A GUIDE FOR SBA LENDERS

UNDERSTANDING STANDARD OPERATING PROCEDURE 50 10 7

DoerenMayhew
CPAs AND ADVISORS

The Small Business Administration (SBA) recently released its much-anticipated Standard Operating Procedures (SOP) 50 10 7 providing significant formatting and procedural updates for all 7(a) and 504 loans. Effective Aug. 1, 2023, the SOP will apply to all applications received by the SBA on, or after that date. Lenders are required to use SOP 50 10 6 for 7(a) and 504 applications submitted through July 31, 2023.

As SBA Lenders prepare to welcome the new SOP, Doeren Mayhew has highlighted the primary changes below to be on the lookout for.

FORMATTING UPDATES

- Part 1 in SOP 50 10 6 has been removed from SOP 50 10 and the contents can be found in the new SOP 50 56, and therefore the remaining text is no longer referred to as Part 2.
- The formerly known Part 2 is now divided into three sections, including:
  1. Core Requirements for All 7(a) and 504 Loans
  2. 7(a) Loan Program Specific Requirements
  3. 504 Loan Program Specific Requirements

  Note, many of the chapters and paragraphs falling under each section now have new titles or have been relocated.

PROCEDURAL UPDATES

Section A: Core Requirements for all 7(a) and 504 Loans

Chapter 1: Primary Applicant Eligibility Requirements Certified by Applicant and Validated by SBA

- If Applicant eligibility information is determined to be invalid by the Lender, the SBA will not use this as a basis to deny or repair the guaranty purchase request. For a 504 loan, it will not impact the debenture guaranty. Instead, digitally submitted applications to the SBA will be screened for eligibility leveraging the administration's technology platform.
- Should the eligibility compliance check performed by the SBA returns with an error code for the Applicant, the Lender must work with the SBA's loan processing centers to clear the code, regardless of whether the Lender is processing the loan via delegated or non-delegated authority.
- Chapter 1 now contains all contents formerly located in Part 2, Section A, except for "Demonstrate the Need for Desired Credit" and "Types of Ineligible Businesses" formerly located in Chapter 3.

Chapter 2: Credit Not Available Elsewhere and Special Transaction Structures

- Delegated Lenders are not required to consider the personal resources of owners of the Applicant and the SBA will not evaluate the personal liquidity of owners at the time of the purchase request, non-delegated loan origination review, or for the purposes of compliance during PARRiS and SMART reviews.
- As an SBA Lender, institutions must certify the Applicant does not have the ability to obtain some, or all of the requested funds on reasonable terms from non-federal, non-state or non-local government sources.

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Chapter 3: Uses of Proceeds

- When a borrower leverages 504 loan proceeds to purchase or lease, and installs fixed assets, the assets must have a useful life of at least 10 years, and be at a fixed location.
- The requirements for an assignment of lease and landlord's waiver has been removed.

Chapter 4: Ethics, Fees and Agents

- Lenders are now only required to conduct a System for Award Management's Exclusions (SAM Exclusions) search once, prior to the agent's first day of work on SBA-related business.
- For 7(a) loans only, the SBA will permit Lenders to charge Applicants a flat fee up to $2,500.

Chapter 5: Other Core Requirements

Personal and Corporate/Other Guaranties: Lenders must obtain financial statements from all individuals and entities guaranteeing the loan, except for supplemental guarantors, or when the Lender credit scores owners/guarantors for 7(a) loans $500,000 or less or for 504 projects $500,000 or less.

Internal Revenue Service (IRS) Tax Transcript/ Verification of Financial Information: Revised guidance for use of IRS Form 8821 to allow an SBA Lender using a Lender Service Provider (LSP) to list SBA Lender and the LSP as designees on line 2.

- **For 7(a) loan only:** For loans $500,000 or less, the Lender must follow the same processes and procedures it uses to verify financial information for its similarly-sized, non-SBA guaranteed commercial loans. At minimum, the Lender must collect business tax returns or tax transcripts to confirm the Applicant filed taxes. For loans greater than $500,000, Lenders must obtain tax return transcripts for the last three years, unless the Applicant is a start-up business.

Hazard Insurance

- **504 loans of all sizes:** Hazard insurance is required on what is being financed by the loan.
- **7(a) loans greater than $500,000 and for 504 projects greater than $500,000:** The SBA requires hazard insurance on all asssets pledged as collateral.
- **7(a) loans $500,000 or less and 504 projects $500,000 or less:** Hazard insurance is required for all real estate acquired, refinanced or improved with the proceeds of an SBA loan.
- **7(a) loans $500,000 or less:** For non-real estate collateral, the SBA requires hazard insurance in accordance with the Lender's hazard insurance policies for their similarly-sized non-SBA guaranteed commercial loans.

Flood Insurance: If any portion of a building purchased with proceeds of an SBA loan that is collateral is located in a special flood hazard area, the Lender must require the Applicant to obtain flood insurance for the building and equipment, fixtures or any inventory under the NFIP or comparable private flood insurance. Policies for condominium and cooperative units will consist of a policy obtained by the individual unit owner.

Life Insurance (For 7(a) Loans Only): Lenders must follow their internal policy for similarly-sized, non-SBA guaranteed commercial loans. When required, the Lender must obtain a collateral assignment identifying the 7(a) Lender as assignee that is acknowledged by the Home Office of the Insurer.

Environmental Policies and Procedures: Environmental policies apply only to real estate acquired, refinanced or improved by the loan proceeds. This section is not applicable to real estate collateral available from, for example, a lien filed for a loan where proceeds not used to acquire, refinance or improve the real estate.

Section B: 7(a) Loan Program Specific Requirements

- **Redefined 7(a) Loans:** SBA has redefined standard 7(a) loans as 7(a) loans greater than $500,000.
- **Combined 7(a) Delivery Method Chapter:** 7(a) Small and SBA Express are combined in one 7(a) delivery method chapter. 7(a) Small loans are loans $500,000 or less and may be processed under the Preferred Lender Program (PLP) authority or non-delegated through the Loan Guaranty Processing Center (LGPC). 7(a) Small loans exclude:
  - Standard 7(a) Loans
  - SBA Express
  - Export Express
  - CAPLines
  - Export Working Capital Program (EWCP)
  - Community Advantage Pilot Program Loans

  SBA Express loans are 7(a) loans $500,000 or less and may only be made by a Lender with SBA Express authority. Lenders may not request an SBA Express loan be processed under non-delegated authority by SBA's LGPC.
- **7(a) Small Loans:** All 7(a) Small loan applications will begin with a screening for an Small Business Scoring Service (SBSS) score. If the Applicant receives an acceptable score, the Lender will close and disburse the loan in accordance with the same processes and procedures it uses for its similarly-sized, non-SBA guaranteed loans.
  - If the Applicant does not receive an acceptable SBSS Score:
    - Lenders may submit via E-Tran a 7(a) loan application for processing under non-delegated procedures to the LGPC.
    - PLP Lenders may approve an application that does not receive an acceptable SBSS credit score using their PLP authority.

    Lenders may override an unacceptable SBSS score by completing a cash-flow analysis demonstrating the reasonable reassurance of repayment. The SBA will not deny the Lender request for loan guaranty based solely upon the Lender's decision to use its PLP authority to underwrite the cash-flow of the business.
- **Procedures For Debt Refinance:** The procedures for debt refinance has been rewritten for standard 7(a), 7(a) Small and SBA Express loans. Users should carefully read the debt refinance requirements to ensure understanding of all changes.
- **Equity Requirements For Standard 7(a) Loans and International Trade Loans (ITL):** Except for transactions for changes in ownership, Lender's requirement for equity and equity injection must be consistent with its requirements for similarly-sized, non-SBA guaranteed commercial loans. However, the Lender may use its discretion to reduce the amount of equity and/or equity injection required, if it determines the Applicant needs leverage exceeding the Lender's conventional requirements. If the Lender or SBA requires an equity injection, they must use the same processes to verify the injection as it uses for its similarly-sized, non-SBA guaranteed commercial loans.
- **Equity Requirements For 7(a) Small and SBA Express:** The credit decision, including how much to factor in a past bankruptcy or whether to require an equity injection, is left to the business judgment of the Lender. In addition, if the Lender requires an equity injection and, as part of its standard processes verifies the equity injection, it must do so for its 7(a) Small and SBA Express loans.
- **7(a) Partial Changes of Ownership:** For standard 7(a), 7(a) Small and SBA Express, partial changes of ownership are permitted. Loan proceeds may be used to fund the purchase of a portion of one or more owner's interest in the business or of the business itself. Both the business and the individual owner(s) who is acquiring the ownership interest must be co-borrowers on the new loan. All remaining owners are subject to the requirements for guaranties covered in

Section A, Chapter 5. However, the percentages of ownership for this requirement will be based on the post-sale percentage of ownership in the business. Note for employee stock ownership plan (ESOP) transactions, there is a statutory requirement if the seller of the employer small business remains as a partial owner, the seller must provide a full, unlimited guarantee regardless of ownership — this statutory requirement cannot be waived. The seller may stay on as an owner, officer, director, stockholder, key employee or employee of the business.

- **7(a) Complete Changes of Ownership:** The SBA revised guidance to state seller debt may not be considered as part of the equity injection, unless either it is on full standby for 24 months of the 7(a) loan, or a debt that is on partial standby (interest payments only being made) may be considered equity when there is historical business cash flow available to make the payments, and at least a quarter of the SBA-required equity injection is from a source other than the seller.
- **Variable Interest Rate Loans:** The date the "complete loan application is received by SBA" is the date the loan is approved and assigned a loan number (for both delegated and non-delegated processing).
- **Collateral For All 7(a) Delivery Methods:** SBA revised guidance to state that, except for international trade loans (ITL), for loans of $50,000 or less, the Lender is not required to take collateral.
- **Collateral for 7(a) Small loans and SBA Express Loans:** Lenders must use commercially reasonable and prudent practices to identify collateral, which conforms to procedures at least as thorough as those used for their similarly-sized, non-SBA guaranteed commercial loans. For loans over $50,000, the Lender must follow the written collateral policies and procedures they have established and implemented for its similarly-sized, non-SBA guaranteed commercial loans.
- **Submission of Application for Guaranty:** SBA revised requirements for the identification of owners to require the Lender to identify the beneficial owners of 20% or more of the Applicant's ownership in E-Tran. Additionally, SBA added a definition of beneficial owner to the application.
- **CAPLines, Export Express and EWCP:** Added new definitions for Exports, Export Transaction, Domestic-to-Foreign Export and Foreign-to-Foreign Export.
- **CAPLines:** SBA added guidance to make it clear that CAPLines may be used for Domestic-to-Foreign Exports, Foreign-to-Foreign Exports and Indirect Exports. Additionally, SBA clarified in CAPLines, the cash flow of the Applicant may include the conversion of assets to cash.
- **E-Tran Terms and Conditions (Formerly "Authorization") Through Disbursement for All 7(a) Loans:** SBA has rewritten this SOP section for all 7(a) loans. Users should carefully read this section to ensure understanding of all changes.

Section C: 504 Loan Program Specific Requirements

The SBA has made the following changes affecting only certified development companies (CDCs):

- **Primary Program Eligibility Factors:** At least one job opportunity must be created or retained per every $90,000 of project debenture ($140,000 for small manufacturers defined as a small business with its primary NAICS Code in Sectors 31, 32 and 33 with all its production facilities located in the United States) and projects meeting an energy public policy goal. A project achieves one of the community development or public policy goals listed in 13 CFR § 120.862 is eligible if the CDC's 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.
- **Permissible Debt Refinance Without Expansion:** The SBA revised guidance for refinancing a project of a qualified debt per SBA Policy Notice 5000-808830. Users should carefully review the revisions as they are extensive.

- **504 Loan and Debenture Terms and Conditions:** For loan maturities, if there is a balloon payment, it must be justified in the loan report and clearly identified in the SBA issued E-Tran terms and conditions. (13 CFR § 120.921(a))
- **Borrower Contribution:** Guidance has been added to clarify that SBA allows borrower's equity in equipment to be counted toward borrower contribution in 504 debt refinancing with and without expansion if the debt was originally used to acquire the specific equipment. The borrower's equity in land and/or buildings and/or equipment previously acquired may be counted toward their contribution if they are part of the project.
- **Collateral Analysis:** CDCs must disclose any deed restrictions on the project property in the collateral analysis section of the CDC's credit memorandum.
- **Collateral and Appraisals:** If the appraisal comes in at less than 90% of the estimated value, the debenture must be reduced or, if available, the CDC must secure additional collateral or additional investment that will be added to the required borrower's contribution and will be sufficient to address the gap in value.
- **Contents of a 504 Loan Application:** CDCs must collect personal financial statements from any proposed guarantors, except supplemental guarantors. They must select the same type of form the used when verifying borrower financial information, including:
  - IRS Form 4506-C
  - IVES Request for Transcript of Tax Return
  - IRS Form 8821
  - Tax Information Authorization

  IRS transcripts and complete verification of borrower financial information are not required until loan closing.
- **SBA E-Tran Terms and Conditions:** If the collateral for the loan includes equipment and/or fixtures, the CDC must obtain a list of all equipment and fixtures that are collateral for the loan. For items with a unit value of $5,000 or more, the list must include a description of the equipment/fixture and serial number, if applicable. The list should be included in the collateral description (Item 4. COLLATERAL) on the UCC-1 Financing Statement.
- **Responsibility for Closing the 504 Loan and Debenture:** Guidance was added stating a priority CDC may not use in-house counsel as its designated attorney. Because the opinion of counsel is only one component of the loan closing, a CDC may not use its in-house counsel to close a 504 loan and obtain an opinion of counsel from an outside designated attorney. The very limited circumstances under which one attorney performs the closing and another provides the opinion of counsel are outlined in the boilerplate opinion of counsel, and involve a project in one state and the CDC counsel in another.
- **CDC's Responsibilities:** Electronically submit closing packages by the deadline established by SBA counsel. No late closing packages will be accepted. SBA counsel will hold late packages over for the next month's debenture sale.

Definition Updates

Included in the updated SOP, the SBA also added and redefined many definitions. To view the full list of updated definitions, view the Appendix in their SBA Information Notice.

WE'RE HERE TO HELP

As you navigate through the complexity of the new SOP, Doeren Mayhew stands ready to assist with any questions you may have. If you're performing your loan review internally, consider leveraging Doeren Mayhew's ***GO***Loan software to ensure compliance with the new SOP. Contact us today to schedule a demo of ***GO***Loan or to learn more about our independent SBA loan review services today.

CONTACT US

Leslie Tripp, Director of SBA Consulting
ltripp@doeren.com
240.508.8349