



# SBA Information Notice

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**TO:** All SBA Employees

**CONTROL NO.:** 5000-1239

**SUBJECT:** Issuance of SOP 50 10 5(E) – Lender  
and Development Company Loan  
Programs

**EFFECTIVE:** 5/25/2012

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The Office of Capital Access is announcing the issuance of an update to the Standard Operating Procedure (SOP) 50 10 5 governing the 7(a) and 504 loan programs. This update will be known as 50 10 5(E) and will be effective on June 1, 2012. This version of the SOP will apply to all applications received by SBA on or after June 1, 2012.

As with previous editions of SOP 50 10 5, SBA will post two versions on the web site. The first version will show all changes as “tracked changes” to enable users to more easily identify what has been modified. (As a note, the Table of Contents has been updated but, for ease of viewing, those changes are not shown.) The second version incorporates all of the changes into the document. The revised SOP may be found on SBA’s website at [www.sba.gov](http://www.sba.gov).

This version of the SOP contains clarifications and changes to issues that arose after the previous update became effective on October 1, 2011. The 7(a) policy clarifications and changes include: (1) eligible uses of loan proceeds in Eligible Passive Company/Operating Company transactions; (2) the allowable charges for legal services, particularly in-house legal services; (3) the manner in which loan packagers may be compensated; (4) whether a personal Home Equity Line of Credit (HELOC) used for business purposes may be refinanced; (5) post-approval adjustments to the interest rate on a variable rate loan; (6) change of ownership situations involving stock purchases; (7) refinancing under CAPLines, particularly when an SBA-guaranteed revolving line of credit can be refinanced into a Working Capital CAPLine, and disbursement on a contract CAPLine; and (8) post-approval loan modifications. The 504 policy clarifications and changes include: (1) the eligibility of short-term debt to be included in project costs; (2) appraisal requirements; and (3) corresponding changes concerning fees for loan packaging for consistency with Subpart B governing the 7(a) program. In addition, several minor clarifications were made to Subpart B, Chapter 3 regarding paying fees to SBA electronically or through [www.pay.gov](http://www.pay.gov). Finally, two minor clarifications were made to the franchise sections and the eligibility of cooperatives was clarified in both Subparts B and C.

The following is a summary of the clarifications and changes made to this version of the SOP.

## **7(a) Loan Policy Changes**

### **Eligible Uses of Loan Proceeds in Eligible Passive Company/Operating Company Transactions**

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**EXPIRES:** 5/1/13

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SBA Form 1353.3 (4-93) MS Word Edition; previous editions obsolete  
Must be accompanied by SBA Form 58

On April 2, 2012, SBA published a direct final rule in the Federal Register to amend existing regulations to clarify the eligible uses of loan proceeds by an Operating Company (OC) in connection with an SBA-guaranteed loan to an Eligible Passive Company (EPC). (77 FR 19531) The direct final rule amends 13 CFR 120.111(a)(5) to clarify that if the OC is a co-borrower with the EPC, part of the loan proceeds of a 7(a) loan may be used for working capital or the purchase of other assets for use by the OC, including the purchase of stock or intangible assets (such as trademarks, copyrights, intellectual property, or goodwill). SBA also amended 13 CFR 120.120(b)(4) to conform to this change.

As SBA received no comments on this direct final rule, the amended regulations will be effective May 17, 2012. Therefore, applications for 7(a) loans received by SBA on or after May 17, 2012 may include loan proceeds for working capital or the purchase of other assets, including intangible assets, for the OC's use as long as the OC is a co-borrower with the EPC. Please note that loan proceeds for working capital and/or the purchase of other assets, including intangible assets, for the OC's use must be disbursed to the OC and cannot be disbursed to the EPC.

### **Allowable Legal Fees, Including In-House Legal Counsel**

SOP 50 10 5(D), Subpart B, Chapter 3, Paragraph VI.D.2 prohibited a lender from being reimbursed by the Small Business Applicant for work performed by lender's in-house legal counsel. SBA is changing that policy to allow lenders to be reimbursed for the direct costs (including reasonable overhead) of legal services provided by lender's in-house counsel in connection with an SBA guaranteed loan, but in no event may the lender be reimbursed for an amount that would exceed the reasonable cost of outside counsel. In accordance with Agency regulations at 13 CFR 120.222(e), charges for legal services (regardless of who provides the service) must be on an hourly basis and must be for requested services actually performed. In addition, as with fees charged for other services provided by the lender to the Small Business Applicant, such charges must be reasonable and customary for the services performed. These fees may be reviewed at any time and lender must refund any fee considered unreasonable by SBA. This change reflects the practice of many lenders on their non-SBA guaranteed commercial loans and will encourage the use of lower cost in-house counsel rather than outside counsel, which is typically more expensive. (The SOP language was revised and the provision was moved from Paragraph VI.D.2 to Paragraph VI.B.2.)

### **Allowable Fees for Packaging and Other Services**

SOP 50 10 5(D), Subpart B, Chapter 3, Paragraphs VI.B.1, IX.D.1 and IX.E.2 stated that fees charged either an applicant or a lender for loan packaging and other services must be reasonable and customary for the services actually performed and may not be a percentage of the loan amount. A standard (flat) fee also is not permitted under SOP 50 10 5(D). In order to more closely reflect the standard industry practice on conventional loans, SBA is revising this policy to permit lenders or third parties, including lender service providers (LSPs), to charge a fee based on a percentage of the loan amount for packaging and other services. The fees must be reasonable and customary for the services actually provided and must be consistent with those fees charged on the lender's similarly-sized, non-SBA guaranteed commercial loans. If a lender or third party charges a fee for loan packaging or other services that is based on a percentage of

the loan amount, in no event may the fee exceed 3% on loans of \$50,000 or less, and for loans over \$50,000, 2% on the first \$1 million and an additional ¼% on amounts over \$1 million, with a maximum fee of \$30,000.

In addition, a minor change was made to subparagraph IX.A.1.b) regarding fees paid in accordance with lender service provider agreements. Some language that was causing confusion was removed in order to clarify that fees paid by the lender to a lender service provider may not be passed on to the Small Business Applicant. Finally, a minor change was made to subparagraph X.D.2, also with regard to lender service provider agreements. A sentence was added to remind lenders that if they permit a lender service provider to access E-Tran on their behalf, the lender is responsible for all entries and certifications made on its behalf into the E-Tran system.

### **Policies regarding Debt Refinancing**

SOP 50 10 5(D), Subpart B, Chapter 2, Paragraph IV.E.2 stated that SBA-guaranteed loan proceeds may not be used to refinance debt in the personal name of the owner(s), with a limited exception for credit card debt in the owner's name that was used for business purposes. SBA recognizes that small business owners may have incurred personal debt other than through the use of a personal credit card (e.g., through a Home Equity Line of Credit or HELOC), and used the funds for business purposes. SBA believes that it is appropriate to expand the limited exception to include such other debt.

Therefore, SBA is allowing the refinancing of other debt in the personal name of the owner(s), such as a HELOC, that was used for business purposes. The borrower must certify that the amount being refinanced was used exclusively for business purposes and provide appropriate documentation, such as a copy of the note and/or current loan statement, to demonstrate that the debt was, in fact, used for business purposes. For example, a sole proprietor may demonstrate that the debt was used for business purposes by providing a copy of the note and documentation that shows the debt is reflected on the business balance sheet and/or the interest deduction is reported on the Schedule "C" not the Schedule "A" of the proprietor's tax return. If the interest deduction reported on the Schedule C includes multiple debts, then the applicant must provide a copy of the appropriate IRS Form 1098 related to the debt being refinanced.

### **Clarification of Interest Rate Policy on Variable Rate Loans**

SOP 50 10 5(D), Subpart B, Chapter 3, Paragraph IV.C.3.a) allowed the lender to delay the initial adjustment period on a variable rate loan, but also stated that "[w]henver a lender delays the initial adjustment period, the spread over the base rate used to calculate the initial Note rate must remain the same once the interest rate begins to fluctuate." That language is inconsistent with subparagraph 2 of the same SOP section, which describes the circumstances under which changes to the interest rate on a variable rate loan are permitted after the loan has been approved. SBA is deleting the sentence quoted above. Thus, for a loan with a delayed initial adjustment period, a Lender may change the spread over the base rate, provided the lender complies with the requirements of subparagraph 2.

## **Change of Ownership Transactions Involving Stock Purchases**

Numerous questions have arisen as to how a change of ownership transaction that involves the purchase of stock (as opposed to assets) can be accomplished with an SBA-guaranteed loan. Typically in a change of ownership transaction, one or more existing owners is purchasing the interest of an existing owner, or an outside party is purchasing the business. Because SBA requires the business to be the borrower, the loan cannot be made to an individual purchasing stock in the business, even if the individual is identified as a co-borrower with the business. For example, if a change of ownership involves one or more individuals:

In a change of ownership between existing individual owners, the applicant business will use the loan proceeds to purchase the stock from the departing owner(s) (a stock redemption) resulting in the remaining stockholder(s) owning 100% of the stock outstanding.

In a change of ownership where an individual wants to purchase all of the stock of a corporation, the applicant business will use the loan proceeds to purchase the stock of all existing owners (a stock redemption) and simultaneously issue the stock to the new owner(s), who will purchase the stock from the company using his/her own funds (but not with an SBA-guaranteed loan). The amount paid for the stock is determined by the business/new owner(s) (not SBA).

If the buyer of the stock is a business entity and that business is acquiring/merging with the selling business, then the buyer may use an SBA-guaranteed loan to purchase all of the stock and absorb the selling business and retire the purchased stock. (SOP 50 10 5(E), Subpart B, Chapter 2, Paragraph IV.H.)

## **Policy Regarding CAPLines**

### *Refinancing under Working Capital CAPLines*

SBA is clarifying the policy regarding debt refinancing under CAPLines. Specifically, SBA is clarifying that only short-term, revolving debt can be refinanced with a Working Capital CAPLine. In addition, SBA is clarifying the conditions under which an existing SBA-guaranteed short-term revolving line of credit (e.g., an SBA Express or Patriot Express revolving line of credit) can be refinanced with a Working Capital CAPLine. (SOP 50 10 5(E), Subpart B, Chapter 2, Paragraph IV.E.11.)

### *Disbursement on Contract CAPLines*

SBA is clarifying the length of time interest only payments may be required on a Contract CAPLine to reflect that final payment on the contract typically is not received until 30-60 days after contract completion. (SOP 50 10 5(E), Subpart B, Chapter 7, Paragraph IV.B.2.d(1).)

## **Post-Approval Loan Modifications**

SOP 50 10 5(D), Subpart B, Chapter 7, Paragraph I provided that lenders are to submit post-approval loan modifications for non-delegated loans to the Standard 7(a) Loan Guaranty Processing Center (LGPC) and for delegated loans to the appropriate Commercial Loan Servicing Center (CLSC). The SOP has been revised to inform lenders that, for all loans that have not been closed or fully disbursed, requests for post-approval loan modifications or notifications of unilateral actions are to be submitted to the LGPC. After a loan is closed and fully disbursed, such requests or notifications are to be submitted to the appropriate CLSC. In addition, the SOP has been revised to advise lenders that if a change is made using E-Tran Servicing, no further notification to SBA is necessary.

### **504 Loan Policy Changes**

#### **Eligible Project Costs**

SOP 50 10 5(D), Subpart C, Chapter 2, Paragraph III.H.4.a)(2)(a) permitted costs incurred by the Borrower, prior to the loan application, for the purchase of land without a building to be included in the project costs. SBA is amending the policy permitting the inclusion of short term debt for land purchased prior to application as an eligible project cost to include not only land with no building, but also land with a building that will be razed prior to construction of the new building. SBA considers the destruction of the building on purchased land to be part of the costs of preparing the land for new construction. The value of the land and new construction must be supported by an appraisal as set forth in SOP 50 10 5(E), Subpart C, Chapter 3, Paragraph II.A.

#### **Appraisal Requirements**

SOP 50 10 5(D), Subpart C, Chapter 3, Paragraph II.A.4 required the appraisal report to identify the CDC and SBA as a client and/or an intended user. To avoid additional expense to the Small Business Applicant, SBA is removing the requirement that the CDC be identified on the appraisal report as the client or an intended user. SBA, however, must continue to be named as either the client or an intended user.

#### **Fees for Agents**

For consistency with Subpart B governing the 7(a) program, corresponding revisions were made to Subpart C, Chapter 8, Paragraph IV.C.1, concerning fees charged by agents in connection with a 504 loan. In addition, a minor change was made to subparagraph IV.A.1.b) regarding fees paid in accordance with a Professional Services Contract. Some language that was causing confusion was removed in order to clarify that fees paid by a CDC in accordance with a Professional Services Contract may not be passed on to the Small Business Applicant.

#### **Additional Information**

Lenders, CDCs and other interested parties may continue to send suggestions concerning the SOP to SBA at [SOP50-10Modernization@sba.gov](mailto:SOP50-10Modernization@sba.gov). This e-mail box is set up to receive only.

Questions regarding SOP 50 10 5(E) should be directed to the lender relations specialist in the local SBA field office. The local SBA field office may be found at [www.sba.gov/localresources](http://www.sba.gov/localresources).

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