

**SBA**

**SOP 50 51 2**

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**LOAN LIQUIDATION &  
ACQUIRED PROPERTY**

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**Office of Financial Assistance  
Borrower and Lender Servicing**

**U.S. Small Business  
Administration**





**SMALL BUSINESS ADMINISTRATION  
STANDARD OPERATING PROCEDURE**

National

SUBJECT:

Loan Liquidation and Acquired Property

S.O.P.

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**INTRODUCTION**

1. Purpose. To update policy and procedural guidance concerning loan liquidation and acquired property.
2. Personnel Concerned. Headquarters and field office personnel engaged in loan liquidation and acquired property activities.
3. Page Changes.

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## CHAPTER 1 PURPOSE AND ORGANIZATION

### 1. What is the Purpose of this Standard Operating Procedure (SOP)?

The purpose of this SOP is to provide you with guidelines for liquidation activities of:

- a. The SBA personnel;
- b. Participating lenders; and
- c. Certified development companies (CDC).

### 2. What is the Scope of Liquidation Activities?

Loan liquidation personnel handle problem accounts which require enforced collection measures or other actions to protect the interests of the Government. Liquidation personnel take all necessary and appropriate steps in connection with the administration and collection of loans classified as “In Liquidation” typically, these steps include:

- a. Workouts;
- b. Recovery from collateral; and
- c. Pursuit of guarantors and other obligors.

### 3. How is this SOP Organized?

- a. This SOP is organized to provide you with both the references to regulations and the policy you need to know to perform your job in loan liquidation.
- b. The term “**You**” refers to the recommending official. The term recommending official is defined in Chapter 4, “General Guidelines for Liquidation Activities.” All references other than “**You**” (recommending official) will be identified in the text.
- c. In this SOP, “**MUST**” is used when the action is mandatory. Deviations from the mandatory actions must be approved by the Associate Administrator for Financial Assistance (AA/FA) or designee.
- d. Chapter 2 states the regulations from the **Code Federal Regulations (CFR)** which relate to the SBA’s loan liquidation functions. The “**MANDATORY**” words in the **CFR** are “**SHALL,**” “**WILL,**” and “**MUST.**” Deviations from the mandatory actions

must be approved by the Associate Administrator for Financial Assistance (AA/FA) or designee.

- e. Chapter 3 contains general guidelines for liquidation activities, including definitions and delegations of authority.
- f. The remaining chapters of this SOP deal with various individual topics which are part of the liquidation process.

#### **4. What are the Sources of Authority and Guidance for Liquidation Activity?**

**a. As a loan liquidation official you must be aware that all liquidation activities you take must conform to:**

- (1) Federal regulations;
- (2) The SBA policy and procedures; and
- (3) The SBA Form 750, “Loan Guaranty Agreement (Deferred Participation).”

**b. What do you need to know about the regulations?**

- (1) From time to time, SBA publishes changes to the CFR to implement new legislation or to clarify or modify existing regulations. These changes are published in the Federal Register and incorporated into the bound version of the CFR annually.
- (2) The subsections of **13 CFR part 120** which pertain to loan liquidation are provided in Chapter 2 of this SOP.

**c. What do you need to know about the SBA Form 750, “Loan Guaranty Agreement (Deferred Participation)?”**

- (1) The SBA 750, is SBA’s contract of guaranty with the lenders in the 7(a) program.
- (2) The lender - SBA contracts for the 7(a) program include:
  - (a) SBA Form 750, “Loan Guaranty Agreement (Deferred Participation)”;
  - (b) SBA Form 750B, “Loan Guaranty Agreement (Deferred Participation) for Short Term Loans”;



- (c) SBA Form 1186, “Supplemental Guaranty Agreement, Certified Lenders Program (CLP)”;
- (d) SBA Form 1347, “Supplemental Guaranty Agreement, Preferred Lenders Program (PLP)”;
- (e) SBA Form 750EX, “Supplemental Guaranty Agreement, Export Working Capital Program (EWCP)”;
- (f) SBA Form 1918, “Supplemental Guaranty Agreement, FA\$TRAK Program”; and
- (g) LowDoc and CAPLINE programs used for the SBA 750B or SBA 750.

**5. What will this SOP Provide?**

This SOP will provide the policy for procedures and administration of all loans classified “in liquidation” status. This would include loans serviced by:

- a. The SBA;
- b. Participating lenders; and
- c. CDCs

**6. When Should You Refer to the Loan Servicing SOP?**

You should be fully familiar with the regulations and polices contained in SOP 50 50, Loan Servicing. You will use SOP 50 50 for liquidation matters whenever the situation is:

- a. Not covered by this SOP; and
- b. The “servicing” approach is more appropriate.



## CHAPTER 2 REGULATIONS AND OTHER AUTHORITIES

This chapter provides **direct citations of subsections of 13 CFR, “Business Credit and Assistance,”** which pertain to loan liquidation. Reference is made to the exact citing at the beginning of each subsection.

**NOTE:**        The “mandatory” words in the CFR are “SHALL,” “WILL,” AND “MUST.”

**1.     13 CFR § 120.512.  
Who services the loan after SBA honors its guarantee?**

Generally, after SBA honors its guarantee, the Lender must continue to hold the Loan Instruments and service and liquidate the loan. The Lender must execute a Certificate of interest showing SBA’s percentage of the loan, and must submit a liquidation plan to SBA for each loan to be liquidated. If SBA elects to service or liquidate the loan, the Lender must assign the Loan Instruments to SBA.

**2.     13 CFR § 120.431.  
Suspension or revocation of eligibility to participate.**

SBA may suspend or revoke the eligibility of a Lender to participate in the 7(a) program because of a violation of SBA regulations, a breach of any agreement with SBA, a change of circumstance resulting in the Lender’s inability to meet operational requirements, or a failure to engage in prudent lending practices. Proceedings for such purposes will be conducted in accordance with the provisions of part 134 of this chapter. A suspension or revocation will not invalidate a guarantee previously provided by SBA.

**3.     13 CFR § 120.540.  
What are SBA’s policies concerning liquidation of collateral?**

**a.     Liquidation policy.**

SBA or the Lender may liquidate collateral securing a loan if the loan is in default or there is no reasonable prospect that the loan can be repaid within a reasonable period.

**b.     Sale and conversion of loans.**

Without the consent of the Borrower, SBA may:

- (1)     Sell a direct loan;

- (2) Convert a guaranteed or immediate participation loan to a direct loan; or
- (3) Convert an immediate participation loan to a guaranteed loan or a loan owned solely by the Lender.

**c. Disposal of collateral and assets acquired through foreclosure or conveyance.**

SBA or the Lender may sell real and personal property (including contracts and claims) pledged to secure a loan that is in default in accordance with the provisions of the related security instrument (see § 120.550 for Homestead Protection for Farmers).

- (1) Competitive bids or negotiated sales.

Generally, SBA will offer loan collateral and acquired assets for public sale through competitive bids at auctions or sealed bid sales. The Lender may use negotiated sales if consistent with its usual practice for similar non-SBA assets.

- (2) Lease of acquired property.

Normally, neither SBA nor a Lender will rent or lease acquired property or grant options to purchase. SBA and the Lender will consider proposals for a lease if it appears a property cannot be sold advantageously and the lease may be terminated on reasonable notice upon receipt of a favorable purchase offer.

**d. Recoveries and security interests shared.**

SBA and the Lender will share pro rata (in accordance with their respective interests in a loan) all loan payments or recoveries, all reasonable expenses (including advances for the care, preservation, and maintenance of collateral securing the loan and the payment of senior lienholders), and any security interest or guarantee (excluding SBA's guarantee) which the Lender or SBA may hold or receive in connection with a loan.

**e. Guarantors.**

Guarantors of financial assistance have no rights of contribution against SBA on an SBA guaranteed or direct loan. SBA is not deemed to be a co-guarantor with any other guarantors.

**4. 13 CFR § 120.10.  
Definitions.**

**Associate.**

- a. An Associate of a Lender or CDC is:
- (1) An officer, director, key employee, or holder of 20 percent or more of the value of the Lender's or CDC's stock or debt instruments, or an agent involved in the loan process;
  - (2) Any entity in which one or more individuals referred to in paragraphs (1)(i) of this definition or a Close Relative of any such individual owns or controls at least 20 percent.
- b. An Associate of a small business is:
- (1) An officer, director, owner of more than 20 percent of the equity, or key employee of the small business;
  - (2) Any entity in which one or more individuals referred to in paragraphs (2)(i) of this definition owns or controls at least 20 percent; and,
  - (3) Any individual or entity in control of or controlled by the small business (except a Small Business Investment Company ("SBIC") licensed by SBA).
- c. For purposes of this definition, the time during which an Associate relationship exists commences six months before the following dates and continues as long as the certification, participation agreement, or loan is outstanding:
- (1) For a CDC, the date of certification by SBA;
  - (2) For a Lender, the date of application for a loan guarantee on behalf of an applicant; or,
  - (3) For a small business, the date of the loan application to SBA, the CDC, the Intermediary, or the Lender.

**Authorization** is SBA's written agreement providing the terms and conditions under which SBA will make or guarantee business loans. It is not a contract to make a loan.

**Borrower** is the obligor of an SBA business loan.

**Certified Development Company (“CDC”)** is an entity authorized by SBA to deliver 504 financing to small businesses.

**Close Relative** is a spouse; a parent; or a child or sibling, or the spouse of any such person.

**Eligible Passive Company** is a small entity or trust which does not engage in regular and continuous business activity, which leases real or personal property to an Operating Company for use in the Operating Company’s business, and which complies with the conditions set forth in § 120.111.

**Intermediary** is the entity in the Microloan program that receives SBA financial assistance and makes loans to small businesses in amounts up to \$25,000.

**Lender** is an institution that has executed a participation agreement with SBA under the guaranteed loan program.

**Loan Instruments** are the Authorization, note, instruments of hypothecation, and all other agreements and documents related to a loan.

**Operating Company** is an eligible small business actively involved in conducting business operations now or about to be located on real property owned by an Eligible Passive Company, or using or about to use in its business operations personal property owned by an Eligible Passive Company.

**Preference** is any arrangement giving a Lender or a CDC a preferred position compared to SBA relating to the making, servicing, or liquidation of a business loan with respect to such things as repayment, collateral, guarantees, control, maintenance of a compensating balance, purchase of a Certificate of deposit or acceptance of a separate or companion loan, without SBA’s consent.

**Rural Area** is a political subdivision or unincorporated area in a non-metropolitan county (as defined by the Department of Agriculture), or, if in a metropolitan county, any such subdivision or area with a resident population under 20,000 which is designated by SBA as rural.

**Service Provider** is an entity that contracts with a Lender or CDC to perform management, marketing, legal or other services.

5. **13 CFR § 120.140.**  
**What ethical requirements apply to participants?**

Lenders, Intermediaries, CDCs, and Associate Development Companies (“ADCs”) (in this section, collectively referred to as “Participants”), must act ethically and exhibit good character. Ethical indiscretion of an Associate of a Participant or a member of a CDC will

be attributed to the Participant. A Participant must promptly notify SBA if it obtains information concerning the unethical behavior of an Associate. The following are examples of such unethical behavior. A Participant may not:

- a. Self-deal;
- b. Have a real or apparent conflict of interest with a small business with which it is dealing (including any of its Associates or an Associate's Close Relatives) or SBA;
- c. Own an equity interest in a business that has received or is applying to receive SBA financing (during the term of the loan or within 6 months prior to the loan application);
- d. Be incarcerated, on parole, or on probation;
- e. Knowingly misrepresent or make a false statement to SBA;
- f. Engage in conduct reflecting a lack of business integrity or honesty;
- g. Be a convicted felon, or have an adverse final civil judgment (in a case involving fraud, breach of trust, or other conduct) that would cause the public to question the Participant's business integrity, taking into consideration such factors as the magnitude, repetition, harm caused, and remoteness in time of the activity or activities in question;
- h. Accept funding from any source that restricts, prioritizes, or conditions the types of small businesses that the Participant may assist under an SBA program or that imposes any conditions or requirements upon recipients of SBA assistance inconsistent with SBA's loan programs or regulations;
- i. Fail to disclose to SBA all relationships between the small business and its Associates (including Close Relatives of Associates), the Participant, and/or the lenders financing the Project of which it is aware or should be aware;
- j. Fail to disclose to SBA whether the loan will:
  - (1) Reduce the exposure of a Participant or an Associate of a Participant in a position to sustain a loss;
  - (2) Directly or indirectly finance the purchase of real estate, personal property or services (including insurance) from the Participant or an Associate of the Participant;
  - (3) Repay or refinance a debt due a Participant or an Associate of a Participant; or

(4) Require the small business, or an Associate (including Close Relatives of Associates), to invest in the Participant (except for institutions which require an investment from all members as a condition of membership, such as a Production Credit Association);

k. Issue a real estate forward commitment to a builder or developer; or

l. Engage in any activity which taints its objective judgment in evaluating the loan.

**6. 13 CFR § 120.410.  
Requirements for all participating lenders.**

A Lender must:

a. Have a continuing ability to evaluate, process, close, disburse, service and liquidate small business loans;

b. Be open to the public for the making of such loans (not be a financing subsidiary, engaged primarily in financing the operations of an affiliate);

c. Have continuing good character and reputation, and otherwise meet and maintain the ethical requirements of § 120.140; and

d. Be supervised and examined by a State or Federal regulatory authority, satisfactory to SBA.

**7. 13 CFR § 120.411.  
Preferences.**

An agreement to participate under the Act may not establish any Preferences in favor of the Lender.

**8. 13 CFR § 120.412.  
Other services Lenders may provide Borrowers.**

Subject to § 120.140 Lenders, their Associates or the designees of either may provide services to and contract for goods with a Borrower only after full disbursement of the loan to the small business or to an account not controlled by the Lender, its Associate, or the designee. A Lender, an Associate, or a designee providing such services must do so under a written contract with the small business, based on time and hourly charges, and must maintain time and billing records for examination by SBA. Fees cannot exceed those charged by established professional consultants providing similar services. *See also* § 120.195.



9. **13 CFR § 120.440.**  
**What is the Certified Lenders Program?**

Under the Certified Lenders Program (CLP), designated Lenders process, close, service, and may liquidate, SBA guaranteed loans. SBA gives priority to applications and servicing actions submitted by Lenders under this program, and will provide expedited loan processing or servicing. All other rules in this part 120 relating to the operations of Lenders apply to CLP Lenders.

10. **13 CFR § 120.450.**  
**What is the Preferred Lenders Program?**

Under the Preferred Lenders Program (PLP), designated Lenders process, close, service, and liquidate SBA guaranteed loans with reduced requirements for documentation to and prior to approval by SBA.

11. **13 CFR § 120.453.**  
**What are the requirements of a PLP Lender in servicing and liquidating SBA guaranteed loans?**

The PLP Lender must service and liquidate its SBA guaranteed loan portfolio (including its non-PLP loans) using generally accepted commercial banking standards employed by prudent lenders. The PLP Lender must liquidate any defaulted SBA guaranteed loan in its portfolio unless SBA advises in writing that SBA will liquidate the loan. The PLP Lender must submit a liquidation plan to SBA prior to commencing liquidation action. The PLP Lender may take any necessary servicing action, or liquidation action consistent with a plan, for any SBA guaranteed loan in its portfolio, except it may not:

- a. Take any action that confers a Preference on the Lender;
- b. Accept a compromise settlement without prior written SBA consent; and
- c. Sell or pledge more than 90 percent of a PLP loan.

**“TO BE REVISED” This section will be revised as it is inconsistent with current legislation.**

12. **13 CFR § 120.520.**  
**When does SBA honor its guarantee?**

- a. SBA, in its sole discretion, may purchase a guaranteed portion of a loan at any time. A Lender may demand in writing that SBA honor its guarantee if the Borrower is in default on any installment for more than 60 calendar days (or less if SBA agrees) and

the default has not been cured. If a Borrower cures a default before a Lender requests purchase by SBA, the Lender's right to request purchase on that default lapses.

- b. Purchase by SBA of the guaranteed portion does not waive any of SBA's rights to recover money paid on the guarantee, based upon the Lender's negligence, misconduct, or violation of this part, including those actions listed in § 120.524 (a), the Loan Guarantee Agreement or the Loan Instruments.

**13. 13 CFR § 120.521.**

**What interest rate applies after SBA purchases Its guaranteed portion?**

When SBA purchases the guaranteed portion of a fixed interest rate loan, the rate of interest remains as stated in the note. On loans with a fluctuating interest rate, the interest rate that the Borrower owes will be at the rate in effect at the time of the earliest uncured payment default, or the rate in effect at the time of purchase (where no default has occurred).

**14. 13 CFR § 120.522.**

**How much accrued interest does SBA pay to the Lender or Registered Holder when SBA purchases the guaranteed portion?**

**a. Rate of interest.**

If SBA purchases the guaranteed portion from a Lender or from a Registered Holder (if sold in the Secondary Market), it will pay accrued interest at:

- (1) The rate in the note if it is a fixed rate loan; or
- (2) The rate in effect on the date of the earliest uncured payment default, or of SBA's purchase (if there has been no default).

**b. Payment to Lender.**

If the Lender submits a complete purchase request to SBA within 120 days of the earliest uncured payment default, SBA will pay accrued interest to the Lender from the last interest paid-to-date up to the date of payment. If the Lender requests SBA to purchase after 120 days from the date of the earliest uncured payment default date, SBA will pay only 120 days of interest. For LowDoc loans, the interest paid to the Lender will be governed by the Supplemental Guarantee Agreement.

**c. Payment to Registered Holder.**

SBA will pay a Registered Holder all accrued interest up to the date of payment.

**d. Extension of the 120 day period.**

Before the 120 days expire, the SBA field office may extend the period if the Lender and SBA agree that the Borrower can cure the default within a reasonable and definite period of time or that the benefits from doing so otherwise will exceed the costs of SBA paying additional interest. If the 120 days have passed, only the AA/FA or designee can extend the period.

**15. 13 CFR § 120.523.**

**What is the “earliest uncured payment default”?**

The earliest uncured payment default is the date of the earliest failure by a Borrower to pay a regular installment of principal and/or interest when due. Payments made by the Borrower before a Lender makes its request to SBA to purchase are applied to the earliest uncured payment default. If the installment is paid in full, the earliest uncured payment default date will advance to the next unpaid installment date. If a Borrower makes any payment after the Lender makes its request to SBA to purchase, the earliest uncured payment default date does not change because the Lender has already exercised its right to request purchase.

**16. 13 CFR § 120.524.**

**When is SBA released from liability on Its guarantee?**

- a. SBA is released from liability on a loan guarantee (in whole or in part, within SBA’s exclusive discretion), if any of the events below occur:
- (1) The Lender has failed to comply materially with any of the provisions of these regulations, the Loan Guarantee Agreement, or the Authorization;
  - (2) The Lender has failed to make, close, service, or liquidate a loan in a prudent manner;
  - (3) The Lender’s improper action or inaction has placed SBA at risk;
  - (4) The Lender has failed to disclose a material fact to SBA regarding a guaranteed loan in a timely manner;
  - (5) The Lender has misrepresented a material fact to SBA regarding a guaranteed loan;
  - (6) SBA has received a written request from the Lender to terminate the guarantee;
  - (7) The Lender has not paid the guarantee fee within the period required under SBA rules and regulations;

- (8) The Lender has failed to request that SBA purchase a guarantee within 120 days after maturity of the loan;
  - (9) The Lender has failed to use required SBA forms or exact electronic copies; or
  - (10) The Borrower has paid the loan in full.
- b. If SBA determines, after purchasing its guaranteed portion of a loan, that any of the events set forth in paragraph (a) of this section occurred in connection with that loan, SBA is entitled to recover any money paid on the guarantee plus interest from the Lender responsible for those events.
  - c. If the Lender's loan documentation indicates that one or more of the events in paragraph (a) of this section may have occurred, SBA may undertake such investigation as it deems necessary to determine whether to honor or deny the guarantee, and may withhold a decision on whether to honor the guarantee until the completion of such investigation.
  - d. Any information provided to SBA prior to Lender's request for SBA to honor its guarantee shall not prejudice SBA's right to deny liability for a guarantee if one or more of the events listed in paragraph (a) of this section occur.
  - e. Unless SBA provides written notice to the contrary, the Lender remains responsible for all loan servicing and liquidation actions until SBA honors its guarantee in full.

**17. 13 CFR § 120.550.  
What is homestead protection for farmers?**

SBA may lease to a farmer-Borrower the farm residence occupied by the Borrower and a reasonable amount of adjoining property (no more than 10 acres and seven farm buildings), if they were acquired by SBA as a result of a defaulted farm loan made or guaranteed by SBA (*see* the Consolidated Farm and Rural Development Act, 7 U.S.C. 1921, for qualifying loan purposes).

**18. 13 CFR § 120.551.  
Who is eligible for homestead protection?**

SBA must notify the Borrower in possession of the availability of these homestead protection rights within 30 days after SBA acquires the property. A farmer-Borrower must:

- a. Apply for the homestead occupancy to the SBA field office which serviced the loan within 90 days after SBA acquires the property;

- b. Provide evidence that the farm produces farm income reasonable for the area and economic conditions;
- c. Show that at least 60 percent of the Borrower and spouse's gross annual income came from farm or ranch operations in at least any two out of the last six calendar years;
- d. Have resided on the property during the previous six years; and
- e. Be personally liable for the debt.

**19. 13 CFR § 120.552.  
Lease.**

If approved, the applicant must personally occupy the residence during the term of the lease and pay a reasonable rent to SBA. The lease will be for a period of at least 3 years, but no more than 5 years. A lease of less than 5 years may be renewed, but not beyond 5 years from the original lease date. During or at the end of the lease period, the lessee has a right of first refusal to reacquire the homestead property under terms and conditions no less favorable than those offered to any other purchaser.

**20. 13 CFR § 120.553.  
Appeal.**

If the application is denied, the Borrower may appeal the decision to the AA/FA. Until the conclusion of any appeal, the Borrower may retain possession of the homestead property.

**21. 13 CFR § 120.554.  
Conflict of laws.**

In the event of a conflict between the homestead provisions at § 120.550 through 120.553 of this part, and any state law relating to the right of a Borrower to designate for separate sale or to redeem part or all of the real property securing a loan foreclosed by the Lender, state law shall prevail.

**22. 13 CFR § 120.938.  
Default.**

- a. Upon occurrence of an event of default specified in the 504 note which requires automatic acceleration, the note becomes due and payable. Upon occurrence of an event of default which does not require automatic acceleration, SBA may forbear acceleration of the note and attempt to resolve the default. If the default is not cured subsequently, the note shall be accelerated. In either case, upon acceleration of the note, the Debenture which funded it is also due immediately, and SBA must honor its

guarantee of the Debenture. SBA shall not reimburse the investor for any premium paid.

- b. If a CDC defaults on a Debenture, SBA generally shall limit its recovery to the payments made by the small business to the CDC on the loan made from the Debenture proceeds, and the collateral securing the defaulted loan. However, SBA will look to the CDC for the entire amount of the Debenture in the case of fraud, negligence, or misrepresentation by the CDC.

**23. 13 CFR § 120.940.  
Prepayment of the 504 loan or debenture.**

The Borrower may prepay its 504 loan, if it pays the entire principal balance, unpaid interest, any unpaid fees, and any prepayment premium established in the note. If the Borrower prepays, the CDC must prepay the corresponding Debenture with interest and premium. If one of the Debentures in a Debenture Pool is prepaid, the Investors in that Debenture Pool must be paid pro rata, and SBA's guarantee on the entire Debenture Pool must be proportionately reduced. If the entire Debenture Pool is paid off, SBA may call all Certificates backed by the Pool for redemption.

## CHAPTER 3 CORRESPONDENCE, REPORTS, AND CONTROL SYSTEMS

### 1. Correspondence.

All correspondence received in field offices must be handled in a professional, business like manner. Prompt response is essential.

#### a. Who handles routine correspondence?

The assigned official responsible for the loan account.

#### b. What are the time frames for response?

As a guideline, you should respond to correspondence within 10 business days, or less.

#### c. What information must you retain and where?

##### (1) Specific loan accounts.

You must place copies of all correspondence and documented telephone calls on substantial matters for specific loan accounts in the related loan file.

##### (2) General subject matters.

You must place copies in an official subject file (e.g. general policy and procedural correspondence from Headquarters)

### 2. What is SBA Form 327, Modification or Administrative Action?

The term “Modification or Administrative Action” refers to an action to modify the authorization or other actions which are necessary to help the borrower respond to a business growth opportunity or to respond to a problem. It also refers to actions that SBA may take that would affect the loan (e.g., change the status of loan from regular servicing to “in-liquidation,” to transfer the loan from one lender to another, etc.)

All 327 actions require approval under the rule of two authority. (See paragraph 2, chapter 4)

Modifications or administrative actions on specific loans are taken by the completion of an SBA Form 327, "Modification or administrative action" or the SBA 327 stamp format. The result is a "327 action."

**a. SBA Form 327.**

SBA 327, "Modification or administrative action" is available as a pre-printed form or on-line from SBA computer software. The report must contain all the essential information pertinent to the issue being considered, such as status of the loan, collateral, guarantors, and comments of the recommending official originating the report.

- (1) The recommending official comments should include:
  - (a) Summary of the request;
  - (b) Evaluation of supporting documentation; and
  - (c) Recommendation for approval or denial.
- (2) The approving official must:
  - (a) Take final action to approve or deny the request; and
  - (b) Document the reason for his/her decision if it is not already clearly stated in the recommendation.

**NOTE:** Documentation by the approving official is not necessary when the recommendation is clear and concise, is the basis of the approving official's determination, and it is so stated on the action by the approving official.

**b. 327 stamp format.**

You may accomplish routine or uncomplicated changes in the authorization by using an SBA 327 stamp:

- (1) The SBA 327 stamp "Modification or administrative action - stamp", is an approved stamp format which can be affixed to incoming borrower/lender/CDC correspondence to reflect SBA action. You may use the SBA 327 stamp in those cases where you are not required to distribute the action to the Office of Financial Operations (OFO) Denver.



- (2) You should limit its use to less complicated requests where the incoming letter (and any enclosures) satisfactorily describes the action requested and provides sufficient information to allow final action.
- (3) In some cases, you may use the SBA 327 stamp for administrative actions that are not in response to bank or borrower requests (e.g., submissions of a request corrections to OFO, Denver).
- (4) You must consecutively number these actions with other 327 actions, and each action must reflect the signature of the recommending and approving officials.

**c. Authority for action.**

You must cite on the SBA 327 form/stamp the applicable SOP chapter and paragraph number that provides authority for the action. If you take more than one action with an SBA 327 form/stamp, you must cite each action with the applicable chapter and paragraph numbers.

**d. Filing of the action.**

You must file the 327 action (with related documents such as a credit memo, etc.) with other 327 actions in the borrower's loan file. The field office may use a photocopy or facsimile as a response to the borrower/lender/CDC.

**e. Actions requiring approval by another office.**

- (1) You must use an SBA 327 to recommend loan servicing action on specific cases which require approval at an office other than the originating office. The proposed action and the signatures and titles of the recommending/approving officials must be on the report. It is essential that the report contain all the pertinent information necessary to make an informed decision. (This section applies when a loan is transferred to another field office. See SOP 50-50, Chapter 3, "Administrative Aspects for Loan Servicing," sub-paragraph 1.d., When do you transfer loans between field offices or between commercial loan service centers?)
- (2) The originating office will forward the action to the next office [e.g., branch to district, district/service center to Borrower and Lender Servicing (BLS)], with a copy retained by the originating office, pending final action. The report must include the comments and recommendation of the highest supervisory official using the rule of two on an SBA 327 at each office and of counsel (on legal issues).

**NOTE:** This process will be the same for actions that must be sent to Headquarters for a final decision.

- (3) The office taking final action will do so on the form, or if needed, by separate letter. The office taking final action will retain a copy and return the original action to the originating office.
- (4) When the action taken requires notice to lender/CDC/borrower, the originating office must:
  - (a) Give such advice by separate letter; and
  - (b) File a copy of the letter in the correspondence section of the loan folder.

**NOTE:** Various SBA automated computer systems may be valuable in making efficient use of your time in preparing 327 actions. See your Information Resource Manager (IRM), for details.

### **3. Transferring Loans Between Field Offices.**

From time to time, you may need to request another field office to accept responsibility for further action on a loan (e.g. borrower moves outside your jurisdiction). A field office should not refuse to accept a valid transfer of a loan, or refuse to perform a reasonable task for another field office. Any loss attributed under any transferred account will be attributed to the transferring office.

### **4. Liquidation Litigation Tracking System (LLTS).**

- a. The LLTS provides a variety of computerized information screens. It is used to monitor the status of liquidation and litigation cases. The LLTS provides a chronological record of liquidation and litigation actions taken. It also contains detailed collateral and guarantor information.
- b. When a problem loan is classified “in liquidation,” a liquidation plan must be developed. Key elements of the plan must be entered into LLTS within 30 days following receipt of the loan. Periodic updates must be made as the loan progresses.

### **5. What are the Requirements of the Liquidation Plan?**

The SBA/participating lender must use the standardized “Lender Liquidation Plan Format” which SBA has developed. You must submit any significant modification to this format to Headquarters for approval. (See “Liquidation Plan Format,” appendix O, for the required elements of the standardized “Lender Liquidation Plan Format.”)

**6. How is a Liquidation Plan Approved?**

- a. Directly in LLTS; or
- b. Via SBA 327 (if so enter general comments into LLTS).

**7. Who is Responsible for Maintaining/Updating LLTS?**

- a. Once the initial data entry screens (A, D, and E) are completed placing a loan “in liquidation” in LLTS, the system is maintained by the liquidation official as liquidation actions occur.
- b. If the loan is placed “in litigation,” the system requires additional input/comments by the assigned SBA field counsel for legal actions as they occur.
- c. The liquidation loan officer must keep LLTS updated. At a minimum, loan status comments must be entered at least every 60 days.

**NOTE:** For time sensitive issues, you must maintain a tickler system (screen C). The reviewing official must ensure that drift is avoided by addressing these issues at portfolio review meetings.

**8. Who is Responsible for Oversight of the LLTS?**

- a. The supervisory official must review the SBA and lender-serviced accounts using LLTS every calendar quarter on:
  - (1) All Colpur accounts and liquidation accounts that have been in liquidation 180 days or more;
  - (2) A random sample of 25 percent of all liquidation accounts under 180 days;
  - (3) Preferred lender program (PLP), and LowDoc liquidation accounts do not need to be reviewed prior to guaranty purchase; and
  - (4) FA\$TRAK loans will be reviewed at time of guaranty purchase with the wrap up report.
- b. The review may be conducted either electronically or face-to-face with the assigned liquidation official. If drift appears in the random review, a more detailed review is required.
- c. The supervisory official must post all comments to LLTS.

**9. What are the Supervisor's Objectives When Conducting the LLTS Portfolio Review? The supervisor objectives are to:**

- a. Track activity and general progress of the loan account;
- b. Ensure that an effective liquidation plan is established and followed;
- c. Ensure that the liquidation loan officer is taking every action necessary to protect the Agency;
- d. Avoid any unwarranted delays; and
- e. Provide guidance for future actions.

**10. What Should the Supervisor Determine at the LLTS Portfolio Review? The supervisor should determine that:**

- a. An acceptable liquidation plan has been established and entered into LLTS; or
- b. General comments from a 327 action are entered into LLTS;
- c. All required factual information has been obtained; and
- d. The supervisor has entered all directional comments into LLTS to document the review.

**11. Where Can You Find More Information About LLTS?**

Complete instructions are in the "LLTS Users Manual" which is located on the SBA Internal Bulletin Board System within the "SBA Data Communications System User Manual" (SBA-DCS). (See paragraph 19, in this chapter titled "Computer Input, Support and Control Systems.")

**12. What Loan Accounting Data is Available, and Where is it Found?**

Field offices currently obtain much of the loan accounting data in the Portfolio Management Query System (PMQD) which you access locally. Occasionally it is necessary to contact the OFO in Denver for special accounting data.

**13. How Do You Use the PMQD System?**

- a. You can access the system through your local area network (LAN).
- b. You may use PMQD as a menu driven system by entering PMQD00; or

- c. You may directly access individual screens for information. See the PMQD00 screen for a directory.

**14. What Accounting Information is Available from the Office of Financial Operations (OFO)?**

- a. Certified statements of account;
- b. Transcripts of account;
- c. Confirmation of loan payoff amounts; and
- d. Other verification support.

These reports should only be ordered when absolutely necessary, as they can be voluminous. Most accounting data is found on the PMQD system.

**NOTE:** Sometimes when requesting a loan payoff in PMQD09, "Accounting Payoff Data" you may find an item has been placed in "suspense." This will freeze the account. You should contact OFO, Denver, who can usually resolve suspense items. This will permit you to obtain the payoff locally.

**15. What is the Procedure for 503/504 Payoff?**

The procedure for 503/504 debenture purchase and acceleration is contained in Chapter 11, "Prepayment or Purchase of a Development Company Loan or Debenture," in SOP 50 50.

**16. Special Computer Inputs/Controls When a Loan is Charged Off.**

You must ensure that vital information is entered into the SBA database at the time a loan is charged off. The LAUD13 must be updated to enable you to "REFER-NOT REFER" a loan for further collection action. This data is relied upon for post charge off activities conducted by Headquarters such as:

- a. Referral to private collection agencies;
- b. Federal salary/retirement offset;
- c. Reporting loan deficiency balances as income to IRS; or
- d. Other automated collection efforts that may be available.

**17. Safekeeping and Control of the Collateral Records?**

- a. The field office collateral cashier is responsible for these functions.
- b. All original notes, debentures, and other like loan documents will be given to and held by the cashier.
- c. The cashier will release documents requested in accordance with established cashier control procedures.

**18. What Must Be Done When Approved Actions Affect Collateral Records?**

When you take action that affects the collateral records, counsel must oversee the preparation and execution of the required legal documents. You must provide the field office collateral cashier with the original new document, or a copy if the original is not available. A copy must be placed in the loan file.

**19. Computer Input, Support and Control Systems.**

There are many computer screens, reports and systems to provide field offices with information from central records. There are also many computer inputs required from the field to update those records. These systems are described in detail in the "SBA Data Communications System User Manual" (SBA-DCS). You may access this user guide via modem through the SBA Internal Bulletin Board. You should become fully familiar with the SBA-DCS user manual. If you need assistance accessing or downloading portions of the manual contact your IRM for assistance.

**CHAPTER 4**  
**GENERAL GUIDELINES FOR LIQUIDATION ACTIVITIES**

**1. Definitions.**

**a. Appraisal.**

A “current appraisal” is one made within the past 120 days, or not more than 1 year if justified in a 327 action.

**b. Approving official.**

Approving official refers to an SBA staff member who has met the requirements outlined in the delegations of authority, as published in the Federal Register. (This is often the line supervisor.)

**c. Claim amount.**

The net outstanding principal balance that would be remaining after the proposed compromise offer is applied to the current principal balance.

**d. Cram down.**

An approval of a bankruptcy, Chapter 11 plan of reorganization, over the objection of a creditor, when the judge finds that the plan is in the best interest of all other creditors and does not unfairly treat the objecting creditors.

**e. Colpur.**

Colpur is collateral purchased or property acquired by SBA or its participating lenders through loan liquidation.

**f. Cost of money to the Government.**

Cost of money to the Government is the interest yield equivalent to that being paid on Treasury securities for similar maturities. These rates are published in the Wall Street Journal, Section C, under the heading of “Treasury Bonds, Notes, and Bills,” “Ask YLD” column.

**g. Debt, evidence of.**

References to borrowers' loans and accounts include:

- (1) Notes;
- (2) Receivables;
- (3) Judgments; and
- (4) Other evidence of debt payable to the SBA.

**h. Drift.**

Drift is when there is serious delay in managing a loan (by SBA/lender) without good documented reason noted in the LLTS.

**i. Field office.**

The term field office is used to indicate district offices, branch offices, commercial loan servicing centers, Santa Ana Disaster Loan Servicing and Liquidation Office, and disaster home loan servicing centers.

**j. Liquidation officer.**

The generic term "liquidation officer" refers to the SBA staff member who performs the basic tasks discussed in this SOP.

**k. Obligor/debtor.**

The terms "obligor" or "debtor" include:

- (1) Borrower;
- (2) Co-borrower;
- (3) Guarantor(s);
- (4) Assumptor(s);
- (5) Judgment debtor(s); and
- (6) Any other party who has liability for a loan account.



**l. Present value.**

Present value is the current worth of future sums of money. This concept is used in many phases of liquidation decision making. To calculate present value refer to:

- (1) Determining present value (appendix); and
- (2) Available software products (e.g. fisCAL).

**m. Recommending official.**

Recommending Official refers to an SBA staff member who has met the requirements outlined in the delegations of authority as published as a Notice in the Federal Register. (This is often the liquidation officer.)

**n. Supervisory attorney.**

Supervisory attorney is the:

- (1) District counsel in a district office;
- (2) Senior litigation counsel in the litigation units and Administrative Law litigation unit, and in the Santa Ana Disaster Loan Servicing and Liquidation Office;
- (3) Supervisory attorney in the commercial loan servicing center(s); and
- (4) Servicing center attorney in a disaster home loan servicing center (or, if there is none, the district counsel in the nearest district office).

**2. What are the SBA's Delegations of Authority?**

- a. The Delegations of authority are published as a Notice in the Federal Register.
- b. What are the limitations on authority to the field?

**(1) Exceptions to policy.**

Instances where circumstances require or suggest an action which is not in full compliance with the mandatory parts ("must") of the SOP are "exceptions to policy." Final authority to approve exceptions lies with the AA/FA or designee. The SBA Form 327, Modification or Administrative Action, must include comments and recommendations of the field office.

**(2) Rule of Two.**

- (a) All actions taken under delegated authority must reflect both the recommending official and the approving official. This process is called the “Rule of Two.”
- (b) Accounts classified as in litigation, must include comments by both counsel and the approving official.
- (c) Final approval, on credit issues where the account is classified in litigation is the responsibility of the approving official (e.g. liquidation division supervisor, ADD/ED).
- (d) Removing the loan from “in litigation” is the responsibility of counsel.

**(3) What happens if your recommendation for action is not approved by the approving official (a split decision)?**

- (a) If the approving official does not approve your recommendation for action, he/she must add comments and recommendations to your 327 action and refer the loan to the second level of authority. That next level of authority must indicate the final action taken and the basis for the decision.
- (b) If the position taken at the second level of authority is contrary to the differing recommendations of both you (the recommending official) and the first approving official, the matter will go forward to the next level of authority until it reaches the point of concurrence in a prior recommendation.

**(4) Example:**

- (a) You are a liquidation specialist and you recommend a workout in an 327 action.
- (b) Your approving official is the chief of liquidation. If the chief of liquidation approves your 327 action, the action is final and the workout is approved.
- (c) If the chief of liquidation declines the action, he or she must refer the action to the second level of authority which, for example, is the assistant district director for economic development (ADD/ED). If the ADD/ED concurs with your recommendation or with the Chief of Liquidation, the action is final. For example, if the ADD/ED concurs

with your recommendation to approve the workout, the workout is approved. However, if the ADD/ED concurs with your chief of liquidation's decision to decline the workout, the workout is declined.

- (d) If the ADD/ED does not uphold your recommendation or the chief of liquidation's decision and recommends yet another action, the ADD/ED must refer the action to the next level of authority. In this case, the ADD/ED would refer the action to the deputy district director (DDD) or district director (DD).

**NOTE:** Regardless of title, all officials must have appropriate delegation of authority from the Associate Administrator for Financial Assistance (AA/FA).

**(5) What can't be approved under the rule of two?**

According to the delegations of authority published in the Federal Register, no SBA employee has the authority to:

- (a) Take action on any loan which is in "litigation" status without legal review and concurrence;
- (b) Deny liability of the SBA under the terms of a participation or guaranty agreement; or
- (c) authorize suit for recovery from a participating lender under any alleged violation of a participation or guaranty agreement.

**3. What Do You Do When You Receive a Written Proposal by an Obligor or Debtor?**

You must formally act on all written requests in compliance with the rule of two.

**a. What do you do if you receive an oral proposal?**

- (1) If the request is grossly lacking in merit or supporting documentation, then you may deny the request without a recommendation; or
- (2) If the request has merit, you must request a written proposal with supporting documentation.

**b. What do you do if the obligor, debtor, or participating lender requests a reconsideration or an appeal?**

- (1) Handle it in the same manner as the original written proposal; then
- (2) You must submit the request to the next level of authority.

**4. What are the Field Offices' Performance Goals for Loans in Liquidation, Litigation, and Colpur Status?**

You should:

- a. Complete loans in liquidation in 12 months, unless you cannot accomplish this for good cause;
- b. Complete loans in litigation in 18 months, unless you cannot accomplish this for good cause, such as delay caused by a U.S. Attorney's office or time spent awaiting a court's determination; and
- c. Dispose acquired assets (Colpur) within 12 months of acquisition, unless you cannot accomplish this for good cause, such as the necessity for remediation efforts to clean up hazardous waste.

**NOTE:** See chapter 11, "Collateral Purchased (Colpur) by SBA and Lender" for additional information on Colpur disposal.

**NOTE:** The Office of Financial Assistance (FA) will provide recovery and guaranty purchase goals through the Office of Field Operations to each district office.

**5. Management Reviews.**

- a. Every 90 days each DD and Santa Ana Disaster Servicing and Liquidation Office Director must chair a meeting of the ADD/ED, district counsel, and liquidation supervisor to review office caseloads of more than 180 days in liquidation status.
  - (1) The purpose is to:
    - (a) Ensure compliance with goals;
    - (b) Set new priorities; and
    - (c) Allocate resources and review related issues.

- (2) Directors must take the lead in promoting a teamwork approach to recoveries. Since liquidation and legal staff have separate areas of responsibility and authority, it is vital that a cooperative attitude exist.
- b. Regional administrators (RA) must ensure that the required meetings take place and discuss any recommendations with their directors.
  - (1) The purpose of the periodic director's review is:
    - (a) To provide for the effective management of resources; and
    - (b) To emphasize the importance of recovery processes.
  - (2) The reviews are not meant to substitute for the existing in-depth portfolio reviews by liquidation supervisors.
- c. For lender oversight and managerial reviews, see Chapter 8, "Lender-Serviced Liquidations."

**6. Placing a Loan "In Liquidation" or "In Litigation" Status.**

You must prepare a 327 action. At a minimum, your report must provide full justification for the action.

Disaster home loans are consumer-type credits and do not require the amount of information necessary for business loans.

**a. When MUST a loan be placed "in liquidation" status?**

A loan MUST be placed "in liquidation" when:

- (1) Foreclosure action by a prior lienholder or a law suit has been instituted against the borrower or obligor with respect to any substantial collateral securing the loan or guaranty and the Agency's interest may be adversely affected;
- (2) The borrower has filed a voluntary petition or any involuntary petition has been filed against the borrower under the bankruptcy code and there is evidence that borrower has assets pledged as collateral which this Agency must protect and the loan is delinquent;
- (3) A receiver has been appointed, an assignment for the benefit of creditors has been made, or other legal actions have been taken for the purpose of liquidating the collateral or obligor's assets; or

- (4) All or a valuable part of the collateral has been abandoned by the obligor.

**b. When SHOULD a loan be placed “in liquidation” status?**

A loan should be placed in liquidation when:

- (1) All reasonable alternatives to collect the debt have been exhausted;
- (2) The borrower cannot, or will not, repay the debt on reasonable terms;
- (3) The collateral is clearly in serious danger of dissipating; or
- (4) Any other circumstances which may substantially and adversely affect the Agency’s position (law suit by a junior lienholder, etc.).

**c. When MUST a loan be placed “in litigation” status?**

An account must be referred to the field office counsel and classified as “in litigation” when:

- (1) There are insolvency proceedings, such as bankruptcy, receivership, assignment for the benefit of creditors involving the obligor and there is evidence that collateral of significant value exists and loan is delinquent;
- (2) A law suit has been instituted against a borrower which may have a substantially adverse effect on the Agency’s position;
- (3) The SBA has been named a party defendant in a suit involving a borrower which may substantially harm the Agency’s position; or
- (4) The Agency must pursue judgment or otherwise enforce its liens through litigation.

**d. When SHOULD you place a loan “in litigation” status?**

An account should be referred to the field office counsel when:

- (1) There are insolvency proceedings, such as bankruptcy, receivership, or assignment for the benefit of creditors involving the borrower. Discuss with counsel, as there may be assets of limited value or borrower may be current with loan payments; or

- (2) There is a need for legal action to effect further recovery or to protect the position of SBA.

**e. Can you recommend placing a loan “in litigation” status without placing the loan “in liquidation” status?**

A loan can be placed in litigation without being in liquidation. A loan is to be placed “in litigation” by use of a 327 action.

**NOTE:** The recommending official may recommend classifying a loan “in liquidation” and “in litigation” on the same 327 action.

**f. When and how to remove a loan from “in litigation” status?**

When the litigation matter is complete or a determination is made that further legal effort would not be warranted or justified, counsel will prepare and approve a 327 action authorizing removal of the loan from an “in litigation” status and transferring it to liquidation or regular servicing for appropriate action.

**g. When and how to remove a loan from “in liquidation” status?**

An account can be returned to servicing by use of a 327 action when the situation that classified a loan as “in liquidation” has been resolved or has been restructured/reamortized by:

- (1) A workout plan;
- (2) A term compromise agreement;
- (3) A judgment has been obtained; and
- (4) At least three monthly payments have been made, as agreed.

**7. Placing/Removing a Loan In or Out of Liquidation/Litigation Status.**

- a. When a liquidation case is identified as needing legal action, you must transfer it to litigation status with the concurrence of counsel.
- b. Counsel will proceed with appropriate action, subject to approval by liquidation personnel, in regard to credit matters.
- c. After transfer to litigation, the loan becomes the responsibility of the legal division. The account will be monitored according to the newly established 18 month litigation time frame.

d. Under the “Rule of Two” for litigation cases:

- (1) For purely credit matters (such as settlements and releases of claims for consideration):
  - (a) The recommending official for these actions will be an official in the Liquidation Division; and
  - (b) The approving official will be an official outside of the legal division (e.g. the liquidation supervisor or ADD/ED).

**NOTE:**        Comments of counsel are required.

- (2) For foreclosure actions, a loan officer/liquidation staff must:
  - (a) Arrange and conduct the sale in accordance with all legal requirements prescribed by SBA counsel;
  - (b) Provide all necessary assistance including arranging for and paying for appraisals, title reports, environmental reports, and auctioneers; and
  - (c) Be responsible for preparing protective bids, providing for the care and preservation of collateral, and attending sales as needed.
- (3) When litigation is completed or a determination is reached that further legal effort would be unproductive:
  - (a) Counsel will prepare a 327 action authorizing removal of the loan from litigation status and transfer it back to liquidation for appropriate action; and
  - (b) If a workout or restructuring plan is approved while a loan is in liquidation status, the account will be removed from liquidation once three regular payments have been received in accordance with the terms of the plan even though a debtor/borrower might remain under the technical jurisdiction of a Bankruptcy Court.

## **8. Risk Management Database, Loan Underwriting Characteristics.**

- a. The Small Business Programs Improvement Act of 1996, Public Law 104-208, requires the Small Business Administration to establish a risk management database to capture information on loans going into default (defined by SBA for this purpose as those that are being transferred to liquidation status after January 1, 1997). This applies to all loans transferred into liquidation status no matter when they were



approved. This involves having available, at loan origination, certain underwriting characteristics for each business loan SBA makes or guarantees, plus additional data on loans that go into default. In order to comply with this requirement, the specified data must be available at the time of loan approval and must be entered into SBA's database when a loan is placed in liquidation.

- b. The SBA and its participating lenders must obtain loan origination data on the specified underwriting characteristics for each business loan the Agency makes or guarantees. This loan origination data will be supplemented by additional information on collateral for loans that go into default, and SBA staff must enter all required data into SBA's systems through a new LLTS screen (titled "Underwriting Characteristics") when a loan is placed in liquidation.
- c. Servicing/liquidation supervisors must verify the entry of this data and its accuracy as part of their regular supervisory reviews. Also, district directors must monitor compliance during their regular 60-day reviews under the Liquidation Improvement Project.
- d. The required information on loans transferred to liquidation status after January 1, 1997, pertains to a borrower's financial condition and collateral at the time of the loan application on an actual and pro-forma basis, along with additional information on collateral at the time a loan goes into default. The risk management database will include:
  - (1) A credit history indicator at time of application;
  - (2) The current ratio and the debt to tangible net worth ratio at the time of loan approval;
  - (3) A collateral analysis at the time of loan approval showing loan to value ratios for both fair market and liquidation valuations; and
  - (4) The net realizable value of loan collateral at default.
- e. Processing personnel must ensure that all information needed to compute the ratios is collected on every business loan, and servicing/liquidation personnel must input this data for loans that go into liquidation after January 1, 1997.
- f. For valid comparisons, ratios must be computed using the same method for each loan. The procedures are detailed in the appendix P, "Loan Underwriting Criteria -- Risk Management Database."

- (1) Field offices must distribute this information and appendix P, “Loan Underwriting Criteria -- Risk Management Database” to each participating lender submitting a request for loan approval after the date of this SOP.
  - (2) Lenders must be aware that the information required to calculate the specified ratios must be in the loan file for each SBA guaranteed loan they originate (since June 17,1997).
  - (3) For lender serviced loans that go into liquidation, the lender must calculate all ratios as of the time of application and provide these ratios to SBA along with the specified information on loan collateral as an attachment (following the LLTS screen format) to the liquidation plan.
  - (4) The liquidation plan must be submitted by the lender to SBA when required according to the type of lender and loan program involved, and must be entered by SBA staff into the Agency’s database when received from the lender.
- g. The SBA has added an “Underwriting Characteristics” screen to LLTS (“V” screen) to meet the legislative requirement. This screen requires the capture of the specified data by field office staff when a loan is transferred to liquidation status. Complete information on the new screen is contained in Section IV, Chapter 4.22 (“Underwriting Characteristics”) for the LLTS in the SBA-DCS User Manual. This section includes input procedures, error messages, field names and descriptions, as well as an example of the screen itself. Although the instructions contain a detailed guide, please note the following.
- (1) All SBA and lender serviced business loans must be included in the data collection effort. This includes CDC loans and disaster business loans, but not disaster home loans.
  - (2) For lender serviced loans, lenders must provide the “Underwriting Characteristics” as an attachment (using a format similar to the LLTS screen) to the liquidation plan. Lenders must submit the plan to SBA at the beginning of the liquidation process or at the time of guaranty purchase, depending upon the requirements of the loan program and type of lender.
  - (3) When SBA receives the liquidation plan and the underwriting characteristics attachment, liquidation staff must enter all data in the LLTS screen for all loans transferred to liquidation after January 1, 1997.
  - (4) All data fields in the LLTS screen must be completed. If information is not available, enter a “0” (zero) in the appropriate space.

**9. Which 327 Actions Must SBA Counsel Review?**

- a. Legal counsel must review all 327 actions involving the following activities (exception are noted in the corresponding categories):
- (1) Exceptions to policy;
  - (2) Conflict of interest/preference;
  - (3) Acquisition of environmentally impaired property;
  - (4) Transfer of a loan to another lender;
  - (5) Subordinations (review includes the 327 action and other documents deemed necessary);
  - (6) Assumptions (review includes the 327 action and other documents deemed necessary);
  - (7) Release or substitution of collateral;
  - (8) Release or substitution of obligors;
  - (9) Workouts;
  - (10) Purchase under the SBA guaranty, including “repairs” and denials of liability;
  - (11) Deeds in lieu of foreclosure;
  - (12) Review of liquidation plans (for issues regarding legal compliance, e.g., legal expenses);
  - (13) Payment of attorneys’ fees;
  - (14) Transfers of a loan into litigation;
  - (15) Transfers of a loan out of litigation;
  - (16) All 327 actions on a loans in litigation status;
  - (17) Purchase and/or payment of prior liens;
  - (18) Payment of real estate taxes;

- (19) Compromise actions;
- (20) All charge-offs;
- (21) Any other document or 327 actions with issues regarding legal compliance;  
and
- (22) Substantive revisions to the loan authorization.

**NOTE:**     Other exceptions may be noted in chapter 10 on “Special Programs.”

- b. Counsel must refer all purely credit issues or administrative aspects to the Liquidation/Servicing Division.
- c. For lender-serviced loans, the lender is responsible for the preparation and legal review of all documentation.
- d. For CDC loans, the CDC is responsible for preparing all documents. The SBA counsel must review all CDC prepared documentation.

**10. What Other 327 Actions Does SBA Counsel Typically Review?**

Besides the 327 actions listed above which counsel must review in each instance, the following are examples of other 327 actions which counsel should review:

- a. Transfers into liquidation status;
- b. Protective bids at foreclosure sales;
- c. Assignment for the benefit of creditors;
- d. Alterations in the terms of any loan instrument;
- e. Disposal of COLPUR;
- f. Transfers to servicing from liquidation; and
- g. Abandonment of collateral.

**NOTE:**     For all matters discussed in this SOP where there is an issue regarding legal compliance, final authority rests with the General Counsel or designee.

**11. Who has Authority to Liquidate SBA Loans?**

The following people have authority to liquidate SBA loans:

- a. Delegated SBA employees per existing delegation of authority as published in the Federal Register; and
- b. Participating lenders with an executed SBA 750.

**12. What is the Federal Statute of Limitations Act?**

- a. Under the Federal statute of limitations [28 U.S.C. 2415(a)], an action by the Government to recover upon a contract is barred unless filed within 6 years from the date a cause of action occurred. The date of the accrual of the cause of action may be subject to various interpretations.
- b. Whenever any doubt exists regarding the applicability of the statute to any claim, counsel will determine if it is necessary to ensure that the statute does not bar any intended action by the Agency.

**13. How Do You Handle Conflicts of Interest?**

You must become fully familiar with 13 CFR § 120.10 and § 120.140 cited in Chapter 2, "Regulations and Other Authorities."

- a. **Conflicts of interest can arise between one's official and personal duties. Some possible conflicts of official duties involve:**
  - (1) Agency employees and their close relatives;
  - (2) Participating lenders' employees and their close relatives; and
  - (3) Certified development companies' employees and their close relatives.
- b. **Special care should be taken in situations involving:**
  - (1) An associate of the participant (see chapter 2, "Regulations and Other Authorities," for a definition);
  - (2) Close relatives of an employee (see chapter 2, "Regulations and Other Authorities," for a definition);
  - (3) Loans to SBA employees and their close relatives;

- (4) Loans to participant's associates;
- (5) Employee/associate bidding on collateral being liquidated; and
- (6) Purchases of collateral or "Colpur" by close relatives of the participating lender's associates.

**c. Loans to SBA employees and their close relatives.**

If an SBA employee or a close relative of an SBA employee is an obligor on a loan, all significant actions affecting their liability must be referred to BLS or the Headquarters Claims Review Committee for final action.

**(1) For this purpose SBA employees also include:**

- (a) Service Corps of Retired Executives (SCORE); and
- (b) SBA Advisory Council members.

**(2) Significant actions affecting their liability include:**

- (a) Charge-offs;
- (b) Compromises;
- (c) Releases of an obligor;
- (d) Substantial workout of payments; and
- (e) Substantial release of collateral.

**d. Loans to participant associates.**

If an associate of a participant is an obligor on a loan, you must refer all significant actions affecting their liability to BLS for final action.

**e. Can an employee/associate bid or purchase at a sale?**

- (1) No. An SBA employee, close relative, or members of the household must not bid or purchase for their own interest either directly or through an agent at any SBA-related sale of collateral or "Colpur."

- (2) Associates of the participating lender, close relative, or members of the household of the participant's associates must not bid or purchase on their own accord or through agents at any SBA-related sale of collateral or "Colpur."

#### 14. What is SBA's Policy on the Sale of a Loan?

A cash sale for less than the total amount due and transfer of the note and related loan documents, without recourse, may be approved when it is within the delegated compromise authority level of a district or branch office with the written consent of the participant, where appropriate. As a matter of policy, a reasonable effort should be made to notify the borrower of the sale of a loan.

#### 15. What is SBA's Policy on Certain Litigation Matters?

When it appears that legal action by the Department of Justice (DOJ) is required to effect further recovery or to protect the position of SBA, the matter must be referred to field office counsel.

It is not contemplated that all matters requiring counsel's comments, opinions, or actions will be classified as "in litigation."

##### a. Litigation instituted against SBA or the Administrator.

An original process or notice of litigation served upon or received by an SBA employee must be brought to the attention of counsel immediately. No acceptance or waiver of service of process will be made without the prior approval of counsel who will coordinate the matter with General Counsel and/or the U.S. Attorney.

##### b. Department of Justice (DOJ).

Disposition of collateral involving litigation and other accounts involved in a suit against SBA must be referred to the Agency's counsel. Where appropriate SBA's counsel must make arrangements through the DOJ for the U. S. Attorney to represent the Agency on all claims more than \$5,000 (exclusive of interest and costs) and all accounts which are secured by a preferred ship mortgage, falling within the U.S. Attorney's delegated authority.

##### (1) How does SBA make recommendations to DOJ?

When referring an account to DOJ, counsel must advise the U.S. Attorney of the Agency's desire to consider and submit a recommendation with respect to any action on the account. This is especially important on participation loans since each action must be coordinated with the participant. The U.S. Attorney should be advised of the pertinent provisions of the participation agreement.

**(2) What is the liquidation staff's role?**

The assigned liquidation official must assist counsel in preparing the referral of an account to DOJ by providing pertinent documentation, including the "Claims Collection Litigation Report" (CCLR), unless counsel request otherwise, as needed on:

- (a) Obligors;
- (b) Guarantors;
- (c) Loan data; and
- (d) Any other credit information and analysis which may be appropriate.

In addition, the liquidation official must inform counsel of any adverse actions.

**(3) What is SBA's policy on inaction by DOJ?**

In the event undue delay is experienced in the handling of an SBA referral, assistance should be requested from the Office of Litigation by memo with a copy to BLS which must be prepared by counsel. The memo must document the pertinent facts about the referral and detailing the follow-up efforts made by the field office.

**c. What are the requirements of the Claims Collection Act?**

Under the Federal Claims Collection Act, documented attempts to settle the obligation and the identification of worthwhile recovery prospects (e.g., property, income) are prerequisites for referral to the DOJ for legally enforced collection. The SBA 327 recommending referral to DOJ for collection should clearly detail the Agency's attempts to reasonably settle the claim and adequately describe and evaluate the attachable assets or other worthwhile recovery possibilities.



**CHAPTER 5**  
**PROBLEM LOANS AND WORKOUT SITUATIONS**

**1. What is SBA's Policy Regarding Workouts of Loans Classified "In Liquidation?"**

- a. SBA's mandate is to foster and assist small business.
- b. You should work with the borrower to structure a workout whenever feasible.
- c. Be creative, since the alternative of liquidating the collateral usually results in reduced net recovery for SBA.

**2. How Do You Determine if a Workout Should Be Considered?**

Analyze the loan based on the following four questions:

- a. Is the borrower cooperative and acting in good faith?;
- b. Will restructuring the repayment plan help the borrower pay the debt?;
- c. Can the borrower's cash flow support the workout plan?; and
- d. Is a workout in the best interest of both the borrower and the SBA?

**3. Is it Necessary to View the Collateral Before Considering a Workout on a Problem Loan?**

Not necessarily. An up-to-date review of the existing collateral versus additional unencumbered assets must be completed, but you are not required to personally view the collateral.

You should personally view the assets if you feel it will be beneficial. If additional collateral is to be taken as consideration for a workout, you must be aware that the Agency's lien could be invalidated if the borrower files bankruptcy within the preference period. Presently the preference period is 90 days; 1 year for insider. (Consult with counsel for further clarification.)

**4. What Types of Relief are Available to the Borrower?**

- a. Reinstatement of maturity;
- b. Deferment of payment;

- c. Postponement of any liquidation action;
- d. Extension of maturity; or
- e. Reamortizations\rescheduled accounts.

**NOTE:** SBA carries a matured loan as “delinquent,” even if paying as agreed. This has a negative impact on your currency rate. It is important that you update the new maturity date in the SBA database as soon as any extension is approved.

See SOP 50 50, “Loan Servicing,” for detailed discussion of these actions.

## **5. What Type of Legal Review and Formal Documentation is Required?**

- a. For SBA-serviced loans:
  - (1) Counsel must review the loan documents to ensure that all existing liens remain intact and any newly pledged collateral is properly secured. Documents to review include:
    - (a) Security agreements;
    - (b) UCC lien filings;
    - (c) Mortgages; and
    - (d) Any other existing collateral documents.
  - (2) Counsel must prepare and/or review documentation necessary to protect the Agency’s interests. Typical documentation may include:
    - (a) A new note;
    - (b) A renewal note;
    - (c) A modification to the note; or
    - (d) An amendment to the original note.

- b. For lender-serviced loans, the lender is responsible for the preparation and review of these documents.
- c. In some instances, it may be necessary to obtain consent of the guarantor(s). Counsel must determine if notice or consent is required and must determine the consequences, if any, of noncompliance by SBA.
- d. For any additional items that counsel must review, see paragraph 9, “Which 327 Actions Must SBA Counsel Review?” in Chapter 4, “General Guidelines for Liquidation Activities.”

**6. What Interest Rate Adjustments May Be Made in a Workout Situation?**

- a. On participation loans, the rate is negotiable with the lender, but may not exceed the maximum rate allowed by SBA under the particular loan program.
- b. On disaster loans, the interest rate may be adjusted despite statutorily mandated rates at loan origination.
- c. On all other direct loans, the interest rate will be the rate in effect at the time the workout is approved.

**NOTE:** See chapter 10, “Special Programs,” for any exceptions.

**7. Special Interest Rate Rules.**

- a. On “Purchased Guaranty Participation” (XGP) loans where the interest rate was frozen at a high rate, you may reduce the rate to current levels.
- b. You may consider a retroactive adjustment of the interest rate.  
  
(See paragraph 14, “Reduction/Elimination of Interest Rates or Accrued Interest,” in Chapter 17, “Compromise Action,” for details.)
- c. In some circumstances the liquidation of the collateral will result in a large loss to the Government. You may reduce the interest rate to the “Cost of Money to the Government” or lower, if it will help produce a viable workout using the rule of two.

**8. What Determines the “Cost of Money to the Government?”**

The Government’s cost of money is equal to the interest rate payable on Treasury issues with similar maturities. You obtain this rate by comparing the workout maturity with the Treasury issues published daily in the Wall Street Journal.

**9. Information for Workout on the Disaster Loan Program.**

See Chapter 10, "Special Programs."

**10. Special Handling of Loans Where Borrower is Willing but Unable to Pay (Hardship Case).**

Often, when the business fails, the individuals are in dire financial straits. There may be, from time to time, a case where they would pay but are unable to financially. In those instances, you should consider the following.

**a. A hardship delay.**

- (1) An SBA 327 must be prepared recommending postponement of collection action for up to 1 year because of the financial hardship circumstances;
- (2) Further delays may be considered based on the specific circumstances of the case; and
- (3) Further delays may only be considered if it appears that the obligor's financial condition may substantially improve in the near term.

**b. Is the primary residence at risk?**

If the primary residence is at risk, you may consider a creative repayment plan payable over time. The end product should reflect a reasonable return to SBA where the individual(s) retain their residence. You should be able to resolve most cases with proper handling.

**c. Other specialized approaches.**

- (1) Special circumstances require innovative approaches. You may have a local economy or marketplace with unique problems that impair your enforcement of collection.

For example:

- (a) A property may be located in a market that is saturated with similar hard to sell properties;
- (b) You may have taken a deed in lieu of foreclosure as part of a settlement agreement in exchange for a life estate interest; or
- (c) You may find some other locally unique problem.

- (2) As with the hardship situation, the best course of action may be to delay collection in hopes that the market, economy, or individual's situation improves. A recommendation must be made on an SBA 327 to the approving official.
- (a) You should consider recommending (by 327 action) to:
- i. Reduce future installments to \$1.00 for a period of no more than 1 year from the date of the next installment due date to provide relief to the borrower;
- NOTE:** The \$1.00 installment is established so that the borrower is reminded regularly of their debt to the Agency while not placing any additional burden at this time of hardship.
- ii. Reestablish the original payment amount to commence at the end of this relief period (to maintain proper follow up of the account); and
  - iii. Reclassify the loan to "Servicing" status.
- (b) This will ensure that:
- i. An annual review of the obligor's financial condition is completed to determine if subsequent annual suspensions (and reviews) of the payment installment are appropriate;
  - ii. The account will not be accidentally referred to a collection agency; and
  - iii. That timely follow up will take place.

**11. Assistance Provided to Existing Borrowers who Suffer Losses in a Declared Disaster?**

For further information, see paragraph 29, with the same name as this paragraph in Chapter 5, "Specific Loan Servicing Actions," in SOP 50 50, Loan Servicing.



## CHAPTER 6 SBA-SERVICED LIQUIDATIONS

This chapter deals with possession, control and protection of collateral when it is determined that a workout is not possible and the loan is SBA serviced. It is important that you document all your findings and actions in the Delinquent Loan Collection System (DLCS) or the Liquidation/Litigation Tracking System (LLTS) as appropriate.

### 1. What is SBA's Policy for SBA-Serviced Liquidations?

- a. You must direct your efforts toward maximizing recovery in a minimum amount of time.
- b. You must promptly proceed to locate, identify, assess, and protect all pledged real and personal property.

### 2. What Initial Steps Should Be Taken if a Workout is Not Possible?

- a. Review the loan documents;
- b. Identify all collateral and lien positions;
- c. Identify the status of taxes;
- d. Identify the status of hazard insurance;
- e. Make a field visit to view collateral;
- f. Assess the collateral value;
- g. Determine the need for care and preservation of the collateral; and
- h. Assess potential environmental issues.

### 3. What Loan Documents Must be Reviewed?

You must begin with an in-depth review of all available loan documents. Review both the loan file and the collateral file (e.g., notes, deeds of trust, UCCs, etc.). This will allow you to be fully familiar with the business assets, obligors, and guarantors, along with any peculiar items and changes that have occurred since the loan was made. In addition, you must determine the exact status of real and personal property taxes, hazard insurance, and prior

liens including open-end provisions, since any of these factors may have an adverse impact on the SBA's collateral position.

#### 4. How Do You Verify What Collateral Actually Remains or is Available?

- a. The loan file is a valuable source of information relative to collateral issues. The loan authorization contains the original requirements and the 327 actions will reveal any adjustments made. It is very important to be thorough.
- b. Collect data through discussions with borrower and any other sources familiar with the borrower.
- c. You must search the public records for all liens of record, including judgments, special assessments, ad valorem, and other tax liens.
- d. Obtain Universal Commercial Code (UCC) lien searches, real estate property reports, business information reports and any other investigative search that is available and warranted.
- e. Determine if any Internal Revenue Service (IRS) liens exist to accomplish a discharge of IRS lien. (See paragraph 14 in this chapter, "Coordination between the Internal Revenue Service (IRS)".)
- f. Visit the business premises.
- g. Obtain an appraisal of the assets.
  - (1) A formal appraisal is justified and valuable when determining how to dispose of the assets.
  - (2) If collateral is nominal, the loan officer's opinion of value should suffice. (See Chapter 16 on "Appraisals".)

**NOTE:** You must obtain an appraisal on any assets, regardless of value, that may be deeded to SBA in exchange for a credit to an obligor's debt (deed-in-lieu).

#### 5. Mandatory Field Visit Requirements.

- a. SBA personnel must make site visits following the guidelines for lenders. (See paragraph 8, "What Steps Should SBA Take after Being Notified of an Adverse Event?" in the subparagraph b., "Site Visits - 'Lender - Serviced Loans'" in Chapter 8, "Lender-Serviced Liquidations")



- b. In addition, if a site visit was not made within the previous 120 days, one must be made prior to the sale or computation of a protective bid for substantial collateral (real or personal).
- c. Hiring a contract appraiser or evaluator is permitted if field office staff is inadequate. The cost must be charged to the loan as a recoverable expense.
- d. You must attend all sales of SBA related collateral, unless visit is waived by an SBA 327 for good cause.

**6. What Should You be Looking for During the Visit?**

You should:

- a. View the business assets to verify what remains versus what was supposed to exist;
- b. Identify, if possible, additional assets to pursue;
- c. Determine whether the collateral requires special protection and the related costs of care and preservation of collateral (CPC); and
- d. Assess what sale technique would be most effective.

(See Chapter 7, “SBA’s Methods of Recovery from Collateral.”)

**7. How Should the Field Visit and Inspection of Collateral be Documented?**

- a. A memorandum report must be prepared covering the inspection of collateral and detailing any major discrepancies with what should have existed based on review of the file.

This report should contain:

- (1) Determination of collateral value;
- (2) Review of Agency’s lien position on collateral;
- (3) Specific identification and description of all worthwhile assets including serial numbers;
- (4) Results of review of loan documents and borrower’s records, including books of account and other financial documents;
- (5) Considerations on the care and preservation of collateral (CPC); and

- (6) Analysis of use of loan proceeds to compare with assets currently on site.
- b. If there is any evidence that pledged items worth more than \$5,000 are missing or have been sold, concealed or otherwise disposed of with intent to defraud the SBA, you should contact the Office of the Inspector General (OIG) and discuss the matter. If a report is required, refer to Chapter 24, "Referrals to the Inspector General" for referral instructions.
- c. Photographs and/or videotaping provide excellent supplements to the written report and should be used whenever possible.
- d. A written evaluation of the collateral should be included in the field visit report, either a formal appraisal or loan officer's estimate as appropriate.
- e. The report must be reviewed by the approving official and comments are to be entered (by the approving official) into LLTS.

## 8. Is it Best to Sell the Assets at the Location or Remove Them to Storage?

Once you have determined what collateral exists, viewed it and estimated the liquidation sale value, you should decide whether to conduct the sale of assets at the borrower's premises.

**Some things you should consider include the following.**

- a. The costs of care and preservation of collateral (e.g., moving and storage fees, sale commission, advertising, utilities, etc.).
- b. Landlord storage costs.

The landlord will usually allow a sale to take place on the premises for a reasonable storage fee or possibly no charge at all. Most of the time, the landlord is more interested in getting the space back to be able to obtain another lease.

- c. Landlord Waiver.

If you have a "Waiver of Landlord Lien," you have specific rights as to possession of the collateral. If you do NOT have the waiver, you should consult with counsel as to landlord rights in your specific state.

- d. Environmental considerations. See paragraph 15.b. of this chapter, "What is SBA's environmental evaluation policy?"
- e. Any other factors which may affect your sale (e.g., location, available parking, security, etc...).

**9. Repossession of Collateral.****a. When is possession obtained?**

- (1) The SBA must take control of the collateral in order to proceed to sale.
- (2) Remember that when you are taking collateral into the Agency's custody you are responsible for taking prudent care and protecting the assets.
- (3) This responsibility is not to be taken lightly as it could have an impact on personal guarantors and collection of any deficiency.
- (4) The liquidation officer should not take possession until he/she:
  - (a) Has a clear plan of action;
  - (b) Knows the property has worthwhile value;
  - (c) Coordinates with counsel as to legal aspects; and
  - (d) Determines what contractor assistance is advisable.

**b. How do you obtain possession?**

Possession may be taken:

- (1) Pursuant to the UCC through peaceful repossession;
- (2) With the assistance from the landlord;
- (3) Directly from the borrower in a cooperative effort; or
- (4) Through enforced debt collection.

If the debtor refuses entry and/or possession, counsel will take the necessary steps to permit entry for the purpose of determining the need for and particulars of enforced collection.

**10. When Don't You Take Possession of Collateral?****a. Do not take possession in the following cases.**

- (1) From an "employee of the borrower," deal with the borrower/owner directly and obtain his/her cooperation whenever possible.

- (2) Of “income producing property” whose value is dependant on income generated or anything that is alive or growing until after arrangements have been made to contract with a competent professional to handle/manage the assets. A back up plan must also be in place.
  - (3) Of property which **MAY** be contaminated by hazardous waste or materials. (See paragraph 15. b., “What is SBA’s environmental evaluation policy?”)
  - (4) Of any individual’s personal effects not specifically identified as SBA collateral.
- b. If you encounter a belligerent borrower, back off. It is the SBA’s policy to abandon or proceed judicially, depending on the value and circumstances, if any threat of violence is perceived. No amount of collateral is worth exposing an employee to danger.

**NOTE:** Cash should be taken with great caution. If cash is taken, an itemized inventory by denomination of all paper and coins must be made and witnessed by at least two other people. The cash taken must be converted to a cashiers, check or money order and applied to the borrowers account as soon as possible.

**11. What is a Typical Sequence of Events When the Borrower and Landlord Cooperate and Peaceful Possession Will be Taken?**

- a. Check for hazardous materials or waste;
- b. Take the keys;
- c. Allow the borrower and employees to take personal belongings;
- d. Change the locks;
- e. Take physical inventory;
- f. Pick up accounts receivable;
- g. Arrange for utilities;
- h. Post the property as necessary;
- i. Notify police and key neighbors if deemed necessary;
- j. Check insurance coverage;

- k. Provide for any special maintenance required for equipment;
- l. Determine security needs; and
- m. Ensure that competent management is in place if needed.

## **12. Selling Collateral After Taking Possession.**

See Chapter 7, “SBA’s Methods of Recovery from Collateral.”

## **13. Release/Subordination of Agency Lien.**

Recommendations for release and/or subordination of SBA lien on loans “in liquidation” will only be considered if they clearly are in the Agency’s best interest. Release/subordination should be used to effect maximum recovery. Each action will be considered based on its effect on the value of the collateral and the ability to obtain greater overall recovery on the loan. (See Appendix HH, “IRS/SBA Memorandum of Understanding (MOU) and Agreement.”)

### **a. Request for release of lien by borrower.**

Generally liquidation by the borrower in a piecemeal fashion is not in the SBA’s best interest. The borrower finds buyers for attractive assets leaving the rest for public auction. In a few instances, however, it may be beneficial. The recommending official must ensure that any sales/releases are for good value and will not adversely affect any subsequent foreclosure sale. Use SBA 327 for approval.

### **b. Other Requests for release of lien.**

- (1) Upon receipt of a request for release of property from an SBA lien, the recommending official should assess the facts, obtain participant approval, and ensure that SBA approval will not constitute waiver of lien.
- (2) You may recommend release of collateral subject to the following.
  - (a) Real and/or personal property may be released for a reasonable amount based on SBA’s estimate of value. If the offer is for less than the estimated value, or the amount to be applied on the loan is less than the proceeds from sale, the basis for release must be clear and the loan file must be fully documented.
  - (b) Proceeds from release must be applied to transaction code 305, collections from the liquidation process.

- (c) The equity or value of any new property taken in substitution for a release must be comparable to what is released. The new asset must be pledged as collateral even though taken subject to a purchase money or prior lien.
- (d) The SBA must not consent to a sale of property in which it holds a security interest or mortgage lien if such action may constitute a waiver of lien or security interest. Consult with counsel.

**NOTE:** When a personal residence is the only worthwhile asset and there are no other prospects for recovery, (e.g., income), you may reach an agreement on release of the house for consideration. Consult with counsel to ensure that the obligor/guarantor remains liable for the deficiency. You should strive to obtain a sum over and above the release amount and settle/compromise the entire SBA claim. This will complete the case and is generally the preferred course of action.

**c. Subordination to another debt.**

Subordination to another debt must be preceded by a careful analysis and full documentation. Few instances are appropriate, but some may be in the best interests of the Agency.

These may include:

- (1) Construction completion where the only way to complete the project and ensure recovery is through additional financing;
- (2) Short term working capital needs;
- (3) Hazardous waste workouts where subordination to a loan for cleanup would be preferable to abandonment;
- (4) Special purpose facilities; or
- (5) Other instances where the facts clearly show the subordination would be in SBA's best interest.

**d. Process SBA 327.**

Process SBA 327, with comments of counsel, for approval of release or subordination requests. Once approved, ask counsel to prepare and/or review the appropriate documents.

**14. Coordination Between SBA and the Internal Revenue Service (IRS).****a. Agreements.**

The SBA and IRS have outstanding agreements (see Appendix II) under which they cooperate on problem accounts. The overriding intent of the agreements is to mutually protect the Government's **overall** interests and to **mutually** strive to maximize recovery. Typical areas of cooperation are:

- (1) Early contact on delinquent taxpayers/borrowers;
- (2) Discharge of IRS tax liens; and
- (3) Cross training on each others procedures.

**b. Who coordinates actions with the IRS?**

- (1) A Headquarters liaison is established between the IRS Office of the Assistant Commissioner and SBA's Office of the AA/FA. Periodic meetings may be held to discuss areas of mutual concerns.
- (2) A regional liaison may be established between the IRS assistant regional commissioner (collection) and SBA's office of the regional administrator. Meetings are held on an "as needed" basis to discuss problems concerning either agency.
- (3) A field liaison is established between designated field office coordinators from each agency. Specific taxpayer/borrower problems must be resolved quickly.

**c. What will happen when a Federal tax deficiency is discovered?**

- (1) The SBA should contact the IRS if SBA knows that a borrower is delinquent in filing or paying Federal taxes.
- (2) The IRS should notify SBA if IRS expects to take enforcement action against a taxpayer they know is an SBA borrower.
- (3) In either case, SBA and IRS should mutually agree on a specific time frame to analyze and resolve the tax problem.

**d. What action does SBA take upon notice from IRS?**

- (1) You must evaluate the borrower's ability to pay the tax deficiency within an agreed upon time frame.

- (2) If you believe the borrower is financially viable, consider methods to make cash flow available to pay IRS, such as:
  - (a) Deferment of payments;
  - (b) Reduction in payments; or
  - (c) Subordination, release, or assignment of collateral.
- (3) If you determine that the borrower is not financially viable, you should advise the IRS immediately.

**e. What action does IRS take upon notice from SBA?**

Normally, IRS will refrain from taking enforcement action, including the filing of a tax lien during the evaluation period. Be aware that IRS may, based on their own judgment, feel that the Government's best interests would be jeopardized by delay. In those instances, IRS will notify SBA of the enforcement action planned.

**f. How do you obtain release of a junior IRS tax lien?**

- (1) To reduce litigation costs and make property more readily marketable, SBA and IRS agree to work together where both have a lien on the same property.
- (2) For the procedure to request a certificate of discharge and a sample cover letter, see Appendix JJ and KK, "IRS Special Procedure for Discharge of Lien" and "Suggested Format for Application for Discharge of Junior IRS lien."
- (3) The certificate of discharge should be returned to IRS for cancellation if it is not used for any reason by SBA.

**g. Skip trace information from IRS.**

You may obtain the last known address on the IRS tax records by submitting a written request to IRS. (See Appendix LL, "Sample Borrower Letter to IRS.")

**15. Environmental Considerations.**

The liquidation officer must be aware of the substantial liability issues concerning hazardous materials and contaminated property. The clean-up costs of a contaminated site can be very costly and the stigma could adversely effect the collateral value. Ownership and/or management of contaminated property can result in liability for clean-up, site restoration, and potential third party claims that arise from the contamination.



**a. What are the effects on collateral?**

When a site is designated as contaminated by Federal or State environmental agencies, a lien may be filed to cover the costs of cleanup and restoration. The property value will be reduced by the lien amount. The SBA's liability for clean-up costs may be affected by the degree of control that the Agency exercises over a borrower and its collateral if hazardous wastes exist. Coordination with and approval of counsel is important.

**b. What is SBA's environmental evaluation policy?**

- (1) You/lender must conduct a preliminary assessment of risk at the beginning of liquidation. You must complete the "Environmental Questionnaire" on all loans supported by real estate, generally excluding residential real estate, with worthwhile equity for SBA in the property. This questionnaire is located in SOP 50 10, "Processing Business Loans."
- (2) If there is any possibility that hazardous materials may exist, or there is a potential for contamination of property (including from adjacent properties), a professional environmental audit, Phase I audit, must be obtained.
- (3) SBA must exercise extreme caution in taking ownership or control (i.e. operational control effecting the environmental decisions of the company) of any property of a firm identified in a "frequently polluting industry" prior to conclusive completion of the necessary level of environmental assessment. (See SOP 50 10). In this situation, you must conduct at least a Phase I audit. Every effort must be made to sell this type of collateral rather than taking ownership and control.

**16. What is a "Preliminary Assessment of Risk?"**

It is the evaluation you perform if there is any evidence that there may be environmental concerns with a property. The "Environmental Questionnaire" (See SOP 50 10), must be used as a tool. If any possibility of contamination exists, a Phase I audit is required, at a minimum.

**a. What is a Phase I Audit?**

A Phase I audit will be performed by a reputable private firm and as a minimum should include the following;

- (1) Inspection of site and adjacent properties;
- (2) Review of historical site property records;

- (3) Review of regulatory agencies' records;
- (4) Personal interviews with individuals knowledgeable with the site operations; and
- (5) The report provided by the auditors will indicate if any areas of concern were detected, and will advise if a Phase II audit is required.

**b. What is a Phase II Audit?**

- (1) This type of assessment is required if it is known that significant contamination exists, or a Phase I recommends it. The report is in much more detail as to specific problem areas already identified.

At a minimum the following items should be included in the Phase II Audit;

- (a) Taking physical samples for testing. (e.g., testing for presence of asbestos, PCB's or radon, soil and groundwater sampling and testing, leak analysis for underground storage tanks);
  - (b) Hydrological investigation of site vicinity; and
  - (c) Determination of the extent of contamination and costs of clean-up.
- (2) When contamination is identified how do you analyze the level of concern?

You should take into consideration your own knowledge and experience, any professional assessments received and their recommendations, and projected costs of clean-up and restoration. This will allow you to make a prudent judgment on how to proceed. As it may pertain, see paragraphs 22 and 23, in this chapter, "When may Collateral be Abandoned?" and "If Collateral is Abandoned..."

**c. What are the limitations on the requirements for a Phase I or II Audit?**

- (1) The approving official may waive the requirements for a Phase I or II audit on a case by case basis.
- (2) Some cases where waiving of an audit may be appropriate are:
  - (a) The SBA has no knowledge that environmental risks exist and the property is not on the list of frequently polluting industries;
  - (b) Phase I audit has recently been conducted by SBA; or

- (c) Equity in the property is so limited that the Agency is not planning to take possession in any event.

## 17. What are the SBA Guidelines for Qualifying Environmental Auditors?

Environmental audits must be performed by a firm that is impartial, has no interest in the property or transaction and has demonstrated expertise in its field. Care must be taken to ensure that the firm hired has no relationship with the property sellers or their representatives. In order to establish their level of expertise and the absence of any conflict of interest, the firm must satisfy SBA as to all the following topics:

- a. How long the contractor has been performing environmental assessments of real property;
- b. Details concerning certification or approval of the contractor pursuant to an official Federal, State or local program or policy to conduct environmental assessments;
- c. Identity, training, and relevant experience of all employees who will work on the project;
- d. Details concerning any membership of the contractor in any organization whose purpose relates to the performance of environmental assessments;
- e. If the assessment will be performed in accordance with generally recognized standards, provide a description of the standards;
- f. The nature of any previous environmental inspections the contractor has performed for the seller or purchaser of the subject property;
- g. A description of any affiliation the contractor now has, or has ever had, with the seller or purchaser of the subject property;
- h. A description of any liability insurance the contractor has to cover claims in the event it fails to discover adverse environmental conditions in its inspection; and is the contractor willing to indemnify SBA for any costs stemming from any negligent failure to detect contamination; and
- i. A certification by the signing individual, under penalty for false statements, 18 U.S.C. § 1001, that the above information is true and correct.

Questions concerning these matters should be formally asked of all auditors whose assessments will be relied upon to determine the degree of environmental risk associated with real estate collateral, and a copy of their response placed in the loan file.

**18. Accounts Receivable (A/R) Guidelines.**

- a. You must identify and pursue pledged A/R in a timely and aggressive manner.
- b. The A/R must be promptly evaluated and collected (or abandoned, if appropriate).
- c. You must directly, or through others:
  - (1) Perform a review of the receivables to the extent of available books and records;
  - (2) Determine potential collectibility;
  - (3) Determine costs of collection;
  - (4) Provide notice to the individual account debtors; and,
  - (5) Ensure proper controls are in place and records maintained.

**19. How do You Handle Collection of A/R?****a. Collection by SBA.**

- (1) You must take possession of the accounts receivable ledger and all supporting documents, (e.g., invoices, orders, receipts, etc.) These supporting documents will be necessary if litigation is required on any of the accounts.
- (2) Notice to the borrower's debtors.

Notice must be given to all A/R debtors in writing. This will notify debtors that SBA is holder of the debt by way of its security interest in the borrower's accounts receivable. The letter should be prepared with input from counsel and mailed on SBA letterhead. See Appendix V for a sample A/R collection letter.

- (3) Supplemental A/R file.

You should set up a supplemental A/R file to collect correspondence and the ledger information. There will probably be many follow up letters and copies are to be kept in the file. Place A/R file with the original loan file.

- (4) The A/R record of debt and payments.

As part of the A/R collection file you should keep a listing of all accounts owing and payments made. Give a copy of the listing to the collateral cashier to ensure prompt identification, recording, and application of payments received.

- (5) Attempt to get the borrower to help resolve disputed claims.
- (6) Consider discounting the receivables that are not collected after several attempts.
- (7) Abandon uncollectible accounts (SBA 327 required).
- (8) You should notify the obligors of any remaining A/R once SBA ceases collection efforts. Advise them that they may collect as they wish and remit the proceeds less collection costs to SBA. This notice must be in writing and will help negate any defenses that obligors might raise in a suit for the deficiency balance.
- (9) Close the A/R supplemental file and place it in the original docket file.

**b. Collection by borrower.**

Borrower collection can be risky for the obvious reason that funds could be diverted. On the other hand, the borrower will be held liable for any deficiency and has a vested interest in collecting the most available. The borrower also can best handle any disputed claims. Analyze the situation carefully, but in the final analysis the basic question that must be answered is “Do you trust the borrower?”

**20. May Pledged Accounts Receivable be Sold?**

Yes. If the sale is in the best interest of the business. There are, however, concerns that the purchaser may use questionable or excessively aggressive collection methods which could reflect adversely on SBA. Therefore, care must be taken to ensure that SBA does not put itself in such a position.

The sale of A/Rs may be held in one of the following manners:

- a. You may sell the A/Rs to the purchaser of a going concern who is a bona fide owner/operator. The A/R's will have their greatest value to the new business owner/operator. You must use an SBA 327 for approval.

- b. You may recommend approval of a sale of A/Rs by another party in interest, (e. g., borrower, court, participant). This does not expose the SBA to potential criticism for collection methods which may be used by the participant. Use an SBA 327 for approval.
- c. All other sales of A/R must be sent through channels to BLS for approval.

**21. Guidelines for Handling Shares of Voting Stock.**

- a. Shares of voting stock held as collateral and registered in the name of the Agency's nominee may be voted at stockholders' meetings to protect SBA's interest as a creditor. Care should be exercised, however, since management control may make SBA liable for hazardous waste cleanup. You must consult with counsel.
- b. The line supervisor may, after documented conversation with counsel:
  - (1) Determine how the shares are to be voted; and
  - (2) Effect the execution of proxies if necessary.
- c. Stock must not be voted in favor of the election of any employee of the Agency as a director of the issuing corporation without the approval of AA/FA or designee.
- d. An SBA 327 is required for this entire process, and it may be used as the vehicle to document the conversation with counsel.

**22. When May Collateral be Abandoned?**

You should abandon collateral when the cost to dispose of the collateral exceeds potential recovery to SBA. This may be appropriate where:

- a. The collateral is of nominal value and costs of sale outweigh the anticipated selling price; or
- b. There is environmental contamination and the clean-up costs exceed the property value.

A cost/benefit analysis must be done on each individual case considered for abandonment. Any recommendation to abandon collateral must be presented on SBA 327 to the approving official who has final authority. When there are issues regarding legal compliance, you must obtain counsel's approval before recommending abandonment.

**23. If Collateral is Abandoned are UCC Liens or Mortgages Released?**

No. Liens will not be released except when consideration is received. Liens on abandoned personal property will remain in effect. However, they will be allowed to lapse at the next refiling date unless the SBA 327 approving the abandonment specifically requires them to be refiled.

Real estate mortgages should only be released with appropriate consideration which must be approved via SBA 327.





**CHAPTER 7**  
**THE SBA'S METHODS OF RECOVERY FROM COLLATERAL**

**1. What is SBA's Policy?**

The SBA's policy is to:

- a. Take action promptly and in the manner most advantageous to the Agency when:
  - (1) The loan is in default; or
  - (2) There is no reasonable prospect of borrower repaying the loan;
- b. Maximize recovery in the sale of collateral in the minimum amount of time; and
- c. Pursue aggressive marketing of the collateral in order to avoid acquiring assets.

**NOTE:** When feasible, you are strongly encouraged to upgrade the legal required advertising for a UCC sale, or for a judicial or summary foreclosure on real estate, to meet SBA's requirements for a "comprehensive public sale."

See 13 CFR §120.540

**2. What Should You Take Into Consideration When Taking Action on a Liquidation Account?**

- a. Statutory authority;
- b. Applicable State law;
- c. Appropriate operating procedures; and
- d. Agency objectives.

**3. What are the Basic Methods in Achieving Recovery?**

**a. Voluntary sale by borrower.**

The owner of real estate or personal property may be able to sell its assets and apply the proceeds to the loan debt.

**(1) The obligor must have:**

- (a) Possession of collateral;
- (b) Clear title to the property free of all liens;
- (c) Agreement with existing lienholders that they are willing to cooperate in the sale and transfer of title; and
- (d) A current appraisal no older than 1 year which can be obtained by the Agency.

You should be aware that experience shows only a small percentage of cases will work in this type of sale. A degree of direct supervision is required, which far exceeds that needed when assets are being sold by a professional auctioneer.

In addition, the borrower may sell the “good” items leaving the Agency without sufficient collateral to hold a public auction.

**(2) The release of SBA’s lien can be for:**

- (a) Cash; or
- (b) A down payment of cash with a note receivable which you must secure with the asset involved.

You should conduct a lien search prior to any arrangement.

**b. Deed in lieu of foreclosure.**

The Agency may accept a deed or bill of sale in lieu of taking foreclosure action. The liquidation officer must conduct a thorough evaluation, as this procedure carries certain risks.

You will need the following information to assist you in making a recommendation:

- (1) Clear title from the owner;
- (2) A written agreement between SBA and all obligors on an agreed amount of credit to be applied to the loan balance;
- (3) A recent appraisal or other reliable indication of value must be available to support the amount credited;

- (4) An assessment of possible pollution problems (See paragraph 15, “Environmental Considerations” in Chapter 6, “SBA-Serviced Liquidations”);
- (5) A determination as to whether the sale complies with the Bulk Sales Act if applicable;
- (6) A current lien search;
- (7) A review from counsel of whether State law will adversely affect SBA’s right to collect the balance of the loan from any obligors; and
- (8) The 327 action recommending this approach must contain documentation that a forced sale would not generate a larger return.

**c. Nonjudicial (summary) sale of personal property.**

Virtually every State has adopted the procedures set forth in the UCC. You must consult with counsel as to the requirements in your particular area. The UCC covers personal property pledged on a loan.

**(1) The two major requirements of the UCC are as follows.**

**(a) Reasonable notice.**

Depending on State law, the secured party will send notice to the debtor, guarantor, and any other secured party from whom you have received written notice of a claim in the collateral.

“Reasonableness” governs the timing of the notice. You may find in the security agreement a specific period of time for notice. Where no time period is specified, reasonable notice depends upon the circumstances.

**(b) Commercial reasonableness.**

Every aspect of a sale of collateral must be commercially reasonable, including the time, place, and terms of the sale.

**(2) What must the liquidation officer do to comply with the UCC requirements?**

**(a) You must:**

- i. Obtain peaceful possession of the property;

- ii. Give proper notice of the sale by certified mail, return receipt requested, to all obligors and guarantors (See the Appendix Y and Z, “UCC Notification, Personal Property Sale -- Direct Loan” and “...-- XGP Loan,” for sample letters);
  - iii. Include all required information in the individual and public notices;
  - iv. Notify all parties having a “security” interest in the collateral;
  - v. Have a current appraisal or other reliable indicator of value for the property to be sold; and
  - vi. Consult with counsel as to the requirements in your specific state.
- (b) You should:
- i. Consider using a professional selling agent, such as an auction company, to establish the commercial reasonableness of the sale; and
  - ii. Make extra sales efforts to show the Agency’s intent to conduct a “well advertised, public, and commercially reasonable sale.”

**(3) What are the types of UCC sales?**

**(a) The UCC public sale.**

You must obtain peaceful possession of the property, give proper notice of the sale as outlined above, and sell to the highest bidder at a well advertised public auction. Once the notice has expired you may consummate the sale.

**(b) The UCC private sale.**

You must obtain peaceful possession and tentatively negotiate an acceptable selling price. You must give public notice to all interested parties as outlined above. This notice must also state that the sale is subject to receipt of a better offer by a specified date.

**(c) The UCC special case sale.**

- i. Items of collateral covered under this section would be perishables, livestock, and any other collateral which would require special handling in which the costs would exceed expected value.
- ii. You should conduct this sale shortly after obtaining possession.
- iii. You should attempt to notify all obligors and guarantors of such a sale.

**d. Foreclosure of deed of trust.**

“Trust Deeds” or “Deeds of Trust” are used in some states to effect a lien on real estate. There is a trustee named, usually an attorney, who is willing to serve in that capacity. If the owner does not pay as agreed, the trustee, as requested by SBA or lender, will advertise, and publicly sell the property and apply the proceeds of the sale to the debt.

**4. Foreclosure of Mortgages.**

The property owner conveys, depending on State law, either a lien on the realty or the title to the realty to SBA or the lender. The mortgage will be canceled or released when the debt is paid. The SBA/lender may sell the property at public sale and apply the proceeds to the debt if the borrower fails to pay. There are certain States which require judicial foreclosure of real property mortgages, while others permit summary, nonjudicial foreclosure sales.

**a. Judicial sale.**

There are some States which do not permit nonjudicial foreclosure sales of real property. The Agency must prove the debt and security held as well as allow all parties an opportunity to be heard in court before the foreclosure can be held.

When you cannot obtain peaceful possession of personal property in some jurisdictions, the court action for possession of the property may result in a judicial sale.

**(1) Judicial foreclosures may be handled as follows:**

- (a) The SBA may initiate action for a judicial foreclosure; or

- (b) The SBA, as a mortgage holder, may be named a party defendant in a foreclosure action by another lienholder.

The DOJ, which represents SBA, will attempt to confine its litigation to the Federal courts. The lender may bring the foreclosure action in State or Federal court.

**(2) The following are types of judicial sales.**

**(a) Receivership sale.**

A receiver, who functions much like a bankruptcy trustee, will take possession of and protect the property. The court will order the receiver to sell the property publicly or privately on terms directed by the Court.

**(b) Bankruptcy sale.**

A bankruptcy trustee in a Chapter 7 bankruptcy, may sell both real and personal property which will be free and clear of liens.

**This sale can be:**

- i. Negotiated;
- ii. Offered publicly by the trustee in the courtroom;
- iii. A sealed bid; or
- iv. An on-site public auction.

**(c) Sale by debtor-in-possession.**

The debtor-in-possession or the trustee in a debt arrangement under the Bankruptcy Code may sell collateral by negotiation or some form of public offering. The sale will be preceded by a hearing and court order.

Confirmation of the court is usually required and the liens will move from the property and attach to the proceeds of the sale.

(3) **Possessory actions.**

The court retains jurisdiction over the property for the purpose of sale and distributing the proceeds after they determine the priority of liens and other interests.

b. **Quasi-judicial sale.**

**This is a process allowing the debtor to:**

- (1) Appear before an entry-level court official; and
- (2) Contest the creditor's right to proceed with the sale of their property.

Counsel will normally handle this procedure as it varies from State to State.

**5. What Type of Sales are Acceptable and How are They Handled?**

The SBA's regulations provide for the sale of loan collateral in accordance with the pertinent security instruments generally by public sale through competitive bidding at an auction sale or a sealed bid sale.

a. **Voluntary sale by borrower.**

See earlier paragraph.

b. **Public auction.**

- (1) Public auctions are conducted in accordance with applicable statutes and are considered to be legally correct.
- (2) The normal procedure involves publication of a notice of sale, usually in a local newspaper, followed by the public auction.
- (3) You should upgrade the legal required advertising to meet SBA's requirements for a comprehensive public sale whenever possible.

c. **Comprehensive public sale.**

(See 13 CFR §120.540 c.)

- (1) Whenever possible, you are strongly encouraged to offer collateral at a comprehensive public sale.

- (2) To meet the requirements of a comprehensive public sale you should consider using additional promotion by:
  - (a) Display advertising;
  - (b) Brochures;
  - (c) Purchasing updated mailing lists;
  - (d) Advertising in trade journals;
  - (e) Including descriptive information and photographs in SBA's Internet listing of acquired assets; and
  - (f) Any other sales support activity that would be used in a well conducted public sale.
- (3) Whenever possible, you should attempt to arrange with the trustee, sheriff, marshal, receiver, or bankruptcy trustee to allow a professional auctioneer, realtor or other sales professional to assist in promoting and conducting the foreclosure sale. All U. S. District Courts and many State courts have the power to provide for this in an order of sale.

**d. Private sales.**

- (1) The UCC authorizes creditors to use either public or private sale for personal property collateral, as may be commercially reasonable, but does not set forth detailed procedures to use for a private sale.
- (2) You should use procedures which provide protection against a sale being held invalid or a loss of liability of the obligors. Coordinate with the borrower whenever possible. The two important items to remember are "notice" and "commercially reasonableness."
- (3) The approving official has authority to approve a private sale of personal property collateral consistent with the UCC, or for real property collateral, if fully justified in the 327 action.
- (4) A current appraisal (within 120 days is preferred, but no more than 1 year as justified in the 327) must be available with the value documented on the 327 action recommending the private sale. This is especially important in the event that a deficiency balance will remain for which remaining obligors will be pursued.



- (5) The approving official has delegated authority to approve the 327 action authorizing the above sales.

**e. Sealed bid sales.**

- (1) You may offer collateral using advertised sealed bids.
- (2) The Agency's requirement that you conduct a comprehensive public sale whenever possible mandates that you promote the sealed bid sale properly.
- (3) You may consider sealed bid sales where the number of potential bidders is perceived to be limited. You should consider that this process requires you to handle all aspects of the sale, which entails:
  - (a) Developing prospects;
  - (b) Writing ads;
  - (c) Working with advertisers;
  - (d) Arranging for payment of expenses;
  - (e) Controlling the bids; and
  - (f) Answering inquiries.
- (4) You must first prepare the:
  - (a) Invitation to bid;
  - (b) Terms and conditions for submitting bids; and
  - (c) Bid form.

(Examples of these forms are in Appendix T)

**f. Sealed bidders auction.**

You may conduct a sealed bidders auction using the following basic steps:

- (1) You solicit your sealed bid in accordance with Appendix S;
- (2) A prearranged formula for selecting the bidding finalists is done;.

- (3) The sealed bid deposits of the finalist are retained; and
- (4) An open public auction is held among the high bidders.

Should this method fail, you are then free to negotiate with interested parties.

**6. Is “Term Financing” Available?**

- a. Yes. But you must fully justify accepting term financing in a 327 action as SBA’s general policy is to sell collateral for cash.
- b. Term financing normally applies to real estate.
- c. You would need to document as a special compelling need to offer terms on personal property.

**7. How Would a Term Sale be Handled?**

- a. The advertising must reflect that:
  - (1) Financing is available to persons who qualify within a specific time period prior to the sale;
  - (2) Financial statements are required;
  - (3) Bank references are needed;
  - (4) The applicant must be of good character;
  - (5) The credit criteria for determining financial responsibility will be the same as if the Agency were processing a new business loan;
  - (6) The net present value of a term bid must exceed a cash bid by at least “10 percent”; and
  - (7) Certification must be made by individuals purchasing on terms that they are not more than 60 days delinquent with child support payments.
- b. The amount of the credit bid should be limited to not more than 80 percent of the successful bid. Purchaser should pay at least 20 percent in cash or certified funds at time of sale.
- c. The terms, rates, security positions, and other factors allowable for Colpur are also applicable for term financing in auction or sealed bid situations.

**8. What Is a Protective Bid?**

- a. A protective bid is:
  - (1) The amount of SBA or lender's bid at a sale; and
  - (2) Established based on the current appraisal less related expenses associated with the foreclosure sale.
- b. It is SBA's policy to bid a fair value at foreclosure sales conducted by SBA.

**NOTE:** The SBA personnel normally will NOT make known the amount of the Agency's protective bid, appraised value or liquidation value. HOWEVER, you are free to discuss a range of acceptable value with the selling agent.

**9. Are Protective Bids Always Required?**

- a. No. There are times when the value is nominal and the related expenses such as moving, storing, reselling, etc., exceed the appraised value. A protective bid is not required, and the sale can be advertised as an absolute auction. However, an SBA Form 327 must be prepared justifying your action.
- b. The key to establishing a need for a protective bid rests on the quality of the appraisal. You will find the appraisal is one of the most important tools of liquidation.

**10. How Do You Prepare a Protective Bid?**

Your baseline for determining the bid should normally be the liquidation value. The SBA will base protective bids on the "sound liquidating value" of the collateral. The protective bid must be approved by 327 action. The following items must be subtracted when establishing a protective bid:

- a. Anticipated costs of acquisition and resale;
- b. Special considerations described below:
  - (1) All prior liens, charges, and claims against the collateral which will have to be paid by the successful bidder;
  - (2) Consideration to be paid IRS for release of a junior tax lien;
  - (3) Expenses of protection, maintenance, and preparation prior to resale;

- (4) Depreciation, vandalism, or other foreseeable decline in value prior to resale; and
- (5) Costs of resale, including advertising, commissions, and administrative expense.

(See Appendix X for an example protective bid.)

**11. What is a Bid in Excess of Sound Liquidating Value?**

- a. This is a bid which is higher than the liquidating value. The bid should not be in excess of the related SBA indebtedness due on the account. There must be no legal avenues of recovery other than the collateral (i.e., obligors who are bankrupt, deceased, or otherwise not worth pursuing). The basic reason for establishing a bid in this manner would be for future negotiating purposes.
- b. When a liquidation officer establishes a bid which is greater than the appraised value, justification must be documented on a 327 action.

**12. Sales By Prior Lienholders - Are Protective Bids Needed?**

- a. You should normally prepare a protective bid:
  - (1) To keep the prior lienholder from bidding in at only a nominal figure; or
  - (2) For use in exercising a right of redemption where that is available to SBA.
- b. If you choose not to enter a bid, it may:
  - (1) Permit a prior lienholder or third party to acquire the collateral at a fraction of its value; and
  - (2) Open the way to an unduly large deficiency judgment by the prior lienholder and reduce SBA's ability to recover from the guarantors.
- c. The SBA's right of redemption may, in some cases, be exercised only by paying the prior lienholder.
- d. You should attempt to use additional advertising and employ the services of a professional sales agent, after discussing with the prior lienholder. This would be done at our expense.

**13. Are there Exceptions to Establishing a Protective Bid?**

Yes.

- a. Some jurisdictions require a lienholder to bid a minimum percentage of the market value of the collateral being sold. You should still compute a protective bid amount based on guidelines in this chapter.
- b. A bid would not be necessary when:
  - (1) The value of the collateral is nominal (e.g., less than \$5,000); or
  - (2) Related cost of the sale (e.g., repairs, EPA clean up, legal, taxes, etc.) exceed the value of the collateral.

**14. What Tolerance Range is Allowed in Protective Bids?**

A reasonable range is usually 10 percent. This should cover any unanticipated events which may unfold at the sale.

**15. When Do You Offer Collateral in Bulk or Piecemeal?**

- a. There are times when it will be beneficial to offer collateral in bulk, in piecemeal or a combination of the two.
- b. You should be aware that some jurisdictions:
  - (1) Prohibit bulk sales (this is now rare);
  - (2) Require that sales of real estate and personal property be separate;
  - (3) Require a parcel or piecemeal offering; or
  - (4) Allow the property owner to direct or designate the order in which parcels or classes of property are to be sold until enough collateral is sold to repay the obligation.

**16. Types of Bidding:****a. Bulk.**

- (1) Bidding should ordinarily commence at a certain figure and proceed as necessary, up to the authorized protective bid.

- (2) You need to also be aware of the legal implications of bulk sales:
  - (a) Acquiring property for less than its “true value”;
  - (b) Meeting the commercially reasonable requirements; or
  - (c) Bulk sales statutes.

**b. Bulk then piecemeal.**

- (1) Your bidding strategy can become more flexible by:
  - (a) Bidding just in bulk;
  - (b) Bidding just on certain parcels; or
  - (c) Bidding on both bulk and certain parcels.
- (2) The bulk bidder should be given the opportunity to increase his bulk bid prior to starting the piecemeal bidding.
- (3) The collateral will be sold by whichever manner of bidding brings the most recovery to SBA.
- (4) Having the bulk bidding first is mandatory whenever there is any possibility of the collateral being sold bulk.
- (5) You must be aware of the various possibilities which may result from piecemeal or bulk bidding. You may find that advertising bulk and then piecemeal can hurt your sale. Potential buyers who are interested in one or a few items may not be willing to spend their time when the possibility exists that everything can go to a bulk bidder.

**c. Piecemeal.**

Piecemeal bidding may be more beneficial for SBA. A typical example would be machine shop in rented premises. The Agency would not want to acquire all of the collateral and may choose to bid on only the major pieces.

You will find the decision to offer in bulk, in bulk and then piecemeal, or just piecemeal will depend on the type of collateral you are selling, the jurisdiction in which you are selling or just the local protocol.

## CHAPTER 8 LENDER-SERVICED LIQUIDATIONS

### 1. What is SBA's Policy on Lender Liquidations?

#### a. It is SBA's policy that all lenders must:

- (1) Service and liquidate all loans which were approved on or after October 1, 1997. For loans approved before October 1, 1997, all lenders are expected to service and liquidate loans they have originated;
- (2) Execute an SBA Form 152, "Participation Certificate," showing SBA's guaranty percentage of the loan;
- (3) Submit a liquidation plan (Refer to Chapter 10, "Special Programs," for any exceptions);
- (4) Maximize recovery in the sale of collateral in the minimum amount of time; and
- (5) Avoid acquiring assets whenever possible through the aggressive marketing of loan collateral.

**NOTE:** Whenever feasible, you are strongly encouraged to upgrade the legal required advertising for a UCC sale, or for a judicial or summary foreclosure on real estate, to meet SBA's requirements for a "comprehensive public sale."

#### b. If SBA chooses to service or liquidate the loan:

- (1) The lender must assign the loan instruments to the SBA;
- (2) You must have the DD's or designee's approval on an SBA 327 justifying this action; and
- (3) The Agency must execute an SBA Form 156, "Certificate of Interest", showing lender's percentage of the loan.

(See CFR § 120.512.)

**2. Lender Oversight and Managerial Reviews.**

- a. During the managerial reviews, lenders who are not adequately liquidating loans must be identified, especially those in the PLP, LowDoc, and FA\$TRAK programs.
- b. Lenders with chronic problems and lenders who do not take suggested corrective actions must be identified by the DD.

The DD must:

- (1) Promptly contact the lenders;
- (2) Must meet with the appropriate officials of those institutions to discuss SBA liquidation procedures and expectations under the Federal regulations, SBA policy and procedures, the 750 agreement, any supplemental guaranty agreements and the authorization; and,
- (3) Annually, the DDs must provide a summary report to their regional administrators and Headquarters on lender liquidation deficiencies within 60 days of the end of each fiscal year.

**3. What Lender Programs Do the Procedures in this Chapter Apply to?**

The liquidation procedures outlined in this chapter apply to the 7(a) guaranty loan program as well as all other SBA/lender programs. Any exceptions to these procedures are outlined in Chapter 10, "Special Programs," for certain loan programs such as:

- a. LowDoc;
- b. FA\$TRAK;
- c. Preferred Lender Program (PLP);
- d. Certified Lender Program (CLP);
- e. Certified Development Company (CDC) Program (503/504 loans);
- f. CAPLines; and
- g. Export Working Capital Program (EWCP).



**4. What Should the Lender Do When it Appears a Borrower May Not Repay Its Loan?**

When the lender determines that there is no longer any reasonable possibility that a borrower will be able to repay the SBA guaranteed loan in an orderly manner, it should immediately contact the SBA to begin the process for enforcing recovery. No two liquidations are the same. Therefore, the following paragraphs should assist the lender in reaching a resolution.

**5. When Must a Lender Notify the SBA Servicing Office of an Adverse Event?**

The participating lender must notify the SBA office servicing the loan when there is an adverse event. The notice should be by telephone, followed with a fax and/or written confirmation. If a servicing center is servicing the loan, it will take appropriate action and forward the loan file to a local field office, if appropriate.

**6. What are Adverse Events?**

Adverse events include, but are not limited to:

**a. Foreclosure or other legal action.**

The institution of a foreclosure action or other legal action against the borrower or other obligor which adversely impacts SBA's interest in any worthwhile collateral securing a loan or guaranty.

**b. Bankruptcy.**

The borrower, a significant obligor, or a person in possession of collateral has filed a voluntary petition or an involuntary petition has been filed against the borrower under any chapter of the Bankruptcy Act.

**c. Receiver appointed or other legal action.**

A receiver has been appointed, an assignment for the benefit of creditors has been made, or other legal action has been taken to liquidate collateral or to force a change in management or ownership.

**d. Abandonment.**

Substantial collateral has been abandoned by the borrower.

**e. Dissipation of collateral.**

Substantial collateral is being, or is in danger of being dissipated.

**f. Other.**

Any other circumstance which may substantially and adversely affect the joint position of the lender and SBA.

**7. How Do You Handle an Adverse Event if the First Notice is a Liquidation Plan?**

If the first notice you receive from the lender is the lender's proposed liquidation plan, you or the line supervisor **must** contact the lender as soon as possible following receipt of the plan to ascertain the essential facts. During the conversation, you (or the line supervisor) must:

- a. Make certain that the lender will make the required field visit; or
- b. Advise the lender that no action, including making demand on the borrower, is to be taken without SBA's written approval.

**8. What Steps Should SBA Take After Being Notified of an Adverse Event?**

**a. Discuss requirement of field visit to the borrower.**

Once you know about any event which creates an "in liquidation" situation, the lender must visit the borrower's business premises. If the lender does not make the field visit within the time frame noted below, the lender must document the reason for not doing so, and you must establish with the lender a new deadline for the visit with an SBA 327.

If it is a lender serviced loan, the lender must perform the field visit. With the exception of PLP, LowDoc, and FA\$TRAK lenders, the lenders are required to notify SBA of their findings. The PLP, LowDoc, and FA\$TRAK lenders must document their findings in the borrower's loan file.

**b. Site Visits - "Lender Serviced Loans."**

- (1) Lenders must make site visits and prepare a comprehensive and detailed report containing an inventory of assets and an assessment of their condition.
  - (a) This action must be performed:
    - i. Within 60 days of an unremedied default in payment; or
    - ii. As soon as possible after default if there are assets of significant value that could be removed or depleted.

- (b) Whether a payment default exists, a site visit must be conducted within 15 days of an event which would cause a loan to be placed into liquidation status, including:
  - i. Business shutdown or abandonment;
  - ii. Foreclosure or other adverse action affecting significant collateral;
  - iii. Bankruptcy or receivership; or
  - iv. Any reason to believe collateral is being lost or its value diminished.
- (2) The recommending official/approving official (e.g., loan officer/line supervisor) will review:
  - (a) The site visit reports at the time of guaranty purchase; and
  - (b) The quality and appropriateness of real estate appraisals, personal property appraisals, and any environmental surveys.
- (3) Alternative to site visits by lender.
  - (a) Lenders may engage third party inventory/appraisal contractors to perform the same duties provided the costs are reasonable in relation to the services provided.
  - (b) Minimum review standards are outlined in subparagraph 8.c., "Minimum collateral evaluation and appraisal standards."
  - (c) If the lender's information conforms in all respects to the SBA standards, SBA personnel will not need to make a site visit, nor will one be necessary prior to the computation of a protective bid for sale purposes.

**c. Minimum collateral evaluation and appraisal standards.**

- (1) A meaningful collateral inspection by lenders and/or SBA is both a comprehensive inventory and a valuation of the collateral. The following is necessary to provide a meaningful inspection of personal property collateral.
  - (a) Specific description and identification including serial numbers.
  - (b) Photographs or videotapes of larger or more significant pieces to establish condition, identity, and pictorial evidence.

- (c) Establishment of individual liquidation values.
  - (d) Evaluation of inventory (especially of retail items).
- (2) This can either be done by videotaping or by actual count. The latter is only necessary if there is sufficient value in the inventory to warrant consideration of sale, and it is needed to verify or establish the value of the inventory on the basis of retail price or cost.
- (3) Retail inventory firms are generally economical and efficient and can provide an accurate accounting of goods.
- (4) A timely and comprehensive inspection may improve the overall recovery on loans where chattels have been overlooked or ignored.
- (5) A thorough review includes an analysis of the use of loan proceeds to compare with assets currently on site.
- (a) Any differences should be addressed in discussions with the borrower.
  - (b) The focus is to evaluate early and effectively in a manner appropriate for the collateral involved. (For instance, if a borrower is a small rural store with little or no appreciable inventory, the cost of having a contractor evaluate and dispose of this asset might well prove counterproductive. On the other hand, if one is working with a retail store where inventory is the only significant source of recovery, it is very important to have a quick and reliable measure so liquidation personnel can have the data necessary to formulate liquidation and disposal methods and alternatives.)
  - (c) If at all possible, site visits should include a review of the borrower's books and records to determine whether any funds were inappropriately taken out of the company or used for unauthorized purposes.
  - (d) In reviews of defaulted loans, the Inspector General's office has frequently found that unauthorized use of funds has occurred but gone undetected, because books and records were not reviewed.
  - (e) In addition, you must make a preliminary review of security instruments and document the amount and condition of the collateral before you prepare the SBA 327 establishing any protective bid in the event of foreclosure sale.

(See Chapters 6 and 10, "SBA-Serviced Liquidations" and on "Special Programs" for exceptions.)

**d. Order lien searches as appropriate.**

Lenders must first determine their exact lien position prior to taking any steps in the foreclosure process.

**e. Order appraisals as appropriate.**

If it is determined that an appraisal is needed, the appraisal must be no older than 1 year to be classified as current. (See Chapter 16, "Appraisals.")

**f. Determine if any environmental issues exist.**

The lender must be alert for possible environmental problems (see Paragraph 6-15 titled, "Environmental Considerations").

**g. Consider potential for workout.**

If the borrower is still operating, assess the potential for workout or restructure of the account. (See Chapter 5, "Problem Loans and Workout Situations.")

**h. Coordinate liquidation with the lender.**

If the borrower has ceased operations or enforced collection is necessary, you should discuss plans for liquidation with the lender. You should reach a tentative agreement with the lender regarding the steps to be taken.

**i. Consider whether to transfer into litigation.**

You must discuss with counsel any questions regarding the possibility of placing a loan into litigation.

**9. What Should the Lender and SBA Do if Immediate On-Site Action is Necessary?**

a. If the needed action is "routine" (e. g., changing locks on a vacated building, ordering a lien search, or obtaining an appraisal) then you may give approval to act.

b. If the needed action is "non-routine," you should call and clear the matter with your line supervisor and counsel, when necessary. Once cleared, you may take (or give approval to take) the action. This information is to be documented either in the field visit report or the liquidation plan as well as documented on an SBA 327.

**10. What are the Factors to Consider in Determining that a Lender Should NOT Liquidate a Loan?**

**a. Competing liens or loans held by lender.**

- (1) If:
  - (a) The SBA and the participating lender have competing liens against any of the borrower's assets; or
  - (b) The lender has a non-SBA loan to the same borrower or its principals;
- (2) Then the lender must not be allowed to handle the liquidation, unless:
  - (a) Any disputes are resolved prior to the commencement of such action; and
  - (b) There is a written agreement as to the distribution of funds expected to be realized.
- (3) In such cases, you must verify that the lender has properly distributed all funds received. (See Chapter 7, "SBA's Methods of Recovery from Collateral.")

**b. Lender's past performance.**

If a lender's past efforts at liquidation were unsatisfactory (poor results, excessive costs, poor responsiveness), SBA should not allow the lender to liquidate until the problems are resolved.

**NOTE:**     You must complete an SBA 327 justifying this action.

**11. What Happens When the Lender Liquidates a Loan?**

The following steps must be taken:

**a. Employment of a public auction firm.**

If the lender hires an auctioneer for purposes of meeting the "commercially reasonable" test, the following information must be obtained.

- (1) The liquidation plan must state that SBA will be made whole if acts or omissions by the auctioneer cause SBA loss. There must be sufficient protection afforded the lender against misconduct or negligence of the auctioneer. This can be ensured through proper liability insurance and bonding

that is either required and/or customary and reasonable. (See Chapter 15, “Contracting With Auction Firms.”)

- (2) The lender may require the auction firm to provide a bond in the amount of the anticipated sale proceeds. This will generally only cover personal property as proceeds from sale of real estate are usually controlled by the trustee or other selling agent.
- (3) The lender may use the requirements of SBA in hiring an auction firm as outlined in Chapter 15, “Contracting with Auction Firms.”

**b. Submission of a liquidation plan to SBA by the lender.**

- (1) A standardized liquidation plan format (see appendix O) has been developed by FA to ensure that liquidation instruction and policies provided to lenders are consistent.
- (2) The lender must attach to the plan the “Underwriting Characteristics” of the loan. (Refer to Paragraph 4-8 titled, “Risk Management Data Base, Loan Underwriting Characteristics,” for additional information.)
- (3) The standardized liquidation format has been developed for use by ALL lenders.
- (4) The lender must submit a liquidation plan to SBA before starting liquidation action on any loan with a principal balance of \$50,000 or more at the time of default. However, SBA approval is required for non-routine (contested) litigation, or litigation with anticipated costs exceeding \$3000. For a loan below \$50,000, the liquidation plan is required at the time of the lender’s request for guaranty purchase. See Chapter 10, “Special Programs,” for liquidation plan requirements for individual lending programs.
- (5) The lender must use the SBA’s standardized lender liquidation plan format.
- (6) You may customize this plan to fit local law and procedures as long as the essential data is captured.
- (7) Major deviations must be approved in advance by the Office of Borrower and Lender Servicing (BLS).

**NOTE:** Refer to Chapter 10, “Special Programs” (e.g., PLP, CLP, LowDoc, etc.) for the requirements of liquidation plans.

**c. Control of sale proceeds.**

The auctioneer or other selling agent must be required to deposit the gross proceeds from the sale of the collateral or Colpur in an escrow account pending payment of authorized expenses/fees and maintain a detailed accounting of the sale. The escrow account should be, if possible, an interest bearing account and identified as being for the benefit of the specific SBA related loan.

**d. Reports to SBA.**

- (1) The lender must submit quarterly status updates for:
  - (a) All liquidation cases beginning at the time of guaranty purchase; and
  - (b) Acquired real property (REO, colpur) beginning 6 months after acquisition.
- (2) These reports must explain what recovery action has taken place since the start of liquidation or the last report, and indicate estimated time to complete the liquidation process or Colpur sale.
- (3) Any circumstance which may substantially and adversely affect the joint position of the lender and SBA must be reported immediately.
- (4) The SBA reserves the right to request additional liquidation status reports at any time.
- (5) This report is not required for FA\$TRAK loans or loans serviced by PLP lenders under \$50,000 principal at the time of default.

**12. The Lender's Liquidation Plan is Reviewed and Approved as Follows.**

- a. The recommending official must promptly review the liquidation plan making appropriate recommendations to the approving official.
- b. Counsel must review for reasonableness of legal fees and the legal procedures to be undertaken.
- c. The approving official must document the approval of the liquidation plan in LLTS within 30 business days following approval.
- d. The approving official may approve the plan in LLTS or by use of a 327 action.



**NOTE:** Refer to Chapter 10, “Special Programs” (e.g., CLP, PLP, LowDoc, etc.) for the requirements relating to liquidation plans.

**13. What if the Lender Requests a Change to the Liquidation Plan?**

It is not unusual for liquidation plans to be changed as events unfold. The lender must obtain the SBA’s approval before proceeding with major changes in the plan and expenses.

**a. Procedure.**

When possible, the lender should submit a written proposal to the SBA. The SBA will then evaluate the proposal and approve any change with a 327 action.

**b. Urgency versus documentation.**

Sometimes situations require swift or even immediate action to protect the interests of the Government. You and the lender should discuss the situation and possible steps to take. Once you reach a general agreement, you must brief the line supervisor (and counsel, if appropriate). You must obtain verbal approval from the approving official before you relay consent to the participant. Document agreed changes should be implemented as soon as practical with a 327 action.

**14. What if SBA Requests a Change to the Liquidation Plan?**

When the liquidation plan is submitted to SBA for approval, the lender must adhere to changes requested by SBA.

**15. What are the SBA Liquidation Officer’s Responsibilities for Follow-Through?**

You must maintain a close working relationship with the lender throughout the course of the liquidation. A summary of all contacts, attempted contacts, and reviews must be entered into the LLTS chronological record.

**a. Ongoing contact.**

The lender must provide copies of significant documentation such as letters, sales notices, and reports as they occur. Such material should be reviewed by the liquidation officer (and counsel, if appropriate), handled as deemed necessary and placed in the loan file. In addition, the lender or its counsel must provide SBA counsel and you with copies of all pleadings.

**b. 90 Day reviews.**

You must make telephone, written, or face-to-face contact with the lender handling the liquidation of the account at least once every calendar quarter.

**c. Supervisory review.**

The supervisory official must review the lender-serviced accounts using LLTS every calendar quarter on:

- (1) All liquidation accounts that have been in liquidation 180 days or more;
- (2) Colpur accounts (see Chapter 11, “Collateral Purchased by SBA and Lender.”); and
- (3) A random sample of 25 percent of all liquidation accounts under 180 days.

The review may be conducted either electronically or face-to-face with the assigned liquidation official. If drift appears in the random review, a more detailed review is required.

**d. Field visits.**

Field visits to the borrower’s premises and to the lender’s office should be made from time to time during the liquidation process.

**e. Attendance at sales.**

- (1) An SBA loan officer need not attend public sales conducted by the lender, particularly if:
  - (a) An SBA representative has viewed, within the past 120 days, the collateral to be offered for sale; or
  - (b) The SBA determines that such attendance would not be necessary to protect SBA’s position.
- (2) A representative of the lender must be in attendance at sales of worthwhile assets.
- (3) In such cases, the lender must send the SBA a report of the events which took place at the sale. Also, the lender must send the SBA a copy of the auctioneer’s (or other selling agent’s) accounting. **Repeated failure of the participant to furnish the required documentation may be justification to revoke the SBA Form 750 Agreement of the participant.**

**f. Monitoring expenses and recoveries.**

You must ensure that liquidating lenders keep expenses in line with the agreed upon liquidation plan. You must also ensure that they properly apply recoveries from the

liquidation process, especially when there are competing liens or non-SBA loans involved.

**16. How Does the SBA and the Lender Handle Insurance?**

The SBA usually does not purchase or continue premiums on insurance during liquidation of the collateral. However, banks usually do purchase or maintain hazard insurance on the collateral as well as public liability coverage and may ask SBA to share in the premium expense. (See Chapter 22, “Insurance Property, Life and Public Liability.”)

**17. May Lenders Who are Liquidating SBA Loans Use Private/Negotiated Sales?**

Yes. Lenders who are liquidating SBA loans may use private/negotiated sales if:

- a. It is practiced in similar sales of non-SBA assets; and
- b. The sales were disclosed in their liquidation plan or subsequent amendments to the plan.

The use of private/negotiated sales are subject to certain conditions, which are described in the following paragraphs.

(See 13 CFR 120.540 c(1).)

**18. What are the Main Requirements for a Private/Negotiated Sale Prior to an Actual Foreclosure?**

The requirements for the lender to use private/negotiated sales are:

- a. The real estate or personal property must be free and clear of all liens or the lienholders must cooperate in the sale and transfer of title; preferably within 120 days and
- b. A current appraisal no older than 1 year must exist, (See Chapter 7, “SBA’s Methods of Recovery from Collateral.”)

**19. What are the Limitations on the Lender’s Use of Private/Negotiated Sales?**

Lenders conducting the liquidation may conduct private/negotiated sales as follows.

**a. Private UCC sales.**

The uniform commercial code (UCC) provides means for conducting private sales of collateral by secured parties in the event of default. The liquidating lender may conduct private UCC sales of collateral without limits as to size/amount, provided:

- (1) The approach used is similar to the means used by the lender in its liquidation of non-SBA loans;
- (2) The sale is deemed to be commercially reasonable under the circumstances;
- (3) The sale satisfies the provisions of the Bulk Sales Act; and
- (4) The expected net recovery at least equals the net amount estimated to be realized from a public sale.

**b. Sales of a “going” business in its entirety.**

A favorable aspect of private/negotiated sales is that they can provide a means to sell the collateral as an operating entity. This may result in a larger recovery, depending on the circumstances. Accordingly, the approving official may authorize the liquidation lender to conduct private/negotiated “going” business sales of collateral in its entirety, without regard to loan size or estimated recovery amount, provided the prerequisites indicated in the prior subparagraph, “Private UCC Sales” are met.

**c. Sales to existing owners.**

Private sales of collateral may not be made to existing owners under any circumstances.

**d. Costs of sale.**

Reasonable costs of advertising, labor, and fees are permissible on all sales of collateral, even if those costs are not specifically described in the liquidation plan.

**e. Term sales.**

- (1) Private sales on terms are subject to the same requirements as other terms sales of collateral or Colpur. Use SBA documents if possible, practical and agreeable to the lender.
- (2) Before purchase of an SBA guaranty, a lender financed sale of assets (seller carryback and/or takeback) on a loan it is liquidating does not require SBA’s approval, and will reduce the loan balance by the amount of the sale.
- (3) After purchase, a lender may sell assets (through a note receivable) on a loan it is liquidating with SBA’s prior written approval.
- (4) See Paragraph 7-6 titled, “Is “Term Financing” Available?” and in Paragraph 11-19 titled, “When Can You Sell on Terms?”

**20. Can a Lender Sell Colpur at a Private or Negotiated Sale?**

Yes. A lender may conduct private or negotiated sales on Colpur accounts regardless of the dollar amount involved. (See Chapter 11, “Collateral Purchased (Colpur) by SBA and Lender.”)

**21. What are the Limitations and Restrictions on the Lender’s Handling of Liquidations?**

The SBA’s limitations and restrictions on the lenders handling of the liquidation of SBA guaranteed loans are essentially incorporated in three requirements as follows.

- a. The SBA must give its consent to the general liquidation plan at the outset (including anticipated litigation) and whenever significant modifications to the plan are needed.
- b. The lender must follow procedures which:
  - (1) Are consistent with generally accepted practices used by prudent lenders; and
  - (2) Are required by this SOP, SBA’s rules and regulations, and SBA’s loan documents.

In this regard, the SBA expects that the participant will use the same degree of prudence it uses when it liquidates its non-SBA loans.

- c. Prior written consent must be obtained from SBA in certain circumstances.

**22. When Must the Lender Obtain the SBA’s Prior Written Consent?**

The lender handling the liquidation of a loan must obtain SBA’s prior written consent in the event of any of the following.

**a. Restrictions on sales to associates of participants.**

Associates of participants must not bid or purchase directly or through agents on their own account at any SBA related sale. This includes sales of collateral or Colpur conducted by either the SBA or the lender. Written permission from the SBA is required to sell any SBA related collateral or Colpur to a close relative who is not a member of the household of participant’s associates. (See Chapter 4, “General Guidelines for Liquidation Activities” for definitions and procedures.)

**b. Legal fees.**

The SBA counsel must review proposed litigation and make a decision on the proper forum to bring an action.

Legal fees must not exceed more than 10 percent of the amount agreed to by SBA in the liquidation plan, as amended. If legal fees exceed the amount of recovery through liquidation on the loan, no payment of those fees may be made unless fully justified and approved by SBA 327.

**c. Protective bids.**

A protective bid is:

- (1) The amount of lender's bid at sale; or
- (2) Established based on the current appraisal and related expenses associated with the foreclosure sale.

Except for PLP, LowDoc and FA\$TRAK loans, the SBA must concur with the lender's recommendation for a protective bid and to subsequent changes of more than 10 percent if a protective bid is entered. For more information related to protective bids, see Chapter 7, "SBA's Methods of Recovery from Collateral."

**d. Compromise of debt.**

Lenders must not unilaterally compromise an SBA account.

**e. Release of an obligor.**

Lenders must not unilaterally release any obligor on an SBA loan. (See Chapter 10, "Special Programs" for any exceptions.)

**f. Variances from lender's usual procedures.**

When the proposed actions vary from either the lender's or the SBA's usual liquidation procedures, you must document the circumstances. A 327 action with counsel's comments is required.

**g. Matters covered by the guaranty agreement.**

The SBA Form 750, "Loan Guaranty Agreement," (with the participant) specifies certain matters which require agreement between the SBA and the lender. The following actions must be approved by SBA if not contained in the lender's liquidation plan.

- (1) Accelerate the maturity of the note. (If the need for immediate action exists, an SBA 327 stamped letter from the participant is sufficient for this action.)
- (2) Make or consent to any substantial alteration in the terms of the Note or related loan instruments.
- (3) Approve any release, substitution, or exchanges of collateral, except where the value released does not exceed 20 percent of the original loan amount.
- (4) Sell, assign, or transfer the note or related loan instruments.
- (5) Sue upon the note or related loan instruments.
- (6) Waive any claim against a borrower, guarantor, standby creditor, or other obligor (see Chapter 10, "Special Programs").
- (7) Purchase, pay installments on, or pay in full a prior lien. (See Chapter 9, "Purchasing SBA's Guaranty" in SOP 50 50, Loan Servicing.)

**23. How Should a Disagreement with the Lender be Resolved?**

- a. An impasse will be handled as an exception to policy.
- b. The approving official and or the district director must make a personal effort to reach an agreement with the participant before the matter is forwarded to the Office of Borrower and Lender Servicing.

**24. How Must You Apply the Proceeds from Liquidation?**

When you are satisfied as to the amount of the expenses and the division of the recovery, the net proceeds (lender's out-of-pocket liquidation expenses can be paid first) from the liquidation process must be applied as follows.

- a. When the SBA guaranty has NOT been purchased, the participant will be allowed to recover up to 120 days of interest from liquidation proceeds, using the interest rate in effect at payment default. All other proceeds received from liquidation must be applied by the lender to the principal balance of the loan. The SBA will then pay only its portion of the principal balance outstanding with no accrued interest at the time of the guaranty purchase. (See SOP 50 50, Chapter 9, "Purchasing SBA's Guaranty.")
- b. When the SBA guaranty HAS been purchased, the participant must apply the net proceeds first to principal, then to interest, unless directed otherwise by SBA. The lender must then remit SBA's share of the net proceeds to the Small Business

Administration, Denver, CO 80259, within 15 days from the time the lender receives the funds from the borrower or from collateral sales, together with:

- (1) An accurately and completely filled out SBA Form 172, "Transaction Report on Loan Serviced by Lender" (see appendix B); and
- (2) An itemized accounting of income and expenses. Denver will send an electronic notice of funds received to the districts.
- (3) Prior to remitting SBA's share, the lender may deduct a servicing fee for collecting SBA's share of a borrower's payment on a loan where SBA has purchased the guaranty (an XGP loan) and it is in liquidation.
- (4) The lender must compute the fee based on SBA's participation in the loan and the number of days of interest collected. (For method of computing the fee, see SBA Form 172, "Transaction Report on Loan Serviced by Lender.") A lender must not collect a servicing fee from principal received (for example, payment from liquidation proceeds).

**25. Improving the Timeliness of Collections From Lenders.**

SBA is seeking to improve the processing of all Agency cash receipts and payments. SBA requires lenders to complete all cash flow transactions in a more timely and accurate manner, taking maximum advantage of technologies, such as electronic funds transfer and electronic data interchange. As stated above, all funds received by lender, net of proper expenses, must be remitted to the Small Business Administration, Denver, CO 80259, within 15 days from the receipt date of payment from the borrower or from collateral sales, detailed on a properly completed SBA Form 172.

- a. Reviews of lenders participating in the Preferred-Lender Program (PLP) and Certified-Lender Program (CLP) will include a review for compliance with the 15-day payment timeframe. Lenders that are found not to be making timely payments may be subject to corrective actions by the Agency.
- b. Servicing and liquidation expenses paid by the lender must be customary and reasonable for the services obtained and consistent with local practice. The SBA will examine expenses during lender reviews and at the time of guaranty purchase or completion of liquidation to ensure that they meet these guidelines. Particular emphasis will be placed on review of legal expenses.

**26. How Can Loans Be Canceled or Charged-Off?**

An account which has been serviced/liquidated by the lender can be canceled or charged off in several ways.



**a. Cancellation of the SBA guaranty.**

The approving official may approve cancellation of the SBA guaranty in instances where SBA has not honored its guaranty and will not be requested to do so. You must send a copy of the SBA 327 approving cancellation to OFO.

**b. Charge off of the loan.**

If the SBA has honored its guaranty and there is no expectation of further worthwhile recovery, you may charge off the loan with counsel's approval. You must review the liquidation actions by the lender to ensure that the liquidation plan was followed and that no observable harm to SBA resulted from the lender's actions. The SBA 327 recommending charge off must include a statement of this finding. (See Chapter 18, "Charge Off Procedures.")



**CHAPTER 9**  
**MISCELLANEOUS ISSUES REGARDING PARTICIPATION LOANS**

**1. How Do You Handle a Lender's Request for SBA to Purchase the Unguaranteed Portion (Lender's Share) of a Loan?**

General authority has not been delegated to field offices to approve the purchase of the participating lender's share of a loan. The approving official does, however, have the authority to decline such a request.

**2. Proposals to Purchase the Unguaranteed Portion (Lender's Share) are an Exception to Policy.**

You must treat proposals to purchase the lender's share as an exception to policy, except in the following situations where authority is delegated.

**a. Situations with companion disaster loans.**

Where the participant will not agree to a justifiable **deferral** of payments with respect to the participation loan, the approving official may:

- (1) Maintain installments on the lender's share to prevent default during the period of deferral (add to SBA share); or
- (2) Authorize purchase of the participant's share of loan.

**b. Loans acquired by the Federal Deposit Insurance Corporation (FDIC).**

The approving official may authorize the purchase of the entire loan (including the lender's share) from the FDIC when it is in the best interest of SBA to do so. The amount paid for the unguaranteed portion of the account cannot exceed the lesser of:

- (1) The agreed upon present (discounted) value of the participant's share; or
- (2) Par (face) value of the participant's share.

**NOTE:** You must compare these two values in the SBA Form 327 authorizing purchase from the FDIC. (See Chapters 9 and 1, "Purchasing SBA's Guaranty" and FDIC in the SOP 50 50, Loan Servicing.)

### 3. **How Do You Handle a Lender's Request to Change the Lender's Participation in a Loan?**

#### a. **Prior to purchase by SBA of its guaranteed share.**

The SBA may authorize an increase in the lender's participation when requested by the lender before the SBA purchases the guaranteed share of the loan. This action requires a 327 action, with a copy to OFO.

#### b. **After the guaranty has been purchased.**

If the SBA authorizes a lender's request to increase its share after the SBA has purchased its guaranty, then:

- (1) A new SBA Form 152, "Participation Certificate," (see Appendix A in SOP 50 50.) must be exchanged for the old one; and,
- (2) The lender must provide the funds necessary to repurchase its increased share.

Copies of both the SBA 327 and the lender's check must be sent to OFO.

#### c. **Decrease in lender's share (unguaranteed portion).**

No authority has been delegated to field offices to decrease the participant's share except as indicated in paragraph 2, "Proposals to Purchase the Unguaranteed Portion (Lender's Share) are an Exception to Policy."

### 4. **How is the SBA Guaranty Terminated or Canceled?**

The SBA guaranty may terminate or be canceled by letter of request from the participant, nonpayment of guaranty fees, or at loan maturity.

**NOTE:** You cannot cancel the guaranty on a loan sold on the secondary market.

#### a. **Letter of request from participant.**

A participant may request in writing that the SBA's guaranty be canceled. You may cancel the participation agreement as of the day the request was received. Use an SBA 327 to accomplish the cancellation. You must send a copy of the completed SBA 327 to OFO.

**b. Nonpayment of guaranty fees.**

The SBA 750 provides for automatic termination of the SBA guaranty if the required guaranty fee is not paid on a timely basis.

**c. Loan maturity.**

- (1) The SBA's obligation to purchase expires automatically 120 days after the maturity date of all loans.
- (2) The approving official may approve a lender's request made before the maturity date to extend the purchase deadline.
- (3) A 327 action is required.

**5. What Must You Advise the Lender When the SBA Guaranty Has Been or Will Be Canceled?**

You must write to a participant to advise or acknowledge when a guaranty has been or will be canceled. You must advise the participant in the letter that:

- a. The SBA does not waive any preexisting causes of action against the participant or borrower; and
- b. The SBA does not waive any defenses against preexisting causes of action.

**6. Are Lender Reports and Fee Requirements Associated with Servicing Still Necessary During Liquidation?**

Various routine reports by lenders and some fee requirements may continue to be necessary during the liquidation of a loan, especially when purchase of the guaranty was not accomplished prior to liquidation. Most of these requirements are covered in the SOP 50 50, Loan Servicing.

**7. How Do You Handle the Purchase of SBA's Guaranteed Share of a Loan if the Loan is Now in Liquidation?**

**a. In general.**

A loan may be classified as "in liquidation" before the SBA has purchased its guaranteed share. If so, you should give immediate consideration to purchasing the guaranty using the help of the servicing personnel, if available. You should be guided by the requirements in Chapter 9, "Purchasing SBA's Guaranty" in SOP 50 50, Loan Servicing.

**b. Special considerations relating to Colpur.**

The acquisition of Colpur, by any means, mandates a purchase of the SBA guaranty **unless** the servicing office documents by use of a 327 action that reasons may exist to deny liability. You should begin the guaranty purchase process as soon as it appears that collateral will be acquired.

**8. What Possible Misunderstanding of Remaining Liability Exists if Colpur is Acquired before the Purchase is Completed?**

There are two common areas of misunderstanding that may develop when the lender acquires Colpur prior to SBA's purchase of its guaranty. They are as follows.

- a. The SBA's guaranty runs to the loan account only. Since the acquisition of collateral usually acts as a credit against the loan (just like a loan payment), the amount of SBA's obligation to the lender is reduced by the amount bid at the sale less expenses.
- b. Colpur is an owned asset of the lender(s) and accrues no interest.
- c. If Colpur is sold for an amount in excess of the credit against the loan, the lender must remit to SBA the Agency's portion of the net proceeds exceeding the credit. Conversely, if the lender sells the property for less than the credit against the loan, SBA will share in its proportionate share of the net shortage, so long as the lender's sale was prudent and commercially reasonably.

**NOTE:** Do not overlook these accounting issues when you discuss liquidation plans with participating lenders.

**9. Is a Grace Period Allowed for Crediting a Borrower's Account When Collateral is Purchased?**

Yes. In some situations, events may be moving faster than the ability of the lender to assemble and submit the necessary documentation to support the purchase request. In those instances, the SBA will allow a grace period of no more than 30 days before deductions will be made to the amount paid the lender.

**NOTE:** The aggregate interest paid must not exceed permissible limits. (See SOP 50 50, Loan Servicing.)

You must describe the events causing the delay in purchase in both:

- a. The SBA 327 authorizing the purchase; and,
- b. The electronic format of SBA 297, "Collateral Purchase Report," (see appendix C and Paragraph 11-7) for guidance in setting up the Colpur account.

**10. How are Loans that Have Been Sold into the Secondary Market Handled?**

Special procedures have been developed to ensure appropriate control and uniform handling of loans sold into the secondary market. The relevant guidelines are contained in Chapter 9, "Purchasing SBA's Guaranty" in SOP 50 50, "Loan Servicing."

**11. When Should the SBA Consider Invoking its Unilateral Purchase Privilege?**

The field office should consider invoking the "SBA Purchase Privilege" contained in SBA 750 if:

- a. The lender will NOT voluntarily request purchase;
- b. The lender will NOT transfer servicing of the loan;
- c. The interests of SBA are being adversely affected by unsatisfactory administration by the lender; and
- d. Liquidation action appears necessary and a strong possibility of a conflict of interests exists (e. g., separate, direct lending by the participant to borrower, an affiliate, a guarantor, or other obligor).





## CHAPTER 10 SPECIAL PROGRAMS

This chapter has been established to identify SBA programs which require different procedures for purchase of the guaranty and liquidation.

Unless specifically outlined in this chapter, all procedures and guidelines discussed in previous chapters will prevail.

### 1. **Low Documentation Loan Program (LowDoc).**

LowDoc is an expedited process under the Agency's 7(a) Guaranty Loan Program which streamlines the loan application process for guaranty loans in amounts of \$150,000 or less. The purpose is to reduce the paperwork and quicken the response time.

#### a. **Who liquidates a LowDoc loan?**

The lender does the liquidation on all LowDoc loans unless otherwise advised in writing by SBA.

#### b. **What requirements must the lender follow?**

- (1) All liquidations must be done prudently and in a commercially reasonable manner; and
- (2) The liquidation must be consistent with SBA's regulations and the guaranty agreement.

#### c. **When does SBA require a LowDoc lender to submit a liquidation plan?**

A liquidation plan, using the standardized liquidation plan format (see Appendix O), is required to be submitted by a LowDoc lender to SBA on LowDoc loans:

- (1) Prior to starting liquidation action for loans with a principal balance more than \$50,000 at the time of default; or

**NOTE:** SBA has 10 business days to notify lender of any changes to the plan.

- (2) When the LowDoc lender requests SBA to purchase the guaranty for loans with a principal balance of \$50,000 or less at the time of default.

**d. Is the lender required to submit a report on LowDoc loans?**

Yes. The lender must provide a **written** status report on **every** LowDoc liquidation every 90 days after guaranty purchase.

**e. How are expenses handled?**

- (1) The SBA shares in reasonable and necessary costs incurred by the participant on a pro-rata basis up to its (SBA's) share of total recoveries; and
- (2) SBA may agree to pay more (on a case by case basis) in bankruptcy situations.

**f. How are costs in excess of the above handled?**

The lender needs to absorb any excess costs.

**g. When does SBA honor its guaranty on a Low Doc loan?**

The SBA will honor the guaranty after the lender has liquidated all personal property (business chattels) and lender indicates how it will pursue:

- (1) Real estate; and
- (2) Guarantors.

**h. Are there exceptions to this policy?**

Yes. The SBA may purchase the guaranty prior to lender liquidating personal property when:

- (1) There is a bankruptcy situation; and,
- (2) The lender provides an explanation for any delay and has a satisfactory recovery plan showing how and when the remaining assets will be liquidated.

**i. How are guaranty purchases handled when the loan is sold on the secondary market?**

The lender is strongly encouraged to purchase loans sold on the secondary market. The SBA will then purchase from the lender as indicated above, or from the secondary market holder if lender does not purchase.

**j. Can SBA purchase directly from the secondary market?**

Yes. The SBA may immediately purchase from the secondary holder if necessary.

**k. Is there a limit on the amount of interest SBA will pay on a LowDoc loan?**

Yes. The SBA will pay up to 120 days of accrued interest on LowDoc loans.

**l. What information is needed at the time of the guaranty purchase?**

- (1) The liquidation plan (if not already provided);
- (2) A complete accounting showing all receipts and disbursements during the liquidation process;
- (3) Identification of all collateral at loan origination with an explanation of the disposition of each item along with proceeds involved;
- (4) The commercial reasonableness must always be addressed;
- (5) Names of any contractors involved and their compensation which could include appraisers, auctioneers, attorneys, etc;
- (6) All other sources of recovery pursued by the lender along with the proceeds received, or the reason for not pursuing; and
- (7) Identification of any remaining sources of potential recovery along with a plan of action.

**m. Is the lender required to submit the above information when SBA has purchased directly from the secondary market?**

Yes. The lender must submit the above mentioned information after it has completed the liquidation action on the account.

**n. Are SBA liquidation loan officers required to make field visits on Low Doc loans?**

No. The SBA liquidation officers are not expected to make field visits on LowDoc loans, but are not restricted from doing so.

**o. Who is responsible for liquidation after the guaranty has been purchased?**

The lender continues to be responsible for all liquidation actions even after the guaranty has been purchased.

**p. When must the lender provide a “wrap up report?”**

- (1) The lender must provide SBA with a wrap up report documenting the lender’s actions and results.

- (a) When the lender determines that the loan will not be fully repaid after all worthwhile collateral has been liquidated; and
  - (b) No further recoveries are anticipated within a reasonable period of time, (see Appendix R, “Final Wrap Up Report” checklist).
- (2) If SBA purchase is requested, the necessary documentation for SBA to complete its purchase review of the loan must be provided (see Appendix Q, “Checklist for Purchase Documents”).

**2. FA\$TRAK Program.**

- a. This program was established to increase the capital available to those businesses seeking loans of \$100,000 or less by permitting lenders to use their existing documentation and procedures and receive an SBA 50% guaranty on the loan. Participation in FA\$TRAK is limited to those lenders which have been approved by SBA and have executed the supplemental guaranty agreement.
- b. Eliminating the requirement that SBA forms be used and application procedures be followed allows lenders to reduce the cost of processing an SBA guaranteed loan. To further reduce the lender’s cost of doing business with the SBA, lenders participating in FA\$TRAK are permitted to use their own internal documentation for servicing actions and are permitted to use their existing procedures for loan liquidation.

**c. Who liquidates FA\$TRAK loans?**

The lender must fully liquidate loans approved under FA\$TRAK.

**d. What procedures must the lender follow?**

The lender must:

- (1) Follow the same policies and procedures it uses for its non-guaranteed portfolio;
- (2) Be able to demonstrate it has followed these policies and procedures; and
- (3) Conduct a commercially reasonable sale.

**e. How are proceeds from the sale of collateral handled?**

Proceeds from the sale of collateral must be applied in the following order:

- (1) To expenses associated with the liquidation;

- (2) To interest (NOT to exceed 120 days of interest on the balance as of the earliest uncured payment default); and
- (3) To any principal balance.

**f. Are care and preservation expenses recoverable from the proceeds of sale?**

Yes. The lender is to ensure that ordinary protective measures are taken. Expenses associated with the protection of collateral may be recovered from the proceeds of the sale of the collateral.

**g. Is there a limit on the amount of expenses SBA will pay?**

**Yes.** The maximum amount that SBA will pay to the lender on a FA\$TRAK loan is 50 percent of the loan balance at the time of default, plus 120 days of interest at the rate in effect on the date of default less 1 percent. This includes SBA's portion of all expenses incurred by the lender.

**h. Who absorbs expenses which exceed the above amount?**

The lender must absorb any expenses that exceed this amount.

**i. Are there exceptions to whom the bank can hire to provide various liquidation functions?**

Yes. The selection of firms owned by the officers, directors, employees, or stockholders (10 percent or greater) to provide care and preservation services, legal assistance, or other services associated with the liquidation must be avoided.

**NOTE:** If it cannot be avoided, the lender must be prepared to justify the benefit to SBA of using the particular firm.

**j. Are there restrictions on who can purchase assets from collateral sales?**

Yes. Collateral sales to the lender's officers, directors, employees, or stockholders (10 percent or greater) or a close relative of either are not permitted.

**k. How is the purchase of the guaranty handled under the FA\$TRAK Program?**

The guaranty will be purchased after:

- (1) The lender has fully liquidated all collateral;
- (2) All obligors have been pursued;

- (3) SBA has reviewed the documentation that supports the loan; and
- (4) Lender has submitted a wrap up report (see Appendix R, “Final Wrap up Report Format”). A liquidation plan is not required as part of the wrap up report for FA\$TRAK loans.

**l. How is the amount purchased determined?**

The purchase amount will consist of the SBA guaranteed percentage of the balance remaining **after** liquidation **plus** up to 120 days of interest calculated at the note rate minus 1 percent (if liquidation proceeds were insufficient to cover a full 120 days of interest) based on the balance outstanding at the time of the earliest uncured default.

**m. What information must the lender submit to receive payment?**

The lender must submit a:

- (1) Transcript of account;
- (2) Summary of liquidation activities;
- (3) Detail of liquidation expenses; and
- (4) Copy of the note and relevant loan documents.

**n. Who reviews this information?**

The servicing office will review the account and prepare the paperwork required to wire SBA’s portion of the proceeds to the lender.

**o. Is SBA permitted to purchase its guaranty prior to liquidation?**

Yes. The SBA reserves the right to purchase its guaranty prior to liquidation.

**p. Are SBA liquidation officers permitted to liquidate FA\$TRAK loans?**

Yes.

**NOTE:** It is expected the right to purchase prior to liquidation and to use SBA personnel to liquidate will be used only in very unusual circumstances.

**q. Is a liquidation plan necessary under the FA\$TRAK Program?**

No. It is not necessary to provide a liquidation plan to SBA.

**r. Does SBA ever review the liquidation action taken by the lender?**

Yes. The liquidation action taken must be fully documented by the lender and will be reviewed by SBA as part of the general review of a lender's use of the FASTRAK Program.

**s. If collateral is sold on terms, is there a guaranty on the Note Receivable?**

No. The lender is permitted to take back a note receivable on the sale of collateral on any terms negotiated between the lender and the buyer. However, the note receivable **WILL NOT** have an SBA guaranty.

**3. Export Working Capital Program (EWCP).**

SBA's Export Working Capital Program (EWCP) is designated to assist small businesses who need export working capital guarantees of \$750,000 or less. Larger businesses and small businesses with greater credit needs will be served by Eximbank. The EWCP applicants who are ineligible for SBA assistance will be notified of such and, if the applicant approves, referred to Eximbank for further assistance.

**a. Who liquidates loans covered under the Export Working Capital Program?**

Lenders must liquidate the collateral associated with the export transactions financed by the EWCP loan (e.g., insurance on foreign receivables, assignment of proceeds under the letter of credit, assignment of an export sale contract). All other collateral associated with EWCP loans should be liquidated by the lender subject to SBA approval.

**NOTE:** Because EWCP loans are short-term and have unique characteristics, the SBA loan officer who approved the EWCP loan must oversee lender liquidation of the loan. Even if the loan officer is housed in a U.S. Export Assistance Center (USEAC), liquidation will remain with that officer.

**b. What are the requirements when the lender participates under the Preferred Lenders Program (PLP)?**

Preferred Lender Program participants are to liquidate collateral associated with all EWCP loans in their portfolio unless SBA determines otherwise (using the PLP rules and regulations).

**c. Is a liquidation plan necessary?**

Yes. A liquidation plan (using the SBA's standardized lender liquidation plan format in appendix O) is necessary when the lender liquidates the collateral. (See Chapters 2

and 8, “Regulations and Other Authorities” and “Lender-Serviced Liquidations” for further guidance.)

**d. When can lender request SBA to purchase the guaranty?**

Lenders may request SBA to purchase the guaranty on a loan that has an uncured default in payment after the lender has liquidated collateral associated with export transactions financed by the EWCP. Such request to purchase may be made as soon as 30 days after an uncured default in payment.

**e. Are there limits for asking SBA to purchase the guaranty for loans made under EWCP?**

Yes. Requests for the purchase of the guaranty must be made within 120 days of default. For revolving loans, the request for purchase must be made within 1 year of default. Note, however, that for all loans, the request for purchase must be made within 120 days after loan maturity.

**f. What are the requirements in post-shipment guarantees?**

The lender must establish that the cause of the loss is not covered by EximBank or other insurers’ applicable post-shipment insurance.

**g. Does the post-shipment rule apply to combined guarantees?**

The post-shipment rule applies if the default occurs after shipment.

**4. Certified Lenders Program (CLP).**

The Certified Lenders Program (CLP) was piloted in 1979 as an experiment in streamlining the financial assistance delivery system of the Small Business Administration

The CLP lenders are expected to liquidate loans they originate unless SBA advises otherwise for reasons including potential conflicts of interest or poor record in loan liquidation. If a CLP lender is deemed to be unable to properly liquidate loans, its status as a CLP lender is to be withdrawn.

**a. When must a liquidation plan be submitted?**

Liquidation plans (using the SBA’s standardized lender liquidation plan format in appendix O) are required to be submitted to SBA prior to the lender’s commencement of liquidation for loans with principal balances of \$50,000 or more at the time of default; however, SBA approval is required for non-routine (contested) litigation, or litigation with anticipated costs exceeding \$3,000. Liquidation plans for loans less



than \$50,000 at the time of default must be submitted to SBA along with the lender's request for guaranty purchase. The SBA must approve, deny, or modify a request for approval of a liquidation plan within 10 business days after the lender makes the request, or the plan will be deemed approved.

**b. How are routine requests handled?**

If a lender requests approval for a routine activity under a liquidation plan, the SBA must respond to the lender's request within 5 business days after the lender makes the request or it will be deemed approved.

**c. What non-routine actions require SBA approval?**

These actions are:

- (1) Preferences (including increases in the amount of any prior lien held by the lender on loan collateral) or conflicts of interest;
- (2) Acceleration of the maturity of a loan;
- (3) Compromises or waivers of any claim against a borrower, guarantor, obligor, or standby creditor;
- (4) Acquisition or purchase of environmentally impaired property;
- (5) Substantial alteration of the terms of any loan instrument;
- (6) Releases of collateral having a cumulative value exceeding 20 percent of the original loan amount; and
- (7) Suit upon any loan instrument.

**d. When can the lender request the purchase of the guaranteed portion?**

The lender may request the purchase of the guaranteed portion anytime after the loan is 60 days or more past due.

**e. Does the CLP lender continue servicing once a request is made to SBA for the purchase of the guaranteed portion?**

Once the CLP lender requests SBA to purchase, the lenders are expected to continue servicing and to liquidate loans they originate unless SBA advises otherwise.

## 5. Preferred Lender Program (PLP).

The Preferred Lender Program (PLP) is another step in the SBA's streamlining process which began in 1978 with the development of the revised SBA Form 750, "Loan Guaranty Agreement," and the SBA Form 1347, "Supplemental Guaranty Agreement Preferred Lender Program," which gave lenders more authority than was the case under previous agreements, especially with regard to the servicing and liquidation of SBA-guaranteed loans.

The PLP was authorized by Section 114 of P.L. 96-302 (84 Stat. 833) which allows SBA to delegate the loan approval and additional servicing and liquidation responsibilities to the PLP Lenders.

### a. Liquidation policy.

- (1) The SBA policy requires PLP lenders to take all routine liquidation actions without prior SBA approval.
- (2) The instructions in this section apply to ALL loans in a PLP lenders' portfolio regardless of program type, including loans not approved under PLP procedures.
- (3) All liquidation actions must be consistent with generally accepted commercial banking practices used by prudent lenders.

### b. Non-routine actions that require prior SBA approval are as follows.

- (1) Any action that would create a conflict of interest or confer any preference on the lender in collection or lien position with respect to SBA's position or the shared SBA/lender position on the guaranteed loan.
- (2) Compromise with any obligor of the principal loan balance outstanding for less than the full amount due. Accrued interest can be adjusted by the lender, if justified, without prior SBA approval.

**NOTE:** Guarantors: If a loan is delinquent or liquidation is contemplated or underway, prior SBA approval is required to release a guarantor for less than the principal balance owed even if actual demand has not yet been made on the guarantor.

- (3) Title property in the name of the Agency without SBA's prior written approval. The lender must not acquire title, in their name or the Agency's, to

environmentally impaired property (property which exceeds the minimum action levels established by relevant regulatory agencies).

- (4) Transfer of a loan to another lender.
- (5) Sell or pledge more than 90 percent of a loan.

**Note:** The lender must notify the Agency in writing when unilateral changes are made to the terms of a loan that will require the Agency to make changes to the SBA database (e.g., changes to interest rate, maturity, etc).

**c. Adverse situations.**

- (1) The SBA office servicing a loan must be notified in writing when a loan is transferred to liquidation status (i.e., the lender determines that enforced collection procedures must be pursued to effect repayment).
- (2) A loan must be transferred to liquidation status when any of the following occur:
  - (a) Foreclosure or suit adversely affecting worthwhile collateral securing the loan is initiated;
  - (b) Voluntary or involuntary bankruptcy petition is filed; or
  - (c) Receiver is appointed or other legal action is initiated for the purpose of liquidating a borrower's assets, or all or a valuable part of the collateral is abandoned by the borrower.
- (3) A Loan should be transferred to liquidation status may be appropriate when:
  - (a) Loan payments are 60 days or more past due;
  - (b) Workout arrangements do not appear feasible; or
  - (c) Any other circumstances or defaults occur which may have a substantial adverse effect on the loan.
- (4) If a loan file is located at an SBA loan processing or servicing center when any liquidation event occurs, the center will transfer the loan to the local SBA office for handling after notification by the lender of the occurrence of the liquidation event.
- (5) Lender must disclose and report:

- (a) All other “non-SBA” loans with borrower(s);
- (b) Guarantor(s), or principal(s); and
- (c) Any potential conflict of interest involving competing liens on collateral securing these loans.

**d. Purchase of the SBA guaranty.**

- (1) The SBA encourages the lender to delay requesting SBA to purchase until liquidation of all worthwhile collateral is complete and a cost-benefit analysis shows that further recovery action is not warranted. If a loan is sold, SBA also encourages the lender to purchase the guaranteed portion directly from Colson and proceed with liquidation. However, SBA will purchase its guaranteed portion after 60 days delinquency if the lender requests.
- (2) Lenders who complete liquidation prior to requesting guaranty purchase will be allowed to recover up to 120 days interest from liquidation proceeds (i.e., as recovery is obtained, the lender may apply liquidation proceeds to interest until a maximum of 120 days is obtained, with the balance going toward principal; interest is calculated using the rate in effect at the time of the earliest uncured payment default; if guaranty purchase is made by SBA prior to completion of liquidation, interest will be calculated at the note rate minus 1 percent.
- (3) If SBA is requested to purchase its guaranty from the lender, lender must provide all applicable items on the “Checklist for Purchase Documents” (see Appendix Q) within 10 days of its request. This includes copies of the executed loan authorization, a certified transcript of account, a summary of major servicing actions, and all changes and modifications to loan documents along with copies of all supporting loan documentation, including settlement sheets so that SBA is able to complete a “pre-purchase review.”
- (4) For all LowDoc loans in a PLP lender’s portfolio, personal property securing the loan must be liquidated **prior** to the purchase of the guaranty from the lender except for bankruptcy situations. For secondary market loans, however, SBA will purchase from the investor if the lender fails to do so.

**e. Site visits.**

- (1) The lender (or its agent) must make and document a site visit to the borrower’s business premises and the site of any other worthwhile collateral within 60 days of an unremedied default in payment, or as soon as possible if there are assets of significant value that could be removed or depleted.

- (2) Whether or not a payment default exists, a site visit must be conducted within 15 days after the lender becomes aware of any event which causes a loan to be placed into liquidation status.
- (3) The report must contain an inventory of assets and an assessment of their condition and value, and include a review of books and records as feasible to determine use of loan proceeds and the existence of any unauthorized use of funds.
- (4) If a site visit is waived under appropriate circumstances, the waiver must be documented by the lender in the loan file.

**f. Lender liquidation plan.**

- (1) Prior to commencing recovery procedures, the lender must prepare a liquidation plan containing information referred to in SBA Form 1979, "Liquidation Plan Format" (see Appendix O) with the "Loan Underwriting Characteristics" attached. The "Loan Underwriting Characteristics" are discussed in Chapter 4 "General Guidelines for Liquidation Activities" and the appendix titled "Loan Underwriting Criteria -- Risk Management Database."
- (2) Lenders must submit a copy of the liquidation plan at the time of their request for guaranty purchase on loans with principal balances more than \$50,000 (also when SBA purchases from the secondary market holder, if the lender does not do so).
- (3) For PLP loans with principal balances of \$50,000 or less when transferred to liquidation, the lender is not required to submit liquidation plans (see Appendix R, "Final Wrap Up Report Format"). However, SBA approval is required for non-routine (contested) litigation, or litigation with anticipated legal expenses exceeding \$3,000.
- (4) The SBA approval of the plan is not required, and **submission of the plan to SBA does not constitute approval of the plan by the Agency or acceptance of its terms.**
- (5) The SBA may request additional information on any liquidation plan or may request that a plan be modified.
- (6) On all loans, the plan and any amendments must be submitted with the final wrap up report at completion of the recovery process.

**g. Workouts.**

- (1) The SBA servicing office must be notified in writing of a loan workout once three regular monthly payments have been made by the borrower under any workout plan and it is appropriate to remove the loan from liquidation status. If payments are being received under a confirmed bankruptcy plan, provide a copy of the plan to SBA.
- (2) The SBA strongly encourages the lender to consider workouts wherever possible prior to liquidation and also after liquidation procedures have commenced.

**h. Collateral disposition.**

- (1) Sales of collateral must be:
  - (a) “Commercially reasonable;”
  - (b) Conform to local laws and practice, and the lender’s procedures on non-SBA loans; and
  - (c) Consistent with generally accepted commercial banking practices used by prudent lenders.
  - (d) The SBA related collateral must NOT be sold back to the original borrower or any other obligor/guarantor on the loan, or sold to lender’s associates or close relatives (including members of household) of lender’s associates (e.g., lender’s officers, directors, stockholders, employees), without prior SBA written approval.
- (2) A lender liquidating collateral from an SBA guaranteed loan may finance the sale with another SBA guaranteed loan, but may NOT do so under the Preferred Lender Program. A lender financed sale of assets (seller carryback and/or takeback) without an SBA guaranty does not require SBA’s approval.
- (3) After purchase of the guaranty, a lender may sell assets on a loan it is liquidating through a note receivable with SBA’s prior written approval.

**\*i. Acquired Property - Deleted.\*****i. Compromise.**

- (1) Compromise is usually not appropriate when it appears there is sufficient equity to fully satisfy the remaining balance due on the debt.

- (2) Compromise should be considered prior to:
  - (a) Foreclosure of a personal residence pledged as security when there is insufficient equity in the property to fully satisfy the deficiency balance remaining after liquidation of all business assets; and,
  - (b) Commencement of litigation.
- (3) Compromise must NOT be considered if there is evidence of fraud or substantial misrepresentation on the part of the offeror.

**j. Fees, expenses, and recoveries.**

- (1) Servicing and liquidation expenses.
  - (a) Servicing and liquidation expenses paid by the lender must be customary and reasonable for the services obtained and consistent with local practice.
  - (b) The SBA will examine expenses upon completion of the liquidation to ensure all expenses meet these guidelines. Particular emphasis will be placed on review of legal expenses.
  - (c) The lender must maintain a transcript of account recording all loan payments, liquidation recoveries, fees and expenses properly chargeable to the loan.
  - (d) The SBA will share in reasonable and necessary expenses incurred by the lender on a pro-rata basis up to SBA's share of total recoveries. The SBA may agree to pay more on a case by case basis.
- (2) Recoveries from liquidation or sale of collateral.
  - (a) Recoveries from liquidation or sale of collateral will be applied to outstanding expenses first (or up to 120 days interest if lender is liquidating prior to guaranty purchase), and the balance to principal.
  - (b) The SBA will NOT pay its share of advances or expenses of the lender before guaranty purchase.
  - (c) After guaranty purchase, it is recommended that the lender aggregate expenses which cannot be paid from liquidation proceeds for submission to SBA when recovery procedures are substantially

completed, or periodically (e.g., monthly) during the liquidation process.

- (3) Recoveries after guaranty purchase.
  - (a) If SBA has purchased its guarantee, the lender must remit SBA's share of any net proceeds to the Small Business Administration, Denver, CO 80259, within 15 days from the time the lender receives the funds from the borrower or from collateral sales. (See Paragraphs 8-24 and 8-25, "How Must You Apply the Proceeds from Liquidation," and "Improving The Timeliness of Collections From Lenders," for a more complete discussion of the topic.
  - (b) The lender must submit an accurately completed "Transaction Report on Loans Serviced by Lenders," SBA Form 172, with each remittance.
    - i. The lender must indicate whether the remittance is a recovery from liquidation of an asset or a loan payment and itemize any expenses deducted from the recovery.
    - ii. The lender must NOT deduct a "servicing" fee on liquidation recoveries.

**k. Litigation, attorney fees, and expenses.**

Whether or not a particular loan was made under the PLP Program, a PLP Lender may handle litigation which SBA considers routine without SBA's prior approval, provided outside counsel for the PLP lender proposes to charge fees which are customary and consistent with SBA guidelines issued by District Counsel for each District Office. Litigation which SBA considers non-routine will require a litigation plan approved in advance by SBA. To determine the costs of lender outside counsel on individual cases and in the aggregate, and to develop or update liquidation plans, all outside lender legal costs must be recorded either in the Guaranty Loan Purchase System (GLPS) initial purchase and modification screens, or the Care and Preservation of Collateral (CPC) System. The GLPS screens have a new line titled "LEGAL EXPENSE TOTAL TO DATE," for which the amount input will not be automatically added to the purchase check/wire, but will be retained as part of the purchase database and legal expense tracking system. If the participant is to be reimbursed for the expenses, the amount to be reimbursed must be reported in the system's transcript section (since expenses were not previously recovered through collections by the lender). The CPC screens have two new "PURPOSE" codes. Code #5 to identify legal expenses (paid separately from any which were reimbursed during the purchase) and Code #6 to identify UCC refiling expenses. The identified transactions and amounts will be automatically recorded in the LLTS "F" Screen and the cumulative total of expenses will be recorded in the "Legal Fee" area.



- (1) What is litigation?

Any matter pending before a judicial or administrative tribunal.

- (2) What is routine litigation?

Routine litigation is uncontested litigation, such as non adversary matters in bankruptcy and undisputed foreclosure actions.

- (3) What is non-routine litigation?

All contested litigation is non-routine. Such litigation consists of those cases where facts or legal issues are in dispute requiring resolution through adjudication.

- (4) When does a Litigation Plan require prior approval by District Counsel?

PLP lenders must submit to District Counsel for prior approval a Litigation Plan for:

- (a) Non-routine litigation; and
- (b) Routine litigation involving estimated legal costs exceeding \$3000.

- (5) What if a PLP Lender fails to submit for prior approval a litigation plan for non-routine litigation or routine litigation involving estimated litigation costs exceeding \$3000.

Legal fees and costs will only be reimbursed to the extent the District Counsel determines such fees and costs were necessary and reasonable.

- (6) What must a Litigation Plan include?

The Plan must include an estimate of the legal fees to be incurred, a description of the legal and factual issues involved, and possible settlement alternatives.

- (7) What are the requirements with respect to the retention of attorneys by PLP lenders?

SBA requires the following:

- (a) PLP legal fees must be reasonable and customary for the services provided;
- (b) SBA may object to the retention of private counsel that is too costly;

- (c) The legal fees of PLP outside counsel for SBA litigation cannot exceed those charged the lender for non-SBA litigation;
  - (d) PLP lenders may not use private counsel for non-legal liquidation services,
  - (e) PLP outside counsel may not double bill for unnecessary work or work that only benefits the lender; and
  - (f) SBA District Counsel must review the actual legal bills in all cases.
- (8) Must SBA District Counsel review the actual legal bills in all cases?

Yes.

**l. Progress reports.**

- (1) The lender must submit quarterly status updates for:
  - (a) All liquidation cases with principal balances more than \$50,000 beginning at the time of guaranty purchase; and
  - (b) Acquired assets (REO, colpur) beginning 6 months after acquisition.
- (2) These reports must explain what recovery action has taken place since the start of liquidation or the last report and indicate estimated time to complete the liquidation process or colpur sale.
- (3) The SBA reserves the right to request additional liquidation status reports at any time.

**m. Paid in full loans.**

Lender must notify the SBA servicing office in writing when a liquidation loan has been paid in full.

**n. Wrap up reports.**

- (1) When the lender determines that the loan will not be fully repaid after all worthwhile collateral has been liquidated and no further recoveries are anticipated within a reasonable period of time, the lender must provide SBA with a wrap up report documenting the lender's actions and results (see "Final Wrap Up Report Format" in Appendix R).

- (2) If SBA purchase is requested, the necessary documentation for SBA to complete its purchase review of the loan must be provided (see “Checklist for Purchase Documents” in Appendix Q).

**o. SBA liquidation.**

The SBA reserves the right to request that a lender transfer servicing to the Agency of a particular liquidation or litigation activity, or to take over servicing of the entire loan.

**6. Disaster Loans - Liquidation.**

**a. Disaster home loans.**

Disaster home loans should be afforded a level of treatment different from that given business loans.

**(1) What is required on the liquidation report?**

- (a) Reports do not require the extent of information necessary for business accounts. Basically, the analysis presented should be sufficient to allow a conclusion as to whether the obligor:
  - i. Cannot repay the debt on reasonable terms; or
  - ii. Can pay but will not do so voluntarily.
- (b) Every report should provide:
  - i. An analysis of the obligors’ repayment ability; and
  - ii. The potential sources of funds for repayment (i.e., collateral, earnings, etc.)
- (c) You should consider each account on its own merits. Liquidation should be recommended only after all reasonable collection efforts have been exhausted.

**(2) What special considerations are given on disaster home loans?**

- (a) Hardship circumstances must be considered in situations where the property is owned and used as the primary and only residence of an individual whose income is fixed or limited by reason of:
  - i. Retirement, disability, or other similar circumstances; and
  - ii. Who relies on support from a survivor, disability, or retirement benefits under a pension, insurance, or other program.
- (b) You may recommend a reduction or suspension of loan principal payments for individuals (and spouses) deemed to be suffering hardship circumstances. Reduced or suspended payments may be authorized for as long as the Agency determines that making regular payments would constitute a substantial hardship.
- (c) If suspension of principal and/or interest payments is appropriate, you must use the SBA 327 to make the recommendation. The 327 action must include LAUD11 input for:
  - i. A future installment date of no more than 1 year from the revised installment due date; and
  - ii. Future installment amount from the original terms.

**NOTE:** The 1 year limit ensures an annual review of the borrower to determine if continued annual suspension and review is appropriate based on the obligor(s) current financial condition.

- (d) Upon approval of the suspension, the account must be returned to the servicing office/center.

**(3) When do you enforce collections?**

- (a) In those home loan situations where it is determined that the obligor can pay, but will not, you should begin preparation to take enforced collection. Upon receipt of such an account in liquidation you should:
  - i. Make a prompt contact with the obligor(s) to attempt to resolve the impasse; and

- ii. Give full consideration to any reasonable workout plan or settlement (compromise) proposal which meets the requirements of the Federal Claims Collection Act.
- (b) If voluntary resolution of the matter is not possible within a reasonable time, you should:
  - i. Proceed with action against any collateral;
  - ii. Identify those assets against which a judgment might be enforced; and
  - iii. Establish a general estimate of recovery.
- (c) If worthwhile recovery prospects are indicated and court action is necessary, the account must be referred promptly to counsel for litigation. These considerations should be a part of your liquidation plan.

**(4) How do you handle uncollectible accounts?**

- (a) If you determine that the obligor(s) cannot pay the debt and there are no substantial, realizable assets, you may recommend that the home loan account be classified to “in liquidation” and “charged off” on the same SBA 327. The SBA 327 should clearly document that:
  - i. A reasonable basis for determining collectibility was used; and
  - ii. That costs would exceed the estimated recovery.
- (b) Approval of the charge off recommendation rests with the approving official subject to legal review. Appropriate instructions to refer or not refer the account to Internal Revenue Service (IRS) and/or a private collection agency must be entered into the SBA data base at the time of charge off.

**b. Disaster business loans.**

- (1) Disaster business loans should generally be liquidated as outlined in this SOP. However, at times you will find that some loans classified as disaster business loans are given to individuals who have suffered loss or damage to their investment rental homes. In these situations the loans are, basically, consumer type credits and, accordingly, should be given a level of treatment different from that given to business loans.

- (2) What level of treatment should be given?

You should treat these types of business loans in the same manner as the disaster home loans.

**c. Disaster farm loans.**

Disaster farm loans should generally be liquidated as outlined in this SOP. However, special attention must be given to the 13 CFR § 120.550 Homestead Protection for Farmers.

**7. Certified Development Company (CDC) Loan Program.**

The SBA provides long-term financing to small businesses through its Certified Development Company Program. The program, commonly referred to as the development company loan program, makes loans available for buying land, buildings, and machinery and equipment; building, modernizing, renovating, or restoring existing facilities and sites.

**a. What kind of assistance should the CDC provide?**

Field offices are encouraged to keep willing and cooperative CDCs involved with loan liquidation where possible. The CDCs can actively assist in actions by doing the “leg work” in cooperation with SBA. This would include:

- (1) Alternatives for workouts;
- (2) Recommending assumptions; and
- (3) Recommending required litigation.

**b. Can a CDC liquidate SBA loans?**

Yes, SBA may negotiate agreements with CDCs to liquidate loans but not to litigate loans.

**c. Are there any special procedures for liquidating loans made by a CDC in the Accredited Lenders Program (ALP)?**

No. Generally these loans are liquidated by SBA in the same manner as outlined in this SOP with the CDCs assistance.

**8. CAPLines Program.**

- a. CAPLines is the name assigned to all of the Agency's short term lending programs except those dedicated entirely to exporting. The CAPLines umbrella consists of five separate and distinctive sub-programs.
  - (1) Seasonal;
  - (2) Contract;
  - (3) Builder;
  - (4) Standard Asset Based; and
  - (5) Small Asset Based.
- b. Each sub-program is only available on a guaranty basis.
- c. The servicing and liquidation guidelines for the various loan programs under the umbrella of CAPLines Program are in the appendix of SOP 50 50.





**CHAPTER 11**  
**COLLATERAL PURCHASED (COLPUR) BY SBA AND LENDER**

**1. What is Colpur?**

Colpur is collateral purchased or acquired by SBA or its participating lender through SBA liquidation.

**2. What is SBA's Policy?**

The SBA's policy is to dispose of collateral purchased in such a manner as to realize the maximum recovery in the minimum amount of time.

**3. What is the Agency's Policy on Obtaining and Retaining Colpur?**

While the Agency will continue to emphasize avoiding the acquisition of assets, it recognizes that acquiring some Colpur may be necessary to protect SBA's position.

- a. You should take all possible steps to keep Colpur levels down without compromising the financial considerations used to govern its acquisition and sale.
- b. You should take all reasonable efforts to sell collateral at the earliest possible time to obtain a reasonable price and thus avoid the acquisition of Colpur.
- c. You should be aware of the importance of:
  - (1) Accurate appraisals;
  - (2) Market and environmental factors;
  - (3) The necessity of realistic bid computations; and
  - (4) The fact that real property should NOT be acquired or held for speculation.
- d. The Agency's goal is to sell Colpur within 12 months of acquisition.
- e. Financial Assistance (FA) will periodically provide each DD a list of their office's Colpur aging report.

- f. All Colpur should be disposed of within 12 months of acquisition if an advantageous recovery can be obtained. In cases where this is not possible, the DD must review and approve a disposition plan.
- g. Factors that might necessitate an extension of the time for disposal include:
  - (1) Legal problems precluding a sale or preventing a sale at a realistic price;
  - (2) Environmental concerns (property undergoing remediation);
  - (3) Seasonal factors (e.g., selling beach property in mid-winter); and
  - (4) Eviction procedures in progress.
- h. There are legitimate instances where a short delay will result in a significant increase in recovery. However, to merely “wait for the market to improve” is NOT a good reason to postpone a sale and may be unwarranted speculation.

**4. In Whose Name Should the Colpur Property Be Titled When Serviced by SBA?**

Title should be placed in the name of the “Administrator, U.S. Small Business Administration, an Agency of the United States.”

**NOTE:** There is a tax advantage in vesting full title in the name of the Agency. By so doing, the real and personal property will be in a nontaxable status with regard to future assessments.

**5. In Whose Name Should the Colpur Property Be Titled When Serviced by the Lender?**

If Colpur can be disposed of in a short time period (normally 120 days), title should be placed in the name of the lender.

If the sale will take longer, the lender must consult with SBA to consider transfer of the property to SBA’s name if significant tax savings could be realized. The value of the property and tax rates must be considered. All lenders (e.g., 7(a), PLP, LowDoc, FA\$TRAK, etc.) must obtain SBA’s approval prior to titling collateral in the name of the Agency.

**6. When Must You Complete an Electronic Form SBA 297, “Collateral Purchase Report”?**

- a. If SBA acquires Colpur in the Agency’s name, an SBA 297 must be completed.

- b. If the lender acquires Colpur:
- (1) Titling it in their name either prior to SBA purchasing the guaranty or after, an SBA 297 is not required as the property is not in the name of the Agency.
  - (2) Titling it in the name of the Agency either prior to SBA purchasing the guaranty or after, you/lender must complete an SBA Form 297. If it is prior to purchase, you must immediately process the purchase. If a lender completes the SBA 297, the form must be sent to the local district office, for immediate input to the LLTS “D” and “R” screens (“Collateral Purchase”), and the “S” screen (Collateral Sale”) when the property is sold (see paragraph 7 below).

**NOTE:** An accurate net realizable value, the acquisition price, and an indication as to whether the Colpur is in partial or full satisfaction of the debt are required whenever SBA acquires an asset.

**7. Preparation of Electronic Format SBA 297, “Collateral Purchase Report.” (This format is the same as the previous SBA 297. See appendix C).**

- a. **Part I of the Electronic SBA 297. Replaces the preparation and submission of the existing paper SBA Form 297 (“Collateral Purchase Report”), and allows for a detailed nationwide inventory system for the identification and reconciliation of properties held as Agency assets, valued consistently at their net realizable value for the general ledger. (See appendix C-iv).**

You must first complete the LLTS “D” screen (“Collateral Data Entry”), for each property (providing a complete description), and then complete the LLTS “R” screen (“Collateral Purchase”), whenever property is acquired. The “R” screen must include the net realizable value computed according to the instructions in appendix C. Electronic certification by the “rule of two” must be completed for the purchase transactions before the Programmatic Accounting Group (PAG) (in Denver) is able to update the general ledger. The screens must be completed within 30 days of property acquisition.

- b. **Part II of the Electronic SBA 297.**

You must complete the LLTS “S” screen (“Collateral Sale”), whenever property is sold. Electronic certification by the “rule of two” must be completed before PAG is able to update the general ledger with the sales data. The screen must be completed within 30 days of the sale.

**c. Date purchased.**

You must use the date the Agency/lender is the successful bidder at the sale, or the date of the written conveyance agreement (if applicable).

**d. Redemption period.**

If the property can be redeemed by the borrower or third party, the expiration date of the redemption period must be entered in the “Comments” section of the report. If the property is redeemed, it will be necessary to inform OFO by the completion of a new SBA 297 LLTS “S” screen.

**e. Purchase price.**

- (1) In the case of a public sale, the term “Purchase Price” will mean the Agency’s or participant’s bid price or amount of consideration set by the court having jurisdiction.
- (2) In the case of a voluntary conveyance, the purchase price must be the consideration set forth in the conveyance agreement.
- (3) When the basis for computing the purchase price is other than the liquidation value, you must state the basis used in the “Comments” section of the LLTS “R” screen of SBA 297.

**f. Liquidation values.**

The report should contain an itemized list of the Colpur by class, type, and/or separate tracts or lots with the detailed liquidation values.

**g. Reporting sale of Colpur.**

Part II, of the electronic format SBA 297, is represented by the LLTS “S” screen and must identify whether the transaction was a partial or final sale of the Colpur, and if it was for cash or terms. Failure to provide this information will unnecessarily delay recording the sale in the SBA database.

**8. How is Colpur to be sold by SBA, the Participating Lender, or another Mortgagee, or Lender?**

- a. For SBA-serviced loans you are strongly encouraged to offer acquired assets (Colpur) for public sale through competitive bids at auctions or sealed bid sales. Lenders may use negotiated sales if consistent with their usual practice for similar non-SBA assets. [See 13 CFR § 120.540 c.]

- b. Colpur acquired through foreclosure.
- (1) Properties obtained through either judicial or non-judicial (summary) foreclosure procedures consistent with State law may be disposed of by negotiated sale immediately after SBA acquires them.
  - (2) The line supervisor is authorized to:
    - (a) Approve an auction or other type of public sale;
    - (b) Approve a negotiated sale;
    - (c) Approve the listing with a qualified broker for the property to be sold in a commercially reasonable manner appropriate to the type of asset and consistent with prevailing local practices; and
    - (d) Approve suitable advertising for a negotiated or other sale by Agency staff.
  - (3) You must justify all negotiated sales or listing prices with a recent appraisal (preferably within 120 days, but no older than a year) of the property or other reliable indication of value (such as an opinion by a qualified broker in situations where prices can be readily ascertained because of similar property sales in an active market).
  - (4) Professional appraisals continue to be preferred. However, experienced brokers may be able to provide equally reliable information faster and at less cost. Residential values may be established through use of comparable sales information.
  - (5) You should use net present value (NPV) calculations in setting or accepting any sales price, taking into account care and preservation expenses as well as other holding costs (see Appendix EE, FF, and GG, "Determining Present Value," "Present Value - Table 1," and "... - Table 2" for NPV example). The commercial reasonableness of any procedure should always be weighed.
  - (6) Whenever possible, in order to avoid the acquisition of an asset (Colpur), the minimum legal requirements for a foreclosure sale conducted by SBA or a participating lender should be supplemented by display or other advertising to obtain maximum exposure for the property to obtain the best price.

- c. Colpur acquired through a deed in lieu of foreclosure.
  - (1) On SBA serviced accounts, this type of Colpur must continue to be exposed to a comprehensive public sale as defined in Chapter 7, “SBA’s Methods of Recovery from Collateral.”
  - (2) Exception.

If a property has a market value of less than \$25,000, the line supervisor may use acceptable methods of sale as outlined in the previous subparagraph 8.b., “COLPUR Acquired Through Foreclosure.”

**9. What are the Responsibilities and Liabilities of Ownership?**

Maintain condition of property to:

- a. Prevent deterioration;
- b. Prevent vandalism;
- c. Avoid a potential “attractive nuisance”;
- d. Prevent personal injury; and
- e. Clean up contamination.

**10. What Special Attention is Given to Colpur Accounts?**

All Colpur accounts over 180 days must be reviewed every 60 days by the approving official to ensure that a reasonable disposal plan is being pursued.

**11. Is There a Dollar Limit for Expenses?**

If SBA’s aggregate share of all advances and expenses on any one Colpur is more than the lesser of \$50,000 or 75 percent of the liquidation value of the property, they must be approved by the district director.

**NOTE:** This limitation does not apply to direct selling costs or the purchase of a prior lien.

**12. How Often Must You Obtain Updated Appraisals on Colpur?**

You must obtain an updated appraisal annually unless justified by a 327 action.

**NOTE:** An appraiser cannot appraise the same piece of Colpur more than two consecutive times, unless justified in a 327 action.

**13. Can You EVER Use an Appraisal Older than 1 Year?**

Only in rare circumstances should an appraisal older than 1 year be used and must be documented by a 327 action.

**14. When is Using an Appraisal Older than 1 Year an Exception to Policy?**

The use of an appraisal over 1 year old in the case of a private sale of collateral or Colpur is an exception to policy and requires Headquarters approval (AA/BLS).

- a. You should perform a site visit at least annually; and,
- b. You should prepare a field visit report which should be forwarded to the approving official and then be placed in the loan file.

**15. What are the Restrictions on a Negotiated Sale of Colpur Property?**

- a. The selling price must be supported by an appraisal not more than 1 year old; preferably, one performed within the past 120 days.
- b. The property must have been offered at least once at a comprehensive public sale unless it was acquired through a foreclosure sale consistent with state law or is valued at less than \$25,000.

**16. What Procedures Should be Followed with Real Estate Brokers When an Account is:**

**a. SBA-serviced?**

- (1) The property must have been subjected to a comprehensive public sale unless it was acquired through a foreclosure sale consistent with state law; or is valued at less than \$25,000.
- (2) The property may be listed on a nonexclusive or exclusive basis with a real estate broker as authorized by a 327 action.

**b. Lender-serviced?**

- (1) The property may be listed with a real estate broker on a nonexclusive or exclusive basis in accordance with the procedures it uses for non-SBA property; and

- (2) The asking price should be supported by a current appraisal or other reliable indication of value.

**17. What are the General Requirements When Using a Real Estate Broker?**

- a. A predetermined **asking price** will be established;
- b. The listing broker must be local to the property being sold, except where the property must be marketed more extensively, and have experience in the type of property being marketed;
- c. All agreements with brokers must be in writing and signed by both parties;
- d. If possible, SBA should reserve the right to sell to customers obtained through its own sources;
- e. The commission to be paid to the broker must be no greater than the rate customarily paid in the area;
- f. The listing broker must be properly licensed and should be a member of a multiple listing service; and
- g. A commission must not be paid unless:
  - (1) The broker negotiates a sale satisfactory to SBA;
  - (2) Title is actually conveyed; and
  - (3) Consideration is paid to SBA in accordance with the sales contract.
- h. No commission will be paid directly or indirectly to:
  - (1) Any employee of SBA;
  - (2) Any employee of the participating lender; and
  - (3) Their close relatives or associates.
- i. The Agency must pay only one commission;
- j. The listing should allow for termination by SBA at its option or should be for a specific limited time (typically 90 days); and
- k. Each SBA office must use a number of qualified brokers on a rotating basis.



**18. What Must a Purchase Offer Contain, and How Do You Process it?**

- a. All offers must:
  - (1) Be in writing from offeror or authorized agent;
  - (2) Provide written proof of agency; and
  - (3) Not be disclosed to other prospective purchasers or their agents.
- b. A good faith deposit of 5 percent must be submitted in the form of cash or certified funds.
- c. Be approved by a 327 action which must reflect:
  - (1) The results of all sales efforts;
  - (2) Current value of the property; and
  - (3) Identity of the purchaser.
- d. A letter of acceptance must be sent to the potential purchaser. (See Appendix OO, "Sample Acceptance Letter for Sale of Property.")

**19. When Can You Sell on Terms?**

- a. Colpur should be sold for cash unless it is more advantageous to SBA to sell on terms.
- b. What terms are acceptable?
  - (1) Down payment of at least 20 percent (may be adjusted to be competitive with the local market);
  - (2) Balance payable in equal monthly payments;
  - (3) Monthly payment must exceed accruing interest;
  - (4) Interest rate should be based on prevailing rates in the area.
    - (a) A rate may be established below market rate (but not less than the cost of money to the Government except in unusual situations). See definition in Chapter 4, "General Guidelines for Liquidation Activities;"

- (b) The interest rate must not exceed the state statutory rate of interest;
- (5) Maturity should not exceed 15 years (balloon payment allowed at maturity); and
- (6) The net present value of any term offer must be compared with any cash offers. The net present value of a term offer must exceed a cash offer by at least “10 percent.” If it does not, take the cash offer.

**20. Is a First Lien Position Required on the Property Financed by SBA?**

Yes. The note must be secured by a first lien on the Colpur being financed.

**21. What Type of Property can Be Sold on Terms?**

**a. Residential Colpur:**

- (1) Should almost always be for cash as numerous sources of financing for this type of property is available;
- (2) A term sale with interest near market can be authorized based on the mortgage market in your area; and
- (3) A 327 action must be prepared justifying both the term sale and any lower interest rate.

**b. Commercial real estate:**

- (1) A term sale with interest rate below market can be authorized; and
- (2) A 327 action must be prepared justifying both the term sale and the lower interest rate.

**c. Personal property Colpur:**

- (1) Sales of personal property must be for cash; and
- (2) Sales to the buyer of the premises housing the personal property may be on terms:
  - (a) Terms may be offered if related to the remaining life of the asset but must not exceed 5 years; and
  - (b) The monthly payment must cover actual accruing interest and depreciation.

**22. What are the Credit Requirements of a Potential Bidder?**

- a. Financial responsibility: credit must be cleared before the sale, not after.
- b. Character.
- c. All sale advertisements must state that for term sales:
  - (1) Potential buyers must be approved prior to the sale;
  - (2) A deadline for receipt of the required documentation to allow time for credit review;
  - (3) Purchaser must provide hazard and public liability insurance; (see Chapter 22, "Insurance");
  - (4) Purchaser must execute SBA Form 1261, "Statements Required By Laws & Executive Orders" (see SOP 50 10 for additional information) and
  - (5) Certification must be made that purchaser (and principals of a borrower who own 50 percent or more of the voting interest of the business) is not delinquent more than 60 days under the terms of any administrative order, court order, or repayment agreement that requires payment of child support.

Principals may be sole proprietors, partners, shareholders of a corporation, or members and/or managers of a limited liability company.

**23. Homestead Protection for Farmers.**

**a. How does it differ from non-farm residential property?**

The Consolidated Farm and Rural Development Act, as amended by Public Law 100-233, provides special homestead protection for a farmer whose residence is acquired by SBA.

The SBA may lease to a farmer, borrower, the farm residence occupied by the borrower and a reasonable amount of adjoining property (no more than 10 adjoining acres and seven farm buildings) if they were acquired by SBA as a result of a defaulted farm loan made or guaranteed by SBA. (See 13 CFR § 120.550 through 120.554.)

**b. What notice is required to borrower?**

Within 30 days of the acquisition of homestead property by SBA, you must notify the borrower of their rights under the Homestead Protection.

This notice must be in writing by “Certified Mail - Return Receipt Requested” and at a minimum contain:

- (1) A copy of the regulation is cited in Chapter 2, “Regulations and Other Authorities;”
- (2) Information that the residence and a reasonable amount of adjoining property may be subject to lease from SBA for a period of up to 5 years;
- (3) Borrower must apply for occupancy rights within 90 days of the date SBA acquired; and
- (4) Advise certain eligibility requirements must be complied with as reflected in the CFR.

**c. What are the specific eligibility requirements?**

- (1) See a copy of the regulation as cited in Chapter 2, “Regulations and Other Authorities;”
- (2) When more than one member of an entity, such as a corporation or a partnership, each possesses and occupies a separate homestead property, each may apply for homestead protection for his or her residence.

**d. Does borrower have appeal rights?**

Yes. Borrower may appeal the field office’s denial of an application upon receipt of written notice of the denial of homestead eligibility. The borrower may appeal the decision to AA/FA in Headquarters.

**e. Does borrower have possession rights?**

Yes. Borrower must have the right to retain possession and occupancy while the application is being processed up to and including the conclusion of any appeal. The property must not be leased or sold to third parties until any appeal is concluded.

**f. What are the requirements of the lease?**

- (1) A right of ingress and egress to a public way must exist or be provided. Sources of water, power/utility lines, and sanitation facilities, if outside the homestead parcel, will be covered by appropriate easements.
- (2) Access for any Colpur remaining after the homestead parcel is taken out must have its own access to a public way.

**No lease will be approved if the remaining Colpur will not have such access.**

- (3) The lease may be for a period of up to 5 years and must contain an option to purchase; and
- (4) That SBA retain termination rights allowing the Agency to terminate the lease by providing a 60 day advance written notice to the farmer/borrower of SBA's intention to terminate the lease.

**g. A termination notice could be given to the borrower due to any of the following conditions:**

- (1) Lessee fails to make payments as agreed;
- (2) Lessee fails to maintain the property in good condition; and
- (3) Interference by lessee in SBA's efforts to sell the remaining Colpur.

**h. Does lessee have the right of first refusal?**

Yes. You must offer the property to the lessee under the same terms and conditions as you would any other purchaser.

**24. National Register of Historic Places.**

Section 106 of the National Historic Preservation Act of 1966 (16 U.S.C. 470f) requires that every Federal agency "take into account" how its undertakings could affect historic properties. To accomplish this, any property owned or acquired by SBA must be reviewed to determine if it possesses characteristics that would qualify it for inclusion on the National Register of Historic Places, and if so, SBA must comply with Section 106 before disposal of the property. The process to follow is contained in regulations entitled "Protection of Historic Properties" (36 CFR Part 800). The SBA may not transfer title or make any major structural changes to a property until this process has been concluded.

**a. Identification.**

If a property is 50 years of age or older, or if it appears old but its age is unknown, contact the State Historic Preservation Office (SHPO) for the state where the property is located to determine whether the property is listed on or eligible for the National Register. The SHPO's are generally connected with the governor's office of the respective State or territory.

**b. Treatment.**

If it is determined during consultation with the SHPO that a property is historic, then appropriate measures must be taken to ensure its protection when it passes out of Federal control. The SBA should consult with the SHPO to determine if restrictions or covenants in the deed or instrument of transfer are necessary to protect the property's historic characteristics or whether other measure are appropriate (placing restrictions as to future use, remodeling, etc.) in the deed to be transferred by SBA. The effect on the sale price of the property can be substantial. Sometimes a "historic" designation improves the property's value; in other instances, the restrictions negate its "highest and best" use.

**25. Preparing a Plan to Dispose of Colpur Property.**

An SBA 327 should be used to outline the disposal plan. The SBA 327 should cover:

- a. Method of sale with possible alternatives;
- b. Minimum acceptable price; and
- c. Any other needed information.

**26. What Should You Consider When Establishing a "Minimum Acceptable Bid"?**

- a. Fair market value of the property;
- b. Protective bid analysis;
- c. Any other pertinent justification;
- d. Usable value of the property to be sold; and
- e. Your acceptable minimal bid must include a 10 percent plus or minus tolerance.

**NOTE:** The SBA personnel normally will NOT make known the amount of the Agency's minimum acceptable sales price, appraised value, or liquidating

value of Colpur. HOWEVER, you are free to discuss a range of acceptable value with the selling agent.

**27. Restrictions for Purchase of Colpur.**

**a. Restrictions on the borrower.**

The SBA does NOT favor selling acquired nonresidential property for less than the full amount due to:

- (1) The borrower from whom it was acquired; or
- (2) The principals responsible for its management.

**NOTE:** The amount due the Agency includes the total Agency investment in the property plus the deficiency and any interest accrued.

**b. Restrictions on SBA employees.**

Employees of SBA, Service Core of Retired Executives (SCORE) volunteers, SBA Advisory Counsel Members, and close relatives of any must not bid or purchase directly or indirectly at any SBA related sale.

**c. Restrictions on the lender.**

Associates of participants must not bid or purchase for their own account, directly or indirectly, at any SBA related sale. The SBA must give written permission to sell any SBA related collateral or Colpur to close relatives of participant's associates (See paragraph 2, "How Do You Handle Conflicts of Interests?" in Chapter 4, "General Guidelines for Liquidation Activities.")

**28. Are There Exceptions to Selling Colpur to the Borrower?**

**a. Nonresidential Colpur** can be sold to the borrower for less than the full amount due when:

- (1) A comprehensive public sale has been held;
- (2) You have exhausted all other sales efforts; and
- (3) The sale is for cash.

**b. Residential Colpur** which was and is proposed to continue to be a primary and only residence may be sold back to an obligor who will continue to be the occupant. The requirements for such a sale are:

- (1) The property is sold for a fair market value; and
- (2) The sale is normally for cash.

**NOTE:** Your documentation supporting a sale of this type must show why the action is not detrimental to the interests of the Agency.

**29. How is Title to Colpur Conveyed to the Purchaser?**

**a. SBA-serviced Colpur.**

- (1) Counsel is to prepare and/or review the conveyance of title to the real property or review the title/escrow company's documentation related to the transfer of the property.

The Deed will usually be by quit claim, bargain and sale deed, without warranty, or a special warranty, if circumstances justify.

**NOTE:** The SBA, based on its tax exempt status, is not liable for documentary stamp taxes with respect to its instruments of conveyance. The agreement must state that all required revenue or documentary stamps must be paid for by the purchaser.

- (2) Counsel is to prepare the bill of sale for conveying personal property without representation or warranty. The instrument of conveyance to the purchaser should include the removal date of personal property and a statement that purchaser will not be permitted to resell the items purchased on the premises. Further, any damage to the premises by removal of the personal property items is the responsibility of the purchaser.

**b. Lender-serviced Colpur.**

- (1) When the Colpur is in the name of SBA and sold by the lender, conveyance should be handled in the same manner as when SBA is doing the servicing.
- (2) When the Colpur is in the name of the lender, it will convey property in the same manner it handles its non-SBA accounts.

**30. What are the Administrative Procedures for Setting up Term Colpur Sales?**

The following procedures are followed to set up a Colpur account sold on terms in the SBA data base.



- a. You should enter “PMQD16” and transmit. Enter the first six numbers of the original loan number. You will need to enter the seventh and eighth number which tells you how many note receivable accounts have been set up. Once you enter the seventh and eighth number, transmit and you should receive the ninth and tenth number which represents the “check digits.”

An example would be: The original loan number 5363523004. Call up PMQD16 - transmit; now enter 53635231 - transmit - the last two numbers should now appear on the screen. The seventh and eighth numbers entered 31 reflects this is the first note receivable set up - if you needed to set up another term sale off of the original account, you would enter “32” as your seventh and eighth number. (See SOP 20 19 2, “Loan Accounting Procedures,” for further detail.)

- b. Your next step would be to complete **SBA Form 515, Note Receivable Report**, which is self-explanatory. (See Appendix H)

You must distribute the SBA 515 as follows:

- (1) The collateral cashier will receive a copy of the SBA 515 and the original note to place in a collateral file;

**NOTE:** If lender serviced, a copy of note will be accepted.

- (2) The collateral cashier will receive a copy of the SBA 515 and a copy of the note to set up a loan file; and

- (3) The original SBA 515 and a copy of the note must be sent to Denver OFO. See SOP 20 19 2, “Loan Accounting Procedures.”

**NOTE:** In certain court actions, a copy of the court order will be used in place of a new note.

- c. Recording requirements.

- (1) You must have all instruments securing the note recorded in the appropriate office of public records in accordance with local requirements.

- (2) You must place contracts of sale on record if required by law or custom or if advantageous to the Agency.

- d. Handling of note receivables if purchaser defaults.

You should follow the same procedures for classifying a regular SBA loan. (See SOP 50 50, “Loan Servicing.”)

**31. Can Colpur be Leased?**

- a. A lease of real property Colpur must be predicated on your inability to sell the property. If you can justify the advantage to SBA, a lease can be executed for periods up to 1 year.
- b. Personal property must NOT be rented.
- c. Lender's request to lease Colpur must be handled by these same considerations.
- d. All leases must be prepared by Counsel.

**32. Terms and Conditions of a Lease.**

- a. A lease or lease purchase must be designed for the protection of the Agency.
- b. You must make an inspection and inventory, jointly with lessee, before and after the period covered by the lease.
- c. The lease must have a provision for:
  - (1) The return of the property to SBA in the same condition (less fair wear and tear only);
  - (2) Reimbursement to SBA for missing items or those returned in unsatisfactory condition; and
  - (3) The lessee to obtain, at his/her expense, casualty and public liability insurance.
- d. The lease should permit the lessor to cancel the lease in the event of sale or redemption of the property prior to the expiration of the policy.
- e. You should not rent Colpur to the borrower from whom it was acquired or to any of the principals responsible for the borrower's management unless:
  - (1) Unusual circumstances exist;
  - (2) It is to the Agency's advantage; and
  - (3) A comparable or more desirable proposal cannot be obtained.

You should support this with an SBA 327.

- f. You must make at least semiannual inspections of the leased property to determine its condition and the compliance to the lease and prepare a report summarizing your findings.

### 33. Profit from Sale of Colpur.

You should protect the SBA against possible allegations of unconscionable profit. This can be accomplished by the use of a professional auctioneer to assist in advertising and conducting foreclosure sales. Sale of property must be advertised as widely as possible under the circumstances. **The benefit you will receive is that the property may be sold at the foreclosure, preventing it from becoming Colpur in the first place.**

#### a. Unconscionable profit.

There is legal precedent which requires a lender to apply Colpur profit to the debt if the period of time the property was actually held by the lender was short and the profit large. The courts found the “profit” was really “equity” which had not been properly developed by the lender in its foreclosure efforts.

#### b. Determination of Colpur profit or commercially reasonable recover.

The amount of funds to be credited to the loan account may be approved by the line supervisor acting on the recommendation of the liquidation loan officer. Counsel’s concurrence is required.

#### c. Compromise of obligor.

Corrective credits to the loan account should occur in conjunction with a compromise with the obligor(s) of the overall indebtedness. The account must be adjusted to reflect the appropriate credit even if a compromise is not possible.

#### d. Funds in excess of loan balance.

Any overage may be retained by SBA, paid into the registry of the court having jurisdiction, or handled in such manner as determined to be the most equitable under the circumstances. A 327 action is required with comments of Counsel.

#### e. Documentation and justification of profit.

- (1) When the profit on a sale of Colpur exceeds 10 percent of the purchase price (20 percent if more than 1 year since acquisition), a 327 action is required.
- (2) The 327 action must document the:

- (a) Circumstances that caused the increase in value;
  - (b) Whether the value may have existed at the time of acquisition; and
  - (c) Distribution of the profit to the general fund, to the loan account, to the court, to junior creditors or to the obligor(s), and justify it.
- (3) If you can justify the profit as a result of special events or circumstances which occurred after the acquisition, the profit may properly belong in the SBA general fund.

**NOTE:** It is not the intention of the Agency to take advantage of a borrower's situation or to make an unreasonable profit on Colpur to the detriment of the debtor(s). The burden of proof is on the Agency since the SBA is typically in control of the marketing efforts and are well aware of the values prior to foreclosure.

#### **34. Abandonment of Colpur.**

##### **a. Personal property.**

For personal property, you must prepare a 327 action recommending abandonment. This decision should be based on the limited value and the fact that the cost of selling would exceed estimated recovery.

##### **b. Real estate.**

For real estate titled in the Agency's name, you cannot abandon it. You must fully detail in those rare instances where the value of the property has fallen to the point that no purchase can be generated.

**NOTE:** The responsibilities and liabilities of the Agency continue as long as the title is held (e.g., unsightly display, potential hazards).

##### **c. Sales efforts.**

There are times that you as a loan officer must become more innovative in disposing of assets. When you have exhausted all of these efforts, an "exception to policy" plan, documented by a 327 action must be prepared. This action must summarize all of the innovative sales efforts attempted as well as any potential liability faced by the Agency.

##### **d. Potential liability.**

- (1) When possible, you should assess a property's potential liability to the Agency at the time the protective bid is computed. Occasions arise where the liability was not known or unforeseen changes occur after SBA has acquired the asset.
- (2) You should annually update the Colpur account to review potential liability.

**e. Hazardous waste.**

The presence of any hazardous waste may have significant ramifications with respect to the value and ability to sell real or personal property. You should be aware, it is not necessarily the case that SBA is liable for cleanup of hazardous waste on property in which the SBA holds title. Relevant statutes, regulations and case law must be carefully reviewed in each instance by Counsel. You should notify Counsel of all communications you receive from Federal, State, or local environmental agencies. Additionally, Counsel should be advised of any instance where it is suspected or alleged that hazardous waste is located on property titled in the Agency's name.

**NOTE:**        The prohibitions of abandoning real property remain applicable even if hazardous waste is discovered.

**f. Documentation and forms which are needed for abandonment action on personal property.**

- (1) A 327 action must be prepared by the recommending official reflecting:
  - (a) The value of the property;
  - (b) The sales effort; and
  - (c) The reason for abandonment.
- (2) Justification must be outlined in the 327 action as to why the property should be abandoned.
- (3) A 327 action must be forwarded to the approving official for final action with comments of counsel.
- (4) An SBA 297 must be prepared;
- (5) The "Date of Sale" will be the approval date of the SBA 327 authorizing the abandonment; and
- (6) The word "Abandoned" will be inserted in the "Gross Sale Price" column.

**35. Options to Purchase.**

The SBA or the participating lender must not grant an option to purchase, to do so will be treated as an exception to policy.

## CHAPTER 12 GUIDELINES FOR PERSONAL GUARANTIES

### 1. **What is a Personal Guaranty?**

A personal guaranty is the obligation to pay the entire indebtedness (unless the guaranty is limited).

### 2. **What Form is Used for a Personal Guaranty?**

You will use the SBA Form 148, "Small Business Administration (SBA) Guaranty," (see Appendix A). This form is executed in connection with loans made by or in participation with the Agency.

### 3. **Circumstances of Default?**

Although not all inclusive, the following circumstances are considered defaults:

- a. Failure to maintain payments as required by the promissory note and authorization;
- b. Failure to pay taxes on personal or real property securing the loan;
- c. Failure to pay withholding taxes;
- d. Cancellation of hazard or life insurance policies;
- e. Abandonment of collateral;
- f. Any other condition which could impact the Agency's collateral position; or
- g. Breach of any agreement or covenant.

### 4. **When Do You Notify a Guarantor of Default?**

When SBA becomes aware of a default (e.g., as noted above), you should consult with counsel to determine if written notification of the default to a guarantors is appropriate.

**5. What Requirements are There for Notifying a Husband and Wife When Both are Liable?**

When written notification is necessary, you should send it by regular and certified mail Return receipt requested both jointly and separately.

**6. When Must You Send a Demand for Payment in Full to All Guarantors?**

You must send it when:

- a. The note has been accelerated;
- b. When the approving official has determined that any of the “automatic in liquidation” situations exist (see SOP 50 50, “Loan Servicing”);
- c. When liquidation action has been authorized; and
- d. Consult with counsel.

**7. Steps to Take to Review the Guarantor’s Financial Condition.**

When you receive a loan classified “in liquidation” you must review the financial condition of each guarantor. This review is made to determine the possible recovery from each guarantor.

**a. What type of review is needed?**

You should analyze and compare the most recent and historical financial information available (e.g., financial statements, tax returns, etc.).

**b. What outside services are available to determine guarantor’s financial condition?**

- (1) Local credit bureau;
- (2) Special reporting services such as:
  - (a) Current assets and income report;
  - (b) Single property check;
  - (c) Skip tracing services;
  - (d) UCC lien search; and



(e) State corporation commission file search.

**c. What do you do if a substantial adverse change in guarantors financial condition is identified?**

If your review reflects a substantial change in a guarantor's financial condition, you should obtain full details.

**(1) What are common adverse changes?**

(a) Disposal of assets; and

(b) Creation of fictitious debts.

**(2) Whom should you refer these matters to if you determine the Agency will suffer a loss?**

You must report it to the Inspector General's Office as detailed in Chapter 24, "Referrals to the Inspector General."

**8. What Do You Do When the Guarantor is Deceased?**

- a. Ascertain the status of life insurance;
- b. Consult with counsel to determine the necessity of filing a probate claim; and
- c. Consult with counsel prior to releasing a claim on a loan in liquidation status with claims against the estate.

**9. What Notices Might the Agency Receive Which Would Indicate a Guarantor Might Be Insolvent?**

- a. Foreclosure notice by a lien holder;
- b. Bankruptcy filing; or
- c. Receivership notification.

**10. What Action Should the Agency Take when Notices of Foreclosure, Bankruptcy, or Receivership Against the Guarantors are Received?**

- a. The liquidation loan officer should determine:
  - (1) The value of any assets involved;

- (2) The amount of any prior liens in order to make decision on paying off balance;
  - (3) The overall strength of the business;
  - (4) The strength of remaining guarantors; and
  - (5) The chances of the loan payments continuing.
- b. The liquidation loan officer must notify counsel to determine what action must be taken to protect the Agency's position.

**11. Will an Account Always Be Liquidated When an Adverse Action Occurs With Guarantor?**

No. You should give consideration to the overall financial stability of the business. If you anticipate full payment from the business, monitoring the guarantor's situation will be satisfactory.

**12. When Can You Release a Personal Guarantor?**

You may release a personal guarantor when:

- a. The loan is fully paid;
- b. The full amount due from a limited guarantor is paid;
- c. A compromise offer has been approved; or
- d. The release is part of a workout, sale, or reorganization of the firm and:
  - (1) Substitution of guarantors and collateral of equal or better value is made; or
  - (2) The release is in the best interests of the Government.

**NOTE:** The liquidation officer must consult with counsel to ensure that no legal rights of the Agency against the borrower, guarantors, or any other party will be adversely affected by the release.

**13. What Do You Do if the Guarantor is Missing?**

A missing guarantor can normally be traced using any of the following methods:

- a. The Skip Trace Service Report available from Equifax;

- b. Various on-line skip trace databases;
- c. Contact with the Internal Revenue Service;  
(see Appendix LL for format)
- d. Nearby places of business;
- e. Obligor's other creditors;
- f. Consumer credit services;
- g. Local participating lenders;
- h. Obligor's neighbors, relatives, former employers;
- i. United States Post Office;
- j. Utility companies;
- k. Local unions;
- l. Department of Veterans Affairs;
- m. State motor vehicle records;
- n. Other licensing or taxing authorities; or
- o. Life insurance companies.

**14. When Do You Take Action Against a Guarantor?**

Generally, the business assets are usually considered to be the primary source of recovery and are ordinarily liquidated prior to taking action against a guarantor.

Nevertheless, collateral can be liquidated in any order determined to be in the best interest of the Agency.

**15. What Actions Can the Agency Take Against the Guarantors?**

Actions which can be taken are:

- a. A suit can be brought against the guarantor or action against nonbusiness collateral securing the guaranty.**

Where immediate action is deemed necessary, you must justify by a 327 action.

Such reasons may include:

- (1) Lack of cooperation;
- (2) Failure to supply financial information;
- (3) Refusing to assist in the liquidation of business assets;
- (4) Possible dissipation of assets; or
- (5) Foreclosure actions by other lien holders.

- b. SBA can process a compromise offer from a guarantor prior to the sale of the business collateral when:**

- (1) The deficiency balance has been determined; and
- (2) It is advantageous to the Agency.

- c. Information to refer a Guarantor to the Department of Justice (DOJ) for a Deficiency Judgment.**

The following should be completed for a referral:

- (1) The recovery potential of each guarantor must be identified; and,
- (2) The 327 action should include recommendations for suit against other obligors, judicial foreclosure action, or any other court action which may be necessary.

**16. Judgments.**

Prior to recommending legal enforcement action against a guarantor, the recommending official:

- a. Should be certain that all reasonable recovery action against the business collateral has taken place;
- b. Must be in compliance with the Federal Claims Collection Act and the Federal Claims Collection Standards; and
- c. Must review and analyze the financial condition of each guarantor. The analysis involves review of:
  - (1) Financial statements;
  - (2) Credit reports;
  - (3) Appraisals; and
  - (4) Financial data submitted at loan processing in comparison to current data obtained.

**17. What Should the Review of the Guarantors Current Financial Condition Allow the Liquidation Officer to Determine?**

- a. Extent of collectibility;
- b. Estimate of the potential costs involved;
- c. Net estimated recovery; and
- d. Sources from which recovery is expected.

**18. What Must the Liquidation Officer Do Prior to Referring a Guarantor for Judgment?**

You must solicit a compromise offer prior to referring the guarantor for judgment, pursuant to the Claims Collection Act.

**19. What Information Must the 327 Action Contain to Proceed with Suit?**

- a. A summary of the actions previously taken;
- b. Your efforts to solicit a compromise;

- c. A determination that reasonable prospects exist for collection under the judgment such as the availability of:
  - (1) Valuable properties;
  - (2) Excess income; and
  - (3) Strong financial condition;
    - (a) A copy of all credit reports;
    - (b) A copy of all appraisals; and
    - (c) A completed Claims Collection Litigation Report (CCLR).

**20. How is the Referral Processed?**

- a. Unless delegated to SBA, the DOJ handles all litigation in coordination with field counsel, Office of Litigation, and/or the litigation units.
- b. The 327 action, along with information listed above, must be forwarded to counsel for review, comment, and referral to the DOJ.

**21. What is the Prime Time for Intensive Follow-up Once the Judgment Has Been Obtained?**

The 90 day period following obtainment of the judgment is the prime time to pursue the previously identified source of collectibility from the obligors.

**22. When Should the Loan Continue in a “in Liquidation/Litigation” Status?**

It should continue until it is:

- a. Paid in full;
- b. Compromised;
- c. Approved repayment plan; or
- d. Charged off.

**23. How are Disagreements with the U. S. Attorney Handled?**

District counsel will report the situation to the Office of General Counsel. The line supervisor will consult with district counsel if guidance is needed.

**24. What Reports and Records are Required Upon Entry of a “Money” Judgment?**

SBA Form 489, “Judgment Report,” (see Appendix G) must be reported to Office Financial Operations (OFO), if it meets the following criteria.

**a. Incomplete judgment.**

If the judicial order does not constitute a final judgment until a sale is held and the deficiency established, the order will not be reported as a judgment until the final deficiency is entered or established following the sale.

**b. Computation of judgment.**

The liquidation officer should request counsel to arrange with the U. S. Attorney to include in judgments to be rendered in favor of SBA, the amount due as computed by OFO plus interest and the interest rate.

**c. Judgment obtained by the participant.**

When the participant obtains the judgment, SBA should concur in the computation of the debt. Also, the liquidation officer must obtain from the lender a signed statement setting forth any information required for the report which is not reflected on the judgment. The statement and a copy of the judgment will be attached to the SBA 489.

**d. Rerecorded judgments.**

If the debtor moves to a new location and the recording and perfecting of a judgment is required in the new jurisdiction, a second SBA 489 to OFO is not necessary.

**25. When is it Not Necessary to Submit an SBA 489 Report?**

Where a judgment has been taken against the primary obligor, you should not submit an SBA 489 on a judgment taken against a guarantor. It is not necessary to make a report on judgments that are “enforcement” judgments, such as those that authorize foreclosure.

**26. Where Should A Copy of the Judgment and Judgment Report Be Sent?**

- a. A copy of the judgment will be attached to each copy of the report; and
- b. A copy of each judgment report will be retained in the loan file.



**CHAPTER 13  
DENIAL OF LIABILITY SUIT AGAINST PARTICIPANT**

**1. Who Has the Authority Within the SBA to Deny Liability?**

No authority has been delegated to field offices to deny liability to purchase. Only the SBA Administrator has the authority to deny liability.

**2. What Reasons Justify a Decision by the SBA to Deny Liability Under its Loan Guaranty?**

a. Regulations:

13 CFR §120.524.

“When is SBA released from liability on its guaranty?”

- (a) SBA is released from liability on a loan guaranty (in whole or in part, within SBA’s exclusive discretion), if any of the events below occur:
- (1) The Lender has failed to comply materially with any of the provisions of these regulations, the Loan Guaranty Agreement, or the Authorization;
  - (2) The Lender has failed to make, close, service, or liquidate a loan in a prudent manner;
  - (3) The Lender’s improper action or inaction has placed SBA at risk;
  - (4) The Lender has failed to disclose a material fact to SBA regarding a guaranteed loan in a timely manner;
  - (5) The Lender has misrepresented a material fact to SBA regarding a guaranteed loan;
  - (6) SBA has received a written request from the Lender to terminate the guaranty;
  - (7) The Lender has not paid the guaranty fee within the period required under SBA rules and regulations;
  - (8) The Lender has failed to request that SBA purchase a guaranty within 120 days after maturity of the loan;
  - (9) The Lender has failed to use required SBA forms or exact electronic copies; or
  - (10) The Borrower has paid the loan in full.

- (b) If SBA determines, after purchasing its guaranteed portion of a loan, that any of the events set forth in paragraph (a) of this section occurred in connection with that loan, SBA is entitled to recover any money paid on the guarantee plus interest from the Lender responsible for those events.
- (c) If the Lender's loan documentation indicates that one or more of the events in paragraph (a) of this section may have occurred, SBA may undertake such investigation as it deems necessary to determine whether to honor or deny the guarantee, and may withhold a decision on whether to honor the guarantee until the completion of such investigation.
- (d) Any information provided to SBA prior to Lender's request for SBA to honor its guarantee shall not prejudice SBA's right to deny liability for a guarantee if one or more of the events listed in paragraph (a) of this section occur.
- (e) Unless SBA provides written notice to the contrary, the Lender remains responsible for all loan servicing and liquidation actions until SBA honors its guarantee in full.

### 3. Evaluating a Denial of Liability.

The decision to deny liability on the SBA loan guaranty requires a thorough review of the facts involved. The decision by SBA to deny liability carries with it the right to defend SBA's position in a court of law.

Before pursuing a recommendation of denial, you must do the following.

- a. Determine that you have sufficient evidence of the wrongdoing by the lender under any one of the reasons for denial stated in the regulations above.
- b. Keep in mind that there does not need to be a monetary loss associated with the lender's actions or inactions in order to sustain a denial of liability. However, if SBA has not been harmed financially, this should be an important factor in the decision whether to deny liability.
- c. All options must be explored to resolve the problem prior to processing a denial of liability. Examples are:
  - (1) Lender corrects deficiencies;
  - (2) Evaluate if a repair is appropriate;
  - (3) Ask lender to voluntarily release SBA from liability on the guaranty; and
  - (4) Be aware of the ruling by the Comptroller General that SBA cannot honor its guaranty when it is aware of the lender's negligence, fraud, or misrepresentation.

Examples include:

- (a) The lender did not perfect the security interest required in the authorization;
- (b) The lender did not disburse loan per use of proceeds in authorization;
- (c) The lender did not properly execute the mortgage/deed of trust, rendering document unenforceable;
- (d) The lender disbursed funds despite knowledge of adverse change in financial condition of borrower;
- (e) The lender released guarantor or compromised the loan without the consent of SBA;
- (f) The lender conferred a preference on itself to the detriment of the SBA loan;
- (g) The lender did not service loan in a manner consistent with prudent lending practices;
- (h) The lender committed fraud or misrepresentation to SBA when recommending approval of the loan; or
- (i) The lender failed to provide timely notice of default which caused serious harm to SBA, including repetitive failure to report the delinquent status of an SBA loan on SBA Form 1502, "Guaranty Loan Status and Lender Remittance Form" (see appendix N).

#### **4. Are There Alternatives to a Full Denial of Liability?**

Yes. The recommendation of a denial of liability should NOT be an automatic response to a problem. The SBA can attempt to reach an amicable adjustment (reduction of the guaranty), or "repair," with the participant as a resolution. Also, sometimes the participant will voluntarily cancel the guaranty.

##### **a. Prepurchase loan adjustments to the guaranty (repairs).Error! Bookmark not defined.**

- (1) Where the issue involves negligence and a sum certain, the field office must discuss the matter with the lender before it can recommend denial. During such discussions, the SBA representatives should explain to the participant the

problems which must be overcome before purchase can be recommended. At the same time, they should seek an insight into the participant's point of view regarding the matter. The SBA must explore every possibility for an amicable and reasonable resolution.

- (2) If you or the participant suggests an adjustment to the guaranty (i.e. a decrease in the SBA's guaranty), the servicing office may purchase on the adjusted basis without referral to Headquarters if the adjustment reasonably approximates the anticipated attributable loss. Any such repair must be authorized by an SBA Form 327. The SBA Form 327 must fully document the findings made in the prepurchase review and contain the comments and concurrence of counsel.

**b. Voluntary release by participant.**

- (1) In some cases, the lender can be induced to release SBA from any further liability under the guaranty. A voluntary cancellation of the guaranty by the lender is preferable to a denial by SBA. Therefore, the SBA should request a letter of release before a denial action is initiated.
- (2) When SBA responds to a letter requesting release, the SBA must advise the lender that SBA's release does not waive any of its preexisting rights or defenses in the event that release is not ultimately consummated. For further details, see the Chapter 9, "Purchasing SBA's Guaranty," in SOP 50 50.

**5. How Do You Determine the Amount of Loss Attributable to the Lender?**

Any denial action based on monetary loss must include an estimate of the loss attributable to the lender's actions or inaction. The basis for the estimate may range from a formal appraisal figure to an educated approximation, depending on the circumstances. Appraisal costs incurred "for this purpose" are a nonrecoverable program expense and, as such, are not chargeable to the borrower. In the SBA Form 327, use the most exact loss figure available and explain how it was determined.

**6. How Do You Handle a Situation of Likely Loss?**

**a. Indeterminable loss prior to purchase.**

Where a substantial, but not total, attributable loss is likely and the SBA has NOT purchased its guaranty, consider encouraging the participant to continue servicing through final liquidation. Agree to negotiate the guaranty adjustments once the actual loss is determined.

**b. Loss established subsequent to purchase.**

Where a substantial attributable loss is likely and the SBA has purchased the guaranty, SBA will rely upon its right to recover damages to the extent of the SBA's resulting loss and any other damages or penalties deemed appropriate. The amount of loss attributable to the lender can be determined while the loan is:

- (1) In servicing;
- (2) In liquidation; or
- (3) When it is finalized, liquidated, or otherwise terminated.

- c. Once the amount of attributable loss is determined, you must request the lender to reimburse SBA for the attributable loss. (Supported by an SBA Form 327.) If this step fails, and further negotiations appear futile, the field office must prepare an SBA Form 327 setting forth the facts in the matter and recommending appropriate action. Refer the action through channels to the Office of Borrower and Lender Servicing in Headquarters.

**7. What are the Field Office's Reporting Requirements When it Recommends Denial?**

- a. The field office must prepare a detailed SBA Form 327 whenever there is serious doubt as to the SBA's legal obligation to honor a demand for purchase.
- b. The report must:
  - (1) Be objective;
  - (2) Be complete, with attachments and exhibits, so that a final determination will be possible after it is reviewed; and
  - (3) Reflect all aspects of the situation, including but not limited to:
    - (a) A clear identification of lender's failure(s);
    - (b) The findings from a review of the documents and lien searches;
    - (c) An estimate of anticipated attributable loss;
    - (d) Details of efforts by SBA and the lender to correct the deficiency(ies);
    - (e) Establishment of the fact that lender cannot or will not correct the deficiency(ies); and

- (f) Comments of each reviewing official, including opinion of district counsel as to the grounds for denial and likelihood for success in court should a resulting denial be contested.

**NOTE:** If district counsel determines that SBA is not legally obligated to purchase the loan, in whole or in part, this decision cannot be overruled at the field level. The issue and the loan file must be referred to the AA/FA for final action based upon legal review by OGC.

- c. The package must include the original and one copy of the SBA Form 327 and must be accompanied by the loan file.
- d. Routing.
  - (1) The full report must be forwarded to the Office of Borrower and Lender Servicing (BLS). The report to BLS must carry the recommendations and signatures of the:
    - (a) Recommending official (liquidation loan officer);
    - (b) Supervisory attorney;
    - (c) Line supervisor (approving official);
    - (d) ADD/ED;
    - (e) District counsel; and
    - (f) District director.
  - (2) During this process, reviewing officials should not hesitate to reopen discussions with the lender (e.g., higher bank level, bank attorney) if clarification is needed or if a release or settlement appears possible.

## 8. Who Has the Authority Within the SBA to Decide to Sue a Participant?

No authority has been delegated below the SBA Administrator to sue a participant. The SBA will, throughout its purchase procedures, retain the right to sue the participant in the event that the participant is later found to have breached the guaranty or participation agreement under which the loan was made. These rights include, but are not limited to, the right to recover the amount paid to lender and/or damages for:

- a. The lender's failure to close, disburse, or service the loan in a reasonably prudent manner;

- b. The lender's noncompliance with SBA rules and regulations or the terms and conditions set forth in the SBA loan documents; and
- c. Fraud, misrepresentation, or negligence.

**NOTE:** The reporting procedures and other considerations for suit against participants are essentially the same as those used for denial actions. However, counsel must consider and comment on all litigative probabilities to ensure that court action would, if taken, have a high likelihood of success.





**CHAPTER 14**  
**BANKRUPTCY PROCEEDINGS**

**1. What Do You Do When a Notice of Bankruptcy is Received?**

- a. Transfer the loan to “in litigation” status if not already done;
- b. Cease all collection/liquidation activities;
- c. Bank/SBA officials must take prompt action to protect the Agency’s interests;
- d. A proof of claim, setting forth SBA’s claim against the collateral and/or individuals, should be filed, if appropriate; and
- e. You should request that counsel file a special request for notice which will ensure all reports filed in the bankruptcy are sent to you.

**2. Who Attends Bankruptcy Hearings?**

Liquidation officers and/or SBA’s legal representative should attend the first meeting of creditors and subsequent hearings. It is important to keep up-to-date on the proceedings.

**3. Is the SBA Representative Required to Attend All Hearings?**

No. If SBA interests will not be affected, or there is nothing of substance to discuss, you do not need to attend.

**4. How Do You Document What Took Place at a Hearing?**

You must prepare a full report, memorandum, or provide other documentation to include:

- a. Details of the matters discussed;
- b. Decisions reached;
- c. Orders issued by the court; and
- d. All other pertinent developments.

**5. How Do You Obtain Possession of Collateral in Bankruptcy?**

- a. You should work closely with the participant or SBA counsel to evaluate collateral.

- b. Counsel should seek “abandonment” or “relief from stay” in any case where there is no equity for unsecured creditors.

**6. What Can Be Done if the Bankruptcy Trustee Insists on Selling the Collateral?**

- a. If a trustee is appointed and insists on selling the collateral, counsel for the Agency/lender may object through an appropriate bankruptcy pleading.
- b. If objection is overruled, monitor the trustee, or the trustee reports, closely for excessive fees or charges which can be disputed when he/she files a request for fees and expenses.

**7. Must SBA Approve Any Sale by the Bankruptcy Trustee?**

- a. No. The Agency may consent to a sale of collateral by the trustee only where:
  - (1) Only where the sale will be advantageous to the SBA; and
  - (2) Only under a written stipulation or court order expressly providing the amount to be deducted from the sales proceeds for administrative costs and expenses.
- b. There may be instances where it makes sense to allow the trustee to sell. This must be documented on an SBA Form 327 and approved by the approving official (line supervisor). You should obtain the comments of counsel on the SBA 327 action.

**8. What Should You Take into Consideration in Deciding Whether You Should Allow the Trustee to Sell?**

- a. Will it avoid delay or other hinderance?
- b. Will it avoid further depreciation and/or vandalism?
- c. Will care and preservation expenses be less?
- d. Will it be more cost effective to use the trustee?
- e. Is hazard, workers compensation, and liability insurance in effect?

The underlying principle is to use the trustee if it costs less and you can obtain the same dollars in a shorter period of time. Remember to allow for trustee fees and trustee attorney fees (e.g., commissions and proceeds for the estate). These costs will be in addition to the normal sale expenses. The recommending official must prepare an SBA Form 327 for consideration by counsel and the approving official. Counsel will prepare any necessary documents required for court approval.

**9. Plans of Reorganization.**

Bankruptcy filings under Chapters 11, 12, and 13 will involve plans for reorganization. You, through SBA's counsel, must begin negotiations from the onset of the bankruptcy. Restructured negotiations are the nucleus from which will evolve a feasible plan to reorganize. If it is not acceptable to SBA, SBA may file its objections to the proposed plan with the court. Determinations to voice an objection or refrain from doing so involve credit/legal considerations which require close interaction between the liquidation loan officer regarding the credit matters and counsel regarding the legal issues.

**a. Objection/no objection to the plan.**

- (1) A "no objection" position may result in a court order to proceed.
- (2) An "objection" will generally result in further discussions and hopefully negotiations.
- (3) These recommendations must be made locally by the recommending official preparing an SBA Form 327 and routing it through counsel and the approving official for a final decision.

**b. Approval of proposed plan.**

Agency approval of a plan of reorganization goes further than a "no objection" position and must be approved by the rule of two.

**c. "Cram Down."**

Even if SBA objects to a proposed plan, it is within the court's discretion to order a "cram down." The line supervisor and counsel may decide whether or not to file an objection or appeal.



**CHAPTER 15**  
**CONTRACTING WITH AUCTION FIRMS**

**1. What is SBA Policy on the Sale of Collateral and of Collateral Purchased (Colpur)?**

- a. The SBA's policy is to offer loan collateral and Colpur for public sale through competitive bids at a "public auction" or "sealed bid sale" unless the property has been acquired through a foreclosure proceeding consistent with State law.
- b. The lender may use negotiated sales if this is their normal practice for non-SBA collateral.

See 13 CFR §120.540 (c) (1)

**2. What is SBA Policy for Hiring Auctioneers for SBA Serviced Loans?**

The SBA must hire only qualified professional auctioneers with good experience and a satisfactory commercial track record to handle its sales.

**3. Why are the Services of an Auction Firm Needed?**

The SBA's defense is strengthened by using a capable and clearly qualified firm should the Agency be challenged as to whether a sale was commercially reasonable. (See Chapter 7, "SBA's Methods of Recovery from Collateral.")

**4. What Qualifications Must an Auction Firm Have Before Being Hired by SBA?**

They should have:

- a. Documented financial strength;
- b. Available full-time staff;
- c. Ability to be bonded, if required. (See paragraph 13, "What are the Requirements for Bonding," in this chapter);
- d. \$1,000,000 liability policy;
- e. Ability to attract well-financed bidders;
- f. Good experience in the type of property being sold;

- g. Facility for storage and conducting sales;
- h. Proper security; and
- i. Equipment moving capabilities.

**5. How Do You Authorize the Use of an Auction Firm?**

- a. You must prepare a 327 action outlining the auction firm to be hired and the expenses associated; or
- b. The information can be outlined in the Liquidation plan which requires recommending official and approving official's signature.

You must document any changes from the requirements outlined in the Master Auctioneer's Agreement.

**6. What is the Minimum Number of Qualified Auctioneers that a Field Office Must Maintain and Use for an SBA Liquidation?**

- a. All field offices must use the services of at least two auctioneers when annual commissions are more than \$50,000.
- b. Field offices must utilize the services of at least three auctioneers when annual commissions are more than \$100,000.
- c. It is strongly encouraged that, as the need for auctions increases, the field offices proportionally increase the number of auctioneers it uses based on the requirements noted above.

**7. What is a Master Auctioneer Agreement?**

This is an agreement between SBA and each auction firm determined to be qualified to sell collateral or Colpur. (See Appendix MM.)

**8. What are the Requirements Maintaining an Auctioneer File for SBA-Serviced Loans?**

- a. Each office is required to maintain a file of all the auctioneers approved, as well as declined with the supporting documentation.
- b. This file must include the Master Auctioneer Agreements.
- c. The file must contain an SBA Form 1307, "Auctioneer Log," for each auctioneer used. You may develop your own computer generated log if it addresses all of the elements

in the current form (see Appendix M) or supply this form to your auctioneers for them to complete and return to the field office. Once you have reviewed the information submitted by the auction firm, it can be placed in the appropriate auctioneer file with no further documentation needed.

- d. All supporting documentation for each auction will be maintained in the borrower's loan file.

**9. What is an Auctioneer Contract?**

- a. This is a contract which must be completed for each sale assigned to the particular auction firm.
- b. The contract is between SBA and the auction firm.
- c. The contract must be filed in the borrower's loan file.

(See Appendix NN, "Sample Auctioneer Contract.")

**10. What are the Auctioneer Responsibilities in Connection With a Sale?**

- a. Attract bidders by proper marketing;
- b. Know the market;
- c. Prepare and present the property for sale;
- d. Conduct and control bidding;
- e. Collect funds;
- f. Oversee removal of sale items;
- g. Provide prompt and full accounting to SBA;
- h. Submit detailed sale report; and
- i. Consult with loan officer on all matters affecting maximum recovery on property to be sold.

**11. What Information Must Be in an Auctioneer's Sale Report?**

- a. Listing of items or lots sold;

- b. Name of successful bidder and bidder number with amount paid;
- c. Original invoices for each expense paid; and
- d. Signed report listing total amount of sale, expenses, commissions (and how computed), and net amount of funds submitted to SBA.

**12. What are the Responsibilities of the Liquidation Staff in Connection With the Auction Sales?**

- a. Review brochures and advertising;
- b. Refer interested buyers to auction firm;
- c. Insure proper viewing time of collateral prior to sale;
- d. Determine need for cleaning, painting, etc., of property;
- e. Monitor sale;
- f. Determine need for and develop a protective bid;
- g. Determine auction firm has systems in place for removal and check out of items sold; and
- h. Prepare a sale report.

**13. What are the Requirements for Bonding?**

- a. The auctioneer is not required to obtain a bond:
  - (1) If anticipated sale proceeds are not expected to be more than \$50,000: or
  - (2) If the amount is more than \$50,000 is paid directly to SBA from the auction proceeds; and
  - (3) The firm has a documented track record of at least 3 years of experience with SBA or a participating lender.
- b. If the auction company does not have the 3-year track record with SBA, a bond in the amount required by State law or \$50,000, whichever is greater, IS REQUIRED on all sales regardless of anticipated sale proceeds.



## CHAPTER 16 APPRAISALS

### 1. What is SBA's Practice on Obtaining Appraisals?

It is SBA's practice to obtain pre-foreclosure appraisals on collateral when the:

- a. Loan is placed in liquidation status, and it appears that collateral will be disposed of to achieve recovery;
- b. Collateral is believed to have significant value;
- c. Collateral is of special purpose in nature; or
- d. Possibility exists that suit will be brought against the remaining obligors for a deficiency balance.

### 2. Why is an Appraisal Needed?

An appraisal must be obtained to make sound liquidation decisions such as:

- a. Determining the method of liquidation;
- b. Granting a request by a borrower for release of collateral; and
- c. Establishing the need for protective bids.

### 3. When Must an Appraisal Be Done?

- a. Negotiated private sales must be supported by at least one appraisal made by a fee appraiser within the past year.
- b. A new appraisal must be completed if the existing appraisal is more than 1 year old.

### 4. When is Using an Appraisal Over 1 Year Old Considered an Exception to Policy?

The use of an appraisal over 1 year old, in the case of a private sale of collateral or Colpur, is an exception to policy and requires Headquarters approval.

(See Chapter 7, "SBA's Method of Recovery from Collateral," and Chapter 11, "Collateral Purchased (Colpur) by SBA and Lender.")

**5. How Many Fee Appraisers Should Your Office Obtain?**

Whenever possible, you should obtain more than one appraiser. When fees paid to appraisers will be more than \$25,000 a year, you should obtain the services of at least two appraisers.

**6. From What Groups Can You Select a Fee Appraiser?**

- a. Local professional appraisal organizations;
- b. Local auctioneers; and
- c. State-certified or licensed appraisers.

The Agency encourages the use of state licensed or certified appraisers whenever it is practical and appropriate.

**7. How is the Employment of a Fee Appraiser Documented?**

Employment of a fee appraiser should be documented by a:

- a. Contract for Appraisal Report (See appendix PP); and
- b. A 327 action outlining all information regarding the:
  - (1) Proposed appraisal;
  - (2) Fee to be charged;
  - (3) Type of report; and
  - (4) Values which will be provided, e.g., piecemeal, going business.

**8. Is a Pre-Payment Review Necessary?**

Yes. You should review the:

- a. Bill for comparison with prevailing local rates; and
- b. Report for content and quality.

The signature authorizing payment will document that work was performed in a satisfactory manner.

**9. What is the Procedure for Paying Appraisal Expenses?**

Payment will be made through the on-line Care and Preservation of Collateral (CPC) Payment System using the procedures outlined in the SBA-DCS User Manual.

**10. What Other Services can Be Obtained by Using the Same Basic Criteria as with Fee Appraisers?**

You may obtain other related services on a fee basis which could include:

- a. Architects;
- b. Project engineers;
- c. Surveyors;
- d. Hazardous waste assessment firms; and
- e. Environmental audit services.

**11. What Type of Collateral Could Be Valued Using a “Desk Estimate?”**

- a. When you are working on a servicing or liquidation matter involving equipment of a general purpose type, a “desk estimate” may be acceptable.
- b. Collateral identified as “general purpose type” could be:
  - (1) Automotive equipment;
  - (2) Office equipment; and
  - (3) Any general purpose property with values available from general references, catalogues, or common knowledge.

**NOTE:** A desk estimate should be the Agency’s last choice. A liquidation officer along with the Agency assumes a lot of responsibility by performing this evaluation, if the Agency is challenged on the value. For this reason, only senior liquidation officers must be used to perform such evaluations.

**12. What Steps Should Be Taken to Complete a Desk Estimate?**

- a. The following information should be prepared:
  - (1) A 327 action stating the reasons for the desk estimate rather than an actual appraisal;
  - (2) A columnar listing of major items of collateral;
  - (3) A statement as to the condition of each item of collateral; and
  - (4) A column to the right of the listing for the values to be placed.
- b. This information should be provided to the senior liquidation loan officer to insert the reasonable values based on their background knowledge and the information at hand.

**13. Should the Liquidation Loan Officer Perform the Desk Appraisal and Handle the Sale or Develop the Protective Bid?**

No. However, If the liquidation loan officer must perform the evaluation and conduct the sales activities, the line supervisor must review the liquidation loan officer's work to minimize potential conflict of interests problems.

**14. How Should You Handle Potential Dispute Situations?**

If you have an irate or noncooperative borrower, an appraisal should always be obtained from an appraiser who can qualify as an expert witness.

## CHAPTER 17 COMPROMISE ACTIONS

### 1. What is the Authority to Compromise?

The SBA can compromise a debt (that is, it can accept less than the full amount owed on a debt) based on the authority contained in the following statutes and regulatory sources:

**a. Section 5(b) of the Small Business Act.**

Section 5(b) of the Small Business Act gives the Administrator authority to effect compromise settlements.

**b. The Federal Claims Collection Act.**

The Federal Claims Collection Act (31 U.S.C. 3701 and following), provides a means for the settlement, adjustment, and compromise of claims by Federal agencies.

**c. 4 CFR § 183.**

4 CFR § 183 prescribes standards for the compromise of claims under the Federal Claims Collection Act.

### 2. What is the General Settlement Policy?

**a. Terms “compromise” or “settlement.”**

The terms “compromise” or “settlement” can be used interchangeably or together to mean the resolution of a debt for less than the amount due through mutual agreement between debtor and SBA.

**b. Obligor does not have the ability to make full payment.**

When it is known that the obligor does not have the ability to make full payment, it may be appropriate to settle for less than the full amount due. However, when the liability of the obligor is clear and the Government can collect fully without protracted litigation (or large unrecoverable expenses) there is little basis to settle for less than what is owed.

**c. Compromised/settlement amount.**

It must bear a reasonable relationship to the estimated net present value of the projected amount of recovery available through enforced collection.

**d. Factors in assessing debtors ability to pay.**

- (1) Health and life expectancy;
- (2) Local economic conditions;
- (3) Present and potential income;
- (4) Equity in pledged or reachable assets;
- (5) Possibility of assets being improperly transferred or concealed by debtor; and
- (6) Applicable exemptions available to debtor under State and Federal law.

**e. Debtor assistance.**

Active cooperation by the debtor may have substantially enhanced recovery. This should be recognized in the settlement analysis.

**f. Benefits to others.**

A compromise proposal which may also benefit junior lienholders is permissible when the benefits to the SBA are significant and there are no better alternatives.

**g. Prompt action.**

- (1) You need to initiate the compromise process within 3 months after a deficiency has been established.
- (2) The SBA Form 327 is to be completed promptly after receipt of the required materials necessary for consideration of the offer.

**h. Documented recovery efforts.**

The file must show that efforts to realize recovery on the assets and to compromise have been made.

**i. Charge off.**

The charge off of an account having substantial equity in reachable assets is NOT an acceptable alternative.

**3. Compromise Attempt.**

The SBA must attempt to reach a compromise settlement with obligors prior to commencement of foreclosure actions against their personal residences or the referral to DOJ for such actions. This is applicable in all cases no matter how the lien originated.

**4. Fraud or Misrepresentation.**

- a. An offer in compromise cannot be accepted if the Agency has knowledge of fraud, substantial misrepresentation, or financial dishonesty on the part of the offeror.
- b. Settlement of claims involving these issues is reserved for the DOJ.

**5. “Rule of Two” Authority.**

- a. Loan officers must justify and explain compromise actions using standard the SBA Form 327 format with appropriate supporting documentation indicating the benefit to the borrower and/or to the Agency. Legal involvement is required as indicated.
- b. **District offices, branch offices, disaster home loan servicing centers, Santa Ana Disaster Loan Servicing and Liquidation Office, commercial loan servicing centers.**

Field office staff may take the following actions by rule of two

- (1) Compromises of interest accrued or adjustment of interest rate:
  - (a) Waiving any amount of accrued interest;
  - (b) Retroactively reduce the applicable interest rate down to and including zero (no interest accrual) for any time period; and
  - (c) Reductions in interest rates for future time periods (limited or indefinite) down to and including zero (no interest accrual).
  - (d) Review by counsel is required if loan documentation is altered.

- (2) The sale of notes, waiving all or a portion of the interest accrued (see below for adjustment of the principal balance).
  - (3) Negotiated sales of Colpur acquired through foreclosure proceedings consistent with state law (and Colpur with a market value of less than \$25,000 acquired through a deed in lieu of foreclosure) can be approved by the rule of two. Legal review of the sale documentation is required.
  - (4) These procedures and authorities for the compromise of accrued interest or the adjustment of the interest rate also apply to “going business” loans.
  - (5) Legal review is required in order to permit comment on legal implications of the recommended action.
- c. **District offices, Santa Ana Disaster Loan Servicing and Liquidation Office**, by the rule of two, can approve compromises of principal amount of \$500,000.
- (1) This authority level is determined by the principal amount forgiven rather than by the principal balance outstanding on the account. (for example, the net outstanding principal balance that would be remaining after the proposed compromise offer is applied to the current principal balance.)
  - (2) Legal review is required in order to permit comment on legal implications of the recommended action.
- d. **Branch offices**, by the rule of two, can approve compromises of principal amount of \$300,000.
- e. **Disaster home loan servicing centers**, by the rule of two, can approve compromises of principal amount of \$100,000.

NOTE: The authority noted in items “a. - e.” of this paragraph also applies to the sale of a note or other evidence of indebtedness for less than the full principal amount due the Agency. Field offices must submit compromise recommendations (rule of two with comments of counsel) involving the forgiveness of outstanding principal more than of the above amounts to the Headquarters Claims Review Committee for final action.

- f. **District offices, branch offices, disaster home loan servicing centers, Santa Ana Disaster Loan Servicing and Liquidation Office** may approve compromises of any size recommended for acceptance by DOJ (including “going businesses”) by the rule of two with legal concurrence for the following.



- (1) Compromises when obligors are in bankruptcy or in litigation under the administrative control of the Department of Justice.

U.S. Attorneys offices have been delegated authority to settle cases involving claims of \$1 million principal (plus any accrued interest) or less, if the referring agency concurs with the settlement.

- (2) For claims more than \$1 million, the approval of the Commercial Litigation Branch of the Civil Division, Department of Justice in Washington D.C., is required.

NOTE: If SBA disagrees with the U.S. Attorney's decision on cases within the delegated authority, the matter must be referred to the Commercial Litigation Branch of the Civil Division, Department of Justice in Washington D.C. for resolution.

**6. What is the Headquarters Claims Review Committee (HCRC) and What Actions Can it Take?**

**a. This committee is comprised of:**

- (1) Assistant Administrator for Borrower and Lender Servicing (Chair);
- (2) Director of the Office of Loan Programs;
- (3) Associate General Counsel for Litigation; or
- (4) Their designees.

**b. The HCRC is authorized to:**

- (1) Sell a note/loan or other evidence of indebtedness owed SBA for less than the principal amount due, upon unanimous vote of its members;
- (2) Compromise an Agency claim against a going business for any principal balance amount, upon unanimous vote of its members; or,
- (3) Release a claim against an obligor in any amount, upon unanimous vote of the members.
- (4) Hear appeals of any decision made by the HCRC, made by the requester to the AA/FA.

- c. Field offices must send these loans to HCRC along with their recommendations (rule of two) with comments of counsel.

## 7. What are the Compromise Procedures?

Early recognition, by all parties, that a compromise settlement is a likely occurrence can lead to greater borrower cooperation and a greater recovery from the business assets. The most knowledgeable person regarding the business assets is the borrower. An honest relationship between the liquidator and the borrower will go a long way towards avoiding unpleasant surprises and the eventual settlement of the debt. You must not make any promises to the borrower. Ordinarily, do not begin formal discussions before the business collateral has been liquidated.

### a. Fact finding.

Once the business assets have been liquidated, you must obtain sufficient evidence to evaluate the obligors ability to pay the remaining debt. Included are financial statements completed under penalty of perjury. Where it appears that the obligor cannot pay, give them an:

- (1) SBA Form 770, "Financial Statement of Debtor;" and
- (2) SBA Form 1150, "Offer in Compromise."

(See Appendix K for these forms.)

- b. Hopefully, the compromise procedure will result in an amicable, reasonable and timely resolution of the obligation. You must not assume the obligor(s) know(s) the Agency procedures and must strive to make sure they:

- (1) Are aware of their continuing liability and that any compromised debt will be treated as income with the IRS (1099-c);
- (2) Are told a compromise settlement is a privilege, not a right;
- (3) Are advised that they must make full disclosure of all assets and liabilities and SBA reserves the right to make such confirmation or appraisals as it deems necessary, either directly or through third parties;
- (4) Understand the concepts of "ability to pay" and "recoverable through legal means," and convey to them our intent to arrive at a figure which is reasonably comparable to the amount achievable if enforcement action were employed;
- (5) Agree to a date for submission of the completed forms and documentation;

- (6) Will receive a letter from you summarizing your discussions, which will document the file and aid in avoiding misunderstandings; and
- (7) Are not told “proposed amounts” which “might” be acceptable, at the initial review.

**c. When should you negotiate an amount to be used as the basis for a settlement?**

**(1) Extensive negotiation.**

Extensive negotiation is not advisable when the decision is based on the debtor’s ability to pay. First, obtain full disclosure of the individual’s situation and then make an objective determination based on the information provided. However, if the borrower does not make an adequate offer, you should discuss it with the borrower with the intent to obtain an acceptable offer.

**(2) Litigative probabilities.**

Litigative probabilities involving issues as to the actual liability of the debtor should be thoroughly explored. The degree of doubt coupled with the potential expense and time involved in pursuing the matter will generally determine the acceptable amount for a settlement.

Counsel must be consulted in these matters.

**(3) Summary rejection.**

Summary rejection of a written or oral proposal is an allowable method to further negotiations.

**(a) Verbal proposals.**

Verbal proposals lacking merit can be rejected by the recommending official (liquidating official) in favor of obtaining a formal compromise proposal.

**(b) Written offers.**

Written offers grossly lacking merit can be rejected by the recommending official but the offeror must be given a reasonable opportunity to increase the offer.

(c) **Department of Justice (DOJ) referrals.**

A DOJ referral (e.g. an offer submitted by them) cannot be summarily rejected. You must obtain legal concurrence and submit each proposal to the approving official before any final, official response is made to the DOJ regarding the offer. (See paragraph 13, "Compromise Proposals Received from the Department of Justice.")

(4) **Counter offer.**

If you decline an offer in which full disclosure has been made, you are generally obligated to propose an amount which could be found acceptable. You should reflect this amount in the SBA 327 report. This offer should be left open for a period of time (e.g. 90 days from date of notice) and if consummated within this time would not have to be approved further.

(5) **Declined offer.**

What do you do if the offer is declined?

- (a) You should begin immediate negotiations to obtain a better offer.
- (b) If the compromise must be submitted to the HCRC, you can put forth a "probably acceptable" range. Take care not to make a commitment since only the HCRC has the authority to commit the Agency for releases of claims more than \$500,000 principal. (See paragraph 1, "Definitions" in Chapter 4, "General Guidelines for Liquidation Activities," for the definition of the term "Claim Amount.")
- (c) You can provide a more complete write up where you feel information was not fully presented.
- (d) Proceed with other recovery options when it is apparent no "deal" will be possible.

**8. The Compromise Package.**

The borrower must submit an offer in writing accompanied by the appropriate supporting documentation to be accepted for processing and presentation to reviewing officials and/or the HCRC.

**a. Information needed from the obligor(s).****(1) SBA Form 1150, Offer in Compromise.**

You must obtain an SBA Form 1150, "Offer in Compromise", containing the offer and signed by each person making the offer. Offers submitted in some other format are only acceptable if the document makes reference to 18 U.S. Code 1001 (false statements) in a fashion similar to that of the SBA 1150.

**(2) SBA Form 770, Financial Statement of Debtor.**

(a) The SBA 770 is a balance sheet and statement of income and expenses which covers each obligor for the most current year. SBA 770 or the equivalent must be used. Signed copies of Federal income tax filings are acceptable for the income and expense requirement. On DOJ referrals Form DJ-35, "Financial Statement of Debtor," may be used. A supplement to Form DJ-35 should be obtained to show pending inheritance or trust data.

(b) For "going business" loans, you must request current interim and last year end financial statements. Consolidated financial statements must be provided if there are affiliates. (See Paragraph 17-12, "Compromise Involving a Going Business," for additional clarification of this procedure.)

**(3) Obligor's beneficiary status.**

A statement must be made of each obligor's beneficiary status under pending inheritance or established trust.

**(4) Source of funds statement.**

Disclosure must be made by each obligor regarding the source of the funds for the offer. Where loans are involved, the collateral for the loan must be specified.

(5) **Reference.**

The face of each supporting document must make reference to its being a part of the SBA 1150.

**b. Needed from the liquidation officer.**

- (1) You need the concurrence of the participating lender whenever possible.
- (2) You need the asset values and income claimed by the obligor and must be verified. This is an established credit practice and relies on a number of sources:

- (a) Reports from credit reporting bureaus; and
- (b) Current Assets and Income Report.

- (3) You need the Dwelling Property Report:

- (a) Discussions with the lender, local realtors, appraisers, and county assessors; and,
- (b) Viewing the assets by the liquidation officer.

A copy of the value verification documentation should be part of the compromise package.

- (4) You need the analysis comparing the original balance sheet (submitted with loan application) and the statements now submitted with the compromise offer, with an explanation as to the disposition of any significant assets which are no longer on the current statements. Major changes should be discussed in detail along with any suspicious transfers of assets.
- (5) You may need appraisals where the value of a significant asset is in question and the difference(s) in value may affect decisions to be made on the compromise. (See Chapter 16, "Appraisals.")
- (6) You must assess the obligors' ability to pay.
- (7) You need comparisons of the new financial information with the previously submitted data in the loan file. Especially review the original personal financial statement submitted with the loan application and compare it with the one now being submitted. Make direct comparisons between major assets owned at that time and the assets now owned. Likewise, review the liabilities

owed then with what is now owed. The obligors need to be contacted for clarification of any major unexplained differences between these statements.

**9. Assessing Obligor’s “Ability to Pay.”**

The adequacy of a compromise offer must begin with an evaluation of the assets of the obligor(s). The starting point is ordinarily the net present value of the forced sale value of such assets (not the loan balance). This value combined with the prognosis of the obligors’ earning power form the basis for determining the adequacy of the offer. The review must balance the right of the Government to collect the amount owed and the obligation to treat all obligors with dignity and fairness.

The following is a list of areas for consideration in assessing the obligor’s ability to pay.

**a. Forced sale equivalent (liquidation value).**

- (1) The basis for this value is normally the amount recoverable from the sale of the assets within a limited period of time (auction type sale). Also to be considered, is the time and expense needed for the Agency to gain control of the asset. In the absence of other available criteria, the following general guidelines should be used as a percentage of market value. An additional deduction of 5 - 10 percent for other expenses should also be considered to establish a realistic forced sale equivalent.

Real Property:

Commercial .....	75%
Residential .....	80%
Unimproved Land.....	50%

Business Assets:

Machinery/Equipment .....	50%
Accounts Receivable/Inventory.....	20%
Furniture/Fixtures .....	10%
Leasehold Improvements.....	5%

- (2) The Claims Collection Act and the GAO standard provide that consideration be given to the time and monies involved with enforced collection to establish a discounted forced sales figure. The forced sale equivalent value needs to be adjusted for the following types of expenses.

Court costs, filing fees;

- (a) Prior liens, taxes, assessments;

- (b) Costs of sale (auctioneer's fees, advertising, lotting, and clean up costs);
- (c) Time of SBA employees (financial, legal, clerical, and administrative);
- (d) U.S. Attorney costs (professional, administrative, out of pocket);
- (e) Possibility of protested litigation or of bankruptcy and related expenses;
- (f) Time mandated by State redemption periods and the cost (depreciation, vandalism, insurance risks) that may result from such delays;
- (g) Care and protection expenses pending resale;
- (h) Extraordinary expenses of eviction, repairs to property, vandalism;
- (i) Costs necessary to bring property to marketable condition;
- (j) Transportation/travel costs; and
- (k) Discount reflecting the present value of future net recovery.

**b. Non-reachable assets and income.**

There may be items which are utilizable to the obligor(s) and have substantial value but are beyond the reach of the Government. The facts of the situation should enter into the Agency's assessment of the obligor's good faith.

**c. Jointly owned property.**

Special problems are encountered when the obligor shares ownership with another of an asset. This, by itself, is not sufficient reason to disregard the asset as having no value. The situation must be closely examined to determine (even to the extent of hiring appraisers and consultants) if the potential value of the property warrants further action.

**d. Individual asset valuations.**

Each worthwhile asset owned by the obligor needs to be assessed. Estimating the values of these assets is not an exact science but the Agency needs to have a uniformity of approach.



(1) **Cash.**

You should only be concerned with cash in amounts substantially in excess of basic living expenses as determined from the SBA 770. Special accounts (IRA's, Keoghs, trust accounts) should be valued net of early withdrawal penalties and other costs.

(2) **Cash surrender value (CSV) of life insurance.**

You should determine the net amount receivable under the terms of the policy. Loans outstanding and other costs may also have to be subtracted out. The policy must often be surrendered in order to receive the CSV. The loan value should be used for analysis if surrendering the policy would leave the family with inadequate protection. This approach is to be used even if the Agency is acknowledged as assignee in the insurance company's home office.

(3) **Accounts/notes receivable.**

The size, age, and collectibility of these assets need to be examined to determine their worth. Typically they have little forced sale value. Ordinarily only large receivables should receive much attention.

(4) **Furniture, fixtures, and other personal effects.**

These are normally not worth very much. Efforts spent in other areas will yield much better results. You will assign a nominal value to the contents of a modest home for compromise situations. If such assets are subject to an Agency lien, the lien may be realized for nominal value or the assets may be abandoned if no such release is possible.

(5) **Jewelry, paintings, antiques, and collections.**

When items in these categories have been assigned substantial value, they should be given special attention. Outside sources may have to be utilized to determine meaningful values on these specialty items.

(6) **Automobiles.**

Automobiles have a ready market and various published books give a handy reference as to value. Gross compromise value "rule of thumb" is 80 percent of loan value. Of course prior encumbrances must be deducted to determine the net compromise value.

**(7) Securities.**

The value of stocks and bonds in publicly traded firms are easily ascertained and can quickly be converted to cash. Ownership interest in firms with closely held corporate stock and in unincorporated firms present much greater valuation problems. Each situation is considered using the best judgment available. If substantial potential worth is apparent, obtain a valuation analysis by a chartered financial analyst or some other qualified person.

**(8) Other assets.**

Common carrier rights, copyrights, liquor licenses, patents, inheritances, and trusts are the types of assets that can be worthless or have substantial value. Confer with counsel regarding local laws and their effect on these assets. The establishment of values for these assets must rely on a reasonable assessment of the circumstances in each case.

**(9) Real estate.**

This is often the asset having the largest value on the balance sheet. For income producing or commercial properties, it is desirable to use a member of a nationally recognized appraisal organization.

(a) For the average residence, some of the acceptable alternatives are:

- i. A "Property Report" by a recognized reporting service;
- ii. A written evaluation from a local realtor (with Multiple Listing Service (MLS) comparables);
- iii. A report from a residential appraiser used by Farmers Home Administration (FHA), Veterans Administration (VA), or other established mortgage lender; or
- iv. Any other local source you may have of similar reliability.

(b) These reports usually furnish the market value of the property. This is not sufficient for our purposes. The following must be weighed:

- i. State redemption periods, homestead exemptions, and the like.

These can substantially delay or negate our ability to get the property: consult with counsel if you have any questions on the impact of this type of legislation. The value analysis must consider the recovery impact of local laws.

ii. Policy regarding primary residence.

Both the DOJ and SBA have strong positions regarding foreclosing on homes. For SBA, a foreclosure action must be considered only as a very last resort. Concerted settlement efforts must first be attempted, and fully documented in the loan file. Similarly, the DOJ will not, as a matter of policy, proceed if a reasonable settlement is at all possible or if the result will cause a cooperative debtor a severe hardship. This policy is consistent with the Claims Collection Act which says that a compromise settlement must be attempted before steps are taken to deprive obligors of their residences.

(See paragraph 10, “Special Handling of Loans where the Borrower is Willing but Unable to Pay,” in Chapter 5, “Problem Loans and Workout Situations.”)

e. **Determinations regarding applicable liabilities/liens.**

Once an evaluation of assets has been made, attention should be shifted to the liability section of the balance sheet. Large new obligations should be reviewed to determine how they came about and how they are secured.

(1) **Debts with senior liens.**

Debts with senior lien positions decrease our equity in the property. If the debt is legitimate and properly perfected it may well eliminate any interest the Agency has in the asset. Junior liens may represent a potential purchaser of the property.

(2) **Unsecured debts.**

Unsecured debts do not affect our interest in assets when the Agency is properly perfected but they are an impediment to the obligors ability to pay. They could lead to a filing of bankruptcy.

(3) **Debts to relatives/close associates.**

Particular attention should be shown to large recent debts of this nature. The debt may encumber assets that would otherwise be available to SBA. You must verify that such debts are real and were created at “arms length.” A written explanation detailing consideration given for the debt, value of security, and date pledged should be made.

**f. Evaluation of income.**

The primary basis for a compromise settlement is the present value of the net realizable equity. However, consideration must be given to the income (present and prospective) of the obligor(s). The concern is not income needed for ordinary living expenses, but that which is significantly in excess of what is needed. There are no hard and fast rules, rather it is the good judgment of the recommending and reviewing officials which will decide each case on its own merits.

**(1) Trust income.**

Substantial income arising from trusts or other fixed source when combined with regular income providing cash flow substantially in excess of normal living expenses are to be reflected in compromise considerations. A copy of the trust must to be obtained and reviewed to make a determination as to its availability.

**(2) Lottery and other prizes.**

No weight will be given to this possibility in evaluating income potential.

**g. Term settlements.**

A cash settlement is the preferred method in compromising a debt. This is not always possible and individual circumstances may dictate a term offer to be most appropriate. Items to consider on term settlements are as follows.

**(1) Time limits.**

Terms should not exceed 5 years. No balloon is permitted on settlements based solely on the potential earnings of the obligors. Where based on the value of residential real estate, a balloon is permitted. You must be sure to properly secure the collateral used in a term settlement.

**(2) Present value.**

The present value of a proposed term settlement should always be calculated using a discount rate reflecting interest rate, term, and recovery prospects. A cash amount within 10 percent of the present value should be obtained from the obligor if possible. If both cash and terms are offered and the term offer does not exceed the cash by 10 percent, take the cash offer.

(3) **Reinstatement of original debt.**

A provision for the automatic reversion to the entire original claim upon failure to reasonably satisfy the repayment requirement must be included in each term compromise settlement. This is also the time to include any allowable local remedies such as confession of judgment which can be included in the settlement agreement.

(4) **Interest rate on term settlements.**

There is no requirement that term settlements bear interest. The reviewing official has the authority to set a reasonable interest rate. When interest is included in the settlement agreement, payments must exceed interest accruals.

(5) **Hardship Term Arrangements.**

Special consideration may be given to the acceptance of a term compromise with a delayed first payment of up to a year when:

- (a) The only worthwhile equity is in residence;
- (b) The family depends on retirement benefits, welfare payments, or other limited income for sustenance; or
- (c) The obligor-residents are in poor health, have limited life expectancy, or low earnings potential.

(See Chapter 5, "Problem Loans and Workout Situations.")

(6) **Recording term settlements.**

- (a) Use SBA Form 515, "Note Receivable Report," when a periodic payment plan is contemplated.
- (b) A new note is usually not required since the compromise agreement itself will ordinarily suffice. Check with counsel.
- (c) An SBA 327 authorizing the term settlement is distributed in the usual manner with an SBA 515 attached.
- (d) When appropriate, the loan balance can be charged off with instructions that it not be included in the various referral processes (collection agencies, IRS).

(7) **Servicing term settlements.**

Service the account as any other. The approving official cannot reduce the gross amount of the compromise, but is able to authorize reduced payments or other relief if needed to carry out the basic intent of the agreement. However, when payments are not made reasonably as agreed, the full amount owed can (if permitted by the agreement) be reinstated and pre-compromise enforcement proceedings resumed.

(8) **Completion of term settlement.**

Upon successful completion of the term settlement, SBA must release all applicable liens.

**10. Preparation of the Compromise Report.**

Once all the necessary information is provided and negotiations have produced a “final” offer, the liquidation officer prepares a report on the proposal using an SBA 327. (See Appendix AA, “Recommended Compromise Report Format.”) The format allows for consideration of the major points in a uniform manner and should be followed to the extent practical and appropriate to the case at hand. Points are to be expanded or cut back depending on the complexity of the matter. An offer that provides for a recovery to SBA which is reasonably related to the present value of the net amount and obtainable through enforced action should be recommended for approval. One that does not meet this standard should be declined.

a. **Attachments.**

Include as attachments to the compromise package copies of the financial data submitted by the obligor and copies of verification documents (credit reports, appraisals, etc).

b. **Recommendations.**

For the purpose of follow up actions the following tasks must be completed separately.

(1) **Charge off.**

A separate SBA 327 recommending charge off must be prepared as a single action report.

(2) **Term compromise.**

A new SBA 327 must be prepared to detail the terms of the note receivable. A copy of this form and an SBA 515 must be sent to OFO.

c. **Multiple debts.**

Obligors having more than one SBA related debt to compromise should be treated in one combined comprehensive report. Copies of this report must be placed in the loan files for each obligation.

d. **Final action taken by HCRC.**

- (1) Four complete copies must be forwarded to the Office of Borrower and Lender Servicing in Headquarters.
- (2) Do not forward the loan file unless requested to do so.

e. **Completing the action.**

Once the compromise is approved, the recommending official will ensure that the steps are promptly taken to finalize the action.

(1) **Application of funds.**

Obtain the settlement funds as quickly as possible and apply them to the principal balance.

(2) **Lump sum.**

Apply using Transaction Code 305, Collection on a Loan, Collections from the Liquidation Process.

(a) **Charge offs.**

Apply using Transaction Code 385, Other Receipts, Recovery on Loans Charged Off - Principal First.

(b) **Term settlements.**

St up as a note receivable and apply funds as called for in the agreement.

**(3) Release of documents.**

Once the agreed upon settlement amount is made in certified funds, the appropriate documents can be released depending upon whether the compromise is in full satisfaction of the outstanding debt or for release of one obligor only.

The line supervisor must prepare a memo to the collateral cashier:

- (a) Authorizing the release; and
- (b) Including the supervisory attorney's opinion that this release will not adversely effect any further avenues of collection (e.g., pursuit of other guarantors, assignment of proceeds from a pending law suit).

**(4) Deficiency balances.**

If the compromise action represented the last available means of recovery, the deficiency balance needs to be charged off. Proper instructions must be entered into the SBA database in Field 73 of LAUD 13 so the account will NOT be included in various post charge off automated collection initiatives (e.g. IRS Offset or referral to a collection agency).

**11. Compromise During Insolvency Proceedings.**

- a. The Agency has delegated authority to the field office to take final action on proposals to settle Agency claims of any size which are in bankruptcy or are under the administrative control of the U.S. Department of Justice.
- b. Field offices may resolve negotiations in the following forums.

- (1) Approval of a proposed plan.
- (2) Objection/no objection to a proposed plan.

It is intended that decisions on these matters be made through agreement between the liquidation and legal divisions.

- (3) Cram down.

The SBA's reaction to a court ordered "cram down" can be decided by the line supervisor and counsel. They may determine whether to enter an objection or appeal.



- (4) Personal guarantors;

Directed action by the Court regarding a business loan will generally not affect the Agency's rights against obligors. Check with counsel.

**12. Compromise Involving a Going Business.**

- a. Only the HCRC has authority to settle a claim of the Agency against a "going" concern EXCEPT for the following which can be handled under the rule of two:
  - (1) Bankruptcy or when the claim is under the administrative control of the United States Department of Justice (concurrence by counsel is required); and/or
  - (2) An adjustment to accrued interest on a "going business," including a retroactive reduction of interest rate.
  
- b. It is NOT the policy of the HCRC to approve settlements on any going concern loan unless the firm:
  - (1) Has settlement arrangements with other creditors;
  - (2) Has made full disclosure;
  - (3) Has proposed a settlement which is clearly in the best interests of the Government; and
  - (4) Will not be able to continue to operate under its current debt structure.
  
- c. **Definition of a going concern/business.**
  - (1) The term "going business" refers to situations where the business is still in operation and under the same ownership.
  - (2) A business is still classified as a going concern for compromise purposes when the legal structure has changed as long as the ownership is essentially the same (e.g. ownership changes from a corporation to a partnership and the principal owners remain the same).

**d. “Informal” arrangements with creditors.**

These will encompass the major creditors within a plan developed by or between a creditors committee, trade association, law firm, or the like. They must involve binding written agreements between the creditors of any worthwhile size and represent the best credit consensus of these major parties at interest. A good informal arrangement would not have a court’s sanction but would, have results that are similar to the results likely to be obtained through a court ordered arrangement.

**e. Special considerations.**

A settlement proposal made to the major creditors may receive positive consideration by SBA only if the following criteria are met.

(1) Collateral values must be protected.

Where the settlement consists of a cash payment the payment needs to be at least as large as the net amount which would be received if the collateral were sold (appraisal needed). If terms are proposed, existing collateral and guarantees must be retained to support the settlement agreement.

(2) Percentage settlements.

When you consider a compromise with a going concern, your figures should be based on the estimated liquidation recovery of the pledged assets and then on a percentage of the remaining unsecured portion of the loan. The percentage approach for compromising the loan should only be used on the unsecured portion.

(3) Equality of treatment.

It is expected that the offer to the Agency will be at least equivalent to what is offered other creditors of the same class.

(4) Conditional acceptance.

The Agency’s acceptance of the plan will be conditioned upon the like acceptance of the other creditors needed to make the plan work. In effect, all the major creditors need to be in agreement for the plan to succeed.

(5) Collateral improvement efforts.

Full consideration must be given to the possibility of obtaining additional collateral. Improving our security position is important in reaching a favorable decision in a “going” business settlement.

(6) Appreciation sharing.

In exchange for forgiving debt at the present time, the obligor may be willing to permit SBA's sharing in potential future earnings or appreciation. Give consideration to the following:

## (a) Assignment of stock.

The SBA can take a passive assignment of corporate stock. Ordinarily this will contain the provision that the stock be sold back to the firm or some third party within a set period of years.

## (b) Profit sharing.

The possibility of profit sharing over a set period of years may be incorporated into a settlement agreement. The agreement should call for audited financial statements and significant noncompliance penalties, up to and including reinstatement of the debt.

## (c) Appreciation Sharing Agreements.

Where the firm has assets which may substantially increase in value, consider the possibility of entering into a "Shared Appreciation Agreement." (See appendix V.) Counsel must review the agreement.

**13. Compromise Proposals Received from the Department of Justice.**

When a claim is being handled by the Department of Justice (DOJ), the authority to accept or reject a compromise offer is invested in the Attorney General. Authority is delegated down to the U.S. Attorney level on claims up to a certain dollar amount. The DOJ requests the recommendation of SBA in most cases, and usually give such recommendations great weight. The DOJ, Civil Division, directive requires that the Agency must be consulted with respect to any significant proposed action.

**a. Response time.**

All requests for a response from the field office must be responded to within 10 working days to the DOJ. An extension of time should be requested from the office which sent the offer if additional time is needed.

**b. Final action authority.**

In all accounts referred to DOJ, final authority rests with DOJ.

**c. Coordination with the U.S. Attorney.**

Supervisory counsel will be the responsible point of coordination for all matters involving SBA accounts being handled by the DOJ. Internally, within SBA, counsel will handle legal matters, and the program side (Liquidation Division) will deal with credit matters.

**d. Direct proposals.**

A compromise proposal received by SBA directly from an obligor on a loan being handled by the DOJ must be photocopied and forwarded to the responsible U.S. Attorney. With this proposal, you will advise DOJ that SBA is preparing a recommendation.

**e. Advise of SBA determination.**

The SBA's recommendation will be provided to the U.S. Attorney together with advice of any special considerations and problem areas.

**14. Reduction/Elimination of Interest Rates or Accrued Interest.**

Interest rate reductions must be fully documented by an SBA 327. The approval levels vary with the situation.

**a. Correction of errors.**

The line supervisor has authority to approve actions to correct mistakes and accounting/calculation errors involving interest rates or interest accrual levels (SBA 327 needed).

**b. Reductions of interest rate (down to and including no interest accrual).**

These actions can be approved by the rule of two as indicated in this chapter in the paragraph on the "Rule of Two" authority.

**c. Retroactive interest rate reduction.**

This involves the elimination or reduction of interest which has already accrued on a loan. These reductions can be handled by the rule of two as indicated in paragraph 5, "Rule of Two' Authority," in this chapter.

## CHAPTER 18 CHARGE OFF PROCEDURES

### 1. What is SBA's Policy Regarding Charge Off Accounts?

The SBA's policy is to be diligent and thorough in its collection of debt and to promptly charge off all uncollectible accounts.

The charge off status will more accurately reflect the status of the individual account and the Agency's entire portfolio.

### 2. Definitions.

#### a. Administrative costs.

Costs which have been incurred through enforced collection such as time, travel, and other out of pocket expenses.

#### b. Charge off.

- (1) Charge off is the process by which SBA recognizes a loss and removes the uncollectible account from its active receivable accounts.
- (2) A charge off does NOT affect SBA's rights against any obligor nor reduce the SBA's ability to proceed with any available remedy.

#### c. Miscellaneous receivables.

These are funds owed to the SBA from participating lenders. They may represent lender's share of care and preservation expenses, borrower's returned checks when the Agency was servicing the account or other unremitted fees.

#### d. Partial charge off.

A partial charge off is the process of writing off a portion of the loan balance. The amount written off is typically based on the balance determined to be uncollectible.

The SBA accounting does NOT provide for a partial charge off. If any portion of the debt is collectible in the near future with out excessive costs, the charge off action must be delayed.

### 3. When is a Charge Off Justified?

A charge off is justified when you have complied with all requirements of collection and liquidation and further collection of any substantial portion of the debt is doubtful.

### 4. How do You Determine When You are Justified in Charging Off a Loan?

**The determination to justify a charge off may be based on one or more of the following.**

- a. You must have exhausted all efforts in maximum recovery from:
  - (1) Voluntary payments from the borrower;
  - (2) Liquidation of collateral;
  - (3) Compromise with obligor leaving only a deficiency balance; and
  - (4) Consideration has been given to any legal remedies available so that no further reasonable expectation of recovery remains.
- b. Estimated costs of future collection exceed any anticipated recovery;
- c. Obligor cannot be located or is judgment proof;
- d. The SBA's rights have expired (e.g., statute of limitations, restrictions of State law, Agency policy);
- e. Debt is legally without merit;
- f. Adjudication of a Chapter 7 Bankruptcy as a no asset case, and,
- g. The inability of Agency or private sector collections efforts to effect further worthwhile recovery.

### 5. When Can't You Charge Off a Loan?

- a. If you are receiving regular loan payments as outlined in the note or a workout plan, you **cannot** charge off an account.
- b. An account which has been referred to the Department of Justice for legally enforced collection **cannot** be charged off.

- (1) You may make a charge off subsequent to referral to DOJ based on new evidence and return of case to SBA. You must coordinate this action with DOJ.
- (2) The DOJ should return to SBA for disposition accounts mutually placed in inactive status by both DOJ and SBA.

**6. What Are the Procedures for Charge Off?**

- a. You must evaluate each obligor, which includes debtor, guarantor, and cosigner, before you can charge off a loan.
- b. You must document the file that a compromise offer was solicited and that any further collection costs would likely exceed recovery.
- c. You must collect or charge off all miscellaneous receivables due from participating lenders. (See Chapter 19, “Administrative Costs, Advances, Expenses and Recoveries.”)
- d. You can charge off an existing loan account even though you may have a Colpur account set up. The only requirement is that the Colpur account must be set up on SBA’s records.
- e. You must prepare a 327 action, which must include legal concurrence in the action.
- f. You should check the principal balance showing on the appropriate computer screens when you are preparing the 327 action. You should also verify that all payments have been processed and advances or expenses finalized.

**7. What Documentation Must Be Contained in the 327 Action?**

- a. All major collateral must be identified outlining how it was disposed of and the recovery achieved.
- b. Each remaining obligor must be identified with documented financial condition.
- c. Each obligor released previously must be identified and the reason for that release.
- d. You must outline your collection efforts.
- e. Your efforts in compromising the debt and the results must be outlined.
- f. You must provide a statement as to:

- (1) Reasons for charge off action; and
  - (2) Estimate of any further recovery possible with estimate of costs (administrative and litigative).
- g. You must review the lender liquidation plan and comment as to compliance with this plan. The following statement must be made, provided the lender complied with the plan:
- The liquidation plan of the lender has been reviewed, and we are of the opinion the basic liquidation plan, as may have been amended, was followed. Further, no observable harm to SBA resulted from the lender's actions.**
- h. You must note in the 327 action whether the loan should be marked "Refer" or "Do Not Refer" on the SBA database (e.g., referral to collection agencies, tax refund offset, Credit Alert Interactive Voice Response System (CAIVRS), etc.).
- i. Counsel must provide review and concurrence on the 327 action. (See paragraph 8, "Field Office Counsel Review of Charge-off Actions.")
- j. The 327 action must adequately explain the recommendation(s).

## **8. Field Office Counsel Review of Charge off Actions.**

### **a. Charge offs require the review and concurrence of SBA counsel.**

- (1) If such review cannot be completed within 30 days, or if counsel determines that additional recovery would be possible through legal action, the loan must be transferred out of "Liquidation Status" and placed into "Litigation Status" only.
- (2) At this point, the loan becomes the responsibility of the district counsel except for normal support provided by loan servicing/liquidation personnel.

### **b. Once a potential charge-off loan is transferred to litigation:**

- (1) Counsel will review the loan to determine the type of action that will be undertaken to attempt further recovery using in-house resources (including SBA's litigation units) and contractor assistance as appropriate.
- (2) Care should be taken that this additional action not come at the expense of neglecting or postponing timely action on more current or significant cases.



**NOTE:** A record of recoveries using these revised procedures will be maintained by district counsels and provided periodically to the Office of Litigation.

- (3) When SBA counsel determines that all appropriate action has been completed and a loan is ready for charge off. The loan will be transferred back to liquidation for processing the final charge off action, including system updates for referral for tax refund and administrative offset and to the Government contract collection agencies.
- c. It is important that close cooperation and coordination be maintained between legal and liquidation staffs so that a teamwork approach will be maintained to recovery procedures.
- d. Loan servicing/liquidation staff will remain responsible for providing support to the legal division even when a loan is classified in litigation, including:
  - (1) Locating principals;
  - (2) Ordering appraisals;
  - (3) Retaining auctioneers; and
  - (4) Making other arrangements for the sale and care and preservation of collateral, and providing for the payment of costs and expenses.

**9. What Financial Information is Needed on Debtor?**

You must have current credit information on each obligor to support a charge off, (i.e., Dun and Bradstreet, Equifax, or Credit Bureau Report). A current SBA Form 770, "Financial Statement of Debtor," is NOT a prerequisite to a charge off.

**10. What Loans Must You Refer to a Collection Agency and When?**

- a. If loans are unsecured or have no remaining worthwhile collateral they should be charged off as quickly as possible and the loans will be referred to collection agencies automatically during the next referral cycle unless they are legally barred from further collection efforts.

- b. If litigation is later initiated against a direct obligor or guarantor, you may withdraw the loan from the collection agency (if it has not already been returned to SBA according to the time frames specified by contract).
- c. You may refer a loan prior to charge off if you designate the loan for referral.

**11. When do You NOT Refer an Obligor to a Collection Agency, IRS, or for a Federal Salary or Retirement Offset?**

A referral is NOT made when the obligor has filed in bankruptcy or has been discharged in bankruptcy or otherwise legally relieved of the debt.

**12. What Referral Actions are Mandatory When You enter a Charge Off in the Computer?**

**a. Private collection agency.**

Loans are referred to private collection agencies for intensive collection follow up and, if appropriate, submission of offers in compromise. (See paragraph 10, "What Loans Must You Refer to a Collection Agency and When.")

**b. IRS Tax Refund Offset Program and administrative offset.**

Loans are referred to the IRS and/or the Treasury Department for offset against any Federal income tax refund or other amounts which may be payable to the obligor(s).

This is an annual procedure which includes all such accounts categorized as charge off within the preceding ten calendar years. Guarantors must be entered into the referral system if they are eligible for referral.

(See Appendix BB.)

**c. Federal Employee Salary Offset.**

The names of all applicable obligors are processed through a periodic computer match with participating Federal agencies and the U. S. Postal Service. All matches are reported to the SBA field office for voluntary settlement or application of the salary offset authority.

Refer to Chapter 3, "Correspondence, Reports, and Control Systems," for proper procedures and codes in making these referrals.

d. **Credit Alert Interactive Voice Response System (CAIVRS).**

Charged off accounts, unless marked “Do Not Refer,” will **automatically** on a periodic basis be referred to CAIVRS data base for credit screening purposes.

**13. What are the Requirements for Retaining Loan Files?**

- a. The General Records retention schedule requires field offices to hold charged off files for 3 years before transferring to the Federal Records Center (FRC).
- b. The FRC will hold charged off files for an additional 7 years and then destroy.
- c. If you have a companion note receivable file, you may retain the charge off file for the life of the note receivable. Your second choice would be to “strip” the charged off file of needed information and place in the note receivable file.
- d. The field offices will receive SBA Form 328, “Notice of Charged Off Loans and Related Receivables” (see Appendix F), once an account is classified in the “Charged Off” status.

When the “Charged Off” account is SBA serviced, the collateral cashier will merge the collateral file with the docket file upon notification of the charged off status. This must be accomplished by receipt of the actual loan file which has been marked “Charged Off” and a copy of the 327 action or receipt of SBA 328. When the file is forwarded to the FRC, all collateral documents will be in the file and destroyed after the 7 year period. **For this reason, it is essential that you have exhausted all reasonable avenues for collection.**

**14. When Do You Reactivate a Charged Off Account?**

You may reactivate a loan from the charged off status when a satisfactory repayment schedule has been established.

If you discover information which reflects potential recovery and liquidation or litigation action is necessary, the account must be worked in the charged off status.

**15. When Does SBA Submit IRS Form 1099-C, “Cancellation of Debt, to the Internal Revenue Service? “**

- a. The SBA will report the debt if the IRS Tax Refund Offset Program has been utilized for several years with little or no collection results.

- b. Headquarters reports the amount of the debt (principal plus interest at charge off) as income to the obligor(s) after the account is no longer eligible for administrative offset.
- c. Compromised debt will be reported the calendar year after the debt was compromised.
- d. If a loan is charged off as a result of a bankruptcy, an IRS Form 1099C will still be issued.
- e. Only direct obligors will be referred (no guarantors)

**Note:** IRS Form 1099c, is used to report charged off debt as income.

**16. What is SBA's Role Once the Account Has Been Referred to the IRS Under the 1099C program?**

SBA must take no further collection action.

**17. What if a Borrower Starts a Repayment Schedule After the Referral is Made?**

The Agency may accept voluntary repayments of the debt at any time. The borrower must file an amended tax return to reflect the reduction of the deficiency.

**18. What Accounts are Referred to the IRS for Offset?**

All loans are referred unless coded "do not refer."

**19. What Accounts are Exempt from IRS and Collection Agency Referral?**

Obligors who have filed in or been discharged in bankruptcy or otherwise legally relieved of the debt.

**20. When is it Necessary to Apply Funds to the Principal Charged Off Balance?**

You would apply proceeds to the principal balance of a charged off loan when:

- a. You located collateral and it is sold;
- b. You process a compromise offer;
- c. A court order so states;

- d. An agreement is reached with the borrower;
- e. A special initiative exists; and
- f. It is beneficial to the Government.

**21. Are Charged Off Accounts Referred to Credit Bureaus?**

Yes.

Certain charged off accounts are automatically reported to credit bureaus as being charged off.



**CHAPTER 19**  
**ADMINISTRATIVE COSTS, ADVANCES, EXPENSES, AND RECOVERIES**

**1. Introduction.**

This chapter relates to:

- a. Procedures for the payment of administrative costs;
- b. Advances legally chargeable to the loan account; and
- c. Various other expenses incurred in connection with accounts in liquidation.

**2. What are Administrative Costs and Who Absorbs Them?**

Administrative costs are known as the cost of doing business. The SBA and the lender each absorb their own costs.

**3. What are Some Examples of Administrative Costs?**

- a. Travel costs by SBA or lender's employees;
- b. Incidental costs such as telephone use; and
- c. Other administrative type costs.

**4. What are Advances and Who Absorbs Them?**

An advance is an expenditure made by a lienholder to protect the value of its collateral and its lien position on the collateral. These advances increase the principal indebtedness **if** the legal instruments permit and are absorbed by the borrower.

**5. What are Some Examples of Advances?**

- a. Payment of taxes on real estate collateral;
- b. Hazard insurance premiums, where authorized;

- c. Payment of installments on prior liens;
- d. Ground or building rents or warehouse charges;
- e. Payment of utility costs;
- f. Audits or audit reports;
- g. Purchase of prior liens;
- h. Maintenance of fire prevention devices;
- i. Repairs or cleanup efforts to prevent excessive depreciation and/or to eliminate fire hazards;
- j. Costs incurred as mortgagee in possession of abandoned property;
- k. Employment of caretakers and/or the purchase or rental of security systems; and
- l. Costs on COLPUR which relates to pre-COLPUR status.

**NOTE:** Care must be taken to ensure the proper account (original account or COLPUR account) is charged.

**6. What is an Expense?**

An expense is an expenditure made by a lienholder to protect the value of its collateral and its lien position on the collateral.

**7. What are Some Examples of Expenses?**

- a. Abstracts of title or title reports for real property;
- b. Title insurance on real property;
- c. UCC-3 lien searches for personal property;
- d. Recording fees for real property and personal property lien recordings and filings;
- e. Real property and personal property appraisals; and



- f. Fees for legal services provided by outside counsel (not including SBA staff counsel and lender/CDC salaried staff counsel), to prepare legal documents.

**8. How are Expenses Classified and Who Absorb Them?**

**a. Recoverable.**

Virtually all loan expenses should be classified as recoverable and are chargeable to the loan account and therefore, absorbed by debtor with the exception of the following:

- (1) If charging the expense to the account is prohibited by law or court action; or
- (2) The expense is clearly not related directly to the administration of the specific loan account.

**b. Nonrecoverable.**

All nonrecoverable expenses must be charged against each office's individual salaries and expense operating budget if:

The expense is identifiable to a loan which has an approval date on or after October 1, 1991.

**9. Are Expenses on COLPUR Accounts Considered Recoverable?**

Yes. Generally, expenses relating to COLPUR must be considered as recoverable and chargeable to the property costs unless:

- a. Charging the expense to the account is prohibited by law or court action; or
- b. Other considerations would warrant classifying the expense as nonrecoverable.

**10. Who is Responsible for Processing the Recoverable and Nonrecoverable Expenses?**

**a. Recoverable.**

The Liquidation Division in each office must continue to process payments of the recoverable expense through the automated miscellaneous disbursements system.

**b. Nonrecoverable.**

The Federal Financial System (FFS) employee in each office in conjunction with the Liquidation Division employee must process the payment of any nonrecoverable expense.

**11. What Entries are “NO” Longer Accepted in the CPC System?**

- a. Charge to code “3” (program expense);
- b. Transaction code 211; and
- c. Use of “dummy” loan numbers 999 990 0005 or 999 991 0008.

**12. Must Individual Checks be Ordered on Each Account?**

Yes. If a vendor bills for services on multiple loans or COLPUR accounts, individual checks must be ordered on each account.

**13. How are Payments Processed for Nonrecoverable Expenses?**

To authorize payment of a nonrecoverable expense, the Liquidation employee must provide the FFS employee the following information (documentation package):

- a. A “work sheet” copy of SF 1034, Public Voucher for Purchases and Services Other than Personal;
- b. The original invoice; and
- c. A copy of the SBA 327, “Modification or Administrative Action,” authorizing payment.
- d. The SBA 327 “rubber stamp” directly on the invoice in place of using SBA 327 is permissible.

**14. Where Must the FFS Employee Return the Documentation Package Once the Payment has Been Processed?**

The FFS employee must return the package to liquidation to place in the loan file for future review.

**15. What is the Basis for Determining the Fund Which the FFS System Must Charge for the Nonrecoverable Payments?**

**a. Loans approved prior to October 1, 1991.**

Payments must be made from the Program Revolving Fund (Business or Disaster);

**b. Loan approved on or after October 1, 1991.**

Payments must be made from the servicing office's Salaries & Expenses Operating Budget (Finance and Investment or Disaster Loan Servicing).

**16. What is the Object Class to be Used for All Nonrecoverable Expenses Input into the FFS?**

The Object Class is 2515 - Other Services - Nonrecoverable Expenses.

**17. Who Must the FFS Employee Contact to Establish a New Vendor Code?**

**a. You must contact:**

The Office of Financial Operations (OFO), Denver, to establish a new vendor code "prior" to making the initial payment to the vendor.

**b. This new vendor code must be:**

- (1) Used to identify nonrecoverable activity; and
- (2) Different from the existing CPC payee file or FFS vendor file codes.

**18. Are Participating Lenders Billed for Their Share of the Nonrecoverable Expenses?**

No. Participants are not billed for their share of the FFS nonrecoverable expenses. (For further information, see paragraph 19, "Does SBA pay expenses to the participating lender prior to the purchase of the guaranty?")

**NOTE:** The FFS system has the necessary instructions that will assist you with these transactions.

**19. Does SBA Pay Expenses to the Participating Lender Prior to the Purchase of the Guaranty?**

- a. The SBA must NOT pay expenses prior to the purchase of the guaranty.
- b. This action may occasionally be required as an exception to policy and can be handled as follows.

(1) If the participant does NOT require immediate payment:

The expense must be treated as recoverable and SBA must pay the participant their share when the guaranty is purchased.

(2) If the participant requires immediate payment:

- (a) The expense must be paid as a nonrecoverable expense through the FFS system.
- (b) It is important to understand that when a lender requires immediate payment, SBA will be reimbursing the lender for SBA's share (guaranty percentage) only. Therefore, there will not be any funds for the Agency to recover from the lender.
- (c) When the lender submits the transcript with the request for purchase, the amount requested for the Agency to pay the lender should be net any expenses paid by the Agency prior to purchase of the guaranty. This will avoid any double reimbursement to the lender.

**NOTE:** The SBA will NOT pay interest or "service fees" on the funds expended by a lender after the guaranty has been honored.

**20. When Do You Use the Imprest Fund for Disbursements?**

The use of the servicing office's imprest fund must be limited to emergency situations which must be documented in a 327 action.

Each support document must show the loan number(s) and the amount of the charge.

**21. What Information Must be on OF 1129, “Cashier Reimbursement Voucher And/Or Accountability Report? “.**

The detail and supporting documentation must be subtotaled into the following categories.

**a. Recoverable transactions.**

- (1) Business Loan and Investment Fund; and
- (2) Disaster Loan Fund.

**b. Nonrecoverable transactions.**

- (1) Business Loan and Investment Fund.  
Loans with an approval date **before** October 1, 1991.
- (2) Disaster Loan Fund.  
Loans with an approval date **before** October 1, 1991.
- (3) Salaries and Expenses - Finance and Investment.  
Loans with an approval date **on or after** October 1, 1991.
- (4) Salaries and Expenses - Disaster Loan Servicing.  
Loans with an approval date **on or after** October 1, 1991.

**22. Have the Procedures for Processing Expenses on 503 and 504 Development Company Loans Changed?**

No. Sections 503 and 504 Development Company Loans expense processing has not changed.

**23. Is There a Maximum Level of Care and Preservation Expense?**

- a. Yes. Unless a greater amount is approved by the district director, SBA’s share of all advances and expenses (both recoverable and nonrecoverable, must not exceed the lesser of \$50,000 or 75 percent of the most recent appraisal. **This does not include purchase of a prior lien or direct selling costs.**

- b. The recommending official must estimate these expenses at the onset of liquidation.

**24. How are Expenses Handled When the Participating Lender is Involved and SBA is Servicing the Account?**

- a. When SBA is servicing the account:
  - (1) The liquidation officer should make all possible attempts to obtain prior approval from lender before incurring expenses; and
  - (2) A check will be ordered to pay the expense and the lender will then be billed for their share of the expense by OFO.
- b. Payment to the lender of SBA's pro rata share must not be made prior to SBA's purchase of the guaranty but may be included in the check covering the purchase only when SBA consented (327 action) to the expenditure at the time it was made by the lender.

**NOTE:** Participants will not be billed when their share of an expense is less than \$5.00 even if the "Bill Participant?" question on the LAQU02 Input Screen is answered, "Y". The expense is forgiven and charged to the general ledger account 5120, Miscellaneous Lending Expenses.

**25. Are Lenders Permitted to Deduct Expenses from Sale Proceeds?**

- a. Yes. The lender is permitted to deduct expenses from any sale proceeds they may be holding from the sale of collateral.
- b. They must provide complete documentation as to the expenses being paid.
- c. The SBA must not pay interest or service fees on the funds expended by a participant after the guaranty has been honored.

**26. How does SBA Know if a Lender Has Not Paid Their Share of an Expense Which has been Billed by SBA?**

The liquidation loan officer must review the weekly delinquency report which will list all miscellaneous receivables due from participating lenders.

**27. Is Participant Allowed to Delay Payment of SBA's Share of an Expense?**

Occasionally, SBA will agree to delay the participant's payment of its share of expenses, with the understanding that appropriate deduction will be made from the participant's share of the liquidation proceeds.

This Agreement must be documented by a 327 action.

**28. What Happens When a Borrower's Check is Returned for Non-sufficient Funds and SBA is Servicing the Account?**

When SBA is servicing an account, you may be notified that a borrower issued a loan payment and the check was returned from their bank for non-sufficient funds. The participating lender will be billed for return of their share of the loan payment which was sent to them within 24 hours of receipt by SBA.

**NOTE:** A deferment must NOT be granted to a participant for funds due as a result of a returned check from an obligor.

**29. What is the Prompt Payment Act?**

The Prompt Payment Act of 1982 requires that a Federal agency must pay interest and penalties on late payments. [See OMB Circular A-125 (rev.), "Prompt Payment"; SOP 20 17, "Fiscal Examination Procedures, OFO"; and FAR Subpart 32.9 for further guidelines.]

Late payments are considered to be:

- a. 30 days after an invoice; or
- b. After the date payment is due under the contract for work provided.

**30. What Expenses are not "Contracted for" and are Not Covered Under the Prompt Payment Act?**

They are payments to commercial banks, sureties, and other participants involved with SBA in the delivery of the Agency's programs. Such as:

- a. Participants' share of receipts and reimbursement of participants' expenses and amounts paid for Pollution Control and Lease Guarantee Claims;
- b. Loan guaranty advances and purchases;

- c. Loan debenture disbursements;
- d. 8(a) disbursements;
- e. Utilities (unless acquired by contract or other written request);
- f. Taxes;
- g. Subscriptions;
- h. Rents;
- i. Protective bids;
- j. UCC filing fees; or
- k. Prior liens payments.

**31. What Payment Guidelines Should be Included in a Contract?**

The following information should be contained in the contract.

- a. Payment of invoices will be made 30 days after the later of, the date a proper invoice is received or the date on which SBA accepts the property or services, if the Agency date-stamps the invoice with the date of receipt at the time of receipt.
- b. A notation that partial payments are prohibited, if applicable.
- c. Separate due dates for partial payments will be shown in the case of partial executions or deliveries.
- d. A stated inspection period following delivery, where necessary, for SBA acceptance of the property or service.
- e. Name, title, phone number, and complete mailing address of officials of the contractor and of the designated billing office.

**32. How are Improper or Defective Invoices Handled?**

- a. Any invoice containing an apparent error, defect or impropriety must be returned promptly to the vendor, but no later than 7 days after receipt.



- b. When the Agency fails to notify the vendor of a defective invoice within 7 days, the number of days allowed for payment of the corrected invoice will be reduced by the number of days between the 7th day and the day notification was transmitted to the vendor.

**33. What Must the 327 Action or SF Form 1034, “Public Voucher for Purchase and Services Other than Personal,” Contain for Processing Payment Requests?**

The 327 action and SF Form 1034 (see Appendix GG) must contain the following:

- a. Charges to be paid with original invoice attached;
- b. A statement that lender does or does not concur;
- c. State if the participant should be billed for the pro-rata share;
- d. A statement that the value of the expenditure compared to SBA’s interest is warranted;
- e. Identify if this is an advance or an expense;
- f. Is the advance/expense recoverable or not;
- g. Name of payee with delivery instructions;
- h. Is the payment covered by the Prompt Payment Act; and
- i. State the delivery deadline for the payment.

**NOTE:** When the lender requests the Agency to reimburse them our guaranteed portion of an expense, their written request must be attached to the SBA 327 action.

**34. How are Recoveries Handled When an Account is in Regular Servicing?**

When an account is in regular servicing, both the participating lender and the borrower must be advised to send the payments directly to the Office Financial Operations (OFO), Denver, CO 80259. Lenders must submit the payments within 15 days of receipt.

**35. Does the Participating Lender have to Submit SBA Form 172 for recovery?**

Yes. You should advise lender that an SBA Form 172 must be submitted along with their check.

**36. Are there Exceptions to Sending the Payments on a Regular Servicing Account to OFO, Denver?**

Yes. If you are working on a problem account which is not classified “in liquidation,” you may instruct the borrower or lender to send the payments and SBA 172, as applicable, to you in the field. **However**, once you have resolved the situation, you must advise them to forward their payment to OFO, Denver, CO.

**37. How are Recoveries Handled When an Account is a Lender Serviced Liquidation?**

The lender must be advised to send all recoveries and SBA 172, to the Small Business Administration, Denver, CO 80259, within 15 days of receipt. See Paragraphs 8-24 and 8-25 “How Must You Apply the Proceeds from Liquidation?,” and “Improving the Timeliness of Collections From Lenders,” for additional guidance.

**38. How Should Payments Received in the Field be Handled?**

You must forward all payments received to OFO, Denver, with the proper transaction code for applying the funds. (See SOP 20 19, “Loan Accounting Procedures,” for transaction “collection” codes and SOP 20 05, “General Cashier Control Procedures” for transaction “expense” codes.)

**39. How Do You Apply Payments Received on an Account in Liquidation?****a. Payments received from the liquidation process would normally be applied to principal. This refers to payments received from:**

- (1) Sale of collateral;
- (2) Single-payment compromises with borrowers;
- (3) Single-payment collections from guarantors; and
- (4) Single payment compromises with guarantors.

**b. The exception to applying payments to principal first would be:**

- (1) If you are working on a restructuring or workout plan with the borrower, collections may be applied first to interest with the balance to principal; or
- (2) Recoveries by private collection agencies or intergovernmental offsets are not normally considered to be collections from the liquidation process. However, they may be classified, as such, if approved as part of a settlement or compromise agreement.

**40. How Do You Apply Payments on an Account Which has been Charged Off?**

- a. All payments on charged off accounts must be applied first to principal, and the balance, if any, to interest which is transaction code 385.
- b. Transaction code 385 is typically used in the following circumstances:
  - (1) To apply proceeds from the sale of “found” collateral;
  - (2) To apply the funds received on a compromise processed after the loan was charged off;
  - (3) When you are required by a legally binding agreement or other court order; or
  - (4) When you have determined that such application is in the best interest of the Government.

**NOTE:** Occasionally, the Department of Justice, a participating lender, or some other approved entity may be servicing the charged off loan. In such instances, SBA must apply any collections in the same manner as the servicing agent.



**CHAPTER 20**  
**EFFECTS OF COMPETING TAX LIENS (STATE, COUNTY AND LOCAL) ON LOAN**  
**COLLATERAL AND COLPUR PROPERTY**

1. **What is the SBA Policy on Payment of Tax Liabilities and Liens on Loan Collateral and COLPUR Property by SBA or Participating Lender?**
  - a. You are authorized to pay accruing and past due property taxes and tax liens on loan collateral and COLPUR property. The payment authorization is based upon your written “best interests” of SBA/Participant analysis (SBA 327). All such payments must be charged to the appropriate loan or COLPUR account. Counsel must concur and a legal opinion must be included in all tax payment authorizations.
  - b. The payment by participating lender of accruing or past due property taxes and tax liens (or purchase) on collateral or COLPUR is authorized when, in the opinion of the approving official, such payment is in the best interests of SBA/participating lender.
  - c. You should work closely with counsel on all issues including the following.
    - (1) Counsel must concur and legal commentary must be included in all tax payment authorizations. All problems relating to payment of taxes must be forwarded for counsel’s comments. The final decision as to such actions must be made by the approving official after consideration of counsel’s comments.
    - (2) Counsel should be consulted to give guidance on the existence and operation of jurisdictional tax law to enable you to independently analyze alternative tax payment proposals.
    - (3) You must provide counsel with all available tax documentation and the legal opinion must at a minimum include comments regarding:
      - (a) Validity of the tax;
      - (b) Relative priorities between loan collateral and tax claim;
      - (c) Any late charge or penalty;
      - (d) The date by which tax should be paid;

- (e) Practical legal consequences of nonpayment; and
- (f) Applicable redemption rights and expiration dates.

**2. Who is Responsible for Payment of Property Taxes on Loan Collateral and COLPUR Property?**

- a. The property owner, usually the borrower or co-obligor, is legally responsible for payment of property taxes.
- b. You should attempt to get the responsible party to pay the taxes on loan collateral. Where you are successful in getting the taxes paid by the appropriate party you should request documentary evidence of payment.
- c. Where taxes are not being paid by the responsible party, SBA or participant must notify all obligors and guarantors. Notice is made by certified mail informing the parties of the delinquency or nonpayment and of their legal responsibility to make the tax payments.

**3. When are SBA Security Interests in Collateral Subordinate to Competing State and Local Tax Claims and Liens?**

- a. The “subordination section” of the Small Business Act (15 USC 646), states when the property interests held by SBA will be lower in priority to valid ad valorem tax liens on the specific property.

An ad valorem tax is a tax imposed on the value of property, the most common ad valorem tax is that which is imposed by states, counties, and municipalities on real estate.

- b. You must be aware that the subordination section of the Act does **NOT** include:
  - (1) Late charges;
  - (2) Penalties;
  - (3) Interest;
  - (4) Water, sewer, curb/sidewalk, or light district assessments;

- (5) “General tax liens” against the property for unpaid ad valorem tax on other property of the taxpayers; and
- (6) Unpaid sales, withholding, income, or other taxes of the taxpayer.

The tax claims based upon the above categories generally are lower in enforcement priority to earlier perfected SBA/participant liens.

- c. Tax liens against property in the debtor’s name are created through statutory authority, and you must take particular care to determine:
  - (1) Time of lien attachment;
  - (2) Whether the amount of the lien is correct;
  - (3) Duration of lien;
  - (4) Scope of lien;
  - (5) Priority and method of lien enforcement; and
  - (6) How payment of the tax is handled in the locality.
- d. You must determine the relative priority between the interest of SBA/participant in the loan collateral and a competing state or local ad valorem tax lien.

**4. How Should You Determine Whether to Pay Priority Taxes on Loan Collateral?**

- a. The decision to pay outstanding taxes, penalties, and other charges must be based on both legal and credit reviews and the critical assessment regarding who holds the superior or priority interest.
- b. Where you determine the taxes and charges are superior to the Agency/participant loan collateral interest, you should consider the following issues:
  - (1) Does the liquidation value of the collateral support payment of the taxes prior to your liquidation sale?
  - (2) Will nonpayment likely impair recovery or chill bidding at a liquidation sale in an amount more than the tax claim?

- (3) Will the taxing authority consent to SBA's liquidation sale subject to the tax?
- (4) Where the sale will be piecemeal and the collateral will be disbursed, will the tax authority agree to collect their taxes from the proceeds of the sale?

**5. What Issues Should You Consider When SBA Has Junior Tax Liens on Collateral?**

- a. Will our lien foreclosure actually wipe out the junior tax lien?
- b. Does the taxing authority have any statutory protective measures to cloud title or chill bidding at our foreclosure sale?
- c. Is the taxing authority contesting our claim to priority status? What effect will that unresolved tax priority question have upon our "commercially reasonable sale?"
- d. Is it prudent to payoff the junior tax lien and then conduct your liquidation sale? If it is, you must consider these factors:
  - (1) The liquidation property value (forced sale) of the taxed collateral;
  - (2) SBA personnel time, out-of-pocket expenses, time commitment to resolution of adversarial situation;
  - (3) Actual and potential expenditures for protection and maintenance of collateral, depreciation of collateral, and associated market related costs;
  - (4) The relative effect of payment or nonpayment on collectibility from obligors and guarantors;
  - (5) Whether the extended risk, such as lack of hazard insurance during the delay of sale, dictates payment of junior liens addressing the identified risk factor; and
  - (6) Will partial payment resolve the tax priority issue?

**6. When does SBA Acquire Tax Immunity for COLPUR?**

- a. Real and personal property owned by the SBA (and other Federal departments and agencies) is immune from State and local taxes under an implied Constitutional immunity repeatedly affirmed by Federal courts.



Participating lenders do not gain this tax advantage where they acquire title to loan collateral property in their name.

- b. The real and personal property acquired by SBA through liquidation sale is immune from State and local taxation from the time of acquisition. The tax immunity may also apply where SBA is a mortgagee in possession. The SBA counsel should make such a determination.
- c. Previously levied ad valorem tax liens are unaffected by SBA's acquisition. However, while the execution of the tax lien may be impaired because of the protection of Section 5(b) of the Small Business Act you are well advised to pay the tax or sell the property subject to the lien at the earliest possible time commensurate with commercially reasonable conduct.
- d. Local taxing authorities must be given prompt notice of SBA's acquisition of property and of our subsequent immunity from taxation.
- e. Local taxing authorities should be given a courtesy notification of our sale of the property. Disputes between the tax authority over SBA's tax exemption may "cloud title" and have an inordinately depressing effect on the marketability of the property.

**NOTE:** When the SBA field office is unable to resolve a tax exemption issue, the matter must be referred through channels to the Office of Borrower and Lender Servicing as an exception to policy.

**7. How Must the Agency Take Title to COLPUR Property?**

Property acquired in liquidation must be titled as follows.

**a. SBA serviced accounts.**

For these accounts, you must title acquired property in the name of "Administrator, U.S. Small Business Administration, an Agency of the United States of America."

**b. Participant serviced accounts.**

Lenders may take title in their name or in the name of the Agency as noted above in order to qualify for Federal governmental tax immunity. If the lender takes title to property in their name you should provide a written justification (e.g. anticipation of prompt sale) in an SBA 327. (Also, see Chapter 11, "Collateral Purchased by SBA and Lender.")

**8. When is SBA Authorized to Pay Taxes on COLPUR?**

The SBA is authorized to pay prior tax liens securing payment of ad valorem taxes and penalties on real and personal property acquired by SBA after a determination that the payment is appropriate or advantageous to the SBA. Depending upon the individual circumstances, SBA may sell the property subject to the tax lien(s).

**9. How Do You Determine if SBA Should Pay Taxes on COLPUR?**

- a. The considerations for payment of prior taxes on COLPUR property are similar to those which should be evaluated in paying prior and junior taxes on loan collateral before acquisition as COLPUR property. (See paragraph 5, "What Issues Should You Consider when SBA has Junior Tax Liens on Collateral?")
- b. If a decision is made to pay the taxes, you must identify the amount to be charged to the loan account as well as the amount to be charged to the COLPUR account. (See Chapter 19, "Administrative Costs, Advances, Expenses, and Recoveries.")

**10. What Documentation is Required to Request Payment of Taxes on Loan Collateral or Colpur Property?**

**You must document (SBA 327) each determination to pay taxes on loan collateral or COLPUR property to include the following items.**

**a. Recommending official must provide:**

- (1) Findings and recommendations including data required for all liquidation disbursements (see Chapter 19. "Administrative Costs, Advances, Expenses, and Recoveries"); and
- (2) Statement of the known or estimated value of the taxed property supports the intended tax payment.

**b. Counsel's opinion which must provide that:**

- (1) The taxes paid constitute an enforceable lien senior to SBA's interest; or
- (2) The lien is in junior enforcement priority to SBA's claim but the approving official has determined payment is in SBA's best interest.

**c. Approval by the approving official.**

- d. Tax authority certification that the taxes are assessed specifically on the loan collateral or COLPUR property.
- e. The original tax invoice approved for payment establishing the date for computation of penalty and interest charged, or a written request from lender for SBA to pay its ratable portion of a previous SBA approval of participant tax payment.

**NOTE:** The date the tax invoice quote is computed for should allow sufficient time for delivery of the Treasury check, and consider accrual of interest to date of delivery.

Alternatively the tax authority may accept a stated amount on a fixed date in the future.



**CHAPTER 21**  
**EFFECTS OF SENIOR COMPETING LIENS (NON-TAX LIENS) ON LOAN**  
**COLLATERAL AND COLPURED PROPERTY**

**1. What is SBA's Policy?**

When a foreclosure is being considered by SBA or a prior lienholder, you must promptly examine all liens on the property and reach an informed decision on how to deal with them. This chapter outlines foreclosure alternatives available to the Agency where our collateral is subject to senior liens.

**2. What Considerations Must You Make Prior to Initiating Lien Foreclosure on SBA's Collateral Subject to Senior, Non-tax Liens?**

**a. Relative priorities.**

The priorities of other competing liens in relation to SBA's interest.

**b. Extent of debt.**

What is the:

- (1) Principal balance;
- (2) Accrued interest and details of delinquency including current; and
- (3) Future costs and fees related to the prior lien(s).

**c. Value of shared collateral.**

Current liquidating value (forced sale) of all property in which SBA and competing creditors share a lien interest.

**d. Value of unshared collateral.**

Current liquidating value (forced sale) of obligor property free of SBA lien but has a lien by competing creditor.

**e. Adequacy of obligors.**

The identity and financial responsibility of the obligors and guarantors of the indebtedness secured by the priority lien. You should determine if those obligors and guarantors are liable on the SBA loan.

**f. Legal aspects.**

A review of counsel should be requested, commenting on the relative lien priorities and the validity and enforceability of those liens against the property, the obligors, and guarantors.

**NOTE:** Counsel should be consulted and their comments must be included in all authorizations (SBA 327) for payment of prior liens. All problems relating to SBA satisfying prior liens must be forwarded for counsel's comments. The final decision as to such action will be made by the approving official after consideration of counsel's comments.

**3. SBA Foreclosure "Subject To" Prior Lien.**

**a. SBA foreclosure without making payment to senior lienholder.**

This procedure involves SBA foreclosure without making payment to the senior lienholder. The foreclosure-purchaser at SBA/lender's sale takes legal title subject to the senior lien. This alternative when correctly handled may net a greater return as the purchaser has built-in financing in the amount of the prior lien.

- (1) For this alternative to operate effectively, you need to develop a working relationship with the senior lienholder. They must formally agree to "stand-by" deferring loan payments during SBA's foreclosure process.
- (2) In most cases, all debt service including the senior lienholder's loan, is in default status. You must resolve the competing interests prior to commencing foreclosure in order to resolve the doubts of potential bidders. Attention should be paid to applicable state "due on sale" provisions in the senior mortgage.
- (3) You may be called upon by prospective bidders to furnish information regarding amount and terms of the prior lien, whether the senior lien is assumable and other potential-buyer minimal requirements.

**b. Bargaining strategies.**

You frequently have junior lienholder-leverage available to you which should be directed toward the senior lienholder in an effort to obtain a degree of cooperation from them in the course of foreclosure proceeding.

- (1) You may enlist the reluctant cooperation of a prior lienholder to standby during our foreclosure by discussing junior lienholder rights of redemption where applicable under State law and the Federal right of redemption in 28 U.S.C. Sec. 2410. You should consult counsel regarding any reliance upon a right of redemption and obtain a written legal opinion from the supervisory attorney.
- (2) In some jurisdictions, the legal fees of the senior lienholder are subordinate to junior liens. You are advised to consult with counsel regarding the applicability of this procedure in your district.
- (3) Where the senior lienholder will not agree to refrain from starting its own foreclosure proceeding, and there is no "due on sale" provision in their loan documents, you may proceed to sale without senior lienholder standby-agreement and let the purchaser negotiate with the senior lienholder.

**4. SBA Foreclosure With Partial Payment to Senior Lienholder Where Loan Collateral Remains "Subject To" Senior Lien.**

- a. This procedure involves SBA foreclosure where the Agency makes a partial payment to the senior lienholder. The purchaser, at SBA's foreclosure sale, takes title subject to the senior lien. This procedure may be favorable to SBA particularly where:
  - (1) There is a questionable senior lien;
  - (2) The SBA's equity value is uncertain; and
  - (3) The necessity for advancing the sum for SBA's protective bid on the senior lien is eliminated.
- b. You should agree with the prior lienholder about the following matters:
  - (1) The number and amount of SBA payments to the prior lienholder;
  - (2) The interest rate on the prior lien indebtedness; and

- (3) The redemption period available to the obligor or other competing lienholders.

**NOTE:** Care must be taken to avoid committing the Agency to further payments to the senior lienholder. No partial payments should be made except to permit a prompt SBA foreclosure.

**5. SBA Purchase of the Prior Lien for Face Value (Par) or at a Discount.**

- a. Purchase of a prior lien requires an additional expenditure of funds and added liquidation risks. Therefore, the non-purchase alternatives covered above are preferred liquidation procedures.
- b. Outright purchase by SBA of a prior lien at a discount is preferred to making full payment of the obligation secured by the prior lien.
- c. Prior liens must not be purchased or fully paid to carry a loan for the debtor's benefit. Where SBA purchases or pays for a prior lien you must:
  - (1) Start collection of the borrowers obligation including the sum expended to purchase the prior lien; and
  - (2) Obtain an opinion of SBA counsel which covers the legal aspects of the purchase transaction.

All transactional documentation must be reviewed by SBA counsel regarding legal form.

- d. Prior liens may be purchased if it is to improve the repayment ability of the loan through a documented workout which may reduce a potential loss to the Agency.
- e. Purchase of a prior lien must be approved under the "Rule of Two." The SBA 327 must justify and support the action reflecting that all of the elements of this section paragraph have been met.
- f. Purchase limitations.**

You must exercise care in determining to purchase a prior lien and should consider the following:



- (1) Your appraisal information should be current and reliable and clearly reflect an obtainable equity for the SBA lien (i.e. substantially over and above the prior lien);
- (2) You must evaluate current market activity for the property type; and
- (3) Your anticipated recovery must be worth the risk, and the cost of purchase together with CPC costs must not exceed 75 percent of the current liquidating value of the property.

**g. Considerations where senior lienholder is in foreclosure.**

Where a senior lienholder is in foreclosure you should determine (after SBA has paid on or purchased the prior debt) whether SBA can:

- (1) Reinstate the original maturity of the senior debt;
- (2) Recover the accrued costs and fees;
- (3) Proceed with the pending foreclosure proceedings; or
- (4) Start foreclosure proceedings at a later date.

**h. Considerations where the participating lender is the senior lienholder.**

Your handling of a purchase of a prior lien held by the participating lender should follow the guidelines established above for any prior lienholder. However, you must not permit the lender to be the liquidating agent for the SBA guaranteed loan.

**NOTE:** You must fully document all such situations.

**6. SBA Foreclosure After Full Payment/Satisfaction of the Senior Lien Alternative.**

- a. Full payment and satisfaction of the prior lien is clearly less desirable than:
  - (1) Purchasing the prior lien for face value (Par) or discount;
  - (2) Permitting the prior lienholder to foreclose and bidding at that foreclosure sale;  
or

- (3) Relying upon applicable State and Federal redemption rights of the obligor and junior lienholders.
- b. Where you are forced to payoff the prior lien of a hostile or indifferent lienholder, you must carefully analyze the comparative costs.

**Those costs include:**

- (1) The time associated in conducting your own foreclosure sale; and
- (2) Incurring a second set of foreclosure costs and fees.
- c. You must document your decision to payoff the prior loan in an SBA 327 to include a thorough analysis of the comparative costs and risks associated with advancing the purchase funds. You must obtain the opinion of counsel in the recommendation to payoff the prior lien.
- d. The primary purpose for purchasing a prior lien is to protect SBA's position and enhance liquidation recovery.

**NOTE:** Where enforcement action is not anticipated for completion within a year of lien payment, the expenditure must be handled as an "exception to policy."

**7. SBA Making a Protective Bid at a Senior Lienholder Foreclosure Sale.**

- a. Upon becoming aware of a senior lienholders foreclosure intentions, you must make the risk and cost analysis (best interests of SBA) required in the previous four alternatives. In the absence of a justification for an alternative cited above you are authorized to let the foreclosure occur. Your participation potentially involves the making of a protective bid for SBA's equity at the sale and a determination of the effect of statutory redemption rights (rights of original mortgager) in the circumstances.
- b. Considerations which warrant prior lien foreclosures with SBA protective bidding at sale include the following.
  - (1) Counsel, for prior lienholders, frequently is able to obtain liquidation relief more efficiently than SBA counsel and the Department of Justice (U.S. Attorney).
  - (2) Avoidance of duplication of effort and costs and expenses.

- (3) Potential SBA equity erosion in favor of senior lienholder where SBA pays loan current.
- (4) The SBA acquisition at prior lienholder's sale may negate the application of pertinent state "anti-deficiency/choice of remedy/one cause of action" statutes which would apply if SBA conducted the foreclosure limiting our liquidation choices. Counsel should be consulted if you have questions regarding the application of State law.

**c. What supplemental support may SBA provide to a foreclosing prior lienholder?**

You are authorized to assist the prior lienholder by supplementing its advertising and foreclosure sales effort with the objective of expanding the potential pool of bidder/purchasers. The assistance should be made with advice of supervisory counsel and may involve a financial expenditure by SBA. In considering the amount of supplemental assistance provided, you are advised that it is better to err on the side of too much, rather than too little assistance.

**d. What are the benefits to SBA resulting from our supplemental support to the foreclosing lienholder?**

- (1) By enhancing notice through supplemental advertising, the senior lienholder's foreclosure sale may rise to the level of a comprehensive public sale.
- (2) Supplemental advertising and sales efforts may lend support to a decision to refrain from active participation in the foreclosure bidding process. Where the advertising results in a large interested bidding pool reflecting actual market interest in the property, it may be reasonable to let the property be sold for whatever it will bring.

**e. What are SBA's protective bid deposit procedures?**

- (1) When a decision has been made to bid at a prior lien foreclosure and a deposit is required, you are authorized to order a treasury check in the appropriate amount through the on-line CPC disbursement system.
- (2) All bid deposits should be held by the collateral cashier until signed-out by the SBA representative attending the sale.

- (3) Unused treasury checks must be returned promptly to OFO, Denver, for cancellation. In no event can the treasury bid check be held for more than 6 months.

**8. What Notice Requirements Must Be Satisfied Before SBA Purchases a Senior Lien?**

- a. You must attempt to notify all obligors, guarantors and parties known to have an interest or claim to the lien property of Agency activities regarding the purchase or liquidation of prior liens. You must also attempt notification to these individual persons of any SBA foreclosure sale.
- b. **Notice to the interested parties is required as:**
  - (1) The SBA should not expend public funds to protect an equity interest in property if the obligors, guarantors, or other interested parties are able to protect it; and
  - (2) The obligors and interested parties should be aware of the increased financial exposure they incur by SBA purchase of prior lien(s).

**9. What SBA Authorization(s) Must Loan Servicing Participants Receive Prior to Payment of a Senior Lien?**

- a. **Lenders servicing liquidation accounts must obtain SBA approval to:**
  - (1) Purchase a prior lien for face value (Par) -- payment in full of prior lien(s);
  - (2) Purchase a prior lien at a discount; or
  - (3) Pay defaulted installments on obligations secured by prior liens.
- b. You should evaluate the proposed participant's liquidation activities under "best interest of SBA" analysis as if being performed by SBA liquidation staff.
- c. Where the participant employs legal counsel the extent of the engagement and costs associated with the legal services provided must be reviewed by supervisory counsel.

**10. What Administrative and Accounting Requirements Exist When Purchasing Prior Liens?**

- a. The creation of a "purchased" prior lien on SBA accounting records and the subsequent administrative record of that account depends upon your submitting your

clear instructions regarding the purchase transaction to OFO, Denver. SBA purchase of prior liens must be taken for short term strategy reasons not for purposes of long-term payout.

- b. Prior liens paid in full or in-part by SBA (lien documents not assigned to SBA) represent expenditures made for protection of SBA's position and are appropriate care and preservation of collateral (CPC) expenses. They must be entered as recoverable expenses in the on-line CPC disbursement system. Interest will accrue on that expenditure at the note rate.
- c. Payments received by SBA on purchased prior liens must be recorded at the time they are received. The payment status and loan balance information on that obligation must be regularly maintained. You must establish a ledger for hand-posting payments. The SBA Form 1149, "Lender's Transcript of Account," is to be used for maintaining all other pertinent data. (see Appendix J). You are additionally responsible to prepare and provide to the obligor each January for income tax purposes a statement of interest paid for the prior year.

**NOTE:** The COLPUR account may be transferred to a note receivable status using SBA 515 providing automatic account maintenance where the authorized payment terms reflect that such handling will be of practical benefit. (See Appendix H)

- d. Where SBA is the successful bidder at a prior lienholder's foreclosure sale, the liquidation activity must be recorded as an acquisition action on SBA Form 297.

#### **11. What Documentary Reporting is Required When SBA Purchases a Prior Lien?**

- a. **You must prepare an SBA 327 where you determine to:**
  - (1) Purchase at par or at a discount a prior lien;
  - (2) Pay defaulted installments on a prior lien; or,
  - (3) Pay a prior lien in full.
- b. **In addition to appropriate data justifying a disbursement, the 327 action must include:**
  - (1) The name and address of the prior lienholder;

- (2) A description of the prior lien;
- (3) A detailed itemization of the principal obligation secured by the prior lien and interest calculated to the date of settlement;
- (4) Settlement date;
- (5) An itemization of outstanding payments; and
- (6) A statement classifying the payment as either an advance on the SBA loan account or an expense on the COLPUR account (part of the cost of acquisition).

**CHAPTER 22**  
**INSURANCE PROPERTY, LIFE, AND PUBLIC LIABILITY**

**1. Property and Hazard Insurance.**

**a. What are the SBA's general requirements for property and other hazard insurance coverage on collateral?**

- (1) The SBA's policy is to require that obligors on SBA direct and guaranty loans maintain appropriate hazard insurance, including fire and extended coverage insurance, on real and personal property securing the loans. The loan authorization should specify the insurance coverage required. When the loan authorization only states a general requirement, then the obligors should obtain and maintain fire and extended coverage insurance for:
  - (a) The insurable value of the real and personal property securing the loan;  
or
  - (b) The amount of the loan balance, whichever is less.
- (2) The insurance policy must include a mortgagee clause naming the SBA or the participant as loss payee.
- (3) The SBA's practice is not to purchase insurance, but participants may do so on loans they service. When they do, the SBA should share in the costs of the insurance if the premiums and the transaction appear to be reasonable.

**b. Who is responsible for providing evidence of insurance?**

Each borrower and obligor must deliver to the participant or to the SBA, whoever is servicing the loan, evidence that all insurance (including liability and business interruption insurance required by the loan documents) is in force with premiums paid.

**c. What form of evidence is acceptable to the SBA?**

Evidence may be in the form of:

- (1) A copy of a binder;
- (2) Copy of the policy; or,
- (3) A certificate of coverage.

Payment of premiums should be clearly indicated. The evidence of insurance must be furnished to the participant or to the SBA at loan closing.

**d. Who is responsible for maintaining required insurance?**

The borrower is responsible for maintaining required insurance from the time the loan is closed until the loan is paid in full. On SBA-serviced loans, a printed message on the reverse side of the SBA Form 1201, "Repayment Notice," advises each borrower of the responsibility to maintain hazard insurance. (See Appendix L.)

**e. What happens if the borrower fails to maintain the required insurance?**

- (1) Failure to maintain required insurance is a serious default. It may be the basis for accelerating maturity of the loan.
- (2) If you believe that required coverage is not in force, you must contact the borrower to determine the facts. If insurance is not in force, you must take necessary steps to ensure that the coverage is restored.

**f. What should you do if you receive a notice of cancellation?**

Mortgagee or loss payable clauses ordinarily provide that the insurer must notify the mortgagee of impending cancellation or expiration of the policy. If SBA or the lender receives such a notice, SBA/lender should make prompt contact with the borrower and guarantors. The loan file should contain:

- (1) The notice;
- (2) An indication of the actions you have taken; and
- (3) The borrower's response.



**g. What do you look for when you review insurance policies when a loan is transferred into liquidation?**

- (1) When an account is transferred to liquidation, all existing policies must be reviewed to determine:
  - (a) Adequacy of coverage;
  - (b) Whether the mortgagee/loss payable clauses are in proper form to protect the Agency's interest; and
  - (c) Whether any situation exists (e.g., vacancy, abandonment) which must be reported to the insurance company as required by the terms of the policy.
- (2) If deficient, it should if possible be brought up to requirements by the participant or the obligors. When the Agency assumes servicing of the loan (e.g., SBA serviced XGP), all insurance coverage should be assigned to SBA. Also, the companies or their agents must be notified of the change.

**NOTE:** Lack of coverage should not be a basis for adjustment of a participant's claim if the participant has made reasonable efforts to keep coverage in force, or no loss resulted from the canceled or lapsed policy.

**h. What is the SBA's policy regarding mortgagee clauses?**

- (1) It is the SBA's policy, whenever hazard insurance is called for on an SBA-serviced account, to require an endorsement naming the mortgagee as a loss-payee. The endorsement must be in the form of the "New York Standard" or "Uniform Standard" mortgage clause or its equivalent. Generally, these are considered by the courts to be a separate contract between the insurer and the mortgagee. As in most contracts, each party has certain rights and responsibilities.

**(a) What are SBA's rights as a named mortgagee?**

The two principal mortgagee rights are:

- i. SBA does not suffer loss of coverage from acts or neglect of the insured; and

- ii. SBA is entitled to a notice period in which to remit unpaid premiums.

**(b) What are SBA's responsibilities for reporting matters to the insurer?**

- i. If the insurance contract requires the mortgagee to notify the insurer of certain events specified in the contract when the mortgagee has actual knowledge of such events, then SBA must provide such notice. Typical of such events are:
    - 1) Change of ownership, interest or possession of the insured property;
    - 2) Appointment and qualification of a trustee in bankruptcy for the insured, or an assignment for benefit of creditors of the insured;
    - 3) Cessation of business operations for a specified time, usually 30 days or 60 days;
    - 4) Unoccupied building on the insured property, unguarded, left at risk, or abandoned;
    - 5) The initiation of foreclosure proceedings involving the insured property (Note: at commencement of foreclosure, you should notify the insurer and confirm that SBA mortgagee coverage will continue until title transfers to the purchaser at foreclosure); or
    - 6) A new usage of the premises which may increase the risk of the insurance company.
- (2) The obligation of the mortgagee to report such events, of which it has actual knowledge, is contractual. While the event may invalidate the policy as to the insured, the Uniform Standard Mortgage Clause preserves the insurance for the SBA. The failure of the SBA, as mortgagee, to notify the insurer of specified events it knows about may either cancel the policy, or else may be a breach of contract for which SBA will be liable to the insurer for damages.

**i. When may the amount of required insurance be reduced?**

The amount of required insurance coverage may be reduced at the request of the borrower or by decision of the loan officer when:

- (1) The remaining coverage is sufficient to protect the SBA's interest;
- (2) The insurer is not liable for payment of damages incurred before the reduction or cancellation;
- (3) Any worthwhile unearned premiums on the canceled amount are to be applied to the loan account (if practicable); or
- (4) The insurer agrees to the reduction in outstanding coverage.

**j. Does the SBA purchase insurance in connection with direct or SBA-serviced loans?**

As a general practice, the SBA does not purchase insurance on property securing direct or SBA-serviced loans or COLPUR. The SBA is NOT a "self insurer". ("Self-insured" implies the existence of a reserve for losses or recourse to a blanket policy). Instead, the SBA simply chooses to assume the risk.

**(1) What do you tell the participant when SBA will not purchase insurance?**

For purchased SBA-serviced loans, you should notify the participant of the SBA's decision not to insure. You should also suggest that if the participant wants to obtain coverage for its insurable interest, the SBA will waive any right to share in any recovery under such special policy. (The participant will have to ascertain whether in its jurisdiction it has a legally insurable interest in the collateral and should be aware of the effect of coinsurance agreements.)

**(2) What are the exceptions when SBA may purchase insurance?**

The SBA may purchase insurance on SBA-serviced loans (and on Colpur) in the following situations:

- (a) When the value of the collateral will ensure full recovery, including the amount to be paid to purchase insurance;

- (b) When partial or total loss of the property may result in an enforceable claim against SBA as “mortgagee in possession” or otherwise;
- (c) When obligors from whom SBA can collect may be released from liability or the Agency might stand to lose other rights of recourse;
- (d) When maintaining reduced or no coverage may have an adverse “psychological” affect on (re)sale efforts. (In such situations, the enhanced (re)sale potential may easily justify the costs of the insurance coverage.) Consider also the risks created by visits by auction attendees or other prospective buyers; and
- (e) When ordered to do so by a court, the SBA must purchase the coverage necessary to comply with the order. If counsel is of the opinion that the order should be appealed, counsel must advise about the continuation of the coverage during the appeal process.

**k. May the participating lender purchase insurance when servicing a loan in liquidation?**

A participating lender who is handling a liquidation may purchase insurance if the lender would usually purchase insurance in such situations. SBA may share pro rata in the cost.

**l. How is the decision to purchase insurance made and approved?**

**(1) Joint decision.**

Ideally, the decision whether or not to purchase insurance should be a joint decision by the participating lender and SBA.

**(2) Advance determination by SBA.**

If the SBA decides that it does not wish to purchase insurance on a bank-serviced account, you must so notify the lender promptly. Your notification letter to the lender should advise that:

- (a) The SBA does not wish to purchase insurance on the lender-serviced loan;

- (b) The SBA waives any claim against the lender for failure to obtain insurance;
- (c) The lender is free to purchase insurance for its own account; and
- (d) The SBA waives any right to share in any recovery from any insurance it then purchases.

**(3) Prior lender action.**

At times, the lender might obtain) coverage before it receives SBA's notice. (The purchase of insurance is a normal practice in the private sector. You must assume that the lender was acting in good faith, unless you have evidence otherwise.) In either instance, the SBA receives the benefit of the coverage. SBA should share in its cost if it appears to be reasonable.

**(4) Approval/ratification.**

The approving official may:

- (a) Approve the joint decision to purchase insurance;
- (b) Ratify the lender's independent action; or
- (c) Authorize the pro rata sharing of the premiums as a CPC expense.

**m. How do you request funds for payment of insurance premiums?**

Each determination to pay premiums for insurance coverage of collateral or COLPUR must be documented by an SBA 327. The SBA 327 must include the following.

- (1) The loan officer's findings and recommendations, including:
  - (a) Statement that the advance is for premium payment for hazard insurance on specific SBA collateral or COLPUR, and no other property;
  - (b) Indication that the policy carries all mortgagee and other clauses required by the SBA and is properly assigned; and

(c) All the data required on disbursements. (See Chapter 19, “Administrative Costs, Advances, Expenses and Recoveries.”)

(2) Opinion of counsel (if pertinent); and

(3) Approval of the approving official.

**n. How must the SBA use insurance loss proceeds?**

(1) With a loan in liquidation or with COLPUR, you generally should not release insurance proceeds or use such funds to pay the costs of replacement or repair.

(2) If the loan’s maturity has not been accelerated, you must apply such funds (or the balance remaining after authorized repairs) to the principal balance (inverse order of maturity).

(3) If the loan has been accelerated, apply the proceeds directly to principal. On COLPUR, the funds must be considered as recovery.

**o. When may SBA use loss proceeds for repairs?**

You may use insurance proceeds to repair the property when:

(1) It is essential that the damage be repaired to preserve the property; or

(2) It is evident that repairing or replacing the property will enhance its value by an amount at least equal to the amount of funds to be used.

**p. When may the SBA release loss proceeds to the borrower or others?**

**(1) Full release.**

Insurance loss proceeds may be released to borrowers, contractors, vendors, or other appropriate parties when it is in the best interests of the SBA. The approving official must obtain satisfactory evidence that:

(a) The property has been repaired or replaced; and

(b) All materialmen’s or workmen’s claims or liens on the property have been or will be discharged simultaneously with the payment of loss proceeds.

**(2) Partial releases.**

Partial releases may be made as the repair or replacement progresses, provided satisfactory arrangements have been made for the discharge of any materialmen's or workmen's liens that could arise.

**(3) Do-it-yourself repairs.**

You must exercise care when the borrower proposes to repair the collateral on a "do-it-yourself" basis, and to use the funds for other than application to the loan balance. Often the repairs are less than adequate, which adversely affects the value of the property.

**(4) Overlapping coverage.**

A borrower will often carry multiple insurance policies with combined coverage on collateral and non-collateral property. Insurance loss proceeds on non-collateral property may be released to borrowers. However, unless such funds are to be used to restore the property, the borrower should be encouraged to apply the proceeds to the indebtedness due on the loan.

**(5) Supplemental liens.**

You should obtain new or supplemental liens on replacement property acquired with insurance proceeds by the borrower.

**(6) Coordinating settlements conducted by participant.**

The servicing lender should coordinate with the SBA any settlements with the insurance company.

**q. How do you handle insurance checks or drafts presented to the SBA for endorsement?**

All checks and drafts issued in settlement of loss or damage to collateral, and presented to SBA for endorsement, must be delivered to and recorded by the collateral cashier. The collateral cashier must give prompt notice to the responsible loan officer. When the borrower requests release of such checks and drafts, the following instructions apply:

**(1) Checks/drafts more than excess of \$5,000.**

Release must be authorized by an SBA 327 upon determination that:

- (a) The loan is current or else arrangements to cure any default are in force; and
- (b) The property has been restored, replaced, or is not needed by SBA.

**NOTE:** Where substantial funds are to be released for repairing or replacing property, appropriate arrangements for clearing all materialman's and workmen's liens should be made.

**(2) Checks/drafts of \$5,000 or Less.**

Release may be authorized for good cause and accomplished as follows:

- (a) The loan officer or loan servicing assistant may, if authorized to release such funds, initial the check register and endorse the check; and
- (b) The collateral cashier then may return the check to the borrower. The collateral cashier must leave a copy of transmittal letter or receipt and a photocopy of the check in the loan file.

**(3) Paid in full loans.**

If the loan is paid in full, any remaining insurance funds should be released to the party entitled to receive them. Consult counsel if you have any questions.

**r. What are the particular insurance requirements for COLPUR?**

All COLPUR which is sold on terms or leased must be covered by hazard insurance, and be otherwise insured as follows.

**(1) COLPUR sold on terms.**

The purchaser of COLPUR sold on terms, or on a deferred payment basis, must provide hazard insurance. You should require the same type of coverage private industry would require on similar property. The amount of fire and extended coverage should be the lesser of:



- (a) The market value of the insurable property; or
- (b) The unpaid balance of the purchase price less the liquidating value of the land and uninsurable improvements.

The purchaser should deliver the policy(ies) to the SBA at the closing of the sale. The SBA should retain the policy(ies) until the deferred portion of the purchase price has been paid in full.

**(2) COLPUR which is leased.**

- (a) Lessees must obtain, at their own expense, hazard insurance (including public liability) in an amount satisfactory to the SBA.
- (b) The amount of fire insurance coverage should equal the market value of the building(s) and other insurable improvements.
- (c) The liability coverage should coincide with private industry requirements for similar situations.
- (d) The lessee should deliver the fire policies and evidence of the liability coverage to the SBA at the beginning of the lease period.

**s. How do you handle unearned premiums from prepaid insurance after liquidation of the collateral?**

When collateral is sold and is not acquired by the SBA, you should generally surrender any prepaid insurance in force for the unearned premium. You may also transfer such insurance to the purchaser in exchange for payment of the unearned premium.

**(1) COLPUR.**

As a general policy, prepaid insurance on property acquired by the SBA should be kept in force by agreement with the insurer until its expires or until the sale of the property. When the SBA sells the COLPUR, at the time of sale, you should surrender the insurance for the unearned premium, or else transfer it to the purchaser in exchange for payment of the unearned premium. For exceptions to this policy, see subparagraph 1.j., “What Are the Exceptions When SBA May Purchase Insurance?”

**(2) Application of reimbursed funds.**

You must apply all unearned (prepaid) premiums received upon surrender of the insurance on the principal loan balance.

**(3) Paid in full accounts.**

When a loan is paid in full, you may release prepaid insurance policies to the next appropriate party in interest (e.g., next loss payee, trustee in bankruptcy). Consult counsel when in doubt as to the next proper party.

**2. Life Insurance.**

**a. How should you handle life insurance policies assigned as collateral?**

- (1) When life insurance is taken as collateral security for a loan or guaranty by either the Agency or a participant, the correct procedure is to obtain acknowledgment of the assignment by the home office of the insurance company. Note of the assignment is usually stamped on the policy.
- (2) Assigned life insurance is collateral. The authority to use its cash reserves or to release, subordinate or realize upon an assigned policy is within the delegations of authority for loan servicing and liquidation. Use an SBA 327 to effect such actions.

**b. What should you consider when you review assigned life insurance policies?**

When an account is transferred to liquidation, you should promptly examine any assigned life insurance policies to determine their status, options, and cash surrender value. You may remind a participant servicing a loan in liquidation to perform a review, and you may request a report on the results.

**(1) Valid endorsement.**

An assignment may not be perfected without a valid home office endorsement on the life insurance policy. In such case, you should promptly contact the insurance company.

(2) **Beneficiary versus assignee.**

It is important that SBA be named assignee, rather than beneficiary, because the insured may change the beneficiary at will, but an assignment cannot be changed without the consent of the assignee.

(3) **Face value.**

Determine if the face value has changed since loan closing.

(4) **Reinstatement and disability clauses.**

Most policies have clauses which provide for premium waivers and paid up benefits in the event of disability. If the insured is disabled, SBA, with the cooperation of the insured, may be able to negotiate paid up coverage.

c. **Who is responsible for keeping the required life insurance in force?**

**The borrower must keep the required life insurance in force.** Other obligors, guarantors, the named insured, and the named beneficiary have an interest in maintaining the policy. The SBA/lender should notify them of significant events affecting the policy, particularly the status of premium payments.

(1) **Payment by SBA or participant.**

Generally, neither SBA nor the servicing lender should advance funds to pay premiums on life insurance assigned as security for loans. However, such payment may be authorized by the approving official on a case by case basis to protect the interests of SBA/lender. You must fully document the justification in an SBA 327.

(2) **Use of cash and loan values for premium payment.**

Many policies provide for accrual of cash surrender values (CSV), which the insured may withdraw for loans and/or premium payment. Dissipation of the CSV should be avoided. If it is in the interests of the SBA, the Agency may authorize use of the cash reserves to keep the policy in force.

**d. Must you keep a separate follow-up system for assigned life insurance policies?**

No. Insurers generally contact all possible sources, including assignees, of nonpayment of premiums and of proposed cancellation of the policy. Therefore, you do not have to maintain a separate tickler or follow-up system for assigned policies.

**e. What do you do after you receive notice of nonpayment or of cancellation?**

You should make prompt contact with the borrower and guarantors if you receive notice that a premium is unpaid or that the insurance policy will be canceled. The loan file should contain:

- (1) The “past-due” or cancellation notice;
- (2) An indication of the actions you have taken; and
- (3) All response obtained.

**f. May you authorize life insurance to be released, reduced or substituted?**

The borrower should retain required life insurance at least until the loan is seasoned and/or otherwise secured. You may authorize the face amount to be reduced as the loan balance declines (327 action). Releases, reductions, or substitutions may be authorized on a case by case basis in view of:

- (1) Other adequate collateral;
- (2) A clean payment record; or
- (3) Other positive credit factors.

**g. How do you dispose of lapsed life insurance policies?**

The terms of the policy and/or the assignment usually govern disposition of the policy upon lapse. Otherwise, lapsed policies which have no cash surrender value, no dividends, no reserves, and which cannot be reinstated at the original insuring age may, if requested, be returned to the owner.

**h. How may the SBA use life insurance benefits?****(1) Non-death benefits.**

On loans in liquidation status, you should apply all non-death benefits arising from assigned life insurance policies (e.g., cash surrender value, dividends, reserves, policy loans) to reduce the principal loan balance.

**(a) Cash surrender values.**

You should surrender assigned life insurance policies to the insurer in return for the total cash value in the event:

- i. All of the other collateral has or will be liquidated to effect recovery on the loan account;
- ii. A deficiency balance exists (or is anticipated), and the insured or other parties at interest will not maintain the premiums in a current status; or
- iii. It would not be in the SBA's best interests to advance funds or use the reserves for payment of the premiums.

**(b) Notification of obligors.**

You should notify insured and all obligors about the impending policy surrender. Consult with counsel to determine if consent of obligors and beneficiaries is necessary.

**(c) Dividends.**

Dividends on assigned life insurance policies may be:

- i. Released;
- ii. Left with the insurance company to purchase additional coverage;
- iii. Applied to future premiums; or

- iv. Applied to the principal balance of the loan (inverse order of maturity).

**(d) Cash reserve.**

The cash reserve of an assigned policy may be:

- i. Withdrawn for payment of regular premiums (i.e., a premium loan). This approach may be beneficial to SBA if the insured/obligor is experiencing serious health problems and SBA is inadequately secured;
- ii. Applied to the costs of converting the policy to “paid up” insurance in an acceptable face amount; or
- iii. Withdrawn and applied to the principal balance of the SBA loan.

**(e) Release the policy.**

With documented justification, you may release the policy to the owner if the insured obtains a maximum policy loan, pays the proceeds to SBA, and pays the SBA an additional payment equal to the difference between the available cash surrender value and the loan amount. Another option would be for the insured to obtain a policy loan, pay the proceeds to SBA, and agree to pay future premiums, and interest on the policy loan, while SBA continues to hold the policy as assignee.

**(2) Death benefits.**

You must apply death benefits from an assigned life insurance policy to the principal balance of the loan as a recovery on collateral, unless otherwise authorized by an SBA 327.

- (a) Requests to use the funds for another purpose should be denied unless the loan is expected to be fully paid from other sources.
- (b) Escrow.
  - i. If the policy was owned by a guarantor, you may consider:
    - 1) Placing the funds in a special escrow account; or

- 2) Releasing the funds to the owner in exchange for collateral of equal or higher value.
- ii. Approval of such action should be based on the determination:
  - 1) That application of the funds to the SBA loan could be unfair or inequitable; and
  - 2) That the SBA's position in the loan does not support release of the funds without consideration, but neither does it require immediate application of the funds to reduce the loan balance.

**3. Liability Insurance. What is SBA's Policy on the Purchase of Liability Insurance?**

Generally, the SBA does not purchase liability insurance except as an incidental part of a hazard insurance policy. The exceptions are the same as those listed in subparagraph 1.j., "What Are the Exceptions When SBA May Purchase Insurance?"

**a. Borrower responsibility.**

To the extent that liability insurance is specifically required by the SBA, the borrower, term purchaser, or lessee is required to maintain it. However, as conditions change, such requirements may be adjusted (e.g., reduced, released) in the same manner as hazard insurance requirements.

**b. SBA-serviced accounts.**

Public liability claims arising from the SBA's use, maintenance, or ownership of property may sometimes be defended under the Federal Tort Claims Act. This factor supports the SBA's policy against specific purchase of public liability coverage.

**c. Lender-serviced accounts.**

If the participating lender is handling the liquidation of an account, the lender may purchase public liability coverage if such action is the regular practice of the lender in such situations. Notification, approval and reimbursement procedures are the same as in situations involving the purchase of hazard insurance.

**d. Term sales or leases of COLPUR.**

You should require term purchasers or lessees of COLPUR to obtain types, kinds, and amounts of insurance typical to private industry requirements for similar situations.



## CHAPTER 23 DISCLOSURE OF LOAN INFORMATION

### 1. What is SBA's Policy Governing Disclosure of Information About Loans?

This chapter provides a very general overview as it relates to "Disclosure of Information" (Freedom of Information Act (FOIA), and Privacy Act Procedures.

If a request for information is pursuant to subpoena, litigation discovery, or otherwise related to litigation matters, you must consult with the SBA attorney handling the case.

#### a. General guidance.

The SBA has very specific policies and guidelines about disclosing information about our loans and loan programs to the public.

- (1) You should review those policies before you disclose any information.
- (2) You also must consult with the FOIA officer in your office or SBA counsel in any situation where you have a question about whether you should disclose information.

#### b. Regulations and policies.

- (1) The SBA's regulations at 13 CFR Part 102;
- (2) The SBA's policies at SOP 40 03, "Disclosure of Information" (Freedom of Information Act); and SOP 40 04, "Privacy Act Procedures;"

#### c. General policy.

The SBA's policy generally is to disclose as much information as possible to the public, under the "openness in Government" policy in the FOIA. However, there are laws that prohibit you from disclosing certain types of information.

**2. Types of Information Generally Available to any Requester Under the Freedom of Information Act (FOIA).**

You may disclose some types of information about SBA's loan programs, or from a specific loan file, to any requestor. Examples of this information include:

**a. Official SBA policies, decisions, and forms, including:**

- (1) Regulations and standard operating procedures (SOP);
- (2) Opinion Digest;
- (3) Size decisions;
- (4) SBA's annual reports;
- (5) SBA forms and publications; and
- (6) Addresses and telephone numbers of SBA offices;

**b. Some information about individual loans, including:**

- (1) Names of all SBA borrowers;
- (2) Original amount of the loan;
- (3) Type of loan (e.g., FA\$TRAK, CAPLines, etc.); and
- (4) Mailing address of a borrower.

**c. Information that is a matter of public record, for example:**

- (1) Recorded mortgages, deed of trusts, fixture filings, and financing statements (UCC-1); and
- (2) Pleadings and documents already filed with a court.

**d. Aggregate statistical information about SBA's loan portfolio, as long as you do not identify specific loan names, for example:**

- (1) Number of SBA loans made to a particular racial/ethnic group;

- (2) Number of SBA loans made to women;
- (3) Number of loans in default status; and
- (4) Number of loans made in a particular city, county, or State.

**3. Types of Information that is “NOT” Available to any Requestor.**

You must NOT disclose the following types of information, to any requestor.

**a. SBA’s internal records which show SBA’s decision-making process, for example:**

- (1) Certain information contained in the 327 actions;
- (2) SBA legal opinions and comments;
- (3) Letters between SBA personnel and personnel from other Federal agencies unless approval is given by the other Federal agency; and
- (4) Certain information contained in the SBA loan officer’s reports.

**b. Some information about individual loans, for example:**

- (1) Status of the loan;
- (2) Racial/ethnic background of the borrower;
- (3) Gender of the borrower; and
- (4) Confidential business or financial information protected by exemption provided by FOIA or Trade Secrets Act, 18 U.S.C. § 1905.

**c. Information about a civil or criminal law enforcement investigation or prosecution, for example:**

- (1) Information which formed the basis for a referral to the Inspector General (IG);
- (2) Written reports made by an SBA employee to the IG;

- (3) Any information prepared by an SBA employee in support of an IG investigation; and
- (4) See Chapter 24, “Referrals to the Office of the Inspector General” for additional information on IG referrals.

**d. Information SBA has received from another Federal agency.**

You should direct the requester to that other agency.

**e. Information protected by FOIA or Trade Secrets Act, 18 USC § 1905.**

**4. What Must You Determine if You Receive a Request for Information Contained in a Loan File?**

**a. Who is the requestor?**

- (1) Where either the borrower or SBA’s lending partner (bank or CDC) for the loan is the requestor, go to SOP 50 50, Chapter 5, “Specific Loan Servicing Actions”.
  - (a) You may give out any of the information discussed in “Specific Loan Servicing Actions.”
  - (b) If the requestor wants other information, use the guidelines in this chapter.
- (2) Where an entity other than the borrower or lender/CDC is the requestor, you should, generally, (if the request is NOT pursuant to subpoena or related to litigation) consider the request to be subject to FOIA. However, SBA handles requests from the following entities in special ways:
  - (a) Congress;
  - (b) Federal and State agencies;
  - (c) Law enforcement personnel; and
  - (d) SCORE volunteers.

For these types of requests, you must consult with SBA counsel or the appropriate FOIA officer for assistance in responding to the request.

**b. Does the request have to be in writing?**

- (1) If the request is subject to FOIA:
  - (a) The request must be in writing;
  - (b) The requestor must be reasonably specific in describing the records he/she wants; and
  - (c) The requestor must state that he/she is asking for the information under FOIA.
- (2) You should advise the requestor of these requirements, if the requestor asks for information over the telephone.

**c. Does the requestor have borrower's written authorization to have access to the borrower's loan file?**

- (1) The FOIA requires that SBA give advance predisclosure notification (Executive Order 12600) to a borrower before disclosing any business information contained in the loan file in response to a FOIA request.
- (2) Where the requestor wants business information about a borrower, it is very helpful (but not required) if the requestor has the borrower's written permission. This will expedite processing of the FOIA request.

Examples of business information are:

- (a) Business tax returns and financial statements;
  - (b) Loan applications; and
  - (c) Business credit reports.
- (3) Business information is classified as a trade secret or as commercial or financial information which may be protected from disclosure under "Exemption 4" of FOIA or the Trade Secrets Act (18 USC § 1905).

- (4) Where the requestor wants personal information about a borrower, you must NOT disclose this information unless you have the borrower's written permission.

Examples of personal information are:

- (a) Personal tax returns and financial statements;
  - (b) Home addresses; and
  - (c) SBA Form 912, "Statement of Personal History."
- (5) If the requestor is the borrower's attorney or other agent, the borrower must provide written authorization to SBA allowing a direct response.

**d. Is the loan file covered by the Privacy Act?**

- (1) What files are covered by the Privacy Act?
  - (a) Generally, files covered or cross referenced by the Privacy Act are files which are filed under an individual's name or social security number.
  - (b) From time to time SBA designates specific categories of its files as covered by the Privacy Act. Examples of files which SBA currently has designated as covered are:
    - i. Disaster home loan files;
    - ii. Official personnel files (OPFs); and
    - iii. Litigation files.
  - (c) If you have any doubt about whether a certain file is covered, check with SBA counsel and SBA's Privacy Act System of Records. (Any records that the Government keeps which can be identified by name, social security number, or other identifier.)
- (2) Penalties for disclosure of information in a file covered by the Privacy Act.
  - (a) Only disaster home loans are covered by the Privacy Act. They are subject to a misdemeanor criminal conviction and/or up to a \$5,000

fine if an individual knowingly discloses information from that file without proper authorization.

- (b) In order to avoid these potential penalties, you must be sure whether the loan file the requester wants is covered by the Privacy Act. Check the Privacy Act Systems of Records.

**e. Is the loan “in litigation” status?**

If a loan is “in litigation” status, you must consult with the SBA attorney assigned to the loan before you disclose any information about the loan to any party.

**f. Should you consult with SBA counsel?**

If you have any doubt about whether it is permissible for you to disclose any information to any party you must consult with SBA counsel.

**5. What Must You Do if You Receive a Subpoena for Your Testimony or for SBA Records?**

**a. Consult with SBA counsel before you accept delivery of any subpoena directed to you personally or to the Agency.**

**b. Advise SBA counsel immediately after you receive a subpoena.**

- (1) If you receive any subpoena that asks for records or for your testimony, you must advise SBA counsel immediately.
  - (a) In some situations, the time period for court filing deadlines starts from the date you received the subpoena.
  - (b) If you do not deliver the subpoena to counsel immediately, SBA might miss a court deadline. You could harm SBA’s interests in some court proceedings.
- (2) The SBA policy requires SBA counsel to review every subpoena where SBA is not a named party in the lawsuit. (See 13 CFR § 102.12.) In all cases, SBA counsel must determine if SBA will comply, or may refuse to comply, with the subpoena.

- c. You must cooperate in complying with a subpoena, in accordance with counsel's advice.**

Your cooperation may include:

- (1) Assisting counsel in gathering SBA records to respond to the subpoena; and
- (2) Testifying in a State or Federal court proceeding.



**CHAPTER 24**  
**REFERRALS TO THE OFFICE OF THE INSPECTOR GENERAL (OIG)**

**1. Referrals to the Inspector General.**

- a. Except when otherwise instructed in writing by DOJ (or other Federal law enforcement agency) during a pending criminal investigation, SBA employees must immediately report to the Office of Inspector General (OIG) any known or suspected misconduct or irregularities involving SBA programs, program participants, or personnel.
- b. The purpose of the OIG referral process is to protect and maintain the integrity of SBA's programs.
- c. Under the IG statute, employees have the right and authority to report matters directly to the OIG, without prior supervisory approval.
- d. You may discuss the matter with your supervisor and/or SBA counsel prior to or as part of your referral. Often, this will be a good idea, especially when the suspected impropriety involves an outside party and may affect more than one program or loan. However, you are not required to do so.

**2. What Matters Must You Refer to the IG?**

**a. Improper conduct by SBA employees.**

You must immediately advise the IG of actual or suspected improper conduct by an SBA employee, for example:

- (1) Solicitation or acceptance of a bribe or gift;
- (2) Violations of any local, State, or Federal law in connection with SBA's activities; and/or
- (3) Violations of any rule or regulation which provides for protecting or maintaining the integrity of SBA's programs and operations.

**b. Irregularities committed by any non-SBA party in connection with an SBA Program.**

You must immediately advise the IG of actual or suspected irregularities committed by persons other than SBA employees, for example:

- (1) Misrepresentations, fraud, and false statements, committed by an applicant, borrower, guarantor, or participating lender, or by any of their agents, attorneys, or representatives;
- (2) Irregularities involving the collateral for SBA transactions, or the proceeds from the collateral. Refer to paragraph 7, "What Are Areas That Commonly Generate IG Referrals?" for additional information/exceptions on this subject);
- (3) Misuse of loan funds or any other funds in which SBA has an interest; and/or
- (4) Any conduct which is the subject of an investigation by another Federal, State, or local agency, for example, the Federal Bureau of Investigations (FBI) or the local police department.
- (5) Refusal of borrowers to provide needed records on request and instances of material discrepancies in lender or borrower loan records.

**c. Requests for the IG to conduct audits.**

You may refer to the IG for audit, any suspected violations committed by participating lenders or other parties participating in SBA's programs, for example:

- (1) Violations of SBA's regulatory requirements regarding loan servicing; and/or
- (2) Violations by an SBA office or program division of SBA's regulations regarding loan servicing.

**3. How Do you Make an IG Referral?**

**a. Telephone report.**

- (1) The IG prefers that SBA employees report improprieties first by telephone.
- (2) You must report the suspected impropriety by telephone to the special agent in charge (SAC) of Investigations with responsibility for your geographical area; or, to the Inspector General Hotline. (See your SBA Telephone Book.)

- (3) The IG representative will listen to your description of the facts of the situation, and will advise you as soon as possible whether the IG will pursue an investigation. The IG may need to make preliminary inquiries or records search in order to make this decision.
- (4) If the IG decides to pursue an investigation or needs further information, the IG may ask you to prepare a written referral.

**b. Written referral.**

If the IG requests that you submit a formal referral, you must prepare a written referral for submission to the SAC or regional IG for investigations with responsibility for your geographic area.

**4. What is the Format and Content of a Written IG Referral?**

**a. Written referral format.**

Your written referral should consist of the following elements when applicable.

- (1) A brief heading to identify the matter you are reporting, for example, misrepresentation, missing collateral, or possible conversion of collateral.
- (2) The complete name and address of the borrower or subject of the report.
- (3) The social security number, tax identification number, date of birth (or approximate age) of the borrower or subject of the report, if known.
- (4) The loan, grant, contract, or transaction number if any.
- (5) A brief statement of the factual basis for the report.
- (6) A brief statement of the nature of the suspected irregularity, including the approximate date the incident occurred.
- (7) A brief statement of significant actions taken to date and the current status.
- (8) The estimated dollar value involved, if known, and the basis for the estimate.
- (9) If the irregularity concerns a loan application, indicate whether the loan was approved or declined, and the date of this action.

- (10) If the irregularity or misconduct concerns an approved loan:
  - (a) The name, address, and tax identification number of the borrower and guarantor(s);
  - (b) The loan number;
  - (c) The amount and date of the loan approved and dates of disbursements, if any;
  - (d) The balance due;
  - (e) If the loan is delinquent, for how long;
  - (f) The participating lender's name, address, and percentage of participation; and
  - (g) Attach a copy of the loan officer's report.
- (11) If the borrower is not directly involved in the suspected irregularity, state the subject's personal or business relationship with the borrower, participating lender, contractor, or surety.
- (12) A brief statement as to whether the matters reported adversely affect SBA, any of SBA's employees, the loan applicant, the borrower, the participant, the contractor, or other claimant.
- (13) If the irregularity or misconduct concerns collateral:
  - (a) Last known location of the collateral;
  - (b) Best available description of the collateral, including identification/serial numbers;
  - (c) Estimated value of the collateral at date of loan application, and at date of sale or other disposition (cite these dates specifically);
  - (d) Any known details about the disposition of the property and/or the proceeds from the property;

- (e) Any explanation given by the borrower or other parties involved in the disposition of the property; and
- (f) Any actions taken by SBA personnel to locate and recover the property, and the results of these actions.

**b. Supervisory review.**

You are NOT required to obtain supervisory review and clearance of the written referral (especially in a situation involving suspected misconduct by another SBA employee). You may obtain supervisory review and counsel comments, if you choose.

**c. Supplemental reports.**

If you discover new or additional information about a matter which you already have referred to the IG, you must prepare a supplemental report. about this information. Send this report to the IG representative identified as handling the matter already referred.

**5. What Happens After You Refer a Matter to the IG?**

**a. IG investigation.**

The IG may choose to conduct an investigation into the particular matter you referred. The IG may also investigate the effect that the matter referred may have on a wider scale, for example, in other SBA offices, in other SBA loans made by the same participating lender, etc. The purpose of the investigation is to discover any violations of regulations or laws. If the IG discovers any such violations, the IG may refer the matter to the U.S. Attorney's Office for criminal or civil prosecution, or may use the information to help SBA maximize recovery on a loan.

**b. IG audit.**

- (1) The IG may choose to conduct an audit of, for example, a participating lender, an SBA office or division, or an SBA program. In this context, the IG will be looking for regulatory and policy violations or problems.
- (2) The IG uses audit information to suggest to the appropriate SBA program management officials how to improve administration of the program, or to decide whether the situation warrants an IG investigation.

**c. IG referral to the U.S. Attorney's Office, Criminal Division.**

The Criminal Division of the U.S. Attorney's Office is responsible for enforcing Federal criminal laws, through criminal law enforcement prosecutions. Parties prosecuted under criminal laws would be subject to incarceration and/or monetary fines. Criminal prosecutions can occur simultaneously with civil enforcement proceedings.

**d. IG Referral to the U.S. Attorney's Office, Civil Division, as Affirmative Civil Enforcement (ACE) Division.**

- (1) The Civil Division of the U.S. Attorney's Office is responsible for enforcing Federal statutes and regulations through civil law enforcement proceedings.
- (2) The Government can obtain monetary damages through such proceedings. This sometimes includes treble damages (the amount of the loss to the Government is tripled).
- (3) Civil enforcement proceedings can occur simultaneously with criminal prosecutions.

**6. What are Your Ongoing Responsibilities After You Have Referred a Matter to the IG?**

**a. Protect SBA's interests and maximize recovery on the loan.**

- (1) After you have made a referral to the IG on a particular loan, you remain responsible for taking appropriate and timely action on that loan. You still must protect SBA's interests and maximize recovery on the loan.
- (2) However, some actions you want to take on the loan or regarding a participating lender may interfere with an IG investigation in progress, or prejudice a criminal proceeding.

In order to avoid any harm to SBA's interests in these matters, you must:

- (a) Consult with your IG representative before taking any action on the loan, for example, before conducting a bank review on a participating lender or before deferring loan payments on a loan.

Consult with the IG representative before you advise "ANY" non-SBA party of the existence/referral of an IG investigation into a particular

matter. Giving this information to the subject of an investigation could interfere with or jeopardize the investigation.

- (b) Maintain close contact with the IG Representative so that you will be aware of the status of the investigation or litigation proceeding. You can use this information to make informed decisions about the actions you should take on the loan or loan program.

**b. Coordinate with SBA counsel where U.S. Attorney's Office is involved.**

- (1) When SBA has previously referred a loan to the U.S. Attorney's Office, for debt collection or otherwise:
  - (a) You must submit your written referral to SBA counsel, instead of directly to the IG representative;
  - (b) The SBA counsel is responsible for sending the report to the U.S. Attorney's Office, and sending a copy of the report to the IG representative; and
  - (c) These procedures also apply to any supplemental reports you prepare.
- (2) When you become aware of a referral of a matter to the U.S. Attorney's Office for criminal or civil law enforcement, you must:
  - (a) Advise local SBA counsel. Counsel will act as liaison with the U.S. Attorney's Office, and will monitor the litigation proceeding on the loan. You should give local counsel copies of all reports you already have given to the IG; and or
  - (b) Give local SBA counsel a copy of any supplemental reports you give to the IG representative on the matter.

**7. What Are Areas That Commonly Generate IG Referrals?**

**a. Missing or converted collateral.**

- (1) The Small Business Act prohibits converting, disposing of, concealing, or removing collateral securing an SBA loan. The U. S. Attorney's Office can prosecute any violation of this law. The penalty is up to a \$5,000 fine and up to a 5 year jail term for the violator.

- (2) You must refer to the IG, any missing or converted collateral valued at more than \$5,000. You may refer missing or converted collateral valued at \$5,000 or less if you have any facts indicating that the collateral was stolen, converted, vandalized, or otherwise wrongfully disposed of. You should make a referral even where you think that the circumstances do not show that any party had the motive to convert the collateral. The IG has the final authority to determine whether the circumstances warrant an investigation.

**b. Missing borrowers or guarantors (“skips”).**

You may refer to the IG, any situation involving missing obligors or guarantors, after local efforts to locate the individual have failed. The IG can run various information searches to assist you in locating the person. An example of this situation is where the borrower or guarantor is missing, and the loan funds are missing.

**c. Felony arrests and convictions of a borrower or guarantor.**

You must refer to the IG, any situation in which you discover that a party to the loan transaction has been arrested or convicted for a felony. The IG can obtain a criminal records check.

- (1) If the criminal records check reveals a past criminal history for the borrower, and the borrower did not report this information on his or her loan application forms, this omission may constitute a misrepresentation to the Government and fraudulent inducement of SBA to approve the loan.
- (2) The IG also might discover criminal activity which is under the purview of other agencies, for example, the Immigration and Naturalization Service (INS), the Drug Enforcement Agency (DEA), or the Internal Revenue Service (IRS). The IG may refer such matters to other Federal agencies, where appropriate.



