

SBA Policy Notice

TO: All SBA Employees and SBA Lenders

CONTROL NO.: 5000-17057

SUBJECT: Revised Guidance on Credit
Elsewhere and Other Provisions in
SOP 50 10 5(J)

EFFECTIVE: April 3, 2018

SBA's Standard Operating Procedure (SOP) 50 10 5(J), *Lender and Development Company Loan Programs*, became effective on January 1, 2018. Based on feedback received from SBA Lenders since the SOP was issued, SBA is issuing this Policy Notice to address lender concerns while SBA continues to review these issues. This Policy Notice revises the guidance on credit elsewhere for 7(a) and 504 loans and the minimum equity requirements for 7(a) loans involving change of ownership transactions between existing owners. In addition, SBA is issuing guidance regarding businesses that are involved with cannabis and their eligibility for SBA financial assistance. For consistency with this new guidance, SBA is also clarifying the leasing policies involving such businesses. Finally, SBA is reducing the minimum monitoring requirements for Working Capital CAPLines.

These changes are effective immediately and will control over any conflicting provisions in SOP 50 10 5(J). SBA will update the SOP after it has concluded its review of these issues and determined whether additional clarifications are needed.

Subpart B - 7(a) Loan Program

Demonstrate the Need for Desired Credit (Credit not available elsewhere) (13 CFR § 120.101), Chapter 2, Paragraph II.E.2.(page 97). This SOP paragraph currently provides that lenders must include in the credit memorandum a determination as to the availability of credit from non-Federal sources related to the Applicant, including but not limited to the liquidity of owners of 10% or more of the equity of the Applicant. Based on feedback from Lenders and Certified Development Companies (CDCs), SBA is increasing the minimum percentage ownership at which owners are subject to personal liquidity consideration from 10% to 20%. As a reminder, the liquidity of the owner includes the liquid assets of the owner's spouse and any minor children.

Businesses Engaged in any Illegal Activity (13 CFR § 120.110(h)). Chapter 2, Paragraph III.A.8. (Page 101). This SOP paragraph currently provides that businesses engaged in any activity that is illegal under federal, state or local law are ineligible for SBA financial assistance. SBA is issuing additional guidance to specifically address businesses that derive revenue from marijuana-related activities or that support the end-use of marijuana. The following applies to both 7(a) and 504 loans:

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SBA Form 1353.1 (12-93) MS Word Edition; previous editions obsolete
Must be accompanied by SBA Form 58

Marijuana-Related Businesses:

1. Because federal law prohibits the distribution and sale of marijuana, financial transactions involving a marijuana-related business would generally involve funds derived from illegal activity. Therefore, businesses that derive revenue from marijuana-related activities or that support the end-use of marijuana may be ineligible for SBA financial assistance.
2. Whether a business is eligible is determined by the nature of the business's specific operations. The following businesses are ineligible:
 - (a) "Direct Marijuana Business" -- a business that grows, produces, processes, distributes, or sells marijuana or marijuana products, edibles, or derivatives, regardless of the amount of such activity. This applies to personal use and medical use even if the business is legal under local or state law where the applicant business is or will be located.
 - (b) "Indirect Marijuana Business" -- a business that derived any of its gross revenue for the previous year (or, if a start-up, projects to derive any of its gross revenue for the next year) from sales to Direct Marijuana Businesses of products or services that could reasonably be determined to support the use, growth, enhancement or other development of marijuana. Examples include businesses that provide testing services, or sell grow lights or hydroponic equipment, to one or more Direct Marijuana Businesses. In addition, businesses that sell smoking devices, pipes, bongs, inhalants, or other products that may be used in connection with marijuana are ineligible if the products are primarily intended or designed for such use or if the business markets the products for such use.
 - (c) "Hemp-Related Business" -- a business that grows, produces, processes, distributes or sells products purportedly made from "hemp" is ineligible unless the business can demonstrate that its business activities and products are legal under federal and state law. Examples of legal hemp products include paper, clothing and rope.

Leasing Part of a Building Acquired with Loan Proceeds (13 CFR § 120.131). Chapter 2, Paragraph V.F.1.g (page 131). Currently, this SOP paragraph provides that, during the life of an SBA-guaranteed loan, the borrower may not lease space to a business that is engaged in any activity that is illegal under federal, state or local law. For consistency with the changes identified above regarding marijuana-related businesses, Lenders are advised that, during the life of the SBA-guaranteed loan, a borrower may not lease space to the ineligible businesses described above because the collateral could be subject to seizure and because payments on the SBA loan would be derived from illegal activity. If a borrower does lease to an ineligible marijuana-related business, SBA District Counsel should be consulted to determine what action should be taken.

Equity requirements (13 CFR § 120.150(f)). Chapter 4, Paragraph I.C.1.b)ii.(b)(ii) (page 174). This SOP paragraph sets forth the minimum equity injection requirements for a change of ownership transaction between existing owners (“partner buyout”) for 7(a) loans greater than \$350,000 and loans of \$350,000 or less that do not meet SBA’s minimum credit score requirements for 7(a) Small Loans. Currently, the minimum equity required for such transactions is a pro-forma equity position after the change of ownership of at least ten (10) percent of the total assets, or the remaining owner(s) must provide an additional equity injection that will result in at least a 10 percent net worth (maximum pro forma debt-to-worth ratio of 9:1).

Effective with the issuance of this Policy Notice, in order for a 7(a) loan to finance greater than 90% of the purchase price of a partner buyout: (1) the remaining owner(s) must certify that he/she has been actively participating in the business operation and held the same ownership interest in the business for at least the past 24 months (Lender must include in the credit memorandum confirmation that the borrower has made the required certification and retain such certification in the loan file); and (2) the business balance sheets for the most recent completed fiscal year and current quarter must reflect a debt-to-worth ratio of no greater than 9:1 prior to the change in ownership. In the event the Lender is unable to document that both (1) and (2) above are satisfied, the remaining owner(s) must contribute cash in the amount of at least 10% of the purchase price of the business, as reflected in the purchase and sale agreement.

Equity Requirements for 7(a) Small Loans. Chapter 4, Paragraph I.C.2.c)ii.(b)(ii) (page 178). For 7(a) loans of \$350,000 or less to finance a partner buyout (excluding SBA Express, Export Express, CAPLine and EWCP), Lenders must follow the revised minimum equity requirements identified immediately above.

Working Capital CAPLines – Monitoring. Chapter 7, Paragraph IV.K.4.a)ii.(i)iii. (page 245). This SOP paragraph currently sets forth the minimum monitoring requirements for Working Capital CAPLines. The semi-annual monitoring requirement was included in the most recent version of the SOP in error. Lenders must comply with the monthly, quarterly and annual monitoring requirements set forth in this SOP paragraph, but may disregard the semi-annual monitoring requirement.

Subpart C - 504 Loan Program

Demonstrate the Need for Desired Credit (Credit not Available Elsewhere) (13 CFR § 120.101). Chapter 2, Paragraph II.E.2. (page 275). This SOP paragraph currently provides that CDCs must include in the credit memorandum a determination as to the availability of credit from non-Federal sources related to the Applicant, including but not limited to the liquidity of owners of 10% or more of the equity of the Applicant. As stated above with respect to Subpart B, based on feedback from Lenders and CDCs, SBA is increasing the minimum percentage ownership at which owners are subject to personal liquidity consideration from 10% to 20%. As a reminder, the liquidity of the owner includes the liquid assets of the owner’s spouse and any minor children.

Businesses Engaged in any Illegal Activity (13 CFR § 120.110 (h)). Chapter 2, Paragraph III.A.8. (page 279).

CDCs must follow the guidance identified above regarding Marijuana-Related Businesses.

Leasing Part of a Building Acquired with Loan Proceeds (13 CFR § 120.131). Chapter 2, Paragraph IV.J.2.a)vii. (page 307).

CDCs must follow the guidance identified above regarding a borrower leasing space to another business during the life of an SBA-guaranteed loan.

Questions

If you have questions or need further assistance, please contact either Robert Carpenter, Acting 7(a) Policy & Program Chief at robert.carpenter@sba.gov or Linda Reilly, 504 Policy & Program Chief at linda.reilly@sba.gov.

Linda E. McMahon
Administrator