

# **SBA**

# **SOP 50 57 2**

---

## **7(a) LOAN SERVICING and LIQUIDATION**

Office of Capital Access  
Small Business Administration  
December 1, 2015



**SMALL BUSINESS ADMINISTRATION  
STANDARD OPERATING PROCEDURE**

<b>SUBJECT:</b> <b>7(a) Loan Servicing and Liquidation</b>	<b>S.O.P.</b>		<b>REV</b>
	<b>SECTION</b> <b>50 57 2</b>	<b>NO.</b>	

**INTRODUCTION**

1. Purpose: Update and consolidate SBA policy and procedures on 7(a) loan servicing and liquidation.
2. Personnel Concerned: All SBA employees.
3. SOP Replaced: SOP 50 57
4. Originator: Office of Capital Access

<b>AUTHORIZED BY:</b> Ann Marie Mehlum Associate Administrator Office of Capital Access		<b>EFFECTIVE DATE</b> 12/1/2015
		<b>PAGE</b>

**SBA Form 989 (5-90) Ref: SOP 00 23**

## Table of Contents

<b>Chapter 1. Introduction.....</b>	<b>9</b>
<u>A.</u> Purpose .....	9
<u>B.</u> Authority .....	9
<u>C.</u> General Policy and Goals.....	9
<u>D.</u> Performance Standards.....	9
<u>E.</u> Exceptions to Policy .....	9
<b>Chapter 2. Definitions .....</b>	<b>11</b>
<u>A.</u> General Terms .....	11
<u>B.</u> Environmental Terms.....	21
<b>Chapter 3 .....</b>	<b>22</b>
<u>A.</u> Servicing and Liquidation.....	22
<u>B.</u> Litigation .....	22
<u>C.</u> Decision-Making .....	22
<u>D.</u> Recordkeeping .....	25
<u>E.</u> Loan Monitoring .....	26
<u>F.</u> Reporting Requirements .....	28
<u>G.</u> SBA Take Over of Servicing or Liquidation.....	30
<u>H.</u> Enforcement Action by OCRM .....	31
<b>Chapter 4 .....</b>	<b>32</b>
<u>A.</u> Collection and Application of Loan Payments.....	32
<u>B.</u> Post-Guaranty Purchase Servicing Fee on SBA Portion of Interest Payments.....	33
<u>C.</u> Remittance of Borrower Loan Payments .....	34
<u>D.</u> Prepayment .....	34
<u>E.</u> Paid in Full Loans.....	35
<u>F.</u> Reinstatement of Guaranty on Loan Mistakenly Coded "PIF" .....	35
<b>Chapter 5. Environmental Risk Management.....</b>	<b>37</b>
<u>A.</u> Overview.....	37
<u>B.</u> General Requirements.....	37
<u>C.</u> When an Environmental Investigation is Required.....	38
<u>D.</u> Environmental Investigation Process for Loans in Regular Servicing Status .....	38
<u>E.</u> Environmental Investigation Process for Loans in Liquidation Status .....	38

<u>F.</u> Environmental Investigation Reports.....	41
<u>G.</u> Remedial Action by Secured Creditor.....	41
<u>H.</u> Taking Title to Contaminated Property or Control of Business with Environment Risks .....	41
<b>Chapter 6. Servicing Requests .....</b>	<b>46</b>
<u>A.</u> General Requirements.....	46
<u>B.</u> Review and Analysis .....	46
<u>C.</u> How To Obtain SBA Approval of a Proposed Loan Action.....	49
<u>D.</u> Implementing Loan Actions .....	51
<b>Chapter 7. Modification of Note .....</b>	<b>52</b>
<u>A.</u> General Requirements.....	52
<u>B.</u> Payment Due Date.....	53
<u>C.</u> Change from Revolving to Non-revolving Loan.....	53
<u>D.</u> Installment Amount .....	53
<u>E.</u> Interest Rate.....	53
<u>F.</u> Maturity Date.....	53
<u>G.</u> Loan Amount .....	54
<b>Chapter 8.....</b>	<b>55</b>
<u>A.</u> Subordination of Lien Position .....	55
<u>B.</u> Inter-creditor Agreements .....	56
<u>C.</u> Substitution of Collateral.....	57
<u>D.</u> Substitution of Guarantor.....	58
<u>E.</u> Release of Lien without Consideration .....	58
<u>F.</u> Release of Lien for Consideration.....	58
<u>G.</u> Release of Guarantor or Co-Borrower .....	59
<u>H.</u> Release of Condemnation Proceeds .....	60
<b>Chapter 9. Insurance Coverage .....</b>	<b>61</b>
<u>A.</u> General Requirements.....	61
<u>B.</u> Mortgagee's Title Insurance.....	61
<u>C.</u> Hazard Insurance .....	61
<u>D.</u> Life Insurance .....	62
<u>E.</u> Flood Insurance.....	64
<b>Chapter 10 .....</b>	<b>65</b>
<u>A.</u> General Requirements.....	65

<u>B.</u> Financial Statements .....	65
<u>C.</u> Restrictions on Compensation, Dividends, Fixed Assets, etc.....	65
<u>D.</u> Standby Agreements .....	65
Chapter 11 .....	67
<u>A.</u> Assumption.....	67
<u>B.</u> Assignment of Lender's Interest in Loan.....	68
<u>C.</u> Sale of Loan in Liquidation Status .....	68
Chapter 12. Deferments.....	69
<u>A.</u> Overview.....	69
<u>B.</u> General Rule .....	69
<u>C.</u> General Requirement—Temporary Cash Flow Problem .....	69
<u>D.</u> Deferred Amount .....	69
<u>E.</u> Amount of Payments during Deferment Period .....	70
Chapter 13. Delinquent Secured Senior Loans.....	71
<u>A.</u> General Requirements.....	71
<u>B.</u> Procedure for Developing Best Strategy to Protect Junior Lien Securing SBA Loan .....	71
<u>C.</u> Options.....	72
Chapter 14. Classifying Loans in Liquidation .....	77
<u>A.</u> When Loans Must Be Classified in Liquidation Status .....	77
<u>B.</u> When the Note Should Be Accelerated.....	77
<u>C.</u> Repurchase from Secondary Market .....	77
<u>D.</u> Demand Letters .....	78
<u>E.</u> Skip Tracing.....	78
<u>F.</u> Obligors in Active Military Service .....	78
<u>G.</u> Liquidation Plans.....	79
<u>H.</u> Payments and Recoveries on Loans in Liquidation Status .....	81
Chapter 15. Site Visits .....	82
<u>A.</u> When Required .....	82
<u>B.</u> Preparation .....	82
<u>C.</u> Goals .....	83
Chapter 16. Workouts .....	86
<u>A.</u> Overview.....	86
<u>B.</u> Required Financial Information .....	86
<u>C.</u> Feasibility Test.....	87

<u>D.</u> Timing .....	87
<u>E.</u> Requirement—New Consideration from Borrower .....	87
<u>F.</u> Options.....	87
<u>G.</u> Agreement Provisions.....	89
<u>H.</u> SBA Approval .....	89
<b>Chapter 17 .....</b>	<b>90</b>
<u>A.</u> General Requirements.....	90
<u>B.</u> Procedure for Selecting Best Method of Liquidation .....	90
<u>C.</u> Liquidation Methods .....	93
<u>D.</u> Credit Bids .....	100
<u>E.</u> Eviction Proceedings.....	100
<u>F.</u> Abandonment .....	100
<b>Chapter 18 .....</b>	<b>101</b>
<u>A.</u> General Requirements.....	101
<u>B.</u> Procedure for Selecting Best Method of Liquidation .....	101
<u>C.</u> Liquidation Methods .....	103
<u>D.</u> Credit Bids .....	108
<u>E.</u> Abandonment .....	109
<b>Chapter 19. Acquired Collateral .....</b>	<b>110</b>
<u>A.</u> General Requirements.....	110
<u>B.</u> Acquiring Title to Collateral .....	110
<u>C.</u> Ownership Responsibilities .....	110
<u>D.</u> Expenses.....	111
<u>E.</u> Timeframe for Disposal .....	112
<u>F.</u> Sale.....	112
<u>G.</u> Abandonment .....	116
<b>Chapter 20. Offer in Compromise.....</b>	<b>117</b>
<u>A.</u> Overview.....	117
<u>B.</u> When Compromise is Appropriate .....	117
<u>C.</u> General Requirements.....	118
<u>D.</u> Compromise with a Going Concern .....	119
<u>E.</u> Offer and Supporting Documents.....	119
<u>F.</u> Review and Analysis of Offer .....	120
<u>G.</u> Inadequate Offers.....	121

<u>H.</u> Payment Terms and Conditions .....	122
<u>I.</u> Obtaining SBA Approval .....	123
<u>J.</u> Completing the Compromise Process.....	123
<b>Chapter 21. Litigation .....</b>	<b>124</b>
<u>A.</u> General Requirements.....	124
<u>B.</u> Legal Counsel Hired by Lenders.....	124
<u>C.</u> Litigation Plans.....	125
<u>D.</u> SBA Take Over of Lender-serviced Litigation.....	126
<u>E.</u> Documentation .....	127
<u>F.</u> Attorney Fees and Costs .....	127
<u>G.</u> Suit for Judgment on Note or Guaranty.....	129
<u>H.</u> Judicial Foreclosure and Deficiency Judgment.....	129
<u>I.</u> Settlement Offers.....	129
<u>J.</u> Bankruptcy Proceedings.....	129
<u>K.</u> Probate Proceedings .....	131
<u>L.</u> Enforcement of Judgments.....	132
<u>M.</u> Application of Litigation Recoveries.....	132
<b>Chapter 22. Expenses and Recoveries .....</b>	<b>133</b>
<u>A.</u> Classification of Expenses .....	133
<u>B.</u> Recoveries .....	134
<u>C.</u> Payment of Non-recoverable Expenses Incurred by Lenders .....	135
<u>D.</u> Recoupment of Recoverable Expenses Incurred by Lenders .....	135
<u>E.</u> SBA Review and Approval .....	136
<b>Chapter 23 .....</b>	<b>138</b>
<u>A.</u> Overview.....	138
<u>B.</u> Interest Paid on Guaranteed Portion of Loan.....	138
<u>C.</u> Annual Service Fee Collection.....	139
<u>D.</u> Requirements .....	139
<u>E.</u> Deadline for Lender Resolution of an SBA Purchased Loan.....	142
<u>F.</u> Extensions to the Prudent Liquidation Deadline .....	142
<u>G.</u> Consequences of Failure to Comply with the Prudent Liquidation Deadline.....	143
<u>H.</u> Practice Tips for Lenders.....	143
<b>Chapter 24 .....</b>	<b>145</b>
<u>A.</u> When SBA May Deny Liability.....	145

<b><u>B.</u></b> Loss Attributable to Lender .....	145
<b><u>C.</u></b> Repairs .....	146
<b><u>D.</u></b> Partial Denial of Liability.....	147
<b><u>E.</u></b> Full Denial of Liability .....	147
<b><u>F.</u></b> Voluntary Termination of Guaranty .....	147
<b><u>G.</u></b> Examples of When a Full or Partial Denial of Liability May Be Justified .....	147
<b>Chapter 25 Inspector General Referrals .....</b>	<b>154</b>
<b><u>A.</u></b> Duty to Report Irregularities .....	154
<b><u>B.</u></b> Irregularities Requiring Referral .....	154
<b><u>C.</u></b> Referral Methods .....	155
<b><u>D.</u></b> Required Information .....	155
<b><u>E.</u></b> Post-referral Responsibility .....	156
<b>Chapter 26 .....</b>	<b>157</b>
<b><u>A.</u></b> General Requirements.....	157
<b><u>B.</u></b> Lender Wrap-up Report .....	157
<b><u>C.</u></b> SBA Charge-off .....	158
<b><u>D.</u></b> Referral to Treasury for Further Collection .....	158
<b><u>E.</u></b> IRS Notification of Cancelled Debt .....	160
<b><u>F.</u></b> Credit Bureau Reporting.....	160



## Chapter 1. Introduction

---

### A. Purpose

SOP 50 57 2 sets out the standard operating policies and procedures of the Small Business Administration ("SBA") for the administration of 7(a) Loans that have been fully disbursed and are in "regular servicing" and "liquidation" status.

**Note:** SBA term loans are considered fully disbursed when the loan has been closed and the final loan disbursement has been made. SBA revolving lines of credit are considered fully disbursed when the loan has been closed and the initial loan disbursement has been made. All SBA loans move from "regular servicing" status to "liquidation" status if the loan is in default and has been classified in liquidation pursuant to Chapter 14 of this SOP.

### B. Authority

The policy and procedures set out in this SOP are based on Section 7(a) of the Small Business Act (15 U.S.C. § 631 et seq.), Part 120 of Title 13 of the Code of Federal Regulations, the Debt Collection Improvement Act of 1996 ("DCIA") and the Federal Debt Collection Procedures Act.

### C. General Policy and Goals

Borrowers should repay their SBA loans in accordance with the terms specified in the Loan Authorization, Note and the other Loan Documents. However, when loan servicing and liquidation actions are necessary, lenders should reflect a balancing of SBA's interest in: (1) achieving the goals of the loan program, i.e., helping entrepreneurs start, build and grow viable small businesses; and (2) maintaining the integrity of the loan program, i.e., ensuring that the Agency can maximize its recovery if the Borrower defaults on the loan.

### D. Performance Standards

1. All Lenders must service and liquidate their SBA loans in a diligent, commercially reasonable manner that is free of conflicts of interest and Preferences, and is consistent with the Loan Authorization, Prudent Servicing and Prudent Liquidation practices, including the Prudent Liquidation Deadline, as defined in Chapter 2 below and the SBA Loan Program Requirements in effect at the time the action is taken. (13 C.F.R. § 120.535)
2. Nationally-chartered and state-chartered Lenders, (i.e., Lenders regulated by federal or state agencies such as the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency or the National Credit Union Administration) that have a non-SBA commercial loan portfolio may use their own loan servicing and liquidation procedures provided that their procedures: (a) are acceptable to their regulators; (b) meet or exceed those used for their similarly-sized non-SBA guaranteed commercial loans; and (c) are not inconsistent with SBA Loan Program Requirements including those associated with the use of the word "must" in this SOP.

### E. Exceptions to Policy

Effective Date: December 1, 2015

Any contemplated Loan Action that is in conflict with the use of the word “must” in this SOP must be treated as an exception to policy. An exception to policy is only appropriate when the policy set forth in this SOP does not adequately address the unique circumstances regarding a particular loan, and the exception, if granted, would not contravene an applicable statute or regulation. A request for an exception to policy must be submitted in writing through the appropriate SBA Loan Center. SBA Loan Centers review and refer requests for an exception to policy to the Director of Financial Program Operations (“OFPO”) and the Director of the Office of Financial Assistance (“OFA”) for joint written approval.

## Chapter 2. Definitions

---

The terms defined below have the same meaning wherever they are used in this SOP. Unless otherwise indicated, defined terms are capitalized wherever they appear.

### A. General Terms

1. **7(a) Loan** means a loan that was made under Section 7(a) of the Small Business Act.
2. **Agency** means the U.S. Small Business Administration.
3. **Agent** means an authorized representative, including an attorney, accountant, consultant, packager, lender service provider, or any other Person representing a loan applicant or a Lender by conducting business with SBA. (13 C.F.R. § 103.1(a))
4. **Appraisal** means, for SBA loan servicing and liquidation purposes, (See SOP 50 10 in effect at the time the loan was approved for SBA Loan Program Requirements pertaining to appraisals for loan origination purposes.), an expert's written opinion as to the value of specific property prepared specifically for the Lender and SBA's use with regard to a particular SBA loan, which is obtained in accordance with following requirements:

#### a. Qualifications of Appraiser

An Appraisal may be performed by an appraiser, broker, auctioneer, retail inventory specialist or other expert, provided that the Person meets the following minimum qualifications:

#### (1) Education and Experience

Has the specific education, training and experience required to develop a professional opinion as to the value of the specific type of property involved;

#### (2) Licensed, Certified and Bonded

Meets all applicable government licensing, certification and bonding requirements;

#### (3) Independent

Has no actual, apparent or potential conflict of interest with SBA, the Lender or Obligors; and has no financial interest in the property to be appraised, provided, however, that when it is commercially reasonable, the Person who appraised the collateral may also sell it as long as the sale is widely advertised and otherwise consistent with applicable law. (For example, an auctioneer hired to appraise personal property collateral may also sell it via a public auction, provided that the sale is widely advertised and otherwise consistent with Article 9 of the Uniform Commercial Code ["UCC"].)

b. Appraisal Standards

(1) Real Property

- (a) A real property Appraisal to support a substitution of collateral Loan Action should comply with the appraisal requirements in SOP 50 10 that applied to the original collateral;
- (b) A real property Appraisal should comply with the [Uniform Standards of Professional Appraisal Practice](#) whenever required by prudent lending practices, e.g., to support Loan Actions dealing with release of liens for consideration, Protective Bids, or deeds in lieu of foreclosure, when it is apparent (based on the tax assessed value, current market conditions, condition of the property, balance owed on prior liens, etc.) that there is plenty of equity to secure the SBA loan; and
- (c) In all other cases, (i.e., when neither SBA Loan Program Requirements nor prudent lending practices require an appraisal in compliance with the [Uniform Standards of Professional Appraisal Practice](#)), a real property Appraisal may consist of a broker price opinion ("BPO") prepared in substantial compliance with the [Broker Price Opinion Board Standards](#). For example, a BPO may be used to support a Loan Action to abandon real property collateral if it is apparent, (based on the tax assessed value, current market conditions, condition of the property, balance owed on prior liens, etc.) that there is little or no equity available to secure the SBA loan.

(2) Personal Property

- (a) A personal property Appraisal to support a substitution of collateral Loan Action should comply with the appraisal requirements in SOP 50 10 that applied to the original collateral;
- (b) A personal property Appraisal should comply with the [Uniform Standards of Professional Appraisal Practice](#) whenever required by prudent lending practices, e.g., to support Loan Actions dealing with unique items of personal property such as coin collections, jewelry, or art work; and
- (c) In all other cases, (i.e., when neither SBA Loan Program Requirements nor prudent lending practices require an appraisal in compliance with the [Uniform Standards of Professional Appraisal Practice](#)), a personal property Appraisal may consist of an auctioneer or other expert's opinion as to value.

c. Report Format

All Appraisal reports should contain the following:

- (1) The appraiser's opinion as to value of the property, including an opinion as to the individual value of any item of personal property valued at \$5,000 or more at the time the loan was made;

- (2) The type of valuation, e.g., liquidation or fair market value, and how the appraisal is to be used;
- (3) The methodology, standards, resources and markets the appraiser used or relied on;
- (4) A complete and accurate description of the collateral, including its current condition, photographs, and the manufacturer, model, and serial number of significant items of personal property, i.e., items with a Liquidation Value of \$5,000 or more;
- (5) The date and location of the appraisal inspection, and the effective date of the valuation;
- (6) The appraiser's certification that he or she has no financial interest in the property or conflict of interest with SBA, the Lender or any Obligor; and
- (7) The appraiser's qualifications and signature.

d. Age of Appraisal

Generally, an Appraisal should be less than 120 calendar days old, and must never be more than one year old, at the time SBA or the Lender relies on it to make a decision affecting an SBA loan.

- 5. **Associate of the Borrower** means an officer, director, Key Employee of the Borrower, or a Person who has an ownership interest of 20% or more in the Borrower's business; any entity in which one or more of the foregoing Persons has an ownership interest of 20% or more in the entity's business; or any Person in control of, or controlled by, the Borrower except a Small Business Investment Company licensed by SBA. (13 C.F.R. § 120.10)
- 6. **Associate of a Lender** means an officer, director, Key Employee of a Lender or other senior lender, or owner of 20% or more of the value of the Lender's stock or debt instruments; an Agent involved in the loan process; or any entity in which one or more of the foregoing Persons, or a Close Relative of any such Person, has an ownership interest of 20% or more. (13 C.F.R. § 120.10)
- 7. **Borrower** means the Person or Persons who executed the Note evidencing the SBA loan. (13 C.F.R. § 120.10)
- 8. **Close Relative** means a spouse, parent, child or sibling, or the spouse of a parent, child or sibling. (13 C.F.R. § 120.10)
- 9. **Computer Tracking System** means the electronic method used by SBA or a Lender to create and maintain a chronological record of the significant activities on an SBA loan, such as Loan Actions and the substance of telephone calls, meetings or letters regarding the loan.

- 10. Credit Bid** means an offer to purchase at a foreclosure sale submitted by a creditor who, instead of paying cash, will "credit" the bid amount against the debt owed to the creditor.
- 11. Default Charges** means all monetary amounts payable as the result of a default on a senior secured creditor's loan, such as prepayment penalties, late fees and interest paid at an escalated rate.
- 12. Denial of Liability** means a determination made by SBA pursuant to 13 C.F.R. § 120.520 and 13 C.F.R. § 120.524 that it is not obligated to purchase the guaranteed portion of the 7(a) Loan. A Denial of Liability may be for the full amount of the guaranteed portion of the loan or any part thereof.
- 13. Early Default** means any of the following events of default that occurred either: (a) within 18 months of the initial disbursement of the loan, or; (b) within 18 months of the final disbursement of the loan if the final disbursement occurred more than six months after the initial disbursement, unless the Borrower cured the default and made the scheduled loan payments for 12 months following the 18 month period:
- a. Failure to make a scheduled loan payment;
  - b. Funding a scheduled loan payment from the sale of collateral rather than from business operations;
  - c. Deferment of more than three consecutive scheduled full payments; or
  - d. Any other event of default that required the loan to be classified in liquidation status, e.g., bankruptcy.
- 14. Financial Hardship** means an inability to pay for basic living expenses, i.e., the costs that must be paid to obtain the following categories of goods and services necessary for the survival of an Obligor, their spouse and dependents as defined by the most current version of the Collection Financial Standards published by the Internal Revenue Service: (1) food and clothing; (2) out-of-pocket health care expenses; (3) housing and utilities; and (4) transportation.
- 15. FTA** means the entity that acts as SBA's fiscal and transfer agent. (13 C.F.R. § 120.600(d))
- 16. Good Faith**, whether capitalized or not, means the absence of any intention to seek an unfair advantage or to defraud another party; i.e., an honest and sincere intention to fulfill one's obligations in the conduct or transaction concerned.
- 17. Guarantor** means a Person who executed a Guaranty as security for a Note executed by a Borrower.
- 18. Guaranty** means SBA Form 148 (*Unconditional Guarantee*), SBA Form 148 L (*Unconditional Limited Guarantee*) or a substantially similar document executed by a Guarantor that contains an unconditional promise to pay the debt owed on a Note if the Borrower fails to pay it.

- 19. Including**, whether capitalized or not, means "including but not limited to," i.e., the list is exemplary and not exhaustive.
- 20. Key Employee** means any Person hired by a business to manage its day-to-day operations, including, for example, the hiring and firing of employees, and the expenditure of money.
- 21. Lender or 7(a) Lender** means an institution that has executed a Participation Agreement (SBA Form 750) with SBA under the 7(a) Guaranteed Loan Program. (13 C.F.R. § 120.10)
- 22. Liquidation Plan** means a Lender's written plan outlining the actions that it intends to take to maximize recovery on a specific SBA loan, which includes the information outlined in the template accessible from [www.sba.gov/for-lenders](http://www.sba.gov/for-lenders).
- 23. Liquidation Value** is the likely price collateral will sell for if sold quickly and with limited exposure to potential buyers. An Appraisal is necessary to determine the Liquidation Value of real or personal property collateral unless it consists of:
- a. Cash or Equivalent—the Liquidation Value of cash or cash equivalent items such as retirement accounts, trust funds, life insurance policies with a cash surrender value, certificates of deposit, letters of credit, or other commercial instruments should be the net amount arrived at after deducting verifiable, documented costs such as penalties for early withdrawal; or
  - b. Motor Vehicles and Stock—the Liquidation Value of items that are customarily sold in a recognized market should be based on industry standards. For example, the Liquidation Value of motor vehicles should be based on NADA or Kelley Blue Book value, and the Liquidation Value of publically-traded stock should be based on official stock exchange prices.
- 24. Litigation Plan** means a Lender's written plan outlining the court proceedings it intends to initiate or otherwise participate in to maximize recovery on a specific SBA loan. The plan includes the information outlined in the template accessible from [www.sba.gov/for-lenders](http://www.sba.gov/for-lenders) as well as any other information or documentation required by Chapter 21. Information such as the qualifications of the attorney the Lender intends to hire, a copy of the engagement letter, and the justification for, and estimate of, any expense listed in Chapter 21, Paragraph F that is presumed to be unnecessary, unreasonable and non-customary such as the use of multiple law firms, travel, or the appointment of a receiver to perform routine liquidation duties.
- 25. Loan Action** means an activity or decision regarding a specific SBA loan including a decision to engage or not to engage in a particular activity, such as a decision not to enter a Protective Bid at a senior lienholder's foreclosure sale.

- 26. Loan Action Record** means the paper or electronic document used to memorialize the decision and justification for a specific Loan Action. It may consist of a memo, email, letter, SBA Form 327 or other document provided that it contains: the Borrower's name and the SBA loan number; the Lender's name and contact information; a reasonable description of the Loan Action; the justification for the Loan Action including an analysis of any Supporting Documentation; and a citation to the applicable SOP provision that provides authority for the proposed Loan Action.
- 27. Loan Authorization** means SBA's written agreement including subsequent modifications thereto, which sets out the terms and conditions under which SBA will guarantee a loan. (13 C.F.R. § 120.10)
- 28. Loan Documents** means the Loan Authorization, Note, Guaranty, lien instruments, and all other agreements and documents related to an SBA loan.
- 29. Loan File**, whether capitalized or not, means the electronic or paper folder dedicated exclusively to storing a hard copy or an electronic copy of all of the Loan Documents pertaining to a specific SBA loan.
- 30. Loan Program Requirements** are requirements imposed upon Lenders by statute, SBA regulations, any agreement the Lender has executed with SBA, SBA SOPs, official SBA notices and forms applicable to the 7(a) loan programs, and loan authorizations, as such requirements are issued and revised by SBA from time to time. (13 C.F.R. § 120.10)
- 31. Material Loss** means: (a) with regard to personal property collateral—a single loss or the aggregate amount of multiple losses totaling \$5,000 or more; and (b) with regard to real property collateral—a loss in the amount of \$10,000 or more.
- 32. Must**, whether capitalized or not, means that the action is mandatory.
- 33. Non-recoverable Expense** means a cost that is not SBA-approved and cannot be recouped by being added to the principal balance of the Note, because the cost was not: (a) related to collection of amounts due under the Note, enforcement of the terms of the Loan Documents, or the preservation or disposal of the collateral; (b) necessary, reasonable or customary; or (c) incurred in accordance with prudent lending practices or SBA Loan Program Requirements.
- 34. Non-routine Litigation** means: (a) all litigation where factual or legal issues are in dispute and require resolution through adjudication; (b) any litigation where legal fees are estimated to exceed \$10,000 in the aggregate; (c) any litigation involving a loan where a Lender has an actual or potential conflict of interest with SBA; or (4) any litigation involving a 7(a) Loan where the Lender has made a separate loan to the same Borrower that is not an SBA loan. (13 C.F.R. § 120.540(c)(1))
- 35. Note** means the promissory note (e.g., SBA Form 147) executed by the Borrower on an SBA loan.
- 36. Obligor** means any Person with direct liability for repaying an SBA loan, such as the Borrower, an assumptor, and every Person with contingent liability, such as a Guarantor.



- 37. Office of Financial Program Operations ("OFPO")** means the SBA office in charge of administering SBA's loan program operations and managing SBA's loan portfolio.
- 38. Person** means any individual, corporation, partnership, Limited Liability Company, association, unit of government, or other legal entity, however organized. (13 C.F.R. § 120.10)
- 39. Pilot Loan Program** means any program designated by SBA as a pilot loan program at the time that the loan is approved by SBA, and as of December 1, 2015, includes Community Advantage. Former pilot programs include: Patriot Express, Community Express, Go Loans, and Dealer Floor Plan.
- 40. Preference** means an arrangement not pre-approved by SBA that gives a 7(a) Lender a preferred position compared to SBA relating to the making, servicing, or liquidation of an SBA loan. (13 C.F.R. § 120.10) E.g., a Lender would receive a Preference if it released the collateral for an SBA loan in order to use it as security for a non-SBA loan to the same Borrower.
- 41. Prudent Liquidation** means Lenders must liquidate and conduct debt collection litigation for 7(a) loans in their portfolio no less diligently than for their non-SBA portfolio, and in a prompt, cost-effective and commercially reasonable manner, consistent with prudent lending standards, and in accordance with Loan Program Requirements and with any SBA approval of either a liquidation or litigation plan or any amendment of such a plan. Lenders and CDCs that do not maintain a non-SBA loan portfolio must adhere to the same prudent lending standards followed by commercial lenders that liquidate loans without a government guarantee. They must also operate in accordance with Loan Program Requirements and with any SBA approval of either a liquidation or litigation plan or any amendment of such a plan. (13 C.F.R. § 120.535(b)). Prudent Liquidation also means that a Lender submits a Wrap-Up Report acceptable to SBA on a SBA loan no later than either 24 months from SBA guaranty purchase date or 24 months after the effective date of this SOP for loans where SBA has previously honored the guaranty and lenders are actively liquidating, whichever is longer, unless a written extension is granted by SBA from the applicable timeframe based on extenuating circumstances. (See Chapter 23, Paragraph J, for more information on Extensions to the Prudent Liquidation Deadline").
- 42. Prudent Servicing** means Lenders must service 7(a) loans in their portfolio no less diligently than their non-SBA portfolio, and in a commercially reasonable manner, consistent with prudent lending standards, and in accordance with Loan Program Requirements. Those Lenders that do not maintain a non-SBA loan portfolio must adhere to the same prudent lending standards for loan servicing followed by commercial lenders on loans without a guarantee. (13 C.F.R. § 120.535(a))
- 43. Protective Bid** means an offer made by a secured creditor to pay a designated price for property at a foreclosure sale to "protect" the secured creditor's interest in the property that might otherwise be eliminated by the foreclosure sale.
- 44. Purchase**, whether capitalized or not, when used in conjunction with SBA's 7(a) loan guaranty ("guaranty purchase") refers to SBA's purchase of the guaranteed portion of a 7(a) Loan.
- 45. Purchase Package** means the packet of documentation prepared and submitted by a

7(a) Lender to support its request to have SBA honor its guaranty by purchasing the guaranteed portion of a loan.

- 46. Real Estate Owned ("REO")** means real property collateral acquired by a Lender or SBA.
- 47. Recoverable Expense** means an SBA-approved, necessary, reasonable and customary cost incurred to collect amounts due under the Note, to enforce the terms of the Loan Documents, or to preserve or dispose of collateral, which according to the terms of the Note, can be recouped by adding it to the principal balance of the loan.
- 48. Recoverable Value** means the net dollar amount that a prudent lender could reasonably expect to recover by liquidating a particular piece of collateral. Recoverable Value is determined by deducting the following amounts from the Liquidation Value of the collateral: (a) the balance owed on senior liens (less amounts waived or subordinated by a Loan Document); (b) Recoverable Expenses associated with any necessary lien foreclosure action; and (c) if the collateral is likely to be acquired by SBA or the Lender at the foreclosure sale (e.g., real property), the expenses associated with the care, preservation and resale of the acquired collateral.
- 49. Repair** means an agreement between SBA and a 7(a) Lender as to a specific dollar amount that will be deducted from the amount SBA pays on the Lender's SBA loan guaranty in order to fully compensate SBA for an actual or anticipated loss on the loan caused by the Lender's actions or omissions. A Repair does not reduce the percent of the loan guaranteed by SBA or SBA's pro-rata share of expenses or recoveries.
- 50. Routine Litigation** means uncontested litigation, such as non-adversarial matters in bankruptcy and undisputed foreclosure actions, the estimated legal fees for which will not exceed \$10,000 in the aggregate. (13 C.F.R. § 120.540(c)(2))
- 51. SBA Loan Center** means the following SBA facilities:
- a. **SBA Standard 7(a) Loan Guaranty Processing Center ("LGPC")**
    - Geographic Coverage: SBA Regions 1-10
    - Loan Type and Status: All term loans not yet fully disbursed and undisbursed revolving line of credit loans.
    - Street Address: 6501 Sylvan Road, Suite 122, Citrus Heights, CA 95601
    - Web Site Address: <http://www.sba.gov/CitrusHeightsLGPC>
    - Telephone Number: Toll Free: (877) 475-2435
    - Email: 7(a) Servicing: [7aloanmod@sba.gov](mailto:7aloanmod@sba.gov)  
ARC Servicing: [ARCloanmod@sba.gov](mailto:ARCloanmod@sba.gov)  
ARC Form 1502 Issues: [ARC1502Inquiries@sba.gov](mailto:ARC1502Inquiries@sba.gov)
  - b. **SBA Commercial Loan Service Center ("CLSC") West**
    - Geographic Coverage: SBA Regions 5, 6 (except for Arkansas, Oklahoma and Texas) 7, 8, 9, and 10.

Loan Type and Status:

- (1) All fully disbursed 7(a) Loans classified in regular servicing status;
- (2) Small Loan Advantage, Express and Pilot Loan Program 7(a) Loans, including Community Advantage loans, in liquidation status;
- (3) 7a Small Loans, Certified Lender Program (CLP) Loans and PLP 7(a) Loans with a Gross Approval Amount up to and including \$350,000 that were approved on or after January 1, 2014 that are in liquidation status; and
- (4) ARC loans classified in servicing and liquidation status.

Street Address: 801 R Street, Suite 101, Fresno, CA 93721

Web Site Address: <http://www.sba.gov/FresnoCLSC>

Telephone Numbers:

Phone: (559) 262-4960

Toll Free: (800) 347-0922

Fax Numbers:

Servicing: (202) 481-0483

Express Purchase: (202) 481-0663

Post-Servicing: (202) 481-1756

Email:

Servicing: [fsc.servicing@sba.gov](mailto:fsc.servicing@sba.gov)

Express Purchase: [fsc.expresspurchases@sba.gov](mailto:fsc.expresspurchases@sba.gov)

Post-servicing: [fsc.postservicing@sba.gov](mailto:fsc.postservicing@sba.gov)

ARC Servicing: [ARCLoanmod@sba.gov](mailto:ARCLoanmod@sba.gov)

ARC Form 1502 Issues: [ARC1502Inquiries@sba.gov](mailto:ARC1502Inquiries@sba.gov)

**c. SBA Commercial Loan Service Center ("CLSC") East**

Geographic Coverage: SBA Regions 1, 2, 3, 4, and 6 (except New Mexico and Louisiana).

Loan Type and Status:

- (1) All fully disbursed Loans 7(a) Loans classified in regular servicing status;
- (2) Small Loan Advantage, Express and Pilot Loan Program 7(a) Loans, including Community Advantage loans, in liquidation status;
- (3) 7a Small Loans, CLP Loans and PLP 7(a) Loans with a Gross Approval Amount up to and including \$350,000 that were approved on or after January 1, 2014, that are in liquidation status; and
- (4) ARC loans classified in servicing and liquidation status.

Street Address: 2120 Riverfront Drive, Suite 100, Little Rock, AR 72202-1794

Web Site Address: <http://www.sba.gov/LittleRockCLSC>

Telephone Numbers:

Phone: (501) 324-5871

Toll Free: (800) 644-8564

Fax Numbers:

Servicing: (202) 292-3878

Liquidation: (202) 481-6481

Email:Servicing: [lisc.servicing@sba.gov](mailto:lisc.servicing@sba.gov)Liquidation: [lisc.504liquidation@sba.gov](mailto:lisc.504liquidation@sba.gov)Customer Service: [lisc.customerservice@sba.gov](mailto:lisc.customerservice@sba.gov)Express Purchase: [LRSC.ExpressPurchase@sba.gov](mailto:LRSC.ExpressPurchase@sba.gov)**d. National Guaranty Purchase Center ("NGPC")**Geographic Coverage: SBA Regions 1-10Loan Type and Status:

- (1) All Standard, CLP, and PLP and 7(a) Loans approved before January, 1 2014 classified in liquidation status
- (2) Standard 7a, CLP and PLP 7(a) Loans with a Gross Approval Amount over \$350,000 that were approved on or after January 1, 2014 in liquidation status; and
- (3) All EWCP 7(a) Loans.

Street Address: 1145 Herndon Parkway, Suite 900, Herndon, VA 20170Web Site Address: <http://www.sba.gov/HerndonNGPC>Telephone Numbers:

Phone: (703) 487-9283

Toll Free: (877) 488-4364

Fax Number:

General: (202) 481-4674

Expense Reimbursement: 202-481-4599

Wrap-up Reports: 202-292-3789

Email:General inquiries: [loanresolution@sba.gov](mailto:loanresolution@sba.gov)Loans sold on the secondary market: [secondarymarketliq@sba.gov](mailto:secondarymarketliq@sba.gov)Loans not sold on the secondary market: [sbapurchase@sba.gov](mailto:sbapurchase@sba.gov)Expense Reimbursement: [SBACPC@sba.gov](mailto:SBACPC@sba.gov)Wrap-up Reports: [SBACChargeoff@sba.gov](mailto:SBACChargeoff@sba.gov)**e. U. S. Export Assistance Centers ("USEACs")**Loan Type and Status: All revolving and non-revolving Export Working Capital ("EWCP") loans in regular servicing status.Geographic Coverage and Contact Information: Available at <https://www.sba.gov/content/us-exports-assistance-centers>

**52. Seasoned Loan** or a loan that is “Seasoned” means that for 18 months after the initial disbursement or 18 months after the final disbursement if it occurred more than six months after the initial disbursement, or if there was a default, the Borrower cured it and for 12 months following the 18 month post-disbursement period, the Borrower did not:

- a. Fail to make a scheduled loan payment;
- b. Fund a scheduled loan payment from the sale of collateral;
- c. Have more than three consecutive scheduled full payments deferred; or
- d. Experience an event of default that required the loan to be classified in liquidation.

**53. Servicing Request** means a Loan Action requested by a Borrower regardless of whether it is simple (e.g., address change) or more complex such as the Loan Actions covered in Chapters 7 through 12 of this SOP (e.g., subordination of lien position).

**54. Should**, whether capitalized or not, means that the action is recommended but not required.

**55. Site Visit Report** means the paper or electronic record documenting the Lender’s findings and conclusions after visiting the Borrower’s business premises. A post-default Site Visit Report should cover, for example, the Lenders efforts to: determine whether a workout is feasible; identify the collateral available for liquidation; establish the collateral’s Recoverable Value; determine whether the Borrower is behind on the rent and whether a liquidation sale of the personal property collateral can be held on-site; determine whether any real property collateral is occupied by a Person other than the Borrower; develop a liquidation strategy; assess any environmental risk associated with the anticipated method of liquidation; and arrange for the care and preservation of the collateral pending liquidation.

**56. Supporting Document** or “Supporting Documentation” means the original, or a complete and accurate executed copy, (i.e., it must contain all of the required signatures and include all of the addendums thereto), of any document relied upon to reach a decision regarding a Loan Action, e.g., a purchase and sale agreement, Appraisal or Environmental Investigation Report.

**57. Treasury** means the U.S. Department of the Treasury Bureau of Financial Management Service.

**58. Wrap-up Report** refers to the documentation, whether or not it is titled “Wrap-up Report,” that a Lender must provide in electronic format to the SBA Loan Center for review and approval by SBA. It includes the information outlined in the template accessible from <http://www.sba.gov/for-lenders>.

## **B. Environmental Terms**

Definitions of the environmental terms used in this SOP, which are capitalized when they appear, are located in Appendix 2 of SOP 50 10, the most current version of which is accessible from the SOP section of SBA’s Web site.

## Chapter 3. Lender Responsibility and Authority

---

### A. Servicing and Liquidation

7(a) Lenders must service and liquidate:

1. All of the SBA loans in their portfolio both before and after SBA purchases the guaranteed portion.
2. The entire debt owed on each 7(a) Loan—not just the Lender's portion—regardless of the guaranteed percentage or whether the guaranty has been purchased.

**Note:** Pursuant to the Secondary Market Improvements Act of 1984, in addition to facilitating the sale of SBA loans to secondary market investors and keeping track of current and prior registered holders ("investors"), whenever a 7(a) Loan is sold on the secondary market, the FTA is responsible for:

1. Tracking loan payment histories;
2. Collecting payments from Lenders on loans sold to investors, (Lenders are permitted to make one payment each month to cover all of the loans they have sold.);
3. Resolving Form 1502 reporting discrepancies with Lenders;
4. Remitting payments to investors, (FTA sends one check to the investor that includes an accounting of the funds for all loans held by that investor.);
5. Forwarding all Servicing Requests from a Lender to the investor and forwarding the response back to the Lender;
6. Notifying SBA of delinquent loans; and
7. Handling SBA and Lender repurchases from investors.

### B. Litigation

Lenders are responsible for conducting all litigation needed to ensure recovery on all of the SBA loans in their portfolios except those loans that have been referred to Treasury pursuant to Chapter 26. After a loan has been referred to Treasury, SBA has sole authority to conduct any litigation that may become necessary; and Lenders must immediately notify the SBA Treasury Offset Division (via fax 202-481-0592 or email [BirminghamTOPS@sba.gov](mailto:BirminghamTOPS@sba.gov)) of any pending litigation, including bankruptcy filings, so that the loan can be recalled from Treasury and appropriate action taken by SBA legal counsel. (See Chapter 21 for information on litigation, including when SBA's prior written approval of a Lender's Litigation Plan is required.)

### C. Decision-Making

#### 1. Unilateral Authority

Lenders have unilateral authority to take all necessary action to service and liquidate the 7(a) Loans in their portfolio. This authority is subject to SBA's right to take over the servicing or liquidation of any loan as provided in Paragraph G and except as provided in Subsections 2 and 3 below, provided that their actions are consistent with the performance standards set out in Chapter 1.

## 2. **Unilateral Actions**

Lenders must notify the appropriate SBA Loan Center in writing or via e-Tran when they take substantive unilateral Loan Actions. For a specific list of unilateral actions and information on how to notify SBA, see the most recent version of the 7(a) Lenders Servicing and Liquidation Matrix. Unilateral actions are conditioned by whether the loan guarantee has been sold in the Secondary Market. Pursuant to the Form 1086, or its successor form, changes made to the terms and conditions of the sold Note other than the single unilateral deferment option, require the prior written consent from the Registered Holder.

## 3. **Actions Requiring Prior Written SBA Approval**

Lenders must obtain SBA's prior written approval before taking any Loan Action that involves:

- a. Exception to policy;
- b. Preference;
- c. Conflict of interest: real, apparent or potential;
- d. Sale or lease of collateral or acquired collateral to the Lender, an Associate of the Lender, an employee of the Lender, or a Close Relative of an employee of the Lender;
- e. Sale or lease of collateral or acquired collateral to an Obligor or a Close Relative or Associate of an Obligor;
- f. Release of a co-Borrower or Guarantor;
- g. Compromise of the principal loan balance, including actions that legally extinguish the deficiency balance of a loan, such as a Deed in Lieu of foreclosure, etc.;
- h. Assumption of the loan with release of an Obligor;
- i. Extraordinary servicing fee;
- j. Prepayment that requires a subsidy recoupment fee;
- k. Liquidation Plan or amended Liquidation Plan for a CLP loan;
- l. Litigation Plan or amended Litigation Plan;
- m. Acquisition of title to any property in SBA's name;
- n. Acquisition of title to Contaminated property in SBA's name or the Lender's name;
- o. Operation or control of a business that handles Hazardous Substances;
- p. Operation or control of a business located on Contaminated Property;

- q. Increase in SBA's guaranty percentage:
- r. Increase or decrease in the loan amount:
  - For non-delegated loans lenders must submit requests to the appropriate SBA loan servicing center to have a loan amount increased or decreased;
  - For delegated loans lenders must obtain approval for increases or decreases in the loan amount directly in e-Tran;
- s. Reinstatement of SBA's guaranty;
- t. Emergency purchase of the loan from the secondary market; or
- u. Transfer or sale of more than 90% of the loan.

As mentioned previously, lender servicing actions are conditioned by whether the loan guarantee has been sold in the Secondary Market. Pursuant to the Form 1086, or its successor form, changes made to the terms and conditions of the sold Note other than the single unilateral deferment option, require the prior written consent from the Registered Holder

#### 4. **Where to Send Notices and Requests for SBA Approval**

##### a. **Prior to Full Disbursement**

Notices and requests for SBA's prior approval pertaining to loans that have been approved but are not fully disbursed should be sent to the LGPC.

##### b. **Post-Full Disbursement**

Notices and requests for SBA's prior approval pertaining to loans that have been fully disbursed should be sent to the appropriate CLSC (at Fresno or Little Rock) or to the NGPC at Herndon. (See the definition of "SBA Loan Center" in Chapter 2 for a complete list.)

##### c. **Revolving Line of Credit Loans**

Notices and requests for SBA's prior approval pertaining to revolving lines of credit loans that have had at least one disbursement should be sent to the appropriate CLSC (at Fresno or Little Rock) or to the NGPC at Herndon. (See the definition of "SBA Loan Center" in Chapter 2 for a complete list.)

**Note:** SBA Loan Centers should respond to Lenders' requests for approval of proposed Loan Actions within 15 business days from the date SBA received the request. (13 C.F.R. § 120.541)

#### 5. **Requests for Reconsideration**

When SBA's prior approval is required, a request for reconsideration of an SBA Loan



Center's decision regarding a proposed Loan Action may only be submitted if relevant new facts are provided. The request for reconsideration must be prepared and submitted in accordance with the procedures that applied to the original request.

## 6. **Appeal of Final Decision**

### a. **Liquidation—Liquidation Plan, Loan Action or Expense**

The final decision of an SBA Loan Center Director or designee regarding approval of a Liquidation Plan, liquidation Loan Action (e.g., compromise), or liquidation expense, which is not related to litigation or environmental risk management, may be appealed to the Director of OFPO, provided that the appeal: (1) is in writing; (2) includes a copy of the decision and Supporting Documents; (3) states the reason(s) why the decision is believed to be incorrect; and (4) is submitted within 30 calendar days of the date of the decision. (13 C.F.R. § 120.542(d))

### b. **Litigation—Litigation Plan or Expense**

The final decision of an SBA Loan Center Director or designee regarding approval of a Litigation Plan or litigation expenses (e.g., attorney fees and costs) may be appealed to the Associate General Counsel for Litigation, who will consult with the Director of OFPO, provided that the appeal: (1) is in writing; (2) includes a copy of the decision and Supporting Documents; (3) states the reason(s) why the decision is believed to be incorrect; and (4) is submitted within 30 calendar days of the date of the decision. (13 C.F.R. § 120.542(e))

### c. **Environmental Risk Management—Denial of Request re Contaminated Property**

The final decision of an SBA Loan Center Director or designee denying a request for approval to take title to Contaminated Property or to take over the operation of a business that handles Hazardous Substances or is located on Contaminated Property may be appealed to the Associate General Counsel for Litigation, who will consult with the Director of OFPO, provided that the appeal: (1) is in writing; (2) includes a copy of the decision and Supporting Documents; (3) states the reason(s) why the decision is believed to be incorrect; and (4) is submitted within 30 calendar days of the date of the decision.

## D. **Recordkeeping**

### 1. **General Requirements**

All servicing and liquidation Loan Action decisions, including the justification for the decision, must be documented in the Loan File or Computer Tracking System.

### 2. **Loan Action Records and Supporting Documents**

Loan Action Records should be dated and kept in the Loan File along with the Supporting Documents, such as Appraisals, credit reports and Environmental Investigation Reports, and any other document relied upon before taking the action memorialized in the Loan Action Record, including, for example, a copy of the Lender Servicing and Liquidation Actions 7(a) Lender Matrix.

### 3. **Correspondence**

Copies of all paper and electronic correspondence concerning the loan must be dated and kept in the Loan File.

#### 4. Telephone Conferences and Meetings

Detailed information concerning telephone calls and face-to-face meetings, i.e., date, time, place, Persons in attendance, substance of conversation, etc., must be kept in the Loan File or entered in a Computer Tracking System.

#### 5. Loan File Retention

##### a. General Rule

Nationally-chartered and state-chartered 7(a) Lenders must adhere to the applicable record retention requirements established by their regulators. SBA supervised Lenders, i.e., Small Business Lending Companies, must retain their Loan Files for at least six years following the final disposition of each loan, (i.e., after the loan has been paid in full or charged-off.) (13 C.F.R § 120.461) Upon request by SBA, Lenders must make electronically stored information available to SBA upon request in a timely manner.

##### b. Exception—Litigation Hold

If litigation involving a 7(a) Loan is reasonably anticipated, all potentially relevant information regarding the loan, including electronically stored information must be preserved. Electronically stored information should be preserved in its originally created or "native" format along with the related metadata as instructed by SBA counsel. Upon request by SBA, Lenders must make electronically stored information available to SBA in a timely manner. This preservation requirement supersedes the general rule above and means that routine retention and destruction policies must be suspended and a "litigation hold" must be put on the Loan File, electronically stored information, and all other relevant documents and data to ensure the preservation of such documents and data until notice is given in writing by SBA counsel that retention is no longer required.

**Note:** "Reasonable anticipation of litigation" arises when an organization is on notice of a credible probability that it will become involved in litigation, seriously contemplates initiating litigation, or when it takes specific actions to commence litigation." Guideline 1. *The Sedona Conference Commentary on Legal Holds: The Trigger & The Process* (Sedona Conference Working Group on Electronic Document Retention & Production, 2010.)

#### E. Loan Monitoring

After a loan has closed, changes often occur that can impact the ability to administer or collect the loan. They include, for example, a Borrower's name change, relocation, or consolidation with another entity; a deterioration in the Borrower's financial condition; and changes that affect the value of collateral, such as failure to pay real estate taxes that can become a senior lien on the collateral. Lenders are responsible for monitoring each SBA loan in their portfolio and for mitigating the risk of loss associated with any change in accordance with Prudent Servicing and Liquidation practices. For example:

## 1. Name, Address or Legal Structure Changes

In addition to notifying SBA and updating the Loan File or Computer Tracking System, if a change in the name, address, legal structure, etc., of an Obligor or any other relevant Person (e.g., a standby creditor) could impact the ability to collect the SBA loan, appropriate corrective action must be taken immediately. For example, a UCC 3 should be filed to reflect a name change and preserve the priority of personal property liens; if a Borrower changes its legal structure, generally the new entity should be required to formally assume the SBA loan; and if an Obligor dies, in addition to collecting the proceeds from any life insurance policy pledged as collateral for the loan, legal action may be necessary to protect the ability to collect the balance owed on the loan.

## 2. Borrower's Creditworthiness

- a. The Borrower's creditworthiness, i.e., financial and operational condition, should be monitored through the use of tools such as periodic submission of financial statements, contact with the Borrower via phone or site visits, or review of relevant financial data from sources such as credit reports, credit scores and tax returns.
- b. If the Loan Documents require the Borrower to submit financial statements, the statements should be reviewed and analyzed in a timely manner.
- c. If the financial information provided by the Borrower raises concerns, an executed copy of [IRS Form 4506-T](#) should be requested, and a transcript of the Borrower's most recent Federal Income Tax return should be obtained and compared to the questionable information.
- d. SBA does not permit Lenders to charge a default interest rate or a separate servicing fee for past due financial statements. (SOP 50 10 in effect at the time the loan was approved) (Submission of the past due financial statements should be required as a condition for considering any future servicing request made by the Borrower.)

**Note:** If an Obligor files bankruptcy, appropriate action must be taken to protect the ability to collect the SBA loan. See Chapter 21 (*Litigation*) for information on bankruptcy proceedings.

## 3. UCC Filings

All UCC filings must be monitored and any document needed to maintain the perfection and priority of the lien securing the SBA loan must be properly prepared and filed, including, for example, a UCC-3 to continue an existing financing statement.

## 4. Taxes and Assessments

Secured SBA loans should be monitored to ensure that all taxes and assessments, which if unpaid could become senior liens against the collateral for the SBA loan, are paid in a timely manner.

**Note:** Although state law varies, secured creditors generally do not have the right to redeem collateral after a tax foreclosure sale. Consult legal counsel for case specific information.

## 5. Insurance

7(a) Loans should be monitored to ensure that all required insurance coverage is in place throughout the term of the loan. See Chapter 9 for information on force placing coverage if the Obligor has allowed it to lapse.

## 6. Senior Secured Loans

The loans of other creditors' secured by senior liens against the collateral for an SBA loan should be monitored and timely, prudent, commercially reasonable action must be taken to prevent elimination of the lien securing the SBA loan through a foreclosure action by the senior lien holder or dissipation of the equity available to cover the SBA loan through, for example, the imposition of Default Charges.

## F. Reporting Requirements

### 1. Monthly 1502 Report—Pre-guaranty Purchase Loans

All loans in regular servicing status and all pre-guaranty purchase loans in liquidation status must be included on the Lender's SBA Form 1502 report, which must be submitted to the SBA on a monthly basis through the FTA. (Detailed information on Form 1502 reporting is available on SBA's Web site at [www.sba.gov/for-lenders](http://www.sba.gov/for-lenders).)

**Note:** A 7(a) Loan should not be reported as "paid in full" simply because it has been transferred to another Lender or because the balance on a revolving loan that the Borrower intends to continue to draw on has been paid to zero. When a loan is reported as "paid in full," it is automatically deleted from SBA's Computer Tracking System and the guaranty is cancelled. Lenders who erroneously report a loan as "paid in full," may submit a written request for guaranty reinstatement pursuant to the requirements set out in Chapter 4.

### 2. Reports to Credit Reporting Agencies

In accordance with the Debt Collection Improvement Act of 1996, Lenders are required to report information to the appropriate credit reporting agencies whenever they extend credit via an SBA loan. Thereafter, they should continue to routinely report information concerning servicing, liquidation, and charge-off activities throughout the life-cycle of the loan. (See Chapter 26 for more information regarding credit reporting requirements for loans in charge-off status.)

- a. Lenders are required to report borrowers of SBA-guaranteed loans to the commercial credit reporting agencies. Reporting of guarantors is not required.
- b. Lenders submit reports to the commercial credit bureau reporting agencies. Appendix 3 of the Guide to the Federal Credit Bureau Program ("GFCBP") lists the designated credit reporting agencies for commercial accounts.
- c. Lenders are required to report commercial account information to the appropriate credit reporting agencies whenever they extend credit via an SBA guaranteed loan. Lenders should continue to report information concerning the extension of credit, including servicing, liquidation, and charge-off activities throughout the life-cycle of the loan.

Note: The GFCBP requires reporting on a quarterly basis, but states "more frequent updates may be provided as necessary to maintain the integrity and accuracy of the information being reported." (GFCBP – Reporting Commercial Account Information - page 3-2).

- d. Generally, Lenders are required to provide information necessary to establish the identity of the Borrower such as:

- Name, address, and taxpayer identification number;
- The amount, status, and history of the debt; and
- The agency or program under which the debt arose.

Note: Each credit reporting agency will have their own data element requirements on credit bureau reporting, in addition to or in place of the above items. Lenders should contact the individual credit reporting agency for the applicable requirements.

- e. Credit Reporting References:

- Debt Collection Improvement Act of 1996
- Federal Claims Collection Standards (FCCS), 31 C.F.R. 900-904
- OMB Circular A-129
- Treasury's Managing Federal Receivables (MFR)
- Guide to the Federal Credit Bureau Program (GFCBP)
- [31 U.S.C. § 3711\(e\)\(4\)](#)

### 3. Reporting Requirements— for SBA Purchased Loans

#### a. Reporting Requirements

1. For loans which SBA has purchased from the secondary market after the effective date of this SOP, lenders must provide the SBA Loan Center with a written status report within 15 business days after receiving notice that SBA purchased its guaranty from the secondary market.(13 C.F.R. § 120.520)
2. In addition, for all loans SBA has purchased,, either from the secondary market or directly from the Lender, Lenders must provide the SBA Loan Center with a written status report every 6 months, starting with 6 months from the date of guaranty purchase, or the effective date of this SOP, whichever is earlier, until the Lender has provided evidence sufficient to SBA that the loan is resolved. (See Chapter 23, paragraph I, for the Deadline for Lender Resolution of an SBA Purchased Loan),
3. The status report on each loan must include, at a minimum, a description of the status of the following:
  - a. Borrower status;
  - b. Obligors;
  - c. Collateral;

- d. REO and acquired personal property collateral;
- e. Workout or restructuring negotiations;
- f. Recoveries and expenses incurred;
- g. Liquidation activities and litigation proceedings;
- h. Reasons preventing the resolution of the SBA loan, and;
- i. Timelines as to when the Lender's resolution activities are expected to be completed.

**b. Failure to Comply—Referral to OCRM**

Lenders who fail to timely or insufficiently provide a written status report may be referred to the SBA Office of Credit Risk Management for appropriate action.

**4. Site Visit Report**

A Site Visit Report, which should be kept in the Loan File, should be prepared after every visit to the Borrower's business premises regardless of whether the loan is in regular servicing or liquidation status. All Lenders must prepare a post-default Site Visit Report. With regard to loans processed under the CLP program, Lenders must provide the SBA Loan Center with a Site Visit Report along with their proposed Liquidation Plan. With regard to all other 7(a) Loans, Lenders must provide the SBA Loan Center with a Site Visit Report along with their Wrap-up Report unless it was previously submitted with the Lender's guaranty purchase request. If a site visit was not conducted, the reason why a site visit was neither necessary nor prudent must be documented in the Loan File and explained in the Wrap-up Report. (See Chapter 15 for information on site visits.)

**5. Wrap-up Report**

A Wrap-up Report must be prepared and submitted in electronic format to the appropriate SBA Loan Center for review and approval within 30 calendar days after Prudent Liquidation is complete or upon receipt of a request from SBA, whichever occurs first. Once approved by SBA, the remaining loan balance, if any, will be charged-off by SBA and any loan that is legally collectible by SBA will be referred to Treasury for further collection efforts after assignment of the appropriate Loan Documents by Lender to SBA.

In addition to the above requirement to submit a Wrap-Up Report 30 calendar days after completion of Prudent Liquidation, Lenders must comply with SBA's Prudent Liquidation Deadline definition in Chapter 2 if the Wrap-Up Report has not been previously submitted. That definition requires Lenders to prepare and submit an acceptable Wrap-up Report in an electronic format to the appropriate SBA Loan Center no later than either 24 months after purchase by SBA or 24 months after the effective date of this SOP, whichever is later, unless an extension is approved in writing by the SBA prior to the expiration of the applicable 24 month period. (See Chapter 26, Paragraph B, and Chapter 23, Paragraph E for more information on the Deadline for Lender Resolution, and Paragraph J for more information on the Extension to the Prudent Liquidation Deadline).

**G. SBA Take Over of Servicing or Liquidation**

SBA may, in its sole discretion, take over the servicing or liquidation, including litigation, on any 7(a) Loan. If SBA elects to do so, the Lender must assign the Loan Documents to SBA within 30 calendar days from receiving notice of SBA's election and provide any assistance requested by SBA. SBA may use contractors to perform servicing or liquidation actions. (13 C.F.R. § 120.535(d))

#### **H. Enforcement Action by OCRM**

The SBA Office of Credit Risk Management may take enforcement action pursuant to 13 C.F.R.

§ 120.1400 and 13 C.F.R. § 120.1500 on the basis of a Lender's servicing and liquidating actions or inactions. (See SOP 50 53 (A) for information on SBA's credit risk management policy and procedures.)

## Chapter 4. Loan Payment Administration

---

This chapter provides SBA policy and procedures with regard to collecting and processing loan payments. (See Chapter 22 for information regarding recoveries on loans in liquidation status.)

### **A. Collection and Application of Loan Payments**

Lenders are responsible for collecting scheduled loan payments and for crediting the payments to the proper account, unless SBA has taken over servicing of the loan.

#### **1. Payments on Loans in Regular Servicing Status**

Unless the terms of the Note specify otherwise, funds from payments received on loans in regular servicing status must be applied in the following order:

##### **a. Accrued Interest**

Funds from payments received on loans in regular servicing status must first be applied to interest accrued to the date the payment was received;

##### **b. Principal**

After the accrued interest has been paid, funds from payments received on loans in regular servicing status must be applied to bring the principal balance of the loan current as of the date the payment was received;

##### **c. SBA Permitted Loan Fees**

After the accrued interest has been paid and the principal balance has been brought current, funds from payments received on loans in regular servicing status may be applied to SBA permitted loan fees; and

**Note:** For information on SBA permitted loan fees, such as late payment fees, extraordinary servicing fees, assumption fees, subsidy recoupment fees, and fees for overdraft and other out-of-pocket expenses, see the most current version of SOP 50 10.

##### **d. Additional Principal**

Any funds remaining from payments on loans in regular servicing status after the accrued interest has been paid, the principal balance has been brought current, and the SBA permitted loan fees have been deducted, must be applied to reduce the principal balance of the loan. The application of additional principal payments to the loan balance will not advance the next payment due date.



## **2. Payments on Loans in Liquidation Status**

### **a. Overview**

- a. After acceleration and demand due to default, (followed by classification of the loan in liquidation in accordance with Chapter 14), the Borrower no longer has a legal right to make payments on the loan. As a result, payments (as opposed to recoveries) on loans in liquidation status are generally rare. In those cases where the Borrower is financially able to resume making regularly scheduled payments, the loan should be returned to regular servicing status. (See Chapter 14 for information on returning loans classified in liquidation to regular servicing status, and Chapter 25 for information on how to apply recoveries.)

### **b. Impact on Liquidation Plan**

Before accepting any payment, other than payment in full, on a loan in liquidation status, determine whether accepting the payment could cure the default and curtail plans for liquidating the loan. For more information, consult legal counsel.

### **c. Application of Payment Proceeds**

Unless the terms of a workout agreement or some other legally binding document (e.g., a court approved bankruptcy plan) specifies otherwise, funds from payments received on loans in liquidation status must be applied in the following order:

#### **(1) Principal**

Funds from payments received on loans in liquidation status must be applied to the principal balance of the loan until it has been paid in full;

#### **(2) Accrued Interest**

After the principal balance of the loan has been paid in full, funds from payments received on loans in liquidation status must be applied to accrued interest; and

#### **(3) SBA Permitted Loan Fees**

After the principal balance of the loan and the accrued interest have been paid in full, funds from payments received on loans in liquidation status may be applied to SBA permitted loan fees.

## **B. Post-Guaranty Purchase Servicing Fee on SBA Portion of Interest Payments**

After SBA has purchased its guaranty, Lenders who collect loan payments that include interest may deduct a servicing fee prior to remitting SBA's share of the payment to SBA, provided that the fee is:

1. Deducted from the interest portion of the payment, (Lenders cannot deduct servicing fees from recoveries or principal only payments.);
2. Based on SBA's percentage of participation in the loan and the number of days of interest collected; and

3. Reflected on SBA Form 172 (*Transaction Report on Loan Serviced by Lender*).

**Note:** For information on other SBA permitted loan fees, such as late payment fees, extraordinary servicing fees, assumption fees, subsidy recoupment fees, and fees for overdraft and other out-of-pocket expenses, see the most current version of SOP 50 10. SBA does not guarantee or pay Lender loan fees. Therefore, loan fees must not be added to the transcript of account submitted with a guaranty purchase request.

## C. Remittance of Borrower Loan Payments

### 1. Before Guaranty Purchase—To Investor

If the loan has been sold on the secondary market, the Lender must remit the guaranteed portion of regular loan payments, along with SBA Form 1502, to the FTA for distribution to the investor by the third day of the next month. (Paragraph 6, SBA Form 1086)

**Note:** SBA permitted loan fees belong to the Lender and are not shared with the secondary market investor.

### 2. After Guaranty Purchase—To SBA

Regardless of whether the loan was sold on the secondary market, Lenders must remit SBA's share of any post-guaranty purchase loan payment to the Agency via [www.pay.gov](http://www.pay.gov) within 15 business days of receipt.

## D. Prepayment

Prepayment is defined as a payment of principal in excess of the amount due according to the loan amortization schedule. The "prepayment amount" does not include accrued interest.

### 1. Loans Not Sold on Secondary Market

Borrowers may, at any time, prepay an SBA loan that was not sold on the secondary market. The prepayment may, however, be subject to an SBA subsidy recoupment fee as provided in Subparagraph 4 below.

### 2. Loans Sold on Secondary Market

Borrowers may, at any time, prepay 20% or less of the unpaid principal balance of a loan sold on the secondary market. The prepayment may, however, be subject to an SBA subsidy recoupment fee as provided in Subparagraph 4 below. In addition, the Lender must comply with the terms of the Secondary Market Guaranty Agreement executed by the Lender. For example, the latest version (SBA Form 1086 (9-10) OMB No.:3245-0185) provides as follow:

For loans approved by or on behalf of SBA after February 15, 1985, Lender must give ten (10) business days advance written notice to FTA to allow time for FTA to request that Registered Holder return the Certificate. On the date of prepayment, Lender will wire funds to FTA consisting of principal and accrued interest through the date immediately preceding the date funds are wired, plus any penalty or other fees due to FTA. (See Paragraph 15 of the Terms and Conditions.)

### **3. No Lender Prepayment Penalty**

Lenders may not impose a penalty or charge a fee for full or partial prepayment of an SBA loan. (13 C.F.R. § 120.221 (e))

### **4. SBA Subsidy Recoupment Fee**

SBA requires Borrowers to pay a subsidy recoupment fee for full or partial prepayment of SBA loans with a maturity of 15 years or longer in accordance with the conditions and requirements of 13 C.F.R. § 120.223. (See the most current version of SOP 50 10 for information regarding subsidy recoupment fees.)

**Note:** Pursuant to SOP 50 10, if a Lender believes that a subsidy recoupment fee should not be required, the Lender may submit a request for a determination as to whether the prepayment was involuntary, supported by the Lender's analysis, to the appropriate SBA Loan Center. SBA Loan Centers review each request and forward requests to the Director of Financial Program Operations ("OFPO") and the Director of the Office of Financial Assistance ("OFA") for joint approval.

## **E. Paid in Full Loans**

Payment in full ("PIF") means payment of the total amount due on the loan, including principal, interest, and any applicable subsidy recoupment fee or Recoverable Expense. When a loan is verified as PIF, the Note should be cancelled and the collateral released in a timely manner.

**Note:** Many states impose significant penalties on creditors who fail to release collateral in accordance with state law. Consult legal counsel for state-specific release requirements.

## **F. Reinstatement of Guaranty on Loan Mistakenly Coded "PIF"**

### **1. General Rule**

SBA may, in its sole discretion, reinstate the guaranty on a 7(a) Loan erroneously reported as paid in full on SBA Form 1502.

### **2. Procedure**

To reinstate the SBA guaranty on a loan mistakenly coded PIF, the Lender must submit a written request for reinstatement to the appropriate SBA Loan Center. The request

must include a reasonable explanation for the mistake; a certification that the all relevant guaranty fees have been paid; and a copy of the lender's transcript of account reflecting the balance of the loan to be reinstated.

## Chapter 5. Environmental Risk Management

---

This chapter sets out SBA policy and procedures for managing environmental risks associated with SBA loans in regular servicing or liquidation status.

### A. Overview

#### 1. Environmental Risks

For secured creditors, the risks associated with Contaminated collateral include, for example:

- a. Impairment of the Borrower's ability to repay the loan due to the high cost of Remediation, regulatory fines and penalties;
- b. Diminishment of the value and marketability of the collateral;
- c. Direct liability for tort claims and Remediation by becoming an owner or operator of the Property, (e.g., by acquiring title at a foreclosure sale or by taking over the operation of the Borrower's business); and
- d. Loss of lien priority if a Governmental Entity cleans up the Property.

#### 2. Definitions

Definitions of the environmental terms used in this SOP, which are capitalized when they appear, are located in Appendix 2 of SOP 50 10, the most current version of which is accessible from the SOP section of SBA's Web site. The defined terms include, for example, the term "Property," which means commercial real property and does not include personal property or residential real estate.

### B. General Requirements

Prudent servicing and liquidation of an SBA loan with respect to environmental risk management includes:

1. Conducting adequate due diligence before taking any Loan Action that could result in a loss, or increase the risk of loss, due to actual or alleged presence of Contamination;
2. Monitoring the loan for compliance with the environmental covenants in the Loan Documents, and requiring the Borrower to take appropriate corrective action if necessary; and

**Note:** Changes in the Borrower's financial condition that could signify an increase in environmental risk include, e.g., regulatory fines discovered while reviewing financial statements. Activities that could signify an increase in environmental risk include, e.g., failure to maintain Engineering Controls or evidence of a Release discovered during a site visit.

3. Compliance with Environmental Laws that allow secured creditors to avoid or significantly limit potential liability.

**Note:** Many Environmental Laws provide secured creditors with a “safe harbor” from liability as an owner or operator. Two of the most important laws are the [Comprehensive Environmental Response, Compensation, and Liability Act](#) (“CERCLA”) and the Resource Conservation and Recovery Act (“RCRA”). To qualify for the exemption under CERCLA or RCRA, the most critical requirements are that the secured creditor: (1) hold indicia of ownership primarily to protect its security interest; (2) take no action that could be construed as “participating in the management” of the Borrower’s facility; and (3) attempt to divest itself of Contaminated acquired collateral at the earliest practicable and commercially reasonable time using commercially reasonable means. For Information on the types of activities that constitute “participating in the management” of a facility or UST system, with regard to CERCLA see *CERCLA Lender Liability Exemption: Updated Questions and Answers*; and with regard to RCRA, see 40 C.F.R § 280.210. Consult legal counsel for loan-specific information.

### C. When an Environmental Investigation is Required

An Environmental Investigation must be conducted before taking any Loan Action that could result in a loss, or increase the risk of loss, due to the actual or alleged presence of Contamination. For example, an Environmental Investigation must be conducted before:

1. Accepting Property as substitute collateral;
2. Releasing a lien on collateral for substantially less than its estimated Recoverable Value based on unsubstantiated allegations of Contamination;
3. Abandoning collateral, which would otherwise have Recoverable Value, based on unsubstantiated allegations of Contamination;
4. Acquiring title to Property held as collateral, e.g., by purchasing it at a foreclosure sale or accepting a deed-in-lieu of foreclosure;
5. Taking over the operation of a business that uses Hazardous Substances or is located on Contaminated Property regardless of whether the Borrower owns the Property;
6. Selling REO or acquired personal property collateral for substantially less than its appraised value based on unsubstantiated allegations of Contamination; and
7. Abandoning REO or acquired personal property collateral based on unsubstantiated allegations of Contamination.

### D. Environmental Investigation Process for Loans in Regular Servicing Status

Environmental Investigations in support of regular loan servicing activities, e.g., substitution of collateral, should be conducted in accordance with SOP 50 10 in effect at the time the loan was approved.

### E. Environmental Investigation Process for Loans in Liquidation Status

Environmental Investigations in support of liquidation activities, e.g., acquiring Property at a foreclosure sale, should be conducted as follows:

## 1. Scope of investigation

The amount of due diligence must be prudent based on the loan specific circumstances such as the Property's appraised value, the amount owed on senior liens, the SBA loan balance, the activities conducted at the Property, the results of previous Environmental Investigations, access to the Property, and the cost and time involved.

## 2. Use of Environmental Professionals

Environmental Investigations on loans in liquidation status must be conducted by an Environmental Professional except for the Environmental Questionnaire ("EQ") portion of an Environmental Investigation that consists of an EQ and Records Search with Risk Assessment ("RSRA").

## 3. Reliance Letter Requirement

An Environmental Investigation Report prepared by an Environmental Professional must be accompanied by a Reliance Letter unless the Environmental Investigation consists of an EQ and RSRA. (See Appendix 3 to SOP 50 10 for the Reliance Letter template.)

## 4. General Procedure

Generally, the following steps should be taken to conduct a post-default Environmental Investigation that will provide adequate information for a prudent lender to make an informed decision regarding the risks of Contamination.

### Step 1. Order an Environmental Site Assessment ("ESA")

**High Risk**—If the risk of Contamination appears to be high, begin with a Phase I ESA. Generally, the risk should be considered high if, for example, there are underground storage tanks at the Property, a NAICS Code for a past or present use of the Property matches one on the List of Environmentally Sensitive Industries (Appendix 4 to SOP 50 10), or past Environmental Investigations have concluded that the Property is Contaminated or that there is a high or elevated risk of Contamination.

Exception for Non-Industrial Condominiums: The Environmental Investigation of a condominium in a non-industrial, multi-unit building may begin with a Transaction Screen or an EQ and RSRA.

**Low Risk**—If the risk of Contamination appears to be low, begin with a Transaction Screen or an EQ and RSRA.

### Step 2. Conduct Additional Necessary, Cost-effective Inquiries

If a prudent lender could not make an informed decision based on the Environmental Investigation Report from Step 1, conduct any additional cost-effective inquiry recommended in the Environmental Investigation Report or otherwise needed to obtain enough information to make an informed decision. For example, when the Property appears to have significant Recoverable Value:

- (1) A Phase I ESA should be conducted if a Transaction Screen or EQ and RSRA shows a high or elevated risk of Contamination;
- (2) Inquiries regarding environmental problems beyond the scope of a Phase I ESA (e.g. asbestos), should be conducted if the problem could have a material effect on the Recoverable Value of the Property;
- (3) A Phase II ESA should be conducted if it is necessary to determine the nature and extent of Contamination identified by a Phase I ESA; and
- (4) A Remediation estimate should be obtained if Remediation is recommended in a Phase II ESA Report.

**Note:** For guidance on how to prepare a Remediation estimate, see ASTM E2137-06 (*Standard Guide for Estimating Monetary Costs and Liabilities for Environmental Matters*). Note also that SBA officials may request an estimate from the SBA environmental engineers at the SBA [Sacramento Loan Processing Center](#).

### Step 3. Additional Requirements for Gas Stations and Dry Cleaners

If, after obtaining a Phase I ESA, a prudent lender would obtain additional information before making a decision regarding Property associated with the operation of a gas station, commercial fueling facility, or a dry cleaner that uses Hazardous Substances, then the Environmental Investigation should also include:

- (1) A Phase II ESA conducted by an independent Environmental Professional with three years of full-time relevant experience who holds a current Professional Engineer's or Professional Geologist's license;
- (2) Any further investigation recommended in the Phase I ESA or Phase II ESA Report;
- (3) An estimate that covers the method, cost and time required for completion of any recommended Remediation; and
- (4) Testing of the equipment related to the operation of the facility.

**Note:** Generally, if a gas station or dry cleaner has been in operation for five years or more, there is a high probability that the Property is Contaminated.

### Step 4. Extra Requirement if Taking Over Business Using Hazardous Substances

- (1) Environmental Regulatory Compliance Audit

Generally, an environmental regulatory compliance audit should be conducted prior to taking over the operation of a business that handles Hazardous Substances. The audit should be conducted in substantial compliance with ASTM E2107-06 (*Standard Practice for Environmental Regulatory Compliance Audits*).



**Note:** Unknown regulatory compliance violations can significantly diminish a secured creditor's estimated recovery. For example, the cost of obtaining licenses and permits needed to operate the business can be substantial, and outstanding regulatory fines and enforcement actions can have a chilling effect on the price potential purchasers are willing to pay for the business assets.

(2) Practice Tip

To avoid "participating in the management" of a Borrower's business and losing the secured creditor liability exemption, it is generally advisable to have a receiver appointed by the court to take possession of the collateral and operate the business. (See Chapter 17 on Real Property Collateral Liquidation for more information on when a Receiver is appropriate and the cost/benefit analysis that is required. See Chapter 21 for SBA requirements pertaining to Non-routine Litigation such as receivership proceedings.)

## **F. Environmental Investigation Reports**

The results of an Environmental Investigation must be set out in a written Environmental Investigation Report, which must be kept in the Loan File. An Environmental Investigation Report should be less than 180 calendar days old at the time it is relied on.

## **G. Remedial Action by Secured Creditor**

Given the complexity of the applicable Environmental Laws and the risks involved, Lenders should obtain a legal opinion from an attorney with Environmental Law expertise before undertaking Remedial action. (See 40 C.F.R. § 280.210(b)(2)(i)(B), which deals with participating in the management of underground storage tanks ["USTs"], as an example of the risks and complexity of the law.)

## **H. Taking Title to Contaminated Property or Control of Business with Environment Risks**

### **1. When Appropriate**

Title to Contaminated Property should not be acquired, and businesses that use Hazardous Substances or are located on Contaminated Property should not be taken over, unless despite the risk of incurring liability as an owner or operator, a prudent lender would do so based on the estimated net recovery.

### **2. Requirement – SBA's Prior Written Approval**

Lenders must obtain SBA's prior written consent before taking title to Contaminated Property or taking over the operation of a business that uses Hazardous Substances or is located on Contaminated Property regardless of whether the Borrower owns the Property.

### **3. How to Obtain SBA Approval**

A written request must be submitted to the appropriate SBA Loan Center.

#### 4. Request Format

The request, which must be accompanied by the appropriate Supporting Documents, must include a thorough analysis of all the relevant factors to determine whether a prudent lender would take the proposed action despite the risks. Such factors and Supporting Documents should generally include:

**a. Appraised Value of Collateral to be Acquired**

Provide the appraised value of the Property supported by a copy of the post-default Appraisal.

**b. Liquidation Value of Collateral to be Acquired**

Provide the estimated Liquidation Value of the Property and explain the basis for the estimate.

**c. SBA Loan Balance**

Provide the SBA loan balance supported by a copy of the transcript of account or other credible evidence of the loan balance.

**d. Amount Owed on Senior Liens**

Provide a list of senior liens against the collateral, including landlord liens and tax liens, and the amount owed on each, supported by a copy of:

- (1) Schedule B of the post-default title report;
- (2) A current UCC lien search if the request includes personal property collateral or taking over the operation of a business;
- (3) Any senior lienholder agreement, landlord lien waiver, subordination agreement or other Loan Document that establishes the priority of the liens against the collateral; and
- (4) Transcript of account or similar proof of compliance with any provision in the foregoing documents that requires a senior lender to subordinate any portion of the senior loan to the SBA loan (e.g., Default Charges).

**e. Foreclosure Costs**

List the foreclosure costs including any extraordinary expenses such as the legal fees and administrative expenses associated with a receivership.

**f. Nature and Extent of the Contamination**

Provide a summary of the nature and extent of the Contamination supported by copies of the Environmental Investigation Report(s) required by Paragraph E.

**g. Clean-up Costs and Liability**

Indicate whether Remediation is required or on-going, and:

- (1) If Remediation is not required—attach a copy of the no further action letter, closure letter, or functional equivalent from the responsible Government Entity.
- (2) If Remediation is recommended—attach a copy of any document that: (a) provides a description of the recommended method and cost of Remediation and anticipated completion date; (b) that establishes the identity of those responsible for Remediation (e.g., Superfund consent decree); or (c) that demonstrates the ability of the responsible party to pay for the cost of Remediation.
- (3) If Remediation is on-going—attach a copy of any document that shows the progress of the cleanup, or that the Person conducting the cleanup has sufficient financial resources to complete it.

**h. Secured Creditor Liability Exemptions**

Provide a list of applicable liability exemptions that the Person who will take title qualifies for, such as the secured creditor exemption under CERCLA, RCRA or a similar state law, the bona fide purchaser exemption under CERCLA § 101(4) and 107(r), or the involuntary acquisition by a government entity exemption under CERCLA § 101(20)(D).

**Note:** Pursuant to 40 C.F.R. § 300.1105(a)(3), acquisition of title by SBA through foreclosure or a deed-in-lieu while administering an SBA loan program is considered an "involuntary acquisition."

**i. Mitigating Factors**

List any mitigating factor and attach a copy of the relevant Supporting Document(s), e.g., an indemnification agreement and the indemnitor's financial statement. Mitigating factors include, for example:

- (1) SBA Environmental Indemnification Agreement—was executed by a Person with sufficient financial resources to cover the cost of Remediation;
- (2) Escrow Account—has been established to cover the cost of a Remediation plan approved by the responsible Government Entity;
- (3) Solvent Government Cleanup Fund—has unconditionally agreed to cover the cost of Remediation; or
- (4) Lender Liability Environmental Insurance—is in place and will cover the cost of Remediation after title is acquired.

j. **Tort Liability**

Provide information regarding the status and anticipated outcome of any known litigation regarding alleged injury to people, property or natural resources due to Contamination at the Property.

k. **Exceptions to Title that Impact Marketability**

Review Schedule B of the post-default title report and indicate whether there is any recorded covenant, deed restriction or other exception to title that will have a negative impact on the Property's Recoverable Value such as a covenant that requires future owners of the Property to indemnify a major oil company or a deed restriction that prevents future owners from using the Property for any purpose other than to operate a gas station that sells a particular brand of gasoline.

l. **Alternative Methods of Recovery**

List and analyze the feasibility of alternative methods of collecting the loan balance that involve less risk. At a minimum, this should include (1) the estimated recovery from other collateral and the Obligor; and (2) alternative methods of liquidation that do not require taking title to the Contaminated collateral such as release of lien for consideration, sale of the Note and assignment of the lien to the purchaser, or appointment of a receiver to operate the business until enough money can be recovered to pay-off the loan or the collateral can be sold.

m. **Acquired Collateral Divestiture Plan**

Provide a description of the plan for disposing of any collateral to be acquired, which includes the holding and resale costs, as well as an explanation of how easy or difficult it will be to resell. For example, have any third parties expressed an interest in purchasing the collateral? Is it currently listed for sale by the owner? If so, why hasn't it sold?

**Note:** Generally, in order to preserve its liability exemption, a secured creditor is required to try to dispose of Contaminated acquired collateral at the "earliest practicable, commercially reasonable time using commercially reasonable means". For more information, see the applicable Environmental Law. For example, 40 C.F.R. 280.210(c)(2)(i) sets out a "bright line" test under RCRA for determining whether a secured creditor is attempting to sell a gas station in an expeditious manner.

n. **Other Relevant Facts or Expenses**

List and discuss any other loan-specific relevant facts. For example:

- (1) Remediation by Secured Creditor—Will additional costs be incurred to Remediate the Property prior to listing it for sale? If so, attach a copy of the legal opinion recommended in Paragraph G above, provide a Remediation estimate, and indicate how the costs will be paid;

- (2) Receivership Proceedings—Will a receiver be appointed, for example, to operate the business or sell the collateral? If so, this is Non-Routine litigation and Lenders must submit attach a draft a proposed Litigation Plan to SBA and receive prior written approval prior to commencing receivership proceedings. The Litigation Plan must that describes why a receiver is appropriate, the prior experience and qualifications of the proposed receiver, and includes an estimate of costs of the court and receivership proceedings. (See Chapter 21 for SBA requirements pertaining to Non-routine Litigation such as receivership proceedings.) The Lender must also have a cost-benefit analysis, in which the Lender should take into consideration the environmental professional's analysis of the contamination clean-up costs to determine if the sale of the property will be cost –effective. (See Chapter 17 for more information on when a receivership is appropriate and the cost-benefit analysis required). The Lender should not move forward with remediation unless approved in writing by SBA. In addition, for environmentally Contaminated real estate that has value and could be sold, but which the Lender should not take over the operation of or take title to due to contamination, the Lender must have a recent appraisal and environmental reports that show that the Contaminated real estate has sufficient value for a receivership to be cost-effective; or
- (3) Emptying and Closing USTs—If there are USTs at the Property and a receiver will not be appointed, indicate whether it will be necessary to empty and close the USTs. (For more information, see, for example, 40 C.F.R. §280.230(b).)

**o. Estimated Net Recovery**

Provide the estimated net recovery from taking the proposed action based on the analysis of factors “a” through “n” above.

## Chapter 6. Servicing Requests

---

### A. General Requirements

Frequently after an SBA loan has been disbursed, circumstances change and give rise to Borrower Servicing Requests. They can range anywhere from a simple request to change a mailing address to a complicated request involving the exchange of collateral. Regardless of the level of complexity, all Servicing Requests must be reviewed, analyzed and acted upon in accordance with Prudent Servicing and lending practices. As long as the Borrower is viable, when responding to a Servicing Request, the goal should be to meet the Borrower's short and long term needs without impairing the integrity of the SBA loan program, i.e., the ability to recover on the loan.

### B. Review and Analysis

Generally, the Loan Documents should not be modified unless there has been a material change in the Borrower's circumstances since the loan was made. The Supporting Documents and the level of analysis required to make an informed decision regarding whether the Servicing Request should be denied or approved, and if so, under what conditions, will vary depending on the circumstances. In all cases, the decision must be justified and documented in a Loan Action Record that is independent of any document prepared by a senior lienholder or any other Person with a conflict of interest. The relevant steps listed below should be followed to ensure that each Servicing Request is properly reviewed and analyzed.

#### 1. Document Receipt of the Servicing Request

All Servicing Requests must be entered in a Computer Tracking System or noted in the Loan File.

#### 2. Ensure that the Servicing Request is in the Proper Format

Borrower requests for modification of loan terms or conditions should be in writing.

#### 3. Research the Applicable Loan Program Requirements

##### a. Requests Concerning Assumptions, or Substitution of Collateral or Obligors

The same SBA Loan Program Requirements that applied to the original loan with regard to Obligors and collateral apply to Servicing Requests on loans in regular servicing status that involve assumption of the loan or substitution of a Guarantor, co-Borrower, or collateral. See SOP 50 10 in effect at the time the loan was approved to find the applicable Loan Program Requirements, including, for example, those pertaining to Appraisals, Environmental Investigations, and SBA Form 912 (*Statement of Personal History*.)

##### b. All Other Servicing Requests

See Chapters 7 through 12 of this SOP to find the applicable Loan Program Requirements for the Loan Actions most commonly requested.

#### **4. Determine Whether the Servicing Request is Properly Supported**

Servicing Requests should be accompanied by the Supporting Documents that a prudent lender would need to make an informed decision. For example:

##### **a. Servicing Requests Involving Credit Issues**

Generally, all Servicing Requests that require a credit analysis, (e.g., an increase in the amount of the SBA loan or a prior lien), should be supported by the Borrower's:

- (1) Current financial statement; and
- (2) Last two federal income tax returns.

##### **b. Servicing Requests Involving Collateral**

In addition to the financial documents listed above, Servicing Requests that involve collateral, (e.g., subordination, substitution or release of lien), should also be supported by a current:

- (1) Appraisal of the relevant collateral;
- (2) Lien search, i.e., a title report if the request involves real property, a UCC search if the request involves personal property; and
- (3) Transcript of account or other credible evidence of the balance owed on any senior liens.

#### **5. Obtain Additional Supporting Documents When Necessary**

Obtain any additional Supporting Documentation needed to properly analyze and decide whether the Servicing Request should be approved. For example:

##### **a. Credit Report**

Generally, a new credit report should be ordered to verify the financial information submitted in support of the proposed Loan Action.

##### **b. Guarantor Financial Statements and Tax Returns**

Current financial statements and federal income tax returns for the past two years should be required from all of the Guarantors—not just the Borrower—when a complete analysis of each Obligor's repayment ability is necessary.

##### **c. Refinance or Purchase and Sale Documents**

A complete executed copy of all of the relevant documents, (e.g., purchase and sale agreement, escrow instructions, estimated closing statement (HUD-1), seller carry-back note, etc.), must be obtained if the Servicing Request involves the sale or refinance of collateral.

**d. Environmental Investigation Report**

A Servicing Request should be supported by an Environmental Investigation Report when required by Paragraph C of Chapter 5.

**e. Evidence of Authority to Take Proposed Action**

Proper evidence should be obtained to establish that each Person whose signature is necessary had the required authority to execute the Loan Documents involved in the Servicing Request, e.g., a board of directors' resolution.

**6. Analyze the Borrower's Financial Condition**

Analyze the Borrower's financial documents to determine whether the Borrower is viable, i.e., will be able to repay the loan if the request is approved. If the Borrower is viable, proceed to Step 7. If not, the Servicing Request should be denied and more appropriate action taken. (See, for example, Chapter 14 [*Classifying Loans in Liquidation*].)

**7. Analyze the Collateral**

If the Servicing Request will impact the collateral, a thorough analysis of its Recoverable Value, before and after the requested modification, should be conducted.

**8. Check for Problems**

The Loan Documents, such as the loan application and collateral documents, as well as the information in the Computer Tracking System should be reviewed to: (1) ensure that the Servicing Request is consistent with the Borrower's previous representations; and (2) ascertain whether there are any non-monetary defaults, collateral deficiencies, or problems with the Loan Documents that need correction.

**9. List Conditions for Approval****a. Compliance with Terms and Conditions of Loan**

Approval of a Servicing Request should be conditioned on curing the defaults identified in Step 8. For example, the Borrower should be required to reinstate lapsed insurance coverage.

**b. Adequate Consideration**

In order for a change in the Loan Documents to be legally binding, the Borrower must provide consideration, (i.e., something of value), before or at the same time that the Borrower receives the benefit of the requested change. For example, as consideration for granting the Servicing Request, the Borrower could be required to:

- (1) Fix errors in the Loan Documents identified in Step 8;
- (2) Waive defenses to litigation;
- (3) Release lender liability claims; or



- (4) Provide additional collateral.

**Note:** All contracts must be supported by valid consideration, which can take the form of money, physical objects, services, promised actions, abstinence from a future action, etc. For example, adequate consideration for a routine servicing action such as a temporary payment deferment can be taken in the form of updated borrower financial information and the increased likelihood that the borrower will repay the loan.

**c. Written Consent of All Obligors**

The written consent to any material change in the terms and conditions of the loan must be obtained from each Obligor in order to protect the ability to recover from them in the event of default.

**10. Comply with SBA Decision Making, Notice and Approval Requirements**

Unless the Lender has unilateral authority to take the requested Loan Action and no notice to SBA is required, Lenders should comply with the applicable SBA Loan Program Requirements pertaining to decision-making authority and notice to SBA. (See Chapter 3, Lender Responsibility and Authority) Unless notice to SBA is required, Lenders with unilateral authority should not notify the SBA Loan Center of the Loan Action.

**11. Comply with the Applicable Recordkeeping Requirements**

In accordance with Chapter 3, the response to the Servicing Request must be noted in the Computer Tracking System or Loan File; a copy of the Loan Action Record and Supporting Documents must be kept in the Loan File; and the substance of any telephone calls or face-to-face meetings regarding the Servicing Request must be kept in the Loan File or entered into a Computer Tracking System.

**Note:** Lenders should consider placing in the loan file a copy of the 7(a) Lender Servicing and Liquidation Action Matrix that they relied on at the time the Loan Action was taken.

**C. How To Obtain SBA Approval of a Proposed Loan Action**

If SBA's prior written approval is required before a Loan Action can be implemented, (See Chapter 3 for a detailed list.), the Lender should submit a written request, usually in the form of a letter, to the appropriate SBA Loan Center in accordance with the guidelines listed below.

**1. Required Documentation**

**a. Letter Outlining Request**

Requests for SBA approval of a proposed Loan Action should be in the form of a clearly and concisely drafted letter based on the Lender's internal credit

memorandum. The letter must be independent of any document or analysis prepared by a Person with a conflict of interest, such as a senior lienholder. And, although SBA reserves the right to request additional information, the letter should generally include:

- (1) A brief description of the proposed Loan Action;
- (2) The justification for the proposed Loan Action, i.e., benefit to the Borrower, Lender and SBA—neither abundance nor lack of collateral alone is sufficient justification for a Loan Action;
- (3) The amount funded, date of funding, current balance and status of the loan;
- (4) The current financial condition of the Borrower;
- (5) If the proposed Loan Action will increase the risk of loss, any mitigating factor, e.g., the value of SBA's collateral will be increased, or the Borrower's business performance will be improved;
- (6) If the proposed Loan Action will impact the collateral, a summary of prior Loan Actions impacting the collateral and an analysis of the Recoverable Value of the collateral both before and after the proposed Loan Action;
- (7) A summary of prior servicing experience with the Borrower, i.e., loan modifications or problems pertinent to the request;
- (8) Whether the written consent of the FTA is required, and if so, whether it has been or will be obtained; and
- (9) A list of the Obligor and a statement as to whether their consent has been or will be obtained for the proposed Loan Action.

#### **b. Credit Memo and Supporting Documents**

A credit memo, which must be independent of any document or analysis prepared by a Person with a conflict of interest, such as a senior lienholder, should accompany a request for approval of a proposed Loan Action. Generally, it is not necessary to include a copy of the Borrower's financial statement or the Supporting Documents such as Appraisals, etc., provided that they are adequately analyzed in the credit memo.

## **2. Where to Submit Requests**

Requests for approval of proposed Loan Actions must be submitted to the appropriate SBA Loan Center. (Prior to full disbursement, requests should be sent to the LGPC at Citrus Heights. After full disbursement, requests should be sent to the CLSC at Fresno or Little Rock, or the NGPC at Herndon. See the definition of "SBA Loan Center" in Chapter 2 for a complete list.)

## **3. SBA Response Time**

SBA should respond to a Lender's request for approval of a proposed Loan Action within 15 business days from the date that SBA received the request, (13 C.F.R. § 120.541), or sooner if possible.

**Note:** SBA will not provide written approval for a proposed Loan Action that the Lender has unilateral authority to take.

#### **D. Implementing Loan Actions**

Loan Actions must be implemented in accordance with prudent lending practices, for example, it may be necessary to:

##### **1. Modify Existing Loan Documents**

If the Loan Action modifies the terms and conditions of the Note or any other Loan Document, each impacted Loan Document must be properly modified;

##### **2. Prepare New Loan Documents**

Any new Loan Document needed to implement the Loan Action must be properly prepared and executed; and

##### **3. Record New or Modified Loan Documents**

Whenever necessary, reasonable or customary, the modified Loan Documents as well as any newly prepared Loan Documents must be properly recorded.

## Chapter 7. Modification of Note

---

### A. General Requirements

#### 1. Review and Analysis of Request for Modification

Requests for modification of the terms of a Note, should be reviewed, analyzed and implemented pursuant to the requirements of Chapter 6, the provisions of applicable statutes, regulations and contracts (e.g., Note and Secondary Participation Guaranty Agreement), and this chapter.

#### 2. Secondary Market Purchase or Investor Consent

##### a. General Rule

With regard to 7(a) Loans sold on the secondary market, the *Secondary Participation Guaranty Agreement* (SBA Form 1086) prohibits any change to the repayment terms of the Note unless the guaranteed portion of the loan has been purchased by SBA or the written consent of the secondary market investor has been obtained—unless the modification involves a one-time deferment that does not exceed a continuous period of three monthly installments. (See Chapter 12 for information on deferments.)

##### b. Alternative—Emergency Repurchase from Investor

Generally, a Lender may only repurchase an SBA loan from the secondary market investor on a "willing buyer-willing seller" basis. However, pursuant to SBA Form 1086, if the viability of the Borrower is at stake and the Lender is unable to obtain investor consent to restructuring the repayment terms of the loan, the Lender may request authority from SBA to repurchase the loan from the investor by submitting a written request along with the following documents to the appropriate SBA Loan Center:

- (1) Current financial statements of Borrower;
- (2) A written decline from the investor to the Lender's specific request; a written statement from the FTA indicating that the investor failed to respond within 30 calendar days; or the FTA's a written statement that the guaranteed interest is part of a pool;
- (3) A statement that the proposed change in repayment terms is solely for the benefit of the Borrower; and
- (4) A certification by the Lender that it will make the requested change if SBA approves the repurchase.

**Note:** Generally, if the loan is held in a secondary market pool rather than by an individual investor, modifications may be approved as long as the interest rate is not altered. Lenders are encouraged to propose modifications that will enable the Borrower to remain viable.

**B. Payment Due Date**

The date that regularly scheduled installment payments are due may be modified to facilitate the Borrower's ability to repay the loan or a workout, provided that the general requirements in Paragraph A are met. For example, payments originally scheduled to be made on a monthly basis, may be changed to a quarterly or annual basis if there is justification for the change such as the seasonal or cyclical nature of the Borrower's revenue stream.

**C. Change from Revolving to Non-revolving Loan**

A loan may be changed from a revolving loan to a non-revolving loan to facilitate the repayment or orderly liquidation of the loan, provided that the general requirements in Paragraph A are met.

**D. Installment Amount**

The installment amount due under a Note may be modified to ensure that the loan balance is properly amortized over the remaining life of the loan, to help a viable Borrower meet long or short term goals, or to facilitate a workout, provided that the general requirements in Paragraph A are met. (See also Chapter 12 on deferments and Chapter 16 on workouts.)

**E. Interest Rate**

The interest rate on the Note may be modified to help a viable Borrower meet long or short term goals, or to facilitate the recovery on a loan in liquidation status, provided that the general requirements in Paragraph A are met. For example, the interest rate may be modified as part of a workout agreement designed to achieve the highest possible recovery in the shortest amount of time.

**F. Maturity Date****1. Extension of Maturity Date**

Subject to the general requirements in Paragraph A, the maturity date of a Note may be extended for up to 10 years beyond its original maturity date if:

- a. The extension is requested before the SBA loan guaranty expires, i.e., less than 180 calendar days after the original maturity date (13 C.F.R. § 120.524(a)(8)); and
- b. The extension will aid in the orderly repayment of the loan (13 C.F.R § 120.531).

**2. Additional Guaranty Fee****a. Loans in Regular Servicing Status**

Pursuant to SOP 50 10 in effect at the time the loan was approved, Lenders must pay an additional guaranty fee, which may be passed on to the Borrower, when the maturity of a short term 7(a) Loan is extended beyond 12 months. The amount of the additional guaranty fee is based on the version of SOP 50 10 in effect at the time the loan was approved. The notice of maturity date extension required by Chapter 3 should be accompanied by evidence that the additional fee has been paid.

**Note:** Pursuant to SOP 50 10 in effect at the time the loan was approved, the additional guaranty fee must be paid within 30 days from the date the extension was approved or the total loan guaranty will be cancelled.

#### **b. Loans in Liquidation Status**

Lenders are not required to pay an additional guaranty fee if a maturity date extension is needed to aid in the orderly liquidation of the loan and no additional funds are disbursed.

#### **G. Loan Amount**

The amount of a 7(a) Loan in regular servicing status may be increased provided that: (1) the general requirements in Paragraph A above are met; (2) the general requirements in SOP 50 10 in effect at the time the loan was approved with regard to loan increases are met; and (3) the additional guaranty fee required by SOP 50 10 in effect at the time of the increase is paid. The amount of the additional guaranty fee is based on the version of SOP 50 10 in effect at the time the loan increase is approved.

**Note:** The amount owed on a fully disbursed 7(a) Loan (as opposed to the amount of the loan) may, in some instances, be increased through the addition of Recoverable Expenses to the principal loan balance. See Chapter 22 for information on Recoverable Expenses and when they may be added to principal. The amount owed on a fully disbursed 7(a) Loan (as opposed to the amount of the loan) may, in some instances, be reduced through a compromise agreement. See Chapter 20 for more information on offers in compromise.

## Chapter 8. Modification of Collateral Requirements

---

### A. Subordination of Lien Position

#### 1. General Requirements

The position of a lien securing an SBA loan may be subordinated (i.e., lowered) when doing so is consistent with SBA loan servicing goals, i.e., it will help the long or short term needs of the Borrower without unduly impairing the ability to recover on the loan. Requests for subordination should be reviewed, analyzed and implemented pursuant to the requirements of Chapter 6 and the following guidelines:

- a. The Borrower should have a satisfactory credit history;
- b. The Borrower should have the ability to repay all of the obligations that would be outstanding after the proposed subordination;
- c. The subordination should be to a specific amount and should not extend to future advances;
- d. There should be sufficient equity in the collateral to adequately secure the SBA loan after the proposed subordination; and
- e. The terms of the subordination should be set out in a document signed by all of the parties to the agreement.

**Note:** SBA Loan Program Requirements prohibit any action that confers a Preference on a Lender without SBA's prior written approval. For example, a Lender would receive a Preference if it subordinated the lien securing an existing SBA loan to a lien securing a new non-SBA loan or a new SBA loan with a lower guaranty percentage than the Lender made to the same Borrower. A Lender would also receive a Preference if it renewed or increased the amount owed on a non-SBA loan or an SBA loan with a lower guaranty percentage if the lien securing an existing SBA loan was previously subordinated to the loan the Lender renewed or increased.

#### 2. Subordination to Facilitate Refinance of a Senior Loan

In addition to the general requirements in Paragraph A.1, the position of a lien securing an SBA loan should not be subordinated to facilitate the refinance of an existing senior loan unless:

- a. The refinancing is on terms that are more favorable to the Borrower;
- b. There is no increase in the principal balance of the senior lien except for necessary, reasonable and customary closing costs;
- c. No cash out of the equity in the collateral will go to the Borrower for non-business

purposes; and

- d. The subordination will not adversely affect the priority of the lien securing the SBA loan.

**Note:** When analyzing a request for subordination to facilitate the refinance of a senior loan, a complete financial analysis may not be necessary if the Borrower has been making timely payments and the refinance terms are more favorable for the Borrower.

### 3. Subordination to Facilitate a New Loan

In addition to the general requirements in Paragraph A.1, the position of a lien securing an SBA loan should not be subordinated to facilitate a new loan unless:

- a. The new loan is necessary to satisfy a legitimate need such as paying for improvements to the collateral that will maintain or increase its value; and
- b. All other avenues of obtaining the funds have been exhausted.

**Note:** The U.S. Department of Agriculture will take a junior lien position on assets already encumbered by an SBA's loan.

### 4. Subordination to Facilitate Assumption of the Loan

The position of the lien securing a 7(a) Loan must not be subordinated to a loan that provides funds to an assumptor to acquire the business or assets of an Obligor, unless the acquisition loan includes funds that will be used to make improvements to the collateral that will maintain or increase its value, in which case, the lien securing the SBA loan may be subordinated up to the documented amount spent on the improvements.

## B. Inter-creditor Agreements

Requests for execution of an inter-creditor agreement, (i.e., a written agreement among creditors who made separate loans to the same borrower with commonality of purpose or collateral, which sets forth the various lien positions and the rights and liabilities of each creditor and its impact on the other creditors), should be reviewed, analyzed and implemented pursuant to the requirements of Chapter 6 and the following guidelines:

1. The inter-creditor agreement should not adversely impact the position of the lien securing the SBA loan;
2. The delineated rights and responsibilities with regard to loan servicing responsibilities, and the remedies in the event of default, should be consistent with prudent lending practices; and
3. Entering into the inter-creditor agreement should not adversely impact the ability to recover on the SBA loan.



## **C. Substitution of Collateral**

### **1. General Requirements**

Requests to allow a substitution of collateral should be reviewed, analyzed and implemented pursuant to Chapter 6 and the following guidelines and requirements:

- a. The collateral offered in substitution should be similar in nature (e.g., real property for real property) or provide a higher level of confidence (e.g., a certificate of deposit for an account receivable), and have a Recoverable Value that is equal to or greater than the Recoverable Value of the existing collateral based on an Appraisal that meets the appraisal requirements set out in SOP 50 10 in effect at the time the loan was approved;
- b. If the substitute collateral is commercial real property, adequate due diligence must be conducted to ensure that the risks of Contamination are minimal as required by Chapter 5 (*Environmental Risk Management*);
- c. There should be no more than a nominal increase (i.e., 3.5% or less) in the amount of any proposed senior lien;
- d. The Borrower should have a satisfactory credit history;
- e. The Borrower's current financial statement should reflect that the Borrower has the ability to pay all of its obligations that will be outstanding after the substitution;
- f. There should be sufficient equity in the collateral to adequately secure the SBA loan after the proposed substitution;
- g. The release and substitution must not impair the ability to foreclose upon the remainder of the collateral or collect the loan balance from the Obligors; and
- h. The release of the existing lien(s) or proceeds thereof must be concurrent with the recording of the new lien(s) in the required position of priority and done pursuant to an escrow agreement signed by all of the parties involved in the transaction.

### **2. Substitution of Residence Held as Collateral**

Requests to allow an Obligor to substitute a lien on a new residence in exchange for releasing the lien on the Obligor's existing residence should be reviewed, analyzed and implemented pursuant to the general requirements in Paragraph C.1 above and the following additional requirements:

- a. All of the proceeds from the sale of the Obligor's existing residence, other than the funds needed to pay off senior liens and necessary, reasonable and customary closing costs, must be used to purchase the new residence, placed in an escrow account to facilitate the purchase of a new residence, or used to pay down the SBA loan;
- b. The amount of equity in the new residence available to secure the SBA loan must be the same as or greater than the amount of equity in the existing residence available to secure the SBA loan;

- c. The release of the existing lien, or proceeds thereof, must be concurrent with the recording of the new lien in the required position of priority and should be done pursuant to an escrow agreement signed by all of the parties involved in the transaction; and
- d. The Obligor must provide the title, hazard and flood insurance required by Chapter 9.

#### **D. Substitution of Guarantor**

Guarantors must not be released without SBA's prior written consent. Requests to allow substitution of a Guarantor should be reviewed, analyzed and implemented pursuant to the requirements of Chapter 6 and the following guidelines:

1. The financial strength of the proposed substitute Guarantor should be equal to or greater than the financial strength of the existing Obligor; and
2. Neither the release of the existing Guarantor nor the substitution for the proposed Guarantor should adversely impact the operation of the business. Substitution of the proposed Guarantor may be conditioned on retention of the original Guarantor for a transitional period (e.g., two years) during which time there must be no material adverse change in the financial condition of the business.

#### **E. Release of Lien without Consideration**

Requests for the release of liens on real or personal property collateral without consideration before the loan has been paid in full should be reviewed, analyzed and implemented pursuant to Chapter 6 and the following guidelines and requirements:

1. The proceeds from the release of lien should be used for business purposes only;
2. The Borrower must have the ability to repay the SBA loan in full;
3. The release should not materially interfere with the operation of the business or decrease the value of the other collateral securing the loan;
4. The Recoverable Value of the remaining collateral should be sufficient to adequately secure the SBA loan after the proposed release; and
5. The release document(s) must not impair the Lender or SBA's interest in, or ability to foreclose upon, the remainder of the collateral.

#### **F. Release of Lien for Consideration**

Requests for the release of liens on real or personal property collateral for consideration should be reviewed, analyzed and implemented pursuant to Chapter 6 and the following requirements:

## 1. General Requirements

- a. The amount of consideration received must be approximately equal to or greater than the Recoverable Value of the collateral, (See Chapter 5 [*Environmental Risk Management*] with regard to the due diligence that must be performed if the collateral is alleged to be worth substantially less than its estimated Recoverable Value due to the alleged presence of Contamination.); and
- b. Release of the lien must not jeopardize the ability to maximize recovery on the loan.

## 2. Practice Tips

### a. Trade Fixtures

If the collateral includes a lien on trade fixtures located on real property collateral, e.g., gas station canopies and pumps, the real property lien should not be released unless the personal property collateral has already been liquidated or additional consideration is received for release of the lien on the trade fixtures.

### b. Public Auctions

If a public auction of machinery and equipment is planned, the lien on the most valuable items should not be released beforehand since it would impair the ability to attract bidders for the remaining collateral.

## G. Release of Guarantor or Co-Borrower

Guarantors and co-Borrowers must not be released without SBA's prior written consent. A request for release of a Guarantor or a co-Borrower should be reviewed, analyzed and implemented pursuant to Chapter 6 and the following requirements and guidelines:

### 1. Loans in Regular Servicing Status

- a. The loan must be Seasoned;
- b. The release must not conflict with the SBA Loan Program Requirements in 13 C.F.R. Part 120 and SOP 50 10 in effect at the time the loan was approved that require Guaranties from specific Persons as a condition for SBA's guaranty of the loan, (e.g., any Person who owns 20 per cent or more of the small business Borrower);
- c. The release must not: jeopardize the ability to maximize recovery on the loan; shift the risk of loss to SBA; or otherwise harm the integrity of the SBA loan program; and
- d. If the request is in conjunction with the sale or reorganization of the small business Borrower and there are sufficient funds to pay off the 7(a) loan, the parties should be encouraged to pay off the 7(a) Loan as part of the transaction. If the loan will not be paid off or substantially paid down, instead of releasing the Guarantor or co-Borrower, they should still be required to guarantee the loan, but their guarantee may be limited to the amount of any funds they are to receive as part of the change of ownership or reorganization.

### 2. Loans in Liquidation Status

- a. The release must not jeopardize the ability to maximize recovery on the loan or the integrity of the SBA loan program;
- b. The release must be conditioned on receipt of consideration in an amount approximately equal to or greater than the amount that could be collected through enforced collection proceedings from the Guarantor or co-Borrower requesting the release;
- c. The Guarantor or co-Borrower requesting the release should be required to provide the same documentation that is required for an offer in compromise; and
- d. The offer and financial documentation provided by the Guarantor or co-Borrower should be reviewed, verified and analyzed pursuant to the requirements of Chapter 20 (Offer in Compromise).

## **H. Release of Condemnation Proceeds**

Requests for release of condemnation proceeds should be reviewed, analyzed and implemented pursuant to the requirements of Chapter 6, the general requirements in Paragraph E (*Release of Lien Without Consideration*) or Paragraph F (*Release of Lien for Consideration*) and the following guidelines:

### **1. Condemned Property Replaced**

When the condemnation proceeds will be used to replace the condemned property, they should only be released pursuant to an escrow agreement approved by legal counsel that conditions release of the funds on:

- a. Receipt of a perfected lien on the substitute collateral in the required lien position;
- b. Compliance with the title, hazard and flood insurance requirements set out in Chapter 9.

### **2. Condemned Property Not Replaced**

When the condemnation proceeds will not be used to replace the condemned property:

- a. Condemnation Proceeds  $\leq$  \$5,000

If the amount of condemnation proceeds is relatively insignificant, i.e., \$5,000 or less, and the release will not adversely affect the ability to recover on the SBA loan, they may be released directly to the Borrower.

- b. Condemnation Proceeds  $>$  \$5,000

If the amount of condemnation proceeds is more than \$5,000, they should be applied to the principal balance of the SBA loan, provided that up to \$5,000 may be released directly to the Borrower if the release will not adversely affect the ability to recover on the SBA loan.

## **Chapter 9. Insurance Coverage**

---

### **A. General Requirements**

All decisions regarding insurance, including the justification for the decision, must be documented in a Loan Action Record and kept in the Loan File.

### **B. Mortgagee's Title Insurance**

#### **1. Substitute Collateral**

When existing real property collateral is released and substitute real property collateral taken, a mortgagee's title insurance policy should be obtained to insure the new lien on the substitute property. (See Chapter 8 for information on substitution of collateral.)

#### **2. Additional Collateral**

When real property collateral is taken as additional collateral, whether a mortgagee's title insurance policy should be obtained will vary depending on the circumstances including the amount of equity available in the property to secure the SBA loan.

#### **3. Installment Sale of REO**

When REO is sold on an installment basis, a mortgagee's title insurance policy must be obtained to ensure the new lien on the REO. (See Chapter 19 for information on term sales of acquired collateral.)

### **C. Hazard Insurance**

#### **1. Modification of Coverage on Existing Collateral**

The hazard insurance coverage requirements set out in the Loan Authorization should not be terminated or reduced unless the insured assets have been sold or have significantly depreciated.

#### **2. Coverage on Substitute or Additional Collateral**

When existing collateral is released and substitute collateral taken, the Lender must ensure that the substitute collateral is adequately insured and that the insurance policies contain a mortgagee clause (or substantial equivalent) in favor of the Lender. (See Chapter 6 for information on how to review and analyze Servicing Requests. See Chapter 8 for additional information on substitution of collateral.)

#### **3. Care and Preservation of Collateral and Acquired Collateral**

Lenders must take prudent action, on a case-by-case basis, to ensure that all collateral and acquired collateral with Recoverable Value is adequately insured in order to protect the ability to recover on the SBA loan. (See, for example, Chapter 15 with regard to post-default site visits and Chapter 19 with regard to ownership responsibilities pertaining to acquired collateral.)

#### **4. Forced Placement**

If hazard insurance is required by the Loan Documents and the Obligor has allowed the coverage to lapse, the decision whether to force-place insurance should be based on prudent lending practices and made on a case-by-case basis. If coverage is continued by the Lender, the cost should be treated as a Recoverable Expense.

#### **5. Release of Policy Proceeds**

##### **a. General Rule—Collateral Repaired or Replaced**

When SBA or the Lender is named as the loss payee on a hazard insurance policy, the proceeds should not be released unless the Supporting Documentation submitted with the request verifies that the insured collateral has been properly repaired or replaced and that no construction or repair related liens have been filed against the property, particularly if the insurance check is for \$100,000 or more.

##### **b. Exception—Controlled Distribution**

If a request for release of insurance proceeds is not accompanied by Supporting Documentation establishing that the insured collateral was repaired or replaced, instead of endorsing and delivering the insurance check to the Borrower, disbursement of the insurance proceeds should be controlled and monitored.

##### **(1) Use of Escrow Agent**

Generally, insurance proceeds, which are required to be used to repair or replace collateral, should be disbursed pursuant to an escrow agreement approved by legal counsel. An escrow company, the first lien holder or an impartial third party such as an attorney, architect or construction loan officer at a financial institution may serve as the escrow agent.

##### **(2) Progress Payments**

Rather than use an escrow agent, a Lender may allow the Borrower to open a federally insured joint savings or custodial account with the Lender; establish a draw schedule based on stages of construction; present paid invoices and lien waivers documenting each stage of construction; and request release of the funds specified in the draw schedule; provided that the Lender verifies that the previous stage of construction was completed and the material and labor involved was paid for before authorizing the next draw on the joint account. (The Borrower should be allowed to retain the interest earned on the funds in the savings account.)

#### **D. Life Insurance**

##### **1. Modification of Requirement**

The life insurance requirements in the Loan Documents should not be modified or terminated unless the reason for requiring the life insurance policy no longer exists.

## **2. Use of Escrow Account to Collect Premiums**

If an assignment of a life insurance policy is required by the Loan Documents, in order to ensure that the Borrower pays the premiums, an escrow account may be set up to collect the funds needed to pay the premiums on the policy. (See SOP 50 10 in effect at the time the loan was approved for SBA Loan Program Requirements concerning life insurance escrow accounts.)

## **3. Continuation of Coverage**

If an assignment of a life insurance policy is required by the Loan Documents and the Lender receives notice that the required payments have not been made, the decision whether or not to continue coverage should be based on prudent lending practices and made on a case-by-case basis. If coverage is continued, the cost should be treated as a Recoverable Expense.

## **4. Release of Policy Proceeds**

### **a. General Rule**

The proceeds from the assignment of a life insurance policy should be applied to the principal balance of the loan. (Application of life insurance proceeds is not considered to be a voluntary loan prepayment. Therefore, a subsidy recoupment fee is not required.)

### **b. Exceptions**

Depending on the circumstances, all or part of the proceeds of a life insurance policy may be released if, in addition to meeting the requirements for release set out in Chapter 8 Paragraph E (*Release of Lien Without Consideration*) or Paragraph F (*Release of Lien for Consideration*), the death of the insured will have no significant impact on the management of the small business Borrower and:

- (1) The proceeds are needed for a valid business purpose;
- (2) The proceeds are needed to prevent Financial Hardship; or
- (3) Based on the strength of the business, there is no reason to anticipate that the loan will not be repaid in full.

### **c. Use of an Escrow Account**

If the estimated strength of the business is not strong enough to justify release or weak enough to justify immediate application to the loan balance, the insurance proceeds may be placed in an escrow account for distribution at a later date after the Lender has had the opportunity to observe the Borrower's on-going operations and is able to make a prudent decision.

## **E. Flood Insurance**

### **1. General Rule—Termination or Modification Not Permitted**

When an SBA loan is secured by improved real estate, a mobile home or other personal property located in a FEMA-designated special flood hazard area ("SFHA") and the community participates in the National Flood Insurance Program ("NFIP"), the Borrower must maintain flood insurance for the life of the loan. (See the [National Flood Insurance Reform Act of 1994](#) for more information.) This requirement pertains to substitute collateral as well as the original collateral for the loan.

### **2. Events Triggering Flood Insurance Review**

The need for flood insurance, as well as the adequacy of any existing flood insurance coverage, should be reviewed whenever the Borrower makes a Servicing Request.

### **3. Forced Placement**

If at any time during the life of a loan, real or personal property collateral, which is located in a SFHA, is not covered by flood insurance or is covered by an inadequate amount of flood insurance, the Borrower must be instructed to obtain adequate flood insurance. If the Borrower fails to do so within 45 calendar days, flood insurance must be purchased on the Borrower's behalf at the Borrower's expense. (The cost should be treated as a Recoverable Expense.) All Borrower Servicing Requests should be declined until the Borrower is in compliance with the applicable flood insurance requirements. (See the [National Flood Insurance Reform Act of 1994](#) for more information.)

### **4. Unavailability of Flood Insurance**

If a Borrower had the required flood insurance when the loan was made, but the coverage has lapsed because the community dropped out of the NFIP and no private insurance is available, documentation establishing why the property is no longer covered by flood insurance must be maintained in Loan File. No SBA financial assistance (including increases, renewals, or extensions) for acquisitions or construction purposes may be made in an SFHA unless the community in which such area is situated participates in the NFIP.



## Chapter 10. Modification of Management Covenants

---

### A. General Requirements

Borrowers should comply with the management covenants in the Loan Documents unless modification is consistent with the loan servicing goals set out in Chapter 1. Requests for modification should be reviewed, analyzed and implemented pursuant to the requirements of Chapter 6 and the guidelines set out below.

### B. Financial Statements

Loan Document provisions requiring Obligor to submit periodic financial statements, should not be modified (e.g., temporarily or permanently waived; changed from audited to compiled or reviewed; or required less frequently), unless a lender using Prudent Servicing actions would modify them based on the circumstances. For example, it may be prudent to modify the requirement if:

1. The loan is Seasoned or the requirement would cause Financial Hardship for the Borrower;
2. The waiver is temporary and limited to one year at a time; and
3. The right to reinstate the requirement is reserved and exercised in the event of default.

### C. Restrictions on Compensation, Dividends, Fixed Assets, etc.

Management covenants in the Loan Documents pertaining to matters such as limitations on compensation, fixed assets, working capital levels, or dividend payments, should not be modified unless a prudent lender would modify them based on the circumstances. For example, modification may be prudent if:

1. The loan is Seasoned;
2. The maturity date of the Note has not been extended, and payments have not been deferred during the 24 month period before the date of the Borrower's request; and
3. Based on an analysis of the Borrower's cash flow for the past three months, the Borrower will have the necessary cash flow to repay all of its debt including the SBA loan after the modification.

### D. Standby Agreements

#### 1. General Rule

Except as provided in Subsection 2 below with regard to equity injections, a standby agreement required by the Loan Documents should not be terminated or modified to allow the Borrower to make full or partial payments to the standby creditor, unless a prudent lender would modify or terminate the standby agreement based on the circumstances. For example, modification or termination may be prudent if:

- a. The loan is Seasoned;

- b. Based on an analysis of the Borrower's cash flow for the past three years, the Borrower will have the necessary cash flow to repay all of its debt including the SBA loan after modification or termination; and
- c. There is minimal risk that the Borrower will not be able to repay the SBA loan in full and in a timely manner.

2. **Standby Agreement Used as Equity Injection**

A standby agreement used in connection with an equity injection required by the Loan Authorization must not be terminated or modified unless the proposed termination or modification is permitted by the applicable Loan Program Requirements in SOP 50 10 in effect at the time the loan was approved.

## **Chapter 11.**

### **Assumption, Assignment or Sale of Loan**

---

#### **A. Assumption**

Requests to allow another Person to assume an SBA loan, (i.e., take over the Borrower's legal obligations and benefits under the Loan Documents), should be reviewed, analyzed and implemented pursuant to the requirements in Chapter 6. In addition:

1. Unless the assumption is part of a workout or the loan is in liquidation status, the proposed assumptor must meet the applicable 7(a) Loan eligibility requirements in the most current version of SOP 50 10;
2. The proposed assumptor should be the primary owner of the business;
3. The proposed assumptor should have business experience and management skills that are equal to or better than the Borrower's;
4. The proposed assumptor must have a satisfactory credit history;
5. The proposed assumptor must have the ability to repay the SBA loan in full;
6. No collateral should be released;
7. No collateral should be subordinated except as provided in Chapter 8, Paragraph A with regard to funds that will be used to make improvements to the collateral that will maintain or increase its value;
8. The proposed assumption should not have a negative impact on the operation of the business;
9. The proposed assumption must not have a negative impact on the Recoverable Value of the collateral;
10. The existing collateral should be adequate to secure the loan, if not and whenever possible, additional collateral should be required as a condition for the assumption;
11. Existing Obligors must not be released without SBA's prior written approval (see Ch. 8 Paragraph G for Release of Guarantor requirements and Ch. 20 for OIC requirements),;
12. The terms of the assumption must be set out in a written agreement signed by all of the parties to the agreement;
13. The terms of the assumption must include a "due on sale or death" clause that prohibits any future assumption of the SBA loan; and
14. The terms of the assumption must not include a real estate contract, i.e., the seller may not retain title to the property until an agreed upon amount is paid.

**Note:** See the most current version of SOP 50 10 with regard to the fee that Lenders may charge for an assumption.

## **B. Assignment of Lender's Interest in Loan**

A 7(a) Lender may assign its interest in a 7(a) Loan to another 7(a) Lender. (For additional information see 13 C.F.R. § 120.430 et seq.) A Lender may assign an individual 7(a) loan to another 7(a) Lender pursuant to a Transfer of Participation Agreement provided it obtains SBA's prior written approval. A Lender may assign a portion or entire 7(a) loan portfolio to another 7(a) Lender provided it provides SBA with a copy of the purchase, sale and assignment documents, any other documentation required by SBA, and obtains SBA's **prior** written approval.

**Note:** SBA does not charge a loan assignment fee, nor does it require or prohibit the assignor Lender from negotiating an assignment fee to be paid by the assignee Lender.

## **C. Sale of Loan in Liquidation Status**

A 7(a) Loan in liquidation status may be sold, provided that:

1. The sale is to a Person other than the Borrower;
2. The sale price bears a reasonable relationship to the amount that could be recovered through enforced collection proceedings;
3. SBA's prior written approval is obtained if the sale involves a compromise of the principal balance of the loan, or purchase of the loan by a Guarantor, a Close Relative of the Borrower, or an Associate of the Borrower;
4. SBA has already purchased the guaranteed portion of the loan if it was sold on the secondary market; and
5. The Lender selling the loan has submitted a complete guaranty Purchase Package and SBA has completed its guaranty purchase review process.

**Note:** For information regarding the sale of SBA loans in the secondary market, see sections 5 (f), (g) and (h) of the Small Business Act (15 U.S.C. 634); 13 C.F.R. § 120 Subpart F; and SBA Form 1086 (*Secondary Participation Guaranty Agreement*).

## Chapter 12. Deferments

---

### A. Overview

A deferment is a temporary solution to a temporary problem. When used appropriately, i.e., when a Borrower is experiencing a temporary cash flow problem, a deferment can enable the Borrower to improve its cash flow so that it can resume payments on its SBA loan. When used inappropriately, i.e., when the Borrower's problems are permanent, a deferment can harm the Borrower, Lender and SBA. Especially if, for example, during the deferment period, the collateral loses its value and the Obligors deplete all of their resources, including the money in their retirement accounts and the equity in their homes, in a futile attempt to turnaround a non-viable business.

**Note:** Free, confidential technical and management counseling is available to small businesses through the nationwide network of [SCORE](#) Chapters and [Small Business Development Centers](#), Women's Business Centers and Veterans Business Outreach Centers.

### B. General Rule

If the Borrower's cash flow problem is temporary, any delinquent payments, as well as full or partial future monthly payments, may be deferred (i.e., postponed without classifying the loan in liquidation) for a stated period of time. (13 C.F.R § 120.530)

### C. General Requirement—Temporary Cash Flow Problem

1. The Borrower's financial information should be reviewed and analyzed in accordance with Prudent Servicing and lending practices to ensure that the Borrower's cash flow problems are temporary and that the Borrower is otherwise viable.
2. When an SBA loan is more than 60 calendar days past due and the Borrower's problems appear to be permanent or long-term, a deferment should not be granted. Instead, the loan should be classified in liquidation and more appropriate Loan Actions should be initiated such as liquidation of the collateral and compromise with the Obligors. (See Chapters 19 - 22.)

### D. Deferred Amount

#### 1. Loan Not Sold on Secondary Market

If the loan has not been sold on the secondary market, the Lender may grant a deferment of up to six consecutive months. During the deferment period, the Lender should monitor the Borrower's operations (through phone calls, site visits, monthly financial statement review, etc.) so that at the end of the deferment period, the Lender can determine whether an additional deferment is necessary and consistent with Prudent Servicing practices. Prior to granting an additional deferment, however, the Lender must have a documented strategy that specifies the justification for a deferment of more than six months. Generally, the amount deferred should not exceed six cumulative monthly payments or 20% of the original loan amount, whichever is less.

## 2. **Loan Sold on Secondary Market**

If the loan has been sold on the secondary market, the Lender may only grant a one-time deferment of up to three consecutive months without the written consent of the investor. Any additional deferment requires the written consent of the investor. (Paragraph 2 of *Secondary Participation Guaranty Agreement* [SBA Form 1086]).

## 3. **Interest Accrual**

Generally, interest will continue to accrue during a deferment period, and may be handled in one of the following ways:

- a. Interest may be paid during the deferment period;
- b. The deferred interest may be paid in a lump sum at the end of the deferment period;
- c. After the deferment period, the loan payment may be increased for a period of time necessary for the Borrower to catch up to the original amortization schedule; or
- d. When payments resume, they may be applied first to accrued interest, then to principal.

## E. **Amount of Payments during Deferment Period**

Payments during a deferment period are not mandatory, but are preferred since even a small payment, such as \$1, will keep the Borrower in the habit of making payments and will also keep the Borrower's pre-authorized debit method of payment active.

**Note:** If the delinquent Borrower is in active military service, consult legal counsel or SBA's Office of Veterans Business Development for information regarding the *Servicemembers Civil Relief Act* and the *Veterans Entrepreneurship and Small Business Development Act*.

## **Chapter 13.**

### **Delinquent Secured Senior Loans**

---

#### **A. General Requirements**

Prudent, commercially reasonable action must be taken to prevent elimination of the lien securing an SBA loan through a foreclosure action by a senior lien holder or dissipation of the equity available to cover the SBA loan due to the imposition of Default Charges.

#### **B. Procedure for Developing Best Strategy to Protect Junior Lien Securing SBA Loan**

When it is apparent that an Obligor is in default on a loan secured by a senior lien on the collateral for an SBA loan, the following steps, when applicable, should be taken to develop a prudent and commercially reasonable strategy for protecting the equity available for application to the SBA loan.

##### **1. Review the Loan Documents**

Begin the process by reviewing the Loan Authorization and other relevant Loan Documents, to determine what priority the lien securing the SBA loan had at the time the loan was closed. For example:

###### **a. Real Property Collateral**

If the senior lien is on real property collateral, review the mortgage, deed of trust or other lien instrument, assignment of rents, title insurance policy, as well as any senior lienholder, inter-creditor, subordination, non-disturbance or attornment agreement.

###### **b. Personal Property Collateral**

If the senior lien is on personal property collateral, review the security agreement, landlord lien waiver, UCC financing statements, and UCC searches, as well as any senior lienholder, subordination or inter-creditor agreement.

##### **2. Order a Current Lien Search**

Order a current title report or UCC search to verify the priority of the lien(s) securing the SBA loan. Or, at a minimum, review the existing title insurance policy or UCC search and gather any other information needed to determine whether there could be any additional liens against the property that could have seniority over the lien securing the SBA loan such as liens for unpaid property taxes.

##### **3. Verify the amount Owed on All Senior Liens**

Ascertain the exact amount owed on all senior liens and verify that the amount does not include advances or Default Charges that were subordinated to the SBA loan pursuant to a subordination agreement, inter-creditor agreement or other Loan Document.

#### 4. Order an Appraisal

Order an Appraisal to obtain up-to-date information regarding the value of the collateral.

**Note:** See the definition of "Appraisal" in Chapter 2, which includes a broker's price opinion, for SBA requirements pertaining to appraisals. Given the inherent conflict of interest, do not rely solely on an appraisal prepared for an Obligor or another lender with a lien on the same collateral, and exercise caution if the Appraisal was prepared by a broker with whom the collateral, if acquired, will be listed for sale.

#### 5. Determine the Recoverable Value of the Collateral

Calculate the Recoverable Value of the collateral encumbered by the senior lien.

#### 6. Estimate Recovery from All Other Sources

Determine the repayment ability of the Obligors (See Chapter 14.) and the Recoverable Value of any additional collateral.

#### 7. Determine Whether the Senior Lienholder Provided Required Notice

If a senior lienholder, who signed a lienholder agreement, has initiated a foreclosure action, determine whether it complied with all of the applicable notice requirements in the relevant Loan Documents. (For example, some senior lienholder agreements require the senior lender to provide written notice of: (1) a default on the senior lender's loan within 30 days of the event of default; and (2) intent to foreclose its lien on the collateral at least 60 days prior to initiating the foreclosure action.)

#### 8. Judicial Foreclosure—Notify Legal Counsel

If a notice of judicial foreclosure is received, the legal counsel, who will be responsible for handling the litigation, should be notified immediately.

#### 9. Analyze Facts, Review Options and Plan Strategy

Based on an analysis of the information collected in Steps 1-8 above, decide which Loan Action or combination of Loan Actions, such as those listed in Paragraph C below, is most appropriate under the circumstances.

### C. Options

Generally, the strategy used to protect the equity available for an SBA loan in a junior lien position includes one or more of the Loan Actions listed below.

#### 1. Bring the Senior Loan Current

In order to maximize recovery on an SBA loan, funds may be advanced to keep the payments on a senior secured loan current if the goal is to:



**a. Facilitate a Workout**

Negotiate a workout that will maximize the recovery on the loan and enable an otherwise viable small business Borrower to continue operating;

**b. Negotiate a Sale of the Collateral**

Work with the Obligor and other lienholders to complete a negotiated sale of the collateral, (See Chapter 17 [*Real Property Liquidation*] or Chapter 18 [*Personal Property Liquidation*] for information on short sales and release of lien for consideration.); or

**c. Foreclose the Lien Securing the SBA Loan**

Preserve the equity available for application to the SBA loan and minimize costs by leaving the senior lien in place and foreclosing the junior lien securing the SBA loan. (See Chapter 17 [*Real Property Liquidation*] or Chapter 18 [*Personal Property Liquidation*] for information on lien foreclosure.)

**2. Purchase or Pay Off the Senior Loan**

When gaining control of the liquidation process is necessary to maximize recovery, especially when doing so would enable an otherwise viable Borrower to retain possession of its business premises so that it can continue to operate and repay the SBA loan, funds may be advanced to purchase or pay off a debt secured by a senior lien, particularly if the senior lienholder offers a discount, and:

- a.** The risk is justified by an Appraisal and Recoverable Value analysis;
- b.** The purchase or pay off amount is consistent with any agreement signed by the senior lienholder regarding the subordination of advances and Default Charges;
- c.** The Obligors are given written notice of the proposed purchase or pay off and their increased financial liability on the SBA loan as a result; and
- d.** If the Borrower is to retain possession of the collateral: (1) the Borrower has the ability to make the payments on the adjusted SBA loan balance; and (2) purchasing or paying off the loan will improve the Borrower's ability to repay the SBA loan.

**3. Wait for Senior Lienholder to Start Foreclosure Proceedings****a. Respond to Complaint for Judicial Foreclosure**

If a senior lienholder initiates a judicial foreclosure action, the legal counsel, who will be responsible for handling the litigation, should be notified immediately and instructed to take whatever legal action is necessary, reasonable and customary under the circumstances. For example, in addition to, or in lieu of, any of the other options listed in this chapter, legal counsel may:

- (1) File a disclaimer or an answer;
- (2) Foreclose the lien securing the SBA loan in the same action; or

(3) Cross-claim for judgment against the Obligor.

**Note:** If SBA has taken over servicing, SBA legal counsel is responsible for managing the litigation in coordination with the local U.S. Attorney's Office, which has final decision-making authority with regard to litigation strategy, credit matters and settlements.

**b. Enter a Protective Bid**

(1) When to Enter

A Protective Bid should be entered at a senior lienholder's foreclosure sale if the Recoverable Value of the property is 10% or more of its Liquidation Value, unless abandonment is appropriate, (i.e., Recoverable Value of less than \$10,000 for real property and \$5,000 for personal property collateral), or a prudent lender would not enter a Protective Bid based on the circumstances that are not reflected in the Appraisal, but are documented in the Loan File. (For example, if the collateral has an appraised value of \$100,000, a Liquidation Value of \$80,000, and a Recoverable Value of \$50,000 [i.e., Liquidation value minus the balance owed on senior liens, foreclosure costs, and holding and resale costs] a Protective Bid should be entered because \$50,000 is more than \$8,000 [10% of \$80,000].)

(2) Protective Bid Amount

(a) Maximum Amount

The maximum amount of a Protective Bid should be the lesser of the balance owed on the SBA loan or the Recoverable Value of the collateral.

(b) Tolerance Range

The amount of a Protective Bid should include a "tolerance range," (i.e., a specific percent of the authorized bid amount by which the authorized bidder is allowed to increase or decrease the amount of the Protective Bid depending on unanticipated events at the foreclosure sale). Generally, an acceptable tolerance range is 10% above or below the authorized bid amount.

(c) Impact on Ability to Collect Deficiency

Because state laws vary, legal counsel should be consulted prior to entering a Protective Bid in order to ascertain the impact, if any, that the Protective Bid amount may have on the ability to collect the deficiency, if any, owed on the loan balance after the bid is entered.

**c. Take a No Bid Position****(1) When Appropriate**

A Protective Bid should not be entered at a senior lienholder's foreclosure sale if abandonment is appropriate, (i.e., Recoverable Value of less than \$10,000 for real property and \$5,000 for personal property collateral), or the Recoverable Value of the collateral is less than 10% of its Liquidation Value. A no bid position may also be justified if based on the circumstances, which are not reflected in the Appraisal but are documented in the Loan File, a prudent lender would not enter a Protective Bid even though the Recoverable Value of the collateral is 10% or more of its Liquidation Value.

**(2) Failure to Conduct an Environmental Investigation**

Failure to conduct the Environmental Investigation required by Chapter 5 is not an acceptable reason for taking a "no bid" position at a senior lienholder's foreclosure sale when there is equity that should be protected. In emergency situations, prudent judgment must be exercised and the best possible due diligence under the circumstances must be conducted in order to avoid unnecessary loss.

**d. Exercise Right of Redemption****(1) Background**

Under federal law, as an Agency of the Federal Government, SBA (but not a 7(a) Lender) has one year from the date of a judicial foreclosure sale to redeem, i.e., buy back, the foreclosed-upon property ([28 U.S.C. § 2410\(c\)](#)). Under state law, SBA and the 7(a) Lender's redemption rights generally stem from their status as a junior lienholder. Whether junior lienholders have redemption rights varies by state. Consult legal counsel for case specific information and advice.

**(2) General Rule**

The redemption rights on an SBA loan should be exercised whenever it would be prudent and commercially reasonable to do so, for example, when the property sells for less than expected at a senior lienholder's foreclosure sale.

**e. Release Right of Redemption for Consideration**

If redemption rights are available under federal or state law but it would not be prudent or commercially reasonable to redeem the foreclosed-upon property, after the senior lienholder's foreclosure sale has been confirmed, the redemption rights associated with the SBA loan may be released upon receipt of cash in an amount approximately equal to 50% of the property's Recoverable Value.

**f. Collect Excess Proceeds from Foreclosure Sale****(1) Requirement**

When the property is not acquired via a Protective Bid at a senior lienholder's foreclosure sale, after the sale, all necessary, reasonable and customary action must be taken to ascertain whether there are excess foreclosure sale proceeds available for distribution to junior lienholders, and if so, all of the funds to which the Lender or SBA is entitled must be collected and applied to the SBA loan balance in accordance with Chapter 22 (*Expenses and Recoveries*).

**(2) Practice Tip—Default Charges**

When ascertaining whether funds are available for application to an SBA loan after a senior lienholder's foreclosure sale, make certain that all Default Charges (and advances, if any) were subordinated to the SBA loan as required by any relevant subordination, lienholder or inter-creditor agreement.

## Chapter 14. Classifying Loans in Liquidation

---

Lenders should make a good faith effort to help delinquent Borrowers bring their loans current. But, when a payment default cannot be cured, the Note should be accelerated, demand made on the Obligor, the loan classified in liquidation, the SBA guaranteed portion re-purchased from the secondary market, and a Liquidation Plan prepared and implemented without further delay.

### A. When Loans Must Be Classified in Liquidation Status

A 7(a) Loan must be classified in liquidation status when the Note is accelerated.

### B. When the Note Should Be Accelerated

**Note:** Lenders do not have a legal right to accelerate, make demand, or liquidate the collateral unless there has been a default on the Note. (For specific information on the Lender's rights in the event of default, see the Note used to document the loan, e.g. (SBA Form 147).

#### 1. Lenders with Non-SBA Loan Portfolios

Lenders with a non-SBA guaranteed loan portfolio may decide whether to accelerate the Note based on their own policies and procedures for similarly-sized non-SBA guaranteed commercial loans.

**Note:** Unless SBA has agreed otherwise in writing, the Borrower must be in default on a payment for more than 60 calendar days before the Lender can request guaranty purchase. A Lender may not request guaranty purchase based solely on a non-payment default such as failure to provide financial statements in a timely manner. For information on the requirements for guaranty purchase, see Chapter 23, 13 C.F.R. § 120.520, and SOP 50 10.

#### 2. Lenders without Non-SBA Loan Portfolios

Lenders without a non-SBA guaranteed loan portfolio should accelerate whenever there has been an event of default on the Note and it is clear to a prudent lender that the Obligor(s) cannot, or will not, keep the loan current through regularly scheduled payments. (E.g., the Borrower closes the business and delivers the keys to the Lender, or is more than 60 calendar days late on a payment that cannot be cured through an SBA approved deferment or catch-up plan.)

### C. Repurchase from Secondary Market

At the time the Note is accelerated and the loan is classified in liquidation, if the loan was sold on the secondary market, the Lender must immediately either repurchase the SBA guaranteed portion or request that SBA purchase it.

## D. Demand Letters

1. Whenever the Note is accelerated, unless prohibited by applicable law (e.g., the automatic stay in bankruptcy), demand should be made on all of the Obligor(s) for immediate payment of the entire loan balance.
2. Demand letter(s) should be sent via regular mail as well as certified mail or some other method that enables the sender to confirm delivery.
3. Reasonable efforts should be made to contact any Obligor who fails to respond, either by telephone or email, to determine their intentions with regard to repaying the loan.

**Note:** In the event of a default on a 7(a) Loan that utilizes SBA Form 147 (*Note*), the Note gives the holder the right to accelerate the Note and liquidate the loan "without notice or demand." In practice, however, the collateral documents, (e.g., deed of trust), or applicable state law generally require the creditor to make a formal demand for payment. What is more, if litigation is necessary, most courts expect to see an acceleration and demand letter as part of the evidence offered by the creditor to prove its case.

## E. Skip Tracing

When a loan is classified in liquidation, a good faith effort must be made to locate and to collect the loan balance from all of the Obligor(s) including those who are missing or difficult to locate.

## F. Obligor(s) in Active Military Service

The military service status of an Obligor must be determined before taking liquidation action that could adversely impact the Obligor; and if an Obligor is in active military service, any action taken must be in compliance with the Servicemember's Civil Relief Act ("SCRA"), (Appendix to 50 U.S.C. §§ 501-596).

**Note:** SCRA provides Servicemembers relief from certain obligations and temporarily suspends judicial and administrative proceedings and transactions involving civil liabilities when military service affects the Servicemember's ability to meet or attend to civil matters. The protections are not automatic. Generally, Servicemembers must request them and show that their military service has materially impaired their ability to meet their obligations. Creditors may, however, seek relief in court by proving otherwise. For detailed information, consult legal counsel or SBA's Office of Veterans Business Development, but, simply stated SCRA:

1. Places limitations on foreclosures and interest rates;
2. Requires creditors to forgive interest in excess of 6 percent on certain pre-service debts;
3. Protects Servicemembers from default judgments if they fail to appear at trial or respond to a lawsuit because of their military service (50 USC App. § 521);
4. Authorizes the court to stay lien foreclosure actions or adjust the Servicemember's obligation to preserve the interests of all parties (50 USC App. § 533);
5. Makes a Servicemember's personal assets that were not pledged as collateral unavailable to satisfy a business obligation (50 USC App. § 596);
6. Prohibits creditors from pursuing adverse actions (e. g., notifying credit reporting agencies, denying credit, changing terms) against Servicemembers solely because they exercise their rights under SCRA (50 USC App. § 518; and

7. Imposes criminal sanctions on creditors who violate certain provisions of the statute including those pertaining to mortgage foreclosures.

## **G. Liquidation Plans**

All Lenders should prepare a Liquidation Plan prior to taking any material action to liquidate a loan, since when properly prepared, a Liquidation Plan helps ensure that the loan is liquidated in a timely, prudent and cost-effective manner that maximizes recovery in the shortest amount of time.

### **1. Format and Content**

A Liquidation Plan for a 7(a) Loan should have a copy of the demand letter attached to it, and should be prepared in accordance with the template accessible from [www.sba.gov/for-lenders](http://www.sba.gov/for-lenders). As set out in the template, the following factors should be considered and discussed in a Liquidation Plan:

#### **a. Site Visit Findings**

For information on site visits, see Chapter 15. (A Liquidation Plan for a CLP loan must include a copy of the Lender's Site Visit Report.)

#### **b. Feasibility of a Workout**

For information on workouts, see Chapter 16.

#### **c. Recoverable Value of the Collateral**

For information on how to determine the Recoverable Value of collateral, see the definition of "Recoverable Value" in Chapter 2.

#### **d. Available Methods of Liquidation**

For information on collateral liquidation, see Chapter 17 with regard to real property collateral and Chapter 18 with regard to personal property collateral.

#### **e. Routine Litigation**

For information on Routine Litigation as well as Non-routine Litigation, see Chapter 21. With regard to CLP loans, Lenders should include Routine Litigation in the Liquidation Plans they are required to submit to SBA for prior approval.

#### **f. Status of Senior Liens**

For information on senior liens, see Chapter 13.

#### **g. Obligors' Repayment Ability**

Generally, to assess the Obligors' repayment ability, an asset search should be conducted on each Obligor and reviewed along with each Obligor's financial statements, tax returns, credit reports and other relevant financial documents in order to analyze the following factors with regard to each Obligor:

- (1) Recoverable Value of any collateral pledged by the Obligor (See Subparagraph c above.);

- (2) Exemptions available to the Obligor under state and federal law;
- (3) Amount that could be recovered from the Obligor's non-exempt assets that were not pledged as collateral through enforced collection proceedings, e.g., obtaining a judgment and executing on it;
- (4) Amount of present and potential income that could be obtained through enforced collection proceedings, e.g., administrative wage garnishment after referral to Treasury (See Chapter 26);
- (5) Litigative risk, i.e., a real doubt concerning the ability to prevail in court because of legal issues or factual disputes;
- (6) The necessary, reasonable and customary administrative and litigation expenses that would be incurred through enforced collection;
- (7) The time it would take to enforce collection; and
- (8) The likelihood that the Obligor's assets have been or will be concealed or fraudulently transferred.

#### **h. Lender's Non-SBA Loans to Obligor**

The Liquidation Plan must disclose whether the Lender has any non-SBA loans to the same Obligor(s), and if so, indicate how the liquidation and litigation expenses and recoveries will be allocated. For information on allocation and approval of expenses and recoveries, see Chapter 22.

## **2. When a Liquidation Plan Must be Submitted to SBA for Approval**

### **a. General Rule—Loans Made Under CLP Authority**

#### **(1) Liquidation Plan**

Except as provided below with regard to emergencies, Lenders must submit a proposed Liquidation Plan to the appropriate SBA Loan Center for each CLP loan classified in liquidation status (13 C.F.R. § 120.540) within 30 business days of completing the site visit required by Chapter 15. A copy of the Lender's Site Visit Report must be attached to the proposed Liquidation Plan. Lenders should include Routine Litigation in the Liquidation Plans they are required to submit to SBA for prior approval.

#### **(2) Amended Liquidation Plan**

Except as provided below with regard to emergencies, Lenders should prepare and submit an amended Liquidation Plan before taking any action or incurring any expense that materially deviates from its original Liquidation Plan for a CLP loan.

### **b. Exception—Emergency Situations**

A Lender may respond to an emergency (e.g., loss or dissipation of collateral), without SBA's written approval of a Liquidation Plan or amended Liquidation Plan for



a CLP loan, provided that it:

- (1) Makes a good faith effort to obtain SBA's written approval before undertaking the emergency action;
- (2) Submits a written Liquidation Plan or amended Liquidation Plan to the SBA Loan Center as soon after the emergency as possible; and
- (3) Takes no further liquidation action without SBA's written approval of the Liquidation Plan or amended Liquidation Plan. (13 C.F.R. § 120.540(f))

#### **c. SBA Response Time**

If SBA does not respond to a Lender's request for approval of a Liquidation Plan for a CLP loan within ten business days from the date on which the request is made, the request is deemed approved. (13 C.F.R. § 120.541(c))

### **H. Payments and Recoveries on Loans in Liquidation Status**

See Chapter 4 for information on how to apply payments received on loans in liquidation. See Chapter 22 for information on how to apply recoveries.

### **I. When Loans Should Be Removed from Liquidation Status**

Regardless of whether or not the guaranty has been purchased SBA loans in liquidation status can be resolved and removed from liquidation in one of three ways:

#### **1. Returned to Regular Servicing**

SBA loans should be removed from liquidation status and returned to regular servicing when the borrower has agreed to the resumption of regular payments pursuant to a workout agreement, bankruptcy plan, reaffirmation agreement, assumption, or other written agreement that provides for resumption of regular payments.

#### **2. Paid in Full**

SBA loans should be removed from liquidation status and classified as "paid in full" when the debt owed on the SBA guaranteed loan has been satisfied. (Purchase of the guarantee from the secondary market should not be confused with satisfaction of the debt through payment by an Obligor or through liquidation recoveries.)

#### **3. Charged-off by SBA**

SBA loans should be removed from liquidation status and classified as "charged-off" by SBA when:

- a. The Lender's Wrap-up Report has been approved, and the remaining loan balance has been charged-off by SBA; or
- b. The Lender has failed to submit an acceptable Wrap-up Report within the timeframe specified by SBA and the SBA Loan Center has determined that the loan should be charged off. (See Chapter 26 for information on Wrap-up Reports.)

## Chapter 15. Site Visits

---

This chapter provides SBA policy and procedures concerning post-default site visits. With regard to loans in regular servicing status, a site visit should be made whenever warranted by prudent lending practices. All site visits should be documented by a Site Visit Report, which should be kept in the Loan File. (See Chapter 3 for site visit reporting requirements.)

### A. When Required

Unless the loan is unsecured, or the aggregate Recoverable Value of the personal property collateral is less than \$5,000 and the Recoverable Value of each parcel of real property collateral is less than \$10,000, a site visit must be conducted:

1. Payment Default—within 60 calendar days of an uncured payment default or sooner if the collateral could be removed, lost or dissipated.
2. Non-payment Default—within 15 calendar days of the occurrence of an adverse event that caused the loan to be classified in liquidation status or sooner if the collateral could be removed, lost or dissipated.

### B. Preparation

Prior to conducting a site visit, the steps listed below should be taken when they are applicable and necessary to obtain sufficient information to make prudent lending decisions.

#### 1. Review the Loan Documents

Determine what collateral was required, what collateral was actually taken, and what priority position the liens had when the loan was closed by reviewing the Loan Authorization and other relevant Loan Documents, including for example:

- a. Personal Property Collateral—The security agreement, landlord lien waiver, UCC financing statements, and UCC searches, as well as any senior lienholder, subordination or inter-creditor agreement; and
- b. Real Property Collateral—The mortgage or deed of trust, assignment of rents, and title insurance policy, as well as any senior lienholder, subordination, inter-creditor or non-disturbance agreement.

#### 2. Obtain a Current Lien Search

Obtain a current title report or UCC search to verify the priority of the lien(s) securing the SBA loan.

#### 3. Contact the Landlord

If the collateral is located on leased premises, contact the landlord to determine whether the rent is past due.

#### 4. **Contact Local Taxing Authorities**

Contact local taxing authorities to determine whether there are delinquent real or personal property taxes that have, or will soon have, priority over the lien securing the SBA loan.

#### 5. **Order an Appraisal**

##### a. **Personal Property**

If the loan is secured and the collateral includes personal property such as machinery, equipment, furniture, fixtures or inventory, hire an auctioneer or other expert to prepare a Liquidation Value Appraisal and to assist with the relevant site visit goals listed below. If the collateral includes unusual personal property that an auctioneer would not ordinarily have the expertise to appraise, e.g., intellectual property, order an Appraisal from an expert with the appropriate qualifications.

##### b. **Real Property**

If the loan is secured and the collateral includes real property, hire a qualified expert to prepare an Appraisal.

**Note:** See the definition of "Appraisal" in Chapter 2 for SBA requirements pertaining to appraisals. Given the inherent conflict of interest, do not rely solely on an appraisal prepared for an Obligor or another lender with a lien on the same collateral, and exercise caution if the Appraisal was prepared by a broker with whom the collateral, if acquired, will be listed for sale.

### **C. Goals**

During a post-default site visit, a good faith effort should be made to gather sufficient information to accomplish the applicable goals listed below.

#### 1. **Inspect and Inventory the Collateral**

Prepare a comprehensive written inventory that includes a complete and accurate description of the collateral, including its current condition, photographs, and the serial numbers of significant items of personal property, i.e., items with a Liquidation Value of \$5,000 or more.

#### 2. **Establish the Recoverable Value of the Collateral**

Determine the amount of expenses that must be taken into consideration to accurately calculate the Recoverable Value of the collateral, such as the cost of any necessary care and preservation measures.

### 3. **Ascertain Whether Real Property Collateral is Occupied**

If the collateral consists of real property, find out whether there are occupants who are entitled to notice, who will need to be evicted, or who are paying rent that can be collected and applied against the SBA loan balance.

### 4. **Assess Environmental Risk**

Review the Environmental Investigation Report prepared at the time the loan was made, look for potential environmental problems while inspecting the Borrower's business premises, and follow the requirements concerning Environmental Investigations set out in Chapter 5.

### 5. **Develop a Liquidation Strategy**

Begin developing a strategy for liquidating the loan. For example, if there is personal property collateral that must be liquidated, determine whether the Borrower and landlord will cooperate so that it can be sold via a public auction held on the Borrower's business premises. (See Chapter 18 for information on public UCC sales.)

### 6. **Ascertain Whether a Workout is Feasible**

If Obligors who have not filed for bankruptcy protection are present and cooperative, obtain a copy of the financial records needed to determine whether a workout is feasible. (See Chapter 16 for information on workouts including how to ascertain whether the Borrower is a good candidate for a successful workout.)

### 7. **Repossess the Personal Property Collateral**

Unless a workout or a judicial foreclosure action is contemplated, make arrangements to repossess the collateral using self-help methods pursuant to UCC Article 9 if it can be done without a "breach of the peace. If the collateral cannot be repossessed without a "breach of the peace;" consult legal counsel about filing a replevin action to obtain a court order requiring the Obligor to turn-over the collateral.

### 8. **Arrange for Care and Preservation of the Collateral**

After acquiring possession or control of the collateral, take prudent and commercially reasonable measures to care for and preserve it until it can be liquidated. For example:

#### a. **Security and Safekeeping**

Make arrangements to keep the collateral safe and secure until it can be liquidated. For example, depending on the circumstances, it may be necessary to have the locks changed, hire a caretaker, pay utility bills, or transport personal property collateral to a secure, temperature-controlled storage facility pending a foreclosure sale.

**b. Insurance**

Purchase or maintain appropriate insurance coverage, such as hazard or general public liability insurance pursuant to the requirements in Chapter 9 (*Insurance Coverage*).

**c. General Maintenance**

Arrange for cost-effective repairs, clean-up, etc., to ensure that the foreclosure sale is commercially reasonable and the collateral sells for the highest possible price.

## Chapter 16. Workouts

---

### A. Overview

The term “workout” refers to the debt collection and negotiation process as well as the final plan agreed upon by a creditor and a debtor with regard to how the problems and issues surrounding the debtor’s delinquent obligation to the creditor can be “worked out” or resolved. Generally, a workout agreement restructures the material terms and conditions of the debtor’s delinquent loan in order to: avoid the need for actions such as foreclosure or bankruptcy; enable the debtor to cure defaults and improve repayment ability; and to enable the creditor to maximize recovery on the loan. Because a workout agreement alters the material terms and conditions of the loan, the loan will generally need to be purchased from the secondary market investor before a formal workout agreement can be executed. Whenever feasible, a good faith effort must be made to negotiate a workout on an SBA loan that is seriously delinquent or classified in liquidation.

**Note:** Free, confidential technical and management counseling is available to small businesses through the nationwide network of [SCORE](#) Chapters, [Small Business Development Centers](#), Women’s Business Centers and Veterans Business Outreach Centers.

### B. Required Financial Information

Current financial information is essential in order to make prudent lending decisions regarding the feasibility and structure of a workout agreement. If the Obligors are not willing to provide the following information, workout negotiations should not be pursued.

#### 1. Financial Statement

- c. A current financial statement that should be signed under penalty of perjury and must show the Borrower’s assets, liabilities, income and expenses, e.g., SBA Form 770 (*Financial Statement of Debtor*);
- d. The Borrower’s last year-end financial statements; and
- e. Affiliates—If the Borrower has any affiliates, a current consolidated financial statement must also be provided;

#### 2. Business Federal Income Tax Returns

A complete copy of the Borrower and each affiliate’s business federal income tax return that was filed with the IRS for the past two years or a written explanation as to why a copy is not available; and

#### 3. Personal Federal Income Tax Returns

A complete copy of the personal federal income tax returns that each Guarantor filed with the IRS for the past two years or a written explanation as to why a copy is not available.

**Note:** Obtaining current financial statements at this stage is critical. Not only are they needed to make prudent lending decisions regarding the feasibility and structure of a workout agreement, but they also provide valuable information that would be difficult to obtain in the event the workout is unsuccessful and enforced liquidation becomes necessary.

### **C. Feasibility Test**

To determine whether a Borrower is a good candidate for the workout process, in addition to reviewing the existing Loan Documents, review the new financial information required by Paragraph B above, conduct a site visit if feasible, and ascertain whether the Borrower is: (1) competent, i.e., has the necessary technical and management skills to turn the business around; (2) cooperative, i.e., willing to take the necessary action to address the problems that caused the default; (3) acting in good faith, and (4) financially and operationally viable.

### **D. Timing**

If a workout is feasible, negotiations should begin immediately and a final workout plan should be put into effect as soon as possible. If an acceptable workout plan is not in place within a reasonable time, (e.g., 60 calendar days), the Lender should move forward with its plan for enforced debt collection.

### **E. Requirement—New Consideration from Borrower**

In order for a workout agreement to be legally binding, the debtor must provide consideration, (i.e., something of value) before or at the same time that the debtor receives the benefit of the workout agreement. For example, in exchange for an agreement to forbear or restructure the loan, the Obligors should generally be required to:

1. Correct Loan Document errors;
2. Waive defenses;
3. Release lender liability claims;
4. Provide additional collateral; and
5. Consent to a speedy and inexpensive method of liquidating the loan if the workout fails. This could include, for example, placing a deed or bill of sale to the collateral in escrow, signing a confession of judgment, or agreeing to waive the automatic stay and to turn-over the collateral if the Obligor subsequently files bankruptcy.

### **F. Options**

The elements of a plan to work out the problems on an SBA loan will vary depending on the circumstances. The final decision, and justification for it, must be documented in the Loan File. The decision should be supported by a credit memo that includes a cash flow and complete liquidation analysis based on the Obligors' current personal and business financial documents required by Paragraph B. The most common workout options are listed below.

**1. Forbearance**

Enforced collection activities may be postponed for a stated period of time in order to provide the Borrower with an opportunity to improve its cash flow and avoid foreclosure.

**2. Reinstatement of Maturity Date**

If the Note has been accelerated, the maturity date may be reinstated. (See Chapter 7 for information on maturity date extensions.)

**3. Deferment**

Delinquent and future payments of principal, interest or both may be deferred for a stated period of time to enable the Borrower to overcome a temporary cash flow problem. (See Chapter 12 for information on deferments.)

**4. Modification of Repayment Terms of Note**

The repayment terms of the Note may be modified, (e.g., the payment amount or interest rate may be lowered or the maturity date may be extended). See Chapter 7 for information on modification of the Note.

**5. Assumption of Loan**

Another Person may assume the loan. (See Chapter 11 for information on assumptions.)

**6. Subordination to Working Capital Loan**

The priority position of a lien securing the loan may be subordinated to a short-term working capital loan. (See Chapter 8 for information on subordination to a new loan.)

**7. Relief on Secured Senior Loan**

A loan secured by a senior lien on the collateral securing the SBA loan may be kept current, purchased or paid off. (See Chapter 13 for information on senior liens.)

**8. Voluntary Sale of Collateral**

The Borrower may be allowed to voluntarily sell all or part of the collateral provided that sale is closely monitored to ensure that it is commercially reasonable and that all of the net proceeds are applied to the principal balance of the SBA loan or used to facilitate the workout plan. (For SBA Loan Program Requirements pertaining to voluntary sale of collateral, see Chapter 17 with regard to real property collateral and Chapter 18 with regard to personal property collateral.)

**Note:** The amount of accrued interest or principal owed on an SBA loan may only be reduced through the offer in compromise process. (See Chapter 20 for information on offers in compromise from going concerns.)



**G. Agreement Provisions**

A workout agreement should be in writing and should include:

1. A list of events of default to date;
2. The consideration for entering into the agreement;
3. Confirmation of the collateral for the SBA loan, which should include the priority of each lien;
4. An acknowledgement that neither SBA nor the Lender is waiving any default, right or remedy by entering into the workout agreement;
5. The forbearance period;
6. The agreed upon workout option(s) such as those listed in Paragraph D;
7. The events that constitute a default under the workout agreement including the dates by which obligations under the workout agreement must be performed;
8. The consequences of default under the workout agreement, e.g., re-acceleration of the Note and delivery or recording of any deed, bill of sale, or confession of judgment placed in escrow; and
9. The signatures of the Lender and all Obligors on the loan.

**H. SBA Approval**

SBA's prior written approval of a workout plan is not required unless the plan includes a compromise of the principal loan balance or some other Loan Action that requires SBA's prior written approval. (See Chapter 3 for information on Loan Actions that require prior written SBA approval.)

## **Chapter 17.**

### **Real Property Collateral Liquidation**

---

#### **A. General Requirements**

All collateral that has Recoverable Value should be liquidated. With regard to real property collateral, if the Recoverable Value of an individual parcel is \$10,000 or more, it must be liquidated unless there is a documented compelling reason for not doing so. The most common methods of liquidating real property collateral are discussed below.

#### **B. Procedure for Selecting Best Method of Liquidation**

Real property collateral must be liquidated in a manner that will maximize recovery on the loan in the shortest amount of time. The most appropriate method will depend on numerous factors including those that can be ascertained by following the steps listed below.

##### **1. Check the Military Service Status of Property Owner-Obligor**

Determine whether the property owner-Obligor is in active military service. If so, consult legal counsel regarding the implications of the Servicemembers Civil Relief Act prior to initiating a lien foreclosure action.

##### **2. Determine the Use of the Property**

Determine how the property is used since it may trigger special requirements. For example, if the property is used as an Obligor's primary residence, the requirements set forth in Paragraph C.4.b. below must be met before initiating a foreclosure action. If the property is used for agricultural purposes, state law may require judicial foreclosure and federal law may provide the Borrower with homestead rights. (For information on farmer homestead rights, see 13 C.F. R. § 120.550, et seq. and the Consolidated Farm and Rural Development Act.) Finally, if the property is used to operate a gas station, a major oil company may have special rights with regard to matters such as notice of default, the right of first refusal, or the ability to control future ownership or use of the property.

##### **3. Review the Loan Documents**

Review the Loan Documents to determine which methods of liquidation are available. For example, in most states, a mortgage must be judicially foreclosed, while a deed of trust may be foreclosed through either judicial or non-judicial proceedings.

##### **4. Order a Title Report**

Order a new title report or at a minimum, review the existing title insurance policy and gather any other information needed to identify all liens and other encumbrances against the property.

## 5. Determine the Amount Owed on Senior Liens

With regard to each parcel of real property collateral, determine the amount owed, including unsubordinated advances and Default Charges, on any debt secured by a senior lien against the property, and deduct that amount from the property's estimated Liquidation Value. If it still appears that the property will have a Recoverable Value of \$10,000 or more, proceed to step 6. If not, see Paragraph F below regarding abandonment.

## 6. Decide How to Handle Each Title Encumbrance

After deducting the amount secured by senior liens, if the collateral appears to have a Recoverable Value of \$10,000 or more, consider the impact, if any, each encumbrance would have on the various methods of liquidation and decide how to handle each encumbrance. For example:

### a. Senior Tax Liens

Consider the possibility of further erosion of equity due to late fees and other penalties, and decide whether to pay delinquent real property taxes or assessments secured by a senior lien.

### b. Senior Non-tax Liens

If there are senior non-tax liens against the property, decide which of the options for dealing with them listed in Chapter 13 is prudent and commercially reasonable under the circumstances.

### c. Junior Non-tax Liens

If there are junior liens against the property other than federal tax liens, find out the balance owed and decide whether to eliminate them through foreclosure or to negotiate their release for consideration.

### d. Junior Tax Liens

If there are junior federal tax liens against the property, find out the balance owed and ask the IRS for a certificate of discharge or work with the IRS to reach an amicable resolution as to the amount that should be applied to the tax lien.

### e. Leases

If tenants are leasing the property, determine: (1) whether the lease enhances or diminishes the Liquidation Value and marketability of the property; and (2) whether a foreclosure sale will extinguish the lease or whether it will survive and bind the purchaser to the lease terms.

**Note:** Review *Subordination, Non-disturbance and Attornment Agreements* carefully since they address lender and tenant rights. Typically, the tenant agrees to "subordinate" the lease to the lender's mortgage; and in the event of default by the landlord-Obligor, the lender agrees not to "disturb" the tenant's possession; and the tenant agrees to "attorn," i.e., recognize the lender or foreclosure sale purchaser as the new landlord.

#### **f. Assignments of Rents**

If the collateral includes an assignment of rents and a tenant is in possession of any portion of the property, decide whether:

- (1) Collecting the rents pending a workout or foreclosure sale is necessary to maximize recovery;
- (2) Collecting the rents would cure the existing default and prevent foreclosure; and whether
- (3) Requesting the court to appoint a receiver to collect the rents could bar a non-judicial foreclosure action.

#### **g. Covenants, Conditions and Restrictions**

If there are other title encumbrances, determine what impact, if any, they will have on the foreclosure process or Recoverable Value of the property. For example, gas station property is often encumbered by special notice of default requirements, purchase options, rights of first refusal, restrictions on how the property can be used, covenants that require future owners to indemnify a major oil company from liability associated with Contamination, and covenants that require future owners to install expensive engineering controls prior to redevelopment.

### **7. Check Status of Hazard Insurance**

If the property is improved, see Chapter 9 for SBA Loan Program Requirements pertaining to ensuring that all collateral with Recoverable Value is adequately insured.

### **8. Order an Appraisal**

Order an Appraisal to obtain up-to-date information on the market value of the property;

**Note:** See the definition of "Appraisal" in Chapter 2 for SBA requirements pertaining to appraisals. Given the inherent conflict of interest, do not rely solely on an appraisal prepared for an Obligor or another lender with a lien on the same collateral, and exercise caution if the Appraisal was prepared by a broker with whom the collateral, if acquired, will be listed for sale.

### **9. Assess Environmental Risks**

When required by Chapter 5, conduct an Environmental Investigation to obtain the information needed to mitigate the risks associated with liquidating Contaminated collateral.

## **10. Check Historic Register Status**

If the property could have historical value based on its age, integrity and significance, determine whether it is listed on, or eligible for, the National Register of Historic Places by contacting the State Historic Preservation Office where the property is located. If so, determine whether the historical significance impacts the Recoverable Value of the collateral.

## **11. Review Relevant Business Records**

When it would be prudent to do so, review the Borrower's books and records showing the cash flow related to the operation and use of the property, and verify that the property and its use do not violate any applicable laws such as those pertaining to zoning and land use.

## **12. Consider Need to Collect Deficiency**

If the recovery from liquidating a single parcel of real property collateral will not be enough to pay the loan in full, consult legal counsel to determine whether use of a particular method of liquidation, e.g., non-judicial foreclosure or acceptance of a deed in lieu, would bar collection of the deficiency or foreclosure of any remaining collateral.

## **13. Estimate Time and Costs Involved**

Estimate the time and expense associated with each viable method of liquidation. This includes: the time and cost associated with pre-liquidation collateral care and preservation; the liquidation action; and post-liquidation care, preservation and resale if acquiring title to the collateral is anticipated.

## **14. Estimate Net Recovery**

Using the information collected in Steps 1-13, calculate the net amount that could be recovered by utilizing each viable method of liquidation to determine which would yield the highest recovery in the shortest amount of time.

## **C. Liquidation Methods**

### **1. Release of Lien for Consideration**

See Chapter 8 for information on release of lien for consideration.

### **2. Voluntary Sale of Collateral by Obligor**

An Obligor may be allowed to conduct a voluntary sale of all or part of the real property collateral securing an SBA loan provided that:

- a.** A voluntary sale would maximize recovery on the loan;
- b.** The Obligor has possession or control of the collateral;
- c.** All other lienholders have provided their written consent to the sale;

- d. An Appraisal has been obtained;

**Note:** See Chapter 2 for SBA requirements pertaining to "Appraisals". Given the inherent conflict of interest, do not rely solely on an appraisal prepared for an Obligor or another creditor with a lien on the same collateral.

- e. The Recoverable Value of the collateral has been established;
- f. The sale is supervised by the Lender (or SBA if SBA has taken over servicing);
- g. The costs of sale are reasonable, necessary and customary;
- h. The lien securing the SBA loan is only released in exchange for cash in an amount equal to or greater than the Recoverable Value of the collateral; and
- i. All of the net proceeds are applied to the principal balance of the SBA loan.

**Note:** When analyzing whether a proposed compromise amount is adequate, consideration may be given to whether the Obligor's cooperation during the liquidation process increased the overall recovery on the loan. (See Chapter 20, Paragraph F.)

### 3. Deed in Lieu of Foreclosure

Real property collateral may be liquidated by accepting a deed in lieu of foreclosure (i.e., a deed by which a debtor conveys fee-simple title to a secured creditor as a substitute for foreclosure) if doing so would maximize recovery on the loan. All deeds in lieu must be accompanied by a written agreement executed by all of the Obligors as to the amount to be applied to the loan balance once title has been transferred. Although this procedure may save time and money, it has inherent risks. For example, accepting a deed in lieu could eliminate the right to collect any deficiency. It could also eliminate the opportunity to foreclose the SBA lien and remove any junior liens before marketing the property as REO. Because state laws vary regarding the impact of accepting a deed in lieu of foreclosure, the advice and assistance of legal counsel should be obtained before undertaking this method of liquidation. Acceptance of a deed in lieu of foreclosure that extinguishes the legal obligation of any of the obligors for the deficiency balance must be taken in accordance with offer in compromise requirements in Chapter 20.

**Note:** In addition to a Foreclosure Policy, Trustee Sale Guarantee, or a Litigation Guarantee, most title insurance companies also offer deed in lieu of foreclosure services that include not only a new title (commitment) report, but review of title issues, recording of the deed in lieu documents, and issuance of a title policy to the Person to whom the lender sells the property after acquiring it via the deed in lieu.

## **4. Lien Foreclosure**

### **a. General**

Foreclosure is an action taken to sell property that was pledged as security for a loan. Since the laws pertaining to the foreclosure of mortgages, deeds of trust, and other types of real property liens vary by state, consult legal counsel to determine which type of foreclosure action is the most appropriate with regard to a particular loan. The two primary methods of real property lien foreclosure actions are judicial foreclosure and non-judicial foreclosure.

### **b. Primary Residences**

Unless the Obligor-owner has engaged in fraud, misrepresentation or other financial misconduct, a good faith effort should be made to reach an agreement covering release of the lien for consideration and compromise of the Obligor's liability for the SBA loan balance prior to initiating a foreclosure action against the Obligor's primary residence. Documentation showing that a Lender has complied with applicable state or federal laws requiring mortgage lenders to work with home owners prior to foreclosure will be considered evidence that a Lender has made a good faith effort to meet the foregoing SBA Loan Program Requirement. (For information on offers in compromise, see Chapter 20.)

### **c. Judicial Foreclosure**

Judicial foreclosure requires filing a lawsuit.

#### **(1) Advantages**

- (a) Deficiency judgment obtainable; and
- (b) Only one action required to foreclose liens and obtain judgment on the Note and Guaranties.

#### **(2) Disadvantages**

- (a) Higher costs and fees than non-judicial foreclosure;
- (b) More time-consuming than non-judicial foreclosure; and
- (c) The mortgagor and junior lienholders usually have statutory redemption rights.

### **d. Non-Judicial Foreclosure**

Non-judicial foreclosure, which ends with the private sale of the property, is available only if the deed of trust or mortgage securing the loan contains a clause or provision granting a power of sale. Strict compliance with the applicable state statutory provisions governing non-judicial foreclosure is mandatory.

**(1) Advantages**

- (a) Fees and costs are generally lower than judicial foreclosure;
- (b) Takes less time than judicial foreclosure; and
- (c) The mortgagor and junior lienholders usually do not have statutory redemption rights.

**(2) Disadvantages**

- (a) Deficiency judgment may not be obtainable (consult legal counsel), and
- (b) Judicial action may still be necessary if there are unlawful occupants who need to be evicted.

**5. Collection of Rents**

If the Loan Documents include an assignment of rents and there are tenants paying rent to an Obligor, consult legal counsel as to the applicable state law regarding the collection of rent pending a workout or foreclosure action. In some cases, this may be accomplished by means of a letter to the tenants. In other cases, a receiver may need to be appointed.

**6. Appointment of Receiver****a. When Receiverships are Appropriate**

A receiver is a Person appointed by the court to preserve and protect the collateral in connection with, or in lieu of, foreclosure. The laws governing receiverships are available in both federal and state law. Generally, however, the court will authorize the receiver to take possession of the property, manage it, collect rents, take any reasonably necessary action to protect and preserve its value, and liquidate the property. The remedy of a receivership is often provided for in contracts in the Loan Documents. State law may also provide separate statutory grounds for appointment of a receiver

**(1) Circumstances where SBA may approve the use of a Receiver**

The remedy of receivership is an extraordinary remedy available only when no other remedy is available, except when it is provided as a remedy in a real estate mortgage. . Receivers should only be used in exceptional circumstances when, for example, to maximize the recovery and minimize loss on a loan, it is necessary to operate the business until it can be sold or the collateral can be liquidated. These circumstances could include, for example:

- (b) Franchise businesses where keeping the business operating as a going concern will enhance the sale price of the collateral. In some cases the franchisor will exercise its rights under an assignment of the lease to take over the operation of the franchise location subject to the lender's rights to the collateral. Prior to appointing a receiver,



Lender should consider the costs of taking an assignment of the franchise agreement, as some franchisors require the Lender to pay an up-front franchisee fee before agreeing to the assignment. If the receiver option is cost-effective, the franchise agreement must be assigned to the Lender, be transferable by the Lender, and there should be written consent from the franchisor to the appointment of a receiver to operate the business temporarily.

- (a) Certain types of businesses where, due to potential liability, required licensure or similar reasons, neither the Lender nor SBA can temporarily operate the business in order to sell it as a going concern and/or sell the collateral directly. Examples include assisted living facilities, group homes, and businesses with live animals as collateral.

(2) Circumstances where SBA may not approve Receivership:

- (a) The Lender is unable to demonstrate that the potential net recovery expected through the receivership will exceed the potential recovery from the Lender liquidating the collateral directly;
- (b) Analysis of the information provided by the Lender shows that it would not be cost-effective to have a receiver appointed; and
- (c) Operation of a business that has an environmentally high risk (i.e. gas station, dry cleaner, or metal plating facility, etc.) for the Lender becoming the liable party.

Note: If the Lender does not have a presence in the area and it appears that the Lender is hiring the receiver as a substitute for the Lender liquidating the collateral directly or the proposed receiver does not have staff experienced in liquidation of the type of assets involved in the business and/or is otherwise unqualified the SBA may decline approval of a receivership.

**b. SBA Approval Required**

**(1) Litigation Plan Required**

The appointment of a receiver involves Non-routine Litigation. Therefore, Lenders must submit a proposed Litigation Plan for SBA approval prior to commencing receivership proceedings. SBA will not approve the appointment of a receiver to perform basic loan liquidation functions, and will not approve or reimburse Lenders for expenses related to receiverships that were not approved in advance by SBA. (See Chapter 21 for information on Litigation Plans and Chapter 22 for information on Recoverable Expenses.)

**(2) Cost Benefit Analysis Required**

Prior to seeking SBA approval to appoint a Receiver, the Lender must conduct

a cost/benefit analysis demonstrating the use of a Receiver will maximize recovery. A copy of the cost benefit analysis and all relevant supporting documentation must accompany the Lender's request for SBA approval to appoint a Receiver. The cost/benefit analysis must discuss and analyze all environmental issues, if applicable.

## 7. Short Sale Approval

A "short sale" is a sale of real property by the owner in which the proceeds from the sale of the property fall short of the balance of the debts secured by liens against the property, and because the owner cannot afford to repay the full amount of the secured debt, the secured creditors agree to release their liens on the real property for less than the total amount that would otherwise be due at closing.

### a. Review and Analysis

Servicing Requests for short sale approval should be reviewed, analyzed and implemented in accordance with Chapter 6 (*Borrower Servicing Requests*).

### b. General Rule

A short sale should not be approved unless:

- (1) The dollar amount of the sale proceeds to be received and applied against the SBA loan balance is approximately equal to or greater than the Recoverable Value of the collateral; and
- (2) The Obligor-seller will remain liable for the SBA loan balance, or approval of the short sale is part of a compromise agreement reached in accordance with the requirements of Chapter 20.

**Note:** Some states, e.g., California, have laws that prohibit lienholders from collecting the deficiency if they consent to a short sale. Consult legal counsel for case-specific information and advice, and before approving a request that will eliminate ability to collect the loan balance, follow the requirements set out in Chapter 20 with regard to offers in compromise.

### c. Required Supporting Documents

The Supporting Documents that should be obtained and reviewed in order to reach a prudent decision regarding whether to approve a short sale include the following:

- (1) Real estate listing agreement;
- (2) Appraisal;

**Note:** See the definition of "Appraisal" in Chapter 2 for SBA requirements pertaining to appraisals. Given the inherent conflict of interest, do not rely solely on an appraisal prepared for an Obligor or another lender with a lien on the same collateral, and exercise caution if the Appraisal was prepared by a broker with whom the collateral, if acquired, will be listed for sale.

- (3) Real estate purchase and sale agreement, short sale and all other addendums;
- (4) Current title report;
- (5) Senior lienholder, subordination, inter-creditor or other agreement with any other creditor with a lien against the property;
- (6) Transcript of account or functional equivalent for any loan secured by a senior lien;
- (7) Pre-approval letter from the buyer's lender; and
- (8) Draft settlement statement (HUD 1).

**d. General Requirements**

**(1) Fair Sales Price**

The sales price must be fair and justified by an Appraisal;

**(2) Consent of All Secured Creditors**

All of the Obligor-seller's creditors with a lien on the property must have consented to the short sale;

**(3) No Sale Proceeds to Seller**

Because the Obligor-seller has no equity in the property, the seller should not receive any funds from the sale proceeds;

**(4) No Subordinated Amounts to Senior Lienholders**

The sale proceeds disbursed to senior lienholders, if any, must not include advances, Default Charges, or any other amount subordinated to the SBA loan by a senior lienholder, subordination, inter-creditor or other agreement;

**(5) No Sale Proceeds to Junior Lienholders, Unsecured Creditors or Others**

No sale proceeds should be disbursed to junior lienholders other than token amounts, i.e., \$500 or less, if necessary for release of lien; unsecured creditors, and any other Person who does not have a senior lien against the property except as provided below with regard to closing costs;

**(6) No Credits to Buyer**

Since short sale property should be sold in "as is" condition, no funds should be credited to the buyer for repairs or any other purpose;

**(7) No Unreasonable Closing Costs**

Generally, since the Obligor-seller has no equity in the property, the seller's closing costs should not be paid from the sale proceeds unless it is necessary under the circumstances, in which case, the amount of any cost that will be paid

from the sale proceeds, e.g., real estate commissions, must be reasonable and justified under the circumstances;

**Note:** Secured creditors, who are asked to accept less than the full amount due to them, can condition their approval of a short sale. For example, their approval can be conditioned on increasing the purchase price, reducing usual and customary sale closing costs such as the amount of commissions paid to realtors, or receiving substitute collateral for the deficiency.

#### **(8) Arrangement for Payment of Loan Balance Deficiency**

Satisfactory arrangements must have been made for payment of the loan balance that will remain after receipt of the sale proceeds, (i.e., consideration for release of the lien), unless the release is part of a compromise agreement reached with the Obligor-seller pursuant to the requirements of Chapter 20.

### **D. Credit Bids**

#### **1. Requirement**

A Credit Bid should be entered at all real property lien foreclosure sales initiated to foreclose a lien securing an SBA loan, whether the sale is judicial or non-judicial.

#### **2. Credit Bid Amount**

To determine the amount of a Credit Bid, the following factors must be considered: (a) Recoverable Value; (b) the SBA loan balance; and (c) need for and ability to collect a deficiency judgment. The Credit Bid amount should be based on the Recoverable Value of the collateral, but should not exceed the loan balance. Further, the entire loan balance should not be bid if doing so would eliminate an otherwise collectible deficiency.

### **E. Eviction Proceedings**

If title to real property collateral is acquired through foreclosure or otherwise and the Obligor-owner refuses to vacate, or there are other Persons unlawfully occupying the premises, it may be necessary to evict them. Eviction laws vary by locality. Consult legal counsel to determine the appropriate course of action.

### **F. Abandonment**

The pursuit of recovery on real property collateral may be abandoned if the collateral has no significant Recoverable Value, i.e., a Recoverable Value of less than \$10,000 per parcel. (See Chapter 5 [*Environmental Risk Management*] for SBA requirements pertaining to the due diligence required before collateral may be abandoned based on unsubstantiated claims that it is Contaminated, since the presence of Hazardous Substances may not significantly impair the market value of the acquired collateral.)

## Chapter 18. Personal Property Collateral Liquidation

---

### A. General Requirements

All collateral that has Recoverable Value should be liquidated. With regard to personal property collateral, if the individual or aggregate Recoverable Value is \$5,000 or more, it must be liquidated unless there is a documented compelling reason for not doing so. The most common methods of liquidating personal property collateral are discussed below.

### B. Procedure for Selecting Best Method of Liquidation

Personal property collateral must be liquidated in a manner that will maximize recovery on the loan in the shortest amount of time. The most appropriate method will depend on numerous factors including those that can be ascertained by taking the steps listed below.

#### 1. Check the Military Service Status of Property Owner-Obligor

Determine whether the property owner-Obligor is in active military service. If so, consult legal counsel regarding the implications of the Servicemembers Civil Relief Act prior to initiating a lien foreclosure action.

#### 2. Review the Loan Documents

Review the applicable Loan Documents to begin the process of determining what personal property is available for liquidation, how the liens on that property can be foreclosed, and how much money can be recovered through liquidation. For example, review the Loan Authorization, and any security agreement, assignment, marine mortgage, certificate of title, landlord lien waiver, senior lienholder agreement, subordination agreement, inter-creditor agreement, deposit account control agreement, and lien search.

**Note:** The law under which a lien was created dictates how it can be foreclosed. For example, if the collateral consists of a lien on equipment or inventory created under [UCC Article 9](#), the lien can be foreclosed by conducting a foreclosure sale pursuant to UCC Article 9 ("UCC sale"). On the other hand, if the collateral consists of a common law assignment of a life insurance policy or a marine mortgage, the UCC does not apply and the lien must be foreclosed according to the applicable state or federal law.

#### 3. Order a Lien Search

Verify the priority of the liens securing the SBA loan by conducting a new lien search. For example, order a current UCC lien search, or follow the steps below to search for liens against special types of property, such as:

##### a. Motor Vehicles and Small Boats

Check for security interests noted on the certificate of title.

**b. Airplanes**

Order a title search, (usually through an airplane title service company), from the [Federal Aviation Administration Registry in Oklahoma City, Oklahoma](#) and if the plane is subject to the Cape Town Convention, the international registry in Ireland.

**c. Documented Vessels**

Order an abstract of title, (usually through a marine title service company), from the U.S. Coast Guard National Vessel Documentation Center in West Virginia.

**d. Tax Liens**

Contact the appropriate Government Entity, (generally the county), to determine, and continue to monitor, whether there are liens for delinquent taxes that have priority over the lien securing the SBA loan and decide whether they should be paid. If there are junior IRS liens against the property, ask the IRS for a certificate of discharge or reach an amicable resolution as to the amount of funds that should be applied to each IRS tax lien.

**4. Determine Amount Owed on Senior Liens**

With regard to each type of personal property collateral, determine the amount owed, including unsubordinated Default Charges, on any debt secured by a senior lien against the property, and deduct that amount from the property's estimated Liquidation Value. If it still appears that the property will have an individual or aggregate Recoverable Value of \$5,000 or more, proceed to step 5. If not, see Paragraph E below regarding abandonment.

**5. Review Relevant Business Records**

If the collateral consists of inventory or accounts, review the Borrower's books and records to determine whether there are accounts receivable that can be collected or inventory that can be returned for cash or credit. If so, see Paragraph C.5 below for information on collecting accounts receivable.

**6. Check Status of Hazard Insurance**

See Chapter 9 for SBA Loan Program Requirements regarding the need to adequately insure collateral with Recoverable Value.

**7. Order an Appraisal**

Order an Appraisal to obtain up-to-date information on the Liquidation Value of the collateral.

**Note:** See the definition of "Appraisal" in Chapter 2 for SBA requirements pertaining to appraisals. Given the inherent conflict of interest, do not rely solely on an appraisal prepared for an Obligor or another lender with a lien on the same collateral, and exercise caution if the Appraisal was prepared by a broker with whom the collateral, if acquired, will be listed for sale.

## 8. Assess Environmental Risks

If there are Hazardous Substances at the Borrower's business premises, follow prudent lending practices in order to minimize the risk and maximize the recovery on the loan. (See, for example, the Practice Tip at the end of Paragraph C.3 below regarding the sale of used chemicals, batteries and tires.) If the collateral includes equipment associated with a gas station or dry cleaner, comply with the requirements in Chapter 5 (*Environmental Risk Management*).

## 9. Calculate Time and Costs Involved

Calculate the time and costs associated with each viable method of liquidation. This includes: repossession or replevin; pre-liquidation collateral care and preservation; the liquidation action; and post-liquidation care, preservation and resale if acquiring title to the collateral is anticipated. For example, a Lender who intends to initiate a marine mortgage foreclosure action should take into account the possibility that it will need to purchase the vessel at the U.S. Marshal's sale.

## 10. Estimate the Net Recovery

Using the information collected in Steps 1-9, calculate the net amount that could be recovered by utilizing each viable method of liquidation to determine which would yield the highest recovery in the shortest amount of time.

## C. Liquidation Methods

### 1. Release of Lien for Consideration

See Chapter 8 for information on release of lien for consideration.

### 2. Voluntary Sale of Collateral by Obligor

An Obligor may be allowed to conduct a voluntary sale of all or part of the personal property collateral securing an SBA loan provided that:

- a. A voluntary sale would maximize recovery on the loan;
- b. The Obligor has possession or control of the collateral;
- c. All other lienholders have provided their written consent to the sale;
- d. An Appraisal has been obtained;

**Note:** See the definition of "Appraisal" in Chapter 2 for SBA requirements pertaining to appraisals. Given the inherent conflict of interest, do not rely solely on an appraisal prepared for an Obligor or another lender with a lien on the same collateral, and exercise caution if the Appraisal was prepared by a broker with whom the collateral, if acquired, will be listed for sale.

- e. The Recoverable Value of the collateral has been established;

- f. The sale is supervised by the Lender (or SBA Loan Center if SBA has taken over servicing);
- g. The costs of sale are reasonable, necessary and customary;
- h. The lien securing the SBA loan is only released in exchange for cash in an amount equal to or greater than the Recoverable Value of the collateral; and
- i. All of the net proceeds are applied to the principal balance of the SBA loan.

**Note:** When analyzing whether a proposed compromise amount is adequate, consideration may be given to whether the Obligor's cooperation during the liquidation process increased the overall recovery on the loan. (See Chapter 20, Paragraph F.)

### 3. UCC Sale

Liens on business assets such as equipment, inventory or fixtures created under [UCC Article 9](#) may be foreclosed by conducting a UCC sale.

#### a. Types of UCC Sales

##### (1) Private Sale

A private UCC sale is not open to the general public, usually does not occur at a pre-appointed time and place, and may or may not be advertised to the general public. Although public sales are preferred, a private UCC sale may be conducted if doing so would maximum recovery on the loan, e.g., when the collateral can be sold as part of the sale of a going concern.

##### (2) Public Sale

A public UCC sale is open to the general public, occurs at a pre-appointed time and place, and is widely advertised. The use of widely advertised public UCC sales is encouraged.

##### (a) Auction or Retail Sale

The most common type of public UCC sale is a public auction where the collateral is sold to the highest bidder. Another common type is a retail sale of the collateral conducted over a limited number of days during which time the prices are gradually lower. Retail sales are often followed by a public auction of any remaining collateral.

##### (b) Sealed Bid Sale

A sealed bid sale is typically advertised to members of the general public who submit confidential bids to be opened at a predetermined place and time. A sealed bid sale differs from a public auction in that it does not allow for interaction between competing bidders.



## **b. Requirements**

### **(1) Possession of the Collateral**

The secured creditor must be able to repossess the collateral without a "breach of the peace." (UCC § 9-609) If not, legal counsel should be consulted to determine whether litigation, such as a replevin action, is appropriate to obtain possession of the collateral.

### **(2) Reasonable Notice of the Sale**

Reasonable notice of the sale must be sent to all Obligors and junior lienholders unless the collateral is perishable or sold in a recognized market such as the New York Stock Exchange. (UCC § 9-611) To ensure compliance, notice of the sale should be sent to all of the Obligors and junior lienholders at least ten calendar days prior to the sale. To prove compliance, the Loan File should be documented with a copy of: (1) the post-default UCC lien search verifying the priority of the lien securing the SBA loan and the identity of any junior lienholders entitled to notice; (2) the notice sent to the Obligors and junior lienholders; and (3) proof that the notice was transmitted.

### **(3) Commercial Reasonableness**

Every aspect of the sale including the method, manner, time, place and terms must be "commercially reasonable." (UCC § 9-610) To prove compliance, the Loan File should, at a minimum, contain a copy of the following documents:

- (a)** Post-default inventory and Appraisal of the property sold;
- (b)** UCC sale brochure and advertisements; and
- (c)** Final accounting for the sale that includes the gross amount of proceeds, an itemized list of expenses, including how they were calculated, and the net amount recovered.

**Note:** A good auction company will keep detailed records of the sale including, e.g., a list of registered bidders, the name of each buyer, and the amount paid for each item.

## **c. Bill of Sale**

The bill of sale should state that the personal property is sold "as is" and "without warranties of any kind including those relating to title, possession, quiet enjoyment or the like." (For more information, see UCC § 9-610.)

## **d. Practice Tips**

### **(1) How to Choose an Auction Company**

Lenders that want help choosing a good auction company should consider the following:

- (a) Is it bonded? Does it have adequate insurance and the necessary licenses, including a dealer's license if you have titled motor vehicles to sell?
- (b) Is it knowledgeable about the type of collateral you have to sell?
- (c) Does it have experience attracting the appropriate customers for the type of property involved?
- (d) Does it have a good reputation in your area? Check its references.
- (e) If it is not possible to hold the auction on the Borrower's business premises, does the company have a facility where the sale can be held?
- (f) Can the auction company perform all of the duties associated with the auction? For example, can it handle the pre-sale preparation and inspection, the advertising, removal, and clean-up? And, most importantly, can it provide you with accurate records concerning all aspects of the sale?
- (g) Is the proposed fee arrangement reasonable, necessary and customary? When possible, request and compare proposals from several companies. Scrutinize the costs, particularly the advertising budget. Be suspicious of an unusually low advertising budget. Adequate advertising is essential for a successful auction. If you decide to pay the company on a commission basis, try to make sure that it will not also charge a buyer's premium, i.e., a percentage of the final bid amount (generally 10% – 20%) that is added on to the price like a sales tax and goes directly to the auction company as additional compensation.

**Note:** A buyer's premium can affect your net recovery because not as many people will attend the auction and those who do will bid lower because they know they will have to pay an extra 10-20% on top of the applicable sales tax.

## **(2) Leased Equipment**

If the UCC search reveals that a valuable piece of equipment is leased, find out the residual amount owed on the lease and pay it off if doing so would (1) allow the equipment to be included in the UCC sale; (2) attract more potential buyers to the sale; and (3) maximize recovery on the loan.

## **(3) Purchase Money Security Interests**

If the UCC search reveals that another creditor has a purchase money security interest in a valuable piece of equipment, (i.e., the Borrower used another creditor's money to purchase the equipment and granted that creditor a security interest in it), consider inviting that creditor to participate in the UCC sale if doing so would (1) attract more potential buyers to the sale; (2) reduce the costs of sale by pro-rating and sharing the costs with the other creditor; and (3) maximize recovery on the loan.

#### **(4) Used Chemicals, Batteries and Tires**

If the collateral includes Hazardous Substances such as used chemicals, batteries or tires, ascertain whether there is a market for it. If so, encourage the Borrower to sell it and apply the net proceeds to the principal loan balance. (See Chapter 8 for information on release of liens for consideration. See the EPA's Website for a list of companies that purchase reusable hazardous waste.)

#### **4. Judicial Foreclosure**

Although the self-help remedies authorized by the UCC tend to be more economical and efficient, personal property liens may also be foreclosed by filing a lawsuit. For example, if the personal property collateral consists of trade fixtures attached to real property collateral and the real property lien must be judicially foreclosed, judicially foreclosing both the real and personal property liens in the same action may be appropriate.

#### **5. Collection of Accounts Receivable**

When an SBA loan is secured by a lien on accounts receivable, a determination as to whether the pledged accounts have Recoverable Value should be made as soon as possible after an event of default. Thereafter, swift, aggressive action must be taken to collect any accounts with Recoverable Value in a manner consistent with applicable law.

##### **a. Collection by Borrower**

The Borrower, who will be liable for any deficiency and is best able to handle disputed claims, may be allowed to collect accounts provided that precautions are taken to ensure that the proceeds are applied to the loan balance.

##### **b. Collection by Lender**

In order to protect the right to a deficiency judgment, when it appears that further collection efforts by the Lender (or SBA if SBA has taken over servicing) would be futile, the Obligors should be provided with written notice of the intent to cease collection efforts and given the opportunity to pursue collection of the remaining accounts provided that the proceeds are applied to the loan balance.

#### **6. Set-off of Deposit Account**

When an SBA loan is secured by a lien on a deposit account, on the occurrence of an event of default the Lender should, in compliance with UCC § 9-607 and the terms of any applicable control agreement, ensure that the cash in the deposit account is applied to the SBA loan balance.

## **7. Surrender of Life Insurance Policy for Cash Value**

When a life insurance policy with a cash surrender value has been assigned as collateral for an SBA loan and a deficiency exists after all of the other collateral has been liquidated, the policy should be surrendered to the insurance company for the cash value and the proceeds applied to the principal balance of the loan unless, under the circumstances, it would be more prudent to keep the coverage in place, even if it requires advancing funds to pay the premiums. Premium payments, if made by the Lender or SBA should be treated as Recoverable Expenses. (See Chapter 22 for information on Recoverable Expenses.

## **8. Foreclosure of Lien on Fixtures**

A lien on fixtures may be foreclosed pursuant to UCC Article 9 or applicable real property foreclosure law. (UCC § 9-604) (See Paragraph C.3 above for information on UCC sales. See Chapter 17 for information on real property lien foreclosure.)

**Note:** A creditor who removes fixtures is responsible to the owner of the real property, other than the debtor, for the cost of repairing any physical damage caused by the removal, but not for any diminution in the value of the real property caused by the absence of the fixtures. (UCC § 9-604)

## **9. Marine Mortgage Foreclosure**

A marine mortgage on a documented vessel can only be foreclosed by filing an admiralty action in the appropriate federal district court, which will issue a warrant for the arrest of the vessel.

## **D. Credit Bids**

### **1. Non-judicial Foreclosure Sales**

Non-judicial personal property lien foreclosure sales, e.g., UCC sales, must be aggressively advertised in order to obtain the highest price and to avoid acquiring title. Generally, unless the collateral has a high estimated Recoverable Value, (e.g., state of the art printing equipment), it is not advisable to enter a Credit Bid or to establish a minimum bid or a reserve amount because doing so could have a chilling effect on the bidding.

### **2. Judicial Foreclosure Sale**

A Credit Bid must be entered when a personal property lien securing an SBA loan is judicially foreclosed. To determine the amount of a Credit Bid the following factors must be considered: (a) Recoverable Value; (b) SBA loan balance; and (c) need for and ability to collect a deficiency judgment. The Credit Bid amount should be based on the Recoverable Value of the collateral, but should not exceed the loan balance. Further, the entire loan balance should not be bid if doing so would eliminate an otherwise collectible deficiency.

**E. Abandonment**

The pursuit of recovery on personal property collateral may be abandoned if the collateral has no significant Recoverable Value, i.e., the individual or aggregate Recoverable Value is less than \$5,000. The decision and justification for abandoning collateral, including the basis for the Recoverable Value estimate, must be documented in the Loan File. (See Chapter 5 [*Environmental Risk Management*] for SBA requirements pertaining to the due diligence required before collateral may be abandoned based on unsubstantiated claims that it is Contaminated, since the presence of Hazardous Substances may not significantly impair the market value of the acquired collateral.)

## **Chapter 19. Acquired Collateral**

---

### **A. General Requirements**

Certain methods of liquidation may result in the acquisition of real property collateral ("Real Estate Owned" or "REO") or personal property collateral. When collateral is acquired, it should be liquidated in a manner that will maximize recovery in the shortest amount of time.

### **B. Acquiring Title to Collateral**

#### **1. General SBA Policy and Requirements**

- a. Title to collateral should not be acquired unless it is necessary to maximize recovery on the loan.
- b. To avoid acquisition, foreclosure sales should be aggressively advertised in order to attract a large number of potential buyers.
- c. Title to collateral must not be taken in SBA's name without obtaining SBA's prior written approval. (13 C.F.R. § 120.536(a)(4))
- d. SBA's ownership of acquired collateral should be reflected on the title as follows: "Administrator, U.S. Small Business Administration, an Agency of the United States Government."

#### **2. Real Property**

- a. Lenders that anticipate reselling REO within 120 calendar days should take title in their own name. Because the Federal Government is exempt from paying future property taxes, Lenders that anticipate resale to take more than 120 calendar days should consult the SBA Loan Center about taking title in SBA's name.
- b. Lenders must not take title to Contaminated property in their own name—or SBA's name—without SBA's prior written approval. (13 C.F.R. § 120.536(a)(5)) (See Chapter 5 on Environmental Risk Management)

#### **3. Personal Property**

Title to personal property collateral should rarely, if ever, be taken in SBA's name.

### **C. Ownership Responsibilities**

Upon acquiring title to real or personal property collateral, the following actions should be taken:

#### **1. Possession and Control**

- a. Take possession of the acquired collateral;

- b. Change the locks immediately on vacant, improved REO. Depending on the circumstances, arrange for additional security if necessary to prevent damage or to avoid liability associated with ownership; and
- c. Begin eviction proceedings if anyone is unlawfully occupying REO and will not leave voluntarily.

## **2. Inventory**

Inventory and photograph all acquired personal property, including property located in and around REO.

## **3. Accounting**

Set up a new file in order to keep all accounting associated with the acquired collateral, e.g., holding and resale costs, separate from the original Loan File since expenses related to acquired collateral cannot be added to the loan balance.

## **4. Taxes**

Monitor and pay taxes and assessments to avoid liens, interest accrual and penalties.

## **5. Care and Preservation**

Take reasonable steps to prevent deterioration, such as arranging for utility services and essential repairs and maintenance. And, if the property has historic significance, consult legal counsel and the SBA Loan Center to ensure compliance with Section 106 of the National Historic Preservation Act of 1966.

## **6. Insurance**

See Chapter 9 for SBA Loan Program Requirements pertaining to insurance coverage on acquired collateral.

## **7. Reporting Requirements**

### **a. SBA Form 297**

Complete SBA Form 297 (*Collateral Purchase Report*) when REO is acquired in SBA's name; and

### **b. Ongoing Reporting Duty**

Notify the SBA Loan Center immediately of any suspected risk of liability associated with the acquired collateral such as the presence of Hazardous Substances.

## **D. Expenses**

### **1. General Requirement**

Expenses related to acquired collateral must be necessary, reasonable and customary.

## **2. Payment of Expenses**

Expenses related to acquired collateral should be paid by the Lender.

## **3. Recoupment of Expenses**

Necessary, reasonable and customary expenses related to acquired collateral paid by the Lender may be recouped as follows:

### **a. General Requirement—SBA Approval**

Any cost, fee or other amount associated with acquired collateral that a Lender seeks to recoup must be reviewed and approved by SBA pursuant to the procedure set out in Paragraph E of Chapter 22 with regard to Recoverable Expenses.

### **b. Recoupment Methods**

#### **(1) Deduction from Recoveries**

Lenders may deduct the amount of the expenses from the proceeds of the sale of the acquired collateral.

#### **(2) Reimbursement by SBA**

Lenders may ask SBA for reimbursement of any expense that was not deducted from the proceeds of the sale of the acquired collateral.

### **c. Denied Expense Approval Requests**

Lenders must reimburse SBA for the amount of any expense denied by SBA that the Lender has already deducted from the proceeds of the sale of the acquired collateral.

## **E. Timeframe for Disposal**

Acquired collateral should be disposed of within 12 months of acquisition.

## **F. Sale**

Acquired collateral should be disposed of by sale.

### **1. Method of Sale**

Acquired collateral should be sold by whatever method, (e.g., broker's sale, public auction, sealed bid sale, etc.), will maximize recovery on the loan in the shortest amount of time.

### **2. Bidding or Acquisition by SBA Official or Lender**

SBA officials and Lenders as well as their employees, Close Relatives and Associates must not, directly or indirectly, bid on, purchase or otherwise take title to acquired collateral except pursuant to a written exception to policy approved by the Director of OFPO.



### 3. Transfer of Title and Closing Costs

#### a. REO—Quitclaim Deed

Buyers should be responsible for all closing costs, and title to REO should be conveyed by means of a quit claim deed (i.e., a deed that conveys a grantor's complete interest in the property but neither warrants nor professes that the title is valid) except in unusual circumstances where the cost of title insurance, use of a warranty deed, or payment of the seller's customary share of the closing costs is necessary to maximize the recovery on the loan in the shortest amount of time.

#### b. Personal Property—Non-recourse Bill of Sale

Acquired personal property collateral should be conveyed by means of a bill of sale that specifies that the property is sold "as is" and "without warranties of any kind including those relating to title, possession, quiet enjoyment or the like."

### 4. Sales Price

The sales price for acquired collateral should be based on an Appraisal. (See the definition of "Appraisal" in Chapter 2 for SBA requirements pertaining to appraisals. See Chapter 5 (*Environmental Risk Management*) for SBA requirements pertaining to the due diligence that must be performed before selling acquired collateral alleged to be worth substantially less than its appraised value due to the alleged presence of Contamination.)

### 5. Use of Real Estate Brokers

REO may be sold by listing it with a real estate broker provided that:

- a. The terms of the listing agreement are not inconsistent with this SOP;
- b. The listing price is supported by an Appraisal;
- c. The listing broker has a good reputation in the area where the property is located for selling the type of property involved, is properly licensed and a member of the most appropriate multiple listing service;
- d. All agreements are in writing and signed by the necessary parties;
- e. The amount of the listing and selling brokers' commission is reasonable, necessary and customary in the community where the property is located for the type of property involved; and
- f. Neither the listing nor selling broker has an actual, apparent, or potential conflict of interest with regard to the REO, Obligors, SBA or the Lender.

## 6. Sale to Obligors, Associates or Close Relatives of the Borrower

Acquired collateral should not be sold to Obligors, Close Relatives of Obligors, or Associates of the Borrower for less than the full amount due on the SBA loan unless it is necessary to maximize recovery on the loan and the following conditions are met:

- a. A comprehensive public foreclosure sale of the collateral was held;
- b. A good faith effort was made to resell the acquired collateral to a disinterested party;
- c. The acquired collateral is sold for fair market value;
- d. It is an all cash sale;
- e. If the sale is to an Obligor to repurchase the Obligor's primary residence, the REO will continue to be the Obligor's primary residence; and
- f. The sale will not harm the integrity of the SBA loan program.

## 7. Purchase Offers

All offers to purchase acquired collateral must:

- a. Be in writing signed by the party making the offer and accompanied by a good faith deposit in the form of a cashier's check, which should generally be for at least 5% of the purchase price;
- b. Not be disclosed to other prospective purchasers or their agents; and
- c. Be reviewed and analyzed based on the sales efforts to date and the value of the property established by an Appraisal.

## 8. Term Sales

### a. When Permitted

Acquired collateral should not be sold by means of a term sale unless doing so is necessary to maximize recovery on the loan.

### b. Buyer Pre-qualification

Potential purchasers buying on credit must be pre-approved.

### c. Terms of Purchase and Sale

With regard to all term sales, the purchaser must:

- (1) Make a down payment of at least 20%;

- (2) Properly execute a promissory note for the balance, which (a) is assignable; (b), has a maturity date that does not exceed 15 years for REO or five years for personal property; (c) has an appropriate interest rate; (c) requires a monthly payment amount that exceeds the amount of interest accrued each month; and (e) contains an acceleration clause that requires the purchaser to immediately pay the entire balance due in the event of default;
- (3) Provide collateral to secure payment of the promissory note in the form of a properly perfected first-position lien on the assets being sold, and when appropriate, properly executed Guaranties;
- (4) With regard to REO, pay for the cost of a mortgagee's title insurance policy; and
- (5) Obtain hazard insurance coverage for the replacement value of the asset(s) being sold that includes a mortgagee clause or equivalent in favor of the Lender (or SBA if SBA has taken over servicing), and any other type of insurance coverage required by statute, e.g., [flood insurance](#), or prudent lending practices.

## 9. Profit on Sale

Because the law varies from state to state, after the sale proceeds have been applied to the loan balance, legal counsel should be consulted to determine whether there are any state specific laws governing distribution of the surplus. Thereafter, any surplus must be remitted to the SBA Loan Center along with a written explanation for the profit and a recommendation based on the applicable law, regarding how the surplus funds should be distributed, e.g., retained by SBA, paid into the registry of the court, or distributed to junior lienholders.

## G. Lease

Generally, acquired collateral should not be leased. However, if it has not sold after a reasonable amount of time (e.g., one year), acquired collateral may be leased if doing so is necessary to maximize recovery on the loan, provided that:

- 1. A comprehensive public foreclosure sale of the collateral was held;
- 2. A good faith effort was made to sell the acquired collateral;
- 3. The terms and conditions of the lease, including the rental rate, are consistent with prevailing market rates and terms;
- 4. A written lease is used, which is legally enforceable, assignable, allows the acquired collateral to be shown to prospective buyers, and can be terminated on reasonable notice if a favorable purchase offer is received;
- 5. The acquired collateral is not leased to an Obligor, Close Relative of an Obligor, or an Associate of the Borrower unless a comparable or more desirable proposal cannot be obtained;
- 6. Leasing the acquired collateral will not harm the integrity of the SBA loan program; and

7. The leased property is inspected at least semi-annually and the inspection findings included in the Lender's quarterly status report on the loan.

#### **H. Abandonment**

Acquired collateral must not be abandoned unless abandonment of the specific REO or acquired personal property collateral has been pre-approved by SBA as an exception to policy obtained in accordance with the procedures set out in Chapter 1.

## Chapter 20. Offer in Compromise

---

### A. Overview

#### 1. Definition

An offer in compromise is an offer made by an Obligor to pay less than what is owed in full settlement of the Obligor's obligation on their SBA loan. Submitting the offer does not ensure that it will be accepted. Rather, it begins a process of evaluation and verification by the Lender and SBA. Generally, an offer in compromise will be accepted if it reflects the Obligor's true ability to pay, and will be rejected if the Obligor can pay the loan in full via a lump sum payment or an installment agreement, or if acceptance of the offer would harm the integrity of the SBA loan program.

#### 2. Legal Authority

The general requirements for compromise of a debt owed on an SBA loan are based on 31 U.S.C. § 3711 and 31 C.F.R. Part 902 (*Standards for the Compromise of Claims* - by an agency of the Federal Government).

#### 3. Effect of Compromise with One Obligor on Remaining Obligors

A compromise with one Obligor does not release the remaining Obligors since each is jointly and severally liable, i.e., full payment may be requested from one or all of the Obligors. No attempt should be made to divide payment responsibility between the Obligors or to use the compromise amount with one Obligor as the basis for the compromise amount required from another. (31 C.F.R. § 902.4)

#### 4. Finality

An offer in compromise that is approved by SBA is final and conclusive on the Obligor, SBA and the Lender unless it was obtained through fraud, misrepresentation, or mutual mistake of fact.

**Note:** Lenders may wish to advise Obligors that acceptance of a compromise offer is considered to be a loss to the Federal Government and may adversely impact the Obligor's ability to obtain future financing from the Federal Government including another SBA loan. Lenders may also wish to advise Obligors that acceptance of a compromise offer could have tax consequences that the Obligor may want to consider.

### B. When Compromise is Appropriate

#### 1. Business Closed

Compromise with an Obligor is appropriate after the business has been closed and all of the collateral has been liquidated.

### Exception—Obligor's Personal Residence

As required by Chapter 17, before foreclosing a lien on an Obligor's personal residence, a good faith effort should be made to negotiate a release of the lien for consideration and to reach a compromise regarding the amount the Obligor owes on their SBA loan.

## 2. Going Concern

Compromise with a going concern is only appropriate when the viability of the business concern is at stake and acceptance of the offer will not harm the integrity of the SBA loan program. (See Paragraph D below for detailed information on compromise with a going concern.) The offer in compromise process must not be used as a means for a business that is experiencing temporary cash flow problems to write down its debt. (See Chapters 8 - 18 for information on tools that can be used to help resolve temporary cash flow problems such as re-amortization, deferment, or a workout.)

## C. General Requirements

The general requirements for compromise of a debt owed on an SBA loan are as follows:

1. The loan must be classified in liquidation status;
2. The Person making the offer must not currently be in bankruptcy, unless the bankruptcy court has permitted the compromise action;
3. The full amount owed on the loan cannot be recovered because:
  - a. The Obligor is unable to pay it in a reasonable time;
  - b. It cannot be collected through enforced collection proceedings within a reasonable amount of time;
  - c. The cost of collection does not justify enforced collection of it;
  - d. There is significant litigative risk, i.e., a real doubt concerning the ability to prevail in court because of legal issues or factual disputes;
  - e. Given the Obligor's special circumstances, (e.g., illness), paying it would cause Financial Hardship.
4. Collection of the loan balance is not be barred by a valid legal defense such as discharge in bankruptcy or the statute of limitations;
5. The Obligor has not engaged in fraud, misrepresentation or other financial misconduct; and
6. The compromise amount bears a reasonable relationship to the amount that could be recovered in a reasonable amount of time through enforced collection proceedings and is sufficient to protect the integrity of the SBA loan program.

**Note:** Obligors do not have a "right to compromise" the amount owed on their SBA loan. In order to protect the integrity of the SBA loan program, Obligors should be referred to Treasury for further collection efforts rather than be allowed to compromise for a nominal amount relative to the amount owed on their loan. (31 C.F.R. § 902.2(e))  
(See Chapter 26 for more information on Referral to Treasury for Further Collection)

## D. Compromise with a Going Concern

In addition to the general requirements in Paragraph C above, the following requirements apply to compromise offers from going concerns:

1. The compromise must be necessary to avoid closure of the small business, i.e., the business must not be able to continue operating under its current debt structure and all other options for remaining viable must have been exhausted including, for example, the sale of non-essential assets and the closure of non-profitable locations;
2. The Borrower must pass the Feasibility Test for a successful workout set forth in Chapter 16;
3. The compromise must be part of an overall debt restructuring plan that involves all of the Borrower's creditors;
4. The specific details regarding the Borrower's secured and unsecured debt and debt reduction arrangement with each of its creditors must be set out in a written agreement signed by all of the Borrower's creditors; and
5. The Borrower's proposed treatment of the SBA loan must be fair and equitable in comparison to the treatment to be received by the Borrower's other creditors. This includes, for example, the percentage of debt to be forgiven, whether collateral is provided or retained if the compromise amount is to be paid in installments, and whether other lenders are allowed to participate in an appreciation sharing agreement.

## E. Offer and Supporting Documents

Unless the basis for compromise is litigative risk, each Obligor submitting an offer in compromise must submit the following documents:

### 1. Written Offer

A signed written offer that must refer to the penalties under [18 U.S.C. § 1001](#) for false statements, identify the source of the funds for the offer, e.g., SBA Form 1150 (*Offer in Compromise*), and explain any special circumstances that the Obligor would like taken into consideration, such as an illness that is causing Financial Hardship (see Chapter 2 for the definition of Financial Hardship);

### 2. Financial Statement

A current financial statement, signed under penalty of perjury showing the Obligor's assets, liabilities, income and expenses, e.g., SBA Form 770 (*Financial Statement of Debtor*). In addition:

- a. **Going Concerns**—If the Obligor is a going concern, the Obligor's last year-end financial statements must also be provided.
- b. **Affiliates**—If the Obligor has any affiliates, a current consolidated financial statement must also be provided.

### **3. Personal Federal Income Tax Returns**

A complete copy of the personal federal income tax returns that the Obligor filed with the IRS for the past two years or a written explanation as to why a copy is not available, together with an executed IRS Form 4506-T (Request for Transcript of Tax Return); and

### **4. Business Federal Income Tax Returns**

For each going concern and affiliate, a complete copy of the business federal income tax returns that were filed with the IRS for the past two years or a written explanation as to why a copy is not available.

## **F. Review and Analysis of Offer**

To determine whether an offer in compromise is acceptable, a good faith effort must be made to verify the accuracy of the Obligor's financial disclosure and to evaluate the adequacy of the amount offered.

### **1. Corroborating Evidence**

Independent financial information must be obtained to determine whether the financial information submitted by the Obligor is complete and accurate. At a minimum, this should include a current credit report. (31 C.F.R. § 902.2)

### **2. Adequacy of Financial Disclosure**

At a minimum, the current credit report and the financial information submitted by the Obligor in the past (e.g., the personal financial statement submitted with the loan application) must be compared to the financial information the Obligor submitted in support of the offer in compromise. Any major discrepancies must be investigated and explained. For example, concerns about the accuracy of tax returns submitted with the offer in compromise should be investigated by ordering and comparing IRS transcripts for the same tax years. All efforts to establish the validity of the Obligor's current financial information should be documented in the Loan File.

### **3. Amount Recoverable Through Enforced Collection**

An analysis must be performed to determine the amount that could be recovered from the Obligor in a reasonable amount of time through enforced collection proceedings. It should, for example, take the following factors into consideration:

- a. Recoverable Value of any collateral pledged by the Obligor that has not already been liquidated (e.g., the Obligor's personal residence);
- b. Exemptions available under state and federal law;
- c. Amount that could be recovered from the Obligor's non-exempt assets that were not pledged as collateral through enforced collection proceedings, e.g., by obtaining a judgment and executing on it;



- d. Amount of present and potential income that could be obtained through enforced collection proceedings, e.g., administrative wage garnishment after referral to Treasury;
- e. Litigative risk, i.e., a real doubt concerning the ability of the Lender or SBA to prove its case in court because of legal issues or factual disputes;
- f. The necessary, reasonable and customary administrative and litigation expenses that would be incurred through enforced collection;
- g. The time it would take to enforce collection; and
- h. The possibility that assets have been or will be concealed or fraudulently transferred.

#### **4. Adequacy of Proposed Compromise Amount**

##### **a. Standard of Review**

The compromise amount must bear a reasonable relationship to the amount that could be recovered in a reasonable amount of time through enforced collection proceedings and must be sufficient to protect the integrity of the SBA loan program.

**Note:** Obligor's do not have a "right" to compromise the amount they owe on their SBA loan. In this regard 31 C.F.R. § 902.2(e) states: "...agencies should consider whether continued collection of the debt, regardless of cost, is necessary to further an enforcement principle, such as the Government's willingness to pursue aggressively defaulting and uncooperative debtors."

##### **b. Minimum Amount**

Generally, the compromise amount should be more than \$5,000.

##### **c. Hardship Exception**

The compromise amount may be \$5,000 or less if a larger amount would cause Financial Hardship. (See Chapter 2 for the definition of "Financial Hardship".)

##### **d. Obligor's Cooperativeness**

When analyzing whether a proposed compromise amount is adequate, consideration may be given to whether the Obligor's cooperation during the liquidation process increased the overall recovery on the SBA loan.

#### **G. Inadequate Offers**

##### **1. Counter Offer**

Generally, if an offer in compromise was made in good faith, but the amount offered does not bear a reasonable relationship to the amount that could be recovered in a reasonable amount of time through enforced collection, a good faith effort should be made to arrive at an acceptable amount by countering the offer.

## 2. Decline Offer and Refer to Treasury

If the Obligor will not agree to an acceptable compromise amount, the offer should be declined; and, as soon as all other cost-effective avenues of collection have been exhausted, a Wrap-up Report should be submitted so that the loan can be charged off and referred to Treasury for offset and other enforced collection efforts. (See Chapter 26 for more information.)

**Note:** Unacceptable offers and counter-offers should not be forwarded to SBA. See Paragraph I below for information on when offers in compromise must be submitted for SBA's prior written approval.

## H. Payment Terms and Conditions

### 1. Cash Compromise—Preferred

The compromise amount should be paid in one lump sum on a specified date. Generally, payment should be received within 60 calendar days of the compromise approval date.

### 2. Term Compromise—If Necessary to Maximize Recovery

The compromise amount should not be payable in installments unless installment payments are necessary in order to maximize recovery on the loan. (31 C.F.R. § 902.2) If the compromise amount is to be paid in installments:

- a. The installment payments should be sufficient in size and frequency to satisfy the debt in three years or less. (This is incorporated in 31 C.F.R. § 901.8(b) – Collection of Payments).
- b. The terms of the compromise must be set out in a written, legally enforceable document;
- c. The amount due under the compromise agreement must be evidenced by a promissory note with a specified maturity date;
- d. Payment of the promissory note should be secured by collateral;
- e. The compromise agreement should prohibit release of the collateral securing the promissory note until the entire compromise amount has been paid in full;
- f. The compromise agreement must provide that in the event of default, the full loan balance, less sums paid on the promissory note, will be reinstated and become immediately due and payable; and
- g. The compromise agreement should provide for remedies in the event of default such as entry of a confession of judgment or delivery and recording of any deed or bill of sale to the collateral securing the promissory note.

## I. Obtaining SBA Approval

Lenders must obtain SBA's prior written approval before entering into a compromise agreement that will result in less than full payment of the outstanding principal balance of the loan. (13 C.F.R. § 120.536(a)(3)) Requests for approval should be submitted to the appropriate SBA Loan Center utilizing the format set out in the Offer in Compromise Tab System, which is accessible from [www.sba.gov/for-lenders](http://www.sba.gov/for-lenders). Failure to obtain SBA's prior written approval could result in a repair or denial of the guaranty.

**Note:** If a compromise involves settlement of litigation involving SBA in conjunction with the U.S. Attorney's Office, the compromise amount must be approved by and paid directly to the Department of Justice ("DOJ").

## J. Completing the Compromise Process

After the compromise has been approved by all of the necessary parties, the following actions should be taken:

1. Prepare and obtain the necessary signatures on a mutual release that is effective when the compromise amount is paid in full (i.e., upon payment of the compromise amount, SBA and the Lender will release the Obligor from further non-tax liability on the loan and the Obligor will release SBA and the Lender from all claims and causes of action arising from the loan);
2. Collect the compromise amount; or if the compromise agreement involves installment payments, set up a separate accounting record for the promissory note, properly perfect the lien on any asset offered to secure payment of the promissory note, and reference the note receivable number that SBA will assign to the promissory note account rather than the parent loan number when remitting payments to the Denver Finance Center;
3. Promptly apply the compromise amount to the principal loan balance;
4. Release the appropriate Loan Documents after verifying that the entire compromise amount has been received; and
5. If there is no legal remedy to collect the loan balance (e.g., from another Obligor) after the compromise amount is received, submit a Wrap-up Report so that the remaining loan balance can be charged-off.

## Chapter 21. Litigation

---

This chapter provides guidance with regard to litigation activities and expenses on 7(a) Loans. (See Chapter 3 regarding Lender Litigation Responsibility and Authority.)

### A. General Requirements

Litigation on SBA loans should be:

1. Necessary, reasonable and customary for the locality;
2. Cost effective;
  - a. Due Diligence—Adequate due diligence should be conducted prior to taking legal action to collect an SBA loan in order to ensure that the contemplated action will be cost-effective.
  - b. Alternative—If the contemplated legal action will not be cost-effective, after the collateral has been liquidated, the Lender should submit a Wrap-up Report so that the loan can be referred to Treasury for enforced collection through the use of tools such as offset, administrative wage garnishment, or DOJ litigation. Lenders receive a pro-rata share of the net amount recovered by Treasury. For more information, see Chapter 26.

**Note:** Litigation expenses that exceed the recovery on affirmative litigation undertaken without an SBA pre-approved Litigation Plan are presumed to be unreasonable. See Paragraph F.3 below for more information.

3. Conducted in the name of the Person responsible for the litigation, i.e., Lenders are not authorized to conduct litigation in SBA's name;
4. Conducted solely by the Person responsible for handling the litigation, i.e., Lenders must not take any action in litigation proceedings handled by SBA, including filing a proof of claim, without SBA's prior written approval; and
5. Consistent with the terms of any senior lienholder agreement, i.e., whenever the litigation is in response to an action initiated by the senior lienholder, legal counsel must enforce the pre-litigation notice and subordination requirements contained in the lienholder agreements, if any, executed by the senior lienholder in order to protect SBA's equity in the collateral and to provide sufficient time to negotiate a workout whenever feasible.

### B. Legal Counsel Hired by Lenders

Any attorney selected by a Lender to perform litigation on an SBA loan must possess the following minimum qualifications:

1. A valid license to practice law in the state where the litigation will be conducted;

2. Expertise in debt collection and bankruptcy law;

If complex litigation is necessary, specialized legal expertise and substantial experience conducting the type of proceedings required based on the circumstances of the loan, (e.g., an attorney hired to have a receiver appointed to operate or sell a gas station must have expertise not only in debt collection and bankruptcy law, but also environmental and receivership law and must have prior experience handling gas station receivership cases);

3. Adequate legal malpractice insurance coverage; and
4. No actual or apparent conflict of interest with SBA, the Lender, an Obligor, senior lienholder, junior lienholder, landlord, competing creditor or any other Person involved in the issues pertaining to the SBA loan.

### C. Litigation Plans

#### 1. Purpose

All Lenders should prepare a Litigation Plan prior to taking any material legal action on an SBA loan since when properly prepared, a Litigation Plan helps ensure that the litigation is cost-effective, necessary, reasonable and customary. It also expedites SBA's review of requests for approval or reimbursement of litigation expenses.

#### 2. Format and Content

A template for preparing a Litigation Plan for a 7(a) Loan is accessible from [www.sba.gov/for-lenders](http://www.sba.gov/for-lenders). Documentation establishing that the proposed attorney meets the requirements of Paragraph B above and a copy of the engagement letter must be attached to the proposed plan. The plan should also include the justification for, and the estimated cost of, any expense that is presumed to be unreasonable, such as those associated with travel, hiring multiple law firms, or appointing a receiver to perform routine liquidation activities. (See Paragraph F.3 below.)

#### 3. When a Litigation Plan Must be Submitted to SBA

##### a. General Rule

##### (1) Litigation Plan

Except as provided below with regard to emergencies, all Lenders, including PLP Lenders, must submit a Litigation Plan for SBA's written approval prior to initiating Non-routine Litigation. (13 C.F.R. § 120.540(c)) Lenders are not required to submit a Litigation Plan to SBA prior to initiating Routine Litigation. But, all Lenders must submit a Litigation Plan if a material change arises during the course of Routine Litigation that transforms it into Non-routine Litigation, e.g., the legal fees exceed \$10,000 in the aggregate. (13 C.F.R. § 120.540(c))

**Note:** With regard to CLP loans, Lenders should include Routine Litigation in the Liquidation Plans they are required to submit to SBA for approval. (Chapter 14.)

## **(2) Amended Litigation Plan**

All Lenders must submit an amended Litigation Plan to SBA for approval before taking any legal action or incurring any expense that materially deviates from its original Litigation Plan. (13 C.F.R. § 120.540(e)) Material changes are those that, for example, cause approved legal fees to increase by more than 15%.

### **b. Exception—Emergency Situations**

A Lender can take legal action to respond to an emergency without SBA's written approval of a Litigation Plan or amended Litigation Plan, provided that the Lender:

- (1)** Makes a good faith effort to obtain SBA's written approval before undertaking the emergency action;
- (2)** Submits a written Litigation or amended Litigation Plan to SBA as soon after the emergency as possible; and
- (3)** Takes no further litigation action without SBA's written approval of the Plan or amended Plan. (13 C.F.R. § 120.540(f))

## **4. How to Obtain SBA Approval**

A request for approval of a proposed Litigation Plan or amended Litigation Plan must be submitted in writing prior to taking action to the appropriate SBA Loan Center.

## **5. SBA Response Time—No Implied Consent**

Generally, SBA will respond to a request for approval of a proposed Litigation Plan or amended Litigation Plan within 15 business days from the date of receipt of the Litigation Plan. However, if a response is not received within that time frame, pursuant to 13 C.F.R § 120.541, SBA will not be deemed to have approved the request.

## **6. Appeal of Loan Center Decision**

See Chapter 3 or information on how to appeal the final decision of an SBA Loan Center Director or designee with regard to approval of a proposed Litigation Plan or Amended Litigation Plan.

## **D. SBA Take Over of Lender-serviced Litigation**

SBA may take over the litigation on a 7(a) Loan handled by Lender's legal counsel if SBA determines that the outcome of the litigation could adversely affect SBA's administration of the loan program or that SBA as an agency of the Federal Government is entitled to legal remedies that are not available to the Lender. (13 C.F.R. § 120.540(d)) For example, SBA may take over Lender-serviced litigation when:

1. The litigation involves important government policy or program issues;
2. The case appears to have great precedential value;
3. The Lender has an actual, apparent or potential conflict of interest with SBA; or

4. The legal fees charged by Lender's counsel are not reasonable, necessary or customary.

## **E. Documentation**

### **1. General Requirement**

All Routine and Non-routine Litigation activities and decisions must be justified and documented. The documentation, including pleadings and all Supporting Documents such as letters, financial statements, credit reports, Appraisals, title reports and UCC lien searches, must be kept in the Loan File.

### **2. Routine Litigation**

Unless specifically requested, Lenders are not required to provide copies of pleadings or other documents pertaining to Routine Litigation to the SBA Loan Center except as required by Chapter 22 (*Expenses and Recoveries*) to support requests for approval or reimbursement of Recoverable Expenses.

### **3. Non-routine Litigation**

To enable SBA to effectively monitor Non-routine Litigation conducted by Lenders—and to expedite the review of requests for approval or reimbursement of litigation expenses—copies of all significant documents, such as the pleadings (e.g., complaints and answers, motions and opposing pleadings, orders and judgments, and bankruptcy plans and discharge orders) and the Supporting Documents, (e.g., letters, financial statements, credit reports, Appraisals, lien searches, etc.), should be provided to the SBA Loan Center at the time the pleading or other document is created or received.

## **F. Attorney Fees and Costs**

### **1. Attorney Fees and Costs Covered by SBA Loan Guaranty**

The SBA loan guaranty only covers attorney fees and the cost of litigation proceedings, e.g., court filing fees, court reporter and transcription fees, incurred to collect the SBA loan that are necessary, reasonable and customary for the locality where the court in which the litigation proceeding was filed is located.

### **2. Examples of Fees and Costs Not Covered by SBA Loan Guaranty**

The SBA loan guaranty does not cover legal fees and costs that are not necessary, reasonable, or customary. This may include, for example, those related to:

- a. Overhead, including for example, conflict of interest determinations, file set up, calendaring, secretarial work, and billing;
- b. Intra-law firm communications and billing by more than one person for the same activity;

- c. Performance of routine loan servicing or liquidation duties such as the preparation of a demand letter, Liquidation Plan, Purchase Package, or a Protective Bid analysis;
- d. Assertion of a claim, cross claim, counterclaim, or third-party claim against SBA;
- e. Rectifying Lender error(s) that would justify a partial Denial of Liability, Repair, or full Denial of Liability;
- f. Defense of an action brought by SBA against a Lender;
- g. Defense of a claim by an Obligor or other Person seeking damages based on a Lender's alleged wrongful action unless SBA expressly directed the Lender to take the alleged wrongful action;
- h. Services rendered by Lender's in-house counsel; or
- i. Services pertaining to litigation handled by SBA legal counsel that were not pre-authorized in writing by SBA.

### 3. **Litigation Expenses That are Presumed to be Unreasonable**

The SBA loan guaranty only covers litigation expenses that are necessary, reasonable, and customary. Litigation expenses related to any of the following categories are presumed to be unreasonable unless the Lender provides justification for incurring the expense that in SBA's sole discretion is sufficient to rebut the presumption:

- a. Attorney fees and costs associated with travel that were not justified and itemized in a Litigation Plan that was pre-approved by SBA;

**Note:** Lenders are expected to hire local legal counsel. SBA recognizes, however, that in unusual circumstances, hiring counsel from another geographic area may be necessary, reasonable and customary. If so, the justification and estimated travel expenses should be included in a Litigation Plan submitted for SBA approval pursuant to Paragraph C.

- b. Inter-law firm communications and billing by more than one law firm for the same activity; when the justification for using more than one law firm was not included in a Litigation Plan that was pre-approved by SBA;
- c. Attorney fees and costs that exceed the recovery obtained in affirmative litigation that was undertaken without a Litigation Plan that was pre-approved by SBA;
- d. The appointment of a receiver to perform routine liquidation activities; and
- e. Generic, i.e., non-itemized, bills for attorney fees or costs.

### 4. **SBA Approval of Attorney Fees**

All actually incurred attorney fees and costs that a Lender seeks to recoup as a Recoverable Expense must be approved by SBA in writing, even if the estimated attorney fees and costs were listed in an SBA approved Litigation Plan.



## 5. How to Obtain SBA Approval of Attorney Fees

Requests for approval of attorney fees and costs (along with the required Supporting Documents) should be submitted to the appropriate SBA Loan Center pursuant to the procedure set out in Chapter 22 (*Expenses and Recoveries*).

## G. Suit for Judgment on Note or Guaranty

### 1. When Suit Should be Filed

Suit based on the Note or Guaranty should be filed to obtain a judgment against an Obligor when that Obligor:

- a. Does not have a valid legal defense to repayment (e.g., discharge in bankruptcy);
- b. Has either the ability to repay the SBA loan in full or substantial part;
- c. Is unwilling to repay the loan or to engage in good faith compromise negotiations; and
- d. Litigation would be a cost-effective method of collecting the loan balance.

### 2. Alternative—Referral to Treasury for Enforced Collection

When litigation would not be cost-effective, after the collateral has been liquidated, the loan should be charged-off and referred to Treasury for enforced collection including a suit for judgment filed by DOJ, if warranted. (See Chapter 26 for information on enforced collection by Treasury. See Chapter 14 or Chapter 20 for information on how to assess an Obligor's repayment ability and net worth for enforced collection purposes. See Chapter 25 for information on how to report fraud and abuse to the SBA Office of the Inspector General.)

## H. Judicial Foreclosure and Deficiency Judgment

Although non-judicial foreclosure is generally preferable, judicial foreclosure may be required by state law or be more appropriate under certain circumstances. For example, judicial foreclosure is appropriate when the proceeds of a non-judicial foreclosure sale will not be sufficient to pay the loan in full and a deficiency judgment will be needed to collect the balance from the Obligors.

## I. Settlement Offers

Offers to settle ongoing litigation should be reviewed, analyzed and processed pursuant to the requirements in Chapter 20 (*Offer in Compromise*).

## J. Bankruptcy Proceedings

**Note:** For general information about federal bankruptcy laws and the bankruptcy process, see Bankruptcy on the United States Courts Website.

### 1. Impact of Automatic Stay on Collection Activities

The moment a bankruptcy petition is filed, the automatic stay, (i.e., an injunction), automatically stops lawsuits, foreclosures, garnishments, and most collection activities against the debtor. Therefore, upon learning that a bankruptcy petition has been filed with respect to an Obligor, (the "debtor" in the bankruptcy proceedings and as used in this Paragraph), legal counsel should be consulted regarding the impact of the automatic stay on any pending or contemplated collection activities. Unless legal counsel determines that the automatic stay has been lifted or is no longer in effect, collection activity against the debtor must stop immediately. (11 U.S.C. § 362)

## 2. Notice Requirements

### a. Pre-charge Off and Referral to Treasury

Upon receipt of notice of a bankruptcy involving an Obligor, including those pertaining to "No Asset" Chapter 7 bankruptcies, the Person receiving the notice must immediately notify the appropriate SBA Loan Center so that the litigation can be monitored by SBA.

### b. Post-Charge-off and Referral to Treasury

Upon receipt of a bankruptcy notice concerning an SBA loan that has been charged-off and referred to Treasury, the Person receiving the notice must ensure that the automatic stay is not violated by immediately notifying the SBA Treasury Offset Division in Birmingham, Alabama so that the loan can be recalled from Treasury and SBA, which has sole responsibility and authority for handling litigation on loans referred to Treasury, can take appropriate action. The notice, which must include the Borrower's name and the SBA loan number, should be faxed or emailed to:

Supervisory Loan Specialist  
Treasury Offset Division  
Fax: 202-481-0592  
Email: [BirminghamTOPS@sba.gov](mailto:BirminghamTOPS@sba.gov)  
Phone: 1-800-736-6048 Extension 7705

## 3. Litigation Requirements

If an Obligor files for bankruptcy protection, at a minimum, the following actions should be taken when necessary to protect the ability to recover on the SBA loan:

- a. File a proof of claim;
- b. Review the debtor's Statement of Financial Affairs and schedules and compare them with the financial documents the debtor provided to the Lender and SBA to determine if there are any material discrepancies with regard to the debtor's alleged assets, liabilities, income or expenses;
- c. Report suspected fraud to the Office of the Inspector General (Chapter 25) and the appropriate Office of the [U.S. Trustee](#);

- d. Monitor the bankruptcy proceedings;
- e. Represent the Lender and SBA's interests at all hearings where the outcome may adversely affect the ability to collect the SBA loan balance;
- f. File a motion for relief from the automatic stay when necessary to pursue enforced collection proceedings against the collateral;
- g. File an objection to discharge of the debt owed on the SBA loan if there is reason to believe that the debtor obtained the loan through fraud, misrepresentation or omission of a material fact, or fraudulently transferred or converted collateral;
- h. File a motion to revoke the debtor's discharge if there is reason to believe that it was obtained through fraud or other acts of impropriety;
- i. Obtain the bankruptcy court's approval of a reaffirmation agreement if the debtor is willing and able to continue paying on the SBA loan;
- j. Review proposed plans and disclosure statements and file an objection when necessary;
- k. Cast a vote to accept or reject proposed plans based on an analysis of the relevant facts;

**Note:** SBA's prior written approval is required before a Lender compromises the principal balance of an SBA loan. (13 C.F.R § 120.536(a)(3)) Therefore, if a proposed bankruptcy plan calls for the reduction of the principal loan balance, the Lender handling the litigation must obtain SBA's written approval before voting in favor of the plan, but not before voting against it - regardless of whether there are additional Obligor who will remain responsible for the entire loan balance.

- l. Resume collection efforts immediately if the bankruptcy case is dismissed and the SBA loan is still in default; and
- m. Take any other action that may be necessary and appropriate under the circumstances.

## K. Probate Proceedings

In addition to collecting the proceeds from any life insurance policy assigned as collateral for the SBA loan, if an Obligor dies, at a minimum, the following actions should be taken when necessary to protect the ability to recover on the SBA loan:

- 1. File a creditor's claim in the probate proceedings within the time prescribed by the applicable law;

**Note:** [31 U.S.C. § 3713\(a\)\(1\)\(B\)](#) gives priority to claims of the United States filed against the estate of an Obligor.

2. Review the inventory of the decedent's estate and compare it with the financial documents the decedent provided to the Lender and SBA to determine if there are any material discrepancies;
3. Report suspected fraud to the SBA Office of the Inspector General (Chapter 25);
4. Monitor the probate proceedings;
5. Represent SBA and the Lender's interests at all hearings where the outcome may adversely affect the ability to collect the SBA loan balance; and
6. Take any other action that is necessary and appropriate under the circumstances.

## **L. Enforcement of Judgments**

### **1. Registration**

After a judgment has been obtained against an Obligor, the judgment, or an abstract thereof, should be recorded in any state or other jurisdictional unit (e.g., territory or foreign country) where the Obligor resides or has assets that can be seized and sold to satisfy the judgment.

### **2. Execution**

After a judgment has been obtained against an Obligor (the "judgment debtor"), the judgment debtor's non-exempt assets should be executed on within 90 calendar days of obtaining the judgment.

### **3. Assignment to SBA**

After a judgment has been obtained against an Obligor, the judgment should be assigned to SBA if the only way to collect it, or most cost-effective way, is to utilize a remedy that is available to SBA—but not the Lender—under the Federal Debt Collection Procedures Act.

## **M. Application of Litigation Recoveries**

Funds recovered through litigation should be applied in the following order:

1. Recoverable Expenses;
2. Principal loan balance; and
3. Accrued interest.

**Note:** When litigation is handled by SBA legal counsel in their capacity as a Special Assistant U.S. Attorney or by the local U.S. Attorney's Office, DOJ is authorized to collect and retain a 10% surcharge pursuant to Section 3011 of the Federal Debt Collection Procedures Act.

## Chapter 22. Expenses and Recoveries

---

This chapter covers expenses related to collecting sums due under the Note, enforcing the terms of the Loan Documents, and preserving or disposing of collateral. See Chapter 19 for information regarding expenses related to acquired collateral.

### A. Classification of Expenses

Expenses are classified by SBA as either Recoverable Expenses, which can be recouped, or Non-recoverable Expenses, which cannot be recouped. (See Paragraphs C and D below.) When reviewing Lender requests for expense approval or reimbursement, SBA may determine that an expense is Recoverable or Non-recoverable in whole or in part.

#### 1. Non-recoverable Expenses

Non-recoverable Expenses are costs that cannot be added to the principal balance of the loan. They include, for example:

- a. Any expense that is not related to collection of amounts due under the Note or to preservation or disposal of the collateral for the loan;
- b. Any fee or cost, or portion thereof, that is not necessary, reasonable or customary;
- c. Lender overhead costs that should be absorbed as a cost of doing business, e.g., telephone calls, photocopying, mileage, meals, etc.;
- d. Fees, e.g., late payment and NSF fees, which SBA allows Lenders to collect if the loan is current, but does not guaranty, (See Chapter 4 for information on loan fees.);
- e. Fees and costs incurred by a Lender to have an independent contractor or a receiver perform routine loan servicing or liquidation duties such as the preparation of a demand letter, Liquidation Plan, Purchase Package, or Protective Bid analysis, or the review of an Appraisal or Environmental Investigation Report;

**Note:** As set out in Chapter 17, receivers should only be used in unusual situations and only after SBA's prior written approval has been obtained. The appointment of a receiver involves Non-routine Litigation. Therefore, Lenders must submit a Litigation Plan for SBA approval prior to commencing receivership proceedings. See Chapter 21 for information on Litigation Plans.

- f. Expenses related to actions taken for the sole benefit of the Lender, as determined by SBA in its sole discretion;
- g. Expenses associated with a claim by an Obligor or other Person seeking damages based on a Lender's alleged wrongful action unless SBA expressly directed the Lender to take the alleged wrongful action; and
- h. The attorney fees and costs listed in Chapter 21 Paragraph F as examples of litigation expenses not covered by the SBA loan guaranty.

## 2. Recoverable Expenses

As set out in Chapter 2 (*Definitions*), Recoverable Expenses are the SBA approved, necessary, reasonable and customary costs incurred to collect amounts due under the Note, to enforce the terms of the Loan Documents, or to preserve or dispose of collateral, which according to the terms of the Note, can be added to the principal balance of the loan. Recoverable Expenses include, for example:

### a. Searches

- (1) UCC lien searches;
- (2) Title reports; and
- (3) Credit and asset search reports.

### b. Appraisals

- (1) Appraisals;
- (2) Environmental Investigation Reports; and
- (3) Site Visit Reports prepared by contractors.

### c. Litigation Expenses

- (1) Attorney fees; and
- (2) Costs such as court filing fees.

### d. Collateral Care and Preservation

- (1) Utility bills;
- (2) Insurance premium payments;
- (3) Caretaker fees;
- (4) Repair bills;
- (5) Real estate and personal property taxes; and
- (6) Expenses related to non-tax senior liens.

## B. Recoveries

### 1. Application of Recoveries

Unless the terms of a workout agreement or some other legally binding document, such as a court order, specify otherwise, recoveries (i.e., funds obtained through liquidation activities) should be applied in the following order:

- a. Recoverable Expenses incurred in the liquidation process;
- b. Principal balance of the loan; and
- c. Accrued interest.

## **2. Remittance of SBA's Share of Recoveries**

SBA's pro-rata share of the net proceeds of any recovery on a 7(a) Loan should be remitted to SBA within 15 business days of receipt regardless of whether the loan has been charged-off by SBA or the Lender. If SBA's share is not remitted in a timely manner, the SBA Loan Center may charge interest on the late amount and refer the matter to the SBA Office of Credit Risk Management.

## **C. Payment of Non-recoverable Expenses Incurred by Lenders**

Lenders must pay their own Non-recoverable Expenses. SBA will not pay, reimburse or approve, in whole or in part, Non-recoverable Expenses incurred by Lenders.

## **D. Recoupment of Recoverable Expenses Incurred by Lenders**

**Note:** The *Prompt Payment Act*, which requires federal agencies to pay interest and penalties on late payments for contracted expenses, does not apply to payments to Lenders for Recoverable Expenses. See SOP 20 17 and Subpart 32.9 of the Federal Acquisition Regulation for further information.

### **1. General Requirement—SBA Approval**

Any cost, fee or other amount that a Lender seeks to treat as a Recoverable Expense must be reviewed and approved by SBA pursuant to Paragraph E below.

### **2. Recoupment Methods**

Recoverable Expenses incurred by a Lender should be paid by the Lender and recouped by one of the following methods:

#### **a. Deduction from Recoveries**

Lenders may deduct the amount of the expenses from the proceeds of the sale of the acquired collateral.

#### **b. Reimbursement by SBA**

Lenders may ask SBA to reimburse them for Recoverable Expenses that were not paid through a deduction from recoveries.

## **E. SBA Review and Approval**

Any cost, fee or other amount that a Lender seeks to treat as a Recoverable Expense must be reviewed and approved by SBA including expenses that the Lender has already deducted from recoveries. Requests for approval must be submitted to SBA in accordance with the following requirements:

### **1. Where to Submit Requests**

Requests must be submitted in electronic format to the appropriate SBA Loan Center.

### **2. Preferred Format**

To expedite the SBA review process, Lenders should utilize the CPC Tab system to organize and submit their requests to the appropriate SBA Loan Center.

### **3. When Requests May be Submitted**

To prevent backlogs and expedite the SBA review process, requests for reimbursement or for approval of Recoverable Expenses deducted from recoveries may only be submitted at the following times:

#### **a. Submission of Loan Guaranty Purchase Request**

Requests for SBA reimbursement of Recoverable Expenses or approval of expenses paid for from recoveries may be submitted with the Lender's Purchase Package.

#### **b. Submission of Wrap-up Report**

All remaining requests for SBA reimbursement of Recoverable Expenses or approval of expenses paid for from recoveries should be submitted with the Lender's Wrap-up Report on the loan.

### **4. Multiple Loans—Allocation of Expenses**

When a request involves multiple loans to the same Borrower, (either SBA loans with different guaranty percentages or non-SBA loans):

- a. If the expense is related to collateral, the expense (as well as any recovery) must be allocated to the loans according to the priority of the lien securing each loan;
- b. If the expense is not related to collateral, the expense (as well as any recovery) must be pro-rated and allocated among the loans to which it relates.

### **5. Contents of Recoverable Expense Request Packages**

Requests should include the following items as applicable:

#### **a. Lender Contact Information**

Lender's name, address, e-mail address, phone and fax numbers, and Tax Identification Number.



**b. Borrower's Name and Loan Number****c. Summary of Expenses**

Multiple invoices must be grouped by the categories set out in Paragraph A.2 of this chapter and summarized in a cover sheet that includes: (1) the date each service was performed; (2) the number of each invoice; (3) the subtotal for each category; and (4) the grand total of all categories.

**d. Itemized Invoices**

A paper or electronic copy of each invoice must be provided and include: (1) the date of the invoice; (2) a thorough description of the goods or services provided; (3) the date the goods were provided or the services were performed; (4) the amount charged for each service or product provided; (5) the total amount due; and (6) if the invoice is for services billed on an hourly basis, the name, title, hourly billing rate and time spent by each individual who performed services covered by the invoice.

**e. Supporting Documents**

Recoverable Expense request packages must include a copy of all of the Supporting Documents pertaining to the invoices, e.g., a copy of the Site Visit Report if the invoice is for a site visit. With regard to litigation expenses, the Recoverable Expense request package must include a copy of the SBA-approved Litigation Plan, pleadings and other documents required by Chapter 21 unless they have already been provided to SBA.

**6. Denied Expense Approval Requests**

Lenders must reimburse SBA for the amount of any expense denied by SBA that the Lender has already deducted from recoveries.

**Note:** For information on how to appeal the final decision of an SBA Loan Center Director or designee with regard to approval of liquidation or litigation expenses, see Chapter 3.

## Chapter 23

### Loan Guaranty Purchase Requests

---

#### A. Overview

This chapter covers the process Lenders should use to request that SBA purchase the guaranteed portion of a loan. Pursuant to 13 C.F.R. § 120.520, SBA will not purchase the guaranteed portion of a loan from a Lender unless the Lender has submitted a complete Purchase Package to SBA, which SBA deems to contain sufficient credible evidence that the Lender made, closed, serviced and liquidated the loan in accordance with SBA Loan Program Requirements and prudent lending practices. In addition, SBA will not purchase the guaranteed portion if it has determined that any of the events listed in 13 C.F.R. § 120.524 has occurred. (See Chapter 24 on Denial of Liability on 7(a) Guaranty). This chapter also covers the deadline for resolution of the purchase loan after SBA purchase.

**Note:** SBA can purchase the guaranteed portion of a loan at any time to protect the interests of the Government or the Borrower ( 13 C.F.R. § 120.520); and if the Lender fails to request purchase in a timely manner, the FTA can request purchase on behalf of the investor (Secondary Participation Guaranty Agreement).

#### B. Interest Paid on Guaranteed Portion of Loan

##### 1. Interest Rate

When SBA purchases the guaranteed portion of a loan in response to a Lender's request, accrued interest is paid at the following rates:

- a. If the Note has a fixed interest rate—accrued interest is paid at the rate specified in the Note unless the loan was made under the SBA Express program, in which case the interest rate is set at the maximum interest rate for standard 7(a) Loans as of the date the loan originated.
- b. If the Note has an adjustable interest rate—accrued interest is paid at the rate in effect on the earliest uncured payment default date unless the loan was made under the SBA Express program, in which case the interest rate is capped at the maximum interest rate for standard 7(a) Loans as of the date of the final disbursement on the loan.

**Note:** The term “earliest uncured payment default date” means the date of the earliest failure by a Borrower to pay the full amount of a regular installment of principal or interest when due. Payments, which are made by a Borrower before the Lender requests that SBA purchase its guaranty, are applied to the earliest uncured payment default amount and if the installment is paid in full, the earliest uncured payment default date advances to the next unpaid installment date. If the Borrower makes a payment after the Lender has exercised its right to request that SBA purchase its guaranty, the earliest uncured payment default date does not change (13 C.F.R. § 120.523) and the payment must be applied to the principal balance of the loan in accordance with Chapter 4.

## 2. Interest Paid to Lenders

- a. Loans Approved On or After May 14, 2007 — Lenders are paid up to a maximum of 120 calendar days interest.
- b. Loans Approved Before May 14, 2007—Lenders are paid the amount of accrued interest allowed by the applicable regulations in effect on May 13, 2007.

## 3. Interest Paid to Secondary Market Investors

Secondary market investors are paid all accrued interest up to the date of purchase. (13 C.F.R. § 120.522(c)) However, if SBA is required to pay a secondary market holder more than 120 calendar days of accrued interest because of Lender delay, SBA may demand that the Lender reimburse SBA for the difference between the amount paid by SBA and 120 calendar days of accrued interest. (*Secondary Participation Guaranty Agreement* (SBA Form 1086) Paragraph 11)

## C. Annual Service Fee Collection

1. For loans approved before December 8, 2004, SBA will collect an Annual Service Fee through the date of guaranty purchase in the amount in place at the time the loan was approved.
2. For loans approved on or after December 8, 2004:
  - a. If the Lender submits a Wrap-up Report acceptable to SBA concurrently with its guaranty purchase request, SBA will collect an Annual Service Fee in the amount in place at the time the loan was approved for a maximum of 120 calendar days from the last interest paid to date and “0” percent thereafter.
  - b. If the Lender does not submit a Wrap-Up Report acceptable to SBA concurrently with its guaranty purchase request, SBA will collect an Annual Service Fee in the amount in place at the time the loan was approved through the date the Lender submits demand of the guaranty purchase and a complete guaranty purchase package acceptable to SBA.

## D. Requirements

Before SBA can honor a Lender’s request for guaranty purchase, all of the following requirements must be met:

### 1. Uncured Loan Default

The Borrower must be in default on a payment due on the Note for more than 60 calendar days unless SBA agreed otherwise in writing. (13 C.F.R. § 120.520)

### 2. Loan Classified in Liquidation

The Lender must report the loan as in “liquidation” status on the Lender’s monthly Form 1502 report.

### 3. Loan Purchased from Secondary Market Investor

If the loan was sold on the secondary market, the Lender must purchase the SBA guaranteed portion of the loan through the FTA or submit a secondary market purchase request to the appropriate SBA Loan Center accompanied by the following documents:

- a. Certified transcript of account;
- b. Executed copy of the Loan Authorization;
- c. Executed copies of all modifications of the Note, if any; and the
- d. Secondary market investor's written approval of all modifications of the Note.

#### **4. Collateral Liquidated**

Prior to requesting guaranty purchase, Lenders should liquidate all of the collateral for the loan, but must, at a minimum, liquidate the following:

##### **a. Loans Approved on or after May 14, 2007**

For loans approved on or after May 14, 2007, unless the Borrower filed for bankruptcy, the Lender must liquidate the business personal property collateral with an aggregate Recoverable Value of \$5,000 or more (13 C.F.R. § 120.520(a));

##### **b. Loans Approved Prior to May 14, 2007**

For loans approved prior to May 14, 2007, the Lender must liquidate the collateral according to the requirements of the program under which the loan was made. For example, the following collateral must be liquidated:

- LowDoc—The business personal property securing the loan unless the loan involves prolonged litigation or other circumstances that will extend the liquidation process more than 90 calendar days past the earliest date that the Lender could request guaranty purchase;
- EWCP—The collateral associated with the export transactions financed by the loan;
- CAPLine—The working capital assets securing the loan; and
- Express and Pilot Loan Programs—All collateral; in addition, all cost-effective means of recovery must be exhausted unless:
  - The loan was made under the Export Express Program;
  - The remaining principal balance of the loan is \$50,000 or less; or
  - The loan involves prolonged litigation or other circumstances that will extend the liquidation process more than 90 calendar days past the earliest date that the Lender could request guaranty purchase.

#### **5. Complete Purchase Package Submitted to SBA**

To request guaranty purchase, Lenders must submit a complete Purchase Package to the appropriate SBA Loan Center in accordance with the following requirements:

### a. Contents of Purchase Package

The Lender should prepare a Purchase Package for the type of loan in question in accordance with the procedural instructions issued by the SBA Loan Center to which the Purchase Package must be sent for review and processing.

- National Guaranty Purchase Center (“NGPC”)
  - Guaranty Purchase requests for all Standard 7(a), CLP, and PLP loans approved before January 1, 2014 must be submitted to the National Guaranty Purchase Center (“NGPC”). Lenders should use the 10 Tab System, which is accessible from [www.sba.gov/HerndonNGPC](http://www.sba.gov/HerndonNGPC), to assemble and organize the required documentation.
  - Guaranty Purchase requests for Standard 7(a), CLP, and PLP loans approved on or after January 1, 2014 for more than \$350,000 must be submitted to the National Guaranty Purchase Center (“NGPC”). Lenders should use the 10 Tab System, which is accessible from [www.sba.gov/HerndonNGPC](http://www.sba.gov/HerndonNGPC), to assemble and organize the required documentation.
  - Guaranty Purchase requests for all EWCP loans. Lenders should use the 10 Tab System, which is accessible from [www.sba.gov/HerndonNGPC](http://www.sba.gov/HerndonNGPC), to assemble and organize the required documentation.

**Note:** For more information on the NGPC 10-Tab System, see the notes posted under “Guaranty Purchase Information” on the NGPC’s Web site.

- Commercial Loan Servicing Centers
  - Guaranty Purchase requests for all Express, Small Loan Advantage, Community Advantage, ARC, and Pilot Loan Program loan guaranty Purchase Packages must be submitted to the appropriate SBA Loan Center, i.e., either the SBA Commercial Loan Service Center West in Fresno or the Commercial Loan Service Center East in Little Rock. Lenders should use the appropriate Purchase Demand kit to assemble and organize the required documentation. Demand kits, such as the ARC 10 Tab or 10 Tab Express kit, are accessible from the Little Rock and Fresno CLSC Web sites.
  - Guaranty Purchase requests for all loans approved on or after January 1, 2014 for \$350,000 or less, including Small 7(a), Standard 7(a), CLP, and PLP loans, must be submitted to the appropriate SBA Loan Center, i.e., either the SBA Commercial Loan Service Center West in Fresno or the Commercial Loan Service Center East in Little Rock. Lenders should use the appropriate Purchase Demand kit to assemble and organize the required documentation. Demand kits, such as the ARC 10 Tab or 10 Tab Express kit, are accessible from the Little Rock and Fresno CLSC Web sites.

### b. Deadline for Submission of Purchase Package

If SBA purchased the guaranteed portion of the loan from the secondary market investor, the Lender must submit a complete Purchase Package to the appropriate SBA Loan Center within 45 calendar days of the purchase. In all cases, in order to

avoid expiration of SBA's guaranty, Lenders must request SBA guaranty purchase no later than 180 calendar days after the maturity date of the loan or the date the Lender completes the liquidation of a matured loan. 13 C.F.R. § 120.524(a)(8)

## **E. Deadline for Lender Resolution of an SBA Purchased Loan**

Lenders must resolve SBA purchased loans as set forth in paragraphs 1-3 below and provide sufficient evidence of resolution as determined by SBA to the appropriate SBA Loan Center within either 24 months of purchase by SBA or 24 months after the effective date of this SOP for loans where lenders are actively liquidating, whichever is longer, unless an extension is approved in writing by SBA prior to the expiration of the applicable 24 month period.

Sufficient evidence of resolution includes the following:

### **a. Returned to Regular Servicing**

Lenders must provide SBA with the relevant terms of the agreement under which the Borrower has agreed to the resumption of regular payments as appropriate evidence of resolution. The Lender must provide this information in writing. The relevant terms include, but are not limited to:

- a. Gross Outstanding Principal and Interest Amounts Outstanding
- b. Payment Amount
- c. Payment Frequency
- d. Interest Rate
- e. Maturity

### **b. Paid in Full**

Lenders must remit SBA's pro-rata share of the net proceeds sufficient to satisfy the debt owed on the SBA purchased loan and verify that the loan is classified as "paid in full" in E-Tran as appropriate evidence of resolution.

### **c. Wrap-up**

Lenders must submit a Wrap-up Report acceptable to SBA and demonstrating completion of all Prudent Liquidation as sufficient evidence of resolution. (See Chapter 26, Paragraph B for more information on the contents of the Wrap-up Report)

## **F. Extensions to the Prudent Liquidation Deadline**

- a. Extension of the Prudent Liquidation deadline of SBA purchased loans may be granted by SBA on a case by case basis if an extenuating circumstance, such as a judicial foreclosure or a bankruptcy proceeding, prevents compliance with that deadline by the Lender. Extensions must be granted in writing.

- b. The Lender must submit a written request for an extension to the Prudent Liquidation

deadline to the appropriate SBA Loan Center as soon as it becomes apparent that an extenuating circumstance will prevent compliance with the deadline, but any such request should be submitted no later than 30 calendar days prior to the expiration of any deadline. At a minimum, the request must include:

- i. A detailed description of the extenuating circumstance preventing timely liquidation;
  - ii. Supporting documentation evidencing the extenuating circumstance;
  - iii. A reasonable estimate of when the Prudent Liquidation will be complete on the SBA purchased loan; and
  - iv. A status report must be submitted with the request for extension (See Chapter 3, Paragraph F).
- c. SBA will review the request and provide a written response granting or denying the extension and, if granted, will provide a new deadline for Prudent Liquidation. Once an extension has been granted, Lenders must continue to submit a report to SBA every 6 months. (See Chapter 3, Paragraph F).
  - d. If the extenuating circumstance provided for in the extension request ceases to exist, the Lender must promptly notify SBA and provide a Wrap-Up Report within 30 calendar days.
  - e. A Lender must comply with the Prudent Liquidation deadline unless an extension is granted in writing by SBA prior to the expiration of the deadline.

#### **G. Consequences of Failure to Comply with the Prudent Liquidation Deadline**

Failure to comply with the Prudent Liquidation deadline will result in the Lender being required to purchase the loan back from SBA. Additionally, Lenders who are found not to comply with the Prudent Liquidation deadline will be referred to the Office of Credit Risk Management for possible enforcement action, which could include, but is not limited to, restriction from future participation in the secondary market and suspension of delegated authority.

#### **H. Practice Tips for Lenders**

##### **a. Submit a Complete Transcript of Account**

Use of SBA Form 1149 (*Lender's Transcript of Account*) is not mandatory, but is recommended in order to expedite the purchase process.

**Note:** SBA does not guaranty or pay Lender loan fees. Therefore, loan fees must not be added to the transcript of account submitted with a guaranty purchase request.

##### **b. Explain Missing Documents**

If a required document is missing, include a written explanation for the omission in the Purchase Package.

**c. Provide Repair Estimate**

If there was a Material Loss on the loan due to Lender error, include an acknowledgment of the error, an estimate of the amount needed to fully compensate SBA for the loss, and the justification for the estimate. For example, since the amount of loss related to collateral is based on its Recoverable Value, if a required lien was not obtained on real or personal property, provide an estimate of the Recoverable Value that the property would have had if the lien had been obtained, along with a detailed explanation of how the Recoverable Value was calculated. Although the acknowledgement is not mandatory and the estimate is not binding on SBA, providing both will expedite the Repair and guaranty purchase process.



## Chapter 24

### Denial of Liability on 7(a) Guaranty

---

#### A. When SBA May Deny Liability

Pursuant to 13 C.F.R. § 120.524(a), SBA is released from liability on its guaranty of a 7(a) Loan and may, in its sole discretion, refuse to honor a guaranty purchase request in full or in part, or recover all or part of the funds already paid in connection with a guaranty purchase, whether they were paid directly to the Lender or to the secondary market investor, if the Lender:

1. Failed to comply materially with a Loan Program Requirement;
2. Failed to make, close, service or liquidate the loan in a prudent manner;
3. Placed SBA at risk through improper action or inaction;
4. Failed to disclose a material fact to SBA in a timely manner;
5. Misrepresented a material fact to SBA regarding the loan
6. Sent a written request to SBA to terminate the guarantee;
7. Failed to pay the guarantee fee within the period required under SBA rules and regulations;
8. Failed to request that SBA purchase a guarantee within 180 days after maturity of the loan. However, if the lender is conducting liquidation or debt collection litigation in connection with a loan that has matured, SBA will be released from its guarantee only if the lender fails to request that SBA purchase the guarantee within 180 days after the completion of the liquidation or debt collection litigation;
9. Failed to use required SBA forms or exact electronic copies; or
10. The borrower has paid the loan in full.

**Note:** Pursuant to 13 C.F.R. § 120.520, SBA will not purchase the guaranteed portion of a loan from a Lender unless the Lender has submitted to SBA documentation that SBA deems sufficient to allow SBA to determine whether purchase of the guaranty is warranted under 13 C.F.R. § 120.524.

#### B. Loss Attributable to Lender

1. **Material Loss or Harm to Program Integrity**

Generally, SBA does not deny liability on a 7(a) Loan guaranty unless the Lender's actions or omissions caused, or could cause, a Material Loss on the loan. SBA may, however, deny liability on a guaranty in the absence of an actual or potential Material Loss if the Lender's misconduct is deemed material to the soundness and integrity of the 7(a) Loan program, such as, for example, if the loan was ineligible for SBA financing, or the Lender failed to disclose or misrepresented a material fact to SBA.

## 2. **Amount of Loss on Collateral**

The amount of a loss related to collateral should be based on the collateral's Recoverable Value.

## 3. **Projected Loss**

If a significant, but not yet quantified loss appears likely, unless SBA has already purchased the loan from the secondary market investor, the Lender should withdraw its guaranty purchase request and resubmit it when the Lender has completed the liquidation process.

# C. **Repairs**

## 1. **Definition**

As set forth in Chapter 2 (*Definitions*), the term Repair means an agreement between SBA and a 7(a) Lender as to a specific dollar amount to be deducted from the funds SBA pays on the Lender's guaranty in order to fully compensate SBA for an actual or anticipated loss caused by the Lender's actions or omissions. A Repair does not reduce the percent of the loan guaranteed by SBA or SBA's pro-rata share of expenses or recoveries.

## 2. **Repair Amount**

The net amount of a Repair must be a specific dollar amount that fully compensates SBA for the actual or anticipated loss caused by the Lender's actions or omissions. Generally, it is determined by multiplying the dollar amount of the loss by the percent of the loan guaranteed by SBA. (E.g., \$50,000 loss x 75% guaranty = \$37,500 Repair)

**Note:** In order to expedite the guaranty purchase review process, Lenders are encouraged to include a Repair estimate in their Purchase Package.

## 3. **When a Repair is Appropriate**

Except in cases involving gross Lender misconduct (See Subparagraph 4 below.), a Repair is appropriate when the Lender's actions or omissions caused an actual or anticipated loss that justifies a partial Denial of Liability by SBA, but rather than have SBA formally deny liability, the Lender agrees to allow SBA to deduct a specific, agreed-upon dollar amount from the amount that SBA owes to the Lender on its guaranty in order to fully compensate SBA for the loss.

## 4. **When a Repair is Not Appropriate**

### a. **Total Loss on Loan**

A Repair is not appropriate if the Lender's actions or omissions caused a total or near total loss on the loan.

**b. Gross Lender Misconduct**

A Repair is not appropriate if the Lender's misconduct is deemed material to the integrity and soundness of the 7(a) Loan program.

**c. Justified Abandonment of Collateral**

A Repair based on a Lender's failure to liquidate personal property collateral is not appropriate if the Lender abandoned the property in accordance with prudent lending practices and SBA Loan Program Requirements. (See Chapter 18 for information regarding abandonment of personal property collateral.)

For example, a Repair for failure to liquidate restaurant equipment (e.g., walk-in freezer, built-in booths, stove hood and related ventilation equipment, pots and pans, etc.) located on leased premises would not be appropriate if the appraised value of the equipment is \$12,000 and the estimated cost of removing, transporting, storing, and selling it is approximately \$10,000. Under the circumstances, abandonment would be justified not only based on the estimated Recoverable Value of \$2,000, but the fact that the actual Recoverable Value could be significantly less due to the Lender's risk of liability for damage done to the leased premises while removing the trade fixtures.

**D. Partial Denial of Liability**

A partial Denial of Liability is justified if the Lender's actions or omissions caused, or could cause, a Material Loss but less than a total or near total loss on the loan, and the Lender does not agree to a Repair that is acceptable to SBA.

**E. Full Denial of Liability**

A full Denial of Liability is justified if the Lender's actions or omissions caused an actual or anticipated total or near total loss on the loan, resulted in SBA guaranteeing an ineligible loan, or are deemed material to the soundness or integrity of the 7(a) Loan program, and the Lender does not voluntarily request that SBA cancel the loan guaranty.

**F. Voluntary Termination of Guaranty**

Lenders may, at any time prior to guaranty purchase, voluntarily request termination of the SBA loan guaranty.

**G. Examples of When a Full or Partial Denial of Liability May Be Justified**

Listed below are examples of common Lender deficiencies that justify SBA Denial of Liability in full or in part. The list is not exhaustive and is provided for illustrative purposes only.

**1. Incorrect Eligibility Determination**

A full Denial of Liability is justified if the Lender made an ineligible loan. A partial Denial of Liability is justified if a portion of the loan proceeds were used for an ineligible purpose.

**2. Use of Suspended or Debarred Agent**

A full Denial of Liability is almost always justified if the Lender placed SBA at risk by making a loan based on a loan package prepared by an Agent who was suspended or debarred by SBA or another federal agency, unless the Lender provides credible evidence that the business failed for totally unrelated reasons.

**Note:** Information regarding the identity of Agents who have been debarred, suspended, proposed for debarment, excluded, disqualified or otherwise declared ineligible from receiving Federal contracts, assistance and benefits is available to the general public via the System for Award Management maintained by GSA at <https://www.sam.gov>. In accordance with SOP 50 10 5(H), Subpart A, Ch. 1, in addition to checking the SAM list for debarred or suspended agents, "lenders are responsible for reviewing SBA's webpage list of Agents that have been subject to an enforcement action or have been otherwise excluded from the privilege of conducting business with SBA and must refrain from doing business with any Agent appearing on the list during the time that an Agent is suspended or revoked from SBA programs. See <http://www.sba.gov/about-sba-services/18351>

### 3. **Early Default Due to Failure to Properly Make or Close Loan**

A full Denial of Liability is almost always justified if the Lender's failure to make or close the loan in accordance with prudent lending practices and SBA Loan Program Requirements contributed to or allowed an Early Default unless the Lender provides credible evidence that the business failure was for totally unrelated reasons. For example, Denial of Liability is almost always justified if the Lender, utilizing its delegated authority, made a loan based on underwriting that was not consistent with prudent lending practices, such as where:

- a. The Lender made the loan even though the Borrower's projected expenses greatly exceeded projected revenues and the Borrower had no other source of income;
- b. The Lender made the loan to a startup business without comparing the Borrower's projected revenue against an industry standard or some other reliable measure including the Lender's own experience making loans to similar businesses;
- c. The Lender's cash flow analysis failed to take into account an obvious fact that could easily affect the Borrower's repayment ability, such as the owner's monthly draw;
- d. The Lender's cash flow analysis contained unjustified and overly optimistic revenue projections, e.g., revenues projected to increase by 100% in year one even though the industry standard is 25% maximum and there is no explanation for the difference; or
- e. The Lender made a material mathematical error in its cash flow calculations, i.e., if the mathematical error had not been made, the Lender would not have made the loan or would have structured it in a way that would not have led to an Early Default.

### 4. **Failure to Use IRS Transcripts to Verify Financial Information**

A full Denial of Liability is justified if there was an Early Default on the loan and the Lender failed to provide credible evidence that it verified the Borrower's financial information by comparing it to relevant IRS tax return transcripts as required by the version of SOP 50 10 in effect at the time the loan was approved. Full Denial of Liability may not be justified, however, if the Lender provided credible evidence that the business

failure was due to factors unrelated to any financial difficulties that the Lender could not have identified through the IRS verification process.

**Note:** As set forth in SOP 50 10, delays in receiving transcripts from the IRS do not excuse a Lender from complying with SBA's IRS tax return verification requirements.

## **5. Failure to Use Loan Proceeds as Required by the Loan Authorization**

A full or partial Denial of Liability may be justified if there was a Material Loss on the loan due to the Lender's failure to ensure that the loan proceeds were used in accordance with the Loan Authorization.

### **a. Examples of When a Full or Partial Denial of Liability is Justified**

#### **(1) Early Default Due to Failure to Buy Key Assets**

A full Denial of Liability may be justified if there was a total or near total loss on the loan due to operational problems caused by the Borrower's failure to purchase the key assets listed in the "Use of Proceeds" section of the Loan Authorization, which resulted in an Early Default. For example, a full Denial of Liability would be justified if a Lender made a \$350,000 loan to purchase the equipment needed to start a new dental practice but failed to ensure that the Borrower purchased the dental chairs, x-ray machines, etc., and as a result, the Borrower could not generate income to repay the loan and SBA suffered a total or near total loss.

#### **(2) Collateral Not Available for Liquidation**

A full or partial Denial of Liability may be justified if there was a Material Loss on the loan because collateral required to be purchased with the loan proceeds, which would have had Recoverable Value, was not purchased and therefore, was not available for liquidation. For example, a partial Denial of Liability would be justified if a Lender made a \$350,000 loan to purchase the equipment needed to start a new dental practice but failed to ensure that the Borrower purchased the equipment, and after several years of operating, the Borrower defaulted and SBA suffered a Material Loss equivalent to the Recoverable Value that the equipment would have had if it had been purchased with the loan proceeds and available for liquidation.

### **b. Credible Evidence of Use of Proceeds**

SOP 50 10 includes a list of documentation considered to be credible evidence that the loan proceeds were used in accordance with the Loan Authorization. A post-default Appraisal or Site Visit Report may also serve as credible evidence that assets were purchased in accordance with the Loan Authorization and available for liquidation.

### **c. Unacceptable Evidence of Use of Proceeds**

Without corroborating documentation, an affidavit from the Borrower or a bank statement showing only a check number and amount is not credible evidence that the loan proceeds were used in accordance with the Loan Authorization.

## 6. Early Default and Failure to Verify an Equity Injection

### a. General Rule

If there was an Early Default on the loan, documentation verifying that any equity injection required by the Loan Authorization was not only made, but that it came from a proper source, must be included in the Lender's Purchase Package.

### b. Rebuttable Presumption

The Lender's failure to verify and properly document a material portion of an injection of cash or non-cash assets required by the Loan Authorization raises a rebuttable presumption that the Early Default was caused by the lack of the injection and a full Denial of Liability is justified. To rebut the presumption, the Lender must provide credible evidence that the primary cause of the default was something other than the lack of the required injection, e.g., the death of an irreplaceable Key Employee or a natural disaster that destroyed the Borrower's business premises and customer-base.

### c. Examples of Credible Evidence of a Cash Injection

Credible evidence of a cash injection includes:

- (1) Documentation showing that a check or wire transfer was processed and that the funds were deposited into an escrow account on the Borrower's behalf or into the Borrower's bank account prior to the initial disbursement on the SBA loan;
- (2) Documentation showing that the injected funds were received by the Borrower prior to the initial disbursement on the SBA loan, such as a copy of a signed third-party escrow settlement statement showing the disbursement on behalf of the Borrower or the Borrower's bank account statement showing the deposit of the injected funds.

### d. Examples of Unacceptable Evidence of a Cash Injection

Without corroborating documentation, a promissory note, gift letter or financial statement is not credible evidence of a cash injection.

### e. Examples of Credible Evidence of a Proper Equity Injection Source

**Note:** Verifying that an equity injection came from a legitimate source is essential in order to prevent loan fraud. According to the SBA Office of Inspector General, an increasingly common loan fraud scheme involves loan brokers, who in conspiracy with others, arrange to have the amount of a required cash injection deposited into the Borrower's bank account until the loan is closed. Thereafter, the funds are withdrawn and reused for the same deceptive practice until all of the loans begin to fail and the fraudulent scheme is uncovered.

Examples of credible evidence that an equity injection came from a source consistent with SBA Loan Program Requirements and prudent lending practices include:

- (1) A gift letter from an identified credible source that includes the amount and date of the gift and releases the Borrower from any obligation to repay the donor,

along with corroborating evidence that the gift amount was actually remitted to the Borrower, such as a copy of the Borrower's bank account statement dated prior to the initial loan disbursement documenting a cash deposit in the amount of the gift;

- (2) A home equity loan agreement plus a statement of account showing funds were drawn for the cash injection and paid into the Borrower's bank account along with credible evidence that the home equity loan would be repaid from sources other than the Borrower's cash flow;
- (3) Shareholder note and full standby agreement along with corroborating evidence that the note amount was actually remitted to the Borrower, such as a copy of the Borrower's bank account statement dated prior to the initial loan disbursement documenting a cash deposit in the amount of the note;
- (4) Business-related expenditures on behalf of the Borrower made with a principal's own funds that are supported by paid receipts or processed checks showing the nature of the expenditures; or
- (5) A deposit into the Borrower's bank account made by an Associate of the Borrower supported by the Associate's bank account statements for at least two months prior to the loan application showing that the Associate had the funds to make the required injection along with corroborating evidence that the funds were actually remitted to the Borrower, such as a bank account statement dated shortly before the initial loan disbursement showing the deposited funds.

**Note:** Large unexplained deposits should always be questioned and the source of the funds verified and documented.

#### **f. Examples of Credible Evidence of an Asset Injection**

Credible evidence of an asset injection includes, for example, an escrow settlement statement, receipt, or cancelled check along with corroborating documentation such as a deed or certificate of title, or invoice marked "Paid," which shows that the Borrower owned or acquired the asset needed for the injection plus credible evidence that the asset was available for use by the Borrower.

### **7. Failure to Obtain Required Lien or Lien Position**

A full or partial Denial of Liability is justified if the Lender failed to obtain either the lien or the lien position required by the Loan Authorization on the property required to be taken as collateral for the loan, and that failure caused, or could cause, a Material Loss on the loan. The amount of the loss should be based on the aggregate Recoverable Value that the property would have had if the Lender had obtained the lien or the required lien position.

### **8. Failure to Prepare and Use an Adequate List of Collateral**

A full or partial Denial of Liability is justified if the Lender failed to prepare and utilize an adequate list of the collateral and that failure caused, or could cause, a Material Loss on the loan. The amount of the loss should be based on the aggregate Recoverable Value that the collateral would have had if the Lender had prepared and utilized an adequate list.

**Note:** A list, which reasonably describes the collateral, should be attached to the security agreement and UCC financing statement to ensure that (1) a security interest "attaches" to the collateral, i.e., that the creditor obtains a lien on the items; and (2) the lien is "perfected," i.e., that the creditor establishes the priority of its lien over those of competing creditors.

**a. Example of When a Full or Partial Denial of Liability Is Justified**

A full or partial Denial of Liability is justified if the collateral required by the Loan Authorization was present at default, but due to the Lender's failure to prepare an adequate list of the collateral when the loan was made, the Lender was unable to enforce its security interest against the Borrower, a trustee in bankruptcy, or a competing creditor, and that failure caused, or could cause, a Material Loss on the loan.

**b. Example of When a Full or Partial Denial of Liability Is Not Justified**

A full or partial Denial of Liability is not justified despite the Lender's failure to prepare an adequate list of collateral when the loan was made, if all of the collateral required by the Loan Authorization was present at default and liquidated, and all of the net proceeds were applied to the principal balance of the loan, i.e., there was no Material Loss on the loan.

**9. Failure to Conduct a Post-default Site Visit**

A full or partial Denial of Liability is justified if the collateral required by the Loan Authorization disappeared or declined in value due to the Lender's failure to conduct a post-default site visit as required by Chapter 15 and that failure caused, or could cause, a Material Loss on the loan. The amount of the loss should be based on the aggregate Recoverable Value of the collateral that was not available for liquidation or the aggregate amount by which the collateral declined in value due to the Lender's failure to properly conduct a timely site visit.

**Note:** A UCC sale conducted at the debtor's business premises where the machinery and equipment is set up, connected to an appropriate power source, and can easily be inspected and tested will usually produce a significantly higher recovery than a sale of the same collateral held off-site after it has been dismantled and moved to a storage facility because the lender failed to conduct a timely site visit and make arrangements with the landlord to conduct an on-site UCC sale.

**10. Failure to Liquidate in a Commercially Reasonable Manner**

**a. Examples of When a Full or Partial Denial of Liability Is Justified**

A full or partial Denial of Liability is justified if the Lender failed to liquidate the loan in a prudent and commercially reasonable manner and the failure caused, or could cause, a Material Loss on the loan. For example, a full or partial Denial of Liability is justified if the Lender:



(1) Failed to safeguard the collateral until it could be liquidated;

- (2) Permitted a substantial decline in the value of collateral to occur because of unnecessary delays or mismanagement of the liquidation process;
- (3) Failed to account for items listed on the pre-closing collateral list that were not listed on the post-default inventory and appraisal; or
- (4) Failed to account for items listed on the post-default inventory and Appraisal that were not included in the liquidation sale.

**b. Example of When Full or Partial Denial of Liability is Not Justified**

A partial Denial of Liability is not justified based on the Lender's failure to liquidate personal property collateral if the Lender abandoned it pursuant to prudent lending practices and SBA Loan Program Requirements. For example, a partial Denial of Liability would not be justified if the Lender abandoned the inventory of a souvenir shop with a Liquidation Value of \$10,000, even though the routine foreclosure costs were estimated at \$5,000, if the collateral could not be repossessed without a breach of the peace and the Lender provided evidence that a replevin action would, at a minimum, cost an additional \$3,000.

**11. Loan Actions Resulting in Lender Preference**

A full or partial Denial of Liability is justified if the Lender took any Loan Action that conferred a Preference on the Lender, which caused, or could cause, SBA to suffer a Material Loss on the loan or is deemed by SBA to be material to the soundness or integrity of the 7(a) Loan program, including, for example, if the Lender:

- a. Applied recoveries from an SBA loan to the Lender's non-SBA loans(s) or to another SBA loan with a lower guaranty percentage in a junior lien position;
- b. Released the collateral for an SBA loan in order to use it as security for a non-SBA loan;
- c. Subordinated the lien securing an existing SBA loan to a lien securing a non-SBA loan or SBA loan with a lower guaranty percentage; or
- d. Renewed or increased the amount owed on a non-SBA loan or an SBA loan with a lower guaranty percentage, after subordinating the lien securing an existing SBA loan to the lien securing the loan the Lender renewed or increased.

## Chapter 25 Inspector General Referrals

---

### A. Duty to Report Irregularities

All SBA officials, Lenders and contractors must be on the lookout for fraud and report any known or suspected irregularities involving SBA programs, program participants, or personnel to the Office of the Inspector General ("OIG"). (13 C.F.R. § 120.197)

### B. Irregularities Requiring Referral

Examples of irregularities that must be referred to the OIG include:

#### 1. Loan Application Fraud

False statements made by, or false documents submitted by, loan applicants or Borrowers with regard to their eligibility for SBA financing. For example:

- a. Overstating income;
- b. Understating or failing to disclose liabilities;
- c. Overstating the value of assets offered as collateral;
- d. Failing to disclose criminal records;
- e. Making false statements regarding U.S. citizenship or immigration status;
- f. Misrepresenting the true ownership of a business;
- g. Using false Social Security numbers;
- h. Creating false work histories;
- i. Submitting altered tax returns; or
- j. Providing fraudulent standby agreements.

#### 2. Loan Closing Fraud

False documents submitted to meet loan closing requirements. This includes, for example, the following types of documents that are often submitted as "proof" that an equity injection required by the Loan Authorization was made:

- a. False gift letter or affidavit;
- b. False promissory note and standby agreement; or
- c. False bank statement and cashier's check.

**3. Loan Agent Fraud**

Actions by Agents who orchestrate, facilitate or otherwise support any of the illegal acts committed by loan applicants, Lenders, or Obligors such as those listed in this chapter.

**4. Misuse of Loan Proceeds**

Misuse of loan proceeds or any other funds in which SBA has an interest.

**5. Conversion of Collateral**

Conversion, concealment, vandalism or unauthorized disposal of collateral for an SBA loan.

**6. SBA Employee Misconduct**

Misconduct by an SBA official or Close Relative of an SBA official, such as soliciting or accepting a bribe in connection with making, closing, servicing or liquidating an SBA loan.

**7. Lender Misconduct**

Misconduct by a Lender, an Associate of a Lender, an employee of the Lender or a Close Relative of an employee, such as soliciting or accepting a bribe in connection with making, closing, servicing or liquidating an SBA loan.

**C. Referral Methods**

A referral to the OIG can be made by:

1. Calling the OIG Hotline toll-free at 1-800-767-0385;
2. Completing the on-line OIG Complaint Submission Form at [http://web.sba.gov/oigcss/client/dsp\\_welcome.cfm](http://web.sba.gov/oigcss/client/dsp_welcome.cfm) and submitting the referral via the Internet; or
3. Mailing the referral to:

U.S. Small Business Administration  
Office of Inspector General  
Investigations Division, Mail Code: 4113  
409 Third Street, SW  
Washington, DC 20416

**D. Required Information****1. Answers to Basic Questions**

A referral to the OIG should include as much information as possible in response to these basic questions:

- a. Who is involved? (Name, occupation, address, phone numbers, email address, etc.)
- b. What occurred and how is SBA involved?
- c. When and where did, or will, the activity take place?
- d. Why does the activity appear to be illegal or improper?
- e. What dollar amount is involved? (E.g., loan amount or value of converted collateral.)
- f. Who can confirm the allegation and how can that Person be contacted?
- g. Who can provide more information?

## **2. Copies of Relevant Documents**

When applicable, copies of documents that support the statements made in response to the above questions should be submitted as part of the referral.

## **E. Post-referral Responsibility**

After referring a matter to the OIG, the Person who made the referral should:

- 1. Report any new or additional information discovered about the matter to the OIG;
- 2. Not disclose or discuss the existence of the OIG referral or investigation to any Person other than SBA officials on a need-to-know basis;
- 3. Coordinate any activities related to the loan with the OIG in order to avoid taking any action that could be detrimental to the investigation or subsequent prosecution; and
- 4. With OIG approval, and in coordination with the OIG, take appropriate and timely action to maximize recovery on the loan.

## Chapter 26

### Lender Wrap-up and SBA Charge Off Procedures

---

#### A. General Requirements

Before the Loan File on an SBA loan classified in liquidation status may be closed, Once all Prudent Liquidation activities are complete and there is little or no likelihood of timely, prudent and cost-effective recoveries no further recovery expected, the Lender must submit a Wrap-up Report must be submitted in electronic format to the appropriate SBA Loan Center for review and approval. Thereafter once approved by SBA, the remaining loan balance, if any, should will be charged-off by SBA and any loan that is still legally collectible by SBA must will be referred to Treasury for further collection efforts.

#### B. Lender Wrap-up Report

##### 1. When Required

- a. A Wrap-up Report must be prepared and submitted in electronic format to the appropriate SBA Loan Center for review and approval within 30 calendar days after Prudent Liquidation is complete or upon receipt of a request from SBA, whichever occurs first. Once approved by SBA, the remaining loan balance, if any, will be charged-off by SBA and all eligible parties of the loans will be referred to Treasury for further collection efforts after assignment of the appropriate Loan Documents by Lender to SBA.
- b. In addition to the above requirement to submit a Wrap-Up Report 30 calendar days after completion of Prudent Liquidation, Lenders must comply with SBA's Prudent Liquidation Deadline definition in Chapter 2 if the Wrap-Up Report has not been previously submitted. That definition requires Lenders to prepare and submit an acceptable Wrap-up Report in an electronic format to the appropriate SBA Loan Center no later than either 24 months after purchase by SBA or 24 months after the effective date of this SOP, whichever is later, unless an extension is approved in writing by the SBA prior to the expiration of the applicable 24 month period. (See Chapter 26, Paragraph B, and Chapter 23, Paragraph E for more information on the Deadline for Lender Resolution, and Paragraph J for more information on the Extension to the Prudent Liquidation Deadline).

##### 2. Consequences of Failure to Submit a Timely Wrap-up Report

If a Lender fails to submit a Wrap-up Report within the timeframe specified in Subparagraph 1. above, in addition to referring the Lender to the SBA Office of Credit Risk Management for possible enforcement action, SBA has the right to require the Lender to purchase the loan back from SBA, charge-off the loan balance and, if appropriate, to refer the loan to Treasury after assignment of the loan documents.

##### 3. Contents

A Wrap- up Report must be submitted in electronic format to the appropriate SBA Loan Center for review and approval and must contain the information outlined in the Wrap-up

Report template on SBA's website, which can be found at the following websites:

For loans serviced at the National Guaranty Purchase Center:

<https://www.sba.gov/content/sba-charge-procedures-summary-suggested-wrap-report>

For loans serviced at the Fresno or Little Rock Commercial Loan Servicing Centers:

[https://www.sba.gov/sites/default/files/files/SBA\\_Charge\\_Off\\_Tabs\\_Wrap-Up\\_Report\\_08052015v2.pdf](https://www.sba.gov/sites/default/files/files/SBA_Charge_Off_Tabs_Wrap-Up_Report_08052015v2.pdf)

## **C. SBA Charge-off**

### **1. General**

Charge-off is an SBA administrative action whereby a loan is reclassified from "liquidation" to "charge-off" status, and the outstanding balance of the loan is removed from the Agency's accounting records. It has no impact on an Obligor's liability for the loan balance.

### **2. When Appropriate**

SBA charge-off is appropriate when the SBA has received a Lender Wrap-up Report that identifies:

- a. All reasonable efforts have been exhausted to achieve recovery from: (1) voluntary payments on the Note; (2) compromise with the Obligors; (3) liquidation of the collateral; and (4) enforced collection; and
- b. Further collection efforts are not cost effective or practical; and
- c. Remaining legally obligated Obligors cannot be located, are unable to pay the loan balance, or are unwilling to pay the loan balance; or
- d. The loan balance is uncollectible due to discharge in bankruptcy (i.e., release of the debtor from any further personal liability for pre-bankruptcy debts), expiration of the statute of limitations (i.e., the passing of the deadline for suing), or the existence of another defense available to the remaining Obligors under state or federal law.

## **D. Referral to Treasury for Further Collection**

### **1. When Referral Required**

After charge-off, if further collection is not barred by a valid legal defense such as compromise, discharge in bankruptcy, or the statute of limitations, the loan and remaining Obligors must be referred to Treasury for further collection efforts after assignment of the loan documents to SBA. (Debt Collection Improvement Act of 1996)

### **2. Assignment of Loan Documents to SBA**

- a. Lenders are to provide an assignment of loan documents as part of the Lender's Wrap-Up Report submission when Lender determines that referral to Treasury for further collection is appropriate.
- b. SBA may request Lenders to assign certain Loan Documents to SBA at any time.

Upon receipt of such a request, Lenders must assign all Loan Documents requested to SBA within 5 business days. Do not assign Loan Documents to SBA unless SBA makes a prior written request for an assignment or the assignment is provided as part of the Lender's Wrap-Up Report submission. (See paragraph C above for Wrap-Up contents, which includes an assignment of the Note to SBA).

### 3. Distribution of Post-Referral Recoveries

SBA shares the net amount recovered on the loan after referral to Treasury with the Lender on a pro-rata basis.

**Note:** Prior to referral, SBA sends an automated letter to the Obligors giving them 60 calendar days to either pay the loan in full or negotiate an acceptable payment plan.

Treasury's two primary delinquent debt collection programs, the Treasury Offset Program ("TOP") and Cross-servicing Program, are managed by the Bureau of Financial Management Service's ("FMS") Debt Management Services ("DMS").

Under TOP, delinquent debt is collected through administrative offset of funds due to Obligors from federal and state sources such as tax refunds, wages, retirement checks and contractor payments.

Under the Cross-servicing Program, in addition to offset (i.e., TOP), delinquent debt is collected through the use of a wide variety of tools such as administrative wage garnishment, skip tracing, negotiated repayment plans, use of private collection agencies, litigation, and preventing receipt of additional federal financial assistance.

### 4. Post-Referral Servicing

#### a. Exclusive Authority of Treasury Department

After SBA charge-off and referral of an SBA loan to Treasury, the Loan File should be retained by the institution originally responsible for liquidating the loan. But, except as provided below with regard to post-Treasury referral litigation, no one other than Treasury can take any further servicing or liquidation action on the loan. This exclusion applies to both SBA and the Lender.

#### c. Notice of Bankruptcy Filing or Other Litigation

Upon receipt of notice of a bankruptcy filing or other litigation concerning an SBA loan referred to Treasury, the Person receiving the notice must immediately notify the SBA Treasury Offset Division in Birmingham, Alabama so that the loan can be recalled from Treasury and SBA legal counsel can take appropriate action in response to the litigation. The notice, which must include the Borrower's name and the SBA loan number, should be faxed or emailed to:

Supervisory Loan Specialist  
Treasury Offset Division  
Fax: 202-481- 5706  
Email: [BirminghamTOPS@sba.gov](mailto:BirminghamTOPS@sba.gov)  
Phone: 1-800-736-6048 Extension 3917



**Note:** Regardless of whether the loan was originally serviced by the Lender, after the loan has been referred to Treasury, all subsequent litigation is handled by SBA legal counsel. (Chapter 3, Paragraph B.) SBA counsel may, however, request that the Loan Documents be assigned to the Lender and the loan returned to the Lender to handle the litigation.

## **E. IRS Notification of Cancelled Debt**

### **1. When IRS Form 1099-C Required**

[IRS Form 1099-C](#) (*Cancellation of Debt*) must be filed with the IRS and mailed to the Borrower—but not Guarantors—whenever the principal owed on an SBA loan is \$600 or more; and the loan balance has become uncollectible as a result of, for example, compromise or discharge in bankruptcy.

### **2. Responsibility for Issuing IRS Form 1099-C**

The SBA Denver Finance Center is responsible for providing the Borrower and the IRS with [IRS Form 1099-C](#) for the aggregate amount of the indebtedness discharged. The aggregate amount reported by SBA will include both the SBA's and the lender's share of the SBA loan. As the lead lender following charge-off, SBA will comply with the reporting requirements for both SBA and the lender by filing a single return.

### **3. When IRS Form 1099-C is Issued**

- a. Compromised debt should be reported the calendar year after the compromise amount was paid in full;
- b. Debt discharged in bankruptcy should be reported the calendar year after the discharge; and
- c. Charged-off debt that is not related to compromise or bankruptcy should be reported the calendar year after:
  - (1) The event occurred that rendered the debt uncollectible, (e.g., the date the statute of limitations for collecting the debt expired), or
  - (2) The date Treasury completed its collection efforts.

## **F. Credit Bureau Reporting**

### **1. Initial Reports**

Charged-off loans should be reported to the appropriate credit bureaus and Federal Government delinquent debtor databases, e.g., *Credit Alert Interactive Voice Response System* ("CAIVRS") and *Debt Check*.

**Note:** CAIVRS is a HUD maintained computer information system that enables lenders to learn if an applicant has previously defaulted on a federally-assisted loan from the USDA, SBA, Department of Education, HUD or VA. Debt Check is a Treasury program that allows agencies and outside lenders to obtain information regarding whether applicants for federal loans, loan insurance or loan guarantees owe delinquent child support or delinquent non-tax debt to the Federal Government.

## **2. Subsequent Reports**

If there is a substantial change in the condition or amount of the delinquent debt after it has been reported, the new information should be promptly reported to each credit bureau and database to which the original disclosure was made.

## **3. Responsibility**

### **a. SBA**

SBA is responsible for reporting the entire amount of all loans that have been charged-off by SBA to the appropriate credit reporting bureaus, and is also responsible for reporting charged-off debt to Federal Government delinquent debtor databases such as CAIVRS and Debt Check.

### **b. Lenders**

Lenders are responsible for reporting to the appropriate credit reporting bureaus the entire amount of all loans, until the time when a final Wrap-Up Report is submitted to SBA, to the appropriate credit reporting bureaus.