

# **SBA**

# **SOP 50 52 2**

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## **DISASTER LOAN SERVICING and LIQUIDATION**

Office of Capital Access  
Small Business Administration  
September 1, 2015



**SMALL BUSINESS ADMINISTRATION  
STANDARD OPERATING PROCEDURE**

<b>SUBJECT:</b> <b>Disaster Loan Servicing and Liquidation</b>	<b>S.O.P.</b>		<b>REV</b>
	<b>SECTION</b> <b>50 52</b>	<b>NO.</b> <b>2</b>	

**INTRODUCTION**

1. Purpose: Update and consolidate SBA policy and procedures on Disaster Loan servicing and liquidation.
2. Personnel Concerned: All SBA employees.
3. SOPs Cancelled: SOP 50 52 1, SOP 50 50 4 and SOP 50 51 3
4. Originator: Office of Capital Access

<b>AUTHORIZED BY:</b> Ann Marie Mehlum Associate Administrator Office of Capital Access		<b>EFFECTIVE DATE</b> 9/01/15
		<b>PAGE</b> 1

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## Chapter 1. Introduction

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### A. Purpose

SOP 50 52 2 sets out the standard operating policies and procedures of the Small Business Administration (“SBA”) for the administration of Disaster Loans that are in “regular servicing” and “liquidation” status. The previous version, SOP 50 52 1, applied only to servicing of Disaster Loans. This version has been revised to include liquidation of Disaster Loans. This SOP does not apply to Immediate Disaster Assistance Program (IDAP) loans.

**Note:** A Disaster Loan moves from “approval” status (governed by [SOP 50 30](#)) to “regular servicing” status when the loan has been closed and the final loan disbursement has been made. It moves from “regular servicing” status to “liquidation” status if the loan is in default and has been classified in liquidation pursuant to Chapter 16 of this SOP.

### B. Authority

The policy and procedures set out in this SOP are based on the [Small Business Act](#), the [Stafford Act](#), the [Debt Collection Improvement Act of 1996](#) (“DCIA”) and [Part 123 of Title 13 of the Code of Federal Regulations](#).

**Note:** Because the Agency's authority to make Disaster Loans is based on Section 7(b) of the [Small Business Act](#), Disaster Loans are also known as “7(b) loans.”

### C. General Policy and Goals

Borrowers should repay their Disaster Loans in accordance with the terms specified in the Note ([Secured](#), [Unsecured](#)) and other Loan Documents. Provided, however, that loan servicing and liquidation activities should reflect a balancing of the Agency's interest in: (1) achieving the goals of the Disaster Loan Program, i.e., helping victims recover from disasters; and (2) maintaining the integrity of the Disaster Loan Program, i.e., protecting the taxpayers' interests in the Agency's ability to maximize its recovery if the Borrower defaults on the loan.

### D. Performance Standards

#### 1. Loans in Regular Servicing

Generally, Disaster Loans must be serviced in a prompt, cost-effective, prudent manner that is consistent with federal debt management and collection guidelines and SBA loan program requirements and reflects a balancing of the Agency's interest in: (1) achieving the goals of the Disaster Loan Program, i.e., helping victims recover from disasters; and (2) maintaining the integrity of the Disaster Loan Program; i.e., protecting the taxpayers' interests in the Agency's ability to recover on the loan.

#### 2. Loans in Liquidation Status

Generally, Disaster Loans must be liquidated in a prompt, cost-effective, prudent manner that is consistent with federal debt management and collection guidelines and SBA loan program requirements; enables SBA to maximize recovery on the loan in the shortest amount of time; and reflects a balancing of SBA's interest in: (1) achieving the goals of the Disaster Loan Program, i.e., helping victims recover from disasters; and (2) maintaining the integrity of the Disaster Loan Program; i.e., protecting the taxpayers' interests in the Agency's ability to recover on the loan.

Recoveries should be collected in an efficient and effective manner to protect the value of the Federal Government's assets. An attempt should be made to maximize recovery using all appropriate collection tools. For more information on the management of recoveries, refer to [Circular A-129](#) and [Managing Federal Receivables](#).

#### **E. Exceptions to Policy**

Any Loan Action that conflicts with the use of the word "must" in this SOP, or any other applicable Loan Program Requirement, must be treated as an exception to policy. An exception to policy is only appropriate when the applicable Loan Program Requirement does not adequately address the unique circumstances of a particular loan, and the exception, if granted, would not contravene an applicable statute or regulation. Prior to taking any Loan Action that would conflict with a Loan Program Requirement under this SOP, written approval must be obtained from the Director of Financial Program Operations ("OFPO").

## Chapter 2. Definitions

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

### A. General Terms

1. **Agency** means the U.S. Small Business Administration (“SBA”).
2. **Agent** means an authorized representative, including an attorney, accountant, consultant, packager, lender service provider, or any other Person representing a loan applicant by conducting business with SBA.
3. **Appraisal** means a licensed Appraiser’s written opinion as to the value of property.

#### a. Qualifications of Appraiser

An Appraisal may be performed by an appraiser, broker, auctioneer, retail inventory specialist or other expert, provided that the Person meets the minimum qualifications listed below and a good faith effort is made to use a local expert with actual knowledge of the property and market conditions where it will be sold:

##### (1) Knowledge and Experience

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

##### (2) Licensed, Certified and Bonded

Meets applicable government licensing, certification and bonding requirements;

##### (3) Independent

Has no conflict of interest with SBA or the Obligors; and has no financial interest in the property to be appraised, provided, however, that when it is cost-effective, the Person who appraised the collateral may also sell it as long as the sale is widely advertised and otherwise consistent with applicable law. (E.g., an auctioneer may appraise and sell personal property collateral via a public auction that complies with Article 9 of the Uniform Commercial Code.)

#### b. Appraisal Standards

##### (1) Real Property

- (a) A real property Appraisal should comply with the [Uniform Standards of Professional Appraisal Practice](#) whenever required by prudent lending practices, e.g., to support Loan Actions dealing with release of liens for consideration, Protective Bids, or deeds in lieu of foreclosure, or when it is apparent (based on the tax assessed value, current market conditions,

condition of the property, balance owed on prior liens, etc.) that there is equity to secure the SBA loan; and

- (b) In all other cases, (i.e., when neither a specific SBA Loan Program Requirement nor prudent lending practices require an Appraisal in compliance with the [Uniform Standards of Professional Appraisal Practice](#)), a real property valuation may consist of a broker price opinion (“BPO”) prepared in substantial compliance with the [Broker Price Opinion Board Standards](#). For example, a BPO may be used to support a Loan Action to abandon real property collateral if it is apparent, (based on the tax assessed value, current market conditions, condition of the property, balance owed on prior liens, etc.) that there is little or no equity available to secure the SBA loan.

(2) Personal Property

- (c) A personal property Appraisal should comply with the [Uniform Standards of Professional Appraisal Practice](#) whenever required by prudent lending practices, e.g., to support Loan Actions dealing with unique items of personal property such as coin collections, jewelry, or art work; and
- (d) In all other cases, (i.e., when neither SBA Loan Program Requirements nor prudent lending practices require an appraisal in compliance with the [Uniform Standards of Professional Appraisal Practice](#)), a personal property Appraisal may consist of an auctioneer or other expert's opinion as to value.

b. Report Format

All 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 secured by a UCC lien;
- (2) The type of valuation, e.g., liquidation or fair market value, 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 manufacturer, model, and serial number of significant items of personal property, i.e., items with a Liquidation Value of \$5,000 or more;
- (5) The date and location of the Appraisal inspection, and the effective date of the valuation;
- (6) The appraiser's certification that he or she has no financial interest in the property or conflict of interest with SBA or any Obligor; and
- (7) The appraiser's qualifications and signature.

c. Age of Appraisal

Generally, an Appraisal should be less than 120 calendar days old, and must never be more than one year old, at the time SBA relies on it to make a decision affecting a Disaster Loan.

4. **Associate of the Borrower** means an officer, director, key employee of a Disaster Business Loan Borrower, or a Person who has an ownership interest of more than 20% in the Borrower's business; any entity in which one or more of the foregoing Persons has an ownership interest of at least 20%; or any Person in control of, or controlled by, the Borrower except a Small Business Investment Company licensed by SBA.
5. **Basic Living Expenses** means those costs that must be paid to obtain the following categories of goods and services necessary for the survival of an Obligor, their spouse and dependents as defined by the most current version of the [Collection Financial Standards](#) published by the Internal Revenue Service: (1) food and clothing; (2) out-of-pocket health care expenses; (3) housing and utilities; and (4) transportation.
6. **Borrower** means the Person or Persons who executed the Note ([Secured](#), [Unsecured](#)) evidencing the Disaster Loan.
7. **Close Relative** means a spouse, parent, child or sibling, or the spouse of a parent, child or sibling.
8. **Computer Tracking System** means the electronic method used by SBA to create and maintain a chronological record of the significant activities on a Disaster Loan, such as Loan Actions, the substance of meetings, telephone calls, or letters regarding the loan, including computer generated letters and phone calls
9. **Conflict of Interest**, whether capitalized or not, means a set of circumstances that creates an actual, apparent, or potential risk that judgment or actions—which should be based on the general policy and goals set out in Chapter 1, Paragraph C—will be unduly influenced by a secondary interest.
10. **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.
11. **Default Charges** means all monetary amounts payable as the result of a default on a senior secured creditor's loan, such as prepayment penalties, swap fees, late fees and interest paid at an escalated rate.
12. **Disaster Loan** means and includes, unless otherwise specifically stated, home and business physical disaster loans, economic injury loans, and pre-disaster mitigation loans made under Section 7(b) of the Small Business Act. Disaster Loan does not include Immediate Disaster Assistance Program (IDAP) loans made under Section 42 of the Small Business Act.
13. **Disaster Home Loan** is a consumer loan made to a homeowner or renter to repair/replace his/her property (both real and personal) or refinance a mortgage (on

residential real estate) which was damaged or destroyed as the result of a declared disaster.

14. **Disaster Business Loan** is a commercial loan made to an individual or legal entity to repair/replace property (both real and personal) or refinance secured loans that was damaged or destroyed as the result of a declared disaster. These loans may have also provided working capital required as a result of a declared disaster.
15. **Disposable Pay** means that part of the employee's compensation (including salary, bonuses, commissions, and vacation pay) from an employer remaining after the deduction of health insurance premiums and any amounts required by law to be withheld. For purposes of this SOP, "amounts required by law to be withheld" include amounts for deductions such as Social Security Taxes and withholding taxes, but do not include any amount withheld pursuant to a court order. ([13 C.F.R. § 140.11](#))
16. **Duplication of Benefits** refers to the duplicate assistance for any part of a loss for which the individual or business has received financial assistance under any other program, insurance or any other source.
17. **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.
18. **Guarantor** means a Person who executed a Guaranty as security for a Note ([Secured](#), [Unsecured](#)) executed by a Borrower.
19. **Guaranty** means [SBA Form 2128](#) (*Unconditional Guarantee*), [SBA Form 2129](#) (*Unconditional Limited Guarantee*) or a substantially similar document executed by a Guarantor that contains an unconditional promise to pay the debt owed on a Note ([Secured](#), [Unsecured](#)) if the Borrower fails to pay it.
20. **Including**, whether capitalized or not, means "including but not limited to," i.e., the list is exemplary and not exhaustive.
21. **Liquidation Plan** means a written plan outlining the actions the Agency intends to take to maximize recovery on a specific Disaster Loan.
22. **Liquidation Value** is the likely price collateral will sell for if sold quickly and with limited exposure to potential buyers. An Appraisal is necessary to determine the Liquidation Value of real or personal property collateral unless it 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; or
  - 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.
- 23. Litigation Plan** means a written plan, whether or not it is entitled “Litigation Plan,” outlining the court proceedings that the Agency intends to initiate or defend against in order to protect its interest in, or maximize its recovery on, a Disaster Loan.
- 24. Loan Action**, (formerly known as an [SBA Form] “327 action”), means an activity or decision regarding a specific SBA loan including a decision to engage or not to engage in a particular activity, e.g., a decision not to enter a Protective Bid at a senior lienholder's foreclosure sale would be a Loan Action.
- 25. Loan Action Record** means the paper or electronic document used to memorialize the decision and justification for a specific Loan Action. It may consist of a memo, email, letter, SBA Form 327 or other document provided that it contains: the Borrower's name and the SBA loan number; a reasonable description of the Loan Action; the justification for the Loan Action including an analysis of any Supporting Documentation; and a citation to the applicable SOP provision that provides authority for the proposed Loan Action.
- 26. Loan Authorization and Agreement** means SBA's written agreement including subsequent modifications thereto, which sets out the terms and conditions under which SBA will make a Disaster Loan.
- 27. Loan Documents** means the Loan Authorization and Agreement, Note ([Secured](#), [Unsecured](#)), Guaranty, lien instruments, and all other agreements and documents related to a Disaster Loan.
- 28. Loan File**, whether capitalized or not, means the electronic or paper folder dedicated exclusively to storing a hard copy or an electronic copy of all of the Loan Documents (including the collateral documents regardless of whether they are kept in a separate folder) pertaining to a specific SBA loan.
- 29. Loan Program Requirements** means the requirements pertaining to SBA's Disaster Loan Program, as issued and revised from time to time, imposed by statutes, regulations, contracts, Loan Authorizations, and SBA Notices and forms.
- 30. Must**, whether capitalized or not, means that the action or prohibition is mandatory.
- 31. Net Earnings Clause** refers to a supplemental annual principal payment that is a designated percentage of a business loan borrower's net earnings.
- 32. Non-recoverable Expense** means a cost that cannot be recouped by being added to the principal balance of the Note ([Secured](#), [Unsecured](#)), because, e.g., the cost was not: (a) related to collection of amounts due under the Note ([Secured](#), [Unsecured](#)), enforcement of the terms of the Loan Documents, or the preservation or disposal of the collateral; (b) necessary, reasonable or customary; or (c) incurred in accordance with prudent lending practices or SBA Loan Program Requirements.
- 33. Note** means the promissory note ([Secured](#), [Unsecured](#)) executed by the Borrower on a Disaster Loan.

- 34. Obligor** means every Person with direct liability for repaying a Disaster Loan, such as the Borrower and any assumptor, and every Person with contingent liability, such as a Guarantor.
- 35. Office of Financial Program Operations ("OFPO")** means the SBA office in charge of administering SBA's loan program operations and managing SBA's loan portfolio.
- 36. Person** means any individual, corporation, partnership, limited liability company, association, unit of government, or other legal entity, however organized.
- 37. 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.
- 38. Real Estate Owned ("REO")** means real property collateral acquired by SBA (formerly known as "COLPUR").
- 39. Recoverable Expense** means a necessary, reasonable and customary cost incurred to collect amounts due under the Note ([Secured](#), [Unsecured](#)), to enforce the terms of the Loan Documents, or to preserve or dispose of collateral, which according to the terms of the Note ([Secured](#), [Unsecured](#)), can be recouped by adding it to the principal balance of the loan.
- 40. Recoverable Value** means the net dollar amount that a prudent lender could reasonably expect to recover by liquidating a particular piece of collateral. Recoverable Value is determined by deducting the following amounts from the Liquidation Value of the collateral: (a) the balance owed on senior liens (less amounts waived or subordinated by a Loan Document); (b) Recoverable Expenses associated with any necessary lien foreclosure action; and (c) if the collateral is likely to be acquired by SBA at the foreclosure sale (e.g., real property), the expenses associated with the care, preservation and resale of the acquired collateral.
- 41. SBA Loan Center** means the following SBA facilities:
- a. Birmingham Disaster Loan Servicing Center
 

801 Tom Martin Drive, Suite 120  
 Birmingham, AL 35211  
 Toll Free Phone: (800) 736-6048  
 Local Phone: (205) 290-7141  
 Fax: (205) 290-7765  
 E-mail: [Birminghamdlsc@sba.gov](mailto:Birminghamdlsc@sba.gov)

The Birmingham Disaster Loan Servicing Center is responsible for housing and servicing all Disaster Loans in regular servicing status in Guam and surrounding island nations as well as Regions 1, 2 (except for Puerto Rico and St. Croix), 3, 4 and 5.
  - d. El Paso Disaster Loan Servicing Center
 

10737 Gateway West, Suite 300

El Paso, TX 79935  
 Toll Free Phone: (800) 487-6019  
 Local Phone: (915) 633-7137  
 Fax: (915) 633-7110  
 E-mail: [EIPasodlsc@sba.gov](mailto:EIPasodlsc@sba.gov)

The El Paso Disaster Loan Servicing Center is responsible for housing and servicing all Disaster Loans in regular servicing status in Puerto Rico and St. Croix as well as Regions 6, 7, 8, 9 (except for Guam) and 10.

e. National Disaster Loan Resolution Center

200 West Santa Ana Boulevard, Suite 180  
 Santa Ana, CA 92701-4134  
 Toll Free Phone: (855) 778-3154  
 Telephone Number: (714) 550-9566  
 Facsimile Number: (714) 567-0136  
 TTY / TDD Number: (714) 550-0655  
 Facsimile Number: (714) 567-0137  
 E-mail: [0946.reception@sba.gov](mailto:0946.reception@sba.gov)

The National Disaster Loan Resolution Center is responsible for housing and liquidating all Disaster Loans in liquidation status in Regions 1 through 10.

**42. Seasoned Loan** or a loan that is “Seasoned” means that for 18 months after the initial disbursement or 18 months after the final disbursement if it occurred more than six months after the initial disbursement, or if there was a default, the Borrower cured it and for 12 consecutive months following the 18 month post-disbursement period, the Borrower did not:

- a. Fail to make a scheduled loan payment;
- b. Fund a scheduled loan payment from the sale of collateral;
- c. Have more than three consecutive scheduled full payments deferred; or
- d. Experience an event of default that required the loan to be classified in liquidation.

**43. Servicing Request** means a Loan Action requested by a Borrower regardless of whether it is simple (e.g., address change) or more complex such as the Loan Actions covered in Chapters 8 through 15 of this SOP (e.g., subordination of lien position).

**44. Severe Financial Hardship** means an inability to pay for Basic Living Expenses based on the criteria set out in Chapter 7.

**45. Should**, whether capitalized or not, means that the action is recommended but not required.

**46. A Site Visit** is a personal visit to inspect and verify the current condition and current use of SBA collateral. A site visit may be conducted to inspect and verify the current

condition and current use of real property collateral or personal property collateral. A site visit may be conducted by SBA personnel or by an SBA vendor at SBA's direction. All site visits should be documented by a Site Visit report, which should be kept in the Loan File or electronic tracking system.

**Note:** A Site Visit should be made whenever warranted by prudent lending practices or whenever an appraisal does not provide enough information as to the current condition and/or current use of the collateral property. A site visit does not take the place of an appraisal. Rather, it is a supplement to an appraisal. In most instances, an existing or current appraisal would suffice to verify the condition or current use of collateral property as long as the appraisal provides an adequate and detailed description of the current condition and current use of that property. However, there may be instances when circumstances dictate the need for a site visit after an appraisal has already been prepared. Circumstances for a site visit may include, but are not limited to: the existing appraisal does not adequately address certain concerns about the collateral property; to determine occupancy status of real property collateral; to determine if damage occurred as a result of a disaster or an event that took place after the date an existing appraisal and/or; SBA received notice (verbal or written) of code violations, vandalism, environmental concerns, damage or any other matter which may affect the value of the collateral property and SBA's ability to maximize recovery. All site visits should be documented by a Site Visit report, which should be kept in the Loan File or electronic tracking system.

- 47. Site Visit Report** means the paper or electronic record documenting the findings and conclusions after visiting the Borrower's business premises. A post-default Site Visit Report should cover, for example, efforts to: determine whether a workout is feasible; identify the collateral available for liquidation; establish the collateral's Recoverable Value; determine whether the Borrower is behind on the rent and whether a liquidation sale of the personal property collateral can be held on-site; determine whether any real property collateral is occupied by a Person other than the Borrower; develop a liquidation strategy; assess any environmental risk associated with the anticipated method of liquidation; and arrange for the care and preservation of the collateral pending liquidation.
- 48. Supporting Document** or "Supporting Documentation" means the original, or a complete and accurate executed copy, (i.e., it must contain all of the required signatures and include all of the addendums thereto), of any document relied upon to reach a decision regarding a Loan Action, e.g., a purchase and sale agreement, Appraisal or Environmental Investigation Report.
- 49. Treasury** means the U.S. Department of the Treasury Bureau of Financial Management Service.
- 50. Valuation** means a commercially reasonable method of establishing the fair market value of an asset based upon the type of collateral and type of action being taken. Such methods may include, but are not limited to, Broker Price Opinion (BPO) reports, Drive-by appraisals, internet valuation websites, Kelley Blue Book, National Automobile Dealers Association (NADA) reports, etc.

**B. Environmental Terms**

The definitions of the environmental terms used in this SOP are the same as those used in [SOP 50 10](#), which are located in Appendix 2 of [SOP 50 10](#), the most current version of which is accessible from the [SOP section](#) of SBA's Web site.



## Chapter 3. Recordkeeping and Disclosure of Information

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### A. Recordkeeping

#### 1. General Requirements

All servicing and liquidation Loan Action decisions, including the justification for the decision, must be documented in the Loan File or Computer Tracking System.

#### 2. Collateral Documents

All original collateral documents such as the Note ([Secured](#), [Unsecured](#)), Guaranties, mortgages, deeds of trust, title insurance policies, security agreements, etc., must be delivered to a collateral cashier who is responsible for placing the documents in a collateral file and for properly safeguarding and maintaining them.

#### 3. Loan Action Records and Supporting Documents

Loan Action Records should be dated and kept in the Loan File along with the Supporting Documents, such as Appraisals, credit reports and Environmental Investigation Reports, and any other document relied upon before taking the action memorialized in the Loan Action Record.

#### 4. Correspondence

Copies of all paper and electronic correspondence concerning the loan must be dated and kept in the Loan File.

#### 5. Telephone Conferences and Meetings

Detailed information concerning telephone calls and face-to-face meetings, i.e., date, time, place, Persons in attendance, substance of conversation, etc., must be kept in the Loan File or entered in a Computer Tracking System.

#### 6. Electronically Stored Information

Because electronically stored information may be needed for litigation purposes and is subject to discovery, all electronically stored information should be preserved in its originally created or "native" format along with the related metadata.

#### 7. Loan File Retention

##### a. General Rule

In general, SBA Loan Centers must adhere to applicable Agency record retention requirements with regard to loan files (Finance, Records Group 50). (See [SOP 00 41](#) for information on records management.)

b. Exception—Litigation Hold

If litigation is reasonably anticipated, appropriate steps must be taken to preserve all potentially relevant information regarding the loan, including electronically stored information. This preservation requirement supersedes the general rule set out in Subparagraph a and means that routine retention and destruction policies must be suspended and a "litigation hold" put on the Loan File and electronically stored information to ensure the preservation of potentially relevant documents and data.

**Note:** "Reasonable anticipation of litigation" arises when an organization is on notice of a credible threat it will become involved in litigation or anticipates taking action to initiate litigation." Guideline 1. *The Sedona Conference Commentary on Legal Holds: The Trigger & The Process* (Sedona Conference Working Group on Electronic Document Retention & Production, August, 2007.)

## B. Disclosure of Information

This Paragraph provides general guidance for responding to requests for information about Disaster Loans. For more detailed information and answers to specific questions, consult legal counsel, the SBA Loan Center FOIA Contact, or the SBA FOIA/PA Office at [foia@sba.gov](mailto:foia@sba.gov) or (202) 401-8203.

### 1. Applicable Statutes, Regulations and SOPs

Disclosure of information on Disaster Loans is governed by the following federal statutes, regulations and SOPs.

#### a. Freedom of Information Act

The [Freedom of Information Act](#) ("FOIA") permits the public to request access to federal agency records, and requires federal agencies to disclose the records sought in a written FOIA request unless the Act specifically exempts the records from disclosure. For more information on FOIA, see [SOP 40 03](#).

**Note:** Under FOIA, the word "record" means a data compilation (e.g., a book, document, map, or photograph) regardless of its format or characteristics (e.g., paper, machine readable or electronic). FOIA does not require agencies to create records, conduct investigations, render opinions, provide subjective evaluations, answer questions or develop information in response to a FOIA request.

#### b. Privacy Act

The [Privacy Act](#) prohibits federal agencies from disclosing any record that is contained in a system of records, which are filed under an individual's name or social security number, to any Person except pursuant to a written request by or with the written consent of the individual to whom the record pertains, unless one of the

exemptions listed in [SOP 40 04](#) applies, such as reporting to a consumer credit bureau. Generally, files covered by the Privacy Act include:

- (1) Disaster Home Loan files; and
- (2) Official Personnel Files (OPFs).

**Note:** Intentional wrongful disclosure of information in a file covered by the Privacy Act is punishable as a criminal misdemeanor and could result in fine of up to \$5,000.

### **c. SBA Regulations and SOPs**

SBA regulations concerning disclosure of information are located in [13 C.F.R. Part 102](#). SBA policy and procedures regarding the Freedom of Information Act are located in SOP 40 03 (Disclosure of Information); and SBA policy and procedures regarding the Privacy Act are located in SOP 40 04 (Privacy Act Procedures).

## **2. Response Time**

### **a. Borrower and Borrower Authorized Requests**

Generally, when information is sought by the Borrower or disclosure of the information is authorized by the Borrower, the Agency's response should be provided within 10 calendar days.

### **b. FOIA Requests**

A FOIA request must be responded to within 20 working days excluding Saturdays, Sundays and legal holidays. This period begins once the correct office within SBA is in receipt of the request and any issues (e.g., processing fees) are resolved. If, however, the responsive records are voluminous, the request requires two or more offices to confer about the records, or the records are located off-site, the Agency is entitled to a 10 working day extension. (See Chapter 2 of [SOP 40 03](#) for more information on the time limits for processing FOIA requests.)

### **c. Subpoenas**

Legal counsel must be consulted to determine the time limits for responding to requests for information sought pursuant to a subpoena.

## **3. Responding to Borrower Requests**

### **a. Requests for Verbal Information**

Before any information concerning a loan may be disclosed over the telephone to a Person claiming to be the Borrower, a reasonable effort must be made to verify that the requestor is in fact the Borrower. This may be accomplished, for example, by asking a series of questions, the answers to which are unique to the Borrower.

**b. Requests for Documentation Prepared by SBA**

At the request of the Borrower, documentation prepared by SBA concerning the Borrower's loan, (e.g., a printout of the computer screen showing the loan balance or an Official Transcript of Account), may be provided to the Borrower but must only be sent to the Borrower's address listed in the Loan File unless the Borrower has provided a signed release authorizing SBA to send the documentation to another address.

**c. Requests for Return of Documents Provided by the Borrower**

At the request of the Borrower, documents provided to SBA by the Borrower, such as Appraisals, tax returns or Environmental Investigation Reports, may be returned to the Borrower provided that:

- (1) The document was prepared by or for the Borrower at the Borrower's expense, i.e., the document was not generated by SBA;
- (2) The document is no longer needed by the Agency;
- (3) Return of the document has been approved by legal counsel;
- (4) A copy of the document and the transmittal letter returning it to the Borrower is kept in the Loan file; and
- (5) The document is sent to the Borrower's address listed in the Loan File unless the Borrower has provided the Agency with a signed release authorizing SBA to send the document to another address.

**4. Responding to Third Party Requests for Information**

**a. General Rule**

Requests for information concerning a loan from any Person other than the Borrower must either be accompanied by a release signed by the Borrower authorizing SBA to release the information to the requestor, or treated as a FOIA request.

**b. Borrower Authorized Requests for Information**

Documentation or verbal information concerning a Borrower's loan may be provided in response to a third party's request for information that is accompanied by a signed release from the Borrower authorizing the disclosure. For example, Borrowers frequently authorize the disclosure of the following information:

**(1) Loan Payoff Amount**

Generally, the Agency's response to a request, typically from an escrow or title company, for information concerning the amount needed to pay off a loan, should be based on information obtained from the Computer Tracking System, and should include the principal balance, accrued interest, and the daily interest accrual amount (*per diem*).

## **(2) Verification of Credit or Mortgage**

Generally, the Agency's response to another creditor's request for verification of a Borrower's credit or mortgage should be based on information obtained from the Computer Tracking System, and should be transmitted to the authorized financial institution via mail, fax, or email within 24 hours.

## **(3) Verification of Disputed Credit Bureau Information**

Because the Borrower has authorized the credit bureau to investigate, a second signed release from the Borrower is not needed to respond to a written credit bureau request for verification or correction of disputed information on the Borrower's credit report. Generally, the Agency's response should be based on information obtained from the Computer Tracking System and transmitted within 10 calendar days. In every case, the Agency's response must be provided within the time frame set out in the [Fair Credit Reporting Act](#) (15 U.S.C. § 1681). Consult SBA legal counsel for more information on the requirements of the [Fair Credit Reporting Act](#).

## **5. Unauthorized Requests for Information**

Any request for information concerning a loan from any Person other than the Borrower that is not accompanied by a release signed by the Borrower authorizing SBA to release the information to the requestor must be processed as a FOIA request. (See [SOP 40 03](#) or consult legal counsel or the SBA Loan Center FOIA Contact for information on responding to FOIA requests.)

## **6. Information Sought By Subpoena**

### **a. Accepting Service of Subpoenas**

Only SBA legal counsel should accept service of a subpoena on behalf of the Agency or an employee acting within the scope of their duties. Subpoenas are time-sensitive and must be promptly referred to the appropriate authorized Agency official for response.

### **b. Responding to Subpoenas**

#### **(1) Civil Subpoenas**

SBA Loan Center Supervisory Legal Counsel has authority to respond to civil subpoenas unless they are of an unusual, sensitive or precedential nature, or involve the Office of the Inspector General, in which case authority to respond must be obtained from the Associate General Counsel for Litigation.

#### **(2) Criminal Subpoenas**

SBA Loan Center Supervisory Legal Counsel does not have authority to respond to criminal subpoenas. Criminal subpoenas must be referred to the Associate General Counsel for Litigation for response, and a copy must be sent to the Legal Division of the Office of the Inspector General.



## Chapter 4. Monitoring Loans in Regular Servicing Status

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After a loan has closed, changes often occur that can impact the ability to administer or collect the loan. They include, for example, a Borrower's name change, relocation, or consolidation with another entity; deterioration of the Borrower's financial condition; and changes that affect the value of collateral, such as failure to pay real estate taxes that can become a senior lien on the collateral. SBA Loan Centers are responsible for monitoring each Disaster Loan in their portfolio and for mitigating the risk of loss associated with any change in accordance with prudent lending practices. For example:

### A. Name, Address or Legal Structure Changes

In addition to updating the Loan File and Computer Tracking System, if a change involving the name, address, legal structure, etc., of an Obligor or any other relevant Person (e.g., a standby creditor) could impact the ability to collect the Disaster Loan, appropriate corrective action must be taken immediately. For example, a UCC-3 should be filed to reflect a name change and preserve the priority of personal property liens; if a Disaster Business Loan Borrower changes its legal structure, generally the new entity should be required to formally assume the Disaster Loan; and if an Obligor dies, in addition to collecting the proceeds from any life insurance policy pledged as collateral for the loan, legal action may be necessary to protect the ability to collect the balance owed on the loan.

### B. Borrower's Creditworthiness

1. Each loan should be monitored to ensure that the Borrower is making the regularly scheduled payments on the loan in a timely manner.
2. A primary means for monitoring each loan should be review of delinquency reports generated by the billing/accounting system. If the system flags a loan for an overdue payment, the Borrower should be contacted by telephone or letter to identify and correct potential problems before the loan goes into default.
3. If the Loan Documents require the Borrower to submit financial statements, the statements should be reviewed and analyzed in a timely manner.
4. If the financial information provided by the Borrower raises concerns regarding the Borrower's repayment ability, an executed copy of IRS Form 4506-T should be requested, and a transcript of the Borrower's most recent Federal Income Tax return should be obtained and compared to the questionable information.

**Note:** If an Obligor files bankruptcy, appropriate action must be taken to protect the ability to collect the SBA loan.

### C. Deceased Obligors

Generally, if an Obligor dies, steps must be taken to protect the Agency's ability to recover on the Disaster Loan, such as the following.

## 1. Collect Proceeds from Life Insurance Policies Assigned as Collateral

If an assignment of a life insurance policy was required by the Loan Authorization, collect and apply the insurance proceeds against the principal balance of the loan in accordance with the Loan Program Requirements in Chapter 11.

## 2. File a Creditor's Claim in Probate Proceedings

Refer the loan to legal counsel to file a claim against the deceased Obligor's estate and monitor the probate proceedings to ensure that the claim is paid before the assets are distributed.

### D. Care and Preservation of Collateral

The collateral for each loan must be monitored and prudent action consistent with the goals of the Agency's Disaster Loan Program must be taken to manage the risk of loss associated with any change in circumstances.

#### 1. UCC Filings

All UCC filings must be monitored, and any document needed to maintain the perfection and priority of the lien securing the Disaster Loan must be properly prepared and filed, including, for example, a UCC-3 to continue an existing financing statement. This duty continues until the loan has been charged off.

#### 2. Taxes and Assessments

Secured Disaster Loans should be monitored to ensure that all taxes and assessments, which if unpaid could result in senior liens against the collateral, are paid in a timely manner.

**Note:** Although state laws vary, secured creditors generally do not have the right to redeem collateral after a tax foreclosure sale. Consult legal counsel for case specific information.

#### 3. Insurance

Disaster Loans should be monitored to ensure that all insurance coverage required by the Loan Authorization is in place throughout the term of the loan. See Chapter 11 for information on force placing coverage if the Obligor has allowed it to lapse.

#### 4. Senior Secured Loans

In the event a senior lienholder takes adverse action (i.e. foreclosure) against common collateral securing the Disaster loan, the loans of other creditors secured by the collateral should be monitored. Timely, prudent, commercially reasonable action must be taken to prevent elimination of the lien securing the Disaster Loan through a foreclosure action by the senior lien holder, or dissipation of the equity available to cover the Disaster Loan through, for example, the imposition of Default Charges.

## Chapter 5. Loan Payment Administration

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This chapter provides SBA's policy and procedures with regard to payments on Disaster Loans in regular servicing or liquidation status. (See Chapter 10 for information on how to apply the proceeds from release of liens for consideration).

### A. Payments on Loans in Regular Servicing Status

Funds from payments received on loans in regular servicing status must be applied first to interest accrued up to the date the payment was received, and the remainder, if any, to the principal balance of the Note ([Secured](#), [Unsecured](#)).

### B. Payments on Loans During and After a Deferment Period

#### 1. Loan Payments During Deferment

Payments are not mandatory during a deferment period, but are preferred because even a small payment will keep the Borrower in the habit of making payments and will also keep the Borrower's pre-authorized debit method of payment active.

#### 2. Application of Loan Payments After Deferment

When regularly scheduled payments resume at the end of a deferment period, they should be applied in the same order as other funds from payments received on loans in regular servicing status. (See Paragraph A above.)

**Note:** During the Deferment period, only principal payments are deferred, interest will continue to accrue daily.

### C. Payments on Loans in Liquidation Status

#### 1. Overview

Payments (as opposed to recoveries) are generally rare after a loan has been classified in liquidation, because the Note ([Secured](#), [Unsecured](#)) has been accelerated and demand has been made for payment of the entire amount due. In those cases where the Borrower is financially able to resume making regularly scheduled payments, the loan should be returned to regular servicing status. (See Chapter 16 for information on returning loans classified in liquidation to regular servicing status.)

#### 2. Application of Funds

Unless the terms of an SBA approved workout agreement or some other legally binding document (e.g., a court approved bankruptcy plan) specifies otherwise, the funds from a payment on a loan in liquidation status should be applied to principal first, and then accrued interest.

## D. Impact of Accepting Payment on a Loan in Litigation Status

Before accepting any payment — other than payment in full — on a loan in litigation status, determine whether accepting the payment could cure the default and curtail plans for liquidating the loan. For more information, consult legal counsel.

## E. Payments on Loans Returned to Regular Servicing Status

When a Disaster Loan that was classified in liquidation is returned to regular servicing status and the Borrower resumes making regular payments, unless the terms of a legally binding agreement provide otherwise, (e.g., a court approved bankruptcy plan or an SBA approved workout agreement), the funds from the payments must be applied first to interest accrued up to the date the payment was received, and the remainder, if any, to the principal balance of the Note ([Secured](#), [Unsecured](#)).

## F. Prepayment

Disaster Loans may be prepaid at any time without penalties. To prepay a Disaster Loan, the Borrower must pay the sum of all of the amounts owed on the Note ([Secured](#), [Unsecured](#)) through the date the funds are received, including principal and accrued interest.

## G. Paid in Full Loans

### 1. Definition of “Paid in Full”

“Paid in full” means that the total amount due on the loan has been paid including principal, accrued interest, and Recoverable Expenses, if any. When a Disaster Loan is verified as “paid in full”, the Note ([Secured](#), [Unsecured](#)) should be cancelled, and the collateral should be released in a timely manner.

### 2. SBA Form 397 (Notice of Fully Paid Account)

Generally, a loan is not considered "paid in full" until receipt of [SBA Form 397 \(Notice of Fully Paid Account\)](#) from the Denver Finance Center verifying that the loan has been paid in full. Upon receipt of [SBA Form 397](#), the Note ([Secured](#), [Unsecured](#)) should be stamped "PAID" or "PAID IN FULL" and the cancelled Note ([Secured](#), [Unsecured](#)) should be returned to the Borrower.

### 3. Procedure for Releasing Collateral

#### a. Compliance with Applicable State Law

After a Disaster Loan is paid in full, the collateral must be released in accordance with applicable state law, and that the appropriate Loan Documents should be returned to the Borrower.

**Note:** Many states impose significant penalties on creditors who fail to release collateral in strict compliance with state law. Consult legal counsel for state specific release requirements.

b. General Rule—Release Only After Receipt of SBA Form 397

Generally, the collateral should not be released until after receipt of [SBA Form 397](#) (*Notice of Fully Paid Account*) from the Denver Finance Center verifying that the loan has been paid in full.

c. Exception—Release Before Receipt of SBA Form 397

Collateral must not be released prior to receipt of [SBA Form 397](#) (*Notice of Fully Paid Account*) unless:

- (1) The release is approved pursuant to, and documented by, a Loan Action Record;
- (2) An escrow agreement approved by legal counsel is utilized, which conditions delivery and recording of the release documents on receipt of sufficient funds to pay the Disaster Loan in full; and
- (3) The funds needed to pay the Disaster Loan in full are in the form of:
  - (a) Certified funds;
  - (b) A cashier's check; or
  - (c) A check from a reputable escrow agent.

**H. Reinstatement of Loans Mistakenly Coded as "Paid in Full"**

1. When a loan is mistakenly coded as "Paid in Full," the collateral should not be released and the loan should be reinstated as soon as possible.
2. If an [SBA Form 397](#) (*Notice of Fully Paid Account*) is mistakenly issued, the matter should be immediately referred to the Denver Finance Center.



## Chapter 6. Environmental Risk Management

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This chapter sets out SBA policy and procedures for managing environmental risks associated with Disaster Loans in regular servicing or liquidation status.

### A. Overview

#### 1. Environmental Risks

For secured creditors, the risks associated with Contaminated collateral include, for example:

- a. Impairment of the Borrower's ability to repay the loan due to the high cost of Remediation, regulatory fines and penalties;
- b. Diminishment of the value and marketability of the collateral;
- c. Direct liability for tort claims and Remediation by becoming an owner or operator of the Property, (e.g., by acquiring title at a foreclosure sale or by taking over the operation of the Borrower's business); and
- d. Loss of lien priority if a Governmental Entity cleans up the Property.

#### 2. Definitions

Definitions of the environmental terms used in this SOP, which are capitalized when they appear, are located in Appendix 2 of [SOP 50 10](#), the most current version of which is accessible from the [SOP section](#) of SBA's Web site. The defined terms include, for example, the term "Property," which means commercial real property and does not include personal property or residential real estate.

### B. General Requirements

Prudent servicing and liquidation of a Disaster Loan includes:

1. Conducting adequate due diligence before taking any Loan Action that could result in a loss, or increase the risk of loss, due to actual or alleged presence of Contamination;
2. Monitoring the loan for compliance with the environmental covenants in the Loan Documents and requiring the Borrower to take appropriate corrective action when necessary; and

**Note:** Indicia of increased environmental risk include, for example, regulatory fines discovered while reviewing financial statements, the Borrower's failure to maintain Engineering Controls, or evidence of a Release discovered during a site visit.

3. Complying with Environmental Laws that allow secured creditors to avoid or significantly limit potential liability.

**Note:** Many Environmental Laws provide secured creditors with a “safe harbor” from liability as an owner or operator. Two of the most important laws are the [Comprehensive Environmental Response, Compensation, and Liability Act](#) (“CERCLA”) and the [Resource Conservation and Recovery Act](#) (“RCRA”). To qualify for the exemption under CERCLA or RCRA, the most critical requirements are that the secured creditor: (1) hold indicia of ownership primarily to protect its security interest; (2) take no action that could be construed as “participating in the management” of the Borrower’s facility; and (3) attempt to divest itself of Contaminated acquired collateral at the earliest practicable and commercially reasonable time using commercially reasonable means. For Information on the types of activities that constitute “participating in the management” of a facility or UST system, with regard to CERCLA see [CERCLA Lender Liability Exemption: Updated Questions and Answers](#); and with regard to RCRA see [40 C.F.R § 280.210](#). Consult legal counsel for loan-specific information.

### C. When an Environmental Investigation is Required

An Environmental Investigation must be conducted before taking any Loan Action that could result in a loss, or increase the risk of loss, due to the actual or alleged presence of Contamination. For example, an Environmental Investigation must be conducted before:

1. Accepting Property as substitute collateral;
2. Releasing a lien on collateral for substantially less than its estimated Recoverable Value based on unsubstantiated allegations of Contamination;
3. Abandoning collateral, which would otherwise have Recoverable Value, based on unsubstantiated allegations of Contamination;
4. Acquiring title to Property held as collateral, e.g., by purchasing it at a foreclosure sale or accepting a deed-in-lieu of foreclosure;
5. Taking over the operation of a business that uses Hazardous Substances or is located on Contaminated Property regardless of whether the Borrower owns the Property;
6. Selling REO or acquired personal property collateral for substantially less than its appraised value based on unsubstantiated allegations of Contamination; and
7. Abandoning REO or acquired personal property collateral based on unsubstantiated allegations of Contamination.

### D. Environmental Investigation Process for Loans in Regular Servicing Status

Environmental Investigations in support of regular loan servicing activities, e.g., substitution of collateral, should be conducted in accordance with [SOP 50 10](#).

### E. Environmental Investigation Process for Loans in Liquidation Status

Environmental Investigations in support of liquidation activities, e.g., acquiring Property at a foreclosure sale, should be conducted as follows:

## 1. Scope of investigation

The amount of due diligence must be prudent based on the loan specific circumstances such as the Property's appraised value, the amount owed on senior liens, the Disaster Loan balance, the activities conducted at the Property, the results of previous Environmental Investigations, access to the Property, and the cost and time involved.

## 2. Use of Environmental Professionals

Environmental Investigations on loans in liquidation status must be conducted by an Environmental Professional except for the Environmental Questionnaire ("EQ") portion of an Environmental Investigation that consists of an EQ and Records Search with Risk Assessment ("RSRA").

## 3. Reliance Letter Requirement

An Environmental Investigation Report prepared by an Environmental Professional must be accompanied by a Reliance Letter unless the Environmental Investigation consists of an EQ and RSRA. (See Appendix 3 to [SOP 50 10](#) for the Reliance Letter template.)

## 4. General Procedure

Generally, the following steps should be taken to conduct a post-default Environmental Investigation that will provide adequate information for a prudent lender to make an informed decision regarding the risks of Contamination.

### Step 1. Order an Environmental Site Assessment ("ESA")

**High Risk**—If the risk of Contamination appears to be high, begin with a Phase I ESA. Generally, the risk should be considered high if, for example, there are underground storage tanks at the Property, a NAICS Code for a past or present use of the Property matches one on the List of Environmentally Sensitive Industries (Appendix 4 to [SOP 50 10](#)), or past Environmental Investigations have concluded that the Property is Contaminated or that there is a high or elevated risk of Contamination.

Exception for Non-Industrial Condominiums: The Environmental Investigation of a condominium in a non-industrial, multi-unit building may begin with a Transaction Screen or an EQ and RSRA.

**Low Risk**—If the risk of Contamination appears to be low, begin with a Transaction Screen or an EQ and RSRA.

### Step 2. Conduct Additional Necessary, Cost-effective Inquiries

If a prudent lender could not make an informed decision based on the Environmental Investigation Report from Step 1, conduct any additional cost-effective inquiry recommended in the Environmental Investigation Report or otherwise needed to obtain enough information to make an informed decision. For example, when the Property appears to have significant Recoverable Value:

- (1) A Phase I ESA should be conducted if a Transaction Screen or EQ and RSRA shows a high or elevated risk of Contamination;
- (2) Inquiries regarding environmental problems beyond the scope of a Phase I ESA (e.g. asbestos), should be conducted if the problem could have a material effect on the Recoverable Value of the Property;
- (3) A Phase II ESA should be conducted if it is necessary to determine the nature and extent of Contamination identified by a Phase I ESA; and
- (4) A Remediation estimate should be obtained if Remediation is recommended in a Phase II ESA Report.

**Note:** For guidance on how to prepare a Remediation estimate, see ASTM E2137-06 (*Standard Guide for Estimating Monetary Costs and Liabilities for Environmental Matters*). Note also that SBA officials may request an estimate from the SBA environmental engineers at the SBA [Sacramento Loan Processing Center](#).

### Step 3. Additional Requirements for Gas Stations and Dry Cleaners

If, after obtaining a Phase I ESA, a prudent lender would obtain additional information before making a decision regarding Property associated with the operation of a gas station, commercial fueling facility, or a dry cleaner that uses Hazardous Substances, then the Environmental Investigation should also include:

- (1) A Phase II ESA conducted by an independent Environmental Professional with three years of full-time relevant experience who holds a current Professional Engineer's or Professional Geologist's license;
- (2) Any further investigation recommended in the Phase I ESA or Phase II ESA Report;
- (3) An estimate that covers the method, cost and time required for completion of any recommended Remediation; and
- (4) Testing of the equipment related to the operation of the facility.

**Note:** Generally, if a gas station or dry cleaner has been in operation for five years or more, there is a high probability that the Property is Contaminated.

### Step 4. Extra Requirement if Taking Over Business Using Hazardous Substances

#### (1) Environmental Regulatory Compliance Audit

Generally, an environmental regulatory compliance audit should be conducted prior to taking over the operation of a business that handles Hazardous Substances. The audit should be conducted in substantial compliance with ASTM E2107-06 (*Standard Practice for Environmental Regulatory Compliance Audits*).

**Note:** Unknown regulatory compliance violations can significantly diminish a secured creditor's estimated recovery. For example, the cost of obtaining licenses and permits needed to operate the business can be substantial, and outstanding regulatory fines and enforcement actions can have a chilling affect on the price potential purchasers are willing to pay for the business assets.

## **(2) Practice Tip**

To avoid "participating in the management" of a Borrower's business and losing the secured creditor liability exemption, it is generally advisable to have a receiver appointed by the court to take possession of the collateral and operate the business.

## **F. Environmental Investigation Reports**

The results of an Environmental Investigation must be set out in a written Environmental Investigation Report, which must be kept in the Loan File. An Environmental Investigation Report should be less than 180 calendar days old at the time it is relied on.

## **G. Remedial Action by SBA as a Secured Creditor**

Given the complexity of the applicable Environmental Laws and the risks involved, a legal opinion from an attorney with Environmental Law expertise should be obtained before the Agency undertaking Remedial action. (See [40 C.F.R. § 280.210\(b\)\(2\)\(i\)\(B\)](#), which deals with participating in the management of underground storage tanks ["USTs"], as an example of the risks and complexity of the law.)

## **H. Taking Title to Contaminated Property or Control of Business with Environment Risks**

### **1. When Appropriate**

Title to Contaminated Property should not be acquired, and businesses that use Hazardous Substances or are located on Contaminated Property should not be taken over, unless despite the risk of incurring liability as an owner or operator, a prudent lender would do so based on the estimated net recovery.

### **2. Requirement – Prior Approval from Associate General Counsel for Litigation**

Prior written approval from the SBA Associate General Counsel for Litigation and Claims must be obtained before taking title to Contaminated Property or taking over the operation of a business that uses Hazardous Substances or is located on Contaminated Property regardless of whether the Borrower owns the Property.

### **3. How to Obtain Approval**

A written request must be submitted to the SBA Associate General Counsel for Litigation and Claims.

#### **4. Request Format**

The request, which must be accompanied by the appropriate Supporting Documents, must include a thorough analysis of all the relevant factors to determine whether a prudent lender would take the proposed action despite the risks. Such factors and Supporting Documents should generally include:

##### **a. Appraised Value of Collateral to be Acquired**

Provide the appraised value of the Property supported by a copy of a post-default Appraisal.

##### **b. Liquidation Value of Collateral to be Acquired**

Provide the estimated Liquidation Value of the Property and explain the basis for the estimate.

##### **c. SBA Loan Balance**

Provide the SBA loan balance supported by a copy of the transcript of account or other credible evidence of the loan balance.

##### **d. Amount Owed on Senior Liens**

Provide a list of senior liens against the collateral, including landlord liens and tax liens, and the amount owed on each, supported by a copy of:

- (1) Schedule B, or equivalent, of the post-default title report;
- (2) A current UCC lien search if the request includes personal property collateral or taking over the operation of a business;
- (3) Any senior lienholder agreement, landlord lien waiver, subordination agreement or other Loan Document that establishes the priority of the liens against the collateral; and
- (4) Transcript of account or similar proof of compliance with any provision in the foregoing documents that requires a senior lender to subordinate any portion of the senior loan to the SBA loan (e.g., Default Charges).

##### **e. Foreclosure Costs**

List the foreclosure costs including any extraordinary expenses such as the legal fees and administrative expenses associated with a receivership.

##### **f. Nature and Extent of the Contamination**

Provide a summary of the nature and extent of the Contamination supported by copies of the Environmental Investigation Report(s) required by Paragraph F.

### g. Clean-up Costs and Liability

Indicate whether Remediation is required or on-going, and:

- (1) If Remediation is not required—attach a copy of the no further action letter, closure letter or functional equivalent from the responsible Government Entity.
- (2) If Remediation is recommended—attach a copy of any document that: (a) provides a description of the recommended method and cost of Remediation and anticipated completion date; (b) establishes the identity of those responsible for Remediation (e.g., Superfund consent decree); or (c) demonstrates the ability of the responsible party to pay for the cost of Remediation.
- (3) If Remediation is on-going—attach a copy of any document that shows the progress of the cleanup, or that the Person conducting the cleanup has sufficient financial resources to complete it.

### h. Secured Creditor Liability Exemptions

Provide a list of applicable liability exemptions that SBA would qualify for if it took title, such as the secured creditor exemption under CERCLA, RCRA or a similar state law, the bona fide purchaser exemption under CERCLA §§ 101(4) and 107(r), or the involuntary acquisition by a government entity exemption under CERCLA § 101(20)(D).

**Note:** Pursuant to [40 C.F.R. § 300.1105\(a\)\(3\)](#), acquisition of title by SBA through foreclosure or a deed-in-lieu while administering an SBA loan program is considered an "involuntary acquisition."

### i. Mitigating Factors

List any mitigating factor and attach a copy of the relevant Supporting Document(s), e.g., an indemnification agreement and the indemnitor's financial statement.

Mitigating factors include, for example:

- (1) SBA Environmental Indemnification Agreement—was executed by a Person with sufficient financial resources to cover the cost of Remediation;
- (2) Escrow Account—has been established to cover the cost of a Remediation plan approved by the responsible Government Entity;
- (3) Solvent Government Cleanup Fund—has unconditionally agreed to cover the cost of Remediation; or
- (4) Lender Liability Environmental Insurance—is in place and will cover the cost of Remediation after title is acquired.

**j. Tort Liability**

Provide information regarding the status and anticipated outcome of any known litigation regarding alleged injury to people, property or natural resources due to Contamination at the Property.

**k. Exceptions to Title that Impact Marketability**

Review Schedule B (or equivalent) of the post-default title report, and indicate whether there is any recorded covenant, deed restriction or other exception to title that will have a negative impact on the Property's Recoverable Value such as a covenant that requires future owners of the Property to indemnify a major oil company or a deed restriction that prevents future owners from using the Property for any purpose other than to operate a gas station that sells a particular brand of gasoline.

**l. Alternative Methods of Recovery**

List and analyze the feasibility of alternative methods of collecting the loan balance that involve less risk. At a minimum, this should include (1) the estimated recovery from other collateral and the Obligors; and (2) alternative methods of liquidation that do not require taking title to the Contaminated collateral such as release of lien for consideration, sale of the Note ([Secured](#), [Unsecured](#)) and assignment of the lien to the purchaser, or appointment of a receiver to operate the business until enough money can be recovered to pay-off the loan or the collateral can be sold.

**m. Acquired Collateral Divestiture Plan**

Provide a description of the plan for disposing of any collateral to be acquired, which includes the holding and resale costs, as well as an explanation of how easy or difficult it will be to resell. For example, have any third parties expressed an interest in purchasing the collateral? Is it currently listed for sale by the owner? If so, why hasn't it sold?

**Note:** Generally, in order to preserve its liability exemption, a secured creditor is required to try to dispose of Contaminated acquired collateral at the "earliest practicable, commercially reasonable time using commercially reasonable means". For more information, see the applicable Environmental Law. For example, [40 C.F.R. 280.210\(c\)\(2\)\(i\)](#) sets out a "bright line" test under RCRA for determining whether a secured creditor is attempting to sell a gas station in an expeditious manner.

**n. Other Relevant Facts or Expenses**

List and discuss any other loan-specific relevant facts. For example:

- (1) Remediation—Will additional costs be incurred to Remediate the Property prior to listing it for sale? If so, attach a copy of the legal opinion recommended in Paragraph G above, provide a Remediation estimate, and indicate how the costs will be paid;

- (2) Receivership Proceedings—Will a receiver be appointed, for example, to operate the business or sell the collateral? If so, attach a draft Litigation Plan that describes the prior experience and qualifications of the proposed receiver and includes an estimate of costs of the court and receivership proceedings; or
- (3) Emptying and Closing USTs—If there are USTs at the Property and a receiver will not be appointed, indicate whether it will be necessary to empty and close the USTs. (For more information, see, for example, [40 C.F.R. § 280.230\(b\)](#).)

**o. Estimated Net Recovery**

Provide the estimated net recovery from taking the proposed action based on the analysis of factors “a” through “n” above.



## Chapter 7. Severe Financial Hardship Relief

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### A. Overview

If an Obligor has experienced a material change in circumstances since the Disaster Loan was made (e.g., catastrophic illness), which has diminished the Obligor's assets or income to the extent that enforced collection would result in Severe Financial Hardship, temporary or permanent payment relief may be appropriate. This chapter provides the policy and procedures for determining whether Severe Financial Hardship relief is appropriate and what type of assistance may be provided.

### B. Requirements for Severe Financial Hardship Relief

Generally, severe financial hardship relief is offered to an individual. Payment relief based on Severe Financial Hardship may be appropriate if the Obligor:

1. Is an individual — not an artificial legal entity such as a limited liability company or a corporation;
2. Is cooperative, e.g., willing but unable to repay the Disaster Loan according to the terms of the Note ([Secured](#), [Unsecured](#));
3. Has not engaged in fraud, misrepresentation or any misconduct;
4. Has provided SBA with a hardship letter as required by Paragraph C below;
5. Has fully disclosed their financial situation to SBA as required by Paragraph C below;  
and
6. Would not be able to pay Basic Living Expenses if SBA were to enforce collection of the loan.

### C. Severe Financial Hardship Relief Request Packages

Each Obligor requesting relief based on Severe Financial Hardship should be instructed to submit the documentation listed below by a specified deadline. If all of the required information is not received by the deadline, the request should either be declined or the Obligor should be advised that the package is incomplete.

#### 1. Hardship Letter

An accurate, clear and concise letter signed by the Obligor seeking Severe Hardship Relief, which includes:

- a. Loan number;
- b. Obligor's name and address;
- c. How and when Obligor can be contacted;

- d. An explanation of the material change in circumstances that caused the Obligor to be unable to pay for Basic Living Expenses;
- e. The date(s) the Obligor's circumstances changed (i.e. the day the Obligor was laid off, got in an accident, became sick, etc.);
- f. Copies of documents that substantiate the material change in circumstance, (e.g., medical bills);
- g. Description of what the Obligor has done to try to cure the default, (e.g. cut back on expenses, spouse took a job, etc.);
- h. An explanation of why any particular living expense listed on [SBA Form 770](#) is excessive and
- i. What the Obligor would like SBA to do to make it possible for the Obligor to repay the loan, (e.g., forbear for a specified period of time, defer payments, modify the terms of the Note ([Secured](#), [Unsecured](#)), etc.).

## 2. Federal Tax Return

A signed copy of the federal income tax return (IRS Form 1040) filed by the Obligor for the previous tax year.

## 3. Financial Statement With List of Basic Living Expenses

A current financial statement (e.g., [SBA Form 770](#) (*Financial Statement of Debtor*)), which shows all of the Obligor's assets, liabilities, income and living expenses including the following:

- a. Living Expenses—food, housekeeping supplies, apparel and services, personal care products and services, and miscellaneous;
- b. Out-of-Pocket Health Care Expenses;
- c. Housing and Utilities; and
- d. Transportation—ownership costs and operating costs.

## 4. Borrower's Authorization and Consent to Verify Information

A signed and dated copy of the "Borrower's Consent to Verify Information and 3<sup>rd</sup> Party Authorization" form ([Birmingham Form](#), [El Paso Form](#), [Santa Ana Form](#)).

## D. Review of Severe Financial Hardship Relief Requests

To determine whether Severe Financial Hardship relief is appropriate, the Obligor's hardship letter and financial information must be reviewed to determine whether the requirements set out in Paragraph B above have been met. In doing so, the following guidelines should be applied:

## 1. Hardship Letter

Although each case should be judged on its merits, generally the following events may be considered a “material change in circumstances” if they result in a significant decrease in income:

- a. Loss of employment or involuntary under-employment;
- b. Catastrophic illness or uncompensated medical bills;
- c. Death of Obligor or spouse;
- d. Call to active military service;
- e. Divorce;
- f. Disability;
- g. Damage to property;
- h. Incarceration;
- i. Business failure; or
- j. Other reasonable cause.

## 2. Financial Information

### a. Adequacy of Disclosure

To determine whether an Obligor has completely and accurately disclosed their assets, liabilities and income and correctly stated their expenses, at a minimum, the information on their financial statement, e.g., [SBA Form 770](#), should be compared to a current credit report and the Obligor’s original loan application. All efforts to verify the financial information should be documented and any major discrepancies should be investigated and explained.

### b. Income—Poverty Guidelines

Generally, if the Obligor’s income is below the [Poverty Guidelines](#) established by the U.S. Department of Health and Human Services (“DHHS”), enforced collection would create Severe Financial Hardship and is inappropriate. Whether the Obligor’s annual income is above or below the poverty line should be determined by comparing it to the DHHS [Poverty Guidelines](#).

### c. Reasonableness of Living Expenses

To ensure that similarly situated Obligors receive the same treatment by SBA, the living expenses claimed by the Obligor on their financial statement, (e.g., [SBA Form 770](#)), should be reviewed to determine whether they are necessary and reasonable,

as opposed to personal lifestyle choices, by comparing them to the [IRS Collection Financial Standards](#) for families in the same geographic area with the same income and number of dependents. If the actual amount spent by the Obligor is higher than the IRS standard amount, the lower IRS standard amount should be used unless the Obligor's hardship letter adequately explains why a particular expense is necessary and reasonable even though it exceeds the IRS standard.

**Note:** Generally, the number of persons allowed for calculating Basic Living Expenses should be the same as the number allowed as exemptions on the Obligor's federal income tax return for the previous year.

#### **d. Equity in Assets**

If it appears that the Obligor's financial disclosure was complete and accurate, the Obligor's assets should be reviewed to determine whether (1) the Obligor has sufficient equity in any asset(s) to repay the loan; and (2) if so, whether the Obligor could sell or borrow against the asset(s) to repay the loan without suffering Severe Financial Hardship. Depending on the circumstances, an Appraisal may be necessary.

### **E. Severe Financial Hardship Relief Options**

If an analysis of the Obligor's hardship letter and financial information indicates that the Obligor would suffer Severe Financial Hardship if SBA were to enforce collection, permanent or temporary financial relief may be granted based on the following guidelines. Decisions to grant temporary financial relief should be consistent with federal debt management and collection guidelines.

#### **1. Balancing Test**

When determining what type of Severe Financial Hardship relief is appropriate, the Obligor's need for financial relief must be balanced against the Agency's interest in protecting the integrity of the Disaster Loan Program, i.e., protecting the taxpayers' interests in the Agency's ability to recover on the loan.

#### **2. Deferment**

Severe Financial Hardship may be used as grounds for providing an Obligor with temporary financial relief such as deferment of past or future payments of principal, interest or both for a stated period of time. The first deferment period should not exceed one year. At the end of the deferment period, a review of the Borrower's financial status should be conducted and a decision made to either reinstate the original payment terms or extend the deferment period. In all cases, an annual review of the Borrower's financial status must be conducted as a reminder of the Borrower's obligation to SBA. (See Chapter 13 for information on deferments.)

#### **3. Modification of Note**

Severe Financial Hardship may be used as grounds for providing temporary financial relief by modifying the repayment terms of the Note ([Secured](#), [Unsecured](#)). For example, the interest rate, payment amount, or frequency of payments may be reduced. Generally: (1) a regular payment of at least \$1.00 should be required as a reminder of the Obligor's financial obligation to SBA; (2) the payment modification period should not exceed one year; (3) at the end of one year, the original payment amount and schedule should be reinstated; and (4) an annual review should be conducted to ascertain the Obligor's current financial status and whether continued payment modification is appropriate. (See Chapter 9 for information on modification of Note.)



## Chapter 8. Servicing Requests

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This Chapter covers Borrower servicing requests made after the loan has been fully disbursed, with the exception of the followings types of requests, which are covered by [SOP 50 30](#) (*Disaster Assistance Program*): requests for loan cancellation; reinstatement of a cancelled loan; and increase in the amount of disaster loans.

### A. General Requirements

Frequently after a Disaster Loan has been disbursed, circumstances change and give rise to Borrower Servicing Requests. They can range anywhere from a simple request to change a mailing address to a complicated request involving the exchange of collateral. Regardless of the level of complexity, all Servicing Requests must be reviewed, analyzed and acted upon in accordance with prudent lending practices. When responding to a Servicing Request, the goal should be to balance the Agency's interests in: (1) achieving the goals of the Disaster Loan Program, i.e., helping victims recover from disasters; and, (2) maintaining the integrity of the Disaster Loan Program; i.e., protecting the taxpayers' interests in the Agency's ability to recover on the loan.

### B. Review and Analysis

Generally, the Loan Documents should not be modified unless there has been a material change in the Borrower's circumstances since the loan was made. The Supporting Documents and the level of analysis required to make an informed decision regarding whether the Servicing Request should be denied or approved, and if so, under what conditions, will vary depending on the circumstances. In all cases, the decision must be justified and documented in a Loan Action Record that is independent of any document prepared by a senior lienholder or any other Person with a conflict of interest. The relevant steps listed below should be followed to ensure that each Servicing Request is properly reviewed and analyzed.

#### 1. Document Receipt of the Servicing Request

All Servicing Requests must be entered in a Computer Tracking System or noted in the Loan File.

#### 2. Determine Whether there is a Conflict of Interest

Determine whether any Obligor on the loan is an SBA employee, a Close Relative of the employee or a member of their household; and if so, any request that would significantly affect that Obligor's liability must be referred to the Office of Financial Program Operations.

#### 3. Ensure that the Servicing Request is in the Proper Format

Borrower requests for modification of loan terms or conditions should be in writing. Verbal requests that are grossly lacking merit may be verbally declined provided that the request and response is recorded in the Computer Tracking System.

#### **4. Research the Applicable Loan Program Requirements**

See Chapters 9 through 15 of this SOP to find the applicable Loan Program Requirements for the Loan Actions most commonly requested by Borrowers.

#### **5. Determine Whether the Servicing Request is Properly Supported**

Servicing Requests should be accompanied by the Supporting Documents that a prudent lender would need to make an informed decision. For example:

##### **a. Disaster Home Loans**

Generally, Servicing Requests on Disaster Home Loans should be supported by the Borrower's:

- (1) Current financial statement ([SBA Form 770](#));
- (2) Pay check stubs for the past two months; and,
- (3) Federal income tax returns for the past two years.

##### **b. Disaster Business Loans**

Generally, Servicing Requests on Disaster Business Loans should be supported by the Borrower's:

- (1) Current financial statement ([SBA Form 770](#)); and,
- (2) Federal income tax returns for the past two years.

##### **c. Servicing Requests Involving Collateral**

In addition to the financial documents listed above, Servicing Requests that involve collateral, (e.g., subordination, substitution or release of lien), should also be supported by a current:

- (1) Appraisal of the relevant collateral;
- (2) Lien search, i.e., a title report if the request involves real property; a UCC search if the request involves personal property; and
- (3) Transcript of account or other credible evidence of the balance owed on any senior liens.
- (4) HUD-1 (e.g. Good Faith Estimate (GFE))

#### **6. Obtain Additional Supporting Documents When Necessary**

Obtain any additional Supporting Documentation needed to properly analyze and decide whether the Servicing Request should be approved. For example:

**a. Credit Report**

Generally, a new credit report should be ordered to verify the financial information submitted in support of the proposed Loan Action.

**b. Guarantor Financial Statements and Tax Returns**

A current financial statement, and federal income tax returns for the past two years should be required from all of the Guarantors—not just the Borrower—when a complete analysis of each Obligor’s repayment ability is necessary.

**c. Refinance, Purchase & Sale, and Other Relevant Documents**

A complete executed copy of all of the relevant documents, (e.g., purchase and sale agreement, escrow instructions, estimated closing statement [HUD-1], seller carry-back note, etc.), must be obtained if the Servicing Request involves the sale or refinance of collateral.

**Note:** (HUD-1) should be required if the Borrower's request involves the sale or refinancing of SBA collateral be certain to review the HUD-1 to ensure that proceeds of the collateral will not be disbursed to the Obligor or junior lienholders.

**d. Environmental Investigation Report**

A Servicing Request must be supported by an Environmental Investigation Report when required by Chapter 6.

**e. Evidence of Authority to Take Proposed Action**

Proper evidence should be obtained to establish that each Person whose signature is necessary had the required authority to execute the Loan Documents involved in the Servicing Request, e.g., a board of directors’ resolution if the document was signed on behalf of a corporation.

**7. Analyze the Borrower's Financial Condition**

Analyze the Borrower's financial documents to determine whether the Borrower is viable, i.e., will be able to repay the loan if the request is approved. If the Borrower is viable, proceed to Step 8. If not, the Servicing Request should be denied and more appropriate action taken. (See, for example, Chapter 7 [Severe Financial Hardship Relief] or Chapter 16 [*Classifying Loans in Liquidation*].)

**8. Analyze the Agency's Collateral Position**

If the Servicing Request will impact the collateral, a thorough collateral analysis, including any effect on the collateral's recoverable value, before and after the requested modification, should be conducted.

**9. Check for Problems**

The Loan Documents, such as the loan application and collateral documents, as well as the information in the Computer Tracking System should be reviewed to: (1) ensure that the Servicing Request is consistent with the Borrower's previous representations; and (2) ascertain whether there are any non-monetary defaults, collateral deficiencies, or problems with the Loan Documents that need correction.

## **10. Balance the Interests**

Decide whether the requested Loan Action is needed to help the Borrower recover from the disaster, and if so, balance the Borrower's need for the proposed Loan Action with the Agency's interest in maintaining the integrity of the Disaster Loan Program; i.e., protecting the taxpayers' interests in the Agency's ability to recover on the loan.

## **11. List Conditions for Approval**

### **a. Compliance with Terms and Conditions of Loan**

Approval of a Servicing Request must be conditioned on curing the defaults and correcting any collateral deficiencies or issues with the Loan Documents identified in Step 9. For example, the Borrower should be required to reinstate lapsed insurance coverage, repay any over-disbursement or duplication of benefits, and make all past-due supplemental payments based on net earnings clause.

### **b. Adequate Consideration**

In order for a change in the Loan Documents to be legally binding, the Borrower must provide consideration, (i.e., something of value), before or at the same time that the Borrower receives the benefit of the requested change. For example, as consideration for granting the Servicing Request, the Borrower could be required to:

- (1) Fix errors in the Loan Documents identified in Step 9;
- (2) Waive defenses to litigation;
- (3) Release lender liability claims; or
- (4) Provide additional collateral.

### **c. Written Consent of All Obligors**

Every effort must be made to obtain the written consent to any material change in the terms and conditions of the loan from each Obligor in order to protect the ability to recover from them in the event of default.

## **12. Comply with Applicable DOJ Decision Making, Notice and Approval Requirements**

Prior written approval must be obtained from the Department of Justice ("DOJ") (via the SBA District Counsel responsible for handling the litigation) before making any decision that impacts the collateral or liability on a loan classified in litigation and referred to DOJ.

## **13. Comply with the Applicable Recordkeeping Requirements**

In accordance with Chapter 3, the response to the Servicing Request must be noted in the Computer Tracking System or Loan File; a copy of the Loan Action Record and Supporting Documents must be kept in the Loan File; and the substance of any telephone calls or face-to-face meetings regarding the Servicing Request must be documented in the Loan File or entered into a Computer Tracking System.

## **C. Required Documentation**

### **1. Written Request**

Servicing requests should be in writing. When SBA personnel review the request, their analysis should consider the following:

- a. A brief description of the proposed Loan Action;
- b. The amount funded, date of funding, current balance and status of the loan;
- c. The current financial condition of the Borrower;
- d. The justification for the proposed Loan Action, i.e., benefit to the Borrower and SBA—neither abundance nor lack of collateral alone is sufficient justification for a Loan Action;
- e. Whether the proposed Loan Action will increase the risk of loss, and if so, any mitigating factor, e.g., the value of SBA's collateral will be increased, or the Borrower's business performance will be improved;
- f. If the proposed Loan Action will impact the collateral, a summary of prior Loan Actions impacting the collateral and an analysis of the Recoverable Value of the collateral both before and after the proposed Loan Action;
- g. A summary of prior servicing experience with the Borrower, i.e., loan modifications or problems pertinent to the request; and
- h. A list of the Obligors and a statement as to whether their consent has been or will be obtained for the proposed Loan Action.

## **D. Implementing Loan Actions**

Loan Actions must be implemented in accordance with prudent lending practices, for example, it may be necessary to:

### **1. Modify Existing Loan Documents**

If the Loan Action modifies the terms and conditions of the Note ([Secured](#), [Unsecured](#)) or any other Loan Document, each impacted Loan Document must be properly modified;

### **2. Prepare New Loan Documents**

#### **Collateral Documents**

Any new Loan Document needed to implement the Loan Action (e.g., a deed of trust or a security agreement needed to obtain a lien on substitute or additional collateral) must be properly prepared and executed by the appropriate parties. On business loans this includes obtaining any necessary board of director resolution or other evidence of a legal entity's authority to execute the new Loan Documents.

### **3. Record New or Modified Loan Documents**

Whenever necessary, reasonable or customary, new or modified Loan Documents must be properly recorded.

#### **E. Borrower' Requests for Reconsideration**

Requests from Obligors for reconsideration of an Agency decision regarding a Servicing Request should be entertained only if the Obligor has provided relevant new facts. Valid requests for reconsideration should be processed in the same manner as the original request. Requests that are not supported by new facts may be verbally denied without processing a Loan Action Record provided that appropriate comments are added to the Computer Tracking System.

## Chapter 9. Modification of Note

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### A. General Requirements

Requests for modification of the repayment terms of the Note should be reviewed, analyzed and implemented pursuant to the requirements of Chapter 8, and the provisions of the applicable statutes, regulations and contracts, including the Note.

Written Consent of All Obligors - Every effort must be made to obtain the written consent to any material change in the terms and conditions of the loan from each Obligor in order to protect the ability to recover from them in the event of default.

### B. Payment Due Date

The payment due date on the Note ([Secured](#), [Unsecured](#)) may be changed to facilitate the Borrower's ability to repay the loan. For example, payments originally scheduled to be made on the first of the month, may be scheduled for the 15<sup>th</sup> of the month. Similarly, payments originally scheduled to be made on a monthly basis, may be changed to a quarterly or annual basis if there is justification for the change such as the seasonal or cyclical nature of the Borrower's revenue stream, provided that the modification does not negatively impact the amount of principal reduction.

### C. Payment Amount

#### 1. Temporary Reduction

The amount of the payment required by the Note ([Secured](#), [Unsecured](#)) may be temporarily reduced to a fixed amount for a specified period of time, if the general requirements in Paragraph A and the following requirements are met:

- a. The reduction should generally be for no longer than 12 months;
- b. The reduced monthly payment is enough to cover accruing interest; and
- c. The Borrower is advised that the reduction will create a balloon payment that will be due at the end of the loan term.

#### 2. Permanent Reduction

The amount of the payment required by the Note ([Secured](#), [Unsecured](#)) may be permanently reduced to a fixed amount, if the general requirements in Paragraph A and the following requirements are met:

- a. The Borrower has established the need for relief based on Severe Financial Hardship as set out in Chapter 7 (*Severe Financial Hardship Relief*); and
- b. The loan is re-amortized to ensure that the reduced monthly payment is enough to pay the loan in full within 30 years of the date of the original Note.

#### D. Interest Rate

The interest rate specified in the Note ([Secured](#), [Unsecured](#)) may be modified if the general requirements in Paragraph A and when Severe Financial Hardship has been established pursuant to Chapter 7, the interest rate on a Disaster Loan may be reduced, provided that the Note and other affected Loan Documents, if any, are properly modified.

#### E. Maturity Date

A disaster loan may be made for a period not exceeding 30 years, except that the maturity date may be extended as provided below:

1. For loans with maturities of 20 years or less, the maturity date of a disaster loan may be extended as follows:

(a) For a period not to exceed 5 years if:

(i) The borrower under such loan is a homeowner or a small business concern (and not a renter, a non-profit entity, or a large business); and

(ii) The loan was made to enable:

(A) the homeowner to repair or replace his home, or

(B) the small business concern to repair or replace plant or equipment which was damaged or destroyed as the result of a disaster; and

(C) SBA determines such action is necessary to avoid severe financial hardship, and

(b) For a period not to exceed 10 years if such extension will aid in the orderly liquidation of such loan.

2. For loans with maturities of more than 20 years, the maturity date of a disaster loan may be extended under the criteria described in ¶ 1(a) above only.

#### F. Loan Amount

##### 1. Increase

The amount of a Disaster Loan may only be increased in accordance with the Loan Program Requirements set out in [SOP 50 30](#) (*Disaster Assistance Program*).

##### 2. Decrease

The amount of a fully disbursed Disaster Loan cannot be decreased.

**Note:** The amount owed on a fully disbursed Disaster Loan (as opposed to the amount of the loan) may, in some instances, be increased through the addition of Recoverable Expenses to the principal loan balance. See Chapter 23 for information on Recoverable Expenses and when they may be added to principal. The amount owed on a fully disbursed Disaster Loan (as opposed to the amount of the loan) may, in some instances, be reduced through a compromise agreement. See Chapter 21 for information on offers in compromise.



## Chapter 10. Modification of Collateral Requirements

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### A. Subordination of Lien Position

#### 1. General Requirements

Requests for subordination should be reviewed, analyzed and implemented pursuant to the requirements of Chapter 8 and the following guidelines:

- a. The Borrower's Servicing Request must include the reason for the subordination and a description of how the new money will be used;
- b. The requested subordination should be necessary to:
  - 1) Provide temporary Severe Financial Hardship relief (See Chapter 7);
  - 2) Refinance an existing loan secured by a senior lien on terms that are more favorable terms for the Borrower; or
  - 3) Pay for necessary repairs or improvements to the collateral, which are required in order to preserve its value. Substantial upgrades are not in keeping with the purpose of the Disaster Loan Program and should not be allowed.
- c. The loan should be current;
- d. The loan should be Seasoned;
- e. The Borrower should have a satisfactory credit history;
- f. No cash out of the equity in the collateral should go the Borrower unless the Borrower pays down the Disaster Loan in substantial part or the purpose of the subordination is to provide temporary Severe Financial Hardship relief in accordance with Chapter 7;
- g. There should be sufficient equity in the collateral to adequately secure the Disaster Loan after the proposed subordination;
- h. The Borrower should have the ability to repay all of the obligations (according to the terms of the loan agreements), which would be outstanding after the proposed subordination;
- i. The subordination should be limited to a specific amount and should not extend to future advances; and
- j. The terms of the transaction must be set out in a properly executed subordination agreement.

## 2. Subordination to Facilitate Refinance of a Senior Loan – No Cash out

In addition to the general requirements in Paragraph A.1, the position of a lien securing a Disaster Loan should not be subordinated to facilitate the refinance of an existing senior loan unless:

- a. The refinancing is on terms that are more favorable to the Borrower;
- b. There is no increase in the principal balance of the loan secured by the senior lien except for necessary, reasonable and customary closing costs;
- c. The subordination will not otherwise adversely affect the priority of the lien securing the Disaster loan. For example, intervening junior lienholders, if any, must not be able to claim priority over the lien securing the Disaster Loan as a result of the subordination.

**Note:** When analyzing a request for subordination to facilitate the refinance of a senior loan, a complete financial analysis may not be necessary if the Borrower has been making timely payments and the refinance terms are more favorable for the Borrower.

## 3. Subordination to Facilitate Refinance of a Senior Loan – Cash out

In addition to the general requirements in Paragraph A.1, the position of a lien securing a Disaster Loan should not be subordinated to facilitate the refinance of an existing senior loan unless:

- a. The refinancing is on terms that are more favorable to the Borrower;
- b. There is no increase in the principal balance of the loan secured by the senior lien except for necessary, reasonable and customary closing costs;
- c. The subordination will not otherwise adversely affect the priority of the lien securing the Disaster loan. For example, intervening junior lienholders, if any, must not be able to claim priority over the lien securing the Disaster Loan as a result of the subordination.
- d. All other avenues of obtaining the funds have been exhausted; and
- e. If the Borrower is financially sound and has fully recovered from the disaster, the Borrower pays down the Disaster Loan balance by 50% or more if the size of the new loan is substantial.

## 4. Subordination to Facilitate a Short-term Working Capital Loan

Under rare circumstances, the priority position of a lien securing a Business Disaster 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. (See Chapter 17 for information on workouts.)

## B. Inter-creditor Agreements

Requests for execution of an inter-creditor agreement, (i.e., an agreement among creditors who made separate loans to the same borrower with commonality of purpose or collateral, which sets forth the various lien positions and the rights and liabilities of each creditor and its impact on the other creditors), should be reviewed, analyzed and implemented pursuant to the requirements of Chapter 8 and the following guidelines:

1. The inter-creditor agreement should not adversely impact the position of the lien securing the Disaster Loan;
2. The delineated rights and responsibilities with regard to loan servicing responsibilities, and the remedies in the event of default, should be consistent with prudent lending practices; and
3. Entering into the inter-creditor agreement should not adversely impact the ability to recover on the Disaster Loan.

## C. Substitution of Collateral

Requests to allow a substitution of collateral, including substitution of a residence held as collateral, should be reviewed, analyzed and implemented pursuant to the requirements of Chapter 8 and the following requirements and guidelines:

1. The substitution should be needed to achieve the Agency mission of helping the Borrower recover from the disaster, e.g., the disaster damaged collateral will be sold and a new collateral will be purchased.
2. The collateral offered in substitution should be similar in nature (e.g., real property for real property) or provide a higher level of confidence (e.g., a certificate of deposit for an account receivable), and the amount of equity in the substitute collateral available to secure the Disaster Loan should be the same or greater than the amount of equity available in the existing collateral.
3. If the substitute collateral is commercial real property, due diligence, as required by Chapter 6 (*Environmental Risk Management*), must be conducted to ensure that the risks of Contamination are minimal;
4. The Borrower should have a satisfactory credit history;
5. The Borrower's current financial statement should reflect that the Borrower has the ability to pay all of its obligations that will be outstanding after the substitution;
6. All of the proceeds from the sale of the existing collateral, other than the funds needed to pay off senior liens and necessary, reasonable and customary closing costs, should be used to purchase the new collateral or to pay down the Disaster Loan unless the purpose of the substitution is to provide temporary Severe Financial Hardship Relief in accordance with Chapter 7;
7. The release and substitution must not impair the ability to foreclose upon the remainder of the collateral or collect the loan balance from the Obligors;

8. The release of the existing lien(s) or proceeds thereof must be done after or concurrent with the recording of the new lien(s) in the required position of priority and done pursuant to an escrow agreement signed by all of the parties involved in the transaction; and
9. The Obligor(s) must comply with the Loan Program Requirements set out in [SOP 50 30](#) (*Disaster Assistance Program*) with regard to title insurance, hazard insurance, and flood insurance coverage on the substitute collateral.

#### **D. Substitution of Guarantor**

##### **1. General Requirements**

Requests to allow substitution of a Guarantor should be reviewed, analyzed and implemented pursuant to the requirements of Chapter 8 and the following guidelines:

- a. The loan must be Seasoned;
- b. The financial strength of the proposed substitute Guarantor should be equal to or greater than the financial strength of the existing Obligor;
- c. The loan must be current or be brought current before the substitution of Guarantor takes place; and
- d. With regard to Disaster Business Loans, neither the release of the existing Guarantor nor the substitution for the proposed Guarantor should adversely impact the operation of the business.

##### **2. Condition – Temporary Retention of Original Guarantor**

With regard to Disaster Business Loans, substitution of the proposed Guarantor may be conditioned on retention of the original Guarantor for a transitional period (e.g., two years) during which time there must be no material adverse change in the financial condition of the business.

#### **E. Release of Lien without Consideration**

Requests for the release of liens on real or personal property collateral without consideration before the loan has been paid in full should be reviewed, analyzed and implemented pursuant to Chapter 8 and the following guidelines and requirements:

1. The loan must be Seasoned;
2. The Borrower must have the ability to repay the SBA loan in full in accordance with the terms of the Note;
3. The Recoverable Value of the remaining collateral should be sufficient to adequately secure the Disaster Loan after the proposed release;
4. The release document(s) must not impair SBA's interest in, or ability to foreclose upon, the remainder of the collateral; and

5. The release must not occur during the pendency of a senior lienholder foreclosure action on the collateral (Chapter 14) unless the release is in connection with a short sale approved in accordance with Chapter 18.

## F. Release of Lien for Consideration

Requests for the release of liens on real or personal property collateral for consideration should be reviewed, analyzed and implemented pursuant to the requirements of Chapter 8 and the following requirements:

### 1. General Requirements

- a. The Obligor requesting the release must disclose the source of the funds to be paid to SBA for the release, which must not conflict with the information the Obligor provided to SBA to establish eligibility for the Disaster Loan;
- b. The amount of consideration received must be approximately equal to or greater than the Recoverable Value of the collateral, (See Chapter 6 [*Environmental Risk Management*] with regard to the due diligence that must be performed if the collateral is alleged to be worth substantially less than its estimated Recoverable Value due to the alleged presence of Contamination.);
- c. The release must not impair SBA's interest in or ability to foreclose upon the remaining collateral, or otherwise jeopardize SBA's ability to maximize recovery on the loan;
- d. The release must not occur during the pendency of a senior lienholder foreclosure action on the collateral (Chapter 14) unless the release is in connection with a short sale approved in accordance with Chapter 18;
- e. Duplication of benefits must not occur as a result of releasing SBA's lien. (For example, when SBA has a lien on both the Borrower's disaster damaged residence and new residence and the Borrower asks SBA to release its lien on the damaged residence so that it can be sold, all of the net proceeds from the sale of a Borrower's disaster damaged residence must be applied to the Disaster Loan in inverse order of maturity in order to avoid duplication of benefits.); and
- f. The funds received as consideration for the release of lien, including liens on unimproved real property, must be applied to the principal balance of the loan.

## G. Release of Guarantor or Co-Borrower

A request for release of a co-Borrower or to release or limit the liability of a Guarantor should be reviewed, analyzed and implemented pursuant to Chapter 8 and the following requirements:

### 1. Loans in Regular Servicing Status

- a. The loan must be Seasoned;

- b. An analysis of the relevant financial statements must indicate that the co-Borrower or Guarantor is no longer necessary; or that reducing the Guarantor's liability to a limited amount—rather than releasing the Guarantor, is reasonable based on the circumstances;
- c. The release must not conflict with SBA Loan Program Requirements, such as those found in [13 C.F.R. Part 123](#) and [SOP 50 30](#) (*Disaster Assistance Program*) that require Guaranties from specific Persons (e.g., any Person who owns 20 per cent or more of a small business Borrower) as a condition for SBA financing; and
- d. The release must not jeopardize the ability to maximize recovery on the loan; shift the risk of loss to SBA; or otherwise harm the integrity of the SBA loan program.
- e. The release should be conditioned on receipt of consideration in an amount approximately equal to or greater than the amount that could be collected through enforced collection proceedings from the Guarantor or co-Borrower requesting the release.

## 2. Loans in Liquidation Status

- a. The release should be conditioned on receipt of consideration in an amount approximately equal to or greater than the amount that could be collected through enforced collection proceedings from the Guarantor or co-Borrower requesting the release;
- b. The Guarantor or co-Borrower requesting the release should be required to provide the same documentation that is required for an offer in compromise;
- c. The request for release and accompanying documentation should be reviewed, verified and analyzed pursuant to the requirements of Chapter 21 (*Offer in Compromise*); and
- d. The funds received as consideration for the release must be applied to the principal balance of the loan.

**Note:** Obligors cannot be released without prior written approval from DOJ and the SBA District Counsel responsible for handling the litigation **if the loan is involved in litigation referred to the Department of Justice (“DOJ”)**.

## H. Release of Condemnation Proceeds

Requests for release of condemnation proceeds should be reviewed, analyzed and implemented pursuant to the requirements of Chapter 8 and the following guidelines:

### 1. Costs Payable from Condemnation Proceeds

#### a. Attorney Fees and Costs

Reasonable, necessary and customary attorney fees and costs incurred to obtain fair compensation for the condemned property may be paid from the condemnation proceeds.

**b. Repairs Required as Result of Partial Taking**

When only a portion of the Borrower's property is condemned, the necessary, reasonable and customary cost of repairs or modifications to the remaining property needed as a direct result of the partial taking may be paid from the condemnation proceeds. (E.g., driveway or parking lot repairs needed after a partial taking for a road widening project.)

**2. Condemned Property Replaced**

When the net condemnation proceeds (i.e., amount remaining after the deductions authorized by Subparagraph 1) will be used to replace the condemned property, they should only be released pursuant to an escrow agreement approved by legal counsel that conditions release of the funds on:

- a. Receipt of a perfected lien on the substitute collateral in the required lien position; and
- b. Compliance with the title, hazard and flood insurance requirements set out in Chapter 11.

**3. Condemned Property Not Replaced**

When the net condemnation proceeds (i.e., amount remaining after the deductions authorized by Subparagraph 1) will not be used to replace the condemned property:

- a. Condemnation Proceeds  $\leq$  \$5,000

If the amount of condemnation proceeds is relatively insignificant, i.e., \$5,000 or less, and the release will not adversely affect the ability to recover on the Disaster Loan, they may be released directly to the Borrower.

- b. Condemnation Proceeds  $>$  \$5,000

If the amount of condemnation proceeds is more than \$5,000, they should be applied to the principal balance of the Disaster Loan, and up to \$5,000 may be released directly to the Borrower if the release will not adversely affect the ability to recover on the Disaster Loan.



## Chapter 11. Insurance Coverage

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### A. General Requirements

Servicing Requests to modify the requirements in the Loan Authorization pertaining to insurance should be reviewed and analyzed in accordance with the requirements in Chapter 8 and those set out below.

#### 1. No Duplication of Benefits

Servicing and liquidation actions on Disaster Loans must not result in a duplication of benefits (“DOB”) to the disaster victim.

**Note:** Various forms of assistance and programs (e.g., flood insurance, disaster repair grants, loans, etc.) help people whose properties have been damaged by natural disasters to rebuild and relocate. By law, (e.g., [44 C.F.R. § 206.191](#)), federal assistance cannot duplicate the benefits provided by other sources. Consequently, if property owners have already received assistance to repair their properties from one program, the other program must ensure they don't provide assistance to cover the same loss.

#### 2. Proper Documentation

All decisions regarding insurance, including the justification for the each decision, must be documented in a Loan Action Record and kept in the Loan File.

### B. Mortgagee's Title Insurance

#### 1. Substitute Collateral

When existing real property collateral is released and substitute real property collateral taken, a mortgagee's title policy insuring the lien on the substitute real property collateral should be obtained if a mortgagee's title insurance policy was required by [SOP 50 30](#) (*Disaster Assistance Program*) for the original real property collateral. (See Chapter 10 for information on substitution of collateral.)

#### 2. Additional Collateral

When real property collateral is taken as additional collateral, whether a mortgagee's title insurance policy should be obtained will vary depending on the circumstances including the amount of equity available in the property to secure the Disaster Loan.

#### 3. Installment Sale of REO

When REO is sold on an installment basis, a mortgagee's title insurance policy must be obtained to insure the purchase money lien on the REO. (See Chapter 20 for information on term sales of acquired collateral.)

## C. Hazard Insurance

### 1. Events Triggering Review of Coverage Amount

The adequacy of the Borrower's hazard insurance coverage should be reviewed whenever the Borrower requests a serving action such as an increase in the loan amount, an extension of the maturity date, or reinstatement of the maturity date.

### 2. Modification of Coverage on Existing Collateral

Generally, the hazard insurance coverage requirements set out in the Loan Authorization should not be terminated or reduced unless the insured assets have been sold or have substantially depreciated.

### 3. Coverage on Substitute or Additional Collateral

When existing collateral is released and substitute collateral taken, the substitute collateral should be insured and the insurance policies should contain a mortgagee clause, or substantial equivalent, in favor of SBA in accordance with the Loan Program Requirements in [SOP 50 30](#) (*Disaster Assistance Program*). (See Chapter 10 for information on substitution of collateral.)

### 4. Coverage on Acquired Collateral

Generally, SBA self-insures. However, prudent action must be taken, on a case-by-case basis, to ensure that all acquired collateral with unusually high Recoverable Value is adequately insured in order to protect the ability to recover on the Disaster Loan.

### 5. Forced Placement

If hazard insurance is required by the Loan Documents and the Obligor has allowed the coverage to lapse, the decision whether to force-place insurance should be based on prudent lending practices and made on a case-by-case basis. If coverage is continued by SBA, the cost should be treated as a Recoverable Expense.

### 6. Release of Policy Proceeds

#### a. General Rule—Collateral Repaired or Replaced

When SBA is named as a loss payee on a hazard insurance policy, the proceeds should not be released unless the Supporting Documentation submitted with the request verifies that the insured collateral has been properly repaired or replaced and that no construction or repair related liens have been filed against the property, particularly if the insurance check is for \$100,000 or more.

Reminder—No Duplication of Benefits: See Paragraph A.1, which prohibits any Loan Action that would result in the duplication of benefits to the disaster victim.

#### b. Exception—Controlled Distribution

- (1) If a request for release of insurance proceeds is not accompanied by Supporting Documentation establishing that the insured collateral was repaired or replaced, instead of endorsing and delivering the insurance check to the Borrower, disbursement of the insurance proceeds should be controlled and monitored.
- (2) Generally, insurance proceeds, which are required to be used to repair or replace collateral, should be disbursed pursuant to an escrow agreement approved by SBA legal counsel. An escrow company, the first lien holder or an impartial third party such as an attorney, architect or construction loan officer at a financial institution may serve as the escrow agent.

## D. Flood Insurance

### 1. General Rule—Termination or Modification Not Permitted

When a Disaster Loan is secured by improved real estate, manufactured housing or other personal property located in a FEMA-designated special flood hazard area ("SFHA") and the community participates in the National Flood Insurance Program ("NFIP"), the Borrower must maintain flood insurance for the life of the loan. (See the [National Flood Insurance Reform Act of 1994](#) for more information.) This requirement pertains to substitute collateral as well as the original collateral for the loan.

### 2. Events Triggering Flood Insurance Review

The need for flood insurance, as well as the adequacy of any existing flood insurance coverage, should be reviewed whenever the Borrower requests a servicing action. Use of [FEMA Form 81-93 \(Standard Flood Hazard Determination Form\)](#) is required and a copy must be retained in the Loan File.

### 3. Forced Placement

If at any time during the life of a loan, real or personal property collateral, which is located in a SFHA, is not covered by flood insurance or is covered by an inadequate amount of flood insurance, the Borrower must be instructed to obtain adequate flood insurance. If the Borrower fails to do so within 45 calendar days, flood insurance must be purchased on the Borrower's behalf at the Borrower's expense. (The cost should be treated as a Recoverable Expense.) All Borrower Servicing Requests should be declined until the Borrower is in compliance with the applicable flood insurance requirements. (See the National Flood Insurance Reform Act of 1994 for more information.)

### 4. Unavailability of Flood Insurance

If a Borrower had the required flood insurance when the loan was made, but the coverage has lapsed because the community dropped out of the NFIP, documentation establishing why the property is no longer covered by flood insurance must be maintained in the Loan File.



## Chapter 12. Assumption or Sale of Loan

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### A. Assumption

Requests to allow another Person to assume a Disaster Loan, (i.e., take over the Borrower's legal obligations and benefits under the Loan Documents), should be reviewed, analyzed and implemented pursuant to the requirements in Chapter 8. In addition:

1. The assumption must be necessary to ensure repayment of the loan after a material change in circumstances, for example:
  - a. The assumption is necessary to ensure that a new legal entity formed by a Disaster Business Loan Borrower will be liable for the loan if the Borrower changes the form of the legal entity under which it does business (e.g., LLC to corporation);
  - b. The assumption is part of a plan for providing Severe Financial Hardship relief pursuant to Chapter 7; or
  - c. The assumption is needed to implement a workout plan on a loan in liquidation status.
2. The proposed assumpor must have a satisfactory credit history;
3. The proposed assumpor must have the ability to repay the Disaster Loan in full;
4. No collateral should be released;
5. No collateral should be subordinated except as provided in Chapter 10, Paragraph A with regard to funds that will be used to make improvements to the collateral that will maintain or increase its value;
6. The proposed assumption must not have a negative impact on the Recoverable Value of the collateral;
7. The existing collateral should be adequate to secure the loan; if not and whenever possible, additional collateral should be required as a condition for the assumption;
8. Existing Obligors must not be released without SBA's prior written approval;
9. The terms of the assumption must be set out in a written agreement signed by all of the parties to the agreement;
10. The assumption agreement must include a "due on sale or death" clause that prohibits any future assumption of the SBA loan;
11. The terms of the assumption must not include a real estate contract, i.e., the seller may not retain title to the property until an agreed upon amount is paid; and
12. With regard to Disaster Business Loans:

- a. The proposed assumptor should be the primary owner of the business; and
- b. The proposed assumptor should have business experience and management skills that are equal to or better than the Borrower's; and
- c. The proposed assumption should not have a negative impact on the operation of the business;

13. With regard to Disaster Home Loans:

- a. The proposed assumptor must be a prospective purchaser of the residence; and
- b. Must inhabit the property as their primary residence.

**B. Sale of Disaster Loan**

Servicing Requests involving the purchase and sale of a Disaster Loan should be reviewed, analyzed and implemented pursuant to the requirements in Chapter 8, and meet the following requirements:

1. The loan must be in liquidation status;
2. The sale must be an arms-length transaction to a Person other than the Borrower; and
3. The sales price must bear a reasonable relationship to the amount that could be recovered through enforced collection proceedings in a reasonable amount of time.

## Chapter 13. Deferments

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### A. Overview

A deferment is a temporary solution to a temporary problem. When used appropriately, i.e., when a Borrower is experiencing a temporary cash flow problem, a deferment can enable the Borrower to improve its cash flow so that it can resume payments on its Disaster Loan. When used inappropriately, i.e., when the Borrower's problems are permanent, a deferment can harm the Borrower and SBA. Especially if, for example, during the deferment period, the collateral loses its value and the Obligor deplete all of their resources.

**Note:** With regard to Disaster Business Loans, free, confidential technical and management counseling is available to small businesses through the nationwide network of [SCORE Chapters](#) and [Small Business Development Centers](#), [Women's Business Centers](#) and [Veterans Business Outreach Centers](#).

### B. General Rule

If the Borrower's cash flow problem is temporary, delinquent payments, as well as full or partial future monthly payments, may be deferred (i.e., postponed without classifying the loan in liquidation) for a stated period of time in order to enable the Borrower to get past the temporary setback.

**Note:** Payments should not be deferred solely because a Borrower has entered the military service. The determination as to whether a deferment is appropriate must be made on a case-by-case basis pursuant to the requirements in this chapter. Consult legal counsel for questions regarding the *Servicemembers Civil Relief Act*.

### C. General Requirements

Prior to granting a deferment, the following documents must be obtained, reviewed and analyzed in order to determine whether the Borrower's cash flow problem is temporary, i.e., whether the Borrower will be able to overcome the cause of its cash flow problem, and be able to make regular payments at the end of the proposed deferment period.

#### 1. Statement Documenting Temporary Nature of Cash Flow Problem

A written statement from the Borrower outlining the reason(s) for their cash flow problem, as well as the reason(s) why the Borrower believes that it is a short-term, rather than a long-term, problem.

**Note:** If the loan is more than 90 calendar days past due and the Borrower's problems appear to be permanent or long-term, more appropriate Loan Action should be taken such as charge-off and Treasury referral, or liquidation of the collateral. (See Chapters 15 and 16.)

## 2. Current Financial Information

The Borrower must provide current financial information, as required by Subparagraphs a and b below, unless the request for a deferment is in response to a new disaster or based on other extraordinary circumstances, such as a fire that destroyed or significantly damaged the Borrower's home or business premises; or the Borrower provided a reasonable written explanation for the temporary financial difficulty and has not previously been granted a deferment or reduction of the Disaster Loan payment amount.

### a. Disaster Home Loans

A current financial statement, preferably on [SBA Form 770](#) (*Financial Statement of Debtor*), which should be signed under penalty of perjury and must show the Borrower's assets, liabilities, income and expenses.

### b. Disaster Business Loans

#### (1) Financial Statement

- (a) A current financial statement, preferably on [SBA Form 770](#) (*Financial Statement of Debtor*), which should be signed under penalty of perjury and must show the Borrower's assets, liabilities, income and expenses;
- (b) The Borrower's last year-end financial statement; and
- (c) If the Borrower has any affiliates, a current consolidated financial statement;

#### (2) Business Federal Income Tax Returns

A complete copy of the Borrower and each affiliate's business federal income tax return that was filed with the IRS for the past two years or a written explanation as to why a copy is not available; and

#### (3) Personal Federal Income Tax Returns

A complete copy of the personal federal income tax returns each Guarantor filed with the IRS for the past two years or a written explanation as to why a copy is not available.

**Note:** Obtaining current financial information at this stage is critical. It is not only needed to make a prudent lending decision regarding the appropriateness of a deferment, but provides valuable information that will be difficult to obtain in the event enforced collection becomes necessary.

## D. Deferred Amount

### 1. Number of Monthly Payments Per Deferment

Generally, the amount deferred at one time should not exceed six cumulative monthly payments, but when justified, up to 12 cumulative monthly payments may be deferred at one time.

## 2. Number of Deferments Per Life of Loan

Generally, Borrowers should not be given more than one deferment. Additional deferments may, however, be granted when justified and documented in the Loan File. Generally, no more than a total of five years of payments should be deferred over the life of the loan.

### E. Loan Payments During Deferment Period

Although the full amount of each monthly payment may be deferred if justified, partial payments should be required if the Borrower is able to make them. The amount of any partial payment required during the deferment period must be based on the Borrower's ability to pay as documented by the financial analysis required by Paragraph B above.

### F. Interest Accrual

Interest continues to accrue during a deferment period. Generally, at the end of the deferment period, when payments resume, the funds will be applied to accrued interest before principal. (See Chapter 5.)

Note: If the delinquent Borrower is in active military service, consult legal counsel or SBA's Office of Veterans Business Development for information regarding the [Servicemembers Civil Relief Act](#) and the [Veterans Entrepreneurship and Small Business Development Act](#).

### G. Procedure When Delinquency Can Not Be Cured

As provided in Chapter 15, when a Disaster Loan is more than 90 days past due and there is no prospect of bringing it current, e.g., through a deferment or workout:

1. Loans that are secured by collateral other than household goods with a balance greater than \$25,000 should be sent to the NDLRC for liquidation; and
2. All other loans should be charged-off and referred to Treasury for offset and cross-servicing if the balance is legally collectible.

**Note:** See Chapter 25 for information on charge-off and referral to Treasury.



## **Chapter 14. Delinquent Senior Liens**

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### **A. General Requirements**

Time is of the essence when a secured senior loan becomes delinquent because statute-specific and agreement-specific deadlines must be met, senior lienholders may impose Default Charges and initiate foreclosure actions, and collateral values can rapidly deteriorate. Therefore, whenever notice of default or foreclosure is received from a senior lienholder:

#### **1. Enforce Lienholder Agreements**

The notice and subordination requirements in any lienholder agreement executed by the senior lender must be enforced to mitigate the risk of loss on the loan.

#### **2. Mitigate the Loss to SBA**

##### **a. Do Not Release the Lien Securing the Disaster Loan**

After receipt of notice of a senior lienholder foreclosure sale, even if a “no bid” position is justified, the lien securing the Disaster Loan must not be released prior to the foreclosure sale unless the request is in conjunction with an arms-length short sale that meets all of the applicable requirements in Chapter 18. (Release of lien not only eliminates SBA’s right to redeem the property in the event it sells for less than anticipated, it eliminates SBA’s right to receive consideration for release of its redemption rights. It also eliminates SBA’s right to collect the excess proceeds from the foreclosure sale in the event the collateral sells for more than the amount owed on the senior lien.)

##### **b. Protect the Equity Available for the Disaster Loan**

Swift, prudent, commercially reasonable action must be taken to prevent elimination of the lien securing the Disaster Loan or dissipation of the equity available to secure it.

#### **3. Monitor Senior Lienholder’s Foreclosure Proceedings**

Whenever a senior lienholder initiates a foreclosure action, the foreclosure proceedings, including the sale, should be closely monitored.

#### **4. Report the Sale**

A report describing all of the relevant facts concerning the sale, including those listed below, should be prepared along with the details of a plan that addresses how the collateral will be sold if it was acquired (Chapter 20) or how the loss will be mitigated if it was not acquired. (Subparagraphs d-g below).

##### **a. Sale date;**

- b. Amount the collateral sold for;
- c. Purchaser's name and contact information;
- d. Amount of unsubordinated debt owed to senior lienholder on the sale date;
- e. Estimated market value of the foreclosed-upon collateral.
- f. Amount of surplus sale proceeds available junior lienholders;
- g. Whether SBA has redemption rights, and if so, the last day to exercise them; and
- h. The impact of the foreclosure sale on the lien position of any other common collateral.

## **B. Best Strategy to Protect Junior Disaster Loan Lien**

When it is apparent that an Obligor is in default on a loan secured by a senior lien on the collateral for a Disaster Loan, steps should be taken to develop a prudent and commercially reasonable strategy for protecting the equity available for application to the Disaster Loan.

## **C. Judicial Foreclosures**

If a senior lienholder initiates a judicial foreclosure action, the legal counsel responsible for handling the litigation should be notified immediately and instructed to take whatever legal action is necessary, reasonable and customary under the circumstances. For example, in addition to, or in lieu of, any of the other options listed in this chapter, legal counsel may:

1. File a disclaimer or an answer;
2. Foreclose the lien securing the Disaster Loan in the same action; or
3. Cross-claim for judgment against the Obligors.

**Note:** If the loan has been referred to DOJ, legal counsel is responsible for managing the litigation in coordination with the local U.S. Attorney's Office, which has final decision-making authority with regard to litigation strategy, credit matters and settlements.

## **D. Protective Bids**

### **1. When to Enter**

A Protective Bid should be entered at a senior lienholder's foreclosure sale if the Recoverable Value is determined to be sufficient or prudent lending practices would advise entering a Protective Bid based on the circumstances that are not reflected in the Appraisal, but are documented in the loan file. A Protective Bid decision should be fully documented in the Loan file.

### **2. Protective Bid Amount**

**a. Maximum Amount**

The maximum amount of a Protective Bid should be the lesser of the balance owed on the Disaster Loan or the Recoverable Value of the collateral.

**b. Tolerance Range**

The amount of a Protective Bid should include a "tolerance range," (i.e., a percentage by which the authorized bidder is allowed to increase or decrease the amount of the Protective Bid depending on unanticipated events at the foreclosure sale).

**c. Impact on Ability to Collect Deficiency**

Because state laws vary, legal counsel should be consulted prior to entering a Protective Bid to ascertain the impact, if any, the Protective Bid amount may have on the ability to collect the deficiency, if any, owed on the loan balance after the bid is entered.

**E. "No Bid" Position**

**1. When a "No Bid" Position is Appropriate**

A "no bid" position at a senior lienholder's foreclosure sale is appropriate when there is justification for abandoning the collateral being foreclosed upon. Per prudent lending practices, a "no bid" position may also be justified based on circumstances, which are not reflected in the Appraisal but are documented in the Loan File. A No Bid decision should be fully documented in the Loan file.

**2. Failure to Conduct an Environmental Investigation**

Failure to conduct the Environmental Investigation required by Chapter 6 does not justify taking a "no bid" position when there is equity that should be protected. In emergency situations, prudent judgment must be exercised and the best possible due diligence under the circumstances must be conducted in order to avoid unnecessary loss.

**F. Redemption Rights**

While under federal law, SBA has one year from the date of a judicial foreclosure sale to redeem, i.e., buy back, the foreclosed-upon property ([28 U.S.C. § 2410\(c\)](#)). Under state law, the redemption rights associated with a Disaster Loan generally stem from SBA's status as a junior lienholder. Whether junior lienholders have redemption rights varies by state. Consult legal counsel for case specific information and advice.

**1. When Redemption is Appropriate**

The redemption rights on a Disaster Loan should be exercised whenever redeeming the property would be prudent and commercially reasonable. For example, redeeming the foreclosed-upon property would be appropriate if it sold for significantly less than market value at the senior lienholder's foreclosure sale and redeeming (i.e., acquiring) the property and reselling it would maximize recovery on the loan.

## **2. Release for Consideration**

If redemption rights are available under federal or state law but it would not be prudent or commercially reasonable to redeem the foreclosed-upon property, the redemption rights associated with the Disaster Loan may be released upon receipt of cash in a lump sum equivalent to 50% of the property's Recoverable Value, but only after the senior lienholder's foreclosure sale has been confirmed.

## **G. Excess Proceeds from Senior Lien Foreclosure Sales**

Generally, as a matter of law, surplus funds generated by a foreclosure sale are paid to the junior secured creditors in accordance with the priority of their liens against the property. Therefore, the following requirements apply whenever the property is not acquired via a Protective Bid at a senior lienholder's foreclosure sale:

- 1. Ascertain Whether There are Surplus Funds Available for Junior Lienholders**
- 2. Collect Subordinated Funds Improperly Held by the Senior Lienholder**
- 3. Collect Excess Sale Proceeds Deposited with the Clerk of the Court**

Promptly claim and collect any surplus funds deposited with the clerk of the court (or other Person) that are available for application to the Disaster Loan balance by virtue of the position of the lien securing the Disaster Loan.

## **Chapter 15. Delinquent Loan Servicing**

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### **A. General Requirements**

#### **1. Verify that the Obligor is Still Legally Responsible for Repaying the Loan**

Prior to taking any collection action against an Obligor, including those listed in this chapter, ensure that the Obligor is still legally obligated to repay the loan. For example, verify that the Obligor's liability for the Disaster Loan has not been discharged in bankruptcy, that the statute of limitations for collecting the debt has not expired, and that the Obligor has not completed an SBA-approved offer in compromise.

#### **2. Comply with Debt Collection Improvement Act**

SBA's efforts to collect delinquent loans are subject to the requirements of the Debt Collection Improvement Act of 1996 ("DCIA"). Therefore, unless enforced collection is barred by a valid legal defense, (e.g., statute of limitations, discharge in bankruptcy, compromise, etc.) strict adherence to the DCIA timeline is required.

#### **3. Use Automated Letters and Telephone Calls When Feasible**

For efficiency of operations, automated collection letters and telephone calls should be utilized whenever feasible.

#### **4. Document Collection Efforts**

All contact with the Borrower to collect a Disaster Loan must be documented in the Loan File or Computer Tracking System to ensure and prove compliance with the DCIA.



## Chapter 16. Classifying Loans in Liquidation

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### A. When the Note Should Be Accelerated

#### 1. General Rule

The Note ([Secured](#), [Unsecured](#)) on a Disaster Loan should be accelerated whenever there has been an event of default, it is clear that the Obligor(s) cannot, or will not, keep the loan current through regularly scheduled payments, and enforced collection against collateral is being considered.

#### 2. Examples of Events of Default

- a. The loan is more than 60 days past due on a payment and there is no SBA approved deferment or catch-up plan in place;
- b. A senior lienholder has initiated a foreclosure action against collateral securing the loan;
- c. A lawsuit, which could adversely affect repayment of the Disaster Loan, has been initiated against an Obligor;
- d. An Obligor has filed a voluntary petition in bankruptcy, or an involuntary petition in bankruptcy has been filed against an Obligor;
- e. With regard to Disaster Business Loans, the business has been shut down or abandoned;
- f. Substantial collateral has been abandoned or is in danger of disappearing, losing its value, or being stolen;
- g. A receiver (i.e., a disinterested person appointed by a court) has been appointed, or some other action has been initiated to liquidate the collateral or an Obligor's assets; or
- h. Any other circumstances that could substantially and adversely affect repayment of the Disaster Loan.

### B. Demand Letters

**Note:** In the event of a default on a Disaster Loan, the Note ([Secured](#), [Unsecured](#)) gives the holder the right to accelerate the Note ([Secured](#), [Unsecured](#)) and liquidate the loan "without notice or demand." In practice, however, the collateral documents, (e.g., deed of trust), or applicable state law generally require the creditor to make a formal demand for payment. If litigation is necessary, most courts expect to see a demand letter as part of the evidence offered by the creditor to prove its case.

Unless prohibited by applicable law (e.g., the automatic stay in bankruptcy), when the Note is accelerated, demand should be made on all of the Obligors for payment of the entire loan balance;

### C. Obligors in Active Military Service

The military service status of an Obligor must be determined before taking liquidation action that could adversely impact the Obligor; and if an Obligor is in active military service, any action taken must be in compliance with the [Servicemember's Civil Relief Act](#) ("SCRA"), (Appendix to 50 U.S.C. §§ 501-596).

**Note:** SCRA provides servicemembers relief from certain obligations and temporarily suspends judicial and administrative proceedings and transactions involving civil liabilities when military service affects the servicemember's ability to meet or attend to civil matters. The protections are not automatic. Generally, servicemembers must request them and show that their military service has materially impaired their ability to meet their obligations. Creditors may, however, seek relief in court by proving otherwise. For detailed information, consult legal counsel or SBA's Office of Veterans Business Development.

#### **Note, Continued**

Simply stated SCRA:

1. Places limitations on foreclosures and interest rates;
2. Requires creditors to forgive interest in excess of 6 percent on certain pre-service debts; Protects servicemembers from default judgments if they fail to appear at trial or respond to a lawsuit because of their military service (50 USC App. § 521);
3. Authorizes the court to stay lien foreclosure actions or adjust the servicemember's obligation to preserve the interests of all parties (50 USC App. § 533);
4. Makes a servicemember's personal assets that were not pledged as collateral unavailable to satisfy a business obligation (50 USC App. § 596);
5. Prohibits creditors from pursuing adverse actions (e. g., notifying credit reporting agencies, denying credit, changing terms) against servicemembers solely because they exercise their rights under SCRA (50 USC App. § 518); and
6. Imposes criminal sanctions on creditors who violate certain provisions of the statute including those pertaining to mortgage foreclosures.

### D. Liquidation Plans

A well drafted Liquidation Plan can help ensure the highest possible recovery on a loan in the shortest amount of time. A Liquidation Plan should be prepared for all Disaster Loans classified in liquidation within 30 calendar days of receipt of the Loan File by the NDLRC.

Workout Negotiations — Not an Exception:

Generally, during the first few weeks following liquidation classification, a workout (Chapter 17) should be negotiated whenever feasible. However, during this same time period, the information and reports needed to liquidate the collateral (Chapters 18 and 19) and enforce collection from the Obligors (Chapters 20, 21 and 23), such as Appraisals or other forms of valuation, title reports, UCC searches, Environmental Reports, asset searches, credit reports, etc., should be obtained so that in the event an acceptable workout plan cannot be

implemented, lien foreclosure and other enforced collection activities can commence without further delay or loss.

## E. When Loans Should Be Removed from Liquidation Status

### 1. Returned to Regular Servicing

Disaster Loans should be removed from liquidation status and returned to regular servicing when regular payments are resumed pursuant to an approved written workout agreement, bankruptcy plan, reaffirmation agreement, assumption, or other written agreement that provides for resumption of regular payments.

### 2. Paid in Full

Disaster Loans should be removed from liquidation status and classified as “paid in full” when [SBA Form 397](#) (*Notice of Fully Paid Account*) is received from the Denver Finance Center. (See Chapter 5 for information on paid in full loans.)

### 3. Charged-off

Disaster Loans should be removed from liquidation status and classified as “charged-off” when the remaining loan balance has been charged-off in accordance with the Loan Program Requirements set out in Chapter 25.

<p><b>Note:</b> See Chapter 5 for information on how to apply payments on loans in liquidation, and Chapter 23 for information on how to apply recoveries.</p>
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## Chapter 17. Workouts

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### A. Overview

The term “workout” refers to the debt collection and negotiation process as well as the final plan agreed upon by a creditor and a debtor with regard to how the debtor’s delinquent obligation to the creditor can be “worked out” (i.e., resolved). Generally, a workout agreement restructures the material terms and conditions of the debtor’s delinquent loan in order to: avoid the need for actions such as foreclosure or bankruptcy; enable the debtor to cure defaults and improve repayment ability; and to enable the creditor to maximize recovery on the loan.

### B. Required Financial Information

Current financial information is essential in order to make prudent lending decisions regarding the feasibility and structure of a workout agreement. If the Obligors are not willing to provide the required Financial Information, workout negotiations should not be pursued. The Requirement Package for a Workout is posted on SBA’s website ([Birmingham](#), [El Paso](#), [Santa Ana](#)).

**Note:** Obtaining current financial statements at this stage is critical. Not only are they needed to make prudent lending decisions regarding the feasibility and structure of a workout agreement, but they also provide valuable information that would be difficult to obtain in the event the workout is unsuccessful and enforced collection becomes necessary.

### C. Workout Feasibility

To determine whether a Disaster Loan Borrower is a good candidate for the workout process, in addition to reviewing the existing Loan Documents, review the financial information required by Paragraph B above, and ascertain whether the Borrower is: (1) willing and able to address the problems that caused the default; (2) acting in good faith, and (3) capable of making payments pursuant to a workout agreement. If a workout is feasible, negotiations should begin immediately and a final workout plan should be put into effect as soon as possible. If an acceptable workout plan is not in place within a reasonable time, (e.g., 60 calendar days), the next step towards enforced debt collection should be taken.

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

### D. Requirement—New Consideration from Borrower

In order for a workout agreement to be legally binding, the debtor must provide consideration, (i.e., something of value) before or at the same time that the debtor receives

the benefit of the workout agreement. For example, in exchange for an agreement to forbear or restructure the loan, the Obligors should generally be required to:

1. Make a good faith payment
2. Correct Loan Document errors;
3. Provide additional collateral; and/or
4. Waive defenses

## **E. Options**

The elements of a plan to work out the problems on a Disaster Loan will vary depending on the circumstances. The final decision, and justification for it, must be documented in the Loan File. The decision should be supported by a credit memo that includes a cash flow and complete liquidation analysis based on the financial information required by Paragraph B. 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 provide the Borrower with an opportunity to improve its cash flow and avoid foreclosure.

### **2. Reinstatement of Maturity Date**

If the Note has been accelerated, the maturity date may be reinstated. (See Chapter 9 for information on maturity date extensions.)

### **3. Deferment and Catch-up Plan**

Delinquent and future payments of principal, interest or both may be deferred for a stated period of time to enable the Borrower to overcome a temporary cash flow problem and a catch-up plan may be negotiated to avoid the need for a balloon payment at maturity. (See Chapter 13 for information on deferments.)

### **4. Modification of Repayment Terms of Note**

The repayment terms of the Note may be modified, (e.g., the payment amount or interest rate may be lowered or the maturity date may be extended). (See Chapter 9 for information on Note modification.)

### **5. Assumption of Loan**

Another Person may assume the loan. (See Chapter 12 for information on assumptions.)

### **6. Voluntary Sale of Collateral**

The Borrower may be allowed to voluntarily sell all or part of the collateral provided that the sale is commercially reasonable, closely monitored, and all of the net proceeds are

applied to the principal balance of the Disaster Loan or used to facilitate the workout plan. (For SBA Loan Program Requirements pertaining to voluntary sale of collateral, see Chapter 18 with regard to real property collateral and Chapter 19 with regard to personal property collateral.)

**Note:** The amount of accrued interest or principal owed on an SBA loan may only be reduced through the offer in compromise process or administrative write-off. (See Chapter 21 for information on offers in compromise from going concerns.)



## Chapter 18. Real Property Collateral Liquidation

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### A. General Requirements

If an acceptable workout agreement has not been implemented within a reasonable time after the loan was classified in liquidation, all collateral that has Recoverable Value should be liquidated, unless there is a compelling reason for not doing so. The most common methods of liquidating real property collateral are discussed below.

### B. Release of Lien for Consideration

See Chapter 10 for information on release of lien for consideration.

**Note:** Proceeds from release of SBA's lien on real property—including raw land—must be applied to the loan balance in the following order: (1) principal; and (2) accrued interest. (Chapter 10)

### C. Voluntary Sale of Collateral by Obligor

An Obligor may be allowed to conduct a voluntary sale of all or part of the real property collateral securing an SBA loan provided that:

1. A voluntary sale would maximize recovery on the loan;
2. The property is being sold at a price that is reasonable as compared to comparable sales.
3. The Obligor has possession or control of the collateral;
4. All other lienholders have provided their written consent to the sale;
5. A current Appraisal has been obtained;

**Note:** See Chapter 2 for SBA requirements pertaining to "Appraisals". Given the inherent conflict of interest, do not rely solely on an appraisal prepared for an Obligor or another creditor with a lien on the same collateral.

6. The Recoverable Value of the collateral has been established;
7. The SBA is kept informed throughout the sale;
8. The costs of sale are reasonable, necessary and customary;
9. The lien securing the SBA loan is only released in exchange for cash in an amount equal to or greater than the Recoverable Value of the collateral; and
10. All of the net proceeds are applied to the principal balance of the SBA loan.

**Note:** Consideration may be given to whether the Obligor's cooperation during the liquidation process increased the overall recovery on the loan when analyzing whether a proposed compromise amount is adequate. (Chapter 21)

#### D. Deed in Lieu of Foreclosure

Deed in Lieu of Foreclosure should not be accepted unless it is absolutely necessary to maximize recovery. 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 accepting a deed in lieu may save time and money, it has inherent risks. For example, it could eliminate the right to collect any deficiency. It could also eliminate the opportunity to foreclose the SBA lien and remove any junior liens before marketing the property as REO. Because state laws vary regarding the impact of accepting a deed in lieu, consult legal counsel before undertaking this method of liquidation.

**Note:** Most title insurance companies offer deed in lieu of foreclosure services that include not only a new title (commitment) report, but review of title issues, recording of the deed in lieu documents, and issuance of a title policy to the Person to whom the lender sells the property after acquiring it via a deed in lieu.

#### E. Foreclosure of Real Property – Judicial and Non-Judicial

##### 1. General

Foreclosure is a legal action taken to sell property that was pledged 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.

##### 2. Primary Residences

Unless the Obligor-owner has engaged in fraud, misrepresentation or other relevant misconduct, a good faith effort should be made to reach a workout prior to initiating a foreclosure action against the Obligor's primary residence. (See Chapter 10 for information on release of liens for consideration, and Chapter 21 for information on offers in compromise.)

##### 3. Judicial Foreclosure

Judicial foreclosure requires filing a lawsuit.

###### a. Advantages

- (1) Deficiency judgment may be obtainable; and
- (2) May only need one action to foreclose liens and obtain judgment on the Note and Guaranties.

**b. Disadvantages**

- (1) Higher costs and fees than non-judicial foreclosure;
- (2) More time-consuming than non-judicial foreclosure; and
- (3) The mortgagor and junior lienholders usually have statutory redemption rights.

**4. Non-Judicial Foreclosure**

Non-judicial foreclosure, which ends with the private sale of the property by a trustee, is available only if the deed of trust or mortgage securing the loan contains a clause or provision granting a power of sale. A law suit is not filed, but strict compliance with the applicable state statutory provisions governing non-judicial foreclosure is mandatory.

**a. Advantages**

- (1) Fees and costs are generally lower than judicial foreclosure;
- (2) Takes less time than judicial foreclosure; and
- (3) The mortgagor and junior lienholders usually do not have statutory redemption rights.

**b. Disadvantages**

- (1) Deficiency judgment may not be obtainable, and
- (2) Judicial action may still be necessary if there are occupants who need to be evicted.

**F. 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 a workout or foreclosure action. 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.

**G. Appointment of Receiver**

A receiver is a Person appointed by the court to preserve and protect the collateral in connection with, or in lieu of, foreclosure proceedings. Receivers should only be used in exceptional circumstances when, for example, to maximize the recovery and minimize loss on a loan, it is necessary to operate the business (e.g., hotel or gas station) until it can be sold or the collateral can be liquidated. The laws governing receiverships vary by state. Generally, however, the court will authorize the receiver to take possession of the property,

manage it, collect rents, and take any reasonably necessary action to protect and preserve its value.

#### H. **Short Sale Approval**

A "short sale" is when the proceeds from the owner's sale of real property fall short of the total amount due on debts secured by liens against the property, and because the owner cannot afford to repay the full amount of secured debt, the secured creditors agree to release their liens for less than the amount that would otherwise be due at closing.

#### I. **Credit Bids**

A 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.

#### J. **Eviction Proceedings**

If title to real property collateral is acquired through foreclosure or otherwise and the Obligor-owner refuses to vacate, or there are other Persons unlawfully occupying the premises, it may be necessary to evict them. Eviction laws vary by locality. Consult legal counsel to determine the appropriate course of action.

#### K. **Abandonment**

The pursuit of recovery on real property collateral may be abandoned if the collateral has no significant Recoverable Value.

**Note:** The presence of Hazardous Substances may not significantly impair the Recoverable Value of real property collateral. See Chapter 6 (*Environmental Risk Management*) for SBA requirements pertaining to the due diligence required before collateral may be abandoned based on unsubstantiated claims that it is Contaminated.

#### L. **Title**

1. Title to collateral should not be acquired unless it is necessary to maximize recovery on the loan.
2. To avoid taking title to collateral, foreclosure sales should be aggressively advertised in order to attract a large number of potential buyers.
3. SBA employees, as well as their Close Relatives and Associates must not, directly or indirectly, bid on, purchase or otherwise acquire title to collateral.
4. SBA's ownership of acquired collateral should be reflected on the title as follows:  
"Administrator, U.S. Small Business Administration, an Agency of the United States Government."

5. Title to personal property collateral should not be taken in SBA's name except in unusual circumstances, (e.g., when title to real property collateral will be taken in SBA's name and the personal property is an integral part of the value of the real property such as a special use manufacturing plant and the equipment needed to operate it).



## Chapter 19. Personal Property Collateral Liquidation

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### A. General Requirements

If an acceptable workout agreement has not been implemented within a reasonable time after the loan was classified in liquidation, all collateral that has a significant Recoverable Value should 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.

**Note:** Prudent action must be taken to avoid loss of collateral or dissipation of collateral value during workout discussions. For example, to ensure that personal property collateral for a Disaster Business Loan such as machinery and equipment, inventory, furniture and fixtures is liquidated as quickly as possible if a workout is not feasible, it is generally advisable to have an auctioneer accompany you on a site visit to inspect and appraise the collateral as soon as the loan is classified in liquidation. That way, you can make preliminary UCC sale plans that can be implemented without further delay if the need arises.

### B. Release of Lien for Consideration

See Chapter 10 for information on release of lien for consideration.

**Note:** Proceeds from release of SBA's lien on personal property must be applied to the loan balance in the following order: (1) principal; and (2) accrued interest. (Chapter 10)

### C. Voluntary Sale of Collateral by Obligor

An Obligor may be allowed to conduct a voluntary sale of all or part of the personal property collateral securing a Disaster Loan provided that:

1. A voluntary sale would maximize recovery on the loan;
2. The collateral is being sold at a price that is reasonable as compared to comparable sales.
3. The Obligor has possession or control of the collateral;
4. All other lienholders have provided their written consent to the sale;
5. A valuation has been obtained;
6. The Recoverable Value of the collateral has been established;
7. SBA is kept informed throughout the sale;

8. The costs of sale are reasonable, necessary and customary;
9. The lien securing the Disaster Loan is only released in exchange for cash in an amount equal to or greater than the Recoverable Value of the collateral; and
10. All of the net proceeds are applied to the principal balance of the Disaster Loan, with the remainder, if any, to accrued interest.

**Note:** When analyzing whether a proposed compromise amount is adequate, consideration may be given to whether the Obligor's cooperation during the liquidation process increased the overall recovery on the loan. (Chapter 21)

#### D. UCC Sale

Liens on assets such as consumer goods, vehicles, equipment, inventory or fixtures created under *UCC Article 9* may be foreclosed by conducting a UCC sale.

##### 1. Types of UCC Sales

###### a. Private Sale

A private UCC sale is not open to the general public, usually does not occur at a pre-appointed time and place, and may not be advertised to the general public. Although public sales are preferred, a private UCC sale may be conducted if doing so would maximize recovery on the loan, e.g., when the collateral can be sold as part of the sale of a going concern.

###### b. Public Sale

A public UCC 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 UCC sales is encouraged.

##### (1) Auction or Retail Sale

The most common type of public UCC sale is a public auction where the collateral is sold to the highest bidder. Another common type is a retail sale of the collateral conducted over a limited number of days during which time the prices are gradually reduced. Retail sales are often followed by a public auction of any remaining collateral.

##### (2) 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 time and place. A sealed bid sale differs from a public auction in that it does not allow for interaction between competing bidders.

##### 2. Requirements

**a. Possession of the Collateral**

The secured creditor must be able to repossess the collateral without a "breach of the peace." ([UCC § 9-609](#)) If not, legal counsel should be consulted to determine whether litigation, such as a replevin action, is appropriate to obtain possession of the collateral.

**b. Reasonable Notice of the Sale**

Reasonable notice of the sale must be sent to all Obligors and junior lienholders unless the collateral is perishable, threatens to decline speedily in value, or is sold in a recognized market such as the New York Stock Exchange. ([UCC § 9-611](#)) To ensure compliance, notice of the sale should be sent to all of the Obligors and junior lienholders at least ten calendar days prior to the sale. To prove compliance, the Loan File should include a copy of: (1) the post-default UCC lien search verifying the priority of the lien securing the Disaster 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.

**c. Commercial Reasonableness**

Every aspect of the sale including the method, manner, time, place and terms must be "commercially reasonable." ([UCC § 9-610](#)) To prove compliance, the Loan File should, at a minimum, contain a copy of the following documents:

- (1) Post-default inventory and Appraisal of the property sold;
- (2) UCC sale brochure and advertisements; and
- (3) 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.

**Note:** A good auction company will keep detailed records of the sale including, for example, a list of registered bidders, the name of each buyer, and the amount paid for each item.

**d. 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 [UCC § 9-610](#).)

**E. Judicial Foreclosure of Personal Property**

Although the self-help remedies authorized by the UCC 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, foreclosing both the real and personal property liens in the same law suit may be appropriate.

## F. Collection of Accounts Receivable

When a Disaster Loan is secured by a lien on accounts receivable, a determination as to whether the pledged accounts have Recoverable Value should be made as soon as possible after an event of default. Thereafter, swift, aggressive action must be taken to collect any accounts with Recoverable Value in a manner consistent with applicable law.

### 1. 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 precautions are taken to ensure that the proceeds are applied to the loan balance.

### 2. Collection by SBA

In order to protect the right to a deficiency judgment, when it appears that further collection efforts by SBA would be futile, the Obligors should be provided with written notice of the SBA's intent to cease collection efforts, and given the opportunity to pursue collection of the remaining accounts, provided that precautions are taken to ensure that the proceeds are applied to the loan balance.

## G. Set-off of Deposit Account

When a Disaster Loan is secured by a lien on a deposit account, on the occurrence of an event of default, the cash in the deposit account should be applied to the Disaster Loan balance in compliance with [UCC § 9-607](#) and the terms of any applicable control agreement.

## H. Surrender of Life Insurance Policy for Cash Value

When a life insurance policy with a cash surrender value has been assigned as collateral for a Disaster Loan and a deficiency exists after all of the other collateral has been liquidated, the policy should be surrendered to the insurance company for its 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. (Premium payments should be treated as Recoverable Expenses.)

## I. Foreclosure of Lien on Fixtures

A lien on fixtures may be foreclosed pursuant to UCC Article 9 or applicable real property foreclosure law. ([UCC § 9-604](#)) (See Paragraph D above for information on UCC sales. See Chapter 18 for information on real property lien foreclosure.)

<p><b>Note:</b> 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 damage caused by the removal, but not for any diminution in the value of the real property caused by the absence of the fixtures. (<a href="#">UCC § 9-604</a>)</p>
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#### J. **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.

#### K. **Manufactured Housing Foreclosure**

The law governing the liquidation of security interests in manufactured housing is complicated, varies from state-to-state, and depends on several factors including (1) how the lien was created; and (2) whether the manufactured housing is located on real property that is owned by the Obligor or leased by the Obligor. Legal counsel should always be consulted prior to initiating foreclosure proceedings involving manufactured housing. Generally, however, the most common method of liquidation is a U.C.C. sale. (See Paragraph D above.)

#### L. **Abandonment**

The decision and justification for abandoning personal property collateral must be documented in the Loan File.

**Note:** The presence of Hazardous Substances may not significantly impair the Recoverable Value of collateral. See Chapter 6 (*Environmental Risk Management*) for SBA requirements pertaining to the due diligence required before collateral may be abandoned based on unsubstantiated claims that it is Contaminated.



## **Chapter 20. Acquired Collateral (REO and Personal Property)**

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### **A. Overview**

#### **1. Recordkeeping**

When real property collateral is acquired (“Real Estate Owned” or “REO”) or personal property collateral is acquired, e.g., through liquidation proceedings, it should be properly recorded.

### **B. Ownership Responsibilities**

Upon acquiring title to collateral, the following actions should be taken:

#### **1. Possession and Control**

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

#### **2. Inventory**

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

#### **3. Accounting**

Keep an accurate and complete record of the costs associated with the acquisition, holding and resale of the acquired collateral.

#### **4. Taxes**

- a. Monitor and pay taxes and assessments to avoid liens, interest accrual, and penalties.
- b. A tax waiver letter should be sent to the taxing authority. Taxes are only paid up to the foreclosure date.

#### **5. Care and Preservation**

- a. Take reasonable steps to prevent deterioration, such as arranging for utility services and essential repairs and maintenance.

- b. If the property has historic significance, consult legal counsel to ensure compliance with Section 106 of the [National Historic Preservation Act of 1966](#).

## **6. Insurance**

See Chapter 11 for SBA Loan Program Requirements pertaining to insurance coverage on acquired collateral.

## **C. Timeframe for Disposal**

Acquired collateral should be disposed in a manner that will maximize recovery in the shortest amount of time.

## **D. Sale**

Acquired collateral should be disposed of by sale.

### **1. Method of Sale**

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

### **2. Collateral should be sold 'as is' and without warranty**

### **3. Bidding or Acquisition by SBA Employees**

SBA employees, as well as their Close Relatives and Associates must not, directly or indirectly, bid on, purchase or otherwise take title to acquired collateral.

### **4. Transfer of Title and Closing Costs**

#### **a. REO—Quitclaim Deed**

Title to REO should be conveyed by means of a quitclaim deed (i.e., a deed that conveys a grantor's complete interest in the property but neither warrants nor professes that the title is valid) except in unusual circumstances where the use of a warranty deed is necessary to maximize the recovery in the shortest amount of time or is required by state law.

#### **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."

#### **c. Closing Costs**

Buyers should be responsible for all closing costs except in unusual circumstances where payment of the seller's customary share of the closing costs is necessary to maximize the recovery in the shortest amount of time or when it is customary in a certain locale.

## 5. Sales Price

The sales price for acquired collateral should be based on an Appraisal. (See Chapter 6 [*Environmental Risk Management*] for SBA requirements pertaining to the due diligence that must be performed before selling acquired collateral alleged to be worth substantially less than its appraised value due to the alleged presence of Contamination.)

## 6. Use of Real Estate Brokers

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

- a. The terms of the listing agreement are consistent with this SOP;
- b. The listing price is supported by an Appraisal;
- c. The listing broker has a good reputation for selling the type of property involved in the area where the property is located, is properly licensed, and is 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 brokers' commissions is reasonable, necessary and customary in the community where the property is located for the type of property involved; and
- f. Neither the listing nor selling broker has an actual, apparent, or potential conflict of interest with regard to the REO, Obligors, or SBA .

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

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

- a. A comprehensive public foreclosure sale of the collateral was held;
- b. A good faith effort was made to resell the acquired collateral to a disinterested party;
- c. The acquired collateral is sold for fair market value;
- d. It is an all cash sale;
- e. If the sale is to an Obligor to repurchase the Obligor's primary residence, the REO will continue to be the Obligor's primary residence; and
- f. The sale will not harm the integrity of SBA's Disaster Loan Program.

## 8. 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 an amount that is customary for the area;
- 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 an Appraisal.

## 9. Term Sales

### a. When Permitted

Acquired collateral should not be sold by means of a term sale unless doing so is necessary to maximize recovery.

### b. Buyer Pre-qualification

Potential purchasers buying on credit must be pre-approved.

### c. Terms of Purchase and Sale

With regard to all term sales, the purchaser must:

- (1) Make a significant down payment, which should be at least 20% of the purchase price;
- (2) 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; (d) requires a monthly payment amount that exceeds the amount of interest accrued each month; and (e) contains an acceleration clause that requires the purchaser to immediately pay the entire balance due in the event of default;
- (3) Provide collateral to secure payment of the promissory note in the form of a properly perfected first-position lien on the assets being sold, and when appropriate, properly executed Guaranties;
- (4) With regard to REO, pay for the cost of a mortgagee's title insurance policy; and
- (5) Purchase adequate insurance coverage for the assets being sold, i.e., hazard insurance and any other type of insurance required by statute, e.g., [flood insurance](#), or prudent lending practices, and provide proof that each policy includes a mortgagee clause or equivalent in favor of SBA.

## 10. Profit on Sale

Because state laws vary, after the sale proceeds have been applied to the loan balance, legal counsel should be consulted to determine whether there are any state specific laws governing distribution of the surplus.

**E. Lease**

Generally, acquired collateral should not be leased. However, if it has not sold after a reasonable amount of time, acquired collateral may be leased if doing so is necessary to maximize recovery, provided that:

1. A comprehensive public foreclosure sale of the collateral was held;
2. A good faith effort was made to sell the acquired collateral;
3. The terms and conditions of the lease, including the rental rate, are consistent with prevailing market rates and terms;
4. A written lease is used, which is legally enforceable, assignable, allows the acquired collateral to be shown to prospective buyers, and can be terminated on reasonable notice if a favorable purchase offer is received;
5. The acquired collateral is not leased to an Obligor, Close Relative of an Obligor, or an Associate of the Borrower unless a comparable or more desirable proposal cannot be obtained;
6. Leasing the acquired collateral will not harm the integrity of SBA's Disaster Loan Program; and
7. The leased property is inspected at least semi-annually and the inspection findings included in the Computer Tracking System.

**F. Abandonment**

Acquired collateral must not be abandoned unless abandonment of the specific REO or acquired personal property collateral has been pre-approved by SBA as an exception to policy obtained in accordance with the procedures set out in Chapter 1.



## Chapter 21. Offer in Compromise

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### A. Overview

#### 1. Definition

An offer in compromise is an offer made by an Obligor to pay less than what is owed in full settlement of the Obligor's obligation on their Disaster Loan. A compromise may be considered when the agency is unable to enforce collection with a reasonable time period. Submitting the offer does not ensure that it will be accepted. Rather, it begins a process of evaluation and verification by SBA. Generally, an offer in compromise will be accepted if it reflects the Obligor's true ability to pay, and will be rejected if the Obligor can pay the loan in full via a lump sum payment or an installment agreement, or if acceptance of the offer would harm the integrity of the SBA Disaster Loan Program.

#### 2. Legal Authority

The general requirements for compromise of a debt owed on an SBA loan are based on [31 U.S.C. § 3711](#) and [31 C.F.R. Part 902](#) (*Standards for Compromise of Claims* – by an agency of the Federal Government).

#### 3. Effect of Compromise with One Obligor on Remaining Obligors

A compromise with one Obligor does not release the remaining Obligors because each is jointly and severally liable, i.e., full payment may be requested from one or all of the Obligors. No attempt should be made to divide payment responsibility between the Obligors or to use the compromise amount accepted from one Obligor as the basis for the compromise amount required from another. ([31 C.F.R. § 902.4](#))

#### 4. Finality

An offer in compromise that is approved by SBA is final and conclusive on the Obligor and SBA unless it was obtained through fraud, misrepresentation, or mutual mistake of fact.

**Note:** *Acceptance of a compromise offer is considered to be a loss to the Federal Government and may adversely impact the Obligor's ability to obtain future financing from the Federal Government including another SBA loan.*

### B. When Compromise is Appropriate

#### 1. General Requirements

##### a. All Collateral Liquidated

Generally, compromise negotiations with an Obligor may only be initiated after all of the collateral has been liquidated; and

## **b. Additional Requirement for Business Loans—Business Closed**

Generally, compromise negotiations with an Obligor on a Disaster Business Loan should not be initiated until after the business is closed.

## **c. Exceptions**

### **(1) Lien on Personal Residence**

If the only remaining collateral is a lien on the personal residence of the Obligor making the offer, compromise negotiations may proceed if the Obligor is willing to pay an additional amount as consideration for release of the lien. (Chapter 10) If the Obligor is unwilling or unable to pay an acceptable amount for release and compromise, rather than extinguish the debt for a nominal amount, compromise negotiations must cease and appropriate action must be taken. (E.g., file suit to foreclose the lien and obtain a deficiency judgment against the Obligor, or abandon the lien, charged-off the loan, and referred the Obligor referred to Treasury for additional enforced collection efforts.)

### **(2) Viable Going Concern**

Compromise negotiations with a going concern may be initiated in rare circumstances if the viability of the business concern is at stake and acceptance of the offer will not harm the integrity of the SBA Disaster Loan Program. (See Paragraph D below for detailed information and Loan Program Requirements regarding compromise with a going concern.) The offer in compromise process must not be used as a means for a business that is experiencing temporary cash flow problems to write down its debt. (See Chapters 9-17 for information on tools that can be used to help resolve temporary cash flow problems such as re-amortization, deferment, or a workout.)

## **C. Offer and Supporting Documents**

Each Obligor submitting an offer in compromise must submit the required documentation ([Birmingham](#), [El Paso](#), [Santa Ana](#)):

### **1. Written Offer**

A signed written offer that should refer to the penalties under [18 U.S.C. § 1001](#) for false statements, and identify the source of the funds for the offer, e.g., [SBA Form 1150](#) (*Offer in Compromise*); and

### **2. Financial Statement**

A current financial statement that should be signed under penalty of perjury and must show the Obligor's assets, liabilities, income and expenses, e.g., [SBA Form 770](#) (*Financial Statement of Debtor*). In addition:

- a. **Going Concerns**—If the Obligor is a going concern, the Obligor's last year-end financial statements must also be provided.
- b. **Affiliates**—If the Obligor has any affiliates, a current consolidated financial statement (or a current financial statement from each affiliate) must also be provided.

### **3. Personal Federal Income Tax Returns**

A complete copy of the personal federal income tax returns that the Obligor filed with the IRS for the past two years or a written explanation as to why a copy is not available;

### **4. Business Federal Income Tax Returns**

For each going concern and affiliate, a complete copy of the business federal income tax returns that were filed with the IRS for the past two years or a written explanation as to why a copy is not available; and

### **5. Optional—Proof of Severe Financial Hardship**

If the Obligor would like SBA to take into account special circumstances such as catastrophic illness, loss of employment, etc., the Obligor should also submit the documentation required by Chapter 7 for Severe Financial Hardship Relief.

## **D. Review and Analysis of Offer**

To determine whether an offer in compromise is acceptable, a good faith effort must be made to verify the accuracy of the Obligor's financial disclosure and to evaluate the adequacy of the amount offered.

## **E. Inadequate Offers**

### **1. Counter Offer**

Generally, if an offer in compromise was made in good faith, but the amount offered does not bear a reasonable relationship to the amount that could be recovered in a reasonable amount of time through enforced collection, a good faith effort should be made to arrive at an acceptable amount by countering the offer.

### **2. Decline Offer and Refer to Treasury**

If the Obligor will not agree to an acceptable compromise amount, the offer should be declined; and, as soon as all other cost-effective avenues of collection have been exhausted, the loan can be charged-off and referred to Treasury for offset and other enforced collection efforts.

## **F. Payment Terms and Conditions**

### **1. Cash Compromise—Preferred**

The compromise amount should be paid in one lump sum on a specified date. Generally, payment should be received within 60 calendar days of the compromise approval date.

## 2. Term Compromise—If Necessary to Maximize Recovery

The compromise amount should only be payable in installments as a last resort to maximize recovery on the loan. ([31 C.F.R. § 902.2](#)) If the compromise amount is to be paid in installments:

- a. The terms of the compromise must be set out in a written, legally enforceable document;
- b. The amount due under the compromise agreement must be evidenced by a promissory note with a specified maturity date;
- c. Payment of the promissory note should be secured by collateral;
- d. The compromise agreement should prohibit release of the collateral securing the promissory note until the entire compromise amount has been paid in full;
- e. The compromise agreement must provide that in the event of default, the full loan balance, less sums paid on the promissory note, will be reinstated and become immediately due and payable; and
- f. The compromise agreement should provide for remedies in the event of default such as entry of a confession of judgment or delivery and recording of a deed or bill of sale to the collateral securing the promissory note.
- g. Establish a note receivable for the amount of the promissory note evidencing the compromise amount.

**Note:** If a compromise involves settlement of litigation conducted by SBA in conjunction with the U.S. Attorney's Office, the compromise amount must be approved by and paid directly to the Department of Justice ("DOJ").

## Chapter 22. Litigation

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### A. Events Requiring a Loan be Classified in Litigation

A Disaster Loan should be classified in litigation status if:

1. An Obligor has filed a voluntary petition in bankruptcy or an involuntary petition in bankruptcy has been filed against an Obligor and Legal Counsel determines that SBA's interests could be adversely impacted by the filing;
2. A deceased Obligor's estate is being administered in probate proceedings;
3. A receiver (i.e., a disinterested Person appointed by a court) has been appointed, or some other action has been initiated to liquidate the collateral or an Obligor's assets;
4. A lawsuit, which could adversely affect repayment of the Disaster Loan, has been initiated against an Obligor;
5. SBA has been named as a defendant in a suit involving an Obligor or collateral for a Disaster Loan;
6. Litigation is cost-effective and necessary to enforce collection on a Disaster Loan; or
7. Any other circumstances where legal representation is necessary to protect the Agency's ability to recover on the Disaster Loan or to protect the integrity of the Disaster Loan Program.



## Chapter 23. Expenses and Recoveries

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This chapter covers expenses related to collecting sums due under the Note ([Secured](#), [Unsecured](#)), enforcing the terms of the Loan Documents, and preserving or disposing of collateral. (See Chapter 20 for information regarding expenses related to acquired collateral.)

### A. Classification of Expenses

Expenses are classified as either Recoverable Expenses, which can be recouped, or Non-recoverable Expenses, which cannot be recouped. (See Paragraphs B and C below.) An expense may be classified as Recoverable or Non-recoverable in whole or in part.

#### 1. Non-recoverable Expenses

Non-recoverable Expenses are costs that cannot be added to the principal balance of the loan. They include:

- a. Any expense that is not related to collection of amounts due under the Note ([Secured](#), [Unsecured](#)), to enforce the terms of the Loan Documents, or preservation or disposal of the collateral for the loan; and
- b. Any fee or cost, or portion thereof, that is not necessary, reasonable or customary.

#### 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 ([Secured](#), [Unsecured](#)), 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. Recoverable Expenses include, for example:

##### a. Searches

- (1) UCC lien searches;
- (2) Title reports; and
- (3) Credit and asset search reports.

##### b. Appraisals and Other Reports

- (1) Appraisals;
- (2) Environmental Investigation Reports; and
- (3) Site Visit Reports prepared by contractors.

##### c. Litigation Expenses

- (1) Service fees; and
- (2) Costs such as court reporter 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.

**B. Payment of Non-recoverable Expenses**

Payment of a Non-recoverable Expense over \$500 incurred by SBA must be 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 expense codes.

**C. Payment of Recoverable Expenses**

Payment of Recoverable Expenses over \$500 must be documented by a Loan Action Record that includes, at a minimum, the following:

1. A copy of the original itemized invoice that 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;
2. The name of payee and check delivery instructions;
3. The reason for the expenditure;
4. A copy of any document prepared by the vendor (e.g., site visit report, Environmental Investigation Report, Appraisal, or legal pleading) for which payment is sought;
5. The deadline for payment; and
6. Whether the payment is covered by the Prompt Payment Act.

**Note:** The [Prompt Payment Act](#) requires federal agencies to pay interest and penalties on late payments for contracted expenses. See [SOP 20 17](#) and [Subpart 32.9 of the Federal Acquisition Regulation](#) for further guidelines. Note, however, that if the cost was not incurred pursuant to a contract, e.g., real estate taxes, payment is not subject to the Prompt Payment Act.

## D. Recoveries

### 1. Application of Recoveries to Loan Balance

Unless the terms of a workout agreement or some other legally binding document, such as a court order, specify otherwise, recoveries (i.e., funds obtained through liquidation activities) should be applied in the following order:

#### a. Non-Litigation Recoveries

- (1) Recoverable Expenses incurred in the liquidation process;
- (2) Principal balance of the loan; and
- (3) Accrued interest.

#### b. Litigation Recoveries

When recoveries are the result of litigation handled by SBA legal counsel in their capacity as a Special Assistant U.S. Attorney or by the local U.S. Attorney's Office:

- (1) 10% surcharge to DOJ pursuant to Section 3011 of the [Federal Debt Collection Procedures Act](#);
- (2) Recoverable Expenses incurred in the liquidation (including litigation) process;
- (3) Principal balance of the loan; and
- (4) Accrued interest.

### 2. Remittance of Recoveries to Denver Finance Center

The net proceeds recovered on Disaster Loans not paid through pay.gov or DOJ should be remitted to the Denver Finance Center within 15 business days of receipt with the proper transaction code for applying the funds. (See SOP 20 19 [*Loan Accounting Procedures*] for information on transaction codes.)

### 3. Recovery Collection

Recoveries should be collected in an efficient and effective manner to protect the value of the Federal Government's assets. An attempt should be made to maximize recovery using all appropriate collection tools. For more information on the management of recoveries, refer to [Circular A-129](#) and [Managing Federal Receivables](#).



## **Chapter 24. Inspector General Referrals**

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### **A. Duty to Report Irregularities**

All SBA officials and contractors must be on the lookout for fraud and report any known or suspected irregularities involving SBA programs, program participants, or personnel to the Office of the Inspector General ("OIG").

### **B. Irregularities Requiring Referral**

Examples of irregularities that must be referred to the OIG include:

#### **1. Loan Application Fraud**

False statements made or submitted by a loan applicant with regard to eligibility for SBA financing, for example:

- a. Overstating income;
- b. Understating or failing to disclose liabilities;
- c. Overstating the value of assets offered as collateral;
- d. Failing to disclose criminal records;
- e. Making false statements regarding U.S. citizenship or immigration status;
- f. Misrepresenting the true ownership of damaged property;
- g. Using false Social Security Numbers;
- h. Creating false work histories; or
- i. Submitting altered tax returns.

#### **2. Loan Closing Fraud**

False documents submitted by a loan applicant with regard to a loan closing requirement, for example:

- j. False evidence of insurance;
- k. False invoices or receipts needed to support disbursements; or
- l. False lien waivers.

#### **3. Loan Agent Fraud**

Actions by Agents who orchestrate, facilitate or otherwise support any of the illegal acts committed by loan applicants, or Obligors such as those listed in this chapter.

#### **4. Misuse of Loan Proceeds**

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

#### **5. Conversion of Collateral**

Conversion, concealment, vandalism or unauthorized disposal of collateral for an SBA loan.

#### **6. SBA Employee Misconduct**

Misconduct by an SBA official, or Close Relative of an SBA official, such as soliciting or accepting a bribe in connection with making, closing, servicing, or liquidating a Disaster Loan.

### **C. Referral Methods**

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](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

### **D. Required Information**

#### **1. Answers to Basic Questions**

A referral to the OIG should include as much information as possible in response to these basic questions:

- a. Who is involved? (Name, occupation, address, phone numbers, email address, 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.

## **E. Post-referral Responsibility**

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

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 the 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 25. Charge-off Procedures

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### A. Charge-off

#### 1. General

Charge-off is an SBA administrative action whereby a loan is moved from “liquidation” status to “charged-off” status. It has no impact on the Obligors’ liability for the loan balance. Decisions regarding when to charge-off a loan should be consistent with federal debt management and collection guidelines.

#### 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 ([Secured](#), [Unsecured](#)); (2) liquidation of the collateral; and (3) litigation and other enforced collection activities against all of the Obligors;
- 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 due to discharge in bankruptcy (i.e., release of the debtor from any further personal liability for pre-bankruptcy debts), expiration of the statute of limitations (i.e., the passing of the deadline for suing), or the existence of another defense available to the remaining Obligors under state or federal law.

### B. Referral to Treasury Cross-Servicing Program

**Note:** Under the [Cross-servicing Program](#), in addition to offset, delinquent debt is collected through the use of a wide variety of tools such as administrative wage garnishment, skip tracing, negotiated repayment plans, use of private collection agencies, DOJ litigation, and preventing receipt of additional federal financial assistance. Prior to referral, SBA sends an automated letter to the Obligors giving them 60 calendar days to either pay the loan in full or negotiate an acceptable payment plan.

#### 1. When Referral Required

After charge-off the loan and remaining Obligors must be referred to [Treasury](#) for inclusion in the [Cross-servicing Program](#), ([Debt Collection Improvement Act of 1996](#)) unless further collection is barred by a valid legal defense such as compromise, discharge in bankruptcy, or the statute of limitations.

### C. IRS Notification of Cancelled Debt

#### 1. When IRS Form 1099-C Required

[IRS Form 1099-C](#) (*Cancellation of Debt*) must be filed with the IRS and mailed to the Borrower whenever the loan balance has become uncollectible (e.g., as the result of a compromise).