage necessary so the combined percentage of guaranty represents a dollar amount that is no more than if the combined loans were guaranteed at 75 percent. This is only applicable when the subsequent loan is received within 90 days from approval of the first loan.

Q2. What is the applicable percentage of guaranty on a loan for a business that received an 80 percent guaranty on a loan of $100,000 or less more than 90 days before the second application is received?

A2. The same as for any other 7(a) loan. When an application is received more than 90 days from the approval date of a prior loan, the determination of the percentage of guaranty is completely independent.

d. Special Considerations for Multiple Loans

When processing two or more 7(a) loans under different loan programs with different amounts of guaranty authority, you must be careful to fund the loans in the order that will provide the maximum percentage of guaranty to all loans.

Q. How should two loans be funded if they are processed under different 7(a) programs with differing limits on the guaranteed portion?

A. To provide the maximum guaranty portion to both loans, the loan approved under the program with the lower guaranty portion must be funded first, because the authority for the 7(a) loan from the program with a higher allowable guaranty portion is limited to that one program and cannot be carried over to subsequent approvals under program with lower authority.

Example A business obtains favorable credit consideration for an $800,000 Pollution Control Loan and a $500,000 Standard Asset Based CAPLines. Since all CAPLines have a maximum SBA share of $750,000 while the Pollution Control Loan has a maximum SBA share of $1,000,000, and a CAPLines is not accepted as part of the Pollution Control Loan, the order of funding is important. The only way SBA can provide the lender a 75 percent guaranty on both loans is to fund the $500,000 Standard Asset Based CAPLines loan (SAB) first (using $375,000 of SBA authority) and fund the Pollution Control loan second (using $600,000 of SBA authority). The combined guaranty portion for the two loans is $975,000. Since the maximum exposure on the Pollution Loan is $1,000,000, the available exposure for the Pollution Loan has not been exceeded.

However if the Pollution loan was funded first (using $600,000 of SBA authority) there would only be $150,000 in guaranty authority available for the Standard Asset Based CAPLines loan since CAPLines loans have a limit of $750,000. In this case the lender could only be provided a 30 percent guaranty for the $500,000 Standard Asset Based CAPLines.

There is one exception to the procedure that the order of funding multiple loans from different loan programs when one program has a higher dollar authority is necessary to provide the maximum benefit. When the multiple loans are for exporting and both International Trade and Export Working Capital Program loans are being funded, the combined total exposure can be $1,250,000, regardless of the order of funding, because the legislation allows for a EWCP component to IT funding.

e. A Zero Percent Guaranty Can Not be Provided For Ineligible Purposes

The percentage of guaranty which SBA provides its participants is the same for every part or purpose of that loan. A 7(a) loan cannot include proceeds for an ineligible purpose, or have any portion of the loan made to an ineligible business.

This rule cannot be altered by assigning a zero percent guaranty to just a portion of the loan. No authority exists to assign a zero percent guaranty to only a portion of a 7(a) loan or to separate a 7(a) loan into autonomous portions and then assign separate guaranty percentages to these independent parts.

For Example - A lender proposed to make a loan for $300,000 where $100,000 was going to reimburse funds to an associate and $200,000 will be for new equipment for the applicant concern. Upon learning that SBA can not make a loan to reimburse an associate, the lender proposed to make this same loan with a 50 percent guaranty, using the logic that the $200,000 of eligible proceeds could be guaranteed at 75 percent (a $150,000 SBA share) while the $100,000 of ineligible proceeds would be guaranteed at zero percent.

A loan such as the one referenced above can not be made or guaranteed by SBA.

6. MAXIMUM DOLLAR AMOUNT FOR 7(a) DIRECT LOANS

. 120.211 What limits are there on the amounts of direct loans?
(a) The statutory limit for direct loans made under the authority of section 7(a)(1)-(19) of the Small Business Act is $350,000. SBA has established an administrative limit of $150,000 for direct loans. The AA/FA may authorize acceptance of an application up to the statutory limit.
(b) The statutory limit for direct loans made under the authority of section 7(a)(20) is $750,000. SBA has established an administrative limit of $150,000. The Associate Administrator for Minority Enterprise Development may authorize the acceptance of an application that exceeds the administrative limit.
(c) The statutory limit on SBA's portion of an immediate participation loan is $350,000. The administrative limit is the lesser of 75 percent of the loan or $150,000. The AA/FA may authorize exceptions to the administrative limit up to $350,000.

a. Total Dollar Limit on Direct Loans

As established in 13 CFR 120.211, there are both statutory and administrative limits on SBA direct loans. These amounts are applicable when direct funds are available. When there are no fiscal year appropriations for direct loans, loans can not be accepted or processed under the guidelines for these programs. If there, are appropriations, approval of direct loans shall be limited to the administrative limits specified above, unless waived by the AA/FA or designee.

b. Status of Direct Funding

Since the Government's fiscal year 1996, there has been no appropriations of funds to SBA for direct loan assistance. Without an appropriation for any 7(a) direct loan program, no application can be accepted for processing under the direct loan program procedures. As of the writing of this SOP, no new appropriations are anticipated. In the event appropriations for direct loan assistance are authorized, OFA will provide policy and procedural guidance.

7. MAXIMUM MATURITIES

a. Establishing the Repayment Period

When you establish a repayment schedule and maturity, you must consider: the borrower's ability to repay, the use of proceeds, and the useful life of the assets being financed.

1. Establishing The Maturity Date

The maturity date for a 7(a) loan is set in terms of the number of months from either the date of Note or the date of initial disbursement to the date when final payment is due. A loan is not actually made until it is disbursed so maturity can be calculated from the date of first disbursement.

2. Who Establishes the Repayment Period?

SBA will only guarantee a loan when the maturity is in compliance with the provisions of 13 CFR 120.212. SBA's fiscal and transfer agent has refused to accept loans into the secondary market where the maturity has exceeded the regulatory limits. If there is a difference of opinion on the length of the repayment period between the Lender and SBA, agreement must be reached before loan approval.

. 120.212 What limits are there on loan maturities?
The term of a loan shall be:
(a) The shortest appropriate term, depending upon the Borrower's ability to repay;

b. The Shortest Reasonable Term

The loan maturity must be set for the shortest term in which the borrower can reasonably be expected to repay the loan. The maximum allowable maturities set forth below will not be applied if the borrower can repay the loan over a shorter period of time.

Q. Can the maturity of a loan exceed the shortest reasonable term the borrower could repay in order to accommodate allowable refinancing?

A. No. While loans for refinancing must provide a substantial benefit as measured by no less than a 20 percent reduction in loan payments, a loan for refinancing cannot be approved if the maturity required to achieve the 20 percent reduction is greater than the payback period the borrower can reasonably be expected to repay the obligation without undue hardship.

(b) Ten years or less, unless it finances or refinances real estate or equipment with a useful life exceeding ten years; and

c. Maturity for Working Capital Loans

The maximum maturity for a non-revolving loan for working capital is 10 years. The terms for a working capital loan should be based on the shortest period in which the borrower can repay the loan, up to 10 years. If a working capital loan has a maturity in excess of 7 years, the loan analysis must justify the need and benefit to the small business for providing this extended term.

d. Maturity for Non-Real Estate Fixed Assets

The maximum maturity for a loan used to purchase machinery, equipment, fixture, or furniture is 25 years, but in most cases should not exceed 10 years. When maturity exceed 10 years for these purposes, you must document that the reasonable economic life of the item(s) acquired are greater than 10 years. When maturity exceeds 10 years, the final maturity must be limited to the useful life of the assets being financed.

e. Maturity for The Acquisition or Construction of Real Estate

The maximum maturity for loans used to purchase existing land and buildings, finance construction of a facility expansion, and/or make significant rehabilitation of an existing structure is 25 years plus the time estimated to be reasonably necessary to complete the construction or renovation. Significant rehabilitation is defined as improvements that cost at least one-third of the purchase price or of the current appraised value of the property. The 25-year maximum maturity is not applicable for loans processed as Builders CAPLines program (subpart C).

f. Maturity for A Loan With Mixed Purposes

When loan proceeds are used for multiple purposes (land & building, working capital, and machinery & equipment), the loan can be amortized on either a weighted average basis or by calculating the sum of equal monthly installments based on the allowable maturities of each purpose.

g. Limits on Maturity

The loan maturity must not exceed the period of maximum guaranty. This prohibits such structures as a working capital loan with a 15-year maturity and an SBA guaranty limited to 10 years.

(c) A maximum of 25 years, including extensions. (A portion of a loan used to acquire or improve real property may have a term of 25 years plus an additional period needed to complete the construction or improvements.)

h. Maturity When Refinancing Existing Assets

The maximum maturity for a loan used to refinance either real estate or acquire fixed assets shall not exceed the remaining prudent economic life of the item(s) acquired with the proceeds of the loan being refinanced, up to 25 years.
Regardless of the maturity for refinancing existing fixed assets or real property, the loan analysis must justify that the asset(s) being refinanced have an economic life not shorter than the maturity provided.

i. Balloon Payments

No loan that SBA makes or guarantees can be structured with a balloon payment.

8. GENERAL POLICY ON INTEREST RATES

a. General Rate Requirements for Guaranty Loans

The maximum interest rate which may be established for any 7(a) guaranty loan shall be governed by the Agency's regulations on interest rates, which shall also preempt any provisions of a state's constitution or law. The participant establishes the interest rate on guaranty loans, subject to SBA's maximum rates, notwithstanding any State law or constitutional provision to the contrary.

The basis for the SBA maximum interest rate for all guaranty loans, regardless of whether the loan is amortized on a fixed or variable rate basis, is an acceptable base rate plus allowable spread, plus an additional variance or spread for loans of $50,000 or less (when applicable), all of which are established exclusively by SBA. Except for variable interest rate loans, a lender must not increase the rate of interest on an SBA guaranty loan as long as the guaranty is in effect, or increase the interest rate on the lender's share of an immediate participation loan as long as SBA is participating in the loan.

b. Base Rate, Allowable Spread, and Allowable Variance

The base rate for all guaranteed loans depends on whether the loan is amortized on a fixed or variable rate basis. For loans amortized on a fixed rate basis, the base rate is the low prime rate, as published in a national financial newspaper each business day, in effect on the date SBA receives an acceptable application. For loans amortized on a variable rate basis, the base rate is either the same base rate used for fixed rate loans or the "optional peg" rate described in paragraph 10(c) of this chapter, which is the same as stated in 13 CFR 120.214(c)

The allowable spread is based on the maturity of the loan. For loans with original maturities less than seven years, the maximum allowable rate cannot exceed 2.25 percent over the prime rate. For loans with original maturities of seven years or more, the maximum allowable rate cannot exceed 2.75 percent over the prime rate. The additional spread variance in rate loans of $50,000 or less are described in paragraph 13.

c. Determining the Date SBA Receives an Application

The date an application is received in an acceptable form determines the base rate for the loan. The base rate is the foundation for the final rate on fixed rate loans and the initial rate for variable rate loans.

(1) Acceptable Form

The processing office must date stamp every application that it receives in an acceptable form on the date it arrives at the SBA office responsible for processing the application. Date stamping loan applications must be in conformance with the requirements detailed in Appendix 1. SBA is not required to date stamp a loan as officially received unless the application physically arrives at the receiving office no later than two hours before the normal closing time of that office, and the application includes sufficient documents to constitute a satisfactory application for the credit loan program and method of delivery loan program for which application is made. This does not mean the application has to be formally accepted, but rather that it needs to contain sufficient information to be accepted. For instance if the application is for a CAPLines Contract Loan the projected cash flow must be present or, if the loan is to be processed under CLP procedures the draft authorization must be included. If the obviously necessary documents are not provided, the processing office is not obligated to stamp the application as received on the date it arrives.

(2) Loan Authorization to Reference Application Receipt Date

The date an application is received (in acceptable form) determines the base rate, from which the initial interest rate is established. This date shall be referenced in the introductory sentence of each Loan Authorization (SBA Form 529B). A lender's date of submittal, as found on the SBA Form 4-I, shall not be reference in the loan authorization.

The receipt date for a PLP loan is the date the lender's request for a loan number is received by SBA in an acceptable form.

9. POLICY ON FIXED INTEREST RATES

. 120.213 What fixed interest rates may a Lender charge?
(a) Fixed Rates for Guaranteed Loans. A loan may have a reasonable fixed interest rate. SBA periodically publishes the maximum allowable rate in the Federal Register.

a. Fixed Rates for Guaranteed Loans

The maximum rate for a loan amortized on a fixed rate basis cannot exceed the suitable base rate (WSJ Prime based on the date that the application is received), plus allowable spread (reference paragraph 10d., this chapter), plus allowable variance for loans of $50,000 or less (if applicable). A fixed rate loan must not be structured with a balloon payment.

(b) Direct loans. A statutory formula based on the cost of money to the Federal government determines the interest rate on direct loans. SBA publishes the rate periodically in the Federal Register.

b. Fixed Rates for Direct and Immediate Participation Loans

The interest rate for direct loans and for SBA's share of immediate participation loans is based on the rate in effect for the calendar quarter the loan is funded. The rate is compiled by the Office of Loan Programs and published in the Federal Register on a quarterly basis. The maximum allowable rate for the lender's share of an immediate participation loan is one (1) percent below the maximum guaranty interest rate for loans with comparable maturities.

10. POLICY ON VARIABLE INTEREST RATES

. 120.214 What conditions apply for variable interest rates?
A Lender may use a variable rate of interest, upon SBA's approval. SBA's maximum allowable rates apply only to the initial rate on the date SBA received the loan application. SBA shall approve the use of a variable interest rate under the following conditions:
(a) Frequency. The first change may occur on the first calendar day of the month following initial disbursement, using the base rate (see paragraph (c) of this section) in effect on the first business day of the month. After that, changes may occur no more often than monthly.

a. Frequency of Interest Rate Adjustment

The lender must specify the frequency at which the interest rate adjustment will occur. Once done the lender has designated certain months as adjustment months. Commonly chosen intervals (or periods of adjustment) include monthly, quarterly, and annually. The first rate adjustment can be effective as soon as the first day of the first month following initial disbursement, providing this day coincides with the first day of a month designated as an adjustment month.

Subsequent adjustments may be at agreed upon intervals, i.e., monthly, quarterly, semi-annually, annually or other suitable period, as long as the frequency is no more often than monthly. All dates of adjustment become effective on the first day of the month, based on the rate in effect for the first business day of the adjustment period.

Q. An SBA guaranty loan was approved for the purpose of providing permanent financing for the acquisition of a building that began construction after the SBA loan was approved. Since our loan was approved, there have been changes to the prime rate. The lender asks if the initial rate can be changed before initial disbursement so the loan will amortize completely by maturity. Can this be done?

A. No, the regulation does not permit alteration of the initial rate of interest between the time an application is received and the first calendar day of the first month after initial disbursement. The correction to amortization can occur within 30 days of initial disbursement.

Once the frequency for interest rate fluctuations is set, you must establish the effective interest rate for that period. The rate of interest for any interval becomes effective on the first calendar day of the interval. However, the actual rate which can be charged for any given interval is not determined until the first business day of the interval and since the rate in effect for any given business day is not known until the following business day, the actual rate cannot be determined until the second business day of any given fluctuation period. The rate of interest will change on the first calendar day of the month or quarter even though the rate may not be known until the second business day of that period. Example, if the first of the month is a Sunday, the base rate is the prime rate in effect on Monday. This rate will be reported in the Wall Street Journal on Tuesday, the third calendar day and second business day of the month. For example:

First Day of Month	Sunday
First Business Day of Month	Monday
Publication Date for the Rate in Effect on First Business Day	Tuesday
Effective Date for Interest Rate Change	Sunday

(b) Range of fluctuation. The amount of fluctuation shall be equal to the movement in the base rate. The difference between the initial rate and the ceiling rate may be no greater than the difference between the initial rate and the floor rate.

b. Range of Variable Interest Rate Fluctuations

When requested by the participant, SBA will permit a lender to limit the upward and downward fluctuations by establishing a floor and ceiling provided that (1) both the ceiling and floor are stated in the note; and (2) the difference between the stated rate in the note and the floor is equal to or greater than the difference between the stated rate in the note and the ceiling. For example, if the rate is 10 percent and the ceiling is 12 percent, the floor must be 8 percent or lower.

(c) Base rate. The base rate shall be the prime rate in effect on the first business day of the month, printed in a national financial newspaper published each business day, or the SBA Optional Peg Rate which SBA publishes quarterly in the Federal Register.

c. Base Rate - Prime or "Optional Peg"

There are two acceptable base rates for SBA guaranty loans. The first is the low prime rate as published each business day in a national financial newspaper. The second is SBA's Optional Peg Rate, which is an intermediate-term rate calculated by SBA from the U. S. Treasury's cost of money. SBA publishes the Optional Peg Rate in the Federal Register at the beginning of each calendar quarter. The lender designates which base rate will be used on their application for guaranty.

(d) Maturities under 7 years. For loans with maturities under seven years, the maximum interest rate shall not exceed two and one-quarter (2 1/4) percentage points over the base rate.
(e) Maturities of 7 years or more. For loans with maturities of seven or more years, the maximum interest rate shall not exceed two and three-quarters (2 3/4) percentage points over the base rate.

d. Designation of Spread

The lender must designate on its application for guaranty the amount of the percentage spread to be added to the base rate at each adjustment date. The spread may vary during the life of the loan, but at no time may it exceed:

(1) 2 3/4 percent over the base rate for maturities of 7 years or longer, or

(2) 2 1/4 percent over the base rate for maturities of less than 7 years.

e. If the Base Rate is Expressed as a Range

When the published base rate is expressed in a range, e.g., 6 1/2 percent to 6 3/4 percent, the spread will be added to the lower rate.

(f) Amortization. Initial amortization of principal and interest may be recomputed and reassessed as interest rates fluctuate, as directed by SBA. With prior approval of SBA, the Lender may use certain other amortization methods, except that SBA does not allow balloon payments.

f. Frequency of Changes to the Installment Amount

There is no requirement that the installment amount must change at the same frequency as the interest rate changes. While SBA wants to avoid circumstances where the installment amount does not cover the required principal and interest to accomplish a pay out by the scheduled maturity, SBA does not want businesses with weaker repayment or those in a start up mode to be subject to uncertain installment amounts or substantial escalations during periods of rising interest rates.

For start-up businesses or borrowers with weak cash flow, the installment amount should not change more frequently than annually, unless the lender provides justification to show the borrower is able to deal with continually changing installments.

g. Various Methods of Amortization

With SBA's approval, a lender may use any of the following methods of amortization to ensure the loan pays out in a timely manner.

(1) Principal and Interest uses equal periodic installments based on the initial interest rate. When possible, loans should be repaid in equal payments of principal and interest, whether monthly, quarterly, semi-annually, or annually. Only when the needs of the small business dictate other repayment terms should you consider deviation.

(2) Principal Plus Interest uses a payment schedule that provides for installments of a fixed amount of principal plus the interest expense for the payment period. This method is not recommended for start-up businesses as it places a greater repayment burden on the business in the initial years when cash flow is likely to be the most limited. The loan officer report must justify the need when this method of amortization is selected. The lender should notify the borrower of the interest change within 30 days of each rate adjustment. However, the fluctuation of the interest rate is not contingent on whether notice is given.

(3) Set Installment Amount Higher than Needed for Amortization is used when there is a concern that the interest cost will escalate over the life of the loan. To assure

appropriate repayment in these circumstances, the lender may opt to amortize the loan with an installment amount that is based on an interest rate that is not more than two points higher than the initial note rate.

This method can be used as long as the installment amount remains constant throughout the life of the loan. The processors report must justify the necessity for establishing a higher installment amount than the stated interest rate would yield and the authorization must clearly inform the borrower that such an installment amount has been established in the note.

(4) Changing the Installment Amount Each Time the Rate Changes allows for the reamortization of the note each time the interest rate is changed. This is the most popular method of amortizing variable rate loans because it assures the lender that the payments will be sufficient to repay the loan by the scheduled maturity. The more frequent the interest rate can be adjusted, the more frequently the installment amount changes. This method is encouraged for businesses with strong cash flow or business life. If used for start-up or businesses with marginal repayment, consideration should be given to lengthening the frequency of interest rate changes so the impact of changing installment amounts will be less frequent.

11. SPECIAL INTEREST RATE STRUCTURES.

a. Split Interest Rates

The participant may use different or "split" interest rates, fixed or variable, on the guaranteed and unguaranteed portions of the loan. SBA has no objection as long as the higher rate is legally permissible and the blended rate is within SBA's allowable maximum. The split interest rate does not violate SBA's no-preference rule because the blended rate is within SBA's allowable maximum.

b. Fixed and Variable Rate Combinations

The participant may use a fixed rate on either the guaranteed or unguaranteed portion and a variable rate on the other portion. SBA has no legal objection as long as the higher rate is permissible and the blended rate is within SBA's allowable maximum. The mixed interest rate does not violate the no-preference rule. A split mixed interest rate is also acceptable.

12. INTEREST RATE REQUIREMENTS FOR AN SBA NOTE

a. Key Elements

The following elements must be included in the SBA note:

(1) Identification of the rate being used as the base rate;

(2) The publication in which the designated base rate appears regularly;

(3) The lender's permanent percentage spread to be added to the base rate;

(4) The initial interest rate of the loan (from disbursement to first adjustment);

(5) The date of the first rate adjustment; and

(6) The frequency of rate adjustment, or interval.

13. WHAT IS THE INTEREST RATE POLICY FOR SMALL LOANS?

. 120.215 What interest rates apply to smaller loans?

For a loan over $25,000 but not exceeding $50,000, the interest rate may be one percent more than the maximum interest rate described above. For a loan of $25,000 or less, the maximum interest rate described above may be increased by two percentage points.

a. Loan of $25,000 or Less

For loans of $25,000 or less, the maximum interest rate may be two percentage points higher than those stated above, i. e., 4.25 percent and 4.75 percent respectively.

b. Loan More Than $25,000, but Not More Than $50,000

For loans that are more than $25,000, but not more than $50,000, the maximum interest rate may be one percentage point higher than those stated above, i.e. 3.25 percent and 3.75 percent respectively.

14. WHAT ARE THE LIMITS ON DISBURSEMENTS?

a. The disbursement period must be stated in the loan authorization and must be tailored to meet the requirements of each individual loan. The initial disbursement period should be no less than 2 months and must not be more than 3 months from the date of the authorization. An exception is permitted if the purpose of the loan is to provide permanent financing for an interim construction project, in which case the initial disbursement can be set for a time period that allows for the completion of the construction providing this time period does not exceed 12 months. The maximum final disbursement can not be established for more than 12 months, unless the purpose is for construction or take out construction financing, in which case the final disbursement can be up to 18 months from the date of the authorization.

b. For further guidance on extensions to the disbursement periods, reference Subpart "A", Chapter 5, paragraph 6h.

c. The importance of establishing an appropriate disbursement period is heightened by its effect on the borrower's ability to change lenders. Once a guaranty loan request is approved and the loan authorization issued, SBA must not accept for processing another guaranty loan request from a second lender until the initial disbursement period identified in the issued loan authorization has passed. The only exception to this requirement is when the original lender agrees to transfer or cancel their loan.

d. If the disbursement period established in the authorization turns out to be insufficient for the borrower, the period may be extended upon the borrower's request to the lender, if the requirements of subpart A, chapter 6, paragraph 7d., are met.

15. THE GUARANTY FEE POLICY FOR 7(a) LOANS

FEES FOR GUARANTEED LOANS
. 120.220 Fees that Lender pays SBA.

a. Guaranty Fees

Participants are required to pay SBA a one-time fee in consideration for the Agency providing its guaranty on loans the participant proposes to provide its qualified applicants. This fee is referred to as the guaranty fee. The schedule of how the fees are to be computed is detailed on the following chart.

(a) The Lender pays a guarantee fee to SBA for each loan as follows:

Maturity Length and Size of Guaranteed Portion	Fee Measured as Percentage of Guaranteed Portion	When Payable	Lender May Get Fee from Borrower	When SBA Refunds Fee from Borrower
12 Months or less, up to	0.25%	With Guarantee Application	When SBA Approves Loan	If Application Withdrawn or Denied 1
More Than 12 months and Total Guaranteed Portion Is $80,000 or Less	2.0%	Within 90 days of SBA Approval	After First Disbursement	If Loan Canceled and Never Disbursed
More Than 12 Months and Amount of Guaranteed Portion of Loan That Is $250,000 or Less	3.0%	Within 90 Days of SBA Approval	After First Disbursement	If Loan Canceled and Never Disbursed
More Than 12 Months and Amount of Guaranteed Portion of Loan Between $250,000 and $500,000	3.0% of 1st $250,000 plus 3.5% of balance	Within 90 Days of SBA Approval	After First Disbursement	If Loan Canceled and Never Disbursed
More Than 12 Months and Amount of Guaranteed Portion of Loan Exceeding $500,000	3.0% of 1st $250,000 plus 3.5% of next $250,000 plus 3.875% of the Amount Exceeding $500,000	Within 90 Days of SBA Approval	After First Disbursement	If Loan Canceled and Never Disbursed

1 Also, if SBA substantially changes the Lender's loan terms and approves the loan, but the modified terms are unacceptable to the Borrower or Lender. (The Lender must request refund in writing within 30 calendar days of the approval).

The guaranty fee is the obligation of the lender, not the borrower. The fact that the statute gives lenders an option to pass the fee on to the borrower after the Agency has collected the fee from the lender does not make this fee a borrower obligation.

The guaranty fee is based on the dollar amount of SBA's guaranteed portion, not the total loan amount. The amount of the fee depends upon the dollar size of the guaranteed portion and the maturity of the loan guaranteed by SBA.

b. Computing The Guaranty Fee

The dollar amount of the guaranty fee associated with each loan SBA guarantees is individually computed based on the requirements specified in .120.220(a). Personnel involved in loan funding can ascertain the Agency's computation of the fee during the funding process. The Agency's amount will be the amount due from the lender unless the office funding the loan notifies SBA Denver (By 327) that an alternative fee is due. The 327 action to alter the fee amount needs to be sent to Denver as soon as possible after funding, and in no case more than 10 working days after funding, in order that the alternative amount can be understood and accepted by the Agency before the lender makes payment or is sent a notice.

The office processing the loan (except for loans processed under a Delegated Authority Program) shall use the fee amount which the Agency's database computes on the respective loan authorization unless an alternative fee amount is required by policy. When an alternative amount is necessary, the processing office shall follow the procedures detailed below.

c. Guaranty Fee Discrepancies

The Agency's database computes one guaranty fee per loan. This computation is made without any consideration for any other existing or companion loans. The amount which the Agency computes becomes the amount the lender is expected to pay. If the office funding a 7(a) loan disagrees with the dollar amount the Agency computed, they must notify the Denver Action Desk by 327 action that the fee has to be changed. Only Denver can change the guaranty fee amount. The funding office must send the 327 action to Denver. This action explains the reason for the alteration and shows the calculations to support the change.

d. Due Date for Guaranty Fee Payment

The lender must pay the guaranty fee to SBA as stipulated in 13 CFR .120.220(a).

(1) Loans with maturities in excess of 12 months require payment of the guaranty fee to SBA within 90 days of the date of loan approval. There is no waiver of this rule.

(2) Loans with maturities of 12 months or less require the Lender to remit the fee with the request. Processing shall not commence without receipt of the fee. Except for short term loans processed under PLP procedures (reference Subpart "D", Chapter 3, paragraph 7(b)(1)) this requirement can not be waived.

This fee must be sent to the office processing the application (except PLP and SBA*Express*).

Upon approval, SBA will forward the guaranty fee to SBA Denver.

No Authority exists to alter or waive the due date for guaranty fee payment.

e. Method of Guaranty Fee Payment

It is the Agency's goal to collect all guaranty fees via electronic commerce. However, this is currently not possible in all cases. For loans with maturities in excess of 12 months, the guaranty fee can and should be remitted electronically by all participants classified as an electronic commerce trading partner of SBA. For lenders not so classified, the Agency will continue to accept lender checks for payment of the required fee on individual loans.

The collection of the required guaranty fee in the following circumstances has to be done manually:

(1) Loans with original maturities of 12 months or less;
(2) Loans where the SBA share is being increased;
(3) Loans being renewed where the maturity goes from 12 months or less to over 12 months;
(4) Loans where the guaranty is being reinstated because it was previously cancelled due to non payment of the required fee in the required time.

In these cases, the required guaranty fee must accompany the action request. Without the check, the action must not be processed or approved by SBA.

SBA offices should only receive guaranty fee payments for the four circumstances referenced above. In all other cases the lender should be instructed to send the fee either electronically or via check directly to DFC.

The guaranty fee remittance received by DFC must always reference the SBA loan number. Unless otherwise specified, the Lender must send this fee to: SBA, Denver, Colorado, 80259-0001.

In cases involving two or more loans with maturities of 12 months or more that are approved within 90 days of each other, the guaranty fee has to be manually computed (reference subparagraph "q" of this paragraph. The lender should be instructed to send the guaranty fee to DFC via either electronic payment (if available) or by check.

In cases where the amount received is in excess of the computed amount due, the field office will be notified by DFC of this excess and informed that the processing office should coordinate any adjustments for collection and proper allocation of fees with DFC.

(b) If the guarantee fee is not paid, SBA may terminate the guarantee. The Borrower may use working capital loan proceeds to reimburse the Lender for the guarantee fee. Acceptance of the guarantee fee by SBA shall not waive any right of SBA arising from the Lender's misconduct or violation of any provision of this part, the guarantee agreement, the Authorization, or other loan documents.

f. Effect of Fee Non-Payment

If the guaranty fee is not paid within the required time frame of 90 days, the guaranty will be automatically cancelled, and the funds reserved for that loan will be returned to the general account to become available to fund other loans.

The SBA holds that the timely payment of the guaranty fee is a requirement for the guaranty to be in effect. For all 7(a) loans with maturities in excess of 12 months, the participant's obligation to pay the fee commences on the day SBA authorizes the guaranty and concludes 90 days thereafter. The participant's responsibility to pay the fee on loans with maturities of 12 months or less must be satisfied before loan processing can commence.

If the guaranty fee is not paid within these time parameters, the Agency will proceed to cancel the guaranty previously issued.

g. Alternative Guaranty Fee Payment Plan

The lender may remit the guaranty fee payment for all loans with a maturity exceeding 12

months through an Automated Clearing House (ACH) process providing the lender has executed a Trading Partner Agreement for ACH exchange. Contact the Denver Action Desk for more information.

h. First Notice of Fee Payment

The SBA Authorization is the lenders first notification that a guaranty fee is due and payable within 90 days of approval. This document informs the lender of the amount of this fee. If for any reason the fee amount cited in the authorization is not in conformance with Agency regulation or policy, and should misrepresent the actual fee amount due, the lender is not relieved of their responsibility to remit the correct amount based on these same policies and regulations.

i. Automatic Notification of Fee Requirement

SBA desires to inform each participant when the fee remains unpaid (not received by SBA) within the required time frame. This notification is given as a courtesy, and is not a requirement. Neither the issuance of any notice of non-payment by SBA nor the receipt of any notice of non-payment by the participant waives the lender's obligation to pay the fee within 90 days of approval. In addition, the obligation to pay the guaranty fee to SBA is not contingent upon the applicant/borrower having paid the fee to the lender.

(1) Second Notice of Fee Payment (Automatic)

If the payment of the guaranty fee has not been processed by the end of the 90th day following the date of loan approval, SBA will generate a "Notice of Overdue Guaranty Fee" and send it to the lender. Such a notice will also be sent if the amount of the fee received is less than the required amount. SBA intends to generate and send the notice 91 days after approval when there has been no fee posting signifying receipt of the guaranty fee.

The notice will identify the loan by lender, applicant name, SBA loan number, approval date, and the amount of the fee that remains outstanding, plus the appropriate SBA office administering the loan.

The lender will be notified that they are required to pay the specified fee and that it must be sent directly to the Denver Finance Center (DFC) within 120 days from the date of approval, which should be approximately 21 days from receipt of this notice. The notice will advise the lender that failure to pay the fee within this time frame will result in the automatic cancellation of SBA's guaranty for that particular loan.

In addition the notice will inform the lender that they should contact the appropriate

SBA office if there are any questions regarding the payment of the guaranty fee.

Notification will also be provided to the SBA field office which processed the request (except for loans processed in the PLP and LowDoc Processing Centers) so they may know which lenders are failing to remit guaranty fees in a timely manner. For loans processed under PLP or LowDoc procedures, the notification of delinquent fees will be provided to the appropriate Commercial Loan Servicing Center.

(2) Field Office Follow-Up Responsibilities

The SBA office administering the loan must contact the lender by telephone to ensure that the responsible individual is aware of the pending cancellation, confirm that the guaranty fee was not received from lender, and inquire as to lender's intentions.

The SBA staff person making contact with the lender must note in the Delinquent Loan Collection System (DLCS) the date and time of contact, name and title of lender contact and a summary of the lender's statement regarding its intentions.

(3) Cancellation Notice (Automatic)

If the full guaranty fee remains unpaid by the beginning of the 121st day from approval, the guaranty will be automatically cancelled. The amount of the cancelled appropriations will not be held in abeyance for subsequent reinstatement. A "Cancellation of Loan Guaranty" notice will be sent to the lender, with notice to the appropriate SBA field office. This notice will advise the lender that:

(a) The guaranty fee has not been paid in full to SBA;

(b) The amount owed to the Agency;

(c) The guaranty which SBA previously authorized has been cancelled;

(d) The name of the SBA field office that the lender should contact if they have any questions regarding the guaranty fee.

(4) Reinstatement of Guaranty After Cancellation

SBA may, at its sole discretion, consider and take action to reinstate a cancelled guaranty. Such an action must be requested in writing, the lender must certify that there has been no adverse change to the condition of the applicant, and funding must be available.

Participants must make a written request for reinstatement of the guaranty. The request must be sent to the SBA office administering the loan. This is true regardless of processing procedures (e.g. Standard, CLP, PLP, LowDoc, SBAExpress, PCLP, etc.) used to initially authorize the guaranty.

Payment of the full fee must accompany the request for reinstatement. SBA shall not initiate the reinstatement unless the guaranty fee has been received. The request from the lender must include a certification that the lender has no knowledge of any adverse change to the condition of the applicant concern since the original application submission. Reinstatement will require the use of the Agency's computer accounting system and a 327 action.

j. Extension of the Guaranty Fee Due Date

Extensions to the date the guaranty fee is due are not permitted and this regulation can not be waived. SBA shall collect all guaranty fees within the allotted time frame of 90 days from the date of approval for all loans with an original maturity exceeding 12 months.

k. Cancellation of Guaranty For Partial Fee Payment

SBA will also cancel a loan's guaranty when the fee is only partially paid. Lenders should receive a "Notice of Overdue Guaranty Fee" when the amount paid is less than the amount due. Offices processing these loans will be notified and must update the DLCS system.

Cancellation of a loan where the guaranty fee is only partially paid will also occur on the 121st day from approval.

l. Additional Guaranty Fee for Loan Increases

When a 7(a) loan is increased, additional appropriations are committed, and an additional guaranty fee is most likely due (reference Q&A number 5 in Subpart "A", Chapter 6, paragraph 10). Increases are funded with appropriations from the current fiscal year. The computation of the additional fee is based on the rules in effect at the time the loan was originally approved, even if the funds come from a different fiscal years appropriation. Therefore, the amount of the additional guaranty fee due for an increase will equal what the guaranty fee would have been if the increase was part of the original loan amount, based on the rules in effect at the time the loan was originally approved, less the amount of the original fee (if already remitted).

The additional guaranty fee associated with the increase must be submitted to and received

by the SBA office processing the request for increase. Without the additional fee, the request will not be processed.

m. Additional Guaranty Fee for Loan Renewals (Short Term Loans Only)

A renewal is defined as the lengthening of the period of repayment, and the continuation of the established conditions. Renewals are provided to revolving loans that have reached stated maturity in order to permit both disbursement and repayment to continue. When a 7(a) loan is renewed, no additional guaranty fee is due, unless the renewal also extends the maturity from 12 months or less to a maturity exceeding 12 months*****.

Under these circumstances, the guaranty fee will be recomputed and charged the lender according to the requisites of sub paragraph 15e above. EWCP loans may be exempt from this requirement. Reference Subpart C, Chapter 1, paragraph 6.

***** This additional fee must accompany the request to extend maturity past 12 months. The lender may pass this expense through to the borrower at the time of any disbursement made after the original maturity date, providing SBA has sent notice to the lender that the maturity renewal has been approved.

n. Additional Guaranty Fee for Maturity Extensions

An extension is defined as the lengthening of the period of repayment in order to accommodate the ultimate completion of payment process. Extensions are provided on loans in a payment only mode (no disbursements). There are no additional guaranty fees for an extension regardless of the original maturity.

o. Limits on Additional Guaranty Fees

No additional guaranty fees will be charged for loans:

(1) Extended beyond their original maturity date to effect collection where no new funds are disbursed, regardless of the original maturity;

(2) Renewed beyond their original maturity date to permit additional disbursements and repayment if the maturity was already more than 12 months.

p. Guaranty Fee Rebates

The guaranty fee may be rebated back to the lender on loans with maturities in excess of 12 months only when there has been no disbursement of the loan and the lender writes SBA requesting cancellation of the guaranty.

Once a loan with a maturity exceeding 12 months has been initially disbursed, no rebate is permitted. This rule eliminates the possibility for a partial rebate of the fee if the loan is only partially disbursed and some amount is cancelled after initial disbursement. This rule does allow for a partial rebate if the amount not needed is cancelled by SBA prior to initial disbursement.

No rebate is permitted on a loan with a maturity of 12 months or less regardless of whether it is disbursed or partially cancelled prior to initial disbursement. However, if the loan is approved on terms that are significantly different than those requested by the lender, a rebate is permitted providing the lender writes to cancel the loan and request a rebate within 30 calendar days of approval. If the loan is declined, the fee check will be returned to the lender.

SBA requires a 327 action to effect a cancellation and rebate. Modification to the Agency's computer to reflect this change shall be made at the office taking the action to effect the cancellation and generate a rebate.

q. Guaranty Fee For Multiple Loans

Whenever one borrower, including its affiliates, receives more than one loan with maturities exceeding 12 months within 90 days of each other, all the loans shall be treated as if they were one loan for purposes of determining the percentage of guaranty and for determining the amount of the guaranty fees.

However, the funding of each loan is independently established, meaning the Agency's computers do not automatically account for other outstanding SBA supported debt. Since the guaranty fee is based on the amount of the SBA share, it is important to compute the fee for any single loan based on the combined SBA shares of all SBA business loans approved within 90 days of each other. The exception is when one of the two loans has a maturity of 12 months or less.

When two loans are funded within 90 days of each other, the applicable fee for the second loan will equal the amount of the fee that would have been charged had the two loans been combined, less the amount of the fee on the first loan.

Example: Consider two loans to the same business at the same time. One request is for 10 years for $150,000 and the other is for 20 years for $325,000. To compute the guaranty fee, add the gross loan amounts together. If the combined total loan amount exceeds $100,000, both loans are guaranteed at 75 percent. Multiply the gross loan amount by the percentage of guaranty and compute the guaranty fee.

Since the combined total of the two loans equals $475,000, the guaranteed portion equals $356,250 ($475,000 X 0.75 percent), so the total guaranty fee is:

[$250,000 X 3.0% = $ 7,500.00] + [$106,250 X 3.5 % = $3,718.75] equals $11,218.75.

This is the fee income SBA is required to collect.

The Agency's database will automatically compute the fees as if no other loan exists and bill the two fee separately:

$150,000 X 0.75 = $112,500 X 3% = $3,375.00
$325,000 X 0.75 = $243,750 X 3% = $7,312.50

The total of the two fees computed without consideration to the combined effect is $10,687.50. This is $531.25 less than the Agency is actually required to receive.

If the lender remits the full amount due but Denver is not informed of the dual loan situation, there would be a rebate back to the lender of the excess (in this case $531.25). For these reasons, it is incumbent on the processing office to inform Denver of what the correct fees should be.

To eliminate the loss of guaranty fee income in these situations, the processing offices must notify Denver DFC that the fee which the Agency computes and reports as owing is incorrect. This notification shall be by 327 action and this notification must be sent to DFC within 10 working days of approval of the second loan.

If no guaranty fee is received within 90 days, Denver DFC will automatically notify the lender that the Agency has not received the fee and that cancellation is imminent. The Agency will also reference an incorrect amount unless the processing office expeditiously submits the required 327 to Denver that corrects the discrepancy.

When two loans with maturities over 12 months are approved within 90 days of each other the first loan funded should reference a guaranty fee equal to what it would be if only that loan were funded. The additional fee (if any) should be added to the required guaranty fee for the second loan. The guaranty fee for the second loan should be for the amount of the fee due for that loan plus any difference that needs to be collected as a result of two loans being provided within 90 days of each other. Denver DFC will need to be told that the need to alter the guaranty fee amount for the second loan is the result of having two loans approved within 90 days of each other. The 327 action informing Denver of the alteration to the guaranty fee in this case should say:

"The dollar amount of the guaranty fee computed by the Agency's database for loan # second loan is incorrect because this loan represents a second loan provided to this same borrower and was approved within 90 days of loan # first loan . The combined SBA shares of all loans approved within 90 days of each other is $_____. The total guaranty fee due for these loans is $_____. The guaranty fee for loan # first loan , based on an SBA share of $_____ is $_____. The guaranty fee for # second loan is $_____ based on the difference between the total fee due and the guaranty fee for the first loan.

Q1. How do we compute the guaranty fee when there is a long term loan and a companion short term (maturity of 12 months or less) loan processed within 90 days or each other?

A1. When the applicant receives both a short and long term 7(a) loan, the percentage of guaranty is computed as if the loans are combined, but the guaranty fee is computed as if the other loan does not exist. The SBA portions of each loan are not combined before determining the total guaranty fee amount when one loan has a maturity of 12 months or less and the other loan is a long term loan with a maturity of more than 12 months.

Examples - Two Loans, Both for $500,000 - One for real estate, the other for machinery and equipment. The first loan has a 20 year maturity, the second for 10 years. If they came in together or within 90 days of each other, they would both be guaranteed at 75 percent. The guaranty fees for these two loans would be:

Loan Number 1		Loan Number 2	
$500,000 X .75 = $375,000		$500,000 X .75 = $375,000	
$250,000 X .03 = $ 7,500			
$125,000 X .035 = $ 4,375		$125,000 X .035 = $ 4,375	
Guaranty Fee	$ 11,875	$250,000 X .03875 = $ 9,687.5	
			$ 14,062.5

When both loans have maturities over 12 months, the fee for the second loan builds upon the SBA share of the first loan.

Now consider the same two loans except loan number 1 is approved with a maturity of 12 months or less. The guaranty fees would be:

Loan Number 1		Loan Number 2	
$500,000 X .75 = $375,000		$500,000 X .75 = $375,000	
$375,000 X .0025	$ 937.50	$250,000 X .03 =	$ 7,500
		$125,000 X .035 =	$ 4,375
Guaranty Fee	$ 937.50		$11,875

When there are multiple loans and one has a maturity over 12 months and the other loan's maturity is 12 months or less, the guaranty percentage is based on the total loan amounts, but the guaranty fee is not. The guaranty fee is computed as if there were no other loans.

Q2. Is there an additional guaranty fee if the short term loan referenced in question 1 above is renewed past 12 months?

A2. Definitely. The renewal of a loan with an original maturity of 12 months or less that established a new maturity that is more than 12 months from initial disbursement (or when the note was signed) requires that both loans have their SBA portions combined and the guaranty fee equal to what it would have been if the short term loan was originally provided a maturity of more than 12 months.

r. Borrower Payment of the Guaranty Fee

Payment of the guaranty fee to SBA is a lender obligation. Reimbursement of this lender expense is an option that may be imposed on the borrower, not the applicant. The lender must pay the guaranty fee to SBA before they can be reimbursed from the borrower. The borrower can only reimburse the lender after the loan has been initially disbursed. The act of initial disbursement changes the classification of an applicant to that of a borrower.

The borrower can either use its own non-SBA funds or a portion of the loan proceeds (if specifically authorized) to reimburse the lender. If the authorization does not have a use of proceeds category for either the reimbursement of the guaranty fee or for general working capital, the lender cannot be reimbursed for paying the guaranty fee to SBA from the loan proceeds.

For example, the proceeds of an SBA Contract CAPLines loan can only be used for the direct labor and material expenses associated with performing a contract. The working capital provided here is specific, not general, and therefore cannot be used to reimburse the lender for any previously paid guaranty fee.

When the maturity of the 7(a) loan exceeds 12 months, the borrower cannot reimburse the lender for the prior payment of the guaranty fee to SBA until the initial disbursement occurs. When the maturity of the 7(a) loan is 12 months or less, the applicant cannot reimburse the lender for the guaranty fee until they are provided a copy of the approved authorization.

No lender is authorized to make the initial disbursement exclusively for the purpose of being reimbursed for paying the guaranty fee or to recoup any expenses associated with loan preparation or closing.

The reason behind this rule is that the requirements for repayment are established by the time any proceeds are initially disbursed, so the initial disbursement needs to include proceeds which will benefit the business in being able to meet their repayment obligation.

16. OTHER FEES ALLOWABLE BY SBA

a. Additional Fees for Direct Loans

There are no additional fees for loans made on a direct basis by SBA.

b. Additional Fees for Guaranty Loans

(c) The Lender shall also pay SBA an annual service fee equal to 0.5 percent of the outstanding balance of the guaranteed portion of each loan. The service fee cannot be charged to the Borrower. SBA may institute a late fee charge for delinquent payments of the annual service fee to cover administrative costs associated with collecting delinquent fees.

(1) Annual Service Fee

See Servicing SOP for comments regarding servicing fee.

. 120.221 Fees which the Lender may collect from a loan applicant.

(a) Service and packaging fees. The Lender may charge an applicant reasonable fees (customary for similar Lenders in the geographic area where the loan is being made) for packaging and other services. The Lender must advise the applicant in writing that the applicant is not required to obtain or pay for unwanted services. The applicant is responsible for deciding whether fees are reasonable. SBA may review these fees at any time. Lender must refund any such fee considered unreasonable by SBA.

(2) Service and Packaging Fees

See Section 120.195 for explanation of the requirements on service and packaging fees.

(b) 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 service fee not to exceed 2 percent per year on the outstanding balance of the part requiring special servicing.

(3) Fee for Extraordinary Servicing

Lenders are permitted to charge SBA borrowers a servicing fee for handling post approval actions not normally provided to a term loan borrower. This fee shall be based on either 0.166 percent of the average outstanding monthly loan balance (principal) or 0.166 percent of the month end principal balance.

Q1. When can a lender collect an extraordinary servicing fee on an SBA Loan?

A1. When the lender can show that extraordinary servicing is required for construction loans or for monitoring accounts receivable and inventory collateral, it may charge an additional servicing fee, not to exceed 2 percent per annum on the outstanding balance of such loans, if approved by SBA.

If receivables or inventory make up only a part of the collateral, the servicing fee may be charged only on that part of the loan secured by such collateral.

On construction loans, the 2 percent extraordinary servicing fee may be charged only on the loan proceeds used for construction purposes. SBA can approve of a servicing fee only at the request of the participating institution. The actual fee must not exceed the cost of the extra service involved, but under no circumstances may the fee exceed 2 percent of the loan amount.

Q2. When is a lender prohibited from collecting extraordinary servicing fee on an SBA Loan?

A2. Additional fees are not permitted for providing such services as:

(i) Changing the installment amount to avoid circumstances where the required payment amount will not be sufficient to pay the loan in full by the maturity date;

(ii) Changing the installment amount after a deferment;

(iii) Providing the release or exchange of collateral - recordation fees are permitted; and

(iv) Any modification to the repayment terms of the note.

Q3. Can the extraordinary servicing fee exceed 2 percent per annum?

A3. SBA does not limit the amount of servicing fees for loans approved under the requirements of the Export Working Capital Loans or CAPLines - Standard Asset Based Loan programs. For any loan processed under the requirements of any other program, the extraordinary fee must not exceed 2 percent.

(c) Out-of-pocket expenses. The Lender may collect from the applicant necessary out-of-pocket expenses such as filing or recording fees.

(4) Out of Pocket Expenses

A lenders may be reimbursed by the SBA borrower for all direct cost associated with recordation of collateral instruments, and for appraisals and environmental impact reports that are obtained in compliance with SBA policy.

(d) Late payment fee. The Lender may charge the Borrower a late payment fee not to exceed 5 percent of the regular loan payment.

(5) Late Payment Fees

A lender may impose a penalty fee of not more than 5 percent of the monthly installment amount for late payment on a loan which SBA guarantees. The lender may charge this fee to a borrower who is more than 10 day delinquent on its regularly scheduled payment.

(e) No prepayment fee. The Lender may not charge a fee for full or partial prepayment of a loan.

(6) Other Penalties and Fees

SBA does not allow prepayment penalty fees on loans which it guarantees. A lender must not require an applicant to pay an application fee for filing an application or a commitment fee with respect to an approved loan. The only exception is that under the Export Working Capital Program, a commitment fee may be charged.

17. FEES NOT ALLOWED BY SBA

. 120.222 Fees which the Lender or Associate may not collect from the Borrower or share with third parties.
The Lender or its Associate may not:
(a) Require the applicant or Borrower to pay the Lender, an Associate, or any party designated by either, any fees or charges for goods or services, including insurance, as a condition for obtaining an SBA guaranteed loan (unless permitted by this part);

a. Use of Lender Specified Vendors as Condition for Obtaining Guaranty

A lender must not require that the applicant obtain the goods or services needed to complete the loan transaction from any specified source. Unless authorized by SBA, the applicant/borrower must be free to choose the provider of such required goods and services. This policy does not limit a lenders ability to require such goods and services or its right to determine that what is provided is in a satisfactory form, but rather only to make sure no limits on selecting the actual provider are placed on the borrower.

(b) Charge an applicant any commitment, bonus, broker, commission, referral or similar fee;

b. Commitment, Bonus, Broker, Commission, Referral or Similar Fees

A lender must not require an applicant to pay an application fee for filing a 7(a) guaranty loan application or a commitment fee for an approved loan except as provided under the Export Working Capital Program.

Lenders are expected to perform the underwriting functions for every loan they make. The participant is responsible for assessing the risk associated with any loan which SBA is asked to guaranty. Compensation for such work is through the receipt of interest. By policy, no lender, or their agent, is permitted to charge or collect any fee connected with processing a loan including the analysis of the case, or the assessment of the risk. In addition, the lender can not charge the borrower any fee for such function if such work is subcontracted out.

(c) Charge points or add-on interest;

c. Points and Add on Interest

(1) Points cannot be charged on SBA loans. Although points may be defined as interest in some cases, their use is not permitted on SBA loans.

(2) SBA does not allow a lender to charge guaranty borrowers add-on interest.

(d) Share any premium received from the sale of an SBA guaranteed loan in the secondary market with a Service Provider, packager, or other loan-referral source; or

d. Sharing of Secondary Market Premiums

Lenders receiving premiums from selling the guaranteed portion of an approved SBA 7(a) loan into the secondary market are not authorized to share this fee with any other entity or individual not directly compensated by the lender.

(e) Charge the Borrower for legal services, unless they are hourly charges for requested services actually

rendered.

e. Legal Services

The lender or its associate may not pass on to the applicant/borrower any cost of legal services not calculated on a hourly basis for services provided in connection with the applicant/borrower's transaction.

SUBPART C - SPECIAL PURPOSE LOANS

WHAT IS THE PURPOSE OF THIS SUBPART?

This subpart explains the special policies and procedures of the specialized 7(a) loan programs which have been created to provide particular types of financing. All special purpose loans have particular conditions, in addition to (or in lieu of) those required of standard 7(a) loans, in order to ensure the particular need is prudently provided and administered. These programs are authorized by either a particular subsection of Section 7(a) of the Small Business Act or by the authority provided the Agency in the overall Act. This chapter describes the special requirements, including unique submission requirements, eligibility and credit criteria, and establishment of post approval procedures. General business loan requirements apply to special purpose loans unless alternatives are stated.

CHAPTER 1 - INTRODUCTION TO SPECIAL PURPOSE LOANS

. 120.300 Statutory authority.
Congress has authorized several special purpose programs in various subsections of section 7(a) of the Act. Generally, 7(a) loan policies, eligibility requirements and credit criteria enumerated in Subpart B apply to these programs. The sections of this subpart prescribe the special conditions applying to each special purpose program. As with other business loans, special purpose loans are available only to the extent funded by annual appropriations.

1. WHAT PROGRAMS WILL BE DISCUSSED IN THIS CHAPTER?

   a. Disabled Assistance Loan (DAL) Program
   b. 7(a)(11) Loan Program
   c. Energy Loan Program
   d. Export Working Capital Program (EWCP)
   e. International Trade Loan Program
   f. Employee Stock Ownership Loan Programs
   g. Veterans Loan Program
   h. Pollution Control Loan Program
   i. 8(a) Participant Loan Program
   j. Defense Economic Transition Loan Program
   k. Defense Loan and Technical Assistance (DELTA) Program
   l. CAPLines Loan Program (including)
      (1) Seasonal CAPLines
      (2) Contract CAPLines
      (3) Builders CAPLines
      (4) Standard Asset Based CAPLines
      (5) Small Asset Based CAPLines

2. FUNDING FOR SPECIAL PURPOSE PROGRAMS

Congress does not separately appropriate funds for each type of loan program the Agency provides to small businesses, but does provide separate appropriations for those programs which can be provided on a direct bases. If funding is not appropriated for the separately funded loan programs, then loans meeting the eligibility and credit criteria of these programs cannot be provided on any basis (direct, immediate participation, or guaranty). The specific eligibility and credit criteria established for direct loans are not transferred to loans provided on a guaranty basis.

Q1. What direct programs are separately funded?

A1. Separately funded loans include: 7(a)10 - Disabled Assistance Loans; 7(a)11 - Economic Development Loans; 7(a)20 - Loans To 8(a) Recipients; 7(a)21 - Defense Economic Transition Loan Program; 7(m) - SBA MicroLoans; and Loans to VietNam Veterans and Disabled Veterans.

Q2. Non-profit sheltered workshops are eligible for DAL-1 direct loan assistance. Can loans be made to non-profit sheltered workshops on a guaranty basis?

A2. Not unless there is direct funding for 7(a)(10) [DAL-1] loans. Non-profit sheltered workshops can only be made under the provisions of the DAL-1 programs. Since the DAL-1 program was established as a direct loan program, this program receives a separate line item appropriations to permit the funding of loans made under the requirements of this program. There can be no approval of a loan made under DAL criteria (including both eligibility and credit) if there is no appropriation. When funds are appropriated for DAL loans, the appropriations can be transferred from supporting direct loans to cover the Agency's obligation if the loan is made on a guaranty basis.

Q3. What is the status of loans to Veterans?

A3. If Congress does not provide an appropriation for SBA's Direct Loan Program for Veterans, loans can not be made under the requirements for SBA's Veteran Loan Program on either a Direct or Guaranty basis. However, loans can be made to veterans on a guaranteed basis (subject to availability of guaranty appropriations), but they would not be subject to the requirements of the direct veterans loan program like the applicant concern must be 51 percent owned by the veteran owning and operating the business.

3. DISABLED ASSISTANCE LOAN PROGRAM (Subject to Separate Funding)

Section 7(a)(10) of the Small Business Act authorizes two special need loan programs to assist the disabled. These programs are collectively known as the Disabled Assistance Loan Program or DAL. The two programs are (1) DAL-1 financial assistance for public or private nonprofit sheltered workshops or any similar organization, and (2) DAL-2 financial assistance for small business owned entirely by handicapped persons.

a. DAL Loans are Subject to Available Funding

Authority to fund DAL loans is separate from all other 7(a) loans. Applications may only be processed under the rules applicable to the DAL program if appropriation have been authorized for section 7(a)(10) loans. When appropriations exist, applications may be processed on a direct, immediate participation, or guaranty basis. Without specific appropriations, DAL loans cannot be provided on any of these bases.

b. DAL Funding - Status

As of the date of this SOP, funding for 7(a)(10) loans had not been provided by Congress since the Federal Government's fiscal year 1995.

c. Regulatory DAL Requirements

The regulatory requirements for disabled assistance are detailed in 13 CFR, sections 120.310 through 120.315.

. 120.310 What assistance is available for the disabled?

Section 7(a)(10) of the Act authorizes SBA to guarantee or make direct loans to the disabled. SBA distinguishes two kinds of assistance:
(a) DAL-1. DAL-1 Financial Assistance is available to non-profit public or private organizations for disabled individuals that employ such individuals; or
(b) DAL-2. DAL-2 Financial Assistance is available to:
(1) Small businesses wholly owned by disabled individuals; and
(2) Disabled individuals to establish, acquire, or operate a small business.

. 120.311 Definitions
(a) Organization for the disabled means one which:
(1) Is organized under federal or state law to operate in the interest of disabled individuals;
(2) Is non-profit;
(3) Employs disabled individuals for seventy-five percent of the time needed to produce commodities or services for sale; and
(4) Complies with occupational and safety standards prescribed by the Department of Labor.

(b) Disabled individual means a person who has a permanent physical, mental or emotional impairment, defect, ailment, disease or disability which limits the type of employment for which the person would otherwise be qualified.

. 120.312 DAL-1 use of proceeds and other program conditions.

(a) DAL-1 applicants must submit appropriate documents to establish program eligibility.
(b) Generally, applicants may use loan proceeds for any 7(a) loan purposes. Loan proceeds may not be used:

(1) To purchase or construct facilities if construction grants and mortgage assistance are available from another Federal source; or

(2) For supportive services (expenses incurred by a DAL-1 organization to subsidize wages of low producers, health and rehabilitation services, management, training, education, and housing of disabled workers).

(c) SBA does not consider a DAL-1 organization to have a conflict of interest if one or more of its Associates is an Associate of the Lender.

. 120.313 DAL-2 use of proceeds and other program conditions.

(a) The DAL-2 loan proceeds may be used for any 7(a) loan purposes.
(b) An applicant may use DAL-2 loan proceeds to acquire an eligible small business without complying with the change of ownership conditions in . 120.202.
(c) A DAL-2 applicant must submit evidence from a physician, psychiatrist, or other qualified professional as to the permanent nature of the disability and the limitation it places on the applicant.

. 120.314 Resolving doubts about creditworthiness.
For the purpose of the DAL Program, SBA shall resolve doubts concerning the creditworthiness of an applicant in favor of the applicant. However, the applicant must present satisfactory evidence of repayment ability. Personal guarantees of Associates are not required for purposes of DAL-1 financial assistance.

. 120.315 Interest rate and loan limit.
The interest rate on direct DAL loans is three percent. There is an administrative limit of $150,000 on a direct DAL loan.

d. DAL Policy Requirements

SBA's Office of Financial Assistance will issue policy guidance regarding the processing and making of loans under the DAL Program once authorization for new appropriations for the DAL programs occurs.

4. LOAN PROGRAM FOR LOW INCOME INDIVIDUALS (Subject to Separate Funding)

Section 7(a)(11) of the Small Business Act authorizes the Agency to provide financial assistance to small businesses which establish or preserve small businesses located in either rural or urban areas with a high proportion of unemployed or low-income individuals, or to small businesses owned by low-income individuals.

Section 7(a)(11) also authorizes the Agency to promote the policies established in section 2(c) of the Act which provides that the Agency will assist small businesses engaged in the production of food and fiber, ranching, raising livestock, aquaculture, and all other farming and agriculture related industries.

a. 7(a)(11) Funding - Status

As of the date of this SOP, funding for 7(a)(11) loans had not been provided by Congress since the Federal Government's fiscal year 1994.

b. Regulatory Requirements for 7(a)(11) Loans

The regulatory requirements for low income assistance are detailed in 13 CFR, sections 120.320.

. 120.320 Policy.

Section 7(a)(11) of the Act authorizes SBA to guarantee or make direct loans to establish, preserve or strengthen small business concerns:

(a) Located in an area having high unemployment according to the Department of Labor;
(b) Located in an area in which a high percentage of individuals have a low income inadequate to satisfy basic family needs; and
(c) More than 50 percent owned by low income individuals.

5. THE ENERGY LOAN PROGRAM

Section 7(a)(12) of the Small Business Act authorizes loans to assist small businesses to engineer, manufacture, distribute, market, install, or service energy measures to conserve the nation's energy resources.

. 120.330 Who is eligible for an energy conservation loan?

SBA may make or guarantee loans to assist a small business to design, engineer, manufacture, distribute, market, install, or service energy devices or techniques designed to conserve the Nation's energy resources.

a. Energy Measures

Energy measures are defined in . 120.331.

. 120.331 What devices or techniques are eligible for a loan?
Eligible energy conservation devices or techniques include:
(a) Solar thermal equipment;
(b) Photovoltaic cells and related equipment;

(c) A product or service which increases the energy efficiency of existing equipment, methods of operation or systems which use fossil fuels, and which is on the Energy Conservation Measures list of the Secretary of Energy;
(d) Equipment producing energy from wood, biological waste, grain or other biomass energy sources;
(e) Equipment for cogeneration of energy, district heating or production of energy from industrial waste;
(f) Hydroelectric equipment;
(g) Wind energy conversion equipment; and
(h) Engineering, architectural, consulting, or other professional services necessary or appropriate for any of the devices or techniques in paragraphs (a) through (g) of this section.

b. Applicant Eligibility

The following energy measures are eligible for financial assistance under this program:

(1) Solar thermal energy equipment of the active type based on mechanically forced energy transfer or the passive type based on convective, conductive, or radiant energy transfer or some combination of these. Active systems generally use mechanical (pumps or store and distribute energy). Passive systems use natural energy flows (conduction, convection, and radiation) and buildings themselves to trap, store, and transport thermal energy within the structure. Frequently, designs combine aspects of both types of systems, resulting in a hybrid system.

(2) Photovoltaic cells and related equipment. Such devices produce electricity when exposed to radiant energy, especially light.

(3) A product or service primarily for conservation of energy through devices or techniques which increase the energy efficiency of existing equipment, methods of operation or systems using fossil fuels and which are on the Energy Conservation Measures List of the Secretary of Energy or which the Administrator determines to be consistent with the intent of section 7(a)(12) of the Act, based on cases submitted by the field offices. For purposes of this program (except those measures on the Energy Conservation Measures List), the applicant must furnish written evidence, satisfactory to SBA, demonstrating projected or actual energy savings.

(4) Equipment primarily for energy production from wood, biological waste, grain, or other biomass sources. This refers to energy generated by the burning of combustible biological materials and/or conversion to solid, liquid or gaseous fuels.

(5) Hydroelectric equipment generates electricity by conversion of the energy of flowing water.

(6) Wind energy conversion equipment which produces , electrical or mechanical, by conversion of the energy of wind.

(7) Equipment primarily for industrial co-generation of energy, district heating or production of energy from industrial waste. Industrial co-generation is the production of , electrical or mechanical, and useful thermal energy from the same primary source and using the rejected heat in a thermal process. District heating is the use of central sources of heat to supply heat to a number of buildings, residential or commercial, in a community. Production of energy from industrial waste is the burning of combustible industrial scrap such as cardboard, waste lubricating oils or by-products from industrial processes to produce energy either directly or by conversion to another fuel.

(8) Engineering, architectural, consulting, or other professional services necessary or appropriate to aid citizens in using any of the above measures.

Enterprises installing or undertaking energy conservation measures for their own benefit are not eligible under this program. Any concern, including a farm, that produces alcohol for use in gasohol is not producing for its own account if at least 75 percent of the total production is to be sold to others. But, this program requires maintenance of this 75 percent minimum during the term of the loan and is subject to monitoring by the participant or SBA.

If eligibility cannot be determined from the regulations or this SOP, the field office may submit any proposal considered to be energy saving and consistent with the Act to the Administrator, through the Director, Office of Loan Programs, for a determination.

c. Limitations On Proceeds Usage

. 120.332 What are the eligible uses of proceeds?
(a) Acquire property. The Borrower may use the loan proceeds to acquire land necessary for imminent plant construction, buildings, machinery, equipment, furniture, fixtures, facilities, supplies, and material needed to accomplish any of the eligible program purposes in . 120.330.
(b) Research and development. Up to 30% of loan proceeds may be used for research and development:
(1) Of an existing product or service; or
(2) A new product or service.

Research and Development Proceeds for research and development may not exceed 30 percent of the total loan amount and are permitted only where a business plan indicates strong prospects of repayment or where the further development of a product or service already being marketed is involved.

(c) Working capital. The Borrower may use proceeds for working capital for entering or expanding in the energy conservation market.

Debt Payment Proceeds are eligible for debt payment where the debt being refinanced was incurred for purposes eligible as stated above.

. 120.333 Are there any special credit criteria?
In addition to regular credit evaluation criteria, SBA shall weigh the greater risk associated with energy projects. SBA shall consider such factors as quality of the product or service, technical qualifications of the applicant's management, sales projections, and financial status.

d. Special Credit Considerations for Energy Loans

Section 7(a)(6)(B) of the Small Business Act provides that loans made under the Energy Loan Program need not be as sound as that required for general loans made under section 7(a). For purposes of 7(a)(12) "Sound value" shall include, but not be limited to, "quality of the product or service; technical qualifications of the applicant or his employees; sales projections; and the financial status of the small business concern."

6. THE EXPORT WORKING CAPITAL PROGRAM (EWCP)

Section 7(a)(14) of the Small Business Act authorizes the Agency to provide extensions of credit, standby letters of credit, revolving lines of credit for export purposes, and other financing to enable small business concerns to develop foreign markets.

Export Working Capital Program (EWCP)
. 120.340 What is the Export Working Capital Program?
Under the EWCP, SBA guarantees short-term working capital loans made by participating lenders to exporters (section 7(a)(14) of the Act). Loan maturities may be for up to three years with annual renewals. Proceeds can be used only to finance export transactions. Loans can be for single or multiple export transactions. An export transaction is the production and payment associated with a sale of goods or services to a foreign buyer.

Under EWCP, SBA guarantees the short term working capital loans made by participating lenders to exporters in support of individual transactions or multiple transactions.

a. Types of EWCP Loans

Two types of loans can be made and supported by an EWCP guarantee:

(1) First, a loan can be made in which the proceeds are used to finance the working capital associated with a single transaction of the exporter; and

(2) Second, a loan can be made in which the proceeds are used to finance the working capital associated with multiple transactions of the exporter. This type of loan is a line of credit with a revolving feature. Draws against and repayments to the line may be repetitive as long as the outstanding balance does not exceed the stated line of credit.

Multiple EWCP's may be outstanding at any given time as long as the total amount outstanding or committed does not exceed SBA statutory limits. Due to their revolving nature, these loans can not be sold on the secondary market.

b. Availability of EWCP Loans

This program is available through lending institutions authorized to participate in SBA's 7(a) loan guarantee program. An exporter may submit an application to a participating lender, who will submit the application for guaranty to SBA.

c. Eligibility Considerations

. 120.341 Who is eligible?
In addition to the eligibility criteria applicable to all 7(a) loans, an applicant must be in business for one full year at the time of application, but not necessarily in the exporting business. SBA may waive this requirement if the applicant has sufficient export trade experience or other managerial experience.

Applicants for an EWCP, in addition to meeting the eligibility criteria applicable to all 7(a) loans, must have a history of at least 12 full months of operations prior to filing an application, or have demonstrated export expertise from prior business experience. Approving official may waive the 12 month requirement, based upon demonstrated export expertise and previous business experience. The justification and recommendation for waiver is to be included in the loan officer's report. Export management companies (EMC) or export trading companies (ETC) may use this program. ETCs and EMCs must take title to the goods or services being exported to be eligible. ETCs or EMCs which have any bank ownership are ineligible for the EWCP loan program.

d. Use of Proceeds

. 120.342 What are eligible uses of proceeds?
Loan proceeds may be used:
(a) To acquire inventory;
(b) To pay the manufacturing costs of goods for export;
(c) To purchase goods or services for export;
(d) To support standby letters of credit;
(e) For pre-shipment working capital; and
(f) For post-shipment foreign accounts receivable financing.

EWCP loan proceeds may be used only to:

(1) Acquire goods or pay for both direct and indirect costs (e.g., labor and overhead) used for the manufacture of goods or sale of services;

(2) Purchase of goods or services for export;

(3) Finance receivables resulting from an export sale; and

(4) Support standby letters of credit used as performance bonds, bid bonds or payment guarantees to foreign buyers.

Lender fees and charges may also be included as eligible use of proceeds as well as any packaging fee paid. Proceeds may not be used to finance professional export marketing advice or services, foreign business travel, participation in trade shows or support staff in overseas offices, except to the extent it relates directly to the transaction being financed.

. 120.343 Collateral.
A Borrower must give SBA a first security interest sufficient to cover 100 percent of the EWCP loan amount (such as insured accounts receivable or letters of credit). Collateral must be located in the United States, its territories and possessions).

e. Collateral Considerations

EWCP loans shall be secured by no less than a first lien on all collateral associated with transactions financed. This includes at least the export inventory & receivables assignment of credit insurance, letters of credit proceeds, and contract proceeds as applicable. Personal guarantee of all 20 percent or more owners is generally required, but may be waived by the approving official.

In general, the inventory produced and the receivables generated by the export sales financed will be considered adequate collateral coverage. When deemed necessary SBA may consider additional collateral by placing a lien on other business assets.

Receivables generated from sales to foreign purchasers are an asset of the domestic company and should not be considered a foreign asset.

. 120.344 Unique requirements of the EWCP
(a) An applicant must submit cash flow projections to support the need for the loan and the ability to repay. After the loan is made, the loan recipient must submit continual progress reports.
(b) SBA does not limit the amount of extraordinary servicing fees, as referenced in . 120.221(b), under the EWCP.
(c) SBA does not prescribe the interest rates for the EWCP, but will monitor these rates for reasonableness.

f. Submission Requirements

Application documentation and requirements are similar to other 7(a) loans, except for the following:

(1) A cash flow projection is required. For a single transaction loan the cash flow will cover only the transaction which is being financed. For a line of credit, the cash flow will cover the overall company's operation for the term of the line of credit.

(2) Applications may be submitted on joint EIB-SBA Form 84-1; this form eliminates the need for Associates of applicant to submit SBA Form 912's, except for any individual with a prior arrest or conviction.

(3) An exporter may also use the EIB-SBA Form 84-1 (with exhibits) to apply for a Preliminary Commitment (PC). A PC is a conditional commitment issued by SBA to an exporter who does not yet have a lender willing to provide the actual loan. When PC applications are approved, SBA issues a preliminary commitment letter to the exporter that details the terms and conditions under which SBA would be willing to guaranty a loan from a participant to that same exporter. The exporter can use the PC to inform lenders of SBA's willingness to guaranty and expedite the process.

The PC that SBA issues provides the exporter 60 days to negotiate financing. Two extensions for 30 days each may be provided by SBA's approving official. The exporter must provide the EIB-SBA Form 84-1 and exhibits plus any other information the lender requests. The lender submits their request for guaranty on SBA Form 4-I and agrees to the terms & conditions specified in the PC.

g. Interest Rates and Fees

(1) Interest Rates:

Interest rates are not regulated on EWCP loans. Therefore, the lender is not limited to the rates specified for Regular 7(a) loans.

(2) Guarantee Fee to SBA:

Guarantee fees are the same as all other 7(a) loan guarantee fees as described in this SOP.

(3) Packaging Fees:

EWCP loan applicants may obtain the assistance of Certified Development Companies (CDCs), Small Business Development Centers (SBDCs), and other SBA approved intermediaries to help them prepare and present their application for a Preliminary Commitment and/or a loan under EWCP. Approved intermediaries may charge the loan applicant a one time packaging fee not to exceed one percent (1%) of the EWCP loan amount.

Other packager's fees will be monitored by SBA for reasonableness as they are for other 7(a) programs. The packaging fee is an eligible use of EWCP loan proceeds.

(4) Lender Fees:

SBA does not regulate fees charged by lenders making EWCP loans.

h. Maturity

If the loan is single transaction the maturity should correspond to the length of the transaction cycle, usually not to exceed 18 months. A maturity greater than 18 months may be approved by the approving official, if justification and recommendation for a longer maturity is included in the loan officer's report.

If the loan is for a revolving line of credit the maturity is typically 12 months. The lender may request reissuance of a line (new loan & loan number) no earlier than 45 days prior to maturity of the existing line. After credit review and approval of the new loan any balance on the existing line may be transferred (refinanced) with the new loan. This will ensure continuity of the line and will avoid any interruption in the exporter's business.

i. Increases

Increases of up to one third of the original loan amount can be processed one time through standard SBA procedures.

j. U.S. Currency For Foreign Receivable Payments

All transactions financed by EWCP loans shall be payable in U.S. dollars unless SBA permits otherwise on an exceptions basis.

k. Guaranty Percentage Of EWCP Loans

All EWCP loans will be guaranteed at 90 percent regardless of the loan amount, providing the SBA share of participation does not exceed $750,000. For EWCP loans over $833,333, the percentage of guaranty will be adjusted accordingly so the SBA share remains with in allowable limits.

7. THE INTERNATIONAL TRADE (IT) LOAN PROGRAM

. 120.345 Policy
Section 7(a)(16) of the Act authorizes SBA to guarantee loans to small businesses that are:
(a) Engaged or preparing to engage in international trade; or
(b) Adversely affected by import competition.

a. Program Purpose

Section 7(a)(16) authorizes this program to provide assistance to:

(1) Businesses presently engaged or preparing to engage in international trade; and

(2) Businesses adversely affected by import competition.

. 120.346 Eligibility.
(a) An applicant must establish that:

b. Eligibility

The applicant must establish either of the following to be eligible.

(1) The loan proceeds will significantly expand an existing export market or develop new export markets; or

(1) That the loan proceeds will significantly expand existing export markets or develop new export markets. To establish this, the applicant must submit a business plan, including both a projection and narrative rationale, that contains enough information to reasonably support the likelihood of expanded export sales. The plan should identify the amount of expected sales abroad. In addition, the applicant must establish that it is in a position to significantly expand existing export markets or is able to develop new ones.

(2) The applicant business is adversely affected by import competition; and

(2) That the applicant is adversely affected by import competition. The applicant must demonstrate injury attributable to increased competition with foreign firms. A narrative explanation and financial statements showing that imported articles which are directly competitive with those produced by the applicant have contributed significantly to a decline in competitive position are required.

A decline in sales and/or production, under-utilization of capacity, decreased profitability and the threat of or actual separation of production employees are some of the factors which evidence adverse impact.

(3) Upgrading facilities or equipment will improve the applicant's competitive position.

(3) In addition to either (1) or (2) above, the applicant firm must also be able to demonstrate that the upgrading productive facilities will allow the applicant to improve its competitive position. The loan officer's report must document evidence that can support the fact that the upgraded facilities and/or equipment will allow the applicant to improve its competitive position.

(b) The applicant must have a business plan reasonably supporting its projected export sales.

c. Business Plan

The application must include a cash flow projection which includes an explanation of the assumption for all sales for the next two years as well as a break out of these sales between export related and domestic (if applicable) related.

. 120.347 Use of proceeds.
The Borrower may use loan proceeds to acquire, construct, renovate, modernize, improve, or expand facilities and equipment to be used in the United States to produce goods or services involved in international trade, and to develop and penetrate foreign markets.

d. Use of Proceeds

Debt payment is not allowed. The use of proceeds is limited to:

(1) Working capital; and

(2) Facilities or equipment. This includes loans to purchase land and building(s); construct a new facility; renovate, improve or expand an existing facility; purchase or recondition machinery, equipment and fixtures; and/or other improvements that will be used in the United States for the production of goods or services.

e. Maturity

Loan maturities may extend to the 25-year maximum as in other 7(a) programs.

. 120.348 Amount of guarantee.
SBA can guarantee up to $1,250,000 for a combination of fixed-asset financing and working capital, supplies and EWCP assistance. The fixed-asset portion of the loan cannot exceed $1,000,000 and the non-fixed-asset portion cannot exceed $750,000.

f. Amount of Loan and Percentage of Guaranty

There is no dollar limit on the gross amount of an IT loan but the SBA share can not exceed $1 million. When an IT loan and an EWCP loan are both outstanding to the same borrower, their combined SBA shares can be for a maximum of $1.25 million, providing:

(1) The fixed-asset portion of the loan (which can include permanent working capital that is repaid on a term basis) is not more than $1 million. SBA interprets this to mean the SBA share must not exceed $1 million, and;

(2) The non-fixed-asset portion (which is narrowly defined to only include funds provided under the guidelines of EWCP) is not more than $750,000.

Q. When processing both a fixed asset IT and non-fixed asset EWCP, does the order of funding make any difference?

A. No. The regulations allow EWCP loans to be funded after the IT loan, providing the combined SBA exposure does not exceed $1.25 million and either component does not have an SBA exposure exceeding its own maximum.

g. Collateral

Only collateral located in the United States, its territories and possessions is acceptable for a loan made under this program. The lender must take a first lien position or first mortgage on the items financed under this section. Require additional supportive collateral as appropriate, including personal guarantees and junior liens on items not financed by loan proceeds.

h. Processing Delivery Restrictions

International Trade loans are not eligible under PLP.

i. Loan Identification

Identify International Trade loans with the prefix IT on the docket number.

8. EMPLOYEE STOCK OWNERSHIP PLAN PROGRAMS

ESOP stands for Employee Stock Ownership Plan Qualified Employee Trusts

. 120.350 Policy
Section 7(a)(15) of the Act authorizes SBA to guarantee a loan to a qualified employee trust ("ESOP") to:
(a) Help finance the growth of its employer's small business; or
(b) Purchase ownership or voting control of the employer.

a. Advantages and Disadvantages of Employee Trust Loans

The following examples indicate some of the advantages and disadvantages of the program from the point of view of both employees and the employer.

(1) To Employees

Workers are able to pool resources through employee trusts to purchase more stock/securities collectively than they could individually. The allocation of stock purchased to the accounts of individual participants establishes a retirement fund for the employee. Some employees may consider having their retirement funds tied so closely to the success or failure of the business a disadvantage. Also, some employees or employee organizations may object to the idea that the workers should have a voice in the operation of the business by owning and voting stock.

(2) To Employers

The major benefit to the employer is usually the manner in which contributions are treated for tax purposes. Payment of principal and interest to the employee trust can be deductible as pre-tax expense while only the interest paid is deductible on a loan made to a business by a bank or other lender.

A stockholder of the employer concern can use the employee trust as a market for the stock in anticipation of retirement. The disadvantage is a dilution of control resulting from the sale of additional stock. Added dividend expenditures can also

result from the sale of stock to the trust.

An ESOP structure is available to any business which can receive a guaranteed under section 7(a) of the Small Business Act. Section 7(a)15 of the Act permits SBA to guarantee loans to qualified ESOPs "with respect to a small business concern." Therefore the employer concern must be eligible for the ESOP to be eligible to receive consideration from SBA.

b. Reporting Requirements

SBA is required to report on its ESOP activity to Congress on an annual basis, and as such, the following information is to be collected and maintained by each office. This information is to be collected on an annual basis, using a fiscal year end time frame, by the processing office, for transmission to the Chief, Administration Information Branch, upon request.

(1) A list of every ESOP loan applicant: showing name, amount, and purpose of loan, as well as disposition.

(2) If declined, indicate coded reasons, plus whether the decline was a screenout or formal actions.

(3) If approved, and date of formal approval along with the loan number issued. In addition, the loan status of all disbursed ESOP as of the date of the gathering of the data.

. 120.351 Definitions.
All terms specific to ESOPs have the same definition for purposes of this section as in the Internal Revenue Service (IRS) Code (title 26 of the United States Code) or regulations (26 CFR chapter I).

c. Definition Of ESOP Program Terms

(1) Employee Trust

The employee trust must be part of a plan sponsored by the employer concern and qualified under either the Internal Revenue Code as an Employee Stock Ownership Plan (ESOP) or the Department of Labor implementation of the Employee Retirement Income Security Act (ERISA).

Department of Labor (DOL) regulations prohibit certain loan transactions under ERISA. DOL may grant an exemption from these regulations after a hearing. This exemption is necessary where an employee trust applicant uses ERISA for SBA

assistance.

It is the responsibility of the applicant, not the lender or SBA, to provide written evidence that it is eligible. The employee trust must meet the following criteria:

(a) Be in existence at the time of application, not organized as the result of a loan condition, and be maintained by the small business concern by whom the participants are employed.

(b) Include at least 51 percent of the employees of the employer concern as participants in the trust. All employees, including management, are to be counted in determining the total number of employees.

(c) Have as its primary purpose investing in qualifying employer securities.

(d) Provide that each employee participating in the plan has a right to direct the trust on how to vote the employer securities that have been, or will be, allocated to the employee account.

(e) Provide written evidence from the IRS that the employee trust qualifies under its regulations or from DOL that the employee trust is exempt from its regulations prohibiting certain loan transactions. If the ESOP trustee advises that IRS or DOL does not issue letters of this type, SBA can accept an opinion from qualified outside counsel.

(2) Loan Agreement

To obtain an SBA guaranteed loan, SBA, the employee trust, and the employer concern must enter into an agreement which stipulates that:

(a) The SBA loan must be solely for the purchase of qualifying employer securities;

(b) The employer concern will use the SBA loan proceeds that it receives from the employee trust solely for the purposes specified in the loan authorization;

(c) The employer concern agrees to provide funds necessary for the trust to repay loan principal and interest;

(d) Specified property of the employer concern is to be available as collateral for the loan;

(e) All unencumbered qualifying employer securities acquired by the trust with the SBA guaranty loan funds must be allocated to the account of plan participants entitled to share in the allocation;

(f) Each plan participant will have a non-forfeitable (vested) right to all such qualifying shares no later than the date the SBA guaranteed loan is paid in full;

(g) The plan participants will have a 90-day right of first refusal before the business is relocated (other than in the same community), sold, liquidated or otherwise loses its identity for any reason other than court action. This provision applies only where employees own less than 51 percent;

(h) The employer concern may not place a maximum or minimum limit on the percentage of voting stock the employee organization can control; and

(i) While it is not an eligibility requirement for all employee organizations to provide procedures which give new employees an opportunity to join, except for ERISA, such procedures should be encouraged in every instance. If the employee trust is qualified under the provisions for ERISA, the agreement must include these conditions.

(i) Each participant who is entitled to distribution from the plan must have the right, with respect to qualifying employer securities not readily tradable on an established market, to require that the employer concern repurchase such securities at either a fair valuation formula, appraisal requirement or other method acceptable to IRS or DOL; and

(ii) Provide procedures for including future employees in the plan.

d. Use Of Proceeds

The ESOP special loan program has limited proceeds usage as defined in .120.352.

. 120.352 Use of proceeds.
Loan proceeds may be used for two purposes.
(a) Qualified employer securities. A qualified employee trust may relend loan proceeds to the employer by purchasing qualified employer securities. The small business concern may use these funds for any general 7(a) purpose.

ESOP proceeds may be used for:

(1) Growth and Development Loans (QUALIFIED EMPLOYER SECURITIES)

The trust may relend loan proceeds to the employer by purchasing qualifying employer securities but not necessarily voting stock. Qualifying employer securities can take the form of bonds, debentures or other types of voting or non-voting securities. The small business concern may use these funds for any purpose for which it could use 7(a) funds if it had borrowed in its own name.

(b) Control of employer. A qualified employee trust may use loan proceeds to purchase a controlling interest (51 percent) in the employer. Ownership and control must vest in the trust by the time the loan is repaid.

(2) Change of Ownership Loans (CONTROL OF EMPLOYER)

This purpose is to permit employees to acquire controlling interest in an employer concern. The employees must use loan proceeds to acquire voting control, a minimum of 51 percent ownership, which must pass to them no later than the date the loan is repaid. If these provisions are met, normal 7(a) constraints on change of ownership do not apply.

e. Responsibility Of The Trustee

The trustee of the ESOP must certify to the following:

(1) The small business concern is not directly or indirectly under the control of the sellers not later than the date the SBA loan is repaid (or as soon thereafter as is consistent with the requirements of the Internal Revenue Code) at least 51 percent of the total voting stock of the small business concern will be allocated to the accounts of at least 51 percent of the employees entitled to share in such allocations.

(2) After purchase, the small business concern will be a corporation that is a small concern under the limits of 13 CFR Part 121.

In addition, the plan's participants or the trustee must provide annual reviews to the lender of employees entitled to share in the allocations and in the management of the small business concern.

f. Unique Eligibility Criteria of the ESOP Program

. 120.353 Eligibility.

SBA may assist a qualified employee trust (or equivalent trust) that meets the requirements and conditions for an ESOP prescribed in all applicable IRS, Treasury and Department of Labor (DOL) regulations.
In addition, the following conditions apply:

(a) The small business must provide the funds needed by the trust to repay the loan; and
(b) The small business must provide adequate collateral.

(1) Collateral:

Primary collateral for an ESOP loan will be the assets of the employer concern, not of the individual participants holding the reciprocal ownership. The personal assets or personal guarantees of employee participants cannot be required as collateral. However, personal guarantees and the pledge of personal assets of principals not participating in the plan are required as appropriate.

(2) Statutory Ceiling:

SBA can guarantee obligations of the employee trust, the employer concern and all other affiliates in a combined amount not to exceed $750,000, SBA exposure.

(3) Outside Resources and Guarantees:

Apply 7(a) rules pertaining to the utilization of resources and credit of the employer concern to this program in the normal manner. Require the trustee of the employee trust to certify that the employee trust is unable to borrow the necessary funds without SBA assistance.

Principals not participating in the employee trust must utilize excess personal resources prior to government guaranteed funds. Do not consider personal resources and guarantees of employee participants when processing a loan under

this program. Normal 7(a) personal resource and personal guaranty requirements apply to any owner of 20 percent or more of the small concern, even if such ownership is through the ESOP. These requirements apply to 20 percent or greater owners, regardless of the form of ownership.

Except for change of ownerships, principals of the employer concern not participating in the employee trust may be asked to guarantee the loan on the same basis as if the employer concern was the borrower.

(4) Employer Concern Percent of Ownership:

Where the purpose of the loan is for growth and development, the amount of voting stock controlled by the employee trust is irrelevant to eligibility. However, in change of ownership loans, the employee trust must control not less than 51 percent of the voting stock no later than the date the loan is repaid.

When the employee trust no longer represents at least 51 percent of all employees due to employees leaving or new employees not joining, restrict the borrower in modification of loan terms. Consider only those actions that SBA deems necessary to effect full payment of the loan in the shortest possible time.

(5) Employer Concern:

The employer concern must be eligible for SBA assistance in its own right. Except for change of ownerships, this program may not do indirectly what SBA cannot do directly. The employer concern must be a corporation.

g. Repayment Considerations For The ESOP Program

. 120.354 Creditworthiness.
In determining repayment ability, SBA shall not consider the personal assets of the employee-owners of the trust. SBA shall consider the earnings history and projected future earnings of the employer small business. SBA may consider the business and management experience of the employee-owners.

Repayment ability is to be based on the ability of the employer concern to generate sufficient cash flow to repay SBA in addition to the other fixed obligations of the business. In a change of ownership, the small business being purchased must over come any competitive disadvantages that caused the original owner to sell the facility.

9. THE VETERANS LOAN PROGRAM (Subject to Separate Funding)

SBA has a Veterans Loan Program for Vietnam-era and disabled veterans.

a. Veteran's Loans Funding - Status

As of the date of this SOP, funding for veterans loans had not been provided by Congress since the Federal Government's fiscal year 1994.

b. Regulatory Requirements for Veteran's Loans

The regulatory requirements for low income assistance are detailed in 13 CFR, sections 120.360 and 120.361.

. 120.360 Which veterans are eligible?
SBA may guarantee or make direct loans to a small business 51 percent owned by one or more of the following eligible veterans:
(a) Vietnam-era veterans who served for a period of more than 180 days between August 5, 1964, and May 7, 1975, and were discharged other than dishonorably;
(b) Disabled veterans of any era with a minimum compensable disability of 30 percent; or
(c) A veteran of any era who was discharged for disability.

. 120.361 Other conditions of eligibility.
(a) Management and daily operations of the business must be directed by one or more of the veteran owners whose veteran status was used to qualify for the loan.
(b) This direct loan program is available only if private sector financing and guaranteed loans are not available.
(c) A veteran may qualify only once for this program on a direct loan basis.

10. THE POLLUTION CONTROL LOAN PROGRAM

Section 7(a)(12)(B) of the Small Business Act authorizes on a deferred participation basis loans to assist small businesses to finance the planning, design, or installation of a pollution control facility.

. 120.370 Policy.
Section 7(a)(12) of the Act authorizes SBA to guarantee loans up to $1,000,000 to an eligible small business to plan, design or install a pollution control facility. An applicant must meet the eligibility requirements for 7(a) loans.

a. Definition of a Pollution Control Facility

A pollution control facility is real or personal property which is likely to help prevent, reduce, abate, or control noise, air or water pollution or contamination by removing, altering, disposing, or storing pollutants, contaminants, wastes or heat and such real or personal property which will be used for the collection, treatment, storage, utilization, processing or final disposal of solid or liquid waste. Any related "resource recovery" property (recycling) is also eligible when it is stated to be useful for pollution abatement by a local, state or Federal environmental regulatory authority.

b. Uses of a Pollution Control Program Loan

The only allowable use of proceeds are the planning, design or installation of a pollution control facility. A pollution control facility is defined above.

c. Additional Submission Requirements

In addition to general submission requirements, applicants must provide plans and/or specifications, as appropriate, for the pollution control facility and written, realistic cost estimates to ensure that the project can be completed with the available sources of funds, including loan proceeds. Applicants should provide copies of any local, state or Federal environmental regulations that relate to the proposed facility with the application.

d. Other Criteria

(1) SBA identifies Pollution Control Loans with the prefix PCL on the loan number.

(2) Pollution Control Loans may only be made on a guaranteed basis.

11. THE 8(a) PARTICIPANT LOAN PROGRAM (Subject to separate Funding)

SBA has a Loan Program for approved participants of the Agency's 8(a) Program. as authorized by section 7(a)(20) of the Small Business Act

a. Loans For 8(a) Participants Funding - Status

As of the date of this SOP, funding for loans to participants in the 8(a) program had not been provided by Congress since the Federal Government's fiscal year 1994.

b. Regulatory Requirements for 8(a) Participant Loans

The regulatory requirements for the 8(a) participant loan program are detailed in 13 CFR, sections 120.375 through 120.377.

. 120.375 Policy.

Section 7(a)(20) of the Act authorizes SBA to provide direct (unilaterally or together with Lenders) or guaranteed loans to firms participating in the 8(a) Program.

. 120.376 Special requirements.
The following special conditions apply (otherwise, 7(a) loan eligibility criteria apply):
(a) The Associate Administrator of Minority Enterprise Development ("MED") may waive the direct loan administrative ceiling of $150,000, and raise it to $750,000.
(b) The SBA portion of a guaranteed loan must not exceed $750,000.
(c) The interest rate on a guaranteed loan shall be the same as on 7(a) guaranteed business loans. The interest rate on a direct loan shall be one percent less than on a regular direct loan.
(d) For a direct loan or SBA's portion of an immediate participation loan, SBA shall subordinate its security interest on all collateral to other debt of the applicant.

. 120.377 Use of proceeds.
The loan proceeds shall not be used for debt refinancing. Only a manufacturing concern may use loan proceeds for working capital.

12. THE DEFENSE ECONOMIC TRANSITION LOAN PROGRAM

Section 7(a)(21) authorizes SBA to make loans on a guaranteed basis to businesses or individuals negatively impacted by a Department of Defense (DOD) installation closure or substantial reduction, the termination or reduction of any DOD contracting program, or to anyone who wants to operate a business in an area detrimentally affected by the termination or substantial reduction of any DOD program.

. 120.380 Program

Section 7(a)(21) of the Act authorizes SBA to guarantee loans to help eligible small businesses transition from defense to civilian markets, or eligible individuals adversely impacted by base closures or defense cutbacks to acquire or open and operate a small business.

a. Special Provision for Funding

This program was established with the requirement that any approvals had to be funded from funds specifically dedicated to the 7(a)(21) program, and not from regular 7(a) funds. For fiscal year 1996, no level of funding has been established for 7(a)(21) loans, either Direct or Guaranty, and none are anticipated in the immediate future.

The enabling legislation specifies that the 7(a)(21) program shall be separately funded. If funds are not specifically allocated for this program, field offices are not authorized to accept any applications for assistance under 7(a)(21) authority. Applications may, however, continue to be accepted under the standard 7(a) program from applicants whose requirements are similar to those identified in this regulation. These applications are to be processed under the same guidelines as those for the regular program in this SOP.

b. Eligibility Criteria

Section 7(a)(21) authorizes SBA to make loans on a guaranteed basis to applicant specified in section 120.381, as follows:

. 120.381 Eligibility.

(a) Eligible small businesses. A small business is eligible if it has been detrimentally impacted by the closure (or substantial reduction) of a Department of Defense installation, or the termination (or substantial reduction) of a Department of Defense Program on which the small business was a prime contractor, subcontractor, or supplier at any tier.

(1) Small business concerns (SBC) that have been, or can reasonably be expected to be detrimentally affected by a DOD installation closure or substantial reduction;

(2) Prime or sub contractor performing under any DOD contracting program who suffered losses as a result of the termination or reduction of said program; and

(b) Eligible individual. An eligible individual, for purposes of this program, includes the following persons involuntarily separated from their position or voluntarily terminated under a program offering inducements to encourage early retirement:

(1) A member of the Armed Forces of the United States (honorably discharged);
(2) A civilian employee of the Department of Defense; or
(3) An employee of a prime contractor, sub-contractor, or supplier at any tier of a Department of Defense program.

(3) Individuals who lost their direct employment from DOD (either active military or civilian employees) or indirect employment as contractors for DOD, as a result of the termination or substantial reduction of a DOD program providing they intend to start, acquire, or operate a business in an area that has been or can reasonably be expected to be detrimentally affected by the termination or substantial reduction of any DOD program.

c. Credit Considerations

Recognizing that greater risk may be associated with loans to small businesses that are eligible for this program, SBA shall resolve any reasonable doubts concerning the small business' proposed business plan for transition to non-defense-related markets in favor of the loan applicant in determining the sound value of the proposed loan.

13. THE DELTA LOAN PROGRAM

DELTA stands for Defense Loan and Technical Assistance. The DELTA Program is a pilot program established under the authority of 7(a)(21) that will operate until all funds have been expended.

(c) Defense loan and technical assistance (DELTA). The DELTA program provides financial and technical assistance to defense dependent small businesses which have been adversely affected by defense reductions. The goal of the program is to assist these businesses to diversify into the commercial market while remaining part of the defense industrial base. Complete information on eligibility and other rules is available from each SBA district office

a. Questions and Answers on DELTA

Q: Are DELTA loans the same as other SBA guarantee loans?

A: Yes. DELTA loans are 7(a) or 504 loans. Except as noted below, all regulations governing 7(a) and 504 also govern DELTA loans.

Q: What are the exceptions? How do DELTA loans differ from 7(a) and 504 loans?

A: DELTA loans differ in terms of eligibility, processing procedures and maximum SBA exposure.

Q: What is the DELTA program?

A: The Defense Loan and Technical Assistance (DELTA) program is a joint SBA/DOD pilot program authorized by Public Laws 103-337 (FY-95 DOD Authorization Act) and 103-403 (FY-95 SBA Authorization Act) and funded by Public Law 103-335 (FY-95 DOD Appropriations Act). DELTA has approximately $900 million in program authority. The DELTA program commenced on July 26, 1995, and terminates when all funds are expended.

b. Eligibility Criteria

To be eligible for a DELTA loan, an applicant must:

(1) Have derived at least 25 percent of total company revenues during any of its prior 5 operating fiscal years from DOD contracts, defense related contracts with the Department of Energy or sub-contacts in support of defense related prime contracts; and

(2) Have been adversely impacted by reductions in defense spending OR be located in an adversely impacted community; and

(3) Meet one of the following public policy objectives:

(a) Retain jobs of defense workers, if firm has been adversely impacted; OR

(b) Create new employment in impacted communities; OR

(c) Modernize or expand the applicant's plant so it can diversify operations while remaining in the national technical and industrial base.

c. Processing Differences

Q: Are DELTA loans processed differently than regular 7(a) or 504 loans?

A: Yes. They are physically processed at either a DELTA Processing Centers (DPC) located in Boston, Chicago, Dallas, and San Francisco, or at a PLP Processing Center. Boston is responsible for DELTA loans originating in regions 1, 2 and 3; Chicago in regions 4, 5 and 7; Dallas in regions 6 and 8; and San Francisco in regions 9 and 10. The credit analysis of a DELTA loan is also evaluated differently than a standard 7(a) or 504 loan.

The originating district office is responsible for screening the application for: documentation completeness; basic 7(a) eligibility; and preliminary eligibility for the DELTA Program. The District then forwards the file to the appropriate DPC. Responsibility for tracking the DELTA application will be done at the DPC, not the originating district. The DPC processes the application and includes the originating district office code in the LATS Home Office Code field when logging their application into Loan Application Tracking System (LATS).

Assignment of the Client Identification Number (CID) and movement through LATS take place at the DPC. After the authorization is issued, the file is returned to the originating district office for closing and servicing.

Disbursements are the responsibility of the originating district office. Modifications to the loan authorization may be made by the originating district office, provided that: action on any modification affecting repayment ability, collateral, loan maturity, or eligibility for the DELTA program (such as substantial changes in the use of proceeds) must be taken only after consultation with the DPC loan officer and/or approving official. This consultation may be by telephone, and noted in the file. The DPC may require the file to be returned for action at the DPC on substantial changes.

Q: What is different about the DELTA loans with regard to loan limit and agency exposure?

A: DELTA loans have a legislatively mandated maximum dollar amount. The gross loan amount on a DELTA loan cannot be more than $1.25 million. The maximum SBA exposure on a DELTA loan is 80 percent which must not exceed $1 million. If both 504 and 7(a) are used, the combined gross loan amount still cannot exceed $1.25 million. 7(a) cannot be used to provide a guaranty on the third party lender's private sector portion of the identified 504 project. All other terms of a DELTA loan are governed by existing 7(a) and 504 regulations.

d. Repayment Considerations

120.382 Repayment ability.

SBA shall resolve reasonable doubts concerning the small business' proposed business plan for transition to non-defense-related markets in favor of the loan applicant in determining the sound value of the proposed loan.

7(a) DELTA loans are not considered typical SBA loans and are processed under guidelines found in section 7(a)(21) of the Small Business Act which states that "any reasonable doubts concerning the firm's proposed business plan for transition to non-defense related markets shall be resolved in favor of the loan applicant...." While Congress did not establish specific guidelines with regard to 504 DELTA loans, benefit of the doubt also should be given the applicant under 504. Subsidy rates for DELTA loans are slightly higher than for regular 7(a) and 504 loans.

e. Processing Considerations

120.383 Restrictions on loan processing.
Since greater risk may be associated with a loan to an applicant under this program, a Certified Lender or Preferred Lender shall not make a defense economic assistance loan under the PLP or CLP programs.

(1) Processing Considerations for 7(a)(21):

Since 7(a)(21) applicants are businesses undergoing significant changes to their operating procedures as a result of being detrimentally impacted from actions taken by the Department of Defense, historical performance will not be an indicator of future performance.

Therefore, the analysis of all credit factors, as well as the eligibility criteria, requires a thorough examination. Hence 7(a)(21) loans are not suitable for processing under the CLP or PLP expeditious processing (except see procedures for DELTA, below).

(2) Processing Consideration for DELTA:

Most DELTA Loans require special handling because they are generally more complicated credits and because of the detrimental impacts being suffered by the businesses. These applications may not be suited for expeditious processing under CLP or PLP procedures. However some applications can be processed expeditiously. If an application meets the following standards, it can be processed under PLP procedures:

(a) It meets SBA eligibility requirements;
(b) The DELTA certification statements are completed, signed, dated and maintained in the lender's loan file;
(c) The lender's credit memo specifies the basis for DELTA eligibility;
(d) The request for PLP number identifies the loan as DELTA.

All DELTA loans processed under PLP procedures should be positively identified as a PLP loan on the LSA010 screen. All 7(a) DELTA loans, shall be identified by sub-program code 1028. All 504 DELTA loans, shall be identified by subprogram code 4006.

Although all reasonable doubts concerning the borrower's proposed business plan for a DELTA loan are resolved in favor of the borrower, if a lender chooses to make DELTA loans PLP, those loans will not be distinguished from other PLP loans in evaluating the lender's repurchase rates under PLP.

14. THE CAPLines LOAN PROGRAM

Under the broad authority of Section 7(a) of the Small Business Act, SBA administratively created four separate short term working capital loan programs to address various working capital needs of small business. In addition, under Section 7(a) (9) of the Act, the Agency is authorized to provide loans to finance residential or commercial construction or rehabilitation for sale. Together these five programs are collectively known as CAPLines.

Caplines Program . 120.390 Revolving credit.
(a) CapLines finances eligible small businesses' short-term, revolving and non-revolving working-capital needs. SBA regulations governing the 7(a) loan program govern business loans made under this program. Under CapLines, SBA generally can guarantee up to $750,000.
(b) CapLines proceeds can be used to finance the cyclical, recurring, or other identifiable short-term operating capital needs of small businesses. Proceeds can be used to create current assets or used to provide financing against the current assets that already exist.

a. General Questions on CAPLines

Q1. What is the CAPLines program?

A1. CAPLines is the umbrella for all of SBA's short term working capital and line of credit programs except those dedicated exclusively to exporting. CAPLines consists of five separate sub-programs which are designed to meet a particular credit need of business by financing short-term, revolving and non-revolving, working capital. There are universal requirements applicable for all CAPLines and unique requirements that are only applicable to a few or one sub-program.

Q2. What are some of the key characteristics of CAPLines loans?

A2. (1) Provides revolving feature for short term loans;

(2) Can be structured utilizing a Master Note with multiple sub-notes;

(3) Can be used to create current assets OR finance existing current assets (but not both together);

(4) Once cash (from sales or collection of receivables) is generated, it must be used to repay the loan;

(5) Can not be processed under CLP, PLP, LowDoc, or any Pilot processing procedures, including SBA*Express* (formerly FA$TRAK);

(6) Repayment ability is based on cash cycle rather than cash flow;

(7) May be increased up to one third, once during the 5 year term (with SBA approval) without submission of a new application, providing the existing loan is performing as authorized;

(8) Does not require annual "clean up" period (except for Seasonal loans); and

(9) CAPLines loans can not be sold in the secondary market.

b. CAPLines Sub-Programs

The following explains the five sub-programs under the CAPLines umbrella:

(1) Seasonal is used, to support buildup of inventory, accounts receivable, or labor & materials above normal usage for seasonal activity;

(2) Contract is used to finance labor and materials for single or multiple contracts;

(3) Builder is used for construction contractors or developers to construct or rehabilitate residential or commercial property (including SPEC houses);

(4) Standard Asset Based is used to support an increase in accounts receivable or inventory; and

(5) Small Asset Based ($200,000 or less) is used to support an increase in accounts receivable or inventory.

The purpose of first three types of CAPLines is to provide working capital in order to create new current assets, while the latter two types provide financing against existing current assets. These are two different credit concepts which the analyst need to be familiar with when processing any CAPLines.

c. Applicability for Start-Up Businesses

None of the sub-programs under CAPLines are intended for start-up businesses. Although the applicant is not automatically required to be in business for 1 year in order to apply (except Seasonal loans), they need to have developed a track record so an adequate assessment of their short term needs can be made.

15. UNIVERSAL REQUIREMENTS FOR ALL CAPLINES

a. General Business Eligibility

All CAPLines applicants must be 7(a) eligible. Additional requirements for each sub-program are discussed under the various sub-programs.

b. Guaranty Percentages and Maximum Loan Amounts

CAPLines are no different than any other 7(a) loan. The guarantee cannot exceed $750,000 or 75 percent of the total loan amount, whichever is less, except for loans where the total guaranteed portion is $80,000 or less which are guaranteed at 80 percent. There is no maximum gross loan amount.

c. Guaranty Fees

The guarantee fee structure for CAPLines is the same as for any other 7(a) loan.

d. Allowable Fees

In addition to the guaranty fee and actual closing costs, lenders may charge a fee equal to 2 percent per annum of the outstanding loan balance for the extraordinary servicing that lines of credit may require. This 2 percent fee is the maximum that can be charged by a lender on any CAPLines except for those loans approved under the Standard Asset Based sub-program, which has no fees limitation. The extraordinary fee should be computed by multiplying 0.167 times either the average daily outstanding for one month or the average monthly outstanding balance. This fee should be calculated and charged monthly.

The servicing fee is not automatic but must be justified based upon the amount of actual work performed by a lender to administer the loan. The fee percentage to be charged must be pre-approved by SBA at the time of loan approval.

1

e. Use of Proceeds

CAPLines proceeds finance either what is, through the Standard Asset Based and Small Asset Based sub-programs, or what will be, through the Seasonal, Contract and Builder's sub-programs. These are detailed separately in this text under the various sub-programs.

Q. Can CAPLines proceeds be used for any purpose other than short term working capital?

A. CAPLines proceeds may not be used for permanent working capital, to acquire fixed assets, to pay delinquent taxes or similar funds held in trust (directly or indirectly), to refinance long term debt, for change of ownership or floor plan financing.

An applicant may utilize both the regular 7(a) and CAPLines programs simultaneously. However, they will be required to submit separate applications.

f. Tax Requirement

CAPLines applicants must be current on payroll taxes or have an IRS approved plan for repayment in good standing at the time of initial disbursement. Failure to pay tax obligations may be a reflection on the character of management. See subpart A. In addition, there must be a depository plan (commonly referred to as a Treasury, Tax & Loan account or TT&L account) in operation at a financial institution or the borrower must be enrolled in the Internal Revenue Service's Electronic Federal Tax Payment System (EFTPS) for the payment of future withholding taxes. The use of the EFTPS system was mandated by Congress in 1993 and will become mandatory for most small businesses by 1999.

When making disbursements for payroll, the lender should deduct all payroll taxes and make appropriate direct deposits to the appropriate Federal and State, if applicable, authorities. This practice provides protection to the lender and SBA because of the provisions of the Federal Tax Lien Act of 1966. This act holds lenders liable for unpaid income tax withholdings when the lender's advances are used for payroll purposes and the lender had knowledge of a deficiency in tax remittances. If the borrower uses a payroll service, the lender does not have to perform this function.

g. Debt Refinancing

CAPLines may refinance existing short term notes as long as:

(1) The refinanced portion does not include any term debt or identifiable permanent working capital; The refinancing will benefit the small business concern AND

(2) It does not put SBA in a position to sustain a loss which the existing lender is presently facing.

A copy of the note(s) being refinanced is required as additional documentation whenever refinancing short term debt is requested. In addition a copy of the transcript of account is needed when same institution debt is refinanced . SBA must make sure the debt being refinanced was approved for short term purposes and was being repaid in accordance with the terms of a short term structured note. If the debt was not being repaid in

accordance with the terms of the note, such that there was no reduction in principal, the debt should be refinanced on a term, rather than revolving basis.

h. Interest Rates

The maximum interest rate a lender is allowed to charge on a CAPLines program loan is the same as for any other 7(a) program. Since the maximum maturity is 5 years, the maximum rate is prime plus 2.25 percent Additional interest for smaller loans are applicable for CAPLines. The rate may be fixed or variable. Interest rate computations can be based on either the daily OR average daily outstanding balance.

i. Establishing the Loan Amount

SBA wants the need being financed to be met with the given loan amount but it also wants to prevent imprudent obligation of excessive appropriations. Generally the loan amount will be based on either a 12 month cash flow projection or a formula related to the timing of cash need. Sometimes the loan will cover a longer time period. The dollar amount of any CAPLines should always be justified by the lender and commented on by the SBA. When requested sufficient funds for growth should be anticipated, justified and supported. More guidance in following section.

j. Maturity and Disbursements

Overall loan maturity cannot exceed 5 years. However, any Seasonal, Contract, or Builder sub-program loan which finances a single transaction should have maturities tied to the seasonal cycle, contract completion date, or project completion date.

All CAPLines must have an exit strategy. Final disbursement shall to occur far enough in advance of maturity so that a sufficient amount of time is available for the assets acquired with the proceeds to be converted back to cash and available to make final payment at maturity. The date of final disbursement shall be established in the Authorization and should be reflective of the time required to permit orderly repayment by the maturity date.

For asset based lines, the final disbursement would be in conjunction with the cash cycle. Disbursements after the last cash cycle has begun, but before maturity, require SBA approval. No advances can be made after maturity. When a balance exists on a CAPLines at maturity, the lender should consider the following:

(a) Enforce final collection;

(b) Renew the line without SBA's guaranty;

(c) Renew the line, requesting SBA's guaranty (new application required if maturity has reached 5 years);

(d) Term out any outstanding balance, with SBA's concurrence. SBA's guaranty would remain in place but there could be no new advances; and/or

(e) Commence liquidation of supporting collateral.

Q. When a loan is renewed, is it considered to be a new loan?

A. No, the act of renewal is an extension of maturity which is the continuation of the existing loan, and existing loan number. No new appropriations are made during the renewal process. Any CAPLines with a maturity of less than 5 years can be renewed so the total revolving repayment period equals 60 months. If the original maturity was for 12 months or less, and the new maturity exceeds 12 months after renewal, an additional guaranty fee, equal to what the fee would have been had the original loan been for 12 month or more, less the amount of fee already paid.

k. General Repayment Characteristics

Repayment is based upon an applicant's demonstrated or projected capability to deliver its product(s), perform its contract(s), sell its inventory, and collect its receivables. Traditional cash flow analysis is not a good indicator for determining repayment ability of these type loans. Payments are to be derived from the turnover of working assets. The anticipated timing and amounts of repayment must be established and relayed to the borrower prior to each disbursement. They should be based upon the cash cycle, seasonal cycle, contract completion date, or project completion date.

NOTE: There are no provisions to permit the payment of interest only for any period exceeding the borrower's cash cycle, seasonal cycle, contract completion date, or project completion date.

l. Master Notes and Sub-Notes

Since CAPLines accommodates the financing of a variety of assets, the mechanics of obligating the different purposes may not all be the same. Each loan will have a Master Note (utilizing SBA Form 147) to cover the total loan amount and general repayment period. In addition lenders can also utilize a system of sub-notes to establish specific repayment periods for particular seasons, contract or construction /renovation project. When the CAPLines will be used to finance the creation of more than on asset (such as the completion of two contracts) it is recommended that sub-notes be used. Sub-notes can also be used to set a specific repayment date for a particular advance or over advance in asset based lending as well as to put a set amount on a demand basis, etc. This is not the normal course of administration, but rather a means to control the exception or unique situation. The conditions of the sub-notes must not conflict with the conditions of the master note, except for variances in repayment schedules. Lenders are not permitted to obtain a 5 year guaranty and then use the sub-note system to limit that authority.

m. Zero Balance Period Requirement

There is no requirement that a zero balance be maintained for any specific time period on any CAPLines except for those made under the Seasonal sub-program. However, if a lender adequately justifies the need for a "clean up" period, this requirement may be placed in the Authorization.

n. Collateral

Applicants must be able to provide the lender with a first lien position on their working assets (i.e. accounts receivable, inventory, or contracts). A second lien position can be considered under certain circumstances for the Builders sub-program. The requirements for personal guaranties are the same as for any other 7(a) program.

NOTE: All liens must be perfected and the lien position verified prior to the initial disbursement. For seasonal, contract or builder loans which revolve for more than one season, contract or construction.renovation project, liens must be perfected prior to the initial disbursement for each season, contract or project.

o. Borrower's Application Process

Applicants must submit an SBA Form 4, with all required exhibits, plus a month-by-month cash flow for the upcoming 12 month period using either SBA Form 74B or SBA Form 1100 (or their equivalent). Additional documentation requirements are specified under each sub-program's requirements later within this text.

p. Lender's Application Process

All participants are eligible to participate in the Small Asset Based, Seasonal, Contract, and Builders sub-programs if they have an executed SBA Form 750 or 750B (for short term loans). Additional requirements are necessary to participate in the Standard Asset Based sub-program. To participate in this sub-program, the lender must send a complete an SBA Form LQS-2 (Lender's Qualification Survey) to the district office serving their geographical area and be approved by that office. (See section on Standard Asset Based for additional guidance on lender approval.)

Lenders make application for guaranty of a CAPLines loan using SBA Form 4-I together with their supporting credit analysis and any additional required documents listed for each sub-program.

q. SBA Processing Restrictions

Seasonal, Contract, Builders, and Small Asset Based applications shall be recommended or signed off on by personnel designated to perform these functions and who have successfully completed SBA's Commercial Credit & Analysis Level III training or the SBA/GreenLine Course sponsored by National Association of Government Guaranteed Lenders (NAGGL). The same is true to recommend or finalize (approve or decline) Standard Asset Based applications except the Level III has to have been conducted since June 30, 1995.

r. Standardized Forms

Lenders participating in the CAPLines sub-programs shall use those forms required by SBA's regular 7(a) loan program PLUS those forms specifically designed to gather semi-annual fee and disbursement information (SBA Forms SAB-159 and CAP-1050). SBA has other forms which are recommended, but not required, as long as the lender's internal forms cover the same information (see Appendix 9).

s. Servicing Requirements

Lenders are expected to prudently administer CAPLines loans in a similar manner as they would administer similar type non-SBA guaranteed loans. Servicing requirements for CAPLines are detailed in the Servicing SOP 50-50.

For any CAPLines with a maturity in excess of 12 months, the lenders shall conduct an annual review of the borrowers financial condition and credit status. The details of this review shall be at the lender's discretion, except for the Standard Asset Based CAPLines where the requirements of the annual review are detailed in Appendix 9. This review can be as of either the anniversary date of initial disbursement or upon receipt of borrowers the annual financial statements.

t. Increases

Any CAPLines may be increased up to one third, one time, during their 5 year term without submission of a new application, providing:

(1) SBA approval is obtained;

(2) The existing loan is performing as authorized.

If the loan to be increased was made on a revolving basis, consideration for an increase can only be made if the loan was reasonably revolving prior to the increase.

If the loan was not performing as authorized, and alternative conditions will not rectify the non-performance, the increase should not be approved.

16. REQUIREMENTS FOR SEASONAL CAPLINES

a. General Characteristics

(1) Only CAPLines sub-program requiring "clean up"

(2) May be structured as a non-revolving loan for one season or a multi seasonal basis as a revolving loan

(3) Finances seasonal upswings in business

(4) Only one seasonal line of credit may be outstanding at any one time (except for loans to agricultural enterprises)

(5) Must adhere to universal CAPLines requirements plus those unique to the Seasonal sub-program

(6) Sub-notes are generally used to obligate funds for any particular season if more than one season is being financed by the loan.

b. Additional Eligibility Requirements

To be eligible for a Seasonal CAPLines, the applicant concern must qualify under the regular 7(a) requirements plus:

(1) Have been in operation for at least 12 calendar months; and

(2) Be able to demonstrate a definite pattern of seasonal activity.

c. Additional Submission Requirements

The lender is required to document the seasonal nature of business and justify proposed dollar amount of the loan. Applicants must submit a month-by-month cash flow for the upcoming 12 months to lender at the time of application and on an annual basis.

d. Use of Proceeds

Borrowers must use the loan proceeds solely to finance the seasonal increases of accounts receivable and inventory (or in some cases associated increased labor costs). Funds must not be used to maintain activity during the slow periods of your cycle.

e. Loan Structure

Seasonal CAPLines revolve between seasons, but not within a season. The loan amount needs to be sufficient to cover the full financing of the increases to seasonal accounts receivable and inventory. Non-revolving means continual advances and repayments can not be made within a seasonal cycle. The loan amount may be advanced to the maximum only once during a seasonal cycle. Loan proceeds may not be paid down and re-advanced within the same seasonal cycle. Revolving means the line will be used to finance multiple seasonal cycles during the life of the loan. If the loan is for one seasonal cycle, it is non-revolving.

Q. Are multiple seasonal cycles permitted within a calendar year?

A. Yes, if your business has more than one season during a calendar year, you may obtain financing for each cycle providing that each cycle is followed by a 30 day out-of-debt (clean up) period. The duration of a single seasonal cycle cannot exceed 11 months from the date of first disbursement since a 30 day clean up must occur after each cycle.

EXCEPTION: The 30 day clean up requirement and the limitation of having only one Seasonal loan outstanding at a time do not apply to agricultural enterprises.

f. Loan Amount, Borrowing Base, and Advance Rate

Q1. How is the Seasonal loan amount determined?

A1. The loan amount is based on the cash flow projections. The amount should correlate to the costs of the seasonal buildup of inventory and/or receivables. Since the loan does not revolve within a season, the loan amount has to equal the total of each disbursement.

Q2. What is the purpose of a Borrowing Base Certificate?

A2. To assist the lender in monitoring the seasonality of a borrower's current assets, to inform them of when payments are coming in to the borrower from its customers, and to determine when payments should be made to the lender.

Q3. How often are Borrowing Base Certificates required?

A3. They are to be submitted to the lender no less frequently than monthly.

Q4. How is the advance rate established?

A4. Advances should be based upon a borrower's direct costs but not their profits.

g. Disbursements & Repayments

Disbursements from the loan are made continually during the seasonal build-up period when the cash requirement for labor, materials, and support of accounts receivables exceeds actual cash receipts.

Principal repayments on the loan must occur as soon as the cash from the seasonal sales has been received by the borrower. Interest should be paid monthly. However, for those businesses which will use the loan proceeds to acquire assets which will not be re-converted back to cash until the end of the season, interest payments would have to be made from the cash flow unassociated with the seasonal activity. If there is no unassociated activity, interest may be paid with principal at the end of the season.

Q. Can a borrower with a Seasonal CAPLines wait until the end of the season and commencement of the clean-up period before repaying all the principal.

A. No, except in very narrow circumstances. The application of principal payments on a Seasonal CAPLines shall occur at the time the asset acquired with the loan proceeds is converted back to cash. The seasonal line is not permanent working capital. If the cash realized from seasonal activities is maintained by the borrower, the risk increases that these funds will be re-used in the business and not available for repayment at maturity. If a borrower will obtain all the cash from the seasonal activity that it borrowed for in one payment (or within 30 days) the seasonal line can be paid off with one payment at the commencement of the clean-up period. Otherwise provision for collections need to be made throughout the season.

The final disbursement of any Seasonal loan should be made in time for the funds to be utilized in the business and converted to cash which can be used to pay off the loan balance at the commencement of a clean up period or maturity.

h. Collateral

SBA will require a first lien position on the assets being financed and personal guaranties. Other collateral will only be required when the current assets, along with other credit factors, are not considered to be sufficient to protect the interests of the Government. Current assets may be used to secure other debt providing the assets being financed can be easily segregated.

i. Loan Authorization Conditions

All Seasonal CAPLines (CAS) loan authorizations will include the following provisions, as appropriate.

(1) Borrower's written agreement that funds advanced may not be used for any purpose other than labor and the seasonal build-up of inventory and accounts receivable.

(2) Borrower's written agreement to furnish the lender a monthly borrowing base certificate, in a form satisfactory to the lender, during the term of the loan.

(3) Borrower's agreement to remit interest on a monthly basis beginning one month from date of note and to make timely principal reductions as soon as cash has been generated from the sale and/or collection of the financed assets.

(4) Borrower and lender acknowledgement that the duration of the seasonal cycle shall not exceed 11 months and each seasonal cycle shall be followed by a 30 day clean up (zero balance) period.

(5) Lender must file on accounts receivable and inventory under the Uniform Commercial Code (UCC).

(6) Agreement by lender that, in the event of default by the borrower, it will execute any right of offset available to it, liquidate working assets which secure the loan, and apply all funds received to the outstanding loan balance prior to requesting that SBA honor the guaranty.

(7) Borrower to provide lender a cash flow projection of all known operational activity on an annual basis during the term of this loan.

(8) Lender to conduct an annual review of the borrowers financial condition and credit status, on either the anniversary date of initial disbursement or upon receipt of annual financial statements.

Optional paragraph (to be included if line is revolving)

(9) Lender is authorized to make advances up to the maximum approved line amount, to meet seasonal needs, as stated in the Authorization without additional SBA approval, providing the lender and borrower are in compliance with all conditions required by the loan authorization.

Disbursements for the financing of any single seasonal activity should discontinue at a sufficient time period before the last payment is due so the activity financed with the disbursement can be completed when the last payment is due. Final disbursement under the Master Note should discontinue in time to permit all activity to be concluded by maturity.

j. Loan Prefixes and Sub-Program Codes

When a Seasonal sub-program loan is approved, processing personnel will designate these loans as CAS, acquire funding using a sub-program code of 1007, and answer "Yes" on the LATS input screen if the line is to be revolving in nature.

17. REQUIREMENTS FOR THE CONTRACT CAPLINES

a. General Characteristics

(1) May be revolving or non-revolving

(2) Can have a master note with multiple sub-notes for the various contracts being financed

(3) Can finances labor and material costs for single or multiple contracts

(4) Must have the proceeds from the contract receivable assigned to lender

(5) Must adhere to the universal CAPLines requirements plus those unique to the contract sub-program.

b. Additional Eligibility Requirements

Contractors who qualify under the regular 7(a) requirements and:

(1) Are able to demonstrate an ability to operate profitably based upon the prior completion of similar contracts.

(2) Possess the overall ability to bid, accurately project costs, and perform the specific type of work required by the contract(s).

(3) Have the financial capacity and technical expertise to complete the contract on time and at a profit.

c. Additional Submission Requirements

In addition to SBA Form 4 and all other required exhibits for a 7(a) loan processed under standard processing procedures, the applicant must submit **two** month-to-month cash flow projections. One should project the full contract period for the specific contract(s) being financed and the other should detail all the contract work to be performed by the SBC, including the contract being financed, for the same time frame.

If the purpose of the Contract CAPLines is to finance multiple contracts, including contracts which have not been awarded, cash flows of the contracts to be financed and all business activity occurring at the same time will not be available at the time of original application. Under these conditions, the borrower shall present both the specific cash flow for the contract to be financed and the second cash flow showing all activity once the award for the contract to be financed is made. The borrower may also provide the projected cash flow of all activity annually and provide the cash flow on the specific contract as they are awarded. SBA requires the lender have information on both the specific and all contract activity for the time periods it will be providing contract financing prior to any disbursements for contract performance.

d. Use of Proceeds

The contractor must use loan proceeds solely to finance the labor and material costs of the specific contract(s) being financed. Proceeds cannot be used to cover overhead or general and administrative expenses.

e. Loan Structure

A single Contract CAPLines may be utilized to fund multiple contracts either simultaneously or over a period of time. Once the overall line amount has been approved by SBA, the lender may advance against additional contracts without SBA approval, providing the borrower and lender are in compliance with all terms of the loan authorization.

Q. Can a borrower have more than one Contract sub-program loan?

A. Yes, if the Contract loan will be used to finance a single contract, you may have

multiple Contract sub-program loans outstanding at the same time.

If the loan is to be made on a revolving basis, a master note should be executed for the total approved line amount. Individual sub-notes should be utilized to finance each separate contract.

f. Loan Amount

(1) For single contract financing, the loan amount is based on the cash flow projection provided by the applicant and should be equal to the amount that is necessary to finance the direct labor and material costs associated with a specific contract.

(2) For multiple contract financing, the master note amount is based on the cash flow projection provided by the applicant for ALL work to be performed by the SBC (not just a specific contract). Since multiple contracts could be financed simultaneously, consideration should be given to the SBC's peak cumulative cash need for labor and material costs. The amount of a sub-note (for each specific contract) is determined the same as discussed above for single contract financing.

g. Disbursements & Repayments

(1) Prior to initial disbursement on any Contract CAPLines, the entity with whom the borrower has entered into the contract with must be advised in writing by both the lender and borrower that an assignment of the contract proceeds is required. Such assignment must be in place before any disbursement for a particular contract is made and include provision for the lender's right to receive all payments from the third party. The lender must be in receipt of the third party's written acknowledgement.

(2) Disbursements are made, when needed, to pay for the labor and materials used on a specific contract. Disbursements will generally be made as the contract progresses, not with one lump sum disbursement to cover all labor and material costs. Only if the contract performance period was 30 days or less should only one disbursement for payroll be allowed. However, if a borrowing contractor wanted to acquire all their materials up front, to take advantage of volume discounts, and/or pay for all acquired materials with in 10 days, to take advantage of prompt pay discounts, the Contract

CAPLines Program will accommodate such a disbursement plan. The cash flow projection submitted by the applicant should be a good indicator for the timing and amount of needed disbursements.

(3) With the assignment of contract proceeds in place, the lender receives all the payments the borrower would normally receive if they were internally financing the contract. Included in these payments is profit, as well as funds which the borrower may need to pay for those items the Contract CAPLines did not cover, such as G&A and Overhead expenses. The Loan Specialist should be concerned that these latter expenses are also being adequately satisfied while the contract is being performed. Under the Contract CAPLines, the lender does not have to, and in most cases should not retain 100 percent of all collections for application against the loan's balance. Some portion of each contract payment can usually be returned to the borrower and the loan will still get paid in full.

(4) Prior to the initial disbursement for any contract being financed with a Contract CAPLine, the borrower should be advised in writing by the lender, of the percentage of each collection to be retained by the lender and applied to the outstanding balance.

(5) The minimum amount of each payment to be retained and applied by the lender should be expressed as a percentage of the total payment. This percentage should be based on the ratio of labor and material expenses to all expenses, plus an additional percentage to cover the necessary interest payment. This calculation should also consider any retainage held back by the contracting authority.

Example: On a monthly basis, it cost a contractor $8,000 in direct labor and materials plus $2,000 in G&A and Overhead to generate a receivable worth $12,000. Assume interest will be $500 per month. What percentage of each collection should the lender retain and apply to the loan and how much should they return to the borrower.

If there was no retainage by the contracting authority, the lender could apply 85 percent ($8,500/$10,000) of each payment against the loan's balance and return 15 percent to the borrower for their use to cover the G&A expenses. If the lender retains any more they could cause the borrower to not be able to meet the obligations which the loan proceeds do not cover. Since the payment amount is $12,000, the lender actually keeps 85 percent or $10,200 of each $12,000 payment.

If there was a 10 percent retainage factor, the receivable generated would still be worth $12,000 but the actual payment amount would only be $10,800. This is because the contracting authority would retain $1,200 of each payment. Since the lender needs to get back enough to cover all direct expenses for which disbursement was made plus interest due, the lender needs $8,500 from each payment, the applicable percentage is still 85 percent because $8,500/$10,000 is 0.85. However, since the payment amount is $10,800, the lender actually keeps and applies $9,180.

(6) The percentage calculation should not be computed by dividing total labor and materials cost by the total contract price, because this would be returning profit to the company with each collection. Profit is to be returned at the conclusion of each contract. However, a portion of each collection should generally be transferred to the borrower to cover their overhead and general and administrative expenses. Therefore, the percentage of how much of each contract payment the lender should keep should be computed by dividing the total labor and material cost by the total contract cost.

The Authorization should include a condition that says:

> All payments by contract obligor, the _____ originating from contract number _____ which was executed on _____, shall be payable to lender. No less than ___ percent of these funds shall be applied on this loan until all principal and interest due hereunder is paid.

h. Maturity

The maximum maturity for a CAPLines Contract:

(1) Financing a single contract, is a maturity date which coincides with the anticipated receipt date of the final payment from the contract vendor following the scheduled completion date of the contract up to a maximum of 5 years.

(2) Financing multiple contracts, is the Master Note maturity, up to a maximum of 5 years. Any contract being financed must conclude prior to the maturity date of the Master Note since complete repayment is required by maturity. Individual sub-notes for specific contracts made under the Master Note should be tied to the anticipated receipt date of final payment (same as described above for single contracts).

i. Collateral

Q. What is SBA's collateral position?

A. SBA requires a direct assignment of the proceeds from the contract(s) being financed and personal guaranties. As long as a direct assignment of the proceeds of the contract is obtained, the remaining other current assets may be used to secure other lines of credit or secure term financing.

j. Loan Authorization Conditions

All Contract CAPLines (CAC) authorizations will include the following provisions, as appropriate.

(1) The entity with whom the borrower entered into the contract(s) must be advised in writing by both lender and borrower of the assignment of the contract(s), including the lender's right to receive all payments from the third party. Prior to any disbursement, the lender must be in receipt of a written acknowledgement from the third party to these actions.

(2) Borrower's written agreement that until the full payment of the note they will immediately notify the lender/SBA of any of the following events with respect to the contract(s):

(a) Modification of any provision which affects the amount due under the contract(s) or otherwise substantially affects the contract(s);

(b) Termination of the contract(s), in whole or in part; failure of either party to perform any of its obligations; and

(c) Rejection of any article delivered and/or non-performance of the contract(s).

(3) Borrower's written agreement that funds advanced for specific contract(s) may not be used for any purpose other than labor and materials on the specific contract(s).

(4) Collateral will include:

(a) An assignment of the proceeds of the contract(s) by the borrower; and

(b) A blanket lien is obtained by the lender on the proceeds of all contracts using a financing statement under the Uniform Commercial Code (UCC).

(5) Agreement by lender that, in the event of default by the borrower, it will execute any

right of offset available to it, liquidate working assets which secure the loan, and apply all funds received to the outstanding loan balance prior to requesting that SBA honor the guaranty.

(6) Borrower to provide lender with a cash flow projection of each contract to be financed with this loan, prior to any disbursement for that individual contract.

(7) Lender to conduct an annual review of the borrowers financial condition and credit status, on either the anniversary date of initial disbursement or upon receipt of annual financial statements.

(8) All payments by contract obligor, the _____ originating from contract number ____ _ which was executed on _____, shall be payable to lender. No less than ___ percent of these funds shall be applied on this loan until all principal and interest due hereunder is paid.

Optional paragraph (to be included if line is revolving)

(9) Lender is authorized to make advances up to the maximum approved line amount, to meet contract labor and material needs, as stated in the Authorization without additional SBA approval, providing the lender and borrower are in compliance with all loan authorization conditions.

(10) Final disbursement under the master note should occur with sufficient time to permit the contract payment resulting from that disbursement to available for application on the Note by stated maturity.

k. Loan Prefixes and Sub-Program Codes

When a Contract sub-program loan is approved, processing personnel will designate these loans as CAC, acquire funding using a sub-program code of 1008, and answer "Yes" on the LATS input screen if the line is to be revolving in nature.

18. REQUIREMENTS FOR THE BUILDERS CAPLINES

The regulations governing the Builders CAPLines are detailed in . 120.391. Section 7(a)(9) of the Small Business Act authorizes SBA to make loans for financing investment property providing the proceeds are solely used to acquire, construct or substantially rehabilitate an individual residential or commercial building which will then be placed for sale to an unaffiliated third party. This program was enacted as an exception to the general rule against financing investments based on the general requirements of sections 2(a) of the Act.

. 120.391 What is the Builders Loan Program?
Under section 7(a)(9) of the Act, SBA may make or guarantee loans to finance small general contractors to construct or rehabilitate residential or commercial property for resale. This program provides an exception under specified conditions to the general rule against financing investment property. "Construct" and "rehabilitate" mean only work done on-site to the structure, utility connections and landscaping.

This program has been incorporated into the CAPLine program as the subprogram Builders CAPLine.

. 120.392 Who may apply?
A construction contractor or home-builder with a past history of profitable construction or rehabilitation projects of comparable type and size may apply. An applicant may subcontract the work. Subcontracts in excess of $25,000 may require 100 percent payment and performance bonds.

. 120.393 Are there special application requirements?
(a) An applicant must submit documentation from:

(1) A mortgage lender indicating that permanent mortgage money is available to qualified purchasers to buy such properties;

(2) A real estate broker indicating that a market exists for the proposed building and that it will be compatible with its neighborhood; and

(3) An architect, appraiser or engineer agreeing to make inspections and certifications to support interim disbursements.

(b) The Borrower may substitute a letter from a qualified Lender for one or more of the letters.

. 120.394 What are the eligible uses of proceeds?
A Borrower must use the loan proceeds solely to acquire, construct or substantially rehabilitate an individual residential or commercial building for sale. "Substantial" means rehabilitation expenses of more than one-third of the purchase price or fair market value at the time of the application. A Borrower may use up to 20 percent of the proceeds to acquire land, and up to 5 percent for community improvements such as curbs and sidewalks.
. 120.395 What is SBA's collateral position?
SBA will require a lien on the building which must be in no less than a second position.
. 120.396 What is the term of the loan?
The loan must not exceed sixty (60) months plus the estimated time to complete construction or rehabilitation.
. 120.397 Are there any special restrictions?
The borrower must not use loan proceeds to purchase vacant land for possible future construction or to operate or hold rental property for future rehabilitation. SBA may allow rental of the property only if the rental will improve the ability to sell the property. The sale must be a legitimate change of ownership.

a. General Characteristics

(1) May be revolving or non-revolving basis.

(2) Could consist of a master note with multiple sub-notes for the various projects being financed.

(3) Provides an exception under specified conditions to SBA's general rule against financing investment property.

(4) Finances direct costs for construction or renovation of residential or commercial buildings that will be resold (including SPEC houses).

(5) Direct costs can include cost of land, landscaping, utility connections and some community improvements, subject to limitations.

(6) Only CAPLines sub-program which, in some cases, permits a second lien position on the asset being financed.

(7) Must adhere to the universal CAPLines requirements plus those unique to the Builders sub-program.

b. Additional Eligibility Requirements

Who may apply for a Builders CAPLine loan? Those businesses which qualify under the regular 7(a) requirements and:

(1) Are construction contractors or homebuilders under SIC code major groups 15, 16, and 17 with a demonstrated managerial and technical ability in profitable construction or renovation;

(2) Must either perform the construction/renovation work or manage the job with at least one supervisory employee on the job site during the entire construction phase;

(3) Renovations must be "prompt and significant". Construction must begin within a reasonable time after loan approval and the cost of renovation must equal or exceed one-third (1/3) of the purchase price of the property. The cost of renovation of buildings already owned by the applicant must equal or exceed one-third (1/3) of the fair market value at the time of loan application;

(4) Have demonstrated a successful performance record in bidding and completing construction/renovation at a profit within the estimated construction period, are able to demonstrate prior prompt payments to suppliers and subcontractors, and the prior successful performance must have been of comparable type and size to the proposed project. (Prior experience in single family construction is not comparable to high-rise apartment construction);

Q. Does a builder have to have been in business one year before being eligible to apply or receive a Builders CAPLines loan?

A. No, there is no 1 year requirement. However, the builder must still have the experience in building a comparable structure to the one(s) to be constructed or renovated with Builder CAPLines proceeds and selling that structure at a profit.

c. Additional Submission Requirements

Q. What are the special application requirements for a Builders CAPLines?

A. In addition to SBA Form 4, applicable exhibits, and a month-by-month cash flow (for ALL work to be performed by the SBC), prior to initial disbursement for any individual project, an applicant must submit:

(1) A letter from a mortgage lender indicating that permanent mortgage money is available to qualified purchasers to buy such properties;

(2) A letter from a real estate broker indicating that a market exists for the proposed building and that it will be compatible with its neighborhood;

(3) A letter from an architect, appraiser or engineer agreeing to make inspections and certifications to support interim disbursements; and

A letter from a lender who has their own real estate lending department, staffed by personnel with appraisal and engineering experience may be substituted for one or more of the above-referenced letters.

(4) Final plans and specifications for the project together with a firm written proposal for the construction costs.

d. Use of Proceeds

Q1. What are the eligible uses of proceeds?

A1. Borrowers must use the loan proceeds solely for direct expenses related to the construction and/or "significant" renovation costs of a specific eligible project (residential or commercial buildings for resale), including labor, supplies, materials, equipment rental, direct fees (building permits, interim disbursement inspection fees, etc.), utility connections (above or below ground), construction of septic tanks, and landscaping.

Proceeds paid to a subcontractor can include the subcontractor's profit. The cost of land is eligible if the land cost does not exceed 20 percent of the project cost. Up to 5 percent of the project cost can be allocated for improvements that benefit all properties in a subdivision, such as streets, curbs, sidewalks, or open spaces.

"Significant" means rehabilitation expenses of more than one-third of the purchase price or fair market value at the time of application.

Q2. Are there any special restrictions?

A2. The borrower must not use loan proceeds to purchase vacant land for possible future construction or to operate or hold rental property for future rehabilitation.

e. Loan Structure

Q1. Does SBA require a separate loan or a separate application for each project an applicant wants to finance?

A1. No, a single line may be utilized to fund multiple projects either simultaneously or over a period of time. Once the overall line amount has been approved by SBA, the lender may advance against additional projects without SBA approval, providing the borrower and lender are in compliance with all terms of the loan authorization.

Q2. Can a borrower have more than one Builder sub-program loan?

A2. Yes, if the Builder CAPLine will be used to finance a single project, you may have multiple Builder sub-program loans outstanding at the same time.

Q3. Can a property be rented while sale is pending?

A3. Yes, SBA may allow the finished property to be rented pending sale only in cases where the rental will enhance the ability to sell the property.

Q4. Are there any restrictions on the final sale of the property?

A4. The sale must be an arms length transaction with legal transfer to an unaffiliated third party.

If the loan is to be made on a revolving basis, a Master Note should be executed for the total approved line amount. Individual sub-notes should be utilized to finance each separate project.

f. Loan Amount

Q. How is the Builder loan amount determined?

A. For a non-revolving loan, the loan amount is based on the firm written proposal of actual costs (not anticipated selling price) provided by the applicant for a single project.

For a revolving loan, the master note amount is based on the cash flow projection provided by the applicant for ALL work to be performed by the SBC (not just a specific project). Since multiple projects could be financed simultaneously, consideration should be given to the SBC's peak cumulative cash requirement for labor, material and other eligible direct costs (see "use of proceeds" for eligible uses). The amount of a sub-note (for each specific project) is based on the firm written proposal of actual costs (not anticipated selling price) provided by the applicant for that particular project.

g. Disbursement and Repayments

Prior to disbursement for each individual project, the lien must be recorded and position verified. Interim disbursements shall be made as construction progresses at stages approved by lender, but shall be advanced only on qualified architect, appraiser or engineer's certification and personal inspection by proper lender officer(s). Amount of disbursement shall not exceed 100 percent of labor, material, and other eligible costs of construction certified to be complete and shall be supported by contractors statements and lien waivers to date.

Prior to final disbursement of construction funds, final lien waivers must be obtained from borrower/contractor and all subcontractors, materialmen, and any independent workers involved in the construction. No disbursement can be made after maturity of the master note.

The repayment of all funds disbursed for any individual project shall occur within the lesser of 36 months after completion of each individual project or at the time of sale. A single principal payment is acceptable. Interest payments must be at least semi-annually and from the applicant's own resources, not from loan proceeds.

h. Maturity

Total maturity of the master note cannot exceed 60 months. However, the maturity date for sub-notes for an individual project is 36 months after completion of the project. If a balance is outstanding at maturity of the master note, the period of extension should be no longer than 36 months from the time construction was completed.

i. Collateral

SBA will accept no less than a second lien position on the property being constructed or renovated if the purpose of the first lien was to acquire the property. If the property is part of a subdivision where the prime lender for the subdivision holds a first lien OR serves as partial collateral for a loan secured by more than one parcel of real estate, the first lienholder must provide a "release clause" for transfer of clear title to any eventual buyer of individual parcels upon receipt of a pre-established payment.

Do not take a second lien position in such situations if the first lien holder requires that the entire loan be paid in full before any property is released. Where Lender/SBA is in a second position, the total amount necessary to release the first and second liens may not exceed 80 percent of the fair market value (selling price) of the completed project. Personal guaranties will also be required.

j. Loan Authorization Conditions

(1) Loan proceeds may only be used for the direct costs of construction or renovation of individually identifiable residential or commercial buildings that will be offered for sale. Each structure, either renovated or constructed, shall be deemed an individual project. Other Use Of Proceed Restrictions:

(a) No more than 5 percent of the total loan may be utilized for site improvements to the common area (curb, sidewalk, common landscaping, etc.) of the renovated or constructed project.

(b) No more than 20 percent of the total loan may be utilized for the acquisition or refinancing of real property upon which this loan financed the renovation or construction.

(2) Prior to initial disbursement for any individual project, lender must be in receipt of a letter(s) from a mortgage lender indicating that permanent mortgage money is available to qualified purchasers of such properties, from a real estate broker indicating that a market exists for the proposed building and that it will be compatible with its neighborhood and from an architect, appraiser or engineer agreeing to make inspections and certifications to support interim disbursements. A letter from a qualified lender may be substituted for one or more of the above-referenced letters.

(3) Borrower shall either perform the construction and/or renovation work or manage the job with at least one supervisory employee on the job site during the entire construction phase.

(4) Individual projects must be repaid within the lesser of 36 months after completion of each individual project or at the time of sale. One single principal payment is acceptable. Interest must be paid at least semi-annually and from the applicant's own resources, not from loan proceeds.

(5) No disbursements can be made after maturity of the master note. If a balance is outstanding at maturity of the master note, a period of extension, not to exceed 36 months from the time the construction was completed may be granted by lender. However, lender must give written notification to SBA of such extensions.

(6) Construction requirements (if project cost is over $25,000): Prior to initial disbursement for any individual project, lender shall be in receipt of and approve the following:

(a) Completed SBA Form 601 executed by borrower/contractor and all subcontractors.

(b) Final plans and specifications for each individual project, prepared by an acceptable licensed architect.

(c) Firm proposal for construction costs of each individual project, based upon approved plans and specifications as referenced above.

(d) Written agreement from borrower/contractor that no material changes in the approved plans and specifications referenced above will be made without the prior written consent of the lender.

(e) Evidence shall be furnished that builder's risk, worker's compensation and general liability insurance are in effect.

(f) Evidence issued by the appropriate regulatory authority that construction meets applicable construction codes, laws, health and sanitation requirements.

(g) In the construction of a new building or an addition to a building, the construction must conform with the "National Earthquake Hazards Reduction Program Recommended Provisions for the Development of Seismic Regulations for New Buildings". Compliance with these requirements shall be evidenced by a certificate issued by a licensed building architect, construction engineer or similar professional, or a letter from a state or local government agency stating that the issuance of an occupancy permit is required and is subject to conformance with building codes and that the local building codes include the Seismic standards.

(h) Interim disbursements shall be made as construction progresses at stages approved by lender, but shall be advanced only on qualified architect, appraiser or engineer's certification and personal inspection by proper lender officers. Amount of disbursement not to exceed 100 percent of labor, material and other eligible costs of construction certified to be completed and shall be supported by contractor's statements and lien waivers to date. Prior to final disbursement of construction funds, final lien waivers must be obtained from borrower/contractors and all subcontractors, materialmen, and any independent workers involved in the construction.

(7) Finished property (projects) shall not be rented pending sale without the prior written consent of lender.

(8) Where the project is part of a subdivision or otherwise held as partial collateral for a loan, the prime lender holding a first lien must provide a "release clause" for transfer of clear title to the buyer of individual parcels upon payment of a fixed amount, without requiring the entire first position loan be paid in full before any parcel is released. Where lender/SBA is in a second lien position, the total amount necessary to release the first and second liens may not exceed 80 percent of the fair market value (selling price) of the completed project.

(9) Final sale of the project must be to an unaffiliated third party. There must be a true transfer of both legal and beneficial title to the property.

(10) Agreement by lender that, in the event of default by the borrower, it will execute any right of offset available to it and apply all funds received to the outstanding loan balance prior to requesting that SBA honor the guaranty.

(11) Lender to conduct an annual review of the borrowers financial condition and credit status, on either the anniversary date of initial disbursement or upon receipt of annual financial statements.

(12) A Borrower may use up to 20 percent of the proceeds to acquire land, and up to 5 percent for community improvements such as curbs and sidewalks.

(13) Borrower to provide lender an estimation of expenses associated with the construction or rehabilitation of each site financed with this loan, in a form satisfactory to lender, prior to any disbursement for that financing.

Optional paragraph (to be included if line is revolving)

(14) Lender is authorized to make advances up to the maximum approved line amount, to meet project labor, material and other eligible needs, as stated in the Authorization without additional SBA approval, providing the lender and borrower are in compliance with all conditions required by the loan authorization.

k. Loan Prefixes and Sub-Program Codes

A Builders CAPLines sub-program loan shall be designate as CAB, and funding shall be acquired using a sub-program code of 1009. A "Yes" answer on the LATS input screen is to be used if the line is to be revolving in nature.

19. REQUIREMENTS FOR STANDARD ASSET BASED CAPLINES

a. General Characteristics

(1) Standard Asset Based loans are generally for more than $200,000;

(2) Finances the cash cycle of qualified businesses;

(3) Supports an increase in accounts receivable and/or inventory;

(4) Can be used for most working capital purposes;

(5) Must revolve;

(6) Requires use of a cash collateral account; and

(7) Must adhere to the universal CAPLines requirements plus those unique to the Standard Asset Based sub-program.

b. Additional Eligibility Requirements

Who may apply? Businesses which qualify under regular 7(a) requirements and can demonstrate the need for a short term revolving line of credit.

c. Additional Submission Requirements

Are there any special application requirements? In addition to SBA Form 4, applicable exhibits, and a month-by-month cash flow for the upcoming 12 month period, the following documents are also required.

(1) SBA Form AB-4 which addresses particular issues about the applicant business and how it operates (applicant completes and signs).

(2) SBA Form AB-4I, Applicant Questionnaire, which determines the level of monitoring and examination that will be required (LENDER completes). **ONLY AVAILABLE TO LENDERS FROM LOCAL SBA OFFICES**

(3) SBA Form SAB-159A, Pilot Compensation Agreement for Anticipated Services To Be Provided and Fees Charged, which describes what fees will be required, how they are calculated and how often they will be charged (lender completes, however, the form requires the signature of borrower, lender, and service representatives).

(4) Not Due At Closing - Since a report on fees is due every six months under this sub-program, and because anticipated fees are reported with the application, the requirement for a report on fees as part of a closing memo is not applicable.

d. Approval of Lender Participants

In order to participate in this program, lenders must complete the Lender Qualification Survey Form LQS-2 and be approved by the local SBA office. The district office must review the Lender Qualification Survey to determine the lender's experience in asset based lending and make determination as to whether lender is qualified to participate in asset based lending (ABL).

Primary responsibility for approving a lender operating in multiple jurisdictions will rest with the district serving the territory where the lender maintains its headquarters. If a lender is approved for participation, the district office shall maintain the original LQS-2 and forward a copy to the Office of Loan Policy, Office of Financial Assistance within 15 days of the lender's approval.

If the lender has prior experience in asset based lending, the survey is required once for initial approval. If the lender does not have prior experience in this type lending, the form is required on an annual basis, until waived by OFA.

e. Use of Proceeds

Borrowers must use the loan proceeds for short term working capital/ operating needs. Proceeds must not be used to pay delinquent withholding taxes or similar trust funds (state sales taxes, etc.), acquisition of fixed assets or floor planning.

f. Determining the Cash Cycle

The cash cycle is the number of days a business takes from the time it acquires inventory, provides a service, manufactures a product, etc. until it collects the cash from the sale of that inventory, service, or product. To measure the length of an applicant's cash cycle, the first step is to compute the turnover ratios and convert these ratios into days. Then add the receivables turnover (ARTO) days to the inventory turnover (ITO) days and subtract payable turnover (APTO) days. The resulting number equals the cash cycle of the business.

For the purposes of this program, you should generally use the last fiscal year-end, rather than the interim statement, for determining the turnovers. An alternative method would be to use a weighted average based on the last 3 years with the most recent year receiving a weight of 3, the next oldest 2, and the oldest a weight of 1.

g. Loan Amount

The BASIC formula for determining a Standard Asset Based loan amount is as follows:

Net Sales Last Fiscal Year	$_____
Minus Net Profit (or Plus Loss)	$_____
Minus Depreciation/Amortization	$_____
Equals Net Annual Cash Expenditure	$_____
Divided by 365 Equals Net Daily Cash Expenditure	$_____
Times Cash Cycle in Days	_____
Equals Basic Working Capital Needs	$_____

Since the above formula uses historical sales rather than projected sales, it only provides you with the basis for determining current cash requirement. This formula is to be used to arrive at a basic loan amount, not a mandatory amount. If the projection of the business is to substantially increase sales and/or if loan maturity is going to be for more than one year, you may need to consider an optional loan amount (to cover future needs) which could be calculated as follows:

Basic W/C Needs (from above)	$_____
Divided by Net Sales Last Fiscal Year Equals	%_____
Enter 1st year Projected Sales	$_____
Times % (Basic Loan Amount/Net Sales) Equals Optional Loan Amount	$_____

If projections are used to determine the loan amount, they must be justified and commented upon in the loan officer's report. There might also be other methods which could be utilized to determine an optional loan amount. Alternative amounts are acceptable providing they relate to actual business need rather than unsupported desire. The loan amount must not be determined just by the amount of available collateral.

If an amount other than the basic loan amount (derived by using the first formula above) is requested, the lender must provide justification in their loan report as to how the proposed loan amount was determined and the SBA loan officer must concur.

NOTE: Once the loan amount to be requested has been determined, the loan officer should compare it to the cash flow submitted by the applicant to insure that it would provide sufficient funds to meet the cash flow requirements.

h. Collateral

Standard Asset Based loans require a first lien position on the working assets being financed, i.e. accounts receivable and/or inventory [excluding work in progress] plus personal guaranties. There are no restrictions on taking fixed assets to bolster the collateral position but they cannot serve as the primary collateral. Although there may be occasions when taking fixed assets as additional collateral seems feasible, it is not encouraged since the borrower may need to utilize them to collateralize long term debt.

Taking additional collateral will only be done in exceptional cases and must be fully justified.

Q. Can current assets be used to secure other lines of credit?

A. No other lines of credit are permitted unless they can be clearly segregated (i.e. floor planning or receivable factoring).

Note: If an applicant carries credit insurance on receivables or has a manufacturer's buyback agreement for inventory, lender should investigate the possibility of obtaining a collateral assignment to further enhance collateral quality.

i. Collateral Assessment

In asset based lending, understanding the nature and quality of the current assets, determining which accounts receivable and/or inventories are eligible, and determining what percentage should be advanced against the eligible assets is an integral part of the loan analysis. To assist in this analysis, SBA requires the applicant to complete SBA Form AB-4 which provides insight into the applicant's business policies and practices regarding their receivables and/or inventories management. Using the applicant's responses on SBA Form AB-4, the LENDER (not the applicant) is required to complete and add up total scores on SBA Form

AB-4I, Applicant Questionnaire. These two forms should give the lender insight into the business and enable them to make determination as to collateral eligibility, advance rates, and the level of monitoring and examination that will be required. **Lenders obtain this from SBA office processing the application.**

Once those determinations have been made, the lender must convey them to the applicant. In addition, the parameters which determine when receivables and inventories will no longer be eligible collateral have to be defined and explained.

The following paragraphs will provide guidance in determining accounts eligibility and advance rates.

j. Accounts Receivable Review and Eligibility

The following factors should be taken into consideration when reviewing accounts receivables:

(1) Applicant's Credit and Collection Policies: Does the applicant have an established credit policy as to who they will extend credit? Is it rigid or liberal? Are specific collection policies in place and does it appear they are being followed? These issues affect the quality of receivables.

(2) Date of Invoice The first date of receivable eligibility is normally the invoice date. SBA permits receivables to remain eligible 3 times the applicant's usual terms (i.e. if invoices are due net 30, they would be eligible for 90 days past the invoice date).

Exceptions are permitted over the 90 day or 3 times the standard terms with SBA's concurrence. Allowances can be made for seasonal businesses with long shipping cycles.

(3) Particular Customer Delinquency If a customer is delinquent on more than 50 percent of its total outstanding invoices, ALL of the accounts due from that customer are ineligible. To re-establish this customer as eligible, all delinquent accounts must be paid in full, unless justified.

(4) Rebilling of Accounts This is the practice of a business issuing a credit to a customer and re-invoicing the obligation in the current billing cycle. It should be determined if the rebilling is due to a change in the product market cycle. If it does not reflect such changes, all rebilled accounts are ineligible.

(5) Foreign Receivables Generally, receivables backed by confirmed letters of credit, standby letters of credit, factor's guarantee (of purchase), credit insurance (either commercial risk or commercial and political risk combinations), or Government enhancements such as those provided by the Export Import Bank or the World Bank should be eligible (less an allowance for disputes, returns, currency fluctuations, credits, excess transportation and other dilution factors). Additional factors may allow foreign receivables to be deemed eligible based on local laws and the collection capability of the cash proceeds.

(6) Contra Accounts or Due From Affiliates Offsetting receivables and payables between the borrower and one of its creditors (contra accounts) are ineligible, unless justified. Accounts due from affiliate companies should always be excluded. Accounts that require subordination to other parties, such as can occur in Governmental contracting when the bonding company requires assignment of the project's receivables should also be considered as ineligible.

(7) Concentrations If any customer constitutes in excess of 20 percent of the total outstanding receivables, everything above the 20 percent is ineligible, unless justified and concurred by SBA. Generally concentration of government and highly rated public companies can be deemed satisfactory.

k. Inventory Review and Eligibility

The following should be taken into consideration when reviewing inventory:

(1) Finished Goods: Eligible if readily saleable and not obsolete.

(2) Work in Progress: Ineligible unless lender provides adequate justification and SBA concurs.

(3) Commodities or Raw Materials: Eligible.

l. Advance Rate for Accounts Receivable

SBA's policy is that the advance rate should not include any profit. For businesses with a cost of goods sold component computed in accordance with Generally Accepted Accounting Principles (GAAP), the maximum advance rate should not exceed the cost of goods sold (CGS) percentage to sales, unless justified. As an alternative, the RMA cost of goods sold percentage may be used to set the maximum advance rate.

SBA's maximum advance rate cannot exceed 80 percent of the eligible receivables, unless justified by lender and concurred with by SBA. The advance rate should not be arbitrarily set at either the CGS percent or the 80 percent maximum. The 80 percent maximum

includes allowances for dilution or receivables by chargeback, returns, bad debt, and credit memos. Factors that should be taken into consideration are:

(1) Control and accounting systems of the borrower;
(2) Enhancements such as credit insurance;
(3) Age of receivables;
(4) Credit quality & borrower's credit policy;
(5) Turnover history;
(6) Industry orientation and condition;
(7) Direct costs required to generate the receivable; and
(8) Gross profit margin.

After initial disbursement, lenders have unilateral authority to increase/decrease the advance rate for receivables (NOT the loan amount) by as much as 5 percent above/below the rate stated in the Authorization without SBA concurrence.

m. Inventory Advance Rate

SBA's overall policy for inventory is the same as stated above for receivables. Advances should be based upon cost of goods sold and should not include profit. SBA's maximum advance rate cannot exceed 50 percent of the eligible inventories, unless justified by lender and concurred by SBA. Factors to consider are:

(1) Typically based on the lesser of the sum of the direct material plus labor cost in manufacturing OR the invoice cost less discount of resale goods in wholesale distribution;
(2) Nature of the product;
(3) Product liability;
(4) Manufacturer's buyback agreements; and
(5) Physical location of inventory (single locations are generally easier to control than multiple locations).

After initial disbursement, lenders have unilateral authority to increase/decrease the advance rate for inventories (NOT the loan amount) by as much as 5 percent above/below the rate stated in the Authorization without SBA concurrence.

n. Borrowing Base Certificates

A borrowing base is the dollar amount derived from multiplying eligible accounts receivable and/or inventories by the approved advance rate(s). A borrowing base certificate is a form which enables the lender to determine the available borrowing base; reconcile sales, receivables and inventories; and from current loan balance and eligible borrowing base, to determine the amount available for disbursement.

The Standard Asset Based sub-program requires a certificate with each advance to determine the amounts that can be disbursed. Additionally, a new certificate is required at least monthly, even if there are no advances within the month. There is no requirement for you to use SBA's form. However, SBA Forms BBC-1 and BBC-2 are included in Appendix 9. You may utilize these forms or use your own as long as it provides the same data.

o. Disbursements and Repayments

Disbursements against the line are expected to go to the borrower's operating account for their discretionary short term use. To insure the requested "draw" is available, the following procedures should be adhered to:

Prior to Each Disbursement: Lender should determine the amount that is available based on the following process:

1. Eligible A/R	$_____
2. Times advance rate	%_____
3. Equals A/R Borrowing Base	$_____
4. Eligible inventory	$_____
5. Times advance rate	%_____
6. Equals inventory Borrowing Base	$_____
7. Total (3 plus 6)	$_____
8. Face amount of Note	$_____
9. Borrowing base (Lesser of 7 & 8)	$_____
10. Loan balance on books	$_____
11. Amount available for disbursement (9 minus 10)	$_____

While a formal aging of accounts receivable and accounts payable plus an inventory listing is only required monthly and not at each disbursement, lenders may obtain other forms of verification of current asset value.

On a monthly basis: Lender should determine the amount of eligible assets to be advanced against based on the following process:

When advancing against receivables:

(1) Obtain an aging of accounts receivable and accounts payable

(2) Eliminate all ineligible receivables (see sub-paragraph 19j)

When advancing against inventory:

(1) Obtain a description of inventory, and certification as to its value

(2) Eliminate all ineligible inventory (see paragraph 19k)

The dollar amount of ineligible receivables and inventory will remain unchanged for the entire month. The actual borrowing base may increase or decrease as the balance on the Note changes and the receivables and inventory are generated or converted back to cash.

Disbursements can be made at any time before the commencement of one cash cycle prior to maturity providing the borrower is not in default AND borrower and lender are in compliance with the terms of the Authorization. Disbursements after the last cycle has begun require SBA approval.

Repayments will come from cash sales and receivable collections. ALL receipts (from cash sales or receivable collections) are to be placed in a cash collateral, deposit-only account (an account where borrower cannot obtain any distributions and does not have any check writing capability). The lender will at least weekly withdraw funds from the cash collateral account and apply those funds first to accrued interest and balance, if any, to principal.

Should any balance remain after the loan has been paid down to a zero balance, those funds may be credited to borrower's operating account. Interest must be paid at least monthly either from borrower's own resources OR loan proceeds. However, there is no provision for interest only payments. Principal payments should be tied to the borrower's cash cycle.

Lenders shall report all disbursement and repayment activity on each Standard Asset Based CAPLines on a semi-annual basis every April 30, and October 31, using SBA Form CAP 1050 (Appendix 9).

p. Examinations

An examination is a physical verification of the assets which compose the borrowing base. As a minimum, on-site verifications shall occur prior to the initial disbursement and at least semi-annually thereafter. The frequency of the examinations is determined by the score on the Applicant Questionnaire, SBA Form AB-4I (low level requires semi-annual examinations and high level requires quarterly examinations). They shall cover no less than 20 percent of the assets (receivables and inventory) which are included in the borrowing base. See Appendix 9, Monitoring, Control, and Examination Standards, for further guidance.

q. Monitoring

The minimum monitoring requirements for Standard Asset Based CAPLines are as follows:

(1) Each disbursement

Borrowing base certificate.

(2) Monthly

Borrowing base certificate;
Aging of accounts receivable/payable;
Inventory listing (if advanced against).

(3) Quarterly

Financial statements

(4) Semi-Annually

Financial statement spread;
Accounts receivable review;
Accounts payable review;
Disbursement report; and
Report on fees and charges;

(5) Annually

Borrower's management information system;
Legal elements;
Loan agreements;
SIC review;
Review of cash flow and related financials ; and
Re-assess exam, monitoring, & control requirements.

High monitoring increases the frequency, such that: Quarterly becomes monthly; semi-annually becomes quarterly; and annually becomes semi-annually.

r. Controls

Funds control covers cash (or near cash) the business generates. Level of control is determined by the score on the Applicant Questionnaire, SBA Form AB-4I, are as follows.

(1) Medium Funds Control ALL cash must be deposited to a cash collateral, deposit-only, account.

(2) High Funds Control Alternatives The customers of the borrower can be instructed to send their remittances via joint payee checks (lender and borrower) to the lender's place of operation. Other alternatives include the use of:

(a) Lock box (post office box under lender control where borrower's customers remit payments for accounts receivable but customers do not know lender has control), or

(b) Block box (post office box under lender control where borrower's customers remit payments for accounts receivable but customers know lender has control).

Different lenders may interchange the concepts of lock box and block box. Under one concept, the customers of the borrower know their remittances go directly to the lender and under the other concept, they do not.

Account controls involve the physical oversight of inventory. There are no minimum account control requirements as these techniques are generally used for only the highest risk accounts. If scoring on the Questionnaire, indicates that account control should be required, following are the alternatives:

(1) Medium Account Control

Borrower segregates inventories subject to lender's lien; and

Borrower provides lender with covenant to allow lender, or its designee, management control of the area in which the collateral is kept, in the event of default or deterioration of the credit.

(2) High Account Control

Lender creates on site segregation using elements of bailment, wherein the collateral is released only from physical control upon instructions (this usually entails use of a third party servicer or field warehouser) OR Lender contracts with a public warehouse to segregate or store collateral and release it only upon instructions from lender.

s. Master Notes and Sub-Notes

SBA Note Form 147 shall be used for all master notes. The lender can utilize sub-notes to establish specific repayment periods (demand basis, specific repayment date for a specific advance, etc.). This is not to be the normal course of administration, but rather as a means to control the exception or unique situation. The conditions of the sub-notes must not conflict with the conditions of the master note, except for variances in repayment schedules. Lenders are not permitted to obtain a 5 year guaranty and then use the sub-note system to limit that authority.

t. Other Fees and Their Disclosure

SBA has no restrictions on the fees a borrower can be charged under the Standard Asset Based CAPLines program. The guiding principle of the no restrictions pilot is that lenders may charge their SBA supported borrowers the same fees and charges they normally charge their non-SBA borrowers for similar services in connection with similar loans. The AA/FA can end or modify this pilot provision before the stated date if it is determined that unreasonable fees are being charged.

The lender must disclose both the anticipated fees they intend to charge a Standard Asset Based CAPLines borrower prior to approval and the actual fees charged semi-annually after initial disbursement.

(1) Anticipated fees are disclosed at the time of application on SBA Form SAB-159A. The type of fee, how often it will be charged and how it will be calculated are disclosed on the form and it is signed by applicant, any service representatives, and the lender.

(2) Actual fees charged are disclosed on a semi-annual basis on SBA Form SAB-159B. All fees charged during the previous six (6) month period are itemized on this form detailing type of fee, who the fee was paid to, and amount of the fee. It is signed by borrower, any service representatives, and the lender. It should be forwarded to SBA at the same time as the quarterly report due as of April 30th, and October 30th.

u. Requirements At Maturity

Standard Asset Based CAPLines with an original and/or modified maturity for less than 60 months may be renewed up to 60 months providing:

(1) Borrower completes Form AB-4;

(2) Lender evaluates borrower utilizing Form AB-4I; and

(3) Copy of lender's AB-4I evaluation is provided SBA with renewal request.

v. Alternative Servicing Standards

Experienced asset based lenders, who prefer to utilize their own internal servicing procedures, as an alternative to the minimum servicing standards set forth in the CAPLines Appendix 9, may request permission to do so from the Office of Financial Assistance.

Requests are to be forwarded with the district office's recommendation, along with copies of the lender's complete written asset based loan servicing policies statement and its Lender Qualification Survey.

The lender's policies must provide for adequate asset protection and for adherence to the revolving intent of the program including a clear indication that a borrower's collections of their receivables that were advanced against have to be applied to the loan. Lender standards which permit collateral replacement and interest only payments will not be accepted.

w. Outside Service Provider Assistance

SBA permits lenders to acquire assistance from an outside or third party service provider, as long as these providers meet certain Agency standards (requirements are detailed in Appendix 9. When a lender hires a provider, they do so with the understanding that the provider is the lender's agent or contractor. The lender is responsible for the type and quality of service being provided in any given loan and will be held accountable to the conditions contained in the various agreements between SBA and the lender.

Service providers may self certify that they meet SBA's standards and should send copies of their Lender Service Agreement and certificate of insurance to the processing SBA office. See subpart A for further Lender Service Provider guidance.

x. Authorization Requirements (SBA Form 529B)

The terms and conditions for CAPLines can be found in the National CAPLines Boilerplate, which can be found at www://sba.gov/banking

The processing office may make alterations as necessary, but a copy of the modified language must be sent to the Loan Programs Division, Headquarters.

y. Loan Prefixes and Sub-Program Codes

When a Standard Asset Based loan is approved, processing personnel will designate these loans as SAB, acquire funding using a sub-program code of 1026. All loans funded with this sub-program code are assumed to be revolving.

20. REQUIREMENTS FOR THE SMALL ASSET BASED CAPLINES

a. General Characteristics

(1) Asset based loan in amounts $200,000 or below;
(2) Must be able to cash flow based on a 7 year amortization;
(3) Finances the cash cycle of qualified businesses;
(4) Supports an increase in accounts receivable and/or inventory;
(5) Can be used for most working capital purposes;
(6) Must revolve;
(7) Does not require use of cash collateral account or detailed servicing required by Standard Asset Based sub-program; and
(8) Must adhere to the universal CAPLines requirements plus those unique to the Small Asset Based sub-program;

b. Additional Eligibility Requirements

Only those businesses which qualify under the regular 7(a) requirements, can demonstrate the need for a short term revolving line of credit, and can demonstrate the ability to repay the requested amount utilizing internally generated cash flow over no more than 7 years, are eligible for the Small Asset Based CAPLines. If such repayment can not be demonstrated, and the loan is to be approved, the monitoring and examination requirements of the Standard Asset Based CAPLines must apply, regardless of the dollar amount of the loan.

c. Additional Submission Requirements

In addition to SBA Form 4, applicable exhibits, and a month-by-month cash flow for the upcoming 12 month period, the following documents are also required:

(1) SBA Form AB-4 which addresses particular issues about the applicant business and how it operates (Applicant completes and signs); and
(2) SBA Form AB-4I, Applicant Questionnaire, which helps the lender determine the risk level of the applicant business (LENDER completes)

Although SBA does not impose specific monitoring or servicing requirements on the Small Asset Based sub-program, the completion of SBA Forms AB-4 and AB-4I every year enables the lender to obtain insight into the borrower's operation and to determine what monitoring or servicing requirements should be used as part of a lenders prudent lending practices. Therefore the annual completion of the Application Questions (AB-4) and Applicant Questionnaire (AB-4I) are required annually.

d. Lender Requirements for Participation

Can any lender participate in the Small Asset Based sub-program? Lenders desiring to participate in the Small Asset Based sub-program shall meet the standard requirements for any CAPLines lender. They should be experienced in asset based lending, but do not need to complete a Lender Qualification Survey or be pre-approved as is required for the Standard Asset Based sub-program.

e. General Requirements

Requirements for the Small Asset Based sub-program are very much like the Standard Asset Based sub-program with the following exceptions.

(1) Although the line will be on a revolving basis, the applicant business must be able to demonstrate adequate cash flow, historical or projected, to repay the full loan amount on a 7 year amortization.

(2) No cash collateral account is required; however, the line must revolve. (Although not required, lender may impose this requirement if they feel the need to do so.)

(3) Borrower is required to make sure the line actual revolves. This can be accomplished by either having the borrower:

(a) Remit all funds collected from the sale of or collection of pledged assets that were advanced against (not all sales as is in the Standard Asset Based sub-program) within 30 days of receipt; or

(b) Remit all funds collected from the sale of or collection of pledged assets. This allows the lender to advance against the borrowing base with out having to track each item of inventory or account receivable. However, it also means the borrower has to turn all collections over to the lender.

(4) No specific monitoring or examination requirements are imposed by SBA other than the annual completion of the Application Questions and Applicant Questionnaire plus the lender must make sure that they are receiving the borrower's collections as outlined above and that the line revolves. The lender is expected to use prudent lending practices to establish their own servicing requirements.

(5) Borrowing Base Certificates are required only on a monthly basis, not with each disbursement.

(6) Fees are limited to the maximum 2 percent annually extraordinary servicing fee that is permitted for all CAPLines.

(7) Completed SBA Forms AB-4 and AB-4I are required annually, and at all maturity renewals. This will be part of the annual review process.

(8) Increases to any Small Asset Based CAPLines which take the gross loan amount above $200,000 require that the monitoring and examination rules plus the lender qualification rules applicable in the Standard Asset Based CAPLines program become effective for the remaining term of the loan unless:

(a) The increase is requested more than 2 years after the original initial disbursement; and

(b) The cumulative dollar amount of all payments (principal and interest) received since initial disbursement is no less than 75 percent of the dollar amount of all disbursements.

Otherwise, except for the above-referenced variances, the use of proceeds, determining the cash cycle, determining the loan amount, collateral, collateral assessment, accounts receivable/inventory eligibility, accounts receivable/inventory advance rates, borrowing base certificates, and disbursements and repayments is the same as the Standard Asset Based sub-program.

f. Loan Authorization Conditions

In addition to standard 7(a) authorization conditions, the following additional conditions shall be in every Small Asset Base CAPLines Authorization.

(1) Borrower's written agreement to remit interest on a monthly basis beginning one month from date of note, and to promptly remit (within 30 days) 100 percent of the collections from any pledged items of inventory or accounts receivables which were advanced against, or remit 100 percent of all collections. Lender to apply 100 percent of same to the line's outstanding balance.

(2) Borrower's written agreement to furnish the lender a monthly borrowing base certificate, in a form satisfactory to the lender, during the term of the loan.

(3) Borrower to provide SBA Form AB-4 annually and at all maturity renewals.

(4) Lender to complete SBA Form AB-4I annually.

(5) Lender must file on accounts receivable and inventory under UCC.

(6) Lender must reconcile the borrowing base certificate at least monthly.

(7) Agreement by lender that, in the event of default by the borrower, it will execute any right of offset available to it, liquidate working assets which secure the loan, and apply all funds received to the outstanding loan balance prior to requesting that SBA honor the guaranty.

(8) Lender is authorized to make advances up to the maximum approved line amount, for working capital purposes, as stated in the Authorization without additional SBA approval, providing the lender and borrower are in compliance with all conditions required by the loan authorization, with the exception that no disbursements can be made (without SBA prior approval) after the commencement of one cash cycle prior to maturity.

(9) Lender to conduct an annual review of the borrowers financial condition and credit status, on either the anniversary date of initial disbursement or upon receipt of annual financial statements. Lender shall modify loan agreements, advance rates, and/or loan covenants, as necessary.

(10) Increases to any Small Asset Based CAPLines which take the gross loan amount above $200,000 require that the monitoring and examination rules plus the lender qualification rules applicable in the Standard Asset Based CAPLines program become effective for the remaining term of the loan.

g. Loan Prefixes and Sub-Program Codes

When a Small Asset Based is approved, processing personnel will designate these loans as SMAB, acquire funding using a sub-program code of 1030, and answer "Yes" on the LATS input screen since the line will be revolving in nature.

SUBPART D - LENDERS

WHAT IS THE PURPOSE OF THIS SUBPART?

This subpart describes the policies and procedures that apply to all lenders participating in the 7(a) loan guaranty program. It also explains the criteria for providing an SBA guaranty to participants through the Agency's expedited loan processes.

CHAPTER 1 - LENDERS

1. WHAT IS THE LOAN GUARANTEE AGREEMENT?

. 120.400 Loan Guarantee Agreements.

SBA may enter into a Loan Guarantee Agreement with a Lender to make deferred participation (guaranteed) loans. Such an agreement does not obligate SBA to participate in any specific proposed loan that a Lender may submit. The existence of a Loan Guarantee Agreement does not limit SBA's rights to deny a specific loan or establish general policies. See also . 120.441(b) and 120.451(d) of this part concerning Supplemental Guarantee Agreements.

Legislation allows SBA to guarantee loans, at its discretion, in cooperation with banks and other lending institutions (excluding Small Business Investment Companies licensed by SBA) through agreements to participate on an immediate or deferred (guaranty) basis. These agreements do not obligate SBA to participate on any particular loan that a lender may submit. The existence of a participation agreement does not limit SBA's right to determine the extent of its participation, as a matter of general policy or for a particular loan. It also does not limit SBA's right to withhold, at its sole discretion, approval of a proposed transfer of the guaranteed portion of any loan.

When a lender applies for an SBA guaranty of a loan that it proposes to make to a small business, it seeks to have the loan backed by the "Full Faith and Credit of the United States." Before any loan can be processed for a guaranty, SBA and the lender must sign an SBA Form 750, "Loan Guaranty Agreement (Deferred Participation)," or SBA Form 750B, "Loan Guaranty Agreement (Deferred Participation) for Short Term Loans." These agreements are the basic contracts between the two parties and list the responsibilities and duties of both parties when making, closing, and administering any individual loan. The SBA 750 and the SBA 750B are blanket guaranty forms. Their purpose is to eliminate the need for a separate agreement with the submission of each application to cover the basic SBA guarantee lending requirements

2. WHAT ARE THE BASIC REQUIREMENTS FOR ALL PARTICIPANTS?

Commercial banks and savings and loan associations are eligible participants. Other types of commercial lenders may apply to become eligible participants through the SBA field office serving the area where the lender operates. These include institutions like credit unions, Production Credit Associations (PCA), Edge Corporations, Federal Land Banks, and other lending agencies under the supervision of the Farm Credit Administration. [See the Appendices for additional information on determining participant eligibility.]

The SBA may not participate with an SBIC. (See subpart A.)

A participating lending institution must meet all of the following requirements.

. 120.410 Requirements for all participating Lenders.

A Lender must:

a. Capability

A participant lender must also have staff with commercial lending experience or must hire staff that will have this experience.

(a) Have a continuing ability to evaluate, process, close, disburse, service and liquidate small business loans;

b. Accessibility to the Public

A participant must hold itself out to the public as engaged in the business of making loans to small businesses, maintain a reasonably accessible office in its own name, have a listed telephone number and be open to the public during regular business hours.

(b) Be open to the public for the making of such loans (not be a financing subsidiary, engaged primarily in financing the operations of an affiliate);

c. Good Character And Reputation

All participants must comply with the requirements detailed in Subpart A, chapter 1, paragraph 14.

(c) Have continuing good character and reputation, and otherwise meet and maintain the ethical requirements of .120.140; and

d. Supervision and Examination

A participant must be subject to continuing supervision and examination by a State or Federal chartering, licensing or similar regulatory authority, satisfactory to SBA, such as a State or National bank or a State or Federal savings and loan association. External or CPA audits not conducted by a regulatory body do not qualify as sufficient supervision and examination.

(d) Be supervised and examined by a State or Federal regulatory authority, satisfactory to SBA.

e. Financial Capacity

Each participating lender must also have the financial capacity to disburse funds on loans when a loan application is submitted to SBA.

3. HOW DO LENDERS BECOME SBA PARTICIPANTS?

a. Banks and Savings and Loan Associations

A State or National bank, or a State or Federal savings and loan association contacts the SBA field office serving the geographical area where the lender's principal office is located to request to be a participant lender. The SBA will presume that such a lender automatically complies with the Agency's examination and supervision requirements. However, the SBA field office must determine whether the lender meets the general requirements of this chapter for all loan participants. If the field office determines that the lender meets these requirements, it may sign an SBA 750 and/or 750B with the lender. For a savings and loan association, send a copy of the executed agreement(s) to the Director, Office of Loan Programs.

b. Lenders Other Than Banks and Savings & Loan Associations

A lending institution other than a bank or savings and loan association seeking approval as a participant lender must demonstrate, to SBA's satisfaction, that it is subject to the Agency's continuing supervision and examination requirements.

This lending institution must file an application (in duplicate) containing the information and documents specified below with the SBA field office serving the geographical area where the lender's principal office is located. The field office reviews the application and provides written comments about the lender, including:

(1) An opinion as to whether the lending institution meets the SBA's participation requirements; and,

(2) Its recommendation as to whether to approve the application.

The field office keeps a copy of the application and submits its memorandum and the original of the application through its regional office to the AA/FA.

The AA/FA makes the final determination on the application and notifies the field office. If the application is approved, the field office executes a loan guaranty agreement, SBA Form 750 or 750B, with the lender and sends a copy of the executed agreement to the Director, Office of Loan Programs.

c. Contents of the Non-Bank Lender Participant Application

(1) Lender's name and address.

(2) Lender's telephone number.

(3) State where the lender is incorporated.

(4) A copy of lender's Articles of Incorporation and by-laws certified by an appropriate officer.

(5) Amount of the lender's paid-in capital and paid-in-surplus.

(6) The lender's proposed geographical area of operations.

(7) A list of officers, directors, associates and holders of ten or more percent of any class of the lender's capital stock. "Associates" are defined in subpart A.

(8) A copy of the most recent audited financial statements on any entity, other than natural persons, holding 10 or more percent of any class of the lender's stock.

(9) An organizational chart showing the relationship of the lender to any associates.

(10) A copy of "Statement of Personal History," SBA Form 1081, for each person listed under above item (7).

(11) An explanation of the lender's methods of funding loans, including the unguaranteed portion.

(12) A detailed explanation of the loan servicing procedures to be used.

(13) A certification that the lender will not be engaged primarily in financing the operations of an affiliate, as defined in 13 CFR Part 121.

(14) A copy of the State or Federal statute or regulations governing the lender's operations, including those pertaining to audit, examination and supervision of the lender. Each lender bears the burden of demonstrating that it is subject to continuing supervision by a State or Federal regulatory authority satisfactory to SBA.

(15) A copy of the latest report covering the examination of the lender.

(16) The dates on which the last three examinations of the lender were performed. No participation application is processed by SBA until the lender provides these examination reports.

(17) A copy of the most recent audited financial statements of the lender.

(18) A copy of the license, if any, issued to the lender by a regulatory authority.

(19) A copy of any brochure or advertisement, if available, describing the lender's lending activities.

(20) A certified copy of a Resolution of the Board of Directors designating the person(s) authorized to submit the application on behalf of the lender.

(21) A copy of a satisfactory opinion of independent counsel that the lender complies with applicable Federal, State, and local laws in the formation and organization of the company, and with appropriate Federal and/or State security laws; and is chartered to conduct its business in the proposed operating area. ("Independent Counsel" is counsel that is not an "Associate" of the lender under subpart A.).

4. MAY AN SBIC BECOME A PARTICIPANT LENDER?

A company licensed by SBA to operate as a Small Business Investment Company (SBIC) is not eligible to become a participating lender with SBA because it is already receiving SBA-leveraged funds. Therefore, it would be inappropriate for those funds to be further guaranteed by SBA.

5. WHAT IS A PREFERENCE?

. 120.411 Preferences

An agreement to participate under the Act may not establish any Preferences in favor of the Lender.

A participating institution must not take any side collateral or guarantee that would secure only its own interest in a loan. A participating institution must not require a borrower to purchase certificates of deposit, maintain a compensating balance not under the control of the borrower, or take a side loan which would have the effect of insuring a risk-free or limited risk investment on the participant's share.

Under the following circumstances, a lender may make a side loan to purchase stock of the participant (as may be required by certain lenders such as PCAS).

a. The enabling authority of the lender requires the purchase as a condition for making the loan.

b. The lender makes a separate side loan not guaranteed by SBA for the borrower to buy the stock or debentures. The side loan must be subordinated to the SBA loan, but the lender may hold a first lien on any stock collateralizing the side loan.

c. The interest to be charged on the side loan must not exceed the maximum rate of interest acceptable for SBA guaranteed loans, and the maturity of the side loan must not be less than that of the SBA loan.

d. In the event of default, either on the side loan or the SBA loan, the lender may not take any action to collect or liquidate the side loan, except canceling or retiring the stock securing the side loan, until the SBA loan has been fully liquidated.

6. WHAT OTHER SERVICES MAY LENDERS PROVIDE TO BORROWERS?

. 120.412 Other services Lenders may provide Borrowers.
Subject to . 120.140, Lenders, their Associates or the designees of either may provide services to and contract for goods with a Borrower only after full disbursement of the loan to the small business or to an account not controlled by the Lender, its Associate, or the designee. A Lender, an Associate, or a designee providing such services must do so under a written contract with the small business, based on time and hourly charges, and must maintain time and billing records for examination by SBA. Fees cannot exceed those charged by established professional consultants providing similar services. See also . 120.195.

7. MAY A LENDER ADVERTISE ITS RELATIONSHIP WITH SBA?

. 120.413 Advertisement of relationship with SBA.
A Lender may refer in its advertising to its participation with SBA. The advertising may not:
(a) State or imply that the Lender, or any of its Borrowers, has or will receive preferential treatment from SBA;
(b) Be false or misleading; or
(c) Make use of SBA's seal.

8. SECURITIZATION

Public Law 104-208 requires SBA to publish regulations establishing uniform policy for banks and non-depository institutions, including SBLCs, to sell the unguaranteed portions of SBA loans. The law requires that the regulations be in place by March 31, 1997. Until the required regulations are published, the following policy applies.

. 120.420 Financings by Nondepository Lenders.
(a) A Small Business Lending Company regulated by SBA or a Business and Industrial Development Company ("Nondepository Lender") may pledge the notes evidencing SBA guaranteed loans or sell the unguaranteed portions of such loans if SBA, notwithstanding the provisions of . 120.453(c), in its sole discretion, gives its prior written consent. The Lender must be secure financially and have a history of compliance with SBA's regulations and any other applicable state or Federal statutory and regulatory requirements.
(b) The Nondepository Lender, SBA, and any third party involved in the transaction, as determined by SBA in its sole discretion, must enter into a written agreement satisfactory to SBA acknowledging SBA's interest as guarantor of the subject loans and accepting that all relevant third parties agree to recognize and uphold those interests under the Act, this part, and the contractual provisions of SBA's Loan Guarantee Agreement. In any such agreement, the parties must agree to the following conditions:

(1) The Nondepository Lender, SBA, or a third party custodian agreeable to SBA, will hold all pertinent Loan Instruments, and the Nondepository Lender will continue to service the loans after the pledge or transfer is made; and

(2) The Nondepository Lender must retain an economic risk in and bear the ultimate risk of loss on the unguaranteed portions. This must be demonstrated to SBA's satisfaction by establishing a sufficient reserve fund at the time of sale of the unguaranteed portions and, in the case of pledging notes, by retaining all of the economic interest in the unguaranteed portion of any loan which a note evidences.

(c) The Nondepository Lender may not use SBA guaranteed loans or the collateral supporting such loans as collateral for any borrowing not related to financing of the guaranteed or unguaranteed portion of SBA loans.

Any securitization agreement must be executed for SBA by the Office of General Counsel.

9. WHAT ACCESS DOES SBA HAVE TO LENDER FILES?

. 120.430 SBA access to Lender files.
A Lender must allow SBA's authorized representatives, during normal business hours, access to its files to review, inspect and copy all records and documents relating to SBA guaranteed loans.

a. What Does SBA Do With its Access to Lender Files?

SBA conducts its Lender Oversight Program.

b. What are the Requirements of SBA's Lender Oversight Program?

The requirements of SBA's Lender Oversight Program are specified in the "Loan Policy and Program Oversight Guide for Lender Reviews." This guide can be found in Appendix 30 of SOP 50-50(4). All personnel involved in the loan processing and servicing functions should be familiar with this guide and must carry out the policies and procedures therein stipulated.

10. SUSPENSION OR REVOCATION OF A LENDER'S PARTICIPATION

. 120.431 Suspension or revocation of eligibility to participate.
SBA may suspend or revoke the eligibility of a Lender to participate in the 7(a) program because of a violation of SBA regulations, a breach of any agreement with SBA, a change of circumstance resulting in the Lender's inability to meet operational requirements, or a failure to engage in prudent lending practices. Proceedings for such purposes will be conducted in accordance with the provisions of part 134 of this Title. A suspension or revocation will not invalidate a guarantee previously provided by SBA.

A field office may recommend suspension or revocation of a lender's privilege to participate. The district office (DO) must forward the recommendation, with substantiating evidence, to the AA/FA. Circumstances which may result in a recommendation for suspension or revocation include:

a. Changes in management adversely impacting the good character and reputation or capability of the lender;

b. Evidence of continuous or substantial failure to properly close loans to fully protect or preserve the interest of the lender and SBA;

c. Consistent failure to properly report on loan disbursement and status;

d. Evidence of continuous or substantial failure to obtain SBA's prior approval on actions when required; and/or

e. Other relevant matters.

The AA/FA reviews all recommendations for suspension or revocation, with appropriate comments from the Office of General Counsel. If the AA/FA decides to suspend or revoke, SBA serves notice as required in 13 CFR Part 134. These regulations allow the lender to "answer" the suspension or revocation action. The AA/FA may request that field offices comment on any answer received from the lender prior to the final decision.

CHAPTER 2 - CERTIFIED LENDERS PROGRAM

1. WHAT IS THE CERTIFIED LENDERS PROGRAM?

.120.440 Under the Certified Lenders Program (CLP), designated lenders process, close, service and may liquidate, SBA guaranteed loans. SBA gives priority to applications and will provide expedited loan processing or servicing. All other rules in this part 120 relating to the operations of Lenders apply to CLP Lenders.

Upon nomination and approval, SBA designates lenders for CLP status. CLP lenders must perform a thorough credit analysis on the loan application packages they submit to SBA so that SBA can rely on that analysis to allow it to perform a credit review instead of a complete credit analysis, thus shortening the SBA loan processing time. For CLP loans, SBA still makes both credit and eligibility decisions about whether to guarantee the loan. The Agency will review the portfolios and practices of CLP lenders from time to time to monitor their ability to process, close, service, and liquidate SBA loans.

2. HOW DOES A LENDER BECOME A CLP LENDER?

Guidance regarding CLP status for PLP lenders is contained in chapter 3 of this subpart, "the Preferred Lenders Program."

120.441 (a) An SBA field office may nominate a Lender or a Lender may request a field office to consider it for CLP status. SBA district directors may approve and renew a lender's CLP status. The District Director will consider whether the lender:
(1) Has the ability to process, close, service and liquidate loans;
(2) Has a satisfactory performance history with SBA, including the submission of complete and accurate loan guarantee application packages;
(3) Has an acceptable SBA purchase rate; and
(4) Has shown the ability to work well with the local SBA office.
(b) If the district director does not approve a request for CLP status, the Lender may appeal to the AA/FA, whose decision will be final. If SBA grants CLP status, it applies only in the field office that processed the CLP designation. A CLP Lender must execute a Supplemental Guarantee Agreement that will specify a term not to exceed two years.

a. What Happens if We Approve CLP Status?

If we approve CLP status, the SBA field office notifies the lender that it has been approved as a CLP participant, and advises it of its initial CLP participation term. The field office sends the lender a "Supplemental Guaranty Agreement, Certified Lenders Program (CLP)," SBA Form 1186 (the CLP agreement), signed by the district director or branch manager. The term of CLP status may not exceed 2 years. The lender must sign and return the CLP agreement to SBA before the lender's CLP status is effective.

A copy of the CLP agreement is in the appendices. A lender may apply to more than one SBA field office for CLP status.

b. What Happens if We Don't Approve CLP Status?

The SBA field office notifies the lender of why we did not approve CLP status. The lender may appeal this decision in writing to the AA/FA, whose decision is final. If a lender wants to re-apply for CLP status, it must wait at least 1 year from the final notice before re-applying.

c. How Do We Renew the Lender's CLP Status?

The SBA field office starts the renewal process just prior to the expiration of the lender's CLP status. We ask the lender if it wants to renew its status. If it does, the SBA district director or branch manager makes the renewal decision. If the renewal is approved, the SBA field office notifies the lender that the CLP renewal has been approved, and advises it of the period of its CLP participation.

The field office sends the lender a new CLP agreement or a renewal agreement (as appropriate) signed by the district director or branch manager. The renewal term may not exceed 2 years. The lender must sign and return the agreement to SBA before the ending date of its CLP status for its CLP status to remain uninterrupted. A copy of a sample renewal agreement is appendix 4.

If the renewal is not approved, the SBA field office notifies the lender of why we did not approve the renewal. The lender may appeal this decision in writing to the AA/FA, whose decision is final. If a lender wants to re-apply for CLP status, it must wait at least 1 year from the final notice before re-applying to the SBA field office.

d. What Happens When a CLP Lender Changes Organizational Structure?

If a CLP lender makes a major change in its structure or organization, it must tell the SBA field office in writing. Major changes include:

(1) Acquisition by another lender;

(2) Merge into another legal entity;

(3) A change of name;

(4) Substantial changes in management;

(5) Substantial changes in how the lender handles SBA loans; or

(6) Take over or closure of the lender by a regulatory agency.

The SBA field office evaluates the effect of any change.
The following charts explain the effect of lender changes.

If a CLP lender continues as the legal entity that signed the CLP agreement and. . .	**Then . . .**
(1) The CLP lender changes its name.	We record the name change. The lender's CLP status is not changed. A new CLP agreement is not needed.
(2) The CLP lender is acquired by another entity. The CLP lender survives as a separate legal entity.	We record the holding company name. The lender's CLP status is not changed. A new CLP agreement is not needed.
(3) The CLP lender acquires another lender. The acquired lender does not continue as a separate legal entity.	The acquired lender may make CLP loans as part of the CLP lender.
(4) The CLP lender acquires another lender. The acquired lender continues as a separate legal entity.	The acquired lender may not make CLP loans. The acquired lender may request CLP status.
(5) The lender is closed or taken over by a regulatory authority.	The lender's CLP status stops automatically terminates.
(6) The lender changes its operations so much that it cannot show that it handles SBA loans the way we require	The SBA may suspend or revoke the lender's CLP status.

If a CLP lender does not continue as the legal entity that executed the CLP agreement and . . .	**Then . . .**
(1) The CLP lender is merged into a non-CLP lender. The original CLP lender's SBA operations are unchanged.	The original lender's CLP agreement is no longer valid. The surviving lender must ask SBA to sign new SBA 750 and CLP agreements.

(2) The CLP lender is merged into another CLP lender.	The CLP lender's agreements with SBA for the merged lender are no longer valid. However, the lender can make SBA loans under the surviving CLP lender's agreement.
(3) The CLP lender is dissolved.	The lender's CLP status automatically terminates.

3. WHAT ARE THE REQUIREMENTS OF CLP LOAN PROCESSING?

The SBA's business loan eligibility, credit policy, and procedures contained in subpart A apply to CLP loans. A CLP lender must keep informed on and must apply all SBA business loan requirements.

a. What Are the Eligibility Requirements?

In addition to SBA's general business loan eligibility standards, the following additional restrictions apply to CLP loans.

(1) Loan Programs and Pilots Not Eligible for CLP

Lenders may use CLP only for 7(a) loans and not for microloan demonstration loan program (microloans) or development company program (504) loans. Lenders may not use CLP for any pilot program unless SBA specifically authorizes use of CLP for the pilot.

(2) Types of Loans Not Eligible for CLP

(a) The following types of credit need loan programs are not eligible under CLP:

(i) Agricultural Enterprises;

(ii) Disabled Assistance Loan program (DAL);

(iii) Energy Conservation;

(iv) International Trade Loans;

(v) Qualified Employee Trusts (ESOP);

(vi) Pollution Control program;

(vii) CAPLines program; and

(vii) Export Working Capital program (EWCP).

In addition, lenders may not use the CLP process for any revolving credits.

(b) The following methods of delivery program are not eligible under CLP:

(i) PLP;

(ii) FA$TRAK;

(iii) LowDoc;

(iv) Capital Access program; and

(v) Premier Certified Lenders program (PCLP).

(3) Additional Restrictions Specific to CLP

(a) Existing SBA loan. If an applicant business already has an SBA loan, the lender may make the CLP loan only if the existing SBA loan is current.

(b) Statement of Personal History. A CLP loan may be made only if questions 6, 7, and 8 on any required "Statement of Personal History" inquiring forms (SBA Form 912), for the CLP application are all answered "No."

(c) Reconsiderations of declined loan applications. Reconsiderations must not be submitted under CLP.

(d) Ethical requirements. A loan is not eligible for CLP if there is any question on possible violation of any of SBA's ethical requirements.

(e) Conflict of interest. A loan is not eligible for CLP if there are any of the real or apparent conflicts of interest listed in subpart A, chapter 2, paragraph 14 of this SOP.

(f) Contaminated collateral. A loan is not eligible for CLP if it will be collateralized by commercial property known to be affected by contamination from a hazardous substance (including petroleum products) in an amount requiring significant cleanup. This restriction does not apply if remediation will be completed before disbursement.

b. What Credit Analysis Must the Lender Perform?

The lender must perform a thorough and accurate credit analysis of the applicant. The lender's written analysis must be included in its credit memorandum in the loan file. It must explain the loan completely enough to allow SBA's reviewers to determine that the file supports the lender's conclusions.

c. What is the Application Procedure for CLP Loans?

The CLP loan packages include the same forms and information as regular 7(a) loan packages. A CLP lender must make sure that all required forms and submissions are complete. In addition, the lender must prepare a draft of the SBA Authorization and include it with the package. The loan package should be clearly marked "CLP"on the SBA 4-I and on the mailing envelope**.**

d. What is the SBA Processing Procedure?

The SBA reviewer relies heavily on the information the lender provides. If the lender's presentation is not adequate for CLP processing, the SBA field office may convert the application from CLP to regular processing.

4. WHAT ARE A CLP LENDER'S POST APPROVAL RESPONSIBILITIES?

a. Who Drafts the SBA Authorization?

The lender drafts the SBA Authorization for a CLP loan. The lender makes sure that the authorization include all collateral and other requirements supporting the loan approval, and all SBA-required authorization provisions.

b. What Are the Closing Requirements?

Closing requirements are the same for CLP loans as for other SBA-guaranteed loans. The same SBA forms are required. The lender must obtain all required collateral positions and meet all other required conditions before loan disbursement. The lender must keep all closing documents in its files.

When a CLP lender closes an SBA-guaranteed loan, it must notify the approving SBA field office in writing of the dates of the first and final disbursement(s). The lender also must refer to SBA any disputed or questionable fees charged by a borrower's representative. The lender may submit this information in a letter or by sending a copy of the appropriate SBA Form 1050 or SBA Form 159.

c. What Are the Servicing and Liquidating Duties of a CLP Lender?

The CLP lender's servicing and liquidating responsibilities for CLP loans are the same as for regular 7(a) loans. If a servicing request from a CLP lender is thorough, complete and clearly stated, SBA will provide an expedited response.

5. IS THERE A CLP LENDER PERFORMANCE REVIEW?

Yes. The SBA field office reviews the CLP lender's performance record to determine whether it should remain CLP. Areas of review must include: loan eligibility, credit quality and analysis, documentation, authorizations, closing procedures, loan performance, servicing, and liquidation. Refer to Appendix 30 of SOP 50-50(4) for additional information on lender reviews.

6. HOW DOES SBA SUSPEND OR REVOKE CLP STATUS?

.120.442 The AA/FA may suspend or revoke CLP status upon written notice providing the reasons at least 10 business days prior to the effective date of the suspension or revocation. Reasons for suspension or revocation may include a loan performance record unacceptable to SBA, failure to make the required number of loans under the expedited procedures; or violations of applicable statutes, regulations or published SBA policies and procedures. A CLP lender may appeal the suspension or revocation under this section under procedures found in part 134 of this chapter. The action of the AA/FA remains in effect pending resolution of the appeal.

CHAPTER 3 - PREFERRED LENDERS PROGRAM

1. WHAT IS THE PREFERRED LENDERS PROGRAM?

.120.450 - Under the Preferred Lenders Program (PLP), designated Lenders process, close, service, and liquidate SBA guaranteed loans with reduced requirements for documentation to and prior approval by SBA.

The PLP lenders are authorized to make SBA guaranteed loans, subject only to a brief eligibility review and assignment of a loan number by SBA. The SBA's Review Branch reviews the portfolios and practices of each PLP lender annually. Working with SBA's field office where the lender has PLP status, the Review Branch verifies the lender's ability to process, close, service and liquidate SBA loans. The SBA approves PLP status for periods of no more than two years at a time. SBA may suspend or revoke a lender's PLP status.

2. HOW DOES A LENDER BECOME A PLP LENDER?

.120.451(a) An SBA field office serving the area in which a Lender's office is located can nominate the Lender, or a Lender can request a field office to consider it for PLP status. The SBA field office forwards its recommendation to an SBA centralized loan processing center which will submit its recommendation and supporting documentation to the AA/FA for final decision.

a. What Does the Lender's Request Include?

The lender's request includes:

(1) Name and address of lender;

(2) Name of any holding company of lender;

(3) Name, address, phone number and fax number for contact person at lender for nomination process;

(4) Geographic area where lender requests PLP status (district or branch office, State, or counties);

(5) A copy of the lender's latest SBA 750 and the date of the earliest SBA 750 with the lender;

(6) If lender is or ever was a CLP lender:

(a) A copy of its latest CLP Agreement;

(b) The date of its earliest CLP Agreement;

(7) If lender was previously a PLP lender:

(a) A copy of its latest PLP Agreement;

(b) The date of its earliest PLP Agreement; and

(c) An explanation of why the lender left the Preferred Lenders program;

(8) A copy of the lender's most recent annual report;

(9) Information about the lender's SBA loan activity for the past 5 years in numbers and dollars, including loan status -- current, paid in full, delinquent, in liquidation, charged off, and undisbursed;

(10) A description of the lender's history, organization, and management, including:

(a) When the lender was chartered;

(b) The location of any branch offices;

(c) Any recent mergers or acquisitions;

(d) Personnel in charge of PLP loans for the lender and their experience with the lender, in the industry, and with SBA loans;

(e) The names of the lender's loan officers who will have SBA loan approval authority;

(f) Where and how PLP loans will be processed, closed, serviced and liquidated, including information about any centralized activities;

(g) The lender's plan for PLP lending, including its estimate of:

(i) How many SBA loans it will make per year;

(ii) How many of the loans will be for real estate, how many for working capital, how many for start-ups, how many for exporting; and

(iii) How many of the loans will be less than $100,000 and how many will be more than $500,000.

b. What Does the SBA Field Office's Nomination Include?

The nomination includes:

(1) Lender identification number (formerly called the Polk number);

(2) The most recent available SBA statistics on lender's loan volume, purchase charge off rates and trends, and currency rate for the last 5 years;

(3) A copy of the field office's most recent written portfolio review of the lender, if any;

(4) The field office's opinion of:

(a) The lender's ability to process, close, service and liquidate SBA loans;

(b) The lender's ability to develop and analyze complete loan packages;

(c) The lender's rapport with the field office;

(d) The lender's commitment to SBA lending; and

(e) An analysis of any repair or denial of liability situations with the lender.

(5) If SBA services the lender's loans in a servicing center, the servicing center's written opinion of the lender's ability to process, close, service, and liquidate SBA loans;

(6) Depending on office structure, the written comments of the supervisors of the Finance, Portfolio Management, and Liquidation and Legal Divisions or equivalent positions in the field office stating:

(a) Whether they recommend the nomination;

(b) If so, why, for how long (not more than 2 years) and for what geographical areas; and

(c) If not, why not.

The SBA field office sends the lender's request and the field office's nomination to the SBA Sacramento Loan Processing Center ("the Center").

c. What Does the Center Do With the Nomination?

The Center analyzes the nomination and sends it with a recommendation to the AA/FA for final decision.

d. What Does SBA Consider in its Decision?

.120,451(b)In making its decision, SBA considers whether the Lender:
(1) Has the required ability to process, close, service and liquidate loans;
(2) Has the ability to develop and analyze complete loan packages; and
(3) Has a satisfactory performance history with SBA.

The AA/FA also considers whether the lender shows a substantial commitment to SBA's quality lending goals, an ability to meet the goals, and a spirit of cooperation with SBA.

e. What Happens if We Approve the Nomination?

.120.451 (c) If the Lender is approved, the AA/FA will designate the area in which it can make PLP loans.
(d) Before it can operate as a PLP Lender, the approved Lender must execute a Supplemental Guarantee Agreement, which will specify a term not to exceed two years.

The Center notifies the lender and SBA field office that:

(1) The nomination is approved;

(2) Length of the preferred status; and

(3) Geographic territory of operation.

The Center sends the lender an SBA Form 1347, "Supplemental Guarantee Agreement, Preferred Lenders Program (PLP agreement)," signed by the Center Director for the AA/FA. The lender must sign and return the PLP agreement to the Center before the lender's PLP status is effective.

The Center sends the appropriate field offices copies of the signed PLP agreement. [A copy of the PLP agreement is provided in the appendices.]

f. How Do We Handle the New PLP Lender's CLP Status?

The SBA's approval of PLP status for a lender in an area where it does not have CLP status automatically includes approval of CLP status. The Center sends the lender a CLP agreement signed by the Center Director for the AA/FA. The lender must sign and return the CLP agreement to the Center before the lender's CLP status is effective. The Center sends the appropriate field offices copies of the signed CLP agreement.

If the new PLP lender already has CLP status in the area in which it receives PLP status, the Center must verify the date that the CLP status ends. If the CLP status ends before the PLP status, the Center extends the CLP expiration date to match the PLP expiration date. This allows us to consider renewals for PLP and CLP for a lender at the same time. If CLP status is extended, the Center sends the lender a new CLP agreement or renewal agreement signed by the Center Director for the AA/FA. The lender must sign and return the agreement to the Center before the lender's new CLP date is effective. The Center sends the appropriate field offices copies of the signed agreement.

[A copy of a sample renewal agreement is in the appendices.]

g. What Happens if We Don't Approve the Nomination?

The Center notifies the lender and SBA field office(s) why we did not approve the PLP nomination. The decision of the AA/FA is final and the lender has no appeal rights. If the lender wants to re-apply for PLP status, it must wait at least 1 year from the date of the decline decision before re-applying to its SBA field office(s).

3. HOW DO WE RENEW THE LENDER'S PLP STATUS?

.120.451(e) When a PLP's Supplemental Guarantee Agreement expires, SBA may recertify it as a PLP Lender for an additional term not to exceed two years. Prior to recertification, SBA will review a PLP Lender's loans, policies and procedures. The recertification decision of the AA/FA is final.

a. Who Starts the Renewal?

(1) The Center automatically starts the renewal process just prior to the expiration of a lender's PLP status. The Center asks for comments from all field offices where the lender has PLP status and from processing and servicing centers that deal with the lender. The comments include:

(a) Whether they recommend renewal;

(b) If they recommend renewal, why, for how long and for what area;

(c) If they do not recommend renewal, why not;

(d) Whether the lender can process, close, service and liquidate SBA loans;

(e) Portfolio trends;

(f) Changes in lender's organization or management;

(g) Any denial of liability or repair situations with the lender;

(h) Reasons for any unfavorable loan volume or repurchase rate data;

(i) Identification of any areas of concern; and

(j) An explanation of any discussions with the lenders that may have impact the PLP decision.

Any SBA office that reviewed the PLP lender within the last 2 years must send a copy of its review to the Center either upon its completion, or no later than with its comments at the time of renewal.

(2) The Center analyzes the package and sends it, along with its recommendation, to the AA/FA for final decision. The AA/FA considers whether the lender:

(a) Can process, close, service, and liquidate SBA loans;

(b) Can analyze complete loan packages;

(c) Has a satisfactory performance history with SBA;

(d) Is in compliance with applicable SBA statutes, regulations and policies;

(e) Is in compliance with the terms of the PLP agreement;

(f) Is an active PLP participant;

(g) Has shown a commitment to SBA's quality lending goals; and

(h) Is a cooperative lending partner.

b. What Happens if We Approve the Renewal?

The Center notifies the lender and SBA field office that:

(1) The renewal is approved;

(2) For how long; and

(3) For what area.

The Center sends the lender a renewal agreement signed by the Center Director for the AA/FA. The lender must sign and return the agreement to the Center before the lender's PLP renewal is effective. The Center sends copies of the signed agreement to the appropriate field offices. A copy of a renewal agreement is in appendix 4.

c. How Do We Handle the Renewed PLP Lender's CLP Status?

The Center renews the CLP status to match the PLP status date. The Center sends the lender a CLP or renewal agreement signed by the Center Director for the AA/FA. The lender must sign and return the agreement to the Center before the lender's CLP renewal is effective. The Center sends copies of the signed agreement to the appropriate field offices.

If the new PLP lender already has CLP status in its PLP area, the Center must verify the date that the CLP status ends. If CLP status ends before the PLP status ends, the Center extends the CLP expiration date to match the PLP date. This allows us to consider renewals for PLP and CLP for a lender at the same time. The Center sends the lender a new CLP Agreement or renewal agreement signed by the Center Director for the AA/FA. The lender must sign and return the agreement to the Center before the lender's new CLP date is effective. The Center sends the appropriate field offices copies of the signed agreement.

d. What Happens if We Don't Approve the Renewal?

The Center notifies the lender and SBA field office(s) why we did not approve the renewal. The decision of the AA/FA is final and the lender has no appeal rights. The lender may not make PLP loans or exercise other PLP authority after its PLP status ends. (Its CLP status may or may not terminate simultaneously.)

If the lender wants to re-apply for PLP status, it must wait at least one year from the decline decision before contacting its SBA field office(s), and then must show how it has overcome the reasons for denial.

e. Short-Term Renewals

Sometimes a lender's PLP status is ending and we have not finished the renewal package. We may not have reviewed the lender yet or we are holding the renewal to allow us to review lenders owned by the same holding company together. If the AA/FA approves, the Center may renew a lender's PLP status for a short time to allow us to finish the renewal process.

4. HOW CAN A PLP LENDER EXPAND ITS PLP AREA?

.120.451(f) A PLP Lender may request an expansion of the territory in which it can process PLP loans by submitting its request to a loan processing center. The center will obtain the recommendation of each office in the area into which the PLP lender would like to expand its PLP operations. The center will forward the recommendations to the AA/FA for final decision. If a PLP Lender is not a CLP Lender in a territory into which it seeks to expand its PLP status, it automatically obtains CLP status in that territory when it is granted PLP status for the territory.

After a lender gets PLP status in any area, it may request PLP status in an expanded geographical area. The lender must make a written request to the Center for expansion.

a. What Does an Expansion Request Include?

A request must include:

(1) Item numbers 1 through 4 and 8 through 10 from paragraph 2.a. above;

(2) Copies of the CLP agreements, if any, lender has in expansion area; and

(3) A copy of its latest PLP Agreement and the date of its earliest PLP agreement.

b. What Does the Center Do With the Expansion Request?

(1) The Center gets comments from:

(a) All field offices where the lender has PLP status;

(b) All field offices where the lender wants to expand; and
(c) Processing and servicing centers that deal with the lender.

(2) The comments include:

(a) Recommendations regarding the expansion;

(b) If they recommend expansion, why, for how long and for what area;

(c) If they don't recommend expansion, why not;

(d) Whether the lender can process, close, service and liquidate SBA loans;

(e) Portfolio trends;

(f) Changes in lender's organization or management;

(g) Any denial of liability or repair situations with the lender;

(h) Reasons for any unfavorable loan volume or repurchase rate data;

(i) Identification of any areas of concern; and

(j) An explanation of any discussions with the lenders that impact the PLP decision.

Any SBA office that reviewed the PLP lender within the last 2 years must send a copy of its review to the Center.

(3) The Center analyzes the package and sends it to the AA/FA for final decision. The AA/FA considers whether the lender:

(a) Can process, close, service, and liquidate SBA loans in the expanded area; and

(b) Can analyze complete loan packages;

(c) Has a satisfactory performance history with SBA;

(d) Has a substantial commitment to SBA's quality lending goals;

(e) Has an ability to meet the goals; and

(f) Has a shown itself to be a cooperative lending partner.

The AA/FA may approve the expansion for some or all of the area the lender requests.

c. What Happens if We Approve the Expansion?

The Center notifies the lender and SBA field office that:

(1) The expansion is approved;

(2) For how long; and

(3) For what area.

Generally we will set the expansion term to match the remaining PLP term.

The Center sends the lender a new PLP or a modification agreement signed by the Center Director for the AA/FA. The lender must sign and return the agreement to the Center before the lender's PLP expansion is effective. The Center sends copies of the signed agreement to the appropriate field offices.

A copy of a sample modification agreement is in appendix 4.

d. How Do We Handle the Expanded PLP Lender's CLP Status?

Approval of PLP status in an expanded area automatically conveys approval of CLP status in the same area. The CLP expiration date is extended to match the PLP expiration date. The Center sends the lender a CLP Agreement signed by the Center Director for the AA/FA. The lender must sign and return the CLP Agreement to the Center before the lender's CLP or PLP status is effective. The Center sends the field office a copy of the signed CLP agreement.

If the new PLP lender already has CLP status in its expanded PLP area, the Center must verify the date that the CLP status ends. If CLP status ends before the PLP status ends, the Center extends the CLP expiration date to match the PLP expiration date. This allows us to consider renewals for PLP and CLP for a lender at the same time. The Center sends the lender a new CLP Agreement or renewal agreement signed by the Center Director for the AA/FA. The lender must sign and return the agreement to the Center before the lender's new CLP date is effective. The Center sends the appropriate field offices copies of the signed agreement.

e. What Happens if We Don't Approve the Expansion?

The Center notifies the lender and SBA field office why we did not approve the expansion. The decision of the AA/FA is final and the lender has no appeal rights.

If the lender wants to re-apply for an expansion, it must wait at least one year from the decline decision before sending a new request to the Center, and must show how it has overcome the reasons for denial.

5. EXTENDING PLP STATUS FROM HOLDING COMPANY TO LENDERS

A holding company may request an extension of PLP status from one of its lenders to another (or others).

a. What Does an Extension Request Include?

A request includes:

(1) Name and address of holding company;

(2) Names of PLP lenders in holding company;

(3) Name, address, and lender identification number (formerly called the Polk number) for lenders for which holding company wants extension;

(4) Name, address, phone number and fax number for contact person at holding company for extension process;

(5) Geographical area holding company wants for the new PLP lenders (district or branch office, State or counties). (the holding company may ask for different areas for different lenders);

(6) Copy of the SBA 750 for each lender for which holding company wants extension;

(7) If these lenders are or ever were CLP lenders:

(a) A copy of the latest CLP Agreement with each lender; and

(b) The date of the earliest CLP Agreement with each lender

(8) If these lenders ever were PLP lenders:

(a) A copy of the lender's latest PLP agreement for each lender;

(b) The date of each lender's earliest PLP agreement; and

(c) An explanation of why the lender left the Preferred Lenders program.

(9) A copy of each lender's most recent annual report, if available;

(10) For each lender, the items in paragraph 2.a.10, of this chapter.

b. How Does the Center Process an Extension Request?

(1) The Center requests comments from:

(a) All field offices where the lender has PLP status;

(b) All field offices where the lender wants to get PLP status; and

(c) Processing and servicing centers that deal with the lender.

(2) The comments include:

(a) Whether they recommend the extension;

(b) If they recommend extension, why, for how long and for what area;

(c) If they don't recommend extension, why not;

(d) Identification of any areas of concern;

(e) an explanation of any discussions with the lender(s) which may impact the PLP decision;

(f) Whether the lender can process, close, service, and liquidate SBA loans;

(g) Portfolio trends;

(h) Changes in lender's organization or management;

(i) Any denial of liability or repair situations with the lender; and

(j) Reasons for any unfavorable loan volume or repurchase rate data.

Any SBA office that reviewed the PLP lender within the last 2 years must send a copy of its review to the Center.

(3) The Center analyzes the package and sends it to the AA/FA for final decision. The AA/FA considers whether each lender:

(a) Can process, close, service and liquidate SBA loans;

(b) Can analyze complete loan packages;

(c) Has a satisfactory performance history with SBA;

(d) Has a substantial commitment to SBA's quality lending goals;

(e) Has an ability to meet the goals;

(f) Has a spirit of cooperation with SBA; and

(g) has a shown itself to be a cooperative lending partner.

c. What Happens if We Approve the Extension?

The Center notifies the lender and SBA field office that:

(1) The extension is approved;

(2) For what lender or lenders;

(3) For how long; and
(4) For what area.

Generally the Center sets the new PLP lender's term to match the remaining term of the original PLP lender.

The Center sends the holding company a PLP agreement signed by the Center Director for the AA/FA. A separate PLP agreement is provided to each approved lender that is a separate legal entity in the holding company. Each lender must sign and return the agreement to the Center before the lender's PLP status is effective. The Center sends the appropriate field offices copies of the signed agreement.

A copy of a sample modification agreement is in appendix 4.

For PLP renewal purposes, SBA will treat all PLP lenders owned by a holding company as a group. That is, each PLP lender owned by the holding company must meet SBA renewal requirements or SBA will not renew the PLP status of any of the lenders in the holding company.

d. How Do We Handle the New PLP Lender's CLP Status?

The SBA's approval of PLP status for a lender in an area where it does not have CLP status automatically includes approval of CLP status. The Center sends the lender a CLP agreement signed by the Center Director for the AA/FA. The lender must sign and return the CLP agreement to the Center before the lender's CLP status is effective. The Center sends the appropriate field offices copies of the signed CLP agreement.

If the new PLP lender already has CLP status in the area in which it receives PLP status, the Center must verify the date that the CLP status ends. If the CLP status ends before the PLP status, the Center extends the CLP expiration date to match the PLP expiration date. This allows us to consider renewals for PLP and CLP for a lender at the same time.

If CLP status is extended, the Center sends the lender a new CLP agreement or renewal agreement signed by the Center Director for the AA/FA. The lender must sign and return the agreement to the Center before the lender's new CLP date is effective. The Center sends the appropriate field offices copies of the signed agreement.

e. What Happens If We Do Not Approve The Extension?

The Center notifies the lender and SBA field office why we did not approve the extension. The decision of the AA/FA is final and the lender has no appeal rights.

If a holding company wants to re-apply for an extension, it must wait at least one year from the decline decision before sending a new request to the Center which must show how it has overcome the reasons for denial.

Q. Can a lender apply for expansion and extension in one request?
A. Yes.

6. WHAT HAPPENS WHEN A PLP LENDER CHANGES ITS STRUCTURE?

a. What Does the Lender Do?

If a PLP lender makes a major change in its structure or organization, it must tell the Center in writing. Major changes include:

(1) The lender is acquired by another lender;

(2) The lender is merged into another legal entity;

(3) The lender changes its name;

(4) The lender substantially changes its management;

(5) The lender substantially changes how it handles SBA loans; and

(6) A regulatory agency takes over or closes the lender

An SBA field office that discovers any of the above circumstances also must immediately notify the Center in writing.

b. What Does the Center Do?

The Center evaluates the effect of any change.

c. What is the Effect of a Change?

The following charts show what happens when the lender makes changes.

If a PLP lender continues as the same legal entity that signed the PLP and CLP agreements and. . .	**Then . . .**
(1) The PLP lender changes its name.	The Center records the name change. The lender's PLP and CLP status is not changed. A new PLP or CLP agreement is not needed.
(2) The PLP lender is acquired by another entity. The PLP lender continues as a separate legal entity.	The Center records the holding company name. The lender's PLP and CLP status is not changed. A new PLP or CLP agreement is not needed.

(3) The PLP lender acquires another lender. The acquired lender does not continue as a separate legal entity.	The acquired lender may make PLP loans under the PLP authority of the acquiring entity.
(4) The PLP lender acquires another lender. The acquired lender continues as a separate legal entity.	The acquired lender may not make PLP loans. The PLP lender may request an extension of its PLP status to the acquired lender.
(5) The lender is closed or taken over by a regulatory authority.	The lender's PLP and CLP statuses automatically terminate. The Center notifies the lender and SBA field office(s) the lender may not make any more PLP loans. The SBA may suspend or revoke the lender's PLP status.
(6) The lender changes its operations so much that it cannot show that it handles SBA loans appropriately	

If a PLP lender does not continue as the legal entity that executed the PLP and CLP agreements and . . .	**Then . . .**
(1) The PLP lender is merged into a non-PLP lender. The original PLP lender's SBA operations are unchanged.	The original PLP lender's agreements with SBA are no longer valid. The surviving lender must ask SBA for new SBA 750, CLP and PLP agreements.
(2) The PLP lender is merged into another PLP lender.	The original PLP lender's agreements with SBA are no longer valid. However, it can make SBA loans under the surviving PLP lender's agreement.
a. The surviving PLP lender's area does not coincide with the PLP area of the merged PLP.	The surviving PLP lender must ask for an expansion in order to continue lending in the merged PLP's area.

(3) The PLP lender is dissolved. It does not merge into another lender.	Its PLP and CLP statuses terminate automatically. The Center notifies the lender and SBA field office(s) the lender may not make any more PLP loans.

d. How Does a Merged Lender Request New SBA Agreements?

A PLP lender merges into a non-PLP lender. If the original PLP lender's SBA operations are unchanged, it may request new lender agreements from SBA. The lender asks the SBA field office for a new SBA Form 750, "Guaranty Agreement." The lender asks the Center for new PLP and CLP agreements.

The request to the Center includes:

(1) Name, address, and legal structure of surviving lender;

(2) Copy of SBA 750 for surviving lender; and

(3) Assurance that former PLP lender has not changed its SBA loan operations, or an explanation of any changes.

The Center asks the SBA field offices if they know of any reason not to approve the request. (For example, staff in a field office may know that the lender has fired all of its SBA loan personnel.) The Center forwards the request to the AA/FA for final decision. If the request is approved, the term of the lender's new PLP and CLP agreements match the remaining term of the original lender's PLP status. If the request is not approved, the lender may immediately ask a field office for a PLP nomination.

7. WHAT ARE THE REQUIREMENTS OF PLP LOAN PROCESSING?

.120.452(a) Subparts A and B of this part govern the making of PLP loans, except for the following:
(1) Certain types of businesses, loans, and loan programs are not eligible for PLP, as detailed in published SBA policy and procedures.

The SBA's business loan eligibility, credit policy, and procedures apply to PLP loans. The PLP lender must keep informed on and must apply all SBA business loan requirements. A lender may not knowingly submit a loan guaranty request under PLP after the applicant had already submitted a request under another application system from the same or a different lender.

a. Eligibility Requirements

An SBA loan must be eligible for the SBA guaranty to be valid. In addition to the rest of SBA's business loan eligibility standards, the following additional restrictions apply to PLP Loans.

(1) Loan Programs and Pilots Not Eligible for PLP

Lenders may use PLP only for 7(a) loans and not for microloan demonstration loan program (microloans) or development company program (504) loans. Lenders may not use PLP for any pilot program unless SBA authorizes use of PLP for the pilot.

(2) Types of Loans Not Eligible under PLP

(a) These types of loans are not eligible under PLP:

(i) Disabled Assistance Loans (DAL);

(ii) Energy Conservation;

(iii) Qualified Employee Trusts (ESOP);

(iv) Pollution Control program; and

(v) CAPLines program

Revolving credits are not eligible for PLP except under the Export Working Capital program (EWCP) and then only if the lender has special authority from SBA to make PLP EWCP loans.

(b) The following methods of delivery program are not eligible under PLP:

(i) CLP;

(ii) FA$TRAK;

(iii) LowDoc;

(iv) Capital Access program; and

(v) Premier Certified Lenders program (PCLP).

(3) Types of Businesses Not Eligible for PLP

These types of businesses are not eligible under PLP:

(a) Agricultural and farm businesses;

(b) Fishing and shore operations (including commercial fishing activities and the construction of new fishing vessels;

(c) Medical facilities (including residential care facilities);

(d) Mines (including sand and gravel pits);

(e) Applicants doing business in foreign countries;

(f) Businesses engaged in teaching, instructing, counseling or indoctrinating religion or religious beliefs, whether in a religious or secular setting; and

(g) Businesses offering products or services of a sexual nature.

(4) Additional Restrictions Specific to PLP are specified in .120.452.

.120.452(a)(2) A Lender may not make a PLP business loan which reduces its credit exposure for any Borrower, except in cases where an interim loan(s) has been made for other than real estate construction purposes to the Borrower which was approved by the Lender within 90 days of receipt of the issuance of a subsequent PLP loan number.
(3) SBA will not guarantee more than the specified statutory percentage of any PLP loan.

The PLP proceeds can only be used to repay debt due the PLP lender when the loan to be refinanced is an interim non-construction loan approved within 90 days of the PLP application or is an interim construction loan that is not disbursed at the time of the PLP request for loan number.

No authority exist for a PLP lender to process a loan under PLP procedures that includes a purpose which is prohibited from being processed under PLP just by assigning a zero percent of guaranty to the portion which is not PLP eligible.

A loan for $300,000 where $100,000 was going to refinance same institution debt can not be processed under PLP procedures because the refinancing of any same institution debt is not eligible under the PLP process. This loan could not be made even if it were guaranteed at 50 percent and the analyst tried to use the logic that the $200,000 in eligible proceeds were guaranteed at 75 percent and the ineligible portion guaranteed at zero percent. The ability to make such adjustments does not exist.

In short, a PLP lender may not refinance its own debt under PLP.

The following restrictions also apply to PLP loans.

(a) Existing SBA loan. If an applicant business already has an SBA loan, the lender may make the PLP loan only if the existing SBA loan is current.

(b) Refinance or Pay Off Existing SBA Loan. No proceeds of a PLP loan may be used to either refinance or pay off an existing SBA loan.

(c) Piggyback loan. A piggyback where the superior lien is held by the PLP lender is not eligible for PLP. See subpart A for more information on piggyback loans.

(d) 100% Financing. A PLP loan may not be used to finance more than 90 percent of the actual cost of any real estate being acquired or of the capital needs for a new business.

(e) SBA Form 912. A PLP loan may be made only if questions 6, 7, and 8 on any required SBA Form 912, Statement of Personal History, for the PLP application are all answered "No."

(f) Ethical requirements. A loan is not eligible for PLP if there is any question of possible violation of any of SBA's ethical requirements.

(g) Contaminated collateral. A loan is not eligible for PLP loan if it will be collateralized by commercial property known to be affected by contamination from a hazardous substance (including petroleum products) in an amount requiring significant cleanup.

This restriction does not apply if remediation will be completed before disbursement.

(h) Reconsiderations of declined loan applications. Reconsiderations of loans previously declined by SBA (regardless of the method by which they were originally processed) are not eligible to be processed under PLP, or any other processing method where the lender is given delegated approval authority.

(i) Previous loss to government. A loan is not eligible for PLP processing if:

(i) The applicant business previously defaulted on a Federal loan or federally assisted financing that resulted in the Federal Government or any of its agencies or departments sustaining a loss in any of its programs; or

(ii) Any of the owners, or those that control the applicant business, or any of its associates, previously owned, operated, or controlled a business which defaulted on a Federal loan (or guaranteed a loan which was defaulted) and caused the federal government or any of its agencies or departments to sustain a loss in any of its programs.

This restriction applies whether or not SBA was involved in the previous loss.

(j) Conflict of interest. A loan is not eligible for PLP if there are any real or apparent conflicts of interest as detailed in 13 CFR .120.140.

b. What is the PLP Loan Application Procedure?

.120.452(b) A PLP Lender notifies SBA of its approval of a PLP loan by submitting to SBA's loan processing center appropriate documentation signed by two of the PLP's authorized representatives. SBA will attach the SBA guarantee and notify the PLP Lender of the SBA loan number (if it does not identify a problem with eligibility, and funds are available).

The PLP loan packages must include the same forms and information as regular 7(a) loan packages. The PLP lender is responsible for the completeness of all of the required forms and information.

(1) How Does the PLP Lender Request an SBA Loan Number?

When the PLP lender believes that a loan is eligible, approves the credit, and completes the loan package, the lender sends the Center:

(a) A copy of front page of SBA Form 4;

(b) A copy of front page of SBA Form 4-I; and

(c) Any forms or checklists required by the Center (to provide evidence of eligibility and required data inputs to generate loan number).

The SBA lets the lender know how to send the request for loan number--by mail, facsimile transmission or electronic transmission.

For regular 7(a) loans with a maturity of 12 months or less, the lender must submit with the loan application a one-time guaranty fee of one quarter of one percent (.25 percent) of the amount to be guaranteed. The field holds the lender's check until the loan is approved. If the loan is declined, the check is returned to the lender. Since SBA does not approve or decline the credit for PLP loans, the lender does not send the check for the guaranty fee for short-term PLP loans (maturity of twelve months or less) to the Center with the request for a loan number. When a loan number is assigned for a short-term loan, the Center tells the lender that the guaranty fee check must be sent directly to DFC at U.S. Small Business Administration, Denver, Colorado 80259-0001. The lender must pay the guaranty fee before it signs the Authorization for SBA. If DFC does not get the check within 10 business days after the Center issues the loan number, the Center cancels the guarantee.

(2) What Does the Center Review?

The Center reviews the request for loan number to:

(a) Check that the lender sent the required items; and

(b) See if there are any eligibility problems.

This eligibility review is a quick look to protect SBA and the lender from making ineligible loans on which SBA could not honor its guarantee. If an SBA loan number is assigned, and we later learn that the loan is not eligible, SBA still may deny liability on our guarantee.

When reviewing eligibility, the reviewer must consult Center counsel about any novel or complex issues. Center counsel provides the reviewer a written opinion regarding eligibility, when requested. Counsel opinions are written for the benefit of SBA and must not to be shown or sent to outside parties (including lenders).

(3) Lender Notification

If a loan is eligible and funds are available, the Center will make its best efforts to give the lender a loan number by fax within one day after it receives the request. If he/she notes an eligibility problem, the reviewer will contact the lender by telephone to explain the problem(s). If the lender chooses, SBA can decline the loan within the 1-day turnaround period and explain the eligibility problem in writing to the lender and the SBA field office. Or if the lender prefers, SBA will keep the application until we can obtain any necessary information or perform any research necessary to try to resolve the problem.

(4) How Does a Lender Request Reconsideration of a Denial?

If SBA notifies a lender that a proposed loan is not eligible and the lender disagrees, the lender may ask that we reconsider our decision. The request for reconsideration must be in writing and oral. It must contain the information needed to make an eligibility decision. The lender must send the reconsideration request to the Center within 30 days after the lender receives the Center's initial decision. The reviewer must consult Center counsel as necessary in reconsidering the eligibility of the proposed loan and must notify the lender of the reconsideration decision.

If we decline the loan on reconsideration, the lender may ask for further reconsideration. The request for further reconsideration must be sent to the Center within 30 days after the last eligibility decision. It must specifically request reconsideration at the next higher level and say why we should reverse the eligibility decision. The Center will send the request to the AA/FA for review and final eligibility decision. The Center will tell the lender the final decision.

Loans ineligible for PLP may under some circumstances be eligible for submission under another SBA loan program [such as CLP or regular 7(a)]. If we decline a PLP loan, and the lender resubmits the loan to SBA under another loan program, the lender must notify the office to which it submits the loan that the loan was declined for a PLP. The lender must provide that office a copy of the Center's denial letter with the application.

8. PLP LENDERS' PROCESSING RESPONSIBILITIES

.120.452(c) The PLP Lender is responsible for all PLP decisions regarding eligibility (including size) and creditworthiness. The PLP Lender is also responsible for confirming that all PLP loan closing decisions are correct, and that it has complied with all requirements of law and SBA regulations.

a. What Is the Lender's Eligibility Review?

The SBA does not delegate to a PLP lender authority to determine SBA loan eligibility. However, a PLP lender must analyze a PLP applicant's eligibility in the same way that SBA analyzes eligibility for a regular 7(a) loan applicant. For example, we review franchise documents to determine that the franchisee has the opportunity for profit and the risk of loss commensurate with ownership. The PLP lender must keep in its loan file documentation supporting its eligibility determination.

For a PLP loan, size of the applicant is determined as of the date of the lender's approval of the loan. A PLP lender may accept as true the size information provided by the applicant, unless credible evidence to the contrary is apparent.

b. What Credit Analysis Must the Lender Do?

The SBA delegates the PLP credit decision to the lender. SBA selects PLP lenders, in part, based on their historical record of performance with SBA. The PLP lenders must be very capable at processing, servicing and liquidating SBA-guaranteed loans. The lender does a thorough and complete credit analysis of the applicant, and establishes that the loan is of such sound value as to reasonably assure repayment.

The lender records the results of this analysis in its lender's credit memorandum in the loan file. This credit memo must show that the lender gathered enough information to make an informed analysis about repayment ability for the loan.

At a minimum, the credit memo must discuss:

(1) Capitalization - The lender must determine whether the business will be adequately capitalized for the project and for business operations. It must also identify the borrower's injection and analyze whether the injection is adequate, and discuss the sources and uses of funds to finance the project.

(2) Repayment Ability - The lender must state the information that let it make a reasonable conclusion that the loan demonstrates repayment ability. The lender must discuss any information in addition to the above items that is pertinent to the analysis, including:

(a) Historical cash flow of the business (including revenues and expenses and impact of owners' withdrawals and officers' compensation);
(b) Projections;

(c) Availability of markets; and

(d) Stability of sales.

Historical data must be reliable and projections must be realistic. The lender must provide enough information to show that it understands the nature of the small business, including:

(a) The type of business;

(b) Its legal structure;

(c) How long it has existed;

(d) Its ownership; and

(e) How long it has been under present ownership.

Much of the description of the business may be in the SBA Forms 4 and 4-I. If so, the lender does not have to repeat it in the credit write-up. However, any information about the nature of the business relevant to repayment and not contained on those forms must be included in the write-up. The lender must analyze the borrower's proposal as to whether it is a reasonable and appropriate undertaking for the business.

(3) Management Ability - The lender must assess the management ability of the business. In doing this, it must consider education, experience, motivation, and stability.

(4) Collateral - The lender must identify assets available to be pledged as collateral, as well as assets actually pledged as collateral. It must evaluate the assets and determine their liquidation value, by appraisal or other acceptable method. The lender must also determine how much collateral is needed to adequately secure the loan.

(5) Credit History - The lender must review the credit reports for consumer debt and business debt to determine if the borrower shows a history of responsible use of debt. If the lender has credit experience with the borrower, it must discuss it.

c. Who Executes the SBA Form 4-I for the PLP Lenders?

The SBA Form 4-I must be signed by two authorized officials of the PLP lending institution to signify that the lender has approved the loan.

d. Who Originates and Executes the Authorization?

For PLP loans, the lender originates the Authorization without SBA review, and signs it for and on behalf of SBA. The lender must make sure that all collateral and other requirements supporting loan approval are in each Authorization.

The lender must include all SBA-required authorization provisions.

At a minimum, the authorization must include the following:

(1) The borrower's correct legal name. If a partnership or corporation, the borrower name used in the Authorization must be the same as the name identified in the partnership agreement or Articles of Incorporation. If individual name(s) are used, the exact name as shown on the loan application must be used. If the borrower has a trade name, it must be included in the borrower's name (e.g. Joan Doe dba Doe Electronics) in the first paragraph of the Authorization.

(2) The correct name and address of the lender and the SBA local office name and address.

(3) The date of request identified in the first paragraph of the authorization must match the application date that appears on the SBA Form 4I.

(4) The guaranty percentage which must meet current SBA requirements.

(5) The amount of the loan must match that identified in the Forms 4 and 4-I.

(6) First and last disbursement deadlines.

(7) Repayment terms which must match the terms identified in the credit write-up. Language acceptable to SBA must be used for variable rate terms, like for fluctuation intervals and when interest becomes fixed. Maturity, interest rate, and ceiling/floor (if any) must be eligible.

(8) Use of proceeds which must match all other references in the file, including the SBA Form 4 and the credit write-up.

(9) Required construction conditions, if the use of proceeds includes construction.

(10) Names of any creditors being repaid.

(11) A list of all collateral required which must be identical to that in the credit write-up, including any required personal guaranties. Collateral identified must correctly secure either the note or a guaranty where applicable. The correct owners of collateral must be identified.

(12) For eligible passive company loans, appropriate borrowers, guarantors, collateral, and lease provisions which are in compliance with Agency requirements.

(13) The requirement that financial statements for the borrower be provided at least annually.

(14) Generally, the requirement that the borrower maintain hazard insurance on all assets pledged as collateral.

(15) The current SBA requirement regarding flood insurance.

(16) Any particular requirements identified in the loan write-up, including standby agreements, appraisals, or business licenses.

(17) Appropriate environmental conditions.

(18) Any conditions required by SBA for all authorizations. These include those provisions in the standard boilerplate, such as a no adverse change condition. Also included are those added by SBA Notice or SOP, such as "buy American" and the current requirements for verification of tax returns and child support certifications.

(19) A proper signature by an authorized representative of the lender, with the following statement by the Administrator's signature line: "Preferred Lender, as Lender and as an Agent of and on behalf of the SBA, for purposes of executing this Authorization."

e. What are the Closing Requirements?

The SBA closing requirements generally are the same for PLP loans as for other SBA-guaranteed loans. The same SBA forms are required. The lender must obtain all required collateral positions and must meet all other required conditions before loan disbursement.

For PLP loans, SBA also delegates to the lender responsibility for all pre-disbursement Authorization requirements in this SOP. The PLP lender acts in SBA's place to take all actions where we say that SBA must do or review something before disbursement, like tax verifications and environmental requirements. The only actions that the lender may not take on a PLP loan are those specifically reserved to SBA. For example, only SBA can enforce compliance by the borrower with our nondiscrimination regulations. For any tax verifications required by SOP or Notice, the lender must identify which tax returns it must use to verify financial data in a PLP loan. The lender then verifies the returns. If it discovers any discrepancy that is significant enough to indicate possible fraud on the part of the small business, the lender must:

(1) Instruct the Center in writing to cancel the loan.

(2) Directly refer the case to the local Office of the Inspector General (OIG). Their "Fraud Hotline" phone number is 1-800-767-0385. The lender must include a cover letter explaining the discrepancy, as well as the names, addresses and telephone numbers of the applicant, business, lender, packager and tax return preparer.

After closing a PLP loan, the lender must send to the Center a copy of the Authorization, after it is signed by the lender for SBA. The lender does not have to send SBA any other disbursement information, except through the required periodic loan status reports.

9. WHAT ARE A PLP LENDER'S SERVICING RESPONSIBILITIES?

Public Law 105-208 provides PLP lenders with the authority to...

.120.453 The PLP lender must service and liquidate its SBA guaranteed loan portfolio (including its non-PLP loans) using generally accepted commercial banking standards employed by prudent lenders. The PLP Lender must liquidate any defaulted SBA guaranteed loan in its portfolio unless SBA advises in writing that SBA will liquidate the loan. The PLP Lender must submit a liquidation plan to SBA prior to commencing liquidation action. The PLP Lender may take any necessary servicing action, or liquidation action consistent with a plan, for any guaranteed loan in its portfolio, except it may not:
(a) Take any action that confers a Preference on the Lender;
(b) Accept a compromise settlement without prior written SBA consent; and
(c) Sell or pledge more than 90 percent of a PLP loan.

As authorized by the statute, a PLP lender can take all routine servicing actions except any that would convey a preference on itself. However, the lender must get SBA's written consent before it can take the following actions which are considered non-routine:

a. A PLP lender cannot compromise a debt; or

b. Take any action to acquire contaminated property.

10. HOW DOES SBA REVIEW THE PLP LENDER'S PERFORMANCE?

Public Law 105-208 required SBA to establish a PLP review function and to review PLP lenders annually.

.120.454 SBA may review the performance of a PLP Lender. SBA may charge the PLP Lender a fee to cover the costs of this review.

The OFA's Review Branch is responsible for reviewing PLP lenders' performance. Personnel in this branch must check whether a PLP lender processes, services, and liquidates loans according to SBA standards, by reviewing the lender's policies, practices, and SBA loan portfolio.

a. What Is the Review Process?

Under the PLP review process, each PLP lender will be examined annually consistent with the statute. This review will be one, but not the exclusive, element used to determine renewal of PLP status. The review focuses on lender PLP operations and involves discussions with lender management, analysis of lending policy and internal controls, and specific case file review.

PLP lender reviews are conducted by a review team comprised of an OFA Review Branch employee as SBA Site Representative and one or more contract reviewers. SBA selects a contractor annually. SBA and the contractor sign a contract to delineate the responsibilities and authorities of each party.

The Review Branch schedules all reviews using input from field offices regarding PLP lending activity and experience. Field offices are also to advise the OFA Review Branch at anytime of concerns that arise regarding any PLP lender. Sufficient advance notice is provided to lenders to allow appropriate loan management personnel to be available when the review is conducted at lender.s site.

Prior to commencement of the review, any prior reviews of the lender are examined. This includes any lender responses to the conclusions of prior reviews. SBA also compiles portfolio statistics on the lender including information from SBA.s field offices. The review team examines loan policy and procedures, internal controls, and case files, and interviews lender staff and obtains additional information, as appropriate. One or more of the team members discusses the preliminary findings of the review with lender representatives. The lender is allowed ample time to discuss, raise any relevant issues, and provide comments which are so noted by the Team.

The review focuses upon material or regulatory deficiencies in the PLP practices of the lender. Material deficiencies are deficiencies that render the loan or any portion of the loan ineligible, not creditworthy, or uncollectible. Regulatory deficiencies are deficiencies in those documents required of the lender or borrower by policy or law, such as proper application forms, certifications, and supplemental statements by either the lender or borrower. Lenders should specifically note that, notwithstanding the results of any review, SBA retains full authority and rights with regard to the purchase of any guaranteed loan.

b. Who Documents the Results of the Review?

The SBA site representative is responsible for preparing a final Report of Review, incorporating all relevant reviewer and lender comments. It includes an "Assessment of Lender's Qualification to Participate in PLP Program." The SBA representative submits the report to the Chief, Review Branch, who forwards it, after final examination, to the Associate Administrator for Financial Assistance (AA/FA).

The AA/FA provides a copy of the report to the PLP lender. Accompanying the report is a transmittal letter that identifies any specific concerns SBA has identified in lender operations. It also states if a written response is suggested or required. Lender response is required only if there are material deficiencies identified or if correctable policy violations are noted that require immediate lender action. Lender response requirements, if any, are also clearly stipulated. Any lender response is attached to the original report and maintained in SBA's files as a part of the report. SBA maintains the confidentiality of all review information and correspondence related to any findings or responses. The AA/FA provides detailed information regarding the review findings to the Sacramento Processing Center and to each district office where the lender has PLP status.

c. Is there a Cost for the Review?

SBA receives no direct or indirect fee for the review process. Contractor costs are reimbursed directly to the contractor by a fee assessed to each PLP lender when reviewed. The lender fee is based upon a sliding scale that corresponds to lender categories, and includes contractor salaries, travel, and administrative expenses. Lender categories are based upon lender volume. The following schedule of PLP lender categories is established for this purpose:

Category of Lender	Annual PLP Loan Approvals
Category A >	150 PLP approvals
Category B	101-150 PLP approvals
Category C	51-100 PLP approvals
Category D	13-50 PLP approvals
Category E	12 PLP approvals

The fee structure is negotiated between SBA and the contractor prior to the start of each fiscal year and is published by SBA. Every effort is made to keep the fee as economical as possible. The PLP lender is also advised of the fee when the review is scheduled. The fee is collected by the contractor when the on-site review activities are completed.

A lender may hold PLP preferred status for multiple entities within its holding company group, or may have multiple locations for loan making and servicing functions. Typically, each separate lending entity that has loan approval authority will have executed a separate SBA Form 1347.

For these lenders, SBA will determine the appropriate category classification and location(s) for the review with input from field offices, the lender, and direction from OFA. SBA will attempt to minimize costs to the lender while still providing a complete review of

all the lender.s PLP activities.

d. Are there any Options for Off-site Review?

For those lenders that approve 12 or fewer loans per fiscal year, an off-site review process might be substituted. SBA has sole discretion whether to allow an off-site review. SBA and the selected off-site lender will make arrangements for specific case files (or copies) to be shipped to the contractor, where they are reviewed and promptly returned. Lending policies and procedures are analyzed by the Review Branch via telephone, phone, fax and/or other off-site means (such as a local SBA field office).

A reduced fee for off-site reviews is charged. This off-site charge is also specified annually by SBA. The lender forwards payment of this fee to the contractor when case files are submitted to the contractor.

e. Are there Guidelines for the Review?

A PLP Review Guide has been developed by SBA with assistance from technical experts within the industry. It provides the basis for both reviewer training and for accomplishing the review itself. All Review Team members are fully trained by SBA in the scope and purpose of the Review by SBA. The Review Guide is also available publicly through the SBA web site (sba.gov/banking).

11. HOW DO WE SUSPEND OR REVOKE PLP STATUS?

.120.455 The AA/FA may suspend or revoke PLP status upon written notice providing the reasons at least 10 business days prior to the effective date of the suspension or revocation. Reasons for suspension or revocation may include loan performance unacceptable to SBA, failure to make the required number of loans under the expedited procedures, or violations of applicable statutes, regulations, or published SBA policies and procedures. A PLP Lender may appeal the suspension or revocation made under this section under procedures found in part 134 of this chapter. The action of the AA/FA remains in effect pending resolution of the appeal.

According to the PLP agreement, suspension, or termination does not affect the guaranty of any PLP loan approved by the lender, so all approved guarantees on disbursed loans remain in place. However, the servicing of these loans changes from PLP to standard 7(a) procedures. If the lender does not keep its 7(a) authority, and the SBA loans are not acquired by another SBA lender, servicing is transferred to SBA. If this is needed, the Center coordinates transfers with appropriate SBA field offices and servicing centers. [See the Loan Servicing and Loan Liquidation SOPs for additional guidance.]

The following chart shows what happens to PLP loans when a lender's PLP status is suspended or revoked before the lender completes the approval or closing processes.

12. WHAT HAPPENS TO A PLP LENDER'S PLP LOANS IF IT LOSES ITS PLP STATUS OR CEASES TO EXIST?

If a lender is no longer PLP because of its status being revoked or not renewed or the lender cease to exist through merger or otherwise, its disbursed loans are treated as stated above.

If a lender is no longer PLP and it has PLP loans that are not fully disbursed and ...	**Then . . .**
1. The authorizations were signed by the lender while it still had PLP status	
a. If the lender keeps its 7(a) authority.	The lender closes and services the loans under 7(a). The Center transfers the loans to the servicing office since the loans are no longer PLP.
b. If the lender does not keep its 7(a) authority and does not transfer its loans.	We cancel any undisbursed balances on the loans. The servicing offices offer assistance to the borrowers.
c. A lender with PLP authority acquires the loans.	The new lender closes and services the loans under PLP if we consent to the transfer.
d. A lender with 7(a) authority acquires the loans.	The new lender closes and services the loans under 7(a)if we consent to the transfer. The Center transfers the loans to the servicing office since the loans are no longer PLP.
2. The loans had PLP numbers but the authorizations were not signed when the lender lost PLP status. a. A lender with PLP authority acquires the loans.	The new lender signs the authorizations and closes and services the loans under PLP, if we consent to the transfer.
b. The loans are not acquired by a PLP lender.	We cancel the loans. The local SBA field office contacts the affected borrowers and offers assistance. (If a former PLP lender is merging with a lender that is requesting a new PLP agreement based on the merger, the acquired loans will regain their PLP status once the new lender obtains PLP status, in which case the loans do not have to be canceled immediately. If the lenders and borrowers agree, the loans may be left.

CHAPTER 4 - SMALL BUSINESS LENDING COMPANIES (SBLC)

1. LOAN PARTICIPANTS REGULATED BY SBA

For a brief period prior to January 4, 1982, Section 120.4(b) of SBA's regulations provided that any lending institution which was not subject to continuing supervision and examination by a State or Federal regulatory authority could be approved as a participating lender subject to certain conditions. The SBA ceased approving such lenders, known as "Small Business Lending Companies" (SBLC) on January 4, 1982.

Approximately 14 existing SBLCs continue to participate with SBA. These entities are subject to direct supervision and examination by SBA. The requirements imposed on an SBLC are detailed in sections 120.470 through 120.476.

a. Definition Of An SBLC

. 120.470 What is an SBLC?

A Small Business Lending Company (SBLC) is a nondepository lending institution licensed by SBA. SBA supervises, examines, and regulates SBLCs. An SBLC is subject to all applicable SBA regulations, including those governing Lenders. SBA has imposed a moratorium on licensing new SBLC's since January, 1982.

(a) An SBLC may only make:

(1) Loans under section 7(a) (except section 7(a)(13)) of the Act in participation with SBA, and/or

(2) SBA guaranteed loans to micro-Lenders in the SBA Microloan program (see subpart G of this part). Such loans are subject to the same conditions as guaranteed loans made to SBA-designated microlenders by SBA participating Lenders.

(b) In addition to complying with . 120.400-120.413, an SBLC must meet the following requirements:

(1) Business structure. It must be a corporation (profit or non-profit).

(2) Written agreement. It must sign a written agreement with SBA.

(3) Capital structure. It must have unencumbered paid-in capital and paid-in surplus of at least $1,000,000, or ten percent of the aggregate of its share of all outstanding loans, whichever is more.

(4) Capital impairment. It must avoid capital impairment at all times. Impairment exists if the retained earnings deficit of an SBLC exceeds 50 percent of combined paid-in capital and paid-in-surplus, excluding treasury stock. An SBLC must give SBA prompt written notice of any capital impairment within 30 calendar days of the month-end financial report that first reflects the impairment. Until the impairment is cured, an SBLC may not present any loans to SBA for guarantee.

(5) Issuance of securities. Without prior written SBA approval, it must not issue any securities (including stock options and debt securities) except stock dividends and common stock issued for cash or direct obligations of, or obligations fully guaranteed as to principal and interest by, the United States.

(6) Voluntary capital reduction. Without prior written SBA approval, it must not voluntarily reduce its capital, or purchase and hold more than 2 percent of any class or combination of classes of its stock.

(7) Reserves for losses. It must maintain a reserve in the amount of anticipated losses on loans and receivables.

(8) Internal control. It must adopt a plan designed to safeguard its funds and other assets, to assure the reliability of its personnel, and to maintain the accuracy of its financial data.

(9) Dual control. It must maintain dual control over disbursement of funds and withdrawal of securities. An SBLC may disburse funds only by checks or wire transfers authorized by signatures of two or more officers covered by the SBLC's fidelity bond, except that checks in an amount of $1,000 or less may be signed by one bonded officer. There must be two or more bonded officers, or one bonded officer and a bonded employee to open safe deposit boxes or withdraw securities from safekeeping. The SBLC shall furnish to each depository bank, custodian, or entity providing safe deposit boxes a certified copy of the resolution implementing these control procedures.

(10) Fidelity insurance. It must maintain a Brokers Blanket Bond, Standard Form 14, or Finance Companies Blanket Bond, Standard Form 15, or such other form of coverage as SBA may approve, in a minimum amount of $500,000 executed by a surety holding a certificate of authority from the Secretary of the Treasury pursuant to 31 U.S.C. 9304 - 9308.

(11) Common control. It must not control, be controlled by, or be under common control with, another SBLC. Without prior written SBA approval, an Associate of one SBLC shall not be an Associate of another SBLC or of any entity which directly or indirectly controls or is under common control with another SBLC.

(12) Management. An SBLC must employ full time professional management.

(13) Borrowed funds. Without SBA's prior written approval, it must not be capitalized with borrowed funds. Shareholders owning 10 percent or more of any class of its stock shall not use borrowed funds to purchase the stock unless the net worth of the shareholders is at least twice the amount borrowed or unless the shareholders receive SBA's prior written approval for a lower ratio.

b. Records To Be Maintained By An SBLC

. 120.471 Records.

Each SBLC must comply with the following requirements concerning records:

(a) Maintenance of Records. It must maintain accurate and current financial records, including books of account, minutes of stockholder, directors, and executive committee meetings, and all documents and supporting materials relating to the SBLC's transactions at its principal business office. Securities held by a custodian pursuant to a written agreement shall be exempt from this requirement.

(b) Preservation of records.

(1) It must preserve in a manner permitting immediate retrieval the following documentation for the financial statements required by . 120.472 (and of the accompanying certified public accountant's opinion), for the following specified periods:

(i) Preserve permanently:

(A) All general and subsidiary ledgers (or other records) reflecting asset, liability, capital stock and surplus, income, and expense accounts;

(B) All general and special journals (or other records forming the basis for entries in such ledgers); and

(C) The corporate charter, bylaws, application for determination of eligibility to participate with SBA, and all minutes books, capital stock certificates or stubs, stock ledgers, and stock transfer registers;

(ii) Preserve for at least 6 years following final disposition of the related loan:

(A) All applications for financing;

(B) Lending, participation, and escrow agreements;

(C) Financing instruments; and

(D) All other documents and supporting material relating to such loans, including correspondence.

(2) Records and other documents referred to in this section may be preserved electronically if the original is available for retrieval within a reasonable period.

c. Reports To Be Maintained By An SBLC

. 120.472 Reports to SBA.
An SBLC must submit the following to the AA/FA:
(a) An audited financial statement prepared by an certified public accountant within three months after the close of each fiscal year, and interim financial reports when requested by SBA;
(b) A report of any legal or administrative proceeding, by or against the SBLC, or against an officer, director, or employee of the SBLC for an alleged breach of official duty, within 10 days after initiating or learning of the proceeding, as well as notification of the terms of any settlement or final judgment (in addition to any reporting under applicable SBA Forms);
(c) Copies of any report furnished to its stockholders (including any prospectus, letter, or other publication concerning the financial operations of the SBLC);
(d) A summary of any changes in the SBLC's organization or financing, such as:
(1) Any change in its name, address or telephone number;
(2) Any change in its charter, bylaws, or its officers or directors (to be accompanied by a statement of personal history on an approved SBA form);
(3) Any changes in capitalization (including those identified in . 120.470);
(4) Any changes affecting the eligibility of the SBLC to continue to participate as an SBLC; and
(5) Notice of a pledge of stock within 30 calendar days of the transaction if 10 percent or more of the stock is pledged by any person (or group of persons acting in concert) as collateral for indebtedness, and such pledge does not involve a transfer for which prior written approval of SBA is required under . 120.473;
(e) Such other reports as SBA may require from time to time by written directive .

2. WHAT HAPPENS WHEN AN SBLC HAS A CHANGE OF OWNERSHIP?

. 120.473 Change of ownership or control.
(a) Any change of ownership or control without prior written approval of SBA is prohibited. An SBLC must request approval of any such change from the AA/FA. Pending the approval, the SBLC may not register the proposed new owners on its transfer books nor permit them to participate in any manner in the conduct of the SBLC's affairs. Change of ownership or control includes:
(1) Any transfer of 10 percent or more of any class of the SBLC's stock, and any agreement providing for such transfer;
(2) Any transfer that could result in the beneficial ownership by any person or group of persons acting in concert of 10 percent or more of any class of its stock, and any agreement providing for such transfer;
(3) Any merger, consolidation, or reorganization; or
(4) Any other transaction or agreement that transfers control of the SBLC.
(b) If transfer of ownership or control is subject to the approval of any State or Federal chartering, licensing, or other regulatory authority, copies of any documents filed with such authority must, at the same time, be transmitted to the AA/FA.

3. WHAT TYPE OF FINANCING IS PROHIBITED FOR SBLCs?

. 120.474 Prohibited financing.
An SBLC may not make a loan to a small business that has receive d financing (or a commitment for financing) from an SBIC that is an Associate of the SBLC.

4. TO WHAT TYPE OF AUDIT WILL AN SBLC BE SUBJECT?

. 120.475 Audits.
Every SBLC is subject to periodic audits by SBA's Office of Inspector General, Auditing Division, and the cost of such audits will be assessed against the SBLC, except for the first audit. Fees are structured based on the SBLC's assets as of the date of the latest audited financial statement submitted to SBA before the audit. The fee schedule is set forth in SBA's Standard Operating Procedures manual.

a. Audit Rates for SBLCs

TOTAL ASSETS	BASE FEE	ADDITIONAL FEE
$500,000 or Less	$800.00	None
$500,001 to $1,000,000	$800.00	0.120 percent more than $ 500,000
$1,000,000 to $3,000,000	$1,400.00	0.030 percent more than $1,000,000
$3,000,001 to $5,000,000	$2,000.00	0.016 percent more than $3,000,000
Over $5,000,000	$2,320.00	0.006 percent more than $5,000,000

The base fee and the additional fee are combined to determine the total fee.
For example, an SBLC with total assets of $2,000,000 would pay an audit fee of $1,700 ($1,400 plus .030 percent $1,000,000). The SBA may assess an additional fee of $250.00 per day required to complete an audit that is delayed beyond twenty days if, in the judgement of SBA, such delay is caused by the SBLCs failure to keep its books or records in the manner prescribed by SBA, or by the SBLCs failure to cooperate with the audit.

5. WHEN CAN SBA SUSPEND AN SBLC LICENSE?

.120.476 Suspension or Revocation.
SBA may revoke or suspend an SBLC for a violation of law, these regulations, or any agreement with SBA. An appeal can be made following the procedures set forth in part 134 of this chapter.

CHAPTER 5 - SBA PILOT PROGRAMS

1. SBA'S PILOT GUARANTY DELIVERY PROGRAMS

The Administrator of SBA may establish pilot programs and may suspend, modify or waive rules for a limited period of time to test these new programs. Public Law 105-208 enacted September 30, 1996, limits SBA's authority when conducting new pilots. Under the legislation, the number of loans under any pilot must not exceed 10 percent of the total number of loans guaranteed during a year. The following pilot programs were in effect prior to this legislative change and are not affected by it:

a. FA$TRAK

FA$TRAK is a program that allows selected lenders to use their own forms and procedures for loans of $100,000 or less and receive an SBA guarantee of 50 percent or less. The program is limited to those lenders approved for *FA$TRAK* participation and that have signed the supplemental guaranty agreement for FA$TRAK. The 2-year pilot began February 27, 1995. Further information about the program is in appendix 6.

b. Capital Access Program

Under the Capital Access Program, Citibank Federal Savings Bank is authorized to use a proprietary system to target small businesses in high-growth/job creating sectors and markets SBA loans to them. Citibank makes the credit decisions and uses its own application forms for loans up to $250,000 guaranteed by SBA up to 70 percent. On February 22, 1995, we approved the pilot for a 2-year period. If the pilot is considered successful at the end of the 2-year period, Citibank will make the process available to any interested SBA lender.

c. Premier Certified Lenders Program (PCLP)

The Premier Certified Lenders program is a program established to designate a number of CDCs with the ability to process, approve, close, and service 504 loans, subject only to a brief eligibility review by SBA, similar to PLP for 7(a) loans. You can get more information about this program from SBA's Office of Program Development in Washington, D.C. The pilot ends on October 1, 1997.

d. Low Documentation (LowDoc) Program

Information on the LowDoc program can be found in appendix 5.

SUBPART H - DEVELOPMENT COMPANY LOAN PROGRAM (504)

CHAPTER 1 PURPOSE OF THE PROGRAM

1. WHAT ARE CERTIFIED DEVELOPMENT COMPANIES (CDC)?

.120.800 What is the purpose of the 504 program?

As authorized by Congress, SBA has established this program to foster economic development, create or preserve job opportunities, and stimulate growth, expansion, and modernization of small businesses.

a. What is the CDC (504) Loan Program and Why Does it Exist?

The 504 program is economic development financing specifically designed to stimulate private sector investment in long-term fixed assets to increase productivity, create new jobs, and increase the local tax base. The stimulus is provided by making long-term, low down payment, reasonably priced fixed-rate financing to healthy and expanding businesses which have the highest probability of successfully creating new jobs and competing in the world marketplace.

b. What is the Role of CDCs?

Loans made under the 504 program loans are administered by community-based development companies approved (certified) by SBA. SBA certified development companies (CDC) promote economic growth within their area of operations by:

(1) Stimulating the growth and expansion of small businesses primarily through financial assistance; and

(2) Offering the 504 loan program to eligible small businesses through a full-time professional staff.

c. How Do CDCs Work With SBA?

The SBA 504 loan program is a financial assistance program that a CDC makes available to eligible small businesses. It may be the only program that the CDC provides, or the CDC may have other loan programs that it oversees such as revolving lines of credit or microloans. No one CDC is exactly like another.

2. HOW A 504 PROJECT IS FINANCED

.120.801 How is a 504 Project financed?

(a) One or more small businesses may apply for 504 financing through a CDC serving the area where the 504 Project is located. SBA issues an Authorization if it agrees to guarantee part of the funding for a Project.
(b) Usually, a Project requires interim financing from an interim lender (often the same lender that later provides a portion of the permanent financing).
(c) Generally, permanent financing of the Project consists of:
(1) A contribution by the small business in an amount of at least 10 percent of the Project costs;
(2) A loan made with the proceeds of a CDC Debenture for up to 40 percent of the Project costs and certain administrative costs, collateralized by a second lien on the Project Property; and
(3) A Third Party Loan comprising the balance of the financing, collateralized by a first lien on the Project property (see Sec. 120.920).
(d) The Debenture is guaranteed 100 percent by SBA (with the full faith and credit of the United States), and sold to Underwriters who form Debenture Pools. Investors purchase interests in Debenture Pools and receive Certificates representing ownership of all or part of a Debenture Pool. SBA and CDCs use various agents to facilitate the sale and service of the Certificates and the orderly flow of funds among the parties.

a. How Does a Small Business Apply For a 504 Loan?

With few exceptions, a small business will apply for a 504 Loan with the CDC serving the area where the **project** is located.

b. Why Does a 504 Project Normally Require Interim Financing?

Loans under the 504 program provide permanent or take-out financing. This means that an interim lender usually provides the interim financing to cover the period between SBA approval of the project and the debenture sale. After the project is completed, the CDC will close the 504 loan. The proceeds from the Debenture sale repay the interim lender for the amount of the 504 project costs that it advanced on an interim basis.

c. How is a 504 Project Typically Financed?

Project financing comes from three sources:

(1) The borrower provides at least 10 percent towards the project costs. This can be in the form of cash or eligible equity. The funds may be borrowed by the business concern as long as the terms of the loan are acceptable to the CDC and SBA and the business concern can handle the cash flow requirements of 100 percent financing.

(Note: PL 104-208 increased the requirement to 15 percent for new businesses or

for projects involving a limited or single purpose building; if the project is for a new business and for a limited or single purpose building, the requirement is increased to 20 percent. Refer to chapter 13 for more guidance.)

(2) Third party lenders, usually financial institutions, provide part of the financing - usually 50 percent of the project costs. They typically have a first lien on the project assets being financed. This loan has no SBA guarantee. The financing from the third-party lender cannot be less than SBA's share of the project financing.

(3) The SBA-guaranteed 504 debenture finances the rest of the project. SBA's approval is in the form of an authorization for debenture guaranty. The small business signs a promissory note with the CDC. The CDC then signs a debenture, fully guaranteed by SBA, which is pooled together with other debentures and then sold to investors at a fixed rate. The proceeds from the debenture sale are the source of the money for 504 financing. The small business's note payments include the debenture payments to the investors as well as administrative costs. The 504 loan is usually secured by a second lien on the project being financed.

Refer to subpart H, chapter 13, for further details regarding the sources of project financing.

3. TERMS AND DEFINITIONS SPECIFIC TO THE 504 PROGRAM

.120.802 Definitions

The following terms have the same meaning wherever they are used in this subpart. Defined terms are capitalized wherever they appear.
Area of Operations is a geographic area in which a CDC conducts its activities.
Associate Development Company (ADC) is an entity approved by SBA to assist CDCs to deliver 504 financing.
Central Servicing Agent (CSA) is an entity that receives and disburses funds among the various parties involved in 504 financing under a master servicing agent agreement with SBA.
Certificate is a document issued by SBA or its agent representing ownership of all or part of a Debenture Pool.
Debenture is an obligation issued by a CDC and guaranteed 100 percent by SBA, the proceeds of which are used to fund a 504 loan.
Debenture Pool is an aggregation of Debentures.
Investor is an owner of a beneficial interest in a Debenture Pool.
Job Opportunity is a full time (or equivalent) permanent job created within two years of receipt of 504 funds, or retained in the community because of a 504 loan.
Net Debenture Proceeds are the portion of Debenture proceeds that finance eligible Project costs (excluding administrative costs).
Project is the purchase or lease, and/or improvement or renovation of long-term fixed assets by a small business, with 504 financing, for use in its business operations.
Project Property is one or more long-term fixed assets, such as land, buildings, machinery, and equipment, acquired or improved by a small business, with 504 financing, for use in its business operations.
Third Party Loan is a loan from a commercial or private lender, investor, or Federal (non-SBA), State or

local government source that is part of the Project financing.
Underwriter is an entity approved by SBA to form Debenture Pools and arrange for the sale of Certificates.

CHAPTER 2. APPLICATION PROCESS TO BECOME A CDC

1. HOW AN ORGANIZATION APPLIES TO BECOME A CDC

.120.810 Applications for certification as a CDC.

(a) Applicants for certification as a CDC must apply to the SBA District Office serving a proposed Area of Operations. An applicant must demonstrate that it satisfies the certification and operating criteria in Secs. 120.820 through 120.829, as well as:
(1) The need for 504 services (if there is already a CDC in the Area of Operations, the applicant must justify the need for another and present a plan to avoid duplication or overlap);
(2) A budget, approved by its Board of Directors; and
(3) A plan to meet CDC operating requirements (without specializing in a particular industry).
(b) The AA/FA, with the recommendation of each District Office in the applicant's proposed Area of Operations, shall make the certification decision.

a. What Kind of Organization May Apply to Become a CDC?

Any non-profit, state-chartered corporation or limited liability company may apply to become a CDC.

b. Where Does an Organization Apply to Become a CDC?

The application is submitted to the SBA district office serving the proposed area of operations. If there is more than one district office serving the proposed area of operations, the application is submitted to the district office where the organization will be headquartered.

c. The Application.

SBA Form 1246, ("Application for Certification as a Certified Development Company,") outlines the requirements for an application. The application exhibits must cover the elements covered in .120.810(a).

A new CDC applicant must submit a budget which demonstrates the required capability. If staff functions are provided by an affiliate (other than an individual), the budget of the affiliate must be provided. Special care must be exercised where the operating capital is being provided in whole or in part by other government agencies. A Federal agency providing funding to a CDC may not impose any restriction on the type of small business being assisted by the development company, unless that agency provides the entire project financing of the small business. (Refer to 13 CFR 120.140(i) for the specific language.)

d. How is the CDC Application Processed?

(1) The district office must provide written notice to all existing CDCs serving the area for which an application is under consideration asking for the CDCs' comments to the application. Existing CDCs serving the area have 30 calendar days to respond. (See Appendix 8 for suggested format)

(2) The applicant must provide Form 1081, "Statement of Personal History," for each officer, director, executive director, loan processor, and loan packager if this function is contracted out. Fingerprint cards must accompany all Form 1081s where:

(a) An individual indicates an arrest record on Form 1081; or

(b) The individual is a paid employee of the CDC. (Note: If the CDC's processing, closing or servicing staff is provided by an outside contractor through an SBA-approved contract, or by an affiliate of the CDC, that individual will be required to provide both a Form 1081 as well as fingerprint cards since it will be the staff of the CDC, even if the staff is donated by and paid for by the affiliate. A CDC's closing attorney or accountant does not have to provide a Form 1081 or fingerprint card.)

The district must process and forward all fingerprint cards and copies of SBA Form 1081 the same manner as SBA Form 912. <u>The fingerprint cards is not to be included with the application to Headquarters.</u>

(3) District prepares recommendation. (See appendix 8 for suggested format)

(4) If the area requested overlaps with an existing CDC's area of operations and the existing CDC protests the approval of a new CDC in its area, portions of appendix 8, "Overlapping of CDC Service Areas," that apply to the situation, especially the statistical analysis, <u>must</u> be completed by the district office. The application must comply with 120.835.

(5) After all appropriate district office officials, including the Finance Division and the district counsel (for legal sufficiency), have reviewed the application and made their recommendations, the district office sends the application, copies of the letters to any existing CDCs, copies of any CDCs' comments, and the district office's analysis and recommendations to the Director, Office of Loan Programs, Headquarters, for final action. The application will be returned if it is not complete.

(6) If the district office is processing more than one application for the same area at the same time, the analysis memorandum for any declined application(s) must be included with the analysis and application for the applicant that is recommended for approval.

e. Headquarters Notification of Final Decision.

Q. How will Headquarters notify the CDC and the district of its decision?

A. Headquarters will send:

(1) A letter to the CDC applicant notifying it of the decision;

(2) A letter to any CDC protesting the new application notifying that CDC of the decision; and

(3) Copies of these letters to the SBA district director.

f. Can the District Office Decline an Application?

Yes. The district office has full authority to decline CDC applications. A letter outlining the reasons for decline and the applicant's rights of appeal must be sent to the CDC applicant with a copy to the Director, Office of Loan Programs, Headquarters. The CDC applicant has 60 days to send an appeal to the district office for action by the next higher authority.

2. CDC NOTICE TO COMMUNITY OF IMPENDING OPERATION

.120.811 Public Notice of a CDC Certification Application.
(a) As part of the application process, the applicant must publish a notice in a general circulation newspaper in the proposed Area of Operations, including the name and location of the proposed CDC, its purpose and Area of Operations, and the names and addresses of its officers and directors. The applicant shall send a copy of the notice to SBA. The notice shall provide the public at least 30 days to submit written comments to the District Office. The SBA shall consider the comments in making its decision on the application.
(b) CDCs serving the proposed Area of Operations shall be directly notified and given at least 30 days to comment.

a. When Should the Public Notice be Published?

The notice should be published at least 10 days prior to the time the application is submitted to the SBA district office. The notice must include all the items in 13 CFR 120.811 (a) as well as the address of the district office to submit written comments.

b. When Should the Applicant CDC Submit to SBA a Copy of the Notice?

The applicant must provide a certified copy of the notice in the application. A "certified copy" is a statement signed by the secretary of the applicant certifying that the notice attached is a true and exact copy of published notice.

c. When Should the SBA District Office Request Comments From Any Other CDCs That May be Affected by the Approval of the Applicant CDC?

As soon as the district office receives the application, the Finance Division must notify in writing other CDCs that operate in the proposed area of operations giving the other CDCs 30 days for comment. Copies of these letters along with the responses must be included in the district office's analysis that is forwarded to the Director, Office of Loan Programs.

3. THE PROBATIONARY PERIOD FOR A NEW CDC

.120.812 Probationary Period for Newly Certified CDCs.

(a) Newly certified CDCs will be on probation for a period of two years, at the end of which the CDC must petition for:
(1) Permanent CDC status;
(2) A single, one-year extension of probation; or
(3) ADC status.
(b) SBA will consider failure to file a petition before the end of the probationary period as a withdrawal from the 504 program. If the CDC elects ADC status or withdrawal, it must transfer all funded and/or approved loans to another CDC, SBA, or another servicer approved by SBA.

a. During the Probationary Period, the Following Must Take Place.

(1) Within 3 months of certification, the CDC's executive director, the loan packaging, processing, servicing, and closing staff, and any individuals under contract for those services must meet with the SBA district office to discuss the 504 credit-underwriting, closing, and servicing standards expected of CDCs. This may include the district office's experience with particular types of credits such as start-up businesses, particular types of businesses, and higher risk businesses for the market area.

(2) After the probationary CDC has submitted six 504 loans to SBA, the executive director and the packaging and processing staff must meet with the SBA district office financing staff to evaluate the quality of the CDC's credit analysis and underwriting standards.

(3) After the probationary CDC has closed three 504 loans, the executive director and staff and any individuals under contract responsible for closing and servicing must meet with the SBA district office closing and servicing personnel to evaluate the closing packages and to review the CDC's servicing systems and responsibilities.

(4) The CDC must have appropriate personnel attend industry training in credit analysis,

504 packaging, closing, and servicing within 1 year of certification.

b. Evaluation at the End of the Probationary Period.

What happens if a CDC, at the end of the 2 year period, does not meet the minimum required number of loan approvals or closing and servicing standards?

(1) If the CDC fails to meet the minimum loan approval as required by the regulations, the CDC may request in writing either a single one-year extension of probation or ADC status. If the CDC fails to make this request to the district office within 30 days after its 2 year anniversary, SBA will consider that the CDC has withdrawn from the 504 loan program and will consider the CDC decertified.

(2) If the district office's evaluation of the CDC's performance indicates the CDC lacks loan packaging, processing, servicing, or closing expertise, the CDC can request only:

(a) a single, 1 year extension of probation; or

(b) ADC status.

(3) If the CDC voluntarily withdraws from the program, is converted to ADC status, or is decertified by the SBA, all approved and/or funded loans will be transferred by SBA to another CDC, to SBA, or to another service provider approved by SBA.

4. CDC'S ARE REQUIRED TO BE NON-PROFIT ORGANIZATIONS

.120.820 CDC Non-Profit Status.

A CDC must be a non-profit corporation (or limited liability company) in good standing. (For-profit CDCs certified by SBA prior to January 1, 1987 may retain their certifications.) An SBIC may not become a CDC.

CHAPTER 3 AREAS OF OPERATIONS

1. REQUIREMENTS DEFINING A CDC's AREA OF OPERATIONS

.120.821 CDC Area of Operations.
A CDC must have a designated Area of Operations, specified by the CDC and approved by SBA. There can be only one statewide CDC in each state, which must foster economic development throughout the state and provide 504 assistance to areas not adequately served by other CDCs.

a. Factors That Determine a CDCs Area of Operations.

What factors must be considered in determining the area of operations for either an applicant CDC or existing CDC wanting to expand its area?

(1) A CDC's area of operations must be geographically defined. A CDC must demonstrate the capacity to market its services and provide evidence of its loan-making, closing, and servicing capabilities throughout the area in which it intends to operate.

(2) A CDC's area of operations must be not less than citywide, and preferably county-wide, multi-county, or statewide. However, there can be only one statewide CDC in each State. The proposed area of operations must be sufficient to support the required level of activity but not greater than can be served by its membership and staff. The CDC is required to demonstrate the need for its services in its proposed area of operations.

(3) If one or more CDCs is already actively serving the area, the applicant CDC must document that the area is under served by the 504 loan program. In areas currently serviced by an existing active CDC(s) with a demonstrated record of performance in the program, the SBA district office must carefully evaluate the need for additional CDCs before accepting an application for certification.

Considerations must include the following:

(a) Will the proposed area result in 2 projects per year? If not, the new CDC risks being converted to ADC status, and its loans transferred to another CDC.

(b) Would the formation of a new CDC result in harm to an existing, active CDC's operations?

(c) Does the application comply with .120.835 (chapter 5)?

b. Are there Limits on the Number of CDCs Operating in One Area?

Yes. There can be no more than one statewide CDC per state. Also, an applicant CDC can apply only for areas not adequately served already. Refer to chapter 5 of this subpart.

c. Does Every State Currently Have a Statewide CDC?

No, not every state has a statewide CDC.

d. Can a CDC's Area of Operations Cross State Lines?

Yes. There are several existing CDCs whose areas of operations cross state lines. Generally, if market areas cross state lines, then it may be appropriate for a CDC to operate in an economic or trade area that traverses state boundaries.

e. Does a CDC's Area of Operations Have to be Contiguous?

No. The word "contiguous" was deleted in the regulations that became effective March 1, 1996. This regulatory change was made because some small businesses appeared to be denied access to 504 financing because there was no active CDC serving their area. However, this change was not meant to encourage new or existing CDCs to pursue geographical areas that are being well served by other CDCs. A CDC's area of operations is generally to be contiguous. There are exceptions, such as when a new or expanding CDC can show that an existing CDC in not adequately serving an area. The purpose of the 504 loan program continues to be local economic development. Statewide CDCs always were able to cover non-contiguous areas of the state as part of their obligation to offer 504 financing throughout the state.

f. What Are Statewide CDCs and Where Do They Operate?

(1) Prior to March 1, 1996, a statewide CDC was the only CDC certified by SBA to provide 504 loans in non-contiguous areas within a state. A statewide CDC promotes economic development throughout the state and provides 504 assistance to specific geographical areas within the State. These areas include:

(a) Areas that do not have a local CDC (Statewide CDCs assume the responsibility to offer the 504 loan program in rural and less-populated areas of a state where the presence of a separate, local CDC is often not economically feasible.);
(b) Areas that were part of the statewide CDC's area of operations prior to the certification of a local CDC, and the certification of the local CDC did not give the local CDC (or local CDCs) exclusive rights to the area;

(3) Areas that were the exclusive area of a local CDC and the statewide CDC

subsequently was specifically approved to expand its marketing area to overlap with the local CDC's area of operations (In these situations, SBA makes the same analysis regarding overlapping of areas of operation as that between two local CDCs.); and

(4) Areas that were part of a local CDC's area of operations but the local CDC was converted to an ADC and another local CDC was not exclusively approved for that area.

(2) A statewide CDC can also assist projects in a local CDC's area of operations under the following circumstances:

(a) One of the circumstances outlined in 13 CFR 120.839 applies (see subpart H, chapter 5);

(b) A project where the local CDC requests that the statewide CDC process the application because there is a potential conflict of interest for the local CDC; and

(c) A project where the local CDC's board declined the loan request. Under this situation, the loan package should include a copy of the letter from the local CDC to the small business. Also, the district office should contact the local CDC to discuss their reasons for not processing the loan and discuss this in the credit memorandum.

In summary, a statewide CDC will not market itself to an area served by an existing, active local CDC, unless an overlapping of service areas has been authorized by SBA Headquarters, in which case the statewide and the local CDC can both market and fund projects in that specific geographical area.

Recent approvals of new CDCs by Headquarters have been only for overlapping areas of operations since, in general, competition has resulted in increased availability of the 504 loan program to small businesses. If there is a dispute among the CDCs, the district office must attempt to get all parties together to work out a resolution prior to submitting the analysis and recommendation to Headquarters.

g. Why is the Term "Project" Used to Define the Location of the Applicant?

Previously, the word "business" was used. However, there was confusion as to what "business" meant. Some CDCs chose to interpret "business" as being where the headquarters of the business was located regardless of where the actual project was.

Since the principal focus of the 504 program is local "economic development," the location of the project initially determines which CDC's (or CDCs') area of operations the applicant falls under. The only exceptions to this policy are outlined in 13 CFR 120.839. (see subpart H, chapter 5)

CHAPTER 4 CDC'S ORGANIZATIONAL REQUIREMENTS

1. CDC'S MEMBERSHIP REQUIREMENT

.120.822 CDC Membership.

A CDC must have at least 25 members (or stockholders for-profit CDCs approved prior to January 1, 1987). No person or entity may own or control more than 10 percent of the CDC's voting membership (or stock). Members must be representative of and provide evidence of active support in the Area of Operations. Members must be from each of the following groups:

(a) Government organizations responsible for economic development in the Area of Operations and acceptable to SBA;
(b) Financial institutions that provide commercial long-term fixed asset financing in the Area of Operations;
(c) Community organizations dedicated to economic development in the Area of Operations such as chambers of commerce, foundations, trade associations, colleges, or universities; and
(d) Businesses in the Area of Operations.

2. SPECIFIC REQUIREMENTS FOR A CDC's BOARD OF DIRECTORS

.120.823 CDC Board of Directors.

The CDC must have a Board of Directors chosen from the membership by the members, and representing at least three of the four membership groups. No single group shall control. The Board members must be responsible officials of the organizations they represent, and at least one must possess commercial lending experience. The Board must meet at least quarterly and shall be responsible for CDC staff decisions and actions. A quorum shall require at least 5 Directors. If there is a vote on loan approval or servicing actions, at least one Board member with commercial loan experience approved by SBA must be present and vote. As an alternative, the Board may obtain the recommendation of another person approved by SBA and possessing commercial lending experience.

a. Can the Board's Actions be Delegated?

The board can delegate management functions to an executive committee. That committee, however, must meet the same requirements as the Board.

b. For Management Purposes, Can an Executive Director, or Other Person in Charge of Day-to-Day Operations of the CDC be Considered an Officer of the CDC?

Yes.

3. REQUIREMENTS FOR A CDC's MANAGEMENT & STAFF

.120.824 Professional Management and Staff.
A CDC must have full-time professional management, including an Executive Director (or the equivalent) managing daily operations. It must also have a full-time professional staff qualified by training and experience to market the 504 Program, package and process loan applications, close loans, service the loan portfolio, and sustain a sufficient level of service and activity in the Area of Operations.
(a) Contracting out to third parties. CDCs may obtain, under contract, marketing, packaging, processing, and servicing services from qualified Lender Service Providers, as that term is defined in part 103 of this chapter, located in the Area of Operations, subject to SBA's prior written approval. CDCs may contract for outside legal and accounting services without SBA approval. Compensation under all such contracts must be reasonable and customary for similar services in the Area of Operations. SBA may audit the contracts.
(b) Contracting out to other CDCs. CDCs may contract with other CDCs for specific services, subject to SBA's prior written approval.

a. Does the CDC Have to Have Full-Time Staff?

Yes. At least one professional staff person who is knowledgeable about and can assist small businesses with their financial needs must be available during regular business hours on a full-time basis.

b. May an Affiliate Provide a CDC's Full-Time Staff?

An affiliate, with SBA's approval, may provide the staff. Approximately half of all CDCs have affiliates, like regional planning commissions, providing staff. In many cases the affiliate provides some or all of the operating expenses as well. Such staffing fulfills the intent of the regulation as long as the affiliate provides:

(1) The equivalent of a full-time staff person; and

(2) An acceptable agreement between the affiliate and CDC approved by the finance, servicing and legal divisions of the field office. Staff performing the functions must have prior related experience and/or training.

c. Does the Full-Time Staff Person Only Perform 504 Activities?

The full-time staff person must be qualified, and either live or do business in proximity to the CDC's operating area, but he or she does not have to perform only 504 activities. That person can be informed about and help a business with other commercial business financing programs (federal, state, or local) as well. The staff may even spend a majority of the time working on other programs so long as he or she is available full-time to advise small business owners on the 504 program.

d. Contracts With Third Party Providers.

Q. Can CDCs contract with packagers and other third-parties, including other CDCs, for 504 marketing, processing, or servicing functions?

A. Yes, The finance, servicing, and legal divisions of the field office (and the servicing center, if appropriate) together have the authority to approve the contracts. The district office must send copies of approved contracts to the Director, Office of Loan Programs, for the CDCs' files held at Headquarters. Under these circumstances, care must be taken that the CDC remains the responsible and involved entity for each loan. It is the CDC's debenture that SBA guarantees.

e. What Must the Contract Include?

If a contractual arrangement is used, there must be a signed agreement between the contractor and CDC. The agreement must specify the following:

(1) The relationship and responsibilities of the CDC and the contractor;

(2) The specific staff services to be performed and who will perform them;

(3) The rate for services can be either an hourly rate or an SBA-approved percentage of the eligible CDC processing or servicing fee as long as it does not exceed, or is in addition to, the eligible CDC fees and as long as the small business concern is not required to pay for other services the third-party contractor may provide (such as accounting services) as a condition of processing or servicing the loan request;

(4) The term of the agreement; and

(5) Under what circumstances and by whom the contract may be voided by the CDC.

f. Is There Any Post Approval Review Process?

The district office must review any contract for staff functions on an annual basis to ensure that there is no self-dealing.

g. Who Pays the Contractor?

Under no circumstances must the compensation paid under the contract be charged directly to the small business receiving assistance. The CDC, not the small business, is to compensate the packager out of the fees it is authorized to collect. A CDC that violates

this provision risks being decertified.

4. FINANCIAL REQUIREMENT TO OPERATE A CDC

.120.825 Financial Ability to Operate

A CDC must be able to sustain its operations continuously, with reliable sources of funds (such as income from services rendered and contributions from government or other sponsors).

Q. What is an acceptable level of financial capacity?

A. A CDC must have the ability to sustain its operations on a continuous basis from reliable sources of funds. These sources may include:

(1) Income from services rendered;

(2) Contributions from Government or other financial sponsorship (including affiliates); and/or

(3) The CDC capital.

5. OTHER REQUIREMENTS FOR OPERATING A CDC

.120.826 Basic requirements for operating a CDC.
A CDC must operate in accordance with applicable statutes, regulations, policy notices, SBA's SOPs, and the information in its application. It must supply to SBA current and accurate information about all certification and operational requirements, and maintain the records and submit the reports required by SBA.

a. What Are a CDC's Office Operating Requirements?

Each CDC must maintain an accessible place of business open to the public during regular business hours with an adequate staff to perform normal business transactions. Although a CDC's place of business may often be located with a sponsoring organization, it must be clearly evident to the public that the CDC is a separate entity. A CDC's place of business must:

(1) Have a separately listed telephone number; and

(2) Have at least one qualified professional staff member available full-time as described in chapter 4, paragraph 3 of this subpart.

The CDC must keep all loan case files and collateral documents either at the principal office of the CDC or maintained in a manner acceptable to SBA that permits their

immediate access. These, along with organizational files, must be accessible to SBA.

b. What Are a CDC's Fiscal Year Requirements?

The CDCs choose their own fiscal year. The CDC must notify the SBA field office of any change.

c. What Are a CDC's Record-Keeping Requirements?

There are two sets of records the CDC must maintain.

(1) The CDC's own records

The CDC must maintain its own financial records including books of account and minutes of all meetings of members, stockholders, directors, executive committees, and other officials. The CDC financial reports furnished to SBA must contain complete disclosure of matters relevant to the act and regulations.

All records and supporting documents relating to a CDC's transactions shall be currently posted (within 45 days) and kept at its principal office, except that portfolio items may be held by a custodian pursuant to a written agreement.

Records and documents which are the basis for or related to its financial statements or loans must be maintained in a manner that permits their immediate availability.

Records may be maintained in a "microfilm system," or computer system instead of keeping the original documents if a reproduction of all documents is stored in a separate place; and equipment for clear projection and for the production of clear facsimile enlargements is available.

(2) Maintaining 503/504 Loan Portfolio Documents

The CDC must develop a filing and control system, acceptable to SBA, which ensures that information and documents related to its loan portfolio are available at its principal office for review by SBA. A rule of thumb regarding file retention requirements is as follows.

(a) Inquiries; Partial Applications; Withdrawn Applications; and Applications Turned Down by the CDC or SBA. These files must be kept for 2 years after notification of incomplete application, withdrawal, or decline. After 2 years, files may be destroyed.

(b) Correspondence. General correspondence must be kept for 1 year. Case-specific correspondence should be filed in case files.

(c) Paid Off Loans (including original application file, servicing file, and closing file). These files must be kept for 2 years after the loan has been paid in full.

(d) Files from Liquidated Loans (including application, closing, and servicing files). These files must be kept for 2 years after the loan has been charged off.

A CDC must make available, at its own expense, documents or copies requested by SBA. The CDCs maintaining computer-stored documents must utilize a scanning system to ensure that any computer-stored documents relating to loan transactions are actual reproductions of original documents.

(Note: Refer to SOP 50 50 for further guidance on this.)

d. What Operational Changes Must a CDC Report to SBA?

(1) CDC Changes to be Reported

Any changes in a CDC's address, telephone number, officers, directors, professional staff, bylaws, or articles of incorporation, must be reported to the SBA field office not later than 30 days after the change takes place. "Statements of Personal History," SBA Form 1081, complete personal resumes, and Fingerprint Cards, "FD 258," must be filed on new officers, directors, and professional staff as required. (Refer to chapter 2, paragraph 1.d. of this subpart for guidance.)

The CDC must submit notice of all changes to the SBA office where the CDC is headquartered via certified mail or other form of delivery from which a receipt of acceptance is obtained. All changes are subject to post-approval by SBA.

If the CDC works with multiple SBA district offices, the CDC is responsible for updating all SBA offices about any changes in the CDC's name, address, telephone number, and professional staff.

(2) Changes reported will be considered approved by SBA unless the CDC is otherwise notified by SBA within 60 days after receipt.

(3) CDC legal name changes must be submitted to the Director, Office of Loan Programs (OLP), for prior approval. After approval, the CDC must send a copy of the board resolution authorizing the change and a copy of the Amendment to the Articles of Incorporation approved by the State acknowledging the legal name change to all the appropriate SBA field offices and to the Director, Office of Loan Programs, Headquarters. The field office shall notify the commercial loan servicing center, the CSA, and any other SBA office processing loans for the CDC.

Remember, the SBA and the CDC must use the legal name, not a "dba" name, on all correspondence.

(4) Within 10 working days of the date a CDC becomes a party to litigation or other legal proceedings, it must file a written report with the SBA field office where the CDC is headquartered. This includes any action taken by the CDC, or by a security holder in a personal or derivative capacity, against an officer, director, employee, or other member of the CDC in an official capacity. The report must be sent by certified mail or other form of delivery from which a receipt of acceptance is obtained. For those CDCs that work with multiple SBA district offices, the SBA district office where the CDC is headquartered must notify the other SBA offices, if appropriate.

The report must describe the proceedings, the CDC's identity and relationship to other parties involved. Upon request by SBA, copies of the pleadings and other documents specified must be submitted by the CDC. Once proceedings are terminated by settlement or final judgment, the CDC shall promptly advise SBA of the terms.

(5) Any change affecting the perception of "good character" as it relates to a CDC must be reported immediately to the SBA field office overseeing that CDC.

6. SERVICES CDCs ARE REQUIRED TO PROVIDE SMALL BUSINESSES

.120.827 Services a CDC Provides to small businesses.
(a) A CDC must operate in and adequately service its Area of Operations. It must market the 504 program, package and process 504 loan applications, and close and service 504 loans. A CDC's loan portfolio must be diversified by business sector.
(b) A CDC may provide small businesses with financial and technical assistance, or may help small businesses obtain such assistance from other sources, including preparing, closing, and servicing loans under contract with Lenders in SBA's 7(a) program.
(c) A CDC also may loan amounts to the Borrower equal to the value of all or part of the Borrower's contribution to a Project in the form of cash or land, including site improvements, previously acquired by the CDC.

Q. What is meant by the requirement that the CDC's portfolio needs to be diversified?

A. The SBA field office staff should review a CDC's annual report for any industry concentrations. Concentrations in either a few industries and/or new businesses should be discouraged since either would indicate a greater vulnerability to market risks.

7. MINIMUM NUMBER OF 504 APPROVALS A CDC MUST MAKE

.120.828 Minimum Level of CDC lending activity.
A CDC must provide at least two 504 loan approvals each full fiscal year.

The SBA believes a CDC is not meeting the requirement of providing economic development and cannot be knowledgeable in the 504 program unless it provides at least two 504 loan approvals in its area of operations per year. "Year" can be either the CDC's fiscal year, or SBA's fiscal year. The CDCs that were certified after August 27, 1993 (the date of the publication of the final regulations for the Associate Development Company program), and that do not provide 504 financing to two concerns on average for any 2 consecutive years, automatically are converted to ADC status.

If a CDC is converted to ADC status, the SBA field office must make sure the CDC's portfolio is transferred to SBA or to another CDC. The CDCs that were approved prior to August 27, 1993, are not automatically converted to ADC status but still risk being decertified or converted to ADC status. (Refer to chapter 8 of this subpart for further clarification.)

8. MINIMUM CDC 504 JOB NUMBERS THAT ARE REQUIRED BY SBA

.120.829 Job Opportunity average a CDC must maintain.
(a) A CDC's portfolio must reflect an average of one Job Opportunity per $35,000 of 504 loan funding. The AA/FA may permit a CDC to average up to one per $45,000 for good cause in:
(1) Alaska; (2) Hawaii; (3) State-designated urban or rural jobs and enterprise zones;
(4) Emment Zones and Enterprise Communities; and (5) Labor Surplus Areas listed in the Department of Labor's publication ``Area Trends.''
(b) A CDC must indicate in its annual report the Job Opportunities actually or estimated to be provided by each Project.
(c) If a CDC does not maintain the required average, it may retain its certification if it justifies to SBA's satisfaction its failure to do so in its annual report and shows how it intends to attain the required average.

Q. Why does SBA have this minimum standard?

A. The principal purpose of the 504 loan program is to foster economic development and to **create and/or preserve job opportunities** by providing long-term financing for small business concerns. In its annual report, a CDC lists the **estimated** jobs created and/or retained for each of its approved and disbursed loans. At the 2 year anniversary of each loan's disbursement, the CDC must list the **actual** jobs created and/or retained for that loan (whether or not the initial approval was based on job creation/retention or some other 504 goal).

Based on these annual reports, SBA is able to report to Congress the number of jobs created and/or retained by the program.

If a particular proposed 504 project does not meet the minimum jobs requirements, a CDC may continue with the project if the project meets either a "public policy" or "community development" goal as long as the CDC's overall portfolio of approved loans, as stated in its current annual report, section D of the Management Summary, as well as any subsequently approved loans, meets or exceeds one job per $35,000 of debenture financing, including the proposed project. (Refer to chapter 10 for more detail on project economic development goals.)

9. REPORTS THAT A CDC IS REQUIRED TO SUBMIT TO SBA

.120.830 Reports a CDC must submit.
A CDC must submit the following reports to SBA:
(a) An annual report within 90 days after the end of the CDC's fiscal year, and such interim reports as SBA may require;
(b) Resumes for all new Associates and staff;
(c) Reports of involvement in any legal proceeding;
(d) Changes in organizational status;
(e) Changes in any condition that affects its eligibility to continue to participate in the 504 program; and
(f) Quarterly service reports on each loan in its portfolio which is 60 days or more past due (and interim reports upon request by SBA).

a. What Are SBA's Requirements for a CDC's Annual Report?

(1) Submission Requirement. Within 90 days after its fiscal year end, a CDC must submit to the SBA field office two copies of an annual report on its activities and operations. The SBA Form 1253 and 1253A describe in detail the information that must be included.

The district office can permit an extension of up to 60 days if the CDC is waiting for its year end financial statements. The SBA district office in which the CDC's headquarters is located is responsible for receiving and reviewing these annual CDC reports. These reports assure SBA that the CDCs maintain their capability to operate within the scope of the program and to make sure that no adverse changes have occurred to the CDC.

(2) CDC Financial Statements. The financial statements must conform with Generally Accepted Accounting Principles (GAAP). (This does not mean that the statements must be audited by a certified public accountant.)

(3) Waiver of Report During Certification Year. A new CDC that is certified within 6 months of its year end will not be required to submit an annual report for that year.

(4) District Office Review. Within 60 days of receipt of the CDC annual report, the SBA field office must forward a copy to the **Director, Office of Loan Programs** along with the field office's analysis and review as well as a CDC operational review. If the annual report has not been properly completed, the CDC must be notified in writing, which shall require the CDC to resubmit a completed annual report within 30 days of receipt of the SBA notice.

(5) Job Monitoring. The SBA must ensure that the CDC is reporting job opportunities correctly. Job totals on the annual report form must equal those on the Employment Impact Schedule. Also SBA must be certain that the CDC is adding the correct columns to determine the totals in Part C, SBA Form 1253A. Once the totals are verified, SBA must verify that the CDC's portfolio has at least one job for each $35,000 of debenture amount by checking that the correct numbers were used by the CDC in the computation in Part C, SBA Form 1253A, entitled "$/Job."

(6) Incomplete or Missing Reports. SBA may cease accepting and processing loan applications if the CDC fails to comply with the annual report requirements. Further, if the CDC has not filed an acceptable annual report with SBA within 90 days following the close of its fiscal year, the Office of Borrower and Lender Servicing may advise the central servicing agent (CSA) to withhold all monthly servicing fees due the CDC until such time as the report has been filed and accepted by the field office.

(7) Required SBA Comments. The SBA field office will review and comment on factors which could impact the continued effectiveness of the CDC. Strengths and weaknesses of the CDC should be addressed in the report. The Chief, FD; the Chief, PM; and the district counsel should sign off on the comments. Comments should be shared with the CDC, and the CDC should be given the opportunity to comment in writing. A suggested format for the annual report review and the operational review is provided in the appendix 8.

CHAPTER 5. EXPANDING A CDC'S AREA OF OPERATIONS

1. WHEN MAY A REQUEST FOR EXPANSION BE REQUESTED?

.120.835 Application to extend an Area of Operations.

SBA may expand a CDC's Area of Operations if the proposed Area of Operation is not being adequately served by existing CDC(s) and the expanding CDC is well-qualified to serve it. A CDC seeking to expand its Area of Operations must apply in writing to the SBA District Office serving the geographic area in which the CDC proposes to expand.
(a) A CDC may submit an application to expand its Area of Operations if the existing CDCs serving the area have not averaged, over the last two years, at least one loan approval per 100,000 of general population in the Area of Operation. The one loan per 100,000 population requirement applies only to the area proposed for expansion, not the entire Area of Operations of the existing CDC or CDCs serving the expanded area. Example to paragraph (a) of this section. CDC A averages 0.8 loans per 100,000 of general population state-wide, but 1.2 loans per 100,000 in city X. CDC B seeks to expand its Area of Operations only into city X. CDC B's application will be denied without further review because CDC A meets the 1 loan per 100,000 population requirement in the proposed expanded Area of Operation.
(b) The application to expand must demonstrate to the satisfaction of SBA the expanding CDC's ability to provide full service to small businesses in the expanded territory, including processing, closing, servicing, and, if authorized, liquidating 504 loans. The expanding CDC must also demonstrate in its application that it will have a local presence and representation in the expanded Area of Operations before submitting any 504 loans for approval.

The SBA intends that certified development companies provide access to the 504 loan program to the small business community. If a CDC is unable or unwilling to serve the small businesses in an area of operations, that area could be determined to be "not adequately served." Thus, another qualified CDC that meets the CDC performance tests and related expansion criteria may apply to expand to serve the area.

Q. When may a CDC request a permanent expansion of its area of operations?

A. A CDC can make a written request that its area of operations be expanded at any time. However, requests will be processed only if the proposed expansion is into an area that is under served.

A request will not be accepted if the activity of the existing CDC (or if there are multiple CDCs serving the area, then the combined activity of all CDCs) in the proposed area meets or exceeds one loan per 100,000 in population per year over the last 2 years. (This also applies to applications from organizations wanting to become a new CDC.)

This calculation will be based on the following.

(1) The area of expansion. The analysis can be county-by-county if one county may

have received less than one loan per 100,000 population and another may have received more. In those cases, an application for those counties that are under one loan per 100,000 can be accepted.

(2) The latest U.S. Census data published by the Department of Commerce.

(3) The number of 504 approvals for the most recent 24-month period preceding the date a complete application for expansion is received by the SBA district office that is making the initial determination. For example, if a complete application from the requesting CDC, or new CDC, was received on February 15, 1996, SBA would use 504 loan approvals for February, 1994, through January, 1996, for the area under consideration.

2. THE PRELIMINARY STEP A CDC TAKES TO CONSIDER EXPANDING

The CDC should contact the SBA district office to request a statistical summary of 504 loan activity for the area into which it wants to expand. This summary must include the number of projects per county for each of the last 2 years, year-to-date approval activity, and the CDCs associated with the loan activity. This summary will allow the applicant CDC to better assess the chances of its expansion request being approved.

(Note: The SBA district office should be able to provide this information through the use of Infoquest, or by contacting the Office of Chief Information Officer.)

3. HOW DOES A CDC APPLY TO SBA FOR AN EXPANSION?

If the inquiring CDC wants to apply for an expansion after reviewing the statistics, it must submit a written request with the following information to the SBA field office:

(a) Description of the new area of operations being requested.

(b) Justification of the need for expansion, including:

(1) Identification of existing CDCs serving the area and their approval activity in the proposed area;

(2) A description of the services the applicant CDC can provide that others are not providing; and

(3) A description of the adequacy of the CDC staff to provide full service to small businesses in the proposed area including processing, closing, servicing, and, if authorized, liquidating 504 loans. The CDC must also submit plans to demonstrate how it will have a local presence such as a local office.

(c) A list of proposed members for the area sorted by city or county, if appropriate, designating who represents each of the required four groups (financial institutions, community organizations, businesses, and government organizations). The lending institutions and the community and government organizations may be regional.

(d) A certified copy of the resolution of the Board of Directors approving the expansion.

(e) A certified copy of any bylaw changes that are required.

(f) A certified copy of any change in the articles of incorporation that are required.

(g) An analysis of the applicant CDC's present 504 loan activity which must address any deficiency in 504 loan activity in its present area of operations (include comments on the 1) the percentage of 504 loans in liquidation and charged off from the Colson "Quarterly 504 Portfolio Report and 2) the number of past due loans on the Colson "Status of Portfolio - 503/504 Program" report).

(h) An analysis of the CDC's annual 504 loan activity (beginning with 1990 or the year the CDC was certified, whichever is more recent), including the number of approvals, cancellations, in liquidation, charged off, and the percentage that have defaulted as a percentage of loans disbursed and the percentage of loans that were to new businesses. This analysis should be year-by-year.

Example:	1993	1994	1995
Approved	10	12	14
Canceled	1	2	1
In Liquidation	1	0	1
Charged Off 1	0	0	
percent Default (in liq and charged off/ disbursed loans)	22.2%	0.0%	7.7%
% New Business (of approvals)	10.0%	0.0%	7.0%

This analysis should include any extenuating circumstances such as changes in, or additions to, CDC personnel.

(Note: For any loans that were approved in 1990 or after that have been charged off, include a brief description of the loan including date of approval, amount approved, disbursement date, date when it went into liquidation, date when it was charged off, and the amount charged off. Also include the type of business, whether new or existing, the collateral value at the time of approval, and what the collateral realized before the loan was charged off.)

(i) A certified copy of the required published notice (see .120.836 below).

(j) Any letters of support from area lenders, community organizations, and the small business community; and

(k) Any correspondence from the CDC which already services an area where the applicant CDC wants to cover on their acceptability of such expansion.

(Note: If the CDC is approved for the expanded area, it must satisfy the "local presence" and "representation" criteria prior to submitting its first 504 application in the expanded area.)

4. WHAT NOTICE TO THE PUBLIC MUST A CDC AND THE SBA GIVE?

.120.836 Public notice and opportunity for response.

SBA will notify all CDCs servicing the proposed area of expansion, allowing at least 30 days for the existing CDCs to respond to the District Office. The expanding CDC also must publish a notice in a general circulation newspaper in the proposed area of expansion, advising of its intent to expand and giving the public at least 30 days to comment to SBA. The burden of proof in opposing the application will be upon the existing CDC or CDCs to show why SBA should not grant the application for extension.

The district office will notify all CDCs serving the proposed expansion area. A copy of the letter notifying the existing CDC(s) as well as any responses or comments must be included in any recommendation that is sent to the Director, Office of Loan Programs.

5. WHEN SHOULD SBA BEGIN ANALYZING THE CDC'S REQUEST?

As soon as the SBA district office receives the request, it should begin the analysis using the appendix (overlapping of CDC service areas) as a guide. It should not wait for the 30-day response period to end.

.120.837 SBA decision on application for extension.

(a) The SBA District Office may consider any factor presented to it concerning the proposed area of expansion, the expanding CDC and its Area of Operations, and the existing CDC or CDCs serving the area, including the following: number of loan approvals per 100,000 of general population; number of loan approvals per 100,000 of small businesses; the density of small businesses; jobs created and retained; the number of 504 loan closings; the average 504 loan amount; urban, suburban, or rural character of the expanding area; the mix of small businesses; the prevailing economic conditions; servicing record and capabilities; currency rates; loss rates; other services provided to small businesses (technical and financial assistance); relationship with the local SBA office; and ties to and knowledge of the local community and its resources.
(b) The SBA District Office will submit a recommendation, with any supporting materials, within 30 days of the end of the comment period to the AA/FA, who will make the final decision within 30 days of his or her receipt of the District Office's recommendation. In making its decision, SBA will consider all information submitted to it, as well as the currency of the expanding CDC's portfolio, including the default rate.

If the analysis under .120.835 shows that all or part of the requested expansion area is not being adequately served by the existing CDC or CDCs, the analysis goes to the next step.

(a) Comments from the Financing Division regarding the CDC's compliance with the regulations governing a CDC's operation (as evidenced by the on-site review, the annual report, and any other correspondence between the SBA field office responsible for oversight of the CDC and the CDC) as well as the adequacy of the applicant CDC's applications and its ability to handle an increase in loan activity;

(b) Comments from the servicing center (or the Portfolio Management division if the files have not been transferred) regarding the adequacy of the applicant CDC's servicing capabilities as well as its estimation of the CDC's ability to handle additional geographic areas;

(c) Comments from Legal regarding the CDC's compliance with the regulations governing a CDC's operations (as evidenced by the on-site review, the annual reports, and any other correspondence between the SBA field office responsible for oversight of the CDC and the CDC) plus other pertinent comments such as the CDC's loan closings and whether the CDC is a "Priority" CDC;

(d) A copy of the most recent on-site review by the office responsible for overseeing the CDC's operations (as required by Subpart H, Chapter 24, paragraph 2.b.);

(e) Copies of all contracts the CDC has for management or staff of the CDC as well as evidence that these have been reviewed and pre-approved by SBA (as required by Subpart H, Chapter 4, paragraph 3); and

(f) Any other pertinent comments regarding the CDC's operations.

When the district office is recommending approval action, the district office must forward the

completed application, analysis, recommendations, and comments from the impacted CDCs, to the Director, Office of Loan Programs, Headquarters, for a final decision, within 45 days (including the 30 day comment period) from the date a complete application for expansion is received. In any case, the district office must forward its recommendation to Headquarters within 60 days of receiving the completed application.

Q. Can the district office decline an application?

A. Yes. The district office has full authority to decline a CDC's expansion request. A letter outlining the reasons for decline and the CDC's rights of appeal must be sent to the CDC with a copy to the Director, Office of Loan Programs, Headquarters. The CDC has 60 days to appeal the decline to the district office for action by the Director, Office of Loan Programs.

6. TEMPORARY EXPANSIONS IMPACTED BY MARCH 1, 1996 REGULATIONS

.120.838 Expiration of existing, temporary expansions.

All existing, temporary expansions of Areas of Operation shall expire 6 months after March 1, 1996, unless a CDC applies for permanent expansion before the expiration date.

7. CDC PROCESSING OF A 504 LOAN REQUEST OUTSIDE ITS AREA

.120.839 Case-by-case extensions.
(a) A CDC may apply to make an individual loan for a Project outside its Area of Operations to the District Office serving the area in which the Project will be located if:
(1) The applicant CDC has previously assisted the business to obtain a 504 loan;
(2) The applicant small business or CDC can document in writing to the AA/FA specific circumstances that would prevent the existing CDC or CDCs serving the area from assisting the business adequately; or
(3) The existing CDC or CDCs serving the area agree to permit the applicant CDC to make the loan.
(b) The applicant CDC must demonstrate that it adequately can service the loan.
(c) The AA/FA may approve the request for good cause shown.

a. CDCs Processing Applications for Businesses Located Outside Their Area?

Applications that fall under 13 CFR 120.839 (a)(1) or (a)(3) can be approved by the SBA district office finance division. For requests under .120.839(a)(1), the SBA district office must solicit comments from the CDC in whose area of operations the project is located prior to making its decision. (Note: The requesting CDC must demonstrate in writing to the satisfaction of the SBA district office or the appropriate SBA servicing center that it can adequately service the loan [(13 CFR 120.839(b) since it is outside its area of operations.].

If there is no CDC where the project is located and the state has no statewide CDC, the district office also can approve a CDC's request to process a 504 loan outside of its area of operations. Again, it also needs to demonstrate to the satisfaction of the district office that it can service the loan.

If the request from the CDC and the small business falls within (a)(2), the CDC must make its request in writing to the SBA district office, which must evaluate the request and forward its recommendation to the Director, Office of Loan Programs, for final action. The CDC must explain how it can adequately service the loan since it is outside of its area of operations [13 CFR 120.839(b)]. The existing CDC(s) serving the area must be provided an opportunity to comment on the request prior to the district office sending its recommendations to Headquarters.

b. Defining the Demonstration of Adequately Servicing the Loan?"

Any CDC applying to make a loan outside of its area of operations must demonstrate in writing to the satisfaction of the district office serving the area where the project will be located as well as the appropriate SBA servicing center, that it can perform the required servicing responsibilities. This would include required site visits, more intensive servicing as needed, and, if a default occurs, assisting SBA in liquidation as needed and as directed by the district office.

CHAPTER 6. ACCREDITED LENDERS PROGRAM (ALP)

1. WHAT IS THE ACCREDITED LENDERS PROGRAM?

.120.840 Accredited Lenders Program.

The SBA may designate a CDC as an Accredited Lender. SBA will provide an Accredited Lender with expedited loan processing or servicing action.

(a) Applications. CDCs may apply to the SBA field office with which it is most active. The SBA office will send its recommendation and the application to the AA/FA for final decision.
(b) Eligibility. In order to be eligible to receive Accredited Lender status, a CDC must have been an active participant in the 504 loan program for not less than the preceding 12 months. In evaluating an application to be an Accredited Lender, SBA will consider all relevant factors, including:
(1) The CDC's ability to work with the local SBA office;
(2) The quality of past performance; and
(3) The quality of the loan portfolio, including the default rate.
(c) Term of designation. CDCs will be designated as ALPs for a two year period, and are eligible to renew the designation for additional two year periods.
(d) Suspension and revocation. The AA/FA may suspend or revoke ALP designation upon written notice stating the reasons therefore at least 10 business days prior to the effective date of the suspension or revocation. Reasons for suspension or revocation may include loan performance unacceptable to SBA or violations of applicable statutes, regulations or published SBA policies and procedures. An ALP may appeal the suspension or revocation made under this section pursuant to the procedures set forth in part 134 of this chapter. The action of the AA/FA shall remain in effect pending resolution of the appeal.

2. WHAT IS THE REASON FOR CREATING AN ALP CDC?

The Accredited Lenders Program (ALP) provides for greater reliance on participating CDCs to process and service loans. ALP-CDCs are accountable for thorough credit and eligibility analysis on loan applications and thorough analysis on servicing action requests prior to submission to the SBA. The Agency will rely on the ALP-CDC's credit analysis in making the decision to guarantee the loan and complete the documentation, within 3 working days.

The main objective is to streamline loan processing and servicing and to shorten response time on routine loan making and servicing actions. The SBA field office must assess the CDC's credit knowledge, familiarity with SBA rules and regulations, and other experience of the CDC's loan officers.

The objective is achieved by relying more heavily on experienced CDCs in whom the SBA has a high level of confidence and trust. A benefit to designated high volume CDCs is the ability to decrease turn-around time on loan approval and routine servicing cases.

Of greatest importance is the benefit to the small business borrowers for whom expedited processing can result in quicker service and improved confidence in the program. For further information regarding expedited procedures granted to ALP CDCs, the chapters on loan processing, closing and servicing in the appropriate SOPs should be referred to.

3. HOW MANY ALPS ARE THERE?

As of June 1, 1997, there were 58 CDCs designated as ALPs, with 45 SBA field offices participating.

4. SBA RECOGNITION OF ALP CDC STATUS BETWEEN SBA OFFICES

Q. If a CDC has been approved as an ALP CDC in one SBA office, is it automatically an ALP CDC in all SBA offices to which it submits loans?

A. Not necessarily. A CDC must apply to each SBA district office in which it wants to have ALP status. Once the CDC is approved as an ALP CDC for a particular district office, the CDC is then an ALP CDC for any SBA branch offices that report to that district office.

If a CDC is an ALP-CDC in one district office, and another district office wants to decline the CDC's application to be an ALP-CDC for its office, the declining district office must submit a memorandum to the Director, Office of Loan Programs, justifying its reasons for decline.

5. SELECTION CRITERIA FOR ALP STATUS

The most important factor in the selection of a CDC for ALP designation is its relationship with the field office. Together, the CDC and SBA must have a successful track record in all phases of CDC activity: marketing the 504 program, loan application processing, approval, closing, servicing, and liquidating if authorized. To meet the specific requirements for ALP candidates the CDC must do the following.

a. Have been an active participant (meet the minimum of two 504 loan approvals in one year) in the 504 loan program during the preceding 12 months. Additionally, it must have had at least twenty 504 loans approved in the most recent 3 years.

b. Have well-trained, qualified loan officers who are knowledgeable concerning SBA's lending policies and procedures for the 504 program. The staff must have at least 3 full years of 504 administrative and loan officer experience, or 2 full years experience plus completion of the CDC industry training program.

c. Have demonstrated the ability to process, close, and service loans under the development company program. The CDC must have a portfolio of at least thirty 503/504 loans. Prior to certification, the SBA field office must perform an on-site review of the CDC's files. The files must be current and complete with regard to insurance, UCC filings, site visit reports, creation and/or retention of jobs information for the two-year anniversary of each debenture, and contact logs.

d. The portfolio must be at least 90 percent current. [Note: If the applicant CDC had loans transferred to it from another CDC that was converted to ADC status or decertified, and those loans are past due, the applicant CDC is allowed to remove those loans from the currency equation. However, those loans also must be removed from all the other criteria (number approved, number closed, etc.).]

e. Have had a liquidation rate in 504 loans that is reasonable and acceptable to the SBA.

f. Have demonstrated to the SBA field office's satisfaction a history of submitting to SBA complete and accurate debenture guaranty application packages including the "Loan Officer's Report," SBA Form 1245.

g. Have demonstrated the ability to perform the required analysis for servicing actions. (Comments from the appropriate servicing center are required.)

h. Have demonstrated to the district counsel's satisfaction the ability to satisfactorily close 504 loans.

Q. Where to I obtain the currency, liquidation, and loss rate data needed to complete my evaluation of an ALP-applicant?

A. Refer to the "Quarterly 504 Portfolio Report"

6. THE APPLICATION AND SELECTION PROCESS

a. A CDC must submit a letter to the SBA field office (usually a district office), requesting ALP status. The letter must address its qualifications for each one of the selection criteria including the listing of its 504 loan portfolio.

b. The SBA field office must review the ALP application and make a recommendation to approve or decline. This recommendation should be made within two weeks of receipt of the CDC's request letter. The field office's recommendation for approval or decline must include:

(1) An evaluation of the completeness of the loan packages;

(2) An evaluation of the CDC staff's knowledge of SBA policies and procedures;

(3) An evaluation of the CDC staff's credit analysis abilities;

(4) An evaluation of the CDC staff's capability and performance related to loan closing; and

(5) An evaluation of the CDC staff's servicing capability and performance. The candidate CDC must be evaluated by both FD and PM field office personnel (including the loan servicing center) as well as the district counsel. The nomination for designation should be co-signed by each.

The field office forwards recommendations for approval to the Director, Office of Loan Programs, for final determination.

The field office has the authority to decline a request by a CDC to be designated as an ALP CDC. A copy of the field office's analysis for decline must be forwarded to the Director, Office of Loan Programs. The CDC may appeal the decision to the Director, Office of Loan Programs through the field office. The field office must analyze the CDC's reasons for appeal prior to forwarding the appeal to Headquarters.

7. PROCEDURES TO SUSPEND OR REVOKE A CDC'S ALP STATUS

SBA may suspend or revoke any ALP-CDC's participation status, at any time, for good cause, in accordance with Agency regulations and policies.

The SBA field office may recommend to the Director, Office of Loan Programs, that a CDC's ALP participation be suspended. The Director, Office of Loan Programs, may suspend or revoke the accreditation of an accredited lender for good cause by forwarding a written statement of suspension or revocation to the accredited lender. The CDC's status will be revoked upon 10 days written notice. Such statement will specify the nature of the sanction and the reasons.

The decision to suspend or revoke accreditation may be appealed by the CDC through the SBA field office to the AA/FA whose decision on any such appeal shall be the final decision of SBA.

8. PROCEDURES TO RENEW AN ALP CDC'S STATUS

ALP status (term) will be granted for 2 years, subject to suspension or revocation described above. The SBA field office must set up a tickler system to remind it when the 2-year anniversary for each ALP-CDC expires.

Ninety days prior to the end of the second year, the CDC may apply for renewal. The renewal must be in the form of a letter to the SBA field office.

The district office will review the currency and liquidation rates for acceptable performance standards. Recommendations for continuation or decline will be sent to the Director, Office of Loan Programs, for final determination.

CHAPTER 7. PREMIER CERTIFIED LENDERS PROGRAM

1. WHAT IS THE PREMIER CERTIFIED LENDERS PROGRAM (PCLP)?

.120.845 Premier Certified Lenders Program.
The SBA has established a pilot program to designate a number of CDCs as Premier Certified Lenders (``PCLPs''), which will be able to process, approve, close and service 504 loans.
(a) Characteristics. Loans processed through the PCL Program will be subject to the same loan terms and conditions as other 504 loans, but final approval by SBA will be limited to eligibility of the guarantee.
(b) Applications. A CDC may obtain information concerning this program from SBA's Office of Pilot Operations in Washington, D.C. A CDC may apply to the SBA field office with which it is most active. The SBA office will send the application with a recommendation to the AA/FA for final decision.
(c) Eligibility. SBA will consider the CDC's ability to work with the local SBA office and the quality of past performance.
(d) Loss reserve. A PCLP must establish a loss reserve for its financings under this program, secured by its segregated assets in favor of SBA, in the amount of the PCLP's historic loss rate or 10 percent of its exposure under the PCLP program, whichever is greater. The PCLP must contribute to the loss reserve for each such financing at the times and in the amounts established by law.
(e) Review. The SBA shall review a PCLP's financings at least annually.
(f) Suspension and revocation. The AA/FA may suspend or revoke PCLP designation upon written notice stating the reasons therefore at least 10 business days prior to the effective date of the suspension or revocation. Reasons for suspension or revocation may include loan performance unacceptable to SBA, failure to meet loss reserve or eligibility criteria, or violations of applicable statutes, regulations or published SBA policies and procedures. A PCLP may appeal the suspension or revocation made under this section pursuant to the procedures set forth in part 134 of this chapter. The action of the AA/FA shall remain in effect pending resolution of the appeal.
(g) Program period. On October 1, 1997, the PCLP pilot program ends.

2. RESTRICTIONS ON NUMBER OF PILOT CDCs

Not more than 15 certified development companies (CDC) may participate.

3. UNIQUE ASPECTS OF THE APPROVAL PROCESS

This program is similar to the PLP process for obtaining a 7(a) guaranty. The SBA processing office will only review the loan request for eligibility. In all other respects, the CDC will have authority to take actions in SBA's place.

4. WHAT ARE THE ADDITIONAL RISKS TO A PCLP CDC?

Each PCLP-CDC is required to fund a loan loss reserve. The amount of the loss reserve will be based on the greater of the **historic loss rate** on debentures issued by the participant CDC, **or** one percent (1 percent) of any loan approved under PCLP. The loss reserve must be made up of segregated assets of the CDC which must be securitized in favor of SBA.

The CDC must make contributions to the loss reserve in the following amounts and at the following intervals: 50 percent when the loan is closed, 25 percent not later than 1 year after the

date when the debenture was closed, and 25 percent not later than 2 years after the date when the debenture was closed.

The CDC must reimburse the SBA for ten percent (10 percent) of any loss sustained by SBA if a PCLP loan is charged off. When there is a loss on a PCLP loan, the loss reserve funds related to that loan plus all accrued interest in the CDC trust account will be "swept" by SBA to collect on the loss. The CDC must remit the loss deficiency within 45 days. If it fails to do so, SBA has the right of legal remedy against the CDC.

5. DO PCLP CDC'S HAVE TO PROCESS LOANS UNDER THIS PROGRAM?

To have a volume of activity sufficient to accurately evaluate the pilot, at least thirty percent (30 percent) of a participating CDC's yearly loan activity should be made under PCLP.

6. HOW DOES A CDC APPLY TO PARTICIPATE AS A PCLP CDC?

Because the expedited closing process must be used for all PCLP loans, each applicant CDC must already be a Priority CDC.

A Priority CDC must apply to the SBA field office where it is most active. The SBA office will send the application with a recommendation to the Director, Office of Program Development, for a final decision.

7. WHAT HAPPENS WHEN A CDC IS APPROVED AS A PCLP CDC?

The PCLP-CDCs must sign a PCLP participation agreement formalizing the CDC's participation in the program. SBA will provide a standard format and text for the Agreement to ensure program-wide consistency and equitability. The Agreement will require the CDC to:

(a) Establish a trust account;

(b) Make required contributions to the loss reserve;

(c) Participate in the expedited closing program;

(d) Reimburse SBA for 10 percent of any losses on a loan approved under PCLP; and

(e) Abide by all procedures established by SBA to implement PCLP.

8. HOW WILL THE TRUST ACCOUNT WORK?

A trust account will be established for each PCLP by the Agency's CSA as part of the 504 master reserve account (MRA) escrow account. The SBA will have direct access to the trust account. If a loan goes into default and is charged off, SBA will access the trust account to deduct the loss amount from the deposited principal funds for that loan plus accrued interest on the principal deposits for all other PCLP loans. No funds may be removed from the account without prior SBA approval.

9. HOW WILL THE LOAN RESERVES BE COLLECTED?

The loss reserve contributions will be collected as part of the debenture funding process, and from subsequent service fee payments by the CSA as specified in the regulations. The CSA will process the contributions and deposit them into the CDC's subaccount of the MRA escrow account for the benefit of the CDC.

CHAPTER 8. ASSOCIATE DEVELOPMENT COMPANIES (ADCS)

1. WHAT IS THE ASSOCIATE DEVELOPMENT COMPANY PROGRAM?

.120.850 ADC functions.

(a) An ADC must support local economic development efforts. An ADC may package, close, and service loans for a CDC under a written contract approved by SBA. Such contracts must meet Service Provider criteria, and specify the rights and responsibilities of the parties (including payment terms). The CDC remains solely responsible to SBA for the processing, closing, and servicing of the loan. It may not charge the Borrower a higher fee because it is using the ADC's services.
(b) An ADC must operate in accordance with statutes, regulations, policy notices, SBA's Standard Operating Procedures (SOPs), and the information in its application. It must supply to SBA current and accurate information about all certification and operational requirements, and maintain the records required by SBA.

The final regulations implementing the ADC program were published on August 27, 1993. The associate development company (ADC) designation was established to expand delivery of the development company loan programs to small businesses in under served areas. The designation provides organizations a way to become or remain a part of the SBA development company program network without meeting all of the requirements of a CDC.

The ADC designation provides cost savings to both "inactive" CDCs and to the SBA. A successful transition to a system of ADCs and CDCs will result in stronger active CDCs with experienced staff providing better service to small business clients and having better loan servicing skills. The SBA will save the staff time required to collect and review annual reports, operational reviews, and loan applications prepared by inexperienced staff. Also, hopefully there will be fewer problem loans resulting in fewer liquidations and reduced loss to the agency.

a. Benefits of ADC Designation to Small Businesses and Lenders:

(1) Increased availability of the development company loan program will result from an area being served by a CDC actively promoting and servicing the loan program.

(2) An active CDC working with an ADC will be able to educate lenders about program requirements and, with a volume of activity, increase lenders' interest in the program.

b. Benefits of ADC Designation to SBA:

(1) Reduced SBA paperwork.

(2) A reduced number of inactive CDCs will result in fewer SBA field operational reviews allowing the Agency to give greater attention to supporting active CDCs.

(3) A decrease in number of improperly prepared loan applications and loans not adequately serviced will result from a decrease in number of inactive CDCs. This will reduce the workload for field offices and reduce possible losses to the agency resulting from error and untimely response to the problems.

(4) Less field office and Headquarter's time will be required for giving notice to and providing extra oversight of CDCs and then carrying out the often painful and time-consuming process for decertification.

c. Benefits to "Inactive" CDCs:

(1) An ADC does not have to maintain a staff experienced in all aspects of 504 loan-making, closing, and servicing. Potential liability which results from actions of an inexperienced staff will be reduced.

(2) An ADC does not have to prepare a thorough 503/504 annual report for submission to SBA.

(3) An ADC which had created a separate entity to comply with SBA-CDC board and membership requirements will no longer have to maintain separate near-duplicate legal entities, sets of corporate documents and financial statements.

(4) Inactive CDCs and SBA field offices are able to transfer program delivery to an organization that will be an active 504 participant without having to go through what can be a difficult confrontation at their local level.

d. Benefits to Active CDCs:

(1) Active CDCs will be able to increase their service areas and program activity.

(2) Through larger loan portfolios, an active CDC's staff will acquire additional experience to improve service to small businesses, participating private lenders and SBA.

(3) Fewer inactive CDCs will reduce bad image problems which have resulted from inability to deliver quality service. This should facilitate the growth of active CDCs.

2. WHAT ARE THE REQUIREMENTS OF AN ADC?

.120.851 ADC eligibility and operating requirements.

(a) An ADC must demonstrate to SBA and maintain the following:
(1) Adequate management ability;
(2) A Board of Directors meeting at least quarterly and chosen from the membership by the members;
(3) A professional staff, including at least one qualified full-time professional with small business lending experience available during regular business hours; and
(4) A budget or financial statements showing the financial capability and funding to sustain continuing operations.
(b) An ADC may contract out for staff services only if SBA gives prior approval. The contract, subject to SBA audit, may not be self-serving, and compensation must be reasonable and customary.

3. PROCEDURES TO APPLY TO BE AN ADC

An ADC must be a non-profit corporation that administers a local economic development program. Its membership must include representation from Government, business, and community groups.

To be designated as an ADC, an organization must demonstrate commitment to local economic development. The organization must have a full-time paid staff including at least one person committed to some aspect of economic development.

If the ADC applicant is not currently a CDC, the applicant must submit a completed SBA Form 1849 (a copy of which is in appendix 8) and the appropriate exhibits to the SBA field office overseeing its area of operations. The field office will review the application and together with its recommendations, submit the request to the Director, Office of Loan Programs for a final determination.

4. ONGOING REQUIREMENTS TO REMAIN AN ADC

The ADC must agree to participate in selected SBA or CDC training activities to maintain a minimum level of program knowledge and understanding. While an ADC will not be required to have trained loan officers, an ADC's staff will be expected to have a general understanding of current rules and regulations. The training could include statewide or regional meetings of CDCs or the CDC training offered by the National Association of Development Companies (NADCO).

The ADC must provide an abbreviated annual report to SBA. In addition to reporting changes in the organization, it will report activity related to its economic development efforts.

5. DOES AN ADC HAVE TO BE AFFILIATED WITH AN ACTIVE CDC?

An ADC does not have to be affiliated with an active CDC. However, for an ADC to participate in active 504 program marketing (going beyond passive marketing such as making brochures available, etc.), loan packaging, and servicing, the ADC must have a working relationship with an active CDC.

If the ADC has staff performing loan packaging and credit analysis for other loan programs, it may enter into an agreement with an active CDC to prepare 504 loan applications and assist with collection of information or monitoring of collateral for loan servicing. In order to ensure loan portfolio and documentation consistency, the active CDC will be held accountable for loan approvals, authorizations, closings, and servicing actions.

If an ADC becomes affiliated with an active CDC for program delivery, the ADC and CDC must have a written agreement (which is not an SBA form) approved by SBA. The agreement must identify what is expected of each party with regard to marketing, preparation of loan applications, responsibility for contact and negotiation with lenders, and compensation by the CDC to the ADC. Participation in the NADCO CDC training may be required depending upon the experience of the ADC staff. Agreements will be reviewed annually in conjunction with the review of the ADC's annual report to SBA. The CDC may terminate the agreement upon thirty days notice to the ADC and SBA.

6. AREA EXPANSION THROUGH CONTRACTING WITH AN ADC

A CDC cannot expand its area of operations by contracting with an ADC whose area of operations is beyond the CDC's. A CDC is certified for a particular geographical area and, therefore, cannot use the services of an ADC to assist businesses outside of the CDC's area of operations. If a CDC wants to expand its area of operations, it must go through the normal application process. See chapter 5 for the procedures.

7. ADC AS PACKAGERS

An ADC may package or service loans for a CDC. A CDC can contract out packaging and/or servicing of 504 development company loans to any entity or individual as long as the contract is reviewed and approved by the SBA field office that oversees the CDC's operations.

8. CONVERTING A CDC TO AN ADC

a. Voluntary Conversion: An "inactive" CDC may convert to ADC designation by sending to SBA's field office a letter surrendering its certificate and requesting ADC designation. If no changes have occurred since their last CDC annual report, the "inactive" CDC will not need to submit copies of Articles of Incorporation, bylaws or membership lists. CDCs which are inactive with regard to the 504 loan program, but which are active in other local economic development activities are excellent candidates for conversion to the ADC designation. Local priorities and funding limitations may require organizations to focus on local programs so that resources are not available to fully staff the 504 loan program. However, such organizations often play a valuable role in their communities' overall economic development program and would be valuable resources to SBA.

A CDC is defined as "inactive" if it does not process through SBA two 504 loan approvals per year.

b. Involuntary Conversion to ADC Designation: If a CDC does not meet the activity requirement on average over two consecutive fiscal years, the CDC will be transferred to ADC designation. (Reference .120.980)

c. Converting Back to a CDC: If a CDC is converted to an ADC, it is allowed to apply to become a CDC again. If the application is received within 12 months of the CDCs conversion to an ADC, the organization may request to be re-certified as a CDC if it is in good standing with SBA and it can demonstrate to SBA's satisfaction that it has made a significant commitment to the Development Company Program that will overcome the deficiencies that led to the CDC's inactivity and original conversion. Refer to subpart H, chapter 24, paragraph 3b.

If the request is more than 12 months since the conversion from CDC to ADC the organization must follow the same requirements as any other organization requesting to become a CDC. (Refer to chapter 2.) In addition, it should provide a listing of the 504 projects, if any, it has assisted while it was an ADC. Such information will assist SBA in determining that the organization can fulfill the requirements of a being a CDC.

Q. How many "inactive" CDCs have been converted to ADCs?

A. Over 100. Their portfolios were transferred to either active CDCs or to SBA.

Regulatory authority for converting a CDC to an ADC is found in .120.980.

9. CAN NON-CDC ORGANIZATIONS BE DESIGNATED AS ADCs?

Yes. Non-profit organizations have applied for and received the ADC designation. These are generally affiliated with an active CDC.

10. CAN ADC STATUS BE SUSPENDED OR REVOKED?

.120.852 Suspensions and revocation of ADCs.

SBA may require corrective action, or the AA/FA may suspend or revoke ADC status upon written notice stating the reasons therefore at least 10 business days prior to the effective date of the suspension or revocation. Reasons for suspension or revocation may include violations of applicable statutes, regulations or published SBA policies and procedures. An ADC may appeal the suspension or revocation made under this section pursuant to the procedures set forth in part 134 of this chapter. The action of the AA/FA shall remain in effect pending resolution of the appeal.

11. OVERSIGHT REQUIREMENTS AND DESIGNATION TERMINATION

a. The ADC Annual Report: ADCs must complete and submit the "ADC Annual Report," SBA Form 1850, to the SBA district office where the ADC's headquarters is located within 30 days of the end of its fiscal year. It is significantly shorter than the detailed CDC annual report. In addition to reporting changes in the organization and its membership, the ADC must report loans made under other loan programs administered by the ADC (eg. EDA, CDBG, or other revolving loan funds) and other economic development related activities.

b. SBA Oversight: The SBA district office must review the ADC's annual report to ensure that the ADC continues to meet the requirements for ADC designation. The SBA district office must notify the ADC of its recommendation regarding continued designation as an ADC. In making your recommendation, you should consider the amount and variety of services provided by the ADC.

If the ADC has a contract with an active CDC, the district office must review the annual contract between the ADC and the CDC to insure that it is current. Comments should be solicited from the CDC regarding the level of service provided by the ADC and the recommendation to continue or terminate the relationship.

c. Termination of ADC Designation: The district office's recommendation for termination of the ADC designation will be evaluated by the Director, Office of Loan Programs. If the Director concurs, a letter will be sent to the ADC notifying them of the decision and identifying the deficiencies leading to the decision. The ADC must be notified of its right to appeal the decision to the AA/FA.

CHAPTER 9. ETHICAL REQUIREMENTS

1. WHAT ARE THE ETHICAL REQUIREMENTS FOR CDCS AND ADCS?

120.855 CDC and ADC ethical requirements.

CDCs, ADCs and their Associates must act ethically and exhibit good character. They must meet all of the ethical requirements of Sec. 120.140. In addition, they are subject to the following:
(a) Any benefit flowing to an Associate or his or her employer from activities as an Associate must be merely incidental (this requirement does not prevent an Associate or an Associate's employer from engaging in a business relationship with the CDC and/or the Borrower in the regular course of business, including providing interim financing or Third-Party loans); and
(b) Unless waived by SBA for good cause, an Associate may not be an officer, director, or manager of more than one CDC or ADC (except that the membership or Board of Directors of a broader-based CDC may include a member or director of a local CDC within its Area of Operations).

A CDC or ADC must inform SBA if any associate of the CDC or ADC:

a. Is currently incarcerated, or on parole or probation;

b. Has been convicted of a felony;

c. Has suffered an adverse final civil judgment in a case involving a breach of trust or the violation of a law or regulation; or

d. Has knowingly made a misrepresentation, false statement, or given false documents to SBA.

2. CONFLICTS OF INTEREST THAT CDCs AND ADCs MUST AVOID

Outlined below are the situations and relationships between the small business and the CDC or ADC that must be avoided to comply with SBA ethical standards.

a. Self-dealing is prohibited by the CDC or ADC, its board of directors, members, employees, and other related parties to the prejudice of the small concern, the development company or SBA.

b. The CDC's loan application to SBA must contain a full disclosure statement from the CDC and the applicant regarding any relationships that could be viewed as a conflict of interest.

c. A CDC or ADC must not permit a relationship to exist or to be created between the CDC, ADC or related parties and the loan applicant or a present borrower if such

relationship could be seen as a conflict or appearance of conflict. The SBA may grant a waiver after a thorough review of the relationship.

d. An officer, director, or manager of a CDC or ADC cannot:

(1) Be an officer, director, or manager of a firm contracted by the CDC or ADC to provide professional staff service to a small business. (Note: An exception to this is the CDC's closing attorney can also be an officer or director of the CDC.)

(2) Be an employee of a management consulting firm that is engaged, by request of a small business, under a separate contract with the small business, to provide management assistance to the small business on an ongoing basis.

e. A CDC or ADC must not, directly or indirectly, provide financial assistance to a small business in which the CDC or ADC or a related party has any financial interest.

f. A CDC or ADC must not require a small business to purchase real or personal property, or services (including insurance and legal services) from the CDC or ADC, a related party, or a designee of either.

g. A CDC or ADC must not provide financial assistance repay or refinance an existing debt due the CDC or ADC or a related party unless SBA shall have first made a written determination, upon the basis of evidence in the file, that:

(1) The terms of the existing indebtedness are causing undue hardship to the small business; and

(2) Refinancing, extension or modification of the outstanding indebtedness is not available.

h. A CDC must not make a 504 loan to an officer, member of the board of directors, or anyone under contract to the CDC. With full disclosure, loans may be approved to a general member who is not now or in the future will be an officer, member of the board of directors, or have a contractual relationship with the CDC. An officer, director, or those under contract with the CDC may only make application for a 504 loan from a CDC with which that person is not an officer, director, or person under contract.

i. If the CDC has a non-bank lending affiliate, the affiliate cannot be the third-party lender in a 504 project where the CDC is the 504 lender.

j. When a CDC's area of operations overlaps with another CDC's area of operations, and the first CDC has other lending programs that the second CDC does not have, the first CDC cannot require a lender (either privately or publicly funded) to work exclusively with

that CDC in order to have access to the CDC's other lending programs. The SBA would consider this to be establishing a preference in the CDC's favor, and the CDC risks being decertified.

CHAPTER 10. PROJECT ECONOMIC DEVELOPMENT GOALS

1. WHAT ARE THE REQUIRED OBJECTIVES OF A 504 PROJECT?

.120.860 Required objectives.

A Project must achieve at least one of the economic development objectives set forth in Sec. 120.861 or Sec. 120.862.

A project does not have to create or retain one job opportunity for every $35,000 of the project's debenture if:

(a) The Project meets 120.862(a) or (b) goals; and

(b) The CDC's portfolio, including the subject loan, has a job opportunity average of one job opportunity created/retained for every $35,000 of debenture.

2. THE POLICY REGARDING JOB CREATION OR RETENTION

.120.861 Job creation or retention.

A Project must create or retain one Job Opportunity for every $35,000 guaranteed by SBA.

a. One "job opportunity" must be created or retained for each $35,000 of debenture assistance. Job opportunities do not all have to be at the project facility. However, 75 percent of the jobs must be in the community where the project is located.

b. "Job opportunity" is defined as follows:

(1) Full-time or equivalent (8 productive hours per day/40 productive hours per week) permanent or contracted employment created within 2 years of financing or retained as a result of the financing; and

(2) At time of application, in order to count a job as retained, the CDC reasonably must show that jobs will be retained that otherwise might be lost to the community if the project was not done. Some examples of this would be:

(a) The small business is being forced to vacate its building; or

(b) Without financing the business may have to close or be moved outside of the community. (This would include businesses for sale.)

Q. Is it acceptable to count all existing jobs in a 504 project as "retained?"

A. No. Job retention must be justified.

3. DO ALL 504 PROJECTS HAVE TO CREATE AND/OR RETAIN JOBS?

No, each project does not have to create or retain jobs. Each 504 project has to create or retain at least one job for every $35,000 of debenture proceeds unless the project can meet one of the community development goals or one of the public policy goals. However, the CDC's total portfolio of funded and unfunded debentures must create or retain one job per $35,000 of gross debenture or less.

Q. What is the basis for the job creation calculation for the CDC?

A. The basis for the calculation is the information provided from the CDC's most recent annual report which includes SBA Form 1253A and the listing of all debentures approved that are funded or not funded. (Add Line C.4. on SBA Form 1253A and the total of the "Unfunded Debentures" listed on Form 1253 to get the total jobs created and retained and the total dollar amount of the approved debentures. Then divide the total dollar amount of the approved debentures by the total amount of the jobs created and retained by the funded and unfunded debentures to determine the ratio of one job per debenture amount for the CDC.)

Be sure that the CDC's annual report is current and that the CDC is calculating the jobs created and retained correctly in paragraph C. of SBA Form 1253A [actual jobs created and retained net of loans transferred to SBA for debentures funded 2 or more years (C.3.) and estimated jobs created and retained for debentures funded less than 2 years net of loans transferred to SBA (C.2.)].

.120.862 Other economic development objectives.

A Project that achieves any of the following community development or public policy goals is eligible if the CDC's overall portfolio of 504 loans, including the subject loan, meets or exceeds the CDC's required Job Opportunity average. Loan applications must indicate how the Project will meet the specified economic development objective.
(a) Community Development goals:
(1) Improving, diversifying or stabilizing the economy of the locality;
(2) Stimulating other business development;
(3) Bringing new income into the community;
(4) Assisting manufacturing firms (Standard Industrial Classification Manual (SIC) Codes 20-49); or
(5) Assisting businesses in Labor Surplus Areas as defined by the Department of Labor.

In order for a project to qualify under .120.862(a), a CDC must prepare a short analysis showing how the project qualifies. If additional justification is necessary, a letter from an appropriate city or town official that specifically addresses compliance with one of the criteria generally will be acceptable. Use of these criteria should not be so restrictive that they are rendered useless.

(b) Public Policy goals:
(1) Revitalizing a business district of a community with a written revitalization or redevelopment plan;
(2) Expanding exports;
(3) Expanding Minority Enterprise development (See Sec. 124.105(b) for minority groups who qualify for this description.);
(4) Aiding rural development;
(5) Increasing productivity and competitiveness (retooling, robotics, modernization, competition with imports);
(6) Modernizing or upgrading facilities to meet health, safety, and environmental requirements; or
(7) Assisting businesses in or moving to areas affected by Federal budget reductions, including base closings, either because of the loss of Federal contracts or the reduction in revenues due to a decreased Federal presence.

There are eight public policy goals:

(1) Business District Revitalization: A project located within a business area of a community with a recognized revitalization or redevelopment plan that encourages business development as a means of enhancing the economic productivity of the area. There should be a recognized incentive given by the community for the business to locate in the particular geographical area, such as lower taxes.

(2) Expansion of Exports: A project in an eligible small business will create, retain or expand its ability to produce or sell its goods or services for purchase by buyers outside of the United States. To qualify, at least 10 percent of the small business's revenue must be from export sales at the time of the project, or will be 10 percent of the SBC's revenue as a result of the project.

(3) Expansion of Minority Business Development: The small business concern must be at least 51 percent unconditionally owned and controlled by an individual(s) who is a member of a group identified in 124.105(b) which lists the eligible designated groups. (Note: Resident aliens are not eligible under this category.)

(4) Rural Development: A project located in any political subdivision or unincorporated area in a non-metropolitan county (as defined by the Economic Development Division, Economic Research Service, U.S. Department of Agriculture) or the equivalent thereof; or any political subdivision or unincorporated area in a metropolitan county or the equivalent with a resident population of less than 20,000, which SBA (district director or his/her designee) may determine to be rural.

(5) Enhanced Economic Competition: A project which increases a small business's competitiveness through advancement of technology, plant retooling (expansion or modernization of manufacturing facilities), or conversion to robotics.

(6) Restructuring Because of Federally Mandated Standards or Policies: A project that enables the business to meet requirements to improve the environment, safety or health of employees, such as pollution control equipment, or removal/encapsulation of asbestos, or that assists a small business that provides environmental services.

(7) Changes Necessitated by Federal Budget Cutbacks: A project that assists a small business that is located in or is locating into an area impacted by Federal budget cutbacks, such as facility closings or cutbacks in defense-related industries.

Q. Does the business itself have to be harmed by the cutbacks?

A. Not necessarily. It just has to be in, or is locating into, an area that has been affected by the cutbacks. The focus is on redeveloping the impacted area, not the individual business.

Only projects that meet one or more Public Policy Goals can have a debenture size that exceeds $750,000 and be as large as $1 million. Projects that only meet one or more Community Development Goal are limited to a debenture size of $750,000). Reference Subpart H, Chapter 13, paragraph 4b.

(8) Expansion of Small Business Concerns Owned and Controlled by Veterans:

The Veterans Act of 1999 expanded the eligibility of SBA's Certified Development Company (CDC) loan (504) program to include 504 loans to veterans and service disabled veteran businesses as one of the program's public policy goals.

Q. The definitions for veteran-owned businesses that have been added to the Act are narrower than Title 13, Code of Federal Regulations, Part 120, section 105, "Special consideration for veterans." .120.105 includes a "business owned or controlled by one of the veteran's dependents.. Which definition do we use for the new Public Policy goal?

A. The narrower definition in the Act is the one to use. It does not include any language regarding dependents.

Veterans are defined in section 3(q) of the Small Business Act (15 U.S.C. 632(q)), especially service-disabled veterans, as defined in such section 3(q).

Small Business Owned and Controlled by a Veteran means a small business: that is not less than 51-percent-owned by one or more veterans or, in the case of any publicly owned business, not less than 51 percent of the stock is owned by one or more veterans; and whose management and daily business operations of which are controlled by one or more veterans.

Small Business Owned and Controlled by a Service-Disabled Veteran means a small business: that is not less than 51-percent-owned by one or more service-disabled veterans or, in the case of any publicly owned business that is not less than 51 percent is owned by one or more service-disabled veterans; and whose management and daily business operations are controlled by one or more service-disabled veterans or, in the case of a veteran with permanent and severe disability, the spouse or permanent caregiver of such veteran.

For more information on the Veterans Entrepreneurship and Small Business Development Act of 1999, or if you have questions on resources available for Veterans at SBA, contact SBA's Office of Veteran.s Affairs at 202-205-6773 or visit the SBA Veteran's Homepage at: www.sba.gov/vets.

4. ELIGIBILITY OF PROJECTS NOT MEETING ONE OF THE CRITERIA

Q. Is a CDC allowed to submit a 504 application for a project that does not qualify under the jobs, community, or public policy criteria?

A. No, even if the CDC's overall portfolio exceeds the one job per $35,000 of debenture requirement. If the project does not qualify under any of the economic development criteria, the debenture either must be reduced to meet the jobs criteria or the project is not eligible for 504 financing.

CHAPTER 11. ELIGIBLE AND INELIGIBLE 504 PROJECTS

1. LEASING POLICIES SPECIFIC TO 504 LOANS

Most 504 projects are either loans to small businesses or loans to eligible passive concerns (EPC) that lease the project property to an Operating Concern (OC). Policies and procedures regarding EPCs can be found in subpart A. However, there are a few leasing situations that are specific to the 504 loan program.

.120.870 Leasing Project Property.

(a) A Borrower may use the proceeds of a 504 loan to acquire, construct, or modify buildings and improvements, and/or to purchase and install machinery and equipment located on land leased to the Borrower by the CDC or an unrelated lessor if:
(1) The remaining term of the lease, including options to renew, exercisable solely by the lessee, equals or exceeds the term of the Debenture; or, in the case of machinery or equipment, equals or exceeds the useful life of the property or the term of the Debenture, whichever is lesser;
(2) The Borrower assigns its interest in the lease to the CDC with right of reassignment to SBA; and
(3) The 504 loan is secured by a recorded lien against the leasehold estate and other collateral as necessary.

Under the 504 loan program, financing is allowed for leasehold improvements and lease-purchase assets including construction on leased land owned by a CDC or an unrelated (to the small business) third-party.

The remaining term of the lease (including options renewable at the prerogative of the small business) must be at least equal to the term of the debenture.

Refer to subpart A, chapter 4, paragraph h.(5).

2. CDC-OWNED PROPERTY

(b) If a CDC leases property to a small business, the rent paid by the small business during the term of the Debenture must be enough to pay principal and interest on all debt incurred by the CDC to finance the Project, and all related expenses. The rent also may include a reasonable return on the CDC's investment.

Q. Are there any specific issues if the CDC actually owns the property?

A. A CDC may buy or construct a plant and lease the facility to a small business through a term lease, lease purchase, or lease with option to purchase. When the CDC owns the land, a mortgage will be required on the property to secure the debenture.

3. LEASING PART OF A NEW OR EXISTING BUILDING

(c) If the Project is for new construction, the Borrower may lease long term up to 20 percent of the Rentable Property in the Project to one or more tenants if the Borrower immediately occupies at least 60 percent of the Rentable Property, plans to occupy within three years some of the remaining space not immediately occupied and not leased long term, and plans to occupy all of the remaining space not leased long term within ten years.

.120.871 Leasing part of an existing building to another business.

13 CFR 120.871 expands on .120.131 (discussed in Subpart A, Chapter 2, paragraph 13) regarding leasing part of an existing building to another business.

(a) The costs of interior finishing of space to be leased out to another business are not eligible Project costs.
(b) Third-party loan proceeds used to renovate the leased space do not count towards the 504 first mortgage requirement or the Borrower's contribution.

Costs in connection with the infrastructure of the building are eligible costs and may be included in the 504 project. Examples of these costs are a new roof/roof repair, windows, HVAC systems, exterior facade work, and so on.

Costs in connection with finishing the interior space that would be leased out are not eligible. Examples of these costs are carpeting, painting, light fixtures, and so on.

Example: The purchase and renovation of an existing building including the purchase of the land is $1,000,000. The small business concern will be leasing out 49 percent of the building to an unrelated business. The cost of renovating the leased space will be $200,000.

Eligible project costs:	$800,000
Ineligible costs:	200,000

If the 504 project financing was, for example, a combination of a first mortgage loan financing 40 percent of the eligible project costs, the SBA 504 loan financing 40 percent and the small business injecting 20 percent, the first mortgage loan would be $320,000; the 504 loan would be $320,000; and the borrower's contribution would be $160,000.

However, the first mortgage lender wants to finance the ineligible project costs of $200,000 and requests that SBA subordinate its lien to this additional financing. The total first mortgage requested would then be $520,000 ($320,000 plus $200,000).

Q. May SBA subordinate its lien to the financing of these ineligible costs?

A. No. Otherwise, SBA would be financing indirectly what it is prohibited from financing directly. Therefore, the lender would need to split the liens with a first mortgage of $320,000 and a subordinated mortgage to SBA of $200,000.

(Note: When a proposed project includes eligible and ineligible project costs, the first step in the analysis is to separate the eligible 504 project costs from the ineligible ones. Once this step is taken, looking at the proposed financing is much easier.)

4. BASIC SIZE ELIGIBILITY REQUIREMENTS FOR 504 PROJECTS

.120.880 Basic eligibility requirements.
In addition to the eligibility requirements specified in subpart A, to be an eligible Borrower for a 504 loan, a small business must:
(a) Use the Project Property (except that an Eligible Passive Company may lease to an Operating Company); and
(b) Together with its affiliates, meet one of the following size standards:
(1) It does not have a tangible net worth in excess of $6 million, and does not have an average net 100 income after Federal income taxes (excluding any carry-over losses) for the preceding two years in excess of $2 million; or
(2) It meets the size standards in Part 121 of this chapter for the industry in which it is primarily engaged.

Q1. If the small business has a tangible net worth of $5 million but has an average net income of $3 million, is it eligible?

A1. No. The small business has to have a both a tangible net worth of $6 million or less and an average net income after taxes of $2 million or less (excluding loss carry-forwards).

Q2. If the small business has a net worth of $10 million and an average net income of $100,000, but $9.5 million is "intangibles" including goodwill and trademarks, is this small business small?

A2. Yes. Only tangible net worth is the benchmark.

Q3. What if the small business has a tangible net worth in excess of $6 million but has 100 employees and its SIC Code size limit is 500 employees. Is it "small"?

A3. Yes. It fits the alternative 7(a) size criteria [as defined in 13 CFR 120.880(b)(2)].

Q4. Are there instances where the small business exceeds both 7(a) and 504 size standards and is still considered "small"?

A4. Possibly. 13 CFR 121.301(e) of SBA's regulations states that the applicable size standards are increased by 25 percent whenever the applicant agrees to use the assistance within a labor surplus area. Labor surplus areas are listed monthly in the Department of Labor publication called "Area Trends."

Q5. The size standard uses the benchmark of net income after taxes. What if the small business is a subchapter S corporation or a partnership where net income is distributed to individuals for their own tax returns? What do you do if the net income exceeds $2 million but is before taxes?

A5. In these situations, you must adjust the net income by the pro rata share of the personal income taxes that were paid because of distributions from the operating company.

5. INELIGIBLE PROJECTS FOR 504 FINANCIAL ASSISTANCE

.120.881 Ineligible Projects for 504 loans.

In addition to the ineligible businesses and uses of proceeds specified in Subpart A of this part, the following Projects are ineligible for 504 financing:
(a) Relocation of any of the operations of a small business which will cause a net reduction of one-third or more in the workforce of a relocating small business or a substantial increase in unemployment in any area of the country, unless the CDC can justify the loan because:
(1) The relocation is for key economic reasons and crucial to the continued existence, economic wellbeing, and/or competitiveness of the applicant; and
(2) The economic development benefits to the applicant and the receiving community outweigh the negative impact on the community from which the applicant is moving; and
(b) Projects in foreign countries (loans financing real or personal property located outside the United States or its possessions).

6. ELIGIBLE PROJECT COSTS

.120.882 Eligible Project costs for 504 loans.
Eligible Project costs which may be paid with the proceeds of 504 loans are:
(a) Costs directly attributable to the Project including expenditures incurred by the Borrower (with its own funds or from a loan):
(1) To acquire land used in the Project prior to applying to SBA for the 504 loan; or
(2) For any other expense toward a Project within nine months prior to receipt by SBA of a complete loan application, unless the time limit is extended or waived by SBA for good cause;
(b) In Projects involving construction, a contingency reserve for cost overruns not to exceed 10 percent of construction cost;
(c) Professional fees directly attributable and essential to the Project, such as title insurance, architecture, engineering, accounting, environmental studies, and legal fees (other than legal fees associated with the closing); and
(d) Repayment of interim financing including points, fees and interest.

The term "project cost" is quite broad and includes all costs necessary to acquire, construct, convert, or expand a plant, including site improvements and land acquisition. Basic elements of project costs are the following.

a. Land

The project may include land, no matter how long it has been held. The value of the land will be at cost if acquired within two years of application. If the land was acquired prior to that time, the value also will be at cost unless the small business submits a professional appraisal acceptable to SBA establishing a different value. The appraisal should include the sales history of the property during the last five years. The appraisal must be conducted by a party other than the borrower, its associates, or the present mortgagee.

b. Land Improvements

Land improvements integral to the project can be included as eligible project costs except those improvements that are to be paid through special tax assessments or user fees. Examples of eligible land improvements are grading, new streets including curbs and gutters, parking lots, utilities, and landscaping.

c. Building and Building Improvements When Some Space is Leased

For a project that is partially leased out, costs for improvements that are an integral part of the structure of the building are eligible project costs. Examples of these costs would be facade expenditures, heating, electrical, plumbing and roofing costs. However, costs in connection with finishing the interior space to be leased out are not eligible.

d. Machinery and Equipment

All costs associated with the purchase, transportation, dismantling, or installation of machinery and equipment can be considered part of the project cost. (If the project is only for machinery and equipment, the machinery and equipment has to have a useful life of at least 10 years.) The CDC, in its analysis, should consider the specific use of and need for the asset by the small business.

Q. If the project does not include the purchase of machinery and equipment, can the eligible project costs include the dismantling, moving, and installation of equipment?

A. Yes, if the equipment is heavy or highly calibrated equipment (such as a large, printing press) which often requires specialty moving services and if these costs are part of a more comprehensive 504 project.

e. Furniture and Fixtures

Furniture and fixtures can be included in the project as eligible project costs if the dollar amount compared to the total project is minimal and will not affect the maturity based upon a weighted average useful life. [Refer to chapter 13, paragraph 4(d) of this subpart.]

f. Professional Fees

Expenditures for professional services and fees directly attributable and essential to the project are eligible. Often title documents are recorded and associated fees are paid at the time of the interim loan. Once the debenture is funded, an amendment to the prior recording is done. Section 120.882(c) allows these fees to be considered as part of the eligible project costs rather than administrative costs associated with the closing of the debenture since they are incurred in conjunction with the interim loan and not at the time of the debenture closing.

Examples are:

(1) Expenditures for zoning changes, title searches, title insurance, attorney's opinion of title, hazard and flood insurance, and recording fees;

(2) Engineering and architectural costs, as well as appraisals;

(3) Environmental costs like site assessments, phase I and/or phase II studies;

(4) Interest and points on the interim construction loan; and/or

(5) Impact and permit fees and utility hook-up fees.

Note: Third Party loan fees such as processing and application fees are not eligible as a project cost

g. Contingency Fund

You should consider requiring a contingency amount not to exceed 10 percent of the construction costs to avoid problems in financing cost overruns. If the residual contingency amount does not exceed 2 percent of the debenture just prior to closing, it may be refunded to the small business at the time the debenture is funded. If the contingency residual is in excess of 2 percent, the debenture has to be reduced by the excess amount.

7. ELIGIBILITY OF PROJECTS THAT RESULTS IN A CHANGE OF OWNERSHIP?

Project ending in a change of ownership is eligible under the following circumstances:

a. The 504 project finances only the acquisition of eligible long-term fixed assets; the acquisition of any other assets such as receivables or goodwill have to be financed by other means such as the 7(a) program; and

b. If the change of ownership includes a stipulation that jobs are going to be retained because of the change of ownership, there has to be a reasonable assurance that the jobs would be lost without the change of ownership. This can be in the form of a statement from the seller to that effect, or some other certification acceptable to the SBA field office.

8. CAN 504 LOAN PROCEEDS BE USED TO PURCHASE STOCK?

Normally no. If the corporation has assets in addition to long-term fixed assets, 504 loan proceeds must not be used to purchase the stock. Instead the 504 loan proceeds can be used to purchase the fixed assets from the corporation. Other financing (such as 7(a) guaranty loans) can be used to purchase the stock of the company. (This may require revaluation of the stock.) The exception would be the rare instance when the corporation's assets are only the eligible long-term fixed assets in which case the purchase of the stock is the purchase of the long-term fixed assets.

9. EXPENDITURES MADE IN ADVANCE OF 504 LOAN PROCESSING

a. Expenditures within 9 months of the date of the application, including land, building, and/or equipment, can be included in the project costs and be reimbursed by the interim lender net of the equity requirement. Costs incurred prior to that date may be included solely at the SBA field office's discretion.

The small business borrower cannot be reimbursed directly from the debenture proceeds for these expenditures, but can be reimbursed indirectly. Since these are eligible project costs, the small business borrower can be reimbursed by an interim lender, who is then paid off by the debenture proceeds. Expenditures that constitute part or all of the equity contribution cannot be covered by the interim lender.

Example: The small business purchased with cash eligible equipment 6 months prior to submitting the 504 application. The equipment is still an eligible 504 project cost and the small business can be reimbursed for its purchase, net of the equity requirement. However, the debenture proceeds cannot reimburse the borrower directly. Therefore, an interim lender will need to reimburse the borrower (except for any 504 equity requirement). When the debenture is closed, the debenture proceeds will be disbursed to the interim lender. One standard exception to the nine months limitation is the acquisition of land.

b. The regulations provide for the acquisition of land without any limitation of time prior to the application. There are many situations where land is acquired prior to its actual use in a business. Examples of this could be:
- The land came on the market before the business needed it;
- The neighboring land had to be developed before development of the project land made economic sense; or
- The small business was anticipating its future needs.

You can consider the refinancing of any previous financing of the land as an eligible 504 project cost if you determine that the intent of small business was to finance the purchase on a "short-term" (interim) basis until the entire project was completed. Existing debt is considered "interim" debt under the following circumstances.

(1) All the debt on the land can be considered "bridge financing" and, therefore, eligible to be refinanced by the 504 project proceeds, if all the land is to be used in the project and the financing is "short-term" in nature.

(2) If only part of the land is to be used in the project, only a pro rata share of the debt can be refinanced by the 504 loan proceeds.

The land has to be part of a 504 project that includes construction or renovation of a building(s).

Q. If the land were purchased with cash from the borrower as part or all of the financing more than 9 months before the application is submitted to SBA, could the cash be considered part of the interim financing and, therefore, eligible to be reimbursed by the 504 loan proceeds?

A. It is up to the SBA field office to determine whether the cash outlay can be considered "bridge financing," as defined in paragraph 10 of this subpart and chapter. If the field office determines that it was, then the interim lender would have to reimburse the borrower net of the borrower's contribution requirement prior to the debenture sale since debenture proceeds can not go directly to the borrower. SBA must be very careful in making a decision determining that the cash outlay can be refinanced by the interim lender and ultimately by the long term debt, since it will result in reducing the equity in the project and the collateral coverage.

10. WHAT IS "BRIDGE FINANCING?"

For purposes of this SOP, "bridge financing" is a "short-term financing" obligation by the applicant to purchase land in anticipation of future occupancy needs of its small business. The applicant does not have to know about the 504 loan program at the time it purchased the land. For 504 loan purposes, this type of debt is eligible for refinancing by the 504 project proceeds.

For example, if the land for the project was acquired 3 years earlier with a loan that was interest only with a balloon payment at the end of 5 years, this is obviously bridge financing (a short-term loan until the entire project is put together at which time the permanent financing is put into place). However, if the land was financed with a fully amortized, 30 year mortgage, this is not a short-term loan, but instead a conventional, long-term loan, and ineligible to be refinanced by the 504 project financing. Whether the term of the financing is sufficiently short to be considered "bridge financing" is a decision to be made by the SBA loan approving officials. However, the borrower's equity in this land can be included in the 504 project as an eligible project cost as all or part of the borrower's contribution.

Q. For the purposes of Section 120.882(a)(1), could a mortgage for the acquisition of land and buildings be considered "bridge financing" and, therefore, an eligible 504 project cost?

A. Section 120.882(a)(1) only says "land," not land and buildings. It is supposed to cover that period when land is bought in anticipation of a building project at some future date that could be several years later. The financing for the land may include improvements to the land such as grading, or there may be structures on the land such as sheds. The 504 financing, when closed, would take out the eligible land bridge financing and the interim building construction loan.

11. CAN A 504 PROJECT INVOLVE MORE THAN ONE SITE?

This is a credit decision that must be carefully made on a case-by-case basis. Generally, it is SBA's policy that one 504 debenture should finance one site. The reason a borrower may want a 504 project to finance more than one site is that it is less costly for the borrower in terms of closing costs; however, there is the added risk that if one 504 debenture financed two or more sites, and one of those sites fails while the other does not, the failure of the one could result in both failing through foreclosure. If these credit concerns can be offset, then financing more than one site may be feasible.

In such projects, the CDC should obtain an agreement from any prior lienholder on the project to the effect that the prior lienholder will claim priority in the proceeds of the sale or other return on the real estate over the interest of SBA only in the principal amount outstanding of the apportioned share that collateral represents to the whole project together with the same proportion of the accrued but unpaid interest remaining on it and its expenses directly related to realizing on this collateral.

12. ARE THERE OTHER ELIGIBLE COSTS?

.120.883 Eligible administrative costs for 504 loans.

The following administrative costs are not part of Project costs, but may be paid with the proceeds of the 504 loan and the Debenture (see Sec. 120.971):
(a) SBA guarantee fee;
(b) Funding fee (to cover the cost of a public issuance of securities and the Trustee);
(c) CDC processing fee;
(d) Borrower's out of pocket costs associated with the closing of the 504 loan (other than legal fees);
(e) CDC Closing Fee (see .120.971(a)(2)) up to a maximum of $2,500; and
(f) Underwriters' fee.

a. What Are Administrative Costs?

Administrative costs are not part of the project costs and, therefore, not part of the Net Debenture. They are added to the Net Debenture to calculate the Gross Debenture.

b. What Are and Are Not Eligible "Closing Costs?"

In determining what is an eligible "closing cost" that can be funded from debenture proceeds, it is the nature of the work, not who performs the work, that determines whether a cost can or cannot be considered part of the funded closing costs.

Generally, only charges incurred for services performed by, or fees charged by, other entities with respect to the loan closing and passed through to the borrower can be funded out of the debenture proceeds. These costs do not count as part of the CDC Closing Fee and may be funded from debenture proceeds in addition to the Closing Fee.

Examples of eligible closing costs are the following:

(1) Title insurance;

(2) Flood insurance;

(3) Recording fees;

(4) Filing fees and title searches;

(5) Abstract costs;

(6) Surveys;

(7) Certified copies of organizational documents;

(8) Settlement agent's fees;

(9) Overnight delivery and postage;

(10) Messenger services;

(11) Certifications required by SBA (such as earthquake, flood, IRS, certificate of occupancy, and certificate of completion); and

(12) Copying costs attributable to the above.

Q1. If the CDC attorney performs title work, can this cost be considered an eligible "closing cost" and funded from the debenture proceeds?

A1. Yes. In some jurisdictions, CDC attorneys do the title work performed in other jurisdictions by abstract or title companies. This cost should be separate from the CDC Closing Fee and can be funded out of the debenture proceeds.

Q2. What "closing costs" are ineligible to be funded from the debenture proceeds?

A2. Legal work, services, costs and functions (in excess of the $2,500 maximum CDC Closing Fee) including:

(a) Facilitating, or attending a closing;
(b) Fees attributable to reviews for legal sufficiency;
(c) Issuance of the opinion of counsel; and
(d) Miscellaneous costs associated with the legal work.

Performed by:

(a) Borrower's counsel;
(b) CDC's outside counsel;
(c) Outside counsel staff, including paralegals;
(d) In-house counsel;
(e) CDC or other staff that assist in-house counsel, and
(f) CDC staff where there is no attorney involved other than post-closing review.

However, all reasonable costs in connection with (a), (b), or (c) above can be charged to the borrower and are considered an out-of-pocket expense to the borrower.

Q3. Do the CDCs need to document to SBA the costs associated with the CDC Closing Fee?

A3. It is recommended that CDCs document these costs, but it is not required.

13. WHAT ARE INELIGIBLE COSTS FOR 504 LOANS?

.120.884 Ineligible costs for 504 loans.

Costs not directly attributable and necessary for the Project may not be paid with proceeds of the 504 loan. These include, but are not limited to, the following:
(a) Debt refinancing (other than interim financing).
(b) Third-Party Loan fees (commitment, broker, finders, origination, processing fees of permanent financing).
(c) Ancillary business expenses, such as:
(1) Working capital;
(2) Counseling or management services fees;
(3) Incorporation/organization costs;
(4) Franchise fees; and
(5) Advertising.
(d) Fixed-asset Project components, such as:
(1) Short-term equipment, furniture, and furnishings (unless essential to and a minor portion of the Project);
(2) Automobiles, trucks, and airplanes; and
(3) Construction equipment (except for heavy duty construction equipment integral to a business' operations and meeting the IRS definition of capital equipment).

Q. Why are automobiles, trucks and airplanes ineligible?

A. They are easily movable. However, boats which constitute the project may be eligible. For example, SBA has financed a ferry boat for commuters that connected two communities in Alaska.

CHAPTER 12. INTERIM FINANCING

1. WHAT IS INTERIM FINANCING?

Interim financing is any disbursement of funds (other than the borrower's contribution) to finance eligible project costs after the loan is approved by SBA but before the debenture is sold.

2. SOURCES OF INTERIM FINANCING

.120.890 Source of interim financing.

A Project may use interim financing for all Project costs except the Borrower's contribution. Any source (including a CDC) may supply interim financing provided:
(a) The financing is not derived from any SBA program, directly or indirectly;
(b) The terms and conditions of the financing are acceptable to SBA;
(c) The source is not the Borrower or an Associate of the Borrower; and
(d) The source has the experience and qualifications to monitor properly all Project construction and progress payments. (If the source lacks such experience or qualifications, SBA may require the interim loan to be managed by a third party such as a bank or professional construction manager.)

a. Who Can Be An Interim Lender?

Interim financing can come from any source provided the interim lender is not an associate of the small business or the small business's associates, since there would be an appearance of a conflict of interest.

b. How is "Associate" Defined?

SBA regulations, 13 CFR 120.10(2) defines an associate of a small business as:

(i) An officer, director, owner of more than 20 percent of the equity, or key employee of the small business;
(ii) Any entity in which one or more individuals referred to in paragraphs (2)(i) of this definition owns or controls at least 20 percent; and
(iii) Any individual or entity in control of or controlled by the small business (except a Small Business Investment Company ("SBIC") licensed by SBA).

c. Could a Relative of the Owner be an Interim Lender?

Yes. Since a relative is not specifically defined as an "associate," a relative could be an interim lender if he or she fits all the other qualifications of an interim lender.

d. Must the Interim Lender Have Any Special Experience?

On construction projects, the interim lender must have the experience or qualifications to properly monitor construction and/or progress payments. If the provider of the interim funds does not have the expertise, the SBA field office can and should require that interim loan proceeds be managed by an independent third-party such as a bank with experience in construction lending or a professional construction manager.

e. Can the CDC be the Interim Lender?

Yes. The interim financing can come from a CDC if the terms and conditions are acceptable to SBA. Restrictions on the charges a CDC may collect do not apply to the interim financing.

When the CDC is the interim lender, mortgages must be recorded prior to beginning construction. Inspections should be made by a qualified engineer, appraiser, or other party satisfactory to SBA prior to all progress disbursements. When loan funds will be used to improve buildings on leased land, assignment of the lease should be obtained.

On all loans where the CDC is the interim lender, the following conditions must be included in the loan authorization unless specifically waived by SBA field counsel, either in the loan report or by separate memorandum to the file:

(1) The small business must furnish a firm construction contract to the CDC from an acceptable contractor at a specified price, including a provision that no material changes are to be made without the prior written consent of the CDC;

(2) The contractor must furnish builder's risk and workman's compensation insurance;

(3) One complete set of plans and specifications of the proposed construction must be submitted to the CDC;

(4) Where the CDC or the small business is to inject funds into the construction project, these funds must be used prior to the disbursement of the interim financing; and

(5) The CDC must make and document periodic inspections of construction.

f. Is "Do-It-Yourself" Construction Allowed?

"Do-it-yourself" construction and/or installation of machinery and equipment, or situations where the applicant acts as its own contractor have proved to be generally unsatisfactory and can cause problems with lien waivers and mechanics liens, causing potential losses to the Agency.

However, if the CDC can make a strong case to SBA that:

(1) The contractor is experienced in the needed construction; and

(2) The cost is the same as, or less than, what an unaffiliated contractor would charge, then it may be permitted.

g. What Other Restrictions Regarding Interim Lending Are There?

(1) Interim financing cannot be derived, directly or indirectly, from any SBA program.

(2) Progress payments from the debenture cannot be made. However, a portion of the debenture proceeds may be put into an escrow account to complete a minor portion of the total project. Please refer to 13 CFR 120.961 for details.

h. What is an Example of Interim Financing of Eligible Project Costs?

Expenses Incurred Prior to the 504 Application:

Purchase of Land (Principal portion of short-term financing)		180,000
Equity in Land		20,000
Purchase of M & E (Within 9 months of application)		100,000
Cost estimates submitted at time of application:		
Construction of Building		600,000
Total Project Costs		900,000
Permanent Financing Structure:		
First Mortgage Lender	50%	450,000
504 Net Proceeds	40%	360,000
Borrower Equity	10%	90,000
Total Financing	100%	900,000

Q. How much would the interim loan be?

A: $810,000. It will have to take out all the eligible pre-application costs other than the required equity in the permanent financing of $90,000. The borrower cannot be reimbursed directly from the net debenture proceeds.

i. Is the Interim Lender Guaranteed Payment From the Debenture When the Project is Finished?

No. The authorization will include a statement that the interim lender must certify that "the interim loan has been disbursed in reasonable compliance with this Authorization." The CDC must provide to both borrowers and lenders a copy of the executed authorization prior to any interim disbursement.

j. Is SBA Form 601 or Bonding Required by SBA for the Construction?

No. The debenture financing is take-out financing. The interim lender is taking on all of the risk associated with the construction period. SBA's guaranty does not cover the construction period. It goes into effect only after the project is completed, the permanent financing loans are closed, and the debenture is sold.

3. CERTIFICATIONS REQUIRED TO CLOSE THE DEBENTURE

a. Certification of Disbursement and Completion

.120.891 Certifications of disbursement and completion.
Before the Debenture is issued, the interim lender must certify the amount disbursed. The CDC must certify that the Project was completed in accordance with the final plans and specifications (except as provided in Sec. 120.961).

b. Certification of "No Adverse Change"

.120.892 Certifications of no adverse change.

Following completion of the Project, the following certifications must be made before the 504 loan closing: (a) The interim lender must certify to the CDC that it has no knowledge of any unremedied substantial adverse change in the condition of the small business since the application to the interim lender; (b) The Borrower (or Operating Company) must certify to the CDC that there has been no unremedied substantial adverse change in its financial condition or its ability to repay the 504 loan since the date of application, and must furnish interim financial statements, current within 90 days of closing; and (c) The CDC must issue an opinion to the best of its knowledge that there has been no unremedied substantial adverse change in the Borrower's (or Operating Company's) ability to repay the 504 loan since its submission of the loan application to SBA.

The CDC's opinion to SBA regarding "no adverse change" must be based on all significant changes in the condition of the borrower, financial, or otherwise.

Examples are:

(1) Deterioration of the borrower's financial condition to the extent that it would endanger the borrower's ability to meet the debt service on the project financing including the 504 loan;

(2) Fraud or misrepresentation by the borrower in the loan application and financial exhibits

submitted to SBA;

(3) A filing under the Bankruptcy Code by or against the borrower;

(4) Assignment of the small business's assets for the benefit of its creditors;

(5) Receivership of the small business imposed by a third-party creditor;

(6) Forfeiture of the small business's corporate charter; and

(7) Discontinuance of the business.

CDCs review current financial statements (no older than 90 days from the date of the 504 loan closing) to make this certification.

In addition, for non-ALP CDCs only, the SBA Finance Division must review the financial statements that the CDC reviewed to determine that the financial condition of the borrower has not experienced substantial, unremedied adverse change since the loan was approved. If SBA disagrees with the CDC's determination of "no adverse change," the debenture will not close until SBA has been satisfied that any adverse change has been remedied.

Q. What may the CDC rely upon for certification that the project was completed in accordance with the final plans and specifications?

A. The CDC may rely upon a certification from a qualified construction or interim lender. It may also rely upon an architect's or general contractor's certificate of completion to satisfy this provision of the regulations.

4. WHEN INTERIM FINANCING IS NOT REQUIRED

When a project is to acquire an existing facility, interim financing will not be required if the following exists:

a. The borrower deposits 10 percent of the total project cost in an escrow account with a designated agent. The borrower's equity contribution may be used as the escrow if SBA secures a lien against it. If SBA cannot secure a lien, the borrower must deposit an additional 10 percent in cash or an irrevocable letter of credit as the escrow. (This is to cover the prepayment penalty risk.) The escrow agreement should specify when and how the escrow is to be dissolved.

b. The borrower agrees in writing to the following:

(1) The deposit will be used to make up any deficiency in the escrow account due to costs associated with the debenture sale; and

(2) The borrower will pay all costs of prepaying the debenture should a lien position as required by the loan authorization not be perfected in a reasonable time (not to exceed 5 months) after disbursement of debenture proceeds. These costs include:

(a) Costs associated with the debenture sale including the CDC fee, CSA fee, CDC attorney fee/closing costs, SBA guaranty fee, funding fee, and underwriters fee.

(b) The cost of prepaying a debenture including the prepayment premium and 6 months worth of interest on the original debenture amount.

c. The SBA field counsel determines that the lien and title positions required by the authorization will exist after closing.

CHAPTER 13. THE SOURCES OF PROJECT FINANCING

1. SOURCES OF PERMANENT FINANCING

.120.900 What are the sources of permanent financing?

**Permanent financing for each Project must come from three sources:
The Borrower's contribution, Third-Party Loans, and the 504 loan.
Typically, the Borrower contributes 10 percent of the permanent financing, Third-Party Loans 50 percent and the 504 loan 40 percent.**

In 504 projects, a private sector lender (third party lender) makes a separate secured loan equal to a certain percentage of the total project cost (usually 50 percent). This is usually secured by a senior lien on project assets acquired with the financing. (This is not an SBA-guaranteed loan.) The 504 debenture, which is fully guaranteed by SBA, usually represents 40 percent of the project cost and is typically secured by a junior lien position on project assets. The borrower's contribution (at least 10 percent) is often cash from personal or business resources or assets purchased with the borrower's cash specifically for the project. The borrower may borrow these funds.

a. General Rules to Determine if a Project Financing Structure Qualifies.

Project funding can be quite flexible and sometimes complicated, depending on how many participants there are. The CDCs are urged to discuss unusual combinations with the district office before a loan guaranty request is submitted. Generally, if the project sources meet the following guidelines, it would qualify as an acceptable structure:

(1) Third party financing must be equal to or greater than the net debenture.

(2) The net debenture does not exceed 40 percent of the total cost of the project.

(3) The borrower's injection must be at least 10 percent of the total project cost and may be more, as required by statute or for credit reasons determined by the CDC or the SBA finance division (see chapter 13, paragraph 1.c. of this subpart for instances when it must be more); and

(4) No more than 50 percent of the project costs can come either directly or indirectly from Federal sources. [Reference 13 CFR .120.930(a).]

b. The Third Party Lender is not Always in a Senior Lien Position.

When the third party lender is the property seller, the 504 loan must be in a senior lien position except under certain circumstances. (Refer to chapter 13, paragraph 3.h. in this subpart for the exception to this.) When the third party lending source is Federal tax-exempt financing (e.g., industrial revenue bond financing or industrial development bond financing), the 504 loan cannot be in a subordinate lien position to the tax-exempt financing. [Reference 13 CFR .120.923(b).]

The 504 program does not require that the third party lender be in a senior lien position, but generally since the third party lender does not have an SBA guaranty on its loan, a senior lien position in the project collateral offsets the lending risk.

(Note: Many of the examples in subpart H do not use 50/40/10 financing since many 504 projects require a greater equity injection or a larger first mortgage. To always use 50/40/10 in the examples creates the incorrect impression for those not familiar with the program that those percentages are the only financing structure available. Other than minimums and maximums, the project and the credit dictate the structure of the financing.)

c. Changes to the Sources of Project Financing as of October 1, 1996.

In general, in an eligible 504 project, the borrower must contribute at least 10 percent of the eligible project costs. As has been shown throughout this SOP, prudent credit judgment through loan analysis could require much more than 10 percent.

On September 28, 1996, Public Law 104-208 was passed which mandated an increase in the minimum required borrower injection from 10 percent to 15 or 20 percent if the business is determined to be "new" or if the 504 project is determined to be a "limited or single-purpose building or structure." This change recognizes the higher risks inherent in these types of 504 projects and seeks to mitigate that risk when approving this type of loan. (see .120.910)

(1) Guidelines for defining 'new business" in a 504 project:

When a 504 project is for a "new" business, the legislation requires the small business (or its owners, stockholders, or affiliates) to provide at least 15 percent of the eligible project costs. Also, the maximum percentage that the 504 loan will finance, in these cases, is 35 percent. The additional 5 percent injection by the borrower can not be used to reduce the exposure of any lender other than SBA.

The basic definition is: If the small business has been in operation for a period of 2 years or less, it is considered to be new.

Q1. What guidelines should be used when there is an existing business which believes that the 504 project should be considered an extension of its existing operations and, therefore, not "new?"

A1. In such cases, consider the following.

(a) Is the clientele for the 504 project similar to that of the existing business?

(b) Are the market demographics for the 504 project similar to that of the existing business?

(c) Is the day-to-day management the same for the existing business and the 504 project?

(d) Is the product or service the same or similar as for the existing business?

Q2. How is the length of time in business determined?

A2. The date the business had its first sale should be used as the date that it started. You should require a statement from the business regarding this issue only when there is a question as to how close the business comes to the 2 year cut-off period. Do not require it routinely.

Q3. What if you determine that the applicant business is new but it has an existing business affiliate that is willing to guaranty the loan? Does this offset the legislative requirement?

A3. A guaranty may mitigate the risk of the 504 project but does not offset the fact that the 504 project is for a "new" business and the additional 5 percent injection is required.

Q4. If the borrower for the 504 project is a new division (separately incorporated) of an existing business in existence for 5 years, is this situation considered "new" or "existing"?

A4. If the new division is for a product to the same clientele as the existing business, the demographics are the same, the management is the same, the product is the same or a similar line or logical extension of the existing product line, and it is the practice of the business to separately incorporate its different divisions, then a reasonable case could be made that the borrower is an extension of an existing business and, therefore, not "new."

Q5. What if the borrower is an EPC?

A5. In these cases, the operating concern (OC) determines whether this is a new or existing business situation. For example, if the OC is a manufacturer that has been in business for ten years, then it is an existing business, even if the EPC was formed within the last 2 years. If the OC is a new manufacturer, the situation involves a new business.

Q6. Is a "change of ownership" considered a "new" business?

A6. If a "change of ownership" results in new day-to-day management, new clientele, new demographics, or a different product line, then it would be considered "new."

Q7. If a business had been a proprietorship for 3 years, and then incorporated one year before the 504 project application was submitted, but management and the other enumerated factors remain the same, is this a "new" business?

A7. This would be considered an existing business.

Q8. The proposed borrower is a new budget hotel owned by a family who owns and operates a similar budget hotel at the other end of town. The demographics are similar. The new hotel will be managed by the eldest daughter who had co-managed the original hotel. Is this "new" or "existing"?

A8. This would be considered an "existing" business. However, if the new hotel was a different type designed to attract a different clientele, such as a luxury hotel versus the original which was a budget hotel, then this could be considered "new."

(2) Guidelines to defining a "single purpose building or structure" in a 504 project.

Under current legislation, if the project being financed involves a limited or single-purpose building or structure, the small business concern (or its owners, stockholders, or affiliates) must provide at least 15 percent of the eligible project costs. As in the case of a new business, the benefit of the added injection must go to reduce the 504 portion of the financing. In this case, the 504 loan could provide no more than 35 percent of the total eligible project costs.

In defining "limited or single-purpose building or structure," the Agency will use the definition for "special-purpose property" included in The Dictionary of Real Estate Appraisal published by the American Institute of Real Estate Appraisers. A special-use or special-purpose property is a property that is appropriate for one use or for a limited use: a building that cannot be converted to another use without a large capital investment. It is one that is designed, equipped, and used for a particular type of business or operation and is not easily adaptable to some other use because of the peculiar nature of the improvements. These properties usually have limited conversion potential.

The legislation tries to address the fact that in a liquidation situation, the forced sale of special-use or special-purpose collateral has a reduced recovery.

The fact that a special-use property is in a desirable location does not necessarily mitigate the fact that it is still a special-use property and, therefore, likely to suffer a reduced recovery in the event of a forced sale.

Examples of special-use or special-purpose properties include: churches, synagogues, theaters, sports arenas, schools, dormitories, cold storage plants, tennis clubs, golf courses, marinas, gasoline service stations, automatic car wash properties, hospitals, medical centers, nursing homes, funeral homes, cemeteries, historic properties, sanitary landfills, museums, clubhouses, and some recreational properties. Generally, SBA considers hotels or motels to be included as a special-use or special-purpose property.

If the application from the CDC does not identify the asset acquired with project proceeds as a special-use or special-purpose asset but the SBA Financing Division has concerns that it is such an asset, the SBA approving official must obtain a certification from the appraiser stating that the property is not considered to be a special-use or special-purpose property. If the appraiser certifies that the structure is not a special-purpose property as defined in the Appraisal Institute's Dictionary of Real Estate Appraisal, the provisions of the new legislation will not apply. If required, the appraiser's certification must be received prior to any loan approval. The requirement for a certification must not be included in the loan authorization as a condition of disbursement.

(3) Projects Classified as Both New and Special

If an applicant is a new business **and** the loan proceeds will be used to construct or acquire a special purpose or use property, the small business concern (or its owners, stockholders, or affiliates) must provide at least 20 percent of the eligible project costs. The 20 percent injection reduces the percentage of the eligible project costs covered by the 504 loan. The maximum percentage of the project financed by the 504 loan in these cases is 30 percent. The additional injection by the borrower can not be used to reduce the exposure of other lenders in the project.

(4) Changes in the Level of Participation for Third-Party Lienholders

When a 504 loan is to a new business or for the acquisition/construction of a limited or single purpose building, a minimum of 50 percent of the total eligible program costs under the 504 program **must** come from:

(a) State or local governments;

(b) Banks or other financial institutions; or

(c) Foundations or other not-for-profit institutions.

Q1. Does this mean that the third party lienholder(s) cannot have less than 50 percent of the project in these two instances?

A1. Correct, once the borrower is required to make an additional contribution because the project involves a start up company or the project collateral will be a special purpose structure, the third party lenders portion can not be less than 50 percent. This regulation was made so the SBA and CDC portion of the overall project financing would receive all the benefit of the additional required contribution.

Q2. Is there any exception?

A2. Yes, under the following circumstances. If the applicant makes a contribution that is above and beyond the required amount, there exists an excess amount. The above and beyond contribution can be used to either reduce the size of the debenture or reduce the third party lender's share, providing the third party lender's share is never less than the SBA/CDC's share.

Example: The project is to assist a new restaurant (new business) acquire a permanent structure. It has been determined that the new building will not be a limited or special purpose asset (general purpose). Therefore, the legislatively mandated contribution is 5 percent over the standard contribution. The project is for $1 million. The legislation requires the following breakdown:

Step 1: Borrower must contribute 15 percent ($150,000)
Step 2: Third-party lender must participate at least 50 percent ($500,000)
Step 3: SBA/CDC finances the difference of 35 percent ($350,000)

However, if the borrower wants to contribute 25 percent towards the project or $250,000, SBA will permit the third party lender's loan to be reduced by the amount of equity that is above and beyond ($100,000) of the legislatively required ($150,000), as long as the third party financing is not less than the CDC/SBA financing.
In this case the applicant would put in $250,000. The lender's share is $400,000, and the SBA/CDC portion is $350,000. Since the SBA/CDC portion does not exceed the third party lender share, this financing would qualify.

Q3. What about cost overruns after the loan is approved but prior to funding?

A3. The authorization should continue to state that the borrower is responsible for any cost overruns. If the borrower requests that the cost overruns be financed, and the CDC and SBA agree, the 50 percent requirement for the

Third Party lienholder will apply as well as the 15 or 20 percent equity requirement unless the borrower's contribution exceeds the minimum legislative requirement. In that case, the option explained in Q&A number 2 above applies.

(5) Additional Restrictions

Any project cost not eligible for 504 project financing, such as tenant improvements, must be covered through non-SBA means, and any lien securing these ineligible costs **must** be junior to the 504 loan.

Q. Does this mean that there cannot be a 7(a) companion loan to this type of borrower (new business or single-purpose building)?

A. A borrower can receive a 7(a) companion loan at the time of project financing for only non-project-related needs such as working capital or for short-term fixed assets.

(6) Interpretations of Public Law 104-208

Any requests for guidance and clarification pertaining to Public Law 104-208 must be case specific. Requests must be submitted in writing and contain an analysis and recommendation by the district office and then must be forwarded to the Director, Office of Loan Programs, for a final determination.

d. Examples of 504 Project Financing

The following are some examples of projects that are funded in accordance with the spirit and policies of the program:

Example 1 (Typical Project)

$ 500,000 (50%) - Third Party Lender (1st lien)
400,000 (40%) - Net Debenture (2nd lien)
100,000 (10%) - Borrower Equity
$1,000,000 (100%)

Example 2 (Federal Sources = 35 percent which is under the 50 percent maximum and is, therefore, eligible)

$ 500,000 (50%) - Third Party Lender (1st lien)
250,000 (25%) - Net Debenture (2nd lien)
100,000 (10%) - CDBG funds (federal source) (3rd lien)
150,000 (15%) - Small business Injection
$1,000,000 (100%)

Example 3 (Third Party and Net Debenture can be the same when equity is 20 percent or more.)

$ 400,000 (40%) - Third Party Lender (1st lien)
400,000 (40%) - Net Debenture (2nd lien)
200,000 (20%) - Small Business Injection
$1,000,000 (100%)

Example 4 (SBA is in 1st lien position when seller of property is the private-sector lending source.)

$ 400,000 (40%) - Net Debenture (1st lien)
500,000 (50%) - 3rd-Party (seller take-back financing) 2nd lien
100,000 (10%) - Small Business Injection
$1,000,000 (100%)

Example 5 (Project is a new business constructing a limited use building including tenant improvements for a tenant under a 3-year lease.)

$ 500,000 (50%) - Third Party Lender (1st lien)
300,000 (30%) - Net Debenture (2nd lien)
200,000 (20%) - Small Business required injection
$1,000,000 (100%) Eligible Project Costs

$ 50,000 tenant improvements financed by the small business itself.

2. BORROWER'S CONTRIBUTION

.120.910 How much must the borrower contribute?

(a) The Borrower must contribute to the Project cash (or property acceptable to SBA obtained with the cash) or land (that is part of the Project Property), in an amount equal to the following percentage of the Project cost, excluding administrative costs:

(1) At least 15 percent, if the Borrower (or Operating Company if the Borrower is an Eligible Passive Company) has operated for two years or less;

(2) At least 15 percent, if the Project involves the acquisition, construction, conversion, or expansion of a limited or single purpose building or structure;

(3) At least 20 percent, if the Project involves conditions described in paragraph (a)(1) and (2) of this section; or

(4) At least 10 percent, in all other circumstances.

(b) The source of the contribution may be a CDC or any other source except an SBA business loan program (see Sec. 120.913 for SBIC exception).

A 504 borrower must contribute at least 10 percent of the eligible project costs; in the projects involving a new business or special purpose property, 15 percent; and in the projects involving both a new business or special purpose property, 20 percent. The borrower's injection may be in the form of either equity or borrowed funds (with terms acceptable to SBA). The adequacy of the borrower's equity position is, as always, a credit matter.

The requirements for a borrower's contribution when the 504 project involves either a special or limited purpose building or the financing of a start up business are discussed in paragraph 1c.(1) and (2) of this chapter.

a. Eligible Land Contribution

.120.911 Land contributions.

The Borrower's contribution may be land (including buildings, structures and other site improvements which will be part of the Project Property) previously acquired by the Borrower or the CDC.

This is a significant change. Regulations in effect prior to March 1, 1996, allowed only equity in the project's land to be contributed as part or all of the borrower's equity. The new regulations additionally allows any equity in improvements on the land previously acquired that are going to be used in the project to be used towards the equity requirement of the project. How does this work?

Example 1. Land and an existing building were acquired for $400,000 ($100,000 cash and a $300,000 loan) 2 years ago. The value of the land is $200,000. The value of the building is $200,000. The borrower wants to renovate and expand the building. Cost of construction to renovate and expand the building will be $500,000.

(In order that the example does not become too complicated, we will assume that the borrower's required injection is 10 percent of the project.)

Q1. What is the allowable equity in the land and building that can be contributed into the project?

A1. The previous regulations allowed only the share of the equity attributable to the land to be used in the project as project equity - in this case, $50,000. The new regulations permit all the equity in the land and some or all of the equity in the improvements, determined by the appraised value of the contributed improvements. In this case, the allowable equity towards the project would be $100,000 because all of the existing improvements are being used in the project.

Q2. What are the eligible project costs?

A2. It depends on whether the financing associated with the acquisition of the land is short or long-term in nature.

(1) If the existing financing is determined to be long-term and not eligible to be refinanced by the 504 project proceeds, the project is the following.

Cost to renovate and expand the building is $500,000
The Project is $500,000 divided by .90 or $555,600.

The existing equity in the land and building of $100,000 is more than adequate to cover the required equity of $55,600 in the project.

(2) If the land and building were acquired more than 9 months before the application was received by SBA, the cost to acquire the land and building could be considered "interim financing" and be an eligible project cost.

Cost to renovate and expand the building is $500,000.

The financing that is considered interim or bridge financing is $400,000.

The Project is $900,000.

The required borrower's contribution is 10 percent or $90,000. Since the borrower already has $100,000 in the project, the $300,000 mortgage and the $500,000 new costs could be completely financed by the bank/SBA 504 financing.

Example 2. The project is to construct an addition costing $300,000 onto a building presently in use by the business. The existing building needs no major renovation. The existing land and building has $100,000 equity and a $400,000 mortgage fully amortized over 30 years with 20 years left.

Q1. What is the eligible equity in the existing land and building towards the project?

A1. The eligible equity is $100,000.

Q2. The credit analysis determines that the applicant needs to contribute 15 percent equity towards the project to keep the overall ratios such as proforma debt-to-worth of the business in an acceptable range. How do the project financing elements break down?

A2. Since the applicant is allowed to contribute the existing equity in the land and building as equity in the project, but the applicant still needs cash of $300,000 to build the addition, the math is as follows.

Step 1.	Divide $300,000 by .85 (100 percent minus the percentage equity) and rounded to the next highest hundred for simplicity	$353,000

Step 2. Determine the percentages of the debenture and the first mortgage. In this case, the applicant is an existing business and the structure is not a single purpose building. Therefore, the third party lender can have a participation of less than 50 percent. In this case, the third party lender is financing 45 percent of the project.

$353,000 times .45 equals 158,850

Step 3. The debenture will finance 40 percent of the project.

$353,000 times .40 equals 141,200

Step 4. The equity contribution is 15 percent.

$353,000 times .15 equals 52,950

(Note: The applicant had up to $100,000 eligible equity to contribute. $52,950 does not exceed $100,000 so the applicant does not have to contribute additional cash.)

Total Project $353,000

Q3. Is the existing mortgage on the building an eligible project cost?

A3. No, it is long term debt. However, the third party lender may consider combining the existing mortgage with the mortgage on the addition. It would be a credit decision, not an eligibility decision, on the part of SBA as to whether it would subordinate its lien position to the larger third party loan. However, since the existing mortgage is already in place, the collateral coverage would still be the same and normally allowable.

Example 3. The small business owns and occupies land and an existing building. The project is to construct an additional building on the land without subdividing the land. The equity in the land is $100,000 and the equity in the building is $100,000. There is a mortgage on the property of $400,000.

Q1. What is the eligible equity that may be contributed to the project?

A1. The equity in the land and existing building may be contributed as equity towards the project since the new building is an improvement to the same property. In this case it would be $200,000.

Q2. What if there is a building on the property that is not used by the business's operations? Can equity in it be used as equity towards the project?

A2. No, it would not be.

Example 4. The small business owns and occupies land and an existing building. Equity in the land and existing building is $200,000. The project is to build a new building on land located at another location.

Q. Can the equity in the land and existing building be used towards the equity requirement in the proposed project?

A. No. The land and existing building are not part of the project even if SBA takes a lien against the property as additional collateral. This is true for both residential and business property taken as additional collateral.

b. Machinery and Equipment Project

On projects involving new machinery and equipment, the allowance given as "trade in" on the old machinery and equipment may be used as part of the equity injection. You must be satisfied that the allowance is not inflated; this must be covered in the CDC's report and analysis.

c. When the Borrower's Contribution is Borrowed

.120.912 Borrowed contributions.
The Borrower may borrow its cash contribution from the CDC or a third party. If any of the contribution is borrowed, the interest rate must be reasonable. If the loan is secured by any of the Project assets, the loan must be subordinate to the liens securing the 504 Loan, and the loan may not be repaid at a faster rate than the 504 Loan unless SBA gives prior written approval. A third party lender may not receive voting rights, stock options, or any other actual or potential voting interest in the small business.

d. The Requirements for Evidence of the Borrower's Contribution

All sources of funds must be listed on the "Use of Proceeds" Form, SBA Form 1429, a closing document. The supporting documentation must be retained by the CDC. It does not have to be submitted to SBA.

The following are some documents a CDC would retain as evidence of contribution:

(1) Copies of all loan documents evidencing the source and terms of any loans;

(2) Copies of paid receipts, canceled checks or other evidence satisfactory to SBA;

(3) A bank's settlement statement evidencing the purchase of the property; and

(4) The "pay-out sheets" maintained by the interim lender.

e. When an SBIC Provides the Borrower's Contribution

.120.913 May an SBIC provide the contribution.
Subject to part 107 of this chapter, SBIC's may provide financing for all or part of the Borrower's contribution to the project. SBA shall consider SBIC funds to be derived from federal sources if the SBIC has leverage (as defined in part 107 of this chapter). If the SBIC does not have leverage, the investment will be considered to be from private funds. SBIC financing must be subordinated to the 504 loan and may not be repaid at a faster rate than the Debenture.

3. RULES COVERING THIRD PARTY LOANS

.120.920 The first lien position.

(a) Amount of Third Party Loans. A Project financing must include one or more Third Party Loans totaling at least as much as the 504 loan. However, the Third Party Loans must total at least 50 percent of the total cost of the Project if:
(1) The Borrower (or Operating Company, if the Borrower is an Eligible Passive Company) has operated for two years or less, or
(2) The Project is for the acquisition, construction, conversion or expansion of a limited or single purpose asset.
(b) Third Party Loan Collateral. Third Party Loans usually are collateralized by a first lien on the Project Property. The SBA cannot guarantee these loans.

a. Examples of Sources of Third Party Loans

Third Party financing can come from, but is not limited to:

(1) Banks and Savings banks;

(2) Pension funds;

(3) Insurance companies;

(4) Commercial lending companies;

(5) Individuals under restricted circumstances;

(6) CDCs, exclusive of Federal funds;

(7) Taxable Industrial Revenue Bonds; and

(8) Funds from Federal tax-exempt obligations issued by a State or local government. If they are not guaranteed by the Federal Government, they qualify as non-Federal funds. However, the lien position of these funds must either be subordinate to or on a parity with SBA. [Reference 13 CFR .120.923(b).]

b. Terms of Third Party Loans

.120.921 Terms of Third Party loans.

(a) Maturity. A Third Party Loan must have a term of at least 7 years when the 504 loan is for a term of 10 years and 10 years when the 504 loan is for 20 years. If there is more than one Third Party Loan, an overall loan maturity must be calculated, taking into account the maturities and amounts of each loan. If there is a balloon payment, it must be justified in the loan report and clearly identified in the Loan Authorization.

(b) Interest rates. Interest rates must be reasonable. SBA must establish and publish in the Federal Register a maximum interest rate for any Third Party Loan from commercial financial institutions. The rate shall remain in effect until changed.

(c) Other terms. The Third Party Loan must not have any early call feature or contain any demand provisions unless the loan is in default. By participating, a Third Party Loan lender waives, as to the CDC/SBA financing, any provision in its deed of trust, or mortgage, or other documents prohibiting further encumbrances or subordinate debt. In the event of default, the Third Party Lender must give the CDC and SBA written notice of default within 30 days of the event of default and at least 60 days prior to foreclosure.

(d) Future Advances. The Third Party Loan must not be open-ended. After completion of the Project, the Third Party Lender may not make future advances under the Third Party Loan except expenditures to collect amounts due the Third Party Loan notes, maintain collateral and protect the Third Party Lender's lien position on the Third Party Loan.

(e) Subordination. The Third Party Lender's lien will be subordinate to the CDC/SBA lien regarding any prepayment penalties, late fees, other default charges, and escalated interest after default due under the Third Party Loan.

(f) Escalation upon default. A Third Party Lender may not escalate the rate of interest upon default to a rate greater than the maximum rate set forth in paragraph (b) of this section. Regarding any Project that SBA approved after September 30, 1996, SBA will only pay the interest rate on the note in effect before the date of the Borrower's default.

Q1. Does the third party lender have to give notice to SBA each time the loan is in default?

A1. No. The third party lender has to give notice to SBA only when the loan is in default and the third party lender intends to act on the default.

There can be times when the borrower is in default because of non-compliance with the loan agreement, but the loan is current and the small business is healthy. In those cases, the third-party lender may not choose to accelerate its note.

Q2. What is meant by "SBA must establish and publish in the Federal Register?"

A2. SBA publishes a maximum rate for third party loans in the Federal Register. The maximum legal interest rate for a commercial loan which funds any portion of the cost of a project is the greater of 6 percent over the New York prime rate or the limitation established by the constitution or laws of a given State.

Q3. Can a third party lender have multiple loans with different maturities?

A3. Yes, as long as the weighted average is at least 10 years for 20-year debentures and 7 years for 10-year debentures.

Example

Use Of Proceeds	Third Party Loan	Percent Actual	Blended Maturity
Land & Building	$ 800,000	0.80 X 15	12.00
M & E	$ 200,000	0.20 X 5	1.00
	$1,000,000	1.00	13.00

Q4. When the third party loan is for ten years and is closed a few months prior to the debenture's closing resulting in its maturing slightly before the 10-year minimum, does the third party loan have to be restructured?

A4. No, that is not necessary.

Q5. Were there any changes to third party financing because of Public Law 104-208 other than what was detailed in paragraph 1 of this chapter?

A5. Yes. For 504 loans approved after September 30, 1996, if a 504 borrower defaults on a third party loan from a State or local government, bank or other financial institution, or foundation or other non-profit institution, SBA's lien is not subject to any prepayment penalties, late fees, or default interest rates (interest rates that are higher than the interest rate on the note prior to the date of default).

c. When the CDC Actually Owns the Project Property

If the CDC holds title to the Project Property and leases it to the small business, the Third Party loan will be made to the CDC.

d. Balloon Payment Terms in Third Party Financing

Balloon payments are allowed in third party financing with SBA's concurrence when the CDC is able to make a clear case to SBA to justify them. The term of the balloon payment provision on third-party financing must be at least 10 years.

e. Third Party Lender Servicing Capability

If the third party lender lacks the experience or qualifications to service a loan properly, you can require that the lender retain an independent third party, such as the note collection department of a bank or savings and loan association, to service the loan.

f. Notification Requirements Regarding Defaults and Foreclosures. CDCs must provide at closing a written agreement with the third party lender providing for a 30-day notification to the CDC and SBA of delinquency and 60-day prior notice of a foreclosure sale. It may be included as a part of another document.

g. Pre-existing Debt on the Project Property

.120.922 Pre-existing debt on the Project Property.
In addition to its share of Project cost, a Third-Party Loan may include consolidation of existing debt on the Project Property. The consolidation must not improve the lien position of the Lender on the pre-existing debt, unless the debt is a previous Third-Party Loan.

Pre-existing debt is not an eligible project cost. Pre-existing debt questions usually involve a credit decision, and sometimes an eligibility decision, on SBA's part. The following are common examples that involve a credit, not eligibility, decision on the part of the CDC and SBA:

Example 1. If a lender has an existing mortgage on the property, and the 504 project consists of improvements to the property (an addition, renovations, expansion, etc.), the lien on the lender's portion of the 504 project cost can be either a second behind its existing mortgage, or the lender can consolidate the two loans, which would result in a first lien position consisting of its existing balance on the original loan plus its financing in the 504 project.

Example 2. If there is an existing mortgage on the property, and the 504 project consists of improvements to the property, and a new lender wants to do the financing in connection with a 504 project, the new lender can refinance and consolidate the existing mortgage with the amount of its financing in the 504 project.

Example 3. If there is 504 financing on a project, and the borrower wishes to do another, "new" 504 project consisting of improvements to the property, the same Third Party lender is permitted to have a first mortgage from the first 504 project and a second mortgage from the "new" 504 financing. This would require SBA to subordinate its previous lien position on the previous project which is a credit, not an eligibility, decision.

Example 4. If the project is an addition to an existing building, and there are existing mortgages on the building, SBA's lien position could be third or more on the entire building. Is that eligible? Yes.

h. Policies on Subordination

.120.923 What are the policies on subordination?
(a) Financing provided by the seller of Project Property must be subordinate to the 504 loan. SBA may waive the subordination requirement if the property is classified as ``other real estate owned'' by a national bank or other Federally regulated lender and SBA considers the property to be of sufficient value to support the 504 loan.

(b) A Borrower is eligible for a 504 loan even if part of the Project financing is tax-exempt. SBA's lien position must not be subordinate to loans made from the proceeds of the tax-exempt obligation.

If there is seller financing on the real estate being acquired, SBA must have a senior lien position on project assets except in the following circumstances:

(1) The borrower assumes an existing note as part of the total financing;

(2) The FDIC has carry-back financing; or

(3) The property is classified as "Other Real Estate Owned," commonly known as OREO, by a national bank, a State-chartered, or other Federally regulated lender.

In these cases, SBA may take a junior lien position if the financing reflects the actual value of the assets to be acquired and not an inflated price.

The loan application must include a market appraisal performed by an independent appraiser who does not have a financial interest in the project. This consideration is especially important if the seller is a financial institution which had previously acquired the property through a foreclosure sale.

SBA to ensure that appraisals are accurate, current and independent.

Q. Why is FDIC seller financing treated differently?

A. The FDIC controls a large inventory of real estate on which they are willing to carry back financing. The purchase of this property can be advantageous to small businesses. FDIC financing is substantially similar to Federal funds and does not pose conflict of interest possibilities that other seller financing may. Therefore, SBA's lien position may be subordinated to FDIC financing of property in its inventory or under its control. This includes loans sold to financial institutions where the institution has a right to sell the loan back to the FDIC.

.120.924 Prepayment of subordinate financing.
The Borrower must not prepay any Project financing subordinate to the 504 loan without SBA's prior written consent.

i. Third Party Lenders and Preferences

.120.925 Preferences.
No Third Party Lender shall establish a Preference.

j. CDC Referral Fees for Locating Third Party Financing

.120.926 Referral fee.
The CDC may receive a referral fee from the Third Party Lender if the CDC secured the lender for the Borrower under a written contract. The Borrower cannot pay this fee. If a CDC charges a referral fee, the CDC will be construed as a Referral Agent under part 103 of this chapter.

The CDCs may be compensated for expenses incurred in obtaining non-Federal, third party financing. This fee cannot exceed 1.5 percent of the third party financing obtained for the small business in a 504 project. The following rules apply:

(1) There must be a contract in place for the services between the CDC and the party paying the referral fee;

(2) The fees do not have to be based on time and charges;

(3) The fee may not be funded out of the debenture proceeds; and

(4) If the CDC provides the borrower's injection, the CDC cannot charge this fee on its own loan.

4. RULES COVERING THE 504 LOANS AND DEBENTURES

a. Amount

.120.930 Amount.
(a) Generally, a 504 loan may not exceed 40 percent of total Project cost plus 100 percent of eligible administrative costs. For good cause shown, SBA may authorize an increase in the percentage of Project costs covered up to 50 percent. No more than 50 percent of eligible Project costs can be from Federal sources, whether received directly or indirectly through an intermediary.
(b) Generally, the minimum 504 loan must be $50,000, although, upon good cause shown, SBA may permit a 504 loan as small as $25,000. The amount of the Debenture must equal the amount of the 504 Loan plus administrative costs.
(c) Upon completion of the Project, the Debenture amount will be reduced by the amount that the unused contingency reserve exceeds 2 percent of the anticipated Debenture.

Q1. What is the maximum percentage of the project from Federal sources?

A1. No more than 50 percent can come from Federal sources. All Federal loans, grants, and loan guarantees from a variety of Federal agencies count towards the 50 percent rule.

(Note: The 7(a) loan program is not an eligible source of 504 project financing. However, it is eligible as a companion loan for shorter term financing needs.)

Revolving loan funds (which many CDCs have) that were capitalized with Federal funds are considered Federal if they are defined as such by the granting agency. Two common examples are the Urban Development Action Grant (UDAG) Program and the Community Development Block Grant (CDBG) Program, both of which are Federal economic development programs. Local governments are able to use the funds from repayment of these loans as an endowment which capitalizes their municipal revolving and development loan funds. Once the initial UDAG loan is repaid, the revolving fund that results is not considered a source of Federal funds; however, once the initial CDBG funds are repaid, the revolving fund that results continues to be considered a source of Federal funds and, therefore, counts toward the 50 percent limitation.

Example:

Source of Funds	Funds	Perc. of Project
State EDA	500,000	16.67 percent
SBA 504	600,000	20.00
Other Federal	600,000	20.00
Municipal	200,000	6.66
Bank	600,000	20.00
Borrower	500,000	16.67

Is this eligible? Yes. Only 40 percent of the project's financing is coming from Federal sources. In this case, the state EDA fund and the municipal fund were not derived from Federal sources.

What would be the lien order for these loans? The bank could get a first lien. The State, municipality, other Federal funds, and SBA could have a shared second lien.

Q2. Is there a limit to the amount of the senior liens in front of SBA's lien?

A2. No, there is no limit. This program was designed to accommodate leveraged financing which would maximize participation from non-SBA guaranteed lenders. However, as the senior liens increase in amount, the risk of loss to SBA in a default increases. This increased risk may be offset by a larger equity injection, additional collateral, or evidence of particularly strong earnings performance by the small business. For further clarification on this issue, refer to subpart A, chapter 2, paragraph 4.e. on "piggyback" loans.

b. 504 Lending Limits

.120.931 504 lending limits.
Borrower and its affiliates under the 504 program covered by this Part must not exceed $750,000 ($1,000,000 if one or more of the public policy goals enumerated in Sec. 120.862(b) applies to the Project).

c. Interest Rate

.120.932 Interest rate.
The interest rate of the 504 Loan and the Debenture which funds it is set by the SBA and approved by the Secretary of the Treasury.

Q. How is the interest rate on the debenture calculated?

A. The interest rate for 10 and 20 year 504 debentures is based on 5 and 10 year U.S. Treasury rates, respectively. Because the issuer is not the U.S. Treasury, investors expect a premium, more commonly known as the "spread," over the base Treasury rate. This spread is set by the market at the time of offering reflecting current market conditions.

Example of a Funding: January, 1997, Funding

	10 years	20 years
Debenture Rate	6.75%	7.15%
Note Rate *	6.84%	7.22%
Effective Rate ** (includes new fees)	8.91%	8.77%

On January 15, 1997, a total of $10,577,000 10 year debentures and $125,805,000 20 year debentures were funded. The spread over the treasury rate was .47 percent for the 10 year debentures and .63 for the 20-year debentures.

* The note rate is amortized monthly and the debenture is amortized semi-annually; therefore, the note rate has to be slightly more than the debenture rate to fully amortize over the same period of time.

** The effective rate assumes a CDC service fee of .625 percent per annum, a CSA fee of .1 percent per annum, and for loans approved after September 30, 1996, an additional .875 percent SBA guaranty fee.

d. Maturity

.120.933 Maturity.
The term of a 504 Loan and the Debenture which funds it shall be either 10 or 20 years.

Q1. Why are only 10 and 20 year maturities used?

A1. The debentures are put together into large pools and sold once a month. It is important that pools include only debentures with the same maturity. Limiting maturity options to 10 or 20 years increases the size of the pools, making the 505 certificates more "liquid," i.e. easier for investors to resell. Investors require a slightly lower interest rate in return for the knowledge that they can sell their security at any time.

Q2. If the project assets have different useful lives, what do you do?

A2. A single debenture may be used for the acquisition of land, existing building and M&E, and construction of a new building. Since the maturity of a debenture relates to the life of the asset(s) being financed, you have to calculate a weighted average of the useful life of the assets being financed to determine whether the term of the debenture should be 10 or 20 years.

The following are some examples of weighted average life debentures:

Example 1

Use of Proceeds	Project Amount	%	Life				
Purchase of land & bldg.	250,000	.50	x 20	=	10.0		
Renovation	100,000	.20	x 20	=	4.0		
M & E	150,000	.30	x 10	=	3.0		
TOTAL	500,000	1.00		=	17.0 *		

* *** Round up to a 20-year debenture**

Example 2

Use of Proceeds	Project Amount	%	Life				
Purchase of land & bldg.	100,000	.20	x 20	=	4.0		
Renovation	100,000	.20	x 20	=	4.0		
M & E	300,000	.60	x 10	=	4.2		
TOTAL	500,000	1.00		=	12.2 **		

**** Round down to a 10-year debenture**

CHAPTER 14. COLLATERAL

1. WHAT IS SBA'S 504 COLLATERAL POLICY?

.120.934 Collateral.
The CDC/SBA takes a junior lien position (usually a second lien) on the Project collateral. In rare circumstances, collateral other than the Project collateral may be accepted by SBA. Sometimes secondary collateral is required. All collateral must be insured against such hazards and risks as SBA may require, with provisions for notice to SBA and the CDC in the event of impending lapse of coverage.

The collateral policy for 504 loans was developed with an understanding of the following issues:

a. The 504 loan program was designed to finance projects that provide local economic development; and

b. The 504 debenture is generally in a junior lien position on the project collateral. That means that in a foreclosure situation, SBA will not receive any money from the project collateral until the prior lien is paid in full. In addition to the costs of acquiring the assets, the prior lien generally includes costs associated with making the loan and liquidating the assets, if necessary.

2. ADEQUACY OF COLLATERAL IN THE 504 LOAN PROGRAM

Adequacy of collateral is made on a case-by-case determination and is part of the credit evaluation of every application. Collateral requirements for 504 loans are less stringent than for 7(a) because the purpose of 504 is to foster economic development. It is expected that 504 loan recipients will provide a continuing economic development impact.

a. The project collateral is sufficient to protect the Government's interests if the applicant can satisfy all of the following factors, (listed in order of importance).

(1) Has a strong, consistent cash flow that is more than adequate to support the new debt;

(2) Has proven management;

(3) Is an existing business; and

(4) The project is a logical extension of the applicant's current operations.

If all four factors are present, no additional collateral and/or borrower's contribution is required.

b. If one or more of the above factors is not met, additional analysis must be conducted. The following eight steps are to be used to determine if additional collateral or other alternatives should be required.

(1) Look at the relative importance of the factor(s) missing and compare them to the relative strengths of the factors that are present and their ability to overcome the weakness of the missing factor(s). (Normally, for existing businesses weaknesses in factor 1 cannot be overcome by strengths in factors 2, 3, or 4.)

(2) If you determine that the relative strength of the factors present overcome the weaknesses of the factor(s) missing, again no additional collateral and/or contribution is required.

(3) If you cannot overcome the weaknesses of the missing factor(s) from an analysis of the applicant, other information may be considered to overcome the weaknesses. This includes the degree of importance of the project's impact on the local economy; the CDC's performance including default and recovery rates on its 504 loans; SBA's experience with the type of business (SIC code, 10-year history); and the equivalent franchise history if appropriate.

(4) If you still cannot overcome the weaknesses of the missing factor(s), calculate the likely recoverable value of the project collateral in a default to determine the amount of the shortfall. Then determine the availability of additional collateral and/or borrower's contribution.

CAUTION: Do not encumber assets or require additional contribution that the borrower needs to sustain ongoing operations.

(5) After determining what additional collateral and/or contribution is available, review your risk analysis and determine how much additional collateral or injection is needed to offset the risk. The additional collateral does not, in all cases, have to fully secure the loan in a default situation.

(6) If the borrower has the additional collateral and/or contribution you have determined to be necessary, you may approve the loan with a requirement for the necessary additional collateral and/or contribution.

(7) If the borrower is unwilling to pledge available collateral (and/or provide an increased contribution) which you have determined to be necessary, you must decline the loan.

(8) If after going through these steps you determine that insufficient collateral is available to offset the repayment risk, you must decline the loan. If the business fails quickly,

no long-term local economic benefit has been established and the loss to the Agency could be substantial.

3. CONSIDERATIONS OF THIRD PARTY LENDERS' LIENS

In its credit analysis, the CDC must provide full information on all collateral being considered to secure the loan, including detailed information on the terms and conditions of prior liens. You must not approve a project unless you determine that the applicant small business will be able to comply with the first lien loan conditions and still repay the SBA loan as evidenced by the cash flow analysis.

4. LEASEHOLD IMPROVEMENTS COLLATERAL CONSIDERATIONS

Leasehold improvements generally have minimal value as collateral since the law provides that improvements which are substantially attached to real property (land and building) become part of the real property, and are, therefore, the property of the landlord. When leasehold improvements are offered as collateral, you must consider other factors which may help to offset the lower valuation of this type of collateral. These factors include the following:

a. The history of the business. Is it well established with proven management?

b. Other collateral that may be available to secure the loan. Are tangible assets, other than working capital assets, available for collateral?

c. The strength of the personal guaranties. Can the personal guaranties be secured with liens on personal assets?

d. The term of the lease on the project property. Can the lease on the property be extended (including options) to at least twice the term of the debenture?

e. The willingness of the landlord to waive its rights to the leasehold improvements. Is the lessor willing to execute a full or partial waiver?

f. The willingness of the landlord to allow the CDC/SBA to cure any default in the lease payments. Will the lessor provide notice and a cure period if the borrower tenant defaults on its payments due under the lease?

g. The landlord's willingness to allow an assignment of the tenant's interests in the lease. Will the lessor agree to allow an assignment of the tenant's interests in the lease to the CDC/SBA? What conditions would the lessor impose on such assignment.

5. MACHINERY AND EQUIPMENT COLLATERAL CONSIDERATIONS

Where a project will finance the acquisition of only machinery and equipment, experience shows that project assets may be inadequate for collateral purposes. If you cannot determine that, based on the business's history and the value of the collateral, the project collateral will reasonably protect the interests of the Government, you must require additional collateral or a greater equity injection.

6. CONSIDERATIONS FOR MIXED-USE COLLATERAL

a. Sometimes a project will involve mixed-use collateral (both real estate and shorter term assets such as machinery and equipment and furniture and fixtures) financed with one debenture. Since most machinery and equipment/furniture and fixtures have a low resale value in situations of duress, the greater the percentage of shorter term assets, the higher the collateral risk in the event the business fails and the assets need to be liquidated.

b. How you consider the collateral and lien positions for these assets depends upon a number of circumstances and there are a number of solutions. Here are several options.

(1) The third party lender and the CDC can take lien positions based on a pro rata share of the assets. In other words, the third party lender's lien position would be proportional to its participation in the project.

(2) The third party lender can take a first mortgage on the real estate, with SBA taking a junior lien position on the real estate, but a first lien position on the short term assets.

(3) Additional equity can be required.

(4) Additional collateral can be required.

(5) The equipment can be removed from the 504 project and financed through a shorter term loan from another source. This source could be a leasing company, a standard commercial loan, or an SBA 7(a) loan.

c. When a project is land and building as well as shorter term assets, the 504 Loan should usually be secured with a first lien on the shorter term assets unless a compelling case can be made that it is in the best interests of SBA to allow a third-party lender a prior lien on the shorter term assets. An example is a restaurant where the shorter term assets such as kitchen equipment and furniture might maximize the resale value.

d. It should be noted that some mixed-use projects are structured so that the amount of machinery and equipment is a small percentage of the total project, or the collateral quality of the machinery and equipment financed is very good (i.e., heavy machine tools with historically high resale values). In such projects, the general policies regarding collateral for nonmixed-use projects would apply. An example would be land and building as well as a large printing press.

7. NEW BUSINESS COLLATERAL CONSIDERATIONS

New businesses are eligible for financing under the 504 program. However, generally the risk of default is greater when the borrower is a new business with no track record and unproven management. Therefore, by statute, new businesses are required to make a minimum equity injection of 15 percent of the project costs. Depending on the circumstances, it may also be appropriate to require additional collateral.

Both CDCs and SBA should always keep in mind that even though this program does not receive a subsidy appropriation, its default and recovery statistics play key roles in the calculation of the fees necessary to keep the program at a zero subsidy rate each year. Therefore, if inadequate collateral is taken, and defaults occur resulting in large losses to the government, there will be a direct negative impact on future years' subsidy rates, and, therefore, future small business borrowing under this program. For this reason it is essential that we maintain prudent underwriting standards.

Refer to subpart H, chapter 13, paragraph 1.c. regarding the equity requirements for 504 projects involving new businesses.

CHAPTER 15. BORROWER'S DEPOSIT

1. RULES GOVERNING THE BORROWER'S DEPOSIT

.120.935 Deposit.

At the time of application for a 504 loan, the CDC may require a deposit from the Borrower of $2,500 or 1 percent of the Net Debenture Proceeds, whichever is less. The deposit may be applied to the loan processing fee if the application is accepted, but must be refunded if the application is denied. If the small business withdraws its application, the CDC may deduct from the deposit reasonable costs incurred in packaging and processing the application.

2. AGREEMENTS REGARDING THE DEPOSIT?

A written agreement between the CDC and the small business informs the applicant of the circumstances under which the applicant may forfeit some or all of the deposit. It should include the following:

a. If the CDC or SBA declines the application, the deposit will be refunded in full within 10 business days after all appeal rights have been exhausted or waived;

b. If a 504 Authorization for Debenture Guarantee is issued by SBA, the deposit may be applied toward the CDC processing fee described in 13 CFR 120.883; and

c. If the applicant withdraws its loan application at any time before SBA issues the debenture authorization, the CDC may deduct its reasonable and necessary costs incurred in packaging and processing the loan application. Such costs must be documented and cannot be a percentage of the loan. Any remaining deposit balance must be remitted to the applicant within ten business days of the withdrawal.

A sample agreement should be placed in the SBA district office's CDC file for future reference in case a dispute arises between an applicant and the CDC over the forfeiture of the deposit.

CHAPTER 16. MISCELLANEOUS SERVICING ISSUES

1. SUBORDINATION OF DEBENTURE TO CDC's OTHER OBLIGATIONS

.120.936 Subordination to CDC.

SBA, in its sole discretion, may permit subordination of the Debenture to any other obligation of the CDC, except debt incurred by the CDC to obtain funds to loan to the Borrower for the Borrower's required contribution to the Project financing.

2. ASSUMPTION OF A 504 LOAN

.120.937 Assumption.

A 504 loan may be assumed with SBA's prior written approval.

Refer to chapter 23 regarding assumption fees.

3. REGULATIONS ON 504 DEFAULTS

.120.938 Default.

(a) Upon occurrence of an event of default specified in the 504 note which requires automatic acceleration, the note becomes due and payable. Upon occurrence of an event of default which does not require automatic acceleration, SBA may forbear acceleration of the note and attempt to resolve the default. If the default is not cured subsequently, the note shall be accelerated. In either case, upon acceleration of the note, the Debenture which funded it is also due immediately, and SBA must honor its guarantee of the Debenture. SBA shall not reimburse the investor for any premium paid.
(b) If a CDC defaults on a Debenture, SBA generally shall limit its recovery to the payments made by the small business to the CDC on the loan made from the Debenture proceeds, and the collateral securing the defaulted loan. However, SBA will look to the CDC for the entire amount of the Debenture in the case of fraud, negligence, or misrepresentation by the CDC.

Further guidance can be found in SOP 50.

CHAPTER 17. MISCELLANEOUS DEBENTURE ISSUES

1. CAN A BORROWER HAVE AN INTEREST IN A DEBENTURE POOL?

No.

.120.939 Borrower prohibition.

Neither a Borrower nor an Associate of the Borrower may purchase an interest in a Debenture Pool in which the Debenture that funded its 504 loan has been placed.

2. CAN A 504 LOAN BE PREPAID?

Yes.

.120.940 Prepayment of the 504 loan or Debenture.

The Borrower may prepay its 504 loan, if it pays the entire principal balance, unpaid interest, any unpaid fees, and any prepayment premium established in the note. If the Borrower prepays, the CDC must prepay the corresponding Debenture with interest and premium. If one of the Debentures in a Debenture Pool is prepaid, the Investors in that Debenture Pool must be paid pro rata, and SBA's guarantee on the entire Debenture Pool must be proportionately reduced. If the entire Debenture Pool is paid off, SBA may call all Certificates backed by the Pool for redemption.

3. IS THERE A MINIMUM DOLLAR AMOUNT FOR A DEBENTURE?

Yes.

.120.941 Certificates.

(a)The face value of a Certificate must be at least $25,000. Certificates are issued in registered form and transferred only by entry on the central registry maintained by the Trustee. SBA guarantees the timely payment of principal and interest on the Certificates.
(b)Before the sale of a Certificate, the seller, or the broker or dealer acting as the seller's agent, must disclose to the purchaser the terms, conditions, yield, and premium and other characteristics not guaranteed by SBA.

CHAPTER 18. 504 LOAN APPLICATION PROCEDURES AND CONTROLS

1. SBA'S 504 ANALYSIS

For non-ALP applications, a 504 application consists of, at a minimum, an SBA Form 1244 and supporting exhibits from the CDC. If the CDC adequately and accurately completes the application, the SBA loan officer will need to review only the CDC's credit analysis without having to re-write the credit and collateral analysis. However, eligibility issues, including affiliation, and EPCs may have to be dealt with in depth.

Any comments by the loan officer should be written on SBA Form 1245, "Loan Officer's Report."

2. SBA LOAN PROCESSING TIME

All regular (non-ALP and non-PCLP) 504 loans should be processed within 15 working days. The processing cycle begins on the day the application is received (as indicated by the date stamp) and ends when the loan authorization is issued. Time awaiting the receipt of additional information is excluded from the processing time. If major delays are anticipated in receiving additional information to complete the package, the application should be returned to the CDC.

Field offices are encouraged to recommend for ALP status those CDCs that have demonstrated capability. This will expedite the processing time in many cases and will ease the SBA loan officer's workload.

3. WHO HAS FINAL APPROVAL AUTHORITY?

For debentures of $50,000 or more, the person in the district office with delegated authority gives final approval. If the debenture is between $25,000 and $50,000, the AA/FA must give the approval. SBA Form 1245 must explain the special reasons for granting a debenture under $50,000.

4. DIFFERENCES IN ALP-CDC AND STANDARD CDC PROCESSING

a. All ALP-CDCs must perform a thorough credit analysis on a loan package before it is submitted to the SBA. The SBA will rely heavily on the CDC's credit analysis but will make the final eligibility and credit decisions, usually within 3 working days.

The ALP CDC must do the following:

(1) Complete SBA Form 1244 including all required exhibits.

(2) Prepare a summary analysis of the project which follows the format of the SBA Form 1245, "SBA Loan Officer's Report," so that the SBA Finance Division can add comments, if any, and attach them to the form for approval action.

(3) Submit an analysis of personal and business credit reports with the loan application as part of the summary analysis. (Note: Actual copies of the reports do not have to be submitted to SBA. If the ALP-CDC cannot obtain a report, the ALP-CDC should inform SBA in advance of submitting the final application so that the Agency can secure a copy of credit reports through its own channels).

(4) Submit the completed package, including two copies of the draft loan authorization. (Note: The authorization may be submitted on a computer disk.); and

(5) Have the letters "ALP" in red ink in the upper right-hand corner of SBA Form 1244 and any related correspondence. Also, the red "ALP" must be placed on the mailing envelope in order to assure expedited SBA mail routing. If a special "ALP" stamp is ordered by the CDC, the CDC may consider adding lines to the stamp for: date sent by CDC, date received by SBA, and date response given to CDC.

b. The SBA Finance Division will do the following:

(1) Receive the completed application package and loan authorizations, and will send the package to the appropriate person for immediate attention.

(2) Determine if the application is complete and acceptable.

(3) Determine if the applicant's business is "small" in accordance with SBA size standards and whether it meets other SBA eligibility standards.

(4) Determine if the use of loan proceeds complies with applicable rules and regulations, as well as with SBA policy statements. (SBA will provide ALP-CDCs with copies of any regulatory changes on a timely basis.).

(5) If the application is incomplete, it will be returned to the CDC to complete the deficiencies (If the application is returned by the CDC, SBA will determine whether to process it as an ALP application or a regular, non-ALP application.)

(6) Make final credit decision based on a review of the credit analysis submitted by the ALP-CDC. (SBA should not have to do such things as spread the financial statements. If the SBA field office finds additional work needs to be done to

correct the CDC's submissions, this indicates the need for a training session between the SBA and CDC loan processing staff.)

(7) Perform its legal review of ALP loans on the same priority basis as it does the eligibility and credit review.

If SBA requires changes in the authorization, the "clock" on the 3 day turn around will stop running until the amended document is finalized. SBA will either:

(a) "Mark up" a copy provided by the ALP-CDC and fax it to the ALP-CDC for production of a final version; or

(b) If the ALP-CDC and the SBA field office have compatible equipment, the ALP-CDC will provide a disk with the authorization on it so that changes may be made by SBA.

(Note: Any significant changes to the authorization by SBA should be discussed with the CDC prior to making them.)

(8) If the application form, including exhibits, are signed, dated and complete, SBA will make a decision and, on approved loans, fax, mail or make available the loan authorization within 3 business days after the application package is received at the field office. If action within the 3 day period is not possible, the SBA Financing Division supervisor will explain, by telephone, why there will be a delay and give the ALP-CDC an estimate of when the decision will be made.

c. If the applicant is a present SBA borrower, the following additional requirements must be met before such an application can be submitted under ALP procedures. If these requirements are not met, the application must be processed as a regular 504 loan.

(1) After the loan is made, the total outstanding SBA debt funded to a borrower and any affiliates under the 7(a) and CDC programs must not exceed the statutory limit.

(Note: Whenever you calculate whether the new 504 loan would cause the SBA borrower to exceed the statutory limit, you should use the dollar amount of all the other SBA obligations at the time the 504 debenture is sold, not when it is approved. The reason is that SBA's guaranty does not go into effect until the debenture is closed and sold. Example: The applicant has a current 7(a) loan with a balance of $400,000. The 504 loan request is for $750,000. The two loans combined exceed the statutory limit. However, the applicant is going to pay off the 7(a) loan with a non-SBA bank loan prior to the 504 debenture closing. Therefore,

the 504 loan can be approved because at the time of the 504 funding when the debenture is sold, only the 504 loan will be outstanding.)

(2) Any existing SBA loan must be current at the time of the ALP loan application's receipt. If it is not, the application must be processed as a regular 504 loan.

(3) Tangible net worth must not be less than when the prior SBA loan was approved.

d. The following are ineligible projects for ALP processing.

(1) Incomplete loan applications.

(2) Applications reflecting questionable character of owners as reflected on SBA Form 912, "Statement of Personal History" (i.e., any "YES" answers). Note that any "YES" on an SBA 912 requires the submission of fingerprints and approval by Headquarters.

(3) Cases involving complicated issues such as environmental concerns, "appearance of conflict of interest," or determination of affiliation that may require research and contact with the appropriate SBA authority.

(4) The reconsideration of an SBA-declined loan application.

CHAPTER 19. PRICING A DEBENTURE

1. COMPUTATION METHOD

Net Debenture Proceeds: The amount that the 504 loan will contribute to the total project cost.

Gross Debenture Proceeds: The amount of the 504 loan and the amount of the debenture that is sold to the investor. The difference between the **net** debenture amount and the **gross** debenture proceeds is the administrative costs which include the funding fee, SBA guaranty fee, CDC processing fee, closing costs, and underwriter's fee.

The amount of the **gross** debenture cannot exceed $750,000 ($1,000,000 for public policy projects).

2. PRICING A 504 DEBENTURE

a. How is SBA's Share of the Total Cost of a Project Determined?

To price a debenture, you must determine SBA's share of a project's total cost. The following hypothetical project will identify the amount of funds required to fund both the eligible project costs (net debenture) and the administrative costs (gross debenture).

To illustrate, assume that total project costs (land, building and machinery and equipment and eligible soft costs) are $600,000. Assuming that the debenture is for 20 years and will finance 35 percent of project costs, participation in project financing would be as follows:

%	Participation	Amount
45%	Third-Party Lender	$270,000
35%	504 Net Debenture	210,000
20%	Small Business Injection	120,000
100%	Total Project Costs	$600,000

Use the following procedure to determine the administrative expenses and the gross debenture amount. Except for the underwriting fee and closing costs, each administrative expense is based on the amount of the net debenture.

Step One: Net Debenture

Determine the Net Debenture ($210,000).

NOTE: For purposes of calculation, the combined total of eligible closing costs and the net debenture cannot exceed $727,500 (for a $750,000 gross debenture) since the fees will bring the gross debenture into the $750,000 maximum range. ($970,000 and $1,000,000 for public policy projects.)

Step Two: SBA Guaranty Fee (1/2%)

Multiply $210,000 by 0.005. 1,050

Step Three: Funding Fee (1/4 of 1%).

Multiply $210,000 by .0025. 525

Step Four: CDC Processing Fee (1-1/2%).

Multiply $289,000 by .015. 3,150

Step Five: Eligible Closing Costs.

Refer to chapter 11, 7.b. 3,000

Step Six: Debenture Amount.

Add items "Step One" through "Step Five" above and divide the total by 0.99500 for 20-year debentures. (For 10-year debentures, this number would be 0.99625.) (Note: This is because the underwriter's fee, Step Seven, is based on the gross debenture, not the net debenture.)

Net Debenture Proceeds	210,000.00
SBA Guaranty Fee	1,050.00
Funding Fee	525.00
CDC Processing Fee	3,150.00
Closing Costs	3,000.00
Total	217,725.00

$217,725.00 . 0.99500 = $218,819.10 (For 10-year debentures, the total would be divided by 0.99625.)

Round this amount to the next even thousand, in this case $219,000. This is the gross

debenture.

Step Seven: Underwriters' Fee.

To determine the exact amount of the underwriter's fee, because this is a 20-year debenture, multiply $219,000 by .00500. (If it was a 10-year debenture, you would multiply "Step Six" by .00375.)

In this example, the underwriter's fee is $1,095.00

(Note: Beginning January 1, 1997, the underwriters' fee for all debentures sold after January 1, 1997, changed from .00625 to .00500 for 20-year debentures and to .00375 for 10-year debentures.)

Step Eight: Balance to Borrower.

The difference between the debenture amount ($220,000) and the sum of net debenture proceeds ($210,000), processing and closing fees ($7,725), and underwriters fee ($1,095) goes to the borrower. Here it would be $180.

b. Separate Payment of the Debenture Fees

Can the borrower pay any of the debenture fees upfront and not have them included in calculating the gross debenture?

Only the CDC processing fee and the closing costs can be paid upfront and deleted from the gross debenture calculations. If the borrower chooses to pay the CDC's processing fee separately, the following applies.

(1) The amount of the CDC's processing fee (see "Step Four") must be the amount in the pricing model. (In this example $3,150.)

(2) If the borrower has paid the CDC processing fee upfront, the borrower then has two choices as follows:

First choice: The borrower can be reimbursed for the CDC fee from the debenture proceeds. The CDC processing fee will be included in calculating the gross debenture. The CDC will receive the fee as usual. However, in this case, the CDC then has to reimburse the borrower.

Second choice: If the borrower does not want to be reimbursed for the CDC processing fee from the debenture proceeds, the gross debenture calculations still includes that amount to get the correct underwriter's fee. Once the underwriter's fee is calculated, a zero is then entered on the CDC processing fee line in the "Servicing Agent Agreement," SBA Form 1506, and the dollar amounts are retotaled and rounded to the next higher thousand for the new gross debenture amount.

3. WHEN IS THE DEBENTURE PRICED?

a. A debenture is always priced as part of the application process.

b. If there are any changes in the 504 portion of the project cost between loan approval and project completion, the debenture is priced again.

c. If the final use of proceeds (as part of the closing process) shows that the borrower has not used the full amount of any contingency fund, then the debenture may be repriced as follows. (Refer to chapter 11, 4.g. of this subpart for an explanation of contingency fund.)

(1) If the amount of the unused contingency fund is 2 percent or less of the approved gross debenture amount, that difference is to be refunded to the borrower from the gross debenture proceeds by the CSA. No change is needed in the debenture pricing. This does not require a 327.

(2) If the amount of the unused contingency fund is greater than 2 percent of the approved gross debenture amount, the net debenture proceeds are reduced by the amount of the unused contingency fund, the debenture pricing is recalculated and a 327 action is processed.

CHAPTER 20. PREPARING THE LOAN AUTHORIZATION

1. AUTHORIZATION FOR DEBENTURE GUARANTEE

The "Authorization for Debenture Guarantee" (504 Authorization) is a written document that provides the terms and conditions under which SBA will guarantee a 504 loan. **It is not a contract to make a loan.**

The 504 Authorization incorporates provisions to which the small business and the CDC must agree and on which the interim lender relies. The small business and the CDC must sign the original and all copies of the 504 Authorization before the third party or interim lender disburses project funds. This should be done within 10 days of date of approval. Except for loans processed under PCLP procedures, SBA Counsel must review any 504 Authorization if, and only if, there are changes to the standard 504 Authorization.

2. EXECUTION OF THE 504 AUTHORIZATION

The SBA signs the 504 Authorization on the date the loan is approved which occurs after legal review (if necessary) and the allocation of funds process is completed. The SBA then forwards the original authorization to the CDC for execution by the CDC and the borrower.

After all parties execute the original (which may be a faxed original) and all copies, the CDC returns it to SBA. By executing and delivering the authorization to SBA, all parties acknowledge the terms and conditions imposed by SBA in authorizing the guarantee of the debenture.

The CDC distributes copies of the executed 504 Authorization to the borrower, the interim lender, and the permanent lender if different from the interim lender.

3. MODIFYING 504 AUTHORIZATIONS AFTER EXECUTION

The CDC may request in writing on behalf of the borrower modifications to the terms and conditions of the 504 Authorization at any time after approval, but before funding. All modifications must be approved by a 327 action by the same level of delegated authority at which the loan was originally approved, except as stated elsewhere in this SOP and by delegation of authority.

a. For an increase or decrease in the amount of an approved loan, the 327 action must clearly support the need for the change in the amount and address the effects on repayment ability, collateral and jobs created or retained. The 327 action must also provide the revised breakdown of the private sector lender, debenture, and CDC/small business injection, including a revised use of funds.

b. Neither the amount or maturity of a loan can be modified after the debenture closing has been completed.

4. EXTENDING AUTHORIZATION DISBURSEMENT PERIOD

The authorization provides for disbursement within a period up to 1 year from the date of approval. The SBA field offices may grant extensions of up to 1 year at a time upon a CDC's written request.

The CDC's extension request must include the most recent fiscal year end financial statement from the borrower (if the borrower is an existing business) if a fiscal year end has occurred between approval of the loan and the request. (Flexibility in this requirement is allowed if the fiscal year end has ended just before the request.) In addition to providing the financial statements, the CDC must have analyzed these statements and provided the results of their analysis as part of the request and recommendation, including a statement as to whether the applicant has suffered a material adverse change since the date of the 504 Authorization. If the request for extending the disbursement period involves a new business, the CDC must make a statement about whether the borrower has suffered a material adverse change since the date of the 504 Authorization.

ALP CDCs are delegated the authority to extend disbursement periods, based on the same requirements as stated above, up to 6 months beyond the initial disbursement date. For any extension to the disbursement period, there must be documentation and justification in the CDC's files for SBA to review during any periodic operational reviews. Once the ALP CDC extends the disbursement time, a copy of the extension approval letter sent to the applicant must also be sent to the SBA field office which processed the loan in order that the Agency records can be changed and the CSA can be notified of the extension. If extensions are required for a period exceeding 2 years, it must be approved by the SBA field office.

Note: In the event of an adverse change, the CDC may request an extension if the adverse condition can be remedied in a reasonable time period. All extensions must be justified by the field office by a 327 action. Extension requests do not have to be sent to Headquarters.

CHAPTER 21. DEBENTURE SALES AND SERVICE AGENTS

.120.950 SBA and CDC must appoint agents.

SBA and the CDC must appoint the following agents to facilitate the sale and service of the Certificates and disbursement of the proceeds.

.120.951 Selling agent.

The CDC, with SBA approval, shall appoint a Selling Agent to select underwriters, negotiate the terms and conditions of Debenture offerings with the underwriters, and direct and coordinate Debenture sales.

.120.952 Fiscal agent.

SBA shall appoint a Fiscal Agent to assess the financial markets, minimize the cost of sales, arrange for the production of the Offering Circular, Debenture Certificates, and other required documents, and monitor the performance of the Trustee and the underwriters.

.120.953 Trustee.

SBA must appoint a Trustee to:
(a) Issue Certificates;
(b) Transfer the Certificates upon resale in the secondary market;
(c) Maintain physical possession of the Debentures for SBA and the Certificate holders;
(d) Establish and maintain a central registry of:
(1) Debenture Pools, including the CDC obligors and the interest rate payable on the Debentures in each Pool;
(2) Certificates issued or transferred, including the Debenture Pool backing the Certificate, name and address of the purchaser, price paid, the interest rate on the Certificate, and fees or charges assessed by the transferror; and
(3) Brokers and dealers in Certificates, and the commissions, fees or discounts granted to the brokers and dealers;
(e) Receive semi-annual Debenture payments and prepayments;
(f) Make regularly scheduled and prepayment payments to Investors; and
(g) Assure before any resale of a Debenture or Certificate is recorded in the registry that the seller has provided the purchaser a written disclosure statement approved by SBA.

.120.954 Central Servicing Agent.

(a) SBA has entered into a Master Servicing Agreement designating a Central Servicing Agent (CSA) to support the orderly flow of funds among Borrowers, CDCs, and SBA. The CDC and Borrower must enter into an individual Servicing Agent Agreement with the CSA for each 504 loan, constituting acceptance by the CDC and the Borrower of the terms of the Master Servicing Agreement.
(b) The CSA has established a master reserve account. All funds related to the 504 loans and Debentures flow through the master reserve account under the provisions of the Master Servicing Agreement. The master reserve account will be funded by a guarantee fee, a funding fee to be published from time to time in the Federal Register, and by principal and interest payments of 504 loans. At SBA's direction, the CSA may use funds in the master reserve account to defray program expenses. In the event a Borrower defaults and its 504 note is accelerated, SBA shall add funds under its guarantee to ensure the full and timely payment of

the Debenture which funded the 504 loan. At SBA's direction, the CSA must pay to the CDC servicing each loan the interest accruing in the master reserve account on loan payments made by each Borrower between the date of receipt of each monthly payment and the date of disbursement to investors. The CSA may disburse such interest periodically to CDCs on a pro rata basis. SBA may use interest accruals in the master reserve account earned prior to October 1991 (not previously distributed to the CDCs) for the costs of 504 program administration.

.120.955 Agent bonds and records.

(a) Each agent (in Secs. 120.951 through 120.954) must provide a fidelity bond or insurance in such amount as necessary to fully protect the interest of the government.
(b) SBA must have access at the agent's place of business to all books, records and other documents relating to Debenture activities.

.120.956 Suspension or revocation of brokers and dealers.

The AA/FA may suspend or revoke the privilege of any broker or dealer to participate in the sale or marketing of Debentures and Certificates for actions or conduct bearing negatively on the broker's fitness to participate in the securities market. SBA must give the broker or dealer written notice, stating the reasons therefore, at least 10 business days prior to the effective date of the suspension or revocation. A broker or dealer may appeal the suspension or revocation made under this section pursuant to the procedures set forth in part 134 of this chapter. The action of the AA/FA will remain in effect pending resolution of the appeal. SBA may suspend or revoke the opportunity for a hearing under part 134 of this chapter.

CHAPTER 22. CLOSINGS

1. RESPONSIBILITY FOR CLOSING THE DEBENTURE AND LOAN

.120.960 Responsibility for closing

The CDC is responsible for the 504 Loan closing. The Debenture closing is the joint responsibility of the CDC and SBA.

2. STEPS LEADING TO DISBURSEMENT

This chapter identifies the procedures to be followed for disbursement of debenture proceeds. The effective implementation of these procedures requires continuing cooperation between financing and legal personnel from initial processing through final closing. Closing of 504 loans is actually a multi-step process involving different parties and responsibilities. The initial steps involve all actions required of the CDC and/or small business to comply with the 504 Authorization; these actions are performed by or at the direction of the CDC. The final steps involve all actions required of the CDC and/or SBA to obtain disbursement of debenture proceeds; these actions are performed by or at the direction of an SBA attorney. The secondary market and 504 sales branch has established a "cut-off" date as a deadline for receipt by the CSA of the documents required for debenture sales.

3. LOAN CLOSING

a. Who Is Responsible For Closing The 504 Loan?

The CDC counsel is responsible for all actions, document preparation, and other procedures necessary to close all 504 loans. Although SBA counsel is available for advice and assistance, the CDC and its attorney are ultimately responsible for the 504 loan closing. Other reference guides are NADCO's Designated CDC/Closing Attorney Training manual and the Central Servicing Agent "User Manual."

b. When Must A CDC Submit The Loan Closing Package?

A district counsel must establish for his/her respective office the date each month when complete loan closing packages must be submitted by the CDCs. For expedited closings, the complete package must be delivered to SBA not later than 5 working days prior to the cut-off date. The district counsel may require more than 5 working days.

c. What Does A Complete Loan Closing Package Include?

The 504 loan closing checklist in the appendix of SOP 70 50 is a guide to field counsel in their 504 loan closing review. In addition to other documents required by the authorization or counsel, the following documents are required for all closings:

(1) The properly executed original loan documents identified in the loan authorization with appropriate lien searches;

(2) A properly executed original copy of SBA Form 1248, "Authorization and Debenture Guaranty," signed by SBA and all other parties named therein;

(3) SBA Form 1504, "Development Company Debenture," properly executed by the CDC;

(4) SBA Form 1506, "Servicing Agent Agreement," properly executed by the CDC and Small business;

(5) SBA Form 1429, "Use of Proceeds - Section 503/504;"

(6) Opinion of CDC counsel;

(7) CDC certification;

(8) CDC resolution;

(9) Any follow-up environmental reports required by SBA; and

(10) Original IRS Form W-9

d. Which SBA Forms Are Mandatory?

The following SBA standard forms are mandatory:

(1) SBA Form 1504, "Development Company Debenture;"

(2) SBA Form 1528, "Resolution of Board of Directors of CDC;"

(3) SBA Form 1505, "Note;"

(4) SBA Form 1506, "Servicing Agent Agreement;"

(5) SBA Form 1429, "Use of Proceeds Section 503/504;"

(6) Opinion of CDC counsel;

(7) CDC certification;

(8) CDC resolution; and

(9) SBA Form 148 for any personal guaranties.

4. EVENTS BETWEEN LOAN CLOSING AND DEBENTURE FUNDING

a. What Are Counsel's Responsibilities?

Counsel will provide services as prescribed in SOP 70 50. The SBA attorney is responsible for:

(1) Reviewing the loan closing package submitted by the CDC to ensure compliance with the authorization, this SOP, and Agency regulations, and applicable State and Federal statutes and recording requirements;

(2) Verifying that the information entered on the debenture, note, servicing agent agreement, and use of proceeds is accurate and complete;

(3) Determining that the loan has been closed in a legally sufficient manner in accordance with the authorization and produce an SBA closing opinion; and

(4) Transmitting the appropriate closing documents to the CSA.

The SBA attorneys may rely upon the opinion of CDC counsel and the CDC Certification, but they must be satisfied from a review of the entire closing package that the conditions of the authorization have been met in a legally sufficient manner.

b. Counsel's Duties In An Expedited Closing For A Priority CDC

When a CDC and its counsel are accepted for the expedited closing process

(see "Priority CDCs," paragraph 6 below), SBA counsel, in fulfilling their responsibility under paragraph 4.a. above, may rely upon a limited ministerial review of the following documents to determine if they conform with the authorization:

(1) Note;

(2) Guarantee(ies);

(3) Debenture;

(4) Use of proceeds;

(5) Servicing agent agreement;

(6) Opinion of CDC counsel;

(7) CDC certification; and

(8) Closing checklist.

The SBA attorneys may rely upon the opinion of CDC counsel and CDC certification regarding all other documents, actions, decisions, and procedures.

c. What Documents Are Forwarded to the CSA?

The SBA counsel is responsible for sending by Federal Express (FEDEX) the following documents to the CSA (no later than 10 business days prior to the scheduled pricing date, which is one week prior to the sale date):

(1) The original "Servicing Agent Agreement," SBA Form 1506;

(2) A copy of the "Note," SBA Form 1505;

(3) A copy of the "Use of Proceeds," SBA Form 1429; and

(4) The original "Debenture," SBA Form 1504.

(5) Original IRS Form W-9

The packages must be addressed to:

Mr. Sanford M. Mortan
Colson Services Corporation
150 Nassau Street, 9th Floor
New York, NY 10038
(Telephone No. (212) 266-7814 for the FEDEX label.)

The SBA field office retains the CDC Board of Directors resolution, opinion of CDC counsel, opinion of SBA counsel, and the original SBA 1429 in the collateral file. The automated clearinghouse (ACH) authorization forms with a voided check attached are to be sent by the CDC directly to the CSA.

Upon receipt, the CSA will fill in the remaining blanks in the Servicing Agent Agreement, execute the agreement, and send two conformed (photo copy that includes all comments and marking appearing on the original) copies (pages 3 and 4 of the Service Agent Agreement and page 1 of the Note) back to the CDC and one conformed copy to the SBA district office. If the CDC wants a complete copy, the CDC must provide a copy as well as the original to Colson who will attach the conformed copy to the complete copy and send it back.

d. To Whom Are the Completed Documents Distributed?

(1) Debenture The Field Counsel will receive two copies from the trustee. Field counsel will send one copy to the CDC, the other will be retained for the office files.

(2) Debenture Amortization Schedule The Trustee will provide two copies to the field counsel. One copy will be retained for the field office's files and the other copy will be forwarded to the CDC.

(3) Prepayment Premium Schedule The Trustee will provide one copy to the field office for retention in SBA's file.

(4) Note The CSA will provide the CDC with two copies (with prepayment premium schedule attached). The CDC should retain one copy for their file and forward the other copy to the borrower. The CSA will provide the field office with one copy to be retained.

(5) Servicing Agent Agreement The CSA will distribute two copies to the CDC who will retain one and forward one to the borrower. The CSA will send one copy to the field office for SBA's files.

5. DEBENTURE FUNDING

The 504 debentures are sold and proceeds disbursed on the Wednesday after the second Sunday of each month. The fiscal agent negotiates the final rate and fees with underwriters on the Tuesday after the first Sunday of each month.

Q. How Are the Debenture Proceeds Disbursed?

A. On the scheduled sale date, the debenture proceeds will be wired to the CSA. Upon receipt of the proceeds, the CSA shall:

(1) Deduct an amount sufficient to cover the following:

(a) Its initiation fee as computed and identified by SBA in the servicing agent Agreement, if applicable; and

(b) A guaranty fee payable to SBA equal to 1/2 of 1 percent;

(2) Disburse the balance of the proceeds within 48 hours of receipt of funds as follows:

(a) Payoff to interim lender;

(b) CDC processing fee; and

(c) Residual to borrower based on the CSA's computations under the pricing model contained in chapter 18 of this SOP.

6. PRIORITY CDCS

a. <u>What is a Priority CDC?</u>

In order to streamline the 504 loan process, SBA instituted an expedited closing procedure on April 24, 1995. A priority CDC is a CDC which receives expedited and priority review of 504 loan closings. To become a priority CDC, a CDC must meet certain conditions.

b. <u>What Conditions Must a CDC Meet to Become a Priority CDC?</u>

To become a priority CDC, a CDC must have the following:

(1) At least one 504 closing attorney, designated as provided below, either retained or working on staff;

(2) Adequate experience and expertise in 504 loan closings;

(3) A history of presenting complete and accurate closing packages;

(4) A qualified and knowledgeable staff;

(5) A satisfactory working relationship with the primary office; and

(6) Insurance coverage as described in Paragraph 6c of the chapter.

c. What Insurance Coverage Must a Priority CDC Have?

A priority CDC must carry a directors and officers liability insurance policy in form and substance satisfactory to SBA, with an endorsement covering CDC committees and staff engaged in the closing process, and with limits of at least $1,000,000/$1,000,000, and a deductible not more than $10,000. The CDC must annually deliver to SBA a certificate from its insurance carrier confirming the existence of this coverage. The policy must provide that SBA will receive at least 20 days prior notice of any lapse of coverage, failure to renew, or cancellation.

d. How Does a CDC Become a "Priority CDC?"

The process of becoming a priority CDC begins in any one of the three following ways:

(1) An ALP-CDC is automatically a priority CDC subject only to receipt of proof of the required insurance coverage and nomination and designation of a designated 504 closing attorney;

(2) A non ALP-CDC may apply to become a "Priority CDC".

(3) An SBA district office may nominate a non ALP-CDC for priority status (even if the CDC does not want to be a priority CDC).

e. How Does a Non ALP-CDC Apply to Become a Priority CDC?

The CDC submits an application in writing to the SBA district office in which the CDC's loan closing packages are primarily reviewed (primary office). The application must address each of the items in 6.b. and must include a copy of the CDC's insurance policy,

or a certificate of insurance or declarations page showing the amount of coverage, amount of the deductible, the premium, and a declaration from the insurance company that SBA will receive the required 20-day notice of cancellation. After review by the district office Financing Division and the district counsel, the application, together with the recommendations of the Financing Division, Legal Division, and the district director, is to be sent to the Director, Office of Loan Programs.

f. How Does a District Office Nominate a Non-ALP CDC?

The district office sends a nomination to the Office of Loan Programs with a copy to the CDC. The nomination must be signed by the district counsel and the district director. In nominating the CDC, the district office confirms that the CDC meets all of the conditions in paragraph 6.a. of this chapter; except the insurance requirement. The district office will need to obtain the insurance information from the CDC prior to submitting the nomination to OLP and submit the evidence together with the nomination.

g. What Must an ALP-CDC do When it is Nominated for Priority Status?

The CDC must submit within a reasonable period of time (as determined by the district director) the following to the district office:

(1) A copy of the CDC's insurance policy, or a certificate of insurance or declarations page showing the required amount of coverage and deductible described in paragraph 9.c. of this chapter, the premium, and a declaration from the insurance company that SBA will receive the required 20-day notice of cancellation.

(2) The name of its designated 504 closing attorney (if the attorney has already been designated) or the complete application to have an attorney qualified to be designated as its designated 504 closing attorney.

h. What Does the SBA Field Office Do?

After review by the district counsel, the district office sends its recommendation of the CDC to the Director, Office of Loan Programs, together with the submissions from the CDC in paragraph 6.g. of this chapter above. The recommendation must address each of the conditions in paragraph 6.b.

i. What Must an ALP-CDC Do to Establish its Priority CDC Status?

Except for evidence of insurance and designation of a 504 closing attorney, SBA has already made a favorable determination regarding all of the conditions required to become a priority CDC in paragraph 6.b. of this chapter when it approved the CDC for ALP status.

Upon designation as an ALP-CDC, the CDC must submit the following to the Director, Office of Loan Programs:

(1) A copy of the CDC's insurance policy, or a certificate of insurance or declarations page showing the required amount of coverage and deductible describe in paragraph 6.c. of this chapter, the premium, and a declaration from the insurance company that SBA will receive the required 20-day notice of cancellation; and

(2) The name of its designated 504 closing attorney (if the attorney has already been designated) or the complete application to have for an attorney qualified to be designated as its designated 504 closing attorney.

j. How Will a CDC be Notified That it is a Priority CDC?

Upon receipt, the nominations or applications will be reviewed by the Office of Loan Programs. The nominations for Designated Closing attorneys will be reviewed by the Office of General Counsel. After acceptance of the attorney by the Office of General Counsel as a Designated Attorney (if not already designated) and acceptance of the CDC as a Priority CDC, the Director, Office of Loan Programs, will notify the CDC in writing of its approval. The attorney will receive a separate acceptance letter from the Office of General Counsel.

k. Under What Circumstances Can a Priority Designation be Terminated?

The AA/FA, or designee, may terminate a CDC's priority designation for good cause, including, but not limited to, the CDC's failure to use a designated attorney, failure to maintain adequate insurance coverage, submission of unsatisfactory closing packages or failure to maintain a good working relationship and good communications with SBA field office personnel.

7. DESIGNATED 504 CLOSING ATTORNEYS

a. What is a "Designated 504 Closing Attorney"?

A designated 504 closing attorney is an attorney accepted by SBA's General Counsel to close 504 loans under the expedited closing procedure. A priority CDC must use designated 504 closing attorneys to close its 504 loans under the expedited closing procedure (except as set forth in paragraph 7.h. below).

b. What Conditions Must an Attorney Meet to Become Designated?

(1) A degree from a recognized law school;

(2) Membership in the bar of the state in which the attorney's 504 closing practice is or will be primarily located;

(3) Professional malpractice insurance coverage as set forth in paragraph 7.c. below.

(4) Attendance of an SBA-approved 504 loan closing training course, such as the professional symposia organized by National Association of Development Companies (NADCO). Attorneys may fulfill this requirement at any time prior to designation or within 6 months after designation; and

(5) Adequate expertise in 504 loan closings.

c. What Are the Insurance Requirements?

A designated 504 closing attorney must carry an adequate professional malpractice liability insurance policy with limits of at least $1,000,000/$1,000,000 and a deductible not to exceed $10,000. (Applicants may request a hardship exemption from the General Counsel with respect to the policy limits or the deductible. Policy limit reductions to $500,000/$1,000,000 will only be granted to sole practitioners and small firms of three or less attorneys, while deductible requirement waivers will only be granted to larger firms with a demonstrated, strong financial history.) Sole practitioners seeking a hardship waiver must state what their present annual premium is and what it would cost to get $1,000,000 with $10,000 deductible and $500,000/$1,000,000 with $10,000 deductible. All other relevant financial information should also be provided.

The designated 504 closing attorney must certify in the opinion of counsel for each 504 closing that the attorney has the required insurance coverage. The attorney must deliver annually to the Office of General Counsel on or before July 1, a certificate from its insurance carrier confirming the existence of this coverage.

d. How Does an Attorney Become a Designated 504 Closing Attorney?

An attorney, or the CDC which retains or employs the attorney, submits the attorney's nomination/ application to the SBA district office in which the attorney's practice is primarily located. An application or nomination must include:

(1) a submission on the attorney's letterhead addressing each of the conditions in paragraph 7.b.;

(2) A copy of the attorney's malpractice insurance policy, or a certificate of insurance or declarations page showing:

(a) The amount of coverage;

(b) Amount of the deductible;

(c) The premium; and

If the attorney requests a hardship exemption with respect to either the insurance policy limits or the amount of the deductible, the attorney must include the request with the nomination or application, supported by appropriate information including:

(d) The amount of the policy limits or deductible; and

(e) The current premium;

(3) The quote obtained for the increased premium;

(4) The size of the firm;

(5) The firm's arrangement for covering the deductible, such as a loss reserve or escrow; and

(6) Evidence of the firm's history and financial strength.

The application is then forwarded to the General Counsel, together with the recommendations of the district director and district counsel. The recommendations must also address each of the conditions in paragraph 7b.

Q1. Can the designated attorney be an employee of the CDC or an employee of the CDC's affiliate(s)?

A1. No. An in-house counsel cannot be a designated attorney for the attorney's CDC employer. In the expedited process, in-house counsel can prepare documents and

otherwise work on closings. However, the opinion of counsel must be signed by an outside designated attorney.

Q2. Can the attorney be an officer or director of the CDC?

A2. An attorney that is too closely associated with the CDC, such as an attorney that is an officer of the CDC, or who is on the board of the CDC and participates in the lending decisions, cannot be that CDC's designated attorney. An attorney who is a member of the CDC, but is not an officer or involved in any way in the lending decisions, may be a CDC's designated attorney if district counsel concludes that the attorney is not too closely associated with the CDC. In such a case, district counsel must consider the attorney's association with the CDC including:

(1) The degree of control exerted by the attorney on the CDC's decision-making;

(2) Any benefits accruing to the attorney through the attorney's association with the CDC; and

(3) Any appearance of conflict of interest.

If district counsel requires further clarification, he or she should contact the Office of Finance and Legislation in the Office of General Counsel.

(Note: The same analysis regarding potential conflicts of interest should be applied to non-designated closing attorneys that are not closing under the expedited process. However, non-designated attorneys can be members of the in-house staff of the CDC.)

e. How Will an Attorney be Notified That it is Designated?

Upon receipt, the nominations or applications will be reviewed by the Office of General Counsel. The General Counsel shall consider the nomination of the CDC, the qualifications and experience of the nominated attorney, the recommendations of the district office, and any comments from the Office of Loan Programs. (The General Counsel also may consider the opinions of the district director and district counsel in any other SBA districts in which the attorney has closed 504 loans, and the views of any other person who is familiar with the attorney's work product.) In evaluating an attorney's qualifications, the General Counsel shall consider the attorney's educational background, experience in 504 loan closings and other commercial and residential closings, quality of work in connection with prior 504 closing packages, working relationship with the SBA district office, knowledge of the 504 program, other credentials, reputation in the legal community, and participation in 504 training.

The General Counsel will notify the attorney that he/she has been accepted as a designated 504 closing attorney.

f. Procedures for Reconsideration

An attorney may request reconsideration by the General Counsel after 6 months, if the attorney is not accepted as a designated 504 counsel.

g. Can an Attorney's 504 Closing Designation be Withdrawn?

An attorney's Designated status may be withdrawn by the General Counsel for good cause, including, but not limited to, unprofessional or unethical conduct, failure to maintain the required insurance coverage, failure to attend the required training or continuing 504 education, submission of unsatisfactory closing packages (based upon audits or other evidence), or failure to maintain a good working relationship and good communication with SBA field office personnel.

h. May a Priority CDC Use Non-Designated Attorneys for Any 504 Closings?

The district office must allow a CDC to use a non-designated attorney for a reasonable time to develop an additional designated attorney or to replace a designated attorney. In either event, SBA counsel will accept the closing package from a non-designated attorney and conduct a non-priority closing review. If there is not enough time to conduct a sufficient review, SBA counsel may hold the package until the next month's debenture sale.

8. AUDITS OF PRIORITY CDC CLOSINGS

a. The SBA attorneys must conduct random audits of priority CDC closing packages. The number and frequency of audits are at the discretion of the district counsel, provided that, for each designated attorney, each quarter, 10 percent of the attorney's packages or one such package, whichever is more, is audited.

b. What Does An Expedited Closing Audit Include?

An expedited closing audit will include a complete review of the entire package, including loan documents, collateral documents, and nonfinancial documentation. The basis for CDC counsel's decisions and risk assessments

may also be reviewed. SBA district counsel will ascertain whether the loan was closed in accordance with SBA regulations and the authorization, that the required collateral and lien positions were obtained, and that the Opinion of CDC counsel accurately reflected the legal status of the documents and the closing. A summary of each audit will be forwarded to the General Counsel promptly upon completion.

c. What Happens If Deficiencies Are Found?

If the audit demonstrates minor deficiencies in the loan packages, the CDC and CDC counsel will be notified by the district counsel and requested to make changes in future packages. If serious deficiencies which may result in a substantial loss are noted, the General Counsel (or a designee) may notify the CDC and CDC counsel in writing, specifying the nature of the deficiencies, and may take such action as the General Counsel may deem appropriate, including placement on probation, suspension, or termination.

9. USE OF CONSTRUCTION ESCROW ACCOUNT

.120.961 Construction escrow accounts.

The CSA, title company, CDC attorney, or bank may hold Debenture proceeds in escrow to complete Project components such as landscaping and parking lots, and acquire machinery and equipment if the component or acquisition is a minor portion of the total Project and has been contracted for completion or delivery at a specified price and specific future date. The escrow agent must disburse funds upon approval by the CDC and the SBA, supported by invoices and payable jointly to the small business and the designated contractor.

If acquisition of machinery and equipment or other portions of a project (such as a parking lot, landscaping, etc.) represent a relatively minor portion of the total project and it has been contracted for delivery at a specified price and date, but cannot be installed or delivered prior to acquisition or completion of the plant, the debenture may be sold. However, all lien positions and collateral required by the authorization must be obtained prior to closing.

After approval by the CDC and SBA, the proceeds authorized for acquisition of such assets must be held in escrow by the CSA or a local title insurance company or bank. Disbursement from such account(s) shall be supported by invoices and made payable jointly to the small business and the supplier in order to ensure authorized use of debenture proceeds. If any funds that were escrowed at a local institution have not been disbursed after a year, the CDC must contact SBA to determine an appropriate course of action.

CHAPTER 23. ALLOWABLE FEES

1. ALLOWABLE FEES THAT A 504 BORROWER MAY BE CHARGED

120.971 Allowable fees paid by Borrower.

(a) CDC fees. CDCs may charge the following fees to the Borrower:

(1) Processing fee. The CDC may charge up to 1.5 percent of the net Debenture proceeds to process the financing. Two-thirds of this fee will be considered earned and may be collected by the CDC when the Authorization for the Debenture is issued by SBA. The portion of the processing fee paid by the Borrower may be reimbursed from the Debenture proceeds;

(2) Closing fee. The CDC may charge a reasonable closing fee sufficient to reimburse it for expenses of in-house or outside legal counsel, and other miscellaneous closing costs (CDC Closing Fee). Closing costs, other than legal fees, may be funded out of the Debenture proceeds;

(3) Servicing fee. The CDC will charge a monthly servicing fee of at least 0.625 percent per annum and no more than 2 percent per annum on the unpaid balance of the loan as determined at five-year anniversary intervals. A servicing fee 1.5 percent in a rural area and 1 percent everywhere else requires SBA's prior written approval, based on evidence of substantial need. The servicing fee may be paid only from loan payments received. The fees may be accrued without interest and collected from the CSA when the payments are made;

(4) Late fees. Loan payments received after the 15th of each month may be subject to a late payment fee of 5 percent of the late payment or $100, whichever is greater. These fees will be collected by the CSA on behalf of the CDC; and

(5) Assumption fee. Upon SBA's written approval, a CDC may charge an assumption fee not to exceed 1 percent of the outstanding principal balance of the loan being assumed.

(b) CSA fees. The CSA may charge an initiation fee on each loan and a monthly servicing fee under the terms of the Master Servicing Agreement.

(c) Other agent fees. Agent fees and charges necessary to market and service Debentures and Certificates may be assessed to the Borrower or the investor. The fees must be approved by SBA and published periodically in the Federal Register.

(d) SBA fees.

(1) SBA charges a 0.5 percent guarantee fee on the Debenture.

(2) For loans approved after September 30, 1996, SBA charges a fee of 0.9375 annually on the unpaid principal balance of the loan as determined at five-year anniversary intervals.

(e) Miscellaneous fees. A funding fee not to exceed 0.25 percent of the Debenture may be charged to cover costs incurred by the trustee, fiscal agent, transfer agent.

120.972 Third Party Lender participation fee and Development Company fee.

(a) Participation fee. For loans approved by SBA after September 30, 1996, SBA must collect a one-time fee from the Third Party Lender equal to 50 basis points on its total participation in a project when the Third Party Lender occupies a senior credit position to SBA in the project.

(b) Development company fee. For loans approved by SBA after September 30, 1996, SBA must collect an annual fee from the CDC equal to 0.125 percent of the outstanding principal balance of the debenture. The fee must be paid from the servicing fees collected by the CDC and cannot be paid from any additional fees imposed on the Borrowers.

a. CDC Processing Fees

The CDC may charge a one-time processing fee of up to one and one-half (1.5) percent of the net proceeds of the debenture based on the pricing instructions. The CDC is not required to provide justification to SBA on the use of its processing fee. Two-thirds of the loan processing fee is considered earned and may be collected by the CDC when the 504 Authorization is issued by SBA. Any deposit must be applied to this portion of the fee. The remainder of the fee is considered earned when the loan is closed. The CDC, in its discretion, may collect the fee when earned or from the debenture proceeds.

These conditions should be made a part of the CDC's pre-application or loan agreements. The processing fee is intended to reimburse a CDC for the following direct and indirect costs:

(1) General administrative and overhead expenses (salaries, lease, office supplies, telephone, travel, advertisement, promotions, etc.); and

(2) All professional services of the CDC related to screening, reviewing, packaging and processing a specific loan application. Any staff services provided under contract by an outside individual(s) or organization(s) for loan making functions will be paid from this fee.

b. Closing Fees

Refer to .120.971(a)(2) and Chapter 11, paragraph 12 of this Subpart.

c. Servicing Fees

CDCs must charge a monthly servicing fee of at least six hundred twenty five one hundredths of one percent (0.625%) nor more than 2 percent per annum on the unpaid balance of the loan as determined at 5 year anniversary intervals. Such fee in excess of one and one half percent (1.5 percent) in a rural area or 1 percent in other areas must be justified by the CDC to the district office and receive written approval by the district office. Once a loan has been approved and funded, the CDC servicing fee cannot be increased.

The reason why a servicing fee must be charged is that the loan may be transferred to another CDC or SBA at some future date.

Q. Can a CDC charge the borrower additional fees other than those provided for in the regulations? For example, what if the borrower needs to have a release of collateral processed? Can the CDC require the borrower to pay an additional fee for this transaction?

A. No, a CDC cannot charge the borrower additional fees other than those provided for in the regulations. The servicing fees are expected to reimburse the CDC for all loan servicing including the preparation of any documents required for a servicing action.

d. Late Fees.

Loans funded from debentures sold after mid-1985 have a penalty provision if the monthly payment is more than 15 days late. The borrower is liable for 5 percent of the late amount or $100, whichever is greater, except where State law prohibits or restricts the amount. This fee is to be remitted to the CSA at the time the delinquent payment is made. If the SBA determines that the CDC is performing its administrative and loan servicing functions in a satisfactory manner, the late payment charge will be remitted to them. If not, the fees will be retained by SBA. The CSA may accept a payment without the late payment fee but the fee must be received within the subsequent 15 day period or the borrower is subject to a declaration of default.

Where SBA has formally deferred a loan or where loans are classified as in liquidation, the late charge will not be assessed while the loan is in deferred or liquidation status. The CDC can waive the late fee charge by written notification directly to the CSA. This does not require SBA's approval.

e. Assumption Fees

When a loan is assumed by another concern, the CDC may, with SBA's prior written approval, charge an assumption fee not to exceed 1 percent of the outstanding indebtedness to either the transferor or the transferee, regardless of whether or not a change in collateral is involved. CDCs may also be compensated for expenses incurred in obtaining an assumption of the third party financing in an amount not to exceed 1 percent of the outstanding third party indebtedness. (The third party lender cannot be the CDC or an affiliate of the CDC.) Such fee may be charged pursuant to a written agreement between the CDC and the small business setting forth the services to be performed and actually performed by the CDC. This agreement is also subject to SBA's prior written approval. This fee may be paid by the third party lender or the small business, but not by both.

f. Fees for Other Services

(1) The CDC may be compensated for other services provided to an small business such as packaging and servicing a 7(a) loan or providing management assistance. Such fees are to be charged pursuant to a formal agreement between the CDC and the 7(a) lender setting forth the roles and relationships of the parties as well as terms and conditions. Before a field office accepts loan applications for processing from a CDC on behalf of a participating lender, it must be satisfied that:

(a) The 7(a) lender has a valid "Participation Agreement," SBA Form 750 with SBA and that the lender affirms its responsibility under such agreement to SBA, not with-standing the contractual relationship with the CDC, with respect to any loan closed or serviced by the CDC on its behalf;

(b) Fees and charges assessed the borrower are limited to those permitted by .120 of 13 CFR and no additional costs are charged to the borrower by the participating lender or the CDC as a result of the contractual relationship with the CDC;

(c) The 7(a) lender is authorized to conduct lending activities within the State; and

(d) The compensation received by the CDC is reasonable relative to the services performed pursuant to the contract.

(2) SBA may, on a pilot basis, allow certain CDCs with the capability to do so, to perform liquidation actions subject to SBA guidelines. A written liquidation plan will specify CDC duties, compensation and fees.

(3) Compensation for services rendered that do not relate to SBA programs such as other Federal, State, and local government programs and private sector programs are beyond the jurisdiction of SBA and are not restricted by SBA.

2. CSA FEES

The CSA monthly servicing fee is one-tenth of one percent (1/10 of 1 percent) of the principal balance of the loan determined at 5 year anniversary levels.

3. FEES RELATING TO SALE OF DEBENTURES

In addition to these fees there are additional costs incurred in the sale of 505 Certificates in the public capital market. These costs are recovered by two fees:

a. Underwriting Fee The underwriters' role is to provide cost-effective advice as to the timing and pricing of offerings, to pool and underwrite 504 debentures, distribute 505 certificates, build and maintain an active secondary market, provide financial advisory services, and develop and introduce innovative forms of securities offerings as opportunities develop. The fiscal agent will periodically review and evaluate the underwriters' performance to determine whether adjustments need to be made. The fiscal agent may add to or replace underwriter(s) if appropriate. The Underwriters' fee is presently 1/2 of 1 percent for 20-year debentures and 3/8 of 1 percent for 10-year debentures.

b. Funding Fee The funding fee is presently 1/4 of 1 percent of the net debenture proceeds and covers other costs associated with selling 504 debentures. These costs include printing of Offering Circular and other documents required for public sales of securities, printing of certificate stock, the costs associated with the Trustee, Fiscal Agent costs, legal costs, and the cost of transferring 505 certificates.

4. FEE CHANGES AS OF OCTOBER 1, 1996

Due to legislation (P.L. 104-208) passed by Congress on September 28, 1996, there have been some changes and additions to fees charged for 504 loans. These changes are effective for all 504 loans approved between October 1, 1996 and September 30, 1997.

a. Borrower On-Going Guaranty Fee

The new legislation authorized an increase in the fee to be paid by the borrower. In order to provide a zero subsidy rate, SBA will impose a borrower guaranty fee of 7/8 of 1 percent per annum. This fee will be collected in the same manner as the previous 1/8 of 1 percent fee.

b. Participation Fee

The new legislation requires that the Agency collect a one-time fee in an amount equal to 50 basis points (1/2 of 1 percent) on the total participation in any project by any institution that is:

(1) A State or local government;

(2) A bank or other financial institution; or

(3) A foundation or other not-for-profit institution when the new participation of the institution will occupy a lien position senior to that of the development company. (Note: This fee only applies to the lender's participation in the eligible **504 project**, not any other financing that it does.)

Public Law 104-208 identified those fees to be paid by the small business. Since, in this case, the law did not state that this fee was to be paid by the small business and since the fee is imposed only in the instance when (1), (2), or (3), has a senior lien to SBA's, then it is our policy that the third party lender, not the small business, is to pay this fee, and generally this fee is not to be passed on to the borrower. This fee is to compensate SBA for the senior lender's lien advantage in a foreclosure situation.

c. Development Company Fee

The new legislation requires that the Agency collect from each CDC an ongoing guaranty fee of 1/8th of one percent (0.125 percent) of the principal balance outstanding of any guaranteed debenture authorized by the Administration during fiscal year 1997. The legislation directs SBA to deduct this fee from the servicing fees collected by CDC pursuant to regulation, but mandates that it not be derived from any fees imposed on the small business borrowers in addition to those already authorized.

Currently, SBA allows a CDC to charge a borrower a servicing fee of between 0.5 percent and 2 percent per annum on the unpaid balance of the loan as determined at five year anniversary intervals. A minimum 0.5 percent fee is required so that there will be an ongoing servicing income to the entity that is servicing the note. This can be particularly important if the CDC ceases operations, or is otherwise unable to service its loans. In such case the availability of the 0.5 percent fee would provide the necessary incentive for another CDC to assume the critical servicing function. In implementing the new development company fee, we must be sure that the minimum 0.5 percent will remain available for this purpose. Therefore, to comply with the new legislation the minimum servicing fee that CDCs will be allowed to charge is 0.625, (the 0.5 fee, plus the new 0.125 fee).

As to the maximum servicing fee that will be allowed to be charged by the CDC, our current regulation allows a CDC to charge the small business applicant not more than 2 percent per annum on the unpaid balance of the loan as determined at five-year anniversary intervals. The regulation also states that a fee in excess of 1.5 percent in a rural area and 1 percent everywhere else requires SBA's prior written approval.

To insure against higher servicing fees being passed on to the small business to offset the fee being charged to the development company, and to ensure consistent application of Agency regulations throughout the country, effective immediately, no servicing fee higher than 1.5 in a rural area or 1 percent everywhere else will be allowed without being fully justified and only upon written approval from the AA/FA, or designee.

The 1/8 of 1 percent per annum (0.125 percent) fee will be collected monthly. The CSA will deduct this fee from the servicing fees remitted to the CDC.

All 504 loan authorizations for loans approved in fiscal year 1997 will contain added language to cover these new fees.

CHAPTER 24. OVERSIGHT AND EVALUATION OF CDCS AND ADCS

1. WHO OVERSEES THE CDCS AND ADCS?

.120.973 Oversight and evaluation of CDCs and ADCs.

SBA may conduct an operational review of a CDC or ADC. The SBA Office of Inspector General may conduct, supervise or coordinate audits pursuant to the Inspector General Act. The CDC or ADC must cooperate and make its staff, records, and facilities available.

2. SBA FIELD OFFICE OVERSIGHT REQUIREMENTS

a. Operational Review

When the SBA field office gets a CDC's annual report, an Operational Review for the CDC must be performed. In those instances where the CDC's area of operation exceeds the field office's area of responsibility, the Operational Review will be performed by the field office where the CDC's headquarters is located.

The annual Operational Review should be based on the review of the CDC's Annual Report and the experience of all field offices the CDC submits 504 loans to including the Financing, Legal, and Servicing Divisions, as well as the Servicing Center. Also note findings of any IG reports, the previous review, and items where the CDC was directed to take action. The field office should use the "Operational Review Format" in Appendix 8 or a comparable form which incorporates the requested information. The objectives of the Operational Review in conjunction with the review of the Annual Report are: (1) evaluation of the effectiveness of the CDC in delivering and servicing SBA loan programs; (2) identification of CDC strengths, weaknesses and recommendations for improvement; and (3) if persistent problems have been identified without correction, a final deadline for such correction(s) and notice of steps for decertification. A copy of the review as well as a letter summarizing the review must be sent to the Executive Director of the CDC, the Chairman of the Board of the CDC, and the Director, Office of Loan Programs.

b. Field Review of the CDC

For each CDC, a field review at the principal office of the CDC must be conducted at least once every 3 years. The district office overseeing the CDC's operations is responsible for conducting the review. The field review should be conducted by appropriate personnel in the district office. In addition to the tri-annual visits, a field review should be scheduled if possible when: problems are identified within the Annual Report; the CDC has had significant changes in key staff, areas of operations or operations; or a significant number of CDC loans are delinquent. The purpose of the field review is to determine through an on-site inspection whether a CDC is complying with SBA policy and procedures. Refer to the SOP 50 for further guidance.

(1) Scheduling the Field Review. Generally, the review should be scheduled within 90 days after the annual report is due.

(2) Preparation for the Review. Before the review is conducted, you should review the annual report and evaluate the CDC file to identify areas of concern. Items to be evaluated in the CDC file should be the reports and correspondence since the last review. Any findings by OIG should be addressed, and the previous review and items where the CDC was directed to take action. If the annual report has not been received, the review should be conducted anyway. Non-receipt of an annual report may be a result of other deficiencies in the CDC. If the CDC works with more than one SBA office, the reviewing SBA office should solicit comments from the other office(s).

(3) Scope of Review Generally, areas to be covered by the review are the following.

(a) Capability The CDC must have appropriate and sufficient staff to manage, market, package and service the 504 portfolio. The requirements regarding staffing should be reviewed thoroughly, especially if the staffing is contributed by an affiliate or if much of the CDC's 504 activities, such as packaging are contracted out. Any contracts should be reviewed also.

(b) Membership The CDC must maintain membership that is representative of the area of operations and the required groups. All changes in membership should be reviewed to make sure that the membership continues to comply with the regulations.

(c) Public Purpose The CDC must finance projects that do, in fact, contribute to the economic development of the communities where the businesses are located. This is measured primarily through job impact. (Are the jobs really there?) The CDC should not be operating in a manner that is self-serving,

either directly or indirectly, for the benefit of an individual or group.

(d) Records The CDC must maintain adequate records that demonstrate compliance with SBA policy (e.g., meeting minutes, accounting records, servicing files, and other records and reports reflecting the CDCs' activities and organization). Review of the board of directors minutes, CDC insurance documents, committee minutes, and changes in the board of directors and subsequent compliance with the regulations are items that especially need review.

(e) Review of Previous Actions required on previous findings should have been taken and such findings resolved. If not, these items should be the subject of the current review.

(f) Case Analysis A determination of the currency, past due, liquidation and charge-off rates should be done prior to the field review. Also the percentage of new business loans should be determined as well as the number of loans approved versus the percentage that actually close. A representative sample of the CDC's portfolio should be selected for analysis. If there are no concerns, at least five loan files should be sufficient. Otherwise, more should be reviewed.

If there are multiple field offices, the reviewing SBA office is responsible for analyzing a representative sample for all field offices.

(4) Report of the Field Review. The field office will summarize the results of its review in a memorandum setting forth the findings and actions taken or to be taken. The findings must be brought to the CDC's attention for action, and a copy of the report is to be provided to the Director, Office of Loan Programs within 30 days after the review is complete.

c. Compliance Audit

The CDC may be subject to periodic audits conducted, supervised or coordinated by the SBA OIG. The Office of Financial Assistance may request that specific CDCs be audited by the OIG either independently or at the written request of the branch/district office or by

the OIG. The CDC must cooperate and assist with the audit by making its staff, books, records, and facilities available. Failure of the CDC to cooperate in this manner will be grounds for the Agency to refuse to issue further guarantees until such time as the CDC consents to such audit.

3. CDC TRANSFER, SUSPENSION AND REVOCATION

.120.980 Transfer of CDC to ADC status.
SBA shall transfer to ADC status any CDC that fails to meet the activity level required by SBA, on average over two consecutive fiscal years. SBA shall notify the CDC in writing of the action and of the opportunity for a hearing pursuant to part 134 of this chapter at least 10 business days prior to the transfer. During the pendency of a hearing, SBA's action will remain in effect.

Policy pertaining to a CDC's conversion from a CDC to an ADC can be found in subpart H, chapter 8, paragraph 8.

a. Can a CDC Voluntarily Surrender or Transfer its Certification?

.120.981 Voluntary transfer and surrender of CDC certification.
A CDC may not transfer its certification or withdraw from the 504 program without SBA's consent. The CDC must provide a plan to SBA to transfer its portfolio. The portfolio may only be transferred with SBA's written consent. If a CDC desires to withdraw from the 504 program, it must forfeit its portfolio to SBA. SBA may conduct an audit of the transferring or withdrawing CDC.

If a CDC wishes to surrender or transfer its certificate, it must state so in a letter (signed by its president or any other officer authorized to do so) to the field office that has jurisdiction over its area of operation. The SBA field office must review the CDC's loan files for any servicing problems prior to determining if the loans are to be transferred to another CDC or to SBA. The format in appendix 8 is to be utilized. After all details have been worked out, the field office is to forward the appropriate documents as well as a 327 action listing the loans to be transferred to the Office of Loan Programs. The Office of Loan Programs will then prepare a letter to the CDC accepting the voluntary surrender. This letter will be sent certified mail with a copy to the field office.

b. How Can SBA Correct a CDC's Servicing Deficiencies?

.120.982 Correcting CDC servicing deficiencies.
SBA may require corrective action, including the transfer of existing or pending financings to another CDC in good standing. SBA must notify the CDC in writing of any servicing, reporting or collection deficiencies and the corrective actions to be taken. SBA may instruct the CSA to withhold service and late fees and may assess the CDC up to $250 per day for expenses incurred by SBA to correct the deficiencies. If non-compliance continues for 90 days, SBA may take the fees as compensation for its efforts to obtain compliance.

.120.983 Transfer of CDC servicing to SBA or another CDC.
If a CDC fails to correct servicing deficiencies, or is unable or unwilling to service its portfolio, SBA may assume the servicing or require the transfer of all or part of the CDC's portfolio to another CDC within or adjoining the deficient CDC's Area of Operations. If there is no suitable CDC, SBA may approve a transfer to another entity. Future service fees from transferred loans will be paid to the transferee. In addition, the CDC's processing authority will be temporarily suspended.

.120.984 Suspension or revocation of CDC certification.
(a) Suspend or revoke. The AA/FA may suspend or revoke the CDC's certification if a CDC:
(1) Violates a statute, an SBA regulation, or the terms of a Debenture, authorization, or agreement with SBA;
(2) Makes a material false statement, knowingly misrepresents, or fails to state a material fact;
(3) Fails to maintain good character;
(4) Fails to operate according to prudent lending standards;
(5) Fails to correct servicing, collection, reporting, or other deficiencies; or
(6) Is unable or unwilling to operate in accordance with the requirements of this part.
(b) Transfer portfolio. Upon suspension or revocation, the CDC must transfer its remaining portfolio and any 504 applications or financings in process to another CDC designated or approved by SBA. If a pending 504 financing is completed after a transfer, any deposit must also be transferred. Any fees must be apportioned by SBA between the two CDCs in proportion to services performed.
(c) Provide written notice. SBA must give written notice to the CDC at least 10 business days prior to the effective date of a suspension or revocation, informing the CDC of the opportunity for a hearing pursuant to part 134 of this chapter.

SBA reserves the right to revoke the eligibility of any CDC, to immediately suspend the eligibility of any CDC or to require any other corrective action (including, but not limited to, the transfer of existing or pending financings to a CDC in good standing) for a violation of law, SBA rules and regulations, any agreement with SBA, or any failure to comply with the operational requirements. However, such revocation or suspension does not invalidate any guarantee previously issued by SBA. Notice of termination, suspension, or revocation will proceed according to 13 CFR Part 134 of SBA's regulations.

The Assistant Administrator of the Office of Hearings and Appeals or an administrative law judge of such office will be the reviewing official for such actions.

Should a field office find that a CDC is in violation of a law, SBA regulations, or agreement with SBA, the CDC must act to correct the violation as soon as possible. All actions are to be documented.

(1) If a violation cannot be resolved, the branch/district office must forward a copy of documentation evidencing the violation to the AA/FA accompanied by the field office's recommendation of action to be taken.

(2) The case will be reviewed and evaluated, and appropriate guidance given on the action to be taken.

c. How Does a Development Company Classified as an ADC Apply to be Recertified as a CDC?

For an ADC to be considered for recertification as a CDC within 12 months of conversion to its ADC status, it must demonstrate to SBA's satisfaction that it has made a significant commitment to the development company loan programs. The following must be submitted to the SBA field office serving the ADC:

(1) A resolution from the Board of Directors stating its desire to become recertified and a commitment to make resources available for this renewed commitment.

(2) A narrative as to what things are being done differently to overcome any deficiencies that led to the CDC's inactivity. Why will the future be different from the past?

(3) Examples of a new direction would be:

(a) Expanded area of operations. This could include the merger of two or more ADCs or the expansion of an ADC into an area not served or under-served by an existing CDC.

(b) Commitment of staff resources. This includes attending community development and financial training classes. In most cases, the organization will need at least one qualified person committed full-time to the 504 program. SBA has found that the major key to a successful CDC is a full-time executive director who will take ownership of the program, market the program to lenders, and bring in good quality 504 loans to SBA. If this commitment is not made, there must be strong off-setting factors to justify recertification.

(4) Amendments to articles and by-laws that may be necessary.

(5) Current membership list with new members identified.

(6) Current Board of Directors list with new board members identified.

(7) SBA Form 1081s for any new Board members and staff as well as fingerprint cards as required by the SOP.

(8) If expanding, a copy of the published announcement in a local newspaper. This is not required for mergers of two or more existing CDCs.

Upon receiving the information, the field office shall do the following.

(1) Review the application for recertification.

(2) Contact the CDC that took over the area formerly serviced by the ADC for its written comments regarding the proposed recertification.

(3) Conduct a field review of the ADC. The inspection of the ADC documentation filing shall be the emphasis at the field visit at the principal office of the ADC. The purpose of the field review is to determine whether the ADC has the capabilities and resources to service the loan portfolio.

(4) Obtain the district counsel's comments on whether the ADC's organization is consistent with applicable State laws and SBA regulations.

(5) Contact the Servicing Center for its comments if it services this CDC's loans.

(6) Submit the analysis and recommendation through the district director to the Office of Loan Programs (OLP) which will issue its decision to the field.

CHAPTER 25. IMPACT OF CURRENT RULES AND LAWS ON OLDER LOANS

.120.990 501, 502, and 503 loans.

SBA has discontinued loan programs for 501, 502, and 503 loans. Outstanding loans remain under these programs, and Borrowers, CDCs, and SBA must comply with the terms and conditions of the corresponding notes and Debentures, and the regulations in this part in effect when the obligations were undertaken or last in effect, if applicable.

.120.991 Effect of other laws.

No State or local law may preclude or limit SBA's exercise of its rights with respect to notes, guarantees, Debentures and Debenture Pools, or of its enforcement rights to foreclose on collateral.

APPENDIX 1 - PROCESSING PROCEDURES

1. INTRODUCTION

This appendix sets forth a standard procedure developed for application in all district offices for loan processing. This procedure provides an orderly flow of documents, identifies control actions and locations and clearly identifies areas of responsibility and accountability. The intent of this SOP is to assist with district office workflow and to standardize procedure as much as possible.

SECTION 1 APPLICANT INQUIRY OR INTERVIEW

2. RECEPTIONIST

When an inquirer requests SBA financial assistance in person the receptionist:

a. If inquiry was made previously, pulls any available material related to previous contacts or requests;

b. If the initial inquiry, record, at a minimum, the name and address in some other manner acceptable to the Chief, FD or ADD/F&I, such as a computerized system; and

c. Provide general information or contacts an interviewer if the inquirer so requests or needs more detailed information than the receptionist can provide.

3. INTERVIEWER

a. Personal interview:

(1) Make a preliminary determination of applicant's eligibility and qualifications pursuant to this SOP;

(2) Explain the step-by-step application procedure (OPC-6 provides an excellent format);

(3) Provide unqualified applicants with advice as to other possible sources of assistance; and

(4) Prepare a record detailing the significant aspects of the interview if a return visit and/or potential problems seem likely and return it to the receptionist.

b. Telephone inquiry:

(1) Make an appointment if an interview is desired.

(2) Record the name and address by a method suitable to the Chief, FD or ADD/F&I or prepare a memo in suitable detail if a potential problem seems likely.

(3) Forward interview memos to the receptionist.

c. Letter inquiry:

(1) Prepare a suitable reply;

(2) Attach the letter to a copy of the reply and mark the copy "Interview File;" and

(3) Forward this to the receptionist and mail the reply.

d. Arrange interviews with Business Development Division as appropriate and take the applicant to that office.

4. BUSINESS DEVELOPMENT OFFICER

a. Upon termination of the interview, complete SBA Form 641A, "Counselor's Case Report."

b. Forward a copy of SBA 641A marked "Interview File" to the receptionist.

5. RECEPTIONIST

File interview memos and any accompanying documents received from an interviewer or Business Development Officer.

SECTION 2 INITIAL PROCEDURES UPON RECEIPT OF APPLICATION

6. MAIL CLERK

The need for proper recordation and control of loan applications requires a uniform mail handling procedure. Follow the detailed procedure set forth below. Upon receipt of incoming mail:

a. Do a preliminary sort of the mail into the following categories:

(1) Personal and that endorsed "Open by Addressee Only;"

(2) Registered, certified, insured and those containing checks and other negotiable instruments and date stamp envelopes containing checks;

(3) Periodicals and "junk" mail; and

(4) All other.

b. Sign any Post Office receipt forms; and log registered, certified, and insured mail and other negotiable instruments on SBA Form 9, "Incoming Negotiable, Registered, and Insured Mail."

c. Open "all other" mail and date stamp:

(1) Financial statements;

(2) Notices of cancellation of insurance;

(3) Past due notices;

(4) Applications for a loan, first page;

(5) Credit reports; and

(6) Letters.

NOTE: Generally, other mail not specified above is not date stamped, and the envelopes are not retained unless they contain information not in the contents regarding the sender or the addressee. (See SOP 00 10 for additional mail handling requirements.)

d. Deliver all mail:

(1) Deliver periodicals and "junk" mail not otherwise deliverable to district director's

or regional administrator's secretary for disposition;

(2) Deliver loan applications to the FD control clerk on the day received; and

(3) Deliver credit reports and SBA 912s to the FD control clerk.

7. CONTROL CLERK

a. Review SBA Form 912, "Statement of Personal History," for completeness. Determine whether all required SBA Forms 912 are included in the application package.

(1) If the information is complete and an affirmative answer was given to questions 6, 7, or 8 on the form, forward the second and third copies to the Office of Security Operations of the Office of Inspector General. File the original copy in the loan case file and note the date on the "Screening Sheet." Initial and date the original copy of SBA 912.

(2) If the information is complete and no affirmative response was given to question 6, 7 or 8 on the form, retain the original copy in the loan case file and discard the second and third copies.

(3) If information is incomplete, note the deficiencies on the screening sheet and, in bold print, state that SBA 912s have not been forwarded to the Office of Security Operations of the Office of Inspector General. Upon receipt of the necessary information, if an affirmative response was given to question 6, 7 or 8 execute the required forms and forward them to the Office of Security Operations of the Office of Inspector General. (See paragraph 3.m.)

b. Prepare SBA Form 370, "Representative Index," as required. Maintain the office copy in an alphabetized file.

c. Prepare a folder for the application package material. Type a pre-acceptance (buff) label showing applicant's name and affix it to a legal file holder.

d. Establish a loan control (LATS) and continue the application's flow in accordance with the LATS procedures. Route the application through the supervisor to the screener to determine basic eligibility and feasibility. Handle screen-outs in accordance with paragraph 10 of this appendix.

e. If credit report/information is not provided by lender or if application is for a direct loan

do the following.

(1) For credit reports ordered manually, prepare the proper order ticket form for the type of credit report required. Retain the original order ticket and forward two copies to the appropriate credit reporting agency. Compare the file order tickets with any bills received from a credit reporting agency.

(2) For credit reports ordered via computer, use a computer terminal with a modem to access the credit reporting agency, enter your security code as assigned by the credit reporting agency and enter the appropriate data. Retain a of the transaction to reconcile with any bills received from a credit reporting agency.

If the bill is correct, submit it to Denver Fiscal Office for payment.

NOTE: Similar procedures are used to obtain credit reports from Dun and Bradstreet. SOP 90 60, "Credit Reporting Service," provides complete instructions.

g. Prepare SBA Form 66, "Charge Out Record," and forward same to the file room.

h. Deliver the application package to the supervisor or his/her designee. The CLP applications are generally routed directly to the designated processing loan officer.

NOTE: When credit reports or other material relating to an application in process are received, forward the material to the processing loan officer.

SECTION 3 SCREENING PROCEDURES

8. SUPERVISORY OFFICIAL

a. Review the application to determine assignment to which processing loan officer. Note the assignment on the screening sheet.

b. Forward the application package to the control clerk.

NOTE: Each application package should generally be assigned to a loan officer on the same day it is received by SBA. This is particularly important on CLP applications where SBA is committed to three day processing.

9. CONTROL CLERK

a. Enter the name of the processor/screener in the loan control system (LATS) and the date forwarded.

b. Forward the application package to the processor/screener.

10. PROCESSING LOAN OFFICER OR DESIGNEE

Screen the application for acceptability.

Make a determination of acceptability within 3 days of the date the application was received in the office. Expedite the screening of CLP packages since processing must be completed within 3 days. The supervisory official, or designee, monitors screening time frames using SBA control data.

a. If the application is acceptable, advise the control clerk to update the control system and proceed with processing. If omitted documentation can be supplied without a material delay to processing, contact the participant (generally by telephone) and request a prompt submission. Confirm this conversation via a follow-up letter or memo. Contact the applicant on direct loans by telephone and outline the deficiencies and arrange for immediate submission. Accept an incomplete application for processing if documentation can be supplied promptly. If material delays are anticipated, return the application for completion.

b. If it is not acceptable (screen-out decline or insufficient information to process):

(1) Draft a letter detailing the reasons the application is being returned (lack of sufficient information to process and/or obvious decline); and

(2) Forward the application package and a typed letter to the appropriate supervisory official.

11. SUPERVISORY OFFICIAL

Process a return or screen-out decline recommendation as follows.

a. If in agreement that the application should be returned without action, sign the letter or initial the file copy to indicate concurrence and forward the letter with the case file to the control clerk.

b. If in disagreement, discuss with the loan officer and return the case file to the processing loan officer.

12. CONTROL CLERK

Process return recommendations as follows.

a. Date the signed letter returning the application and forward it and the applicant's personal papers to the applicant (original only) or lender (original and courtesy copy).

b. Update the SBA control system, noting the return action and date (LATS).

c. File a copy of the letter of return in the 149 file.

SECTION 4 PROCESSING PROCEDURES

13. PROCESSING LOAN OFFICER

Process accepted application adhering to criteria and time frames contained in this SOP.

a. Obtain a credit report or credit bureau information if not supplied by a lender.

b. If appropriate, get a copy of SBA Form 641A, "Counselor's Case Report."

c. If appropriate, get input from the Portfolio Management Division.

d. Determine whether a field visit is needed.

e. Consult counsel, as appropriate, on eligibility, size, unusual conditions, etc.

g. Complete analysis and prepare loan officer's report, date, and sign it. All documentation should be completed before the loan report is signed by the loan officer.

h. If decline is recommended, prepare a decline letter.

i. If approval is recommended, prepare a copy of a loan authorization and an optional letter of approval.

j. Forward the loan case file to the appropriate supervisor. (Loan authorization or decline letter should be typed in final form when forwarded with loan case file.)

14. SUPERVISORY OFFICIAL(S)

a. Take final action on all applications as authorized by official delegation of authority and/or appropriate SOP's.

b. On applications where the first level supervisor is not authorized to take final action, make comments and a recommendation and refer the case through channels to higher authority, advising the control clerk of the status. The control clerk updates the control system where reviewer delays of more than one day are anticipated.

c. If the supervisor takes final action and no funds allocation is required, sign and date the loan report, sign the loan authorization, and forward the loan case file to the control clerk.

15. CONTROL CLERK

a. If the application is approved:

(1) Enter appropriate data into the LATS system;

(2) Enter the assigned case number on the application form and related documents;

(3) Send a letter of advice to the lender/applicant unless the transmittal letter or other means of notification is sent within 3 days;

(4) Post SBA's share to loan funds control record and strike a new balance;

(5) Type and affix a label and place all documents in SBA Form 232, "Loan Case Folder," as described in paragraph 15.d. below; and

(6) Forward the loan case file to the documents examiner.

b. If the loan case is to be held pending availability of funds, note the date and action taken of SBA loan control system.

c. If the application is declined:

(1) Forward signed decline letter to lender or applicant;

(2) Update loan control system (LATS where appropriate);

(3) Update the lender file if it is a participation loan request; and

(4) Place a copy of the decline letter in the case file and forward the case file to the file room.

d. Order of filing in loan case file, from bottom to top in each section.

(1) Authorization, etc.

(a) Copy of 135 or equivalent (LATS) data.

(b) Copy of authorization.

(2) Credit File.

(a) Credit reports.

(b) All supporting application documentation in the sequence listed on SBA Form 4, "Application for Business Loan."

(c) "Application for Business Loan," SBA Form 4.

(d) Financial statements obtained in the course of servicing the loan, in chronological order.

(3) Examiners Reports.

(a) "Lender's Application for Guaranty," SBA Form 4-I and/or "Loan Officer's Report."

(b) "Field Visit Reports," SBA Form 712, and memoranda to the file in

chronological order.

(4) Correspondence - Letters and memoranda from outside sources in chronological order.

(5) Loan Servicing Documents.

(a) Copies of miscellaneous collateral documents.

(b) Copies of "Standby Agreements."

(c) Copy of "Landlord's Waiver."

(d) Copies of "Assignments of Life Insurance."

(e) Copies of "Personal Guaranty," SBA Form 148.

(f) Copies of "Chattel Mortgages" or U.C.C. documents.

(g) Copies of "Mortgages" or "Deeds of Trust."

(h) Conformed copy of the "Note."

(6) Miscellaneous Documents - Settlement Sheets, etc.

APPENDIX 2 - AGENCY COMPUTER DATA

1. PMEI01 - FRANCHISE CODE INQUIRY BY NAME

a. Purpose

The SBA maintains statistical portfolio performance data on business loans provided to franchises. The data is designed to measure the failure and charge off rates of individual franchisees. The data is a compilation of portfolio performance from loans to individual franchisors, that are combined to give the performance of the overall franchisee. This data is at least 1 year past initial disbursement. The SBA field personnel may access this data through the PMEI01 system. The date that is accessible in the field is an aggregation of each loan made to a business operating as a particular franchise such that the results provide insight into the overall operation of the franchise/franchisor.

Replace the franchise code list in SOP 20 19. The user accesses the current list of franchise numbers - additions and deletions are available to field offices as soon as they are made by Headquarters.

b. Input Procedures

(1) Clear screen as appropriate for your terminal type.

(2) Key in PMEI01 XXXXXXXXXX with XXXXXXXXXX = one to ten alpha-numeric characters representing the franchise name to be found.

(3) Press the transmit key.

(4) Possible displays.

(a) DCS system error message. See chapter 3 of "SBA Data Communications System User Manual."

(b) PME system error message. See paragraph 1.c. of this appendix.

(c) The first page of the franchise names that start with the one to ten letters or numbers entered.

(5) When the first screen of franchise names is displayed, the cursor will be placed at the paging field. To display page 2, etc. enter the page number at this location and press the transmit key.

(6) To exit the paging program, tab to the right of the DEL> field and press the

transmit key.

IMPORTANT NOTES

(a) If there is a space in the name, such as Burger King, PMEI01 reads only up to the space.

(b) For a more general inquiry, such as a listing of all franchise names beginning with a specific letter, enter PMEI01, space and the letter (PMEI01 B).

(c) The maximum number of franchise names displayed on the screen at any time is 17.

(d) If you are unable to find a franchise name or have any problem, call Headquarters (202-205-6490) for the assignment of a number.

c. Error Messages

(1) SEARCH PARAMETER REQUIRED - 1 to 10 alphanumeric characters representing the franchise name to be found were not entered.

(2) SEARCH PARAMETER IS TOO LARGE - more than 10 alphanumeric characters representing the franchise name to be found were entered.

(3) NO MATCH FOUND - No franchise name could be found which matches the 1 to 10 alphanumeric characters inputted by the user.

2. PMEI02 - FRANCHISE LOAN EXPERIENCE INQUIRY

a. Purpose

The PMEI02 provides an automated means to inquire on franchise loan experience over a 10 year period for franchises by office, region, and national totals.

b. Input Procedures

(1) Clear screen as appropriate for your terminal type.

(2) Key in PMEI02.

(3) Press the tansmit key.

(4) Possible displays.

(a) DCS system error message. See chapter 3 of "SBA Data Communications System User Manual."

(b) PME system error message. See II.c of this appendix.

(c) The PMEI02 screen appears with the cursor positioned at the "FRANCHISE CODE" field, the first data input field.

(5) Complete the screen by entering the five digit franchise code and then the location code(s) in the related fields, using the TAB to move to the next field for data entry. After completing the screen, move the cursor to the XMIT field and press the transmit key.

(6) The data on the screen is accepted. If errors are detected, fields containing errors will blink and an error message will appear at the bottom of the screen. TAB to the field(s) in error, make necessary corrections, TAB to the XMIT field and press the transmit key. If problems continue, call Headquarters at PAL.

c. Error Messages

(1) FRANCHISE CODE CANNOT BE SPACES - Franchise code is blank. Enter franchise code.

(2) LOCATION CODE CANNOT BE SPACES - All location codes are blank. Enter at least one location code.

(3) INVALID FRANCHISE CODE - The franchise code which was entered does not exist on the database.

d. Location Codes

At least one SBA LOCATION CODE must be inputted. For only one or two location codes, tab through the others. Enter "7700" in SBA LOCATION CODE for national totals. All other location codes for the branches, districts, and regions are in the Agency telephone directory next to the listings for the offices as "Office ID #".

3. PMEI03 - SIC LOAN EXPERIENCE INQUIRY

a. Purpose

The PMEI03 provides an automated means to inquire on SIC loan experience by

office, region, and national totals for the past 10 years.

b. Input Procedures

(1) Clear screen as appropriate for your terminal type.

(2) Key in PMEI03.

(3) Press the transmit key.

(4) Possible displays.

(a) DCS system error message. See chapter 3 of the "SBA Data Communication System User Manual."

(b) PME system error message. See 3.c. of this appendix.

(c) The PMEI03 screen appears with the cursor positioned at the "SIC CODE" field, the first data input field.

(5) After the input screen appears, enter the four digit SIC code and then the location code(s) in the related fields to complete the screen. Use the TAB to move to the next field. Key in all required data, TAB to the XMIT field and press the transmit key.

(6) The data on the screen are accepted. If errors are detected, fields containing errors will blink and an error message will appear at the bottom of the screen. TAB to the field(s) in error, make necessary corrections, TAB to the XMIT field and press the transmit key. If problems continue, call Headquarters at PAL.

c. Error Messages

1. SIC CODE CANNOT BE SPACES - SIC code is blank. Enter SIC code.

2. LOCATION CODE CANNOT BE SPACES - All location codes are blank. Enter at least one location code.

3. INVALID SIC CODE - The SIC code entered does not exist on the database.

d. Location Code

At least one SBA LOCATION CODE must be inputted. For only one or two location codes, TAB through the others. Enter "7700" in SBA LOCATION CODE if you want to inquire on national totals. All other location codes for field offices are in the SBA Telephone Directory.

4. ACCESSING THE NON-PROCUREMENT LIST

You can check the names of individuals or entities that are debarred from participation with the Federal Government by accessing the Lists of Parties Excluded from Federal Procurement and Non-procurement Programs (Lists of Parties) electronically through GSA's Federal Supply Service System 24 hours a day, 7 days a week. You can access it through SBA's Home Page by using the http://www.arnet.gov/epls address

All Federal agencies, including SBA, must check the General Service Administration's (GSA) Excluded Parties List (EPL) for all primary-tier transactions. The EPL includes a Procurement Entries List and a Nonprocurement Entries List of Debarred and Suspended Persons. GSA maintains the list and makes it available as follows:

Procurement entries lists contractors that are excluded Government wide, unless otherwise noted, from Federal procurement, and/or sales programs. An exclusion may also be the result of actions by a Federal agency under authority of a statute, Executive order, or regulation applying to procurement programs.

Non-procurement Entries lists individuals and entities excluded Government-wide, unless otherwise noted, from certain types of Federal financial and non-financial assistance and benefits. An exclusion may also be based on an administrative debarment or suspension by any Federal agency or the voluntary exclusion of a person under agency regulations implementing Executive Order 12549.

Parties Excluded from Procurement and Non-procurement Programs (Reciprocal Listings) lists individuals, entities, and contractors that are excluded from both procurement and non-procurement programs.

To obtain a download of the entire database, you must download the procurement/non-procurement list and the reciprocal list.

To obtain a procurement download only, you must download the procurement list and reciprocal list.

To obtain a non-procurement download only, you must download the non-procurement list and reciprocal list.

The treatment to be accorded to a party listed depends on the type of action taken and the authority under which the action was taken. Refer to the appropriate cause and treatment code for each action.

Access to the lists by SBA requires entry of the Agency's acronym at:

AGENCY--enter "SBA" and press return.

Lenders should enter their company name at:

OTHER USERS--enter up to 30 characters and press return.

You will be asked to verify the data you entered is correct.

You should now be at the main menu screen. Each option is explained once it is selected.

MAIN MENU

R - Reports Menu (Password is required for nonprocurement and reciprocal reports.)

S - Search Menu (Used to query database.)

V - View Codes or Contacts (Used to view cause and treatment codes or Agency contacts.)

H - Help

Q - Quit

To obtain a password contact P. Owens at 202-501-4740. Please note, you do not need a password to search or query the database.

5. INPUTING USE OF LOAN PROCEEDS DATA

To assess the use of SBA loan proceeds within its business loan programs 12 new data elements or Use of Proceeds (UoP) options have been added to the loan application tracking system (LATS). All processing offices shall start providing use of proceeds information for all loans funded via the LATS System, effective with this notice. The programming for these options includes edits which prevent completion of the funding process unless the applicable options correctly add up to the loan amount. The UoP options must be completed and mathematically correct in order that the funding process can be completed.

The 12 UoP options are horizontally located across the middle of the LSA010 screen. This is one of five screens needing data input before a loan is funded. All 12 options will not be used for every loan. However all 12 require some numeric indicator, so options which are not applicable to the particular case will still need to be filled with at least a 0.00. Some options are specifically reserved for only 7(a) and others for just 504. In addition, some options are used to report one type of proceeds usage for 7(a) and another type of usage for 504. This is because the data needed for 7(a) is limited to just the loan we guarantee, but in 504 financing, we need data on the debenture (that portion of each project we guaranty), the administrative fees, and the other sources of project financing.

To accurately compute loss and subsidy rates as well as to verify compliance with recent legislation, SBA needs data on 504 loans which includes the amount of third party lenders financing and other borrowings, as well as the amount of the applicant's equity injections. By having the additional options to capture more than just the loan amount for 504, SBA has options available to report piggyback and non-SBA related financing as well as equity injections for 7(a).

Since the options are so varied, close attention when inputing the data is needed in order for the Agency to provide heretofore unknown answers regarding the different uses for the loans we support. During the initiation phase of the UoP options, the recommending loan specialist should complete the use of proceeds spread and provide the actual amounts to the personnel inputing the data. A format is provided on the last page of this notice.

An explanation of the uses of each option follows.

a. R/E AMT (Real Estate Amount) For 7(a) this option should report the amount used to:

(1) Acquire an existing building and/or land;

(2) Construct or add an addition to a building;

(3) Take out or convert an interim construction loan to permanent financing (this is not considered debt refinancing);

(4) Leasehold improvements to new or existing space; and

(5) Renovate existing real estate.

For 504 loans, report the same items but in a different way. Report only the appropriate percentage of the project associated with the R/E AMT which the net debenture finances. This means the full amount in the project's R/E AMT has to be multiplied by the percentage which the net debenture finances. This percentage is in the authorization.

b. F/A AMT (Fixed Asset Amount) For 7(a) report proceeds used to acquire any fixed assets other than real estate. Fixed Assets includes:

(1) Machinery and Equipment;

(2) Automotive Equipment; and

(#) Furniture & Fixtures.

For 504, report the same items but only the appropriate percentage of the project associated with the F/A AMT which is included in the net debenture.

c. W/C AMT (Working Capital Amount) For 7(a) report proceeds used to:

(1) Change a borrower's current assets or current liabilities (except the Current Portion of Long Term Debt); and

(2) Change other assets such as pre-paid expenses. Proceeds used to pay off existing accounts payable and notes payable which resulted from delinquent accounts payable are included in this option. The acquisition of inventory, payment of accrued expenses, and payment of credit card debt related to the business are also included.

Option c. is not available for 504 loans.

d. REF-SBA (Refinance SBA Debt) For 7(a) report proceeds used to: exclusively refinance any existing (including disaster) SBA debt regardless of that debt's age. This does not include refinancing the non-SBA debt portion of a piggyback financing arrangement previously approved and disbursed

This option is not available for 504 loans.

e. REF-NON (Refinance Non-SBA Debt) - For 7(a) report proceeds used to refinance any existing debt (except SBA debt) permitted under Agency policy. This includes both the current portion of long term debt and the long term portions of each debt refinanced via an SBA loan. It does not include the refinancing of accounts payable or notes payable with an original repayment period of one year or less, or any other refinancing of a current liability (except CP/LTD).

This option is not available for 504 loans.

f. CoO (Change of Ownership) - For 7(a) report proceeds used to affect the complete change of ownership and acquire 100 percent of the ownership interest in a concern via either the purchase of assets of a going concern or purchase of 100 percent of the stock or purchase of a business as a going concern. This includes .Goodwill. resulting from the purchase of the business. Proceeds used for the redemption of less than 100 percent of all outstanding stock - corporate buyout of a stockholder or purchase of all of one owners interest by another individual, shall be placed under the "Other" category.

504 proceeds can not be used to purchase an existing business as a going concern and therefore this option is not available for 504. However, a project can be defined as the purchase of the assets of an existing business. In this case the proceeds are to be spread between the type of assets (basically R/E and F/A) being acquired.

g. OTH-SBA (Other Uses of SBA Proceeds) For 7(a) report proceeds used to accomplish those items that cannot be placed in any of the first 6 categories such as:

(1) Redeem less than 100 percent of the outstanding stock of a corporation;

(2) Acquire intangible assets such as licenses or franchises;

(3) It should be noted that 100 percent of all proceeds can not be placed in this option. The OFA clearance is needed to lift the computer edit which prevents this programming. The OTHER option will generally be the location for only non-standard items.

For 504, report proceeds used to cover the "soft costs" associated with the project which the net debenture finances a fixed percentage. These cost include professional fees and other expenses which are part of the net debenture. Under no circumstances are 504 administrative fees to be here.

h. NET-504 (Net Debenture) Not available for 7(a) and equal to the total of a, b, and g

for 504 loans.

i. 1st-POS (Senior Financing) For 7(a) report all the proceeds of the companion loan in a piggyback structure when this other loan has a senior security position on the same assets securing the SBA guaranteed note.

For 504, report the amount of the third party lenders (TPL) financing secured in a senior position to the debenture. If the TPL loan is secured on a co-shared position, report the amount of this financing in option k.

j. ADM-FEE (Administrative Fees) Not available for 7(a). For 504 the amount here represents the SBA/CDC fees charged as part of a 504 project, which makes up the difference between the net and gross debentures (which includes the amount provided the borrower in order to round the gross debenture up to the nearest whole thousand).

k. OTH-NON (Other Non-SBA Financing) For 7(a) report any financing associated with the financing spread between options 1 thru 7 which has not been placed in a thru g, plus i, or l.

For 504, report any 504 project financing not reported in options b, c, g, i, j, or l. An example would be subordinate seller financing.

l. INJECT (Borrowers Injection) For 7(a), use option to report the applicants contribution towards the purpose(s) being financed with the loan. For a start up, report the net worth shown in the proforma column. For an existing business, report the applicant's contribution towards satisfying the purpose(s) being financed with the 7(a) loan, regardless of the source of this equity. Debt on formal standby goes here but debt which is subordinated as to payment goes to option k.

For a 504 loan, report the borrowers equity contribution towards the cost of the total project.

Every business loan must have its use of proceeds information spread between the applicable options. For all 7(a) loans, the total of options a through g must equal the total amount of the loan. For 504, the sum of options a, b, and g must equal h and h plus j must equal the loan amount. If the combined totals of these options do not equal the full loan amount, the computer will not allow the funding process to be completed. All twelve options must have a numerical indicator so 0.00 will signify either not applicable or no funds used for this option's purpose.

Some 7(a) loans may involve the type of funds that are referenced by options i and k. While these options cover items that are not part of a 7(a) loan, the data will be of value in assessing the effectiveness of the overall 7(a) loan program.

Additional Guidelines For Reporting 504 Proceeds Usage

Since a 504 debenture finances only a portion of each category of proceeds used in a project (plus all the administrative fees) and the authorization details all the usage of the project's proceeds rather than just net debenture proceeds, mathematical computations are necessary to report just the SBA portion of each 504 project.

When completing the UoP options for a 504 loan, it is recommended that the proceeds for the net debenture be input first. This will involve using options a, b, g, and h. To get the actual amounts for options a, b, and g, multiply the total proceeds for the R/E, F/A, and OTHER categories by the applicable debenture percentage. The totals of these three options must equal option h. Some rounding may be necessary to make each option a whole dollar amount and if more rounding is needed place all the difference into the option with the largest dollar amount.

Next complete option j. which when added to option h equals the gross debenture (loan amount). Option i equals the amount of the TPLs loan. Option k generally equals the amount borrowed from a source other than the CDC or third party lender and in numerous 504 loans will be N/A or 0.00. All 504 loans must have an amount in option l. For 504, the combined total of options h, i, k, and l equals the project cost. While option j is not included in the definition of the project, option j is part of SBA's gross debenture.

Inputing Proceeds Amounts

The dollar amount of the total loan of any 504 loan shall be in increments that are no smaller than whole thousands while the same amount for 7(a) shall be in increments no smaller than whole hundreds. However, the individual components or UoP options of either type of loan can be in increments that are less than whole hundreds. Always avoid pennies.

The input variables for the 12 UoP options have space for up to $99.9 million dollars since there are 8 spaces followed by a decimal and two spaces. The largest number in any option would be 99999999.99 (commas not included). Remember, for 7(a) loans options a - g must equal the total loan amount and for 504 loans, options a, b, and g, (which equals option h) plus option j equals the gross debenture and loan amount. The Agency's computer will be programmed to check for this compliance.

Guidance On Loan Funding

It has been noted that credit decisions to approve or increase loans are presently

occurring without the proper follow-up to appropriate the funds associated with the action. A loan is not approved or increased until the LSA010 screen is completed, and can be printed out. Approving officials are charged with the responsibility to assure that all loans are properly approved. The generation of a loan number prior to the LSA010 screen being completed has **not** completed the process.

Miscellaneous

The "Construction Amount" category available on the LSA010 screen is not one of the 12 UoP options, but will remain a viable input field. Offices should continue to use this category as previously required.

Modifications

The UoP options are part of SBA's LATS system, which reports data on the loan at the time of approval. The UoP options will not be part of the LAUB loan accounting system which permits changes and updating over the life of the loan. Therefore, when increases or cancellations are made, the UoP options will go unchanged.

Questions on the use of proceeds process should be "E-Mailed," not phoned, to SOP-5010 with the subject heading of UoP or "Use of Proceeds."

In the "Use of Proceeds" format, you would enter the following:

1.	R/E AMT	112,000	(.40 times 280,000)
2.	F/A AMT	0	
7.	Other	8,000	[.40 times (4,000 + 16,000)]

Q. What if the first-mortgage lender decided to refinance the existing mortgage on the building. Would that be included in the project financing?

A. No. It is not part of the project financing.

Cut Along Dotted Line

- -

USE OF PROCEEDS REPORT

Loan Name: _____

Effective: 12-01-97

SubProgram Code: _____

1. R/E Amt _____	5. REF-NON_____	9. 1st-POS _____
2. F/A Amt _____	6. CoO _____	10. ADM-FEE _____
3. W/C Amt _____	7. OTH _____	11. OTH-NON _____
4. REF-SBA _____	8. NET-504 _____	12. INJECT _____

APPENDIX 3 - RESTRICTIONS ON FOREIGN CONTROLLED ENTERPRISES

Various Federal laws prohibit foreign controlled U.S. enterprises from certain types of activities. These activities are listed below for your guidance. Exercise special care in processing loans involving the types of enterprises.

1. GENERAL RESTRICTIONS FOR FOREIGN CONTROLLED ENTERPRISES

Foreign controlled enterprises operating in the United States, whether in branch or subsidiary form, may not do the following.1/

a. Engage in operations involving the utilization or production of atomic energy (42 U.S.C. 2133(d)).

b. Own vessels which transport merchandise or passengers between U.S. ports or tow U.S. vessels carrying such merchandise or passengers between U.S. ports (46 U.S.C. Appx. 802, 883, 888). There are exceptions to this general rule, one of which permits a foreign controlled U.S. manufacturing or mining company to engage in shipping activities related to its principal business (46 U.S.C. Appx. 833-1).

c. Acquire rights of way for oil pipelines or leases or interests therein for mining coal, oil, or certain other minerals on Federal lands other than the outer continental shelf if the foreign investor's home country does not permit such mineral leasing to U. S. controlled enterprises (30 U.S.C. 181, 185).

d. Engage in radio or television broadcasting unless the Federal Communications Commission (FCC) finds the grant of a license to be in the public interest (47 U.S.C. 301). The FCC has granted licenses for broadcasting activities ancillary to another business of a foreign controlled enterprise.

e. Acquire control of a company engaged in any phase of aeronautics (49 U.S.C. Appx. 1301(1), 1378(a)).

1/ In certain cases foreign enterprises can acquire a minority interest in corporations engaging in the activities noted but certain management requirements may have to be met.

f. Be issued permits for intra-United States air commerce or navigation (49 U.S.C. 1371, 1401(b), 1508).

g. Obtain a fishery loan from the Secretary of Interior for the financing or refinancing or the cost of purchasing, constructing, or operating commercial fishing vessels or gear (16 U.S.C. 742c(b)(7)).

h. Sell obsolete vessels to the Secretary of Commerce in exchange for credit towards new vessels (46 U.S.C. Appx. 1160(h)).

i. Receive a preferred ship mortgage (46 U.S.C. Appx. 922).

j. Purchase vessels converted by the Government for commercial use or surplus war-built vessels at a special statutory sales price (50 U.S.C. Appx. 1737, 1745).

k. Obtain special Government emergency loans from the USDA for agricultural purposes after a natural disaster (7 U.S.C. 1961) or USDA loans to individual farmers or ranchers to purchase and operate family farms (7 U.S.C. 1922, 1941).

l. Establish an Edge Act corporation to engage in international or foreign banking (12 U.S.C. 619). 1/

m. Purchase Overseas Private Investment Corporation (OPIC) insurance or guarantees (22 U.S.C. 2198(c)).

n. Obtain construction-differential or operating-differential subsidies for vessel construction or operation (46 U.S.C. Appx. 1151 ff., 802).

o. During war or a national emergency, acquire or charter U.S. flag vessels, vessels owned by a U.S. citizen or shipyard facilities (46 U.S.C. Appx. 835) or acquire controlling interest in corporations owning the vessels or facilities described above without the approval of the Secretary of Commerce (46 U.S.C. Appx. 835).

1/ In addition to its limitations on stock ownership by foreign enterprises, the Edge Act requires that all the directors of the corporation be United States citizens.

2. MANAGEMENT-RELATED RESTRICTIONS ON FOREIGN ENTERPRISES

In certain cases, a foreign controlled enterprise operating in the United States must meet certain requirements relating to management in order to engage in particular activities. The foreign investor, however, can continue to own all the equity in the enterprise because the laws in question do not contain limitations relating to stock ownership. Unless these management requirements are met,

foreign controlled enterprises may not do the following:

a. Organize a national bank (all directors must be United States citizens) (12 U.S.C. 72).

b. Engage in dredging or salvaging operations in U.S. waters (To register a vessel to engage in these activities, the president or chief executive officer of a domestic corporation and the chairman of its board must be U.S. citizens. The foreign citizens serving as directors cannot be more than a minority of the number necessary to constitute a quorum.) (46 U.S.C. Appx. 316).

c. Fish in the territorial water of the United States, land fish caught on the high seas and, except for corporations of countries with traditional fishing rights, fish in the United States fishing zone (See 2.b of this appendix for the management requirements.) (16 U.S.C. 1801, 1821, 46 U.S.C. Appx. 7105) 1/

d. Transport certain commodities procured by or financed for export by the United States Government or an instrumentality thereof. (See 2.b of this appendix for the management requirements.) There are certain statutory exceptions to this rule (46 U.S.C. Appx. 1241).

e. Obtain certain types of vessel insurance. (See 2.b of this appendix for the managements requirements.) (46 U.S.C. Appx. 1281 ff.)

f. Obtain licenses to operate as customs-house brokers (19 U.S.C. 1641). (At least two of the officers must be U.S. citizens.)

1/To the extent that these activities involve the coast wise trade, certain limitations on stock ownership would have to be met (Cf. Sec. 1).

3. RESTRICTIONS APPLICABLE TO FOREIGN BRANCHES OR INDIVIDUALS

a. In certain cases the form of business organization chosen by a foreign controlled enterprise will determine whether it will be treated differently from an enterprise controlled by United States citizens. If a foreign controlled enterprise chooses to operate through a sole proprietorship or a branch office rather than a corporation organized under the laws of one of the states, it may not:

(1) Obtain licenses to construct dams, reservoirs, houses, and transmission

lines (16 U.S.C. 797(e));

(2) Obtain licenses to develop and utilize geothermal steam and associated resources on Federal lands (30 U.S.C. 1001 ff.); or

(3) Obtain certain rights of way, mining rights, leases or other rights on Federal lands. (See, generally, 43 CFR.)

These restrictions would not apply if the foreign controlled enterprises operated through a domestic subsidiary.

b. In addition to restrictions previously noted, foreign citizens may not:

(1) Act as officers and serve in certain other positions on certain vessels (Cf. 46 U.S.C. 8103); or

(2) Function as operators in radio or television stations (47 U.S.C. 303(1)).

4. OBTAINING EX-IMBANK's COUNTRY LIMITATION SCHEDULE

The Country Limitation Schedule (CLS) is made available by Ex-ImBank and is updated as needed or annually. A current schedule can be obtained via the internet @ http://www/exim.gov/country/country.htm.

APPENDIX 4 - GUIDELINES TO DETERMINE LENDER ELIGIBILITY

1. STATEMENT OF PURPOSE

Appropriate enabling legislation authorizes SBA to make participation loans, at its discretion, in cooperation with banks and other lending institutions (excluding Small Business Investment Companies licensed by SBA) through agreements to participate on an immediate or deferred (guaranty) basis. Such agreements do not obligate SBA to participate on any particular loan or loans that a lender may submit. The existence of a participation agreement does not limit SBA's right to determine the extent of its participation from time to time, as appropriate, as a matter of general policy or with respect to particular loans. It also does not limit SBA's right to withhold, at its sole discretion, approval of a proposed transfer of the guaranteed portion of any loan.

2. ELIGIBLE LOAN PARTICIPANTS

Participating lending institutions must meet all of the following requirements.

a. Capability

Have a continuing capability to evaluate, process, close, disburse, and service commercial term and other loans authorized by SBA to small business concerns. Such capability exists when the lending institution's operations are at all times conducted by persons possessing the aforementioned capabilities. The financial institution must hold itself out to the public as engaged in the making of such loans, maintain a reasonably accessible office in its own name, have a listed telephone number, and be open to the public during regular business hours.

b. Good Character and Reputation

A lending institution possesses good character and reputation if all members of its management, including officers and directors, possess good character and reputation. In addition, persons of good character and reputation must own a minimum of 90 percent of the lending institution.

c. Financing Subsidiaries

The lender may not be a concern that is or will be engaged primarily in financing the operations of an affiliate as defined in 13 CFR Part 121.

d. Supervision and Examination

Be subject to continuing supervision and examination by a State or Federal chartering,

licensing, or similar regulatory authority such as the Federal Reserve, Comptroller of the Currency, National Credit Union Administration, Office of Thrift Supervision, and/or Farm Credit Administration

3. FINANCIAL CAPACITY

In addition to the foregoing regulatory requirements, SBA will expect, as a matter of policy, each participating lender to have adequate the financial capacity to disburse private sector funds on loans at the time loan applications are submitted to SBA.

4. LOAN PARTICIPANTS SUBJECT TO REGULATION BY OTHERS

a. Banks and Savings and Loan Associations

A State and/or National bank or a State or Federal savings and loan association which seeks approval as a loan participant with SBA is to contact the SBA district office serving the geographical area where its principal office is located. The SBA presumes that such lender automatically complies with the examination and supervision requirements of item 2.d of this appendix. However, the district office determines whether such lender meets the general requirements for all loan participants under items 2.a, b, c AND 3 of this appendix. If the district office determines that such lender meets these requirements, it may enter into a "Loan Guaranty Agreement," SBA Form 750 and/or 750B with the particular lender. In the case of a savings and loan association, transmit a copy of the executed agreement to the AA/FA.

b. Loan Participants Other Than Banks and Savings & Loan Associations

A lending institution other than a bank or savings and loan association seeking approval to become a participant with SBA must demonstrate, to SBA's satisfaction, that it is subject to continuing supervision and examination in accordance with item 2.d of this appendix.

Such lending institution must file an application (in duplicate) containing the information and documents set forth in item 4.c with the SBA district office serving the geographical area where its principal office is located.
The district office reviews the application and prepares a memorandum setting forth any comments it has concerning the institution, including:

(1) An opinion as to whether the lending institution meets the requirements of Item 2.a, b, c, and 3 of this appendix; and

(2) Its recommendation as to whether to approve the application.

The district office retains a copy and submits the memorandum and the original of the application through its regional office to the Assistant Administrator for Financial Assistance.

Headquarters makes the final determination on such applications and notifies the district office through the regional office. Upon notice of favorable determination, the district office proceeds to enter into a "Loan Guaranty Agreement," SBA Form 750 or 750B, and submits a copy of the executed agreement to the AA/FA.

c. Loan Participant Application

(1) Applicant's name and address.

(2) Applicant's telephone number.

(3) State of incorporation of the applicant.

(4) A copy of applicant's Articles of Incorporation and By-laws certified by an appropriate officer.

(5) Amount of the applicant's paid-in capital and paid-in-surplus.

(6) The applicant's proposed geographical area of operations.

(7) A list of officers, directors, associates and holders of ten or more percent of any class of the applicant's capital stock. "Associates" are defined in the regulations (13 CFR Part 120).

(8) A copy of the most recent audited financial statements on any entity, other than natural persons, holding 10 or more percent of any class of stock.

(9) An organizational chart showing the relationship of the applicant to its associates, if any.

(10) A copy of Statement of Personal History, SBA Form 1081, for each person listed under Item 4.c(7).

(11) Explain the applicant's methods of funding loans, including the unguaranteed.

(12) Explain loan servicing procedures to be utilized.

(13) An affirmation that the applicant will not be engaged primarily in financing the

operations of an affiliate, as defined in 13 CFR Part 121.

(14) A copy of the State or Federal statute or regulations governing the applicant's operations, including those pertaining to audit, examination and supervision of the applicant. Each applicant bears the burden of demonstrating that it is subject to continuing supervision by a State or Federal regulatory authority satisfactory to SBA.

(15) A copy of the latest report covering the examination of the applicant.

(16) The dates on which the last three examinations of the applicant were performed. No participation application is processed by SBA until and unless such examination report is provided. It is the applicant's responsibility to provide such report.

(17) A copy of the most recent audited financial statements of the applicant.

(18) A copy of the license, if any, issued to the applicant by a regulatory authority.

(19) A copy of any brochure or advertisement describing the applicant's lending activities, if available.

(20) A certified copy of a Resolution of the Board of Directors designating the person(s) authorized to submit the application on behalf of the applicant.

(21) A copy of a satisfactory opinion of independent counsel that the applicant complies with applicable Federal, State, and local laws in the formation and organization of the company and with appropriate Federal and/or State security laws and is chartered to conduct its business in the proposed operating area. ("Independent Counsel" is one that is not an "Associate" under 13 CFR Part 120.)

5. SBICs NOT ELIGIBLE TO PARTICIPATE

Companies licensed by SBA to operate as Small Business Investment Companies (SBIC's) are ineligible to become participating lenders with SBA. However, there is no prohibition against an affiliate of a licensed SBIC, other than a subsidiary, to wholly or partly own a participating lender.

6. SCOPE OF APPLICATION

The procedure and requirements outlined herein are not applicable to lending institutions currently participating with SBA. They are applicable to prospective financial institutions

seeking to become participants. The procedure for suspension and/or revocation of a lender's privilege to participate, as set forth in item 8 below, applies to all participants, current as well as prospective.

7. LOAN PARTICIPANTS REGULATED BY SBA - SBLC's

Prior to January 4, 1982, Section 120.4(b) of 13 CFR provided that any lending institution which was not subject to continuing supervision and examination by a State or Federal regulatory authority could be approved as a participating lender subject to certain conditions. Effective as of that date, this section was repealed, and SBA ceased accepting applications for such lenders, known as "Small Business Lending Companies" (SBLC). Existing SBLCs continue to participate with SBA and are subject to direct supervision and examination by SBA.

8. SUSPENSION AND REVOCATION OF LENDER'S PRIVILEGE TO PARTICIPATE

Under Part 120 13 CFR, SBA reserves the right to revoke or temporarily suspend the eligibility of any lender to participate as a result of any violation of SBA regulations, any breach of any agreement with SBA or any change of circumstances resulting in the lender's inability to meet the operational requirements. Such revocation or suspension of the privilege to participate does not invalidate any guaranty previously entered into by SBA.

District offices may recommend suspension or revocation of a lender's privilege to participate. Forward such recommendation, with substantiating evidence, through the regional office to the AA/FA.

Circumstances which may result in a recommendation for suspension or revocation include:

a. Changes in management reflecting adversely on the good character and reputation and/or capability of the lender;

b. Evidence of continuous and/or substantial failure to properly close loans to fully protect or preserve the interest of the lender and SBA;

c. Consistent failure to properly report on disbursement and status of loans;

d. Evidence of continuous and/or substantial failure to obtain SBA's prior approval on waivers, alterations, consents, and similar servicing matters; and

e. Other matters of a significant nature;

The AA/FA reviews all recommendations for suspension or revocation, with appropriate comments from the Office of General Counsel. If AA/FA makes a determination to suspend or revoke, SBA serves notice as required in 13 CFR Part 134. Headquarters may request that field offices comment on any Answer received prior to the final decision. Pursuant to 13 CFR Part 134, the process involves the AA/FA, General Counsel, and the Office of Hearings and Appeals.

RESERVED

APPENDIX 5 - CENTRALIZED LOWDOC PROCESSING

1. INTRODUCTION

a. This appendix contains the policies, procedures, and guidelines specific to SBA's Low Documentation Loan Program (LowDoc). This program is a streamlined method by which the Agency provides its guaranty to eligible lenders on loan applications from eligible small businesses. The maximum loan amount for this program is $150,000, which includes the outstanding balance on any SBA loans excluding disaster loans. The streamlining in this program involves:

(1) Reduced paperwork for both the lender and applicant once the lender decides to apply for a guaranty on their proposed loan;

(2) A 36 hour response time by SBA on its decision to guaranty (this is based on consecutive working days); and

(3) Alternative post approval responsibilities from standard practices for the lender.

b. LowDoc is a financing vehicle which relies on the character and credit history of the borrower and the experience and judgment of the lender. The lender is expected to perform credit analysis on LowDoc loans in a manner consistent with prudent lending practices, and to summarize that analysis in its request to SBA for a loan guaranty.

c. This appendix discusses how a lender becomes a LowDoc lender, loan eligibility requirements, underwriting issues, and processing systems. Unless specifically addressed in this guide, all policies and procedures specified in the SBA's standard operating procedures (SOP) manuals (SOP 50 10, 50 50, and 50 51) and in the Code of Federal Regulations (CFR) Title 13, Part 120, shall apply.

d. To summarize, applications submitted for consideration under LowDoc procedures must meet the following criteria:

(1) The total loan amount (including the balance of any other SBA loans except disaster loans) must not exceed $150,000;

(2) The applicant business and its owners, partners, or principals must have a good credit history;

(3) The owners, partners, or principals must be of good character, (i.e., not have made an affirmative response to the questions in item IV of section D5 of SBA Form 4-L "Application for LowDoc Loan"); and

(4) The loan request must not involve any complex issues. Loans processed under LowDoc procedures should have straight forward structures, not involve situations requiring any determinations from legal counsel about the sufficiency of any proposed condition, or require a waiver of the policies established for the 7(a) Loan Program or LowDoc process.

If any of these criteria can not be satisfied, the application is not eligible for consideration under LowDoc. It may be considered under regular 7(a) procedures by the field office that serves the area where the business is located or will be located.

2. LENDER PARTICIPATION

a. Lender Participation

Participation in LowDoc Program is open to existing PLP and CLP lenders, plus other lenders who are experienced in making small business loans of $150,000 or less, including those which are not currently SBA lenders. Non-PLP/non-CLP lenders who want to become LowDoc lenders must have executed an SBA Form 750, "Loan Guaranty Agreement," and be experienced in making small business loans of $150,000 and less. In accordance with 13 CFR Part 120.410, a lender must have at least 20 qualifying loans outstanding that were initially approved in an amount of $150,000 or less. Qualifying loans are those that are categorized as commercial, industrial, or commercial real estate loans as identified on Call Reports. Lenders will certify to this fact by signing the LowDoc application form.

b. Lender Training

Training of participant lenders is a role shared by field offices and Headquarters staff alike. Each field office is responsible for ensuring that lenders doing business in its service area are knowledgeable of SBA's loan policies and procedures, as well as current Agency goals and objectives. LowDoc Processing Center (LDPC) staff are responsible for notifying LowDoc lenders of new policies and procedures relative to the LowDoc Program. The Office of Financial Assistance staff are responsible for developing materials for use in lender training activities to ensure that all LowDoc procedures and policies are consistently applied and administered.

c. Oversight and Review

(1) SBA will continue to monitor the performance of the LowDoc Program on an ongoing basis by tracking program activity and performance and by conducting periodic lender case file reviews to verify compliance with policy and procedural requirements and ensure that established credit standards are being maintained.

(2) Program oversight is the responsibility of Headquarter.s Office of Financial Assistance (OFA) which monitors program usage, payment performance, and adherence to established policies and procedures. Program oversight includes quality assurance measures related to the processing and servicing of LowDoc loans in the centers. OFA is responsible for taking appropriate measures to ensure that the program operates in a safe and sound manner.

(3) Conducting lender visits for the purpose of reviewing LowDoc loan files also provides the opportunity to acquaint lenders with other programs and services offered by the Agency. At the same time, the reviewer should elicit comment from the lender concerning possible areas of improvement to LowDoc and other programs, as well and pass those comments along to OFO for coordination with OFA.

(4) As stipulated in 13 CFR . 120.431: "A Lender must allow SBA.s authorized representatives, during normal business hours, access to its files to review, inspect and copy all records and documents relating to SBA guaranteed loans." SBA reserves the right to terminate a lender's participation in LowDoc at any time for just cause.

(5) What are the Requirements of SBA's Lender Review Program?

The requirements of SBA's Lender Oversight Program, including the oversight of LowDoc Lenders, are specified in the "Loan Policy and Program Oversight Guide for Lender Reviews." This guide can be found in Appendix 30 of SOP 50-50(4).

3. LOWDOC LOAN TERMS

a. Amount

The maximum amount for a LowDoc loan to any one small business, plus its affiliates[1], including the balance of any other outstanding SBA debt, except disaster assistance loans, is $150,000. A business can have more than one outstanding LowDoc loan so long as its total outstanding SBA guaranteed debt (regardless of the guaranteed portion) does not exceed $150,000.

b. Interest Rate

The interest rate on a LowDoc loan is negotiated between the lender and borrower and may be fixed or variable. However, under SBA regulations, the maximum rates are:

(1) 2 1/4 percent over the Wall Street Journal Prime on loans with maturities less than 7 years;

(2) 2 3/4 percent over the Wall Street Journal Prime on loans with maturities of 7 years or more;

(3) For loans of $25,000 and less, these rates may be increased by 2.0 percentage points; or

(4) For loans of $25,001 to $50,000 these rates may be increased by 1.0 percentage point.

c. Maturity

The maturity for a LowDoc loan is determined by:

(1) Ability to repay;

(2) Use of loan proceeds; and

(3) Useful life of the assets being financed.

Loans for working capital purposes may not exceed 7 years, except in cases where a longer maturity (not more than 10 years) may be needed to ensure repayment. The

[1] Affiliates are generally defined as businesses that have common ownership, common management, or contractual relationships. For additional information, refer to section 121.103 of CFR 13 or Subpart A, chapter 3, paragraph 3, of SOP 50-10(4).

maximum maturity of loans used to finance personal property, i.e., machinery & equipment and furniture & fixtures, is limited to the economic life of those assets, not to exceed 25 years.

d. Repayment Terms

The lender should schedule repayment terms to coincide with the historical cash flow of the business. Loans are generally amortized in equal periodic installments of principal **and** interest over the life of the loan. Principal **plus** interest, semiannual, or annual payments are discouraged. Lines of credit and balloon payments are prohibited.

Short-term and single payment loans are allowed only with an identified and reliable source of repayment. Sources of income outside of the business being financed may be used to help substantiate repayment ability in the LowDoc Program. These sources of income must be clearly identified by the lender when submitting the application to the LDPC. For an outside source of income to be relied upon to demonstrate repayment ability, it must be constant, consistent, and sufficient to meet the needs of the individual(s) and repay the loan. Reliance upon the earning capacity of an individual(s) is subjective. It is subject to income from potential employment being sufficient to meet personal needs plus repay the loan.

4. LOWDOC ELIGIBILITY REQUIREMENTS

All loans processed under LowDoc procedures are subject to the eligibility and credit requirements of the 7(a) program as stipulated in statute, regulation, or policy, unless specifically amended by this appendix. SBA's current edition of "Processing Function" SOP [SOP 50-10(4)] is the basic source document for an explanation of these requirements.

LowDoc eligibility is ultimately determined by the LDPC. Lenders are responsible for ensuring that the applicant and the proposed use of loan proceeds are eligible. Lenders are to complete the "LowDoc Eligibility Checklist" for LowDoc loans and use it as a basis for responding to the eligibility questions on the LowDoc Application Form (SBA Form 4-L). Checklists must be retained in lenders' loan files and be available for review by SBA. If there are any questions or uncertainties regarding the eligibility of a particular applicant, the lender should contact the LDPC for determination before submitting the application.

Summarized below are the eligibility requirements that are unique to loans processed under LowDoc procedures. They are referred to as the LowDoc Eligibility Criteria. These factors are generally in addition to the standard requirements of SBA's 7(a) loan program. Failure to satisfy these requirements does not render a loan ineligible for consideration under the 7(a) program. Rather they only prevent an application from being processed under LowDoc procedures.

The following LowDoc Eligibility Criteria apply only to applications processed under LowDoc

procedures. They are all referenced on SBA's LowDoc Eligibility Checklist. Any loan excluded from LowDoc processing because of the first four reasons can only be considered under regular 7(a) processing. Loans excluded from LowDoc for any of the other reasons may be eligible to be initially processed under other methods of processing.

a. Dollar Amount Restriction

The total loan amount of any loan request processed under LowDoc procedures (including the balance of any other existing or pending SBA loans except disaster loans) can not exceed $150,000.

b. Credit History

As part of the overall character evaluation, an applicant's credit history is significantly relied upon during the processing of LowDoc applications. As a result, applicant concerns and their principals can not have a negative credit history (based on the business and personal credit reports) including no experience with bankruptcy.

c. Character

Each owner, partner, or shareholder must not be:

(1) Presently under indictment, on parole or probation;

(2) Charged for any criminal offense other than a minor motor vehicle violation; or

(3) Convicted, placed on pre-trial diversion, or on any form of probation, including adjudication withheld pending probation, for any criminal offense other than a minor motor vehicle violation.

Center Directors (C/D) have the same authority as ADD/EDs to clear the 912 and waive fingerprints. In the absence of the C/D, the acting C/D has the authority to take these actions. When a 912 is cleared for processing, the C/D must waive the fingerprints and requirement for a completed FD 258.

If an application includes a 912 that has an affirmative response, this 912 must be cleared by the C/D or else the application must be declined for not being eligible for LowDoc processing. If the affirmative response is that the subject is presently under indictment or on probation or parole, the loan is not eligible for any assistance. An affirmative response to the other questions does not prevent the loan from being considered under standard processing procedures.

d. Policy Waiver Restriction

Loans processed under LowDoc procedures shall not require that a waiver of SBA policy be provided in order for the proposed structure, or terms and conditions to be satisfied.

e. Complex Credit Issues

Loans processed under LowDoc procedures shall be straight forward, and not involve complex issues. They shall not require extensive risk assessment or a multitude of credit and collateral issues if approved. They shall not require excessive legal review to determine if the conditions will be legally sufficient.

Examples of inappropriate requests include, but are not limited to: Loans structured with a piggyback arrangement; loans to acquire a building situated on leased land; or loans where repayment has to be determined from a combination of historical and projected statements from different businesses.

f. Special Size Standards

To eliminate the need to deal with numerous and varied size standards for different industries, LowDoc has established its own alternative size standard. An applicant (including all affiliates) must have average annual sales for the preceding 3 fiscal years of $5.0 million or less **and** employ 100 or fewer individuals averaged over the previous 12 calendar months from the date of application.

The following exceptions to the above size standard must be met by applicants in these industries:

(1) Farms ($500,000);

(2) Travel Agents ($1.0 million);

(3) Real Estate Agents ($1.5 million);

(4) Engineering, Architectural, and Surveying Services ($4.0 million);

(5) Fishing, Hunting, and Trapping ($3.0 million); or

(6) Dry-cleaning Plants ($3.5 million).

Applications that do not meet the special size standards for LowDoc but do meet regular 7(a) size standards must be processed under procedures other than LowDoc.

g. Refinancing Existing Debt

No more than 25 percent of the proceeds of any loan processed under LowDoc procedures may be used to repay same institution debt (i.e., debt owed to the lender submitting the application).

The refinancing of existing SBA direct or guaranty debt is not authorized to be processed under any procedure other than regular 7(a).

h. Other SBA Programs

The following type of special 7(a) programs are not eligible for LowDoc processing:

Export Working Capital Program
International Trade
Defense Loan and Technical Assistance (DELTA)
CapLines
Employee Stock Ownership Plans (ESOP and ERISA)
Pollution Control
Community Adjustment & Investment Program (CAIP)

5. STANDARD 7(a) ELIGIBILITY REQUIREMENTS

Because all loans processed under LowDoc procedures are subject to the eligibility and credit requirements of the 7(a) program, processors of LowDoc requests need to be familiar with the standard eligibility requirements of the 7(a) program. Summarized below are other factors of eligibility that apply to all 7(a) loans. These standards are herein provided to inform personnel involved in loan processing about the other requirements that must be considered as part of the processing of any 7(a) application. These requirements are also referred on the LowDoc Eligibility Checklist, even those that are not specifically factors applicable to LowDoc.

a. Type of Business

Most types of small businesses are eligible. The following types of business, however, are **not** eligible:

(1) Nonprofit, religious, or charitable organizations;

(2) Businesses primarily engaged in lending or investment activities;

(3) Businesses engaged in real estate investment and other speculative activities;

(4) Businesses principally engaged in teaching, instructing, counseling, or indoctrinating religion or religious beliefs;

(5) Pyramid sales distribution plans;

(6) Businesses engaged in illegal activities;

(7) Businesses deriving more than one-third of their revenue from legal gambling activities;

(8) Private clubs not open to the general public;

(9) Consumer and marketing cooperatives;

(10) Loan packagers earning 30 percent or more of their revenue from packaging SBA loans;

(11) Businesses engaged in activities of prurient sexual nature; and

(12) Businesses or their Associates that have previously defaulted on a Federally assisted loan.

b. Credit Not Available Elsewhere

The SBA provides financial assistance only to an applicant for whom the desired credit is not otherwise available on reasonable terms from non-Federal sources. The lender must certify on all applications that, based on its knowledge of the terms and conditions generally available in its market, credit is not otherwise available on reasonable terms from non-Federal sources. The lender must substantiate this certification in its file.

c. Personal Resources of Principals

An applicant must show that the desired funds are not available from the personal resources of any owner who owns 20 percent or more of the applicant business. For any loan that is for $250,000 or less, SBA requires that any such owner must inject any personal liquid assets which are in excess of two times the total financing package or $100,000, whichever is greater.

For the purposes of this section, liquid assets include cash or cash equivalent, savings accounts, CDs, marketable securities, cash value of life insurance, or similar assets. Qualified retirement accounts, such as IRAs, Keogh, or 401k plans are **not** considered liquid assets.

Either the lenders or SBA may still require additional injections beyond what is required under the personal resources provision to make the loan credit worthy when credit factors indicate a need for additional capitalization.

d. Purpose of Loan Proceeds

LowDoc loans may be used for almost any legitimate business purpose. Examples include financing accounts receivable and inventory, purchasing machinery and equipment, purchasing and/or improving real estate, and purchasing or starting a business.

Loan proceeds may **not** be used for the following purposes:

(1) Payments, distributions, or loans to Associates of the applicant;

(2) Paying delinquent withholding or sales taxes or any other funds held in trust or replenish funds used to pay such accounts;

(3) Paying funds to any owner or replenish funds used for that purpose, except for **eligible** changes of ownership;

(4) Refinancing any debt which is already on reasonable terms or which does not provide at least a 20 percent cash flow improvement to the applicant; or

(5) Refinancing or paying any creditor in a position to sustain a loss, causing a shift to SBA of all or part of a potential loss from an existing debt.

e. Refinancing Existing Debt

The lender may refinance existing non-SBA applicant debt **only** when the debt is not already financed or cannot be refinanced on reasonable terms elsewhere, **and** a substantial benefit (as defined below) will be provided the applicant.

(1) Provides at least a 20 percent decrease in the scheduled amortized payment from that of the existing debt.

(2) Improves debt coverage to an acceptable level. The portion of the refinanced loan that results in the improved cash flow, i.e., the 20 percent decrease, must be used in turn to finance the hiring of additional staff, purchasing of assets, an increase in receivables or for other growth related financing needs - not simply to provide increased funds for owner withdrawals.

Any debts to the participating lender that are being refinanced must have been current (within 29 days) for at least the last 36 months according to the original terms of the debt agreement (payment transcript should be retained in the borrower's files) and the collateral securing such loan(s) should be pledged on the new loan. Reference Subpart A, Chapter 2, paragraph 3j, Q&A # 2.

f. Change of Ownership

Change of ownership loans are eligible provided the business benefits from the change. In most cases this benefit should be seen in promoting the sound development of the business or preserving its existence. Proceeds **may not** be used to purchase only part (i.e., less than 100 percent) of the ownership of any owner, partner, or shareholder, nor may they be used to enable a borrower to purchase part of a business in which he or she has no existing interest.

A loan may not be used for one partner/shareholder or group of same to purchase the entire interest(s) of another partner/shareholder or group of same to the exclusion of the others. Loans for this purpose are made to the business to purchase the entire interest of the seller.

g. Franchises

Franchises are eligible provided the franchisee has the right to profit on the basis of its efforts, and the ownership of the franchisee bears the risk of loss. Franchises are not eligible if the franchisor retains the power to control the operations to such an extent that the franchisee is virtually operating under an employment contract.

SBA has established a centralized review and clearance procedure for franchises called the Central Registry (Registry). If a franchise is listed on the Registry and certifies that no changes have been made to its franchise documents since the date listed, disbursement may occur with no further review or clearance if the loan is approved. If the franchise is not listed on the Registry or indicates changes to its franchise documents since the date listed, review, and clearance must be performed by the LDPC prior to any disbursement.

Lenders are responsible for reviewing the franchise documents and determining the issue of control prior to submission of applications.

The presence of a franchise on SBA.s PMEI01 and PMEI02 systems **IS NOT** sufficient to qualify an applicant operating under the franchise as eligible for financial assistance. These systems only indicate that the Agency has experience with them and what the historical performance has been over a 10 year time span.

h. Eligible Passive Company (EPC)

An EPC[2] is eligible provided it uses loan proceeds to acquire or lease and/or improve or renovate real or personal property that it leases to an Operating Company (OC)[3] for use by the OC. An EPC may be in any legal form of ownership structure. The following conditions apply to all legal forms:

(1) The use of proceeds must be an eligible use as if the OC were obtaining the financing directly.

(2) The EPC and the OC must be small under the appropriate size standards in 13 CFR part 121.

(3) The lease between the EPC and the OC must be in writing and must be subordinated to SBA's mortgage, deed of trust, or security interest on the property. Also, the EPC (as landlord) must furnish an assignment of all rents paid under the lease as collateral for the loan.

(4) The lease between the EPC of the OC, including options to renew exercisable solely by the OC, must have a remaining term approximate to the term of the loan at the time of loan closing.

(5) The OC must be a co-borrower with the EPC or a guarantor on the loan.

(6) Each individual who owns 20 percent or more of the EPC must guarantee the loan.

(7) Each individual who owns 20 percent or more the OC must guarantee the loan.

[2] An Eligible Passive Company (EPC) is a small entity which does not engage in regular and continuous business activity, which leases real or personal property to an Operating Company for use in the Operating Company's business.

[3] An Operating Company (OC) is an eligible small business actively involved in conducting business operations now or about to be located on real property owned by an Eligible Passive Company, or using or about to use in its business operations personal property owned by an Eligible Passive Company.

i. Government and Child Support Obligations

All applicants and their principals and guarantors must be current on all Government obligations, such as payroll and income taxes, existing SBA debt, and student loans. If the lender is aware of any delinquencies of this nature, the lender must submit the application for processing under regular 7(a) guidelines. All owners of 50 percent or more of the applicant concern must also certify, by signing the Authorization, that they are not more than 60 days delinquent on child support obligations.

6. CREDIT STANDARD

Lenders are to analyze and document LowDoc loans in a manner consistent with prudent lending practices. The strengths of the principal's character, credit, and capacity, as determined by the lender, may be considered to offset a marginal credit factor such as sporadic historical earnings, marginal owner equity, or insufficient collateral. Applications that do not meet the lender's standards for character, credit, and capacity should not be considered under LowDoc.

Instead of the traditional in-depth analysis of a 7(a) application, SBA reviews the information submitted by lenders on LowDoc applications, and if applicable the lender.s credit analysis and the applicant's financial statements. However, as stated before, the lender is expected to perform the same level of analysis as it does for similar non-SBA loan requests and consistent with prudent lending practices. Thus, to the extent possible, the lender should summarize its justification for the guaranty request on the LowDoc applications and supporting documentation. Simple statements to the effect that specific credit factors are satisfactory are not sufficient.

In order to maintain the program.s credit quality and streamlined application processes, complicated applications requiring a great amount of explanation or marginal applications which need an in-depth analysis should be submitted under regular 7(a) procedures.

a. Repayment

Since most LowDoc loans are long-term in nature, repayment considerations should take into account the cash flow of the business. Historic actual cash flow, as provided by an analysis of the sources and uses of cash of the business, is the best indicator of repayment ability and should be utilized for all existing businesses.

If repayment cannot be ensured from historic cash flow or from reasonable projections, as could be the case for start-up businesses, the lender should document its knowledge and judgment of the principal's management ability, character, capacity, and credit in determining whether future cash flow will be adequate to service the needs of the applicant.

The lender should comment, on the LowDoc application or in its credit analysis memorandum, on the extent to which the principal's character, credit, and capacity compensate for the previous marginal cash flow of the business and strengthen an otherwise weak SBA-guaranteed loan request.

With respect to sources of repayment, the smaller the business the more important its principals and the strength of character of those principals become when analyzing a credit request. Given that most LowDoc applicants are relatively smaller businesses, the lender should carefully analyze the repayment ability of both the business and its principals. Analyzing the debt-to-income ratios of the business and its principals separately and jointly (combined) will determine a more accurate overall repayment ability. Outside sources of income may be considered in establishing repayment ability.

b. Management

Management is the single most important issue in evaluating the potential success of a business. The lender must evaluate management.s depth of knowledge and experience in the managerial and technical skills necessary to operate the business. Lenders assess and document the adequacy of management on the application. Lenders should consider the size and type of business and management's ability with respect to sales (growth), plus financial and operational matters. Businesses managed by absentee owners are discouraged.

c. Capital

All applicants are generally expected to reflect an adequate net worth position. The capital position of a business is often seen as a measure of its financial strength, credit worthiness, and ability to withstand financial adversity. It serves as a quick reference to identify credit risk, and provides some insight into the likelihood of the owner's commitment and willingness to work through difficult situations.

As is the case under regular 7(a) guidelines, the exact level of equity necessary for a LowDoc application should be decided on a case-by-case basis. However, under LowDoc, as stated above, the principal's character, credit, and capacity may offset a marginal equity position, provided other credit factors are satisfactory.

For an existing business, the lender may finance 100 percent of a particular asset provided the business has an adequate net worth and demonstrates repayment ability. Applications to start or purchase a business are not eligible for 100 percent financing.

Applicants with very weak capital positions resulting from losses or with dramatically improved forecasts should not be submitted under LowDoc. They should receive complete financial analysis under the regular 7(a) process.

d. Collateral

Collateral is not a primary consideration under the LowDoc Program. However, to reach adequate collateral coverage, the business must pledge all available assets. Generally, all assets financed with loan proceeds should secure the loan. If a portion of the loan remains under collateralized, consider other available assets of the business as additional collateral.

If business assets do not fully secure the loan, personally-owned assets of the principals should be pledged, generally non-real estate assets and investment properties first and then the principals. primary residences. While lenders may, of course, require the primary residences of principals at any time, SBA requires such assets only when equity in the residence is at least 25 percent of the fair market value. Unwillingness on the part of the applicant to pledge available collateral is basis for decline solely for the lack of collateral. Apply prudent lending practices in assessing the realistic recovery value of collateral. A formal evaluation by an individual known by the lender to be competent will be acceptable for real estate collateral for LowDoc loans.

e. Personal Guarantees

The SBA requires the personal guaranty of any person owning 20 percent or more of the business. Consider requiring the guaranty of spouses where legal and appropriate. In this regard, be aware of the rules in the Equal Opportunity Act and the interpretations of the Federal Reserve in Regulation B. Lenders can require a third party guarantor if it strengthens an otherwise weak application.

f. New Business and Purchase of Existing Business

Applications to start or for a new business (any business less than 2 years old) and to achieve a change of ownership by purchase of an existing business or purchase of the entire interest of one or more of the current owners by the business are eligible under LowDoc. Lenders must thoroughly analyze and underwrite each request before considering it for an SBA guaranty. In all cases, the applicant must submit a comprehensive business plan to the lender. Lenders should analyze and evaluate the soundness and viability of business plans, along with financial projections.

Under LowDoc, the credit risks for these types of applications should be relatively easy to identify and understand as a general rule. The lender should submit more complicated start-up and buy-out applications under regular 7(a).

7. GUARANTY PERCENTAGE AND FEES

a. Percentage of SBA's Guaranty

The policies concerning the maximum percentage of guaranty which SBA provides on 7(a) loans are described in Subpart B, Chapter 1, paragraph 5. These same policies apply to loans processed under LowDoc procedures.

The basic rules are: If no other loans are involved, SBA will provide an 80 percent guaranty on loans of $100,000 or less and a 75 percent guaranty on loans over $100,000 but not exceeding $150,000.

b. Guaranty Fee

The SBA guaranty fee for LowDoc loans is . of 1 percent of the guaranteed amount when the term of the loan is 12 months or less, regardless. When the guaranteed portion is $80,000 or less, the guaranty fee is 2 percent of the amount guaranteed. When the guaranteed portion is more than $80,000, the guaranty fee is 3 percent of the amount guaranteed.

c. Application Fees

A lender **cannot** charge a LowDoc applicant the following fees: processing fees, origination fees, application fees, points, brokerage fees, bonus points, or any other such fees.

A reasonable packaging fee which is in line with those charged for similar services in the local geographic area may be charged. This fee must be disclosed on the Borrower's Application page, including the name and address of the packager. The following closing costs are typically borne by the borrower: surveys, title reports, appraisals, filing and recording fees, lender.s attorney fees, and other charges related to closing.

8. LOWDOC PROCESSING

a. Where Should a Lender Submit its Request for Guaranty?

Lenders will deal with one of two LowDoc Processing Centers (LDPC), depending on the location of the small business concern being financed. If the business is located in SBA Region I, II, III, IV, or V, the application will be submitted to the Hazard LDPC. If it is in SBA Region VI, VII, VIII, IX, or X, the application will be submitted to the Sacramento LDPC.

b. What Information Must the Lender Submit?

Only the LowDoc Application Form (SBA Form 4-L). Other documents should only be submitted upon request by SBA. However, it is very important that all of the data required on the application form be submitted. This will minimize the need for time consuming follow up calls and will permit the centers to operate in the most efficient manner possible. Faxing the application form will work best. Once an electronic loan guaranty transmission system is in place, it will be the preferred application process.

A lender **MUST VERIFY** the accuracy of the applicant's financial data against income tax data by submitting IRS Form 4506, Request for Copy or Transcript of Tax Form to the Internal Revenue Service (IRS). This verification is generally beneficial in evaluating both character and credit considerations. To prevent delays, it is a good idea for lenders to send the IRS Form 4506, which the applicant must sign, to the IRS at the earliest point in time in the application process. The IRS generally responds within 10 days. This policy does not apply to start-up applications (reference Q&A number 2 in Subpart A, chapter 6, paragraph 4f).

c. Submitting the Application

Lenders can either fax or mail the application package to the LDPC. Most will be faxed. Due to the limited space available to enter data on the LowDoc application form, it is critical that lenders ensure that applications are either printed legibly or typed to enable the faxed copies to be as clear as possible.

d. Approved Loans

If the application is approved, the LDPC will notify the lender by fax. Every attempt will be made to respond to a LowDoc guaranty request within 36 hours (1.5 business days), based upon consecutive working days. It is the responsibility of the lender to complete all other closing documents.

All Loan Authorizations will be prepared from the nationally approved standardized list of terms and conditions. This list includes covenants required by the laws of individual states.

e. Declined Loans

All Lenders submitting applications processed but declined under LowDoc procedures will receive a letter (generally by fax) from the LDPC stating the reasons for denial plus the applicant's rights to further consideration. Depending upon the reason(s) for decline, these rights may include the ability for the application to be reconsidered under LowDoc procedures or to be considered a first time application under standard (non-LowDoc) processing procedures, requiring a whole new submission. Some applications may have no rights for subsequent processing if a reason for decline is an ineligibility factor that cannot be overcome.

f. Reconsiderations

A request for subsequent consideration must be made in writing to the appropriate SBA district or branch office (not the LDPC) responsible for processing standard 7(a) applications where the business is or will be located.

(1) The LDPC may decline some applications for reasons which cannot be overcome. Examples include where the applicant is a large business, or a principal is on probation or parole. Under such circumstances, there are no reconsideration rights for the applicant or lender.

(2) Applications declined for any of the LowDoc eligibility reasons listed below can only be reprocessed under regular 7(a) procedures. This means subsequent processing must be accomplished with a new application under standard procedures. Under these circumstances, an SBA Form 4, SBA Form 4-I, and all required attachments and exhibits are required. This application will be considered to be a first time submission.

(a) The total loan amount request (including the balance of any other SBA loans except disaster loans) exceeds $150,000;

(b) A character issue exists, based on a positive response to any of the questions in item IV of section D5 of SBA Form 4-L;

(c) A waiver of any 7(a) Loan Program or LowDoc regulation, policy, or procedure is needed;

(d) The applicant concern does not qualify under the special size standard established for LowDoc loans;

(e) The purpose is not eligible under LowDoc procedures (for example, more than 25 percent of the total proceeds are proposed for same institution debt refinancing);

(f) The type of loan is not eligible under LowDoc because the request involves a Special 7(a) Loan Program as referenced in paragraph 4h of this appendix.

(g)* A level of complexity exists which is not suited for LowDoc processing. The case requires in-depth credit or legal analysis for a full understanding of the risk(s) associated with the request. An example would be where the applicant is an affiliate to another company and there are numerous intercompany transactions that have to be accounted for before size can be accurately determined;

(h)***** A negative credit history (business and/or personal) exists, such as bankruptcy or a negative business or personal credit report.

***** Note: LowDoc processed applications declined for LowDoc eligibility reasons (g) or (h) can be reconsidered under LowDoc procedures if the complexity or negative credit issue can be fully explained and/or resolved to the sole satisfaction of the SBA processing office. The SBA credit file must document this analysis.

(3) SBA may reconsider applications declined for reasons other than those listed in (1) or (2) under LowDoc procedures at the appropriate field office. The lender must show in the application that the reason(s) for decline have been overcome. The SBA Loan Officer Report must comment on this justification and conclude with a recommendation.

If a reconsideration can continue to be processed under LowDoc procedures, the lender must submit the request within 30 days of the date of decline. The lender must make the request in writing, on its letterhead. The lender must address how each of the reasons for decline has been overcome, with particular attention to impact, if any, on repayment ability or business viability.

Field offices will not accept any requests for reconsideration under LowDoc procedures received after 30 days. Field offices must consider requests made after 30 days under standard processing procedures with a complete 7(a) application. The 7(a) application will be considered a first time submission.

(4) Applicants declined under LowDoc procedures may benefit from the Agency's entrepreneurial development services available from:

(a) Service Corp of Retired Executives (SCORE);

(b) Small Business Development Center (SBDC);

(c) Business Information Centers (BIC's); or

(d) One Stop Capital Shops (OSCS's).

SBA offers these services through its field office structure. The applicant may find the Agency's entrepreneurial development services useful to improve its documentation and internal operations.

(5) Whenever an application processed under LowDoc procedures is declined, the LDPC will:

(a) Notify the lender of the reasons for the decline, state the procedures for reconsideration, and identify the appropriate field office to contact for subsequent processing (if applicable);

(b) Forward the original decline file to the appropriate field office, to enable that office to expedite reconsideration if asked, and determine the appropriate non-financial services to offer the applicant and lender; and

(c) Maintain a copy of the original application file for 90 days.

(6) Field offices must not use LowDoc procedures to process any application which has not been previously processed and declined by a LDPC.

(7) Field offices must complete reconsideration within 36 hours. It is important that field offices educate their lenders on the necessity of providing a complete LowDoc reconsideration package. The request should fully explain how the reasons for decline have been overcome including any impact, if any, on repayment ability or business viability.

(8) Once declined under LowDoc, an application must not be submitted through any other expedited guaranty process, such as PLP or *SBAExpress*, unless otherwise indicated.

9. LOAN CLOSING POLICIES

The lender must close LowDoc loans in accordance with the terms and conditions specified in the Authorization as well as according to standard 7(a) procedures.

a. Loan Closing Forms

The lender may use its own closing forms except for the following SBA forms:

(1) *Note, SBA Form 147;

(2) *Guaranty, SBA Form 148;

(3) *Compensation Agreement, SBA Form 159;

(4) *Settlement Sheet, SBA Form 1050;

(5) *Certification Regarding Debarment SBA Form 1624;

(6) *Certification page of Disclosure Statement and Statements Required by Law and Executive Order, SBA Form 1261;

(7) *SBA Form 601, Agreement of Compliance, for construction loans only;

(8) SBA Form 793, Notice to New SBA Borrowers; and

(9) SBA Form 722, EEO Poster;

b. Documents Retained by the Lender

In addition to the original executed documents denoted by (*) above, the lender must retain all original closing documents in the borrower's file, and have them ready for review by SBA upon request, including but not limited to:

(1) The original signed and dated LowDoc Application (SBA Form 4-L);

(2) Copy of the Loan Authorization;

(3) Signed and dated (as appropriate) credit source documents, including personal and business financial statements (including affiliates), management resumes, credit reports, projections with assumptions, collateral lists, appraisals and similar information, and any information providing the basis for loan approval;

(4) Other relevant information, including environmental questionnaires or audits, lien search information, a transcript of account (participating lender debt refinance), leases, offers to purchase, Standby Agreements, evidence of required licenses; and

(5) IRS verification information.

c. Items Sent to SBA

(1) The documents to be sent to SBA after the closing of any LowDoc loan are the same as for any other 7(a) loan. The documentation includes:

(a) SBA Form 2004 (Certification); and

(b) SBA Form 159 (Compensation Agreement).

(2) Within 90 days from the date of the Authorization, the lender must forward the guaranty fee (based on the guaranteed portion of the loan) to the SBA's Denver Finance Center, Denver, CO 80259-0001.

10. LOAN SERVICING AND LIQUIDATION

a. Servicing

(1) The lender must service its LowDoc loans using generally accepted commercial banking standards of loan servicing employed by prudent lenders. The lender must not use lower standards for LowDoc loans compared with other loans in the lender's portfolio of similar size and type. The lender must retain documentation regarding the actions it takes on a loan in its loan file.

(2) The lender may take all servicing actions without approval from SBA (unilaterally) that it deems prudent and necessary on non-liquidation loans except for the following non-routine actions.

They must not:

(a) Take any actions 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.

(b) Compromise with any obligor of the principal loan balance outstanding for less than the full amount due. Accrued interest can be adjusted by the lender, if justified, without prior SBA approval.

NOTE: **Guarantors:** 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.

(c) Title property in the name of the Agency without SBA.s prior written approval. The lender must not acquire title (in their name or the Agency.s) to environmentally impaired property (property which exceeds the minimum action levels established by relevant regulatory agencies).

(d) Transfer a loan to another lender.

(e) Sell or pledge more than 90 percent of a loan.

(3) The lender must notify the Agency when unilateral changes are made that will require the Agency to make changes to the SBA data base (e.g., changes to interest rate, maturity, installment frequency, etc).

(4) Loan Purchases.

(a) How much interest will SBA pay?

The SBA will pay a maximum of 120 days of accrued interest.

(b) When will SBA purchase its guaranty?

Generally, except for bankruptcy situations, SBA will not honor its guaranty on a LowDoc loan until the lender has:

(i) Liquidated all personal property; and

(ii) Indicated in writing how it will pursue real property assets or other sources of recovery, including personal guarantors.

(c) Exceptions to SBA's policy on when to purchase.

The SBA may approve exceptions to this policy on a case-by-case basis if the lender submits to SBA:

(i) An adequate explanation for any delay; and

(ii) A satisfactory recovery plan showing how and when the lender will liquidate all remaining assets.

NOTE: This exception/deviation to this policy must be approved by the district director or designee level.

(d) Procedures for Purchase.

(i) The SBA will make payment on its guaranty only after SBA has reviewed and approved all documentation supporting the making, closing, servicing, and liquidation of the loan.

(ii) For loans sold in the secondary market, SBA strongly urges the lender to purchase from the holder and SBA will purchase from the lender as indicated above. However, SBA may immediately purchase from the secondary market holder if necessary.

(5) Submission of a LowDoc liquidation plan.

When the lender must submit liquidation plan.

(a) For loans with a principal balance more than $50,000 at the time of default, the non-PLP lender must submit its liquidation plan before starting liquidation action. For loans with a principal balance of $50,000 or less, the non-PLP lender is not required to submit a plan before starting liquidation action.

However, it must prepare a liquidation plan and submit the plan to SBA at the time of guaranty purchase. If SBA desires changes to the plan, it has 10 business days to notify the lender after receipt of the plan.

PLP lenders are required to follow the procedures established for liquidating any loan in their portfolio not originally processed under PLP procedures.

(b) When SBA purchases the guaranteed portion of the loan from the secondary market holder before liquidation, the lender still must submit to SBA the information described below, after it has completed liquidation action on the account.

b. Liquidation

(1) Who liquidates a LowDoc loan?

The lender does the liquidation on all LowDoc loans unless otherwise advised in writing by SBA.

(2) What requirements must the lender follow?

(a) All liquidations must be done prudently and in a commercially reasonable manner; and

(b) The liquidation must be consistent with SBA's regulations and the guaranty agreement.

(3) When does SBA require a LowDoc lender to submit a liquidation plan?

A liquidation plan, using the standardized liquidation plan format (see appendix 15 in SOP 50 51) is required to be submitted by a LowDoc lender to SBA on LowDoc loans:

(a) Prior to starting liquidation action for loans with a principal balance more than $50,000 at the time of default; or

NOTE: SBA has 10 business days to notify lender of any changes to the plan.

(b) When the LowDoc lender requests SBA to purchase the guaranty for loans with a principal balance of $50,000 or less at the time of default.

(4) Is the lender required to submit a report on LowDoc loans?

Yes. The lender must provide a **written** status report on **every** LowDoc liquidation every 90 days after guaranty purchase. Prior to purchase, the lender must submit status reports on liquidation cases when requested by SBA.

(5) How are expenses handled?

(a) The SBA shares in reasonable and necessary costs incurred by the participant on a pro rata basis up to its (SBA's) share of total recoveries; and

(b) SBA may agree to pay more (on a case by case basis) in bankruptcy situations upon a written request from the lender.

(6) How are costs in excess of the above handled?

The lender needs to absorb any excess costs.

(7) When does SBA honor its guaranty on a Low Doc loan?

SBA will honor the guaranty after the lender has liquidated all personal property (a/k/a business chattel) and lender indicates how it will pursue:

(a) Real estate; and

(b) Guarantors.

(8) Are there exceptions to this policy?

Yes. The SBA may purchase the guaranty prior to lender liquidating the personal property when there is a bankruptcy situation and the lender provides an explanation for any delays plus has a satisfactory plan of recovery showing how and when the remaining assets will be liquidated.

(9) How are guaranty purchases handled when the loan is sold on the secondary market?

The lender is strongly encouraged to purchase loans sold on the secondary market. The SBA will then purchase from the lender as indicated above, or from the secondary market holder if lender does not purchase.

(10) Can SBA purchase directly from the secondary market?

Yes. The SBA may immediately purchase from the secondary holder if necessary.

(11) Is there a limit on the amount of interest SBA will pay on a LowDoc loan?

Yes. The SBA will pay up to 120 days of accrued interest on LowDoc loans.

(12) What information is needed at the time of the guaranty purchase?

(a) The liquidation plan (if not already provided);

(b) A complete accounting showing all receipts and disbursements during the liquidation process;

(c) Identification of all collateral at loan origination with an explanation of the disposition of each item along with proceeds involved;

(d) The commercial reasonableness must always be addressed;

(e) Names of any contractors involved and their compensation which could include appraisers, auctioneers, attorneys, etc;

(f) All other sources of recovery pursued by the lender along with the proceeds received, or the reason for not pursuing; and

(g) Identification of any remaining sources of potential recovery along with a plan of action.

(13) Is the lender required to submit the above information when SBA has purchased directly from the secondary market?

Yes. The lender must submit the above mentioned information after it has completed the liquidation action on the account.

(14) Are SBA liquidation loan officers required to make field visits on LowDoc loans?

No. The SBA liquidation officers are not expected to make field visits on LowDoc loans, but are not restricted from doing so.

(15) Who is responsible for liquidation after the guaranty has been purchased?

The lender continues to be responsible for all liquidation actions even after the guaranty has been purchased.

(16) When must the lender provide a "wrap up report?"

The lender must provide SBA with a wrap up report documenting the lender's actions and results at the following times:

(a) When the lender determines that the loan will not be fully repaid after all worthwhile collateral has been liquidated; and

(b) No further recoveries are anticipated within a reasonable period of time (see Appendix 18, "Final Wrap Up Report," checklist in SOP 50 51).

If SBA purchase is requested, the necessary documentation for SBA to complete its purchase review of the loan must be provided (see Appendix 17, "Checklist for Purchase Documents," in SOP 50 51).

APPENDIX 6 - FA$TRAK PROGRAM GUIDE

CANCELLED

Replaced By April 1, 2000 Program Guide

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APPENDIX 7 - ENVIRONMENTAL EVALUATION DOCUMENTS

1. ENVIRONMENTAL QUESTIONNAIRE

a. Environmental Evaluation Policy

The SBA requires an environmental assessment to be made on all commercial real estate scheduled to collateralize any SBA business loan, in order that the potential environmental risks associated with this collateral can be known. The SBA must conduct a review on all its direct loans and require a similar review from the lender on every participation loan, regardless of the procedures under which the guaranty is sought (Standard, Certified, Preferred, LowDoc, Fa$trak, and others as necessary). For both SBA and lender staff, the assessment should be accomplished prior to finalization of the application. **If the real estate which will collateralize the loan is currently or was historically occupied by a type of business appearing on SBA's frequent polluting industries list, the initial assessment must be accomplished before SBA can approve the loan and issue a loan number**. If the subject real estate is not currently or was not historically used by an occupant of the type appearing on the frequent polluting industries list, the assessment must be completed prior to initial disbursement of any loan proceeds. For purposes of this paragraph, environmental assessment not only includes conducting a background check of all occupants and neighbors, as well as a physical inspection, as required in SBA Form 1738, "SBA's Environmental Questionnaire," but also includes any subsequent survey and more comprehensive audit the questionnaire leads the analyst to conduct.

b. Use Of Alternative Environmental Evaluations

Participants and SBA field staff may use SBA Form 1738, "SBA's Environmental Questionnaire" for purposes of conducting the initial environmental assessment. However, this form is optional, not required. The SBA recognizes that there many worthwhile formats and surveys available to assess the environmental condition and risk of a given piece of property, and does not discourage their use. Participants may utilize any comparable format to perform their initial assessment, providing the selected format addresses no less than the same elements as the SBA questionnaire.

Use of the questionnaire and the field visit can be waived by the ADD/FA, on a case-by-case basis, when the loan amount is $100,000 or less. This waiver may be appropriate where the applicant is a low-risk industry, SBA or the participant has documented knowledge of no environmental risks at the site, or a recently-

completed Phase I audit demonstrates no such risks.

Furthermore, the supervising loan officer may instruct the applicant to obtain a professional environmental audit at any time or may deny the loan due to a lack of repayment ability arising from environmental hazards.

A current copy of the SBA Form 1738 follows.

OMB Approval No.: 3245-0265
Expiration Date: 11-30-93

ENVIRONMENTAL QUESTIONNAIRE

INSTRUCTIONS: Use the following as a guide to determine if a Phase I or Phase II audit is needed. The lender is to complete it during an on-site inspection when commercial real estate is to be taken as collateral. Residential real estate is excluded.

1. Determine the prior, current and planned uses for the property. If any of these involve operations that used or use toxic chemical, require a Phase I audit.

2. To the extent possible, determine the prior, current and planned uses of all adjoining property. If any of these involve operations that used or use toxic chemicals, require a Phase I audit.

3. Conduct a visual inspection of the facility, preferably accompanied by the current owners. The following observations may trigger the need for a Phase I audit:

   * any evidence that chemicals are used in the operation of the facility.
   * discarded chemical containers.
   * waste piles of any type (ask about buried waste and the presence of underground storage tanks).

   * evidence of distressed vegetation of non-vegetative areas.
   * oily films on standing water.
   * discolored soils.
   * unusual odors.

4. Determine that all relevant environmental permits and/or notifications are in place. If not, require a Phase I audit. (Consult local regulatory authorities about requirements.)

5. Determine whether the facility has ever been involved in:

   * any citations, claims or complaints regarding environmental problems.
   * any notice of violations.
   * any environmental clean-up actions.

Lender or SBA Report on Issues Covered by This Questionnaire:

Recommendation:

Acknowledgement By the Applicant:

I acknowledge that I have read this questionnaire and have responded to the issues and questions posed therein to the best of my knowledge.

Corporation) _____
Business Name

by: _____
(Name & Title)

(Other) _____
Business Name

By: _____
(Name & Title)

ENVIRONMENTAL INDEMNIFICATION AND REMEDIATION AGREEMENT

[NAME OF INDEMNITOR], a [NAME OF STATE] Corporation, ("Indemnitor") enters into this Environmental Indemnification and Remediation Agreement ("Agreement") in order to induce [NAME OF LENDER] ("Lender") and the United States Small Business Administration ("SBA") to provide a loan to [NAME OF BORROWER] ("Borrower").

For valuable consideration and intending to be bound legally, the undersigned parties agree as follows:

1. Definitions.

For purposes of this Agreement, the following definitions apply:

1.1. "Environment" shall have the meaning set forth at 42 U.S.C. . 9601.

1.2. "Release" means any spilling, leaking, pumping, pouring, emitting, emptying, discharging, injecting, escaping, leaching, dumping, or disposing into the Environment.

1.3. "Contaminant" means any substance that is hazardous or detrimental to the Environment and which is regulated by law, including, without limitation, any hazardous substance (as that term is defined at 42 U.S.C. . 9601), and petroleum (as that term is defined at 42 U.S.C. . 6991).

1.4. "Agency" means any Federal, state or local governmental agency with statutory or regulatory authority to enforce laws regarding the release of any Contaminant into the Environment.

1.5. "Property" means [INSERT ADDRESS] now owned by Indemnitor, and described in greater detail in the mortgage that will be executed by Borrower for the benefit of Lender and SBA to secure a loan made to finance Borrower's purchase of the Property from Indemnitor. The term "Property" also includes groundwater.

1.6. "ESA Report" means a Phase II report or other report that contains the results from an Environmental Site Assessment of the Property which involved the physical sampling and analysis of surface waters, subsurface waters, land surface, or subsurface strata, at all locations at the Property where a diligent inquiry has determined that there is a potential for any Contaminant to exist, to determine the existence, nature, and quantitative volume of Contaminants that were released on or into the Property. Such inquiry will include, at a minimum, an inspection of the Property and adjacent properties, review of relevant site records, review of any relevant Agency files, and interviews with persons knowledgeable about site operations (e.g., current owner and its employees, neighbors, etc.). The ESA Report is identified as follows: [NAME OF REPORT, DATE AND NAME OF COMPANY THAT PREPARED REPORT].

1.7. "Remediation" means investigation, remediation, clean-up, and monitoring, including all actions within the definition of "removal" and "remedial" actions as those terms are defined in 42 U.S.C. ¸ 9601.

1.8. "Indemnitor" includes: (1) any parent or subsidiary corporation of Indemnitor, and (2) any affiliated corporation of Indemnitor (i.e. any corporation that is owned by the same parent corporation that owns Indemnitor).

1.9. When describing the release of a contaminant "on" the Property, such term encompasses the release of a contaminant "on, into, under, from or above" the Property, and includes any Contaminant originally Released on the Property that subsequently migrates to another site..

2. Recitals.

2.1. Borrower desires to purchase the Property, and has submitted applications to Lender and SBA for loan which are to be secured by the Property.

2.2. Activities at the Property prior to the transfer of the Property to Borrower may have resulted in the release of Contaminants that may be hazardous or detrimental to the Environment.

2.3. The ESA Report indicates that there has been a release of a Contaminant on the Property, and that Remediation is or may be necessary under law.

2.4. Lender and SBA will not make a loan to Borrower unless they are provided with indemnification from Indemnitor against losses they may sustain as the result of Agency actions or third party claims regarding the release of any Contaminant on the Property.

2.5. Indemnitor desires to assist Borrower in its efforts to secure loans from Lender and SBA by agreeing to perform Remediation of Contaminants released on the Property prior to the transfer to Borrower, and to provide indemnification from any related demand, claim or suit, in accordance with the terms of this Agreement.

3. Remediation and Investigation Obligations.

3.1. Indemnitor agrees, at its sole cost and expense, to cause to be performed such Remediation of all Contaminants on the Property that were identified in the ESA Report described in paragraph 1.6 above which may be required by any Agency. Such Remediation obligations shall continue until such time as any Agency exercising authority over the Remediation at the Property approves such actions and provides written notice that no further action will be required.

3.2 Indemnitor warrants that it has no knowledge of any release of any Contaminant on the Property, other than the Contaminant(s) identified in the ESA Report, which has not been completely Remediated .

3.3. In the event that any Contaminant, not identified in the ESA Report, is found to have been released on the Property prior to the transfer of the Property to Borrower, Indemnitor further agrees, at its sole cost and expense, to cause to be performed Remediation of any such Contaminant, which may be required by any Agency. Such Remediation obligations shall continue until such time as any Agency exercising authority over the Remediation at the Property approves such actions and provides written notice that no further action will be required.

3.4. In the event that Indemnitor completes its Remediation obligations under paragraphs 3.1 or 3.3, and any Agency subsequently requires Remediation of any Contaminant for which Indemnitor Is responsible under this Agreement, Indemnitor will perform such Remediation until the responsible Agency approves such actions and provides written notice that no further action will be required. Indemnitor.s obligations shall continue until full repayment of the loan or satisfaction of the debt owed SBA/Lender.

4. Indemnity from Claims. Indemnitor further agrees to indemnify, defend and hold harmless Lender and SBA, and any assigns or successors in interest which take title to the Property, from and against all liabilities, damages, fees, penalties or losses arising out of any demand, claim or suit by any Agency or any other party relating to any Contaminant for which Indemnitor is responsible under this Agreement.

5. Manner of Performance.

5.1. Indemnitor shall perform Remediation in a prompt manner and in compliance

with all applicable laws, and in a manner and at times which will not unreasonably interfere with Borrower's use of the Property.

5.2. Indemnitor warrants that it has exercised due care in selecting the contractor that prepared the ESA Report to ensure that the contractor (1) is qualified and competent to perform the environmental investigation; (2) has obtained any license or certification necessary for the performance of such investigation; and (3) is not an employee of Indemnitor or of any company or organization in which Indemnitor has any ownership interest or has any other conflict or potential conflict of interest.

5.3. Indemnitor further warrants that it has exercised due care in selecting the contractor that prepared the ESA Report to ensure that the contractor has obtained all necessary insurance to cover its failure to perform any errors or omissions in its environmental investigation, and agrees to assign to SBA, Lender, Borrower or any of their assigns, upon request, any such rights Indemnitor may have to make a claim upon such insurance policy.

5.4. Indemnitor further warrants that it has exercised due care to ensure that the environmental site assessment that served as the basis for the ESA Report was consistent with the definition in paragraph 1.6 above.

6. Cooperation To Indemnitor. Borrower, Lender, SBA, and any of their assigns and successors in interest who take title to the Property shall provide reasonable cooperation to Indemnitor (1) to allow Indemnitor to cause to be performed any Remediation and (2) to allow Indemnitor to conduct its defense of any claim or suit, for which Indemnitor is responsible under paragraph 4 above. This shall include, but not be limited to, Indemnitor's being given access to the Property, without cost to Indemnitor, so

as to allow Indemnitor to undertake any investigation or Remediation that it believes may be necessary to comply with its obligations under this Agreement. Such access must be at reasonable times, and upon reasonable notice by Indemnitor to the occupant (or if there is none) the owner of the Property.

7. Reporting Requirements

7.1. Indemnitor shall promptly provide Lender, SBA and Borrower with copies of any written communications between Indemnitor and any Agency regarding Remediation. As its sole option, Lender, SBA and/or Borrower may waive in writing the right to obtain some or all of such communications.

7.2. Indemnitor shall promptly provide Borrower, Lender and SBA with a copy of (1) any written communication received from any Agency regarding any Contaminant released on or into the Property for which Indemnitor may be responsible under this Agreement, and (2) any notice of any demand, claim or suit referenced in paragraph 4 for which Indemnitor may be responsible.

7.3. Borrower, Lender and SBA shall promptly provide Indemnitor with a copy of (1) any written communication received from any Agency regarding any Contaminants released on or into the Property for which Indemnitor may be responsible under this Agreement, and (2) any notice of any demand, claim or suit referenced in this Agreement for which Indemnitor may be responsible.

8. Parties.

8.1. In the event that Borrower, Lender and/or SBA transfers or assigns the Property to a third party and provides Indemnitor with written notice of this transfer or assignment, Indemnitor's obligations under this Agreement shall also extend to such

assignee or transferee. Borrower, Lender and SBA may undertake such transfer or assignment without Indemnitor.s consent.

8.2. Indemnitor shall not transfer or assign any of its obligations under this Agreement to any other party without the express written consent of Lender, SBA or their transferee or assignee.

9. Interpretation and Execution of Agreement.

9.1. All provisions contained in this Agreement are severable and the invalidity or non-enforceability of any provision shall not affect or impair the validity or enforceability of the remaining provisions of this Agreement.

9.2. This Agreement constitutes the entire agreement between the parties and, to the extent there is a conflict, supersedes (1) all prior agreements and understandings between Indemnitor and either Lender or SBA not expressly referred to herein, both written and oral with respect to the subject matter contained in this Agreement, and (2) any Agreement that Indemnitor has executed or will execute with the Borrower addressing the remediation of or indemnification related to any Contaminant that has been Released on the Property for which Indemnitor is responsible under this Agreement. Any amendments or modifications hereto, in order to be effective, shall be in writing and executed by the parties hereto.

9.3. This Agreement may be executed in one or more identical counterparts each of which shall be deemed an original, and all of which, taken together, shall constitute one and the same Agreement.

9.4. Failure by Borrower, Lender or SBA (or any of their assigns) to undertake any obligation under this Agreement, or exercise reasonable care in undertaking such

obligation, shall not be construed as releasing Indemnitor from any obligations under this Agreement. Any such failure will not preclude Indemnitor from pursuing any right that may exist under law to obtain recovery from the responsible party.

10. Notices

All notices required under this Agreement shall be made to the following:

(1) All notices to SBA shall be made to District Counsel, Small Business Administration, [INSERT ADDRESS].

(2) All notices to Lender shall be made to [INSERT NAME OF OFFICIAL, NAME OF LENDER AND ADDRESS].

(3) All notices to Borrower shall be made to [INSERT NAME OF OFFICIAL, NAME OF BORROWER AND ADDRESS].

(4) All notices to Indemnitor shall be made to [INSERT NAME OF OFFICIAL, NAME OF INDEMNITOR AND ADDRESS].

11. Authority To Sign.

By signing below, each individual represents and warrants that he or she has proper authority to execute this Agreement. Indemnitor has attached as Exhibit "A" to this Agreement a valid, certified resolution, unlimited of attorney, or other evidence confirming such authority.

IN WITNESS WHEREOF, the parties have caused this Agreement to be executed as of the latest date set forth below.

[INDEMNITOR]

Dated: _____ By: _____

PRINT NAME: _____

TITLE: _____

[LENDER]

Dated: _____ By: _____

PRINT NAME: _____

TITLE: _____

U.S. SMALL BUSINESS ADMINISTRATION

Dated: _____ By: _____

PRINT NAME: _____

TITLE: _____

[BORROWER]

Dated: _____ By: _____

PRINT NAME: _____

TITLE: _____

APPENDIX 8 - DOCUMENTS RELATED TO THE 504 PROGRAM

RESOLUTION BY THE BOARD OF DIRECTORS
TO BECOME A CERTIFIED DEVELOPMENT COMPANY

WHEREAS, _____ has been formed under the non-profit corporation statutes of the State of _____ for the purpose of applying for certification as a U.S. Small Business Administration Section 503 Certified Development Company, and

WHEREAS, an application has been prepared for submission to the U.S. Small Business Administration for said certification,

NOW THEREFORE BE IT RESOLVED by the Board of Directors of the _____ that application be made with the U.S. Small Business Administration for certification as a Section 503 Certified Development Company and that _____ as President and _____ ___ as Secretary be authorized to execute the necessary application documents for submission of the application to the U.S. Small Business Administration.
PASSED, APPROVED, AND ADOPTED THIS _____ DAY OF _____, 19__.

_____
President

ATTEST:

_____
Secretary

CDC RECOMMENDATION FORMAT

Date:

To: Director, Office of Loan Programs

From: SBA District/Branch Office

Subject: Request for Certification for (CDC Name)

1. The Application For Certification (SBA Form 1246) was submitted to this office on _____ and was dated _____.

2. Name and Address of Applicant: (this should include both street and mailing address if different)

3. Area of Operations: (List all counties if more than one)

4. Organization:

   A. At least 25 members are required, the total number of members listed by this applicant is_____.

   B. The membership has the required representation from all four groups
   ( ) Yes ( ) No

   C. Government involvement: (A statement discussing all Government involvement in applicant corporation.)

   D. Affiliate:

   Name: _____

   Net worth/fund balance $_____ as of ___
   Brief Background:

   E. Certified copy of the public notice received (date)
   Publication date _____.

5. Management:

The required SBA Form 1081s, Fingerprint Cards, FD 258 and resumes on each officer, director, executive director, and any 10 percent or more stockholder has been received and reviewed and the SBA 1081's submitted to the Office of Security Operations of the Office of Inspector General (date) .

A. List of the Corporate Officers:

Name	Office	Present Occupation
	PRESIDENT	
	VICE PRESIDENT	
	SECRETARY	
	TREASURER	
	MANAGER	
	OTHER	

B. Other Directors who are not Officers (List all).

(The above officers/directors must represent at least three of the four required groups; one must be a person with commercial lending experience.)

C. ____(name and title of individual)____ is responsible for the day-to-day management. (Include a background summary on the individual indicating his/her qualifications.)

D. Based on the data submitted and reviewed, none of the officers or directors currently are, or formerly were, employees of SBA or any other Federal agency except as stated below: (List any exception showing name, agency, and dates worked.)

7. Financial Information:

A. The applicant's net worth/fund balance is $_____ as of _____.

B. The applicant's financial year-end will be _____.

C. The initial start-up cost and operating funds for the first two years will be provided by _____.

8. Operation:

A. The professional staff that will be responsible for the following functions are:

Packaging:
Processing:
Servicing:
Legal (Closing):
Accounting:

(The individuals' names and whether they are CDC staff or contracted staff must be indicated. If contractual, the firm's name and beginning and ending date of contract along with the hourly fee should be shown. If more than one function will be performed by the same individual, those functions may be lumped together.)

B. During the first two years of operation, the applicant anticipates:

Year 1 _____ 504 loans, totaling $_____ (SBA Portion only)

Year 2 _____ 504 loans, totaling $_____

9. Field Office Evaluation:

A. Short narrative on the need for the applicant's service as a CDC.

B. Short narrative on the applicant's ability to participate in the program successfully.

C. If the new CDC requests as part of its area of operations an area already covered by another CDC or CDCs, the "Overlapping of CDC Service Areas" must be included.

D. Legal Opinion

Field Counsel has reviewed the applicant's By-Laws, Articles of Incorporation, and any required changes, amendments, and or addendum. Field Counsel is of the opinion that the applicant meets the requirements for a Certified Development Company.

_____ _____
Field Counsel Date

10. Field Office Recommendation:

( ) Approval ( ) Disapproval

(Be very specific as to what you are recommending including what other CDCs are allowed to market and do projects in the same areas.)

Loan Officer _____ Date _____
F/D Chief _____ Date _____
ADD/F&I _____ Date _____
Branch Mgr _____ Date _____
Dist. Director _____ Date _____

Or Designee (if applicable)

REQUEST FOR COMMENTS ON NEW CDC OR PROPOSED EXPANSION

Date:

To (CDC)

A Certified Development Company, _____, has submitted an application for certification (or is seeking an expansion of its operating area). The proposed certification (or expansion) includes the following counties presently serviced by your development company:

Because your operating area might be affected by our decision, we are extending the opportunity for you to comment on the proposal. In order to allow sufficient time for your response, we ask that you reply within thirty (30) days of this date to the address below:

Your assistance in this matter is greatly appreciated.

Signed

Branch Manager/District Director

cc: (CDC requesting certification or expansion)

RECOMMENDATION FOR EXPANSION OF OPERATING AREA

Date

To: Director, Office of Loan Programs

From: District/Branch Office

Subject: Request for Expansion of Operating Area for (CDC name)

1. The request for expansion of operating area was submitted to this Office on _____ and was dated _____.

2. Field Office Evaluation:

   A. Short narrative on the need for the applicant's services in the new area. Include a statistical analysis of all 504 projects done in the proposed area over the last two years.

   B. Short narrative on the applicant's past participation in the 504 program. This should include an analysis of the CDC's portfolio including currency rate and any liquidations and recoveries (or losses).

   C. If the expanding CDC requests as part of its area of operations an area already covered by another CDC or CDCs, the "Overlapping of CDC Service Areas" must be included.

   D. Legal Opinion

      Field Counsel has reviewed the applicant's By-Laws, Articles of Incorporation, and any required changes, amendments, and or addendum. Field Counsel is of the opinion that the applicant meets the requirements for expansion into the new area.

      _____ _____

      Field Counsel Date

3 Field Office Recommendation:

( ) Approval ( ) Disapproval

(Be very specific as to what you are recommending including what other CDCs are allowed to market and do projects in the same areas.)

Loan Officer _____ Date ____
F/D Chief _____ Date ____
ADD/F&I _____ Date ____
Branch Mgr _____ Date _____
Dist. Director _____ Date _____

(if applicable)

CDC ANNUAL REPORT GUIDE
CERTIFIED DEVELOPMENT COMPANY PROGRAM

INTRODUCTION

Certified Development Companies are required to submit an annual report on their operations to SBA. When necessary for regulatory, oversight and evaluation purposes, interim reports of a similar nature may also be required. Such reports are to be prepared in accordance with the instructions and attachments set forth in this guide.

The annual report (original and one copy) must be filed with the SBA field office serving the area where the CDC is located within 90 days after the CDC's fiscal year end. Other regulatory requirements for this report are set forth in 13 CFR 108.503-3(f). The report has been designed to standardize reporting requirements and to insure that uniform and comparable data are provided to SBA by all CDCs in a timely manner.

> As the reports are microfiched for storage by some offices, please submit the report and exhibits on letter size (8 1/2x11) paper if possible.

ORGANIZATION OF THE ANNUAL REPORT: The Annual Report is composed of three parts as follows:

I. MANAGEMENT REPORT

The Management Report is designed to provide analytical data on the impact of the CDC's assistance to small business and a summary on the status of its portfolio. This report will include the following:

A. A summary of the CDC's loan activity and the job creation/retention impact of its portfolio (Exhibit I.A, Management/Program Activity Summary - SBA Form 1253 A).

B. A schedule of economic impact (job creation/retention) of the CDC's portfolio (Exhibit I.B, Analysis of Employment Impact - see attached example format). If the portfolio's actual investment average exceeds that permitted by 13 CFR 120, Subpart H, the CDC must provide an explanation and plan for reducing the average.

C. A schedule of programs and activities other than the 504 program (Exhibit I.C, Summary of Other Programs and Activities). The CDC should summarize on one or two pages the various programs and activities that it and its affiliates offer to small businesses and for local economic development. Source of support should be identified (Federal, state, local government, private etc.). For other loan programs, the number of businesses assisted, the amount of assistance and job creation/retention should be summarized.

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D. A Success Story (Exhibit I.D) for a project closed for two or more years. The summary should identify type of business, location of project (including area population), 504 project financing, job results and other factors making it a success. The summary should be limited to one page.

II. OPERATING REPORT

The Operating Report is intended to provide information that will insure that the CDC's membership and method of operations are consistent with the requirements of the program. Accordingly, the report should contain the following:

A. Overview of CDC Activity (Exhibit II.A): This should include: an assessment of the CDC's activities and accomplishments during the past year, comments on the general lending and business environment in the area of operations, and a summary of events affecting the CDC (eg, major community events, plant closings, change of administration in local government, etc.).

B. Economic Development Strategy (Exhibit II.B, one or two pages): The CDC should provide an update and describe how its activities during the past year have contributed to the prior Economic Development Strategy. New needs or objectives should be briefly outlined and any significant changes or problems should be discussed.

C. Officers/Directors/Membership/Staff Update: Provide names, addresses, occupations and telephone numbers for the following (as of the end of the CDC's fiscal year):

1) Each Officer and Director. The Office held should be disclosed. Changes in the Board since the last report should be notated with an asterisk. (Exhibit II.C-1)

2) Each Member. (if a stockholder, should note the percentage ownership or voting control), County represented (if appropriate), & group the member represents (Government, Financial Institution, Community Organization or Business Organization). Changes since last year should be notated with an asterisk. (Exhibit II.C-2)

3) Each individual who performs professional staff functions pursuant to Section 108.503-1(b)(3). For each, identify the area of primary responsibility (marketing, packaging, servicing, etc.) and approximate percentage of time devoted to financial assistance activities (eg 100%, 50%, 25%, etc.). (Exhibit II.C-3)

(Changes in staff, directors and officers are to be reported during the year as they occur.

D. CDC Board Meetings (Exhibit II.D): Provide a schedule, listing dates of CDC Board meetings during the fiscal year, number of members present and name(s) of borrower(s) for loans approved for submittal to SBA for authorization or closing.

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E. Contractual Agreements (Exhibit II.E): In summary, describe all arrangements between the CDC and parties who provide services to the CDC under contract for SBA programs. If new or changed from the prior year, please provide a copy of such contract(s).

F. Analysis of Income: (Exhibit II.F) In a schedule form, describe services provided by the CDC and revenue associated with those services. Provide an analysis of contributions to the CDC (show source, amount and restrictions, if any).

G. Legal: (Exhibit II.G) Provide a signed statement of the CDC Secretary describing:

1. any changes to the Articles or By-Laws, or a statement that no changes have been made. (If a change was made, file a copy of the amendment(s)), and

2. a statement as to whether the CDC is involved in any legal proceedings as either plaintiff or defendant. (If so, provide a summary description).

III. FINANCIAL REPORT

The Financial Report (Exhibit III) includes the CDC's financial statements, which are to be prepared in conformance with Generally Accepted Accounting Principles. If staff and overhead are provided by an affiliate of the CDC, a copy of the financial statements of the affiliate must be provided. In addition, an explanation of how much, and in what form, the affiliate is subsidizing the CDC's operations is required.
The statements should include the following:

1. Balance Sheet,
2. Income/Expense Statement, and
3. Change in Financial Position.

The Financial Report will also include the accountant's report and footnote disclosures necessary to make the statements clear.

(Note: If the affiliate is a government body that has extensive financial statements and compliance audits for other governmental agencies, SBA requires only the general financial statements and any specific financial statements relating to the Certified Development Company program as well as any notes to the financial statements.)

Please note: The estimated burden hours for completion of this form is 40 hours per response. If you have any questions or comments concerning this estimate or any other aspects of this collection, please contact Chief, Administrative Information Branch, U.S. Small Business Administration, 409 3rd Street, SW, Washington, DC 20416 and Gary Waxman, Clearance Officer, Paperwork Reduction Project (33245-0013), Office of Management and Budget, Washington, DC, 20503.

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ANALYSIS OF EMPLOYMENT IMPACT: SAMPLE FORMAT
FOR COMPUTER OR MANUALLY PREPARED SCHEDULES

On the back of this page is an example format of three schedules necessary to provide information for completion of the CDC Annual Report - Management & Program Activity Summary. They are listings of individual projects within three categories:

1. DEBENTURES FUNDED TWO OR MORE YEARS: Total Actual Jobs (2 years after funding) created, retained and total will be inserted on Line C.3 of the SBA Form 1253 A.

2. DEBENTURES FUNDED LESS THAN TWO YEARS: Total Estimated Jobs created, retained and total will be inserted on Line C.2 of the SBA Form 1253 A.

3. DEBENTURES AUTHORIZED, BUT NOT FUNDED: Note: for the Example Format on the back, show SBA approval date in the Date Funded Column.

Line C.1 of the SBA Form 1253 A is the total of Estimated Jobs created, retained and total for all Funded and Unfunded Debentures.

NOTES: For the above schedules (Example on back)

(1) All Job Numbers are full-time equivalents.

(2) List all debentures, except canceled authorizations.

   a. if the Loan has been transferred to SBA for servicing, put "T" next to the Loan Number, and
   b. if the Loan has been voluntarily prepaid, put a "P" next to the loan number. (This will enable SBA to determine what is currently in the CDC's portfolio.)

(3) Estimated Job Opportunities are from the SBA Form 1244, Loan Application.

(4) Actual Jobs created and retained are as reported by the SBC two years after the debenture was funded.

(5) The "Objective" column is the Category by which project was eligible: J "JOBS", C "Community/Area Project", or P "Public Policy Goal".

(6) In the final column (which is optional) show Pre-project employment from loan application, and Current year employment updated annually from information provided by the borrower.

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CDC: XXX Development Corporation
Analysis of Employment Impact
For Fiscal Year Ended: September 30, 1996

SBC Name	Loan Number	Date Funded	Loan Amount (000)	Estimated Job Opportunities Created	Ret.	Total	Actual 2-Year Anniv. Job Opportunities Created	Ret.	Total	Objective J	C	P	Pre Project	Employment Current Year
Debentures Funded Less Than Two Years														
1. Quality	14183008	03/90	176	12	0	12	Not necessary to enter until the 2-year anniversary.			X			(Optional) To be entered if the CDC wants to follow this Total Funded Less information	
2. Valley	78163004	04/91	238	15	2	17				X				
Than Two Years	414	27	2	29										
Debentures Funded Two or More Years														
3. Aspen	92423003	03/88	500	4	0	4	6	0	6	X				
4. Kern	81773006	10/87	379	0	0	0	2	0	2		X			
Total Funded Two or More Years			879	4	0	4	8	0	8					
Total Funded Debentures			1293	31	2	33	8	0	8					
Unfunded Debentures														
5. Baker	76573008		734	0	4	4						X		
Total Unfunded Debentures			734	0	4	4								
Funded and Unfunded Grand Totals			2027	31	6	37								

SBA Form 1253 A (1-92) Previous Editions are Obsolete

CDC ANNUAL REPORT - MANAGEMENT & PROGRAM ACTIVITY SUMMARY

CERTIFIED DEVELOPMENT COMPANY FISCAL YEAR END

CDC Name_____ ____/____/____

City, State_____

Chief Operating Officer_____, Telephone (____)_____

A. 503/504 LOAN APPROVALS:

	Current Year #	Current Year $ Amount	Program To Date #	Program To Date $ Amount
1. Loans Approved by SBA.....	_____	$_____	_____	$_____
2. LESS a. Loans Funded. Approved Any Yr)	____	$_____	_____	$_____
b. Authorizations Canceled.....	_____	$_____	_____	$_____
Total Funded & Canceled.....	_____	$_____	_____	$_____
3. Unfunded Authorizations (1 - 2).....	N / A	$ N / A	_____	$_____

a. Number of Unfunded Authorizations outstanding less than one year _____

b. Number of Unfunded Authorizations outstanding for one year or more _____

B. 503/504 DEBENTURES FUNDED:

(Debenture Approval Amount including Fees)	Number	$ Amount
1. Debentures funded during current year	_____	$_____
2. Debentures funded, Program To Date	_____	$_____
3. Voluntarily Prepaid by SBC(s), Program To Date . .	_____	$_____
4. Transferred to SBA for servicing, Program To Date .	_____	$_____
5. Portfolio Serviced by CDC [2 - (3 + 4)].	_____	$_____

C. EMPLOYMENT IMPACT (see Section 108.503 (d) of SBA Regulations):

Estimated Jobs for C(1) and C(2), Actual Jobs for C(3)

	Created	Retained	Total	$ / Job
1. Loans Approved, Program to Date . . . . (net of cancellations)	_____	_____	_____	$_____
2. Debentures Funded Less Than 2 Years . * (Estimated Jobs, Form 1244)	_____	_____	_____	$_____
3. Debentures Funded 2 or More Years . . * (Actual Jobs, as of 2 years)	_____	_____	_____	$_____
4. Total CDC Portfolio (total of 2 + 3). .	_____	_____	_____	$_____

* including loans voluntarily prepaid, but excluding loans transferred to SBA

D. TOTAL PROJECT (503/504 LEVERAGE):
($ Loan approval, not current balance)

	Current Year Amount	%	Program To Date Amount	%
1. Third-party Financing				
a. Private Sector Financing	$_____	____	$_____	____
b. State & Local Government	$_____	____	$_____	____
c. Federal Programs other than 503/504	$_____	____	$_____	____
TOTAL Third-party	$_____	____	$_____	____
2. Debenture Financing				
DEBENTURE PROCEEDS	$_____	____	$_____	____
3. SBC/CDC Injection				
a. SBC Receiving Assistance	$_____	____	$_____	____
b. CDC Direct Participation	$_____	____	$_____	____
c. Other	$_____	____	$_____	____
TOTAL SBC/CDC INJECTION	$_____	____	$_____	____
TOTAL PROJECT (1 + 2 + 3)	$_____	100%	$_____	100%

E. PORTFOLIO DIVERSIFICATION (Section 108.503-3(b) of SBA Regulations):
(Loans Approved, Net of Cancellations)

	Current Year # loans	%	Program To Date # loans	%
1. New Businesses: Percent of All Loans .	_____	_____	_____	_____

2. Concentration by SIC Category:
(for top 3 SIC Codes in which more than 10% of the portfolio is concentrated)

SIC Code (4 Digit)	Description	Current Year # loans	%	Program To Date # loans	%
a._____	_____	_____	_____	_____	_____
b._____	_____	_____	_____	_____	_____
c._____	_____	_____	_____	_____	_____

F. OTHER FINANCING SERVICES:
(Administered by CDC or an Affiliate)

	Current Year # loans	$ Amount	Program To Date # loans	$ Amount
1. SBA 502 Loans	_____	$_____	_____	$_____
2. 7(a) Loan Applications	_____	$_____	_____	$_____
3. EDA Revolving Loan Fund	_____	$_____	_____	$_____
4. CDBG Revolving Loan Fund	_____	$_____	_____	$_____
5. Other_____ .	_____	$_____	_____	$_____

SUGGESTED FORMAT FOR CDC ANNUAL REPORT & OPERATIONAL REVIEW

I. CDC: ___ Name: _____
___ Address: _____
___ City,state,zip:_____
___ Telephone #: _____/_____-_____

STAFF:__ Executive Director/President:_____
___ Marketing Principal (if any):_____
___ Packaging Principal (if any):_____
___ Servicing Principal (if any):_____

___ Check above, if different from last annual report.

II. CDC OPERATIONS:

A. Program Activity (CDC Fiscal Year)

1. How many 504 Loans were approved? . . . . . _____

2. How many 504 loans were closed? . . . . . _____

3. How many jobs are anticipated to be created or retained for projects closed in last two years? . . . _____ and what is the average debenture investment per job? . $_____

4. Did the CDC package other SBA loans?_____. How many? . _____

5. Did the CDC package non SBA loans?_____. How many? . ._____

6. Did any of the CDC's 503/504 loans become delinquent by 2 or more payments?_____, How many? . . . . . _____

7. Did the CDC initiate servicing actions and inform SBA of problem(s), status and actions?. . . . . _____

8. Did the CDC follow up with its problem loans and document efforts toward workout, deferment or assumption in cooperation with SBA? . . . . . _____

B. CDC Organization

1. If CDC staff changes were made, were you provided copies of SBA 1081, fingerprint card and resume? . . _____

a. Did the new staff have related experience in small business finance? . . . . . _____

2. Has the CDC reported changes in the membership of its Board of Directors and general membership? . . . _____

a. Do the memberships comply with representation set forth in CFR 13, Part 120?. . . . . _____*

3. Are there any indications of control being vested in a small group which might impair the CDC? . . . . _____*

* please provide written comments on back

C. CDC Financial Capability

1. Are CDC financial statements in conformance with GAAP? . . . . . _____
Y N

2. Are current year revenues and expenses consistent with those for prior years?. . . . . _____
a. If the CDC lost revenue from one source, what was the source?_____
Was the source replaced?_____. By what?_____

3. Do they indicate that the CDC has financial capability to market, package and service the loans?. . _____
If no please provide comments on back.

4. Have any legal actions been filed or taken against the CDC?_____. Summary in Annual Report? Y N

D. CDC Reports

_____ 1. Was the CDC Annual Report filed in a timely manner?. _____
If not,
Was an extension granted?. . . . . _____
or Was the CDC informed that fees would be withheld or processing would stop until compliance? . . . _____

III. Overall Rating of CDC

(please circle the "X" to reflect your assessment)	Serious Problem -3	-2	Satisfactory -1	0	+1	Very Good +2	+3
A. Quality of Loan Applications	X	X	X	X	X	X	X
B. Completeness of Closing Documents	X	X	X	X	X	X	X
C. Timeliness of Servicing Actions	X	X	X	X	X	X	X
D. Documentation of Servicing Actions	X	X	X	X	X	X	X
E. Staff Capability / Experience	X	X	X	X	X	X	X

IV.
Comments:_____
_____
_____
_____

V. Problem Situations: For any problems identified,

A. Have written comments been attached to this review? . . . Y N

B. Has this review & comments been discussed with the CDC? . Y N

C. Do you recommend that the CDC be decertified? . . . . . Y N

_____ _____ _____
Reviewing L/O FD Chief PM Chief

SUGGESTED GUIDELINE FOR FIELD REVIEW OF A CDC

TO BE CONDUCTED AT A MINIMUM ONCE EVERY THREE YEARS

I. CDC OPERATIONS:

A. Location: Is the CDC location open to the public during regular business hours? Does it have a separately listed telephone number?

B. Staff: Is there at least one qualified professional to respond to program inquiries on a full-time basis? Is staffing adequate for both packaging and servicing functions?

C. Do they maintain current copies of SOPs 50-10 and 50-50, program notices, and current forms?

D. Are minutes of the meetings and corporate document files maintained (e.g. do the minutes reflect quorum for meetings at which loans are approved and are loan resolution copies maintained with the minutes)?

II. CDC SERVICING COMPLIANCE: (For this part, pull sample case files.)

A. Have field visits been made to Small Business Concerns (SBCs)?

B. Have borrower and affiliate annual financial statements been received and analyzed?

C. Has the CDC followed up on past-due payments?

D. Are UCC filings current? (for those CDCs that maintain UCCs.)

E. Is a system maintained to insure borrowers are current with insurance payments and taxes?

F. Do the files reflect communication with the participating third-party lender, especially for projects with payment problems or other adverse changes?

G. Does the CDC request and analyze SBC and affiliate financial statements prior to requesting servicing actions, as appropriate?

OVERLAPPING OF CDC SERVICE AREAS

PROCEDURE FOR ANALYSIS AND EVALUATION

[When there is an overlapping issue to be considered, the following procedure must be used in evaluating new CDC applications and CDC applications for expansion.]

A. BACKGROUND:

A CDC needs to have a service area with an adequate population of individuals and businesses to support the operations of the organization. At a minimum, it needs to be able to generate at least two 504 loans per year.

Through membership, bank relationships and staff/office organization, a CDC must be able to adequately market the program and service the loans in its service area.

Organizations desiring to participate in the SBA/CDC network without the responsibility for staffing, membership and legal structure of a CDC, will be able to participate as Associate Development Companies. This includes inactive CDCs that forfeit their certification.

B. ANALYSIS:

1. Does the cumulative approval activity by all CDCs covering the area being considered by the new or expanding CDC exceed an average of 1 per 100,000 in population averaged for the previous two years, or 24 months, whichever is greater?

   a. If each geographic unit (county in most cases) exceeds this standard, the application cannot be accepted for processing and must be returned.

   b. If no geographic unit exceeds the standard, continue processing for all areas in question.

   c. If some areas exceed the 1 per 100,000 standard and some do not, continue processing for those areas that do not exceed the standard.

2. If the area under consideration is under the 1 per 100,000 standard, this is not an automatic approval for the applicant. It is a "maybe." You should address the following concerns (that apply) in the analysis before making a recommendation:

   a. Competition may be beneficial to the program and may provide an incentive to the existing CDCs to more actively market in their entire area of operations to meet the 1 per 100,000 standard in each of its geographic units within its service area.

   b. However, we will not permit ruinous competition that could harm an existing CDC that is doing a good job and that has done the pioneering work of developing the program in a given area.

   c. In the case of a statewide or multicounty CDC, analysis must first be made of the adequacy of its overall level of activity including service to rural areas. If (a) this is satisfactory, (b) the area under consideration represents a significant portion of its activity, and (c) it appears that the potential loss of the activity to competition will have a detrimental impact on its ability to continue to serve the balance of its area, the application should be declined. County-by-county analysis may be relevant. If some counties are underserved and others are not, it may be desirable to consider expansion into certain counties only.

   d. If a CDC applies for an area served by an existing CDC that is already certified to operate in all or part of the applicant's existing territory, appropriate weight should be given, along with the other factors described in this appendix, to the equity that would be served by a reciprocal approval and the further overlapping of territories.

   e. Consideration must also be given to the caliber of the applicant's and the existing CDC's loan servicing and portfolio quality.

C. SUPPORTING DOCUMENTATION:

1. An analysis should be performed to compare the existing CDC's market penetration in each of the counties under consideration. The standard for comparison must be the number of loans per 100,000 population in each of the counties during last three years.

   County: Population:

19

By CDC

19

By CDC

2. An analysis for the last two years should be performed to compare the overall 504 loan approval rate per CDC divided by the overall population base for that CDC.

3. An analysis of the quality of the portfolios of the existing CDC and the expanding CDC should be made including number of loans classified as: approved, canceled, regular servicing, paid in full, in liquidation, and charged off.

4. Comment on the principal 504 staff person (or persons) for the existing CDC, the proposed CDC or the expanding CDC. If the staff function is provided by a contractor, be sure to comment on whether that contractor does 504 loans for other CDCs or 7(a) packaging for lenders and the quality of the analysis.

D. EXISTING CDC'S COMMENTS:

Attach any comments from existing CDCs who may be affected by the approval of a new CDC or the expansion of an existing CDC and analyze the comments.

E. SERVICING CENTERS COMMENTS:

Solicit and attach any comments from the appropriate Loan Servicing Center regarding the quality of the servicing actions from the existing CDC and the expanding CDC, if appropriate.

F. CDC ANNUAL REVIEW:

Attach a copy of the most recent SBA review of all applicable CDCs' operations.

G. MAP

Attach a map of the area under consideration including which existing CDCs cover which areas that are under consideration.

OPINION OF CDC COUNSEL

Date:

District Counsel
U.S. Small Business Administration (SBA)
District Office Address
City, State 00000

RE: Borrower:
504 Loan:
Loan Amount:
Project Property:

Dear Sir or Madam:

We have acted as designated 504 closing counsel to _____ (the "CDC") in connection with the above-referenced 504 Loan. We certify that we currently have in effect the insurance coverage required by or acceptable under Paragraph B.7 of SBA Procedural Notice 5000-479.

In rendering the opinions and representations expressed in this letter, we have examined and relied upon the accuracy of executed originals or copies (as designated) of the following documents:

1. A copy of the executed Authorization and Debenture Guarantee, with any accompanying amendments (the "Authorization");

2. The original executed Debenture (SBA Form 1504), which is incomplete as to the interest rate and payment amount;

3. The original executed Note (SBA Form 1505), which is incomplete as to the interest rate and amount of monthly payment, and which evidences a 504 Loan to Borrower from CDC in the above-referenced amount, together with an Assignment of the Note made by CDC to SBA (the "Note Assignment");

4. Copies of the executed note[s] to and deed of trust or mortgage to _____ (the "Interim Lender") in the [aggregate] amount of $_____ (the "Interim Loan"); or

4. Copies of the executed note[s] to and deed of trust or mortgage to _____ (the "Third Party Lienholder") in the [aggregate] amount of $_____, (the "Third Party Lienholder Loan");

5. All original executed Guarantees (SBA Form 148), which are incomplete as to the interest rate, executed by _____ and _____, together with an Assignment of each Guarantee made by CDC to SBA (the "Guarantee Assignments"); [specify each Guarantee]

6. The original executed deed of trust, from Borrower, as grantor, to _____, as trustee, for the benefit of CDC (the "Deed of Trust"), conveying certain property located in _____ County, _____, as more particularly described in the deed of trust, as collateral, together with an original executed Assignment of the Deed of Trust made by CDC to SBA (the "Deed of Trust Assignment"); or

6. The original executed Mortgage, from Borrower, as mortgagor, to CDC, as mortgagee, (the "Mortgage"), designed to create a valid lien on certain property located in _____ County, _____, as more particularly described in the Mortgage, as collateral, together with an original executed Assignment of the Mortgage made by CDC to SBA (the "Mortgage Assignment");

7. The original executed Assignment of Leases, from Borrower to CDC (the "Assignment of Leases"), together with an original executed Reassignment of the Assignment of Leases made by CDC to SBA (the "Reassignment");

8. The original executed Security Agreement, from Borrower [and Operating Company, if not a co-Borrower] as debtor to CDC as secured party (the "Security Agreement"), together with an original executed Assignment of the Security Agreement made by CDC to SBA (the "Security Agreement Assignment");

9. The original executed [UCC-1] Financing Statements for all personal property required by the Authorization as collateral, naming Borrower [and Operating Company, if not a co-Borrower] as debtor and CDC as secured party (the "Financing Statements"), together with the original executed Assignments of the Financing Statements made by CDC to SBA (the "Financing Statements Assignments");

[Specify any other lien instruments required by the Authorization]

10. The original executed Resolution of the Board of Directors of CDC (SBA Form 1528);

11. The original executed Resolution (SBA Form 160) of Borrower [and of any corporate guarantors]; or

11. The original executed Certificate as to Partners (SBA Form 160A) of Borrower [and any partnership guarantors]; or

11. The original executed Resolution (SBA Form ___) of Borrower [and of any limited liability company guarantors];

12. [Certified] copies of the Certificate and Articles of Incorporation, a copy of the Bylaws and an original current good standing certificate from _____ for CDC;

13. The original executed Certification by CDC;

14. The original executed Certification by Interim Lender; and/or

15. The original executed Certification by Third-Party Lienholder;

16. The original executed Certification by Borrower;

17. The original executed Opinion of Borrower's Counsel [if there is Borrower's Counsel];

18. The commitment for an ALTA loan policy of title insurance issued by ___ _____ (the "Title Company") in the amount of $_____ effective as of _____; and the following title and lien searches, with copies of attachments, including all recorded easements, covenants, restrictions, and other exceptions (including conditions shown by a survey):

[Specify any State and county lien searches, and any UCC lien searches by title company/searcher and date, and any other title insurance policy reviewed]

18. A [copy of or an original] survey certified to CDC and SBA, or a prior survey acceptable to CDC, SBA, and the title insurer, and a survey affidavit of no change [in those jurisdictions where a survey customarily is provided for title insurance coverage];

19. An original executed certification or affidavit of ownership and/or other pertinent documentation (such as bills of sale, invoices, and/or purchase orders) by Borrower relating to ownership of the [describe any specific equipment or other personal property collateral].

20. Original Federal and state tax lien reports or certificates issued by [describe issuer of report];
[This can be part of 17 above.]

21. The original executed Servicing Agent Agreement (SBA Form 1506);

22. The original executed Use of Proceeds (SBA Form 1429);

23. Original executed Loan Agreement [if CDC uses one];

24. [Specify any other documents unique to the specific 504 Loan, such as a deed of trust on other real estate.]

We also have examined such other documents and information, including the provisions of the Small Business Act, as amended, and the Small Business Investment Act of 1958, as amended, and the regulations issued under them, the corporation law (including non-profit corporation law, if applicable) of the State of _____ , and other applicable Federal and state laws and regulations as are necessary or appropriate, in accordance with prudent legal practice, to enable us to form the opinions and make the representations expressed in this letter.

Based upon the foregoing, we are of the opinion, as of the date of this letter, that:

(a) CDC is a [non-profit] corporation duly organized, in good standing, and validly existing under the laws of the State of _____;

(b) The Debenture has been duly authorized, executed and delivered by an authorized officer of CDC and, when the principal amount stated in the Debenture, less fees and expenses, has been disbursed on behalf of CDC or its assigns and Borrower, and when the Debenture is appropriately completed in accordance with the Servicing Agent Agreement, the Debenture will be a valid and binding obligation of CDC, enforceable in accordance with its terms;

(c) The Note Assignment, the Guarantee Assignments, the Deed of Trust Assignment [or the Mortgage Assignment], the Reassignment, the Security Agreement Assignment, the Financing Statements Assignments and any other CDC assignments required by the Authorization (collectively, the "Assignments") have been duly authorized, executed and delivered by an authorized officer of CDC and are valid and binding obligations of CDC, enforceable in accordance with their respective terms;

(d) Any other instruments and supporting documents required by the Authorization to be executed by CDC have been duly authorized, executed and delivered by an authorized officer of CDC and are valid and binding obligations of CDC, enforceable in accordance with their respective terms; and

(e) To our knowledge, the 504 loan has been closed in accordance with the terms and conditions of the Authorization.

Our opinion as to the enforceability of the obligations of CDC under the Debenture and the Assignments is subject to the following qualifications:

1. The effect of any applicable bankruptcy, insolvency, reorganization, fraudulent conveyance, moratorium or other laws affecting creditor's rights generally; and

2. The exercise of judicial discretion in accordance with general principles of equity.

We express no opinion as to the laws of any state other than _____ We express no opinion with respect to title to any property.

Based upon the foregoing and on our knowledge, we also make factual representations, but do not opine, to the following:

We have made arrangements for the prompt recording or filing of all relevant documents. [Attorneys may specify the arrangements at their option.]

Upon receipt and application by the Interim Lender of the net Debenture proceeds in the amount of $_____, [and the payment of any accrued, outstanding interest by Borrower], the Interim Lender has stated that the Interim Loan will be paid in full.

or if the Interim Lender and the Third-Party Lienholder are the same

Upon receipt and application by the Third-Party Lienholder of the net Debenture proceeds in the amount of $_____, [and the payment of any accrued, outstanding interest by Borrower], the Third-Party Lienholder has stated that the principal balance of the Third Party Lienholder Loan will be _____ _____ and _____/100 Dollars ($_____).

* The following paragraph must be used when the Project Property consists wholly or partially of real estate. *

The Title Company has issued [or will issue] an ALTA loan title insurance policy in the amount required by the Authorization insuring that CDC and SBA hold a valid _____ lien on the Property subject only to the liens expressly permitted by the Authorization. There either (1) are no contractor's, mechanic's or materialman's liens on the Property currently filed and no exception for same in the title insurance commitment/policy, or (2) the Title Company is providing affirmative coverage to CDC and SBA over any such liens, affording reasonably adequate protection against material loss arising from any such liens.

In addition, the Title Company is providing such endorsements as are necessary or appropriate reasonably to protect CDC and SBA against material loss arising from other exceptions in the title insurance commitment/policy not expressly permitted by the Authorization. In the case of subsequent issuance, [state how appropriate title insurance protection is afforded at the time of submission according to local practice; for example, "the title company issued a title insurance commitment evidencing its willingness to insure, has provided us with a satisfactory marked-up copy after the closing and has collected its full premium for the policy"].

* The following paragraph must be used when the Project Property consists wholly or partially of personal property. *

With respect to the personal property (in which a security interest subject

to Article 9 of the Uniform Commercial Code is granted which may be perfected by the filing of financing statements), upon the filing of the Financing Statements, the security interests of CDC and SBA in such property will have been perfected, and CDC and SBA will be in the lien position required by the Authorization.

For purposes of the opinions and representations made in this letter, the words "our knowledge" refer to the knowledge of the lawyers and other legal professionals within our firm working on this 504 loan, and mean that, in the course of our representation of the CDC in matters with respect to which we have been engaged by the CDC as counsel, no information has come to our attention that has given us actual knowledge or actual notice or reasonably would lead us to conclude that anything in this letter or in any of the documents referred to in this letter on which we have relied (including the Certification by the CDC) is misleading or inaccurate, or that further inquiry is appropriate.

In forming the opinions and making the representations set forth above, we have assumed, and nothing has come to our attention which would lead us to conclude to the contrary, the following:

(a) all documents submitted to us as copies are authentic, all copies conform to the original documents, all signatures are genuine, and all public records reviewed are accurate and complete;

(b) each party, person, or entity ("Party") other than CDC has taken all actions necessary to authorize the actions contemplated to be performed by such Party in connection with the 504 Loan, and has duly and validly executed and delivered each instrument, document, and agreement executed in connection with the 504 Loan to which such Party is a signatory, and such Party's obligations set forth therein are its legal, valid, and binding obligations, enforceable in accordance with their respective terms;

(c) each person executing any instrument, document, or agreement on behalf of any party (other than CDC, Borrower, and Guarantors) has been duly authorized to do so; and

(d) each Party other than CDC has performed or will perform the actions contemplated to be performed by such Party in connection with the 504 Loan.

(e) no fraud exists with respect to (a) through (d).

This letter is solely for the benefit of SBA, including its counsel, and may not be relied upon by any other person or entity without our prior written approval. We are aware that SBA will rely upon this letter in guaranteeing the Debenture. The opinions and representations in this letter are limited to the matters set forth in this letter. We do not undertake to advise you of any changes in the opinions expressed in this letter that may result from occurrences after the date of this letter.

We are submitting the 504 Loan closing package to you with this letter.

As the individual attorney signing this letter, I further certify that I am authorized to do so and that I am a licensed, active member, in good standing, of the Bar of the State of _____.

Very truly yours,

Effective: 01-29-99

XYZ Law Firm
By: _____
for the Firm

APPENDIX 9 - CAPLINES RELATED DOCUMENTS

MONITORING, EXAMINATION, AND CONTROL STANDARDS

The administration of any **Asset Based** CAPLines account involves numerous activities to assure the required revolving feature of these loans is maintains and that sufficient value in the collateral exists to cover the outstanding balance. The principal activities include:

a. Monitoring and Financial Examination: The continual review of the borrowing base certificates and accompanying financial information to evaluate the borrower's management of the collateral.

b. Collateral Examination: Conducting periodic examinations of the collateral to verify its value and ability to be converted to cash as well as analyzing the financial data and source documents to ascertain the validity of the statements, as well as conduct an analysis of in-depth point in time information on the collateral such as what is obtained during a field examination.

c. Funds Control: Perpetual control of the proceeds generated by the business as a result of having the use of the **Asset Based** proceeds that limit a borrower's discretionary use of the cash receipts generated as a result of having the loan. Potential control of the accounts which secure the loan including the segregation of different classes and types of inventory.

The degree of monitoring and control required depends upon the mode of operation and financial capabilities of the business, the nature of the collateral, and the risk assessment of these factors.

All applicants for an **Asset Based** CAPLines loan must complete an SBA Form AB-4, (Supplemental Information for Asset Based Lines of Credit) as part of their application documentation and the Lender will use this information to complete the applicant questionnaire in order to derived a score. The resulting score is used to determine the level of monitoring and control to be required on the loan. All **Asset Based** borrower's will be subject to certain minimum standards regardless of their score and can expect to be subject to more stringent requirements when the factors evaluated show higher risk or at the discretion of the lender and SBA.

The specific requirements for all **Standard Asset Based** sub-program loans are detailed on the following pages. These same items are available for use on any **Small Asset Based** CAPLines, even though they are not required. The requirements for the **Small Asset Based** CAPLines are detailed in the text of paragraph 20 of subpart C in SOP 50 10(4).

The following standards represent the servicing requirements for any Standard Asset Based CAPLines. These requirements are divided between the functions of monitoring, examination, and control. In addition, each requirement is divided between two levels of responsibility, which are called minimum or maximum for the monitoring and examination requirements and called medium and high for control requirements. The initial selection of the requirements depends upon the score obtained at the completion of the applicant questionnaire.

PROCEDURE: **MINIMUM** MONITORING AND FINANCIAL EXAMINATION

1. **Prior to each disbursement** and no less frequently than monthly, borrower shall submit a borrowing base certificate to their lender who shall review for accuracy, adjust for ineligible items, and determine the value of collateral eligible for advancement of proceeds. Prior to released of funds, lender to indicate the report was satisfactory.

2. **Prior to each disbursement**, lender shall reconcile the borrowing base certificate and establish the allowable borrowing base by multiplying the value of the eligible collateral derived from a newly submitted borrowing base certificate times the applicable advance rate. The existing outstanding principal balance shall be subtracted from the borrowing base to determine the maximum allowable amount to be advanced.

3. **On a monthly basis**, lender shall receive selected operating reports from borrower including an aging of receivables and payables and an inventory schedule (when advances are made against inventory). Lender shall reviewed reports against actual borrowing base disclosures.

4. **On a quarterly basis**, lender shall receive selected operating reports from borrower including financial statements (of a quality of lender's choosing) within 60 days of the conclusion of each operating quarter.

4a. **On a quarterly basis**, lender shall cross review the interim financial statements, current asset reports, and borrowing base reports for changes, inconsistencies, and deterioration.

4b. **On a quarterly basis**, lender shall conduct a review of bad debt, obsolete inventory, and accrual policies.

5a. **On a semi-annual basis**, lender shall conduct a ratio analysis and compare a spread of key ratios to analyze and changed which may impacted turnover and dilution of current assets. Examples include: days sales outstanding; days inventory on hand; accounts payable; allowances for bad debt; allowance for or actual percentages of returns/credits; current ratio; etc. Lender shall act on results as needed.

5b. **On a semi-annual basis**, lender shall conduct a covenant compliance review.

5c. **On a semi-annual basis**, lender shall compare the status of borrower's accounts payable, term debts and leases, with prior semi-annual periods. Lender shall act on results as needed.

6a. **On an annual basis**, lender shall review management information system and controls and make necessary remediation if required.

6b. **On an annual basis**, lender shall conduct a legal review for any actions, claims, tax deficiencies, and liens.

6c. **On an annual basis**, lender shall conduct a review of bad debt, obsolete inventory, and accrual policies.

6d. **On an annual basis**, lender shall modify loan agreements, advance rates and/or loan covenants, as necessary.

6e. **On an annual basis**, lender shall conduct an SIC peer group review on selective items in #5a;

PROCEDURE: **MAXIMUM** MONITORING AND FINANCIAL EXAMINATION

1. Increase the frequency of all activities other than those done monthly as follows: annual to semi-annual, semi-annual to quarterly, and quarterly to monthly.

NOTE: Regardless of the score obtained from the applicant's questionnaire, lenders have unilateral authority to increase the frequency of any of the above stated monitoring and financial examination requirements with out SBA's concurrence. Reduction in the frequency beyond what is authorized requires lender justification and SBA concurrence.

Most of the required servicing can be conducted at the lender's office (off-site), but selected requirements have to be done at the borrower's place of business (on-site).

PROCEDURE: **MINIMUM** ACCTS RECEIVABLE EXAMINATION REQUIREMENTS

FREQUENCY: Prior to initial disbursement and not less than semi-annually.

Off-Site

1. Compare aging statements with borrowing bases over the concluded semi-annual period to determine turnover and condition of receivables pool.

2. Mail blind verifications to 20 percent of borrower's account debtors to determine their reported payables to borrower on specific date, compared with reports given to lender voluntarily.

NOTE: The 20 percent figure should include a representative sample of borrower's largest customers.

3. Conduct a red flag analysis, reviewing available information submitted by borrower for:

   a. Unusual rollovers of accounts;

b. Changes in credit performance of specific accounts over 90 day period;

c. Cash receipts not in parity with reported account turnover and deposits made to cash collateral account;

d. Deteriorating markets or specific accounts;

e. Unusual credit or warranty activity;

f. Changes in credit policy or due diligence of accounts;

g. The advent of other financing activity causing reduction in collateral pool (e.g. creation of affiliated entities to extend financing not covered by the **Standard Asset Based** line or investor financing of selective A/R assets).

4. Cross-age selective data like contra accounts; specific turnover of the 10 largest accounts to test for stability, credit adherence, etc.;

On-Site

5. Compare present shipping documents to invoices and A/R listing for the most recent quarters financial data on the largest five accounts to determine confirmation of amounts, margins, receiving statements and acceptances.

6. Compare elements of dilution (e.g. over aged A/R; contras; affiliated transactions; offsets & credits; concentrations; rollovers, etc.) by reviewing source documents such as cash receipts journals; credit memos; shipping reports; repair and warranty files; credit files/in-house agings; payable/ receivable ledgers; foreign accounts; call reports and various communications.
7. Use source documents to review current and past delinquencies for account debtor trends and compare to financial reports and agings given in prior financial statements and borrowing base certificates to lender.

8. Test credit memos to financial reports and adjustments to the certificate

9. Summarize activity by determining revised ineligibility and advance rate standards, or covenant changes.

PROCEDURE: **MAXIMUM** ACCTS RECEIVABLE EXAMINATION REQUIREMENTS

1. Increase the frequency of all activities other than those done monthly as follows: annual to semi-annual, semi-annual to quarterly, and quarterly to monthly.

PROCEDURE: **MINIMUM** INVENTORY EXAMINATION REQUIREMENTS

FREQUENCY: Prior to initial disbursement and not less than semi-annually

Effective: 12-01-97

Off-Site

1. Overview components of eligible inventory to determine items with most movement, credit/return potential; over-stocking; markdowns; obsolescence.

2. Analysis by product lines and vendor support; including changes in vendors; offsets; reported Purchase Money liens; shifts in strategy or stocking; etc.

3. Test eligibility compliance issues for needed changes

4. Review for red flags: unusual turnover; changes in long standing supplier relationships; selective item or product group turnover changes; aging of certain items, or product groups; rise in returns or .bad orders,. etc.

5. Review any consignments or co-tenancy arrangements which might be pre-standing.

6. Interview other personnel generally for opinions or inconsistencies from what principals might have reported.

On-Site

7. Selectively review how borrower determines the carrying cost of inventory or raw materials and check same to the selected inventory accounting method disclosed.

8. Tie the inventory or stocking reports given lender by item or group concurrently, test counts of 20 percent of the dollars, or 10 percent of the items to determine compliance. If substantial variances exist, expand audit till reasons are determined. The results should weigh in advance rates, future eligibility or modification of the loan status and confirmation of asset in financial statements.

9. Confirm slow moving and obsolete items and integrate results in borrowing base and future adjustments in loan agreement if necessary.

10. Test reported pricing and gross margins during test counts by item or product groups.

11. When inspecting the inventories and raw materials, review care and custody issues; issues which might impact salability/marketability; rotation of stocks; contingent liabilities (environmental, zoning, employee safety, etc.).

12. Review covenants including insurance, etc.

13. Test and examine records for consignments and joint warehousing arrangements.

14. Interview other personnel generally for opinions or inconsistencies from what principals might have reported.

Effective: 12-01-97

PROCEDURE: **MAXIMUM** INVENTORY EXAMINATION REQUIREMENTS

1. Increase the frequency of all activities other than those done monthly, to wit: annual to semi-annual, semi-annual to quarterly, and quarterly to monthly.

PROCEDURE: **MEDIUM** ACCOUNT CONTROL

1. If borrower segregates its inventories that are subject to the lender's lien, provide lender both a landlord waiver and acknowledgement of conditional control, if not acquired previously. By covenant support, borrower agrees to grant lender, or its designee, management control of the area in which the collateral is kept, in the event of certain specific defaults, or deterioration of the credit.

PROCEDURE: **HIGH** ACCOUNT CONTROL

1. Medium account control is modified to provide that lender now either: contracts with a public warehouse to segregate or store collateral and release it upon instructions only; or it creates on site segregation using elements of bailment, wherein the collateral is released only from physical control upon instructions. This normally entails use of a third party servicer, or field warehouser.

PROCEDURE: **MINIMUM** FUNDS CONTROL

1. Lender to establish a cash collateral account under their control for borrower's use to deposit all proceeds (cash and checks) received from the sale of any of borrowers inventory or services including all collections of all receivables resulting from such sales. Lender to clear or sweep the account including deposit funds at their discretion, but no less frequently than weekly, and apply all proceeds to the outstanding interest and principal of the **Asset Based** loan.

PROCEDURE: **HIGH** FUNDS CONTROL

1. Minimum funds control is modified to provide that lender now either: 1) operates itself or by designee the borrower.s postal box; or 2) transfers collections to its own postal box (lock box). Lender to provide account debtors of borrower with instructions to remit all balances due borrower to the account they control.

Note:

The overriding test of control is that the lender only advances against any borrowing base after they have established a process to receive all of a borrower's cash or near cash receipts resulting from the sale of any of the assets included in the borrowing base, upon their arrival, as well as eliminate any borrower discretion to operate outside such a system.

COMPENSATION AGREEMENT FOR ANTICIPATED SERVICES TO BE PROVIDED
AND FEES TO BE CHARGED IN CONNECTION WITH A STANDARD ASSET BASED SUB-PROGRAM
APPLICATION AND LOAN MADE IN PARTICIPATION WITH SBA

SBA LOAN NUMBER

The Lender and the undersigned representatives (accountant, appraiser, attorney, engineer, service provider, etc.) hereby indicate that they intend to charged the following fees in connection with the above referenced Standard Asset Based loan. A general description of the services performed, or to be performed, by the Lender or undersigned and the compensation scheduled to be paid by the borrower shall be set forth below.

The undersigned Representative hereby attest that no other fees are anticipated to be charged and none will be charged by the representative in connection with this loan, unless concurred with by the Borrower using SBA Form SAB-159A. Original of this Form shall be submitted to the SBA office processing this application with copy maintained by Lender.

General Description Of Services	Anticipated Amount To Be Paid Anticipa

REPRESENTATIVE: Section ,13 of the Small Business Act (15 USC 642) requires disclosure concerning fees. Parts 103, 108, and 120 of Title 13 of the Code of Federal Regulations contain provisions covering appearances and compensation of persons representing SBA applicants. Whoever commits any fraud, by false or misleading statement or representation, or by conspiracy, shall be subject to the penalty of any applicable Federal or State statute.

Date: _____, 19 _____ _____
Representative/Provider

By: _____

The participating LENDING INSTITUTION hereby certifies that the above representation of service rendered and amounts charged by the above representative are reasonable and satisfactory to it.

Date: _____, 19 _____
Lending Institution

By: _____

APPLICANT hereby certifies to SBA that the above representation, description of services and amounts are correct and satisfactory to applicant.

Date: _____, 19 _____
Borrower

By: _____

SEALAttested: _____

NOTE: The foregoing certification must be executed, if by a corporation, in the corporate name by duly authorized officer and duly attested; if by partnership, in the firm name, together with signature of a general partner.
SBA Form SAB-159A

COMPENSATION AGREEMENT FOR ACTUAL SERVICES PROVIDED AND FEES
CHARGED IN CONNECTION WITH BASIC ASSET BASED SUB-PROGRAM
APPLICATION AND LOAN MADE IN PARTICIPATION WITH SBA

The Lender and the undersigned representatives (accountant, appraiser, attorney, engineer, service provider, etc.) hereby certify that they have charged the following fees in connection with the above referenced Basic Asset Based sub-program loan. A general description of the services performed, or to be performed, by the Lender or undersigned and the compensation paid or to be paid by the borrower shall be set forth below. If the compensation exceeds $1,000, the service must be itemized on a schedule attached showing each date services were performed, time spent each day, and description of service rendered on each day listed.

SBA LOAN NUMBER

The undersigned Borrower and representative hereby certify that no other fees have been charged or will be charged by the representative in connection with this loan, unless provided for in the loan authorization specifically approved by SBA.

Date Charged	General Description Of Services	Paid To	Date Paid

REPRESENTATIVE: Section ,13 of the Small Business Act (15 USC 642) requires disclosure concerning fees. Parts 103, 108, and 120 of Title 13 of the Code of Federal Regulations contain provisions covering appearances and compensation of persons representing SBA applicants. Whoever commits any fraud, by false or misleading statement or representation, or by conspiracy, shall be subject to the penalty of any applicable Federal or State statute.

Date: _____, 19 _____ _____
Representative/Provider

By: _____

The participating LENDING INSTITUTION hereby certifies that the above representation of service rendered and amounts charged by the above representative are reasonable and satisfactory to it.

Date: _____, 19 _____
Lending Institution

By: _____

APPLICANT hereby certifies to SBA that the above representation, description of services and amounts are correct and satisfactory to applicant.

Date: _____, 19 _____
Borrower

By: _____

SEALAttested: _____

NOTE: The foregoing certification must be executed, if by a corporation, in the corporate name by duly authorized officer and duly attested; if by partnership, in the firm name, together with signature of a general partner.

SBA Form SAB-159B

LENDER'S SEMI-ANNUAL FUNDS DISBURSEMENT REPORT

FOR THE SIX MONTH PERIOD ENDING: _____ 19____

This Report Shall Be Used To Provide SBA With A Synopsis Of Disbursement And Collection Activity For Every Revolving And CAPLines Loan On A Semi-Annual Basis Every April 30 & October 31 Over The Term Of The Loan. This Report Shall Be Sent To The SBA Office Servicing The Account. Lenders May Complete The Top Half For Every Disbursement And Collection Plus Provide The Summary Information Or Complete The Summary Information And Attach A Copy Of Their Transcript Of Account.

BORROWER'S NAME: _____ LOAN NUMBER: _____

LENDER'S NAME: _____ DATE: _____

TRANSACTION DATE	DOLLAR AMOUNT DISBURSED	DOLLAR AMOUNT COLLECTED	BALANCE OUTSTANDING

DISBURSEMENT ACTIVITY SUMMARY FOR THE PERIOD COVERED BY THIS REPORT
Lenders To Complete This Summary For All Revolving And CAPLines Loans

TOTAL NUMBER OF DISBURSEMENTS (This Period): _____

TOTAL DOLLAR AMOUNT OF DISBURSEMENTS (This Period): _____

TOTAL NUMBER OF COLLECTIONS (This Period): _____

TOTAL DOLLAR AMOUNT OF COLLECTIONS (This Period): _____

HIGHEST OUTSTANDING LOAN BALANCE (This Period): _____

The provisions of 18 USC 1001 and 15 USC 645 provide certain criminal penalties for making false statements, willfully overvaluing collateral, or other prohibited acts. To induce SBA to directly or indirectly, to participate in this loan, the *Borrower*, subject to these provisions, acknowledges receipt of the above listed amounts on the above listed dates, and certifies: (1) that the proceeds of these disbursements will be, and all previous disbursements have been, used in accordance with the herein applicable Loan Authorization; (2) that there has been no substantial adverse change in the financial condition, organization, operation, or fixed assets since application for this loan was filed or since the previous disbursement; and (3) that there are no liens or encumbrances against the collateral securing this loan except those disclosed in the application for this loan. *Lender* certifies that disbursement of loan proceeds was made and the loan proceeds were used as set forth above and in accordance with the Loan Authorization (Any deviation from the Loan Authorization must be authorized in writing by SBA prior to expenditure of loan funds). Lender certifies that the Borrower's repayments were made and received as noted above. To further induce SBA to participate in the loan, *Lender* certifies that neither its Associates, Officers, Agents, Affiliates, or Attorneys have charged or will charge or receive, directly or indirectly, any bonus, fee, commission, or other payment or benefit, or require compensating balances, Certificate of Deposit, or other security in connection with making or servicing of this loan (other than those reported on SBA Form 4 "Application For Business Loan" or BAB-159 "Basic Asset Based Sub-Program Compensation Agreement"). This form must be properly executed and returned to the SBA when due. If there are additional disbursements, itemize on a separate sheet, sign, date, and attach hereto.

Signatures Of Lender And Borrower To Be Acquired With Each Report

LENDER: _____ AUTHORIZED SIGNATURE: _____ DATE: _____

BORROWER: _____ AUTHORIZED SIGNATURE: _____ DATE: _____

SBA REVIEW: _____ TITLE: _____ DATE: _____

SBA Form CAP-1050

Effective: 12-01-97

BORROWING BASE CERTIFICATE & REPORT TO LENDER

FOR THE PERIOD ENDING _____, 19__ EFFECTIVE DATE OF LAST REPORT: _____

THIS FORM SHALL BE INITIALLY COMPLETED BY ALL ASSET BASED BORROWERS TO REPORT AND RECONCILE THEIR ACCOUNTS RECEIVABLE AND INVENTORY. THE VALUES HEREIN DO NOT PREVENT THE LENDER FROM MAKING THEIR OWN DETERMINATION OF APPROPRIATE VALUES.

ACCOUNTS RECEIVABLE (As of This Period)

1.	Accounts Receivable From Previous Report	$_____
2.	(+) New Total Sales From Last Report	$_____
3.	(-) Less Cash Sales From Last Report	$_____
4.	(=) Total Credit Sales Since Last Report	$_____
5.	(-) Account Receivable Collection Since Last Report	$_____
6.	(+/-) Adjustments	
	(-) Non-Trade Receivables	$_____
	(-) Affiliated Company Receivables	$_____
	( ) Other: _____	$_____
7.	(=) Net Accounts Receivable (As Of Period End)	$_____
8.	(-) Accounts Receivable Over 90 Days	$_____
9.	(=) Eligible Accounts Receivable (As Of Period End)	$_____
10.	(X) ___% of Eligible Accounts Receivable	$_____

INVENTORY (As of This Period)

11	**RAW MATERIAL INVENTORY**	$_____
12.	(+/-) Adjustments	
	( ) _____	$_____
	( ) _____	$_____
13.	(=) Total Eligible Raw Material Inventory:	$_____
14.	(X) ___% of Raw Material Inventory	$_____
15.	**WORK IN PROGRESS INVENTORY**	$_____
16.	(+/-) Adjustments	
	( ) _____	$_____
	( ) _____	$_____
17.	(=) Total Eligible Work In Progress Inventory:	$_____
18.	(X) ___% of Work In Progress Inventory	$_____
19.	**FINISHED GOODS INVENTORY**	$_____
20.	(+/-) Adjustments	
	( ) _____	$_____
	( ) _____	$_____
21.	(=) Total Eligible Finished Goods Inventory:	$_____
22.	(X) ___% of Eligible Finished Goods	$_____

RECONCILIATION

23.	Total Lines 10, 14, 18, & 22	$_____
24.	Face Amount of Note:	$_____
25.	Borrowing Base (Lesser of Line 23 or 24)	$_____
26.	Loan Balance form Previous Report	$_____
27.	(+) Plus Total Advances Since Last Report	$_____
28.	(-) Less Total Payments Since Last Report	$_____
29.	(=) Loan Balance Per Borrowers Books (Line 26 + 27 - 28)	$_____
30.	Approximate Amount Available To Borrower (Line 25 - 29)	$_____

The Above Is Certified To Be In Accordance With The Revolving Line Of Credit Authorization (SBA Form 529B)

Borrower: _____ Loan Number: _____

Authorized Signature: _____ Date: _____

* A Current Listing And Aging Of Accounts Receivable And Accounts Payable Are Attached

** Description Of Inventory And Certification Of Values Are Attached.

Effective: 12-01-97

SBA Form BBC-1

BORROWING BASE CERTIFICATE & REPORT TO LENDER

FOR THE PERIOD ENDING: _____, 19____

DATE OF LAST REPORT: _____, 19____

THIS FORM SHALL BE INITIALLY COMPLETED BY ALL CAPLINES ASSET BASED SUB-PROGRAMS BORROWERS TO REPORT AND RECONCILE THEIR ACCOUNTS RECEIVABLE AND INVENTORY. THE VALUES HEREIN DO NOT PREVENT THE LENDER FROM MAKING THEIR OWN DETERMINATION OF APPROPRIATE VALUES.

Pursuant to the Loan Authorization and the Note between undersigned (Borrower) and (Lender) dated ( ), the Borrower hereby requests an additional loan as follows:

1.	**Loan Balance on Previous Report**	**$**_____
2.	**Advances Since Last Report**	**$**_____
3.	**Total Payments Since Last Report (agrees w/#4 on reverse as long as loan balance exceeds collections)**	**$**_____
4.	**Loan Balance on Books**	**$**_____
5.	**Amount Available to Borrow (from Collateral Reconciliation)**	**$**_____
6.	**Amount Requested (If #5 above is positive)**	**$**_____
7.	**Check attached for balance (If #5 above id Negative)**	**$**_____

BORROWING BASE

a.	**Total Accounts Receivable**	**$**_____
b.	**Ineligible Accounts Receivable**	**$**_____
c.	**Eligible Accounts Receivable**	**$**_____
d.	**Accounts Receivable Advance Rate Percentage**	**%**_____
e.	**Borrowing Level For Accounts Receivable**	**$**_____
f.	**Total Inventory**	**$**_____
g.	**Ineligible Inventory**	**$**_____
h.	**Eligible Inventory**	**$**_____
i.	**Inventory Advance Rate Percentage**	**%**_____
j.	**Borrowing Level For Inventory**	**$**_____
k.	**Borrowing Base (e + i)**	**$**_____

The Above Is Certified To Be In Accordance With The Revolving Line Of Credit Authorization (SBA Form 529B)

Borrower: _____

Loan Number: _____

Authorized Signature: _____ **Date:** _____

***** **A Current Listing and Aging of Accounts Receivable and Accounts Payable are Attached**

****** **Description Of Inventory And Certification Of Values Are Attached.**

SBA Form BBC-2

BORROWING BASE CERTIFICATE & REPORT TO LENDER

COLLATERAL RECONCILIATION

ACCOUNTS RECEIVABLE

1.	**Accounts Receivable Last Report**	**$**_____
2.	**Credit Sales Since Last Report**	**$**_____
3.	**Total**	**$**_____
4.	**Collections Since Last Report**	**$**_____
5.	**Accounts Receivable Per Books**	**$**_____
6.	**Ineligible Accounts Receivable**	**$**_____
7.	**Eligible Accounts Receivable**	**$**_____

INVENTORY

8.	**Inventory Per Books**	**$**_____
9.	**Ineligible Inventory**	**$**_____
10.	**Eligible Inventory**	**$**_____

RECONCILIATION

11.	**Accounts Receivable Borrowing Base** **(_____ percent of 7 above)**	**$**_____
12.	**Inventory Borrowing Base** **(_____ percent of 10 above)**	**$**_____
13.	**Total**	**$**_____
14.	**Face Amount of Note**	**$**_____
15.	**Borrowing Base**	**$**_____
16.	**Loan Balance on Books**	**$**_____
17.	**Amount Available to Borrow** **(#15 minus 16)**	**$**_____

SBA Form BBC-2

BORROWING BASE CERTIFICATE & REPORT TO LENDER

LISTING OF INELIGIBLE ACCOUNTS RECEIVABLE AND INVENTORY

ACCOUNTS RECEIVABLE

A.	**Accounts Receivable over 90 days**	**$**_____
B.	**Contra Accounts**	**$**_____
C.	**Foreign Accounts**	**$**_____
D.	**Affiliate Accounts**	**$**_____
E.	**Retention, Dated Sales, Consigned Sales**	**$**_____
F.	**Credit Memo/Balances**	**$**_____
G.	**Bonded Jobs**	**$**_____
H.	**Pre-Billed Accounts**	**$**_____
I.	**Total Ineligible Accounts Receivables**	**$**_____

INVENTORY

J.	**Work in Progress**	**$**_____
K.	**Other Ineligibles**	**$**_____
	(specify)	
L.	**Total Ineligible Inventory**	**$**_____

SBA Form BBC-2

BORROWER'S LISTING AND AGING OF ACCOUNTS RECEIVABLE

FOR THE PERIOD ENDING: _____ 19___ DATE OF PRIOR REPORT: _____

CUSTOMER NAME	BILLING DATE	0 - 30	31 - 60	61 - 90	OVER 90	TOTAL
		$	$	$	$	$
REPORT TOTALS						

Mark All Non-Trade Receivables With A Single Asterisk *
Mark All Receivables To Affiliated Companies With A Double Asterisk **

I Certified This Report To Be In Accordance With The Requirements Of The SBA Authorization For The Loan Referenced Below

BORROWER: _____ LOAN NUMBER: _____

AUTHORIZED SIGNATURE: _____ DATE: _____
SBA Form CAP-ARA

BORROWER'S LISTING AND AGING OF ACCOUNTS PAYABLE

FOR THE PERIOD ENDING: _____ 19___ DATE OF PRIOR REPORT: _____

CUSTOMER NAME	BILLING DATE	0 - 30	31 - 60	61 - 90	OVER 90	TOTAL
REPORT TOTALS		$	$	$	$	$

Mark All Non-Trade Payables With A Single Asterisk *
Mark All Payables To Affiliated Companies With A Double Asterisk **

I Certified This Report To Be In Accordance With The Requirements Of The SBA Authorization For The Loan Referenced Below

BORROWER: _____ LOAN NUMBER: _____

AUTHORIZED SIGNATURE: _____ DATE: _____

SBA Form CAP-APA

Approval Of Lender Participants

Lenders desiring to participate in the **Standard Asset Based** sub-program shall complete a lender qualification survey and be approved as a **Standard Asset Based CAPLines** lender at the local SBA level by the senior economic development supervisor for the office - the person supervising Processing Division team leaders, chiefs, or supervisory loan officers.

Lender approval should be based on information provided in the lender qualification survey. This survey intends to identify a lender's practices and experiences in making and servicing revolving lines of credit, not term loans. A lender's historical experience in receiving guaranty support on their term loans is not an adequate basis for determining a lender's capabilities in administering asset based loans. While experience, relationships, and cooperation in term lending are key factors, potentially **Standard Asset Based** loans will originate from a separate division of the participating institution which is less familiar with SBA lending, but dedicated to ABL. Lender experience in ABL is paramount to the overall success of this program. The Survey should be reviewed for the data and insight it provides SBA as to this experience.

Questions on the Lenders fees should be carefully examined to determine if they address the fee question in a manner that an applicant could understand. A schedule of fees which the lender anticipates charging prospective borrowers will enhance the answer to these questions since the such a schedule should be what the lender provides an applicant at the time of application.

For lenders initiating an asset based lending program, without prior experience, the survey shall be submitted annually, until waived by OFA. These lenders should also be encouraged to hire the services of a third party service provider unless they provide written justification on their capabilities of satisfying the servicing and monitoring requirements of **Standard Asset Based** loans.

If a lender is inexperienced in ABL, a field visit to discuss the lender's capabilities in internally administering these type loans is recommended. Each district shall maintain copies of the lender qualification surveys approving the lender for participation within its territory. Primary responsibility for approving a lender operating in multiple jurisdictions will rest with the district serving the territory where the lender maintains its headquarters. A copy of each survey shall be forwarded to the Office of Loan Policy, Office of Financial Assistance within 15 days of the lender's approval.

Since many lenders operate in multiple jurisdictions, districts should provide reciprocity, whenever possible, to lenders already approved for **Standard Asset Based** loans by another district, without requiring the submission and review of another Survey. If questions or problems arise regarding the extension of reciprocity to a lender already approved by another district, contact Headquarters.

U.S. SMALL BUSINESS ADMINISTRATION
STANDARD ASSET BASED PROGRAM
LENDER QUALIFICATION SURVEY

TO BE COMPLETED BY ALL POTENTIAL PARTICIPANTS IN SBA'S
STANDARD ASSET BASED PROGRAM PRIOR TO PARTICIPATION

IDENTIFICATION QUESTIONS

LENDER: _____

ADDRESS: _____

CITY: _____

STATE: _____ ZIP CODE: _____

HAVE YOU REVIEWED THE PROGRAM GUIDE MATERIAL FOR THE OPERATION OF SBA'S ASSET BASED PROGRAMS ?

YES: _____ NO: _____

IF NO, SBA RECOMMENDS YOU OBTAIN A COPY.

ARE YOU PRESENTLY A PARTICIPANT IN SBA GUARANTEED LENDING? YES: _____ NO: _____

IF YES, FOR HOW MANY YEARS? _____

NAME AND TITLE OF BANK OFFICIAL SUPERVISING SBA TERM LENDING PROGRAMS:

_____ TITLE: _____

DOES YOUR INSTITUTION SUBMIT APPLICATIONS FOR SBA GUARANTY TO MORE THAN ONE SBA OFFICE?

YES: _____ NO: _____

IF YES, LIST EACH OFFICE BY ITS CITY DESIGNATION:

_____

_____

_____

_____ ARE YOU CURRENTLY A CLP DESIGNATED LENDER? YES: _____ NO: _____

ARE YOU CURRENTLY A PLP DESIGNATED LENDER? YES: _____ NO: _____

INDICATE EACH SBA OFFICE LISTED ABOVE WHICH PROVIDED YOU WITH THE CLP DESIGNATION BY A SINGLE ASTERISK AND PLP DESIGNATION BY A DOUBLE ASTERISK

THE DOLLAR AMOUNT OF COMMERCIAL & INDUSTRIAL LOANS OUTSTANDING AS OF YOUR LAST YEAR END REPORT EQUALS:

$_____

THE DOLLAR AMOUNT OF SBA GUARANTEED LOANS OUTSTANDING AT YOUR INSTITUTION EQUALS:

$_____

DOES YOUR INSTITUTION HAVE AN EXISTING ASSET BASED LENDING DEPARTMENT?

YES: _____ NO: _____

WILL YOUR ABL DEPARTMENT BE RESPONSIBLE FOR SUPERVISING SBA STANDARD ASSET BASED PROGRAM APPLICATIONS?

YES: _____ NO: _____

IF YES, PLEASE PROVIDE A COPY OF YOUR ABL DIVISIONS POLICY MANUAL - SBA WILL MAINTAIN ITS CONFIDENCE.

IF NO, DESCRIBE HOW YOUR INSTITUTION WILL MONITOR AND CONTROL SBA's STANDARD ASSET BASED CREDITS.

_____

_____

_____

_____

_____

_____

_____ NAME AND TITLE OF BANK OFFICIAL SERVING AS SBA CONTACT FOR STANDARD ASSET BASED LOANS:

NAME: _____ TITLE: _____

VOICE TELEPHONE: _____

FACSIMILE NUMBER: _____

Effective: 12-01-97

BANK ASSET SIZE: $ _____ NUMBER OF BRANCHES: _____

Form LQS-2 **PAGE 1**

LENDERS QUALIFICATION SURVEY

GENERAL QUESTIONS

YOUR INSTITUTION'S EQUITY TO TOTAL ASSETS PERCENTAGE AS OF THE LAST REGULATORY AUDIT IS: _____ %

DO YOU CURRENTLY PROVIDE LINES OF CREDIT TO SMALL AND MEDIUM SIZED BUSINESSES? YES _____ NO _____

IF YES, DO YOU CONTROL THE COLLECTION OF RECEIPTS? YES _____ NO _____

IF YES, DESCRIBE YOUR METHOD(S) FOR CONTROL OF THE RECEIPTS:

_____

_____

_____

_____

_____

IF NO, ARE YOU WILLING TO COMMENCE CONTROLLING THE COLLECTION OF RECEIPTS? YES _____ NO _____

DO YOU CURRENTLY PROVIDE ASSET BASED, WORKING CAPITAL LOANS TO SMALL AND MEDIUM SIZED BUSINESSES?

YES _____ NO _____

IF YES, DESCRIBE DIFFERENCES BETWEEN SERVICING ABL CREDITS FROM LINES OF CREDIT REFERENCED ABOVE:

_____

_____

_____

IF YES, THE NUMBER IN THE LAST TWELVE MONTHS: _____

IF YES, AVERAGE DOLLAR AMOUNT IN LAST TWELVE MONTHS: _____

IF YES, FAILURE RATE EXPERIENCED IN LAST TWELVE MONTHS: _____

IF YES, DOLLARS CHARGED OFF IN LAST TWELVE MONTHS: _____

IF YES, DO YOU CONDUCT REGULAR FIELD EXAMS OF PLEDGED COLLATERAL? YES _____ NO _____

IF YES, WHAT IS THE AVERAGE FREQUENCY? (M, Q, SA, A): _____

IF YES, WHO PERFORMS THESE EXAMS? LIST ALL PERSONS OR ENTITIES WHO CONDUCT THESE EXAMS AND INCLUDE THEIR APPROXIMATE PERCENTAGE OF THE TOTAL EXAMS PERFORMED

_____

_____

_____DOES YOUR INSTITUTION UTILIZE A FORMALIZED BORROWING BASE DOCUMENT TO CONTROL DISBURSEMENTS OF LINES OF CREDIT?

YES _____ NO _____

DOES THIS BORROWING BASE INCLUDE A SECTION TO RECONCILE THE REPORT WITH THE PRIOR REPORT?YES _____ NO _____

ON A PERCENTAGE BASIS, WHAT IS THE FREQUENCY YOUR INSTITUTION REQUIRES UPDATED FINANCIAL STATEMENTS?

PERCENTAGE	
_____	MONTHLY
_____	QUARTERLY
_____	SEMI-ANNUALLY
_____	ANNUALLY
_____	OTHER (SPECIFY)_____

_____

LENDERS QUALIFICATION SURVEY

ON A PERCENTAGE BASIS, WHAT IS THE FREQUENCY YOUR INSTITUTION REQUIRES AN AGING OF ACCOUNTS RECEIVABLE AND PAYABLES REPORTS TO BE SUBMITTED FOR REVIEW ?

PERCENTAGE

_____ MONTHLY

_____ QUARTERLY

_____ SEMI-ANNUALLY

_____ ANNUALLY

_____ OTHER (SPECIFY) _____

INDICATE WHICH OF THE FOLLOWING METHODOLOGIES DESCRIBE YOUR INSTITUTION'S PROCEDURES TO CONTROL DISBURSEMENTS AND ASSIGN APPROPRIATE PERCENTAGES TO EACH.

PERCENTAGE

_____ INSTITUTION DISBURSES DIRECTLY TO BORROWER'S OPERATING ACCOUNT

_____ INSTITUTION DISBURSES ON JOINT PAYEE BASIS

_____ INSTITUTION DISBURSES TO BORROWER'S PAYROLL ACCOUNT

_____ INSTITUTION DISBURSES TO BORROWER'S PAYROLL AGENT

INDICATE WHICH OF THE FOLLOWING METHODOLOGIES DESCRIBE YOUR INSTITUTION'S PROCEDURES TO CONTROL A BORROWER'S CASH GENERATED FROM INVENTORY SALES AND/OR ACCOUNTS RECEIVABLE COLLECTIONS AND ASSIGN APPROPRIATE PERCENTAGES TO EACH.

PERCENTAGE

_____ BORROWER COLLECTS, NO EXAMS

_____ BORROWER COLLECTS, BUT WE CONDUCT EXAMS

_____ BORROWER TELLS CUSTOMERS TO REMIT BY JOINT PAYEE CHECK TO BOTH THEMSELVES AND LENDER

_____ BORROWER INSTRUCTS CUSTOMERS TO REMIT DIRECTLY TO LENDER'S DEPOSIT ONLY ACCOUNT

_____ BORROWER'S COLLECTIONS DIRECTLY ASSIGNED TO LENDER

_____ NONE OF THE ABOVE (DESCRIBE YOUR PROCEDURES ON SEPARATE PAPER)

ACCOUNTS RECEIVABLE QUESTIONS

DOES YOUR INSTITUTION LEND AGAINST ACCOUNTS RECEIVABLE? YES _____ NO _____

IF YES, WHAT IS YOUR AVERAGE ADVANCE RATE AGAINST RECEIVABLES? _____ %

IF YES, WHAT HAS BEEN YOUR INSTITUTION'S HIGHEST ADVANCE RATE AGAINST ACCOUNTS RECEIVABLE?

_____DESCRIBE THE CIRCUMSTANCES ABOUT YOUR HIGHEST ADVANCE RATE:

_____IF YES, INDICATE WHICH OF THE FOLLOWING ARE ROUTINELY EXCLUDE FROM A BORROWER'S BORROWING BASE OF RECEIVABLES:

_____ NO EXCLUSIONS

_____ OVER AGED RECEIVABLES

_____ CONTRA ACCOUNTS

Effective: 12-01-97

_____ INTERCOMPANY TRANSACTIONS

_____ CONCENTRATED RECEIVABLES TO SINGLE CUSTOMER

_____ OTHER(s): _____

LQS-2 **PAGE 3**

LENDERS QUALIFICATION SURVEY

IF YOUR INSTITUTION LENDS AGAINST ACCOUNTS RECEIVABLE, WHAT LEVEL OF CONCENTRATION OF RECEIVABLES TO ONE CUSTOMER OF YOUR BORROWER IS CONSIDERED SIGNIFICANT IN DETERMINING ELIGIBILITY? _____ %

INVENTORY QUESTIONS

DOES YOUR INSTITUTION LEND AGAINST INVENTORY? YES _____ NO _____

IF YES, WHAT IS YOUR AVERAGE ADVANCE RATE AGAINST INVENTORY? _____ %

IF YES, THIS ADVANCE RATE IS BASED ON (circle) COST or RETAIL

IF YES, INDICATE YOUR GENERAL ADVANCE RATE POLICY ON THE FOLLOWING:

RAW MATERIAL _____ %

WORK IN PROGRESS _____ %

FINISHED GOODS _____ %

IF YES, WHAT HAS BEEN YOUR INSTITUTION'S HIGHEST ADVANCE RATE AGAINST INVENTORY?

_____ %

WHAT WERE THE CIRCUMSTANCES OF THE HIGHEST A/R ADVANCE REFERENCED ABOVE?

_____

_____

_____CHECK ALL ITEMS YOUR INSTITUTION EXCLUDES FROM INVENTORY IN THE BORROWING BASE:

NO EXCLUSION _____

OBSOLETE ITEMS _____

LIENED (PMSI) INVENTORY _____

ITEMS SECURING OTHER LOC _____

ITEMS PER AGING REPORT _____

WHEN LENDING AGAINST INVENTORY, WHAT IS THE FREQUENCY THAT YOUR INSTITUTION REQUIRES ANY OF THE FOLLOWING?

INVENTORY SUMMARY: _____

ACTIVITY OF DEBITS & CREDITS: _____

INVENTORY LISTING: _____

BORROWER INVENTORY COUNTS: _____

OTHER (SPECIFY): _____

DOES YOUR INSTITUTION PERFORM A *QUANTITATIVE* REVIEW OF INVENTORY PRIOR TO INCLUSION IN THE BORROWING BASE?

YES _____ NO _____

DOES YOUR INSTITUTION PERFORM A *QUALITATIVE* REVIEW OF INVENTORY PRIOR TO INCLUSION IN THE BORROWING BASE?

YES _____ NO _____

ANTICIPATED STANDARD ASSET BASED PROGRAM PARTICIPATION

DOES YOUR INSTITUTION DESIRE TO SUBMIT A COPY OF YOUR TRANSCRIPT OF ACCOUNT TO REPORT DISBURSEMENTS & COLLECTIONS OF LOAN FUNDS IN LIEU OF A SEMI-ANNUAL DISBURSEMENT REPORT? YES _____ NO _____

IF YES, PROVIDE A SAMPLE COPY OF A TRANSCRIPT OF ACCOUNT ON AN EXISTING LINE OF CREDIT RECIPIENT WHERE THE LINE HAS BEEN OUTSTANDING FOR AT LEAST 12 MONTHS, AND AN INDEX/GLOSSARY EXPLAINING WHAT EVERY CODE (not just for the sample) OR SYMBOL ON YOUR INSTITUTION'S TRANSCRIPT OF ACCOUNT SIGNIFIES - SBA WILL MAINTAIN ITS CONFIDENCE.

LENDERS QUALIFICATION SURVEY

DOES YOUR INSTITUTION DESIRE TO UTILIZE ITS OWN BORROWING BASE CERTIFICATE IN LIEU OF THE SAMPLE SBA REPORT?

YES _____ NO _____

IF YES, PROVIDE A SAMPLE COPY OF YOUR INSTITUTION'S BORROWING BASE CERTIFICATE - SBA WILL MAINTAIN ITS CONFIDENCE.

QUESTIONS ON FEES

DESCRIBE ALL THE FEES AND EXPENSES YOUR INSTITUTION PRESENTLY CHARGES ITS BORROWING CUSTOMERS WHO RECEIVE ANY FORM OF LINES OF CREDIT STARTING WITH INITIATION, PACKAGING, AND FINDER FEES, THROUGH PROCESSING, APPROVAL, AND CLOSING FEES, TO SERVICING, UNUSED LINE, EXAMINATION, MONITORING, FLOAT AND FINAL PAYMENT FEES. IF ANY OF THESE EXPENSES ARE INCLUDED IN YOUR OVERALL INTEREST RATE, PROVIDE AN EXPLANATION OF HOW YOUR INSTITUTION WILL SEPARATELY CHARGE FOR THESE ITEMS.

USE ADDITIONAL PAPER IF NECESSARY

DESCRIBE ANY FEES THAT YOUR INSTITUTION DOES NOT PRESENTLY CHARGE ITS LINE OF CREDIT BORROWERS THAT YOU ANTICIPATE CHARGING CUSTOMERS WHO RECEIVE AN SBA STANDARD ASSET BASED PROGRAM GUARANTY SUPPORT.

USE ADDITIONAL PAPER IF NECESSARY

LQS-2 **PAGE 5**

APPLICATION QUESTIONS FOR ASSET BASED SUB-PROGRAMS

TO BE INCLUDED WITH SBA FORM 4

THIS FORM MUST BE COMPLETED AND INCLUDED WITH SBA FORM 4 TO APPLY FOR ALL SBA ASSET BASED PROGRAMS

NAME OF BUSINESS: _____

BUSINESS ADDRESS: _____

ACCOUNTS RECEIVABLES

1. DO YOU SELL PRODUCT(S) ON CREDIT? **YES:** _____ **NO:** _____

IF YES, ANSWER ALL PARTS OF QUESTION 1:

1A. WHAT PERCENTAGE OF YOUR TOTAL SALES IS FOR CREDIT? _____ **%**

1B. WHAT ARE THE CREDIT TERMS YOU PROVIDE YOUR CUSTOMERS?

_____

_____ **1C.DESCRIBE THE**

PROCEDURES YOU FOLLOW WHEN EXTENDING CREDIT/TERMS TO ITS CUSTOMERS:

_____

_____

1D. DO ANY OF YOUR CREDIT CUSTOMERS ACCOUNT FOR OVER 10% OF YOUR TOTAL CREDIT SALES?

YES _____ **NO** _____ **IF YES, LIST THESE CUSTOMERS:**

_____

_____

1E. DO YOU MAINTAIN CREDIT INSURANCE TO COVER YOUR RECEIVABLES? **YES:** _____ **NO:** _____

IF YES, WHAT PERCENTAGE OF TOTAL SALES ARE COVERED BY THIS INSURANCE? _____ **%**

1F. DESCRIBE THE DISCOUNT POLICY OF YOUR BUSINESS:

_____

_____

1G. THE TOTAL DOLLAR AMOUNT OF RECEIVABLES WRITTEN OFF LAST FISCAL YEAR WAS: **$**_____

2. DESCRIBE THE WARRANTIES, GUARANTIES, OR OTHER DEVICES PROVIDED BY YOUR BUSINESS TO SUPPORT PRODUCT QUALITY:

_____

_____

3. FOR YOUR BUSINESS' MOST RECENTLY COMPLETED FISCAL YEAR:

TOTAL CREDIT SALES WERE: **$**_____ **TOTAL RETURNS WERE:** **$**_____

TOTAL ALLOWANCES WERE: **$**_____ **TOTAL CREDITS WERE:** **$**_____

4. DO YOU SELL TO OTHER BUSINESSES ON CREDIT WHICH ALSO SELL TO YOU?

YES: _____ **NO:** _____

5. DO YOU SELL OVERSEAS? **YES:** _____ **NO:** _____

6. DESCRIBE THE PRIMARY INDUSTRY(S) TO WHOM YOU SELL ON CREDIT:

_____

_____

SBA Form AB-4

PAGE 2 ADDITIONAL ASSET BASED SUB-PROGRAMS APPLICATION QUESTIONS

INVENTORY

1. **DESCRIBE THE METHOD OF ACCOUNTING FOR INVENTORY YOUR BUSINESS USES (LIFO, FIFO, WEIGHTED AVERAGE, ETC.):**

_____

_____

2. **HOW MANY DIFFERENT STOCK KEEPING UNITS (SKU) DO YOU MAINTAIN?** _____

3A. **DO YOU CARRY ITEMS FOR SALE THAT ARE CONSIGNED BY OTHERS?** **YES:** _____ **NO:** _____

IF YES, WHAT PERCENTAGE? _____ **%**

3B. **DO YOU CONSIGN ANY OF YOUR ITEMS FOR SALE TO OTHERS?**

YES: _____ **NO:** _____

IF YES, WHAT IS ITS PERCENTAGE OF TOTAL SALES? _____ **%**

4. **DESCRIBE YOUR BUSINESS' PROCEDURE FOR MAINTAINING AND PHYSICALLY COUNTING ITS INVENTORY:**

_____

_____

5. **THE DOLLAR VALUE OF TOTAL SALES RETURNED LAST YEAR WAS:** **$** _____

6. **DO YOU MAINTAIN PRODUCT LIABILITY INSURANCE?** **YES:** _____ **NO:** _____

7. **NAME ANY CREDITORS WHO HOLD PURCHASE MONEY LIENS AGAINST YOUR INVENTORY:**

_____

_____

8. **DO YOU MAINTAIN ANY INVENTORY OFF PREMISES WHICH YOU OWN?** **YES:** _____ **NO:** _____

9. **IN HOW MANY DIFFERENT LOCATIONS DO YOU MAINTAIN INVENTORY?** _____ **10.HOW FREQUENTLY DO YOU CONDUCT A PHYSICAL INVENTORY?**

_____

11. **DO YOU SEPARATE "SECONDS" OR RETURNED INVENTORY FROM FIRST LINE MERCHANDISE?**

YES: _____ **NO:** _____

12. **DO YOU HOLD NON-OWNED GOODS/INVENTORY FOR OTHER INDIVIDUALS OR FIRMS?**

YES: _____ **NO:** _____

IF YES, THE APPROXIMATE DOLLAR VALUE OF THE ITEMS IS: **$** _____

13. **EXPLAIN YOUR METHOD(s) FOR BILLING CUSTOMERS:**

_____

_____

_____

_____

_____

_____

AUTHORIZED SIGNATURE: _____ **DATE:** _____

PRINTED NAME & TITLE: _____

SBA Form AB-4

Effective: 12-01-97

THIRD PARTY SERVICE PROVIDERS
Qualification Criteria

The following standards have been formulated as guidelines for lenders participating in SBA's Asset Based Program for use when evaluating and selecting an outside or third party service provider (provider) who may perform those examination, monitoring, or control functions required to prudently administer asset based loans guaranteed by the SBA: 1) experience; 2) competence; 3) character; 4) equal opportunity; 5) financial responsibility; 6) coverage; 7) business authorities; and 8) confirmation.

These standards are numerically arranged from 1 to 8. Those standards noted by an "a" after the number are required for lender approval of Providers who will perform examination services. The standards noted with a "b" are required for lender approval of providers who will perform monitoring or control services.

The lender shall have the responsibility for providing the required examination, monitoring, or control functions. Under this program, the lender may contract with a provider who meets these standards to assist the lender with the examination, monitoring, or control functions. SBA takes no position on the approvability or quality of any provider.

Providers Who Will Perform Examination Services.

1a. Experience

Provider must demonstrate that it has successfully been in business continuously as an individual, partnership, limited liability company, or corporation for not less than 3 years. This experience must substantially consist of examining, auditing, analyzing or reviewing supporting documents and physical quantification of accounts receivable, inventory or their equivalents. Experience is not limited to accounting firms, collateral control companies, or asset based lenders, provided however, the applicant's experience has been directly related to asset based lending.

2a. Competence

Provider must be capable of submitting a description or outline of services offered, methodology in delivering and documentation supporting, together with at least two examples of past engagements performed in the last 2 years.

3a. Character

Provider shall certify in writing to the lender that:

- During its business career it or its parent organizations, partnerships or venture partners, have not been convicted of violations of any Federal/State criminal laws.

- It has never been in litigation with the SBA or with any SBA participating lender in connection with SBA lending.

- It is in compliance with Internal Revenue Service (IRS) reporting requirements and not subject to IRS enforcement procedures when it applies to become a provider.

4a. Equal Opportunity

Provider must certify in writing that:

- It does not discriminate, nor will it discriminate, in its hiring practices with respect to race, creed, age, gender, or national origin.

- It is in compliance with all Federal, State, and local regulations governing employee safety and workman's compensation, as applicable.

5a. Financial Responsibility

Provider must furnish proof that:

- It maintains at least $500,000 of unencumbered professional liability coverage from a reputable insurance carrier, or financially provided by an equivalent source. Coverage amount must insure each incident and on an aggregate annual basis.

- Such insurance covers employees, agents and subcontractors for principal loss as a result of errors, omissions or negligence in quantifying accounts receivable, or inventory.

- Coverage extends to the geographic area provider is requesting to service.

6a. Coverage

Provider must indicate whether it is applying for a specific state[s], region[s], or locale[s] and support this by explanation of staffing.

7a. Business Authorities

Provider must be legally permitted to conduct its services in whatever area it is applying to serve. Such legal authority may be evidenced by, but is not limited to, occupational permits, Federal or State registration, or any other legal requirements to conduct business.

8a. Confirmation

Provider shall submit the company names, addresses, and authorized phone contacts of not less than

three references which can support the Approved Examination Servicer (AES) by offering opinions relating to present or past services rendered. The services must generally equate to those for which the applicant seeks AES status.

Providers Who Will Perform Monitoring & Control Services

1b. Experience

Provider must demonstrate that it has successfully been in business continuously as an individual, partnership, or corporation for not less than 3 years. The experience must substantially consist of examining, auditing, analyzing or reviewing documents supporting, and physical quantification of, accounts receivable, inventory or their equivalents. Experience is limited to providers which can further demonstrate experience in obtaining actual or contingent dominion over collateral assets including: bank lock boxes, postal block boxes, segregation of inventories and raw materials utilizing elements of, or actual use of legal bailment in connection with asset based lending. Further, applicant should also demonstrate experience in supervising movement of accounts receivable and inventory in and out of the borrowing base, independent of the borrower or its physical location.

2b. Competence

Provider must be capable of submitting a description or outline of services offered, methodology in delivering and documentation supporting, together with at least two examples of past engagements performed in the last 2 years. An Approved monitoring and control servicer (AMCS) contractor must offer examples covering: 1) Examinations; 2) Information monitoring with examinations and 3) collateral control services performed. This includes administration of lock boxes, postal block boxes, bailment, or its elements and continuous monitoring of collateral assets, independent of borrower or its physical location.

3b. Character

Provider shall certify in writing to the lender that:

- Since its inception, provider and its parent (if any), affiliated partnerships or venture partners, have not been convicted of a violation of any federal or state criminal laws.

- It has not been engaged in litigation with the SBA or with any SBA participating lender in connection with SBA lending.

- It is in compliance with Internal Revenue Service (IRS) reporting requirements and must not be subject to IRS enforcement procedures when it applied to become a provider.

4b. Equal Opportunity

Provider must certify that:

- It has not discriminated, nor will it discriminate, in its hiring practices with respect to race, creed, age, gender, or national origin.

- It is presently in compliance with all Federal, State, and local regulations governing employee safety and workman's compensation, as applicable.

5b. Financial Responsibility

Provider must provide proof that it maintains at least $1,000,000 of unencumbered professional liability coverage from a reputable insurance carrier, or financially provided by an equivalent source. Coverage amount would insure each incident and on an aggregate annual basis. It must cover employees, agents and subcontractors for principal loss as a result of errors, omissions, or negligence in examining, monitoring and controlling collateral assets such as accounts receivable, inventory and their equivalents. Moreover, coverage should extend to the establishment of any aspect of bailment, in controlling borrower inventories. All coverage must extend to the geographic area the provider is requesting to service.

6b. Coverage

Provider must indicate whether it is applying for a specific State[s], region[s], or locale[s] and support this by explanation of staffing. Coverage in foreign markets must be specified, including an explanation of staffing and methods of quality control.

7b. Business Authorities

Provider must be legally permitted to conduct its services in whatever area it is applying to serve. Such legal authority may be evidenced by, but is not limited to, occupational permits, Federal or State registration, or any other legal requirements to conduct business.

8b. Confirmation

Provider shall submit the company names, addresses, and authorized phone contacts of not less than three references which can support the AMCS application by offering opinions relating to present or past services rendered. The services must generally equate to those for which the applicant seeks AMCS status.

APPENDIX 10 - COC's AND 8(a) PLANS
FINANCIAL REVIEW OF CERTIFICATES OF COMPETENCY AND 8(a) BUSINESS PLANS

1. CERTIFICATES OF COMPETENCY (COC)

a. General

The COC Program is an appellate procedure for small businesses which are the apparent successful offerors on Government contracts, but which are denied such contract awards by the contracting agency because of a determination that they can not perform the contract satisfactorily due to a lack of capacity and/or credit. When this occurs, affected contractors may apply to SBA for a certificate of competency (COC), to prove their competency. When a COC is approved, the contracting agency is obligated to award, despite their earlier objections.

The COC process requires the coordination of staff from both the office of Government Contracting and Minority Enterprise Development (GC/MED) and Economic Development (ED). The industrial specialist (a/k/a/ COC Specialist) from the area office of government contracting (GC) reviews the contractor's non-financial capacity while the loan specialist from the Processing Division reviews the contractor's financial capacity. Both must make a recommendation to either issue or deny the COC based on the review of their respective segments. The final determination is made by the area director (AD), Office of Government Contracting. The overall program is administered by GC/MED.

The SBA's mission is to advise, counsel, and assist small business. This should be kept in mind during the COC process. The COC program is an important vehicle for small businesses to obtain Federal contracts. The success of the program and the reputation of SBA rest on the eventual outcome of contract performance. This program relies heavily on the financial expertise of processing economic development specialists.

The denied contractor is responsible for submitting data to establish its competency within the applicable time limits. SBA is responsible for establishing what documentation is needed, pointing out deficiencies in the material presented, and making every effort to obtain any additional information or explanation to support or refute the contractor's claims. However, the applicant's failure to understand the requirements and respond in a timely manner will evidence a lack of competency.

The issuance of a COC means the contractor who was the apparent successful offeror will actually receive the contract. In most cases the COC recipient will also be the lowest priced offeror. The SBA estimates that this program has already saved the

taxpayers millions of dollars in procurement cost.

b. Determining Financial Capacity

SOP 60 04 outlines the responsibilities of the Processing Division for COCs, including the format for the financial review. The financial evaluation of a COC is an important function and the quality of the analysis and loan officer report is as important as one for a loan request. Processing must determine whether the small business has sufficient resources or has a commitment for cash or credit in amounts that are adequate to permit the performance of the contract, as well as to meet its other commitments.

Supervisory ED personnel should assign their most experienced and capable loan officers to COC evaluations. Satisfactory completion of SBA's senior commercial credit and analysis course (Level III) is required for all recommenders.

The supervisory ED specialist is responsible to ensure that the financial analysis and report of the district loan officer are sufficient to make a sound COC decision. The supervisory EDS or designee must carefully review each COC report for adequacy of the evaluation and documentation of the recommendation.

c. Working Capital Analysis

The major indicator of a contractor's financial capacity to perform on a contract is the availability of sufficient funds to meet expenses as they come due, as well as sufficient funds to continue performing all other activities not related to the one contract. This involves understanding the timing of the contract's cash needs rather that its accrual availability. Generally, a contractor will have expenses which must be paid (such as labor cost) before collection for contract work is received. Contracts usually require that work be performed, invoices made, and approval of the work to date obtained, before a receivable is generated. Then there is the timing until the contracting authority remits payment.

The timing is particularly acute during the initial phase of a term contract, when the contracting authority has more administrative duties to complete before payment can begin. Therefore, an analysis of the timing of the cash flow on a cash (not accrual) basis is key.

Remember, labor can not be paid with receivables and not all vendors will arrange to wait past 30 days for payment of the contract materials they supply. Therefore contractors need to have a ready supply of cash funds to cover those expenses that must be met before payment is received. In addition, a contractor's cash on hand is not necessarily available to be dedicated to the one contract being examined for a COC.

The business must continue to conduct its other work, and at least part of the available cash is generally needed for these endeavors.

d. Financial Assistance for COC Recipients

When a loan is needed to finance initiation and/or performance of the contract and no other source is available, the contractor should be advised of SBA's Contract loan program. The SBA can assist the contractor in locating a lender who provides this type of financing and furnish any application documents needed. Most or all of the financial information and data on the specific contract required for COC consideration is ordinarily acceptable for loan purposes. Frequently, the only additional information required for the loan application is personal financial statements of the principals. If a loan application is submitted at the time the COC is referred to SBA, process the two applications simultaneously without delay. Use of progress payments to the extent available before SBA financing is preferable. However, this does not preclude consideration of an SBA loan. Gear repayment to receipts of contract proceeds.

e. Field Visits

Processing personnel are required to make a field visit on all COC contractors referred for credit unless waived by the area director (AD) Office of Government Contracting. Paragraph 11 of SOP 60-04(4) specifies the requirements for waiver. If the AD has a special reason to request that Processing make a visit for credit purposes, the district is to make every effort to accommodate the request. If a field visit is not possible, but a timely meeting with the applicant would be beneficial, invite the applicant to the district office.

2. FINANCIAL REVIEW OF 8(a) BUSINESS PLANS

a. General

The implementation of the 8(a) program is the responsibility of the Office of Minority Enterprise Development (MED) within the overall Office of Government Contracting

and Minority Enterprise Development (GCMED). Its purpose is to assist eligible 8(a) concerns to attain self sufficiency in the market place. Processing economic development specialist perform the financial analysis and evaluation of such firms.

b. Financial Evaluation

The purpose of the review is to determine if the applicant has the financial capacity to participate in the 8(a) Program with a reasonable assurance of success. If the applicant has not attained a competitive position in the market place, focus the analysis on whether viability can be reasonably anticipated from participation in the 8(a) Program, combined with other types of SBA assistance.

The minimum supporting data should include a current balance sheet and P&L statement for the past several years, if available, for existing firms. Or, it should include a pro forma balance sheet and a projected P&L for a new business along with a listing of banks and other credit sources of financial support.

APPENDIX 11 - PROCEDURES FOR REQUESTING WAIVERS, RECONSIDERATION AND POLICY INTERPRETATIONS

The AA/FA and OFA Staff desire to provide all Agency staff with accurate and expeditious responses to their requests for credit or policy reconsiderations; waivers of existing procedures, policies, and regulations. In order to efficiently accomplish this, contact with OFA staff by field personnel has to be limited to the ADD/ED or equivalent senior finance supervisor (ADD/ED or equivalent) or persons with higher authority. This will ensure that the subject under consideration will be fully discussed by the requesting office prior to the issue being submitted to Headquarters. Matters relating to loan making and servicing (SOPs 50 10 and 50 50) must be directed to the Loan Programs Division. Matters relating to loan liquidation (50 51) must be directed to the Office of Portfolio Management.

Unless specified within the body of the regulation, the Agency cannot alter or waive regulatory requirements of the business loan programs. The policy and procedures of the Business Loan Program are divided between the policies directly associated with statutory or regulatory provisions of the law or regulation and those established under the authority provided the Agency to maintain both prudent and quality lending practices. Policies directly associated with law or regulation cannot be waived unless a waiver is specifically permitted.

If the field office is requesting an "exception to policy" or "eligibility determination" from the Associate Administrator for Financial Assistance (AA/FA) or designee, then the field office must submit a complete analysis and recommendation following the same guidelines as for a formal 327 action. The format should be in a memorandum style addressed to Associate Administrator for Financial Assistance and include the following:

1. Cause for the Request: Reference the SOP or Regulation cite for the specific policy or procedure being considered for waiver.

2. Background: The name of the small business concern. The name of the lender. The reason for the request. This may also include a synopsis of any justification from the business or lender (as appropriate).

3. Justification for the Requested Action. A borrower or lender request without SBA office input is not acceptable. The fact that the waiver has been requested by a lender or applicant is not sufficient justification to warrant consideration by OFA. This justification can be from non-SBA personnel, but the office submitting the request must comment on this justification and make their own formal recommendation before forwarding the request to Headquarters.

4. SBA Analysis: The independent analysis of the submitting office. The analysis should support

the office's recommendation.

5. Comments and/or Recommendation from legal counsel when appropriate (always for environmental waivers).

6. Recommendation: A recommendation for approval or denial* must be made. This recommendation should be based on the analysis. If the office is unable to make a final decision as a result of a split, it would be submitted to OFA.

* The field can decline policy/regulatory waiver requests made by lenders or borrowers without having the requests sent to the AA/FA or designee for final determination. Therefore, recommendations for decline should only be sent to OFA if the recommendation is the result of a formal request for reconsideration of a previously declined action.

Regardless of the recommendation, a report and recommendation must be sent to OFA when the office does not have authority to grant a waiver.

7. Signatures Required: Financial Analyst, ADD/ED (or equivalent), District Counsel or Branch Counsel (when required by SOP), and District Director or Branch Manager.

All signatories should provide their own justifications when they find the request does not address any pertinent issues.

8. Attachments: Attach the written request from the lender.

You must fax the request to the attention of the Director of the Loan Programs Division. The fax number is (202) 205-7722. Requests that are "E-Mailed" will not be accepted.

For questions on interpretation of policy, the same format is required. It is important to provide as much detail as possible, the citation in the SOP, your analysis of the policy, and your recommendation as to its interpretation or change.

To ensure consistency, the OFA staff has been instructed not to respond to any telephone requests.

APPENDIX 12 - RESERVED

APPENDIX 13 - RESERVED

APPENDIX 14 - RESERVED

APPENDIX 15 - RESERVED

APPENDIX "X" - EXAMPLES AND SAMPLES

CASE EXAMPLES FOR POLICY, PROCEDURES, AND CREDIT CLARIFICATION

The primary purpose of appendix "X" is to provide various case scenarios and examples of situations that require clarification about the Agency's policies and procedures. These cases are designed to provide the readers with further understanding of SBA policy and procedures, including how to interpret the requirements of the Agency in different situations. The topics will generally be broken down between eligibility, structure, and credit matters, followed by more defining sub-topics, including a reference to the appropriate Subpart of this SOP. We hope that this method of communication proves beneficial to the processors of requests for financial assistance.

Subject: ELIGIBILITY
Reference: Subpart H, Chapter 13, Paragraph 1
Sub-Topic: New Versus Existing Applicant

Would the following be classified as a "new" or "existing" business?

BACKGROUND:

The project is a new assisted living center. It will be owned 75 percent by Mr. A and 25 percent by Mr. A's children. Mr. A. also owns and operates another assisted living center that was established in 1989. The ownership in the existing business is 75 percent by Mr. A and 25 percent by Mr. As mother-in-law.

Public Law 104-208 requires an additional 5 percent borrower.s contribution beyond the minimum 10 percent for 504 projects to new businesses for a total borrower.s contribution of 15 percent.

The SBA field office believes that the proposed project should be considered .new,. not an extension of an existing business. Part of SBA.s rationale was that the existing business, although in operation since 1989, had a major expansion in 1996 resulting in an increase from 26,000 sq. ft. to 116,000 sq. ft. Because of the expansion, the loan officer believed that the existing business should be considered less than 2 years old, and therefore, new.

The CDC believed that the new assisted living center should be considered an extension of an existing business and therefore, not new. The 1996 expansion of the existing business, the CDC believed, did not create a new business but expanded an existing business by building more rooms.

ANALYSIS:

To analyze this case, SBA must ask the four questions found in SOP 50 10(4), Subpart H, Chapter 13, Paragraph 1.c.(1). The following are those questions, as well as the answers for this case as provided by the inquiring field office:

Q1: Is the clientele the same (or similar) as for the existing business?

A1: The clientele is projected to be similar.

Q2: Are the market demographics the same?

A2: The area is the same area of the city; therefore, the demographics are the same.

Q3: Is the proposed day-to-day management the same for the existing business and the 504 project?

A3: Mr. A. will operate both facilities on a day-to-day basis, although Mr. A.s son (A, Jr.) will also be involved in the new facility management. Therefore, the day-to-day management is at least similar for both the existing business and the 504 project.

Q4: Is the product or service the same or similar as for the existing business?

A4: The service, assisted living, is the same.

CONCLUSION:

Based on the answers to the questions, SBA determined that the applicant is an existing business and not required to contribute an additional 5 percent towards the project.

Regarding the loan officer's concern that the existing business had a major expansion within the last 2 years, the following is provided.

Since the expansion was just to enlarge the number of rooms available which did not result in any basic changes to the business, the business can be considered an existing business.

Subject: ELIGIBILITY
Reference: Subpart A, Chapter 2, Paragraph 8.q.
Sub-Topic: Prior Loss to the Government - Number 1

Is a person who acquires a business that has received an SBA loan or guaranteed loan but has not signed the Note or a Guarantee, liable under the "Prior Loss" regulation?

BACKGROUND:

The owner of a business which has a guaranteed loan suddenly disappears. During his absence, his wife files for divorce and is awarded ownership of the business. He reappears and files bankruptcy. The wife sells the business to her brother. The wife's brother makes several payments on the loan but stops when he decides that he is not obligated since he did not sign the Note or a Guarantee.

13 CFR .120.110 (q), regarding ineligible types of businesses, states in part:

> "... businesses owned or controlled by an applicant or any of its Associates which previously owned, operated, or controlled a business which defaulted on a Federal loan (or guaranteed a loan which was defaulted) and caused the Federal Government or any of its agencies or Departments to sustain a loss in any of its programs."

ANALYSIS:

The owner is subject to the rule because he signed the Note. The loss of the business through the divorce proceedings and his bankruptcy do not release him from his responsibility under the Prior Loss rule.

The wife, although subject to this rule, could request and might be granted waiver of the rule by SBA. The circumstances of her acquisition, ownership, and operation of the business would weigh heavily in the decision. Community property issues may also affect the decision.

If the wife's brother bought the business, including its liabilities, he is subject to the rule even if he did not formally assume the loan. He made a conscious decision after making payments to quit paying. Even if he did not make payments, he was still liable for the debt because of the manner in which he bought the business. He owned and controlled a business that defaulted on a Federally guaranteed loan.

The wife's brother would not be subject to the rule if he had only bought the assets of the business. Any

business assets which collateralize the loan would still be subject to the lien(s) against them. In this situation, the wife would be subject to the rule and a waiver would be unlikely.

CONCLUSION:

A third party who acquires ownership or control of a business that has a Federal loan or Federally guaranteed loan may be subject to the Prior Loss rule even though they have not signed the Note or a Guarantee. Thorough evaluation by the lender/SBA of the circumstances of the acquisition of the business by a third party or parties is necessary to determine whether they are subject to the prior loss rule.

Subject: ELIGIBILITY
Reference: Subpart H, Chapter 13, Paragraph 2
Sub-Topic: Acceptability of Sweat Equity

Is "Sweat Equity" an eligible "Borrower's Contribution?"

BACKGROUND:

A 504 project is proposed for $600,000 which is broken down as follows:

- $100,000 to purchase the land; and
- $500,000 to construct the building.

The borrower is required to contribute 10 percent towards the eligible project costs. The applicant also happens to be a general contractor. The borrower has stated that if he builds the building himself as a general contractor, the actual cost will only be $450,000.

QUESTION:

Can he contribute the difference between what it would cost for another contractor to build the building ($500,000) and the cost if he does it ($450,000) as "sweat equity" of $50,000 towards the borrower.s contribution requirement of $60,000?

ANSWER:

No. When the development company program began, the borrower was not permitted to be his own general contractor. When the policy was changed to allow the applicant to be his own general contractor, it was with the following restrictions:

- The cost to build the building could not include a profit to the applicant-general contractor;

- Estimates from independent contractors would need to be obtained to support the actual costs that the applicant-general contractor was going to charge; and

- The contractor would have to be experienced in the type of construction.

CONCLUSION:

Generally, construction where the applicant acts as its own contractor has proven to be unsatisfactory and has caused problems with lien waivers and mechanics liens resulting in losses to the Agency. This risk is offset somewhat if the restrictions are followed resulting in less cost to the borrower and greater collateral coverage for SBA.

Subject: ELIGIBILITY
Reference: Subpart H, Chapter 13, Paragraph 4.a.
Sub-Topic: Size Limitation of a 504 Debenture as a part of the project

When can the SBA net debenture represent more than 40 percent of the eligible project costs?
BACKGROUND:

After a 504 loan was approved, but prior to its being closed, SBA received a request from the borrower to increase SBA's debenture from the approved 40 percent of eligible project costs to 50 percent of the eligible projects costs.

The regulation governing the amount of the debenture (.120.930) states the following:

> "(a) Generally, a 504 loan may not exceed 40 percent of total Project cost plus 100 percent of eligible administrative costs. For good cause shown, SBA may authorize an increase in the percentage of Project costs covered up to 50 percent. No more than 50 percent of eligible Project costs can be from Federal sources, whether received directly or indirectly through an intermediary."

The project was approved in mid-1996 to finance the long-term fixed assets for a new automotive refinishing and body works service business. Eligible project costs totalled $500,000 for the purchase of land, construction of a building, purchase of machinery and equipment, and estimated eligible professional fees of $20,000. The net debenture portion was $200,000, which represented 40 percent of the eligible project costs. The applicant was to provide the minimum equity contribution of $50,000. At this point, the project financing was in accordance with SOP policy and regulations.

After the loan was approved, during the construction phase, Mr. B, the owner of the new business, incurred expenses that he said he was led to believe were eligible project costs. For example, he incurred legal fees for the bank's attorney as well as costs to establish the new business. All of these costs are ineligible 504 project costs. Mr. B claims that the loan officer at the CDC, who had since left, did not explain adequately what were eligible and ineligible 504 project costs. If these expenses were not considered eligible 504 project costs, Mr. B would then have to pay for them from other sources. If he used his cash reserves to pay these expenses, he would not have enough cash left to pay his required 10 percent injection into the 504 project.

Mr. B decided to telephone SBA Headquarters through his congressman and the SBA regional office. He requested that SBA increase the debenture so that it would finance 50 percent of the

project costs and the first mortgage lender would continue to finance the other 50 percent of the project costs. He used .120.930(a) as his reason why SBA can do this. He believed that "good cause shown" was the alleged lack of clarity and misinformation from the CDC that led to his misunderstanding of what were eligible and ineligible 504 costs resulting in his incurring more costs than he was able to finance. Is he right? If SBA agrees to this, the project will be 100-percent-financed from the combination of an SBA debenture (50 percent) and the bank loan (50 percent).

ANALYSIS:

Section 120.910 of CFR 13 states that the borrower **must** contribute 10 percent into the project. There are no exceptions to the contribution being less than 10 percent.

> .120.910 How much must the borrower contribute?
>
> The Borrower must contribute to the Project cash (or property acceptable to SBA obtained with the cash) or land (that is part of the Project Property) valued at 10 percent or more of the Project cost (exclusive of administrative cost). The source of the contribution may be a CDC or any other source except an SBA business loan program (see Sec. 120.913 for SBIC exception).

When would the net debenture represent more than 40 percent of the eligible project costs?

Section 120.930(a) allows the net debenture to exceed 40 percent of the eligible project cost when approved by the AA/FA. This clause has only been used in the past to assist borrowers in those rare situations where the final project costs were <u>less</u> <u>than</u> estimated <u>and</u> the 504 loan had already been closed with the 504 liens filed. In order to save the small business the added costs that would have been incurred if SBA insisted that the 504 loan be reclosed at a reduced amount, the first mortgage is reduced instead, resulting in the debenture being more than 40 percent of the project. SBA regulations require the third-party loan to be "at least as much as the 504 loan" (.120.920). Therefore, SBA has the latitude to reduce the third-party lender's participation as long as the participation is <u>not less than</u> the SBA's debenture. The borrower's equity requirement, however, cannot be less than 10 percent.

Example:

The estimated project cost is $500,000 broken down as follows:

$ 50,000 (10%) Borrower.s Contribution
200,000 (40%) SBA Debenture
250,000 (50%) Third-party loan
$500,000

When the project is completed, the actual cost is $480,000 and the SBA debenture has already closed. Since the borrower.s contribution has already been made, the only piece to the financing that can be adjusted is the third-party loan. This is reduced to $230,000. This results in the following percentages:

$ 50,000 (10.4%) Borrower.s Contribution
200,000 (41.7%) SBA Debenture
230,000 (47.9%) Third-party loan
$480,000

Since the third-party loan is still more than or equal to the debenture, the financing is still eligible.

Q1: Can a 504 project be proposed from the outset that has the SBA net debenture representing more than 40 percent of the eligible projects costs?

A1: No.

Q2: At what point in time can a debenture be approved for more than 40 percent of the eligible project costs and by whom?

A2: At the time of closing of the permanent financing for the project, this issue arises. Only the AA/FA, or designee, can approve an exception to policy to allow the net debenture to exceed 40 percent of the eligible project costs.

CONCLUSION:

Decline Mr. B's request that SBA's debenture in his project be increased to 50 percent of eligible project costs. His request was replacing his required injection with an increase in SBA's debenture. As shown above, this is ineligible.

SOP 50-10(4) - INDEX

504 Loans

SMALL BUSINESS ADMINISTRATION
STANDARD OPERATING PROCEDURE

Subject: Revision "A" to SOP 50-10(4), Business Loan Processing Function

INTRODUCTION

1. Purpose:

   To update policy and procedural guidance for processing business loan applications.

2. Personnel Concerned:

   Headquarters and field personnel engaged in business loan making activity.

3. Page Changes:

Remove	Insert
565 - 582	565 - 582-14

4. Effective Date: September 14, 1998

5. Originator:

   Office of Financial Assistance (OFA)

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SMALL BUSINESS ADMINISTRATION
STANDARD OPERATING PROCEDURE

Subject: Revision "B" to SOP 50-10(4), Business Loan Processing Function

INTRODUCTION

1. Purpose:

   To update policy and procedural guidance for processing business loan applications.

2. Personnel Concerned:

   Headquarters and field personnel engaged in business loan making activity.

3. Page Changes:

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53 - 60	53 - 60-4
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Effective: 01-29-99

Subject: Revision "B" to SOP 50-10(4), Business Loan Processing Function

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637 - 638	637 - 638
643 - 652	643 - 652
687 - End	687 - End

4. Effective Date: January 29, 1999

5. Originator:

Office of Financial Assistance (OFA)
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SMALL BUSINESS ADMINISTRATION
STANDARD OPERATING PROCEDURE

Subject: Revision "C" to SOP 50-10(4), Business Loan Processing Function

INTRODUCTION

1. Purpose:

   To update policy and procedural guidance for processing business loan applications.

2. Personnel Concerned:

   Headquarters and field personnel engaged in business loan making activity.

3. Page Changes:

Remove	Insert
582-1 thru 582-6	582-1 thru 582-6

4. Effective: May 20, 1999

5. Originator:

   Office of Financial Assistance (OFA)

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SMALL BUSINESS ADMINISTRATION
STANDARD OPERATING PROCEDURE

Subject: Revision "D" to SOP 50-10(4), Business Loan Processing Function

INTRODUCTION

1. Purpose:

   To update policy and procedural guidance for processing business loan applications.

2. Personnel Concerned:

   Headquarters and field personnel engaged in business loan making activity.

3. Page Changes:

Remove	Insert
xxvii - xxviii	xxvii - xxviii
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567 - 582-14	567 - 582-12

4. Effective Date: October 1, 1999

5. Originator:

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SMALL BUSINESS ADMINISTRATION
STANDARD OPERATING PROCEDURE

Subject: Revision "E" to SOP 50-10(4), Business Loan Processing Function

INTRODUCTION

1. Purpose:

   To update policy and procedural guidance for processing business loan applications.

2. Personnel Concerned:

   Headquarters and field personnel engaged in business loan making activity.

3. Page Changes:

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Effective: 12-01-00

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685 - 696	685 - 696
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4. Effective: December 1, 2000

5. Originator:

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