U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, D.C. 20416

November 21, 2013

The Honorable Lee Terry
U.S. House of Representatives
Washington, DC 20515

Dear Representative Terry:

Thank you for your letter regarding the Small Business Administration (SBA) 504 Loan Program. While the overarching mission of this program is to provide greater access to capital for small businesses trying to procure long-term fixed rate financing for fixed assets, the SBA also takes very seriously its responsibility to be a good steward of taxpayer dollars by minimizing losses related to the program. Acting Administrator Hulit has asked me to respond to your specific questions, which I have done below:

1. What actions are the SBA taking to try and reduce their loss rates on SBA 504/CDC loans?

   In order to reduce loss rates on 504 loans, SBA has taken actions both to reduce new defaults and to increase recoveries on defaulted loans in the new 504 Servicing and Liquidation SOP (SOP 50 55 – effective October 1, 2013). For example, SBA's policies and procedures related to deferments and workouts were revised to promote the resumption of payments from borrowers experiencing short term difficulty whenever feasible. The borrower deferment "catch-up payment" period was extended from 5 to 10 years to aid in this effort. And, in situations where default cannot be avoided, SBA has made it easier for the CDCs to do a better job of liquidating the loans by providing detailed information on a variety of collection methods that can be used to recover from obligors and collateral. (See response to #5 for a list of available collection methods.) In addition, the new SOP also emphasizes the Office of Credit Risk Management's ability to take administrative action or enforcement action when CDCs fail to properly service or liquidate their 504 portfolios.

2. What happens once a small business (borrower) is no longer able to pay back their debt to the SBA?

   In general, when it becomes apparent that a 504 borrower can no longer make payments to keep the note current and a deferment or catch up plan is not feasible, the note is accelerated, demand is made on the obligors, the loan is classified in liquidation, SBA purchases the debenture, and eligible obligors are referred to the Treasury Offset Program. Then, a liquidation plan is prepared by the CDC, reviewed by SBA and implemented. The liquidation plan considers and discusses the relevant factors affecting recovery of the loan, including site visit findings, feasibility of a workout, recoverable value of collateral, the obligors' ability to repay the loan, available methods of liquidation, contemplated litigation, the status of the Third Party Loans and other senior liens, and disclosure of other non-SBA loans made to the borrower by the CDC. After all of these factors are analyzed, a decision is made on the best course of action to maximize recovery on the defaulted loan.

a) Does the SBA place a lien on the business?

SBA places a lien on the Project Property at the time of the 504 loan closing and before the debenture sale. After default, SBA enforces its rights as a lienholder.

b) Is the SBA in the first or second lien position? Why?

SBA is usually in a second lien position behind the Third Party Lender in accordance with the statute and regulations governing the 504 loan program. See, Section 502(3)(E)(i) of the Small Business Investment Act of 1958 and 13 C.F.R. § 120.934.

3. If there are no cash assets to be recovered, does the SBA proceed with a liquidation of all existing assets of the property?

Yes, SBA proceeds with liquidation of the collateral securing the 504 loan.

4. If the private sector guarantor of the loan (such as a commercial bank) recovers more than they had at risk, does SBA recover the excess from this private sector entity?

a) For example: If a bank loans a business $50,000; the SBA loans $40,000 and an individual puts up $10,000, and then the business goes bankrupt. If the bank seizes the property in foreclosure and is able to sell it for $60,000, this is more than they had at risk. Does the SBA recover the surplus $10,000 from the bank?

Chapter 13 of SOP 50 55 discusses actions to be taken when the Third Party Lender's senior loan becomes delinquent and the Third Party Lender forecloses on the Project Property. In general, prudent and commercially reasonable actions must be taken to prevent elimination of SBA's lien securing the 504 loan or dissipation of any equity available to secure it, and provides guidance for determining what action should be taken under various scenarios.

Generally, if an unrelated third-party purchases the Project Property at the Third Party Lender's foreclosure sale for a price that is more than the amount owed on the Third Party Lender's loan, SBA receives the excess foreclosure sale proceeds.

On the other hand, if the Third Party Lender purchases the Project Property at its own foreclosure sale, and then sells the Project Property for a price that is more than the amount owed on the Third Party Lender's loan, the Third Party Lender is not required by law or contract to pay the surplus amount to SBA. SOP 50 55 outlines the circumstances under which SBA would authorize the entry of a Protective Bid at the Third Party Lender's foreclosure sale if there appears to be equity available for application to the 504 loan balance.

5. What steps does the SBA take in order to try and recover its investment? Is this an exhaustive list?

SBA tries to recover its investment through various actions, including:

- Workouts (i.e., restructuring of the loan terms)
- Assumption or Sale of Loan
- Administrative Wage Garnishment and Federal Salary Offset
- Liquidation of Real and Personal Property Collateral
- Release of Collateral for Consideration
- Release of Redemption Rights
- Offers in Compromise
- Suit for Judgment against Obligors and Guarantors
- Reimbursement by PCLP CDCs for their share of the loss
- Treasury Referral

For more information, please see SOP 50 55.

6. Of all the SBA 504/CDC loans that fail or go into default, what percentage of the amount of the loans are recovered by SBA through any and all means?

    a) For example: If the SBA has $1 million worth of 504/CDC loans go into default in a given fiscal year, what percentage of the value of that $1 million ends up being recovered?

SBA honors its guarantee by purchasing the debenture on defaulted loans and subsequently seeking recoveries as described above. Cumulative recovery rates for purchases tend to vary, depending on economic factors such as real estate values at the time of purchase, loan characteristics such as the size of the loan, and timing factors such as the amount of time that has passed since purchase. SBA's Office of the Chief Financial Officer produces a report displaying cumulative recovery rates for the 504 Program by fiscal year of loan purchase dating back to FY 2004. The report provides a detailed history of recovery rates over time and by year of purchase for the past ten fiscal years, and provides a more accurate answer than attempting to provide a specific recovery rate for a given fiscal year. The web-based report is accessible at: http://www.sba.gov/sites/default/files/files/WDS_Table10_RecoveryRates_Report(2).pdf

We appreciate your support of SBA and the Nebraska small business community. If you and your staff have any further questions, please contact Nicholas Coutsos, Assistant Administrator for Congressional and Legislative Affairs at (202) 205-6335.

Sincerely,

Ann Marie Mehlum
Associate Administrator
for Capital Access