

SBA

SOP 50 51 3

LOAN LIQUIDATION

Office of Capital Access
U.S. Small Business Administration

November 15, 2010



SMALL BUSINESS ADMINISTRATION STANDARD OPERATING PROCEDURE

National

SUBJECT:	S.O.P.		REV
	Loan Liquidation	SOP 50 51	3

Introduction

1. Purpose: Update SBA policy and procedures on 7(a) and 504 liquidation
2. Personnel Concerned: All SBA Employees
3. SOP Canceled: SOP 50 51 2
4. Originator: Office of Capital Access

AUTHORIZED BY:		EFFECTIVE DATE: 11/15/10
Eric R. Zarnikow Associate Administrator Office of Capital Access		PAGE 1

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Chapter 1. Introduction

A. Purpose

The purpose of SOP 50 51 3 ("SOP") is to provide SBA personnel, Lenders and CDCs with standard operating policies and procedures for handling 7(a) and 504 Loans that are in default.

B. Authority

The policy and procedures set out in this SOP are based on Section 7(a) of the Small Business Act (15 U.S.C. § 636(a)), Title V of the Small Business Investment Act of 1958 (15 U.S.C. §§ 695, et seq.), and Subpart E of [Part 120](#) of Title 13 of the Code of Federal Regulations.

C. Resources

The forms, templates, tools and other resource materials referred to in this SOP are continually being updated and modified. The most current version of each is accessible from the "Electronic Lending" section of SBA's Web site, which is located at www.sba.gov/banking.

1. Forms and Templates

SBA forms and templates are accessible from www.sba.gov/banking by selecting the Web site for the appropriate SBA Loan Center, i.e., the [National Guaranty Purchase Center](#) ("NGPC") or the [Commercial Loan Servicing Centers](#) ("CLSC"). The most commonly used forms are listed below.

- a. [Liquidation Plan for 7\(a\) Loans](#) (SBA Form 1979)
- b. [Litigation Plan for 7\(a\) Loans](#)
- c. [7\(a\) Lender's Demand Letter for Guaranty Purchase](#)
- d. [Lender's Transcript of Account](#) (SBA Form 1149)
- e. [Wrap-up Report for Standard 7\(a\), CLP, PLP and EWCP Loans](#)
- f. [Offer in Compromise Form](#) (SBA Form 1150)
- g. [Financial Statement of Debtor](#) (SBA Form 770)

- h. [CDC Quarterly Delinquency Report](#)
- i. [Liquidation Plan for 504 Loans](#)
- j. [Litigation Plan for 504 Loans](#)
- k. [Wrap-up Report for 504 Loans](#)
- l. [Risk Management Database Form](#)

2. Environmental Risk Management Materials

The materials listed below are needed to comply with SBA's environmental risk management policy and procedures set out in Chapter 9. They are located in the Appendix to [SOP 50 10 5](#), which can be found on SBA's Web site at www.sba.gov by selecting "Tools" on the homepage, and selecting "SOPs" under "Library & Reference."

- a. Environmental Definitions—Appendix 2
- b. Environmental Reliance Letter—Appendix 3
- c. NAICS Codes of Environmentally Sensitive Industries—Appendix 4

3. Tools and Quick Reference Guides

Liquidation tools and guides developed by SBA, such as those listed below, are accessible from www.sba.gov/banking by selecting the Web site for the appropriate SBA Loan Center, i.e., the [NGPC](#) or the [CLSC](#).

- a. [7\(a\) Lender Action Matrix](#)
- b. [Tab System](#) for Standard 7(a), CLP, PLP and EWCP Loan Purchase Packages
- c. [Demand Kit](#) for Express and Pilot Loan Program Loan Purchase Packages
- d. [Tab System](#) for Recoverable Expense Payment Packages for Standard 7(a), CLP, PLP and EWCP loans

- e. [FAQ's](#), template, sample and instructions for SBA Form 1502 Reporting
- f. [Tab System](#) for Offer in Compromise

Chapter 2. Definitions

A. Introduction

The terms listed below have the same meaning wherever they are used in this SOP. Unless otherwise indicated, defined terms are capitalized wherever they appear.

B. General Terms

1. **7(a) Lender** or **Lender** means an institution that has executed a participation agreement with SBA under the 7(a) Guaranteed Loan Program.
2. **7(a) Loan** means a loan that was made under Section 7(a) of the Small Business Act.
3. **504 Loan** means a loan made under Title V of the Small Business Investment Act.
4. **Agency** means the U.S. Small Business Administration.
5. **Approving Official** means a supervisory or lead SBA staff member or SBA management official with appropriate authority to approve proposed Loan Actions.
6. **Associate of the Borrower** means an officer, director, Key Employee of the Borrower, or a Person who has an ownership interest of 20% or more in the Borrower's business; any entity in which one or more of the foregoing Persons has an ownership interest of 20% or more in the entity's business; or any Person in control of, or controlled by, the Borrower except a Small Business Investment Company licensed by SBA. ([13 C.F.R. § 120.10](#))
7. **Associate of a 7(a) Lender, CDC or Third Party Lender** or other senior lender means an officer, director, Key Employee of 7(a) Lender, CDC, Third Party Lender or other senior lender, or owner of 20% or more of the value of the 7(a) Lender, CDC, Third Party Lender or other senior lender's stock or debt instruments; an agent involved in the loan process; or any entity in which one or more of the foregoing Persons, or a Close Relative of any such Person, has an ownership interest of 20% or more. ([13 C.F.R. § 120.10](#))
8. **Authorization** or **Loan Authorization** means SBA's written agreement providing the terms and conditions under which SBA will guarantee a loan or a debenture.

9. **Authorized CDC Liquidator** ("ACL") means a CDC authorized to conduct 504 Loan liquidation and litigation pursuant to [13 C.F.R. § 120.975](#).
10. **Borrower** means the Person or Persons who executed the Note evidencing the SBA Loan.
11. **Certified Development Company** ("CDC") means an entity authorized by SBA to make 504 Loans to small businesses under sections 503 or 504 of the Small Business Act.
12. **Close Relative** means a spouse; a parent; a child; a sibling; or the spouse of a parent, child or sibling.
13. **Credit Bid** means an offer to purchase at a foreclosure sale submitted by a creditor who, instead of paying cash, will "credit" the bid amount against the debt owed to the creditor.
14. **Default Charges** means and includes all monetary amounts payable as the result of a default on a Third Party Loan or other senior loan such as prepayment penalties, late fees and interest paid at an escalated rate.
15. **Earliest Uncured Payment Default Amount** means the amount of the earliest regular installment of principal or interest that a Borrower fails to pay in full when due.
16. **Earliest Uncured Payment Default Date** means the date of the earliest failure by a Borrower to pay the full amount of a regular installment of principal or interest when due. Payments, which are made by a Borrower before the 7(a) Lender requests that SBA purchase its guaranty, are applied to the Earliest Uncured Payment Default Amount and if the installment is paid in full, the Earliest Uncured Payment Default Date advances to the next unpaid installment date. If the Borrower makes a payment after the 7(a) Lender has exercised its right to request that SBA purchase its guaranty, the Earliest Uncured Payment Default Date does not change. ([13 C.F.R. § 120.523](#))
17. **Early Default** means a default that occurred within 18 months of the initial disbursement of the proceeds from an SBA Loan (unless the final disbursement occurred more than six months after the initial disbursement, in which case the 18-month period will begin to run from the date of the final disbursement), unless the Borrower cures the default and makes scheduled loan payments for 12 consecutive months after the initial 18-month period.

The following events of default would constitute an Early Default if they occurred within the specified 18-month period: an unremedied failure by the Borrower to make one or more scheduled loan payments; funding scheduled loan payments from the sale of collateral rather than from business operations; deferment of more than three consecutive scheduled full payments; or a problem or event requiring the loan to be classified in liquidation status such as the filing of a bankruptcy petition.

18. **Good Faith**, whether capitalized or not, means the absence of any intention to seek an unfair advantage or to defraud another party; i.e., an honest and sincere intention to fulfill one's obligations in the conduct or transaction concerned.
19. **Guarantor** means a Person, other than the Borrower, who executed a Guaranty to secure payment of the Note.
20. **Guaranty** means SBA Form 148 (*Unlimited Guarantee*) or a substantially similar document executed by a Guarantor to secure payment of the Note.
21. **Key Employee** means, for purposes of this SOP, any Person hired by the business to manage day-to-day operations.
22. **Legal Counsel** is the generic term used for the attorney who performs the legal work discussed in this SOP on behalf of the 7(a) Lender, CDC or SBA.
23. **Liquidation Officer** is the generic term for the 7(a) Lender, CDC or SBA staff member who performs the credit functions discussed in this SOP.
24. **Liquidation Plan** means a 7(a) Lender's or CDC's written plan outlining the actions it intends to take to recover on an SBA Loan, which contains the information outlined in the template for [7\(a\) Loans](#) or the template for [504 Loans](#) accessible from www.sba.gov/banking.
25. **Liquidation Value** is the likely price collateral will sell for if sold quickly and with limited exposure to potential buyers. A Post-default Appraisal is necessary to determine the Liquidation Value of real or personal property collateral unless the collateral consists of:
 - a. Cash or Equivalent—the Liquidation Value of cash or cash equivalent items such as retirement accounts, trust funds, life insurance policies with a cash surrender value, certificates of deposit, letters of credit, or other commercial instruments should be the net amount arrived at after deducting verifiable, documented costs, such as penalties for early withdrawal;

- b. Motor Vehicles and Stock—the Liquidation Value of items that are customarily sold in a recognized market should be based on industry standards. For example, the Liquidation Value of motor vehicles should be based on NADA or Kelley Blue Book value, and the Liquidation Value of publically traded stock should be based on official stock exchange prices.
26. **Litigation Plan** means a 7(a) Lender or CDC's written plan outlining the litigation it intends to initiate or otherwise participate in to recover on an SBA Loan, which contains the information outlined in the template for 7(a) Loans or the template 504 Loans accessible from www.sba.gov/banking.
27. **Loan Action**, (formerly known as an SBA Form 327 Action), means an activity or decision regarding a specific SBA Loan including a decision not to engage in a particular activity. For example, a decision not to enter a Protective Bid at a senior lienholder's foreclosure sale is a Loan Action.
28. **Loan Action Record** means the paper or electronic documentation that memorializes a Loan Action taken with regard to a specific SBA Loan.
29. **Loan Documents** means the Authorization, Note, Guaranty, lien instruments, and all other agreements and documents related to an SBA Loan.
30. **Loan File**, whether capitalized or not, means the electronic or paper folder dedicated solely to storing a hard copy or electronic copy of all of the Loan Documents pertaining to a specific loan.
31. **Loan Program Requirements** means the requirements imposed on 7(a) Lenders or CDCs by statute, SBA regulations, any contract between SBA and the 7(a) Lender or CDC, applicable SOPs, Loan Authorizations, official SBA notices, forms and program guides as such requirements are issued and revised by SBA from time to time. For CDCs, this term also includes requirements imposed by debentures, as that term is defined in [13 C.F.R. § 120.802](#).
32. **Material Loss** means: (a) with regard to personal property collateral—a single loss or the aggregate amount of multiple losses totaling \$2,500 or more; and (b) with regard to real property collateral—a loss in the amount of \$5,000 or more.
33. **Must**, whether capitalized or not, means that the action is mandatory.

34. **Non-recoverable Expenses** means the costs associated with the liquidation or litigation of an SBA Loan that cannot be added to the principal balance of the Note because, for example, the costs are not related to collection of amounts due under the Note, enforcement of the terms of the Loan Documents, preservation or disposal of the collateral for the loan; were not necessary, reasonable or customary; or were not incurred in accordance with prudent lending practices or Loan Program Requirements.
35. **Non-routine Litigation** means: (1) all litigation where factual or legal issues are in dispute and require resolution through adjudication; (2) any litigation where legal fees are estimated to exceed \$10,000 in the aggregate; (3) any litigation involving a loan where a 7(a) Lender or CDC has an actual or potential conflict of interest with SBA; or (4) any litigation involving a 7(a) or 504 Loan where the 7(a) Lender or CDC has made a separate loan to the same Borrower which is not a 7(a) or 504 Loan. ([13 C.F.R. § 120.540\(c\)\(1\)](#))
36. **Note** means the promissory note executed by the Borrower on the SBA Loan.
37. **Obligor** means and includes every Person with direct liability for repaying an SBA Loan such as the Borrower and any assumptor, and every Person with contingent liability such a Guarantor.
38. **Office of Financial Assistance ("OFA")** means the SBA office in charge of administering SBA's 7(a) and 504 loan programs.
39. **Person** means any individual, corporation, partnership, limited liability company, association, unit of government, or other legal entity, however organized.
40. **Pilot Loan Program** means and includes the following SBA loan programs: Community Express, Patriot Express and Export Express. It also includes the Gulf Opportunity ("GO") pilot loan program and loans made under future SBA pilot loan programs.
41. **Post-default Appraisal or Appraisal** means an expert's written opinion as to the value of specific property obtained in accordance with following requirements:
- a. **Qualifications of Appraiser**
- A Post-default Appraisal may be performed by an appraiser, broker, auctioneer, retail inventory specialist or other expert, provided that the Person meets the following minimum qualifications:

(1) Education and Experience

Has the specific education, training and experience required to develop a professional opinion as to the value of the specific type of property involved;

(2) Licensed and Bonded

Meets all applicable licensing and bonding requirements;

(3) Independent

Has no real or apparent conflict of interest with SBA, the 7(a) Lender, CDC, or Obligor; and has no financial interest in the property to be appraised; and

(4) Insured

Maintains insurance coverage, either as required by applicable law or if not required by law, which is sufficient to compensate SBA and 7(a) Lender or CDC for any loss suffered as a result of an error or omission.

b. Appraisal Standards**(1) Real Property**

A Post-default Appraisal of real property may consist of a real estate agent's opinion as to fair market value unless prudent lending practices require an appraisal that complies with the Uniform Standards of Professional Appraisal Practice.

(2) Personal Property

A Post-default Appraisal of personal property may consist of an auctioneer or other expert's opinion as to Liquidation Value unless prudent lending practices require an appraisal that complies with the Uniform Standards of Professional Appraisal Practice.

c. Report Format

All Post-default Appraisal reports should contain the following:

- (1) The appraiser's opinion as to value of the property, including an opinion as to the individual value of any item of personal property valued at \$5,000 or more at the time the loan was made;
- (2) An explanation as to the type of valuation, i.e., purpose of the appraisal, and how the appraisal is to be used;
- (3) The methodology, standards, resources and markets the appraiser used or relied on;
- (4) A complete and accurate description of the collateral, including its current condition, photographs, and the serial numbers of significant items of personal property, i.e., items with a Liquidation Value of \$5,000 or more;
- (5) The dates and location of the appraisal inspection, and the effective date of the valuation;
- (6) A statement by the appraiser that he or she has no financial interest in the property or conflict of interest with SBA, 7(a) Lender, CDC or Obligors; and
- (7) The appraiser's qualifications and signature.

d. Age of Appraisal

Generally, a Post-default Appraisal should be less than 120 days old, and must never be more than one year old, at the time SBA, the 7(a) Lender or CDC relies on it to make a decision affecting an SBA Loan.

42. **Post-default Environmental Investigation** means an Environmental Investigation conducted in accordance with the requirements set out in Chapter 9.
43. **Post-default Environmental Investigation Report** means the written account of a Post-default Environmental Investigation conducted in accordance with the requirements set out in Chapter 9.
44. **Preference** means any arrangement not pre-approved by SBA that gives a 7(a) Lender or a CDC a preferred position compared to SBA relating to the making, servicing, or liquidation of an SBA Loan. ([13 C.F.R. § 120.10](#))

45. **Protective Bid** means an offer made by a secured creditor to pay a designated price for property at a foreclosure sale to "protect" the secured creditor's interest in the property that might otherwise be eliminated by the foreclosure sale.
46. **Purchase**, whether capitalized or not, when used in conjunction with SBA's 7(a) loan guaranty ("guaranty purchase"), refers to SBA's purchase of the guaranteed portion of a 7(a) Loan; and when used in conjunction with SBA's 504 Loan debenture guaranty ("debenture purchase"), purchase refers to SBA's purchase of the debenture sold to fund the 504 Loan.
47. **Purchase Package** means the packet of documentation prepared and submitted by a 7(a) Lender to support its request to have SBA honor its guaranty by purchasing the guaranteed portion of the loan.
48. **Real Estate Owned** ("REO") means real property collateral acquired by a 7(a) Lender, CDC or SBA (formerly referred to by SBA as "COLPUR").
49. **Recommending Official** means an SBA staff member responsible for making recommendations regarding proposed Loan Actions that require approval by the Rule of Two.
50. **Recoverable Expenses** means the SBA approved, necessary, reasonable and customary costs incurred to collect amounts due under the Note, to enforce the terms of the Loan Documents, or to preserve or dispose of collateral, which according to the terms of the Note can be added to the principal balance of the loan.
51. **Recoverable Value** means the net dollar amount that a secured creditor complying with prudent lending standards could reasonably expect to recover from collateral. Recoverable Value is determined by deducting the following amounts from the Liquidation Value of the collateral:

a. **Senior Liens**

The balance owed on senior liens, including landlord liens and tax liens, taking into account any relevant Loan Document such as a Third Party Lender Agreement, landlord lien waiver, subordination agreement, or senior lienholder agreement;

b. **Extraordinary Recoverable Expenses**

The cost of any other large Recoverable Expense not addressed in subsection c below, such as necessary Remediation;

c. Other Costs

If appropriate, 10% of the remaining Liquidation Value to reflect the estimated total of the following expenses:

- (1) Cost of appraisals and Environmental Investigation Reports;
- (2) Cost of title reports or U.C.C. lien searches;
- (3) Pre-foreclosure sale collateral care and preservation expenses;
- (4) Costs of foreclosure sale;
- (5) Eviction costs;
- (6) Post-foreclosure sale REO or acquired personal property care and preservation expenses;
- (7) REO or acquired personal property collateral resale costs; and
- (8) Any other Recoverable Expenses.

52. **Repair** means an agreement between SBA and a 7(a) Lender as to a specific dollar amount that will be deducted from the amount SBA pays on the Lender's guaranty in order to fully compensate SBA for an actual or anticipated loss caused by the Lender.
53. **Routine Litigation** means uncontested litigation, such as non-adversarial matters in bankruptcy and undisputed foreclosure actions, the estimated legal fees for which will not exceed \$10,000 in the aggregate. ([13 C.F.R. § 120.540\(c\)\(2\)](#))
54. **Rule of Two** means the SBA decision-making process that requires the concurrence of two authorized Agency Officials: a Recommending Official and an Approving Official.
55. **SBA Loan**, whether capitalized or not, means and includes both 7(a) and 504 Loans.
56. **SBA Loan Center** means the following SBA facilities:

a. National Guaranty Purchase Center ("NGPC")

Address:

1145 Herndon Parkway, Suite 900
Herndon, VA 20170

Telephone Numbers:

Phone: (703) 487-9283
Toll Free: (877) 488-4364

Fax Number:

General: (202) 481-4674
Expense Reimbursement: 202-481-4599
Wrap-up Reports: 202-292-3789

Email:

General inquiries: loanresolution@sba.gov
Loans sold on the secondary market: secondarymarketliq@sba.gov
Loans not sold on the secondary market: sbapurchase@sba.gov
Expense Reimbursement: SBACPC@sba.gov
Wrap-up Reports: SBACChargeoff@sba.gov

Hours of Operation:

Monday - Friday 8:00 A.M. to 4:30 P.M. Eastern Time

b. SBA Commercial Loan Service Center West

Address:

2719 N. Air Fresno Drive, Suite 107
Fresno, CA 93727

Telephone Numbers:

Phone: (559) 487-5136
Toll Free: (800) 347-0922

Fax Numbers:

Servicing: (202) 481-0483
Express and Pilot Loan Program Guaranty Purchases: (202) 481-0663
Express and Pilot Loan Program Liquidation: (202) 481-0663
504 Loan Liquidation: Fax Number: (202) 481-6481

Email:

Servicing: fsc.servicing@sba.gov

Express and Pilot Loan Program Liquidation Notices & Guaranty Purchases: fsc.purchasing@sba.gov
 504 Loan Liquidation: fsc.504liquidations@sba.gov

Hours of Operation:

Monday - Friday 8:00 A.M. to 4:30 P.M. Pacific Time

c. SBA Commercial Loan Service Center East

Address:

2120 Riverfront Drive, Suite 100
 Little Rock, AR 72202-1794

Telephone Numbers:

Phone: (501) 324-5871
 Toll Free: (800) 644-8564

Fax Numbers:

Servicing: (202) 292-3878
 Express and Pilot Loan Program Guaranty Purchases: (202) 292-3877
 504 Loan Liquidation: (202) 481-6481
 Lender Liaison: (202) 741-6959

Email:

Servicing: lpsc.servicing@sba.gov
 Express and Pilot Loan Program Liquidation Notices & Guaranty Purchases: lpsc.expresspurchase@sba.gov
 504 Loan Liquidation: lpsc.504liquidation@sba.gov
 Customer Service: lpsc.customerservice@sba.gov

Hour of Operation:

Monday - Friday 8:00 A.M. to 4:30 P.M. Central Time

57. **Should**, whether capitalized or not, means that the action or procedure is preferred, but not mandatory.
58. **Third Party Lender** means a commercial or private lender, investor or Government Entity that made a loan, which is part of the financing for a 504 Loan project.
59. **Third Party Loan** means a loan made by a Third Party Lender, which is part of the financing for a 504 Loan project.

- 60. Wrap-up Report** refers to the document or documents summarizing the liquidation activities on an SBA Loan that 7(a) Lenders and CDCs must submit to the appropriate SBA Loan Center when the liquidation process is complete pursuant to Chapter 20, Paragraph E.

C. Environmental Terms

The definitions of the environmental terms used in this SOP are the same as those used in SOP 50 10 5. They are located in Appendix 2 of [SOP 50 10 5](#), which can be found on SBA's Web site at www.sba.gov by selecting "Tools "on the homepage, and selecting "SOPs" under "Library & Reference."

Chapter 3. Classifying Loans in Liquidation

A. When Loans Must Be Classified in Liquidation Status

An SBA Loan must be classified in liquidation status if any of the adverse events listed below occur:

1. The loan is more than 60 days past due with no prospect of a deferment or a workout;
2. A Third Party Lender or another senior lienholder has initiated a foreclosure action against collateral securing the loan;
3. A lawsuit, which will adversely affect repayment of the SBA Loan, has been initiated against an Obligor;
4. An Obligor has filed a voluntary petition in bankruptcy, or an involuntary petition in bankruptcy has been filed against an Obligor;
5. The Borrower's business has been shut down or abandoned and the Obligors have not made other arrangements to repay the SBA Loan;
6. Substantial collateral has been abandoned or is in danger of disappearing, losing its value, or being stolen;
7. A receiver has been appointed by a court, or some other action has been initiated to liquidate the collateral or an Obligor's assets; or
8. Any other circumstances that could substantially and adversely affect repayment of the SBA Loan.

B. When Loans Should Be Removed from Liquidation Status

SBA Loans should be removed from liquidation status and returned to regular servicing after three consecutive timely payments have been made pursuant to a written workout agreement, bankruptcy plan, reaffirmation agreement, assumption or other written agreement that cures the default.

Chapter 4. SBA Liquidation

A. Responsibility and Authority

When an SBA Loan is classified in liquidation status, one of the three SBA Loan Centers listed below is responsible for either (1) liquidating the loan; or (2) overseeing the liquidation conducted by a 7(a) Lender or CDC.

1. National Guaranty Purchase Center (Herndon, VA)

Standard 7(a), CLP, PLP and EWCP Loans;

2. SBA Commercial Loan Service Center West (Fresno, CA)

- a. Express and Pilot Loan Program 7(a) Loans made in the western or mid-western United States; and
- b. 504 Loans made in the western or mid-western United States.

4. SBA Commercial Loan Service Center East (Little Rock, AR)

- a. Express and Pilot Loan Program 7(a) Loans made in the eastern or mid-eastern United States; and
- b. 504 Loans made in the eastern or mid-eastern United States.

B. Performance Standards

In general, SBA personnel must ensure that all SBA Loans are liquidated in a prompt, cost-effective, prudent and commercially reasonable manner consistent with applicable Loan Program Requirements.

C. Loan Actions

1. Rule of Two Approval

Loan Actions must be approved pursuant to the Rule of Two whenever required by this SOP.

2. Documentation Requirements

a. Loan Action Record

Loan Actions requiring approval pursuant to the Rule of Two must be documented by a Loan Action Record.

b. Contents of Loan Action Record

A Loan Action Record should include the following:

- (1) The Borrower's name and loan number;
- (2) A reasonable description of the Loan Action;
- (3) The justification for the Loan Action including an analysis of any supporting documentation; and
- (4) The recommendation and signature of the Recommending Official and the approval and signature of the Approving Official if the Loan Action required approval pursuant to the Rule of Two.

c. Format

A memo, email, letter, SBA Form 327 or other document may serve as a Loan Action Record provided that it meets the requirements of Subparagraph C.2.b. above.

d. Recordkeeping

Loan Action Records should be numbered according to the chronological order in which the Loan Actions occurred and placed in the loan file along with the supporting documentation, if any.

3. Review by Legal Counsel

- a. Legal Counsel must review and comment on the legal issues related to Loan Actions proposed by SBA Liquidation Officers, as well as Lenders and CDCs who have submitted requests on Loan Actions requiring SBA approval, if the proposed Loan Action involves:

- (1) Any issue concerning a loan classified in litigation status;

- (2) Any issue with legal implications including CDC requests for reassignment of Loan Documents and exceptions to policy;
 - (3) Conflicts of interest and Preferences;
 - (4) Acquisition of Contaminated Property or a business that handles Hazardous Substances;
 - (5) Purchase reviews pertaining to 7(a) Loan guaranties and 504 Loan debentures;
 - (6) Review of Litigation Plans and Liquidation Plans that include litigation expenses;
 - (7) Payment of attorneys' fees and costs;
 - (8) Compromise;
 - (9) Charge-off;
 - (10) Redemption rights;
 - (11) Substantive revisions to a Loan Authorization if SBA approval of the changes is required;
 - (12) Modification of the terms of any Loan Document;
 - (13) Workouts;
 - (14) Deeds in lieu of foreclosure;
 - (15) Transfer of a loan out of litigation status;
 - (16) Subordination;
 - (17) Assumption; or
 - (18) Transfer of title to REO.
- b. Legal Counsel should review and comment on the legal issues related to Loan Actions proposed by SBA Liquidation Officers, as well as Lenders and CDCs who have submitted requests on Loan Actions requiring SBA approval, if the proposed Loan Action involves:

- (1) Transfers of a loan into litigation status;
- (2) Sale of a loan;
- (3) Transfer of a loan to another 7(a) Lender or CDC;
- (4) Release or substitution of collateral;
- (5) Release or substitutions of Obligors;
- (6) Purchase, pay off, or payment on a loan secured by a senior lien;
- (7) Payment of real estate taxes;
- (8) Protective Bids;
- (9) Credit Bids; or
- (10) Abandonment of collateral or acquired collateral.

4. Split Decisions

If the Approving Official does not approve a proposed Loan Action that requires approval by the Rule of Two, the Approving Official must add comments and recommendations and refer the matter to the SBA official with the next higher level of decision-making authority.

5. Exceptions to Policy

When the policy set forth in this SOP does not adequately address the unique circumstances regarding a particular loan, an exception to policy may be appropriate provided it does not contravene any applicable regulation. Exceptions to policy must be approved by the Director of OFA or designee pursuant to the Rule of Two and documented by a Loan Action Record.

Note: See Chapter 22 (*7(a) Guaranty Purchase*), Chapter 23 (*Denial of Liability on a 7(a) Guaranty*) and Chapter 25 (*Debenture Purchase*) for information on authority to deny liability or to recover funds already paid on a 7(a) guaranty or 504 Loan debenture.

D. Review of Quarterly Status Reports**1. Liquidation Officer**

Liquidation Officers should promptly review the Quarterly Status Reports submitted by 7(a) Lenders following guaranty purchase and by CDCs following debenture purchase to ensure that the loan is being liquidated in a prompt, cost-effective, prudent and commercially reasonable manner consistent with Loan Program Requirements; and must provide a copy of any report that covers Non-routine Litigation conducted by a 7(a) Lender or CDC and Routine Litigation conducted by a CDC to the local District Counsel responsible for monitoring the litigation.

2. District Counsel

The SBA District Counsel responsible for the geographic area where the litigation is taking place should promptly review Quarterly Status Reports covering Non-routine Litigation conducted by a 7(a) Lender or CDC and Routine Litigation conducted by a CDC to ensure that:

- a. The attorney performing the litigation activities has the qualifications set out in Chapter 15 (*Litigation*);
- b. The litigation, fees and costs involved are necessary, reasonable and customary;
- c. The outcome will not adversely affect SBA's administration of the loan program; and
- d. The remedies sought are adequate, i.e., that it is not necessary for SBA to take over the litigation to obtain remedies that are only available to the Federal Government. ([13 C.F.R. § 120.540\(d\)](#))

E. Review of Requests for Loan Action Approval**1. Liquidation Officer**

Liquidation Officers are responsible for serving as the Recommending Official and reviewing all requests from 7(a) Lenders and CDCs for approval to take actions requiring SBA's prior written approval.

2. Legal Counsel

Legal Counsel are responsible for reviewing and commenting on the legal issues related to all requests from 7(a) Lenders and CDCs for approval to take actions set out above in Paragraph B.3.

3. Approving Official

Supervisory Liquidation Officers serve as the Approving Official with regard to all requests from 7(a) Lenders and CDCs for approval to take actions requiring SBA's prior written approval.

4. No Approval if 7(a) Lender or CDC Has Unilateral Authority

SBA's written approval should not be provided for proposed Loan Actions that a 7(a) Lender or CDC has unilateral authority to take.

5. SBA Response Time

Generally, SBA should respond to a 7(a) Lender or CDC's request for approval of proposed actions requiring SBA's prior written approval within 15 business days. ([13 C.F.R. § 120.541\(a\)](#))

Chapter 5.
7(a) Lender Liquidation

A. Responsibility

1. A 7(a) Lender is responsible for conducting all liquidation activities on the 7(a) Loans in its portfolio both before and after SBA purchases the guaranteed portion.
2. A 7(a) Lender is required to pursue collection of the entire debt on each 7(a) Loan—not just the 7(a) Lender's non-SBA guaranteed portion—regardless of the guaranteed percentage or whether the guaranty has been purchased.

B. Authority

1. Unilateral Authority

Except as provided in Subsection 2 below and provided that its actions are consistent with the performance standards set out in Paragraph D below, a 7(a) Lender has unilateral authority to take all necessary action to liquidate a 7(a) Loan.

2. Actions Requiring Prior SBA Approval

See the [7\(a\) Servicing and Liquidation Action Matrix](#), which is accessible from www.sba.gov/banking, or [13 C.F.R. § 120.536](#) for a detailed list of actions that require prior written approval from the appropriate SBA Loan Center.

3. How to Obtain SBA Approval

a. Where to Submit Requests

Requests for approval of proposed Loan Actions requiring SBA's prior written approval should be submitted to the appropriate SBA Loan Center:

(1) Standard 7(a), CLP, PLP and EWCP Loans

The National Guaranty Purchase Center in Herndon, Virginia;
and

(2) Express and Pilot Loan Program Loans

- (a) The SBA Commercial Loan Service Center in Fresno, California for loans made in the western and mid-western United States; or
- (b) The SBA Commercial Loan Service Center in Little Rock, Arkansas for loans made in the eastern or mid-eastern United States.

Note: For a map of SBA Loan Center state coverage areas and contact information, see the definition of "SBA Loan Center" in Chapter 2.

b. SBA Response Time

Except for requests concerning CLP Liquidation Plans, SBA should respond to a Lender's request for approval of a proposed Loan Action within 15 business days. ([13 C.F.R. § 120.541](#))

C. Documentation Requirements

All substantive 7(a) Lender liquidation activities and decisions must be justified and documented. Documentation, such as appraisals, credit reports, and other supporting documents, must be kept in the loan file for future review by SBA.

D. Performance Standards

A 7(a) Lender may liquidate its 7(a) Loan portfolio using the same practices and procedures it uses for its non-SBA commercial loans, provided that it liquidates its SBA loan portfolio no less diligently than its non-SBA portfolio, and in a prompt, cost-effective and commercially reasonable manner, consistent with prudent lending practices and in accordance with the Loan Program Requirements in effect at the time the action is taken. ([13 C.F.R. § 120.535](#) and [13 C.F.R. § 120.180](#)) A 7(a) Lender that does not maintain a non-SBA loan portfolio must adhere to the same prudent lending standards followed by commercial lenders that liquidate loans without a government guaranty.

E. SBA Takeover of Lender Liquidation

SBA may, in its sole discretion, take over the liquidation of any 7(a) Loan. If SBA elects to do so, the 7(a) Lender must assign the Loan Documents to SBA and provide any liquidation assistance requested by SBA. ([13 C.F.R. § 120.535\(d\)](#))

F. Reporting Requirements

1. Monthly 1502 Report

Loans in liquidation status must be included on the 7(a) Lender's SBA Form 1502 Report submitted to the SBA on a monthly basis.

Note: Information on [Form 1502 reporting](http://www.sba.gov/banking) is available on SBA's Web site at www.sba.gov/banking and [Colson Services Corp.'s](http://www.colsonservices.com) Web site at <http://www.colsonservices.com>.

2. Quarterly Status Report on Purchased 7(a) Loans

Within 15 business days after receiving notice of SBA's purchase of the guaranteed portion of a 7(a) Loan from the secondary market or within 90 business days of SBA's purchase directly from the 7(a) Lender, and every 90 days thereafter, the 7(a) Lender must provide the SBA Loan Center with a written report on the loan that includes, at a minimum, a description of the status of the following:

- a. Obligors;
- b. Collateral;
- c. REO and acquired personal property collateral;
- d. Workout negotiations;
- e. Recoveries and expenses incurred; and
- f. Liquidation and litigation proceedings.

3. Wrap-up Report

A 7(a) Lender must submit a Wrap-up Report for each loan once the liquidation is complete. (See Chapter 20 for information on Wrap-up Reports.)

Chapter 6. CDC Liquidation

A. Responsibility

Pursuant to [13 C.F.R. § 120.975](#), the scope of a CDC's liquidation authority and responsibility is based on its designation as a Premier Certified Lender Program ("PCLP") CDC; an Authorized CDC Liquidator ("ACL"); or a non-PCLP CDC or a non-ACL.

1. PCLP CDCs

a. ACL PCLP CDCs—Entire Portfolio

An ACL PCLP CDC is responsible for liquidating all of the 504 Loans in its portfolio. ([13 C.F.R. § 120.975\(a\)](#))

b. Non-ACL PCLP CDCs—PCLP Portfolio Only

A Non-ACL PCLP CDC is responsible for liquidating only the PCLP 504 Loans in its portfolio. ([13 C.F.R. § 120.848\(f\)](#))

2. ACLs

A CDC that has received written approval from SBA to act as an ACL is responsible for liquidating all of the 504 Loans in its portfolio ([13 C.F.R. § 120.975\(b\)](#)).

Note: A CDC may apply to become an ACL by submitting an application to the appropriate SBA Loan Center, which will review the application and forward its recommendation to the Office of Financial Assistance for a final decision. (For information on SBA requirements to become an ACL, see [13 C.F.R. § 120.975](#).)

3. Non-PCLP CDCs and Non-ACLs

SBA Loan Centers are primarily responsible for liquidating the 504 Loans that do not fall under the liquidation authority of PCLP CDCs and ACLs. However, SBA Loan Centers may authorize non-PCLP CDCs and non-ACLs to liquidate specific 504 Loans on a case-by-case basis. SBA Loan Centers may also require assistance from non-PCLP CDCs and non-ACLs. For example, non-PCLP CDCs and non-ACLs may be asked to:

- a. Draft Liquidation Plans;
- b. Conduct site visits;
- c. Identify local appraisers, auctioneers and other independent contractors;
- d. Obtain information concerning Third Party Loans; and
- e. Attend foreclosure sales on behalf of SBA.

B. Authority

1. Unilateral Authority

Except as provided in Subsection 2 below and provided that its actions are consistent with the performance standards set out in Paragraph F below, the responsible CDC has unilateral authority to take all necessary actions to liquidate the 504 Loan.

2. Actions Requiring Prior SBA Approval

See the *CDC Servicing and Liquidation Action Matrix* accessible from the [CLSC Web site](#) or [13 C.F.R. § 120.536](#) for a detailed list of actions that require prior written approval from the appropriate SBA Loan Center.

3. How to Obtain SBA Approval

a. Where to Submit Requests

Requests for approval of proposed Loan Actions requiring SBA's prior written approval should be submitted to the appropriate SBA Loan Center:

(1) West and Midwest U.S.—Fresno, CA

504 Loans made in the western or mid-western United States are handled by the SBA Commercial Loan Service Center in Fresno, California.

(2) East or Mideast U.S.—Little Rock, AR

504 Loans made in the eastern or mid-eastern United States are handled by the SBA Commercial Loan Service Center in Little Rock, Arkansas.

Note: For a map of SBA Loan Center state coverage areas and contact information, see the definition of "SBA Loan Center" in Chapter 2.

b. SBA Response Time

SBA should respond within 15 business days to a CDC's request of approval of a proposed Loan Action. ([13 C.F.R. § 120.541](#))

C. Reassignment of Loan Documents

Generally, if a CDC is responsible for handling the liquidation of a 504 Loan, the Loan Documents must be reassigned by SBA back to the CDC so that the CDC has legal standing to enforce collection.

1. CDC Requests for Reassignment of Loan Documents

When reassignment of the Loan Documents is necessary to enable a CDC to liquidate a 504 Loan, the CDC, including PCLP CDCs and ACLs, must submit a written request to the appropriate SBA Loan Center that includes the following information:

- a. The reason why the reassignment is necessary, i.e., information regarding the CDC's liquidation strategy including the type of debt collection activities planned;
- b. A list of the specific Loan Documents that should be reassigned; and
- c. If the liquidation strategy includes litigation:
 - (1) The name, phone number and qualifications required by Chapter 15 (*Litigation*) of the attorney selected by the CDC to conduct the litigation;
 - (2) Whether there is a risk of adverse precedent; and
 - (3) The estimated legal fees and costs.

Note: The Loan Documents must be reassigned to the CDC before the CDC can take any legal action on a 504 Loan, including filing a Proof of Claim.

2. SBA Review of CDC Requests for Reassignment of Loan Documents

CDC requests for reassignment of Loan Documents must be approved pursuant to the Rule of Two and if the CDC's liquidation strategy includes any type of litigation activity, including Routine Litigation, the request must be reviewed by the District Counsel responsible for monitoring the litigation.

D. Use of Independent Contractors

A CDC may hire an independent contractor that does not have a real, apparent, or potential conflict of interest with SBA, the CDC, or the Borrower for liquidation related services provided that the CDC obtains the SBA Loan Center's prior written approval of the qualifications of the contractor, the terms and conditions of the engagement contract, and any modifications to the contract.

E. Documentation Requirements

All liquidation activities and decisions by a CDC must be justified and documented. Documentation, such as appraisals, credit reports, and other supporting documents, must be kept in the loan file for future review by SBA.

F. Performance Standards

504 Loans must be liquidated in a prompt, cost-effective and commercially reasonable manner, consistent with prudent lending practices and in accordance with the Loan Program Requirements in effect at the time the action is taken. (13 C.F.R. § 120.535)

G. SBA Takeover of CDC Liquidation

SBA may, in its sole discretion, take over the liquidation of any 504 Loan. If SBA elects to do so, the CDC must re-assign the Note and other Loan Documents to SBA, if appropriate, and provide any assistance requested by SBA to liquidate the loan. (13 C.F.R. § 120.535(d))

H. Reporting Requirements

1. Quarterly Delinquency Report

A CDC must submit a [Quarterly Delinquency Report](#) to the appropriate SBA Loan Center on each loan in its portfolio that is 60 days or more past due until the debenture has been purchased. ([13 C.F.R. § 120.830\(f\)](#)) The [format](#) for the report is accessible from www.sba.gov/banking.

2. Quarterly Status Report—CDC Serviced Liquidations

Within 15 business days of receiving notice that the debenture was purchased and every 90 days thereafter, the CDC conducting liquidation or litigation on the 504 Loan must provide the SBA Loan Center with a written report that includes, at a minimum, a description of the status of the following:

- a. Obligors;
- b. Collateral;
- c. REO and acquired personal property collateral;
- d. Workout negotiations;
- e. Recoveries and expenses incurred; and
- f. Liquidation and litigation proceedings.

3. Interim Reports

Upon request, CDCs must provide SBA with interim reports. ([13 C.F.R. § 120.830\(g\)](#))

4. Wrap-up Report

A Wrap-up Report must be submitted to the appropriate SBA Loan Center on each 504 Loan after it has been liquidated by a CDC. (See Chapter 20 for information on wrap-up procedures.)

Chapter 7. Site Visits

A. When Required

Unless the loan is unsecured, or the aggregate Recoverable Value of the personal property collateral is less than \$2,500 and the Recoverable Value of each parcel of real property collateral is less than \$5,000, a site visit must be conducted as follows:

1. Payment Default—within 60 days of an uncured payment default or sooner if the collateral could be removed, lost or dissipated.
2. Non-payment Default—within 15 days of the occurrence of the adverse event that caused the loan to be classified in liquidation status, (e.g., bankruptcy filing, foreclosure by prior lienholder, business shutdown), or sooner if the collateral could be removed, lost or dissipated.

B. Pre-site Visit Preparation

Prior to conducting a site visit, the steps listed below, when applicable, must be taken.

1. Review the Loan Documents

Ascertain specifically which pieces of property serve as collateral for the SBA Loan and whether any senior liens were permitted when the loan was made by reviewing the Loan Authorization and other relevant Loan Documents, including for example:

a. Personal Property Collateral

The security agreement, landlord lien waiver, U.C.C. financing statements, and U.C.C. searches, as well as any subordination agreements; and

b. Real Property Collateral

The mortgage or deed of trust, assignment of rents and title insurance policy, as well as any subordination or non-disturbance agreement.

2. Obtain a Current Lien Search

Obtain a current title report or U.C.C. search to accurately verify the priority of the lien(s) on the property securing the SBA Loan.

3. Contact the Landlord

If the collateral is located on leased premises, contact the landlord to determine whether the rent is past due.

4. Contact Local Taxing Authorities

Contact local taxing authorities to determine whether there are delinquent real or personal property taxes that have priority over the lien securing the SBA Loan.

5. Hire an Auctioneer

If the collateral includes personal property such as machinery, equipment, furniture, fixtures or inventory, hire an auctioneer or other expert to prepare a Liquidation Value Post-default Appraisal and to assist with the relevant site visit goals listed below.

6. Order a Post-default Appraisal

If the collateral includes real property or unusual personal property that an auctioneer would not ordinarily have the expertise to appraise such as intellectual property, order a Post-default Appraisal of the collateral.

C. Goals

To comply with prudent lending standards, during a site visit a good faith effort must be made to accomplish the applicable goals listed below.

1. Inspect and Inventory Collateral

Prepare a comprehensive written inventory that includes a complete and accurate description of the collateral, including its current condition, photographs, and the serial numbers of significant items of personal property, i.e., items with a Liquidation Value of \$5,000 or more;

2. Establish the Recoverable Value of Collateral

Gather any other information needed to establish the Recoverable Value of the collateral such as the cost of any necessary care and preservation measures.

3. Identify Occupants

If the collateral consists of real property, ascertain whether there are occupants who are entitled to notice, who will need to be evicted, or who are paying rent that can be collected and applied against the SBA Loan balance.

4. Assess Environmental Risk

Review the Environmental Investigation Report prepared at the time the loan was made and follow the requirements concerning Post-default Environmental Investigations set out in Chapter 9.

5. Review Borrower's Books

Review the Borrower's books and records to determine, for example, whether funds were inappropriately taken out of the business or used for unauthorized purposes, and whether there are any collectible accounts receivable.

6. Develop a Liquidation Strategy

Begin developing a strategy for liquidating the loan. For example, determine whether it will be necessary to have a receiver appointed to collect the rents from occupants of real property; whether the personal property collateral can be repossessed without a breach of the peace; which method of liquidation would maximize recovery on the loan in the shortest amount of time, e.g., judicial or non-judicial foreclosure, private sale or on-site public auction, or release of lien for consideration.

7. Initiate Workout or Compromise Negotiations

If Obligors who have not filed for bankruptcy protection are present and cooperative, obtain a copy of the financial records needed to determine whether a workout is feasible or a compromise can be negotiated.

8. Arrange for Care and Preservation of Collateral

Take prudent and commercially reasonable measures to care for and preserve the collateral until it can be liquidated. For example:

a. Repossession

If a judicial foreclosure action is not contemplated: (1) repossess the collateral using self-help methods pursuant to U.C.C. Article 9 if it can be done without a "breach of the peace;" or (2) obtain a court order authorizing repossession if the Obligor will not turn over the collateral without a fight.

b. Security and Safekeeping

After acquiring possession of, or control over, the collateral, keep it safe and secure until it can be liquidated. For example, depending on the circumstances, it may be necessary to change the locks, hire a caretaker, pay utility bills, or transport personal property collateral to a secure temperature-controlled storage facility pending the foreclosure sale.

c. Insurance

Purchase or maintain appropriate insurance coverage, such as hazard or general public liability insurance.

d. General Maintenance

Arrange for cost-effective repairs, clean-up, etc., to ensure that the foreclosure sale is commercially reasonable and the collateral sells for the highest possible price.

e. Taxes

Depending on the circumstances, pay taxes and assessments that could become senior liens on the collateral if not paid and continue to monitor and pay taxes and assessments as necessary.

D. Site Visit Reports

Site visits must be documented in a report that addresses the site visit goals set out above. CLP Lenders and CDCs must provide the SBA Loan Center with a site visit report along with their proposed Liquidation Plan. All other 7(a) Lenders must provide the SBA Loan Center with a site visit report along with their Wrap-up Report if it was not previously submitted with a guaranty purchase request. If a site visit was not conducted, the reason why a site visit was not required must be documented in the loan file and explained in the Wrap-up Report.

Chapter 8. Liquidation Plans

A. General

When properly prepared, a Liquidation Plan will help ensure that the SBA Loan is liquidated in a timely, prudent and cost-effective manner that will maximize recovery in the shortest amount of time. A Liquidation Plan should be prepared after a site visit has been conducted and before any significant action is taken to liquidate the loan.

B. Format and Content

A template for preparing a Liquidation Plan for a [7\(a\) Loan](#) or a [504 Loan](#) is accessible from www.sba.gov/banking.

C. Factors to Consider

When preparing a Liquidation Plan, the factors listed below should be considered.

1. Site Visit Findings

For information on site visits, see Chapter 7.

2. Feasibility of a Workout

For information on workouts, see Chapter 11.

3. Recoverable Value of the Collateral

For information on how to determine the Recoverable Value of collateral, see the definition of Recoverable Value in Chapter 2.

4. Available Methods of Liquidation

For information on collateral liquidation, see Chapter 13 with regard to real property collateral and Chapter 14 with regard to personal property collateral.

5. Need for Litigation

For information on litigation, see Chapter 15.

6. Status of Senior Liens

For information on Third Party Loans or other senior liens, see Chapter 10.

7. Obligors' Repayment Ability

For information on life insurance requirements and how to analyze an Obligor's repayment ability, see Chapter 12.

8. Non-SBA Loans Made to Obligor

The Liquidation Plan must indicate whether the Lender has any outstanding non-SBA Loans to an Obligor, and if so, how the liquidation expenses and recoveries will be allocated.

D. When to Prepare

1. Liquidation Plan

A Liquidation Plan should be prepared as soon as a site visit has been conducted and before taking any significant action to liquidate the loan. With regard to 504 Loans, the Liquidation Plan should be completed no later than 30 days after purchase of the debenture.

2. Amended Liquidation Plan

An Amended Liquidation Plan should be prepared before taking any action or incurring any expense that materially deviates from the original Plan.

E. Obtaining SBA Approval of Liquidation Plans

1. When Required

a. General Rule

Except as provided below regarding emergencies, pursuant to [13 C.F.R. § 120.540\(b\)](#) SBA's prior written approval of a Liquidation Plan or an Amended Liquidation Plan must be obtained before taking any material action to liquidate:

- (1) 7(a) Loans made under a Lender's Certified Lender Program ("CLP") authority; and

- (2) 504 Loans handled by CDCs except those made under a CDC's PCLP authority.

b. Exception—Emergency Situations

A CLP Lender or a CDC may take limited actions to respond to an emergency (e.g., loss or dissipation of collateral), without SBA's written approval of a Liquidation Plan or Amended Liquidation Plan, provided that it:

- (1) Makes a good faith effort to obtain SBA's written approval before undertaking the emergency action;
- (2) Submits a written Liquidation Plan or Amended Liquidation Plan to the SBA Loan Center as soon after the emergency as possible; and
- (3) Takes no further liquidation action without SBA's written approval of the Liquidation Plan or Amended Liquidation Plan. ([13 C.F.R. § 120.540\(f\)](#))

2. How to Obtain

To obtain SBA approval, the proposed Liquidation Plan must be submitted to the SBA Loan Center responsible for the loan, which will review and decide whether to approve the proposed plan. (For a map of SBA Loan Center state coverage areas and for contact information, see the definition of "SBA Loan Center" in Chapter 2.)

a. CLP Loans

The National Guaranty Purchase Center in Herndon, Virginia; and

b. All 504 Loans

- (1) The Commercial Loan Service Center in Fresno, California for loans made in the western and mid-western United States; or
- (2) The Commercial Loan Service Center in Little Rock, Arkansas for loans made in the eastern or mid-eastern United States.

3. SBA Response Time

a. 7(a) Loans

SBA should respond to a CLP Lender's request for approval of a Liquidation Plan within ten business days. If SBA fails to do so, the request will be deemed approved. ([13 C.F.R. § 120.541\(c\)](#))

b. 504 Loans

SBA should respond to a CDC's request for approval of a Liquidation Plan within 15 business days. If SBA fails to do so, the request will not be deemed approved unless SBA approves it in writing.

4. Appeal Process

The final decision of a SBA Loan Center Director or designee regarding a Liquidation Plan or Amended Liquidation Plan may be appealed to the Director of the Office of Financial Assistance, provided that the appeal: (1) is in writing; (2) includes a copy of the decision and supporting documents; (3) states the reason why the decision is believed to be incorrect; and (4) is submitted within 30 days of the decision. ([13 C.F.R. § 120.540\(g\)](#))

Chapter 9. Post-default Environmental Risk Management

A. General

1. Definitions

Definitions of the environmental terms used in this SOP, which are capitalized whenever they appear, are located in Appendix 2 of [SOP 50 10 5](#), which can be found on SBA's Web site at www.sba.gov by selecting "Tools" on the homepage, and selecting "SOPs" under "Library & Reference."

Note: The term "Property" as used in this Chapter refers only to commercial property—not residential property.

2. Regulations

All 7(a) Lenders and CDCs, including PLP Lenders and PCLP CDCs, must obtain SBA's written approval before taking title to Contaminated Property or control of a business that handles Hazardous Substances. [13 C.F.R. § 120.536 \(a\)\(5\)](#)

B. When an Environmental Investigation Is Required

1. Before Taking Title to Property

A Post-default Environmental Investigation must be conducted before taking title to any Property in order to determine whether it is Contaminated unless a prudent lender would conclude that an investigation was not necessary under the circumstances.

2. Before Taking Control of a Business Using Hazardous Substances

A Post-default Environmental Investigation must be conducted before taking control of a business that handles Hazardous Substances in order to ascertain the risks involved. Exceptions to this policy may only be authorized by the SBA Loan Center Director after consultation with the Associate General Counsel for Litigation.

C. Use of Environmental Professionals

All Transaction Screen, Phase I and Phase II Environmental Site Assessments must be performed by an Environmental Professional and be accompanied by a Reliance Letter, the template for which is located in Appendix 3 of [SOP 50 10 5](#). A Reliance Letter is not required for an Environmental Questionnaire and Records Search with Risk Assessment, and only the risk assessment portion must be completed by an Environmental Professional.

D. Environmental Investigation Process

The type and scope of the Post-default Environmental Investigation required varies depending on the risk of Contamination. This SOP provides minimum standards. To comply with prudent lending standards, additional tests or inquiries may be required. Generally, however, unless access to the property is restricted or the collateral consists of a commercial condominium, (See the *Exceptions* listed below.), the Post-default Environmental Investigation associated with an SBA Loan should proceed as flows:

- Step 1:** Determine whether any underground liquid fuel storage tanks are located on the Property. If there are, a Phase I Environmental Site Assessment ("ESA") is required unless the tanks are associated with a gas station or a dry cleaning operation in which case, the procedures set forth below in Paragraph E apply and must be followed.
- Step 2:** Determine the NAICS codes for the Property's uses since the SBA Loan was funded.
- Step 3:** Determine whether any of the NAICS codes match a code located on the list of NAICS Codes of Environmentally Sensitive Industries located in Appendix 4 to [SOP 50 10 5](#).

Match:

- (1) Gas stations and dry cleaning facilities—follow the procedures set out in Paragraph E below.
- (2) All other environmentally sensitive industries—begin the Environmental Investigation with a Phase I ESA.

No Match:

At a minimum, the Post-default Environmental Investigation should begin with an Environmental Questionnaire, (which for liquidation purposes may be completed by the Liquidation Officer), and Records Search with Risk Assessment; or a Transaction Screen.

Step 4: Complete any additional testing, record searches or other inquiries recommended by the Environmental Professional who conducted the initial investigation required by Step 1 or 3.

Step 5: In addition to the foregoing requirements, if taking control of a business that handles Hazardous Substances is contemplated, the Post-default Environmental Investigation should also include an environmental audit to determine whether the business has the required environmental permits and is otherwise in compliance with applicable Environmental Laws.

Exceptions:

1. **Commercial Condominiums**—If the collateral consists of a single unit in a multi-unit building, the Post-default Environmental Investigation may begin with an Environmental Questionnaire and Records Search with Risk Assessment.
2. **Restricted Access**—If it is not possible to gain access to the Property to complete all of the steps outlined above, the reason should be documented in the loan file, prudent judgment exercised, and the best possible due diligence under the circumstances conducted. This includes, at a minimum, a Records Search with Risk Assessment.

E. Special Procedures for Gas Stations and Dry Cleaners

The Post-default Environmental Investigation for SBA Loans secured by any interest in real or personal property associated with the operation of a gas station or a dry cleaning facility at any time since the SBA Loan was funded should include the following:

1. Site Assessment

- a. A Phase I ESA, or a Phase II ESA if the gas station or dry cleaning facility is more than five years old, conducted by an independent Environmental Professional who holds a current Professional Engineer's or Professional Geologist's license and has three years of full-time relevant experience;

- b. The results of any further investigation recommended by the Environmental Professional conducting the ESA; and
- c. If the Property is Contaminated, a detailed estimate of the recommended method and cost of Remediation; and

2. Equipment Testing

Testing of all trade fixtures and equipment related to the operation of the business, including underground storage tanks, lines and related equipment, by an independent contractor using a methodology acceptable to the Government Entity with oversight authority.

F. Environmental Investigation Report

1. Documentation Requirement

The Post-default Environmental Investigation Report must be kept in the loan file for inspection by SBA. If a Post-default Environmental Investigation was not conducted, the reason why an Environmental Investigation was not conducted must be documented in the loan file and explained in the Wrap-up Report.

2. Age of Report

A Post-default Environmental Investigation Report must be less than 180 days old at the time it is relied on.

G. Obtaining SBA Approval of Loan Actions with Environmental Risk

1. When Required

a. Before Taking Title to Contaminated Property

If the Post-default Environmental Investigation Report concludes that the Property is Contaminated, SBA's prior written approval must be obtained from the appropriate SBA Loan Center prior to taking title to the Property. ([13 C.F.R. § 120.536\(a\)\(5\)](#)) (See Paragraph H below regarding the information that must accompany a request for SBA approval.)

b. Before Taking Control of Business

Regardless of the conclusions reached in the Post-default Environmental Investigation Report, SBA's prior written approval must be obtained from the appropriate SBA Loan Center prior to taking control of a business that handles Hazardous Substances. ([13 C.F.R. § 120.536 \(a\)\(5\)](#)) (See Paragraph H below regarding the information that must accompany a request for SBA approval.)

2. How to Obtain

To obtain prior written approval from SBA to take title to Contaminated Property or control of a business that handles Hazardous Substances, a written request should be submitted to the appropriate SBA Loan Center with a copy to the SBA District Counsel responsible for the geographic area where the Property or business is located. The request should include a risk-benefit analysis that discusses, at a minimum, the balance owed on the loan and other relevant facts such as:

a. Fair Market Value of Property or Business

Include a copy of the Post-default Appraisal establishing the fair market value of the Property or business;

b. Nature and Extent of Contamination

Include copies of all relevant Reports and Reliance Letters, including a copy of the Report covering the results of the environmental compliance audit required by Step 5 in Paragraph D if the request is for approval to take control of a business that handles Hazardous Substances;

c. Remediation

If Remediation is necessary or on-going, include a discussion of the:

- (1) Recommended method of Remediation;
- (2) Status of on-going Remediation, if any;
- (3) Environmental Professional's estimated cost of Remediation;
- (4) Environmental Professional's estimated completion date of Remediation;

- (5) Government Entity's designation, if any, of the Person(s) responsible for the cost of Remediation; and
- (6) Person(s) currently paying for any on-going Remediation;

d. Anticipated Recovery

Recoverable Value of the Contaminated Property or anticipated recovery from operating the business;

e. Feasibility of Recovery from Other Sources

Estimated recovery from other sources such as additional collateral or Obligor;

f. Mitigating Factors

(1) Indemnification Agreement

An SBA Environmental Indemnification Agreement executed by a Person who possesses sufficient financial resources to cover the cost of Remediation;

Note: If the loan balance is less than the cost of Remediation, indemnitors may wish to exercise their option of paying the loan balance in full, in which case, there is no need to acquire title to Contaminated Property or to take control of the Borrower's business.

(2) Active Remediation Completed

A written statement from the responsible Government Entity that active Remediation is complete and the results of any ongoing monitoring are acceptable;

(3) "No Further Action" Letter

A "no further action letter" or "closure letter" from the responsible Government Entity stating that no further Remediation or monitoring is required;

(4) Minimal Contamination

Documentation showing that the extent of Contamination and cost of Remediation is minimal or insignificant compared to the Recoverable Value of the Property;

(5) Availability of Government Clean-up Funds

A written statement from a Government Entity that the Property has been unconditionally approved to participate in a solvent fund that will cover the full cost of Remediation;

(6) Escrow Account

Documentation showing that an escrow account, which contains a minimum of 150% of the total estimated cost of Remediation, has been established to pay the Remediation costs in full and SBA, the 7(a) Lender or CDC is a party to the agreement governing the account;

(7) Groundwater Contamination Originated Offsite

Documentation showing that the Contamination consists solely of groundwater Contamination that originated from another property, and:

- (a) Another Person with sufficient resources is performing Remediation pursuant to a Remediation action plan that has been approved by the appropriate Government Entity; or
- (b) The applicable Environmental Law does not hold an owner or operator liable for groundwater Contamination that originates from another site; or
- (c) The responsible Government Entity has provided satisfactory written assurance that it will not hold the Property owner liable for the Contamination;

(8) Insurance

Documentation showing that environmental pollution insurance coverage is in place that will cover the full cost of Remediation;

(9) Consent Decree

Consent Decree or equivalent issued by the responsible Government Entity establishing that a third party is responsible for the Contamination; and

(10) "Other Factor(s)"

Documentation of other factors that may have a mitigating effect such as an agreement not to sue present and future Property owners from the responsible Government Entity, or evidence that Engineering or Institutional Controls are in place that will prevent the spread of Contamination or reduce the risk of human contact with it.

Note: General questions concerning SBA's environmental policy and procedures should be directed to SBA District Counsel for the geographic area where the Property is located.

H. SBA Review of Requests to Acquire Title to Contaminated Property

Note: SBA environmental engineers, who are located at SBA's Sacramento Loan Processing Center, are available for consultation with SBA Liquidation Officers and Legal Counsel regarding technical environmental issues.

1. Liquidation Officer's Responsibility

The Liquidation Officer handling the SBA Loan is responsible for reviewing requests to take title to Contaminated Property and for providing a recommendation as to whether the Agency should approve the request based on an analysis of the following factors:

- a. Fair market value of the Property based on a Post-default Appraisal;
- b. Nature and extent of the Contamination based on the Post-default Environmental Investigation Report;
- c. Cost of Remediation;
- d. Recoverable Value and marketability of the Property;

- e. Estimated recovery from other sources such as additional collateral or pursuit of Obligors;
- f. Mitigating factors relied on by the Lender or CDC as well as any other factors that could reduce the financial risk associated with acquiring title.

2. **Legal Counsel's Responsibility**

SBA District Counsel for the area where the Property is located must review all requests to acquire title to Contaminated Property and provide a legal opinion as to whether the Agency should approve the request based on an analysis of the following factors:

a. **Applicable Law**

The applicable federal, state and local law governing liability for the Contamination.

b. **Post-default Environmental Investigation Report**

The nature, extent and source of the Contamination, the cost of Remediation and other findings and conclusions set out in the Post-default Environmental Investigation Report.

c. **Mitigating Factors**

The mitigating factors relied on by the Recommending Official as well as any others that might be available to the 7(a) Lender, CDC or SBA.

d. **Legal Defenses**

Legal defenses available to the 7(a) Lender, CDC or SBA such as:

- (1) Federal or state law providing liability protection to lenders, and federal laws protecting Government Entities that acquire property involuntarily such as [CERCLA](#) Sections 101(2)(D) and 101(35)(A);
- (2) Determination by the responsible Government Entity that a third party is responsible for the Contamination, e.g., Super Fund Site Consent Decree or Water Quality Control Board finding regarding ground water Contamination that originated off-site; or

- (3) Government Entity's agreement not to sue.

e. Litigative Risk

- (1) Litigative risk associated with affirmative litigation if necessary to enforce an Environmental Indemnification Agreement, to compel a third party to Remediate the Property, etc.; or
- (2) Litigative risk associated with defensive litigation if suit is filed against the 7(a) Lender, CDC or SBA to recover the cost of Remediation or damages for wrongful death, personal injury or property damage caused by Contamination at the Property.

f. Time and Cost of Litigation

If litigation will be necessary, an estimate of the time as well as the necessary, reasonable and customary costs involved.

3. Approving Official's Responsibility

The Supervisory Liquidation Officer is responsible for deciding whether, and if so, under what circumstances, SBA should approve a request to take title to Contaminated Property, and whenever the decision is to recommend approval, for forwarding the Loan Action request to the Director of the Office of Financial Assistance, who must obtain the concurrence of the Associate General Counsel for Litigation.

I. SBA Review of Requests to Take Over Business Using Hazardous Substances

1. Recommending Official's Responsibility

The Liquidation Officer handling the SBA Loan is responsible for reviewing requests to take control of a business that handles Hazardous Substances and for providing a recommendation as to whether the Agency should approve the request based on an analysis of the following factors:

- a. Findings and conclusions contained in the Post-default Environmental Investigation Report including the results of the environmental compliance audit required by Step 5 of Paragraph D;
- b. Monetary risk involved, i.e., potential liability for Contamination including the cost of Remediation;

- c. Risk mitigating factors;
- d. Accuracy of the estimated recovery from operating the business;
- e. Estimated recovery from other sources such as additional collateral or pursuit of Obligors;
- f. Extent to which the anticipated recovery outweighs the risk associated with operating the business.

2. Legal Counsel's Responsibility

The SBA District Counsel for the area where the business is located must review all requests to take over the operation of a business that handles Hazardous Substances, and must:

- a. Review the Post-default Environmental Investigation Report, including the results of the environmental compliance audit required by Step 5 of Paragraph D, and the Recommending Official's comments on the proposed Loan Action;
- b. Apply the applicable Environmental Law to the facts to determine whether the 7(a) Lender, CDC or SBA is likely to incur liability for Contamination if it becomes an operator;
- c. Determine whether the proposed legal strategies, such as petitioning the court to have a receiver appointed to operate the business, are sufficient for reducing the risk;
- d. Balance the legal and accompanying monetary risk against the estimated recovery; and
- e. Render a legal opinion as to whether, and if so, under what circumstances, SBA should approve the request.

3. Approving Official's Responsibility

The Supervisory Liquidation Officer is responsible for deciding whether, and if so, under what circumstances, SBA should approve a request to take control of a business that handles Hazardous Substances, and whenever the decision is to recommend approval, for forwarding the Loan Action request to the Director of the Office of Financial Assistance, who must obtain the concurrence of the Associate General Counsel for Litigation.

Chapter 10.
Third Party Loans and Other Senior Liens

A. General

If there are senior liens against the property securing the SBA Loan, such as the lien securing a Third Party Loan, the balance and status of the loan as well as the senior lienholder's liquidation strategy should be ascertained in order to decide which of the options listed below is prudent under the circumstances.

B. Payment Advances

If it is necessary to prevent a senior lienholder from foreclosing on and extinguishing the lien securing the SBA Loan in order to maximize recovery, funds may be advanced to keep the payments on the senior lienholder's loan current while working towards a negotiated sale of the property or foreclosure of the lien securing the SBA Loan provided that the amount advanced is added to the SBA Loan balance.

C. Purchase or Pay Off

To maximize recovery on the SBA Loan or to gain control of the liquidation process, particularly when doing so would enable an otherwise viable Borrower to retain possession of its business premises so that it can continue to operate and pay off debt owed to SBA, a debt secured by a senior lien may be purchased or paid off, particularly if the senior lienholder offers a discount, and:

1. The risk is justified by a Post-default Appraisal and Recoverable Value analysis;
2. The purchase or pay off amount is consistent with any agreement signed by the senior lienholder regarding the subordination of Default Charges;
3. The purchase or pay off amount is added to the SBA Loan balance;
4. The Obligors are given written notice of the proposed purchase or pay off and their increased financial liability on the SBA Loan as a result; and
5. With regard to 504 Loans, the debenture has been purchased and the CDC has obtained SBA's prior written approval.

In addition, if the Borrower is to retain possession of the collateral:

6. The Borrower has the ability to make the payments on the adjusted SBA Loan balance; and
7. Purchasing or paying off the loan will improve the Borrower's ability to repay the SBA Loan.

D. Protective Bids

1. When to Enter

A Protective Bid should be entered at a Third Party Lender or other senior lienholder's real or personal property foreclosure sale if the Recoverable Value of the property is 10% or more of its Liquidation Value.

2. Protective Bid Amount

The maximum amount of a Protective Bid should be the lesser of the balance owed on the SBA Loan or the Recoverable Value of the collateral. The amount, which requires Rule of Two approval when SBA is liquidating or asked to approve a request from a Lender or CDC, should include a "tolerance range," i.e., the amount by which the authorized bidder is allowed to increase or decrease the bid depending on unanticipated events that unfold at the sale. An acceptable tolerance range is 10% above or below the authorized bid. Because state laws vary, Legal Counsel should be consulted prior to entering a Protective Bid in order to ascertain the impact, if any, that the Protective Bid amount may have on the ability to collect any deficiency on the loan.

E. No Bid Position

1. When Appropriate

A no bid position at a Third Party Lender or other senior lienholder's foreclosure sale is appropriate if the Recoverable Value of the collateral securing the SBA Loan is less than \$5,000 or 10% of its Liquidation Value.

2. Failure to Conduct Environmental Investigation

Failure to conduct a Post-default Environmental Investigation is not an acceptable reason for taking a "no bid" position at a senior lienholder's foreclosure sale when there is equity that should be protected and applied to the SBA Loan balance. In emergency situations, prudent judgment must be exercised and the best possible due diligence under the circumstances conducted in order to avoid unnecessary loss.

F. Redemption Rights

1. Definitions and Background

a. Redemption Rights

Redemption rights are granted by statute and provide specified Persons, such as Federal Government Agencies, the mortgagor and junior lienholders, with the opportunity to redeem foreclosure sale property. Redemption rights are intended to induce bidders, including the foreclosing lender, to submit bids approaching the fair market value of the property, thereby preventing the foreclosing lender from acquiring the property for less than fair value, while enhancing the likelihood that the proceeds from the foreclosure sale will satisfy all of the debts secured by the property. On the other hand, they can cause problems for the foreclosing lender since the possibility that the property may be redeemed may have a chilling effect on the bidding and the ultimate price received. As an agency of the Federal Government, [28 U.S.C. § 2410\(c\)](#) provides SBA (but not a 7(a) Lender or CDC) with one year from the date of a judicial foreclosure sale to redeem. Under state law, whether SBA, the 7(a) Lender or CDC has a right to redeem varies by state.

b. Net Profit

For purposes of this Chapter, the term "Net Profit" means the price set forth in an executed purchase and sale agreement that the buyer has agreed to pay for the property acquired by the foreclosing lender minus the following amounts: (1) the amount of the bid entered by the foreclosing lender; (2) the reasonable, necessary and customary expenses incurred by the foreclosing lender for the care and preservation of the acquired property; and (3) the reasonable, necessary and customary costs of reselling the property.

2. Exercise of Redemption Rights

The redemption rights on an SBA Loan should be exercised whenever it would be prudent and commercially reasonable to do so, for example, when the property sells for less than expected at a senior lienholder's foreclosure sale.

3. Release of Redemption Rights

a. General

If it would not be prudent to redeem the foreclosed-upon property, the redemption rights associated with the SBA Loan may be released for consideration pursuant to the requirements of this Chapter.

b. Post-foreclosure Sale

After confirmation of a foreclosure sale conducted by a senior lienholder, the redemption rights on an SBA Loan may be released for consideration, which must be applied to the principal loan balance, as follows:

(1) Release for Immediate Consideration

If the foreclosure sale purchaser or any other Person requests an immediate release of the redemption rights on an SBA Loan, they may be released for a lump sum equivalent to the greater of \$1,000 or 50% of the Recoverable Value of the collateral as established by a Post-default Appraisal obtained by SBA, the 7(a) Lender or CDC within 120 days of the foreclosure sale; or

(2) Release for Future Consideration from Foreclosing Lender

If the foreclosing lender acquires title and requests release of the redemption rights on the SBA Loan in exchange for consideration to be paid from funds generated from the resale of the property, the redemption rights may be released for consideration in a dollar amount equivalent to the greater of \$1,000 or 50% of the Net Profit from the resale of the property provided that the foreclosing lender has agreed in writing that it will:

- (a) Immediately begin to aggressively market the property for sale at a price no less than the Liquidation Value of the property as established by a Post-default Appraisal obtained by SBA, the 7(a) Lender or CDC within 120 days of the foreclosure sale;
- (b) Provide SBA, the 7(a) Lender or CDC with a copy of the listing agreement and quarterly status reports on its marketing efforts;

- (c) Not sell the property to an Associate or Close Relative of any Person involved with the SBA Loan or the foreclosure action;
- (d) Enable SBA, the 7(a) Lender or CDC to calculate and pre-approve in writing, the amount of consideration due by providing a copy of the following documents at least ten days prior to closing the sale of the property: (1) the order confirming the foreclosure sale; (2) evidence that Default Charges, if any, were subordinated to the SBA Loan pursuant to any applicable Third Party Lender Agreement or other subordination agreement; (3) an itemized list of expenses incurred to hold and market the property; (4) the purchase and sale agreement; and (5) the estimated closing statement; and
- (e) Instruct the closing agent to disburse the amount due as consideration directly to SBA, the 7(a) Lender or CDC.

c. Pre-foreclosure Sale

A request for release of the redemption rights on an SBA Loan prior to confirmation of a senior lienholder's foreclosure sale, e.g., by entering into an agreement not to exercise the redemption rights on the SBA Loan, must not be approved, and such agreements must not be entered into, unless all of the following conditions have been met:

- (1) The request is from a senior lienholder that has filed a foreclosure action;
- (2) The foreclosing lender agrees that if it acquires title at the foreclosure sale, it will resell the property pursuant to the conditions set forth in the subparagraph above entitled *Release for Future Consideration from Foreclosing Lender* and will pay consideration in a dollar amount equivalent to the greater of \$1,000 or 50% of the Net Profit;
- (3) The agreement is not assignable and is void if the foreclosing lender does not acquire title to the property at the foreclosure sale;
- (4) Any necessary Department of Justice approval is obtained if the redemption rights were granted to SBA as a Federal Government Agency by [28 U.S.C. § 2410\(c\)](#);

- (5) The foreclosing lender agrees to enter a bid that does not include Default Charges, if any, subordinated to the SBA Loan by a Third Party Lender Agreement or other subordination agreement;
- (6) The agreement does not preclude SBA from entering a Protective Bid at the foreclosure sale or from redeeming the property in the event the foreclosing lender enters a bid that is less than the balance due on its loan;
- (7) SBA, the 7(a) Lender or CDC retains its statutory right as a junior lienholder to the excess proceeds from the foreclosure sale;
- (8) In order to preserve the right to collect the deficiency balance on the SBA Loan, written consent to the pre-foreclosure sale release agreement is obtained from all of the remaining Obligors when required by applicable law; and
- (9) All other applicable prudent lending practices and Loan Program Requirements are complied with, particularly those designed to protect the ability to collect the deficiency and to preserve the integrity of SBA's loan program.

G. Excess Proceeds from Senior Lien Foreclosure Sale

1. Requirement

After any Third Party Lender or other senior lienholder's foreclosure sale where the property was not acquired to protect the equity available for the SBA Loan, the Liquidation Officer must ascertain whether there are excess foreclosure sale funds available for distribution to junior lienholders and take the necessary and appropriate action to obtain the funds available for application to the SBA Loan balance.

2. Practice Tip—504 Loan Default Charges

When ascertaining whether funds are available for application to a 504 Loan, make certain that all amounts attributable to Default Charges were subordinated to the 504 Loan as required by the Third Party Lender Agreement.

H. Obtaining SBA Approval of Loan Actions Regarding Senior Liens

1. When Required

a. 7(a) Loans

Except for CLP Lenders, who must submit a Liquidation Plan for SBA approval, 7(a) Lenders are not required to obtain SBA's prior written approval of their strategy with regard to senior liens.

b. 504 Loans

CDCs must obtain SBA's prior written approval before purchasing or paying off the Third Party Loan or any other loan secured by a senior lien on the collateral for a 504 Loan.

2. SBA Response Time

SBA will respond to a request for prior written approval to purchase or pay off a debt secured by a senior lien on the collateral for an SBA Loan within 15 business days. ([13 C.F.R. § 120.541\(a\)](#))

I. SBA and CDC Use of Treasury Checks

1. When Treasury Checks May Be Used

When authorized pursuant to the Rule of Two, a Treasury check may be ordered from the SBA Denver Finance Center and used by SBA or a CDC to enter a Protective Bid at a foreclosure sale or to purchase or pay off a debt secured by a senior lien.

2. How to Order a Treasury Check

a. Lead Time

Requests for Treasury checks must be submitted to the SBA Loan Center responsible for overseeing the liquidation of the loan in sufficient time to allow for review and submission of approved requests to the SBA Denver Finance Center, which normally requires at least 30 days lead time to issue a Treasury check.

b. Required Information

A request for a Treasury check must be in writing and must set out (1) the exact amount of the check to be issued; (2) the name, address and Taxpayer Identification Number of the payee; and (3) the reason the check is required. In addition:

(1) Check for Protective Bids

If the Treasury check is for a Protective Bid, the request must indicate that the Person conducting the foreclosure sale will accept a Treasury check rather than a cashier's check, and include copies of the following documents:

- (a) The foreclosure sale notice;
- (b) A current title search or U.C.C. lien search;
- (c) Verification of amount owed to senior lienholders; and
- (d) A Post-default Environmental Investigation Report if required by this SOP.

(2) Check for Pay Off or Purchase of Senior Lien

If the Treasury check is to pay off or purchase a Third Party Loan or another loan secured by a senior lien, it must be transmitted to the senior lienholder by means of an escrow letter that contains appropriate instructions concerning the conditions under which the Treasury check can be cashed, e.g., the senior lienholder's note and collateral documents have been assigned to SBA, or the senior lienholder's note has been stamped "paid" and the collateral has been released. In addition, the request must also include a copy of:

- (a) The Third Party Lender Agreement or the agreement with the senior lienholder, if any; and
- (b) The Third Party Lender or senior lienholder's transcript of account, which must document that the purchase or payoff amount is consistent with the limitations, if any, in the Third Party Lender Agreement or similar agreement on Default Charges.

3. Limitation on Dollar Amount

The amount of a Treasury check cannot exceed \$999,999. If the amount needed exceeds \$999,999, an additional check for the remainder must be ordered for an amount that is not exactly the same as the original check or one of the checks may be cancelled.

4. Prevention of Unauthorized Use

Treasury checks must be kept in a secure location and only handled by an authorized SBA or CDC employee, who is either attending the foreclosure sale for which the check was obtained or transmitting the check pursuant to escrow instructions.

5. Disposition of Unused Checks

CDCs must promptly return all unused Treasury checks to the appropriate SBA Loan Center. SBA Loan Centers must promptly return all unused Treasury checks to the SBA Denver Finance Center. Unused Treasury checks should be transmitted by overnight mail, along with an explanation for the return. In no event may unused Treasury checks be kept for more than six months.

Chapter 11. Workouts

A. General

A workout agreement (or "forbearance agreement") is an agreement between a creditor and debtor that restructures the material terms and conditions of a loan in default in order to: avoid liquidation or litigation proceedings; enable the debtor to cure the defaults and improve repayment ability; and to enable the creditor to maximize recovery on the loan. Whenever feasible, a good faith effort must be made to negotiate a workout on an SBA Loan.

B. Feasibility Test

To determine whether the Borrower is a good candidate for a workout, in addition to reviewing the Loan Documentation, conduct a site visit and ascertain whether the Borrower is: (1) competent, i.e., has the necessary technical and management skills to turn the business around; (2) cooperative, i.e., willing to take the necessary action to address the problems that caused the default; (3) acting in good faith, and (4) financially and operationally viable.

Note: Free, confidential technical and management counseling is available to small businesses through the nationwide network of [SCORE](#) Chapters and [Small Business Development Centers](#).

C. Limitations

1. 7(a) Loans

Prior to purchase of the SBA-guaranteed portion of the loan from the secondary market investor, modification of the repayment terms of the Note without the prior written consent of the investor is limited to one deferment of up to three consecutive monthly payments. (SBA Form 1086 - *Secondary Participation Guaranty Agreement*)

Note: Generally, if the loan is held in a secondary market pool rather than by an individual investor, modifications requests are approved as long as they do not alter the investors' interest rate. Therefore, if the Borrower is a good candidate for a workout pursuant to the standards set out in Paragraph B above, Lenders are encouraged to propose modifications that will enable the Borrower to remain viable. Proposed changes should be submitted to SBA's fiscal and transfer agent, currently [Colson Services Corp.](#) for consideration. SBA approval is not required.

2. 504 Loans

Prior to purchase of the debenture from the investor, modification of the repayment terms of the Note is limited to deferments made pursuant to Paragraph E.4. below. (See Chapter 25 for information on the impact of debenture purchase including the reduction of fees paid by the Borrower.)

D. Requirement—New Consideration from Borrower

In order for a workout agreement to be legally binding, both the creditor and debtor must provide something of value ("consideration"). For example, in exchange for the 7(a) Lender, CDC or SBA's agreement to forbear or restructure the loan, the Obligor(s) should be required to do one or more of the following:

1. Fix any errors in the Loan Documents;
2. Waive defenses;
3. Release lender liability claims;
4. Provide additional collateral; or
5. Allow entry of a confession of judgment if the workout fails.

The Borrower's consideration must be received, (and the Loan Documents modified if necessary), before or at the same time that the Borrower receives the benefit of the workout agreement, e.g., the Loan Documents must have been corrected, defenses waived, claims released and liens on additional collateral obtained and perfected.

E. Workout Options

The workout options, i.e., methods used to avoid liquidation or litigation, used on a particular loan will vary depending on the circumstances including the limitations listed above in Paragraph C if SBA has not purchased the guaranteed portion of a 7(a) Loan or the 504 Loan debenture. The most common workout options are listed below.

1. Forbearance

Enforced collection activities may be postponed for a stated period of time in order to allow the Borrower to improve cash flow.

2. Reinstatement or Extension of Maturity Date

If the Note has been accelerated, the maturity date can be reinstated. In addition, the maturity date of the Note may be extended up to ten years beyond the original maturity date if it will aid in the repayment of the SBA Loan, provided that with regard to 504 Loans, the debenture has been purchased by SBA. ([13 C.F.R. § 120.531](#))

3. Repayment Plan for Past-due Amounts

A plan to repay the past-due amounts may be negotiated. Generally, a down payment should be required followed by monthly payments that should be remitted along with the regular monthly payment.

4. Deferment

Past or future payments of principal, interest or both may be deferred for a stated period of time.

- a. The Borrower should pay the deferred amount within five years of the expiration of the deferment period, provided that with regard to 504 Loans, the deferred amount must be repaid within five years of the expiration of the deferment period if SBA has not purchased the debenture; and
- b. Interest should continue to accrue and may be dealt with in one of the following ways:
 - (1) Interest is paid during the deferment period;
 - (2) Deferred interest is paid in a lump sum at the end of the deferment period;
 - (3) Payments made after the deferment are applied first to accrued interest, then to principal; or
 - (4) All interest payments are deferred to the maturity date of the Note; and
- c. With regard to 504 Loans, if SBA has not purchased the debenture, the CDC notifies the Central Servicing Agent ("CSA") of the deferment in order to avoid acceleration of the Note and purchase of the debenture.

5. Modification of Note

The repayment terms of the Note such as the interest rate, amount or the frequency of payments may be modified, provided that with regard to 504 Loans, the debenture has been purchased by SBA, and with regard to 7(a) Loans that have been sold in the secondary market, the guaranteed portion has been purchased by SBA or the written consent of the secondary market investor has been obtained pursuant to Paragraph C.1 above.

6. Reduction of Loan Balance

The amount of accrued interest or principal owed on the SBA Loan may be reduced as part of a workout plan, provided the reduction is done pursuant to a compromise agreement that meets the requirements set forth in Chapter 16.

7. Assumption of Loan by Third Party

Another Person may assume an SBA Loan, i.e. take on the Borrower's legal obligations under the Loan Documents, provided that the existing Obligor is not released from liability except with the prior approval of SBA, and provided that the assumpor is "reasonably equal" to or "better" than the existing Obligor in terms of financial condition and business experience.

8. Subordination to Working Capital Loan

Under rare circumstances, the lien priority position of the SBA Loan may be subordinated to a short-term working capital loan when doing so is necessary to enable the Borrower to continue operating and to maximize recovery on the loan.

9. Relief on Senior Loan

A loan secured by a senior lien on the collateral securing the SBA Loan, including the Third Party Loan in a 504 Loan transaction, may be kept current, purchased or paid off if doing so will enable the Borrower to sustain its business operations by eliminating the risk of foreclosure by the senior lienholder and enable SBA, the Lender or CDC to gain control of the workout process. (See Chapter 10 for information regarding Third Party Loans and other senior liens.)

10. Voluntary Sale of Collateral

The Borrower may be allowed to conduct a voluntary sale of all or part of the collateral and apply the proceeds to the loan balance, provided that:

- a. A voluntary sale would maximize recovery on the loan;
- b. The Obligor has possession of the collateral;
- c. All other creditors with a lien on the collateral have consented to the sale in writing;
- d. A Post-default Appraisal has been obtained;
- e. The Recoverable Value of the collateral has been established;
- f. The sales price is based on the Post-default Appraisal;
- g. SBA, 7(a) Lenders and CDCs as well as their employees, Close Relatives and Associates must not, directly or indirectly, bid on or purchase the collateral;
- h. The collateral must not be sold to the Obligors, Associates or Close Relatives of the Borrower for less than the full amount due on the SBA Loan;
- i. The sale is closely supervised to ensure that the costs are reasonable and the net proceeds are applied to the loan balance;
- j. The lien securing the SBA Loan is released in accordance with the requirements of Chapter 13 with regard to release of real property liens for consideration and Chapter 14 with regard to release of personal property liens for consideration;
- k. The sales price is paid in cash unless a term sale is necessary to maximize recovery on the loan, in which case: (1) a down payment of 20% or more must be received along with a promissory note for the balance secured by a properly perfected first-position lien on the property involved ; and (2) the Borrower assigns the note and security documents to SBA, the Lender or CDC; and
- l. SBA's prior written approval has been obtained if required. (For information on when SBA's prior approval is required, see Chapter 5 with regard to 7(a) Loans and Chapter 6 with regard to 504 Loans.)

F. Agreement Provisions

A workout agreement must be in writing and should include: (1) a list of events of default to date; (2) a confirmation of the SBA Loan collateral and lien priority; (3) an acknowledgement that SBA, the 7(a) Lender or CDC is not waiving any defaults, rights or remedies by entering into the workout agreement; (4) the forbearance period; (5) the agreed upon workout option(s) such as those listed in Paragraph D above; (6) the events that constitute a default under the workout agreement, including the date by which the obligations under the workout agreement must be performed; (7) the consequences of default under the workout agreement, e.g., the collateral must be turned over and a confession of judgment entered; and (8) the signatures of SBA, the 7(a) Lender or CDC and all Obligors on the loan.

G. Obtaining SBA Approval of Workout Agreements

1. When Required

a. 7(a) Loans

SBA's prior written approval is not required to enter into a workout agreement unless it includes a compromise of the principal balance of the loan or some other action that requires SBA's approval pursuant to [13 C.F.R. § 120.536\(a\)](#).

b. 504 Loans

SBA's prior written approval is required to enter into a workout agreement that restructures the material terms and conditions of a 504 Loan. ([13 C.F.R. § 120.536\(b\)\(6\)](#))

2. How to Obtain

Requests for approval of a proposed workout agreement must be submitted to the appropriate SBA Loan Center.

3. SBA Response Time

SBA should respond to a request for prior written approval to enter into a workout agreement within 15 business days. ([13 C.F.R. § 120.541\(a\)](#))

H. Return to Regular Servicing

When the Obligor has made at least three consecutive timely payments under the terms of a workout agreement, the loan may be returned to regular servicing status.

Chapter 12. Obligors

A. Acceleration and Demand Letters

Unless prohibited by applicable law, e.g., bankruptcy law pertaining to the automatic stay, when an SBA Loan is classified in liquidation status, the Note must be accelerated and a timely demand must be made on all Obligors for payment of the loan balance. The demand letter(s) should be sent via regular and certified mail or other method that enables the sender to confirm delivery in order to ensure that documentary evidence is available in the event litigation becomes necessary.

Note: The basic federal statute that protects Obligors in active military service against foreclosure actions is the [*Servicemembers Civil Relief Act*](#) , (50 U.S.C. App. § 501 *et seq.*).

B. Skip Tracing

Once the Note has been accelerated, a Good Faith effort must be made to locate, and to collect the loan balance from, any missing Obligor(s).

C. Life Insurance

If an assignment of a life insurance policy was required by the Loan Authorization, coverage must be continued, even if the Obligor has allowed it to lapse, unless: (a) there has been a substantial change in circumstances that renders the assignment unnecessary; and (b) the loan file has been documented to reflect the basis for the decision and why it was prudent and commercially reasonable.

D. Repayment Ability Analysis

To assess an Obligor's ability to repay, the Obligor's financial statements, tax returns, credit reports and other relevant financial documents should be reviewed and taken into consideration along with the following factors:

1. Recoverable Value of collateral pledged by the Obligor to secure the Note or a Guaranty;
2. Equity in assets owned by the Obligor that were not pledged as collateral that may be available for execution if a judgment is obtained against the Obligor;
3. Obligor's income;

4. Obligor's cooperativeness;
5. Likelihood that the Obligor's assets have been or will be concealed or fraudulently transferred; and
6. Exemptions available to the Obligor under state and federal law.

E. Release of Personal Guaranty

For information on release of an Obligor's personal Guaranty for consideration, see Chapter 16 on compromise agreements.

F. Deceased Obligors

If an SBA Loan is classified in liquidation and an Obligor dies, prudent action must be taken when necessary to ensure that the SBA Loan is paid, e.g., through an assumption agreement, from the proceeds of life insurance pledged as collateral for the loan, or from the assets of the decedent's estate. (See Chapter 15 (*Litigation*) for information on probate proceedings.)

Chapter 13. Real Property Collateral

A. General

All collateral that has a Recoverable Value should be liquidated. With regard to real property collateral, if the Recoverable Value is \$5,000 or more, it must be liquidated unless there is a documented compelling reason for not doing so. The most common methods of liquidating real property collateral are discussed below.

B. Procedure for Selecting Best Method of Liquidation

Real property collateral must be liquidated in a manner that will maximize recovery on the loan in the shortest amount of time. The most appropriate method will depend on numerous factors including those that can be ascertained by following the steps listed below.

1. Determine the Use of the Property

Determine the use of the property since special requirements may apply depending on how the property is used or classified. For example, if the property is used as an Obligor's primary residence, the requirements set forth in Paragraphs C.1.b. and C.3.b. below must be met before initiating a foreclosure action. If the property is agricultural, state law may require judicial foreclosure and federal law may provide the Borrower with homestead rights. (For more information, see the *Consolidated Farm and Rural Development Act*, and [13 C.F.R. § 120.550](#), et seq.) Finally, if the property is used to operate a gas station, special duties may be owed to a major oil company with regard to matters such as notice of default, the oil company's right of first refusal, or its ability to control future ownership or use of the property.

2. Review the Loan Documents

Review the Loan Documents to ensure that the method of liquidation is consistent with the terms of the Loan Documents.

3. Order a Lien Search

Order a new title search, or at a minimum, review the existing title insurance policy and gather any other information needed to identify all liens and other encumbrances against the property. Then, consider the impact, if any, each encumbrance has on the choice of liquidation methods. For example:

a. Senior Tax Liens

Determine, and continue to monitor, whether there are liens for delinquent property taxes and assessments that have priority over the lien securing the SBA Loan and decide whether they should be paid.

b. Senior Non-tax Liens

If there are senior non-tax liens against the property, decide which of the options listed in Chapter 10 is prudent under the circumstances.

c. Junior Non-tax Liens

If there are junior liens against the property other than federal tax liens, decide whether to eliminate them through foreclosure or negotiate their release for nominal consideration.

d. Junior Tax Liens

If there are junior federal tax liens against the property, work with the IRS to reach an amicable resolution as to the amount that should be applied to the tax lien or ask the IRS for a certificate of discharge.

e. Leases

If tenants are leasing the property, determine: (1) whether the lease enhances or diminishes the Liquidation Value and marketability of the property; and (2) whether a foreclosure sale will extinguish the lease or whether it will survive and bind the purchaser to the lease terms.

Note: If the Loan Documents include a *Subordination, Non-disturbance and Attornment Agreement*, review it carefully since it addresses lender and tenant rights. Typically, the tenant agrees to "subordinate" the lease to the lender's mortgage; and in the event of default by the landlord (Obligor on the SBA Loan), the lender agrees not to "disturb" the tenant's possession; and the tenant agrees to "attorn," i.e., recognize the lender or foreclosure sale purchaser as the landlord.

f. Assignments of Rents

If the collateral includes an assignment of rents and a tenant is in possession of any portion of the property, decide whether:

- (1) Collecting the rents pending a workout or foreclosure sale is necessary to maximize recovery;

- (2) Collecting the rents would cure the existing default and prevent foreclosure; and whether
- (3) Requesting the court to appoint a receiver to collect the rents could bar a non-judicial foreclosure action.

g. Title Encumbrances

If there are other title encumbrances, such as purchase options, rights of first refusal or covenants that restrict the use of the property or require future owners to indemnify another Person from liability associated with Contamination, determine the impact they have on the Liquidation Value and marketability of the property.

4. Check Status of Hazard Insurance

Check the status of the hazard insurance coverage on the property. Pursuant to prudent lending practices, Lenders and CDCs must ensure that all collateral with a significant Recoverable Value is adequately insured in order to protect the ability to recover on the SBA Loan.

5. Order a Post-default Appraisal

Order a Post-default Appraisal, and collect any other information, such as the amount owed on senior liens, to establish the Recoverable Value of the property.

6. Assess the Environmental Risk

Consider the findings set out in the Post-default Environmental Investigation Report required by Chapter 9 since Contamination can diminish the Recoverable Value and marketability of real property and create liability under applicable Environmental Laws.

7. Check Historic Register Status

Determine whether the property is listed on or eligible for the [National Register of Historic Places](#) by contacting the [State Historic Preservation Office](#) where the property is located. If so, determine what impact the listing may have on the Recoverable Value of the collateral.

8. Review Relevant Business Records

Depending on the circumstances, it may be prudent to review the Borrower's books and records showing the cash flow related to the operation and use of the property, and to verify that the property and its use do not violate any applicable laws such as those pertaining to zoning and land use.

9. Consider Need to Collect Deficiency

Ascertain whether use of the intended method, e.g., non-judicial foreclosure or acceptance of a deed in lieu, would be sufficient to pay the loan in full and whether it would bar collection of any deficiency (i.e., the amount still owed on the debt after the sale of the collateral) from the Obligor.

10. Estimate Time and Costs Involved

Estimate the time and expense associated with the intended method of liquidation including:

- a. Foreclosure costs, fees and time-line;
- b. Care and preservation expenses pending foreclosure; and
- c. REO costs, such as expenses associated with resale, if title to the collateral is acquired.

C. Liquidation Methods

1. Release of Lien for Consideration

Real property liens may be released for consideration as follows:

a. Commercial Real Estate

(1) General

A lien on commercial real estate may be released for consideration provided that:

- (a) The amount received is approximately equal to or greater than the Recoverable Value of the collateral; and
- (b) Release of the lien will not jeopardize the ability to maximize recovery on the loan.

For example, if the collateral includes a lien on trade fixtures located on the real property such as gas station canopies and pumps, the real property lien should not be released unless the personal property collateral has already been liquidated or additional consideration is provided for release of the personal property liens. (See Chapter 14 for information on personal property collateral liquidation.)

(2) Practice Tip—504 Loan Default Charges

With regard to 504 Loans, make certain that all amounts attributable to Default Charges on the Third Party Loan, which were subordinated to the 504 Loan by the Third Party Lender Agreement, are paid to SBA rather than the Third Party Lender.

b. Residential Property

When a personal residence is the Obligor's only worthwhile asset and there is no other prospect for recovery (e.g., from income in excess of that needed to meet living expenses), the lien may be released for consideration. In such cases, a good faith effort must be made to obtain not only an amount equal to the Recoverable Value of the residence as consideration for release of the lien, but also an additional amount sufficient to compromise the Obligor's remaining liability. (See Chapter 16 for information on compromise agreements.)

2. Deed in Lieu of Foreclosure

Real property collateral may be liquidated by accepting a deed in lieu of foreclosure (i.e., a deed by which a debtor conveys fee-simple title to a secured creditor as a substitute for foreclosure) if doing so would maximize recovery on the loan. All deeds in lieu must be accompanied by a written agreement executed by all of the Obligors as to the amount to be applied to the loan balance once title has been transferred. Although this procedure may save time and costs, it has inherent risks. For example, accepting a deed in lieu may eliminate the right to collect any deficiency or the ability to foreclose the lien securing the SBA Loan.

Note: Generally, judicial or non-judicial foreclosure should be used rather than a deed in lieu when there are junior liens on the property that should be eliminated to maximize recovery on the loan. Further, if acceptance of a deed-in-lieu would release the Obligors, SBA's prior written approval is required.

3. Lien Foreclosure

a. General

Foreclosure is a legal action taken to sell property that was pledged by an Obligor as security for a loan. Since the laws pertaining to the foreclosure of mortgages, deeds of trust, and other types of real property liens vary by state, consult Legal Counsel to determine which type of foreclosure action is the most appropriate with regard to a particular loan. The two primary methods of real property lien foreclosure actions are judicial foreclosure and non-judicial foreclosure.

b. Primary Residences

Unless the Obligor-owner has engaged in fraud, misrepresentation or other financial dishonesty, a good faith effort must be made to reach an agreement covering release of the lien for consideration and compromise of the Obligor's liability prior to initiating a foreclosure action against the Obligor's primary residence.

c. Types of Foreclosure Actions

(1) Judicial Foreclosure

Judicial foreclosure requires filing a lawsuit.

(a) Advantages

- i. Deficiency judgment obtainable; and
- ii. Only one action required to foreclose liens and obtain judgment on the Note and Guaranties.

(b) Disadvantages

- i. Higher costs and fees than non-judicial foreclosure;
- ii. More time-consuming than non-judicial foreclosure; and
- iii. The mortgagor and junior lienholders usually have statutory redemption rights.

(2) Non-Judicial Foreclosure

Non-judicial foreclosure, which ends with the private sale of the property, is available only if the deed of trust or mortgage securing the loan contains a clause or provision granting a power of sale. Strict compliance with the applicable statutory provisions governing non-judicial foreclosure is mandatory.

(a) Advantages

- i. Fees and costs are relatively inexpensive;
- ii. Less time-consuming than judicial foreclosure; and
- iii. The mortgagor and junior lienholders usually do not have statutory redemption rights.

(b) Disadvantages

- i. Deficiency judgment may not be obtainable (Consult Legal Counsel for information on specific loans.); and
- ii. Judicial action may still be necessary if there are unlawful occupants who need to be evicted.

4. Collection of Rents

If the Loan Documents include an assignment of rents and there are tenants paying rent to an Obligor, consult Legal Counsel as to the applicable state law regarding the collection of rent pending workout or foreclosure. In some cases, this may be accomplished by means of a letter to the tenants. In other cases, a receiver may need to be appointed.

5. Appointment of Receiver

Under certain circumstances, it may be necessary to have a receiver appointed by the court to preserve and protect the collateral in connection with, or in lieu of, a foreclosure proceeding. The laws governing receiverships vary by state. Generally, however, the court will authorize a receiver to bring and defend actions, take and keep possession of the property, receive rents, collect debts, etc.

6. Short Sale Approval

a. General

The term "short sale" is used to describe a real estate transaction where the seller owes more on the debt(s) secured by the property than the property is worth, and the seller's secured creditor(s) agree to release their lien(s) on the property even though the creditor(s) will receive less than the full amount due on the debt(s) from the proceeds of the sale. Generally, because the proceeds belong to the secured creditor(s)—not the seller—the secured creditor(s) can negotiate the amount of closing costs paid from the proceeds of a short sale, such as real estate commissions.

b. Standard of Review

A request from an Obligor to approve a short sale should be analyzed in the same manner as any other request for release of lien for consideration. The test is whether the dollar amount offered as consideration in exchange for release of the lien is approximately equal to or greater than the Recoverable Value of the property. At a minimum, the documents that should be reviewed include:

- (1) Real Estate Listing Agreement;
- (2) Real Estate Purchase and Sale Agreement;
- (3) Short Sale Addendum to Purchase and Sale Agreement;
- (4) Current title report;
- (5) Draft settlement statement;
- (6) Consent letter from any other lender whose agreement is required to complete the short sale;
- (7) Post-default Appraisal of the property; and
- (8) Pre-approval letter from the purchaser's lender.

c. Release of Lien Only—Not Liability for Loan Balance

Approval of a short sale should not include forgiveness of the remaining SBA Loan balance unless it is part of a compromise agreement that complies with the requirements set forth in Chapter 16.

D. Credit Bids**1. Requirement**

A Credit Bid should be entered at all real property lien foreclosure sales initiated by SBA, a 7(a) Lender or CDC to foreclose a lien securing an SBA Loan, whether the sale is judicial or non-judicial.

2. Credit Bid Amount

To determine the amount of a Credit Bid the following factors must be considered: (a) Recoverable Value; (b) the loan balance; and (c) need for and ability to collect a deficiency judgment. The Credit Bid amount should be based on the Recoverable Value of the collateral and should not exceed the amount of the loan balance. Further, the entire loan balance should not be bid if doing so would eliminate an otherwise collectible deficiency.

E. Eviction Proceedings

If title to real property collateral is acquired by SBA, the 7(a) Lender or CDC through foreclosure or otherwise and there are tenants or others unlawfully occupying the premises, it may be necessary to evict them. Consult Legal Counsel to determine the appropriate course of action.

Chapter 14. Personal Property Collateral

A. General

All collateral that has a Recoverable Value should be liquidated. With regard to personal property collateral, if the aggregate Recoverable Value is \$2,500 or more, it must be liquidated unless there is a documented compelling reason for not doing so. The most common methods of liquidating personal property collateral are discussed below.

B. Procedure for Selecting Best Method of Liquidation

Personal property collateral must be liquidated in a manner that will maximize recovery on the loan in the shortest amount of time. The most appropriate method will depend on numerous factors including those that can be ascertained by taking the steps listed below.

1. Review the Loan Documents

Review the applicable Loan Documents to begin the process of determining what personal property is available for liquidation, how the liens on that property can be foreclosed, and how much money can be recovered by liquidating it. For example, review the Authorization and any security agreement, assignment, marine mortgage, certificate of title, landlord lien waiver, senior lienholder agreement, subordination agreement, deposit account control agreement, lien search, etc.

Note: Generally, the law under which a lien was created dictates how it can be foreclosed. For example, if the collateral consists of a lien on personal property such as equipment or inventory created under Article 9 of the Uniform Commercial Code ("U.C.C."), the lien can be foreclosed by conducting a foreclosure sale pursuant to U.C.C. Article 9 ("U.C.C. sale"). On the other hand, if the collateral consists of a common law assignment of a life insurance policy or a marine mortgage, the U.C.C. does not apply and the lien must be foreclosed pursuant to the applicable state or federal law.

2. Order a Lien Search

Order a current U.C.C. search to identify the liens against most types of personal property collateral. Follow the steps below to search for liens against special types of property, such as:

a. Motor Vehicles and Small Boats

Check for security interests noted on the certificate of title.

b. Airplanes

Order a title search, (usually through an airplane title service company), from the Federal Aviation Administration Registry in Oklahoma City, Oklahoma and if the plane is subject to the Cape Town Convention, the international registry in Ireland.

c. Documented Vessels

Order an abstract of title, (usually through a marine title service company), from the U.S. Coast Guard National [Vessel Documentation Center](#) in West Virginia.

d. Tax Liens

Determine, and continue to monitor, whether there are liens for delinquent personal property taxes or assessments that have priority over the lien securing the SBA Loan and decide whether they should be paid. If there are junior IRS liens against the property, ask the IRS for a certificate of discharge or reach an amicable resolution as to the amount of funds that should be applied to each IRS tax lien.

3. Review the Relevant Business Records

If the collateral consists of inventory or accounts, review the Borrower's books and records to determine whether there are accounts receivable that can be collected or inventory that can be returned for cash or credit.

4. Check Status of Hazard Insurance

Check the status of the hazard insurance coverage on the property. Pursuant to prudent lending practices, Lenders and CDCs must ensure that all collateral with a significant Recoverable Value is adequately insured in order to protect the ability to recover on the SBA Loan.

5. Order a Post-default Appraisal

Order a Post-default Appraisal and gather any other information needed in order to establish the Recoverable Value of the collateral.

6. Assess the Environmental Risk

If there are Hazardous Substances at the Borrower's business premises, follow prudent lending practices in order to minimize the risk and maximize recovery; and if the collateral includes equipment associated with a gas station or dry cleaner, comply with the requirements set forth in Chapter 9.

7. Estimate the Time and Costs Involved

Estimate the time and expense associated with each available method of liquidation.

C. Liquidation Methods**1. Release of Lien for Consideration**

Personal property liens may be released for consideration provided that (1) the consideration is approximately equal to or greater than the Recoverable Value of the collateral; and (2) release of the lien will not jeopardize the ability to maximize recovery on the loan. For example, if a public auction is planned, the lien on the most valuable pieces of equipment should not be released beforehand since it would impair the ability to attract bidders for the remaining collateral.

Note: See Chapter 16 (*Compromise*) for information on release of an Obligor's personal Guaranty for consideration. See Chapter 11 (*Workouts*) for information on voluntary sale of collateral by an Obligor.

2. U.C.C. Sale

Liens on business assets such as equipment, inventory or fixtures created under [U.C.C. Article 9](#) may be foreclosed by conducting a U.C.C. sale.

a. **Types of U.C.C. Sales**

(1) **Private Sale**

A private U.C.C. sale is not open to the general public, usually does not occur at a pre-appointed time and place, and may or may not be advertised to the general public. Although public sales are preferred, a private U.C.C. sale may be conducted if doing so would maximum recovery on the loan, e.g., when the collateral can be sold as part of a sale of a going concern (i.e., a commercial enterprise actively engaged in business with the expectation of indefinite continuance).

(2) **Public Sale**

(a) **Auction or Retail Sale**

A public U.C.C. sale is open to the general public, occurs at a pre-appointed time and place, and is widely advertised. The use of widely advertised public sales such as auctions, retail or sealed bid sales is encouraged.

(b) **Sealed Bid Sale**

A sealed bid sale is typically advertised to members of the general public who submit confidential bids to be opened at a predetermined place and time. A sealed bid sale differs from a public auction in that it does not allow for interaction between competing bidders.

b. **Requirements**

(1) **Possession of the Collateral**

The secured creditor must be able to repossess the collateral without a "breach of the peace." ([U.C.C. § 9-609](#)) If it cannot be repossessed without breaching the peace, consult Legal Counsel to determine whether litigation, such as a replevin action, is appropriate to obtain possession of the collateral.

(2) Notice

Reasonable notice of the sale must be sent to all Obligors and junior lienholders at least ten days prior to the sale unless the collateral is perishable or sold in a recognized market such as the New York Stock Exchange. To prove compliance, the file must be documented with: (1) a post-default U.C.C. lien search verifying the priority of the lien securing the SBA Loan and the identity of any junior lienholders entitled to notice; (2) the notice sent to the Obligors and junior lienholders; and (3) proof that the notice was transmitted. ([U.C.C. § 9-611](#))

(3) Commercial Reasonableness

Every aspect of the sale including the method, manner, time, place and terms must be "commercially reasonable." ([U.C.C. § 9-610](#)) To prove compliance, at a minimum, the file must be documented with: (1) a Post-default Appraisal of the property prepared prior to the sale; and (2) all records pertaining to the sale including, at a minimum, the following:

- (a) The inventory of the property sold;
- (b) The sale brochure and advertisements;
- (c) The list of registered bidders;
- (d) Name of buyer(s) and amount paid for each item; and
- (e) The final accounting for the sale that includes the gross amount of proceeds, an itemized list of expenses, including how they were calculated, and the net amount recovered.

c. Bill of Sale

The bill of sale should state that the personal property is sold "as is" and "without warranties of any kind including those relating to title, possession, quiet enjoyment or the like." (For more information, see [U.C.C. § 9-610.](#))

d. Credit Bids

U.C.C. sales should be aggressively advertised in order to obtain the highest price and to avoid acquiring title to personal property collateral. Generally, it is not advisable to enter a Credit Bid or to establish a minimum bid or reserve amount for a U.C.C. sale since doing so could have a chilling effect on the bidding.

e. Practice Tips**(1) Leased Equipment**

If the U.C.C. search reveals that a valuable piece of equipment is leased, find out the residual amount owed on the lease and pay it off if doing so would (1) allow the equipment to be included in the U.C.C. sale; (2) attract more potential buyers to the sale; and (3) maximize recovery on the loan.

(2) Purchase Money Security Interests

If the U.C.C. search reveals that another creditor has a purchase money security interest in a valuable piece of equipment (i.e., the Borrower used another creditor's money to purchase the equipment and granted that creditor a security interest in it), consider inviting that creditor to participate in the U.C.C. sale if doing so would (1) attract more potential buyers to the sale; (2) reduce the costs of sale by *pro-rating* and sharing the costs with the other creditor; and (3) maximize recovery on the loan.

(3) Used Chemicals, Batteries and Tires

If the collateral includes Hazardous Substances such as used chemicals, batteries or tires, ascertain whether there is a market for it. If so, encourage the Borrower to sell it and apply the proceeds to the loan balance. (See Paragraph C.2. above for information on release of lien for consideration. See EPA's Website for a [list](#) of companies that purchase reusable hazardous waste.)

3. **Judicial Foreclosure**

Although the self-help remedies authorized by the U.C.C. tend to be more economical and efficient, personal property liens may also be foreclosed by filing a lawsuit. For example, if the personal property collateral consists of trade fixtures attached to real property collateral and the real property lien must be judicially foreclosed, judicially foreclosing both the real and personal property liens in the same action may be appropriate. If judicial foreclosure is utilized, a Credit Bid should be entered.

4. **Collection of Accounts Receivable**

Pledged account receivables must be collected or abandoned in a timely and commercially reasonable manner consistent with the U.C.C.

a. **Collection by Borrower**

The Borrower, who will be liable for any deficiency and is best able to handle disputed claims, may be allowed to collect accounts provided that prudent precautions are taken to ensure that the proceeds are applied to the loan balance.

b. **Collection by SBA, 7(a) Lender or CDC**

In order to protect the right to a deficiency judgment, when it appears that further collection efforts by SBA, the 7(a) Lender or CDC would be futile, the Obligor should be provided with written notice of the intent to cease collection efforts and given the opportunity to pursue collection of the remaining accounts provided that the proceeds are applied to the loan balance.

5. **Set-off of Deposit Account**

A creditor, (e.g., SBA, a 7(a) Lender or CDC), that has a lien on a deposit account may instruct the bank to pay the balance of the cash in the deposit account to the creditor for application to the creditor's loan on the occurrence of an event of default if the creditor, debtor and the bank have provided for such an action in a control agreement, or the creditor becomes the bank's customer with respect to the deposit account; and the creditor complies with the U.C.C. requirements regarding notice and commercial reasonableness. ([U.C.C. § 9-607\(a\)\(5\)](#))

6. Surrender of Life Insurance Policy for Cash Value

When a life insurance policy with a cash surrender value has been assigned as collateral for an SBA Loan and a deficiency exists after all of the other collateral has been liquidated, the policy should be surrendered to the insurance company for the cash value and the proceeds applied to the principal balance of the loan unless, under the circumstances, it would be more prudent to keep the coverage in place, even if it requires advancing funds to pay the premiums.

7. Foreclosure of Lien on Fixtures

A lien on fixtures may be foreclosed pursuant to U.C.C. Article 9 or applicable real property foreclosure law. ([U.C.C. § 9-604](#)) (See Paragraph C.4. above for information on U.C.C. sales. See Chapter 13 for information on real property lien foreclosure.)

Note: A creditor who removes fixtures is responsible to the owner of the real property, other than the debtor, for the cost of repairing any physical injury caused by the removal, but not for any diminution in the value of the real property caused by the absence of the goods removed. ([U.C.C. § 9-604](#))

8. Marine Mortgage Foreclosure

A marine mortgage on a documented vessel can only be foreclosed by filing an admiralty action in the appropriate federal district court, which will issue a warrant for the arrest of the vessel.

Chapter 15. Litigation

A. SBA Responsibility and Authority

1. SBA District Counsel

Generally, the SBA District Counsel, who is responsible for the geographic area where the litigation will occur, is responsible for the following litigation activities:

- a. Conducting all litigation needed to ensure recovery on non-PCLP CDC 504 Loans and non-ACL 504 Loans unless, with the concurrence of the local SBA District Counsel, the SBA Loan Center elects to authorize the CDC to conduct the litigation;
- b. Conducting all litigation taken over from a 7(a) Lender or CDC pursuant to Paragraph E below;
- c. Conducting all litigation in which SBA is named as a party; and
- d. Monitoring Routine and Non-routine litigation conducted by CDCs;
- e. Monitoring Non-routine Litigation conducted by 7(a) Lenders; and
- f. Keeping the SBA Loan Center informed of the status of litigation proceedings by routinely entering information regarding all significant litigation activities into the Agency's computer tracking system.

2. SBA Loan Center Legal Counsel

Generally, SBA Loan Center Counsel is responsible for monitoring Routine Litigation conducted by 7(a) Lenders.

Note: For detailed information on the role of the Department of Justice in SBA litigation, as well as the litigation authority and responsibility of SBA Legal Counsel, see Chapter 6 of [SOP 70 50 3](#) (*Legal Responsibilities*).

3. SBA Loan Center

The SBA Loan Center is responsible for providing any necessary support whether the litigation is handled by Loan Center Counsel or District Counsel.

B. 7(a) Lender Responsibility and Authority

7(a) Lenders, are responsible for all litigation needed to ensure recovery on all of the SBA Loans in their portfolio.

C. CDC Responsibility and Authority

1. Conducting Litigation

CDCs are responsible for the litigation needed to ensure recovery on the SBA Loans in their portfolio as follows:

- a. PCLP CDCs and ACLs**—are responsible for all litigation needed to ensure recovery on all of the SBA Loans in their portfolio; and
- b. Non-PCLP CDCs and non-ACLs**—do not have general litigation authority and therefore are not responsible for conducting the litigation on the 504 Loans in their portfolio unless the SBA Loan Center has specifically authorized them to handle the litigation on a specific 504 Loan as documented by a Loan Action Record that includes the concurrence of the District Counsel responsible for the geographic area where the litigation will occur.

2. Prerequisite—Reassignment of Loan Documents to CDC

The Loan Documents must be reassigned to the CDC before the CDC can take any legal action on a 504 Loan, including the filing of a Proof of Claim. (See Chapter 6 (*CDC Liquidation*) for information on how to obtain SBA approval of a request for reassignment of the Loan Documents.)

3. Providing Litigation Support to SBA

If SBA is conducting the litigation, the CDC must provide support upon request, e.g., order a Post-default Appraisal, attend a foreclosure sale or obtain information on the Third Party Loan. A CDC must never take any action on a 504 Loan in litigation conducted by SBA without SBA's prior written approval. This includes filing a Proof of Claim in a bankruptcy proceeding.

D. Performance Standards for Lender and CDC Litigation

The following requirements apply to all litigation conducted by a 7(a) Lender or CDC on an SBA Loan to enforce collection or otherwise protect the interests of the Lender or CDC and SBA.

1. General Requirements

- a. All litigation activities must be necessary, reasonable and customary for the locality;
- b. There must be no conflict of interest between the 7(a) Lender or CDC and SBA ([13 C.F.R. § 120.535\(c\)](#));
- c. The litigation must be cost effective;
- d. All litigation activities must be conducted in the name of the 7(a) Lender or CDC—not SBA, and SBA must not otherwise named as a party to the litigation;

<p>Note: Only an Assistant U.S. Attorney or Special Assistant U.S. Attorney is authorized to represent SBA in litigation.</p>
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- e. The SBA Loan Program Requirements pertaining to Litigation Plans must be complied with; and
- f. Whenever possible, the Obligor's non-exempt assets must be executed on within the first 90 days after the judgment is obtained and a copy of the judgment recorded in any state where the Obligor resides or has assets that can be seized or sold.

2. Attorneys—Required Qualifications

The attorney selected by a 7(a) Lender or CDC to conduct litigation on an SBA Loan must have:

- a. A valid license to practice in law in the state where the litigation will be conducted;
- b. Expertise in debt collection and bankruptcy law;
- c. Adequate malpractice insurance coverage; and
- d. No conflict of interest.

3. Attorney Fees

a. Amount

The fees and costs charged by the attorney selected by a 7(a) Lender or CDC to conduct litigation on an SBA Loan must be necessary, reasonable and customary for the locality. (See also Chapter 2 (*Definitions*) for the definition of "Recoverable Expense" and Chapter 19 (*Expenses and Recoveries*) for examples of Non-recoverable legal fees.)

b. SBA Approval of Attorney Fees

All attorney fees and costs incurred in connection with either Routine Litigation or Non-routine Litigation must be approved by SBA. See Chapter 19 (*Expenses and Recoveries*) for information on how to obtain SBA approval, as well as reimbursement or payment of attorney fees and related costs.

Note: If SBA is conducting the litigation, SBA will not approve, pay or reimburse Lenders or CDCs for legal fees incurred by a Lender or CDC that SBA did not request in writing.

c. How to Obtain SBA Approval of Attorney Fees

Requests for approval of attorney fees and costs should be submitted to the appropriate SBA Loan Center pursuant to the procedure set out in Chapter 19 (*Expenses and Recoveries*). Upon receipt, the SBA Loan Center will forward a copy of the request to the SBA Loan Center Legal Division or SBA District Counsel responsible for monitoring the litigation.

d. Appeal process

See Chapter 19 (*Expenses and Recoveries*) for information on how to appeal the final decision of an SBA Loan Center Director or designee regarding attorney fees and costs.

E. SBA Takeover of Lender or CDC Litigation

SBA may take over litigation that a 7(a) Lender or CDC Lender is conducting or proposes to conduct if SBA determines that the outcome could adversely affect SBA's administration of the loan program or that the Government is entitled to legal remedies that are not available to the 7(a) Lender or CDC. (For examples, see [13 C.F.R. § 120.540\(d\)](#).)

F. Litigation Plans

1. Format and Content

A template for preparing a Litigation Plan for a [7\(a\) Loan](#) as well as a template for preparing a Litigation Plan for a [504 Loan](#) is accessible from www.sba.gov/banking.

2. When Required

a. Litigation Plan

(1) Non-Routine Litigation

A Litigation Plan is required for all Non-routine Litigation conducted by 7(a) Lenders and CDCs except for PCLP CDCs. ([13 CFR § 120.540\(c\)](#))

Note: All CDCs, including PCLP CDCs, must have the relevant Loan Documents reassigned to them before taking any legal action on a 504 Loan. (See Chapter 6 (*CDC Liquidation*) for information on how to request reassignment of the Loan Documents.

(2) Routine Litigation

A Litigation Plan is not required for Routine Litigation unless a material changes arises during the course of Routine Litigation that causes the legal fees to exceed \$10,000 in the aggregate, or otherwise transforms it into Non-Routine Litigation.

Note: CLP 7(a) Lenders and CDCs that are required to submit a Liquidation Plan must include all contemplated Routine Litigation in their Liquidation Plan.

b. Amended Litigation Plan

An Amended Litigation Plan is required before a 7(a) Lender or CDC takes any legal action or incurs any expense that materially deviates from its original Litigation Plan ([13 C.F.R. § 120.540\(e\)](#)). Material changes are those that, for example, cause approved legal fees to increase by more than 15%.

G. Obtaining SBA Approval of Litigation Plans

1. When Required

a. General Rule

Except as provided below regarding emergencies, SBA's prior written approval of a Litigation Plan or Amended Litigation Plan is required.

b. Exception—Emergency Situations

A CDC or 7(a) Lender can take actions to respond to an emergency without SBA's written approval of a Litigation Plan or Amended Litigation Plan, provided that the 7(a) Lender or CDC:

- (1) Makes a good faith effort to obtain SBA's written approval before undertaking the emergency action;
- (2) Submits a written Litigation or Amended Litigation Plan to SBA as soon after the emergency as possible; and
- (3) Takes no further litigation action without SBA's written approval of the Plan or Amended Plan. ([13 C.F.R. § 120.540\(f\)](#))

2. How to Obtain

Requests for approval of Litigation Plans must be submitted to the SBA Loan Center responsible for the loan involved in the proposed litigation. SBA Loan Center Counsel will coordinate the review and approval of the Litigation Plan with the District Counsel who will be responsible for the litigation pursuant to Subparagraph A.1. above.

3. **SBA Response Time—No Implied Consent**

Generally, SBA will respond to a request for approval of a proposed Litigation Plan or Amended Litigation Plan or attorney fees and costs within 15 business days. However, if a response is not received within 15 business days, SBA's consent may not be implied. ([13 CFR § 120.541](#))

4. **Appeal Process**

The decision of an SBA District Counsel regarding approval of a Litigation Plan or Amended Litigation Plan may be appealed to the SBA Associate General Counsel for Litigation, provided that the appeal: (1) is in writing; (2) includes a copy of the decision and supporting documents; (3) states the reason(s) why the decision is believed to be incorrect; and (4) is submitted within 30 days of the decision. ([13 C.F.R. § 120.540\(g\)](#))

H. **Documentation Requirements**

1. **General Requirement**

All Routine and Non-routine Litigation activities and decisions must be justified and documented. The documentation, including pleadings and all supporting documents such as letters, financial statements, credit reports, Post-default Appraisals, title reports and U.C.C. lien searches, must be kept in the loan file.

2. **Non-routine Litigation**

To enable SBA to effectively monitor Non-routine Litigation conducted by 7(a) Lenders and CDCs—and to expeditiously review requests for approval, payment or reimbursement of legal expenses—copies of all significant documents, such as the pleadings listed below and the supporting documents listed above, (i.e., letters, financial statements, credit reports, Post-default Appraisals, title reports and U.C.C. lien searches, etc.), must be provided to the SBA District Counsel responsible for monitoring the Litigation at the time the pleading or other document is generated or received.

- a. Complaints and answers;
- b. Motions and opposing pleadings;
- c. Orders and judgments; and

- d. Bankruptcy plans and discharge orders.

3. Routine Litigation

a. 7(a) Lenders

Unless specifically requested, 7(a) Lenders are not required to provide copies of pleadings or other documents pertaining to Routine Litigation to the SBA Loan Center Legal Division responsible for monitoring the litigation except as required by Chapter 19 (*Expenses and Recoveries*) to support requests for approval, reimbursement or payment of the expenses associated with the Routine Litigation.

b. CDCs

CDCs must provide copies of significant pleadings and other documents pertaining to Routine Litigation to the SBA District Counsel responsible for monitoring the litigation at the time the pleading or other document is generated or received.

I. Bankruptcy Proceedings

a. Requirements for All SBA Loans

If a voluntary or involuntary bankruptcy petition is filed that involves an Obligor, (the "debtor" in the bankruptcy proceedings and as used in this paragraph), the Person responsible for handling the litigation, (i.e., the 7(a) Lender, CDC or SBA), must at a minimum, ensure that the following actions are taken when necessary to protect the ability to recover on the SBA Loan:

- (1) A proof of claim is filed;
- (2) The debtor's Statement of Financial Affairs and schedules are reviewed and compared with the financial documents the debtor provided to the 7(a) Lender or CDC at the time the loan was made to determine if there are any material discrepancies with regard to the debtor's alleged assets, liabilities, income, expenses, etc.;
- (3) Suspected fraud is reported to the Office of the Inspector General, (See Chapter 21), and the appropriate Office of the U.S. Trustee;
- (4) The bankruptcy proceedings are monitored;

- (5) SBA and the Lender or CDC's interests are represented at all hearings where the outcome may adversely affect the ability to collect the SBA Loan balance;
- (6) A motion for relief from the automatic stay is filed when needed to pursue enforced collection proceedings against the collateral;
- (7) A objection to the discharge of the debt owed on the SBA Loan is filed if there is reason to believe that the debtor obtained the loan through fraud, misrepresentation or omission of a material fact, or fraudulently transferred or converted the collateral;
- (8) A motion to revoke the debtor's discharge is filed if there is reason to believe that it was obtained through fraud or other acts of impropriety;
- (9) The bankruptcy court's approval of a reaffirmation agreement is obtained if the debtor is willing and able to continue paying on the SBA Loan;
- (10) An objection to the debtor's plan or disclosure statement is filed when necessary;
- (11) A vote is cast to accept or reject proposed plans based on an analysis of the relevant facts;
- (12) Collection efforts are immediately resumed if the bankruptcy case is dismissed and the SBA Loan is still in default; and
- (13) Any other action that may be necessary and appropriate under the circumstances is taken.

b. Additional Requirement for 504 Loans

When notice of a bankruptcy filing is received, including those pertaining to "No Asset" Chapter 7 bankruptcies, the Person receiving the notice must ensure that the SBA Loan Center, SBA District Counsel and the CDC all receive prompt notice of the proceedings.

J. Probate Proceedings

If an Obligor dies, at a minimum, the Person responsible for handling the litigation, (i.e., the 7(a) Lender, CDC or SBA), must at a minimum, ensure that the following actions are taken when necessary to protect the ability to recover on the SBA Loan:

1. A creditor's claim is filed in the probate proceedings within the time proscribed by the applicable law;

Note: [31 U.S.C. § 3713\(a\)\(1\)\(B\)](#) gives priority to claims of the United States filed against the estate of an Obligor.

2. The inventory of the decedent's estate is reviewed and compared with the financial documents the decedent provided to the 7(a) Lender or CDC at the time the loan was made to determine if there are any material discrepancies;
3. Suspected fraud is reported to the Office of the Inspector General (See Chapter 21.);
4. The probate proceedings are monitored;
5. SBA and the Lender or CDC's interests are represented at all hearings where the outcome may adversely affect the ability to collect the SBA Loan balance; and
6. Any other action that is necessary and appropriate under the circumstances is taken.

Chapter 16. Compromise

A. General

If a deficiency exists after all of the collateral has been liquidated, Obligors who are unable to pay the deficiency in full within a reasonable amount of time, may be able to settle their liability on an SBA Loan for less than the full amount due (the "compromise amount") by entering into a compromise agreement. Obligors entering into compromise agreements should be advised that the difference between the principal loan balance and the compromise amount may be reported to the IRS and treated as income for federal income tax purposes. (See Chapter 20 for information regarding IRS Form 1099-C.)

B. When Compromise is Appropriate

1. General Requirements

A compromise offer should be solicited from each Obligor as soon as it becomes apparent that there will be a deficiency after the collateral has been liquidated, provided that:

- a. Collection of the deficiency is not barred by a valid legal defense such as discharge in bankruptcy or the statute of limitations;
- b. The Obligor has not engaged in fraud, misrepresentation or other financial misconduct; and
- c. The Obligor does not appear to have the ability to pay the deficiency in full within a reasonable amount of time; or the Obligor refuses to pay the deficiency in full, and the full amount cannot be recovered through cost-effective enforced collection proceedings within a reasonable amount of time.

2. Prior to Foreclosure on Obligor's Residence

Provided the requirements in Subparagraph 1 above are met, as set out in Chapter 13 (*Real Property Liquidation*), a good faith effort must be made to reach an agreement covering release of the lien on an Obligor's residence for consideration and compromise of the Obligor's liability prior to initiating a foreclosure action against the Obligor's primary residence.

C. Compromise Amount

1. General Rule

The compromise amount must bear a reasonable relationship to the amount that could be recovered and applied to the SBA Loan balance in a reasonable amount of time through enforced collection, and generally should be more than \$5,000.

2. Hardship Exception

The compromise amount may be \$5,000 or less in cases involving valid financial hardship.

3. Documentation Requirements

To determine whether a proposed compromise amount is acceptable, the following documents should be obtained and the accuracy of the information in them verified to the extent feasible:

a. Written Offer

A written offer signed by each Obligor proposing the compromise amount, which should refer to the penalties under [18 U.S.C. § 1001](#) for false statements. (See, for example [SBA Form 1150](#) (*Offer in Compromise*), which is accessible from www.sba.gov/banking.)

b. Financial Statement

A current financial statement from each Obligor proposing the compromise amount, which should be signed under penalty of perjury and must show the Obligor's assets, liabilities, income and expenses. (See for example [SBA Form 770](#) (*Financial Statement of Debtor*), which is accessible from www.sba.gov/banking.)

(1) Going Concerns

If the compromise involves a going concern (i.e., a commercial enterprise actively engaged in business with the expectation of indefinite continuance under the same ownership), the Obligor's current interim and last year-end financial statements are also required.

(2) Affiliates

If the Obligor has affiliates, the Obligor and affiliate's current consolidated financial statement is also required.

c. Corroborating Evidence

A current credit report on each Obligor proposing the compromise amount should be obtained. Additional efforts to establish the validity of the Obligor's current financial information in light of all previously submitted information should be documented and any major discrepancies must be investigated and explained.

4. Adequacy of Amount Offered

To determine whether a proposed compromise amount bears a reasonable relationship to the amount that could be recovered through enforced collection procedures within a reasonable amount of time, the following factors should be taken into consideration:

- a. Exemptions available under state and federal law;
- b. Recoverable Value of Obligor's non-exempt assets;
- c. Litigative risk, i.e., a real doubt concerning the ability to prove in court that the full amount is due;
- d. The possibility that assets have been or will be concealed or fraudulently transferred;
- e. The necessary, reasonable and customary administrative and litigation expenses that would be incurred through enforced collection;
- f. The time it would take to enforce collection;
- g. Obligor's income;
- h. Whether the Obligor fully and accurately disclosed assets, income, liabilities and expenses; and
- i. Whether the Obligor's cooperation during the liquidation process increased the overall recovery on the loan.

5. Payment Terms and Conditions

a. Cash Compromise—Preferred

The compromise amount should be paid in one lump sum at a specified time, generally within 60 days of the compromise approval date.

b. Term Compromise—If Necessary to Maximize Recovery

The compromise amount should not be payable in installments unless installment payments are necessary in order to maximize recovery on the loan. If the compromise amount is to be paid in installments, the compromise agreement should provide for the following:

- (1) A promissory note that is assignable and has a maturity date that does not exceed five years;
- (2) Collateral to secure payment of the promissory note;
- (3) A prohibition against release of the collateral securing the promissory note until the entire compromise amount is paid in full;
- (4) Reinstatement of the full loan balance, less sums paid on the promissory note, in the event of default on the compromise agreement; and
- (5) Remedies, such as entry of a confession of judgment in the event of default on the compromise agreement.

D. Compromise with Joint and Severally Liable Obligors

A compromise agreement with one Obligor does not release the remaining Obligors. When two or more Obligors are jointly and severally liable on an SBA Loan (i.e., full payment of the loan may be requested from just one Obligor or from all Obligors), no attempt should be made to divide payment responsibility between the Obligors or regard the compromise amount with one Obligor as a measure for determining the amount required from the remaining Obligors. ([4 C.F.R. § 103.6](#))

E. Obtaining SBA Approval of Compromise Agreements

1. When Required

SBA's prior written approval of a compromise agreement is required if it: (1) reduces the principal balance of the loan (including a principal reduction that is part of insolvency proceedings subject to court approval); or (2) involves some other action for which SBA's prior written approval is required pursuant to [13 C.F.R. § 120.536\(a\)](#). (For additional information on when SBA's prior written consent is required, see Chapter 5 with regard to 7(a) Loans and Chapter 6 with regard to 504 Loans.)

2. How to Obtain

Requests for approval of a proposed compromise agreement should be submitted to the appropriate SBA Loan Center utilizing the format set out in the [Offer in Compromise Tab System](#), which is accessible from www.sba.gov/banking. In addition, if the proposed compromise involves Non-routine Litigation, a copy must be submitted to the SBA District Counsel responsible for monitoring the litigation.

F. Completing the Compromise Process

After the compromise has been approved by all necessary parties, the following actions should be taken:

1. Obtain and confirm receipt of the compromise amount;
2. Promptly apply the compromise amount to the principal loan balance;
3. Release the appropriate Loan Documents after verifying that the entire compromise amount has been received;
4. If the compromise agreement involves installment payments, set up a separate record for the promissory note and properly perfect the lien on any asset offered to secure payment of the promissory note; and
5. If there is no legal remedy to collect the loan balance after the compromise amount is received, submit a Wrap-up Report or equivalent documentation so that the remaining loan balance can be charged-off.

G. Alternative—Treasury Department Referral

If an acceptable compromise agreement cannot be reached and all other cost-effective collection efforts have been exhausted, a Wrap-up Report or equivalent documentation should be submitted so that the loan can be charged off and referred to the U.S. Department of the Treasury for offset and other collection activities. (See Chapter 20 for information on wrap-up procedures.)

H. SBA Review of Proposed Compromise Agreements

1. Review Standard

Prior to approving a proposed compromise agreement, the Recommending Official, Approving Official and Legal Counsel should ensure that:

- a. All document requirements have been met;
- b. All of the following conditions have been met:
 - (1) There is no evidence of fraud, misrepresentation or other financial misconduct by the Obligor;
 - (2) The Obligor fully and accurately disclosed their assets, income, liabilities and expenses; and
 - (3) The Obligor is unable to pay the loan in full within a reasonable time; or the Obligor refuses to pay the loan in full and the full amount cannot be recovered through cost-effective enforced collection proceedings within a reasonable amount of time.
- c. The compromise amount bears a reasonable relationship to the amount that could be recovered through enforced collection procedures in a reasonable amount of time. ([4 C.F.R. Part 103](#))

2. Roles and Responsibility

a. Liquidation Officer

The Liquidation Officer serves as the Recommending Official with regard to compromise offers and must: review and analyze the compromise offer based on the review standard set out above in subsection 1; recommend whether to reject, accept or counter the offer; and explain the reason for the recommended action.

b. Legal Counsel

Legal Counsel must review and comment on proposed Loan Actions involving compromise offers pursuant to the review standard set out above in subsection 1 and the procedures set out in [SOP 70 50.3](#) (*Legal Responsibilities*).

c. Approving Official**(1) Supervisory Liquidation Officer**

Except as provided in subsection (2) below (*Loans Referred to DOJ*), the Supervisory Liquidation Officer serves as the Approving Official on proposed Loan Actions involving compromise offers without regard to dollar amount or whether the offer is from a going concern.

(2) Loans Referred to DOJ

Once an SBA Loan has been referred to the Department of Justice ("DOJ") for litigation, DOJ—not SBA—has compromise approval authority. SBA should respond within ten business days to compromise proposals from DOJ. SBA Legal Counsel is DOJ's point of contact. However, Legal Counsel and Liquidation Officers should work together to respond to DOJ's compromise proposals. Compromise amounts must be paid directly to DOJ – not SBA and SBA should not file a Satisfaction of Judgment or any other pleading unless specifically directed to by DOJ.

Chapter 17. Sale of Loan

A. Requirements

An SBA Loan in liquidation status may be sold to a Person other than the Borrower, provided that:

1. The sale price bears a reasonable relationship to the amount that could be recovered through enforced collection proceedings in a reasonable amount of time;
2. SBA's prior written approval is obtained if the sale involves a compromise of the principal balance of the loan or the purchaser is a Guarantor, a Close Relative of the Borrower, or an Associate of the Borrower; and
3. SBA has already honored its guaranty, i.e., if the sale involves a 7(a) Loan, SBA has already purchased the guaranteed portion, and if the sale involves a 504 Loan, SBA has already purchased the debenture.

B. Documentation

The decision to sell an SBA Loan must be justified and documented. Copies of the supporting documentation such as appraisals, credit reports, etc., must be kept in the loan file for future review by SBA.

C. Disclosure of Information

Consult Legal Counsel for case specific information regarding disclosure of information concerning an SBA Loan to a prospective purchaser.

Chapter 18. Acquired Collateral

A. General

Certain methods of liquidation may result in the acquisition of real property collateral ("Real Estate Owned" or "REO") or personal property collateral.

B. Acquiring Title to Collateral

1. General SBA Policy and Requirements

- a. Title to collateral should not be acquired unless it is necessary to maximize recovery on the loan.
- b. To avoid acquisition, foreclosure sales should be aggressively advertised in order to attract a large number of potential buyers.
- c. Title to collateral must not be taken in SBA's name without obtaining SBA's prior written approval. ([13 C.F.R. § 120.536\(a\)\(4\)](#))
- d. If written approval is granted to acquire title to collateral in SBA's name, SBA's ownership should be reflected on the title as follows: "Administrator, U.S. Small Business Administration, an Agency of the United States Government."

2. Real Property

- a. 7(a) Lenders that anticipate reselling REO within 120 days should take title in their own name. If disposition will take longer than 120 days, 7(a) Lenders must consult the SBA Loan Center responsible for the loan as to whether title should be taken in SBA's name in order to take advantage of favorable tax treatment.
- b. CDCs and 7(a) Lenders must not take title to Contaminated property in their own names—or SBA's name—without SBA's prior written approval. ([13 C.F.R. § 120.536\(a\)\(5\)](#))

3. Personal Property

Title to personal property collateral should rarely, if ever, be taken in SBA's name.

C. Ownership Responsibilities

Upon acquisition of real or personal property collateral, the following actions should be taken:

1. Possession and Control

- a. Take possession of the acquired collateral;
- b. Change the locks immediately on vacant, improved REO. Depending on the circumstances, arrange for additional security if necessary to prevent damage or avoid liability associated with ownership.
- c. Begin eviction proceedings if tenants are unlawfully occupying REO and will not leave voluntarily.

2. Inventory

Inventory and photograph all acquired personal property, including property located in and around REO;

3. Accounting

Set up a new file and keep all accounting with regard to the acquisition, holding and resale of the acquired collateral separate from the original loan file;

4. Taxes

Monitor and pay past due taxes and assessments to avoid liens, interest accrual and penalties;

5. Care and Preservation

Take reasonable steps to prevent deterioration, such as arranging for utility services and essential repairs and maintenance; and if the property has historic significance, consult with SBA District Counsel for the area where the property is located to ensure compliance with Section 106 of the National Historic Preservation Act of 1966;

6. Insurance

7(a) Lenders and CDCs must insure acquired collateral of material value if it would be prudent and commercially reasonable to do so;

7. Reporting Requirements

a. SBA Form 297

Complete SBA Form 297 (*Collateral Purchase Report*) when REO is acquired in SBA's name; and

b. Ongoing Reporting Duty

Notify the SBA Loan Center immediately if there is any reason to suspect any risk of liability associated with the acquired collateral such as the presence of Hazardous Substances.

D. Expenses

Expenses related to acquired collateral must be kept separate from the original loan account since they cannot be added to the loan balance. SBA will reimburse 7(a) Lenders and CDCs for reasonable, necessary and customary expenses related to acquired collateral. Requests for reimbursement of such expenses must be submitted to SBA in accordance with the procedures set out in Chapter 19.

E. Timeframe for Disposal

Acquired collateral should be disposed of within 12 months of acquisition.

F. Sale

Acquired collateral should be disposed of by sale. Depending on the circumstances, however, lease or abandonment may be consistent with prudent lending practices and necessary to maximize recovery on the loan.

1. Method of Sale

Acquired collateral should be sold by using whichever method, e.g., broker's sale, public auction, sealed bid sale, etc., will maximize recovery on the loan in the shortest amount of time.

2. Bidding or Acquisition by SBA Official, Lender, CDC or Associates

SBA officials, 7(a) Lenders and CDCs as well as their employees, Close Relatives and Associates must not, directly or indirectly, bid on or purchase acquired collateral except pursuant to a written exception to policy approved by the Director of OFA pursuant to the Rule of Two and documented by a Loan Action Record.

3. Transfer of Title and Closing Costs

a. REO—Quitclaim Deed

Buyers should be responsible for all closing costs, and title to REO should be conveyed by means of a quit claim deed (i.e., a deed that conveys a grantor's complete interest or claim in certain real property but that neither warrants nor professes that the title is valid) except in unusual circumstances where the cost of title insurance, use of a warranty deed, or payment of the seller's customary share of the closing costs is necessary to maximize the recovery on the loan in the shortest amount of time.

b. Personal Property—Non-recourse Bill of Sale

Acquired personal property collateral should be conveyed by means of a bill of sale that specifies that the property is sold "as is" and "without warranties of any kind including those relating to title, possession, quiet enjoyment or the like."

4. Sales Price

The sales price for acquired collateral should be based on a Post-default Appraisal.

5. Use of Real Estate Agents

REO may be sold by listing it with a real estate agent provided that:

- a. The terms of the listing agreement are not inconsistent with this SOP;
- b. The listing price is supported by a Post-default Appraisal;
- c. The listing agent has a good reputation in the area where the property is located for selling the type of property involved, is properly licensed and a member of the most appropriate multiple listing service;
- d. All agreements are in writing and signed by the necessary parties;
- e. The amount of the listing and selling agents' commission is customary in the community where the property is located for the type of property involved; and

- f. Neither the listing nor selling real estate agent has a real, apparent, or potential conflict of interest with regard to the REO, Obligors, SBA or the 7(a) Lender or CDC.

6. Sale to Obligors, Associates or Close Relatives of the Borrower

Acquired collateral should not be sold to Obligors, Associates or Close Relatives of the Borrower for less than the full amount due on the SBA Loan unless it is necessary to maximize recovery and the following conditions are met:

a. Non-residential REO

- (1) A comprehensive public sale foreclosure sale was held;
- (2) All other efforts to resell the REO have been exhausted; and
- (3) It is an all cash sale.

b. Residential REO

Residential REO, which served as the primary residence of an Obligor, may be sold back to that Obligor provided that:

- (1) A comprehensive public sale foreclosure sale was held;
- (2) Reasonable efforts have been made to resell the REO to a disinterested party;
- (3) The REO will continue to be the Obligor's primary residence;
- (4) The REO is sold for fair market value; and
- (5) It is an all cash sale.

c. Acquired Personal Property Collateral

- (1) A comprehensive public foreclosure sale was held;
- (2) All other efforts to resell the acquired property have been exhausted; and
- (3) It is an all cash sale.

7. Purchase Offers

All offers to purchase acquired collateral must:

- a. Be in writing signed by the party making the offer and accompanied by a good faith deposit in the form of a certified check for a minimum of 5% of the purchase price;
- b. Not be disclosed to other prospective purchasers or their agents; and
- c. Be reviewed and analyzed based on the sales efforts to date and the value of the property established by a Post-default Appraisal.

8. Installment Sales

a. When Permitted

Acquired collateral should not be sold by means of an installment sale unless doing so is necessary to maximize recovery on the loan.

b. Buyer Pre-qualification

Potential purchasers buying on credit must be pre-approved.

c. Terms of Purchase and Sale

The following requirements apply to all installment sales:

- (1) The Purchaser must pay approximately 20% down;
- (2) Purchaser must properly execute a promissory note for the balance, which (a) is assignable; (b), has a maturity date that does not exceed 15 years for REO or five years for personal property; (c) has an appropriate interest rate; and (d) requires a monthly payment amount that exceeds the amount of interest accrued each month;
- (3) Purchaser must provide collateral to secure payment of the promissory note in the form of a properly perfected first-position lien on the assets being sold as reflected by a mortgagee's title insurance policy for REO or a U.C.C. lien search for personal property; and

- (4) Purchaser must obtain hazard insurance coverage for the replacement value of the asset(s) being sold that includes a mortgagee clause or equivalent in favor of SBA, the 7(a) Lender or CDC, and any other type of insurance coverage, e.g., flood insurance, that would be prudent under the circumstances.

9. Profit on Sale

The sale of acquired collateral must not result in an unconscionable profit. After the proceeds from the sale have been applied to the loan balance, any surplus must be remitted to the SBA Loan Center along with a written explanation for the profit and a recommendation of how the surplus funds should be distributed, e.g., retained by SBA, paid into the registry of the court, distributed to junior lienholders, or paid to the Borrower.

G. Lease

Acquired collateral should not be leased. However, if an acceptable purchase offer has not been received after a reasonable amount of time, acquired collateral may be leased if doing so is necessary to maximize recovery on the loan, provided that:

1. It is not leased to an Obligor or Associate of the Borrower unless a comparable or more desirable proposal cannot be obtained;
2. A written lease is used, which is legally enforceable, assignable, and can be terminated on reasonable notice if a favorable purchase offer is received ([13 CFR 120.545\(c\)\(2\)](#)); and
3. The leased property is inspected at least semi-annually and the inspection findings included in the appropriate quarterly status report to SBA.

H. Abandonment

1. Real Estate Owned ("REO")

Given the liability and financial responsibility associated with ownership, REO must never be abandoned. REO may be disposed of by means other than sale (e.g., by transferring title to a local Government Entity), provided that: (1) a good faith effort has been made to sell the property; and (2) there is no potential liability associated with the proposed method of disposal.

2. Acquired Personal Property Collateral

Acquired personal property collateral may be abandoned provided that: (1) a good faith effort has been made to sell the property and the actions taken have been fully explained and documented in the loan file; (2) neither SBA's name nor the 7(a) Lender's or CDC's name appears on the certificate of title, if any; and (3) there is no potential liability associated with abandonment.

Chapter 19. Expenses and Recoveries

A. Classification of Expenses

Expenses are classified by SBA as either recoverable or non-recoverable. When reviewing payment requests, SBA may determine that an expense is recoverable or non-recoverable in whole or in part.

1. Non-recoverable Expenses

Non-recoverable Expenses are the costs associated with liquidation of a loan that cannot be added to the principal balance. For example:

- a. The portion of fees or costs incurred that were not necessary, reasonable or customary;
- b. Expenses that are not related to collection of amounts due under the Note or to preservation or disposal of the collateral for the loan;
- c. Interest and service fees on expenses incurred after SBA purchased its guaranty;
- d. Legal expenses incurred in asserting a claim, cross claim, counterclaim, or third-party claim against SBA or in defense of an action brought by SBA against a 7(a) Lender or CDC, unless payment of such fees or costs is otherwise required by federal law;
- e. Legal expenses incurred in connection with the performance of liquidation activities that do not require the services of an attorney, unless preauthorized by SBA;
- f. Legal expenses incurred by taking actions for the sole benefit of the 7(a) Lender or CDC, as determined by SBA;
- g. Legal expenses incurred in the defense of, or payment of any settlement or adverse judgment resulting from a suit, counterclaim or other claim by an Obligor or other Person seeking damages based on a 7(a) Lender's or CDC's alleged wrongful action unless SBA expressly directed the 7(a) Lender or CDC to take the alleged wrongful action;

- h. Expenses incurred by a 7(a) Lender or CDC that failed to liquidate the SBA Loan in accordance with prudent lending practices including those pertaining to promptness; or
- i. Expenses incurred by a 7(a) Lender or CDC that failed to liquidate the SBA Loan in accordance with Loan Program Requirements, including those pertaining to Liquidation or Litigation Plans.

2. Recoverable Expenses

As set out in Chapter 2 (*Definitions*), Recoverable Expenses are the SBA approved, necessary, reasonable and customary costs incurred to collect amounts due under the Note, to enforce the terms of the Loan Documents, or to preserve or dispose of collateral. Although Recoverable Expenses can be added to the principal balance of the loan, they should be treated as a side obligation to avoid: (1) violating the *Secondary Participation Guaranty Agreement*, which prohibits Lenders from adding Recoverable Expenses to the balance of a loan sold in the secondary market; (2) inconsistencies with SBA Form 1502 reporting; and (3) inconsistencies in the transcript of account required for guaranty purchase. Recoverable Expenses include, for example:

a. Searches

- (1) U.C.C. lien searches;
- (2) Title reports; and
- (3) Credit and asset search reports on Obligor.

b. Appraisals

- (1) Post-default Appraisals;
- (2) Post-default Environmental Investigation Reports; and
- (3) Site visit reports prepared by contractors.

c. Litigation Expenses

- (1) Attorney fees; and
- (2) Costs such as court filing fees.

d. Collateral Care and Preservation

- (1) Utility bills;
- (2) Insurance premium payments;
- (3) Caretaker fees;
- (4) Repair bills;
- (5) Real estate and personal property taxes; and
- (6) Expenses related to non-tax senior liens, including Third Party Loans.

Note: Recoverable Expenses related to REO and acquired personal property collateral cannot be added to the loan balance and must be kept separate from expenses related to the original loan.

B. Recoveries

1. General

Recoveries are the proceeds obtained through liquidation of the SBA Loan.

2. Application of Liquidation Proceeds

Unless the terms of a workout agreement or some other legally binding document, such as a court order, specify otherwise, recoveries should be applied in the following order:

- a. Recoverable Expenses;
- b. Principal balance of the loan; and
- c. Accrued interest.

3. Remitting Recoveries to SBA

SBA's share of the net proceeds recovered on an SBA Loan should be remitted to SBA via www.pay.gov within 15 business days of receipt. If SBA's share is not remitted in a timely manner, SBA may charge interest on the late amount.

C. Payment of Non-recoverable Expenses

1. Non-recoverable Expenses Incurred by Lenders and CDCs

SBA does not pay Non-recoverable Expenses incurred Lenders or CDCs.

2. Non-Recoverable Expenses Incurred by SBA

- a. Non-recoverable Expenses incurred by SBA are not *pro-rated* and shared with the 7(a) Lender or CDC.
- b. Payment of a Non-recoverable Expense over \$500.00 incurred by SBA must be approved pursuant to the Rule of Two and documented by a Loan Action Record, which may consist of a "stamp" on a copy of the invoice and should include a "worksheet" copy of [SF 1034](#), (*Public Voucher for Purchases and Services Other than Personal*) and the original invoice.

Note: See [SOP 20 05](#) (*General Cashier Control Procedures*) for information on expense codes.

D. Payment of Recoverable Expenses

Note: The [Prompt Payment Act](#), which requires federal agencies to pay interest and penalties on late payments for contracted expenses, does not apply to payments to 7(a) Lenders or CDCs for Reimbursable Expenses. See [SOP 20 17](#) and [Subpart 32.9 of the Federal Acquisition Regulation](#) for further information.

1. Recoverable Expenses Incurred by SBA

Recoverable Expenses incurred by SBA should be authorized and paid by SBA pursuant to the Rule of Two and documented by a Loan Action Record, which includes, at a minimum, the following:

- a. A copy of the original invoice;
- b. Whether the 7(a) Lender should be billed for its *pro-rata* share;
- c. Reason for the expenditure;
- d. Name of payee and check delivery instructions;

- e. Whether the payment is covered by the Prompt Payment Act; and
- f. The deadline for payment.

2. Recoverable Expenses Incurred by 7(a) Lenders

Recoverable Expenses incurred by a 7(a) Lender should be paid by the 7(a) Lender and reimbursed by one of the following methods:

a. Deduction from Recoveries

7(a) Lenders may deduct Recoverable Expenses from the recoveries on the loan provided that the expenses, both liquidation and litigation, have been reviewed and approved by SBA pursuant to Paragraph F below; or

b. Reimbursement by SBA

7(a) Lenders may submit requests for reimbursement of SBA's *pro-rata* share of Recoverable Expenses after SBA has purchased its guaranty. Requests for reimbursement of Recoverable Expenses incurred prior to guaranty purchase should be included in the 7(a) Lender's Purchase Package.

3. Recoverable Expenses Incurred by CDCs

Recoverable Expenses incurred by CDCs are paid by the following methods:

a. Direct Payment to Vendor

A CDC may submit a request to SBA for direct payment of a Recoverable Expense to a vendor at any time after the debenture has been purchased.

b. Reimbursement by SBA

A CDC that paid a Recoverable Expense may submit a request to SBA for reimbursement any time after the debenture has been purchased.

c. Deduction from Recoveries

PCLP CDCs and ACLs may deduct Recoverable Expenses from the recoveries on the loan provided that the expenses, both liquidation and litigation, have been reviewed and approved by SBA pursuant to Paragraph F below.

E. Obtaining SBA Approval, Payment or Reimbursement of Expenses

1. When Required

Any expense, which a Lender or CDC seeks to have classified as a "Recoverable Expense," must be reviewed and approved by SBA.

2. How to Obtain

a. Where to Submit

Requests for approval of a deduction, payment of, or reimbursement for, an expense related to the liquidation of an SBA Loan must be submitted to the appropriate SBA Loan Center.

b. Multiple Loans—Proration and Allocation of Expenses

If the request for approval of a deduction, payment or reimbursement involves multiple loans to the same Borrower, (either SBA Loans with different guaranty percentages or non-SBA Loans), the Recoverable Expenses must be pro-rated and allocated among the loans to which the expense relates.

c. Reimbursement Requests for \$5,000 or More

(1) 7(a) Loans

7(a) Lenders may submit a request for reimbursement of a Recoverable Expense that exceeds \$5,000 at any time.

(2) 504 Loans

CDCs may submit a request for reimbursement of a Recoverable Expense that exceeds \$5,000 at any time after the debenture has been purchased.

d. Reimbursement Requests for Less Than \$5,000—Quarterly Rule

When a Recoverable Expense is less than \$5,000, 7(a) Lenders and CDCs should compile their invoices and submit them on a quarterly basis or when the aggregate amount totals \$5,000 or more.

e. **Contents of Recoverable Expense Request Packages**

(1) Standard 7(a), CLP, PLP and EWCP Loans

7(a) Lenders should prepare their requests for reimbursement or approval of deducted Recoverable Expenses on Standard 7(a), CLP, PLP and EWCP loans in accordance with the [tab system](#) found on the NGPC's Web site, which is accessible from www.sba.gov/banking.

(2) 504 Loans and 7(a) Express and Pilot Loan Program Loans

7(a) Lenders and CDCs should include the following items, when applicable, in their requests for payment, reimbursement or approval of deducted Recoverable Expenses on 7(a) Express and Pilot Loan Program loans and 504 Loans:

(a) Lender or CDC Contact Information

Recoverable Expense request packages must include the 7(a) Lender or CDC's name, address, e-mail address, phone and fax numbers, and Tax Identification Number.

(b) Summary of Expenses

7(a) Lenders and CDCs submitting multiple invoices must group them by the categories set out in Paragraph A of this Chapter and submit a summary that includes: (1) the date each service was performed; (2) the number of each invoice; (3) the subtotal for each category; and (5) the grand total of Recoverable Expenses.

(c) Itemized Invoices

Recoverable Expense request packages must contain a copy of the original invoice(s), which must be dated and include: (1) a thorough description of the goods or services provided; (2) the date the goods were provided or the services were performed; (3) the amount charged for each service or product provided; and (4) the total amount due. In addition, if the invoice is for services billed on an hourly basis, it must specify the name, title, hourly billing rate and time spent by each individual who performed services covered by the invoice.

(d) Supporting Documents

Recoverable Expense request packages must include a copy of all supporting documents such as the site visit report, Post-default Environmental Investigation Report, Post-default Appraisal, or legal pleadings for which payment or reimbursement is sought.

3. Appeal Process

a. Liquidation Expenses

The final decision of an SBA Loan Center Director or designee regarding approval, payment or reimbursement of a liquidation expense that is not related to attorney fees or costs, may be appealed to the Director of the Office of Financial Assistance, provided that the appeal: (1) is in writing; (2) includes a copy of the decision and supporting documents; (3) states the reason(s) why the decision is believed to be incorrect; and (4) is submitted within 30 days of the decision. ([13 C.F.R. § 120.542\(d\)](#))

b. Litigation Expenses

The final decision of an SBA Loan Center Director or designee regarding approval, payment or reimbursement of an expense related to debt collection litigation may be appealed to the Associate General Counsel for Litigation, provided that the appeal: (1) is in writing; (2) includes a copy of the decision and supporting documents; (3) states the reason(s) why the decision is believed to be incorrect; and (4) is submitted within 30 days of the decision. ([13 C.F.R. § 120.542\(e\)](#))

F. SBA Review of Expense Requests

1. Responsibility for Review of Liquidation Expenses

All requests for payment, reimbursement or approval of deducted expenses, which are not related to litigation, must be reviewed by a Liquidation Officer, who must prepare a recommendation regarding the request.

2. Responsibility for Review of Litigation Expenses

Regardless of whether the amount was included in an approved Litigation Plan, all requests for payment, reimbursement or approval of deducted litigation expenses must be reviewed by Legal Counsel as follows:

a. Routine Litigation

Prior to payment, reimbursement or approval of deducted expenses, litigation expenses associated with Routine Litigation must be reviewed according to the guidance set out in Chapter 6 of [SOP 70 50 3](#) (*Legal Responsibilities*) by the SBA legal division or attorney responsible for monitoring the litigation, i.e., SBA Loan Center Legal Counsel with regard to Routine Litigation conducted by 7(a) Lenders; and the SBA District Counsel with regard to Routine Litigation conducted by CDCs.

b. Non-Routine Litigation

Prior to payment, reimbursement or approval of deducted expenses, litigation expenses associated with Non-routine Litigation must be reviewed according to the guidance set out in [SOP 70 50 3](#) (*Legal Responsibilities*) by the SBA District Counsel responsible for monitoring the litigation.

3. Authority to Approve Liquidation and Litigation Expenses

The Supervisory Liquidation Officer serves as Approving Official on proposed Loan Actions pertaining to requests for payment, reimbursement or approval of deducted liquidation and litigation expenses.

4. Denial of Expense Approval, Payment or Reimbursement Requests

a. 7(a) Loans

If SBA denies a 7(a) Lender's request for reimbursement, SBA will either (1) deduct the expense from the 7(a) Lender's Purchase Package; or (2) if the 7(a) Lender has already deducted the expense from recoveries, the 7(a) Lender will be required to reimburse SBA.

b. 504 Loans

If SBA denies a CDC's request for expense payment or reimbursement, SBA will notify the CDC of its decision and, if the CDC has already deducted the expense from recoveries, the CDC will be required to reimburse SBA.

Chapter 20. Wrap-up Procedures

A. General

Before the file on an SBA Loan classified in liquidation status may be closed, a Wrap-up Report or equivalent documentation covering the various topics discussed in this Chapter should be submitted to the appropriate SBA Loan Center. Upon approval of the wrap-up documentation, SBA will charge-off the remaining loan balance, if any, and refer any loan that is still legally collectible to the U.S. Department of the Treasury ("Treasury Department") for further collection efforts.

B. Abandonment of Collateral

1. When Allowed

The pursuit of recovery on real or personal property collateral may be abandoned if the collateral has no significant Recoverable Value, i.e., an aggregate Recoverable Value of less than \$2,500 for personal property, and a Recoverable Value of less than \$5,000 per parcel of real property. The decision and justification for abandoning collateral, including the basis for the Recoverable Value estimate, must be fully documented.

2. Abandonment Based on Environmental Concerns

The presence of Hazardous Substances may or may not have a significant negative impact on the Liquidation or Recoverable Value of the collateral. Therefore, failure to conduct a Post-default Environmental Investigation is not an acceptable reason for abandoning collateral. The pursuit of recovery on collateral should not be abandoned based on environmental concerns unless a Post-default Environmental Investigation has been conducted that provides the relevant facts needed to make an informed decision. (See Chapter 9 for information on Post-default Environmental Investigations.)

<p>Note: See Chapter 18 for SBA policy and procedures regarding abandonment of REO and acquired personal property collateral.</p>
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C. Charge-off

1. General

Charge-off is an SBA administrative action that removes the outstanding balance of an uncollectible loan from its accounting records. It has no impact on an Obligor's liability or SBA's right to collect the loan balance.

2. When Appropriate

Charge-off is appropriate when:

- a. All reasonable efforts have been exhausted to achieve recovery from: (1) voluntary payments on the Note; (2) compromise agreements with the Obligors; (3) liquidation of the collateral; and (4) cost-effective methods of enforced collection;
- b. The estimated cost of further collection efforts exceeds the anticipated recovery;
- c. The only remaining avenue of recovery is from Obligors who cannot be located or who are unable to pay the loan balance; or
- d. The loan balance is uncollectible because of a discharge in bankruptcy (i.e., release of the debtor from any further personal liability for pre-bankruptcy debts), the expiration of the statute of limitations (i.e., the passing of the deadline for suing), or another defense available to Obligors under state or federal law.

D. IRS Notification of Cancelled Debt

1. When IRS Form 1099-C Required

[IRS Form 1099-C](#) (*Cancellation of Debt*) is filed with the IRS and mailed to the Borrower—but not Guarantors—whenever \$600 or more of the principal balance owing on an SBA Loan is cancelled as the result of, for example, a compromise agreement, discharge in bankruptcy or charge-off action.

2. Responsibility for Issuing IRS Form 1099-C

a. SBA

SBA is responsible for providing Borrowers and the IRS with IRS Form 1099-C for SBA's share of the cancelled portion of any 7(a) Loan or 504 Loan after the Treasury Department has exhausted its collection efforts.

b. Lenders

7(a) Lenders are responsible for providing Borrower and the IRS with IRS Form 1099-C for the 7(a) Lender's share of the cancelled portion of any 7(a) Loan after the Treasury Department has exhausted its collection efforts.

3. When IRS Form 1099-C Issued

- a. Compromised debt is reported the calendar year after the debt was compromised;
- b. Debts discharged in bankruptcy are reported the calendar year after the discharge; and
- c. Charged-off debts (non-compromise and non-bankruptcy related) are reported the calendar year after the event occurred that rendered the debt uncollectible such as the date the period for collecting the debt prescribed by the statute of limitations expired. Generally, SBA issues IRS Form 1099-C after there has been no recovery by the Treasury Department for a period of six years.

E. Wrap-up Reports

1. When Required

For each SBA Loan classified in liquidation status, a Wrap-up Report or equivalent documentation should be submitted to the appropriate SBA Loan Center within 90 days of completing all reasonable and cost-effective recovery efforts.

2. Contents

The Wrap-up Report should include the following:

a. Status of Obligors

A discussion of the status of the Obligors that includes the following information and supporting documentation, when applicable:

- (1) Name, address and Taxpayer Identification Number or Social Security Number for each Obligor;
- (2) A description of the efforts made to locate any missing Obligor(s);
- (3) List of all the Obligors released from liability and the reason for the release, e.g., compromise, discharge in bankruptcy, etc.;
- (4) List of all the Obligors still liable for the loan balance;
- (5) An estimate of the potential recovery from each remaining Obligor and the basis for the estimate; and
- (6) A description of any efforts made to obtain a compromise offer from each Obligor.

b. Status of Collateral

A discussion of the status of the collateral that includes the following information and supporting documentation, when applicable:

- (1) List of how and when each significant item or category of collateral was liquidated and the amount recovered;
- (2) List of any remaining collateral;
- (3) Justification for abandoning the remaining collateral, and a description of the efforts made to compromise with the owner-Obligor if it includes a lien on a personal residence;
- (4) Summary section of any Post-default Appraisal;
- (5) Summary section of any Post-default Environmental Investigation Report or an explanation for why an Environmental Investigation was not conducted; and a
- (6) Description of the efforts to liquidate any life insurance policy with a cash-surrender value.

c. Status of Collection Activities

A statement verifying that there are no on-going or contemplated collection activities including, for example, collection of payments under a workout agreement or plans to execute on a judgment, and that SBA may refer the loan, if it is legally collectible, to the Treasury Department of further collection efforts. (If there are on-going or contemplated collection activities, charge-off is not appropriate and the loan cannot be referred to the Treasury Department.)

d. Site Visit Report

A copy of the post-default site visit report or an explanation for why a site visit was not conducted.

e. Recoveries

If not previously reported to SBA, a list of all recoveries that indicates the source, amount, date and manner in which the recovery was applied to the loan balance, as well as the applicable supporting documents and an explanation as to why the recoveries were not reported and submitted to SBA.

f. Expenses

A discussion of the expenses incurred to liquidate the loan including the following information and supporting documents, when applicable:

- (1) A list of all expenses incurred to liquidate the loan; and
- (2) A request for approval, payment or reimbursement of any Recoverable Expense, including Recoverable Expenses deducted from recoveries, which have not already been reviewed and approved by SBA accompanied by the supporting documents required by Paragraph E.2 of Chapter 19.

g. Recommendation

A recommendation regarding whether:

- (1) The loan balance should be charged-off;

- (2) The loan should be referred to the Treasury Department for further collection efforts; and whether
- (3) The loan should be referred to the Office of the Inspector General ("OIG") to investigate any suspected fraud or abuse. (See Chapter 21 for information on OIG Referrals.)

F. Treasury Department Referral for Further Collection

1. When Loans Are Referred

After charge-off, if further collection is not barred by compromise, discharge in bankruptcy, the statute of limitations or another legal defense, the loan and remaining Obligor, are referred to the [Treasury Department](#) for further collection efforts.

2. Collection Actions Taken By Treasury Department

After referral, the Treasury Department may attempt to collect the balance due on the SBA Loan from the remaining Obligor by various methods including, for example, those listed below.

- a. Offset of funds due Obligor from federal sources including:
 - (1) Tax refunds;
 - (2) Wages, including federal civilian and military pay;
 - (3) Retirement, including federal civilian and military retirement pay;
 - (4) Contractor or vendor payments;
 - (5) Travel advances and reimbursements;
 - (6) Certain benefits, including Social Security benefits (other than Supplemental Security Income), Railroad Retirement benefits (other than tier 2), and Black Lung (part B benefits); and
 - (7) Any other payments, which are not exempt by law or by action of the Secretary of the Treasury;
- b. Reporting the status of the Borrower's SBA Loan to credit bureaus that can retain negative credit information for up to seven years;

- c. Referring the debt to a private collection agency;
- d. Asking the Department of Justice collect the debt through litigation; or
- e. Preventing receipt of additional federal financial assistance.

3. Notice to Obligators of Pending Referral

Prior to referring a loan to the Treasury Department, SBA sends an automated letter to the remaining Obligators giving them a final opportunity to either pay the loan in full or negotiate an acceptable payment plan. If an acceptable payment plan is not established within 60 calendar days of the date of the warning letter, SBA refers the loan to the Treasury Department for further collection efforts.

G. Credit Bureau Reporting

SBA reports charged-off SBA Loans made to businesses to credit bureaus and Federal delinquent debtor databases, i.e., *Credit Alert Interactive Voice Response System* ("CAIVRS") and *Debt Check*, the Treasury Department's Web-based credit alert system.

H. Record Retention

1. SBA Loan Centers

In general, SBA Loan Centers must adhere to applicable Agency record retention requirements with regard to loan files (Finance, Records Group 50).

2. 7(a) Lenders

7(a) Lenders must adhere to applicable record retention requirements established by their regulators. SBA supervised Lenders (Small Business Lending Companies and non-federally regulated lenders) must retain their SBA Loan records for at least six years following the final disposition of each loan. ([13 CFR § 120.461](#))

3. CDCs

CDCs must retain their paid in full 504 Loan records for nine years, and their charged-off 504 Loan records for ten years.

I. SBA Review of Wrap-up Activities

1. Rule of Two

Decisions regarding proposed Loan Actions involving wrap-up related activities such as charging-off a loan balance and whether to approve Wrap-up Reports or the equivalent documentation submitted by 7(a) Lenders and CDCs, must be made pursuant to the Rule of Two and documented by a Loan Action Record.

2. Roles and Responsibilities

a. Liquidation Officer

The Liquidation Officer serves as the Recommending Official and is responsible for reviewing and recommending whether the Agency should approve or disapprove proposed wrap-up related Loan Actions as well as Wrap-up Reports and equivalent documentation. For example, the Liquidation Officer must determine whether:

- (1) The 7(a) Lender or CDC acted in compliance with any SBA approved Liquidation or Litigation Plan and if not, whether SBA suffered any harm as a result;
- (2) SBA received its pro-rata share of the recoveries on the loan, and approved all of the expenses deducted by the 7(a) Lender or CDC;
- (3) Charge-off is appropriate based on the standard set out in Paragraph C above;
- (4) IRS Form 1099-C should be issued pursuant to Paragraph D above;
- (5) The loan should be referred to the Treasury Department for further collection efforts based on the standards set out in Paragraph F above; and whether
- (6) The loan should be referred to the Office of the Inspector General to investigate any suspected fraud or abuse. (See Chapter 21 (Inspector General Referrals) for more information.)

b. Legal Counsel

Legal Counsel must review proposed Loan Actions recommending:

- (1) Charge-off of the loan balance—and render an opinion as to whether there are any remaining cost-effective methods to collect the outstanding loan balance; and
- (2) Referral to Treasury Department for further collection—and render an opinion as to whether there are legal impediments to the referral such as a compromise agreement, expiration of the statute of limitations, discharge in bankruptcy, or other defense.

c. Supervisory Liquidation Officer

The Supervisory Liquidation Officer serves as the Approving Official with regard to proposed wrap-up related Loan Actions and approval of Wrap-up Reports and equivalent documentation.

Chapter 21. Inspector General Referrals

A. What Matters Should be Referred

All SBA officials, Lenders, CDCs and contractors should be on the lookout for fraud; and must report any known or suspected irregularities involving SBA programs, program participants, or personnel to the Office of the Inspector General ("OIG"). ([13 C.F.R. § 120.197](#)) Whether acting alone or in collusion with others, loan applicants, Borrowers and other Obligor may intentionally provide false information to SBA, Lenders or CDCs. Examples of irregularities that must be referred include:

1. Loan Application Fraud

Misrepresentation or false statements made by loan applicants or Borrowers with regard to their eligibility for SBA financing. For example:

- a. Overstating income;
- b. Understating or failing to disclose liabilities and debts;
- c. Overvaluing collateral;
- d. Failing to disclose criminal record;
- e. Making false claims of U.S. citizenship;
- f. Failing to disclose true ownership of the business;
- g. Using false Social Security numbers to conceal poor credit histories;
- h. Submitting altered tax returns;
- i. Providing fraudulent standby agreements; or
- j. Creating false work histories.

2. Loan Agent Fraud

Actions by corrupt loan agents who orchestrate, facilitate or otherwise support any of the illegal acts committed by loan applicants or Obligor such as those listed in this Chapter.

3. **Equity Injection Fraud**

A significant and reoccurring problem is the submission of false documents to demonstrate that a required equity injection was made.

a. **Examples**

- (1) False gift letters or gift affidavits;
- (2) False promissory notes and standby agreements;
- (3) False financial statements; or
- (4) False bank statements and cashier checks.

b. **Indications of Fraud**

Indications of fraud with regard to an equity injection to watch out for include:

- (1) Gift letters and gift affidavits (Investigation often proves such “gifts” to be false – either the money does not exist, or it is never paid into the business, or it is subsequently repaid to the donor.);
- (2) Tax returns reporting income that appears inadequate to support the required equity injection;
- (3) Bank statements that upon close inspection appear to have been altered;
- (4) Bank account records showing a recent, unexplained, large dollar deposit into the Borrower’s account; and
- (5) Credit reports showing a poor credit history for a Borrower who claims to have substantial cash.

4. **Misuse of Loan Proceeds**

Misuse of loan proceeds or any other funds in which SBA has an interest; or

5. **Conversion of Collateral**

Conversion, concealment, vandalism or disposal of collateral; or

6. SBA, Lender or CDC Misconduct

Misconduct by a Lender, CDC or SBA official such as the solicitation, offer or acceptance of a bribe to make an SBA Loan or to purchase a debenture or the guaranteed portion of an SBA Loan.

B. How to Make a Referral

A referral to the OIG can be made by:

1. Calling the OIG Hotline toll-free at 1-800-767-0385;
2. Completing the on-line [OIG Complaint Submission Form](http://web.sba.gov/oigcss/client/dsp_welcome.cfm) at http://web.sba.gov/oigcss/client/dsp_welcome.cfm and submitting the referral via the Internet; or
3. Mailing the referral to:

U.S. Small Business Administration
Office of Inspector General
Investigations Division, Mail Code: 4113
409 Third Street, SW
Washington, DC 20416

C. What Information Should Be Provided

1. Answers to Basic Questions

A referral to the OIG should include as much the information as possible in response to the questions listed below.

- a. Who is involved? (Name, occupation, address, phone numbers, etc.)
- b. What occurred and how is SBA involved?
- c. When and where did, or will, the activity take place?
- d. Why does the activity appear to be illegal or improper?
- e. What dollar amount is involved? (E.g., loan amount or value of converted collateral.)
- f. Who can confirm the allegation and how can that Person be contacted?
- g. Who can provide more information?

2. Copies of Relevant Documents

When applicable, copies of documents that support the statements made in response to the above questions should be submitted as part of the referral.

D. Post-referral Responsibility

After referring a matter to the OIG, the Person who made the referral must:

1. Report any new or additional information discovered about the matter to the OIG;
2. Not disclose or discuss the existence of the OIG referral or investigation to any Person other than SBA officials on a need-to-know basis;
3. Coordinate any activities related to the loan with the OIG in order to avoid taking any action that could be detrimental to an investigation or subsequent prosecution; and
4. With OIG approval, and in coordination with the OIG, take appropriate and timely action to maximize recovery on the loan.

Chapter 22.
7(a) Guaranty Purchase

A. General

1. Overview

SBA's policy is to promptly process guaranty purchase requests from 7(a) Lenders. As explained in this Chapter, to demonstrate that SBA is obligated to honor its guaranty and purchase the guaranteed portion of the loan, Lenders are required to submit a Purchase Package to the appropriate SBA Loan Center that contains the Lender's certification as well as credible evidence that the loan was made, closed, serviced and liquidated in a commercially reasonable manner that is consistent with SBA Loan Program Requirements and prudent lending practices. (See [13 C.F.R. § 120.524](#) and Chapter 23 for information regarding denial of liability on a 7(a) Loan guaranty.)

2. Interest Paid on Guaranteed Portion of Loan

a. Interest Rate

If SBA purchases the guaranteed portion of a loan from a 7(a) Lender or secondary market investor, accrued interest is paid at the following rates:

1. Fixed Rate

If the Note has a fixed interest rate, accrued interest is paid at the rate specified in the Note.

2. Adjustable Rate

If the Note has an adjustable interest rate, accrued interest is paid at the rate in effect on the Earliest Uncured Payment Default Date unless there was no default, in which case accrued interest is paid at the rate in effect at the time of purchase.

b. Interest Paid to Lenders

(1) Loans Approved On or After May 14, 2007—Lenders are paid up to a maximum of 120 days interest.

(2) **Loans Approved Before May 14, 2007**—Lenders are paid the amount of accrued interest allowed by the applicable regulations in effect on May 13, 2007.

c. Interest Paid to Secondary Market Investors

Secondary market investors are paid all accrued interest up to the date of purchase. ([13 C.F.R. § 120.522\(c\)](#))

d. Lender's Duty to Reimburse SBA for Excess Interest Payment

In the event SBA is required to pay a secondary market holder more than 120 days of accrued interest because of Lender delay, the Lender must reimburse SBA for the difference between the amount paid by SBA and 120 days of accrued interest. (SBA Form 1086 (*Secondary Participation Guaranty Agreement*))

B. Requirements

Before a Lender may request that SBA purchase the guaranteed portion of a loan, all of the following requirements must be met:

1. Uncured Loan Default

Generally, unless SBA agrees otherwise in writing, the Borrower must be in default on a payment due on the Note for more than 60 calendar days. ([13 C.F.R. § 120.520](#))

2. Loan Classified in Liquidation and Transferred to NGPC

The Lender must contact the appropriate SBA Loan Center and request that the loan be classified in liquidation status. In addition, the Lender must also request that the loan file be transferred to the National Guaranty Purchase Center ("NGPC") unless the loan was made under the Express Program or a Pilot Loan Program, in which case the loan file should remain at the Commercial Loan Servicing Center ("CLSC").

3. Collateral Liquidated

In general, Lenders are encouraged to liquidate all loan collateral prior to requesting guaranty purchase. In particular, the following collateral must be liquidated prior to requesting purchase:

a. Loans Approved on or after May 14, 2007

For loans approved on or after May 14, 2007, unless the Borrower has filed for bankruptcy, the Lender must complete all prudent and commercially reasonable efforts to liquidate the business personal property collateral with an aggregate Recoverable Value of \$2,500 or more ([13 C.F.R. § 120.520\(a\)](#)); and

b. Loans Approved Prior to May 14, 2007

For loans approved prior to May 14, 2007, the Lender must liquidate the collateral according to the requirements of the program under which the loan was made. For example:

(1) LowDoc

The business personal property securing the loan;

(2) EWCP

The collateral associated with the export transactions financed by the EWCP loan;

(3) CAPLine

The working capital assets that secured the loan; and

(4) Express and Pilot Loan Programs

All collateral; in addition, all other commercially reasonable means of recovery must be exhausted unless:

(a) The loan was made under the Export Express Program;

(b) The remaining principal balance of the loan is \$50,000 or less; or

(c) The loan involves prolonged litigation or other circumstances that will extend the liquidation process more than 90 days past the earliest date that the Lender could request purchase.

4. **Loan Purchased from Secondary Market Investor**

If the loan was sold on the secondary market, the Lender is encouraged to purchase the SBA guaranteed portion through the fiscal transfer agent, currently Colson Services Corp. Alternatively, the Lender must submit a secondary market purchase request to the appropriate SBA Loan Center accompanied by the following documents:

- a. Certified Transcript of Account;
- b. Executed copy of the Loan Authorization;
- c. Executed copies of all modifications of the Note, if any; and the
- d. Secondary market investor's written approval of all modifications of the Note.

Note: If SBA purchases the loan from the secondary market investor, the Lender must submit a status report within 15 business days of the purchase as required by Chapter 5, Paragraph F of this SOP and a Purchase Package within 45 calendar days of the purchase as required by Paragraphs 5 and 6 below.

5. **Complete Purchase Package Submitted to SBA**

Lenders must submit a complete Purchase Package to the appropriate SBA Loan Center within the time deadlines indicated below. If SBA's share of the loan balance is more than \$10,000, the Lender should prepare a standard Purchase Package for the type of loan in question. If SBA's share of the loan balance is less than \$10,000, Lenders may prepare a streamlined version of the standard Purchase Package required for the type of loan in question.

a. **Deadline for Submission of Purchase Packages**

(1) **Loans Purchased from Secondary Market by SBA**

If SBA purchased the guaranteed portion of the loan from the secondary market investor, the Lender must submit a complete Purchase Package to the appropriate SBA Loan Center within 45 calendar days of the purchase. If the Lender fails to do so, the SBA Loan Center must promptly follow up with the Lender, and if the Lender continues to be non-responsive, treat it as a failure to comply with SBA Loan Program Requirements and pursue one of the following corrective actions:

(1) litigation against the Lender to recover all or part of the funds already paid on the guaranty; (2) suspension of the Lender's ability to sell SBA Loans on the secondary market; (3) suspension of the Lender's PLP status, if any; (4) refusal to purchase the guaranteed portion of any other SBA Loans made by the Lender; or (5) any other action permitted by SBA Loan Program Requirements.

(2) Expiration of SBA Guaranty

A complete Purchase Package must be submitted to SBA no later than 180 days after the maturity date of the loan or the date the Lender completes its liquidation or debt collection litigation in connection with a matured loan. If a complete Purchase Package is not submitted within this timeframe, SBA may deny liability on the guaranty pursuant to [13 C.F.R. § 120.524\(a\)\(8\)](#).

b. Contents of Standard Purchase Package

If there was an Early Default on the loan or if SBA's share of the loan balance is more than \$10,000, Lenders should prepare a standard Purchase Package for the type of loan in question in accordance with the procedural instructions issued by the SBA Loan Center to which the Purchase Package must be sent for review and processing.

(1) Standard 7(a), CLP, PLP and EWCP Purchase Packages

Standard 7(a), CLP, PLP and EWCP loan Purchase Packages must be submitted to the NGPC. Lenders should use the [10 Tab System](#) available on the [NGPC Web site](#), which is accessible from www.sba.gov/banking, to assemble and organize the required documentation.

(2) Express and Pilot Loan Program Purchase Packages

Express and Pilot Loan Program loan Purchase Packages must be submitted to the appropriate CLSC. Lenders should use the [10 Tab System](#) available on the [CLSC Web site](#), which is accessible from www.sba.gov/banking, to assemble and organize the required documentation.

c. Contents of Streamlined Purchase Package

Unless there was an Early Default on the loan, if SBA's share of the loan balance is less than \$10,000, the Lender may submit a streamlined version of the standard Purchase Package to the appropriate SBA Loan Center. To do so, the Lender should utilize the applicable 10-Tab System, but is only required to submit the documents listed below. Provided, however, that SBA may, in its sole discretion, require the Lender to submit a standard Purchase Package. For example, the SBA Loan Center may require the Lender to submit a standard Purchase Package if it finds indicia of possible fraud or misrepresentation.

Tab 1—Signed demand letter;

Tab 2—Executed Loan Authorization

Tab 3—Eligibility Checklist (PLP, LowDoc, Express and Pilot Loan Program loans only); franchise, license, dealer, jobber or similar agreement (if applicable); SBA Form 1919 and SBA Form 1920SX Part C or SBA Form 2238 (Express and Pilot Loan Program loans only);

Tab 4—Note; Guaranties (if applicable);

Tab 6—Certified transcript of account;

Tab 9—Lender certification that loan proceeds were disbursed in accordance with the Loan Authorization; certification that liquidation is complete and all avenue of collection exhausted (if applicable); final Wrap-up Report; and

Tab 10—Wire transfer instructions, Risk Management Database Form, and SBA Form 159 (*Compensation Agreement*).

C. Practice Tips for Lenders

1. Submit a Complete Transcript of Account

Use of [SBA Form 1149](#) (*Lender's Transcript of Account*) is not mandatory, but is recommended in order to expedite the purchase process.

2. Do Not Assign Loan Documents to SBA

Do not assign the Loan Documents to SBA without obtaining SBA's prior written approval to transfer servicing of the loan to SBA.

3. Explain Missing Documents

If a required document is missing, include a written explanation for the omission in the Purchase Package.

D. Turnaround Time on Purchase Requests

1. Pre-guaranty Purchase Reviews

Generally, pre-purchase reviews should be conducted within 45 days of receipt of a complete Purchase Package.

2. Post-secondary Market Purchase Reviews

- a. Generally, post-purchase reviews should be conducted within 90 days of SBA's purchase of the guaranteed portion of a 7(a) Loan from the secondary market investor.
- b. A post-purchase review must be conducted prior to charging-off or selling a loan unless the Lender was taken over by the FDIC in a receivership proceeding.

E. Incomplete Purchase Packages

1. Postponement of Guaranty Purchase Decision

In order to preserve the integrity of the 7(a) Loan Program, Lenders must provide SBA with sufficient credible evidence to enable SBA to determine whether the Lender has complied with the applicable Loan Program Requirements and prudent lending standards. Therefore, as set forth in [13 C.F.R. § 120.524\(c\)](#), SBA may postpone its decision on a guaranty purchase request until it has received all of the relevant documentation without waiving its right to deny liability or to take other appropriate action.

2. Procedure for Requesting Additional Documents

Generally, all additional documents needed to complete a purchase review should be requested in a single communication, and the request and response should be entered in the Guaranty Purchase Tracking System ("GPTS").

a. Lender's Failure to Respond to Pre-purchase Request

If during the course of a pre-purchase review, the Lender fails to provide an adequate response to SBA's request for additional documentation within a reasonable time, the Lender's purchase request should be placed in inactive status. If after one year the Lender has still not provided an adequate response, a notation should be made in the GPTS that the purchase process was terminated due to the Lender's failure to provide adequate documentation. If the Lender submits adequate documentation thereafter, depending on the circumstances, the loan may be reactivated to process the purchase request.

b. Lender's Failure to Respond to Post-purchase Request

If during the course of a post-purchase review, the Lender fails to provide an adequate response to SBA's request for additional documentation within a reasonable time, the Lender's failure to respond should be treated as a failure to comply with SBA Loan Program Requirements, which may form the basis for a recommendation to commence litigation against the Lender to recover all or part of the funds SBA already paid on the guaranty.

F. SBA Review of Purchase Requests

1. Recommending Official

Liquidation Officers serve as the Recommending Official with regard to guaranty purchase reviews. In general, they are responsible for reviewing Purchase Packages and recommending whether SBA should purchase the guaranteed portion of the loan. If the recommendation is to not purchase the guaranty, in full or in part, the Recommending Official should provide a clear description of the Lender's deficiencies, an estimate of the actual or anticipated loss to SBA, a thorough explanation of the reason for the recommendation based on application of the relevant Loan Program Requirements to the facts, and a description of the SBA Loan Center's efforts to negotiate an adequate repair, voluntary cancellation of the guaranty, or reimbursement of amounts already paid on the guaranty. Specific examples of the Recommending Official's responsibilities include the following:

a. Loans Flagged in GRTS

Whenever a guaranty purchase review involves a loan flagged in the Guaranty Repair Tracking System ("GRTS") as having possible denial of liability issues, the Recommending Official must research and resolve each issue prior to making a purchase recommendation.

b. Lender Eligibility Determinations

If the loan was made under the Lender's delegated authority, as part of the guaranty purchase review process the Recommending Official must review all of the documentation relied on by the Lender to determine whether the loan was eligible.

c. Early Defaults

If there was an Early Default on the loan, the Purchase Package must be reviewed with the highest degree of scrutiny. If there was an Early Default, the Recommending Official must determine whether the Lender's failure to make or close the loan in accordance with SBA Loan Program Requirements or prudent lending practices allowed or contributed to the Early Default, or whether the Lender provided credible evidence that the cause of the Early Default was unrelated to any financial difficulties that the Lender could have identified or prevented by complying with SBA Loan Program Requirements or prudent lending practices. If the loan was made under the PLP or *Express* Programs, the Recommending Official's review must include, but is not limited to, the following underwriting documents: (1) the Lender's credit memorandum and all of the supporting documentation that the Lender relied on in its credit analysis; (2) the Borrower's complete loan application; and (3) the SBA Form 912 (*Statement of Personal History*) or SBA Form 1919 (*Express and Pilot Loan Programs Borrower Information Form*) completed by each Person required to do so by the applicable Loan Program Requirements.

d. Cash or Asset Equity Injections

Whenever a cash or asset equity injection is required by the Loan Authorization, the Recommending Official must determine whether the documentation supplied by the Lender establishes that the Lender properly verified the injection in accordance with the version of SOP 50 10 that was in effect at the time the loan was approved. For example, the documentation should show that the injection:

(1) came from a legitimate source; (2) occurred prior to the initial loan disbursement; and (3) consisted of the required amount of cash or the required value of non-cash assets. Pursuant to SOP 50 10, the value of non-cash injected assets must be carefully ascertained. Therefore, Lender' claims that the injected assets were worth more than their depreciated (net book) value should be supported by an Appraisal.

Note: If there was an Early Default, the Lender's failure to verify and properly document a required injection raises a rebuttable presumption that the default was caused by the lack of the injection and a full denial of liability may be justified. (See Chapter 23 for more information.)

e. Lender Weakness or Pattern of Deficiencies

If, while reviewing a particular Lender's Purchase Packages, the Recommending Official identifies weaknesses or patterns of deficiencies that do not rise to the level of a full or partial denial of liability on specific loan guaranties, the Recommending Official should, nevertheless, bring the matter to the attention of the Lender and the SBA Office of Credit Risk Management.

2. Legal Counsel

a. Responsibility

The SBA Loan Center Legal Counsel is responsible for reviewing all proposed Loan Actions pertaining to guaranty purchase reviews; providing advice on legal issues regarding guaranty purchases as set out in [SOP 70 50 3](#) (*Legal Responsibilities*); and rendering an opinion as to whether SBA is obligated to honor its guaranty or is entitled to recover funds already paid on a guaranty.

b. Weight of Legal Opinion

If SBA Loan Center Legal Counsel renders an opinion stating that SBA is not obligated to honor its guaranty or is entitled to recover funds already paid, Legal Counsel's opinion may not be disregarded at the SBA Loan Center level. If the Approving Official disagrees with Legal Counsel's opinion, the loan must be referred to the Associate Administrator for Capital Access ("AA/CA") through the Director of OFA for final action.

3. **Approving Official**

a. **Purchase and Repair—Supervisory Liquidation Officers**

Supervisory Liquidation Officers serve as the Approving Official on proposed Loan Actions pertaining to guaranty purchase reviews, and may approve purchase and Repair recommendations, provided Legal Counsel concurs. Supervisory Liquidation Officers may also refer to the AA/CA through the Director of OFA recommendations to approve denial of liability in full or in part or to commence litigation against the Lender to recover amounts already paid on the guaranty. However, if the Supervisory Liquidation Officer does not agree with the Liquidation Officer's recommendation, the proposed Loan Action must be referred to the next higher level of authority. In addition, if the Supervisory Liquidation Officer disagrees with Legal Counsel's opinion that SBA is not obligated to honor its guaranty or is entitled to recover funds already paid, the loan must be referred to the AA/CA through the Director of OFA for final action.

b. **Denial of Liability—Associate Administrator for Capital Access**

Only the AA/CA has delegated authority to approve denial of liability in full or in part on a 7(a) Loan guaranty or commencement of litigation against a 7(a) Lender to recover amounts already paid on a guaranty, provided that the AA/CA must obtain the concurrence of the Office of General Counsel ("OGC") with regard to any decision to file suit against a Lender.

Chapter 23.
Denial of Liability on 7(a) Guaranty

A. When SBA May Deny Liability on a 7(a) Guaranty

1. General

SBA may be released from liability on its guaranty of a 7(a) Loan, in full or in part, for any of the reasons set out in [13 C.F.R. § 120.524\(a\)](#); and may recover funds already paid in connection with a guaranty purchase, whether they were paid directly to the Lender or to the secondary market investor.

2. Reasons for Denying Liability

When SBA denies liability on a 7(a) Loan guaranty pursuant to [13 C.F.R. § 120.524\(a\)](#), the most common reasons include instances where the Lender:

- a. Failed to comply materially with a Loan Program Requirement;
- b. Failed to make, close, service or liquidate the loan in a prudent manner;
- c. Placed SBA at risk through improper action or inaction;
- d. Failed to disclose a material fact to SBA in a timely manner; or
- e. Misrepresented a material fact to SBA regarding the loan.

Note: As set out in Chapter 22 (*7(a) Guaranty Purchase*), Paragraph A.1., Lenders must demonstrate that SBA is obligated to purchase the guaranteed portion of the loan by providing credible evidence that the loan was made, closed, serviced and liquidated in a commercially reasonable manner consistent with SBA Loan Program Requirements and prudent lending practices.

B. Who May Approve Denial of Liability Recommendations

Recommendations that SBA deny liability on a 7(a) Loan guaranty, in whole or in part, must be approved by the Associate Administrator for Capital Access ("AA/CA"), who may request an opinion from the Office of General Counsel ("OGC"). Recommendations that SBA commence litigation against a Lender to recover funds already paid on a guaranty must be approved by the AA/CA and include OGC concurrence.

C. Loss Attributable to Lender

1. Material Loss or Harm to Program Integrity

Generally, SBA does not deny liability on a 7(a) Loan guaranty unless the Lender's actions or omissions caused, or could cause, a Material Loss on the loan. SBA may, however, deny liability on a guaranty in the absence of an actual or potential Material Loss if the Lender's misconduct is deemed material to the soundness and integrity of the 7(a) Program, such as, for example, if the loan was ineligible for SBA financing, the Lender failed to disclose or misrepresented a material fact to SBA, or the Lender breached SBA's conflict of interest regulations.

2. Amount of Loss on Collateral

The amount of a loss related to collateral should be based on the collateral's Recoverable Value. Therefore, both the adequacy of the Lender's Post-default Appraisal required by Chapter 7 and the reasonableness of the deductions that the Lender used to establish the Recoverable Value pursuant to Chapter 2 must be reviewed in order to determine the amount of the loss. If the Lender failed to obtain a Post-default Appraisal, SBA may base the amount of the loss on a percentage of the value that the Borrower assigned to the collateral when it applied for the SBA Loan.

3. Projected Loss

If a significant, but not yet quantified loss appears likely, the SBA Loan Center should encourage the Lender to withdraw its guaranty purchase request and to resubmit it when the Lender has completed the liquidation process.

D. Repairs

1. General

As set forth in Chapter 2 (*Definitions*), the term Repair means an agreement between SBA and a 7(a) Lender as to a specific dollar amount to be deducted from the funds SBA pays on the Lender's guaranty in order to fully compensate SBA for an actual or anticipated loss caused by the Lender.

2. Repair Amount

The net amount of a Repair must be a specific dollar amount that fully compensates SBA for the actual or anticipated loss caused by the Lender.

Generally, it is determined by multiplying the dollar amount of the loss caused by the Lender by SBA's guaranty percentage of the loan.

3. When a Repair is Inappropriate

A Repair is never appropriate and must not be pursued if the Lender's actions or omissions caused a total or near total loss on the loan, or if the Lender's misconduct is deemed material to the integrity and soundness of the 7(a) Program.

4. Impact of Repair on Guaranty Percentage

A Repair does not reduce the percent of the loan guaranteed by SBA or SBA's *pro-rata* share of expenses or recoveries.

E. Partial Denial of Liability

A partial denial of liability is justified if a purchase review indicates that the Lender's actions or omissions caused, or could cause, a Material Loss but less than a total, or near total, loss on the loan. If the SBA Loan Center recommends a partial denial of liability, it should proceed as follows:

1. Notice to Lender of Partial Denial of Liability Recommendation

Before seeking AA/CA approval of its recommendation to partially deny liability or to commence litigation against the Lender to recover funds already paid on the guaranty, the SBA Loan Center should attempt to reach an agreement with the Lender as to the amount of a Repair or the amount of the guaranty purchase disbursement that should be reimbursed by the Lender.

2. Procedure When Lender Agrees to Adequate Repair

If a pre-purchase review indicates that a partial denial of liability is justified and the Lender agrees to an adequate Repair, the SBA Loan Center should:

- a. Obtain approval pursuant to the Rule of Two of the proposed Loan Action, i.e., acceptance of the negotiated Repair;
- b. Enter the Repair code in the Guaranty Purchase Tracking System ("GPTS") along with the net dollar amount of the Repair; and
- c. Disburse to the Lender an amount that reflects the guaranteed portion of the loan minus the net dollar amount of the Repair.

3. Procedure When Lender Will Not Agree to Adequate Repair

If a pre-purchase review indicates that a partial denial of liability is justified, but the Lender will not negotiate in good faith or agree to an adequate Repair, the SBA Loan Center should:

- a. Obtain approval pursuant to the Rule of Two of the proposed Loan Action, i.e., recommending that the AA/CA approve a partial denial of liability on the guaranty in the estimated dollar amount of the loss to SBA caused by the Lender;
- b. Provide the Lender with written notice of the SBA Loan Center's recommendation;
- c. Update the GPTS; and
- d. Send the recommendation along with the loan file to OFA.

4. Procedure When Lender Agrees to Reimburse SBA

If a post-purchase review indicates that recovery of a portion of the funds already paid on the guaranty is justified and the Lender agrees to reimburse SBA, the SBA Loan Center should:

- a. Obtain approval pursuant to the Rule of Two of the proposed Loan Action, i.e., repayment by the Lender of the negotiated amount of the guaranty purchase disbursement;
- b. Enter the net voluntary repayment amount and reason code in the GPTS;
- c. Instruct the Lender to send a check for the net dollar amount of the repayment to the SBA Loan Center; and
- d. Code the Lender's check "T/C 375" and send it to the Denver Finance Center with the loan number and the comment "Repayment of Guaranty Purchase Disbursement."

5. Procedure When Lender Will Not Agree to Reimburse SBA

If a post-purchase review indicates that recovery of a portion of the funds already paid on the guaranty is justified, but the Lender will not negotiate in good faith or agree to reimburse SBA, the SBA Loan Center should:

- a. Obtain approval pursuant to the Rule of Two of the proposed Loan Action, i.e., recommending that the AA/CA, with OGC concurrence, approve commencement of litigation against the Lender to recover the estimated dollar amount of the loss to SBA caused by the Lender;
- b. Provide the Lender with written notice of the SBA Loan Center's recommendation;
- c. Update the GPTS; and
- d. Send the recommendation along with the loan file to OFA.

F. Full Denial of Liability

A full denial of liability is justified if a purchase or other review indicates that the Lender's actions or omissions: caused an actual or anticipated total or near total loss on the loan; resulted in SBA guarantying an ineligible loan; or are deemed material to the soundness or integrity of the 7(a) loan program. If the SBA Loan Center recommends a full denial of liability, it should proceed as follows:

1. Notice to Lender of Full Denial of Liability Recommendation

Before seeking AA/CA approval of its recommendation to deny liability in full or to commence litigation against the Lender to recover funds already paid on the guaranty, the SBA Loan Center should notify the Lender in writing of its alternative, i.e., voluntary cancellation of SBA's guaranty, or, if SBA has already purchased the guaranteed portion of the loan, reimbursement of the amount paid.

2. Procedure if Lender Agrees to Voluntarily Cancel Guaranty

If a pre-purchase or other review indicates that a full denial of liability is justified and the Lender agrees that cancellation of SBA's guaranty is appropriate, the SBA Loan Center should:

- a. Obtain the Lender's concurrence to SBA's cancellation of the guaranty;
- b. Document that the Lender agreed to voluntary cancellation of SBA's guaranty in a Loan Action Record;
- c. Enter the voluntary cancellation and reason code in GPTS if the cancellation is done in connection with a purchase request; and

- d. Instruct the Denver Finance Center to classify the loan as "Paid in Full" with termination code "D" to indicate denial of liability.

3. Procedure if Lender Will Not Voluntarily Cancel Guaranty

If a pre-purchase review indicates that a full denial of liability is justified, but the Lender will not agree to voluntarily cancel SBA's guaranty, the SBA Loan Center should:

- a. Obtain approval pursuant to the Rule of Two of the proposed Loan Action, i.e., recommending that the AA/CA approve a full denial of liability on the guaranty;
- b. Provide the Lender with written notice of the SBA Loan Center's recommendation;
- c. Update the GPTS; and
- d. Send the recommendation along with the loan file to OFA.

4. Procedure if Lender Agrees to Reimburse SBA

If a post-purchase review indicates that a full denial of liability is justified and the Lender agrees to reimburse SBA for the full amount paid on the guaranty, the SBA Loan Center should:

- a. Document the Lender's decision to reimburse SBA for the full amount paid on the guaranty in a Loan Action Record;
- b. Update the GPTS; and
- c. Instruct the 7(a) Lender to reimburse SBA by paying the amount due on-line at www.pay.gov using on-line SBA Form 172, which should be completed by entering the phrase "Principal Only" at the top of the form, the amount paid on line 11d, and the phrase "Repayment of Guaranty Purchase T/C 375" in Box 13.

5. Procedure if Lender Will Not Agree to Reimburse SBA

If a post-purchase review indicates that recovery of the full amount already paid on the guaranty is justified, but the Lender refuses to voluntarily reimburse SBA, the SBA Loan Center should:

- a. Obtain approval pursuant to the Rule of Two of the proposed Loan Action, i.e., recommending that the AA/CA, with OGC concurrence, approve commencement of litigation against the Lender to recover the funds already paid on the guaranty;
- b. Provide the Lender with written notice of the SBA Loan Center's recommendation;
- c. Update the GPTS; and
- d. Send the recommendation along with the loan file to OFA.

G. Examples of Lender Deficiencies Justifying Full or Partial Denial of Liability

Listed below are examples of common Lender deficiencies that justify SBA denial of liability in full or in part. The list is not exhaustive and is provided for guidance purposes only.

1. Incorrect Eligibility Determination

A full denial of liability is justified if the Lender made an ineligible loan.

2. Early Default Due to Failure to Properly Make or Close Loan

A full denial of liability is almost always justified if the Lender's failure to make or close the loan in accordance with Loan Program Requirements or prudent lending practices contributed to or allowed an Early Default. For example, denial is almost always justified on a PLP, Express or Pilot Loan Program loan based on deficient underwriting if the Lender was clearly negligent in its cash flow analysis by failing to take into account an obvious fact that could easily affect the Borrower's ability to repay the loan, such as, if:

- a. The Lender made the loan even though the Borrower's projected expenses greatly exceeded projected revenues and the Borrower had no other source of income; or
- b. The Lender failed to justify cash flow projections for the Borrower by comparing the projected revenue of a start-up business against an industry standard or some other reliable measure including the Lender's own experience making loans to similar businesses.

3. **Failure to Use IRS Transcripts to Verify Financial Information**

A full denial of liability is justified if the loan involves an Early Default and the Lender failed to provide credible evidence that it verified the Borrower's financial information by comparing it to relevant IRS tax return transcript as required by the version of SOP 50 10 in effect at the time the loan was approved. Full denial may not be justified, however, if the Lender provides credible evidence that the business failure was due to factors unrelated to any financial difficulties that the Lender could have identified through the IRS verification process.

Note: As set forth in [SOP 50 10](#), delays in receiving transcripts from the IRS do not excuse a Lender from complying with SBA's IRS tax return verification requirements.

4. **Failure to Use Loan Proceeds as Required by Loan Authorization**

A full or partial denial of liability may be justified if there was a Material Loss on the loan due to the Lender's failure to ensure that the loan proceeds were used in accordance with the Authorization as required by the version of SOP 50 10 in effect at the time the loan was approved.

a. **Examples of When Full or Partial Denial May be Justified**

A full or partial denial of liability may be justified if there was a Material Loss on the loan due to, for example:

(1) **Early Default Due to Failure to Buy Key Assets**

Operational problems caused by the Borrower's failure to purchase the assets listed in the "Use of Proceeds" section of the Loan Authorization that resulted in an Early Default; or

(2) **Collateral Not Available for Liquidation**

A reduced recovery because collateral required to be purchased with the loan proceeds was not available for liquidation.

b. Credible Evidence of Use of Proceeds

[SOP 50 10](#) includes a list of documentation considered credible evidence that the loan proceeds were used in accordance with the Authorization. A Post-default Appraisal that lists the assets can also serve as credible evidence that assets were purchased in accordance with the Loan Authorization and available for liquidation.

c. Unacceptable Evidence of Use of Proceeds

Without corroborating documentation, an affidavit from the Borrower or a bank statement showing only a check number and amount is not credible evidence that the loan proceeds were used in accordance with the Loan Authorization.

5. Failure to Verify Equity Injection

a. Early Default—Rebuttable Presumption

If there was an Early Default on the loan, the Lender's failure to verify and properly document a material portion of an injection of cash or non-cash assets required by the Loan Authorization raises a rebuttable presumption that the default was caused by the lack of the injection and a full denial of liability is almost always justified. To rebut the presumption, the Lender must provide credible evidence that the primary cause of the default was something other than the lack of the required injection, e.g., the death of an irreplaceable Key Employee or a natural disaster that destroyed the Borrower's business premises and customer-base.

b. No Early Default—Case-by-Case Analysis Required

If there wasn't an Early Default on the loan, whether a full or partial denial of liability is justified depends on an analysis of the relevant facts such as the length of time the business was in operation before the default, the cause of the business failure, and whether the Lender provided credible evidence that the primary cause of the default was something other than the lack of the required injection.

c. Examples of Credible Evidence of Cash Injection

Credible evidence of a cash injection includes:

- (1) Documentation showing that a check or wire transfer was processed and that the funds were deposited into an escrow account on the Borrower's behalf or into the Borrower's bank account prior to the initial disbursement on the SBA Loan;
- (2) Documentation showing that the injected funds were received by the Borrower prior to the initial disbursement on the SBA Loan, such as a copy of a signed third-party escrow settlement statement showing the disbursement on behalf of the Borrower or the Borrower's bank account statement showing the deposit of the injected funds.

d. Examples of Unacceptable Evidence of a Cash Injection

Without corroborating documentation, a promissory note, gift letter or financial statement is not credible evidence of a cash injection.

e. Examples of Credible Evidence of Proper Source of Injection

SOP 50 10 requires Lenders to verify the source as well as the existence of an equity injection. Examples of credible evidence that an equity injection came from a source consistent with SBA Loan Program Requirements and prudent lending practices include:

- (1) A gift letter from an identified credible source that includes the amount and date of the gift and releases the Borrower from any obligation to repay the donor, along with corroborating evidence that the gift amount was actually remitted to the Borrower, such as a copy of the Borrower's bank account statement dated prior to the initial loan disbursement documenting a cash deposit in the amount of the gift;
- (2) A home equity loan agreement plus a statement of account showing funds were drawn for the cash injection and paid into the Borrower's bank account along with credible evidence that the home equity loan would be repaid from sources other than the Borrower's cash flow;
- (3) Shareholder note and full standby agreement along with corroborating evidence that the note amount was actually remitted to the Borrower, such as a copy of the Borrower's bank account statement dated prior to the initial loan disbursement documenting a cash deposit in the amount of the note;

- (4) Business-related expenditures on behalf of the Borrower made with a principal's own funds within six months of the Borrower's loan application to the Lender that are supported by paid receipts or processed checks showing the nature of the expenditures; or
- (5) A deposit into the Borrower's bank account made by an Associate of the Borrower supported by bank account statements for at least two months prior to the loan application showing that the Associate had the funds to make the required injection along with corroborating evidence that the funds were actually remitted to the Borrower, such as a bank account statement dated shortly before the initial loan disbursement showing the deposited funds.

Note: Large unexplained deposits should always be questioned and the source of the funds documented.

f. Examples of Credible Evidence of an Asset Injection

Credible evidence of an asset injection includes escrow settlement statements, receipts or cancelled checks along with corroborating documentation such as corresponding deeds to the Borrower, or invoices marked "Paid" showing that the Borrower acquired the assets needed for the injection within six months of the Borrower's loan application to the Lender, plus credible evidence that the assets were available for use by the Borrower.

6. Failure to Obtain Required Lien Position

A full or partial denial of liability is justified if the Lender failed to obtain the lien position on the collateral required by the Loan Authorization and that failure caused, or could cause, a Material Loss on the loan. The amount of the loss should be based on the aggregate Recoverable Value that the collateral would have had if the Lender had obtained the required lien position.

7. Failure to Prepare and Use an Adequate List of Collateral

A full or partial denial of liability is justified if the Lender failed to prepare and utilize an adequate list of the collateral and that failure caused, or could cause, a Material Loss on the loan. The amount of loss should be based on the aggregate Recoverable Value that the collateral would have had if the Lender had prepared and utilized an adequate list.

Note: Prudent lending practices require lenders to attach a list, which reasonably describes the collateral, to the lender's security agreement and U.C.C. financing statement to ensure that (1) a security interest "attaches" to the collateral, i.e., that the lender obtains a lien on the items; and (2) the lien is "perfected," i.e., that the lender establishes the priority of its lien over those of competing creditors.

a. Example of When a Full or Partial Denial Is Justified

A full or partial denial of liability is justified if the collateral required by the Loan Authorization was present at default, but due to the Lender's failure to prepare an adequate list of the collateral when the loan was made, the Lender was unable to enforce its security interest against the Borrower, a trustee in bankruptcy, or a competing creditor, and that failure caused, or could cause, a Material Loss on the loan.

b. Example of When a Full or Partial Denial Is Not Justified

A full or partial denial of liability is not justified despite the Lender's failure to prepare an adequate list of collateral when the loan was made, if all of the collateral required by the Loan Authorization was present at default and liquidated, and all of the proceeds were applied to the loan balance, and as a result, there was no Material Loss on the loan.

8. Failure to Conduct a Post-default Site Visit

A full or partial denial of liability is justified if the Lender failed to conduct a post-default site visit in a prudent and commercially reasonable time and manner and as a result of that failure, collateral disappeared or declined in value and caused, or could cause, a Material Loss on the loan. The amount of loss should be based on the aggregate Recoverable Value of the collateral that was not available for liquidation or the aggregate amount by which the collateral declined in value due to the Lender's failure to properly conduct a timely site visit. (See Chapter 8 for information on site visits.)

Note: A U.C.C. sale conducted at the debtor's business premises where the machinery and equipment is set up, connected to an appropriate power source, and can easily be inspected and tested will usually produce a significantly higher recovery than a sale of the same collateral held off-site after it has been dismantled and moved to a storage facility because the lender failed to conduct a timely site visit and make arrangements with the landlord to conduct an on-site U.C.C. sale.

9. Failure to Liquidate in a Commercially Reasonable Manner

A full or partial denial of liability is justified if the Lender failed to liquidate the loan in a commercially reasonable and prudent manner and the failure caused, or could cause, a Material Loss on the loan. For example, a full or partial denial of liability is justified if the Lender:

- a. Failed to act in a timely manner to safeguard the collateral until it could be liquidated;
- b. Permitted a substantial decline in the value of collateral to occur because of unnecessary delays or mismanagement of the liquidation process;
- c. Failed to account for items listed on the Lender's pre-closing collateral list but not on the Lender's post-default inventory of collateral; or
- d. Failed to account for items listed on the Lender's post-default site visit inventory and appraisal that were not included in the liquidation sale.

Chapter 24.
Prepayment of 504 Loans and Debentures

A. General

This chapter covers prepayment of 504 Loans and debentures. The procedures for prepayment are the same for all 504 Loans including those that have not been classified in liquidation status. For prepayment policies and procedures regarding 503 loans, see the SBA regulations and SOPs in effect at the time the 503 loan was made, i.e., prior to 1987.

B. When 504 Loans and Debentures Can Be Prepaid

1. When a Borrower Can Prepay a 504 Loan

Generally, if a Borrower provides the CDC with 45 days prior written notice, the Borrower can prepay a 504 Loan on the third Thursday of any month. (See the *CDC Note* ([SBA Form 1505](#)) and the *Servicing Agent Agreement* ([SBA Form 1506](#)).

2. When a CDC Can Prepay a Debenture

Generally, if a CDC provides SBA with at least 30 days written notice, the CDC can prepay a debenture sold to fund a 504 Loan on any semi-annual debenture payment date prior to the debenture maturity date. (See the *Development Company 504 Debenture* ([SBA Form 1504](#)).

C. Prepayment Amount

1. 504 Loan Prepayment Amount

Full, but not partial, prepayment of a 504 Loan is allowed. Pursuant to [13 C.F.R. § 120.940](#), the terms of the *CDC Note* ([SBA Form 1505](#)) and the *Servicing Agent Agreement* ([SBA Form 1506](#)), to prepay the 504 Loan, the Borrower must pay the sum of all of the following amounts due and owing through the date of the next semi-annual debenture payment:

- a. Principal balance;
- b. Interest;
- c. SBA guaranty fees;

- d. Central servicing agent ("CSA", currently Colson Services Corp.) fees; and
- e. Prepayment premium, if owed.

2. Debenture Prepayment Amount

Pursuant to the terms of the *Development Company 504 Debenture* ([SBA Form 1504](#)), to prepay the debenture the CDC must pay the sum of all of the following amounts due and owing through the date of the next semi-annual debenture payment:

- a. Outstanding principal balance of the debenture;
- b. Interest accrued and unpaid to the prepayment date; and
- c. Prepayment premium, if owed.

Note: If the Borrower wires the correct amount to prepay the 504 Loan, the CDC should have sufficient funds to prepay the corresponding debenture.

3. Prepayment Premium Amount

Pursuant to the terms of the *CDC Note* ([SBA Form 1505](#)), Borrowers who prepay during the first half of the term of the 504 Loan must pay a prepayment premium. The formula for determining the amount of the prepayment premium is specified in the corresponding *Development Company 504 Debenture* ([SBA Form 1504](#)).

D. Procedure for Prepayment of 504 Loans and Debentures

When the Borrower provides notice that it wishes to prepay a 504 Loan, proceed as follows:

1. Document the Loan Action

If SBA is servicing the 504 Loan, document the proposed Loan Action, i.e., prepayment of the 504 Loan and the corresponding debenture.

2. Obtain CSA's Estimate of Prepayment Amount

Obtain an estimate of the amount required to prepay the debenture via the CSA's Web site at www.colsonservices.com or by faxing a [Workup Request Form](#) to the CSA at (212) 313-0163.

3. Schedule Prepayment with CSA

Schedule a date for prepayment of the debenture via the CSA's Website at www.colsonservices.com or by faxing a [Workup Request Form](#) to the CSA at (212) 313-0163. The request must be received by the CSA at least eight calendar days prior to the requested prepayment date.

4. Send Borrower Prepayment Instructions

Advise the Borrower of the estimated prepayment amount; and provide the Borrower with information regarding the prepayment process.

5. Obtain Exact Prepayment Amount from CSA

Obtain the exact prepayment amount, which should be available after the sixth business day of the month of prepayment, from the CSA's Web site at www.colsonservices.com.

6. Instruct Borrower to Wire Prepayment Funds to CSA

Notify the Borrower of the exact prepayment amount and instruct the Borrower to wire the necessary funds to the CSA no later than noon Eastern Standard Time on the third Thursday of the month in which the prepayment is scheduled.

Note: The CSA will not accept checks. Further, if the CSA does not receive the correct amount on time, it will terminate the transaction and reschedule the prepayment to the next semi-annual debenture payment date, which could result in the need for additional funds.

7. Notify CSA When Prepayment Requirements Met

Notify the CSA when the prepayment procedures listed in Subparagraphs 1 through 6 above have been met. The notice may be faxed to (212) 313-0163 or sent via www.colsonservices.com and must be received by the CSA at least eight calendar days prior to the requested prepayment date.

8. Release the Collateral

After receipt of written confirmation from the CSA that the debenture has been prepaid in full, endorse the Note as "Paid in Full" and release the collateral securing the 504 Loan.

9. Close the 504 Loan File

Close the 504 Loan file upon receipt of the cancelled debenture from the trustee, currently the Bank of New York, who will return it after the next semi-annual debenture payment date.

E. Cancelling or Rescheduling Prepayment Date

Once a prepayment date has been scheduled, if it appears that the debenture cannot be prepaid as planned, notify the CSA as soon as possible; and follow the procedural steps as outlined in Paragraph D above to reschedule the prepayment.

Chapter 25. Debenture Purchase

A. General

This chapter covers the purchase of debentures guaranteed by SBA when the corresponding 504 Loan is classified in liquidation status. For policies and procedures regarding 503 loans, see the SBA regulations and SOPs in effect at the time the loan was made, i.e., prior to 1987.

B. When CDC Required to Request Purchase

A CDC must promptly request that SBA purchase the debenture if the 504 Loan is three months or more past due. ([13 C.F.R. § 120.970\(f\)](#)) To request that SBA purchase a debenture, the CDC must send a written request to the appropriate SBA Loan Center, which includes the reason for the debenture purchase request and an explanation of why pre-debenture purchase workout options are not feasible. (See Chapter 11 for information regarding workouts.)

C. When SBA Required to Purchase

If the Note evidencing the 504 Loan is accelerated, SBA is required to purchase the debenture sold to fund the loan, ([13 C.F.R. § 120.970\(f\)](#)), since acceleration of the Note causes the corresponding debenture to become immediately due and payable in full to the investor.

D. Purchase Amount

To purchase a debenture, SBA is required to pay the balance due on the debenture plus interest through the next semi-annual debenture payment date—but not the prepayment premium.

Note: When SBA purchases a debenture, it does not add the amount attributable to pre-paid interest to the balance of the 504 Loan.

E. SBA Procedure for Purchasing Debentures

1. Obtain Authorization to Purchase the Debenture

Obtain approval by the Rule of Two of the proposed Loan Action, i.e., classification of the loan in liquidation status; purchase of the debenture; wire transfer of funds by the Denver Finance Center to the CSA; and termination of CSA servicing.

2. Schedule the Debenture Purchase

SBA can purchase a debenture at any time. It is not necessary for SBA to wait until the month before a debenture's semi-annual payment date to purchase a debenture. Generally, however, SBA Loan Centers schedule debenture purchases between the 1st and 11th business days of the month by creating and downloading an MS Excel spreadsheet on the CSA Web site located at www.colsonservices.com and emailing the spreadsheet to the CSA and the trustee (currently The Bank of New York).

3. Obtain Exact Debenture Purchase Amount

After the SBA Loan Center has emailed the spreadsheet to the trustee, the trustee will furnish the CSA with the balance due on the debenture plus interest through the next semi-annual debenture payment date for each 504 Loan listed on the spreadsheet. Thereafter, the CSA will update its computer system with the information supplied by the trustee and send an email to the Denver Finance Center that includes one claim letter for each group of 504 Loan debentures scheduled to be purchased on or before a specified semi-annual payment date.

4. Purchase Debenture

The CSA's claim letter is paid by the Denver Finance Center.

5. Send Notice of Purchase to CDC

The SBA Loan Center should provide the CDC with notice that the debenture has been purchased and the information regarding the revised accounting information on the 504 Loan set forth in Paragraph F below.

F. Impact of Debenture Purchase on 504 Loan

Purchase of the debenture results in several changes with regard to the 504 Loan including the following:

1. CSA Servicing Terminated

Currently, the CSA does not provide accounting services with regard to the 504 Loan after the debenture has been purchased. For up-to-date information on services that are provided, see the CSA's Web site at www.colsonservices.com.

2. Fees Eliminated

All debenture-related fees are eliminated, including CSA fees and CDC servicing fees. Provided, however, that with regard to 504 Loans returned to servicing pursuant to an approved workout agreement, if the loan was approved on or after October 1, 2009 and the debenture has been purchased, the CDC may receive a servicing fee equivalent to the servicing fee paid prior to debenture purchase, which will be paid by the Borrower in addition to the payments required under the terms of the workout agreement. (See Chapter 11 for information on workouts.)

3. Prepayment Premium Eliminated

The prepayment penalty is eliminated unless the loan was made under the 503 loan program, in which case the prepayment penalty is added to the principal balance of the loan.

4. Loan Modification Possible

The terms and conditions of the 504 Loan may be substantially modified if necessary to maximize recovery on the loan.

5. Remittance of Payments and Recoveries to SBA

Because the CSA is no longer involved, all loan payments and liquidation recoveries must be remitted to SBA.

6. New Loan Number Assigned

A new SBA Loan number is assigned to the 504 Loan and must be used when requesting information or approval of proposed Loan Actions.

Chapter 26.
Reimbursement of Loss on PCLP Debentures

A. PCLP CDC's Duty to Reimburse SBA

Unless a higher percentage is required by the applicable Loan Program Requirements, a PCLP CDC must reimburse SBA for 10% of any loss suffered by SBA as a result of a default on a 504 Loan funded by a PCLP debenture. ([13 C.F.R. § 120.847\(a\)](#)) The PCLP CDC may use its Loan Loss Reserve Fund ("LLRF") for this purpose.

B. Amount of Reimbursement Obligation

After a PCLP CDC has submitted its Wrap-up Report, (or when SBA otherwise determines that the PCLP CDC has exhausted all reasonable collection efforts), the SBA Loan Center should take the following steps to calculate the amount of SBA's loss and the PCLP CDC's reimbursement obligation:

1. Request a transcript of account for the 504 Loan from the Denver Finance Center that includes only transactions involving payment or receipt of cash by SBA;
2. Calculate SBA's loss by adding together the amount of principal and interest owed by the Borrower immediately after SBA purchased the debenture and any Recoverable Expense paid by SBA; and deducting from that total, the amount of any recovery SBA received after purchasing the debenture; and
3. Calculate the dollar amount of the PCLP CDC's reimbursement obligation by multiplying the dollar amount of SBA's loss by .10.

C. Notification of Reimbursement Obligation

The SBA Loan Center should notify the PCLP CDC of its calculations in a letter that sets out:

1. The amount of the PCLP CDC's reimbursement obligation;
2. The deadline for payment, i.e., within 30 days of the date of the letter;
3. How the reimbursement amount was calculated (a copy of the transcript of account and supporting documentation should be included); and
4. The PCLP CDC's appeal rights pursuant to [13 C.F.R. § 120.847\(h\)\(2\)](#) set forth in Paragraph D below.

D. Appeal Process

The final decision of an SBA Loan Center Director or designee regarding the calculation of SBA's loss and the PCLP CDC's reimbursement obligation may be appealed to the Director of the Office of Financial Assistance who will consult with the Director of the Office of Credit Risk Management, provided that: (1) the PCLP CDC reimbursed SBA for 10% of any loss amount that is not in dispute within 30 days of the date of SBA's notification letter; and provided further that (2) the appeal: (a) is in writing; (b) includes a copy of the notification letter and supporting documents; (c) states the reason why the calculations are believed to be incorrect; and (d) is submitted within 30 days of the date of the notification letter. ([13 C.F.R. § 120.847\(h\)\(2\)](#))

E. Payment Deadline

The PCLP CDC must reimburse SBA no later than 30 days after SBA's notification of the reimbursement obligation or issuance of a final decision on the PCLP CDC's appeal of the SBA Loan Center's decision. ([13 C.F.R. § 120.847\(h\)\(1\)](#))

F. SBA's Right to LLRF

In addition to any other action available to SBA, if the PCLP CDC does not satisfy its entire reimbursement obligation within 30 days after SBA's notification of the reimbursement obligation or the issuance of a final decision on a PCLP CDC's appeal of the SBA Loan Center's decision, SBA may cause funds in the PCLP CDC's LLRF to be transferred to SBA to cover the PCLP CDC's reimbursement obligation. ([13 C.F.R. § 120.847\(i\)](#))