

**MATERIAL DEFICIENCIES IDENTIFIED IN FOUR 7(A) RECOVERY  
ACT LOANS RESULTED IN \$3.2 MILLION OF QUESTIONED COSTS**

**Report Number: ROM 11-05  
Date Issued: June 29, 2011**

**Prepared by the  
Office of Inspector General  
U. S. Small Business Administration**



U.S. Small Business Administration  
Office of Inspector General

# Memorandum

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To: Grady Hedgespeth  
Director, Office of Financial Assistance

Date: June 29, 2011

John A. Miller  
Director, Office of Financial Program Operations  
/S/ original signed

From: John K. Needham  
Assistant Inspector General for Auditing

Subject: Material Deficiencies Identified in Four 7(a) Recovery Act Loans Resulted in \$3.2 Million of Questioned Costs  
ROM 11-05

This report identifies four early-defaulted loans that we believe warrant immediate attention by the Small Business Administration (SBA) in order to recover approximately \$3.2 million. We reviewed these loans as part of our ongoing audit of purchased 7(a) Recovery Act<sup>1</sup> loans. The objective of the audit is to determine whether purchased 7(a) Recovery Act loans were originated, closed, and purchased in accordance with the SBA's rules and regulations, and commercially prudent lending standards. These four loans are part of a judgmental sample of Recovery Act loans approved for \$500,000 or more that had been purchased as of September 30, 2010.

Early-defaulted loans are those loans that default within 18 months of initial loan disbursement. An early default can be an indication of material loan origination deficiencies and as a result, the SBA requires the highest degree of scrutiny to be imposed during the pre and post purchase reviews of these loans.

To assess the internal controls relevant to our audit objective, we reviewed the SBA's policies and procedures regarding loan origination, closing and purchasing. To answer the objective, we reviewed all origination, closing and purchase actions as documented in SBA and lender loan files. We conducted the audit of these four loans from November 2010 to January 2011 in accordance with Government Auditing Standards prescribed by the Comptroller General of the United States.

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<sup>1</sup> American Recovery and Reinvestment Act of 2009, Public Law 111-5

The SBA is authorized under Section 7(a) of the Small Business Act to provide financial assistance to small businesses in the form of government-guaranteed loans. These loans are made by participating lenders under an agreement with the SBA to originate, service, and liquidate loans in accordance with the SBA's regulations, policies, and procedures. If a lender fails to comply materially with the SBA's regulations, the loan agreement, or does not make, close, service, or liquidate a loan in a prudent manner, the SBA has exclusive discretion to release itself, in whole, or in part, from liability on the loan guaranty.

The Recovery Act provided the SBA with \$730 million to expand the agency's lending and investment programs, and create new programs to stimulate lending to small businesses. Under the provisions of the Recovery Act, the SBA temporarily eliminated the upfront guaranty fees and increased the maximum guaranty percentage to 90 percent for most 7(a) loans.<sup>2</sup>

As of May 31, 2011, the SBA had improperly honored its guaranty on three of the four loans identified in this report when full denial of the guaranty should have been pursued due to material noncompliance<sup>3</sup> with SBA requirements. The remaining loan was purchased from the secondary market on August 31, 2010, and on May 24, 2011, the SBA completed its post purchase review and sent a letter to the lender requesting additional mitigating information or full reimbursement of the guaranty. Subsequent reports will be issued to address deficiencies identified on other loans in our sample.

The deficiencies identified in the four loans, as fully described in the appendices of this report, included:

- Inadequate verification of equity injection;
- Inadequate verification of financial information;
- Inadequate business valuation;
- Questionable repayment ability; and/or
- Inappropriate change of ownership.

## CONCLUSION

The audit found that the lenders did not originate and close the four 7(a) Recovery Act loans in accordance with the SBA's rules and regulations, and commercially prudent lending standards. Furthermore, SBA loan officers did not identify the deficiencies in three of the loans during their purchase reviews. The SBA purchased its guaranty on these four loans, which resulted in approximately \$3.2 million of questioned costs. As a result, we recommended that the SBA seek recovery of approximately \$3.2 million. A draft of this report was provided to the

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<sup>2</sup> Under the Recovery Act, the maximum guaranty for SBAExpress loans remained at 50 percent.

<sup>3</sup> For purposes of this report, noncompliance which resulted in or may result in improper payments is considered material.

SBA for comment. The SBA agreed with all of the recommendations and proposed actions that were responsive.

## **RECOMMENDATIONS**

We recommend the Director, Office of Financial Program Operations:

1. Seek recovery of \$37,696, plus interest, from UniBank on the guaranty paid by the SBA for the loan to [FOIA Ex. 4]
2. Seek recovery of \$373,532, plus interest, from Chetco Federal Credit Union on the guaranty paid by the SBA for the loan to [FOIA Ex. 4]
3. Seek recovery of \$1,445,021, plus interest, from Excel National Bank on the guaranty paid by the SBA for the loan to [FOIA Ex. 4]
4. Seek recovery of \$1,376,641, plus interest, from Excel National Bank on the guaranty paid by the SBA for the loan to [FOIA Ex. 4]

## **AGENCY COMMENTS AND OFFICE OF INSPECTOR GENERAL RESPONSE**

On April 21, 2011, we provided a draft of the report to the SBA for comment. On May 26, 2011, the SBA provided written comments, which are contained in their entirety in Appendix V. The SBA agreed with all of the recommendations and proposed actions that were responsive.

### **Recommendation 1**

Subsequent to the issuance of our draft audit report, the SBA received liquidation recoveries that reduced its exposure from \$561,721 to \$37,696.<sup>4</sup> Our report was modified accordingly to reflect this reduction. The SBA also completed its post-purchase review of this loan subsequent to the issuance of our draft report and concurred with our findings regarding inadequate verification of financial information and questionable business valuation. The SBA stated it will send a letter to the lender by June 3, 2011 requesting additional information. If no mitigating information is provided, the SBA will request full recovery from the lender by June 30, 2011. If the lender refuses to pay, the loan will be forwarded to SBA headquarters for further action by July 15, 2011. The SBA's proposed actions are responsive to recommendation 1.

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<sup>4</sup> Although the SBA cited an outstanding SBA share of \$31,413 in its response to our draft report, we determined the outstanding balance was actually \$37,696. It appears the SBA used a 75 percent guaranty to arrive at the \$31,413 figure rather than the 90 percent guaranty that was authorized for this loan.

**Recommendation 2**

The SBA explained that it has twice reached out to the lender for supplemental information, but the information provided in both instances was not sufficient to overcome the denial. As a result, the SBA stated it will request full repayment of the loan by June 30, 2011. The SBA's proposed actions are responsive to recommendation 2.

**Recommendation 3**

Subsequent to the issuance of our draft audit report, the SBA received recoveries that reduced its exposure from \$1,473,996 to \$1,445,021. Our report was modified accordingly to reflect this reduction. The SBA stated it will insist upon full repayment by June 30, 2011 unless sufficient mitigating documentation is received from the lender. If the lender refuses to pay, the loan will be forwarded to SBA headquarters for further action by July 15, 2011. The SBA's proposed actions are responsive to recommendation 3.

**Recommendation 4**

Subsequent to the issuance of our draft audit report, the SBA received recoveries that reduced its exposure from \$1,403,891 to \$1,376,641. Our report was modified accordingly to reflect this reduction. The SBA stated it will insist upon full repayment by June 30, 2011 unless sufficient mitigating documentation is received from the lender. If the lender refuses to pay, the loan will be forwarded to SBA headquarters for further action by July 15, 2011. The SBA's proposed actions are responsive to recommendation 4.

**ACTIONS REQUIRED**

Please provide your management response for each recommendation on SBA Forms 1824, *Recommendation Action Sheet*, within 30 days from the date of this report. Your responses should identify the specific actions taken or planned to fully address each recommendation and the target dates for completion.

We appreciate the courtesies and cooperation of the Office of Capital Access during this audit. If you have any questions concerning this report, please call me at 202-205-7390 or Terry Settle, Director, Credit Programs Group at 703-487-9940.

**APPENDIX I.** [FOIA Ex. 4]

The deficiencies on this loan will result in a \$37,696 improper payment if it is not recovered as a result of the post purchase review by the SBA. During our ongoing audit of purchased 7(a) Recovery Act loans, we identified a problematic loan [FOIA Ex. 4] made by UniBank (lender) to [FOIA Ex. 4] (borrower).

**BACKGROUND**

Unibank was authorized by the SBA to make guaranteed loans under the Preferred Lender Program (PLP). As a PLP lender, Unibank was permitted to process, close, service, and liquidate SBA loans with limited documentation and review by the SBA.

On March 3, 2009, the borrower entered into an agreement to purchase the existing business known as [FOIA Ex. 4] to be funded by a \$632,000 SBA loan, \$200,000 of equity injection, and \$200,000 of seller take back financing for a total project cost of \$1,032,000. The first loan disbursement was made on May 14, 2009 and the borrower defaulted approximately nine months later on March 1, 2010. Therefore, this loan is considered an early default loan in accordance with SBA policy. On August 31, 2010, the SBA purchased the principal guaranty for \$561,721 from the secondary market. On May 24, 2011, the SBA completed its post purchase review and sent a letter to the lender requesting additional mitigating information or full reimbursement of the guaranty. As of May 31, 2011, the SBA's share of the loan balance was \$37,696, which reflected liquidation recoveries received after purchase.

**RESULTS****Inadequate Verification of Financial Information**

The lender did not properly obtain complete tax transcripts to verify the accuracy of the seller's financial information as required in a change of ownership transaction. According to Standard Operating Procedures (SOP) 50 10 5(A), for a change of ownership the lender must verify the seller's business tax returns or a sole proprietor's Schedule C. Tax transcripts for the seller's personal tax returns were received from the IRS; however, the file did not include the Schedule C transcript information as required. Without proper verification, financial information provided by the seller could not be relied upon in determining the value of the business or the borrower's repayment ability. The loan defaulted in nine months due to a significant decrease in revenues from what was reported for this business prior to its sale. The lender informed the OIG that it believes the financial information provided by the seller included multiple businesses and did not represent the financial condition of the business being purchased.

### **Inadequate Business Valuation**

The project lacked feasibility because the borrower paid more for the business than it was worth. An accurate business valuation was required for this change of ownership transaction per SOP 50 10 5(A). The SOP states that determining the value of a business is the key component to the analysis of any loan application for a change of ownership. A business valuation assists the lender and the buyer in determining that the seller's asking price is supported by historic operations. For this loan, the lender obtained a combined real estate appraisal and business valuation performed by an independent state certified appraiser who valued the land at \$775,000 and the business at \$160,000. Given the total project cost of \$1,032,000, this appraisal/business valuation indicates that the borrower paid \$97,000 more for the business and land than it was worth.

The lender, however, ignored the independent business valuation claiming that the appraiser's approach was too conservative, and instead, assigned its own business value of \$384,729 to support loan approval. Two days after loan approval, the executive vice president of the bank reviewed and accepted the independent appraisal/valuation, indicating that the in-house valuation was overstated. It is unknown why the executive vice president accepted this appraisal/valuation after the loan was approved. As a result, we question the loan officer's basis for using an internal business valuation rather than the independent, professionally prepared valuation. Furthermore, any valuation prepared using the financial information of the seller is questionable given the fact that a proper IRS verification was not performed. As a result, there is no assurance the \$160,000 independent valuation of the business was reliable and the borrower may have paid even more than the \$97,000 in excess that is described above.

### **CONCLUSION**

Based on the above identified deficiencies, this loan will result in a \$37,696 improper payment if it is not recovered as a result of the post purchase review by the SBA.

**APPENDIX II.** [FOIA Ex. 4]

The deficiency on this loan resulted in a \$373,532 improper payment that should be recovered. During our ongoing audit of purchased 7(a) Recovery Act loans, we identified a problematic loan [FOIA Ex. 4] made by Chetco Federal Credit Union (lender) to [FOIA Ex. 4] (borrower).

**BACKGROUND**

Chetco Federal Credit Union made this loan under the Patriot Express Pilot Loan Initiative. Under the Patriot Express Program, Chetco Federal Credit Union was permitted to process, close, service, and liquidate Patriot Express loans with limited documentation and review by the SBA. On March 3, 2009, the lender approved a \$500,000 line of credit to the borrower. The line of credit financed the purchase of inventory and provided working capital. The first loan disbursement was made on March 20, 2009. The borrower defaulted approximately nine months later on January 1, 2010. Therefore, this loan is considered an early default loan in accordance with SBA policy. A purchase review was completed by the SBA and on May 20, 2010, the SBA honored its principal guaranty for \$373,532.

**RESULTS****Questionable Repayment Ability**

[FOIA Ex. 4] was established in November 2006 and had net losses and negative debt service coverage in 2007, 2008, and the first two months of 2009. As a result, repayment ability was based on projections. The projections, however, were unreasonable and suggested that sales would increase from \$125,686 in 2008 to \$5.4 million, or by 4,196 percent for the first year following loan disbursement. Second and third year sales were projected to increase to \$12.5 million and \$17.9 million, respectively. Although the projections were supported by detailed explanations for how the borrower planned to increase sales, there was no explanation for how the business would be able to increase its production capacity to meet this demand. Furthermore, total operating expenses for 2008 were 97.5 percent of sales while first year projected total operating expenses were only 11 percent of sales. Given the aggressiveness of the projections, we performed a break-even analysis and determined the borrower would need to reach sales of at least \$1.3 million to demonstrate repayment ability. There was no assurance the business would be able to reach this level of sales since it represents a 934 percent increase over 2008 sales. Furthermore, given the questionable projected operating expenses, it is likely that an even higher level of sales would be required to break even.

According to SOP 50 10 5(A) the lender's credit analysis must demonstrate that there is a reasonable assurance of repayment and the lender is required to use

appropriate, prudent, and generally accepted industry credit analysis processes and procedures which are generally consistent with those used for its similarly sized non-SBA guaranteed commercial loans. For the reasons discussed above, the lender's credit analysis did not demonstrate a reasonable assurance of repayment and therefore, this loan should not have been made.

## **CONCLUSION**

Based on the above identified deficiency, this loan resulted in a \$373,532 improper payment that should be recovered.

### **APPENDIX III. [FOIA Ex. 4]**

The deficiencies on this loan resulted in a \$1,445,021 improper payment that should be recovered. During our ongoing audit of purchased 7(a) Recovery Act loans, we identified a problematic loan [FOIA Ex. 4] made by Excel National Bank (lender) to [FOIA Ex. 4] (borrower).

### **BACKGROUND**

Excel National Bank was authorized by the SBA to make guaranteed loans under the Preferred Lender Program (PLP). As a PLP lender, Excel National Bank was permitted to process, close, service, and liquidate SBA loans with limited documentation and review by the SBA. On August 18, 2009, using PLP procedures, the lender approved a \$1,782,000 loan to the borrower to purchase an existing [FOIA Ex. 4] located in Vicksburg, MS. The first loan disbursement was made on September 1, 2009 and the borrower defaulted four months later on January 1, 2010. Therefore, this loan is considered an early default loan in accordance with SBA policy. On April 26, 2010, the SBA purchased the principal guaranty for \$1,496,880 from the secondary market and on June 7, 2010, completed its post purchase review fully honoring its loan guaranty. As of May 31, 2011, the SBA's share of the loan balance was \$1,445,021, which reflected recoveries received after purchase.

### **RESULTS**

#### **Questionable Loan Transaction**

The loan authorization required the borrower to inject \$212,500 into the business. The loan file indicated the equity injection actually totaled \$224,900 and was comprised of payments of three promissory notes to the borrower totaling \$110,000, a wire transfer from a checking account of another motel owned by the borrower for \$100,000, and two checks from the borrower totaling \$14,900. In accordance with SOP 50 10 5(A), lenders are expected to use reasonable and prudent efforts to verify that equity is injected and used as intended, and failure to do so may warrant a repair or partial/full denial. In accordance with SOP 50 51 2(C), the lender was also required to verify and document the source of the injection if the injection exceeds, as in this case, \$200,000 or 1/3 of the loan amount, whichever is less. Nevertheless, the lender did not adequately verify the source of \$164,900 of equity allegedly injected into the business, and our review did not show that the lender investigated or took action to resolve questionable circumstances surrounding the two promissory notes constituting the remaining \$60,000 of the borrower's injection.

One of the promissory notes was for \$50,000 and appeared to be from a relative of the borrower. Our audit found that payment of this note, however, was not the actual source of the \$50,000 of equity injection as indicated by the lender.

Documentation in the file showed the \$50,000 actually came from a loan advance to the borrower in relation to another motel he owned, which should have raised concerns to the lender about whether these funds would truly be used as intended and not redirected back to the other business.

The source of the \$100,000 wire could not be verified because there was a large unexplained deposit made into the checking account approximately three months prior to the wire. Furthermore, as these funds were also provided from the other motel owned by the borrower, there was also no assurance these funds would be used as intended and not redirected back to the other business.

Lastly, the two checks totaling \$14,900 were written from the borrower's business account, but since there were no statements provided for this account, there was no evidence for the source of funds. Given the suspicious transfer of funds between the borrower's businesses as described above, we question the source of funds for these checks.

Furthermore, although the loan file included checks made payable to the closing attorney and two promissory notes to support the remaining \$60,000 of the equity injection, the legitimacy of these two promissory notes is questionable because they were dated November 10, 2008, just before the borrower entered into the purchase-sale agreement on November 18, 2008. One of these promissory notes appeared to be from a family member of the borrower who also may have been an owner of the selling business based on a common last name. The remaining promissory note appeared to be from the 25 percent owner of the selling corporation. Additionally, documentation in the loan file showed that the 25 percent owner of the selling corporation was also a manager of the buying company.

According to SOP 50 10 5(A), loan proceeds are prohibited from being used for a change of ownership transaction if the seller is remaining as an officer, director, stockholder, or employee of the business. The same SOP also requires lenders to analyze each application in a commercially reasonable manner, consistent with prudent lending standards. Based on the relationships described above, the lender should have verified that the loan amount was appropriate given the potential transfer of funds from the seller to the borrower and the continued involvement by an owner of the selling corporation.

## **CONCLUSION**

Based on the above identified deficiencies, this loan should not have been made and resulted in a \$1,445,021 improper payment that should be recovered.

## APPENDIX IV. [FOIA Ex. 4]

The deficiency on this loan resulted in a \$1,376,641 improper payment that should be recovered. During our ongoing audit of purchased 7(a) Recovery Act loans, we identified a problematic loan [FOIA Ex. 4] made by Excel National Bank (lender) to [FOIA Ex. 4] (borrower).

### BACKGROUND

Excel National Bank was authorized by the SBA to make guaranteed loans under the Preferred Lender Program (PLP). As a PLP lender, Excel National Bank was permitted to process, close, service, and liquidate SBA loans with limited documentation and review by the SBA. On October 22, 2009, using PLP procedures, the lender approved a \$1,700,000 loan to the borrower to purchase two new hotels located in Corsicana, TX. The first loan disbursement was made on November 13, 2009 and the borrower defaulted approximately seven months later on June 1, 2010. Therefore, this loan is considered an early default loan in accordance with SBA policy. On August 13, 2010, the SBA purchased the principal guaranty for \$1,499,910 from the secondary market and on April 1, 2011, completed its post purchase review fully honoring its loan guaranty. As of May 31, 2011, the SBA's share of the loan balance was \$1,376,641, which reflected recoveries received after purchase.

### RESULTS

#### Inadequate Evidence of Equity Injection

The lender did not adequately verify and document the source for the \$1 million of required equity injection. According to SOP 50 51 2(C), lenders are required to verify and document the source of any cash injection that is greater than 1/3 of the loan amount or \$200,000, whichever is less. The SOP states that lenders are expected to use reasonable and prudent efforts to verify that equity is injected and used as intended, and failure to do so may warrant a repair or partial/full denial. Verification of a cash injection requires documentation, such as a copy of a check along with evidence, such as a bank statement *dated before, but close to, disbursement* showing that the funds were deposited into the borrower's account (emphasis added). A promissory note, gift letter, or financial statement alone is not generally sufficient evidence of cash injection.

The loan file showed the equity injection totaled \$1,020,000 and was comprised of checks and wires from the owners totaling \$316,000, gifts totaling \$679,000, and a wire from an owner's wife totaling \$25,000. Our audit found, however, that \$878,000 of the alleged equity injection, including \$210,000 of the checks and wires from the owners, \$643,000 of the gifts, and the \$25,000 wire from the owner's wife, were all injected into the business 11 to 17 months prior to loan disbursement and therefore, did not meet the SBA's equity injection verification

requirements. Furthermore, we found evidence that some of these funds may have been for the borrower's purchase of a different hotel in 2008. For example, two of the checks from the owners were written to [FOIA Ex. 4] but were identified on an Equity Injection Summary Sheet in the loan file as checks to the seller. [FOIA Ex. 4] was not the seller of the hotel being purchased in this loan transaction. We also found that the wire from the owner's wife was provided in August 2008 to acquire land in an area that was over 150 miles from the property being purchased in the SBA loan transaction. Additionally, we question why the gift letters were dated shortly before loan approval, but the funds were injected into the business back in 2008. The source of funds for many of these deposits was also questionable due to missing bank account statements or large unexplained deposits in the providers' accounts.

We also questioned the validity of a \$90,000 transfer of funds from the borrower to the seller in the form of an "official check receipt" dated April 6, 2009. There was no other support for the source of these funds besides a November 4, 2009 letter from an individual who appeared to be the seller, stating he recently repaid a loan to one of the borrowers for funds he borrowed several years earlier. Without a cancelled check and bank statements to evidence the repayment of this loan, the source of these funds is unknown and questionable. Further, we questioned the source of a \$36,000 gift and \$16,000 in checks from the borrowers due to missing bank account statements. As a result, we are questioning the entire alleged equity injection amount of \$1,020,000.

## **CONCLUSION**

Based on the above identified deficiency, this loan should not have been made and resulted in a \$1,376,641 improper payment that should be recovered.

## APPENDIX V. AGENCY COMMENTS

U.S. SMALL BUSINESS ADMINISTRATION  
WASHINGTON, D.C. 20416MEMORANDUM  
May 26, 2011

To: Peter L. McClintock  
Deputy Inspector General  
/S/ original signed

From: John A. Miller  
Director, Office of Financial Program Operations

Subject: Response to Draft Report on the “Audit of Purchased 7(a) Recovery Act Loans”,  
Project No. 10508

Thank you for the opportunity to review the draft report. We appreciate the role the Office of Inspector General (OIG) plays in assisting management in ensuring that these programs are effectively managed.

On February 17, 2009, President Obama signed into law the American Recovery and Reinvestment Act of 2009 (the “Recovery Act”) (P.L. 111-5). Section 501 of the Recovery Act authorized SBA to reduce or eliminate certain fees on 7(a) and 504 loans. Section 502 of the Recovery Act authorized SBA to guarantee up to 90 percent of a 7(a) loan except for SBA Express. The loans in this report were made under sections 501 and 502.

The report identifies four loans that OIG believes warrant immediate attention by the agency in order to recover approximately \$4 million of improper payments.

- One loan was purchased from the secondary market in August 2010, but a post purchase review had not been completed by SBA when the draft audit was prepared. A review has since been conducted, as described further below;
- Two loans were purchased from the secondary market and SBA conducted the post purchase reviews; and
- One loan received a pre-purchase review.

Deficiencies identified in the four loans included:

- Inadequate verification of equity injection;

- Inadequate verification of financial information;
- Inadequate business valuation;
- Questionable repayment ability; and/or
- Inappropriate change of ownership.

OFPO has been in frequent communication with OIG during this process.

With that introduction, OFPO Management's response to the recommendations in the draft report is noted as follows:

**1. *Seek recovery of \$561,721, plus interest, from UniBank on the guaranty paid by SBA for the loan to* [FOIA Ex. 4]**

OFPO concurs with this recommendation. This is the case mentioned above where a post-purchase review had not been conducted prior to the draft report being issued. Since that time the OFPO's Herndon National Guaranty Purchase Center (NGPC) completed its review of the case and received an update on the disposition of the loan collateral from the lender. Subsequent to the draft audit, the lender notified SBA that collateral had been liquidated substantially reducing SBA's exposure on this loan to \$31,413. Nonetheless, the major IG findings regarding inadequate verification of financial information and questionable business valuations remain outstanding. OFPO will send a letter to the lender by June 3, 2011 requesting additional information. If no mitigating information is provided, OFPO will request full recovery of \$31,413 from the lender by June 30, 2011. If the lender refuses to pay, the loan will be forwarded to HQ for further action by July 15, 2011. OFPO expects full recovery.

**2. *Seek recovery of \$373,532, plus interest, from Chetco Federal Credit Union on the guaranty paid by SBA for the loan to* [FOIA Ex. 4]**

OFPO concurs with this recommendation. The Fresno Commercial Loan Service Center reviewed the additional documents the lender provided in early May, and determined the lender should be billed for the guaranteed funds honored by SBA. This determination is based on the confirmation that the lender did not perform an adequate credit analysis. This loan should have been declined based on the borrower's questionable repayment ability (unrealistic projection of income). OFPO has twice reached out to the lender for supplemental information, but the information provided in both instances was not sufficient to overcome the denial. OFPO will notify the lender of our findings that the information submitted was insufficient to overcome the full denial and will request full repayment of the loan by June 30, 2011 requesting additional information. OFPO expects full recovery.

**3. *Seek recovery of \$1,473,996, plus interest, from Excel National Bank on the guaranty paid by SBA for the loan to*[FOIA Ex. 4]**

OFPO concurs with this recommendation. The major issues regarding this case included improper source of the equity injection and that a seller remained as an employee/associate of the business. After a thorough review of the case by the Herndon NGPC staff, OFPO concurs that

the Post Purchase Review should be adjusted to account for this material deficiency. OFPO formally notified the lender during the week of May 16 that a full denial is in order; however, subsequent discussions between the lender and OFPO indicate that mitigating information and documentation may be forthcoming by June 3, 2011. Absent sufficient mitigating documentation from the lender, OFPO will insist upon full repayment by June 30, 2011. If the lender refuses to pay, the loan will be forwarded to HQ for further action by July 15, 2011.

**4. *Seek recovery of \$1,403,891, plus interest, from Excel National Bank on the guaranty paid by SBA for the loan to* [FOIA Ex. 4]**

OFPO concurs with this recommendation. The major issues involving this loan included the inadequate evidence of equity injection, validity of monies transferred between seller and the borrower, questionable equity injection made to a [FOIA Ex. 4] and equity injections that were paid directly from the sources of the equity injections to the seller vs. the borrower's operating account. After a thorough review of the case by Herndon NGPC staff, OFPO concurs that the Post Purchase Review should be adjusted to account for this material deficiency. OFPO formally notified the lender during the week of May 16 that a full denial is in order; however, subsequent discussions between the lender and OFPO indicate that mitigating information and documentation may be forthcoming by June 3, 2011. Absent sufficient mitigating documentation from the lender, OFPO will insist upon full repayment by June 30, 2011. If the lender refuses to pay, the loan will be forwarded to HQ for further action by July 15, 2011.

Again, thank you for the opportunity to review the draft report. Please let us know if you need additional information or have any questions regarding our response.