

How is existing capital under management treated with respect to Regulatory Capital? Specifically, take an example of a fund that has 50% of its capital invested in portfolio companies, 20% of its capital uninvested but reserved for follow on investments in their portfolio companies, and 30% of its capital uninvested and not reserved for existing portfolio companies. How much of this capital would be considered as Regulatory Capital that could be leveraged by the Early Stage SBIC program?

Section 107.1150 of the new rule indicates both the amount of commitments an Early Stage SBIC may receive with respect to Regulatory Capital and how much leverage an Early Stage SBIC may receive with respect to Leverageable Capital. Regulatory Capital is generally defined as the contributed capital of a Licensee, plus unfunded binding commitments by Institutional Investors to contribute capital to a Licensee. Please review 13 CFR 107.50 and 13 CFR 107.230 for the exact definitions. Leverageable Capital is also defined by 13 CFR 107.50, but in general means Regulatory Capital minus the unfunded binding commitments. In general, Early Stage SBICs may receive leverage commitments equal to Regulatory Capital up to \$50 million, but may only have leverage outstanding at any time equal to their leverageable Capital.

As an example: An Early Stage SBIC has \$35 million in unfunded binding commitments by Institutional Investors plus \$5 million in contributed capital. Regulatory capital will equal \$40 million and Leverageable Capital will equal \$5 million. The Early Stage SBIC may receive up to \$40 million in Early Stage Debenture commitments and may issue up to \$5 million in SBA guaranteed leverage. As the SBIC draws more private capital, it may issue more SBA leverage from its remaining commitments. The SBIC may draw from its SBA leverage commitments for 4 years after the government fiscal year end (September 30) in which it received its commitments. So, if the SBIC received its \$40 million leverage commitment on September 28, 2014, it will be able to draw from that commitment through September 30, 2018.

Does the SBA allow two parent funds of different vintage years, but managed by the same General Partner, drop down \$25 million of capital into each of two separate SBICs, and obtain 1:1 leverage for both funds—i.e., \$25 million of SBA leverage per fund? The SBICs will not invest in the same companies. No, this is specifically prohibited under the Early Stage Regulations; you may not have two or more licensees simultaneously in operation that are under Common Control (managed by same GP). Additionally, Applicants may not structure a “double drop-down” with each fund investing into a single SBIC either. This would result in an overly complex legal structure not contemplated by the current time-frames.

Can a drop down SBIC invest in the parent’s existing portfolio companies along with the existing investor syndicate? If so, what are the limitations? Would we need to get additional participation from new third party investors?

The action would be subject to the requirements of the conflict of interest regulations found under section [13 CFR 107.730](#). It may or may not be necessary to include a third-party; each case is different and the specific circumstances have to be considered. In general, SBA looks for terms and conditions that are fair and equitable to the SBIC.

Can an SBIC with less than 1:1 leverage invest more than 10% of its total capital in any one company—i.e., exceed the overline limit?

The overline limit was updated due to legislative changes. While SBA believes requests to exceed the overline limit should be rare, it remains possible to request an exemption. The exemption must be approved by the Associate Administrator for the Office of Investment and Innovation. In general, Early Stage SBICs should not plan to exceed this overline limit as SBA believes that portfolio diversity is important in risk management.

In section III. (Early Stage Licensing Process) D. (Licensing) 2 (Background and Documentation Review), I see the following line: "Due to the short timeframe for Licensing, Early Stage SBIC Applicants may not make pre-licensing investments." Is it a requirement that the fund not have made ANY investments prior to obtaining the SBA license to be an Early Stage SBIC? We are currently raising a 2011 year vintage fund of \$50-\$100M that has already made a few investments. Does this disqualify us from the possibility of becoming licensed?

Investments made prior to receiving a license cannot be counted towards leverageable Regulatory Capital, but do not disqualify applicants.

How will management fees be calculated?

Please see [13 CFR 107.520](#) and [SBIC Tech Note #7A](#). Please note that these reflect maximum management fees only. Early Stage SBICs should recognize that management expenses contribute to overall fund losses and capital impairment.

Can a small amount of the cost basis of existing portfolio companies in a fund be contributed to the new SBIC (contribution in kind)? If not, can the shareholdings be contributed to the SBIC as portfolio companies even if their cost basis cannot be used to calculate Regulatory Capital (the reason for this would be so that reserves for these investments could be made from regulatory capital and the proceeds from these investments upon exit would be used to repay sba leverage and generate returns for private capital investors)?

SBA does not allow in-kind contributions, because they create problematic valuation issues. Consequently, even non-Regulatory Capital in-kind contributions are also not allowed. SBICs are to be de-novo investment vehicles without prior encumbrances.

I am looking on information on the eligibility of a company for SBIC loans. My client is a company owned by a holding company, and that holding company is owned by a private equity fund. Does this indirect ownership by a private equity fund, which would seem to qualify as an Affiliate, disqualify my client from accepting a SBIC loan? I would appreciate any guidance that you can provide.

This appears to be a permissible leveraged buyout transaction where SBICs provide mezzanine capital to companies with a private equity sponsor.

The online FAQ indicates that all Early Stage SBICs must use the Model LPA. Does that mean only new funds can participate in the program? I am working with a client who currently is raising a fund and already has a LPA in place with investors. Is it possible for this client to apply and participate without having to amend and restate its LPA to match the Model LPA? For instance, is it possible set up a parallel fund structure, perhaps waive the model LPA requirement, or use a side letter to the existing fund LPA to address Model LPA terms?

The requirement to use the Model is absolute. Applicants may consider forming a drop-down subsidiary, but the drop down would have to use the Model LPA, and could not contain any references to governance by the Parent's LPA. The SBICs LPA must be a self-contained document.

Fees are 1% commitment and 2% draw down. Are these annual fees? Or one-time fees?

The 1% commitment fee is a one-time fee. The 2% draw down fee is charged each time you draw leverage, but is limited to 2% of the amount drawn. SBA also charges an annual fee based on outstanding leverage. The annual fee is set at the time of commitment, but may be no higher than the statutory limit of 1.38%. SBA's annual fee has never exceeded 1%. For leverage drawn from commitments approved in FY 2014 the annual fee will be 35.5 basis points.

The program offers a 1:1 match. Could we lower this to \$0.50 for every dollar that we have raised? So that, if our fund were \$40M, we could add another \$20M from the SBIC program?

Yes. Applicants may take less than 1:1 leverage, but they should clearly indicate how much leverage they are requesting.

Does the SBA have any visibility on what the spread will be?

The spread is approximately 131 bps over the 10 Year Treasury for the Early Stage Debenture (ESD): the current FHLBC cost of funds is approximately 110 bps over the 10 Year Treasury; and the margin above cost of funds for the FHLBC is approximately 21 bps. The Federal Home Loan Bank of Chicago maintains a Discount Debenture Calculator (LMI Debenture Calculator) that can be accessed at: <http://www.sba.gov/content/low-or-moderate-income-lmi-debentures>. This Discount Calculator provides the coupon rates for all types of SBIC Program Discount Debentures, including Early Stage Debentures. Please note that since LMI Debentures and Energy Saving Debentures are priced the same, they are combined on the calculator under the button called "SBIC Discount". The calculator provides the estimated proceeds from draws of both the Early Stage Current Pay Debenture (called the "Early Stage Standard") and the Early Stage Discount Debenture (called the "Early Stage Discount"). The coupon rate is priced the same for a draw of either type of Early Stage Debenture.

Please note that the FHLBC cost of funds is not a fixed spread; it represents the cost for funds that the FHLBC pays on the date of each...

Could you at least give me some direction as to whether this spread would likely be higher or lower than the standard SBIC debenture program?

Please review the pricing table for the standard SBIC debenture program found at:

<http://www.sba.gov/content/trust-certificate-rates-annual-charge-debenture-program> for a comparison of rates between the standard SBIC debenture program and Early Stage Debentures.

We would ask for a 1:1 funding ratio from SBA...is that typical? Thus we would expect a \$40M of capital in our Fund.

Maximum allowable leverage under the Early Stage program is one tier, up to a maximum of \$50 million per fund. As this is the first time SBA is offering this program, we do not yet know what the “typical” leverage will be.