

# **SBA Fundamentals Training**

**May 15, 2024**





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## Meet the Lender Service Team

**Over 100 Years of SBA Experience!**



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# Agenda

**Why Make SBA Loans?**

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**Your Current Status/Plan for SBA Lending**

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**Overview - SBA Programs, Governance, Process**

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**How to Make the Best of this Conference**

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## Quick Check of the Room

**What is your experience with SBA lending?**

- Never done an SBA Loan
- Less than 20 Career SBA Loans
- 20 – 50 Career SBA Loans
- More than 50 SBA Loans

**My institution is...**

- Regular 7a Lender
- Express Lender
- PLP Lender
- Third-party Lender on 504 loans
- None of the above/not sure

**SBA department?**

- We have an SBA department
- I am the SBA department
- We do not have an SBA department/not sure



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# **Why Make SBA Loans?**

**Why should you learn about SBA loan programs and make them available to your clients & prospects?**

**Because it's a competitive marketplace and you need all of the options available to you!**



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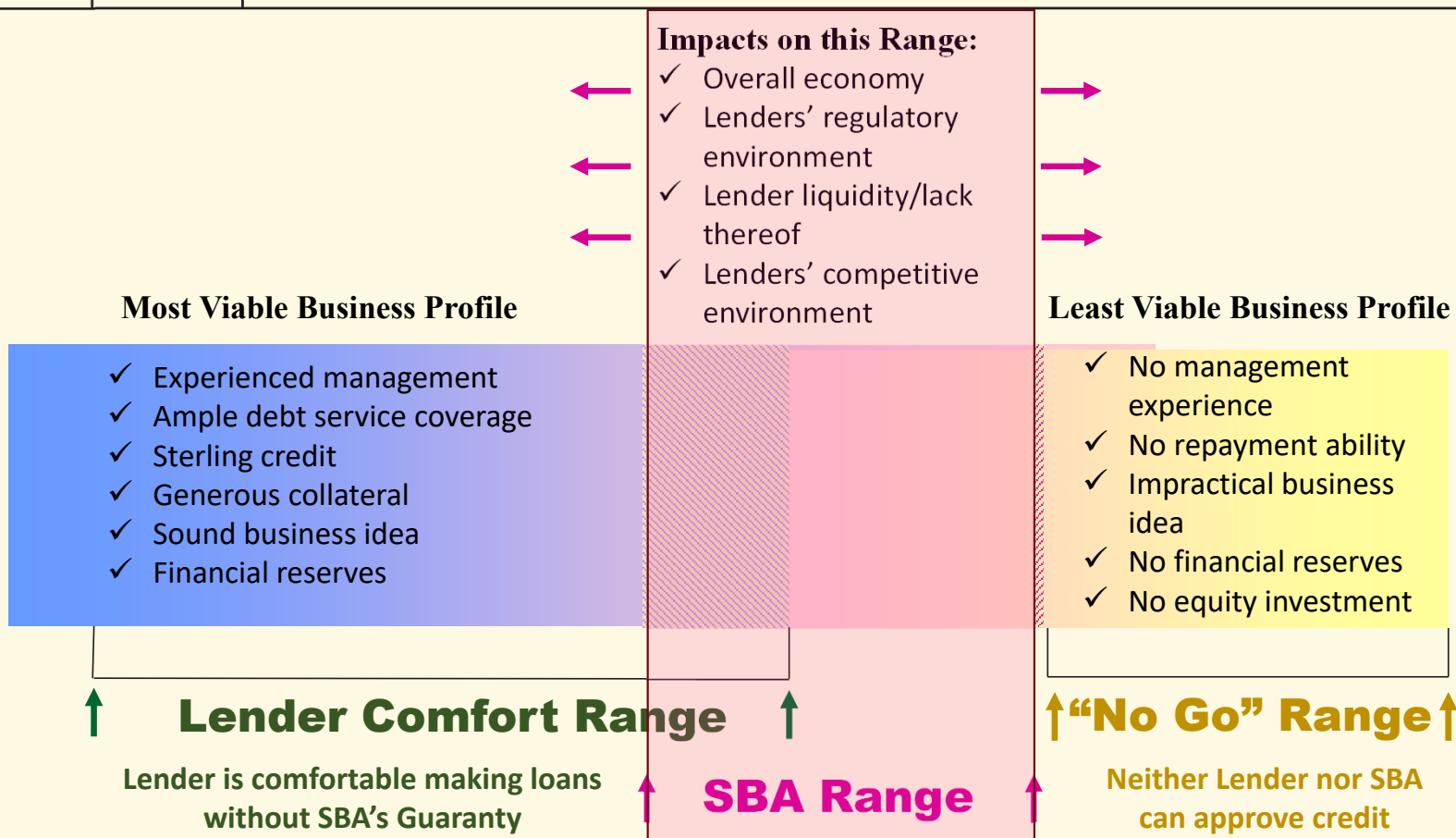
# Lender Benefits





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# Advantage of SBA's Loan Guaranty

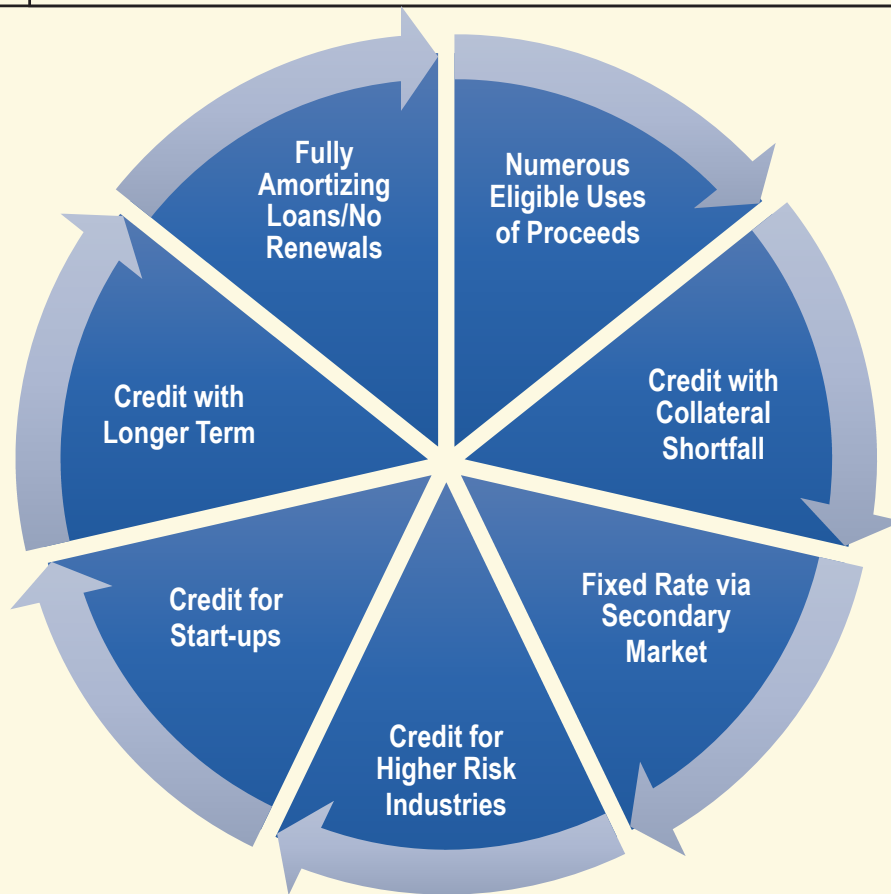






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## Borrower Benefits





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## Common SBA Objections

Too much paperwork

Takes too long

Borrower don't like paying fees

Interest rates are too high

It's only for "bad" loans & businesses

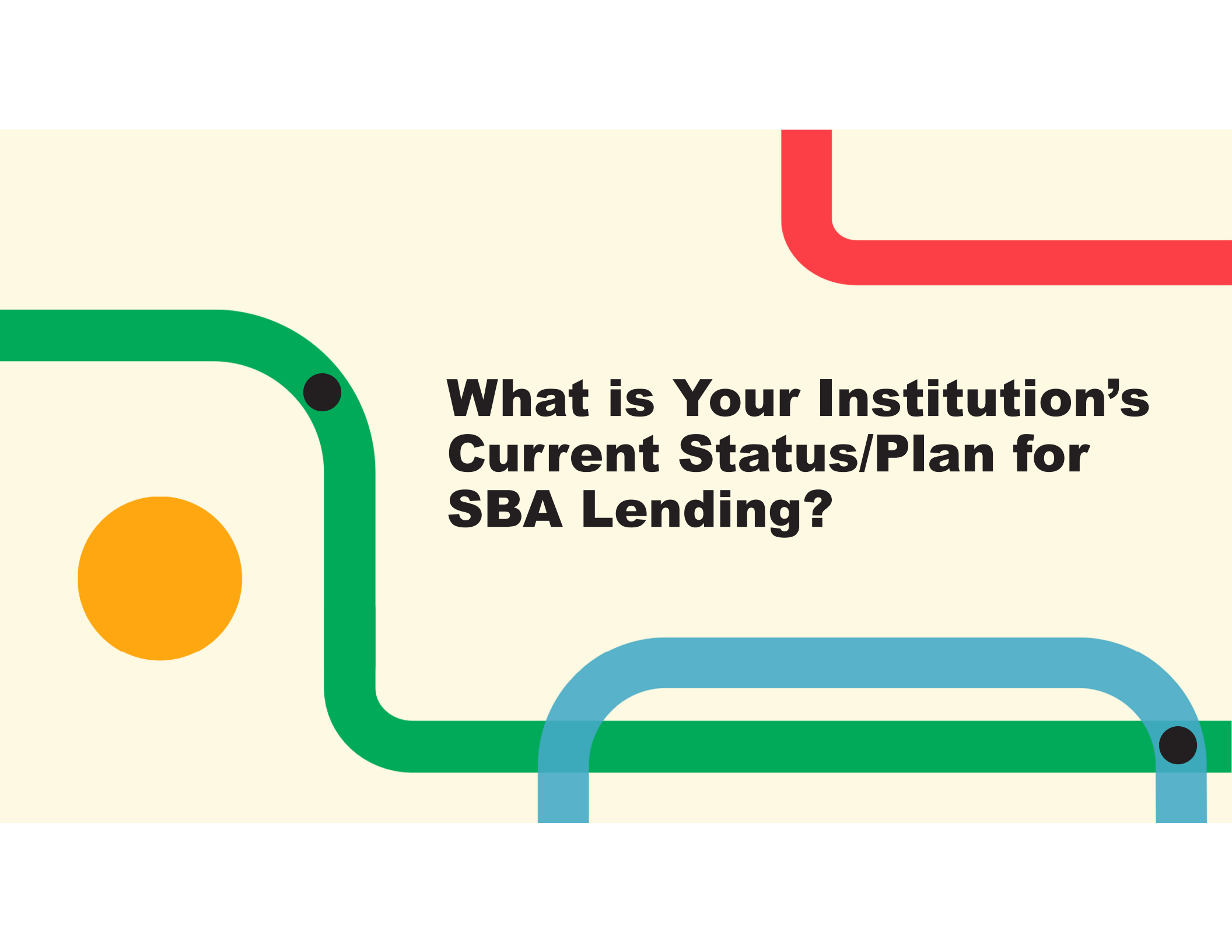
Borrowers need perfect credit

SBA doesn't honor its guaranty

SBA is the lender of last resort

We don't have anyone who knows the SBA Programs

Unsure which program is best

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**What is Your Institution's  
Current Status/Plan for  
SBA Lending?**



## **Where's Your Institution at with SBA Lending?**

**Is Management “on board” and supportive of SBA lending initiative?**

**Is Credit Administration willing to adopt SBA terms/conditions?**

**Are Lenders willing to offer the SBA solution?**

**Are you passing on deals that could've been structured with an SBA guaranty?**

**Are you tired of losing deals to active, competing SBA lenders?**

**Do you have the necessary staffing to undertake SBA lending?**

**Are you missing out on SBA lending opportunities because you lack expedited processing & tools (i.e. Preferred Lender Processing “PLP” and SBA Express)?**

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# **SBA's Mission and Financial Assistance**



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## SBA's General Mission

### Technical Assistance & Counseling

SBDC,  
SCORE,  
Women's  
Business  
Centers

### Financial Assistance

Deferred  
Participation  
Guaranteed  
Loan Programs

### Contracting Assistance

Export  
Assistance  
Offices

### Disaster Recovery Assistance

Personal and  
Business Loans

### Advocacy, Laws & Regulations

"Small  
business  
watchdog"



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## SBA's Financial Assistance Mission

Provide eligible borrowers with access to capital when meeting Credit Elsewhere

Lender protection & reduced risk via the government loan guaranty

Borrower-friendly loan terms not otherwise available

Lender must prove/show reasonable assurance of repayment

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# **Overview of SBA Loan Programs**



# SBA 504 Loans: **Best Fit for Financing**

- **Fixed Assets**
- **Over \$500,000**



Owner Occupied  
Real Estate

Equipment

Projects over  
\$500,000



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## SBA 504 Overview

Economic development loan program, **jointly provided by lenders and Certified Development Companies (WBD)**, offering eligible borrowers:

---

**Uses** Fixed asset financing- equipment and owner-occupied real estate- AND debt refinancing

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**Lower Down Payment** Low down-payment -as low as 10%

---

**Fixed rates** Long-term, below-market, fixed rates - fixed for 10, 20 or 25 years

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**Structure and Size** Fully amortizing loans, no balloon payments  
504 loans up to \$5.0MM/\$5.5MM  
Project size greater than ~ \$500,000





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## **Eligible Use of Funds**

### **Eligible**

- **Owner Occupied Commercial Real Estate**
- **Equipment** (including shipping and installation costs)
- Project Related Eligible Soft Costs
  - Professional Fees
  - Appraisal & Environmental Reports
  - Interim Interest
- **Refinance w/ Expansion**
  - Up to 100% of expansion costs
- **Permanent Refinance Program**

### **Ineligible 504 Costs (but 7(a) eligible)**

- Working Capital; Inventory;  
Other Current Assets
- “Goodwill”; Other Intangible  
Assets

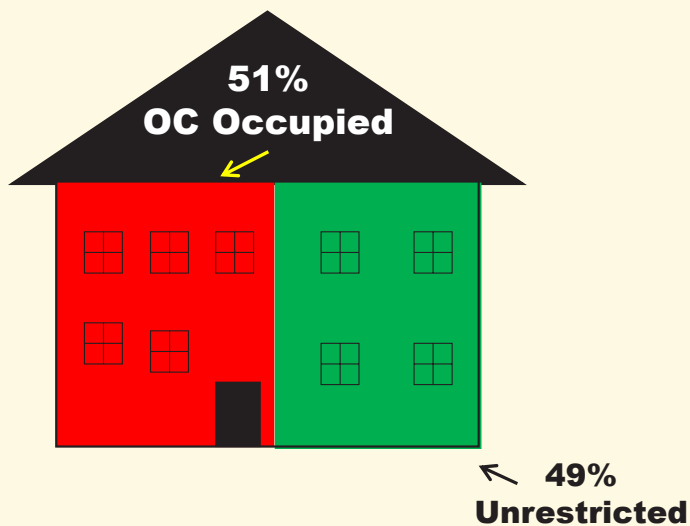




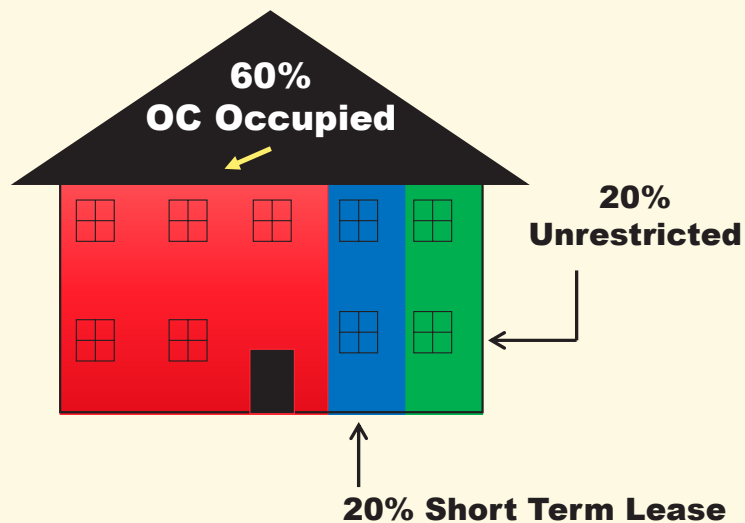
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## Eligibility Occupancy Rules

### Existing Real Estate



### New Construction



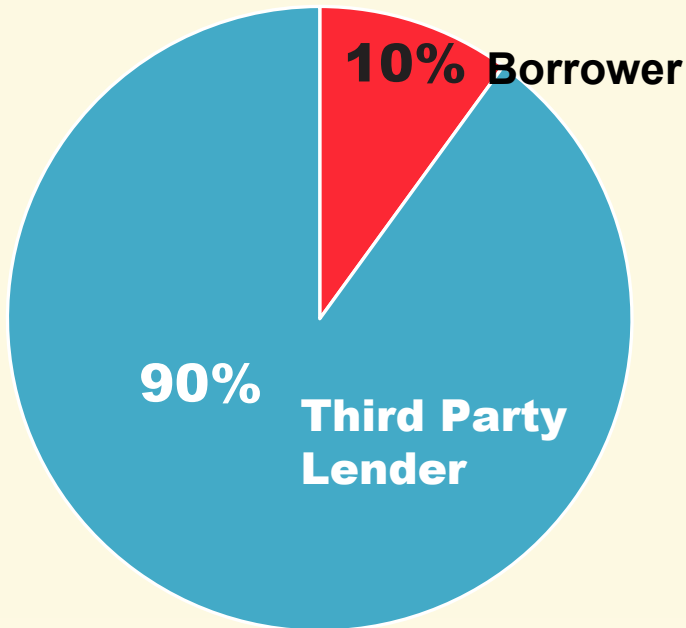
Borrower must begin occupying this space in Year 3 and occupy it by Year 10

Rentable Property in both cases may also include exterior space, not including parking, used by the business; e.g. storage yard for contractors, trucking companies, landscapers, etc.

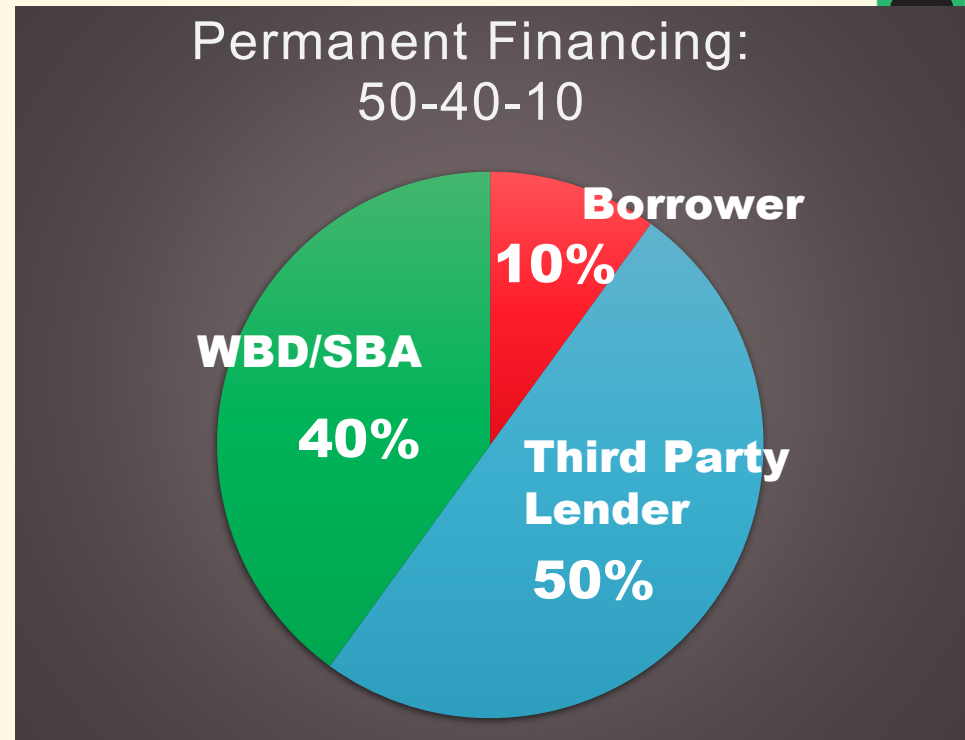


# Typical 504 Structure

Interim Financing



Permanent Financing:  
50-40-10

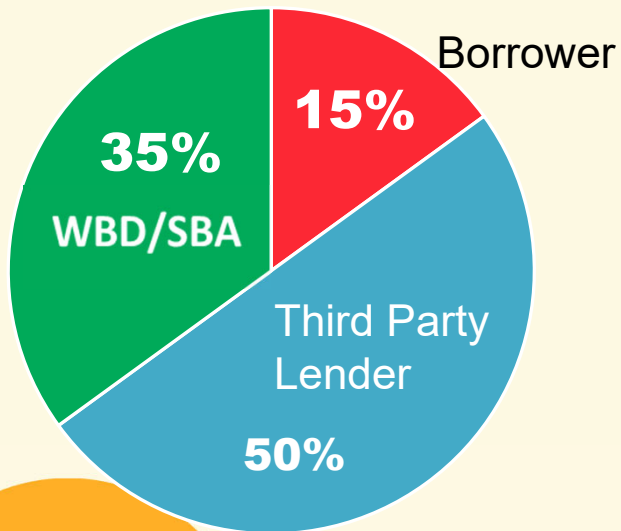


- Third Party Lender's portion is a conventional loan
- Additional collateral may be taken for Interim Financing
- 504 portion has 100% SBA guaranty

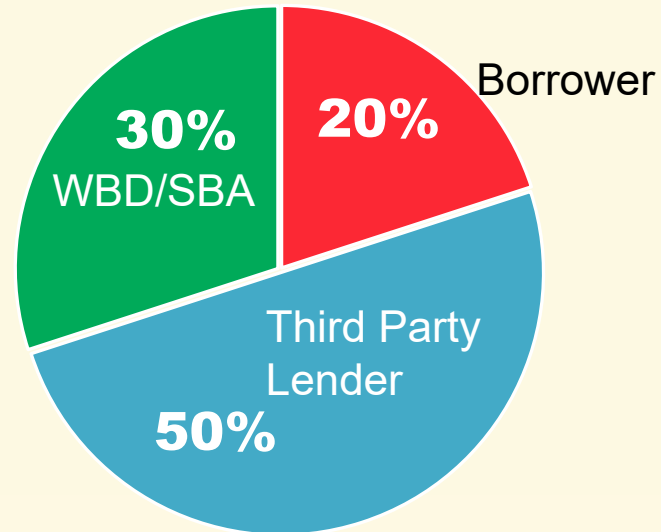


# Special 504 Program Structures

Start-up OR Special Purpose  
50-35-15



Start-up AND Special Purpose R/E  
50-30-20



Third Party Lender must be at 50% participation in both scenarios

## SBA 7(a) Loans: **Best Fit for Financing**

- **Fixed Assets up to \$500,000**
- **Other Asset Types up to \$5,000,000**



## 7(a) Loan Guarantees –By Loan Amount

85%

Less than or equal to

**\$150,000**

Greater than

75%

- **SBA has deferred participation with regard to its guarantee – business must fail in order for Lender to ‘collect’ on the loan guaranty**
- **Maximum guarantee of \$3,750,000 aggregate to Applicant & Affiliates**
- **2 or more loans within 90 days, loan amounts are combined to determine guaranty percentage**





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## 7(a) Vs 504

### SBA 7(a)

### SBA 504

Wider range of eligible use of proceeds; not limited to fixed assets

Lower Origination Fees on projects over \$500M

Lender controls/establishes loan closing date

Competitive, long-term fixed rates

Lender retains higher loan balances on its books

Lender has superior lien position over SBA; lower risk of loan loss

Fee income from sale of guaranteed portion of loan

Borrower-friendly personal collateral requirements

Borrower makes single monthly loan payment

WBD/SBA responsible for loan liquidation activities

No interim financing risk; Lender's exposure is protected by SBA guaranty at all times

Lender has the ability to sell 1<sup>st</sup> mortgage; limited opportunity

More opportunity for debt refinancing

More flexible seller financing

CRA credit

Lender's 1<sup>st</sup> mortgage not subject to SBA Annual Servicing Fee

Potentially lower down-payment

No monthly 1502 reporting for Lender

Ability to offer Lines of Credit

Higher SBA program limits for manufacturers (NAICS 31, 32, 33)

## **SBA Express: Best Fit for**

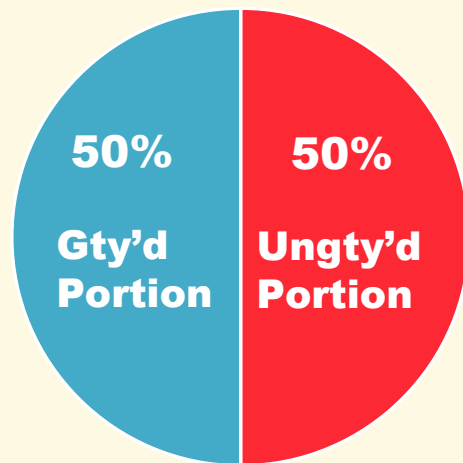
- **Lines of Credit OR**
- **Term Loans Up to  
\$500,000 with Reduced SBA  
Guarantee**





# Express Loan Guarantees

## SBA Express: Delegated Authority



- \$500,000 loan amount limit under multiple Express loans/lines.
- \$250,000 loan guaranty limit under multiple Express loans/lines.
- Participating Lender applies for an SBA loan guarantee; always Delegated authority.
- SBA has deferred participation with regard to its guarantee – business must fail in order for Lender to 'collect' on the loan guaranty.
- Loan guarantee never exceeds 50%.



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## Express vs 7(a)

### SBA Express

### SBA 7(a)

Term Loans and/or Lines of Credit up to \$500,000	Term Loans (only) up to \$5,000,000 (CAPLines program notwithstanding)
Loan guaranty limited to 50%	Loan guaranty between 75%-85% based on loan amount
Lender uses its own Note, Collateral and Guaranty documents	Lender can use SBA Note & Guaranty documents
No SBA SBSS scoring Lender may use its own "credit scoring"	Lender must use SBA SBSS scoring for loans up to \$500,000
Limited fee income potential from sale of loans due to small loan sizes & lower guaranty %	Significant fee income potential from sale of loans due to high loan limits & guaranty %
Lines of Credit <u>may not</u> be sold	(CAPLines program notwithstanding)
Delegated Authority = Fast Approval & Closing (Separate SBA approval to become an Express lender)	Non-Delegated Processing = Credit Certainty with Longer Approval timeline (Delegated Authority notwithstanding)
SBA doesn't review Lender's application Subject to review for compliance at Guaranty Purchase	Non-Delegated Lender's credit decision may not be "second-guessed" at time of Guaranty Purchase



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## 7(a) & Express Term Loans – Maximum Maturity

Real Estate

25 Years +  
Construction  
up to 12  
months

Up to 10  
Years

(may be up to 15 if  
supported by IRS  
asset class useful life)

Machinery/Equipment

Working Capital &  
Intangible Assets

Up to 10  
Years

No balloon  
structures

SBA requires loan  
maturity to be equal to  
the amortization schedule



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## Express Lines of Credit–

## Maximum Maturity

**As of 1/1/18,  
Express Lines  
of Credit  
must contain  
these  
maturity  
requirements**

- **Maximum maturity is 10 years, including both the Draw and Term-out periods**
- **Term-out period must equal or exceed the Draw (i.e. revolving) Period**
- **Maximum Draw Period is 5 years**
- **No draws permitted after the initial 5 year period**
- **Line must have a stated maturity**
- **Line must have a term-out period**

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# **7(a) and Express Interest Rates**



## Maximum Interest Rates

7(a) and Express Loan Amounts	Maximum Rate
Loans > \$350,000	WSJ Prime + 3.00%
Loans > \$250,000 ≤ \$350,000	WSJ Prime + 4.50%
Loans > \$50,000 ≤ \$250,000	WSJ Prime + 6.00%
Loans ≤ \$50,000	WSJ Prime + 6.50%

**Example:** Lender could offer a \$400,000 loan to finance equipment and working capital with either a floating rate of Prime + 3.0%, or a fixed rate up to 11.5% for full term or a period of time, with a maturity of 10 years in either case.



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## 7(a) & Express Interest Accrual Method

### Unsold Loans:

- SBA doesn't require a specific interest accrual method for these loans.
- Lender may compute interest using either **30/360**, or **Actual/365** (aka 365/365), or **Actual/360** (aka 365/360).
- However, Lenders are advised that if they use **Actual/360** method that they cannot then charge the maximum allowable rate of interest, such as Prime + 3% for loans over \$350,000, because it will result in an Annual Percentage Rate that exceeds SBA's regulatory maximum.

### Sold Loans:

- SBA requires that loans sold on the secondary market have interest accrual calculated on either 30/360 or Actual/365 (aka 365/365).



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## 7(a) Interest Rates – Floors & Ceilings

- **SBA allows Lenders to limit the upward and downward adjustments by establishing a floor and ceiling on a 7(a) loan, provided that:**
  - Both the floor and ceiling are stated in the Note; and
  - 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.
  - Example #1, if the Note rate is 9% and the floor is 8%, the ceiling must not exceed 10%.
  - Example #2, if the Note rate is 9% and the ceiling is 11%, the floor must be 7% or lower.
- **In general, floors are problematic for lenders in very low rate environments (think 2008–2015 or 2020-2021), while ceilings are problematic in rising rate environments (think today).**

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# **7(a) and Express Loan Fees**



## Great News on SBA Fees for FY24!

Gross Loan Size	Loan Maturity	Fee
≤ to \$150K	Any	Waived For FY 2024
> \$150K ≤ \$1 Million	Any	Waived For FY 2024
> \$1 Million ≤ \$2 Million	More than 12 months	1.45% of gty'd portion up to \$1 million plus 1.7% of gty'd portion over \$1 million
> \$2 Million ≤ \$5 Million	More than 12 months	3.5% of gty'd portion up to \$1 million plus 3.75% of gty'd portion over \$1 million
<b>Borrower's up front fee for Express Loans</b>		
≤ \$500,000	Any	Waived for FY 2024
<b>Lenders Annual Service Fee</b>		
≤ \$1 Million	Any	Waived for FY 2024
> \$1 Million < %5 Million	Any	0.55% of gty'd portion of outstanding balance



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## Situational Fees

Fee	Purpose	Guidance
Origination, doc prep or similar fees		Prohibited by SBA <u>BUT:</u>
Packaging Fee	When lender prepares SBA app; based on % of loan or hourly basis	Loan up to \$150K – max 5% Loan over \$150K – max 3% or \$30K
NEW – SERVICE FEE	Non-interest expense & corporate allocation for UW, closing, monitoring credit, regulatory compliance	1. Flat fee up to \$2,500 OR 2. Hourly for services performed OR 3. Max of 5% for loans ≤ \$150M; 3% for loans > \$150M; \$30M cap Cannot exceed similar non-SBA loans
Out of Pocket Expenses	Direct costs associated necessary expenses as a result of an SBA requirement	Lender may be reimbursed by borrower or from loan proceeds
Prepayment Penalty/ Subsidy Recoupment Fee	For loans with maturity 15 years or longer, when borrower prepays 25%+ in first 3 years	5% of loan bal. - Year 1 3% of loan bal. - Year 2 1% of loan bal. - Year 3

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# **7 (a) and Express Eligibility**



## Credit Elsewhere – Eligibility Begins Here!

**Lender must determine that...**

Borrower is unable to obtain the loan on reasonable terms without a Federal guaranty, or from alternative sources, without undue hardship

In other words, Borrower must demonstrate a need for SBA's guaranty!

If some/all of the loan is available on reasonable terms, the SBA loan request must be reduced by the amount available from other sources, or declined

**Personal liquid assets no longer scrutinized**



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## Credit Elsewhere –Documentation

- Lender must document reason(s) why Borrower can't obtain financing without SBA support.
- These are the acceptable credit factors that meet the credit elsewhere requirement:
  - Applicant needs a longer maturity than Lender's loan policy permits;
  - Applicant's collateral does not meet Lender's policy requirements;
  - Lender's policy doesn't normally allow loans to new businesses or businesses in the applicant's industry;
  - Other factors Lender feels cannot be overcome but for the SBA guaranty;
- **Lender's loan application must specifically identify one/more of these specific factor(s) justifying why the Borrower meets the "credit elsewhere test."**





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## Eligible “Small” Businesses

### Applicants must be:

- an operating business
- organized for-profit
- located in the U.S
- small by SBA standards, including Affiliates
- demonstrate a need for credit

### NAICS Standard

- 500 employees: manufacturers
- 100 employees: wholesalers
- \$7MM-\$38.5MM: average annual revenue

### Alternative

- \$20MM tangible net worth  
and
- \$6.5MM or less after-tax net profits (previous 2-year average)



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## Ineligible Business Types

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ineligible  
business  
types  
listed in  
the SOP

- ⊘ Non-profits
- ⊘ Passive Businesses
- ⊘ Involved in
- ⊘ Illegal Activity
- ⊘ Associates with
- ⊘ Poor Character
- ⊘ Prior Government Losses & Delinquent Federal Debt

**SOP:**

Section A  
Chapter 1  
Paragraph F

**Applicant to  
self-certify**



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# Eligible Use of SBA Proceeds

## Common Uses

- **Permanent Working Capital – 7(a) or Express**
- **Revolving Working Capital – Express only**
- **Inventory & Supplies – both**
- **Furniture, Fixtures, Leaseholds – both**
- **Machinery & Equipment – both**
- **Owner-occupied Real Estate Purchase, Construction, Renovation – both**

## Complex Uses

- **Change of Ownership – including valuation-supported Goodwill & Intangibles; both**
- **Debt Refinance –for loans that meet certain criteria; both**



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## Ineligible Uses of SBA Proceeds

- ⦿ Payments, distributions or loans to Associates
- ⦿ Payment of delinquent Federal, state, or local payroll taxes, sales taxes, or similar
- ⦿ Passive real estate or personal property investment
- ⦿ Floor-plan financing
- ⦿ To finance relocation of applicant business resulting in net reductions in jobs
- ⦿ Refinancing debt owed to a Small Business Investment Co
- ⦿ A loan to an Applicant for the benefit of an ineligible affiliated business



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## Change of Ownership – Basic Eligibility

### 1. Complete Change of Ownership:

- Non-owner(s) purchase 100% ownership interest of the business;

### 2. Partner Buyout:

- One/more existing owner(s) purchase/redeem ownership from other existing owner(s) resulting in 100% ownership by the purchasing owner(s); there may be other existing owner(s) whose ownership remains static outside of this transaction (known as “creeping control”).
- With option 1 or 2, Seller cannot remain an officer, director, stockholder or key employee; may enter into a consulting contract that lasts 12 months or less

### 3. NEWLY ELIGIBLE – PARTIAL CHANGE OF OWNERSHIP:

- Non-owner(s) purchase a portion of 1 or more existing owner’s interest in the business, or of the business itself
- All other remaining owners subject to SBA requirements for personal guarantees with 6-month look-back
- With option 2 or 3, purchasing owner(s) are required to be co-borrowers with business entity (for General Partnership, all remaining partners must be co-borrowers)



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## Change of Ownership – Business Valuation Requirements

- ✓ Business Valuation required when financing a Change of Ownership.
- ✓ Business Valuation must exclude value of real estate being acquired.
- ✓ When amount being financed **minus** the appraised value of Real Estate and/or Equipment being financed is.

Amount of Financing	Type of Valuation Required
Loans ≤ \$250,000	Internal Valuation prepared by Lender <b>(1)</b>
Loans > \$250,000	External Valuation prepared by Independent Qualified Source
Close Relationship between Buyer & Seller <b>(2)</b>	External Valuation prepared by Independent Qualified <b>Source</b>

(1) If permitted by Lender's policies; else obtain External Valuation

(2) e.g. Sales between family members, business partners or employee/employer



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## Change of Ownership – Business Valuation Providers

### Independent Qualified Sources:

An individual who regularly receives compensation for business valuations and is accredited by:

- Accredited Senior Appraiser (ASA)
- Accredited in Business Valuation (ABV)
- Certified Valuation Analyst (CVA)
- Certified Business Appraiser (CBA)
- Business Certified Appraiser (BCA)

### Requirements for Special Purpose Property:

- See page 309 of SOP 50 10 7.1 for list of property types.
- Certified General Real Property Appraiser who completed at least 4 going concern appraisals in last 36 months for equivalent special use property
- Appraisal must allocate separate values to land, building, equipment & **intangibles**



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## Change of Ownership – Financing Goodwill

- Business valuation-supported Goodwill can be financed
- For 7a loans over \$500M:
  - **Complete Change of Ownership:**
    - Minimum 10% equity injection (of total project costs)
    - Seller Debt considered part of Equity Injection if it does not include a balloon payment and:
      - On full standby (no principal or interest payments) at least 2 years; OR
      - On partial standby (interest only payments) AND:
        - Historic cash flow shows pro forma DSC of at least 1.15X; AND
        - At least 25% of equity injection (2.5% of project) comes from another source
  - Existing business acquiring another business in same 6-digit NAICS code with identical ownership and in same geographic area is considered a “business expansion” and does not require an equity injection
  - Loan to an ESOP for purchasing at least 51% in the employer small business is not subject to SBA’s requirement for equity injection





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## Change of Ownership – Financing Goodwill (cont)

- For 7a loans over \$500M:
  - **Partner Buyout:**
    - Minimum 10% equity injection (of purchase price) UNLESS:
      - Remaining owner(s) certify that he/she has been actively participating in the business operation and held the same ownership interest in the business for at least the past 24 months  
**AND**
      - Balance sheets for most recent fiscal year & YTD reflect a Debt-to-Worth ratio of no greater than 9:1 prior to the change in ownership
  - **Partial Change of Ownership:**
    - Minimum 10% equity injection (of purchase price) UNLESS:
      - Balance sheets for most recent fiscal year & YTD reflect a Debt-to-Worth ratio of no greater than 9:1 prior to the change in ownership
  - **Equity Injection Definition:**
    - New cash or other acceptable assets added into project not currently on Applicant's business balance sheet.



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## Debt Refinance –Basic Eligibility

SBA loan proceeds may not be used to pay a creditor in a position to sustain a loss.

- **Maximum maturity:**
  - 25 years if refinancing real estate.
  - 10 years if refinancing debt for all other purposes unless remaining useful life is longer with supporting documentation.
- **Applies to both 7(a) and Express.**

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## **Debt Refinance –Eligible Use of Proceeds**

### **10 types of obligations are eligible for refinance:**

1. Debt structured with demand note or balloon payment;
2. Debt with Interest Rate exceeding SBA's maximum;
3. Credit card debt used for business expenses with Applicant certification;
4. Debt that is over collateralized per SBA rules;
5. Revolving Lines of Credit if extending maturity or reducing rate;
6. Debt with maturity that was not appropriate for the financing purpose;
7. Debt used to finance a Change of Ownership;
  - a. If Seller Debt, must be in place & current on payments (not on standby) at least 24 months;
8. Debt on business balance sheet with borrower certification that interest expense is reported on business tax returns and debt was used solely for business purposes;
9. HELOC with Applicant certification it was used exclusively for business purposes; OR
10. Fully amortizing debt with another lender if refinance will result in 10% reduction in monthly payments.

**Applies to both 7(a) and Express.**

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## **Debt Refinance – Eligible Use of Proceeds**

- Provide transcript showing loan is, and has been, current (no payment made more than 29 days late) for the prior 12 months/life of loan, whichever is less
- **Refinancing Same-Lender Conventional Loans:**
  - If existing debt fully amortizing, must reduce required payments at least 10%.
  - Can be processed GP or SBA Express. (Not eligible for PLP)
- **Refinancing Same or Other-Lender 7a Loans:**
  - Must reduce required payments at least 10%
- **Refinancing 504 Loans:**
  - Not eligible to refinance only the Third Party Lender's 1<sup>st</sup> mortgage loan
  - Justification to refinance the existing 504 loan must be included in credit memo
  - Any applicable 504 prepayment penalties will apply.
  - Must reduce required payments at least 10%

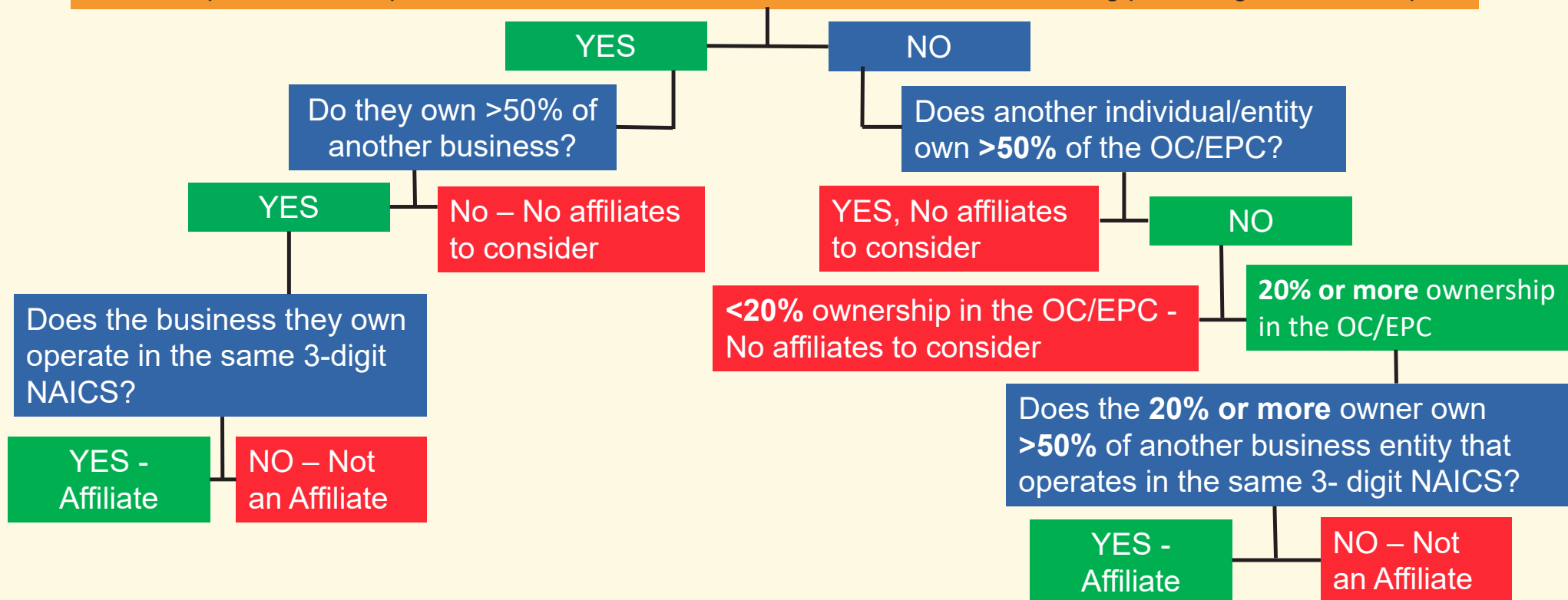
**Applies to both 7(a) and Express.**



## Affiliation Redefined: For individuals owning the OC or EPC:

**Does the individual own >50% of the OC/EPC (applicant)?**

\*Ownership Interests of Spouse & Minor Children must be combined when determining percentage of ownership





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## More Affiliation Clarity

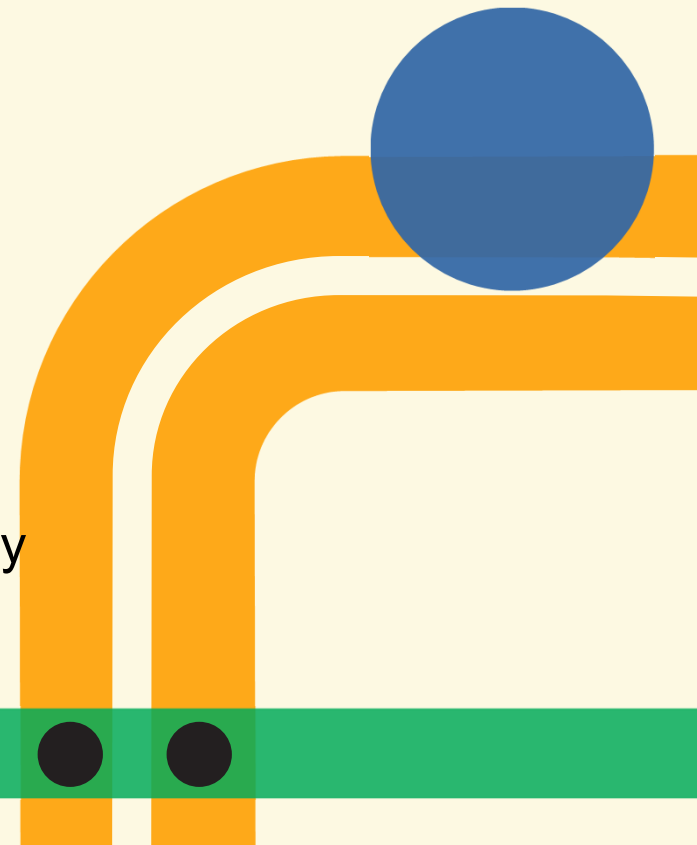
- **Ownership interests of spouses and minor children must be combined when determining amount of ownership interest**
- **When determining % of ownership an individual has in the Applicant, SBA considers beneficial ownership of entities Example:**
  - John Smith owns 35% of Applicant
  - Jane Doe owns 15% of Applicant
  - Jane Doe, Inc. owns 50% of Applicant
    - Jane owns 100% of Jane Doe, Inc. Therefore, Jane owns 65% of Applicant.
- **Stock options, convertible securities and agreements to merge**
  - SBA treats them as though the rights in the agreement have been exercised
- **Management Agreements no longer trigger Affiliation, but review to ensure Applicant is not a Passive Business**



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## Franchise Lending

- Franchise, License, Dealer, Jobber and Similar Agreements **no longer trigger Affiliation**
- SBA **no** longer maintains a **Franchise Directory** of “eligible” brands
- Recommended for Lender to review Agreement to ensure Applicant is not an ineligible business model
  - Illegal activity
  - Restricting patronage for anything other than capacity
  - Discriminatory hiring practices





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## Lending to Real Estate Holding Companies – aka Eligible Passive Companies (EPC)

### SBA prohibits:

- Financing assets which are held for their passive income
- Such as non-owner occupied real estate

### Exceptions to this prohibition:

- Commercial real estate owned by an EPC and leased to a related Operating Company (“OC”)
- Business personal property (i.e. trucks & trailers) by an EPC and leased to a related OC

### Results in an eligible loan structure known as:

- An EPC/OC relationship

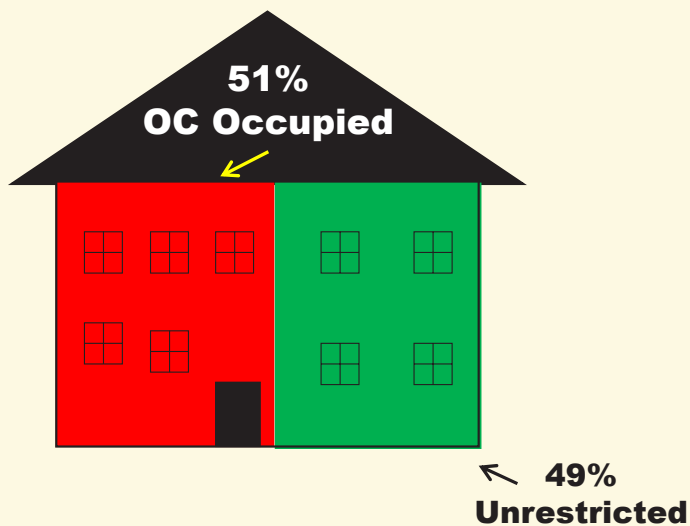




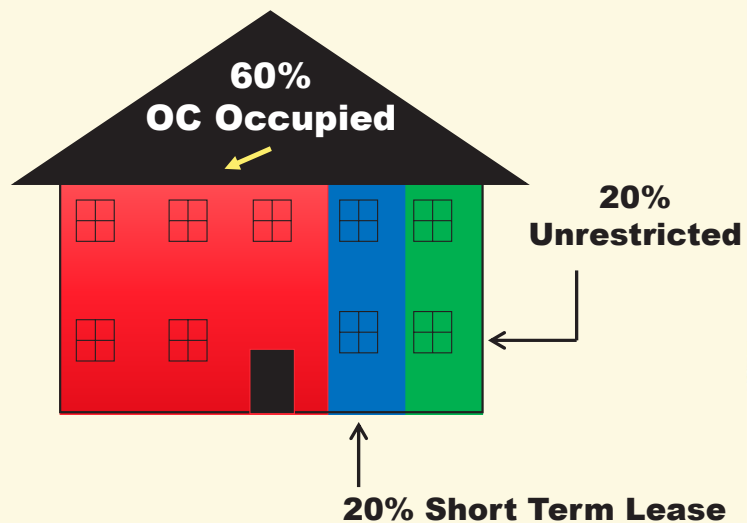
57

## Eligibility Occupancy Rules

### Existing Real Estate



### New Construction



Borrower must begin occupying this space in Year 3 and occupy it by Year 10

Rentable Property in both cases may also include exterior space, not including parking, used by the business; e.g. storage yard for contractors, trucking companies, landscapers, etc.



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## EPC Leasing & Sub-Leasing Rules

Acquire | Lease | Improve | Renovate

OC must be an Eligible Business

EPC leases directly to OC

Lease is subordinated to Lender's Mortgage

Lease term including renewal options must equal Express loan maturity

EPC provides collateral for Assignment of Rents

Rent/Lease payments must not exceed EPC's holding costs

**Sub-lease:** OC must lease 100% from EPC, then OC may sublease a portion



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## EPC/OC Guarantor Rules

### Guarantor

- OC must minimally be an unlimited **Guarantor** of the EPC's loan (in all cases)

### Co-Borrower

- OC must be a **Co-Borrower** of the EPC's loan if receiving loan proceeds for purchase of tangible or intangible assets, or for working capital

### Other Rules

- Each 20%+ owner of either EPC or OC must provide unlimited Guarantee
- When spouse's combined ownership in either EPC or OC totals 20%+, both provide unlimited Guarantee
- If owner is a Trust, then Trustee shall execute unlimited Guarantee on behalf of the Trust



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## Prior Loss or Delinquency

- **Loan ineligible if the business, or its owner(s), have caused a loss to the federal government:**
  - This applies to losses caused on any federal government financing type, including previous SBA loans, student loan, etc.
- **Loan ineligible if there is a delinquent federal debt:**
  - Delinquent means not paid within 90 days of the due date
- Lender must check **Credit Alert Verification Reporting System (CAIVRS)** to determine if there is a prior loss or delinquent debt in the business' or owners' history:
  - <https://entp.hud.gov/caivrs/public/home.html>



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## Character Evaluation

### Ineligible SBA Candidates:

- Incarcerated individuals
- Individual on probation or parole (*will be removed 5/30/24*)
- Individuals under indictment for a felony or any crime involving or relating to financial misconduct or a false statement

**Other types of criminal activity no longer require court documentation, fingerprinting, FBI background check, etc**





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## Assisting Non-U.S. Citizen Owners

### Requirements:

- If the business is not owned at least 51% by U.S. citizens and/or Legal Permanent Residents (LPRs), it is not eligible for SBA financing
- Documentation required for LPRs:
  - USCIS Form G-845
  - Release/Authorization Form
  - Form 551 (Green Card)

### Verification Process:

- Outlined in NADCO TechBrief 4/10/24 for 504. SBA and NAGGL have not yet issued guidance for 7a.

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# **7(a) and Express Underwriting**



## 7(a) Small Loans – Screening Process

### What is an SBA Small Loan?

All loans  $\leq$  \$500,000 that are not Express loans

### What is the pre-screening process?

E-Tran results create an SBA “credit” score

- If  $\geq$  155: “acceptable”

Submit application via E-Tran under GP (General Processing = full SBA review) or PLP (Preferred Lender Processing = delegated authority)

- If  $<$  155: “unacceptable”

Submit as a “reconsideration” under GP or PLP

Lender must complete a cashflow analysis that demonstrates reasonable assurance of repayment





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## 7(a) Small and Express Loans – Credit Analysis

### Do What You Do:

- Follow underwriting procedures used for similarly-sized non-SBA commercial loans, BUT
  - If Lender's financial analysis demonstrates that Applicant lacks reasonable assurance of repayment in a timely manner from business cash flow, loan request must be denied
- Lenders may use their own business credit scoring model (cannot rely solely on consumer credit scores)
- Credit decision, including how much to factor in a past bankruptcy or whether to require an equity injection, is left to Lender's judgment



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## 7(a) Loans – Credit Analysis

### What is a “large” loan?

- Any loan > \$500,000.
- Processed under GP or PLP.

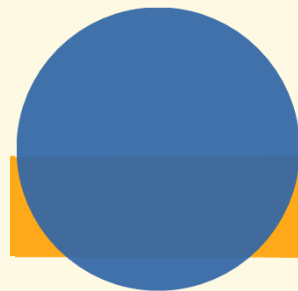
### What is the pre-screening process?

- SBA does not utilize E-tran credit scoring for 7(a) loans > \$500,000

### SBA-specific underwriting requirements

- Pro forma DSC at least 1.15x either historic or projected; if relying on projections include comments on borrower’s assumptions
- Global pro forma DSC at least 1.0x for Borrower and any Affiliates
- Pro forma balance sheet with DTW and current ratios as of Day One with 7a loan in place
- Analysis of working capital adequacy

See SOP 50 10 7.1 pages 108-111 for full requirements





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## Equity Injection –7(a) and Express Programs

### 10% Minimum on loans over \$500M for change of ownership

- Complete change of ownership = at least 10% of total project costs
- Partner buyout = at least 10% of purchase price unless:
  - Buyer's been actively participating in business operation & held same or increasing ownership % at least the past 24 months; AND
  - Balance sheets for most recent FYE & YTD reflect Debt to Worth no greater than 9 to 1 prior to ownership change
- Partial change of ownership – at least 10% of purchase price unless FYE & YTD balance sheets have DTW no greater than 9 to 1 prior to ownership change

### All other loans over \$500M:

- Follow Lender's policy for similarly- sized non-SBA commercial loans
- However, Lender may reduce equity injection required if it determines Applicant needs leverage that exceeds conventional requirement

### 7(a) and Express Loans up to \$500M:

- Decision on whether to require equity injection is left to business judgment of Lender
- Explain decision in Credit Memo



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## Sources of Equity –All Programs

### Cash

- Lender uses same process to verify injection as it uses for similarly-sized non-SBA guaranteed commercial loans

### Non-Cash

- Contributed Fixed Assets – if supported by Appraisal or Valuation by independent 3<sup>rd</sup> party

### Standby Debt

- See slide 48 for seller standby requirements on seller financing
- SBA Form 155, or Lender's form, and attach copy of Standby Note

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## 7(a) and Express Collateral Requirements

Loan Amount	Collateral Requirement
7(a) & Express loans up to \$50,000	<ol style="list-style-type: none"><li>1) Not required to take any collateral.</li><li>2) Personal Guarantee must be obtained; follow guarantee requirements.</li></ol>
7(a) & Express loans \$50,001 up to \$500,000	<ol style="list-style-type: none"><li>1) Lender <b>must</b> follow written collateral policies &amp; procedures it has established for similarly-sized non-SBA commercial loans.</li><li>2) Personal Guarantee must be obtained; follow guarantee requirements.</li></ol>
7(a) loans greater than \$500,000	<ol style="list-style-type: none"><li>1) Lender <b>must</b> have 1<sup>st</sup> security interest in any assets being acquired, refinanced or improved with loan proceeds.</li><li>2) Lender <b>must</b> collateralize loan to maximum extent possible – i.e. be <u>Fully Secured</u> – up to loan amount.</li><li>3) Lender <b>must</b> lien available equity in personally owned residential and/or investment real estate when equity position is 25% or greater (LTV 75% or less).</li><li>4) If fixed assets of OC or EPC don't fully secure the loan, Lender <u>may</u> secure A/R &amp; INV, advancing no more than 10% of NBV.</li><li>5) Personal Guarantee must be obtained; follow guarantee requirements.</li></ol>



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## 7(a) Collateral Concept >\$500M –“Fully Secured”

Lender has a collateral security interest in all available fixed assets  
and

The combined adjusted Net Book Value (NBV)  $\geq$  the SBA loan amount

### Liens on personal RE can be limited to:

- Amount of collateral shortfall OR
- 150% of equity in property

**Net Book Value =**  
Asset Original Price  
minus  
Depreciation & Amortization

### Net SBA advance rates:

- New M&E 75% cost
- Used M&E 50% NBV or 80% OLV
- Improved R/E 85% of Market Value
- Unimproved R/E 50% of Market Value
- Furniture & Fixtures 10% NBV or Appraisal
- A/R & INV 10% NBV (optional)

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## **Collateral Appraisals – 7(a) and Express Loans**

### **RE Appraisal required**

- On any CRE collateral on 7(a) loan over \$500,000
- On 7(a) loan up to \$500,000 for transactions between existing owners or family members, or if Lender requires for similarly-sized non-SBA loans

### **Follow FIRREA and USPAP requirements**

#### **Appraisals**

Must be ordered by the Lender and identify the lender (and SBA) as “client” or “intended user” and dated within 12 months of the SBA application date

#### **Appraiser must be**

Independent, State-Licensed or Certified (State-Certified if RE value over \$1MM); Conflict-free

#### **Required prior to closing**

Credit Memo must include estimate of value. If appraisal less than estimate, document loan file with justification per SOP page 116 (for loans over \$500M) or 145 (up to \$500M)



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## Personal Guarantees

- **Owners of 20% or more:**
  - Must provide unlimited personal guarantee.
- **Owners of less than 20%:**
  - Delegated Lender (on Express or PLP loans) or SBA (on GP loans) may require personal guarantee of from owners of < 20%.
  - If requiring the personal guarantee, it may be unlimited or limited.
- **Lender (or SBA):**
  - May require others to guarantee; based on control or influence in business.
  - Must obtain PFS from every guarantor.
- **Ownership divestiture to avoid guarantee:**
  - Anyone subject to SBA's guaranty requirements 6 months prior to the SBA application date continue to be subject to SBA's requirements even if that person divested ownership interest to less than 20% (but still has some ownership).
  - The only exception to the 6-month rule is when someone completely divests their interest prior to the date of SBA application. Complete divestiture includes divestiture of all ownership interest and severance of any relationship with the Applicant and/or EPC, in any capacity, including being an employee (paid or unpaid).





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## Other Guarantee Requirements

### Spousal Guarantees:

- Each spouse owning less than 20% of applicant business must personally guarantee the loan when their combined ownership is 20% or more.
- For a non-owner spouse, Lender must require the signature of that spouse on the appropriate collateral documents.

### Corporate & Other Guarantees:

- All entities that own 20% or more of a business applicant must provide an unconditional guarantee.
- If the entity that owns 20% or more of the applicant business is a Trust (irrevocable or revocable), the Trust must guarantee the loan; Trustee will execute the unlimited guarantee on behalf of the Trust.
- If the Trust is revocable, Trustor also provides unlimited personal guarantee.



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## Life Insurance Requirements – 7(a) and Express Loans

- **7(a) Loans and Express Loans regardless of amount:**
  - Lender follows its internal policy for similarly sized non-SBA loans commercial loans
    - If life insurance will be taken, Lender's credit memo to indicate amount of assignment and who it will be required on.
    - Closing documentation to include collateral assignment identifying Lender as Assignee, acknowledged by home office of Insurer.
  - If not requiring life insurance, comment on how this is in accordance with Lender's policy

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# **Overview of SBA Governance**



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## SBA Governance

### Law

Small Business Act of 1953

(15 USC 631 et seq.)



### CFR

Code of Federal Regulations

Statutory requirements of SBA loan programs are congressionally mandated



### SOP

Standard Operating Procedures

SBA's policies and procedures for processing all loan requests under the various programs

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# **Overview of SBA Process**

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## **7(a) & Express - Lender Responsibilities**

1. Conduct eligibility review and credit analysis in accordance with current SOP 50 10 7.1 and then comply with specific program requirements
2. Submit complete loan applications (when necessary, e.g. 7a) to LGPC
3. Maintain complete and accurate SBA loan files
4. Perform credit analysis in prudent and commercially reasonable manner, including proving the loan request has reasonable assurance of repayment
5. Perform required loan monitoring, reporting, and loan reviews as required by SBA
6. And in all cases, comply with SBA requirements in effect at the time of loan application to avoid future loan guaranty repairs or denials
7. Close & disburse using enforceable documentation, service and liquidate loans using prudent practices.



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## Foundational Principles – 7(a) & Express Lending

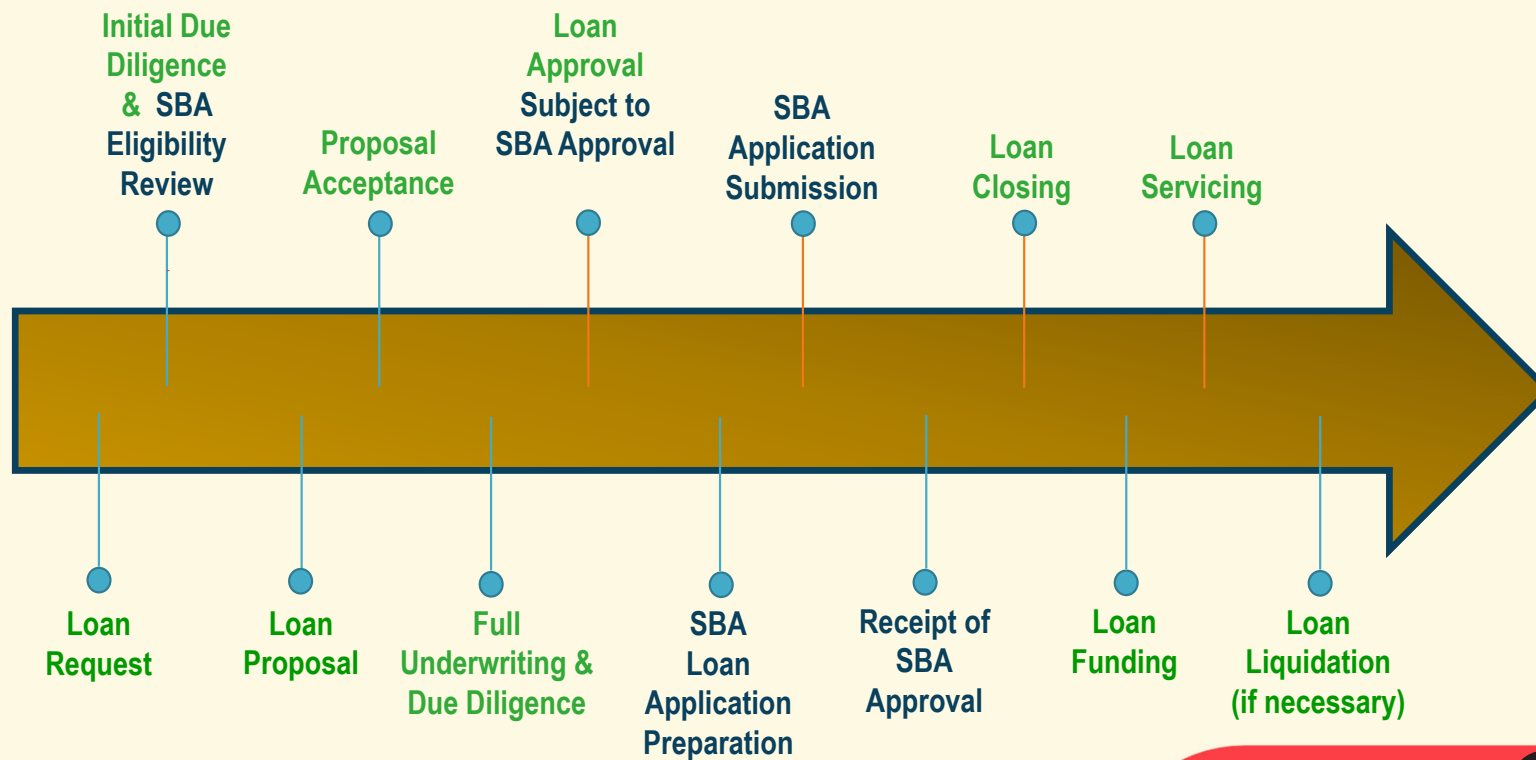
SBA loans make access to credit possible for eligible borrowers for eligible uses of proceeds on terms that the Lender could not otherwise provide under its conventional loan policy, which enhances the business' cash flow and/or working capital position(s), while at the same time reducing the Lender's credit risk via a government loan guaranty

1. Lender makes Credit Decision - Subject to SBA guaranty
2. Lender's Capital is at Risk - Guaranty is a credit enhancement
3. 5 C's of Credit apply - Prudent & Commercially Reasonable
4. Deferred Participation - SBA guaranty 'called' at Default
5. Solid Management & Cash Flow - DOESN'T MAKE A BAD LOAN GOOD
6. GREAT loan structuring tool - Borrower has platform for success



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# SBA & Conventional Lending Process







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## 7(a) GP Loan Approval Process

**Lender's Loan Approval  
"Subject To"  
SBA Approval**

### Application Preparation

- Lender uses **internal** resources to determine program eligibility & prepare the SBA application
- Lender **hires an external Lender Service Provider** to determine program eligibility & prepare the SBA application

- Application submitted via E-Tran
- SBA approval turnaround time is 1-2 weeks for loans  $\leq$  \$500M, and 2-4 weeks for loans  $>$  \$500M

**SBA Approval**



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## 7(a) PLP & Express Loan Approval Process

**Lender's Loan Approval Under Delegated SBA Certification**

### Application Preparation

- Lender uses **internal** resources to determine program eligibility & prepare the SBA application
- Lender hires an **external Lender Service Provider** to determine program eligibility & prepare the SBA application

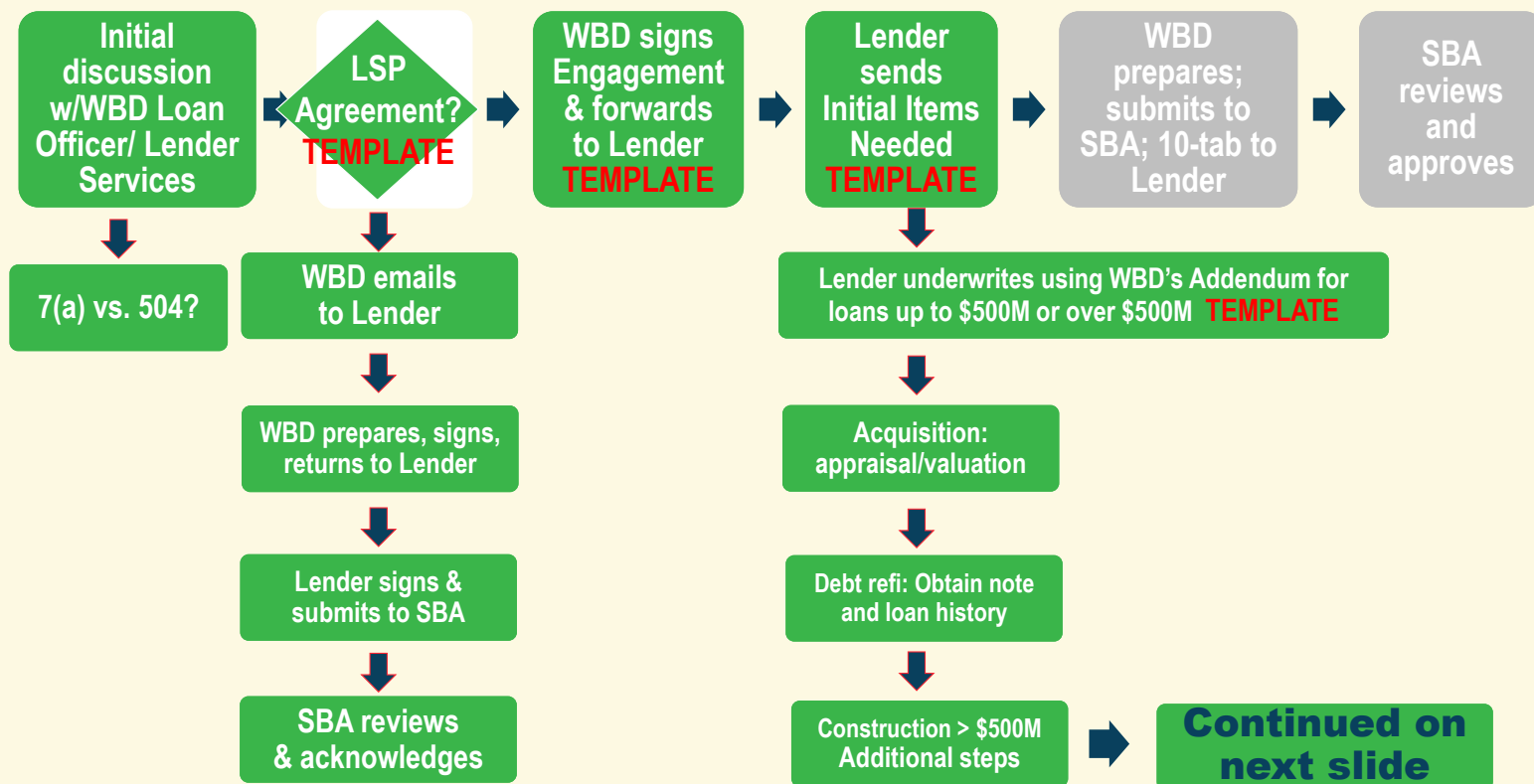
- Application submitted via E-Tran
- SBA approval issued after 1-2 business day Compliance Check In Etran

**SBA Approval**



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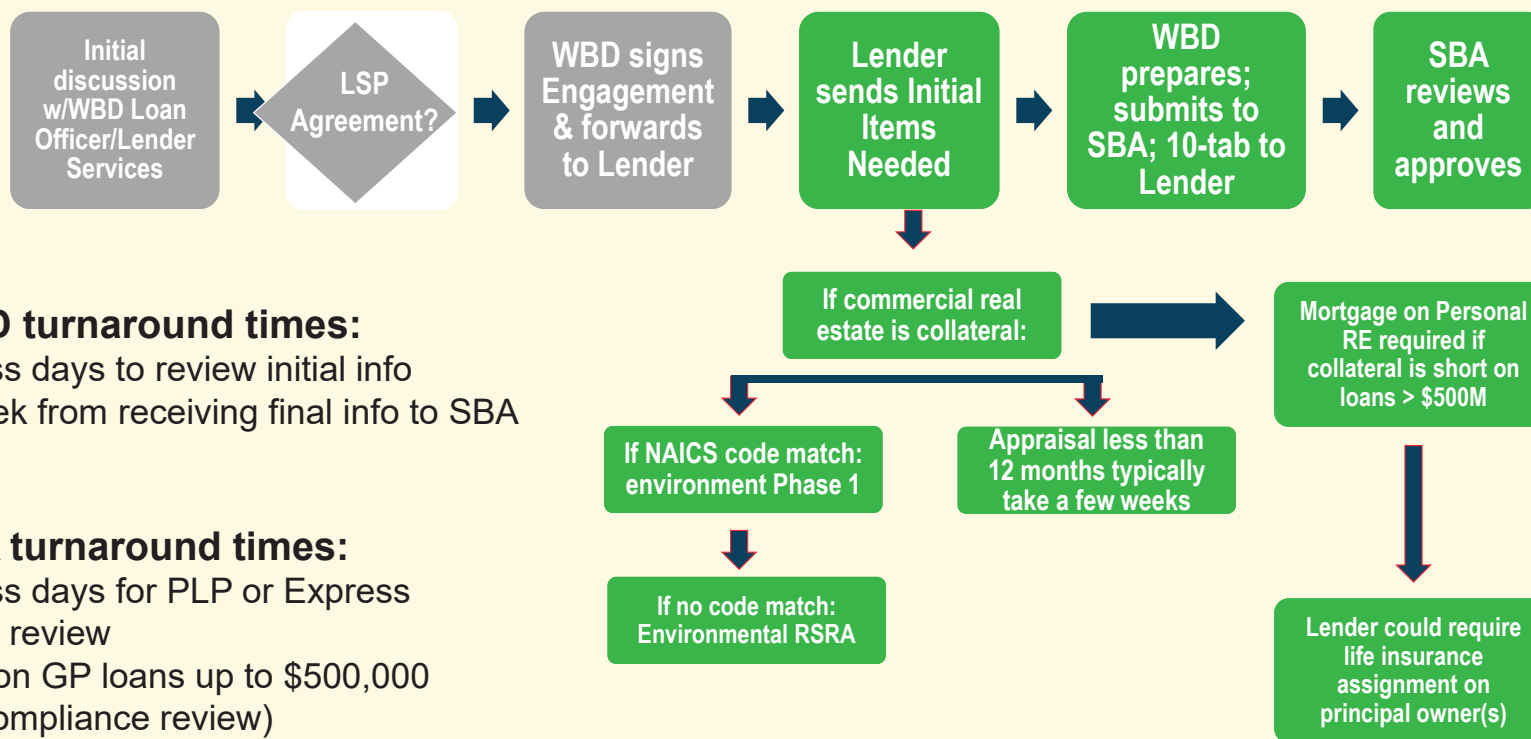
# 7(a) Application Timeline with WBD





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## 7(a) Application Timeline (cont.)



### Typical WBD turnaround times:

- 2-3 business days to review initial info
- Up to 1 week from receiving final info to SBA submission

### Typical SBA turnaround times:

- 1-2 business days for PLP or Express compliance review
- 1-2 weeks on GP loans up to \$500,000 (includes compliance review)
- 2-4 weeks on GP loans over \$500,000 (includes compliance review)



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## Scope of Services

- **Customized to align with Lender's process and needs**
- **Topics to consider:**
  - Due diligence items:
    - CAIVRS searches
    - SAM.gov searches
    - IRS transcripts of business tax returns
  - Form 1919 (recently revised & more difficult for borrower to complete; Form 1920 no longer required):
    - WBD can prepare 1919 if borrower completes our Owner/Key Management Form
  - WBD interaction with borrower?
    - We can request info directly from borrower, or we can remain behind the scenes at lender's discretion
    - Conference call with lender & borrower to walk through 7a process
  - Who at bank is involved in process/receives communication?
    - Loan officers, dedicated SBA staff, support staff?
  - Closing assistance – SBA specific forms (detailed on next slide)



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### **Terms and Conditions document (replaces Authorization)**

- WBD attaches PDF of all info entered in Etran

### **Preparation of SBA Closing Forms:**


- Form 147 – Note (repayment terms copied from Terms & Conditions doc)
- Form 148 – Guarantee
- Form 722 – Equal Opportunity Poster
- Form 601 – Agreement of Compliance (if financing construction/leaseholds)
- Form 155 – Standby Creditor's Agreement (if applicable)
- SBA Borrower's Certification

### **Review of Bank-Prepared Documentation:**

- Any of the above the bank would prefer to prepare
- Collateral documents (mortgage, security agreement, landlord's waiver, life insurance assignment)
- Any other documentation needed for compliance with SBA requirements (evidence of insurance, title/UCC/flood searches, equity injection)

### **Customized list of Closing and Post-Closing Instructions**

- Post-closing document review upon request.

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# **How to move forward with SBA Lending**



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## Steps for Getting Started

- Contact SBA to Enter into 750 Agreement:
  - Eastern half of Wisconsin: Ellie Berg, Lender Relations Specialist, [Elvira.Berg@sba.gov](mailto:Elvira.Berg@sba.gov) or (414) 297-1488
  - Western half of Wisconsin: Chris Dedrick, Lender Relations Specialist, [Christena.Dedrick@sba.gov](mailto:Christena.Dedrick@sba.gov) or (608) 441-5560
- Determine Staffing/Support Needs:
  - Internal staff – Plan for keeping them trained
  - Outsourcing – Due diligence for working with a Lender Service Provider
- Policy/Process/Procedures
  - Incorporate SBA loans or create an Addendum
- Prudent Practices
  - Sign up for Updates from SBA – <https://www.sba.gov/updates>
  - Other resources available:
    - <https://www.sba.gov/partners/lenders/7a-loan-program>
    - <https://www.wbd.org/>
    - <https://www.naggl.org/default.aspx>





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## How to Become a PLP or SBA Express Lender

- SOP 50 56 1 – Lender Participation Requirements
  - <https://www.sba.gov/document/sop-50-56-1-lender-participation-requirements>
- Delegated Authority Criteria
  - SOP pages 28 – 31
  - Must be met to apply for PLP or Express status
- Preferred Lenders Program (PLP)
  - SOP pages 31 – 39
  - Lender has processed and fully disbursed at least 10 SBA loans within past 24 months
- SBA Express
  - SOP pages 39 – 44
  - Lender must have at least 20 commercial/business loans for \$500,000 or less in its portfolio as of most recent FYE
  - If lender has less than 3 years SBA lending experience, initial term of Express participation will be limited to 1 year or less
- Lender Relations Specialists available to assist



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## SBA's Top Reasons for Repairs or Denials


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



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## SBA's Top Reasons for Repairs or Denials (cont)

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

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# **How to make best use of this conference**



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## Tomorrow's Recommended Sessions if New to SBA Lending

### Session 1 (9:15 – 10:30 AM)

- 7(a) GP Processing – Bill Reed, SBA
- E-Tran Application – Todd Miller, ATW Miller Group

### Session 2 (10:45 AM – Noon)

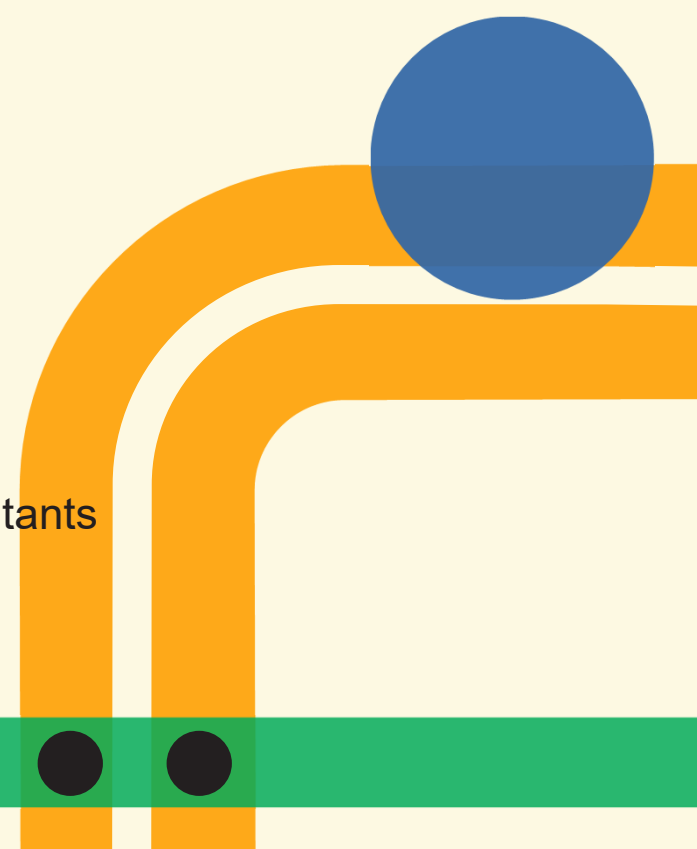
- 504 Loan Program – Kyle Kuntz, WBD
- SBA Loan Servicing/Modification – John Gossett, SBA

### Session 3 (1:30 – 2:45 PM)

- 504 Case Studies – Kyle Kuntz, WBD
- SBA Form 1502 Reporting – Victor Cruz, Guidehouse
- Environmental Due Diligence – Chris Valcheff, Truenorth Consultants

### Session 4 (3:15 – 4:30 PM)

- E-Tran Servicing Actions – John Gossett, SBA



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# **Wrap Up and Questions**

# Thank You!

## Join us for Networking

**4:00 – 7:00 PM**

Open to all who attended today's workshop or are registered for tomorrow's conference

Beer, wine and snacks provided by WBD  
Mixed drinks available for purchase