SBA

SOP 50 57 3.1

7(a) LOAN SERVICING and LIQUIDATION

Office of Capital Access
Small Business
Administration

U.S. Small Business Administration

Standard Operating Procedure
Summary

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Table of Contents

Standard Operating Procedure Summary 2

Chapter 1. Introduction 17

A. Purpose 17

B. Authority 17

C. General Policy and Goals 17

D. Performance Standards 18

E. Exceptions to Policy 18

Chapter 2. Definitions 20

A. General Terms 20

B. Environmental Terms 32

Chapter 3. Lender Responsibility and Authority 33

A. Servicing and Liquidation 33

B. Litigation 33

C. Decision-Making 34

1. Lender Authority 34
2. Unilateral Actions 34
3. Loan Actions That Require Prior Written SBA Approval 34
4. Where to Send Notices and Requests for SBA Approval 36
5. Requests for Reconsideration 37
6. Appeal of Decision 37

D. Recordkeeping 38

1. General Requirements 38
2. Loan Action Records and Supporting Documents 38
3. Correspondence 38
4. Telephone Conferences and Meetings 39
5. Loan File Retention 39

E. Loan Monitoring 40

1. Name, Address or Legal Structure Changes 40
2. Borrower's Creditworthiness 40
3. UCC Filings 41
4. Taxes and Assessments 41
5. Insurance 41
6. Loans Secured by Senior Liens on SBA Loan Collateral 42

F. Lender Reporting Requirements 42

1. Monthly 1502 Report—Pre-guaranty Purchase Loans 42

2. Reports to Credit Reporting Agencies....42
3. SBA Guaranty Purchased Loans....43
4. SBA Approved Litigation Plans....44
5. Site Visit Report....44
6. Wrap-up Report....45

G. SBA Take Over of Servicing or Liquidation....45

H. Enforcement Action by OCRM....45

Chapter 4. Loan Payment Administration....46

A. Collection and Application of Loan Payments....46
1. Payments on Loans in Regular Servicing Status....46
2. Borrower Payments on Loans in Liquidation Status....47

B. Post-Guaranty Purchase Servicing Fee on SBA Portion of Interest Payments....48

C. Remittance of Borrower Loan Payments....48
1. Before Guaranty Purchase—To Investor....48
2. After Guaranty Purchase—To SBA....49

D. Prepayment....49
1. Loans Not Sold in Secondary Market....49
2. Loans Sold in Secondary Market....49
3. No Lender Prepayment Penalty....49
4. SBA Subsidy Recoupment Fee....49

E. Paid in Full Loans....50

F. Reinstatement of Guaranty on Loan Mistakenly Coded "PIF"....50
1. General Rule....50
2. Procedure....50

Chapter 5. Environmental Risk Management....51

A. Overview....51
1. Environmental Risks....51
2. Definitions....51

B. General Requirements....51

C. When an Environmental Investigation is Required....52

D. Environmental Investigation Process for Loans in Regular Servicing Status....53

E. Environmental Investigation Process for Loans in Liquidation Status....53
1. Scope of investigation....53
2. Use of Environmental Professionals....53
3. Reliance Letter Requirement....53
4. General Procedure....53

F. Environmental Investigation Reports....56

G. Remedial Action by Secured Creditor 56

H. Taking Title to Contaminated Property or Control of Business with Environmental Risks 56
1. When Appropriate 56
2. Requirement – SBA's Prior Written Approval 56
3. How to Obtain SBA Approval 56
4. Request Format 56

Chapter 6. Servicing Requests 62

A. General Requirements 62

B. Review and Analysis 62
1. Document Receipt of the Servicing Request 62
2. Ensure that the Servicing Request is in the Proper Format 62
3. Research the Applicable Loan Program Requirements 62
4. Determine Whether the Servicing Request is Properly Supported 63
5. Obtain Additional Supporting Documents When Necessary 63
6. Analyze the Borrower's Financial Condition 64
7. Analyze the Collateral 64
8. Check for Problems 64
9. List Conditions for Approval 64
10. Comply with SBA Decision Making, Notice and Approval Requirements 65
11. Comply with the Applicable Recordkeeping Requirements 65

C. How To Obtain SBA Approval For a Proposed Loan Action 66
1. Required Documentation 66
2. Where to Submit Requests 67
3. SBA Response Time 67

D. Implementing Loan Actions 68
1. Modify Existing Loan Documents 68
2. Prepare New Loan Documents 68
3. Record New or Modified Loan Documents 68

Chapter 7. Modification of Note 69

A. General Requirements 69
1. Review and Analysis of Requests to Modify a 7(a) Loan Note 69
2. Secondary Market Purchase or Investor Consent 69

B. Payment Due Date 70

C. Change from Revolving to Non-revolving Loan 70

D. Installment Amount 70

E. Interest Rate 70

F. Maturity Date Extensions 70
1. Extension of Maturity Date 70

2. Additional Guaranty Fee 71
G. Loan Amount Increases 71

Chapter 8. Modification of Collateral 72

A. Subordination of Lien Position 72
1. General Requirements 72
2. Subordination to Facilitate the Refinancing of a Senior Loan 72
3. Subordination to Facilitate a New Loan 73
4. Subordination to Facilitate Assumption of an SBA Loan 73
B. Inter-creditor Agreements 73
C. Substitution of Collateral 74
1. General Requirements 74
2. Substitution of Residence Held as Collateral 74
D. Substitution of Guarantor 75
E. Business Ownership Change 76
F. Leasing Real Property 76
G. Release of Lien without Consideration 77
H. Release of Lien for Consideration 77
1. General Requirements 77
2. Practice Tips 77
I. Release of Guarantor or Co-Borrower 77
1. Loans in Regular Servicing Status 77
2. Loans in Liquidation Status 78
J. Release of Condemnation Proceeds 78
1. Condemned Property Replaced 78
2. Condemned Property Not Replaced 79

Chapter 9. Insurance Coverage 80

A. General Requirements 80
B. Mortgagee's Title Insurance 80
1. Substitute Collateral 80
2. Additional Collateral 80
3. Installment Sale of REO 80
C. Hazard Insurance 80
1. Modification of Coverage on Existing Collateral 80
2. Coverage on Substitute or Additional Collateral 80
3. Care and Preservation of Collateral and Acquired Collateral 81
4. Forced Placement 81
5. Release of Hazard Insurance Policy Proceeds 81

D. Life Insurance 82
1. Modification of Requirement 82
2. Use of Escrow Account to Collect Premiums 82
3. Continuation of Coverage 82
4. Release of Life Insurance Policy Proceeds 82

E. Flood Insurance 83
1. General Rule—Termination or Modification Not Permitted 83
2. Events Triggering Flood Insurance Review 83
3. Forced Placement 83
4. Unavailability of Flood Insurance 83

Chapter 10. Modification of Management Covenants 85

A. General Requirements 85

B. Financial Statements 85

C. Restrictions on Compensation, Dividends, Fixed Assets, etc. 85

D. Standby Agreements 85
1. General Rule 85
2. Standby Agreement Used as Equity Injection 86

Chapter 11. Assumption, Assignment or Sale of Loan 87

A. Assumption 87

B. Assignment of Lender's Interest in a 7(a) Loan 88

C. SBA Loan Portfolio Transfers 88

D. Sale of SBA Loan in Liquidation Status 88

Chapter 12. Deferments 90

A. Overview 90

B. General Rule 90

C. General Requirement—Temporary Cash Flow Problem 90

D. Deferred Amount 90
1. Loan Not Sold in Secondary Market 90
2. Loan Sold in Secondary Market 91
3. Interest Accrual 91

E. Amount of Payments during Deferment Period 91

Chapter 13. Delinquent Secured Senior Loans 93

A. General Requirements 93

B. Procedure for Developing Best Strategy to Protect Junior Lien Securing SBA Loan 93
1. Review the Loan Documents 93

2. Order a Current Lien Search 93
3. Verify the amount Owed on All Senior Liens....93
4. Order an Appraisal 94
5. Determine the Recoverable Value of the Collateral....94
6. Estimate Recovery from All Other Sources 94
7. Determine Whether the Senior Lienholder Provided Required Notice 94
8. Judicial Foreclosure—Notify SBA District Counsel 94
9. Analyze Facts, Review Options and Plan Strategy 94

C. Lender Options.... 95
1. Bring the Senior Loan Current 95
2. Purchase or Pay Off the Senior Loan 95
3. Wait for Senior Lienholder to Start Foreclosure Proceedings....96

Chapter 14. Special Purpose Loans and Temporary PPP Loan Program 99

A. Overview.... 99

B. CAPLines Loan Program (CAPLines).... 99
1. Seasonal CAPLines....99
2. Contract CAPLines 100
3. Builders CAPLines 100
4. Working Capital CAPLines 101

C. International Trade Loan Program (IT) 103
1. IT Loan Export Compliance 103
2. ITL Loan Monitoring....103

D. Export Working Capital Loan Program (EWCP) 104
1. Processing Methods 104
2. EWCP Loan Post-Approval/Pre-Disbursement Requests for Changes 104
3. Prohibited Uses of EWCP Loan Proceeds 105
4. EWCP Export Compliance 105
5. Additional Guidance For Specific Types of EWCP Loans....106
6. Miscellaneous EWCP Loan Servicing Actions 112
7. Troubled EWCP Loans 113

E. Export Express Loan Program (Export Express).... 113
1. Export Compliance 114
2. Transaction-Specific Working Capital and SBL/C Financing....114
3. Lender Verification and Reporting Responsibilities....115

F Paycheck Protection Program (PPP) Loan 115
1. PPP Loan Servicing Responsibilities....115
2. PPP Loan Servicing Actions....115
3. PPP Borrower Bankruptcy Filing 117
4. When Lenders May Submit Requests for PPP Loan Guaranty Purchase with SBA Charge Off....117
5. Lender Requests for Guaranty Purchase With SBA Charge Off 118

6. When Lenders May Submit Requests for PPP Loan Guaranty Purchase Without SBA Charge Off....119
7. Borrower Forgiveness Requests Receieved After Lender Guaranty Purchase Request 119

Chapter 15. Classifying Loans in Liquidation....121

A. When Lenders Must Classify SBA Loans in Liquidation Status....121

B. When Lenders Should Accelerate an SBA Loan Note....121
1. Lenders with Non-SBA Loan Portfolios....121
2. Lenders without Non-SBA Loan Portfolios....121

C. Repurchase from Secondary Market....122

D. Demand Letters....122

E. Skip Tracing....122

F. Obligors in Active Military Service....122

G. Lender Liquidation Plans....123
1. Format and Content....123
2. When a Liquidation Plan Must be Submitted to SBA for Approval....125

H. Lender Application of Payments and Recoveries for Loans in Liquidation Status....126

I. When Lenders Should Remove a Loan from Liquidation Status....126
1. Loan Returned to Regular Servicing....126
2. Loan Paid in Full....126
3. Loan Charged Off by SBA....127

Chapter 16. Site Visits....128

A. When Lender Site Visits are Required....128

B. Lender Preparation for Site Visits....128
1. Review the Loan Documents....128
2. Obtain a Current Lien Search....129
3. Contact the Landlord....129
4. Contact Local Taxing Authorities....129
5. Order an Appraisal....129

C. Lender Site Visit Objectives....129
1. Inspect and Inventory the Collateral....129
2. Establish the Recoverable Value of the Collateral....129
3. Ascertain Whether Real Property Collateral is Occupied....130
4. Assess Environmental Risk....130
5. Develop a Liquidation Strategy....130
6. Ascertain Whether a Workout is Feasible....130
7. Repossess the Personal Property Collateral....130
8. Arrange for Care and Preservation of the Collateral....130

Chapter 17. Workouts 132

A. Lender Workout Overview 132

B. Required Financial Information 132
1. Financial Statement 132
2. Business Federal Income Tax Returns 132
3. Personal Federal Income Tax Returns 133

C. Workout Feasibility Test 133

D. Workout Timing 133

E. Workout Requirement—New Consideration from Borrower 133

F. Workout Options 134
1. Forbearance 134
2. Reinstatement or Extend Maturity Date 134
3. Loan Payment Deferment 134
4. Modification of Note Repayment Terms 134
5. Assumption of Loan 134
6. Subordination to Working Capital Loan 134
7. Relief For Secured Senior Loan 135
8. Voluntary Sale of Collateral 135

G. Workout Agreement Provisions 135

H. SBA Approval of Lender Workout Agreements 136

Chapter 18. Real Property Collateral Liquidation 137

A. General Requirements 137

B. Procedure for Selecting Best Method of Liquidation 137
1. Military Service Status of Property Owner-Obligor 137
2. Use of the Property 137
3. Loan Document Review 137
4. Title Report 137
5. Amount Owed on Senior Liens 138
6. Title Encumbrances 138
7. Hazard Insurance Status 139
8. Appraisal Update 140
9. Environmental Risks 140
10. Historic Register Status 140
11. Borrower Business Records Review 140
12. Anticipated Deficiency Balance of SBA Loan 140
13. Estimated Liquidation Time and Cost 141
14. Estimated Net Recovery 141

C. Liquidation Methods 141
1. Release of Lien for Consideration 141
2. Voluntary Sale of Collateral by Obligor 141

3. Deed in Lieu of Foreclosure....142
4. Lien Foreclosure....142
5. Collection of Rents....144
6. Appointment of Receiver....144
7. Short Sale Approval....146

D. Credit Bids....148
1. Requirement....148
2. Credit Bid Amount....149

E. Eviction Proceedings....149

F. Abandonment....149

Chapter 19. Personal Property Collateral Liquidation....150

A. General Requirements....150

B. Procedure for Selecting Best Method of Liquidation....150
1. Military Service Status of Property Owner-Obligor....150
2. Loan Document Review....150
3. Lien Search....150
4. Amount Owed on Senior Liens....151
5. Borrower Business Records Review....151
6. Hazard Insurance Status....151
7. Appraisal Update....151
8. Environmental Risks....152
9. CEstimated Liquidation Time and Cost....152
10. Estimated Net Recovery....152

C. Liquidation Methods....152
1. Release of Lien for Consideration....152
2. Voluntary Sale of Collateral by Obligor....152
3. UCC Sale....153
4. Judicial Foreclosure....156
5. Collection of Accounts Receivable....157
6. Set-off of Deposit Account....157
7. Surrender of Life Insurance Policy for Cash Value....157
8. Foreclosure of Lien on Fixtures....158
9. Marine Mortgage Foreclosure....158

D. Credit Bids....158
1. Non-judicial Foreclosure Sales....158
2. Judicial Foreclosure Sale....158

E. Abandonment....159

Chapter 20. Acquired Collateral....160

A. General Requirements....160

B. Acquiring Title to Collateral 160
1. General SBA Policy and Requirements 160
2. Real Property 160
3. Personal Property 160
C. Ownership Responsibilities 160
1. Possession and Control 161
2. Inventory 161
3. Accounting 161
4. Taxes 161
5. Care and Preservation 161
6. Insurance 161
7. Reporting Requirements 162
D. Expenses 162
1. General Requirement 162
2. Payment of Expenses 162
3. Recoupment of Expenses 162
E. Timeframe for Disposal 163
F. Sale 163
1. Method of Sale 163
2. Bidding or Acquisition by SBA Official or Lender 163
3. Transfer of Title and Closing Costs 163
4. Sales Price 164
5. Use of Real Estate Brokers 164
6. Sale to Obligors, Associates or Close Relatives of the Borrower 164
7. Purchase Offers 165
8. Term Sales 165
9. Profit on Sale 166
G. Lease 166
H. Abandonment 167

Chapter 21. Offer in Compromise 168

A. Offer in Compromis Overview 168
1. Definition 168
2. Legal Authority 168
3. Effect of Compromise with One Obligor on the Obligations of Remaining Obligors 168
4. Finality of Compromise Action 168
B. When Compromise is Appropriate 169
1. Business Closed 169
2. Going Concern 169
3. Prior to Non-Judicial Foreclosure or Deed in Lieu of Foreclosure 169
C. General Compromise Requirements 169

D. Compromise with a Going Concern Business 170

E. Compromise Offer and Supporting Documents 171
1. Written Offer 171
2. Financial Statements 171
3. Personal Federal Income Tax Returns 171
4. Business Federal Income Tax Returns 171

F. Review and Analysis of Offer in Compromise 171
1. Corroborating Evidence 172
2. Adequacy of Financial Disclosure 172
3. Amount Recoverable Through Legally Enforced Collection Actions 172
4. Adequacy of Proposed Compromise Amount 173

G. Inadequate Compromise Offers 173
1. Counteroffer 173
2. Decline Offer and Refer to Treasury 174

H. Compromise Payment Terms and Conditions 174
1. Cash Compromise Offers—Preferred 174
2. Term Compromise Offers—If Necessary to Maximize Recovery 174

I. Obtaining SBA Approval of Compromise Actions 175

J. Completing the Compromise Process 175

Chapter 22. Litigation 176

A. General Requirements 176
1. Necessary, Reasonable and Customary for the Locality; 176
2. Cost Effective; 176
3. Conducted in the Name of the Person Responsible for the Litigation 176

B. Legal Counsel Hired by Lenders 176

C. Litigation Plans 177
1. Litigation Plan Purpose 177
2. Format and Content of Litigation Plan 177
3. When Lenders Must Submit a Litigation Plan to SBA 178
4. SBA Response Time—No Implied Consent (13 C.F.R. §120.541) 179
5. Appeal of SBA District Counsel Decision on Litigation Plan 180

D. Debt Collection Litigation Expenses 180
1. Debt Collection Litigation Expenses Covered by SBA Loan Guaranty 180
2. Debt Collection Litigation Expenses Incurred without a Pre-approved Litigation Plan 180
3. Unreasonable Debt Collection Litigation Expenses 180

E. Particular Litigation Activities 182
1. Suit for Judgment on Note or Guaranty 182
2. Judicial Foreclosure and Deficiency Judgment 182
3. Settlement Offers 182

4. Bankruptcy Proceedings 183
5. Probate Proceedings 185
6. Enforcement of Judgments 185

F. Application of Litigation Recoveries 186

G. Litigation Plan Documentation & Updates 186

H. SBA Takeover of Lender-Serviced Litigation (13 C.F.R. §120.540(d)) 187

I. Reimbursement Requests for Debt Collection Litigation Expenses 187
1. SBA Approval of Debt Collection Litigation Expenses 187
2. How to Obtain SBA Approval of Debt Collection Litigation Expenses 187
3. Best Practices for Debt Collection Litigation Expense Reimbursement Requests 188

Chapter 23. Expenses and Recoveries 189

A. Classification of Expenses 189
1. Non-Recoverable Expenses 189
2. Recoverable Expenses 190

B. Liquidation Recoveries 191
1. Application of Recoveries 191
2. Remittance of SBA's Share of Recoveries 192

C. Payment of Non-Recoverable Expenses Incurred by Lenders 192

D. Reimbursement of Recoverable Expenses Incurred by Lenders 192
1. General Requirement—SBA Approval 192
2. Reimbursement Methods 192

E. SBA Review and Approval 193
1. Where and How to Submit Reimbursement Requests 193
2. Preferred Format for Lender Reimbursement Requests 193
3. When Lenders May Submit Reimbursement Requests to SBA 193
4. Multiple Loans—Allocation of Expenses 193
5. Contents of Recoverable Expense Request Packages 194
6. Denied Expenses Deducted From Liquidation Recoveries 194

Chapter 24. Loan Guaranty Purchase Requests 196

A. SBA Guaranty Purchase Overview 196

B. Interest SBA Pays on Guaranteed Portion of Loan 196
1. Interest Rate 196
2. Interest SBA Pays to Lenders 197
3. Interest Paid to Secondary Market Investors 197

C. Lender Annual Service Fee Collection. 198

D. Guaranty Purchase Requirements 198
1. Loan is in Uncured Payment Default 198
2. Loan is Classified as “In Liquidation” 198

3. Loans Sold in the Secondary Market 198
4. CollateralLiquidation 199
5. Complete Purchase Package Submission to SBA 200

E. Prudent Liquidation Deadline for Lender Resolution of an SBA Purchased Loan 201
1. Loans Returned to Regular Servicing 201
2. Loans Paid in Full 201
3. Wrap-up Report 202

F. Extensions to the Prudent Liquidation Deadline 202

G. Lender Consequences for Failure to Comply with Prudent Liquidation Deadline 202

H. Practice Tips for Submitting Complete Purchase Packages 203

Chapter 25. Denial of Liability on 7(a) Loan Guaranty 204

A. When SBA May Deny Liability on a 7(a) Loan Guaranty 204

B. Losses Attributable to Lender Actions or Inactions 204
1. Material Loss or Harm to Program Integrity 204
2. Losses on Recoveries From Collateral 205
3. Projected Losses 205

C. SBA Guaranty Repairs 205
1. Repair Definition 205
2. Repair Amount 205
3. When a Repair is Appropriate 205
4. When a Repair is Not Appropriate 206

D. Partial Denial of Liability 206

E. Full Denial of Liability 206

F. Voluntary Termination of SBA Guaranty 207

G. Examples of When a Repair or a Full or Partial Denial of Liability is Justified 207
1. Incorrect SBA Loan Eligibility Determination by Delegated Lender 207
2. Lender Use of Suspended or Debarred Agent 207
3. Early Default Due to Lender Failure to Properly Make or Close an SBA Loan 208
4. Early Default and Lender Failure to Use IRS Transcripts to Verify Borrower Financial Information 208
5. Lender Failure to Ensure Borrower Use of SBA Loan Proceeds as Required by the Loan Authorization 209
6. Early Default and Lender Failure to Verify a Required Equity Injection 210
7. Lender Failure to Obtain Required Lien or Lien Position on Collateral 211
8. Lender Failure to Prepare and Use an Adequate List of the Required Collateral 211
9. Lender Failure to Conduct a Timely Post-Default Site Visit 212
10. Lender Failure to Conduct Prudent Liquidation Actions 213
11. Loan Actions Resulting in Lender Preference 213

Chapter 26. Inspector General Referrals 215

A. Duty to Report Irregularities 215
B. Irregularities Requiring Referral 215
1. Loan Application Fraud 215
2. Loan Closing Fraud 215
3. Loan Agent Fraud 216
4. Misuse of Loan Proceeds 216
5. Conversion of Collateral 216
6. SBA Employee Misconduct 216
7. Lender Misconduct 216
C. Referral Methods 216
D. Required Referral Information 217
1. Answers to Basic Questions 217
2. Copies of Relevant Documents 217
E. Post-referral Responsibility 217

Chapter 27. Lender Wrap-up and SBA Charge Off 218

A. General Requirements 218
B. Lender Wrap-up Report 218
1. When Wrap-up Report Required 218
2. Consequences of Failure to Submit a Timely Wrap-up Report 218
3. Contents of Wrap-up Report 219
C. SBA Loan Charge Off 219
1. General 219
2. When Appropriate 219
D. Assignment of Loan Documents and Referral to Treasury for Further Collection 220
1. When Referral Required 220
2. Assignment of Loan Documents to SBA 220
3. Distribution of Post-Referral Recoveries 220
4. Post-Referral Servicing 221
E. Credit Reporting 222
1. Lender Responsibility for Credit Reporting 222
2. SBA Responsibility for Credit Reporting 222
F. Reporting Cancelled Debt to IRS 222
1. When IRS Form 1099-C Required 222
2. Responsibility for Issuing IRS Form 1099-C 222
3. When IRS Form 1099-C is Issued 222

Chapter 1.
Introduction

A. Purpose

This SOP sets forth the standard operating policies and procedures of the Small Business Administration ("SBA") that apply to the administration of 7(a) Loans that have been fully disbursed and are in "regular servicing" or "liquidation" status.

Because Paycheck Protection Program (PPP) Loans are 7(a) loans, this SOP applies to the servicing and liquidation of PPP Loans to the extent that it is not superseded by or in conflict with PPP-specific requirements.

Note: SBA term Loans are considered fully disbursed when the Loan has been closed and the final Loan disbursement has been made.

SBA revolving lines of credit are considered fully disbursed when the Loan has been closed and the initial Loan disbursement has been made.

All SBA Loans move from "regular servicing" to "liquidation" status if there is a default on the Note and the Lender classifies the Loan as "in liquidation" pursuant to Chapter 15 of this SOP.

B. Authority

The policy and procedures set out in this SOP are based on Section 7(a) of the Small Business Act (15 U.S.C. § 631 et seq.), Part 120 of Title 13 of the Code of Federal Regulations ("CFR"), the Debt Collection Improvement Act of 1996 ("DCIA"), Public Law 104-134 (1996), as revised, and the Federal Debt Collection Procedures Act of 1990, 28 U.S.C. 3001, et seq.

C. General Policy and Goals

Lenders must advise Borrowers of their obligation to repay their SBA Loan(s) in accordance with the terms specified in the SBA Loan Note. However, when Loan servicing and liquidation actions are necessary, Lenders should reflect a balancing of SBA's interest in: (1) achieving the goals of the Loan program, i.e., helping entrepreneurs start, build and grow viable small businesses; and (2) maintaining the integrity of the Loan program, i.e., ensuring that the Agency can maximize its recovery if the Borrower defaults on the Loan.

D. Performance Standards

1. Lenders must service and liquidate their SBA Loans in a commercially reasonable manner that is free of conflicts of interest and Preferences and consistent with the Loan Authorization, Prudent Servicing and/or Prudent Liquidation practices (including the Prudent Liquidation Deadline defined in Chapter 2 of this SOP), and the SBA Loan Program Requirements in effect at the time a Loan Action is taken. (13 C.F.R. § 120.535) Lenders must also service and liquidate their SBA Loans no less diligently than they do for their portfolio of non-SBA loans. Lenders that do not maintain a non-SBA Loan portfolio must adhere to the same prudent lending standards for loan servicing followed by commercial lenders on loans without a government guarantee. (13 C.F.R. § 120.535)

2. Nationally-chartered and state-chartered Lenders, (i.e., Lenders regulated by federal or state agencies such as the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, the National Credit Union Administration, the Farm Credit Administration or a state banking regulator) that have a non-SBA commercial loan portfolio may use their own loan servicing and liquidation procedures provided that their procedures: (a) are acceptable to their regulators; (b) meet or exceed those used for their similarly-sized non-SBA guaranteed commercial loans; and (c) are not inconsistent with SBA Loan Program Requirements including those associated with the use of the word "must" in this SOP.

E. Exceptions to Policy

SBA will treat any contemplated Loan Action, as defined in Chapter 2 below, that is in conflict with the use of the word "must" in this SOP as an exception to policy. An exception to policy is only appropriate when the policy set forth in this SOP does not adequately address the unique circumstances regarding a particular Loan, and the exception, if granted, would not contravene an applicable statute or regulation. Lenders may use this procedure only in situations where a minor deviation from standard policy is necessary for the specific situation. SBA will consider exceptions to policy on a case-by-case basis and SBA's decision will only apply to the specific request.

Lenders must submit all requests for an exception to policy in writing to the appropriate SBA Loan Center, prior to taking the proposed Loan Action. SBA Loan Centers will review each request to either resolve or refer it, along with a written recommendation, to the Director of the Office of Financial Program Operations ("OFPO") and the Director of the Office of Financial Assistance ("OFA") for joint review and written determination.

For Export Working Capital Program (EWCP) and International Trade Loan Program (IT) Loans, the D/OFPO and D/OFA will consult with the Director of International Trade Finance (D/ITF). For Export Express Loan Program Loans, the D/OFPO and D/OFA will consult with the D/ITF and obtain the concurrence of the Director of the Office of Credit Risk Management (D/OCRM).

Lenders must not take the proposed exception to policy Loan Action without SBA's prior written approval. SBA's failure to respond to a request for an exception to policy does not constitute approval of the request.

Chapter 2.
Definitions

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. **7(a) Loan or Loan** means a loan that was made under Section 7(a) of the Small Business Act.

2. **Agency** means the U.S. Small Business Administration.

3. **Agent** means an authorized representative, including an attorney, accountant, consultant, packager, lender service provider, or any other Person representing a Loan applicant or a Lender by conducting business with SBA. (13 C.F.R. § 103.1(a))

4. **Appraisal** means, for SBA Loan servicing and liquidation purposes, an expert's written opinion as to the value of specific property prepared specifically for the Lender and SBA's use with regard to a particular SBA Loan, which is obtained in accordance with all the following requirements[1]:

   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 following minimum qualifications:

   (1) Education and Experience

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

   (2) Licensed, Certified and Bonded

   Meets all applicable government licensing, certification and bonding requirements;

   (3) Independent

   Has no actual, apparent or potential conflict of interest with SBA, the Lender or Obligors; and has no financial interest in the property to be appraised, provided, however, that when it is commercially reasonable, the Person who appraised the

[1] *See* SOP 50 10 for SBA Loan Program Requirements pertaining to appraisals for Loan origination purposes.

collateral may also sell it as long as the sale is widely advertised and otherwise consistent with applicable law. (For example, an auctioneer hired to appraise personal property collateral may also sell it via a public auction, provided that the sale is widely advertised and otherwise consistent with Article 9 of the Uniform Commercial Code ["UCC"].)

b. Appraisal Standards

(1) Real Property

(a) A real property Appraisal to support a substitution of collateral Loan Action should comply with the appraisal requirements in SOP 50 10 in effect at the time the Loan Action is taken.

(b) A real property Appraisal should comply with the Uniform Standards of Professional Appraisal Practice (USPAP) whenever required by prudent lending practices, such as to support Loan Actions involving the release of liens for consideration, Protective Bids, or deeds in lieu of foreclosure, 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 sufficient equity to secure the SBA loan; and

(c) In all other cases (where SBA Loan Program Requirements and prudent lending practices do not require an appraisal in compliance with the USPAP), a real property Appraisal 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

(a) A personal property Appraisal to support a substitution of collateral Loan Action should comply with the appraisal requirements in in SOP 50 10 in effect at the time the Loan Action is taken;

(b) A personal property Appraisal should comply with the USPAP 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

(c) In all other cases (i.e., when neither SBA Loan Program Requirements nor prudent lending practices require an appraisal in compliance with USPAP), a personal property Appraisal may consist of an auctioneer or other expert's opinion as to value.

c. 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 of personal property valued at $5,000 or more at the time the Loan was made;

(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, the Lender or any Obligor; and

(7) The appraiser's qualifications and signature**.**

d. 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 or the Lender relies on it to make a decision affecting an SBA Loan.

5. **Associate of a Small Business** means an officer, director, owner of more than 20 percent of the equity, or Key Employee of the small business; an entity in which one or more individuals referred to in the previous clause owns or controls at least 20 percent; and an individual or entity in control of, or controlled by, the small business, except a Small Business Investment Company licensed by SBA. (13 C.F.R. §120.10)

6. **Associate of a Lender** means an officer, director, Key Employee, or holder of 20 percent or more of the value of the Lender's stock or debt instruments, or an Agent (13 C.F.R. §103.1) involved in the Loan process; or any entity in which one or more individuals referred to in the previous clause, or a Close Relative of any such individual owns or controls at least 20 percent. (13 C.F.R. §120.10)

7. **Borrower** means the Person or Persons who executed the Note evidencing the SBA Loan. (13 C.F.R. §120.10)

8. **Close Relative** means a spouse, parent, child or sibling, or the spouse of a parent, child or sibling. (13 C.F.R. §120.10)

9. **CLP** means Certified Lenders Program.

10. **Computer Tracking System** means the electronic method used by SBA or a Lender to create and maintain a chronological record of the significant activities on an SBA Loan, such as Loan Actions and the substance of telephone calls, meetings or letters regarding the Loan.

11. **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.

12. **Debt Collection Litigation Expenses** means the legal fees and expenses associated with actions conducted by a Lender's outside legal counsel related to matters of adjudication before a local, state or federal court, which are subject to the $10,000 threshold for determining Non-Routine Litigation in accordance with 13 CFR §120.540(c). Debt Collection Litigation Expenses do not include the legal fees and expenses associated with a Lender's non-judicial execution of the rights and responsibilities under the SBA Loan Documents, including the development of Loan modification agreements, forbearance and Loan workout agreements, non-judicial foreclosures and other liquidation actions that are not subject to the $10,000 threshold for determining Non-Routine Litigation. Payment of any legal fees or expenses, whether or not they are Debt Collection Litigation Expenses, is subject to the requirements of 13 C.F.R. § 120.542.

13. **Default** means any event, including when a Borrower fails to make a payment when due, listed in the SBA Form 147 "Note" or other Loan Documents.

14. **Default Charges** means all monetary amounts payable as the result of a default on a senior secured creditor's loan, such as prepayment penalties, late fees and interest paid at an escalated rate.

15. **Denial of Liability** means a determination made by SBA pursuant to 13 C.F.R. §120.520 and 13 C.F.R. §120.524 that it is not obligated to purchase the guaranteed portion of the 7(a) Loan. SBA may deny liability for the full amount of the guaranteed portion of the Loan or any part thereof.

16. **Early Default**. For SBA guaranty purchase reviews, Early Default means any of the following events of Default that occur either: (a) within 18 months of the initial disbursement of the Loan, or (b) within 18 months of the final disbursement if the final disbursement occurs more than six months after the initial disbursement, unless the Borrower cures the Default and makes scheduled Loan payments without default for 12 months following the 18-month period:

    a. Borrower failure to make a scheduled payment of principal and interest on an SBA Loan when due. For Loans that require annual payments of principal and interest, an Early Default occurs if a Borrower fails to make either of the first two

annual payments when due. In such cases, a Borrower may cure an Early Default by making the first two annual payments within 60-days of the date they were due and the third annual payment on or before the date it is due;

b. Borrower use of collateral sale proceeds rather than cash flow from business operations to fund a scheduled Loan payment;

c. Lender deferment or Borrower curing of defaulted payments equal to more than three consecutive scheduled payments of principal and interest; or

d. Any other event of Default that requires a Lender to classify a Loan in liquidation status, e.g., bankruptcy.

17. Financial Hardship means an inability to pay for basic living expenses, i.e., the 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.

18. FTA means the entity that acts as SBA's fiscal and transfer agent. (13 C.F.R. §120.600(d))

19. Good Faith means whether capitalized or not, an honest and sincere intention to fulfill one's obligations in the conduct or transaction concerned.

20. Guarantor, including **Supplemental Guarantor** as defined in SOP 50 10, means a Person who executed a Guaranty as security for a Note executed by a Borrower.

21. Guaranty means an unconditional promise to pay the debt owed on a Note if the Borrower fails to pay it. SBA requires Guarantors to execute an SBA Form 148 (Unconditional Guarantee), SBA Form 148 L (Unconditional Limited Guarantee) or an equivalent Lender's form to evidence their guarantee of an SBA Loan.

22. Including, whether capitalized or not, means "including but not limited to," i.e., the list is exemplary and not exhaustive.

23. Key Employee means any Person hired by a business to manage its day-to-day operations, including, the hiring and firing of employees and the expenditure of money.

24. Lender or 7(a) Lender means an institution that has executed a Loan Guaranty Agreement (Deferred Participation) with SBA under the guaranteed loan program. (13 C.F.R. §120.10)

25. Liquidation Plan means a Lender's written plan outlining the actions it intends to take to recover on a specific SBA loan. The plan must include information outlined in the template accessible from www.sba.gov/for-lenders.

26. **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 publicly-traded stock should be based on official stock exchange prices.

27. **Litigation Plan** and any amendments to the Litigation Plan are a Lender's written plan outlining the litigation proceedings it intends to initiate or otherwise participate in to maximize recovery for a specific SBA Loan. The Litigation Plan includes the information outlined in the template accessible from www.sba.gov/for- lenders as well as any other information or documentation required by Chapter 22 of this SOP. Litigation Plans should also include information such as the qualifications of the attorney the Lender intends to hire, a copy of the engagement letter, and justification for any estimated expenses listed in Chapter 22 Paragraph D of this SOP that SBA may otherwise presume to be unnecessary, unreasonable and non-customary such as the use of multiple law firms, travel, or the appointment of a receiver to perform routine liquidation duties.

28. **Loan Action** means an activity or decision regarding a specific SBA Loan including a decision to engage or not to engage in a particular activity, such as a decision not to enter a Protective Bid at a senior lienholder's foreclosure sale.

29. **Loan Action Record** means the paper or electronic document used to memorialize the activity or 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; the Lender's name and contact information; 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 regulation or SOP provision that provides authority for the proposed Loan Action.

30. **Loan Authorization** means SBA's written agreement, including subsequent modifications thereto, which sets out the terms and conditions under which SBA will guarantee a Loan. For 7(a) Loans approved after August 1, 2023, Loan Authorization means the electronic record of the terms and conditions of the Loan in E-Tran.

31. **Loan Documents** means the Loan Authorization, Note, Guaranty, Supporting Documentation, Loan Action Record, lien instruments, and all other agreements and

documents related to an SBA Loan.

32. **Loan File,** whether capitalized or not, means the electronic files and paper documents dedicated exclusively to storing electronic copies and hard copies of all of the Loan Documents pertaining to a specific SBA Loan. Lenders must retain all Loan Documents in their original form as set forth in SOP 50 10.

33. **Loan Program Requirements or SBA Loan Program Requirements** are requirements imposed upon Lenders by statute; SBA and applicable government-wide regulations; any agreement the Lender has executed with SBA or to which the Lender is subject; SBA SOPs; Federal Register Notices; and official SBA notices and forms applicable to the 7(a) Loan program; as such requirements are issued and revised by SBA from time to time. (13 C.F.R. §120.10) (See 13 C.F.R. §120.180 for information on compliance with SBA Loan Program Requirements, including what SBA Loan Program Requirements govern a specific action.)

34. **Material Loss** means: (a) with regard to personal property collateral—a single loss or the aggregate amount of multiple losses totaling $5,000 or more; and (b) with regard to real property collateral—a loss in the amount of $10,000 or more.

35. **Must**, whether capitalized or not, means that the action is mandatory.

36. **Non-Recoverable Expense** means a cost associated with an internal Lender function that is not reimbursable by SBA nor recuperable from the Borrower by adding it to the principal balance of the Note, because the cost was not: (a) related to collection of amounts due under the Note, enforcement of the terms of the Loan Documents, or the preservation or disposal of the collateral; (b) necessary, reasonable or customary in the geographic area where the expense was incurred; or (c) incurred in accordance with prudent lending practices or SBA Loan Program Requirements.

37. **Non-Routine Litigation** means: (a) all litigation where factual or legal issues are in dispute and require resolution through adjudication; (b) any litigation where Debt Collection Litigation Expenses are estimated to exceed $10,000 in the aggregate, even if a Lender deducts such fees from Recoverable Expenses; (c) any litigation involving a Loan where a Lender has an actual or potential conflict of interest with SBA; or (d) any litigation involving a 7(a) Loan where the Lender has made a separate loan to the same Borrower that is not an SBA loan. (13 C.F.R. §120.540(c)(1)

38. **Note** means the promissory note (e.g., SBA Form 147) or Lender's equivalent note executed by the Borrower on an SBA Loan.

39. **Obligor** means any Person with direct liability for repaying an SBA Loan, such as the Borrower, an assumptor, and every Person with contingent liability, such as a Guarantor.

40. **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.

41. **Person** means any individual, corporation, partnership, association, unit of government, or

other legal entity, however organized. (13 C.F.R. §120.10)

42. **Pilot Loan Program** means any program designated by SBA as a pilot Loan program at the time that the Loan is approved by SBA. (13 C.F.R. §120.3)

43. **Preference** means any arrangement giving a Lender a preferred position compared to SBA relating to the making, servicing, or liquidation of a business loan with respect to such things as repayment, collateral, guarantees, control, maintenance of a compensating balance, purchase of a Certificate of deposit or acceptance of a separate or companion loan, without SBA's consent, e.g., a Lender would receive a Preference if it released the collateral for an SBA Loan in order to use it as security for a non-SBA loan to the same Borrower and Lender failed to get SBA's prior approval for such action.) (13 C.F.R. §120.10)

44. **Prudent Liquidation and Prudent Liquidation Deadline** mean Lenders must liquidate and conduct debt collection litigation for 7(a) Loans in their portfolio no less diligently than they do for their non-SBA portfolio; in a prompt, cost-effective and commercially reasonable manner consistent with prudent lending standards, in accordance with Loan Program Requirements, and, if applicable, an SBA approved Liquidation or Litigation Plan, or any amendments to such a plan. Lenders that do not maintain a non-SBA loan portfolio must adhere to the same prudent lending standards followed by commercial lenders that liquidate loans without a government guarantee. They must also operate in accordance with Loan Program Requirements and with any SBA approval of either a Liquidation or Litigation Plan, or any amendment to such a plan. (13 C.F.R. §120.535(b)) Prudent Liquidation Deadline means that a Lender submits a Wrap-Up Report for an SBA Loan, acceptable to SBA, no more than 24 months after the date SBA purchases its guaranty, unless SBA grants a written extension of that timeframe based on extenuating circumstances. (See Chapter 24, Paragraph F of this SOP for additional guidance on extensions to the Prudent Liquidation Deadline).

45. **Prudent Servicing** means Lenders must service 7(a) Loans in their portfolio no less diligently than they do for their non-SBA portfolio, in a commercially reasonable manner that is consistent with prudent lending standards, and in accordance with Loan Program Requirements. Lenders that do not maintain a non-SBA loan portfolio must adhere to the same prudent lending standards for loan servicing followed by commercial lenders on loans without an SBA guaranty. (13 C.F.R. §120.535(a))

46. **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.

47. **Purchase,** whether capitalized or not, when used in conjunction with SBA's 7(a) Loan guaranty ("guaranty purchase") refers to SBA's purchase of the SBA guaranteed portion of a 7(a) Loan.

48. **Real Estate Owned ("REO")** means real property collateral acquired by a Lender or SBA.

49. **Recoverable Expense** means an SBA-approved, necessary, reasonable and customary cost in the geographic area where the expense was incurred to 1) collect amounts due under the Note, 2) enforce the terms of the Loan Documents, or 3) preserve or dispose of collateral, which according to the terms of the Note can be recouped by adding it to the principal balance of the Loan.

50. **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 Lender or SBA is likely to acquire the collateral at a foreclosure sale (e.g., real property), the expenses associated with the care, preservation and resale of the acquired collateral.

51. **Repair** means an agreement between SBA and a 7(a) Lender regarding a specific dollar amount that SBA will deduct from the amount that SBA pays on the SBA guaranty for a 7(a) Loan, to compensate SBA for an actual or anticipated loss on the Loan caused by the Lender's actions or inactions. A Repair does not reduce the SBA Loan guaranty percentage or SBA's pro-rata share of expenses or recoveries.

52. **Routine Litigation** means uncontested litigation, such as non-adversarial matters in bankruptcy and undisputed foreclosure actions, in which estimated Debt Collection Litigation Expenses do not exceed $10,000 in the aggregate. (13 C.F.R. §120.540(c)(2))

53. **SBA Legal Counsel** means SBA Associate General Counsel for Litigation, SBA Area Counsel, SBA District Counsel or SBA Center Counsel.

54. **SBA Loan Center** means the following SBA facilities:

a. SBA 7(a) Loan Guaranty Processing Center ("LGPC")

Geographic Coverage: SBA Regions 1-10

Loan Type and Status: All term loans not yet fully disbursed and undisbursed revolving line of credit loans.

Street Address: 6501 Sylvan Road, Suite 122, Citrus Heights, CA 95601

Web Site Address: http://www.sba.gov/CitrusHeightsLGPC

Telephone Number: Toll Free: (877) 475-2435

Email: 7(a) Servicing: 7aloanmod@sba.gov

b. SBA Commercial Loan Service Center ("CLSC") West

WEST*

Address	801 R Street, Suite 101, Fresno, CA 93721
Phone Number	(800) 347-0922
Website	http://www.sba.gov/FresnoCLSC
Email	Servicing:……..fsc.servicing@sba.gov Express Purchase:…....fsc.expresspurchases@sba.gov Post-servicing:…….fsc.postservicing@sba.gov ARC Servicing:……..……ARCloanmod@sba.gov ARC Form 1502 Issues:. ARC1502Inquiries@sba.gov
Fax Numbers	Servicing……..(202) 481-0483 Express Purchase……..(202) 481-0663 Post-Servicing……..(202) 481-1756

***Geographic Coverage:** Alaska, Arizona, California, Colorado, Guam, Hawaii, Idaho, Illinois, Indiana, Iowa, Kansas, Louisiana, Michigan, Minnesota, Missouri, Montana, Nebraska, Nevada, New Mexico, North Dakota, Utah, Washington, Wisconsin, Wyoming

Loan Type and Status:

(1) All fully disbursed 7(a) Loans classified in regular servicing status, including partially disbursed revolving lines of credit;

(2) Loans in Liquidation status:
All 7(a) Loans of $500,000 or less, SBA Express, Export Express and Pilot Loan Programs (including Community Advantage).

c. SBA Commercial Loan Service Center ("CLSC") East

EAST*

Address	2120 Riverfront Drive, Suite 100, Little Rock, AR 72202-1794
Phone Number	(800) 644-8564
Website	http://www.sba.gov/LittleRockCLSC

Email	Servicing:…… lrsc.servicing@sba.gov Liquidation:…… lrsc.504liquidation@sba.gov Customer Service:….. lrsc.customerservice@sba.gov Express Purchase:... LRSC.ExpressPurchase@sba.gov
Fax Numbers	Servicing:…… (202) 292-3878 Liquidation:…… (202) 481-6481

***Geographic Coverage:** Alabama, Arkansas, Connecticut, Delaware, Florida, Georgia, Kentucky, Maine, Maryland, Massachusetts, Mississippi, New Hampshire, New Jersey, New York, North Carolina, Oklahoma, Pennsylvania, Puerto Rico, Rhode Island, South Carolina, Tennessee, Texas, The U.S. Virgin Islands, Vermont, Virginia, Washington, DC, West Virginia

Loan Type and Status:

(1) All fully disbursed 7(a) Loans classified in regular servicing status, including partially disbursed revolving lines of credit;

(2) Loans in Liquidation status:
All 7(a) Loans of $500,000 or less, SBA Express, Export Express and Pilot Loan Programs (including Community Advantage).

d. National Guaranty Purchase Center ("NGPC")

Geographic Coverage: SBA Regions 1-10

Loans Classified in Liquidation Status:

Standard 7(a), CLP or PLP – Loan Amount over $500,000
Seasonal CAPLines
Contract CAPLines
Builders CAPLines
Working Capital CAPLines
Export Working Capital Program (EWCP)
International Trade Loan Program (ITL)
USCAIP Guaranty (NAFTA)
Export Import Harmonization
Small/Rural Lender Advantage
Dealer Floor Plan

Street Address: 1165 Herndon Parkway, Herndon, VA 20170

Web Site Address: National Guaranty Purchase Center (Herndon, VA) (sba.gov)

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

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

Email:
General inquiries: loanresolution@sba.gov
Loans sold on the secondary market: secondarymarketliq@sba.gov
Loans not sold on the secondary market: sbapurchase@sba.gov

Wrap-up Reports: SBAChargeoff@sba.gov

e. U. S. Export Assistance Centers ("USEAC")

Geographic Coverage: SBA Regions 1-10

Loan Type, Status and Contact Information: All revolving and non-revolving Export Working Capital Program (EWCP), Export Express Loan Program (Export Express) and International Trade Loan Program (ITL) Loans in regular servicing status. Lenders may contact the SBA Export Finance Manager serving the geographic market where the Borrower is located for guidance regarding the servicing and/or liquidation of these types of SBA Loans; however, final approval authority for all servicing and liquidation actions pertaining to these types of Loans rests with the CLSCs and NGPC, according to the geographic and Loan type guidance provided in this Paragraph above.

55. 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:

a. Made all scheduled Loan payments;

b. Did not fund a scheduled Loan payment from the sale of collateral;

c. Did not have more than three consecutive scheduled full payments deferred; and

d. Did not experience an event of Default that required the Loan to be classified in liquidation.

56. Servicing Request means a Loan Action requested by a Lender that requires prior SBA approval, regardless of whether it is simple (e.g., address change) or more complex such as the Loan Actions covered in Chapters 7 through 12 of this SOP (e.g., subordination of lien

position).

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

58. **Site Visit Report** means the paper or electronic record documenting the Lender's findings and conclusions after visiting or a contracting a third party to visit the Borrower's business premises. A post-Default Site Visit Report should cover, for example, the Lenders 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.

59. **Supporting Document or "Supporting Documentation"** means the original, or a complete, legally enforceable (if relevant) and accurate executed copy (i.e., it must contain all the required signatures and include all exhibits and/or addenda 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.

60. **Treasury** means the U.S. Department of the Treasury Bureau of the Fiscal Service.

61. **Universal Purchase Package** is the set of documents prepared and submitted by a 7(a) Lender to support the Lender's request for SBA to honor its guaranty by purchasing the SBA guaranteed portion of a Loan.

62. **Wrap-up Report** refers to the documentation, whether or not it is titled "Wrap-up Report," that a Lender must provide in electronic format to the SBA Loan Center within 30 calendar days after all Prudent Liquidation actions are completed, for review and approval by SBA. It includes the information outlined in the template accessible from http://www.sba.gov/for-lenders. See Chapter 27 of this SOP for additional guidance on Wrap-up Reports.

B. Environmental Terms

Definitions of the environmental terms used in this SOP, which are capitalized when they appear, are located in the Appendix section of SOP 50 10.

Chapter 3.
Lender Responsibility and Authority

A. Servicing and Liquidation

7(a) Lenders must service and liquidate:

1. All the SBA Loans in their portfolio both before and after SBA purchases the guaranteed portion of the Loan.

2. The entire debt owed on each 7(a) Loan—not just the Lender's portion—regardless of the guaranteed percentage or whether the guaranty has been purchased.

Note: Pursuant to the Secondary Market Improvements Act of 1984, in addition to facilitating the sale of SBA Loans to secondary market investors and keeping track of current and prior registered holders ("investors"), whenever a Lender sells a 7(a) Loan on the secondary market, the FTA is responsible for:

a. Tracking loan payment histories;

b. Collecting payments from Lenders on Loans sold to investors, (Lenders are permitted to make one payment each month to cover all of the Loans they have sold.);

c. Resolving SBA Form 1502 reporting discrepancies with Lenders;

d. Remitting payments to investors, (FTA sends one check or wire to the investor that includes an accounting of the funds for all Loans held by that investor);

e. Forwarding all Servicing Requests from a Lender to the investor and forwarding the response back to the Lender;

f. Notifying SBA of delinquent Loans;

g. Processing all borrower prepayments;

h. Forwarding all SBA fee remittances to SBA’s Denver Finance Center; and

i. Handling SBA and Lender repurchases from investors.

B. Litigation

Lenders are responsible for conducting all litigation needed to ensure recovery on all the SBA Loans in their portfolios except those Loans that have been referred to Treasury pursuant to Chapter 27 of this SOP and those Loans for which SBA has taken over servicing.

After a Loan has been referred to Treasury or if SBA has taken over servicing, SBA has sole authority to conduct any litigation that may become necessary. For Loans referred to Treasury, Lenders must immediately notify the SBA Treasury Offset Division (via fax 202-481-0592 or by email to BirminghamTOPS@sba.gov) of any litigation they become aware of or any litigation notices they receive, including bankruptcy filings, so that the Loan may be recalled from Treasury and appropriate action taken by SBA District Counsel. (See Chapter 22 of this SOP for information on litigation, including when SBA District Counsel's prior written approval of a Lender's Litigation Plan is required.) For Loans that SBA has taken over servicing, Lenders must immediately notify the appropriate SBA Loan Center of any litigation of which they become aware, including any litigation notices or bankruptcy filings they receive, so SBA may take appropriate action.

C. Decision-Making

1. Lender Authority

Lenders have unilateral authority to take all routine actions to service and liquidate all the 7(a) Loans in their portfolio, except as provided in Subparagraphs 2 and 3 below and provided that the actions are consistent with the performance standards set out in Chapter 1 of this SOP. This authority is subject to SBA's right to take over the servicing or liquidation of any Loan as provided in Paragraph G of this Chapter.

2. Unilateral Actions

Lenders must notify the appropriate SBA Loan Center in writing or via E-Tran when they take substantive unilateral Loan Actions. For a specific list of unilateral actions and information on how to notify SBA, see the most recent version of the 7(a) Lenders Servicing and Liquidation Matrix. Unilateral actions are conditioned by whether the Loan guaranty has been sold in the Secondary Market. Pursuant to SBA Form 1086, or its successor form, changes made to the terms and conditions of a sold Note, and the financial payment amounts due other than the single unilateral deferment option, require the prior written consent of the Registered Holder.

3. Loan Actions That Require SBA's Prior Written Approval

Lenders must obtain SBA's prior written approval before taking any Loan Action that involves a/an:

a. Exception to policy;

b. Preference (13 CFR §120.10);

c. Conflict of interest: real, apparent or potential;

d. Sale or lease of collateral or acquired collateral to the Lender, an Associate of the Lender, an employee of the Lender, or a Close Relative of an employee of the Lender;

e. Sale or lease of collateral or acquired collateral to an Obligor or a Close Relative or Associate of an Obligor for an SBA Loan in liquidation status;

f. Release of a co-Borrower or Guarantor, except for limited guaranties taken to secure an owner's interest in collateral. (See Chapter 11 of this SOP for additional guidance on the release of Obligors in Loan assumption transactions.);

g. Compromise in lieu of full payment of the principal balance of an SBA Loan, including actions that legally extinguish the deficiency balance of a Loan, such as a deed in lieu of foreclosure, etc.;

h. Assumption of a 7(a) Loan with the release of an Obligor for Loans that are in payment Default or liquidation only. (See Chapter 11 of this SOP for additional guidance.);

i. Extraordinary servicing fee (13 CFR §120.221);

j. Determination that a Loan prepayment is involuntary, in connection with a subsidy recoupment fee (13 CFR §120.223);

k. Liquidation Plan and any amendments to a Liquidation Plan for a CLP Loan (See Chapter 2 of this SOP for the definition of CLP);

l. Litigation Plan and any amendments to a Litigation Plan for Non-Routine Litigation;

m. Acquisition of title to any property in SBA's name;

n. Acquisition of title to Contaminated property in SBA's name or the Lender's name;

o. Operation or control of a business that handles Hazardous Substances;

p. Operation or control of a business located on Contaminated Property;

q. Increase in SBA's guaranty percentage:

r. Increase or decrease in the Loan amount:

(1) For non-delegated Loans, Lenders must submit requests to the appropriate SBA Loan Center to have a Loan amount increased or decreased;

(2) For delegated Loans, Lenders must obtain approval for increases or decreases in the Loan amount directly in E-Tran;

s. Reinstatement of SBA's Loan guaranty;

t. Emergency purchase of the Loan from the secondary market; or

u. Transfer or sale of more than 90 percent of the outstanding principal balance of a Loan;

v. Change in the ownership of a Borrower, including a change in percentage of ownership, for 12 months after final disbursement on any Loan.

As mentioned previously, Lender Loan Actions are conditioned by whether the guaranteed portion of the Loan has been sold in the Secondary Market. Pursuant to SBA Form 1086, or its successor form, changes made to the terms and conditions of the sold Note other than the single unilateral deferment option, require the prior written consent of the Registered Holder. This written request must be sent to the FTA.

4. Where to Send Notices and Requests for SBA Approval

a. Prior to Final Loan Disbursement

Lenders must send notices and requests for SBA's prior approval pertaining to Loans that have been approved, but are not fully disbursed, to the LGPC in Citrus Heights, CA. For EWCP Loans, Lenders may send post-approval/pre-disbursement notices and requests to the Export Finance Manager at the appropriate USEAC, who will review the request and forward a recommendation to the LGPC for approval.

(1) Transfer of SBA Guaranty Between Participating SBA Lenders

(a) To transfer an SBA guaranteed Loan to another participating SBA Lender prior to final disbursement, Lenders must submit a Servicing Request including a detailed explanation and supporting documentation to the LGPC. After final disbursement, Lenders must submit all Loan transfer requests to the appropriate CLSC.

(b) To transfer more than one SBA guaranteed Loan to another participating Lender prior to final disbursement, Lenders must submit a Service Request including a detailed explanation and supporting documentation to the LGPC. LGPC will forward the request to the D/FA for a decision. See Chapter 11, Paragraph C of this SOP for additional guidance on how to transfer an SBA Loan portfolio.

b. After Final Loan Disbursement

For Loans that are fully disbursed, Lenders must send Servicing Requests for any Loan Action that requires SBA's prior written approval to the appropriate CLSC (in Fresno or Little Rock) or the NGPC in Herndon, VA. The CLSC/NGPC will consult with the appropriate USEAC or SBA Legal Counsel as needed. (See

definition of "SBA Loan Center" in Chapter 2 of this SOP for guidance on where to send requests by Loan type, location and status.)

c. Revolving Line of Credit Loans

For revolving lines of credit that have had at least one disbursement, Lenders must send Servicing Requests to the appropriate CLSC (in Fresno or Little Rock) or the NGPC in Herndon, VA. The CLSC or NGPC will consult with the appropriate USEAC as needed. (See definition of "SBA Loan Center" in Chapter 2 of this SOP for guidance on where to send requests by Loan type, location and status.)

Note: The appropriate SBA District Counsel or Center Counsel will make determinations for all Lender Servicing Requests that involve Lender Litigation Plans, Debt Collection Litigation Expenses and other legal expenses. SBA Loan Centers will make the determinations for all other Lender Servicing Requests. SBA Loan Centers, Center Counsel or District Counsel should respond to Lender Servicing Requests within 15 business days from the date SBA receives the Servicing Request. (See 13 C.F.R. §120.541 for additional guidance.)

5. Requests for Reconsideration

For Lender Loan Actions that require SBA's prior approval, Lenders may submit requests for reconsideration of an SBA Loan Center or SBA District Counsel decision regarding a proposed Loan Action only if relevant new facts are provided. Lenders must include new information and/or facts to support all reconsideration requests. Lenders must prepare and submit requests for reconsideration in accordance with the procedures that applied to the original request. When a Loan Action involves a Litigation Plan or Debt Collection Litigation Expenses, Lenders are limited to one request for reconsideration and SBA District Counsel or Center Counsel will review and decide the request. After the first request for reconsideration, Lenders must follow the appeal procedures set out in Subparagraph 6.b. below.

6. Appeal of Decision

a. Liquidation—Liquidation Plan, Loan Action or Expense

Lenders may appeal the decision of an SBA Loan Center Director or designee regarding a Liquidation Plan, liquidation Loan Action (e.g., compromise) or liquidation expense, which is not related to litigation or environmental risk management, to the Director of OFPO, who will consult with the SBA Associate General Counsel for Litigation. The Lender's appeal must: (1) be in writing; (2) include a copy of the decision and Supporting Documents; (3) state the reason(s) why the Lender believes the decision is incorrect; and (4) be submitted within 30 calendar days of the date of the decision. (13 C.F.R. §120.542(d))

b. Litigation—Litigation Plan, Debt Collection Litigation Expenses and other Legal Expenses

Lenders may appeal the decision of an SBA Center or District Counsel regarding a Litigation Plan or Debt Collection Litigation Expenses and other legal expenses to the SBA Area Counsel who will consult with the SBA Associate General Counsel for Litigation and the Director of OFPO, and issue a final agency decision. The Lender's appeal must (1) be in writing; (2) include a copy of the original and reconsideration decisions and Supporting Documents; (3) include a statement and analysis of why the Lender believes the underlying decision is in error; and (4) be submitted within 30 calendar days of the date of the original or reconsideration decision, whichever is most recent. (13 C.F.R. §120.542(e)) Lenders should submit such requests to the appropriate SBA Loan Center for tracking purposes.

c. Environmental Risk Management—Denial of Request Regarding Contaminated Property

Lenders may appeal the decision of an SBA Loan Center Director or designee denying a request for approval to take title to Contaminated Property or to take over the operation of a business that handles Hazardous Substances or is located on Contaminated Property, to the Associate General Counsel for Litigation who will consult with the Director of OFPO, provided that the appeal: (1) is in writing; (2) includes a copy of the original decision and Supporting Documents; (3) states the reason(s) why the Lender believes the decision is incorrect; and (4) is submitted within 30 calendar days of the date of the original decision.

D. Recordkeeping

1. General Requirements

Lenders must document all servicing and liquidation Loan Action decisions, including the justification for the decisions, in the Lender's Loan File or Computer Tracking System.

2. Loan Action Records and Supporting Documents

Lenders must keep dated Loan Action Records in their Loan File, along with Supporting Documents, such as Appraisals, credit reports, Environmental Investigation Reports and any other document relied upon before taking the action memorialized in the Loan Action Record, including, for example, a copy of the Servicing and Liquidation Actions 7(a) Lender Matrix.

3. Correspondence

Lenders must keep dated copies of all paper and electronic correspondence concerning an SBA Loan in their Loan File.

4. Telephone Conferences and Meetings

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

5. Loan File Retention

a. General Rule

Lenders must retain the original Note; personal guaranty(ies); security/collateral documents such as mortgages, deeds of trust and/or security agreements; SBA Loan applications (SBA Form 1919 or any other application documents); SBA Form(s) 159; and any SBA Environmental Indemnification Agreements in their Loan File. Lenders must retain hard-copy records of Loan Documents requiring original signatures, unless the original signature was made electronically in accordance with applicable standards governing electronic signatures. (See applicable appendices in SOP 50 10 for guidance on electronic signature standards and record retention requirements.)

Federally-regulated 7(a) Lenders must also comply with their federal financial institution regulatory agency requirements governing how long to retain Loan Documents.

SBA small business lending companies (SBLC) and non-federally regulated SBA Lenders must retain their Loan Files for at least six years following the final disposition of each SBA Loan (i.e., after the Loan has been paid in full or charged-off by SBA). (13 C.F.R. §120.461)

Upon request by SBA, Lenders must make SBA Loan information available to SBA in a timely manner. Pursuant to 13 C.F.R. §120.1010, Lenders must allow SBA's authorized representatives, including representatives authorized by the SBA Office of the Inspector General, during normal business hours, access to their Loan Files to review, inspect, and copy all records and documents relating to SBA guaranteed Loans, or as requested for SBA Lender oversight.

b. Exception—Litigation Hold

If litigation involving a 7(a) Loan is reasonably anticipated, Lenders must preserve all potentially relevant information regarding the Loan, including electronically stored information. Lenders must preserve electronically stored information in its originally created or "native" format, along with the related metadata as instructed by SBA Legal Counsel. Upon request by SBA, Lenders must make electronically stored information available to SBA in a timely manner. This preservation of information requirement supersedes the general rule above and means that Lenders must suspend all routine documentation retention and destruction policies and

place a "litigation hold" on the Loan File, the Computer Tracking System where electronically created information is stored, and on all other relevant documents and data to ensure that such documents and data are preserved until SBA Legal Counsel provides written notice that retention is no longer required.

Note: Reasonable anticipation of litigation arises when an organization is on notice of a credible probability that it will become involved in litigation, seriously contemplates initiating litigation, or when it takes specific actions to commence litigation.

E. Loan Monitoring

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

1. Name, Address or Legal Structure Changes

In addition to notifying SBA and updating the Loan File and Computer Tracking System, if a change in 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 SBA Loan, Lenders must take appropriate corrective actions immediately. For example, Lenders should file a UCC 3 financing statement to reflect a name change and preserve the priority of personal property liens; if a Borrower changes its legal structure, Lenders should require the new entity to formally assume the SBA Loan; and if an Obligor dies, in addition to collecting the proceeds from any life insurance policy pledged as collateral for the Loan, Lenders should take any legal action necessary to protect the ability to collect the balance owed on the Loan.

2. Borrower's Creditworthiness

a. Lenders should monitor the Borrower's creditworthiness, i.e., financial and operational condition, through the use of tools such as periodic submission of financial statements, contact with the Borrower via phone or site visits, and/or review of relevant financial data from sources such as credit reports, credit scores and tax returns.

b. If the Loan Documents require the Borrower to submit financial statements, Prudent Servicing practices require Lenders to request and, if provided, review and analyze the financial statements in a timely manner. If financial statements

are not provided, Lenders must demonstrate their use of an alternative method to monitor the Borrower's financial condition.

c. If the financial information provided by the Borrower raises concerns, Lenders should ask the Borrower to provide an executed copy of IRS Form 4506-C or Form 8821, to obtain and compare the IRS transcript of the Borrower's most recent federal income tax return to the questionable information.

d. With the exception of SBA Express and Export Express Loans, SBA does not permit Lenders to charge a Default interest rate on 7(a) Loans. However, Lenders may charge a separate extraordinary servicing fee for past due financial statements if consistent with those fees the Lender charges on its similarly-sized, non-SBA guaranteed commercial loans (see SOP 50 10 for additional guidance on the default interest rate policy for SBA Express and Export Express Loans and permissible fees on 7(a) Loans). Lenders may require Borrowers to submit past due financial statements as a condition for considering any future servicing requests made by the Borrower. (See Chapter 15 of this SOP for guidance on when a Lender may accelerate an SBA Loan Note and commence liquidation actions, and Chapter 17 of this SOP for additional guidance on Loan workouts.)

> **Note:** If an Obligor files for bankruptcy protection, Lenders must take appropriate action to protect the legal ability to collect the SBA Loan. See Chapter 22 (Litigation) of this SOP for guidance and information on bankruptcy proceedings.

3. UCC Filings

Lenders must monitor all UCC filings for SBA Loans, and prepare and timely file any document needed to maintain the perfection and priority of the lien securing an SBA Loan. This includes, for example, the filing of a UCC-3 financing statement to continue an existing financing statement.

4. Taxes and Assessments

Lenders must monitor secured SBA Loans to ensure that all taxes and assessments, which if unpaid could become senior liens against the collateral for the SBA loan, are paid in a timely manner.

> **Note:** Although state law varies, secured creditors generally do not have the right to redeem collateral after a tax foreclosure sale. Lenders should consult their legal counsel for case specific information and advice.

5. Insurance

Lenders must monitor all SBA Loans to ensure that all required insurance coverage remains in force throughout the term of the Loan. See Chapter 9 of this SOP for guidance on force placing insurance coverage if the Borrower has allowed the policy to lapse.

6. Loans Secured by Senior Liens on SBA Loan Collateral

Lenders must monitor the loan(s) secured by senior liens on the collateral that secures an SBA Loan, to ensure that the lien securing the SBA Loan is legally preserved and that the equity in the property that secures the SBA Loan is protected from dissipation due to default or other charges imposed by the senior lienholder. See Chapter 13 of this SOP for additional guidance.

F. Lender Reporting Requirements

1. Monthly 1502 Report—Pre-guaranty Purchase Loans

Lenders must include all SBA Loans in regular servicing status and all pre-guaranty purchase SBA Loans in liquidation status on the Lender's SBA Form 1502 report, and submit the report to SBA monthly through the FTA. (Additional information on reporting is available at FTA Wiki (sba.gov).

> **Note:** Lenders must not report 7(a) Loans as "paid in full" when they transfer an SBA Loan to another Lender or when the balance for a revolving SBA Loan on which the Borrower intends to continue receiving draws, is paid to zero. When an SBA Loan is reported as "paid in full," it is automatically deleted from SBA's Computer Tracking System and the guaranty is cancelled. Lenders who erroneously report a Loan as "paid in full" may submit a written request for reinstatement of the SBA guaranty pursuant to the requirements set out in Chapter 4 of this SOP.

2. Reports to Credit Reporting Agencies

In accordance with the Debt Collection Improvement Act of 1996, Lenders are required to report information to an appropriate credit reporting agency whenever they extend credit via a 7(a) Loan, and must continue to report information pertaining to 7(a) Loan servicing and liquidation activity throughout the life of the Loan. (See Chapter 27 of this SOP for additional information regarding credit reporting requirements for Loans that SBA has charged off.)

a. Lenders are required to report 7(a) Loan Borrowers only. Reporting of Guarantors is not required. Appendix 3 of the Guide to the Federal Credit Bureau Program ("GFCBP") lists the designated credit reporting agencies for commercial accounts.

> **Note:** The GFCBP requires reporting on a quarterly basis, but states "more frequent updates may be provided as necessary to maintain the integrity and accuracy of the information being reported." (GFCBP - Reporting Commercial Account Information - page 3-1).

b. Lenders are required to provide information necessary to establish the identity of the Borrower such as:

- Name, address, and taxpayer identification number;
- The amount, status, and history of the debt; and
- The agency or program under which the debt arose.

> **Note:** Credit reporting agencies may maintain additional data elements. Lenders should contact the individual credit reporting agencies for applicable data reporting requirements.

c. Credit Reporting References:

- Debt Collection Improvement Act of 1996
- Federal Claims Collection Standards (FCCS), 31 C.F.R. 900-904
- OMB Circular A-129
- Treasury's Managing Federal Receivables (MFR)
- Guide to the Federal Credit Bureau Reporting
- 31 U.S.C. § 3711(e)(4)

3. SBA Guaranty Purchased Loans

a. Reporting Requirements

(1) **Immediate:** Lenders must submit a written Loan status report to the appropriate SBA Loan Center within 15 business days after receiving notice that SBA has purchased the guaranteed portion of the Loan from the secondary market. (13 C.F.R. §120.520)

(2) **Periodic:** For all SBA guaranty purchased Loans (including from the secondary market and directly from the Lender), Lenders must submit a written Loan status report to the appropriate SBA Loan Center every six months, beginning six months from the date of guaranty purchase, until the Loan is paid in full or the Lender submits a Wrap-up Report acceptable to

SBA. (See Chapter 24 Paragraph E of this SOP for guidance on Prudent Liquidation Deadlines and other requirements for SBA guaranty purchased Loans).

(3) The Lender's status report for each Loan must include, at a minimum, a discussion of the following:

(a) Borrower status;

(b) Obligors;

(c) Collateral;

(d) REO and acquired personal property collateral;

(e) Workout or restructuring negotiations;

(f) Recoveries and expenses incurred;

(g) Liquidation activities and litigation proceedings;

(h) Issues preventing a more timely resolution of the SBA Loan, and;

(i) Timeline for when a Lender expects to complete its Loan servicing and/or Loan liquidation actions.

b. Failure to Comply—Referral to OCRM

SBA Loan Service Centers may refer Lenders that fail to provide timely and sufficient written status reports to the SBA Office of Credit Risk Management (OCRM) for appropriate action.

4. SBA Approved Litigation Plans

a. Amendments to Litigation Plans

Lenders must submit an amendment to a Litigation Plan to address any material changes arising during the course of the litigation that were not addressed in the original plan or an amended plan. Lenders must obtain SBA's written approval of the amended Litigation Plan prior to taking any further litigation action. (See Chapter 22, Paragraph C of this SOP for additional guidance on Litigation Plans and amendments to Litigation Plans.)

5. Site Visit Report

Lenders should prepare a Site Visit Report after every visit to the Borrower's business premises, regardless of whether the Loan is in regular servicing or liquidation status, and keep a copy of the report in their Loan File. All Lenders must prepare a post-Default Site Visit Report within 60-days of a payment Default on an SBA Loan, or sooner if

there is a risk that collateral could be removed, lost or dissipated.

With regard to Loans processed under CLP, Lenders must include a Site Visit Report with the proposed Liquidation Plan they submit to the appropriate SBA Loan Center for review and approval.

With regard to all other 7(a) Loans, Lenders must include a Site Visit Reports with their Wrap-up Report, unless it was previously submitted with the Lender's Universal Purchase Package. Lenders that do not conduct a site visit must document their reasons for why a site visit was neither necessary nor prudent, keep a copy of this action in their Loan File, and include it in their final Wrap-up Report. (See Chapter 16 of this SOP for additional guidance on site visits.)

6. Wrap-up Report

Lenders must prepare and submit a Wrap-up Report in electronic form to the appropriate SBA Loan Center for review and approval within 30 calendar days after Prudent Liquidation actions are completed, or immediately upon receipt of a request from SBA - whichever occurs first. After SBA approves the Lender's Wrap-up Report, SBA will charge off the remaining balance of the Loan and refer the Obligors for all legally collectible Loan balances to Treasury for further collection actions after the Lender assigns the Loan Documents to SBA.

Lenders must also comply with SBA's Prudent Liquidation Deadline as defined in Chapter 2 of this SOP. This requires Lenders to prepare and submit a Wrap-up Report, acceptable to SBA, to the appropriate SBA Loan Center no more than 24 months after the date SBA purchases its guaranty, unless SBA grants a written extension of that timeframe based on extenuating circumstances. (See Chapter 24, Paragraphs E and F, and Chapter 27, Paragraph B of this SOP for more information on the Prudent Liquidation Deadline.)

G. SBA Take Over of Servicing or Liquidation

SBA may, in its sole discretion, take over the servicing and/or liquidation, including litigation, for any 7(a) Loan. If SBA elects to do so, the Lender must assign the Loan Documents to SBA within 30 calendar days from receiving notice of SBA's election and provide any assistance requested by SBA. SBA may use contractors to perform servicing or liquidation actions. (13 C.F.R. § 120.535(d))

H. Enforcement Action by OCRM

OCRM may impose or take informal enforcement actions against a Lender pursuant to 13 C.F.R. §120.1300, or formal enforcement actions against a Lender pursuant to 13 C.F.R. §120.1400, based on a Lender's servicing and/or liquidation actions or inactions. (See also SOP 50 53, 13 C.F.R. §120.1500 and 13 C.F.R. §120.1600 for information on SBA's credit risk management policy and procedures.

Chapter 4.
Loan Payment Administration

This chapter provides SBA policy and procedures with regard to collecting and processing Loan payments. (See Chapter 23 of this SOP for information regarding recoveries for Loans in liquidation.)

A. Collection and Application of Loan Payments

Lenders are responsible for collecting scheduled loan payments and crediting the payments to the proper account, unless SBA has taken over the servicing of the Loan.

1. Payments on Loans in Regular Servicing Status

Unless the terms of the Note specify otherwise, Lenders must apply funds received for payments on SBA Loans in regular servicing status in the following order:

a. Accrued Interest

Lenders must apply funds received for each installment payment first to pay interest that has accrued to the day the Lender receives the payment;

b. Principal

After the accrued interest has been paid, Lenders must apply the funds received for each installment payment to the principal balance of the Loan, to bring the principal current;

c. SBA Permitted Loan Fees

After the accrued interest is paid and the principal balance has been brought current, Lenders may apply any excess funds received to SBA permitted fees, such as late fees.

> **Note:** For information on SBA permitted Loan fees, such as late payment fees, extraordinary servicing fees, assumption fees, subsidy recoupment fees, and fees for overdraft and out-of-pocket expenses, see the most current version of SOP 50 10. Lenders may not pass the cost of the 7(a) Lender's Annual Service Fee (also known as the "SBA on-going guaranty fee") to the Borrower. See SOP 50 10 for additional information on the 7(a) Lender's Annual Service Fee and how it is paid.

d. Additional Principal

Lenders must apply any funds remaining from payments on Loans in regular servicing status after the accrued interest has been paid, the principal balance has been brought current, and the SBA permitted Loan fees have been deducted, to reduce the principal balance of the Loan. The application of additional principal payments to the Loan balance will not advance the next payment due date.

2. Borrower Payments on Loans in Liquidation Status

a. Overview

After acceleration and demand due to Default, (followed by classification of the Loan in liquidation status in accordance with Chapter 15 of this SOP), the Borrower no longer has a legal right to make payments on the Loan. As a result, Borrower payments (as opposed to collateral liquidation recoveries) for Loans in liquidation status are generally rare. In cases where the Borrower is financially able to resume making regularly scheduled payments, and executes a written agreement that provides for the resumption of regular payments, Lenders should remove the Loan from liquidation status and return it to regular servicing. Lenders must submit a copy of any executed workout or modification agreement to the appropriate SBA Loan Center along with their request to change the status of the Loan back to regular servicing. (See Chapter 15 of this SOP for information on returning Loans classified in liquidation to regular servicing status, and Chapter 23 of this SOP for guidance on how to apply recoveries.)

b. Impact on Liquidation Plan

Before accepting any borrower payment (other than payment in full) for a Loan in liquidation status, Lenders must determine whether accepting the payment could cure the Default and curtail plans for liquidating the Loan. For more information, Lenders should consult with their legal counsel.

c. Application of Borrower Payment Proceeds

Unless the terms of a workout agreement or some other legally binding document (e.g., a court approved bankruptcy plan or workout agreement) specifies otherwise, Lenders must apply funds received from borrower payments for Loans in liquidation status in the following order:

(1) Principal

Lenders must apply funds received from payments for Loans in liquidation status to the principal balance of the Loan until it is paid in full;

(2) Accrued Interest

After the principal balance of the Loan is paid in full, Lenders must apply funds from payments received for Loans in liquidation status to accrued

interest; and

(3) SBA Permitted Loan Fees

After the principal balance and accrued interest of the Loan is paid in full, Lenders may apply funds from payments received for Loans in liquidation status to SBA permitted Loan fees. The on-going SBA guaranty fee (annual service fee) Lenders must pay to SBA is based on the outstanding principal balance of the Loan prior to guaranty purchase. It is payable to SBA until such time that SBA purchases the guaranty, and Lenders may not charge the annual service fee to the Borrower. See SOP 50 10 for additional guidance.

B. Post-Guaranty Purchase Servicing Fee on SBA Portion of Interest Payments

After SBA has purchased its guaranty, Lenders who collect Loan payments that include interest may deduct a servicing fee prior to remitting SBA's share of the payment to SBA, provided that the fee is:

1. Deducted from the interest portion of the payment, (Lenders may not deduct servicing fees from recoveries or principal only payments.);

2. Based on SBA's percentage of participation in the Loan and the number of days of interest collected; and

3. Reflected on the remittance form that Lenders submit to SBA using payment code 172 in http://www.pay.gov/.

> **Note:** For information on other SBA permitted Loan fees such as late payment fees, extraordinary servicing fees, assumption fees, subsidy recoupment fees, and fees for overdraft and other out-of-pocket expenses, see the most current version of SOP 50 10. SBA does not guarantee nor pay Lender Loan fees. Therefore, Lenders must not add Loan fees to the transcript of account submitted with a guaranty purchase request.

C. Remittance of Borrower Loan Payments

1. Before Guaranty Purchase—To Investor

If the guaranteed portion of the Loan has been sold in the secondary market, the Lender must remit the guaranteed portion of regular Loan payments, along with SBA Form 1502, to the FTA for distribution to the investor by the third day of the next month. (See Section 3.2 of SBA Form 1086). The remittance amount will exclude the retention of a minimum of 1.0 percent for those Loans sold in the SBA secondary market for a premium (see Section 1.5 of SBA Form 1086 for additional guidance). This adjustment is a reduction of the reported interest collected for the benefit of the investor.

Note: SBA permitted Loan fees belong to the Lender and are not shared with the secondary market investor.

2. After Guaranty Purchase—To SBA

Regardless of whether the Loan was sold on the secondary market, Lenders must remit SBA's share of any post-guaranty purchase Loan payment using payment code 172 in www.pay.gov within 15 business days of receipt.

D. Prepayment

Prepayment is defined as a payment of principal in excess of the amount due according to the Loan amortization schedule. The "prepayment amount" does not include accrued interest.

1. Loans Not Sold in Secondary Market

Borrowers may, at any time, prepay an SBA Loan that was not sold in the secondary market. The prepayment may, however, be subject to an SBA subsidy recoupment fee as provided in Subparagraph D.4 below.

2. Loans Sold in Secondary Market

Borrowers may, at any time, prepay an SBA Loan sold in the secondary market. If the prepayment amount is greater than 20 percent of the unpaid principal balance of the Loan, the Lender must provide written notice to the FTA pursuant to the terms of the SBA Form 1086 executed at the time the guaranteed portion of the Loan was sold. Refer to SBA Form 1086 for guidance on the notification process. The prepayment may also be subject to an SBA subsidy recoupment fee as provided in Subparagraph D.4 below.

3. No Lender Prepayment Penalty

Lenders may not impose a penalty or charge a fee for full or partial prepayment of an SBA Loan. (13 C.F.R. §120.221)

4. SBA Subsidy Recoupment Fee

SBA requires Borrowers to pay a subsidy recoupment fee for voluntary full or partial prepayment of SBA Loans with an original maturity of 15 years or more in accordance with the conditions and requirements set forth in 13 C.F.R. §120.223. The subsidy recoupment fee is paid to the FTA and is due at the time the prepayment is remitted. If the Lender advances funds to pay the subsidy recoupment fee on behalf of the Borrower, the Lender must recover such funds from the Borrower without seeking reimbursement of the advanced funds from SBA after guaranty purchase (See the most current version of SOP 50 10 for information regarding subsidy recoupment fees.).

Note: SBA has no statutory authority to waive a subsidy recoupment fee. However, pursuant to SOP 50 10, if a Lender believes that the prepayment of a Loan is involuntary, the Lender may submit a request, supported by the Lender's analysis, to the appropriate SBA Loan Center for a prepayment determination. The SBA Loan Center will review the request and submit its recommendation to the Director of the Office of Financial Program Operations (D/OFPO), or designee, and the Director of the Office of Financial Assistance (D/FA), or designee, for a joint determination as to whether the prepayment is voluntary or involuntary.

E. Paid in Full Loans

Paid in full ("PIF") means payment of the total amount owed on the Loan, including principal, interest, and any applicable subsidy recoupment fee or Recoverable Expense. When the guaranteed portion of a Loan is sold in the secondary market and the Loan is paid in full prior to maturity, Lenders must follow the prepayment guidance provided in Subparagraph D.2 above. Lenders must not report such Loans as paid in full on an SBA Form 1502 until the FTA verifies and receives the final payoff amount. Lenders may cancel the Note and release any remaining collateral after the FTA verifies that the Loan is PIF. (See Chapter 21 of this SOP for guidance on when SBA may treat a Loan as "paid in full" after an offer in compromise has been accepted and approved by SBA.)

Note: Many states impose significant penalties on creditors who fail to release collateral in accordance with state law. Lenders should consult their legal counsel for state-specific release requirements.

F. Reinstatement of Guaranty on Loan Mistakenly Coded "PIF"

1. General Rule

SBA may, in its sole discretion, reinstate the guaranty for a 7(a) Loan that a Lender erroneously reported as paid in full on SBA Form 1502.

2. Procedure

To reinstate the SBA guaranty on a Loan mistakenly reported as PIF, the Lender must submit a written request for reinstatement to the appropriate SBA Loan Center. The Lender's request must include a reasonable explanation for the mistake; a certification that the Lender has paid all relevant guaranty fees; confirmation that the Lender has not released any Obligors without SBA's prior written approval; and a copy of the lender's transcript of account reflecting the balance of the Loan for reinstatement.

Chapter 5.
Environmental Risk Management

This chapter sets out SBA policy and procedures for managing environmental risks associated with SBA 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/or 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 the Environmental Definitions Appendix of SOP 50 10, the most current version of which is accessible in the SOP section of SBA's website. 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 Prudent Liquidation of an SBA Loan with respect to environmental risk management 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 if necessary; and

> **Note:** Certain changes in the Borrower's financial condition could signify an increase in environmental risk including regulatory fines discovered while reviewing financial statements. Certain activities could signify an increase in environmental risk including failure to maintain Engineering Controls or evidence of a Release discovered during a site visit.

3. Compliance 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 Environmental 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) holds indicia of ownership primarily to protect its security interest; (2) takes no action that could be construed as "participating in the management" of the Borrower's facility; and (3) attempts to divest itself of the 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. Lenders should consult their legal counsel for Loan-specific information.

C. When an Environmental Investigation is Required

Lenders must conduct an Environmental Investigation 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, Lenders must conduct an Environmental Investigation 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

Lenders should conduct Environmental Investigations in support of Loan Actions for SBA Loans in regular servicing status, e.g., substitution of collateral, in accordance with the guidance provided in SOP 50 10.

E. Environmental Investigation Process for Loans in Liquidation Status

Lenders should conduct Environmental Investigations in support of Loan Actions for SBA Loans in liquidation status, e.g., acquiring Property at a foreclosure sale, as follows:

1. Scope of investigation

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

2. Use of Environmental Professionals

Lenders must ensure that Environmental Investigations on Loans in liquidation status are conducted by an Environmental Professional in accordance with the Environmental Protection Agency's Standards and Practices for All Appropriate Inquiries (AAI); except for the Environmental Questionnaire ("EQ") portion of an Environmental Investigation, which consists of an EQ and a Records Search with Risk Assessment ("RSRA").

3. Reliance Letter Requirement

Environmental Investigation Reports must include a Reliance Letter, unless the Environmental Investigation consists of an EQ and RSRA. The Lender must affix a copy of the Reliance Letter to the Environmental Investigation Report. (See Reliance Letter Appendix to SOP 50 10 for the Reliance Letter template.)

4. General Procedure

For Properties with sufficient Recoverable Value, Lenders must take the following steps 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, Lenders must begin with a Phase I ESA. Generally, the risk should be considered high if, for example, there are underground storage tanks (USTs) at the Property, a NAICS Code for a past or present use of the Property is on the List of Environmentally Sensitive Industries in the NAICS Code Appendix of 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 unit 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, Lenders may 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, Lenders must 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 sufficient Recoverable Value:

(1) Lenders should conduct a Phase I ESA if a Transaction Screen or EQ and RSRA shows anything other than a "low risk" of Contamination;

(2) Lenders should conduct inquiries regarding environmental problems beyond the scope of a Phase I ESA (e.g. asbestos), if the problem could have a material effect on the Recoverable Value of the Property;

(3) Lenders should conduct a Phase II ESA if it is necessary to determine the nature and extent of Contamination identified by a Phase I ESA; and

(4) Lenders should obtain a Remediation estimate if Remediation is recommended in a Phase II ESA Report. An Environmental Professional must prepare the Remediation estimate.

> **Note:** See ASTM E2137-22 (Standard Guide for Estimating Monetary Costs and Liabilities for Environmental Matters) for additional guidance on Remediation estimates.

Step 3. Additional Requirements for Gas Stations, Commercial Fueling Facility 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 such as chlorinated and/or petroleum-based solvents, and there is sufficient Recoverable Value, the Lender's Environmental Investigation should also include:

(1) A Phase II ESA conducted by an independent Environmental Professional with at least 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, commercial fueling facility, 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 Control of a Business That Uses Hazardous Substances

(1) Environmental Regulatory Compliance Audit

Generally, Lenders should conduct an environmental regulatory compliance audit prior to taking over the operation of a business that handles Hazardous Substances. Lenders should conduct the audit in substantial compliance with ASTM E2107-20 (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 effect 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. (See Chapter 18 of this SOP for guidance on when the appointment of a receiver is appropriate and the cost/benefit analysis that is required. See also Chapter 22 of this SOP for guidance pertaining to Non-Routine Litigation such as receivership proceedings.)

F. Environmental Investigation Reports

The results of an Environmental Investigation must be set out in a written Environmental Investigation Report, which Lenders must keep in their Loan File. An Environmental Investigation Report should be less than 180 calendar days old when a Lender relies on it to evaluate a Loan Action.

G. Remedial Action by Secured Creditor

Given the complexity of the applicable Environmental Laws and the risks involved, Lenders should obtain a legal opinion from an attorney with Environmental Law expertise before 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 a Business with Environmental Risks

1. When Appropriate

Lenders should not acquire title to Contaminated Property and/or take control of businesses that use Hazardous Substances or are located on Contaminated Property, 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 – SBA's Prior Written Approval

Lenders must obtain SBA's prior written consent 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 SBA Approval

Lenders must submit a written Servicing Request to the appropriate SBA Loan Center, which must consult with the Associate General Counsel for Litigation, or designee, before SBA may agree to allow the Lender or SBA to take title to Contaminated Property or take control of a business that uses Hazardous Substances. (See Chapter 6 of this SOP for additional guidance on the submission of Lender Servicing Requests.)

4. Request Format

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

a. Appraised Value of the Collateral Lender Proposes to Acquire

Lenders must provide a copy of the post-Default appraisal of the Property.

b. Liquidation Value of Collateral Lender Proposes to Acquire

Lenders must provide an estimated Liquidation Value for the Property they propose to acquire, including the basis for their estimate.

c. SBA Loan Balance

Lenders must provide a transcript of account or other credible evidence of the outstanding SBA Loan balance.

d. Amount Owed on Senior Liens

Lenders must provide a list of senior liens against the Property that secures the SBA Loan, including landlord liens and tax liens, and the amount owed on each, supported by a copy of:

(1) Schedule B of the post-Default title report;

(2) A current UCC lien search if the Service Request includes personal property collateral or taking over the operation of a business;

(3) Any senior lienholder agreement, landlord lien waiver, subordination agreement and/or other Loan Documents that establish the priority of the liens against the Property; and

(4) Transcripts of account to support compliance with any provisions in the foregoing documents that require a senior lienholder to subordinate any portion of the senior loan to the SBA Loan (e.g., Default Charges).

e. Foreclosure Costs

Lenders must 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

Lenders must provide a summary of the nature and extent of the Contamination supported by copies of the Environmental Investigation Report(s) required by Paragraph E of this Chapter.

g. Clean-up Costs and Liability

Lenders must indicate whether Remediation is required or on-going, and:

(1) If Remediation is not required—Lenders must attach a copy of the "no further action" letter, closure letter, or functional equivalent from the responsible Governmental Entity.

(2) If Remediation is recommended—Lenders must 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 Persons responsible for the 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—Lenders must attach a copy of any document that shows the progress of the project and the financial resources of the Person conducting the cleanup to complete the project.

h. Secured Creditor Liability Exemptions

Lenders must provide a list of the applicable liability exemptions to which the Person who will take title will qualify, 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 of foreclosure while administering an SBA Loan program is considered an "involuntary acquisition."

i. Mitigating Factors

Lenders must submit a list of 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) An SBA Environmental Indemnification Agreement (see Appendix to SOP 50 10) executed by a Person with sufficient financial resources to cover the cost of Remediation;

(2) An Escrow Account established to cover the cost of a Remediation plan approved by the responsible Governmental Entity;

(3) A Solvent Government Cleanup Fund that has unconditionally agreed to

cover the cost of Remediation; or

(4) Lender Liability Environmental Insurance is in place to cover the cost of Remediation after title is acquired.

j. Tort Liability

Lenders must 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

Lenders must review Schedule B of the post-Default title report and indicate whether there is any recorded covenant, deed restriction or other exception to title that could have a negative impact on the Property's Recoverable Value. These restrictions could include 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

Lenders must 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 a release of lien for consideration, a sale of the Note and assignment of the lien to the purchaser, or the appointment of a receiver to operate the business until enough money is recovered to pay-off the Loan or the collateral is sold.

m. Acquired Collateral Divestiture Plan

Lenders must provide a plan for disposing any Property it proposes to acquire, including all holding and resale costs, and the anticipated difficulty in finding a buyer for the Property. This assessment should include, for example, answers to questions such as 1) have any third parties expressed an interest in purchasing the Property?, and 2) is the Property currently listed for sale by the owner, and 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. Lenders must list and discuss any other Loan-specific relevant facts. For example:

(1) Remediation by Secured Creditor—Does the Lender anticipate incurring additional costs to Remediate the Property prior to listing it for sale? If so, Lenders must attach a copy of the legal opinion recommended in Paragraph G of this Chapter, provide a Remediation cost estimate, and indicate how the costs will be paid;

(2) Receivership Proceedings—The appointment of a receiver to operate the business or sell the Property is considered Non-Routine litigation for which Lenders must submit a Litigation Plan and receive prior written approval from SBA District Counsel before commencing any receivership proceedings. The Lender's Litigation Plan must explain how the appointment of a receiver will maximize recovery or minimize losses before the business is sold or the collateral is liquidated (see Chapter 18 of this SOP for additional guidance on when a receivership is appropriate and the requirement to provide a cost/benefit analysis to support the appointment of a receiver). The cost-benefit analysis must include an Environmental Professional's assessment of the costs to clean the Property, in addition to all other projected income and expenses associated with operating the business, which supports the cost effectiveness of holding and selling rather than abandoning the Property. The Litigation Plan must also describe the prior experience and qualifications of the proposed receiver and include an estimate of all legal fees and costs associated with the proposed receivership (see Chapter 22 of this SOP for additional guidance regarding Non-Routine Litigation). Lenders may not proceed with Property remediation without prior written approval from SBA District Counsel.

(3) Emptying and Closing USTs—If there are USTs at the Property and a receiver is not appointed, Lenders must 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

Lenders must estimate the Recoverable Value of taking the proposed Servicing Action based on an analysis of factors "a" through "n" above.

p. Lender Appeal of Denied Servicing Request

Lenders may appeal the decision of an SBA Loan Center Director or designee denying a request for approval to take title to Contaminated Property or to take

over the operation of a business that handles Hazardous Substances or is located on Contaminated Property, to the Associate General Counsel for Litigation who will consult with the Director of OFPO, provided that the appeal: (1) is in writing; (2) includes a copy of the original decision and Supporting Documents; (3) states the reason(s) why the Lender believes the decision is incorrect; and (4) is submitted within 30 calendar days of the date of the original decision.

Chapter 6.
Servicing Requests

A. General Requirements

Frequently after an SBA Loan has been disbursed, circumstances change that can give rise to Borrower requests for Loan Actions. These Loan Actions can lead to Lender Servicing Requests that range anywhere from a simple request to change to a Borrower's mailing address to a complicated request involving the exchange or substitution of collateral. Regardless of the level of complexity, Lenders must review, analyze and act upon all Loan Actions in accordance with Prudent Servicing and Prudent Liquidation practices. As long as the Borrower is financially viable, when responding to a Borrower's request for a Loan Action, Lenders should strive to meet the Borrower's short-term and long-term needs without impairing the integrity of the SBA Loan program, i.e., preserving the Borrower's ability to repay the SBA Loan over time.

B. Review and Analysis

Generally, Lenders should not modify Loan Documents unless there has been a material change in the Borrower's circumstances since the Loan was made. The Supporting Documents and level of analysis required for SBA to make an informed decision regarding whether to approve or deny a Servicing Request, and under what conditions, will vary depending on the circumstances. In all cases, Lenders must justify and document their decision 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. Lenders should follow the relevant steps listed below to ensure that each Servicing Request is properly reviewed and analyzed.

1. Document Receipt of the Servicing Request

Lenders must enter all Loan Actions into their Computer Tracking System and/or Loan File.

2. Ensure that the Servicing Request is in the Proper Format

Lenders should require Borrowers to submit all requests to modify the terms and/or conditions of an SBA Loan, in writing.

3. Research the Applicable Loan Program Requirements

a. Requests Concerning Assumptions, or Substitution of Collateral or Obligors

For assumptions and the substitution of collateral or Obligors, Lenders must comply with the Loan Program Requirements of SOP 50 10 in effect at the time the assumption or substitution of collateral or Obligors takes place, in accordance with 13 C.F.R. §120.180. See SOP 50 10 in effect at the time these Loan Actions are taken to find the applicable Loan Program Requirements, including, for

example, those pertaining to Appraisals and Environmental Investigations.

b. All Other Servicing Requests

Lenders may refer to Chapters 7 through 12 of this SOP for guidance on developing Servicing Requests for some of the more common Loan Actions.

4. Determine Whether the Servicing Request is Properly Supported

Lenders should ensure that all Servicing Requests include the Supporting Documents that a prudent lender would need to make an informed decision. For example:

a. Servicing Requests Involving Credit Issues

Generally, Lenders should ensure that all Loan Actions that require a credit analysis (e.g., an increase in the amount of the SBA Loan or prior lien) are supported by the Borrower's:

(1) Current financial statement; and

(2) Most recent two years of federal income tax returns.

b. Servicing Requests Involving Collateral

In addition to the financial documents listed above, Lenders should ensure that Loan Actions involving collateral (e.g., subordination, substitution or release of lien) are also supported by a current:

(1) Appraisal of the relevant collateral;

(2) Lien search, i.e., a title report if the action involves real property collateral, or a UCC search if the action involves business personal property collateral; and

(3) Transcript of account or other credible evidence of the balance owed on any senior liens.

5. Obtain Additional Supporting Documents When Necessary

Lenders should obtain any additional Supporting Documentation needed to properly analyze and approve their Servicing Request. For example:

a. Credit Report

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

b. Obligor Financial Statements and Tax Returns

Lenders should require all Obligors, including the Borrower and all Guarantors, to

provide current financial statements and federal income tax returns for the most recent two years when a complete analysis of each Obligor's repayment ability is necessary.

c. Refinance or Purchase and Sale Documents

Lenders must obtain an executed copy of all the relevant documents, (e.g., purchase and sale agreement, escrow instructions, estimated closing statement (HUD-1), seller carry-back note, etc.) if their Servicing Request involves the sale or refinance of collateral.

d. Environmental Investigation Report

Lenders should obtain an Environmental Investigation Report when required by Chapter 5 Paragraph C of this SOP.

e. Evidence of Authority to Take Proposed Action

Lenders should obtain and provide proper evidence to establish that each Person whose signature is necessary has the required authority to execute the Loan Documents involved in the Servicing Request, e.g., a board of directors' resolution.

6. Analyze the Borrower's Financial Condition

Lenders must analyze the Borrower's financial statements to determine whether the Borrower is financially viable, i.e., will be able to repay the Loan if the request is approved. If the Borrower is viable, Lenders should proceed to Step 7. If not, Lenders should deny the requested Loan Action and take more appropriate actions. (See Chapter 15 of this SOP for guidance on classifying Loans into liquidation status.)

7. Analyze the Collateral

If the Servicing Request will impact the collateral, Lenders should conduct a thorough analysis of the Recoverable Value of the collateral before and after the requested Loan Action.

8. Check for Problems

Lenders should review the existing Loan Documents and their Computer Tracking System to: (1) ensure that all Loan Actions are 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.

9. List Conditions for Approval

a. Compliance with Terms and Conditions of Loan

Lenders should condition their approval of every Loan Action upon the Borrower

curing any Default identified in Step 8 above. For example, Lenders should require Borrowers to reinstate lapsed insurance coverage and/or provide any past due financial statements prior to approving any Loan Action.

b. Adequate Consideration

Lenders must ensure that Borrowers provide consideration (i.e., something of value), before or at the same time the Borrower receives the benefit of a proposed requested Loan Action, to make the change in the Loan Documents legally binding. For example, as consideration for granting a Loan Action, Lenders could require Borrowers to:

(1) Fix errors in the Loan Documents identified in Step 8 above;

(2) Waive defenses to litigation;

(3) Release lender liability claims; or

(4) Provide additional collateral.

> **Note:** All contracts must be supported by valid consideration, which can take the form of money, physical objects, services, promised actions, abstaining from a future action, etc. For example, adequate consideration for a routine Loan Action such as a temporary payment deferment can include requiring the Borrower to provide updated financial information.

c. Written Consent of All Obligors

Lenders must obtain the written consent to any material change in the terms and conditions of the Loan from each Obligor, to protect the legal ability to recover from them in the event of Default.

10. Comply with SBA Decision Making, Notice and Approval Requirements

Unless the Lender has unilateral authority to take the requested Loan Action and no notice to SBA is required, Lenders must comply with applicable SBA Loan Program Requirements pertaining to decision making authority and notice to SBA. (See Chapter 3 of this SOP for additional guidance on Lender responsibility and authority). Unless prior SBA approval and/or notice to SBA is required, Lenders should not notify the SBA Loan Center regarding their routine Loan Actions.

11. Comply with the Applicable Recordkeeping Requirements

In accordance with Chapter 3 of this SOP, Lenders must note and/or enter SBA's response to all Servicing Requests in the Lender's Computer Tracking System and/or Loan File; keep a copy of the Loan Action Record and Supporting Documents in the

Lender's Loan File; and enter the substance of any telephone calls and/or face-to-face meetings regarding the Servicing Request in the Lender's Loan File and/or entered into the Lender's Computer Tracking System.

Note: Best Practice: Lenders should consider placing a copy of the Servicing and Liquidation Actions 7(a) Lender Matrix in effect at the time a Loan Action is taken, in their Loan File.

C. How To Obtain SBA Approval For a Proposed Loan Action

If SBA's prior written approval is required before a Lender may take a Loan Action (see Chapter 3 of this SOP for a detailed list of such actions), Lenders must submit a written Servicing Request to the appropriate SBA Loan Center in accordance with the guidelines listed below.

1. Required Documentation

a. Letter Outlining Request

Lenders should submit all Servicing Requests that require prior written SBA approval in a clearly and concisely drafted letter or electronic mail submission based on the Lender's internal credit memorandum. Lender Servicing Requests must not exclusively rely on any document or analysis prepared by a Person with a conflict of interest, such as a senior lienholder. Although SBA reserves the right to request additional information, all Lender Servicing Requests should include:

(1) A brief description of the proposed Loan Action;

(2) Justification for the proposed Loan Action, i.e., benefit to the Borrower, Lender and SBA—neither abundance nor lack of collateral alone is sufficient justification for a Loan Action;

(3) The amount funded, date of funding, current balance and status of the SBA Loan;

(4) The current financial condition of the Borrower and other Obligors, as needed;

(5) If the proposed Loan Action increases the risk of loss on the SBA Loan, Lenders should include any mitigating factors that may increase the value of the SBA Loan collateral or improve the performance of the Borrower's business;

(6) If the proposed Loan Action will impact the collateral, Lenders must include 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;

(7) A summary of the Lender's prior servicing experience with the Borrower, i.e., SBA Loan and non-SBA Loan modifications or problems pertinent to the request;

(8) If the written consent of the FTA on behalf of the registered holder is required, whether the Lender has or will obtain it; and

(9) A list of all the Obligors associated with the Servicing Request and a statement from the Lender as to whether they have or will obtain consent from all the Obligors for the proposed Loan Action.

b. Credit Memo and Supporting Documents

Lenders should include a credit memo, which must be independent of any document or analysis prepared by a Person with a conflict of interest, such as a senior lienholder, with every Servicing Request they submit to SBA for approval. Generally, Lenders do not need to include a copy of the Borrower's financial statements or other Supporting Documents such as Appraisals, etc., if the Lender has adequately analyzed the Supporting Documents in their credit memo, subject to SBA's request for additional information as needed.

2. Where to Submit Servicing Requests

Lenders must submit all Servicing Requests to the appropriate SBA Loan Center. Prior to final disbursement of a 7(a) Loan, Lenders should submit Servicing Requests to the LGPC in Citrus Heights, CA, or for EWCP Loans, the appropriate USEAC. After final disbursement, Lenders should submit Servicing Requests for all Loans in regular servicing status to the CLSC in Fresno, CA or Little Rock, AR, and the CLSC will consult with the appropriate USEAC as needed. For Loans over $500,000 in liquidation status, Lenders should submit Servicing Requests to NGPC. See definition of "SBA Loan Center" in Chapter 2 of this SOP for additional guidance on where to send Servicing Requests.)

3. SBA Response Time

SBA will attempt to respond to a Lender's request for approval of a Servicing Request within 15 business days from the date that SBA received the request, (13 C.F.R. §120.541), or sooner if possible. SBA's failure to provide a response to a Lender's Servicing Request within 15 business days does not imply that SBA has approved the Servicing Request.

Note: SBA will not provide written approval for proposed Loan Actions that fall within the Lender's unilateral authority.

D. Implementing Loan Actions

Lenders must implement Loan Actions in accordance with Prudent Servicing and/or Prudent Liquidation practices. For example, Lenders may need to:

1. Modify Existing Loan Documents

If the approved Loan Action modifies the terms and conditions of the Note or any other Loan Document, Lenders must modify each impacted Loan Document;

2. Prepare New Loan Documents

Lenders must properly prepare and ensure proper execution of any new Loan Document needed to implement an approved Loan Action; and

3. Record New or Modified Loan Documents

Whenever necessary, reasonable and/or customary, Lenders must properly record modified Loan Documents, as well as any new Loan Documents, in the public record.

Chapter 7.
Modification of Note

A. General Requirements

1. Review and Analysis of Requests to Modify a 7(a) Loan Note

Lenders should review, analyze and implement Borrower requests to modify the terms of a 7(a) Loan Note pursuant to the requirements of Chapter 6 of this SOP, the provisions of applicable statutes, regulations and contracts (e.g., SBA Loan Note and SBA Form 1086 (Secondary Participation Guaranty Agreement)), and this Chapter 7.

2. Secondary Market Purchase or Investor Consent

a. General Rule

With regard to 7(a) Loans sold on the secondary market, the Secondary Participation Guaranty Agreement (SBA Form 1086) prohibits any change to the repayment terms of the Note unless SBA or the Lender has repurchased the SBA guaranteed portion of the Loan or the Lender has obtained the written consent of the secondary market investor—unless the modification involves a one-time deferment that does not exceed a continuous period of three monthly installments. (See Chapter 12 of this SOP for guidance on payment deferments.)

b. Alternative—Emergency Repurchase from Investor

Generally, a Lender may only repurchase an SBA Loan from the secondary market investor on a "willing buyer-willing seller" basis. However, pursuant to SBA Form 1086, if the viability of the Borrower is at stake and the Lender is unable to obtain investor consent to restructuring the repayment terms of the Loan, the Lender may request authority from SBA to repurchase the Loan from the investor by submitting a written request along with the following documents to the appropriate SBA Loan Center:

(1) Current financial statements of Borrower;

(2) A written decline from the investor to the Lender's specific request; a written statement from the FTA indicating that the investor failed to respond within 30 calendar days; or the FTA's a written statement that the guaranteed interest is part of a pool;

(3) A statement that the proposed change in repayment terms is solely for the benefit of the Borrower; and

(4) A certification by the Lender that it will make the requested change if SBA approves the repurchase.

Note: Generally, if the Loan is held in a secondary market pool rather than by an individual investor, the FTA may approve Note modifications as long as the interest rate is not altered. Lenders are encouraged to propose modifications that will enable Borrowers to remain viable.

B. Payment Due Date

Lenders may modify the date that regularly scheduled installment payments are due, to facilitate a Borrower's ability to repay the Loan or comply with the terms of a workout agreement, provided that the general requirements in Paragraph A of this Chapter are met. For example, Lenders may change the payment basis from monthly to quarterly or annual, if such a change is justified based on the seasonal or cyclical nature of the Borrower's revenue stream. Changes to the frequency of installment payments is not permitted if the SBA guaranteed portion of the Loan is sold in the secondary market.

C. Change from Revolving to Non-revolving Loan

Lenders may change an SBA Loan from revolving to non-revolving to facilitate repayment or the orderly liquidation of the Loan, provided that the general requirements in Paragraph A of this Chapter are met.

D. Installment Amount

Lenders may modify the installment amount due under a Note to ensure that the Loan balance is properly amortized over the remaining life of the Loan, to help a viable Borrower meet long or short-term goals, and/or to facilitate a workout, provided that the general requirements in Paragraph A of this Chapter are met. (See also Chapter 12 (deferments) and Chapter 17 (workouts) of this SOP for additional guidance.)

E. Interest Rate

Lenders may modify the interest rate on a Note to help a viable Borrower meet long or short-term goals or to facilitate recovery for a Loan in liquidation status, provided that the general requirements in Paragraph A of this Chapter are met. For example, Lenders may modify the interest rate as part of a workout agreement designed to achieve the highest possible recovery in the shortest period of time.

F. Maturity Date Extensions

1. Extension of Maturity Date

Subject to the general requirements in Paragraph A of this Chapter, Lenders may extend the maturity date of a Note for up to 10 years beyond the original maturity date if:

a. The extension is requested before the SBA loan guaranty expires, i.e., less than

180 calendar days after the original maturity date (13 C.F.R. §120.524(a)(8)); and

b. The extension will aid in the orderly repayment of the Loan. (13 C.F.R §120.531).

2. Additional Guaranty Fee

a. Loans in Regular Servicing Status

Pursuant to SOP 50 10 in effect at the time the Loan was approved, Lenders must pay an additional guaranty fee, which Lenders may pass on to the Borrower, when the maturity of a short-term 7(a) Loan is extended beyond 12 months (see SOP 50 10 for additional guidance on SBA guaranty fees associated with the extension of maturity dates for EWCP Loans). No additional guaranty fees are required for short-term Loans that are extended beyond their original 12-month maturity date when SBA determines that the extension is needed to ensure the orderly repayment of the Loan and no new funds are disbursed. The amount of the additional guaranty fee is based on SOP 50 10 in effect at the time the Loan was approved. Lenders should include evidence of the payment of any additional guaranty fee with their notice of maturity date extension, as required by Chapter 3 of this SOP.

> **Note:** Pursuant to SOP 50 10, Lenders must pay an additional guaranty fee in connection with the extension of the maturity date for a loan with an original maturity term of 12-months or less, or any increase to the original Loan amount, within 30 days from the date of the maturity date extension or Loan increase, to avoid a cancelation of SBA's guaranty.

b. Loans in Liquidation Status

Lenders are not required to pay an additional guaranty fee if a maturity date is extended to aid in the orderly liquidation of the Loan and no additional funds are disbursed.

G. Loan Amount Increases

Lenders may increase the amount of a 7(a) Loan in regular servicing status provided that: (1) the general requirements in Paragraph A of this Chapter are met; (2) the general requirements in SOP 50 10 with regard to Loan increases are met; and (3) the additional guaranty fee required by SOP 50 10 in effect at the time the Loan was approved is paid. Lenders must pay the additional guaranty fee within 30 days from the date the Loan is increased to avoid cancellation of the SBA guaranty.

Chapter 8.
Modification of Collateral

A. Subordination of Lien Position

1. General Requirements

Lenders may subordinate the position of a lien securing an SBA Loan when doing so is consistent with Prudent Servicing, i.e., it will help the long or short-term needs of the Borrower without unduly impairing the ability to recover payment on the Loan. Lenders must review, analyze and implement subordination requests pursuant to the requirements of Chapter 6 of this SOP and the following guidelines:

a. The Borrower must have a satisfactory credit history;

b. The Borrower must have the ability to repay all of the obligations that would be outstanding after the proposed subordination;

c. The subordination must be to a specific amount and must not extend to future advances;

d. There should be sufficient equity in the collateral to adequately secure the SBA Loan after the proposed subordination; and

e. The terms of the subordination must be set out in a document signed by all the parties to the agreement.

> **Note:** SBA Loan Program Requirements prohibit any action that confers a Preference onto a Lender without SBA's prior written approval. (See 13 CFR §120.10 for definition of Preference.) For example, a Lender would receive a Preference if it subordinated the lien securing an existing SBA Loan to a lien securing a new non-SBA loan or a new SBA Loan with a lower guaranty percentage that the Lender made to the same Borrower. A Lender would also receive a Preference if it renewed or increased the amount owed on a non-SBA loan or an SBA Loan with a lower guaranty percentage if the lien securing an existing SBA Loan was previously subordinated to the loan the Lender renewed or increased.

2. Subordination to Facilitate the Refinancing of a Senior Loan

In addition to the general requirements in Subparagraph A.1 above, Lenders should not subordinate the position of a lien securing an SBA Loan to facilitate the refinancing 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 senior lien except for necessary, reasonable and customary closing costs;

c. No proceeds from the refinanced senior loan may go to the Borrower for any reason other than necessary, reasonable and customary closing costs; and

d. The subordination will not adversely affect the priority of the lien securing the SBA Loan.

> **Note:** When analyzing a request for subordination to facilitate the refinancing of a senior loan, Lenders may not have to perform a complete financial analysis if the Borrower has been making timely payments and the refinancing provides more favorable terms for the Borrower.

3. Subordination to Facilitate a New Loan

In addition to the general requirements in Subparagraph A.1 above, Lenders should not subordinate the position of a lien securing an SBA Loan to facilitate a new loan unless:

a. The new loan is necessary to satisfy a legitimate need such as paying for improvements to the collateral that will maintain or increase its value; and

b. All other avenues of obtaining the funds have been exhausted.

4. Subordination to Facilitate Assumption of an SBA Loan

Lenders must not subordinate the lien securing a 7(a) Loan to a lien that secures a loan that provides funds to an assumptor of the SBA Loan to acquire the business or assets of SBA Loan Borrower. However, if the acquisition loan includes funds that the assumptor will use to make improvements to the collateral that will maintain or increase the value of the collateral, Lenders may subordinate the lien securing the SBA Loan up to the documented amount of funds spent to improve the value of the collateral.

B. Inter-creditor Agreements

Lenders should review, analyze and implement requests for the execution of an inter-creditor agreement involving an SBA Loan, (i.e., a written 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) pursuant to the requirements of Chapter 6 of this SOP and the following guidelines:

1. The inter-creditor agreement should not adversely impact the position of the lien securing the SBA Loan;

2. The delineated rights and responsibilities regarding loan servicing responsibilities and the remedies in the event of Default, should be consistent with Prudent Servicing practices; and

3. Entering into the inter-creditor agreement should not adversely impact the ability to recover payment on the SBA Loan.

C. Substitution of Collateral

1. General Requirements

Lenders should review, analyze and implement requests to substitute the collateral for an SBA Loan pursuant to Chapter 6 of this SOP and the following guidelines:

a. 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 have a Recoverable Value that is equal to or greater than the Recoverable Value of the existing collateral based on an Appraisal that meets the appraisal requirements set out in SOP 50 10 in effect at the time the Loan Action is taken, in accordance with 13 C.F.R. §120.180;

b. If the substitute collateral is commercial real property, Lenders must conduct adequate due diligence to ensure that the risks of Contamination are minimal, as required by Chapter 5 (Environmental Risk Management) of this SOP;

c. When no additional credit is extended to the Borrower, there should be no more than a nominal increase in the amount of any proposed senior lien - to cover the closing costs associated with the substitution of collateral transaction;

d. The Borrower should have a satisfactory credit history;

e. The Borrower's current financial statement should reflect that the Borrower has the ability to pay all of its obligations that will remain outstanding after the substitution;

f. There should be sufficient equity in the collateral to secure the SBA Loan after the proposed substitution;

g. The release and substitution must not impair the ability to foreclose upon the remaining collateral or collect the Loan balance from the Obligors; and

h. The release of the existing lien(s) or proceeds thereof must be 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 the parties involved in the transaction.

2. Substitution of Residence Held as Collateral

Lenders should review, analyze and implement requests to substitute a lien on a new residence of an Obligor in exchange for releasing the lien on the Obligor's existing residence pursuant to the general requirements in Subparagraph C.1 above and the following guidelines:

a. The Obligor must use all the proceeds from the sale of their existing residence, other than the funds needed to pay off senior liens and necessary, reasonable and customary closing costs, to purchase a new residence, place the funds in an escrow account for the purchase of a new residence, or pay down the SBA Loan;

b. The dollar amount of the equity available in the new residence to secure the SBA Loan must be equal to or greater than the dollar amount of equity in the existing residence;

c. The release of the existing lien, or proceeds thereof, must be concurrent with the recording of the lien on the new residence in the required position of priority, and should be done pursuant to an escrow agreement signed by all the parties involved in the transaction; and

d. The Obligor must provide the title, hazard and/or flood insurance as required by Chapter 9 of this SOP.

D. Substitution of Guarantor or Assumption of Personal Guaranty

Lenders must not release Guarantors without SBA's prior written approval; except for limited guaranties taken to secure an owner's interest in collateral. In Loan assumption and assumption of personal guaranty transactions, Lenders must obtain SBA's prior written approval to release an existing Obligor for Loans that are in payment Default or liquidation only (see Chapter 11 of this SOP for additional guidance). Lenders should review, analyze and implement requests to substitute a Guarantor pursuant to the requirements of Chapter 6 and Chapter 3 of this SOP and the following guidelines:

1. The financial strength of the proposed substitute Guarantor should be equal to or greater than the financial strength of the existing Guarantor; and

2. Substituting the proposed Guarantor and releasing the existing Guarantor should not adversely impact the operation of the business. Lenders may condition the substitution of a Guarantor upon retention of the original Guarantor for a transitional period (e.g., two years), during which time the Lender may not release the original Guarantor if there is a material adverse change in the financial condition of the business. (See Subparagraph I of this Chapter for additional guidance on the release of a Guarantor or co-Borrower.)

E. Borrower Business Ownership Change

Any change in the ownership of a Borrower's business (including a change in the percentage of ownership) for 12 months after final disbursement on any 7(a) Loan requires SBA's prior written

approval.

1. Lenders must submit a Servicing Request for SBA's prior written approval to the appropriate SBA Loan Center. All Servicing Requests must include the reason(s) for the Borrower's business ownership change, details regarding the requested Loan Action and the Lender's recommendation for Loan Action. The SBA Loan Center will review each request and make a determination after:

   a. Verification that the proposed changes to the ownership of the Borrower's business complies with limitations on the maximum amount of SBA guaranteed Loans to a Borrower, including affiliates; and

   b. Verification that there is no active delinquency on an obligation to or no prior loss to the Government caused by the new owner(s), or any business owned, operated and/or controlled by the new owner(s).

F. Leasing Real Property Acquired with SBA Loan Proceeds

If at any time during the term of an SBA Loan, the Borrower (or, if the Borrower is an EPC, the Operating Company) leases the real property that was acquired with the SBA Loan proceeds to a third party, in violation of 13 C.F.R. §120.131, SBA may take appropriate action including accelerating the Note and making demand for payment in full (see SOP 50 10 for additional guidance on the determination of occupancy requirements). In addition, SBA's review of any future application for SBA financial assistance submitted on behalf of the Borrower, the Operating Company (if applicable), and any Associate(s) will take into consideration any prior failure to comply with SBA Loan Program Requirements, including occupancy requirements, in connection with an outstanding SBA Loan.

G. Release of Lien without Consideration

Lenders must review, analyze and approve or decline requests for the release of liens on real or personal property collateral without consideration before the Loan has been paid in full pursuant to Chapter 6 of this SOP and the following guidelines:

1. Borrower should use any proceeds from the release of collateral for business purposes only;

2. Borrower must have the ability to repay the SBA Loan in full;

3. The release must not materially interfere with the operation of the business or decrease the value of the other collateral securing the SBA Loan;

4. The Recoverable Value of the remaining collateral should be sufficient to adequately secure the SBA Loan after the proposed release; and

5. The release document(s) must not impair the Lender or SBA's interest in, or ability to foreclose upon, the remaining collateral.

H. Release of Lien for Consideration

Lenders must review, analyze and approve or decline requests for the release of liens on real or personal property collateral for consideration pursuant to Chapter 6 of this SOP and the following guidelines:

1. General Requirements

a. The amount of consideration received must be equal to or greater than the Recoverable Value of the collateral or the outstanding balance of the SBA Loan, whichever is less. (See Chapter 5 [Environmental Risk Management] of this SOP with regard to the due diligence that Lenders must perform if the collateral is alleged to be worth substantially less than its estimated Recoverable Value due to the alleged presence of Contamination.); and

b. Release of the lien must not jeopardize the ability to maximize recovery on the SBA Loan.

2. Practice Tips

a. Trade Fixtures

If the collateral includes a lien on trade fixtures located on real property collateral, e.g., gas station canopies and pumps, Lenders should not release the real property lien unless the personal property collateral has already been liquidated or additional consideration is received for release of the lien on the trade fixtures.

b. Public Auctions

If a public auction of machinery and equipment is planned, Lenders should not release the lien on the most valuable items prior to the auction since it may impair the ability to attract bidders for the remaining collateral.

I. Release of Guarantor or Co-Borrower

Lenders must not release Guarantors or co-Borrowers without SBA's prior written approval, except for limited guaranties taken to secure a property owner's interest in collateral for an SBA Loan (see Paragraph D of this Chapter for guidance on the release of Obligors in Loan assumption and personal guaranty assumption transactions). Lenders must review, analyze and approve or decline requests for the release of a Guarantor or a co-Borrower pursuant to Chapter 6 of this SOP and the following guidelines:

1. Loans in Regular Servicing Status

a. The loan must be Seasoned;

b. The release must not conflict with SBA Loan Program Requirements in 13 C.F.R.

Part 120 and SOP 50 10 in effect at the time the Loan Action is taken, which require Guaranties from specific Persons as a condition for SBA's guaranty of the Loan, (e.g., any Person who owns 20 percent or more of the small business Borrower);

c. The release must not jeopardize the ability to maximize recovery on the SBA Loan, shift the risk of loss to SBA, or otherwise harm the integrity of the SBA Loan program; and

d. Guarantor or co-Borrower obligations may be limited to the amount of funds they receive in exchange for divesting their interests in the Borrower's business, subject to prior written SBA approval in accordance with the compromise authority granted in 13 C.F.R 120.536(a)(3). Lenders must review, verify and analyze all release requests and accompanying documentation pursuant to the substitution of Guarantor guidance provided in Paragraph D of this Chapter for operating businesses, or the offer in compromise guidance provided in Chapter 21 (Offer in Compromise) of this SOP for Loans in liquidation.

2. Loans in Liquidation Status

a. The release must not jeopardize the ability to maximize recovery on the SBA Loan or harm the integrity of the SBA Loan program;

b. Lenders must condition the release on SBA approval and receipt of consideration in an amount equal to or greater than the amount that could be collected through legally enforced collection proceedings against the Guarantor or co-Borrower requesting the release;

c. The Guarantor or co-Borrower requesting the release must provide the same documentation that is required for an offer in compromise; and

d. Lenders must review, verify and analyze the offer and financial documentation provided by the Guarantor or co-Borrower requesting the release pursuant to the requirements of Chapter 21 (Offer in Compromise) of this SOP.

J. Release of Condemnation Proceeds

Lenders must review, analyze and implement requests for the release of condemnation proceeds pursuant to the requirements of Chapter 6 of this SOP, the general guidance provided in Paragraph E (Release of Lien Without Consideration) or Paragraph F (Release of Lien for Consideration) of this Chapter, and the following guidelines:

1. Condemned Property Replaced

When condemnation proceeds will be used to replace the condemned property, Lenders should release the proceeds pursuant to an escrow agreement approved by Lender's legal counsel that conditions the release of funds upon:

a. Receipt of a perfected lien on the substitute collateral in the required lien position;

b. Compliance with the title, hazard and flood insurance requirements set out in Chapter 9 of this SOP.

2. Condemned Property Not Replaced

When the condemnation proceeds will not be used to replace the condemned property:

a. Condemnation Proceeds of $5,000 or less:

If the condemnation proceeds are relatively insignificant, i.e., $5,000 or less, and the release will not adversely affect the ability to recover payment on the SBA Loan, Lenders may release the proceeds directly to the Borrower.

b. Condemnation Proceeds of more than $5,000

If the condemnation proceeds are more than $5,000, Lenders should apply the proceeds to the principal balance of the SBA Loan, provided that Lenders may release up to $5,000 directly to the Borrower if the release will not adversely affect the ability to recover payment on the SBA Loan. The application of condemnation proceeds to an SBA Loan is not considered a voluntary Loan prepayment. Therefore, a subsidy recoupment fee is not required.

Chapter 9.
Insurance Coverage

A. General Requirements

Lenders must document all decisions regarding insurance, including justification for their decisions, in a Loan Action Record and retain the documented decisions in their Loan File.

B. Mortgagee's Title Insurance

1. Substitute Collateral

When existing real property collateral is released and substitute real property collateral is taken, Lenders should obtain a mortgagee's title insurance policy to insure the new lien on the substitute property. (See Chapter 8 of this SOP for guidance on the substitution of collateral.)

2. Additional Collateral

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

3. Installment Sale of REO

When REO is sold on an installment basis, Lenders must obtain a mortgagee's title insurance policy to insure the title relative to the new lien on the REO. (See Chapter 20 of this SOP for guidance on term sales for acquired collateral.)

C. Hazard Insurance

1. Modification of Coverage on Existing Collateral

Lenders should not terminate or reduce the hazard insurance requirements for collateral as set out in the Loan Authorization unless the insured assets have been sold or have significantly decreased in value. See SOP 50 10 for additional guidance on hazard insurance requirements at the time of Loan origination.

2. Coverage on Substitute or Additional Collateral

When existing collateral is released and substitute collateral is taken to secure an SBA Loan, the Lender must ensure that the substitute collateral is adequately insured and that the insurance policies contain a mortgagee clause (or substantial equivalent) in favor of the Lender. (See Chapter 6 of this SOP for guidance on how to review and analyze Servicing Requests and Chapter 8 of this SOP for guidance on the substitution of collateral.)

3. Care and Preservation of Collateral and Acquired Collateral

Lenders must ensure that all collateral and acquired collateral with Recoverable Value is adequately insured, in order to protect the Recoverable Value for the SBA Loan. (See Chapter 16 of this SOP for post-Default site visits and Chapter 20 of this SOP for ownership responsibilities pertaining to acquired collateral.)

4. Forced Placement

If the Loan Documents require hazard insurance and the Obligor has allowed the insurance coverage to lapse, Lenders should force-place insurance based on Prudent Servicing practices on a case-by-case basis. The cost of insurance that is forced-placed by a Lender is a Recoverable Expense.

5. Release of Hazard Insurance Policy Proceeds

a. General Rule—Collateral Repaired or Replaced

When the Lender or SBA is named as a loss payee on a hazard insurance policy, Lenders should not release insurance proceeds without Supporting Documentation to verify that the insured property has been adequately repaired and/or replaced and that any construction or repair-related liens against the property are released.

b. Exception—Controlled Distribution

If a request to release insurance proceeds is not accompanied by Supporting Documentation to verify that the insured property has been adequately repaired and/or replaced, Lenders should control and monitor the disbursement of the proceeds as follows, instead of endorsing and delivering the insurance check to the Borrower:

(1) Use of Escrow Agent

Lenders may disburse insurance proceeds pursuant to an escrow agreement approved by the Lender's legal counsel. An escrow company, the first lienholder or an impartial third party such as an attorney or architect may serve as the escrow agent.

(2) Progress Payments

Lenders may allow Borrowers to 1) open a federally-insured joint savings or custodial account with the Lender, 2) establish a draw schedule based on the stages of construction, 3) present paid invoices and lien waivers to document each stage of construction, and 4) request the release of funds specified in the draw schedule; provided that the Lender verifies that the previous stage of construction was completed and the material and labor involved was paid for before authorizing the next draw on the joint or custodial account. (Lenders

should allow Borrowers to retain any interest earned on the funds in the account.)

D. Life Insurance

1. Modification of Requirement

Lenders should not modify or terminate the life insurance requirements in the Loan Documents unless the reason for requiring the life insurance policy no longer exists. Lenders must follow their internal policies for similarly-sized, non-SBA guaranteed commercial loans.

2. Use of Escrow Account to Collect Premiums

If the assignment of a life insurance policy is required by the Loan Documents, in order to ensure that the policy premiums are paid, Lenders may set up an escrow account to collect the funds needed to pay the premiums. (See SOP 50 10 in effect at the time the Loan Action is taken for SBA Loan Program Requirements concerning escrow accounts for commercial real estate taxes and insurance.)

3. Continuation of Coverage

If an assignment of life insurance is required by the Loan Documents and the Lender receives a notice that the Borrower has not made the required policy payments, the Lender should base its decision to continue the insurance coverage on Prudent Servicing practices on a case-by-case basis. The Lender's cost to continue the coverage is a Recoverable Expense.

4. Release of Life Insurance Policy Proceeds

a. General Rule

Lenders should apply the proceeds from an assigned life insurance policy to the principal balance of the Loan. (Application of life insurance proceeds is not considered a voluntary Loan prepayment for subsidy recoupment fee determination purposes.)

b. Exceptions

Depending on the circumstances, Lenders may release all or part of the proceeds of a life insurance policy if, in addition to meeting the requirements for release set out in Chapter 8 Paragraph E (Release of Lien Without Consideration) or Paragraph F (Release of Lien for Consideration) of this SOP, the death of the insured has no significant impact on the future management of the Borrower's business and:

(1) The proceeds are needed for a valid business purpose; or

(2) The proceeds are needed to prevent a Financial Hardship; and

(3) There is a reasonable and prudent expectation that the Borrower will repay the SBA Loan in full based on the financial strength of the business.

c. Use of an Escrow Account

If the financial strength of the Borrower's business is insufficient to justify releasing the insurance proceeds to the Borrower, or weak enough to support applying the proceeds to the Loan balance, Lenders may place the insurance proceeds in an escrow account for distribution after the Lender has had the opportunity to observe the Borrower's on-going business operations and is able to make a prudent decision.

E. Flood Insurance

1. General Rule—Termination or Modification Not Permitted

When an SBA Loan is secured by improved real estate, a mobile home 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. (SBA flood insurance requirements are based on the Standard Flood Hazard Determination, FEMA Form 086-0-32 or its successor. See the National Flood Insurance Reform Act of 1994 and SOP 50 10 for more information and guidance on SBA flood insurance requirements.) This requirement pertains to substitute collateral as well as the original collateral for the Loan.

2. Events Triggering Flood Insurance Review

Lenders should review the need for flood insurance, as well as the adequacy of any existing flood insurance coverage, whenever a Borrower makes a Servicing Request.

3. Forced Placement

If at any time during the life of a Loan, real or personal property collateral located in a SFHA is not covered by an adequate amount of flood insurance, the Lender must instruct the Borrower to obtain adequate flood insurance. If the Borrower fails to do so within 45 calendar days, the Lender must purchase flood insurance on the Borrower's behalf and at the Borrower's expense. This cost is treated as a Recoverable Expense. The Lender should also decline all Borrower Servicing Requests until the Borrower complies 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 and no private insurance is available, the Lender must document the reasons why the property is no longer covered by flood insurance and maintain this documentation in its Loan File. Lenders may not provide SBA financial assistance (including increases, renewals, or extensions) to acquire or construct property located in an SFHA unless the community in which such property is located participates in the NFIP or is otherwise covered by private insurance that is equivalent to NFIP.

Chapter 10.
Modification of Management Covenants

A. General Requirements

Lenders should ensure that Borrowers comply with the management covenants in the SBA Loan Documents, unless modification is consistent with the Prudent Servicing practices and the Lender performance guidelines set out in Chapter 1 of this SOP. Lenders must review, analyze and implement Borrower requests to modify Loan Documents pursuant to the guidance provided in Chapter 6 of this SOP and the guidelines set out below.

B. Financial Statements

Lenders should not modify Loan Document provisions that require Obligors to submit periodic financial statements (e.g., temporarily or permanently waive; change from audited to compiled or reviewed; or require less frequently), , unless a lender exercising Prudent Servicing practices would do so based on the circumstances. For example, it may be prudent to modify financial statement submission requirements if:

1. The SBA Loan is Seasoned and the existing requirements would cause a Financial Hardship for the Borrower;

2. The waiver is temporary and limited to one year at a time; and

3. The right to reinstate the requirement is reserved and exercised in the event of Default.

C. Restrictions on Compensation, Dividends, Fixed Assets, etc.

Lenders should not modify management covenants in the Loan Documents pertaining to matters such as limitations on compensation, fixed assets, working capital levels, or dividend payments unless such modifications are supported by Prudent Servicing practices. For example, it may be prudent to modify these requirements if:

1. The Loan is Seasoned;

2. The Lender has not extended the maturity date of the SBA Loan Note nor deferred Loan payments during the 24-month period prior to the date of the Borrower's request; and

3. Based on the Lender’s analysis of the Borrower's cash flow for the past 24-months, the Lender has a prudent basis to conclude that the Borrower has the ability to repay all its debts in full, including the SBA Loan, if the modification is approved.

D. Standby Agreements

1. General Rule

Except as provided in Subparagraph D.2. below with regard to equity injections, Lenders

should not terminate nor modify a standby agreement required by the Loan Documents, to allow a Borrower to make full or partial payments to the standby creditor, unless Prudent Servicing practices would support doing so. For example, it may be prudent for a Lender to modify standby agreement requirements if:

a. The loan is Seasoned;

b. Based on the Lender's analysis of the Borrower's cash flow for the past three years, a prudent Lender would conclude that the Borrower has the financial ability to repay all its debt, including the SBA Loan, if the standby agreement is modified or terminated; and

c. A prudent lender would conclude that there is a minimal risk that the Borrower will be unable to repay the SBA Loan in full over the term of the Loan.

2. Standby Agreement Used as Equity Injection

When an SBA Loan Authorization requires the use of a standby agreement for equity injection purposes, e.g., in changes of business ownership situations, Lenders must not terminate or modify the standby agreement for 24 months after disbursement of the SBA Loan, subject to Prudent Servicing practices, in accordance with the Loan Program Requirements of SOP 50 10 in effect when the action is taken.

Chapter 11.
Assumption, Assignment or Sale of Loan

A. Assumption

Lenders should review, analyze and implement Borrower requests to allow another Person to assume an SBA Loan (i.e., take over the Borrower's legal obligations and benefits under the Loan Documents) pursuant to the guidance and requirements provided in Chapter 6 of this SOP and the following:

1. Unless the assumption is part of a workout or the Loan is in liquidation status, Lenders must ensure that the proposed assumptor satisfies the 7(a) Loan eligibility requirements set out in SOP 50 10 in effect at the time the assumption Loan Action is approved;

2. Lenders must ensure that the proposed assumptor will be the primary owner of the business;

3. Lenders should ensure that the proposed assumptor has business experience and management skills that are equal to or better than the Borrower's;

4. Lenders must ensure that the proposed assumptor has a satisfactory credit history;

5. Lenders must ensure that the proposed assumptor has the ability to repay the SBA Loan in full;

6. Lenders should not release any collateral in conjunction with the proposed assumption;

7. Lenders should not subordinate any collateral, except as provided in Chapter 8 Paragraph A of this SOP with regard to funds the assumptor will use to maintain or increase the value of the collateral;

8. Lenders must ensure that the proposed assumption will not negatively impact the operation of the business;

9. Lenders must ensure that the proposed assumption will not negatively impact the Recoverable Value of the collateral;

10. Lenders should ensure that the existing collateral is adequate to secure the Loan. If the existing collateral is inadequate, and whenever possible, Lenders should condition their approval of the proposed assumption on the provision of additional collateral from the existing Obligor(s) or assumptor;

11. Lenders must not release existing Obligors without SBA's prior written approval for Loans that are in payment Default or liquidation (see Chapter 8, Paragraphs D and I of this SOP for guarantor substitution and release requirements, and Chapter 21 of this SOP for OIC requirements);

12. Lenders must ensure that the terms of the assumption are set out in a written agreement signed by all the parties to the agreement;

13. Lenders must ensure that the terms of the assumption agreement include a "due on sale or death" clause that prohibits any future assumption of the SBA Loan; and

14. Lenders must ensure that the terms of the assumption agreement do not include a real estate contract, i.e., the seller may not retain title to the property until an agreed upon amount of funds is paid.

> **Note:** See the most current version of SOP 50 10 with regard to the fee that Lenders may charge for an assumption. (See Chapter 8, Paragraph D of this SOP for guidance on the assumption of personal guaranties.)

B. Assignment of Lender's Interest in a 7(a) Loan

Lenders may assign their interest in a 7(a) Loan to another 7(a) Lender. (For additional information see 13 C.F.R. §120.430 et seq.) Lenders may assign individual 7(a) Loans to another 7(a) Lender pursuant to a transfer of participation agreement, provided the original and acquiring Lenders obtain SBA's prior written approval. To transfer an SBA Loan to another participating SBA Lender, Lenders must submit a Servicing Request, including a detailed explanation and supporting documentation, to the appropriate CLSC.

C. SBA Loan Transfers

Lenders may assign a portion of or its entire 7(a) Loan portfolio to another 7(a) Lender provided that the Lender provides SBA with a copy of the purchase, sale and assignment documents, any other documentation SBA requires, and obtains SBA's prior written approval. (See SOP 50 56 for additional guidance on the transfer of an SBA Loan portfolio.)

> **Note:** SBA does not charge a Loan assignment fee, nor does it require or prohibit the assigning Lender from negotiating with the assignee Lender to pay an assignment fee,

D. Sale of SBA Loan in Liquidation Status

Lenders may sell an SBA Loan in liquidation status, provided that:

1. The sale is to a Person other than the Borrower;

2. The sale price bears a reasonable relationship to the amount the Lender could recover through enforced collection proceedings;

3. The Lender obtains SBA's prior written approval if the sale involves a compromise of the principal balance owed to SBA on the Loan, and/or the Lender proposes to sell the Loan to a Guarantor, Close Relative of the Borrower, or an Associate of the small business;

4. SBA or the Lender has purchased the guaranteed portion of the Loan if it was sold on the

secondary market;

5. The Lender proposing to sell the Loan has submitted a complete Universal Purchase Package to SBA and SBA has completed its guaranty purchase review process, and

6. The Lender shares the Loan sale proceeds with SBA based on SBA's participation interest in the Loan after guaranty purchase.

> **Note:** For information regarding the sale of SBA Loans in the secondary market, see sections 5 (f), (g) and (h) of the Small Business Act (15 U.S.C. 634); 13 C.F.R. §120 Subpart F; and SBA Form 1086 (Secondary Participation Guaranty Agreement).

Chapter 12.
Deferments

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 Loan. When used inappropriately, i.e., when the Borrower's problems are permanent, a deferment can harm the Borrower, Lender and/or SBA. Especially if, for example, during the deferment period, the collateral loses its value or the Obligors deplete all their resources, including the money in their retirement accounts and the equity in their homes, in a futile attempt to turnaround a non-viable business.

Note: 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, Lenders may defer (i.e., postpone without accelerating the Note or transferring the Loan into liquidation status) any delinquent payments, as well as full or partial future monthly payments for an SBA Loan, for a stated period of time. (13 C.F.R. §120.530) Generally, interest will continue to accrue during the deferment period. (See Subparagraph D.3 of this Chapter for guidance on how Lenders may collect and apply accrued interest.)

C. General Requirement—Temporary Cash Flow Problem

1. Lenders should review and analyze the Borrower's financial information in accordance with Prudent Servicing practices, to ensure that the Borrower's cash flow problems are temporary and that the Borrower is financially viable.

2. When an SBA Loan is more than 60 calendar days past due and the Borrower's problems appear to be permanent or long-term, Lenders should not grant a deferment. Instead, Lenders should transfer the Loan into liquidation status and pursue more appropriate Loan Actions such as workout, liquidation of collateral and/or compromise with the Obligors. (See Chapters 17-21 of this SOP.)

D. Deferred Period

1. Loan Not Sold in Secondary Market

For SBA Loans that Lenders have not sold in the secondary market, Lenders may grant payment deferments of up to six consecutive months. During the deferment period,

Lenders should monitor the Borrower's operations (through phone calls, site visits, monthly financial statement review, etc.,) so that at the end of the deferment period, the Lender is able to determine whether an additional deferment is necessary and consistent with Prudent Servicing practices. Prior to granting an additional payment deferment, Lenders must prepare and document a Loan repayment strategy to justify a deferment of more than six months. Generally, deferments should not exceed six cumulative monthly payments, or 20 percent of the original Loan amount, whichever is less.

2. Loan Sold in Secondary Market

For SBA Loans that Lenders have sold in the secondary market, Lenders may grant only one payment deferment of up to three consecutive months without the prior written consent of the investor. Lenders must immediately notify the FTA and the appropriate SBA Loan Center in writing if they defer any payments for Loans sold in the secondary market. Any additional payment deferment requires the prior written consent of the investor. (See Section 3.8 of Secondary Participation Guaranty Agreement [SBA Form 1086]).

3. Interest Accrual

Generally, interest will continue to accrue during a deferment period, and Lenders may collect the accrued interest in one of the following ways:

a. Lenders may allow Borrowers to pay accrued interest during the deferment period;

b. Lenders may allow Borrowers to pay the accrued interest in a lump sum at the end of the deferment period;

c. After the deferment period, Lenders may increase the Loan payments for a period of time to allow the Borrower to catch up to the original amortization schedule;

d. If a Lender allows the Borrower to resume making the same pre-deferment regular payments after the deferment period ends, the Lender must apply the payments to accrued interest first and then to principal, and extend the original Loan maturity date for up to 10 years to ensure the orderly repayment of the Loan (See Chapter 4 of this SOP for guidance on the application of payments for Loans in regular servicing status, and Chapter 7 of this SOP for guidance on maturity date extensions.);

e. Lenders may not capitalize or add accrued interest to the principal balance of the Loan.

E. Amount of Payments during Deferment Period

Payments during a deferment period are not mandatory, but are preferred since even a small payment, such as $1.00, will keep the Borrower in the habit of making payments and will also keep the Borrower's pre-authorized debit method of payment active.

Note: If the delinquent Borrower is on active duty, Lenders should consult with their 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.

Chapter 13.
Delinquent Secured Senior Loans

A. General Requirements

Lenders must take prudent and commercially reasonable actions to prevent 1) the elimination of a lien securing an SBA Loan through a foreclosure action initiated by a senior lienholder, or 2) dissipation of the equity available to secure an SBA Loan due to the imposition of Default Charges.

B. Procedure for Developing Best Strategy to Protect a Junior Lien Securing an SBA Loan

When it is apparent that an Obligor is in default on a loan secured by a senior lien on the collateral for an SBA Loan, Lenders should take the following steps to develop a prudent and commercially reasonable strategy to protect the equity available for the SBA Loan.

1. Review the Loan Documents

Lenders should begin the process by reviewing the Loan Documents to determine the priority of the lien securing the SBA Loan at the time the Loan was approved and closed. For example:

a. Real Property Collateral

For senior liens on real property collateral, Lenders should review the mortgage, deed of trust or other lien instrument, assignment of rents and title insurance policy, as well as any senior lienholder, inter-creditor, subordination, non-disturbance and/or attornment agreements.

b. Personal Property Collateral

For senior liens is on personal property collateral, Lenders should review the security agreement, landlord lien waiver, UCC financing statements and UCC searches, as well as any senior lienholder, subordination and/or inter-creditor agreements.

2. Order a Current Lien Search

Lenders should order a current title report or UCC search to verify the priority of the lien(s) securing the SBA Loan. Or, at a minimum, Lenders should review the existing title insurance policy or UCC search and gather any other information needed to determine whether there are any additional liens against the property that could have seniority over the lien securing the SBA Loan, such as liens for unpaid property taxes.

3. Verify the amount Owed on All Senior Liens

Lenders should ascertain the exact amount owed on all senior liens and verify that the amount does not include advances or Default Charges that were subordinated to the SBA

Loan pursuant to a subordination agreement, inter-creditor agreement or other Loan Document.

4. Order an Appraisal

Lenders should order an Appraisal to obtain current information regarding the value of the collateral.

> **Note:** See the definition of "Appraisal" in Chapter 2 of this SOP, which includes a broker's price opinion, for SBA requirements pertaining to appraisals. Given the inherent conflict of interest, Lenders must not rely solely on an appraisal prepared for an Obligor or another lender with a lien on the same collateral, and exercise caution if the Appraisal was prepared by a broker that will list the collateral, if acquired, for sale.

5. Determine the Recoverable Value of the Collateral

Lenders should calculate the Recoverable Value of the collateral encumbered by the senior lien.

6. Estimate Recovery from All Other Sources

Lenders should determine the repayment ability of all the Obligors for the SBA Loan (see Chapter 15 of this SOP for guidance on evaluating the financial condition of Obligors) and the Recoverable Value of any additional collateral.

7. Determine Whether the Senior Lienholder Provided Required Notice

If a senior lienholder, who signed a lienholder agreement, has initiated a foreclosure action, Lenders must determine whether the senior lienholder complied with all the applicable notice requirements in the relevant Loan Documents. (For example, some senior lienholder agreements require the senior lender to provide written notice of: (1) a default on the senior lender's loan within 30 days of the event of default; and (2) intent to foreclose its lien on the collateral at least 60 days prior to initiating the foreclosure action.)

8. Judicial Foreclosure—Notify SBA District Counsel

If a notice of judicial foreclosure is received, Lenders must immediately notify the appropriate SBA Loan Center for assignment of the action to the SBA District Counsel responsible for monitoring the litigation.

9. Analyze Facts, Review Options and Plan Strategy

Based on an analysis of the information collected in Steps 1-8 above, Lenders must decide which Loan Action or combination of Loan Actions, such as those listed in Paragraph C below, is most appropriate under the circumstances.

C. Lender Options

Generally, the strategy used to protect the equity available for an SBA Loan in a junior lien position includes one or more of the Loan Actions listed below.

1. Bring the Senior Loan Current

To maximize recovery on an SBA Loan, Lenders may advance funds to keep the payments on a senior secured loan current if the goal is to:

a. Facilitate a Workout

Lenders may negotiate a workout plan to enable a viable Borrower to continue operating their business;

b. Negotiate a Sale of the Collateral

Lenders should work with the Obligor and other lienholders to complete a negotiated sale of the collateral (see Chapter 18 [Real Property Collateral Liquidation] or Chapter 19 [Personal Property Collateral Liquidation] of this SOP for guidance on short sales and the release of liens for consideration); or

c. Foreclose the Lien Securing the SBA Loan

To preserve the equity in the property that secures the SBA Loan and minimize costs by leaving the senior lien in place, Lenders may foreclose the junior lien securing the SBA Loan. (See Chapter 18 [Real Property Collateral Liquidation] or Chapter 19 [Personal Property Collateral Liquidation] of this SOP for guidance on lien foreclosure.)

2. Purchase or Pay Off the Senior Loan

When gaining control of the liquidation process is necessary to maximize recovery, especially when doing so would enable an otherwise viable Borrower to retain possession of its business premises so that it can continue to operate and repay the SBA Loan, Lenders may advance funds to purchase or pay off a debt secured by a senior lien, particularly if the senior lienholder offers a discount, and:

a. The risk is justified by an Appraisal and Recoverable Value analysis;

b. The purchase or pay off amount is consistent with any agreement signed by the senior lienholder regarding the subordination of advances and Default Charges;

c. The Obligors are given written notice of the proposed purchase or pay off and their increased financial liability on the SBA Loan as a result; and

d. If the Borrower is to retain possession of the collateral: (1) the Borrower has the ability to make the payments on the adjusted SBA Loan balance; and (2) purchasing or paying off the senior lienholder loan will improve the Borrower's ability to repay

the SBA Loan.

3. Wait for Senior Lienholder to Start Foreclosure Proceedings

a. Respond to Complaint for Judicial Foreclosure

If a senior lienholder initiates a judicial foreclosure action, Lenders must immediately notify the appropriate SBA Loan Center for assignment of the action to the SBA District Counsel responsible for monitoring the litigation. In addition to, or in lieu of, any of the other options listed in this chapter, SBA District Counsel may advise the Lender to:

(1) File a disclaimer or an answer;

(2) Foreclose the lien securing the SBA Loan in the same action; or

(3) Cross-claim for judgment against the Obligors.

> **Note:** If SBA has taken over the servicing for the Loan, SBA District Counsel is responsible for managing the litigation in coordination with the local U.S. Attorney's Office, which has final decision-making authority regarding litigation strategy, credit matters and settlements.

b. Enter a Protective Bid

(1) When to Enter

Lenders should enter a Protective Bid at a senior lienholder's foreclosure sale if the Recoverable Value of the property is equal to or greater than 10 percent of the Liquidation Value of the property, unless abandonment is appropriate (i.e., Recoverable Value of less than $10,000 for real property and $5,000 for personal property collateral), or a prudent lender would not enter a Protective Bid based on circumstances that are not reflected in the Appraisal, but are documented in the Loan File. (For example, if the collateral has an appraised value of $100,000, a Liquidation Value of $80,000, and a Recoverable Value of $50,000 [i.e., Liquidation Value minus the balance owed on senior liens, foreclosure costs, and holding and resale costs] Lenders should enter a Protective Bid because $50,000 is more than $8,000 [10 percent of $80,000].)

(2) Protective Bid Amount

(a) Maximum Amount

The maximum amount of a Protective Bid is the lesser of the balance owed on the SBA Loan or the Recoverable Value of the collateral.

(b) Tolerance Range

Lenders should include a "tolerance range" in their Protective Bid amount (i.e., a specific percent of the authorized bid amount by which the Lender is allowed to increase or decrease the amount of the Protective Bid depending on unanticipated events at the foreclosure sale). Generally, an acceptable tolerance range is 10 percent above or below the authorized bid amount.

(c) Impact on Ability to Collect Deficiency

Because state laws vary, Lenders should consult their legal counsel prior to entering a Protective Bid in order to ascertain the impact, if any, that the Protective Bid amount may have on the ability to collect the deficiency balance of the Loan, if any, after the bid amount is entered into the public records and applied to the Loan. Lenders should consult with the trustee, court and/or other appropriate party regarding the proper payee for a protective bid check.

c. Take a No Bid Position

(1) When Appropriate

Lenders should not enter a Protective Bid at a senior lienholder foreclosure sale if abandoning the collateral is appropriate (i.e., Recoverable Value of less than $10,000 for real property and $5,000 for personal property collateral), or the Recoverable Value of the collateral is less than 10 percent of its Liquidation Value. Lenders may also justify a no bid position if circumstances not reflected in the Appraisal, but documented in the Loan File, would cause a prudent lender not to enter a Protective Bid, even though the Recoverable Value of the collateral is equal to or greater than 10 percent of the Liquidation Value of the collateral.

(2) Failure to Conduct an Environmental Investigation

A Lender's failure to conduct an Environmental Investigation required by Chapter 5 of this SOP is not an acceptable reason for taking a "no bid" position at a senior lienholder foreclosure sale, when there is equity in the collateral that a prudent Lender would protect. In emergency situations, Lenders must exercise prudent judgment and conduct the best possible due diligence under the circumstances, to avoid an unnecessary loss.

d. Exercise Right of Redemption

(1) Background

Under federal law, as an Agency of the federal government, SBA (but not 7(a) Lenders) has one year from the date of a judicial foreclosure sale to redeem, i.e., buy back, a foreclosed property (28 U.S.C. § 2410(c)). Under state law, SBA and the 7(a) Lender's redemption rights generally stem from their status as a

junior lienholder. Junior lienholder redemption rights vary by state. Lenders should consult their legal counsel for case specific information and advice.

(2) General Rule

Lenders should exercise the redemption rights for an SBA Loan whenever it is prudent and commercially reasonable to do so. For example, it may be appropriate for Lenders to exercise redemption rights when a property sells for less than expected at a senior lienholder foreclosure sale.

e. Release Right of Redemption for Consideration

If redemption rights are available under federal or state law, but redeeming the foreclosed property is not prudent or commercially reasonable, after the senior lienholder foreclosure sale is confirmed, Lenders may release the redemption rights associated with the SBA Loan upon receipt of cash in an amount approximately equal to 50 percent of the property's Recoverable Value.

f. Collect Excess Proceeds from Foreclosure Sale

(1) Requirement

When the collateral for an SBA Loan is not acquired via a Protective Bid at a senior lienholder foreclosure sale, Lenders must take all necessary, reasonable and customary actions to ascertain whether there are any excess foreclosure sale proceeds available for distribution to the junior lienholders. Lenders must collect all of the funds to which the Lender and/or SBA are entitled and apply them to the SBA Loan in accordance with the guidance provided in Chapter 23 (Expenses and Recoveries) of this SOP.

(2) Practice Tip—Default Charges

When ascertaining whether funds are available for application to an SBA Loan after a senior lienholder foreclosure sale, Lenders must make certain that all Default Charges (and advances, if any) were subordinated to the SBA Loan as required by any relevant subordination, lienholder and/or inter-creditor agreement.

Chapter 14.
Special Purpose Loans and Temporary PPP Loan Program

A. Overview

This chapter provides servicing and liquidation guidance for Loans made under the following SBA Loan programs: CAPLines Loan Program (CAPlines), International Trade Loan Program (ITL), Export Working Capital Loan Program (EWCP) and Export Express Loan Program (Export Express). Guidance related to the making of special purpose Loans through final disbursement, and in some cases, the monitoring of such Loans (e.g., CAPLines and EWCP Loans) is covered in SOP 50 10 and the 7(a) Working Capital Pilot Program Guide. This chapter sets forth the Loan Program Requirements related to the servicing and liquidation of special purpose Loans. In addition, Lenders must adhere to the Prudent Servicing and Prudent Liquidation guidance provided in this SOP.

This chapter also provides servicing and liquidation guidance for loans made under the Paycheck Protection Program, a temporary 7(a) Loan program authorized under Sections 7(a)(36), 7(a)(37) and 7A of the Small Business Act.

B. CAPLines Loan Program (CAPLines)

CAPLines include Seasonal CAPLines, Contract CAPLines, Builders CAPLines and Working Capital CAPLines. A brief description of the disbursement and repayment guidelines for each type of CAPLine is provided below. (See SOP 50 10 for additional guidance and resources for CAPLines.)

1. Seasonal CAPLines

Lenders may make Seasonal CAPLines to finance seasonal increases in a Borrower's accounts receivable and inventory (or in some cases the associated labor cost increases). See SOP 50 10 for additional Seasonal CAPLines eligibility requirements.

a. Disbursement and Repayment

(1) Disbursements for Seasonal CAPLines occur continually throughout the Borrower's seasonal business build-up period, when the cash requirements for labor, materials and the support of accounts receivable exceed actual cash receipts. The final disbursement of a Seasonal CAPLine should be made in time for the funds to be utilized in the business and converted to cash that must be used to pay off the Seasonal CAPLine balance at the beginning of the required 30 day clean up period, or CAPLine maturity.

(2) Repayment of the principal balance of a Seasonal CAPLine must occur as soon as the cash from seasonal sales is received by the Borrower. Interest accrues on the outstanding balance of a Seasonal CAPLine and Borrowers are generally required to pay interest monthly.

b. Borrowing Base Certificate (BBC)

Lenders may use BBCs to monitor a Borrower's seasonal activity. If the Lender does so, Borrowers must submit the BBC to the Lender no less frequently than monthly.

2. Contract CAPLines

Lenders may make Contract CAPLines to finance the costs associated with specific contract(s). See SOP 50 10 for additional Contract CAPLines eligibility requirements.

a. Disbursement and Repayment

Disbursements are generally made as each contract progresses, instead of in a lump sum disbursement to cover all costs. Lenders may make a single disbursement for contract performance periods of 30 days or less. Borrowers may also use Contract CAPLine proceeds to acquire the materials needed for a contract up front, to take advantage of volume and/or prompt payment discounts.

Contract CAPLines generally require an assignment and direct payment of the contract proceeds to the Lender. When such an assignment is in place, the Lender receives all the payments the Borrower would normally receive as performance progresses. Lenders must apply all such payments received first to interest due on the CAPLine, with the remainder to the principal balance of the CAPLine until it is paid in full.

3. Builders CAPLines

SBA may make or guarantee CAPLines to finance the activities of small general contractors to construct or rehabilitate residential or commercial property for resale. The Builders CAPLines program provides an exception, under specified conditions, to the general rule against financing investment property. "Construct" and "rehabilitate" mean work done on-site to the structure, utility connections and/or landscaping of real property. (13 C.F.R. §120.391)

Borrowers must use the proceeds of a Builders CAPLine solely for direct expenses related to the construction and/or "substantial" renovation costs of a specific eligible project (residential or commercial buildings for resale), including labor, supplies, materials, equipment rental, direct fees (building permits, interim disbursement inspection fees, etc.), utility connections (above or below ground), construction of septic tanks, and landscaping. ("Substantial" means rehabilitation expenses of more than one-third of the purchase price or fair market value at the time of application.)

a. Disbursement and Repayment

The repayment of all Builders CAPLines funds disbursed for any individual project must occur within 36 months after completion of each individual project or at the time of sale, whichever is less. A single principal payment is acceptable. Interest

payments must be made at least semi-annually and from the applicant's own resources, not from CAPLine proceeds.

Final lien waivers must be obtained from the Borrower/contractor and all subcontractors, material men, and any independent workers involved in the construction, prior to final disbursement of the Builders CAPLine proceeds. No disbursement of Builders CAPLine proceeds may occur after maturity of the master Note.

4. Working Capital CAPLines

Borrowers must use the proceeds of Working Capital CAPLines for short-term working capital or operating needs only including domestic-to-foreign exports, foreign-to-foreign exports and indirect exports. Borrowers must not use Working Capital CAPLine proceeds to pay delinquent withholding taxes or similar funds held in trust (e.g., state or local sales taxes), or for floor planning. If Working Capital CAPLine proceeds are used to acquire fixed assets, Lenders must refinance the portion of the Working Capital CAPLine used to acquire the fixed asset into an appropriate term loan facility no later than 90 days after Lender discovers that the Working Capital CAPLine was used to finance a fixed asset.

a. Disbursement and Repayment

Lenders have the option to disburse the proceeds of a Working Capital CAPLine based on a BBC, or a 1:1 collateral ratio. If the Lender uses a BBC, repayments will come from cash sales and accounts receivable collections. These proceeds must pay down the CAPLine as they are collected, with availability to re-advance on the CAPLine if the Borrower is conforming to the maximum amount of the BBC. If the Lender uses the 1:1 collateral ratio requirement, proceeds from cash sales and receivable collections must pay down the CAPLine as collected, consistent with Borrowers operating cash cycle.

b. Monitoring

The minimum monitoring requirements for Working Capital CAPLines are as follows:

(1) **Monthly -** Review of BBC; aging of accounts receivable/payable and inventory listing (if advanced against);

(2) **Quarterly -** Review Borrower prepared financial statements; and

(3) **Annually -** Review Borrower's management information system, legal elements, Loan Documents, NAICS status, and cash flow related financial statements; and reassess exam, monitoring and funds control requirements**.**

c. Level of Funds Control

The level of funds control for a Working Capital CAPLine, whether a BBC is used or

not, is determined by the Lender's banking relationship with the Borrower.

(1) If the Lender has the Borrower's deposit accounts, the Lender is not required to utilize cash collateral accounts or other types of controlled accounts, but must follow its established procedures for its similarly-sized, non-SBA guaranteed commercial lines of credit, to monitor payments received.

(2) If the Lender does not have the Borrower's deposit accounts, the Lender must utilize some form of controlled account as follows:

(a) Lenders may direct Borrowers to require their customers to send remittances via joint payee checks made payable to both the Lender and Borrower, to the Lender; or

(b) Lenders may establish a lock box (a bank account under Lender's control where Borrower's customers remit payments for accounts receivable).

d. Final Disbursement

The final disbursement for a Working Capital CAPLine must occur far enough in advance of maturity to provide sufficient time for the Borrower to convert the assets financed with the CAPLine back to the cash needed to make the final payment owed at maturity. The date of the final disbursement must be established in the Loan Authorization and should reflect the time required to permit an orderly repayment of the CAPLine by the maturity date. Disbursements after the last cash cycle has begun, but before maturity, require SBA's prior written approval. However, if maturity coincides with the scheduled annual review of the CAPLine (including an annual review conducted by the Lender coincidental with the maturity of the CAPLine), the Lender may advance on the CAPLine up to the date of maturity in conjunction with the Lender's annual review and in accordance with the Lender's policies and procedures for its similarly-sized non-SBA guaranteed commercial lines of credit. No advances may be made after the Working Capital CAPLine maturity date.

e. Unpaid Working Capital CAPLine Balances at Maturity

When a balance exists on a Working Capital CAPLine at maturity, Lenders should consider the following actions:

(1) Enforce final collection;

(2) Renew the CAPLine without SBA's guaranty;

(3) Renew the CAPLine with an SBA approved guaranty (a new application is required when the term to maturity for the original CAPLine reaches 10 years);

(4) Convert the outstanding balance on the CAPLine to a term Loan, in accordance with the guidance provided in Chapter 7, Paragraph F of this SOP. In such

cases, SBA's guaranty would remain in place with no new advances allowed on the Loan; and/or

(5) Commence liquidation actions. (See Chapter 19, Paragraph C.5 of this SOP for guidance on the collection of accounts receivable.)

C. International Trade Loan Program (IT)

Under the IT Loan Program ("IT" "IT Program"; "IT Loan(s)"; and "IT Loan Program"), SBA guarantees term Loans to small businesses that export or are developing new export markets. SBA also guarantees term Loans to improve the competitive position of small businesses adversely affected by import competition. (See: SOP 50 10 for additional guidance, resources and requirements for IT Loans.)

The primary contacts for Lenders and Borrowers participating in the IT Program are Export Finance Managers ("EFM"), who are SBA employees working at a United States Export Assistance Center ("USEAC"). EFMs are SBA's nationwide network of international trade finance specialists serving regional territories and are typically based in a multi-agency USEAC.

Questions regarding the unique servicing and liquidation aspects of IT Loans may be directed to the appropriate EFM for assistance, with final authority for all Servicing Actions resting with the appropriate SBA Loan Center. (See: SOP 50 10 for additional guidance, resources and requirements.)

1. IT Loan Export Compliance

An IT Loan may not be made to a business that directly or indirectly exports to a foreign country listed as a prohibited country (as identified by Note #7 in the Ex-Im Bank Country Limitation Schedule).

2. ITL Loan Monitoring

The IT Loan Program has unique eligibility and collateral requirements that must be addressed at the time of Loan approval and documented in the Loan File. SBA requires Lenders to obtain information from the Borrower pertaining to their use of Loan proceeds and its projected impact on the Borrower's export sales, and to retain documentation for this in the Lender's Loan File.

When an IT Loan is used to finance indirect exports (see SOP 50 10 for definition of indirect exports), Borrowers must provide documentation to the Lender (typically in the form of a letter, invoice, order, or contract) to support that the Borrower's domestic customers are, in fact, exporting their goods or services.

If the criteria are met for refinancing, the Lender must obtain documentation to verify that the new IT Loan will be used for export development activities.

Lenders must disburse IT Loan proceeds in accordance with the Loan Authorization. Failure to do so may cause SBA to deny liability under its guaranty.

(See Chapters 24 and 25 of this SOP for additional guidance on the SBA guaranty purchase review process and denial of liability on an SBA guaranty.)

D. Export Working Capital Loan Program (EWCP)

Under the EWCP program, SBA guarantees short-term working capital Loans made by participating Lenders to small business exporters. There are three (3) specific types of EWCP Loans**:**

- Single Transaction-Specific Loans;
- Transaction Based-Revolving Lines of Credit; and
- Asset Based Loans ("ABL").

(See: SOP 50 10 for additional guidance, resources and requirements for EWCP Loans.)

1. Processing Methods

a. EWCP Loan Processing Under Non-Delegated Authority

Lenders with delegated PLP-EWCP authority may and all Lenders without PLP-EWCP delegated authority must submit their application for an SBA guaranty, along with supporting documentation, to SBA for prior approval. SBA makes the final determination as to the eligibility and creditworthiness of the applicant, including approving the uses of proceeds, the adequacy of collateral pledged, the structure of the Loan, and any equity injection required from the applicant.

b. EWCP Loan Processing Under Delegated PLP-EWCP Authority

When a Lender submits an application for an EWCP Loan guaranty under their delegated PLP-EWCP authority, SBA does not review the Lender's determination of eligibility, analysis of the credit, or structure of the Loan or line of credit prior to issuing a Loan number. PLP-EWCP Lenders must analyze eligibility and credit worthiness in accordance with SBA Loan Program Requirements and properly document their file. The PLP-EWCP Lender's analysis is subject to SBA's review and determination of adequacy when the Lender requests SBA to purchase its guaranty or when SBA is conducting lender oversight actions.

2. EWCP Loan Post-Approval/Pre-Disbursement Requests for Changes

Lenders must submit all post-approval/pre-disbursement requests for changes to an EWCP Loan to the appropriate EFM, unless the change is within the Lender's delegated PLP-EWCP authority.

EFMs are the primary contacts for Lenders and Borrowers participating in the EWCP program. Due to the unique servicing and liquidation aspects of EWCP Loans, Servicing

Requests requiring SBA approval may be directed to the local EFM for additional assistance. The EFM will review the Servicing Request and submit it to the appropriate SBA Loan Center for final approval.

3. Prohibited Uses of EWCP Loan Proceeds

EWCP Loan proceeds may not be used to:

a. Support a Borrower's domestic sales of goods or services, except for indirect exports;

b. Acquire fixed assets or capital goods for use in the Borrower's business;

c. Acquire, equip, and/or rent commercial space overseas;

d. Finance pre-shipment or purchase order financing under a transaction-specific or transaction-based revolving EWCP facility for foreign-to-foreign export transactions; or

e. Finance professional export marketing advice or services, foreign business travel, participation in trade shows or support staff in overseas offices; except to the extent it relates directly to the transaction that is financed with an EWCP Loan.

4. EWCP Export Compliance

Lenders must monitor the export transactions of EWCP Loan Borrowers as follows:

a. Certifications

(1) EWCP Loan Borrowers must certify that appropriate tax withholding deposits for payroll advances have been made and that no Loan proceeds have been or will be used to pay delinquent withholding taxes or other similar trust funds (state sales tax, etc.). The Lender may include this certification as part of its BBC reporting package.

(2) Borrowers must provide a copy of a valid export license for each different product they export and for each different country to which they export their products, or provide a letter stating that a valid export license is not required including the authority by which this statement is made. Borrowers may provide these items with their BBC reporting package.

b. Foreign Risk Mitigation

(1) Prohibited Countries and Parties

Lenders must review:

(a) The Ex-Im Bank Country Limitation Schedule (Ex-Im Schedule) to ensure

that none of the Borrower's export sales or transactions that are financed with an EWCP Loan are to businesses located in prohibited countries (identified as Note #7 on the Ex-Im Schedule); and

(b) The Department of Treasury OFAC sanctions lists (sanctionssearch.ofac.treas.gov/) to ensure that none of the Borrower's export transactions financed with an EWCP Loan are to prohibited parties.

i. For federally-regulated Lenders, compliance with the procedures required by the Lender's Federal Financial Institution Regulator will constitute compliance with the above referenced OFAC requirement.

ii. For SBA Supervised Lenders, the Lender must check the OFAC sanctions lists prior to the first disbursement of funds on each specific export transaction.

(2) EWCP Loan Advances

On an asset-based revolving line of credit where advances are made against a borrowing base of foreign receivables and/or export-related inventory, the maximum advance rates are 90 percent on eligible foreign receivables and 75 percent on eligible export-related inventory located within the United States.

Control accounts may be required at the discretion of the LGPC for non-delegated loans, or the PLP-EWCP Lender for loans processed under their delegated authority.

At a minimum, the Borrower must submit a BBC to the Lender at least monthly, or as frequently as the Lender customarily requires for its Borrowers on similarly-sized, non-SBA guaranteed loans if more often than monthly, along with an aging of foreign accounts receivable and listing of export-related inventory, as appropriate. If the borrowing base shows the Borrower is over-advanced, the Lender must immediately require the Borrower to make a payment to reduce the Loan balance so it is within the borrowing base formula.

Advance rates on foreign purchase orders/contracts or foreign accounts receivable when sold on open account (no credit insurance or letter of credit to mitigate the foreign risk) may not exceed 80 percent.

(3) Borrower Accounts Receivable

Borrower payment terms must be consistent with prudent lending practices. See SOP 50 10 for additional guidance regarding typical terms of sale.

5. Additional Guidance for Specific Types of EWCP Loans

EWCP Loans are self-liquidating Loans with the conversion of export-related trading assets to cash as the primary source of repayment. Lenders must ensure that EWCP Loans are secured by no less than a first security interest in all the working assets associated with the financed transactions. This includes export inventory and receivables,

assignment of credit insurance, letters of credit proceeds, and contract proceeds, as applicable. Lenders must also ensure that all collateral is located in the United States, its territories, or possessions.

a. Asset Based EWCP Loans

LGPC, or PLP-EWCP Lenders for Loans processed under delegated authority, may require an assignment of contract proceeds for an EWCP asset based line of credit.

(1) Documentation Requirements for Asset Based EWCP Loans

(a) Copy of letter of credit and/or copy of buyer's order/contract, if applicable.

(b) Export credit insurance-related material (e.g., policy, application, buyer credit limit), if applicable.

(c) Copy of export license(s), if required.

(d) Aging of accounts receivable and accounts payable, and inventory reports (dated within 180 days of Loan application or Loan review).

(e) Cash flow projection statement with monthly (quarterly is an option for asset-based Loans) sales projections for the lesser of 12 months or the term of the Loan, highlighting the export transaction(s) the Borrower expects to finance. Borrowers may limit their cash flow projections to the proposed export transaction(s) or base them on their anticipated export cash cycle, and must show their ability to complete the projected export transaction(s) and repay the EWCP Loan.

(f) If indirect exporting is financed, a letter, invoice, order, contract, or other documentation from the Borrower's customer certifying that they will sell the goods/services purchased from the Borrower to a foreign buyer.

(2) Lender Responsibilities

At the applicable frequency, Lenders must verify the Borrower's BBC for accuracy, confirm the export working assets that are eligible for financing along with the appropriate advance rate for each asset type, and establish the maximum level of financing available relative to the outstanding balance of the EWCP Loan. This must be done in accordance with the provisions of the EWCP Loan Authorization.

(3) Adding a New Foreign Customer to a Borrowing Base

If the EWCP Loan Authorization does not expressly authorize, or specifies that prior SBA approval is required for 1) the financing of goods or services sold to a particular customer, 2) the use of an alternative risk mitigation strategy or foreign currency, or 3) the provision of new export sales terms, the Lender must prepare a Servicing Request in accordance with the guidance provided in

Chapter 6 of this SOP before including the working assets of the proposed transaction(s) in the BBC. Such EWCP Servicing Requests may be submitted to the local EFM, who will evaluate and submit it to the appropriate SBA Loan Center for final approval. Lenders with PLP-EWCP authority may proceed with Loan Actions without prior SBA approval, except for those actions that require prior SBA approval (see Chapter 3 of this SOP for additional guidance on PLP Lender responsibility and authority).

(4) Disbursement

When the BBC indicates that financing is available under the EWCP Loan, disbursements up to the maximum amount indicated in the BBC may be made to the Borrower, in accordance with the Lender's usual practices for its similarly sized non-SBA Loans.

(5) Managing Export Sales Proceeds

The EWCP Loan Authorization will indicate whether a control account is required to collect the Borrower's export accounts receivable, to allow the Lender to apply the proceeds to the principal balance of the Loan. If a control account is not required, Borrowers would have to submit their export sales proceeds or other sources of funds to the Lender for application to the EWCP Loan balance since subsequent advances are based on the availability under the Loan borrowing base. Under the conditions described in the next paragraph, Lenders may allow Borrowers to retain such proceeds as needed, provided that the EWCP Loan is within its borrowing base limits.

(6) Control Accounts and Over Advances (Out-of-Margin)

The LGPC for non-delegated loans, or the PLP-EWCP Lender for delegated loans, determines if a control account is required for an EWCP Loan based on their credit analysis. Normally, Lenders must apply 100 percent of the foreign accounts receivable collection proceeds to the EWCP Loan balance and require the Borrower to request additional advances as needed based on a BBC.

Another option is for the Lender to allow the Borrower to maintain a balance within the Borrower's borrowing base limits and retain foreign accounts receivable collection proceeds that are not immediately applied to the EWCP Loan balance. This option is available only to Borrowers that are:

(a) In business for two years or more; and

(b) Have financial records satisfactory to SBA for non-delegated Lender Loans or the PLP-EWCP Lender for delegated Loans, and the ability to provide a current aging reports for foreign accounts receivable.

In deciding whether to permit a Borrower to retain their foreign accounts receivable collection proceeds, PLP-EWCP Lenders must follow their policies and procedures for their similarly-sized, non-SBA guaranteed loans.

EWCP Loan Borrowers must submit a BBC to the Lender at least monthly, or as frequently as the Lender requires for its similarly-sized non-SBA guaranteed loans, along with an aging report for the Borrower's foreign accounts receivable and a listing of the Borrower's export-related inventory, as appropriate.

Lenders must review the Borrower's BBC(s) to ensure that the EWCP Loan is not over-advanced according to the collateral requirements in the BBC. If the BBC indicates that the Loan is over-advanced, the Lender must immediately require the Borrower to make a payment to reduce the Loan balance to achieve compliance with the BBC. If an EWCP Loan cannot be brought back into compliance with the borrowing base formula within 60 days, or a payment plan is not otherwise established, the EWCP Loan must be serviced as a payment Default in accordance with the guidance provided by Chapter 15 of this SOP. Out-of-margin advance amounts remain eligible for SBA guaranty purchase, provided that the amount of the advance was within the Borrower's borrowing base at the time it was advanced.

b. Transaction Based EWCP Loans

(1) Setting Up Financing for Export Transactions

(a) Borrower Documentation. Lenders must obtain a copy of all the export purchase orders and contracts a Borrower chooses to finance, along with a transaction budget indicating the projected cost of fulfilling each transaction, which may include overhead costs.

(b) Lender Underwriting Responsibility. Lenders must review the proposed transactions and refer to the Loan Authorization to determine the appropriate level and manner of financing, and document the Loan File accordingly.

(c) Lender Collateral Responsibilities. Lenders must ensure that all appropriate collateral requirements, as set forth in the EWCP Loan Authorization, are satisfied. These include:

- Establishing a control account.
- Obtaining an assignment of proceeds for each purchase order or contract that is financed. Written acknowledgement of the assignment by the foreign customer is not required.

(d) Unforeseen Transactions. If the EWCP Loan Authorization does not expressly authorize or if it requires prior SBA approval to finance a particular transaction, the Lender must prepare a Servicing Request in accordance with the guidance provided in Chapter 6 of this SOP before disbursing any funds for the proposed transaction. EWCP loan Servicing Requests may be submitted to the local EFM who will evaluate the request and submit it to the appropriate SBA Loan Center for final approval.

(2) Transaction Monitoring

(a) Frequency of Monitoring. Lenders must perform the required and recurring EWCP Loan Actions listed below at least monthly. However, if a Lender customarily performs these actions more frequently for their similarly-sized, non-SBA guaranteed loans, they must perform them as frequently for their EWCP Loans as well. Lenders are responsible for setting the applicable schedule of deadlines for Borrower submission of the required financial information and documentation described below.

(b) Borrower Documentation. Lenders must obtain from Borrowers a current status report in a format acceptable to the Lender for all of the Borrower's EWCP Loan export transactions, including a current aging of any associated accounts receivable. If the Borrower fails to provide the required financial information in a timely matter, the Lender, as provided in the Loan Authorization, should not make any further advances on the Loan. Lenders may contact the local EFM to review EWCP Loan servicing alternatives. If 30 days after the submission deadline the Lender is still unable to obtain the required financial information, the Loan should be serviced as a payment Default in accordance with the guidance provided in Chapter 15 of this SOP.

(c) Lender Responsibility. Lenders must confirm that each export transaction financed with an EWCP Loan conforms to the authorized advance rates and remains in good standing with regard to required payments.

(d) Disbursement. Lenders must ensure that EWCP Loan Borrowers submit a separate request for each transaction identifying the transaction customer, the amount of funding requested, cumulative past draws for the transaction, and the expected shipment and payment dates for the transacted items. If the Lender's transaction review indicates that financing is available under the EWCP Loan, the Lender may make disbursements up to the maximum project budget amount in accordance with the Lender's normal practices.

(e) Out-of-Margin Transactions and Cost Overruns. If the Lender's transaction review indicates that the Borrower can no longer complete the transaction as planned, the Lender must immediately work with the Borrower to address the situation. Lenders may consult with the local EFM for guidance, as needed. If the Borrower cannot bring the EWCP Loan back to within its budget and margins within 60 days, and an alternative plan is not otherwise established, the Lender must service the Loan must as a payment Default in accordance with the guidance provided in Chapter 15 of this SOP.

(f) Managing Transaction Proceeds. A control account is required for transaction based EWCP Loans to track the proceeds of foreign accounts receivable as they are paid by foreign customers. Lenders must ensure that transaction proceeds are applied to the EWCP Loan balance, either in their entirety or as a percentage of the proceeds, in an amount that is at least sufficient to pay off the initial advance for the transaction.

c. EWCP Loans Used for Stand-By Letters of Credit (SBL/C)

EWCP Loan proceeds may be used to secure stand-by letters of credit (SBL/C) issued to support a Borrower's export transactions.

(1) Lender Credit Analysis for EWCP Loans Used for SBL/C

The Lender's credit analysis for EWCP Loans used to support an SBL/C must document the Borrower's history and ability to satisfy obligations that require an SBL/C, such as those involving bids, advanced payment, performance bonds, supplier advances, and warranty guarantees and/or bonds.

(2) EWCP Loan Disbursements for SBL/C Draws

All SBL/C secured by an EWCP Loan must expire before the EWCP Loan maturity date, unless SBA provides prior written consent. If the Lender receives SBA's prior written consent to use EWCP Loan proceeds to fund a draw on an SBL/C issued prior to the EWCP Loan maturity date, such disbursement will be covered by the SBA guaranty.

(3) SBL/C Interest Payments

Lenders must document in their Loan File whether they will require the Borrower to make interest payments on an SBL/C, and if so, the amounts, frequency, and conditions under which such payments must be made.

(4) Collateral For EWCP Loans That Secure SBL/C

SBA requires additional collateral for EWCP Loans used to support the issuance of an SBL/C. In such situations, Borrowers must deposit cash into an account held by the Lender in an amount equal to 25 percent of the SBL/C. This deposit must remain in the account held by the Lender for the entire term of the SBL/C.

SBA (for non-delegated EWCP Loans) or a PLP-EWCP Lender may allow export inventory, foreign accounts receivable or other acceptable collateral to replace the required cash deposit. However, for ABLs, the ABL borrowing base must support at least 25 percent of the total of all SBL/C issued under the EWCP Loan.

The EWCP Loan Authorization boilerplate also contains specific provisions related to SBL/C collateral requirements, and all Lenders must document their justification for collateral decisions in their Loan File.

(5) EWCP Loan Maturities - Generally

The term of an EWCP Loan term must be the shortest possible term based on the proposed use of Loan proceeds and the Borrower's ability to repay. The

maximum maturity for an EWCP loan is 36 months. The maturity date is set in terms of the number of months from either the date of the Note or the date of initial disbursement, to the date when final payment is due. If the Loan is not reissued, or extended, all outstanding amounts are due and payable on that day. SBA's guaranty remains in effect for disbursements made through the maturity date, subject to the terms and conditions of the Loan Documents.

SBL/C(s) funded by an EWCP Loan must expire prior to the maturity date of the EWCP Loan, unless SBA provides prior written approval to issue an SBL/C that expires after the maturity date of the EWCP Loan. EWCP Loan disbursements made after an EWCP Loan maturity date are not covered by SBA's guaranty, unless the disbursement(s) fund draw(s) against an SBL/C that SBA approved prior to the maturity date of the EWCP Loan.

d. Maturities For Specific Types of EWCP Loans

(1) Single transaction-specific EWCP Loans are either non-revolving Loans or revolving lines of credit that support a specifically identified, single export transaction. The LGPC (for non-delegated EWCP Loans) or PLP-EWCP Lenders may approve a maturity of up to 36 months to correspond with the length of the transaction cycle. When the EWCP Loan term exceeds 12 months, PLP-EWCP Lenders must include justification for a longer maturity in their credit memorandum, and non-delegated Lenders must include justification in the application they submit to the EFM for review.

(2) Transaction based revolving lines of credit may support multiple export transactions or a single, specifically identified export transaction on a continuous basis during the term of the EWCP Loan. While the term of a revolving line of credit typically does not exceed 12 months, LGPC (for non-delegated Lenders) or PLP-EWCP Lenders may allow an initial EWCP Loan term of up to 36 months, with annual renewals.

(3) Asset based EWCP Loans (ABL) are revolving lines of credit based on a monthly BBC that reports the level of assets (normally accounts receivable and inventory) available to support the EWCP Loan amount. The term of an ABL is typically 12 months. Reissued ABLs are new SBA Loans that require an additional SBA guaranty fee when the Loan is reissued. However, ABLs may have a term of up to 36-months with annual renewals. In such cases, non-delegated Lenders must provide updated Borrower financial statements to SBA annually and delegated Lenders must retain the results of their annual EWCP Loan renewal actions in their Loan File.

6. Miscellaneous EWCP Loan Servicing Actions

a. EWCP Loan Increases

Lenders may increase the original EWCP Loan amount by submitting a Servicing

Request in accordance with the guidance provided in Chapter 6 of this SOP. Lenders must underwrite EWCP Loan increases according to the requirements of SOP 50 10. Servicing Requests may be submitted to the local EFM for review and submission to the appropriate SBA Loan Center for final approval. Lenders must pay an additional SBA guaranty fee for the Loan increase based on the fee structure in effect at the time the Loan was originally approved.

b. Extraordinary Servicing Fees

Lenders may charge extraordinary servicing fees and set the interval of the fees in a manner that is reasonable and prudent based on the level of extraordinary effort required, in accordance with the guidance provided in SOP 50 10. Such fees must not be higher than the fees charged by the Lender on similarly-sized, non-SBA guaranteed commercial lines of credit. A Servicing Request for extraordinary fees that were not included in the original EWCP Loan approval may be submitted to the local EFM for review and submission to the appropriate SBA Loan Center for final approval.

7. Troubled EWCP Loans

a. EFM Point of Contact

Local EFMs are available to assist Lenders with servicing issues related to EWCP Loans. EFMs can assist Lenders in assembling the documentation needed to complete Servicing Requests and Universal Purchase Packages.

b. Site Visits

Lenders must conduct site visits in accordance with the guidance provided in Chapter 16 of this SOP.

c. Liquidation of Foreign Accounts Receivable Collateral

When an EWCP Loan is not performing as agreed and collateral includes foreign accounts receivable, Lenders must make demand for payment on the Borrower's foreign accounts receivable. Lenders must also pursue collections from any domestic risk mitigation sources such as export credit insurance or international letters of credit. When all cost effective domestic-based efforts to collect foreign accounts receivable are exhausted, Lenders are not required to enforce collection from the Borrower's customers outside of the United States. After documenting the Loan File for their actions, Lenders may treat the outstanding balances of foreign accounts receivable as uncollectable with no Recoverable Value.

E. Export Express Loan Program (Export Express)

The Export Express Loan Program guarantees revolving lines of credit or term Loans of $500,000 or less to support small businesses that want to develop the export side of their business. It offers many of the streamlined features of the SBA Express Loan Program

while providing a higher guaranty percentage to mitigate international credit risk.

Export Express Loans are generally subject to the same Loan processing, closing, servicing, and liquidation requirements (including maturity terms, interest rates, and fees) as SBA Express Loans. (See SOP 50 10 for additional information and guidance on Export Express Loans).

- Lenders must submit applications for Export Express Loans to SBA via E-Tran and retain all required documentation in their Loan File. Lenders must also prepare and sign the Loan Authorization on behalf of SBA.

1. Export Compliance

Export Express Borrowers are required to comply with all U.S. export regulations. When an Export Express Loan finances specific export transactions (including indirect exports) Lenders must determine if the Borrower is authorized to conduct business with the parties and the country(ies) to which their goods or services will be shipped.

Lenders must check the Ex-Im Bank's Country Limitation Schedule and the Department of Treasury Office of Foreign Assets Control (OFAC) Sanctions Lists to ensure that none of the borrower's export transactions are conducted with prohibited parties located in prohibited countries.

a. Federally-regulated Lender compliance with the procedures required by the Lender's Federal Financial Institution Regulator satisfies the above referenced OFAC requirement.

b. SBA supervised Lenders must check the OFAC sanctions lists prior to first disbursement of funds for each of an Export Express Loan Borrower's specific export transactions. Lenders may not make Export Express Loans to Borrowers that directly or indirectly export their goods or services to a foreign country listed as a prohibited country (designated as Note #7 on the Country Limitation Schedule) or if the transaction would be prohibited under any of the sanctions programs administered by OFAC.

2. Export Development Activity Financing

Borrowers must use Export Express Loan proceeds for an export development activity as defined in SOP 50 10, which includes obtaining an SBL/C when required as a bid bond, performance bond, or advance payment guarantee. For Export Express Loans over $50,000, Lenders must, to the maximum extent practicable, follow the written collateral policies and procedures it has established for its similarly-sized, non-SBA guaranteed commercial loans. For Export Express Loans over $50,000 that are used to support the issuance of an SBL/C, Lenders must require cash collateral that is equal to or greater than 25 percent of the SBL/C amount.

3. Lender Verification and Reporting Responsibilities

Lenders must obtain documentation to verify that any new SBA Express Loan will be used exclusively for export development activities. Lenders must report the full amount of SBA Express Loan principal and interest on SBA Form 1502.

F. Paycheck Protection Program (PPP) Loans

1. PPP Loan Servicing Responsibilities

a. Lenders must service PPP loans until they are fully forgiven or paid in full, or in the event of a Default or other qualifying event (as set forth in the promissory note, including business closure), until SBA purchases the guaranty and charges off any uncollectable remaining balance of the Loan. Lenders should work with the borrower to seek forgiveness at the end of the borrower's Loan forgiveness covered period or, in the event of a Default or other qualifying event, to request guaranty purchase and charge off in accordance with the procedures outlined below. Lenders must work with borrowers that do not receive full forgiveness to achieve repayment of the remaining balance of the Loan, even if SBA has purchased the guaranty.

2. PPP Loan Servicing Actions

Lenders must:

a. Keep an accurate record for each PPP Loan under its direct control;

b. Document all Loan modifications including changes of ownership. Borrowers may not receive PPP Loan forgiveness if the Loan details are incorrect in E-Tran;

c. Issue a decision to SBA in accordance with PPP Loan Program Requirements when the borrower submits a forgiveness application. In the event a borrower does not submit an application for forgiveness within 10 months of the end of the covered period, the Lender must communicate with the borrower to determine the status of the business (e.g., whether the business is open, closed, in bankruptcy, etc.) and notify the borrower of the date the first payment on the Loan is due. Lenders must document communication attempts and results in their Loan File;

d. Collect and apply all PPP Loan and forgiveness payments;

e. If a borrower does not submit a forgiveness application within 10 months of the end of the covered period, or if the PPP Loan is partially forgiven or forgiveness of the Loan is denied in full, the Borrower must make payments in accordance with the terms of the Note and the Lender must continue servicing the Loan until it is paid in full or SBA charges off the Loan after guaranty purchase.

Additionally, Lenders must:

a. Submit separate monthly SBA Form 1502 reports that include the Loan status information for their PPP Loans, regardless of whether the Borrower made a payment in the current month or the Loan is in deferment, until the Loan is paid in

full, fully forgiven, or, if applicable, until SBA purchases the guaranty for the Loan;

b. Report the principal and interest reduction from the SBA forgiveness remittance and any Loan payments received from the Borrower on SBA Form 1502, before the Lender submits a guaranty purchase request. (See Subparagraph F.4 and F.6 of this Chapter for guidance on when a Lender may submit a guaranty purchase request for a PPP Loan)

c. Take reasonable steps to monitor PPP Loan Borrowers that remain in repayment status, to ensure that the Borrower's business continues to operate and that payments are made on the Loan. Lenders are not required to obtain updated financial information annually, or at any other interval, because repayment analysis was not required when the PPP loan was made.

Available PPP Loan servicing actions:

a. Loan Maturity Extensions.

(1) Lenders may extend the maturity date for a PPP Loan for an additional 10 years beyond the original maturity date, to aid in the orderly repayment of the Loan. Such maturity date extensions must occur prior to the expiration of SBA's Loan guaranty, which occurs 180 days after the later of the original maturity date or Lender's completion of liquidation actions. For PPP loans, SBA considers a pending Lender request to SBA for a forgiveness payment or a pending SBA Loan review decision to fall within the liquidation action extension period, since the Lender is waiting to receive funds from SBA to pay the PPP Loan in full or in part.

b. Collateral and Personal Guaranties.

(1) PPP Loan Program Requirements do not allow Lenders to take any additional collateral or require any personal guaranties when extending the maturity of a PPP Loan or making other Loan modifications.

c. Interest Rate Modifications and Loan Fees.

(1) Lenders are not allowed to charge an interest rate higher than one percent on a PPP loan.

(2) Lenders are not permitted to charge a default interest rate or charge a separate servicing fee for PPP Loans.

d. PPP Loan Workouts.

(1) Lenders have unilateral authority to negotiate with borrowers to enter into a workout agreement for repayment of the outstanding balance of a PPP Loan, regardless of whether SBA has purchased the guaranty. If the Lender receives any post-guaranty purchase payments from the Borrower, the Lender must send

the full payments to SBA via Pay.Gov (https://www.pay.gov/) using the payment code 172. When submitting the payment, Lenders should select "Paycheck Protection Program (PPP)" from the four choices listed under the type of payment. This will allow SBA to receive 100% of the payment and apply it to the Loan.

e. If the borrower for a PPP Loan becomes more than 60 days past due, the Lender should make demand for payment in full and submit a request for guaranty purchase and charge off through the PPP Loan platform;

f. For PPP Loans that are not fully forgiven, Lenders must remit the full amount of any post-guaranty purchase payments or recoveries the Lender receives for the PPP Loan to SBA via Pay.gov (https://www.pay.gov/) using payment code 172.

3. PPP Borrower Bankruptcy Filing

PPP borrowers that file for bankruptcy protection after Loan disbursement are eligible to apply for forgiveness if the Loan funds have been used for eligible payroll and nonpayroll purposes during the covered period. If the Loan is not fully forgiven and the borrower files for bankruptcy protection other than a Chapter 7 case, Lenders must provide SBA with a notice of the bankruptcy filing, file a proof of claim, and continue to monitor the bankruptcy case. Because PPP Loans are unsecured, SBA does not expect Lenders to take action in such bankruptcy proceedings beyond filing a proof of claim. SBA considers the filing of a proof of claim as a nominal administrative action prior to requesting SBA to purchase its guaranty, and SBA will not reimburse Lenders for the administrative costs associated with the filing of a proof of claim.

After SBA has purchased its guaranty for a PPP Loan, Lenders must send any subsequent payments or recoveries received from the bankruptcy action to SBA via Pay.Gov (https://www.pay.gov/) using the payment code 172. SBA does not anticipate a need for Lenders to incur expenses related to litigating PPP Loans; however, SBA will honor Litigation Plans with prior SBA approval. SBA will generally not approve Litigation Plans unless SBA determines that there is a reasonable expectation for recovery in excess of legal expenses.

4. When Lenders May Submit PPP Loan Guaranty Purchase Requests With SBA Charge Off

Lenders may submit requests to simultaneously purchase the SBA guaranty and charge off the remaining balance of a PPP Loan when a Borrower:

a. Is 60 days or more past due on scheduled Loan payments and the Default is not cured;

b. Has permanently closed its business and does not plan to submit a forgiveness application;

c. Has filed for Chapter 7 bankruptcy protection;

d. Has filed for Chapter 11, 12 or 13 bankruptcy protection, once a period of at least 60 days has elapsed from the end of the PPP Loan deferment period, or any time after an order is entered confirming a bankruptcy reorganization plan if the plan does not provide for full payment of the PPP Loan balance; or

e. In the case of self-employed individuals, sole proprietors, single-member LLCs, or independent contractors, the owner is deceased.

5. Lender Requests for SBA Guaranty Purchase With SBA Charge Off

a. Lenders must submit requests for SBA guaranty purchase and charge off for individual PPP Loans through the PPP Loan platform.

b. Guaranty purchase and charge off requests must be made by the Lender that owns the Loan at the time of purchase, i.e., the Lender of record in the PPP platform/E-Tran.

c. For changes in Borrower ownership, Lenders must provide details related to the sale of the business including purchaser information. Lender's must also provide any assumption agreement(s) or other documentation related to the change of ownership, as applicable.

d. Lenders have the option to request SBA to purchase the guaranty for a first draw PPP Loan, second draw PPP Loan, or both PPP Loans made to the same Borrower, if applicable. The PPP platform automatically ties a first draw PPP Loan to a second draw PPP Loan made to the same Borrower if both Loans were made by the same Lender. SBA encourages Lenders to simultaneously request guaranty purchase for both PPP loans, if applicable.

e. SBA will pay accrued interest (that has not been paid either by the borrower or SBA) through the payment deferment period, plus up to a maximum of 120 days of additional interest due to payment Default, at the time of guaranty purchase.

f. In addition to submitting all of the required documentation associated with a PPP Loan, including a certified copy of the signed Note and any modifications to the Note, Lenders must also submit an executed SBA Assignment with every guaranty purchase request for a PPP Loan, for referral of the Loan to Treasury after SBA charge off.

g. SBA will remit guaranty purchase payments to the ACH account where the Lender directed SBA to remit forgiveness payments (to the current Lender of record in the PPP Loan platform/E-Tran).

h. SBA is released from liability on its guaranty if a Lender fails to submit a request for SBA to purchase its guaranty within the later of 180 days after the maturity date of the PPP Loan or completion of the Lenders liquidation actions, including pending Lender requests for an SBA forgiveness payment or pending SBA final Loan review decisions.

i. After SBA guaranty purchase and charge off, if further collection is not barred by a valid legal defense such as compromise, discharge in bankruptcy, or the statute of limitations, SBA will refer the PPP Loan and all remaining Obligors to Treasury for further collection.

6. When Lenders May Submit PPP Loan Guaranty Purchase Requests Without SBA Charge Off

a. A Borrower or any owner of 20 percent or more of the Borrower has been indicted for or convicted of a felony related to the PPP Loan;

b. A Borrower has filed an appeal of a final SBA Loan review decision with the SBA Office of Hearings and Appeals (OHA) in accordance with PPP Loan Program Requirements. Lenders may request guaranty purchase 60 days after the Borrower has filed its appeal with OHA;

c. The Lender has filed a Suspicious Activity Report (SAR) with respect to the PPP Loan; or

d. The Lender's request for a forgiveness payment or an SBA Loan forgiveness review has been pending with SBA for more than 12 months. In this circumstance, the Lender should contact SBA through the PPP Loan platform to coordinate the submission of a guaranty purchase request. If SBA purchases the guaranty while a Lender request for a forgiveness payment or an SBA Loan forgiveness review decision has been pending with SBA for more than 12 months, and SBA determines that the Borrower is eligible for Loan forgiveness in any amount, SBA will not remit a forgiveness payment to the Lender. Instead, SBA will apply the approved forgiveness amount to the PPP Loan to reduce the amount owed by the Borrower.

e. See Chapter 27 of this SOP for additional guidance on the submission of Wrap-up Reports.

7. Borrower Forgiveness Requests Received After Lender Guaranty Purchase Request

Lenders are encouraged to work with Borrowers to process forgiveness applications before requesting guaranty purchase. If a Borrower submits a PPP Loan forgiveness application/request to the Lender after the Lender has submitted its guaranty purchase request to SBA, the Lender must submit its PPP Loan forgiveness decision to SBA in accordance with the following PPP Loan Program Requirements:

a. If SBA has not yet completed its guaranty purchase and charge off process (if applicable), the Lender must immediately withdraw its guaranty purchase request in the PPP Loan platform. SBA will then complete its review of the Lender's forgiveness decision prior to reviewing the Lender's guaranty purchase request.

b. If SBA has completed its guaranty purchase, the Lender must comply with the PPP Loan forgiveness rules in effect when the Borrower submitted its forgiveness request to the Lender, and submit the Lender's forgiveness decision to SBA. If the

Borrower is eligible for PPP Loan forgiveness in any amount, SBA will not remit a forgiveness payment to the Lender. In such cases, SBA will apply the approved forgiveness amount (if any) to the outstanding balance of the Loan.

c. SBA expects Lenders to accept and make a decision on any PPP Loan forgiveness application submitted by a Borrower within five years from the date that SBA issued the PPP Loan number to the Lender. To the extent that any PPP Loan Borrower has received an extension of its maturity date for a period longer than five years, that Borrower must submit its Loan forgiveness application on or before five years from the date that SBA issued the PPP Loan number to the Lender. SBA is imposing this five-year PPP Loan forgiveness deadline because extensions of maturity beyond five years for PPP Loans are allowed only to aid in the orderly repayment of the Loan.

Chapter 15.
Classifying Loans in Liquidation

Lenders should make a good faith effort to help delinquent Borrowers bring their SBA Loans current. However, when a Borrower is unable to cure a payment Default, Lenders should accelerate the Note, make formal demand on all the Obligors, classify the Loan in liquidation status, make arrangements for SBA or the Lender to re-purchase the SBA-guaranteed portion of the Loan from the secondary market (if applicable), and prepare and implement a Liquidation Plan without further delay.

A. When Lenders Must Classify Loans in Liquidation Status

Lenders must classify SBA Loans in liquidation status when they accelerate the Note or receive a notice that the Borrower has filed for bankruptcy protection.

B. When Lenders Should Accelerate an SBA Loan Note

Note: Lenders do not have a legal right to accelerate, make demand, or liquidate the collateral unless there has been a Default on the Note. (For specific information on the Lender's rights in the event of Default, see the Note used to document the Loan, e.g. SBA Form 147.)

1. Lenders with Non-SBA Loan Portfolio

Lenders with a non-SBA guaranteed loan portfolio may decide whether to accelerate the Note based on their own policies and procedures for their similarly-sized non-SBA guaranteed commercial loans.

Note: Unless SBA has agreed otherwise in writing, the Borrower must be in Default on a payment for more than 60 calendar days before the Lender may request guaranty purchase. A Lender may not request guaranty purchase based solely on a non-payment Default such as failure to provide financial statements in a timely manner. See 13 C.F.R. § 120.520, SOP 50 10 and Chapter 24 of this SOP for additional information and guidance on SBA guaranty purchase requirements.

2. Lenders without Non-SBA Loan Portfolios

Lenders without a non-SBA guaranteed loan portfolio should accelerate the SBA Loan Note whenever there has been an event of Default on the Note and it is clear to a prudent lender that the Obligor(s) cannot, or will not, keep the Loan current through regularly scheduled payments (e.g., the Borrower closes the business and delivers the

keys to the Lender or is more than 60 calendar days late on a payment that cannot be cured through an SBA-approved deferment or workout plan.)

C. Repurchase from Secondary Market

At the time the Note is accelerated and the Loan is classified in liquidation, if the Loan was sold on the secondary market, the Lender must immediately either repurchase the SBA guaranteed portion or request that SBA purchase it.

D. Demand Letters

1. Whenever the Note is accelerated, unless prohibited by applicable law (e.g., the automatic stay in bankruptcy), Lenders should make demand on all Obligors for immediate payment of the entire balance of the Loan.

2. Demand letter(s) should be sent via regular mail as well as certified mail or some other method that enables the sender to confirm delivery.

3. Reasonable efforts should be made to contact any Obligor who fails to respond, either by telephone or email, to determine their intentions with regard to repaying the Loan.

> **Note:** In the event of a Default on a 7(a) Loan that utilizes SBA Form 147 (Note), the Note gives the holder the right to accelerate the Note 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. What is more, if litigation is necessary, most courts expect to see an acceleration and demand letter as part of the evidence offered by the creditor to prove its case.

E. Skip Tracing

When a Loan is classified in liquidation, a good faith effort must be made to locate and commence collection actions against all the Obligors including those who are missing or difficult to locate.

F. 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 on active duty, any action taken must be in compliance with 50 U.S.C. Ch. 50: Service Members Civil Relief Act ("SCRA"), 50 U.S.C. §§ 3901-4043.

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. Lenders should consult their legal counsel or SBA's Office of Veterans Business Development for additional guidance, but 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 (50 U.S.C. §3937);
3. Protects Servicemembers from default judgments if they fail to appear at trial or respond to a lawsuit because of their military service (50 U.S.C. §3931);
4. Authorizes the court to stay lien foreclosure actions or adjust the Servicemember's obligation to preserve the interests of all parties (50 U.S.C §3958);
5. Makes a Servicemember's personal assets that were not pledged as collateral unavailable to satisfy a business obligation (50 U.S.C. §4026);
6. 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 U.S.C. §3919); and
7. Imposes criminal sanctions on creditors who violate certain provisions of the statute including those pertaining to mortgage and lien foreclosures (50 U.S.C. §§ 3953 and 3958).

G. Lender Liquidation Plans

All Lenders should prepare a Liquidation Plan prior to taking any material action to liquidate a Loan. When properly prepared, a Liquidation Plan helps ensure that the Loan is liquidated in a timely, prudent and cost-effective manner that maximizes recovery in the shortest amount of time.

1. Format and Content

A Liquidation Plan for a 7(a) Loan should have a copy of the demand letter attached to it, and should be prepared in accordance with the template accessible from www.sba.gov/for-lenders. As set out in the template, the following factors should be

considered and discussed in a Liquidation Plan:

a. Site Visit Findings

See Chapter 16 of this SOP for guidance on site visits. (A Liquidation Plan for a CLP Loan must include a copy of the Lender's Site Visit Report.)

b. Feasibility of a Workout

See Chapter 17 of this SOP for guidance on Loan workouts.

c. Recoverable Value of the Collateral

See the definition of "Recoverable Value" in Chapter 2 of this SOP for guidance on how to determine the Recoverable Value of collateral.

d. Available Methods of Liquidation

See Chapter 18 (Real Property Collateral Liquidation) and Chapter 19 (Personal Property Collateral Liquidation) of this SOP for guidance on collateral liquidation.

e. Litigation

See Chapter 2 and Chapter 22 of this SOP for guidance on Routine Litigation and Non-Routine Litigation. With regard to CLP Loans, Lenders should include Routine Litigation in the Liquidation Plans they are required to submit to SBA for prior written approval.

f. Status of Senior Liens

See Chapter 13 of this SOP for guidance on the handling of senior liens.

g. Obligors' Repayment Ability

Generally, to assess the Obligors' repayment ability, an asset search should be conducted on each Obligor and reviewed along with each Obligor's financial statements, tax returns, credit reports and other relevant financial documents in order to analyze the following factors with regard to each Obligor:

(1) Recoverable Value of any collateral pledged by the Obligor (see Subparagraph G.1.c. above.);

(2) Exemptions available to the Obligor under state and federal law;

(3) Amount that could be recovered from the Obligor's non-exempt assets that were not pledged as collateral through enforced collection proceedings, e.g., obtaining a judgment and executing on it;

(4) Amount of present and potential income that could be obtained through enforced collection proceedings, e.g., administrative wage garnishment after referral to Treasury (see Chapter 27 of this SOP);

(5) Litigative risk, i.e., the likelihood of not prevailing in court because of legal issues or factual disputes;

(6) The necessary, reasonable and customary administrative and litigation expenses that would be incurred through enforced collection;

(7) The time it would take to enforce collection; and

(8) The likelihood that the Obligor's assets have been or will be concealed or fraudulently transferred.

h. Lender's Non-SBA Loans to Obligor

The Liquidation Plan must disclose whether the Lender has any non-SBA loans to the same Obligor(s), and if so, indicate how the liquidation and litigation expenses and recoveries will be allocated. See Chapter 23 of this SOP for guidance on the allocation and approval of expenses and recoveries.

2. When Lenders Must Submit a Liquidation Plan to SBA for Approval

a. General Rule—Loans Made Under CLP Authority

(1) Liquidation Plan

Except as provided below with regard to emergencies, Lenders must submit a proposed Liquidation Plan to the appropriate SBA Loan Center for each CLP Loan classified in liquidation status (13 C.F.R. §120.540) within 30 business days of completing the site visit required by Chapter 16 of this SOP. A copy of the Lender's Site Visit Report must be attached to the proposed Liquidation Plan. Lenders should include Routine Litigation in the Liquidation Plans they are required to submit to SBA for prior written approval.

(2) Amended Liquidation Plan

Except as provided below with regard to emergencies, Lenders must prepare and submit an amended Liquidation Plan before taking any action or incurring any expense that materially deviates from its original Liquidation Plan for a CLP Loan.

b. Exception—Emergency Situations

A Lender may respond to an emergency (e.g., loss or dissipation of collateral), without SBA's prior written approval of a Liquidation Plan or amended

Liquidation Plan for a CLP Loan, provided that it:

(1) Makes a good faith effort to obtain SBA's written approval before undertaking the emergency action;

(2) Submits a written Liquidation Plan or amended Liquidation Plan to the SBA Loan Center as soon after the emergency as possible; and

(3) Takes no further liquidation action without SBA's prior written approval of the Liquidation Plan or amended Liquidation Plan. (13 C.F.R. §120.540(f))

c. SBA Response Time

If SBA does not respond to a Lender's request for approval of a Liquidation Plan for a CLP Loan within ten business days from the date on which the request is made, the request is deemed approved. (13 C.F.R. §120.541(c))

H. Lender Application of Payments and Recoveries for Loans in Liquidation Status

See Chapter 4 of this SOP for guidance on how to apply payments received for Loans in liquidation. See Chapter 23 of this SOP for guidance on how to apply liquidation recoveries.

I. When Lenders Should Remove a Loan from Liquidation Status

Lenders should remove Loans from liquidation status for one of the following three reasons:

1. Loan Returned to Regular Servicing

Lenders should return SBA Loans to regular servicing status when the borrower has agreed to the resumption of regular payments pursuant to a workout agreement, bankruptcy plan, reaffirmation agreement, assumption, or other written agreement that provides for resumption of regular payments that will pay the Loan balance in full. After guaranty purchase, the appropriate SBA Loan Center must approve the return of any Loan to regular servicing status.

2. Loan Paid in Full

Lenders should remove an SBA Loan from liquidation status and classify it as “paid in full” when the debt owed on the Loan is paid in full. (Lenders should not confuse the repurchase of SBA’s guaranteed portion of a Loan from a secondary market investor with satisfaction of the debt by payment(s) from an Obligor or the application of collateral liquidation proceeds.) After guaranty purchase, Lenders should request a payoff confirmation from the appropriate SBA Loan Center before classifying a Loan as “paid in full”. SBA may cancel an SBA guaranty and code the Loan as Paid if Full if a Lender notifies SBA that they are voluntarily terminating the SBA guaranty for any reason.

3. Loan Charged Off by SBA

SBA removes a Loan from liquidation status and classifies it as "charged off" when SBA completes its review and approves an acceptable Lender Wrap-up Report for the Loan. (See Chapter 27 of this SOP for additional information on Wrap-up Reports.)

Chapter 16.
Site Visits

This chapter provides SBA policy and procedures concerning post-Default site visits. If not required by Loan Program Requirements, Lenders should conduct a site visit whenever warranted by Prudent Servicing practices. Lenders should document all site visits and keep a copy of their site visit report in their Loan File. (See Chapter 3 of this SOP for site visit reporting requirements.)

A. When Lender Site Visits Are Required

In the following circumstances, unless the Loan is unsecured, or the aggregate Recoverable Value of the personal property collateral is less than $5,000 and the Recoverable Value of each parcel of real property collateral is less than $10,000, Lenders must conduct a site visit within the following time frames:

1. **Payment Default**—within 60 calendar days of an uncured payment Default, or sooner if the collateral could be removed, lost or dissipated.

2. **Non-payment Default**—within 15 calendar days of the occurrence of an adverse event that causes the Loan to be classified in liquidation status, or sooner if the collateral could be removed, lost or dissipated.

3. **EWCP Loans** – physical site visits may be waived for EWCP Loans secured only by foreign accounts receivable, with the written concurrence of the SBA Export Finance Manager at the appropriate USEAC. Lenders must coordinate site visits in accordance with the guidance provided in this Chapter for all other collateral.

B. Lender Preparation for Site Visits

Prior to conducting a site visit, Lenders should take the steps listed below when they are applicable and necessary to obtain sufficient information to make prudent lending decisions.

1. Review the Loan Documents

Determine what collateral was required, what collateral was actually taken, and what priority position the liens had when the Loan was closed by reviewing the Loan Authorization and other relevant Loan Documents, including for example:

a. **Personal Property Collateral**—The security agreement, landlord lien waiver, UCC financing statements, and UCC searches, as well as any senior lienholder, subordination and/or inter-creditor agreement; and

b. **Real Property Collateral**—The mortgage or deed of trust, assignment of rents, and title insurance policy, as well as any senior lienholder, subordination, inter-creditor and/or non-disturbance agreement.

2. Obtain a Current Lien Search

Obtain a current title report or UCC search to verify the priority of the lien(s) securing the SBA Loan.

3. Contact the Landlord

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

4. Contact Local Taxing Authorities

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

5. Order an Appraisal

a. Personal Property

If the Loan is secured and the collateral includes personal property such as machinery, equipment, furniture, fixtures and/or inventory, hire an auctioneer or other expert to prepare a Liquidation Value Appraisal and to assist with the relevant site visit goals listed below. If the collateral includes unusual personal property that an auctioneer would not ordinarily have the expertise to appraise, e.g., intellectual property, order an Appraisal from an entity with the appropriate qualifications.

b. Real Property

If the Loan is secured and the collateral includes real property, hire a qualified appraiser to conduct an Appraisal of the property.

Note: See the definition of "Appraisal" in Chapter 2 of this SOP for SBA requirements pertaining to appraisals.

C. Lender Site Visit Objectives

During a post-Default site visit, Lenders should make a good faith effort to gather sufficient information to accomplish the applicable goals listed below:

1. Inspect and Inventory the Collateral

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

2. Establish the Recoverable Value of the Collateral

Determine the amount of expenses that must be taken into consideration to accurately calculate the Recoverable Value of the collateral, such as the cost of any necessary care and preservation measures.

3. Ascertain Whether Real Property Collateral is Occupied

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

4. Assess Environmental Risk

Review the Environmental Investigation Report prepared at the time the Loan was made, look for potential environmental problems while inspecting the Borrower's business premises, and follow the requirements concerning Environmental Investigations set out in Chapter 5 of this SOP.

5. Develop a Liquidation Strategy

Begin developing a strategy for liquidating the Loan. For example, if there is personal property collateral that must be liquidated, determine whether the Borrower and landlord will cooperate so that it can be sold via a public auction held on the Borrower's business premises. (See Chapter 19 of this SOP for guidance on conducting public UCC sales.)

6. Ascertain Whether a Workout is Feasible

If Obligors who have not filed for bankruptcy protection are present and cooperative, obtain a copy of the financial records needed to determine whether a workout is feasible. (See Chapter 17 of this SOP for guidance on workouts including how to ascertain whether the Borrower is a good candidate for a successful workout.)

7. Repossess the Personal Property Collateral

Unless a workout or a judicial foreclosure action is contemplated, make arrangements to repossess the collateral using self-help methods pursuant to UCC Article 9, if possible without creating a "breach of the peace." If a Lender cannot repossess the collateral without a "breach of the peace," the Lender should consult their legal counsel about filing a replevin action to obtain a court order requiring the Obligor to turn over the collateral.

8. Arrange for Care and Preservation of the Collateral

After acquiring possession or control of the collateral, take prudent and commercially reasonable measures to care for and preserve it until it can be liquidated. For example:

a. Security and Safekeeping

Make arrangements to keep the collateral safe and secure until it can be liquidated. For example, depending on the circumstances, it may be necessary to have the locks changed, hire a caretaker, pay utility bills, and/or transport personal property

collateral to a secure, temperature-controlled storage facility pending a foreclosure sale.

b. Insurance

Purchase or maintain appropriate insurance coverage, such as for hazard or general public liability, pursuant to the requirements in Chapter 9 (Insurance Coverage) of this SOP.

c. General Maintenance

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

Chapter 17.
Workouts

A. Lender Workout Overview

The term "workout" refers to the Loan collection and negotiation process as well as the final plan agreed upon by a Lender and Borrower to "workout" or resolve the problems and/or issues involving the Borrower's delinquent obligations on an SBA Loan. Generally, a workout agreement materially restructures the terms and conditions of a Borrower's delinquent SBA Loan in order to: avoid the need for actions such as foreclosure or bankruptcy; enable the Borrower to cure Defaults and improve repayment ability; and enable the Lender to maximize recovery on the Loan. Because a workout agreement materially alters the terms and conditions of the Loan, the Loan will need to be purchased from the secondary market investor before a formal workout agreement is executed. Whenever feasible, Lenders must make a good faith effort to negotiate a workout on an SBA Loan that is seriously delinquent or classified in liquidation.

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.

B. Required Financial Information

Current financial information is essential to making Prudent Servicing decisions regarding the feasibility and structure of an SBA Loan workout agreement. Lenders should not pursue workout negotiations if the Obligors are unwilling to provide the following basic information:

1. Financial Statements

a. A current financial statement signed under penalty of perjury showing the assets, liabilities, income and expenses, e.g., SBA Form 770 (Financial Statement of Debtor) of all Obligors.

b. The Borrower's last year-end financial statements including accounts receivable aging and debt schedules; and

c. Affiliates—If the Borrower and/or Guarantors have any affiliates, a current financial statement for each affiliate;

2. Business Federal Income Tax Returns

A complete copy of the Borrower and each affiliate's business federal income tax

returns that were filed with the IRS for the most recent 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 that each Obligor filed with the IRS for the most recent two years, or a written explanation as to why a copy is not available.

> **Note:** Obtaining current financial statements at this stage is critical. Not only are they needed to make Prudent Servicing 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 liquidation proceedings become necessary.

C. Workout Feasibility Test

To determine whether a Borrower is a good candidate for the workout process, in addition to reviewing the existing Loan Documents, Lenders should review the new financial information required by Paragraph B above, conduct a site visit or document the file as to why a site visit is not feasible, and ascertain whether the Borrower is: (1) competent, i.e., has the necessary technical and management skills to turn the business around; (2) cooperative and willing to take the necessary action to address the problems that caused the Default; (3) acting in good faith; and (4) financially and operationally viable.

D. Workout Timing

If a workout is feasible, Lenders should begin negotiations immediately in order to put a final workout plan 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 Lender should move forward with its plan for enforced debt collection.

E. Workout Requirement—New Consideration from Obligors

Obligors must provide consideration (i.e., something of value) to the Lender before or at the same time the Obligors receive the benefit of a workout agreement, to make the agreement legally binding. For example, in exchange for an agreement to forbear or restructure a Loan, Lenders should generally require Obligors to:

1. Correct Loan Document errors;

2. Waive defenses;

3. Release lender liability claims;

4. Provide additional collateral; and

5. Consent to a speedy and inexpensive method of liquidating the Loan if the workout fails.

This could include, for example, placing a deed or bill of sale to the collateral in escrow, signing a confession of judgment, or agreeing to waive the automatic stay and to turn over the collateral if the Obligor subsequently files for bankruptcy protection.

F. Workout Options

The elements of a plan to work out the problems of an SBA Loan will vary depending on the circumstances. Lenders must document their final decisions and the justification for them in their Loan File. Lenders should support their decisions with a credit memo that includes a cash flow and collateral liquidation analysis based on the Obligors' financial information specified in Paragraph B of this Chapter. The most common workout options are listed below.

1. Forbearance

Lenders may postpone liquidation actions for a stated period of time, to allow the Borrower or Obligors to improve their financial ability to perform under a proposed workout plan.

2. Reinstate or Extend Maturity Date

If the Lender has accelerated the Note, the Lender may reinstate or extend the maturity date of the Note. (See Chapter 7 of this SOP for guidance on maturity date extensions.)

3. Loan Payment Deferment

Lenders may defer delinquent and future payments of principal and/or interest for a stated period of time to enable the Borrower to overcome a temporary cash flow problem. (See Chapter 12 of this SOP for guidance on deferments.)

4. Modification of Note Repayment Terms

Lenders may modify the repayment terms of the Note (e.g., reduce the payment amount and/or interest rate or extend the maturity date). See Chapter 7 of this SOP for guidance on Note modifications.

5. Assumption of Loan

Another Person may assume the Loan. (See Chapter 11 of this SOP for additional guidance on Loan assumptions.)

6. Subordination to Working Capital Loan

Lenders may subordinate the lien securing an SBA Loan to a short-term working

capital loan. (See Chapter 8 of this SOP for guidance on subordinations.)

7. Relief For Secured Senior Loan

Lenders may advance funds to keep a loan secured by a senior lien on the collateral for an SBA Loan current, or purchase or pay off the senior loan. (See Chapter 13 of this SOP for additional guidance on the handling of delinquent senior liens.)

8. Voluntary Sale of Collateral

Lenders may allow the Obligors to sell all or part of the collateral securing an SBA Loan; provided that the sale is closely monitored to ensure that it is commercially reasonable, and all net proceeds from the sale are applied to the principal balance of the SBA Loan or used to facilitate the workout plan. See Chapter 18 (Real Property Collateral Liquidation) and Chapter 19 (Personal Property Collateral Liquidation) of this SOP for guidance on the voluntary sale of collateral.

Note: Lenders must follow SBA's offer in compromise procedures to reduce the principal and/or accrued interest owed on an SBA Loan. (See Chapter 21 of this SOP for additional guidance, including offers in compromise from going concern businesses.)

G. Workout Agreement Provisions

Lenders must ensure that all workout agreements are in writing and include the following, as applicable:

1. A list of the Borrower's events of Default to date;

2. The consideration given for entering into the agreement;

3. Confirmation of the collateral for the SBA Loan, including the priority of each lien against the property;

4. An acknowledgement that neither SBA nor the Lender is waiving any Default, right or remedy by entering into the workout agreement;

5. The forbearance period;

6. The agreed upon workout option(s) such as those listed in Paragraph F above;

7. The events that constitute a default under the workout agreement including the dates by which the Lender and Obligor(s) must perform the obligations stated in the workout agreement;

8. The consequences of default under the workout agreement, e.g., re-acceleration of the Note

and delivery or recording of any deed, bill of sale, or confession of judgment placed in escrow; and

9. The signatures of the Lender and all Obligors for the workout agreement. Lenders must provide SBA with a fully executed workout agreement with any request to extend SBA's Prudent Liquidation Deadline after guaranty purchase (see Chapter 24 Paragraph F of this SOP for additional guidance).

H. SBA Approval of Lender Workout Plans

SBA's prior written approval of a workout plan is not required unless the plan includes a compromise of the principal loan balance or some other Loan Action that requires SBA's prior written approval. (See Chapter 3 of this SOP for a list of Loan Actions that require SBA's prior written approval.)

Chapter 18.
Real Property Collateral Liquidation

A. General Requirements

Lenders should liquidate all collateral for an SBA Loan that has Recoverable Value. Lenders must liquidate real property collateral that has an individual parcel or aggregate Recoverable Value of $10,000 or more unless doing so would create a Financial Hardship (see Chapter 2 of this SOP for the definition of Financial Hardship). The most common methods of liquidating real property collateral are discussed below.

B. Procedure for Selecting Best Method of Liquidation

Lenders must liquidate real property collateral in a manner that will maximize recovery for the Loan in the shortest amount of time. Numerous factors influence which liquidation method is most appropriate. These factors include the following:

1. Military Service Status of Property Owner-Obligor

Lenders must determine whether the property owner-Obligor is in active military service. If so, the Lender must consult with its legal counsel regarding the implications of the Servicemembers Civil Relief Act prior to initiating a lien foreclosure action.

2. Use of the Property

How the property is used may trigger special requirements. For example, if the property is used as an Obligor's primary residence, the requirements set forth in Subparagraph C.4.b. below must be met before initiating a foreclosure action. If the property is used for agricultural purposes, state law may require judicial foreclosure and federal law may provide the Borrower with homestead rights. See 13 C.F.R. §120 550 et seq. and the Consolidated Farm and Rural Development Act for additional information on farmer homestead rights. Finally, while SOP 50 10 Loan origination policy generally prohibits restrictive covenants, if the property is used to operate a gas station, a major oil company may have special rights with regard to notice of Default, the right of first refusal, and/or the ability to control future ownership and/or use of the property. Therefore, Lenders must review all title reports before taking any specific action.

3. Loan Document Review

Lenders must review the Loan Documents to determine which methods of liquidation are available. For example, a mortgage must be judicially foreclosed in most states, while a deed of trust may be foreclosed through either judicial or non-judicial proceedings.

4. Title Report

Lenders should order a new title report or, at a minimum, review the existing title insurance policy and gather any other information needed to identify all liens and other encumbrances against the property.

5. Amount Owed on Senior Liens

Lenders must determine the amount owed, including unsubordinated advances and Default Charges, on any debt secured by a senior lien against the property, and deduct that amount from the property's estimated Recoverable Value. If it still appears that the property will have a Recoverable Value of $10,000 or more, proceed to step 6. If not, see Paragraph F of this Chapter regarding abandonment.

6. Title Encumbrances

After deducting the amount of debt secured by senior liens, if the collateral still has Recoverable Value of $10,000 or more, Lenders must consider the impact, if any, that each encumbrance would have on the various methods of liquidation and decide how to handle each encumbrance. For example:

a. Senior Tax Liens

Consider the possibility of further erosion of equity due to late fees and other penalties, then decide whether to pay delinquent real property taxes or assessments secured by a senior lien.

b. Senior Non-tax Liens

If there are senior non-tax liens against the property, decide which of the options for dealing with them listed in Chapter 13 of this SOP is prudent and commercially reasonable under the circumstances.

c. Junior Non-tax Liens

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

d. Junior Tax Liens

If there are junior federal tax liens against the property, find out the balance owed and ask the IRS for a certificate of discharge, or work with the IRS to reach an amicable resolution regarding the amount to apply to the tax lien.

e. Leases

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

purchaser to the lease terms; and (3) a Borrower or operating company has leased space to any business that the Borrower or operating company knows is engaged in any activity that is illegal under federal, state or local law, or any activity that can reasonably be determined to support or facilitate an activity that is illegal under federal, state or local law (such as a marijuana dispensary). If a Borrower or operating company has leased space to such a business, the Lender must notify the appropriate SBA Loan Center as soon as the Lender becomes aware of the lease and advise of the action(s) the Lender intends to take.

Note: Review subordination, non-disturbance and attornment agreements carefully since they address lender and tenant rights. Typically, the tenant agrees to "subordinate" the lease to the lender's mortgage; and in the event of default by the landlord-Obligor, the lender agrees not to "disturb" the tenant's possession; and the tenant agrees to "attorn," i.e., recognize the lender or foreclosure sale purchaser as the new landlord. Lenders should consult with their legal counsel for assistance with review of such agreements.

f. Assignments of Rents

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

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

(2) Collecting the rents would cure the existing Default and prevent foreclosure; and

(3) Requesting the court to appoint a receiver to collect the rents could bar a non-judicial foreclosure action.

g. Covenants, Conditions and Restrictions

If there are other title encumbrances, determine what impact, if any, they will have on the foreclosure process or Recoverable Value of the property. For example, gas station property is often encumbered by special notice of Default requirements, purchase options, rights of first refusal, restrictions on how the property can be used, covenants that require future owners to indemnify a major oil company from liability associated with Contamination, and covenants that require future owners to install expensive engineering controls prior to redevelopment.

7. Hazard Insurance Status

If the property is improved, see Chapter 9 of this SOP for SBA Loan Program Requirements pertaining to ensuring that all collateral with Recoverable Value is

adequately insured.

8. Appraisal Update

Lenders must order an updated Appraisal to determine the current market value of the property;

> **Note:** See the definition of "Appraisal" in Chapter 2 of this SOP for SBA guidance pertaining to Appraisals. Given the inherent conflict of interest, do not rely on an Appraisal prepared solely for an Obligor or another lender with a lien on the same collateral, and exercise caution if the Appraisal was prepared by a broker with whom the collateral, if acquired, will be listed for sale.

9. Environmental Risks

When required by Chapter 5 of this SOP, Lenders must conduct an Environmental Investigation to obtain the information needed to mitigate the risks associated with liquidating Contaminated collateral.

10. Historic Register Status

If the property could have historical value based on its age, integrity and significance, Lenders must determine whether it is listed on the National Register of Historic Places (NRHP). If so, Lenders must determine whether the historic significance of the property impacts the Recoverable Value of the collateral. If the property is not listed on the NRHP but may have historic significance such that it may be eligible to be listed on the NRHP, or is part of an historic district recognized by the NRHP, Lenders should complete further due diligence by contacting the State Historic Preservation Office (SHPO) where the property is located to determine the actual historic significance of the property. After consultation with the SHPO, Lenders must determine if the historic significance impacts the Recoverable Value of the collateral.

11. Borrower Business Records Review

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

12. Anticipated Deficiency Balance of SBA Loan

If the recovery from liquidating a single parcel of real property collateral is not enough to pay the SBA Loan in full, Lenders must consult their legal counsel to determine whether use of a particular method of liquidation, e.g., non-judicial foreclosure or acceptance of a deed in lieu of foreclosure, would bar collection of the deficiency or

foreclosure of any remaining collateral. Any collateral liquidation action that legally extinguishes a projected deficiency balance requires SBA's prior written approval. (See Ch. 21 (Offer in Compromise) of this SOP for additional guidance.)

13. Estimated Liquidation Time and Cost

Lenders must estimate the time and expense associated with each viable method of liquidation. This includes: the time and cost associated with pre-liquidation collateral care and preservation; the liquidation action; and post-liquidation care, preservation and resale, if acquiring title to the collateral is anticipated.

14. Estimated Net Recovery

Using the information collected in Steps 1-13 above, Lenders should calculate the net amount that could be recovered by utilizing each viable method of liquidation listed in Subparagraph C. below, to determine which method will yield the highest possible recovery in the shortest period of time.

C. Liquidation Methods

1. Release of Lien for Consideration

See Chapter 8 of this SOP for guidance on the release of liens for consideration.

2. Voluntary Sale of Collateral by Obligor

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

a. A voluntary sale would maximize recovery on the Loan;

b. The Obligor has possession or control of the collateral;

c. All other lienholders have provided their written consent to the sale;

d. A current Appraisal has been obtained;

> **Note:** See Chapter 2 of this SOP for additional guidance pertaining to "Appraisals". Given the inherent conflict of interest, do not rely on an Appraisal prepared solely for an Obligor or another creditor with a lien on the same collateral, and exercise caution if the Appraisal was prepared by a broker with whom the collateral, if acquired, will be listed for sale.

e. The Lender has established the Recoverable Value of the collateral;

f. The Lender supervises the sale (or SBA supervises the sale if SBA has taken over servicing);

g. The costs of sale are reasonable, necessary and customary;

h. 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

i. All the net proceeds are applied to the principal balance of the SBA Loan.

> **Note:** When analyzing whether a proposed compromise amount is adequate, SBA may consider the extent to which the Obligor's cooperation during the liquidation process increased the overall recovery for the Loan. (See Chapter 21, Paragraph F of this SOP for further guidance.)

3. Deed in Lieu of Foreclosure

Real property collateral may be liquidated by accepting a deed in lieu of foreclosure (i.e., a deed by which a debtor conveys fee-simple title to a secured creditor as a substitute for foreclosure) if doing so would maximize recovery on the Loan. All deeds in lieu of foreclosure must be accompanied by a written agreement executed by all the Obligors regarding the amount to be applied to the Loan balance once title has been transferred. Although this procedure may save time and money, it has inherent risks. For example, accepting a deed in lieu of foreclosure could eliminate the right to collect any deficiency balance on the Loan. 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 of foreclosure, Lenders should obtain the advice and assistance of their legal counsel before undertaking this method of liquidation. Lender approval and acceptance of a deed in lieu of foreclosure action that extinguishes the legal obligation of any of the Obligors for the deficiency balance of an SBA Loan must be undertaken in accordance with the offer in compromise guidance provided in Chapter 21 of this SOP.

> **Note:** In addition to a foreclosure title policy, trustee sale guarantee, or a litigation guarantee, most title insurance companies also offer deed in lieu of foreclosure services that may include a new title commitment report, review of title issues, recording of the deed in lieu of foreclosure documents, and issuance of a title policy to the Person that acquires the property from the Lender after the Lender acquires the property via a deed in lieu of foreclosure action.

4. Lien Foreclosure

a. General

Foreclosure is a legal action taken to acquire title to the property that secures an SBA Loan. Since the state laws pertaining to the foreclosure of mortgages, deeds of trust, and other types of real property liens vary by state, Lenders should consult their legal counsel to determine which type of foreclosure action is most appropriate with regard to a particular Loan. The two primary methods of real property lien foreclosure are judicial and non-judicial foreclosure.

b. Primary Residences

Unless the Obligor-owner has engaged in fraud, misrepresentation or other financial misconduct, Lenders should make good faith efforts to reach an agreement to release the lien on an Obligor's residence for consideration, and compromise the remaining balance of the SBA Loan prior to initiating a foreclosure action against an Obligor's primary residence. Documentation showing Lender compliance with applicable state or federal laws requiring mortgage lenders to work with homeowners prior to foreclosure is considered evidence that a Lender has made a good faith effort to meet this SBA Loan Program Requirement. (See Chapter 21 of this SOP for guidance on offers in compromise.)

c. Judicial Foreclosure

Judicial foreclosure requires the filing of a civil legal action against the owner of a property that secures an SBA Loan.

(1) Advantages

(a) Deficiency judgment obtainable; and

(b) Only one action required to foreclose liens and obtain judgment on the Note and Guaranties.

(2) Disadvantages

(a) Higher costs and fees than non-judicial foreclosure;

(b) More time-consuming than non-judicial foreclosure; and

(c) The mortgagor and junior lienholders usually have statutory redemption rights.

d. Non-Judicial Foreclosure

Non-judicial foreclosure, which ends with the private sale of the property, is available only if the deed of trust or mortgage securing the Loan contains a clause or provision granting a power of sale. Strict compliance with applicable state statutory provisions governing non-judicial foreclosure is mandatory. Lenders must obtain SBA's prior written approval for any collateral liquidation action that

legally extinguishes a projected deficiency balance for an SBA Loan. See Ch. 21 (Offer in Compromise) of this SOP for additional guidance.

(1) Advantages

(a) Fees and costs are generally lower than judicial foreclosure;

(b) Takes less time than judicial foreclosure; and

(c) The mortgagor and junior lienholders usually do not have statutory redemption rights.

(2) Disadvantages

(a) Lenders may be unable to obtain a deficiency judgment for the SBA Loan (Lenders should consult their legal counsel for guidance), and

(b) Lenders may need to conduct additional legal actions to evict unlawful occupants of the property.

5. Collection of Rents

If the Loan Documents include an assignment of rents and tenants are paying rent to an Obligor, Lenders should consult their legal counsel regarding applicable state law for the collection of rents pending a foreclosure action. In some cases, Lenders may collect rents by sending a letter to the tenants. In other cases, Lenders may need to appoint a receiver.

6. 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. The laws governing receiverships are available in both federal and state law. Generally, the court will authorize the receiver to take possession of the property, manage it, collect rents, take any reasonably necessary action to protect and preserve its value, and liquidate the property. The remedy of a receivership is often provided in the Loan Documents. State law may also provide separate statutory grounds for the appointment of a receiver.

a. When Receiverships are Appropriate

The appointment of a receiver is an extraordinary remedy that Lenders should utilize only when there are no other more viable recovery options. Lenders should use receiverships only when it is necessary to operate a business to maximize recovery and/or minimize losses, before the business is sold and/or the collateral is liquidated.

(1) Circumstances where SBA may approve the appointment of a receiver include:

(a) When keeping the business operating as a going concern will enhance the sale price of the collateral or the business itself. If the business is operating as a franchise, Lenders must check with the franchisor to determine if they may temporarily operate during the process of trying to sell the business to a new franchisee. Generally, the appointment of a receiver is considered an event of default in the franchise agreement.

(b) For certain types of businesses where required licensure or similar restrictions prevent the Lender or SBA from temporarily operating the business, in order to sell it as a going concern and/or sell the collateral directly. Examples include assisted living facilities and businesses with live animals as collateral.

(2) Circumstances where SBA may not approve the appointment of a receiver include:

(a) When the Lender is unable to demonstrate that appointing a receiver will result in a potential net recovery that exceeds the recovery the Lender could obtain by liquidating the collateral directly;

(b) When analysis of the information provided by the Lender shows that it would not be cost-effective to appoint a receiver;

(c) When operating the business by a receiver would expose the Lender and SBA to a high risk of liability for environmental contamination (e.g., gas station, dry cleaner, or metal plating facility, etc.).

(d) When the Lender does not have a presence in the area where the business operates, and it appears that the Lender is hiring a receiver as a substitute for liquidating the collateral directly; and

(e) When the proposed receiver does not have staff with experience in liquidating the types of assets involved in the business and/or is otherwise unqualified to operate the business.

b. SBA Approval Required

(1) Litigation Plan Required

The appointment of a receiver involves Non-Routine Litigation. Therefore, Lenders must submit a proposed Litigation Plan to the appropriate SBA Loan Service Center for written approval by SBA District Counsel prior to commencing receivership proceedings. SBA will not approve the appointment of a receiver to perform basic loan liquidation functions and will not approve or reimburse Lenders for expenses related to receiverships that were not approved in writing and in advance by SBA District Counsel. (See Chapter 22 of this SOP for guidance on Litigation Plans and Chapter 23

of this SOP for guidance on Recoverable Expenses.)

(2) Cost Benefit Analysis Required

Prior to seeking SBA approval to appoint a Receiver, Lenders must conduct a cost/benefit analysis demonstrating how the use of a receiver will maximize recovery. Lenders must submit a copy of their cost/benefit analysis and all relevant supporting documentation with their request for SBA approval to appoint a receiver. The Lender's cost/benefit analysis must discuss and analyze all environmental issues, when applicable.

7. Short Sale Approval

A "short sale" is a sale of real property by the owner in which the proceeds from the sale fall short of the amount owed on the debts secured by the liens on the property. Because the owner cannot afford to repay the full amount of the secured debt, the secured creditors agree to release their liens on the property for less than the total amount that would otherwise be due at closing.

a. Review and Analysis

Lenders should review, analyze and implement Borrower requests for short sales in accordance with the guidance provided in Chapter 6 of this SOP and below.

b. General Rule

Lenders should not recommend and/or approve a short sale unless:

(1) The net sale proceeds to be received and applied to the SBA Loan balance is equal to or greater than the Recoverable Value of the collateral; and

(2) The Obligor-seller will remain liable for the SBA Loan balance, or approval of the short sale is part of a compromise agreement reached in accordance with the guidance provided in Chapter 21 of this SOP.

> **Note:** Some states, e.g., California, have laws that prohibit lienholders from collecting the deficiency balance of a loan if they consent to a short sale. Lenders should consult their legal counsel for case-specific information and advice. Any short sale action that extinguishes the deficiency balance of an SBA Loan must comply with the guidance provided by Chapter 21 of this SOP for offers in compromise.

c. Required Supporting Documents

Lenders should obtain and review the following Supporting Documents in order

to reach a prudent decision regarding whether to recommend and/or approve a short sale:

(1) Real estate listing agreement;

(2) Current Appraisal;

> **Note:** See the definition of "Appraisal" in Chapter 2 of this SOP for additional guidance. Given the inherent conflict of interest, do not rely on an appraisal prepared solely for an Obligor or another lender with a lien on the same collateral, and exercise caution if the Appraisal was prepared by a broker with whom the collateral, if acquired, will be listed for sale.

(3) Real estate purchase and sale agreement, short sale and all other addenda;

(4) Current title report;

(5) Senior lienholder subordination, inter-creditor and/or other agreement with any other creditor with a lien against the property;

(6) Transcript of account or functional equivalent for any loan secured by a senior lien;

(7) Pre-approval letter from the buyer's lender; and

(8) Draft settlement statement (HUD 1).

d. General Requirements

(1) Fair Sales Price

The sales price must be fair and justified by a current Appraisal;

(2) Consent of All Secured Creditors

All the Obligor-seller's creditors with a lien on the property must consent to the short sale;

(3) No Sale Proceeds to Seller

Because the Obligor-seller has no equity in the property, the seller should not receive any funds from the sale proceeds;

(4) No Subordinated Amounts to Senior Lienholders

The sale proceeds disbursed to senior lienholders, if any, must not include

advances, Default Charges, or any other amount subordinated to the SBA Loan by a senior lienholder, subordination, inter-creditor and/or other agreement;

(5) No Sale Proceeds to Junior Lienholders, Unsecured Creditors or Others

Lenders should not disburse sale proceeds to 1) junior lienholders other than token amounts, i.e., $500 or less, if necessary for release of lien; 2) unsecured creditors, or 3) any other Person who does not have a senior lien against the property, except as provided below with regard to closing costs;

(6) No Credits to Buyer

Since short sale property should be sold in "as is" condition, Lenders should not provide the buyer with a credit for repairs or any other purpose;

(7) No Unreasonable Closing Costs

Since the Obligor-seller has no equity in the property, the seller's closing costs should not be paid from the sale proceeds unless it is necessary under the circumstances. The amount of any cost that will be paid from the sale proceeds, e.g., real estate commissions, must be reasonable and justified under the circumstances;

Note: Secured creditors who are asked to accept less than the full amount owed to them, may require conditions for their approval of a short sale. For example, creditors may condition their approval on increasing the purchase price, reducing usual and customary sale closing costs such as the amount of commissions paid to broker/realtors, or receiving substitute collateral for the deficiency balance of their loan.

(8) Arrangement for Payment of Loan Balance Deficiency

Lenders must make satisfactory arrangements for repayment of the remaining balance of the SBA Loan after the proceeds from a short sale are applied, including releasing the lien as part of a compromise agreement reached with the Obligor-seller pursuant to the guidance provided in Chapter 21 of this SOP.

D. Credit Bids

1. Requirement

Lenders should enter a Credit Bid at all real property lien foreclosure sales initiated to foreclose a lien securing an SBA Loan, whether the sale is judicial or non-judicial.

2. Credit Bid Amount

Lenders must consider the following factors when determining their Credit Bid amount: (a) Recoverable Value of the property; (b) SBA Loan balance; and (c) need for and ability to collect a deficiency judgment. Lenders should base their Credit Bid amount on the Recoverable Value of the collateral; however, the Credit Bid should not exceed the SBA Loan balance. Furthermore, Lenders should not bid the entire SBA Loan balance if doing so would eliminate an otherwise collectible deficiency.

E. 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, Lenders may need to commence eviction proceedings. Eviction laws vary by locality. Lenders should consult their legal counsel to determine the appropriate course of action.

F. Abandonment

Lenders may abandon the pursuit of recovery from real property collateral if the real property has insignificant Recoverable Value, i.e., a Recoverable Value of less than $10,000 per parcel. (See Chapter 5 [Environmental Risk Management] of this SOP for SBA requirements pertaining to the due diligence required to avoid abandoning collateral based on unsubstantiated claims that the property is Contaminated, since the presence of Hazardous Substances may not significantly impair the market value of the acquired collateral.)

Chapter 19.
Personal Property Collateral Liquidation

A. General Requirements

Lenders should liquidate all collateral for an SBA Loan that has Recoverable Value. Lenders must liquidate personal property collateral that has an individual or aggregate Recoverable Value of $5,000 unless doing so would create a Financial Hardship (see Chapter 2 of this SOP for the definition of Financial Hardship). The most common methods of liquidating personal property collateral are discussed below.

B. Procedure for Selecting Best Method of Liquidation

Lenders must liquidate personal property collateral in a manner that maximizes recovery for an SBA Loan in the shortest period of time. The most appropriate method depends on numerous factors including the following:

1. Military Service Status of Property Owner-Obligor

Lenders must determine whether the property owner-Obligor is on active military duty. If so, Lenders must consult with their legal counsel regarding the implications of the Servicemembers Civil Relief Act prior to initiating a lien foreclosure action.

2. Loan Document Review

Lenders must review the applicable Loan Documents to begin the process of determining what personal property is available for liquidation, how the liens on that property can be foreclosed, and how much money can be recovered through liquidation. Relevant Loan Documents include the Loan Authorization, and any security agreement, assignment, marine mortgage, certificate of title, landlord lien waiver, senior lienholder agreement, subordination agreement, inter-creditor agreement, deposit account control agreement, and/or lien search.

> **Note:** The law under which a lien was created dictates how it can be foreclosed. For example, if the collateral consists of a lien on equipment or inventory created under UCC Article 9, the lien can be foreclosed by conducting a foreclosure sale pursuant to UCC Article 9 ("UCC sale"). On the other hand, if the collateral consists of a common law assignment of a life insurance policy or a marine mortgage, the UCC does not apply and the lien must be foreclosed according to the applicable state or federal law.

3. Lien Search

Lenders must verify the priority of liens securing and SBA Loan by conducting a new lien search. Lenders should order a current UCC lien search, or follow the steps below

to search for liens against special types of property, such as:

a. Motor Vehicles and Small Boats

Check for security interests noted on the certificate of title, if title is available.

b. Airplanes

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

c. Documented Vessels

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

d. Tax Liens

Contact the appropriate governmental entity (generally the county) to determine the existence of liens for delinquent taxes that may have priority over the lien securing the SBA Loan, and decide whether the delinquent taxes should be paid. If there are junior IRS liens on the property, ask the IRS for a certificate of discharge or reach an amicable resolution regarding the amount of funds that should be applied to each IRS tax lien.

4. Amount Owed on Senior Liens

Lenders must determine the amount owed, including unsubordinated Default Charges, on any debt secured by a senior lien on the personal property collateral, and deduct that amount from the property's estimated Liquidation Value. If the property still has an individual or aggregate Recoverable Value of $5,000 or more, proceed to step 5. If not, see Paragraph E of this Chapter regarding abandonment.

5. Borrower Business Records Review

If the collateral consists of inventory or accounts, Lenders must review the Borrower's books and records to determine whether there are accounts receivable that can be collected or inventory that can be returned for cash or credit. If so, see Subparagraph C.5 below for guidance on collecting accounts receivable.

6. Hazard Insurance Status

See Chapter 9 of this SOP for SBA Loan Program Requirements regarding the need to adequately insure personal property collateral with Recoverable Value.

7. Updated Appraisal

Lenders must order an updated Appraisal to determine the Liquidation Value of personal property collateral.

> **Note:** See the definition of "Appraisal" in Chapter 2 of this SOP. Given the inherent conflict of interest, do not rely on an Appraisal prepared solely for an Obligor or another lender with a lien on the same collateral, and exercise caution if the Appraisal was prepared by a broker or auctioneer with whom the collateral, if acquired, will be listed for sale.

8. Environmental Risks

If there are Hazardous Substances located at the Borrower's business premises, Lenders must follow prudent lending practices in order to minimize the risk and maximize the recovery for the SBA Loan. (See, for example, the Practice Tip at the end of Subparagraph C.3 below regarding the sale of used Hazardous Substances.) s If the collateral includes equipment associated with a gas station, commercial fueling facility, or dry cleaner, Lenders must comply with the requirements in Chapter 5 (Environmental Risk Management) of this SOP.

9. Estimated Liquidation Time and Cost

Lenders must estimate the time and costs associated with each viable method of liquidation. This includes repossession or replevin; pre-liquidation collateral care and preservation; the liquidation action; and post-liquidation care, preservation and resale if acquiring title to the collateral is anticipated. For example, a Lender who intends to initiate a marine mortgage foreclosure action should consider the possibility that it will need to purchase the vessel at a U.S. Marshal’s sale.

10. Estimated Net Recovery

Using the information collected in Steps 1-9 above, Lenders should calculate the net amount that could be recovered by utilizing each viable method of liquidation listed in Subparagraph C. below, to determine which method will yield the highest possible recovery in the shortest period of time.

C. Liquidation Methods

1. Release of Lien for Consideration

See Chapter 8 of this SOP for guidance on the release of liens for consideration.

2. Voluntary Sale of Collateral by Obligor

Lenders may allow an Obligor to conduct a voluntary sale of all or part of the personal property collateral securing an SBA Loan provided that:

a. A voluntary sale would maximize recovery on the Loan;

b. The Obligor has possession or control of the collateral;

c. All other lienholders have provided their written consent to the sale;

d. A current Appraisal has been obtained;

> **Note:** See the definition of "Appraisal" in Chapter 2 of this SOP for Appraisal guidelines. Given the inherent conflict of interest, do not rely on an Appraisal prepared for an Obligor or another lender with a lien on the same collateral, and exercise caution if the Appraisal was prepared by a broker or auctioneer with whom the collateral, if acquired, will be listed for sale.

e. The Recoverable Value of the collateral has been established;

f. The sale is supervised by the Lender (or appropriate SBA Loan Center if SBA has taken over servicing);

g. The costs of sale are reasonable, necessary and customary;

h. 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

i. All the net proceeds are applied to the principal balance of the SBA Loan.

3. UCC Sale

Lenders may foreclose liens on business assets such as equipment, inventory or fixtures created under UCC Article 9 by conducting a UCC sale.

a. Types of UCC Sales

(1) 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 or may not be advertised to the general public. Although public sales are preferred, a private UCC sale may be conducted if doing so maximizes recovery for the SBA Loan, e.g., when the personal property collateral is sold as part of the sale of a going concern business.

(2) Public Sale

A public UCC sale is open to the general public, occurs at a pre-appointed time and place, and is widely advertised. Lenders are encouraged to use widely

advertised public UCC sales.

(a) 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 lowered. Retail sales are often followed by a public auction of any remaining collateral.

(b) Sealed Bid Sale

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

b. UCC Sale Requirements

(1) Possession of the Collateral

UCC Article 9 § 609 permits secured creditors to repossess collateral without creating a "breach of the peace." () If this is not possible, Lenders should consult their legal counsel to determine whether litigation, such as a replevin action, is an appropriate and cost effective method to obtain possession of the collateral.

(2) Reasonable Notice of the Sale

Lenders must send a reasonable notice of the sale to all Obligors and junior lienholders, unless the collateral is perishable or sold in a recognized market such as the New York Stock Exchange. (UCC § 9-611) Lenders should send the notice of sale to all the Obligors and junior lienholders at least ten calendar days prior to the sale, to ensure compliance with UCC requirements. Lenders should document the Loan File with a copy of: (1) the post-Default UCC lien search verifying the priority of the lien securing the SBA Loan and the identity of any junior lienholders entitled to notice; (2) the notice sent to the Obligors and junior lienholders; and (3) proof that the notice was transmitted.

(3) 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:

(a) Post-default inventory and Appraisal of the sold property;

(b) UCC sale brochure and advertisements; and

(c) 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 a list of registered bidders, the name of each buyer, and the amount paid for each item.

c. UCC 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. (See UCC § 9-610 for additional information.)

d. Practice Tips

(1) How to Choose an Auction Company

Lenders should consider the following when choosing an auction company:

(a) Is it bonded? Does it have adequate insurance and the necessary licenses, including a dealer's license if the sale will include titled motor vehicles?

(b) Is it knowledgeable about the type of collateral that will be sold?

(c) Does it have experience attracting the appropriate customers for the type of property involved?

(d) Does it have a good reputation in the area? Reference checks?

(e) If it is not possible to hold the auction on the Borrower's business premises, does the company have a facility where the sale can be held?

(f) Can the auction company perform all of the duties associated with the auction? For example, can it handle the pre-sale preparation and inspection, the advertising, removal, and clean-up? And, most importantly, can it provide an accurate record of all aspects of the sale?

(g) Is the proposed fee arrangement reasonable, necessary and customary? When possible, Lenders should request and compare proposals from several companies and scrutinize the costs, particularly the advertising budget. Adequate advertising is essential for a successful auction and an unusually low advertising budgets may be a cause for concern. If the

company is paid on a commission basis, make sure that it will not also charge a buyer's premium, i.e., a percentage of the final bid amount (generally 10% – 20%) that is added on to the price like a sales tax and goes directly to the auction company as additional compensation.

> **Note:** A buyer's premium can also affect your net recovery because not as many people will attend the auction and those who do will bid lower because they know they will have to pay an extra 10-20% on top of the applicable sales tax.

(2) Leased Equipment

If the UCC search reveals that a valuable piece of equipment is leased, determine the residual amount owed on the lease and pay it off if doing so would (1) allow inclusion of the equipment in the UCC sale, (2) attract more potential buyers to the sale, and (3) maximize recovery for the Loan.

(3) Purchase Money Security Interests

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

(4) Hazardous Substances

If the collateral includes Hazardous Substances such as used chemicals, batteries or tires, ascertain whether there is a market for the Hazardous Substances. If so, encourage the Borrower to sell the Hazardous Substances and apply the net proceeds to the principal balance of the SBA Loan. (See Chapter 8 of this SOP for guidance on the release of liens for consideration. See EPA's website for a list of companies that purchase reusable hazardous waste.)

4. Judicial Foreclosure

Although the self-help remedies authorized by the UCC are more economical and efficient, filing a civil legal action to foreclose personal property liens is an option. For example, if the personal property collateral consists of trade fixtures attached to real property collateral and the real property lien must be judicially foreclosed, judicially foreclosing both the real and personal property liens in the same action may be appropriate.

5. Collection of Accounts Receivable

When an SBA Loan is secured by a lien on accounts receivable, Lenders should determine whether the pledged accounts have Recoverable Value as soon as possible after an event of Default. Thereafter, Lenders must take swift, aggressive action to collect any accounts with Recoverable Value in a manner that is consistent with applicable law.

a. Collection by Borrower

The Borrower, who is liable for any deficiency balance on the SBA Loan, is best able to handle disputed claims on their accounts. Lenders may allow Borrowers to collect accounts receivable provided that precautions are taken to ensure that the proceeds are applied to the SBA Loan balance.

b. Collection by Lender

In order to protect the right to a deficiency judgment, when it appears that further collection efforts by the Lender (or SBA if SBA has taken over servicing) would be futile, Lenders should provide the Obligors with written notice of the intent to cease collection efforts and give the Obligors the opportunity to pursue collection of the remaining accounts, provided that the proceeds are applied to the SBA Loan balance.

c. Collection of Foreign Accounts Receivable

When collateral includes foreign accounts receivable, as is commonly the case with EWCP Loans, Lenders must make demand for payment on the foreign accounts receivable. Lenders must also pursue collection from any domestic risk mitigation sources such as export credit insurance or international letters of credit. When all cost effective domestic-based efforts to collect foreign accounts receivable are exhausted, Lenders are not required to enforce collection from the Borrower's foreign customers outside of the United States. After documenting the Loan File for their actions, Lenders may treat the outstanding balances of foreign accounts receivable as uncollectable with no Recoverable Value.

6. Set-off of Deposit Account

When an SBA Loan is secured by a lien on a deposit account, on the occurrence of an event of default, Lenders should, in compliance with UCC § 9-607 and the terms of any applicable control agreement, ensure that the cash in the deposit account is applied to the SBA Loan balance.

7. Surrender of Life Insurance Policy for Cash Value

When a life insurance policy with a cash surrender value has been assigned as collateral for an SBA Loan and a deficiency exists after all of the other collateral has been

liquidated, Lenders should surrender the policy to the insurance company for the cash value and apply the proceeds 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, if made by the Lender or SBA are treated as Recoverable Expenses. (See Chapter 23 of this SOP for guidance on Recoverable Expenses.)

8. Foreclosure of Lien on Fixtures

Lenders may foreclose a lien on fixtures pursuant to UCC Article 9 or applicable real property foreclosure law. (UCC § 9-604) (See Subparagraph C.3 above for guidance on UCC sales, and Chapter 18 of this SOP for guidance on real property lien foreclosure.)

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

9. Marine Mortgage Foreclosure

Lenders may foreclose a marine mortgage on a documented vessel by filing an admiralty action in the appropriate federal district court, which will issue a warrant for the arrest of the vessel.

D. Credit Bids

1. Non-judicial Foreclosure Sales

Lenders must aggressively advertise non-judicial personal property lien foreclosure sales, e.g., UCC sales, in order to obtain the highest price and avoid acquiring title to the property. Unless the collateral has a high estimated Recoverable Value (e.g., state of the art printing equipment), it is not advisable to enter a Credit Bid or to establish a minimum bid or a reserve amount, because doing so could have a chilling effect on the bidding.

2. Judicial Foreclosure Sale

Lenders must enter a Credit Bid when a personal property lien securing an SBA Loan is judicially foreclosed. Lenders must consider the following factors when determining the amount of a Credit Bid: (a) Recoverable Value of the personal property collateral; (b) SBA Loan balance; and (c) need for and ability to collect a deficiency judgment. Lenders should base the Credit Bid amount on the Recoverable Value of the collateral; however, the Credit Bid should not exceed the Loan balance. Furthermore, Lenders should not bid the entire SBA Loan balance if doing so would eliminate an otherwise

collectible deficiency.

E. Abandonment

Lenders may abandon the pursuit of recovery from personal property collateral if the property has insignificant Recoverable Value, i.e., the individual or aggregate Recoverable Value is less than $5,000. Lenders must document their decision and justification for abandoning collateral, including the basis for the Recoverable Value estimate, in their Loan File. (See Chapter 5 [Environmental Risk Management] of this SOP for SBA requirements pertaining to the due diligence required to avoid abandoning collateral based on unsubstantiated claims that it is Contaminated, since the presence of Hazardous Substances may not significantly impair the market value of the collateral.)

Chapter 20.
Acquired Collateral

A. General Requirements

Certain methods of liquidation may result in the acquisition of real property collateral ("Real Estate Owned" or "REO") or personal property collateral. When collateral is acquired, Lenders should liquidate it in a manner that will maximize recovery in the shortest period of time.

B. Acquiring Title to Collateral

1. General SBA Policy and Requirements

a. Lenders should not acquire title to collateral unless it is necessary to maximize recovery for an SBA Loan.

b. To avoid acquisition, Lenders should aggressively advertise foreclosure sales in order to attract a large number of potential buyers.

c. Lenders must not take title to collateral in SBA's name without obtaining SBA's prior written approval. (13 C.F.R. 120.536(a)(4))

d. When approved by SBA, Lenders should state SBA's ownership of acquired collateral on the title as follows: "Administrator, U.S. Small Business Administration, an Agency of the United States Government."

2. Real Property

a. Lenders that anticipate reselling REO within 120 calendar days should take title in their own name. Because the Federal Government is exempt from paying future property taxes, Lenders that anticipate resale to take more than 120 calendar days should consult the appropriate SBA Loan Center about taking title in SBA's name.

b. Lenders must not take title to Contaminated property in their own name—or SBA's name—without SBA's prior written approval. (13 C.F.R. 120.536(a)(5)) (See Chapter 5 (Environmental Risk Management) of this SOP.)

3. Personal Property

Lenders should rarely, if ever, take title to personal property collateral in SBA's name, and must not take title in SBA’s name without SBA’s prior written approval.

C. Ownership Responsibilities

Lenders should take the following actions upon acquiring title to real or personal property

collateral:

1. Possession and Control

a. Take possession of the acquired collateral;

b. Change the locks immediately on vacant, improved REO. Depending on the circumstances, arrange for additional security if necessary to prevent damage or to avoid liability associated with ownership; and

c. Begin eviction proceedings if anyone is unlawfully occupying REO and will not leave voluntarily.

2. Inventory

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

3. Accounting

Upon taking title to real or personal property collateral, lenders must credit the SBA Loan(s) for the value of the acquired collateral, based on the foreclosure laws of the jurisdiction in which the property is located, and set up a new file in order to keep all accounting records associated with the acquired collateral, e.g., holding and resale costs, separate from the original Loan File. Lenders may not add expenses related to the acquired collateral to the SBA Loan balance. Lenders must share any gain and may share any loss on the sale of acquired collateral with SBA according to SBA's participation interest in the Loan after guaranty purchase. See Chapter 23 of this SOP for additional guidance on the remittance of recoveries and the submission of requests for reimbursement of recoverable expenses.

4. Taxes

Monitor and pay taxes and assessments to avoid liens, interest accrual and penalties.

5. Care and Preservation

Lenders should take reasonable steps to prevent deterioration of the acquired collateral, such as arranging for utility services and essential repairs and maintenance. If the property is listed on the National Register of Historic Places (NRHP) or has historic significance such that it may be eligible for listing on the NRHP, or is part of an historic district recognized by the NRHP, Lenders should consult with their legal counsel and the appropriate SBA Loan Center to ensure compliance with section 106 of the National Historic Preservation Act of 1966.

6. Insurance

See Chapter 9 of this SOP for SBA Loan Program Requirements pertaining to insurance coverage for acquired collateral.

7. Reporting Requirements

a. SBA Form 297

Lenders should consult with the appropriate SBA Loan Center to complete SBA Form 297 (Collateral Purchase Report) when REO is acquired in SBA's name; and

b. Ongoing Reporting Duty

Lenders should notify the appropriate SBA Loan Center immediately if there is any suspected risk of liability associated with the acquired collateral such as the presence of Hazardous Substances.

D. Expenses

1. General Requirement

Expenses related to acquired collateral must be necessary, reasonable and customary.

2. Payment of Expenses

Lenders should pay the expenses related to acquired collateral and seek reimbursement from SBA in accordance with the guidance provided in Chapter 23 of this SOP.

3. Recoupment of Expenses

Lenders may recoup necessary, reasonable and customary expenses related to acquired collateral as follows:

a. General Requirement—SBA Approval

SBA must review and approve any cost, fee or other amount associated with acquired collateral that a Lender seeks to recoup pursuant to the procedures set out in Chapter 23, Paragraph E of this SOP (Recoverable Expenses).

b. Recoupment Methods

(1) Deduction from Recoveries

Lenders may deduct the expenses associated with the acquired collateral from the acquired collateral sale proceeds.

(2) Reimbursement by SBA

Lenders may request SBA to reimburse any expense that was not deducted

from the acquired collateral sale proceeds.

c. Denied Expense Approval Requests

Lenders must reimburse SBA for the amount of any expense that SBA denies, when the Lender has already deducted the denied expense from the acquired collateral sale proceeds. Reconciliation of such expenses occurs when the Lender submits a final Wrap-up Report to the appropriate SBA Loan Center. See Chapter 27 of this SOP for additional guidance on Wrap-up Reports.

E. Timeframe for Disposal

Lenders should dispose of acquired collateral within 12 months of acquisition.

F. Sale

Lenders should make diligent efforts to sell all acquired collateral.

1. Method of Sale

Lenders should attempt to sell acquired collateral by whatever method (e.g., broker's sale, public auction, sealed bid sale, etc.) will maximize recovery in the shortest period of time.

2. Bidding or Acquisition by SBA Official or Lender

SBA officials and Lenders as well as their employees, Close Relatives and Associates must not, directly or indirectly, bid on, purchase or otherwise take title to acquired collateral, except pursuant to a written exception to policy in accordance with the procedures set out in Chapter 1 of this SOP.

3. Transfer of Title and Closing Costs

a. REO—Quitclaim Deed

Lenders should advise buyers that the buyer is responsible for all closing costs, and that title to the REO will convey by means of a quit claim 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 cost of title insurance, use of a warranty deed, or payment of the seller's customary share of the closing costs is necessary to maximize recovery in the shortest period of time.

b. Personal Property—Non-recourse Bill of Sale

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

4. Sales Price

Lenders should base their asking price for acquired collateral on the current appraised value of the property. (See the definition of "Appraisal" in Chapter 2 of this SOP for SBA guidelines pertaining to appraisals. See Chapter 5 (Environmental Risk Management) of this SOP for SBA requirements pertaining to the due diligence that Lenders must perform before selling acquired collateral for substantially less than its appraised value due to the alleged presence of Contamination.)

5. Use of Real Estate Brokers

Lenders may utilize the services of a real estate broker to list REO for sale provided that:

a. The terms of the listing agreement are not inconsistent with this SOP;

b. The listing price is supported by a current Appraisal;

c. The listing broker has a good reputation in the area where the property is located for selling the type of property involved, 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' commission 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, SBA and/or the Lender.

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

Lenders should not sell acquired collateral to Obligors, Close Relatives of Obligors, or Associates of the Borrower for less than the full appraised value of the property unless it is necessary to maximize recovery in the shortest period of time, and the following conditions are met:

a. A comprehensive public foreclosure sale of the collateral is/was held;

b. A good faith effort is/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

Obligor will continue to use the REO as the Obligor's primary residence; and

f. The sale will not harm the integrity of the SBA Loan program. (See Chapter 3, Paragraph C.3.d. and e. of this SOP for additional guidance regarding Loan Actions that require SBA's prior written approval.)

7. Purchase Offers

Lenders must handle all offers to purchase acquired collateral as follows:

a. Require all offerors to submit their offer in writing signed by the party making the offer, along with a good faith deposit in the form of a cashier's check for at least five percent of the purchase price;

b. Lenders must not disclose the offers they receive to other prospective purchasers or their agents; and

c. Lenders must review and analyze all offers based on the sales efforts to date and the value of the property established by a current Appraisal.

8. Term Sales

a. When Permitted

Lenders should not sell acquired collateral by means of a term sale unless doing so is necessary to maximize recovery.

b. Buyer Pre-qualification

Lenders must pre-approve potential purchasers buying on credit.

c. Terms of Purchase and Sale

With regard to all term sales, Lenders must require purchasers to:

(1) Make a down payment of at least 20 percent;

(2) Properly execute a promissory note for the balance of the agreed upon purchase price, which (a) is assignable; (b) has a maturity date that does not exceed 15 years for REO or 5 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) Obtain hazard insurance coverage for the replacement value of the asset(s) being sold that includes a mortgagee clause or equivalent in favor of the Lender (or SBA if SBA has taken over servicing), and any other type of insurance coverage required by statute, e.g., flood insurance, or prudent lending practices

9. Profit on Sale

Because the law varies from state to state, Lenders should consult with their legal counsel to determine whether there are any state specific laws governing the distribution of a surplus from the sale of acquired collateral. Lenders must remit any surplus to the appropriate SBA Loan Center along with a written explanation for how the surplus was created and a recommendation, based on applicable law, for how to distribute the surplus funds, e.g., retain by SBA, pay into the registry of the court, or distribute to junior lienholders.

G. Lease

Generally, Lenders should not lease acquired collateral. However, if the property has not sold after a reasonable period of time (e.g., one year), Lenders may lease acquired collateral if doing so is necessary to maximize recovery in the shortest period of time, 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 Lender to show the acquired collateral to prospective buyers, and can be terminated upon 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 Small Business unless a comparable or more financially beneficial proposal is unavailable;

6. Leasing the acquired collateral will not harm the integrity of the SBA Loan program; and

7. Lender inspects the leased property at least semi-annually and the inspection findings are included in the Lender's semi-annual status report on the Loan.

H. Abandonment

Lenders must not abandon acquired collateral (including REO) without SBA's prior written approval as an exception to policy in accordance with the procedures set out in Chapter 1 of this SOP.

Chapter 21.
Offer in Compromise

A. Offer in Compromise 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 SBA Loan. Submitting an offer does not ensure that a Lender or SBA will accept it. Rather, it begins a process of evaluation and verification by the Lender and SBA. Generally, SBA will accept an offer in compromise if it reflects the Obligor's true ability to pay. SBA will reject an offer 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 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 et seq. (Standards for the compromise of claims - by an agency of the federal government).

3. Effect of Compromise with One Obligor on the Obligations of Remaining Obligors

A compromise with one Obligor does not release the obligations of the remaining Obligors since each Obligor is jointly and severally liable for the SBA Loan they promise to pay or personally guarantee, i.e., Lenders may request full payment from one or all the Obligors. Lenders should make no attempt to divide payment responsibility between the Obligors or use the compromise amount with one Obligor as the basis for the compromise amount required from another. (31 C.F.R. 902.4)

4. Finality of Compromise Action

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

> **Note:** Lenders must advise Obligors that acceptance of a compromise offer is considered a loss to the Federal Government, which may adversely impact the Obligor's ability to obtain future financing from the Federal Government including another SBA Loan. Lenders should also advise Obligors that acceptance of a compromise offer could have tax consequences that the Obligor may want to consider.

B. When Compromise is Appropriate

1. Business Closed

Compromise with an Obligor is appropriate after the business has been closed and all the collateral has been liquidated.

Exception—Obligor's Personal Residence

As required by Chapter 18 of this SOP, before foreclosing a lien on an Obligor's personal residence, Lenders should make a good faith effort to negotiate a release of the lien for consideration and reach a compromise agreement regarding the amount the Obligor owes on their SBA Loan.

2. Going Concern

Compromising with a going concern business is only appropriate when the viability of the business is at stake and acceptance of the offer will not harm the integrity of the SBA Loan program. (See Paragraph D of this Chapter for detailed guidance on compromising with a going concern.) Lenders must not use the offer in compromise process as a means to write down the debt of a business that is experiencing temporary cash flow problems. (See Chapters 8 through 17 of this SOP for guidance on tools Lenders may use to resolve temporary cash flow problems such as re-amortization and/or deferment of Loan payments, or a Loan workout.)

3. Prior to Non-Judicial Foreclosure or Deed in Lieu of Foreclosure

When any deed in lieu of foreclosure or non-judicial foreclosure action will legally extinguish the remaining balance of an SBA Loan, Lenders must review and analyze such actions in accordance with the compromise guidelines provided in this Chapter 21.

C. General Compromise Requirements

The general requirements for compromising a debt owed on an SBA Loan are as follows:

1. Lenders should classify the Loan in liquidation status;

2. The Person making the offer must not currently be in bankruptcy, unless the bankruptcy court has permitted the compromise action;

3. The full amount owed on the Loan cannot be recovered because:

a. The Obligor is unable to pay it in a reasonable period of time;

b. It cannot be collected through legal proceedings within a reasonable period of time;

c. The projected cost of collection exceeds the projected recovery;

d. There is significant litigative risk, i.e., the likelihood of not prevailing in court due to legal issues or factual disputes;

e. Given the Obligor's special circumstances (e.g., illness), paying it would cause a Financial Hardship.

4. Collection of the Loan balance is not barred by a valid legal defense such as discharge in bankruptcy or the statute of limitations;

5. The Obligor has not engaged in fraud, misrepresentation or other financial misconduct; and

6. The compromise amount bears a reasonable relationship to the amount that the Lender or SBA could recover in a reasonable period of time through legal collection proceedings and is sufficient to protect the integrity of the SBA Loan program.

> **Note:** Obligors do not have a "right to compromise" the amount owed on their SBA Loan. In order to protect the integrity of the SBA Loan program, SBA will refer Obligors to Treasury for further collection actions rather than enter into a compromise agreement for a nominal amount relative to the amount owed on an SBA Loan. (31 C.F.R. §902.2(e)) (See Chapter 27, Paragraph D of this SOP for more information on SBA's referral of Loans to Treasury for further collection.)

D. Compromise with a Going Concern Business

In addition to the general requirements in Paragraph C above, the following guidance applies to compromise offers from going concern businesses:

1. The compromise must be necessary to avoid a closure of the business, i.e., the business must not be able to continue operating under its current debt structure and the Lender must have exhausted all other options to allow the business to remain viable including the sale of non-essential assets and the closure of non-profitable business segments or locations;

2. The Borrower must pass the feasibility test for a successful workout set forth in Chapter 17 of this SOP;

3. The compromise must be part of an overall debt restructuring plan that involves all of the Borrower's creditors;

4. The Lender must provide specific details regarding all the Borrower's secured and unsecured debt and the Borrower must provide the debt reduction arrangements it has made with each of its other creditors, in a written agreement signed by all the Borrower's creditors; and

5. The Borrower's proposed treatment of the SBA Loan must be fair and equitable in comparison to the treatment to be received by the Borrower's other creditors, including the

percentage of debt to be forgiven, whether collateral is provided or retained if the compromise amount is to be paid in installments, and whether other lenders are allowed to participate in an asset appreciation sharing agreement.

E. Compromise Offer and Supporting Documents

Unless the basis for compromise is litigative risk, Lenders must require each Obligor submitting an offer in compromise to provide the following documents:

1. Written Offer

A signed written offer that must 1) refer to the penalties under 18 U.S.C. §1001 for false statements, 2) identify the source of the funds for the offer, e.g., SBA Form 1150 (Offer in Compromise), and 3) explain any special circumstances that the Obligor would like taken into consideration, such as an illness that is causing Financial Hardship (see Chapter 2 of this SOP for the definition of Financial Hardship);

2. Financial Statements

A current financial statement, signed under penalty of perjury, showing the Obligor's assets, liabilities, income and expenses, e.g., SBA Form 770 (Financial Statement of Debtor). In addition:

a. Going Concern Businesses—If the SBA Loan Borrower is a going concern business, the Obligor submitting an offer must also provide the most recent year-end financial statements for the business.

b. Affiliates—If the Obligor submitting an offer has any affiliates, the Obligor must provide a current financial statement for each affiliate.

3. Personal Federal Income Tax Returns

A complete copy of the personal federal income tax returns the Obligor filed with the IRS for the most recent two years, or a written explanation as to why a copy is not available, together with an executed IRS Form 4506-C or Form 8821 (Request for Transcript of Tax Return); and

4. Business Federal Income Tax Returns

If the offeror is a going concern business, the Borrower must provide complete copies of the federal income tax returns for the business and any affiliates that were filed with the IRS for the most recent two years, or a written explanation as to why a copy is not available, together with an executed IRS Form 4506-C or Form 8821 (Request for Transcript of Tax Return).

F. Review and Analysis of Offer in Compromise

To determine whether an offer in compromise is acceptable, Lenders must make a good faith

effort to verify the accuracy of the financial disclosure submitted by each Obligor making an offer, to evaluate the adequacy of the amount offered.

1. Corroborating Evidence

Lenders must obtain independent financial information to determine whether the financial information submitted by an Obligor making an offer is complete and accurate. At a minimum, this should include a current credit report. (31 C.F.R. §902.2)

2. Adequacy of Financial Disclosure

At a minimum, Lenders must compare the financial information an Obligor submitted with the original Loan application, and any subsequent financial disclosures, to the financial information the Obligor submits with the offer to compromise their obligation(s) for the Loan. Lenders must investigate and explain any major discrepancies. For example, Lenders should investigate concerns about the accuracy of tax returns submitted with an offer in compromise by ordering and comparing the tax returns to IRS transcripts for the same tax years. Lenders should document all their efforts to establish the validity of the Obligor's current financial information in their Loan File.

3. Amount Recoverable Through Legally Enforced Collection Actions

Lenders must perform an analysis to determine the amount that could be recovered from the Obligor in a reasonable period of time through enforced legal collection proceedings. Lenders should, for example, take the following factors into consideration:

a. Recoverable Value of any collateral for the Loan that the Lender has not already liquidated (e.g., the Obligor’s personal residence);

b. Exemptions available under state and federal law;

c. Amount that the Lender could recover from the offeror’s non-exempt assets that were not pledged as collateral, through legally enforced collection proceedings, e.g., by obtaining a judgment and attaching/executing it to achieve a recovery from the other assets an offeror may own;

d. Amount of present and potential income that the Lender or SBA could obtain through enforced collection proceedings, e.g., administrative wage garnishment after referral to Treasury;

e. Litigative risk, i.e., the likelihood of not prevailing in court due to legal issues or factual disputes;

f. The necessary, reasonable and customary administrative and litigation expenses the Lender would incur to enforce collection actions;

g. The time it would take to enforce collection; and

h. The possibility that Obligors have and/or will conceal and/or or fraudulently convey assets.

4. Adequacy of Proposed Compromise Amount

a. Standard of Review

The compromise amount must bear a reasonable relationship to the amount that the Lender and SBA could recover in a reasonable period of time through enforced collection proceedings, and must sufficiently protect the integrity of SBA Loan programs.

> **Note:** Obligors do not have a "right" to compromise the amount they owe on their SBA loan. In this regard 31 C.F.R. §902.2(e) states: "…agencies should consider whether continued collection of the debt, regardless of cost, is necessary to further an enforcement principle, such as the Government's willingness to pursue aggressively defaulting and uncooperative debtors."

b. Minimum Amount

Lenders should generally consider and submit compromise offers of $5,000 or more.

c. Hardship Exception

Lenders may consider and submit compromise offers of less than $5,000 if a larger amount would cause Financial Hardship. (See Chapter 2 of this SOP for the definition of Financial Hardship.)

d. Obligor's Cooperativeness

When analyzing whether a proposed compromise offer is adequate, Lenders may give consideration to the extent of an Obligor's cooperation during the liquidation process to increase the overall recovery for the SBA Loan.

G. Inadequate Compromise Offers

1. Counteroffer

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 the Lender and/or SBA could recover in a reasonable period of time through enforced collection actions, Lenders should make a good faith effort to increase the offer to an acceptable level by making a counteroffer.

2. Decline Offer and Refer to Treasury

If the Obligor will not agree to an acceptable compromise amount, Lenders should decline the offer, complete all other cost-effective liquidation actions, and submit a Wrap-up Report to SBA to enable SBA to charge off and refer the Loan to Treasury for offset and other enforced collection actions. (See Chapter 27 of this SOP for additional information.)

> **Note:** Lenders should not forward unacceptable offers and counteroffers to SBA. See Paragraph I of this Chapter for guidance on when Lenders must submit offers in compromise to SBA for prior written approval.

H. Compromise Payment Terms and Conditions

1. Cash Compromise Offers—Preferred

Lenders should encourage offerors to remit compromise offers in a lump sum on a specified date, within 60 calendar days of the compromise approval date.

2. Term Compromise Offers—If Necessary to Maximize Recovery

Lenders should avoid negotiating compromise offers that are payable in installments over time unless installment payments are necessary to maximize recovery for an SBA Loan. (31 C.F.R. §902.2(f)) If compromise offers are paid in installments:

a. The installment payments should satisfy the debt in three years or less. (This is incorporated in 31 C.F.R. §901.8(b) – Collection in Installments.)

b. The Lender and offeror must establish the terms of the compromise payments in a written, legally enforceable document;

c. Lenders must require the offeror(s) to execute a promissory note with a specified maturity date for the amount due under the compromise agreement;

d. Lenders should require the offeror(s) to provide collateral to secure the promissory note;

e. The compromise agreement should prohibit the release of collateral securing the promissory note until the entire compromise amount is paid in full;

f. The compromise agreement must provide that in the event of default, the Lender and SBA will reinstate and make the full balance of the original SBA Loan, less sums paid the on promissory note, immediately due and payable; and

g. 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 any deed or

bill of sale to the collateral securing the promissory note.

I. Obtaining SBA Approval of Compromise Actions

Lenders must obtain SBA's prior written approval before entering into a compromise agreement that will result in less than full payment of the outstanding principal balance of the Loan. (13 C.F.R. §120.536(a)(3)) Lenders should submit requests for approval to the appropriate SBA Loan Center utilizing the format set out in the Offer in Compromise (OIC) Tabs, which is accessible from www.sba.gov/for-lenders. Failure to obtain SBA's prior written approval could result in a repair or denial of the guaranty.

Note: If a compromise involves settlement of litigation involving SBA in conjunction with the U.S. Attorney's Office, the U.S. Attorney's Office must approve and receive payment for the compromise amount.

J. Completing the Compromise Process

1. After all necessary parties have approved the compromise action, Lenders must take the following actions: Prepare and obtain the necessary signatures on a mutual release that is effective when the compromise amount is paid in full (i.e., upon payment of the compromise amount, SBA and the Lender will release the Obligor from further non-tax liability on the Loan and the Obligor will release SBA and the Lender from all claims and causes of action arising from the Loan);

2. Collect the compromise amount, or if the compromise agreement involves installment payments, set up a separate accounting record for the promissory note, properly perfect the lien on any asset offered to secure payment of the promissory note, and reference the note receivable number that SBA will assign to the promissory note account rather than the parent Loan number when remitting payments to the Denver Finance Center;

3. Promptly apply the compromise amount to the principal balance of the Loan;

4. Release the appropriate Loan Documents after verifying that the entire compromise amount has been received; and

5. If there is no legal remedy to collect the Loan balance (e.g., from another Obligor) after the compromise amount is received, submit a Wrap-up Report to SBA to enable SBA to charge off the remaining balance of the Loan.

6. SBA may consider full payment of the outstanding principal balance of a Loan as payment in full for the Loan, when supported by the analysis required by this Chapter. In such cases, if the Borrower demonstrates good cause in accordance with 13 CFR §120.110(q), SBA may exclude the reporting of unpaid accrued interest as a prior loss to the government.

Chapter 22.
Litigation

This chapter provides guidelines and requirements with regard to conducting litigation activities and incurring Debt Collection Litigation Expenses for 7(a) Loans. (See also Chapter 3 of this SOP regarding Lender litigation responsibility and authority.)

A. General Requirements

Litigation involving SBA Loans must be:

1. **Necessary, Reasonable and Customary for the Locality;**

2. **Cost Effective;**

   a. **Due Diligence**—Any Person conducting litigation to collect an SBA Loan must exercise sufficient due diligence prior to initiating any legal action, to ensure that the contemplated action is cost-effective.

   b. **Alternative**—After the Lender has liquidated the collateral and determines that there are no further cost-effective options to collect the deficiency balance of an SBA Loan, the Lender must submit a Wrap-up Report to SBA to enable SBA to charge off and refer the Loan to Treasury for further legally authorized collection actions, including the use of tools such as federal offset, administrative wage garnishment, and/or Department of Justice (DOJ) litigation. Lenders receive a pro-rata share of the net amount recovered by Treasury. (See Chapter 27 of this SOP for additional information on Wrap-up Reports and SBA charge off.)

3. **Conducted in the Name of the Person Responsible for the Litigation**

   Lenders are not authorized to conduct litigation in SBA's name and must not take any action in litigation proceedings that SBA is handling, including the filing of a proof of claim;

B. Legal Counsel Hired by Lenders

Any attorney selected by a Lender to perform litigation on an SBA Loan must meet the following minimum qualifications:

1. Hold an active license to practice law in the state where the litigation will be conducted;

2. Maintain an office and practice regularly in the general locale or judicial district where the majority of the litigation will occur, unless otherwise pre-approved by SBA;

3. Possess appropriate expertise for the proposed areas of litigation;

In most cases, the attorney must have expertise in bankruptcy and debt collection. If complex litigation is necessary, the attorney should have specialized legal expertise and substantial experience conducting the particular type of proceedings; e.g., an attorney hired to have a receiver appointed to operate or sell a gas station must have expertise not only in debt collection and bankruptcy law, but also environmental and receivership law with prior experience handling gas station receivership cases;

4. Have adequate legal malpractice insurance coverage; and

5. Have no actual or apparent conflict of interest with SBA, the Lender, an Obligor, a Guarantor, senior lienholder, junior lienholder, landlord, competing creditor, or any other Person involved in the issues pertaining to the SBA Loan.

Note: SBA will not approve fees and expenses for a non-local firm to manage or oversee a local firm's litigation activities. If extraordinary circumstances exist, SBA may pre-approve the use of and reimbursement of a non-local firm to engage the services of a local firm. The local firm must meet the qualifications required by SBA to perform the litigation. However, even in such situations, SBA will not approve the fees and costs of a non-local firm to manage or oversee the services of a local firm.

C. Litigation Plans

1. Litigation Plan Purpose

Lenders must submit a Litigation Plan to the appropriate SBA Loan Center for SBA District Counsel approval prior to initiating any Non-Routine Litigation on an SBA Loan. Lenders should use the current SBA template or submit identical information.

Although Lenders are not required to submit Litigation Plans for Routine Litigation to SBA, Lenders should prepare a Litigation Plan for Routine Litigation for their own use because, when properly and completely prepared, a Litigation Plan helps to ensure that the litigation is cost-effective, necessary, reasonable and customary. Litigation Plans also expedite SBA's review of requests for approval of the Plan and/or reimbursement of Debt Collection Litigation Expenses if a Non-Routine Litigation Plan becomes necessary. If prepared, Lenders should keep the Litigation Plan for Routine Litigation in their Loan File.

Note: Lenders must prepare a Litigation Plan prior to initiating any Non-Routine Litigation for an SBA Loan, even if the Lender anticipates deducting litigation fees and expenses from the liquidation recoveries for the Loan.

2. Format and Content of Litigation Plan

The template for preparing a Litigation Plan for a 7(a) Loan is accessible from www.sba.gov/for-lenders. Lenders must include documentation establishing that the proposed attorney meets the requirements of Paragraph B above, with their Litigation Plan. The plan must also include the estimated cost and justification for any expense that SBA may otherwise deem unreasonable, such as costs associated with travel, hiring multiple law firms, using a non-local firm, or appointing a receiver to perform routine liquidation activities. (See Subparagraph D.3 of this Chapter for additional guidance on reasonable legal expenses.)

3. When Lenders Must Submit a Litigation Plan to SBA

a. General Rule

(1) Litigation Plan (13 C.F.R. §120.540(c))

Except as provided in Paragraph C.3.b. below with regard to emergencies, all Lenders must prepare and submit a Litigation Plan to the appropriate SBA Loan Center for SBA District or Center Counsel written approval prior to initiating Non-Routine Litigation. Except for Loans approved under CLP authority, Lenders are not required to submit a Litigation Plan to SBA prior to initiating Routine Litigation. For any change in Routine Litigation that elevates a legal action to Non-Routine Litigation status, e.g., when actual or projected Debt Collection Litigation Expenses exceed $10,000 in the aggregate, or when the legal issues are contested, Lenders must submit a Non-Routine Litigation Plan to SBA. In such cases, Lenders must submit a Non-Routine Litigation Plan to SBA within thirty (30) days of the litigation becoming non-routine, including 30 days from the date that a legal fee invoice reflects aggregate Debt Collection Litigation Expenses in excess of $10,000. (See Chapter 2, Paragraph A.12 of this SOP for the definition of Debt Collection Litigation Expenses.)

Note: As explained in Subparagraph D.2. of this Chapter, SBA will not reimburse Lenders for legal fees and expenses incurred for Non-Routine Litigation that were not included and submitted in an initial or amendment to a Litigation Plan and approved by SBA District Counsel prior to the incurrence of such fees and expenses, except under the emergency situations set forth below.

Note: With regard to CLP loans, Lenders should include Routine Litigation in the Liquidation Plans they are required to submit to SBA for approval by the appropriate SBA Loan Center. (See Chapter 15 of this SOP for additional guidance on CLP Liquidation Plan requirements.)

(2) Amendment to Litigation Plan

Lenders must submit an amendment to a Litigation Plan to SBA for approval

by SBA District Counsel prior to taking any legal action or incurring any expense that materially deviates from the original Litigation Plan. Material changes include activities that cause actual or projected legal fees to exceed the previously approved budget by more than 15 percent.

b. Limited Waiver of Prior SBA Approval for a Litigation Plan or Amendment to a Litigation Plan (13 C.F.R. §120.540(f))

(1) SBA may in its discretion, and upon written request by a Lender, waive the requirement for SBA's prior approval of a Litigation Plan or an amendment to a Litigation Plan if one of the following extraordinary circumstances exist.

(a) Expeditious action is required to avoid potential risk of loss on the Loan or the potential for dissipation of collateral;

(b) An immediate response to litigation initiated by a Borrower, Guarantor or third party is required; or

(c) Another urgent need arises.

(2) A Lender may take legal action to respond under the preceding circumstances without SBA District Counsel's written approval of a Litigation Plan or amendment to a Litigation Plan, provided that the Lender:

(a) Makes a good faith effort to obtain SBA District Counsel's written approval before undertaking the emergency action;

(b) Submits a written Litigation Plan or amendment to a Litigation Plan to the appropriate SBA Loan Center for SBA District Counsel's review and approval as soon as possible after the emergency occurs; and

(c) Takes no further litigation action without SBA District Counsel's written approval of the Litigation Plan or amendment to a Litigation Plan.

c. Obtaining SBA Approval of Litigation Plan

Lenders must submit a request for approval of a proposed Litigation Plan or amendment to a Litigation Plan in writing to the appropriate SBA Loan Center, for SBA District Counsel approval prior to taking any action contemplated by the Litigation Plan, except under the emergency situations set forth above.

4. SBA Response Time—No Implied Consent (13 C.F.R. §120.541)

Generally, SBA will respond to Lender requests for approval of proposed Litigation Plans or amendments to Litigation Plans within 15 business days from the date that SBA receives the request. However, if a Lender does not receive a response from SBA within that time frame, it may not conclude that SBA has approved the request.

5. Appeal of SBA District or Center Counsel Decision on Litigation Plan

See Chapter 3 of this SOP for guidance on how to appeal the decision of an SBA District or Center Counsel regarding a proposed Litigation Plan or amendment to a Litigation Plan.

D. Debt Collection Litigation Expenses

1. Debt Collection Litigation Expenses Covered by SBA Loan Guaranty

SBA's Loan guaranty covers Debt Collection Litigation Expenses (e.g., court filing fees, court reporter and transcription fees) incurred to achieve a recovery for an SBA Loan, which are necessary, reasonable and customary for the locality in which the litigation proceeding is filed.

2. Debt Collection Litigation Expenses Incurred without a Pre-approved Litigation Plan

SBA will not reimburse Debt Collection Litigation Expenses incurred for Non-Routine Litigation if they were not included and submitted in a Litigation Plan or an amendment to a Litigation Plan and approved by SBA District or Center Counsel prior to the incurrence of such Debt Collection Litigation Expenses, except under the emergency situations set forth in 13 C.F.R. §120.540(f).

For Litigation Plans that SBA has previously approved, SBA will not reimburse Debt Collection Litigation Expenses incurred in excess of 15 percent of the amount most recently approved by SBA Center or District Counsel in a Litigation Plan or an amendment to a Litigation Plan. (Example**:** SBA approves a legal budget of $20,000. Lender seeks reimbursement of $40,000 (expenses increased by 100 percent). Lender was required to submit an amendment to the Litigation Plan because expenses increased by more than 15 percent. SBA District Counsel may approve up to $23,000 of the Debt Collection Litigation Expenses (the originally approved $20,000 plus 15 percent) and decline $17,000 (the remaining 85 percent)).

3. Unreasonable Debt Collection Litigation Expenses

SBA presumes that litigation expenses related to any of the following categories are unreasonable unless the Lender provides justification for incurring the expense that in SBA's sole discretion is sufficient to rebut the presumption:

a. Overhead, including conflict-of-interest determinations, file set up, calendaring, secretarial work, billing for preparation of a Litigation Plan or an amendment to a Litigation Plan;

b. Intra-law firm communications and billing by more than one person for the same activity;

c. Inter-law firm communications and billing by more than one law firm for the

same activity when the justification for using more than one law firm was not included in a Litigation Plan that was pre-approved by SBA District Counsel. SBA will not approve the fees and costs of a non-local firm to manage or oversee the services of a local firm;

d. Attorney fees and costs associated with travel that were not justified and itemized in a Litigation Plan that was pre-approved by SBA District Counsel;

> **Note:** Lenders are expected to hire local legal counsel maintaining an office and practicing regularly within the judicial district where the majority of the litigation is conducted. However, SBA recognizes that in extraordinary circumstances, hiring counsel from another geographic area may be necessary, reasonable and customary. If so, Lenders should include the justification and estimated travel expenses in such circumstances in the Litigation Plan submitted to SBA for approval by SBA District Counsel.

e. Performance of routine Loan servicing and/or liquidation duties such as the preparation of a Liquidation Plan, Universal Purchase Package or Protective Bid analysis;

> **Note:** Activities such as handling a non-judicial foreclosure actions or issuing a final demand letter in Routine Litigation involving an uncontested judicial foreclosure proceeding, if such activities are normally handled by an attorney pursuant to local rules or practice, are not considered unreasonable.

f. Assertion of a claim, cross claim, counterclaim, or third-party claim against SBA, including all routine communications between Lender's counsel and SBA;

g. Rectifying Lender errors that would justify a partial Denial of Liability, Repair, or full Denial of Liability;

h. Defense of an action brought by SBA against a Lender;

i. Defense of a claim by an Obligor or other Person seeking damages based on a Lender's alleged wrongful action, unless SBA expressly directed the Lender to take the alleged wrongful action;

j. Services rendered by Lender's in-house counsel;

k. Services pertaining to Non-Routine Litigation handled by Lender's legal counsel that were not pre-authorized in writing by SBA Legal Counsel;

l. Debt Collection Litigation Expenses that exceed the recovery obtained in

affirmative litigation;

m. The appointment of a receiver to perform routine liquidation activities; and

n. Generic and non-itemized bills for Debt Collection Litigation Expenses.

E. Particular Litigation Activities

1. Suit for Judgment on Note or Guaranty

a. When Lenders Should File Suit

Lenders should file a suit based on an event of Default on the Note or Guaranty for an SBA Loan to obtain a judgment against an Obligor when the Obligor:

(1) Does not have a valid legal defense to repayment, e.g., discharge in bankruptcy;

(2) Has the ability to repay the SBA Loan in full or substantial part;

(3) Is unwilling to repay the Loan or to engage in good faith compromise negotiations; and

(4) Litigation is a cost-effective method for collecting the Loan balance.

b. Referral to Treasury for Enforced Collection

Lenders must submit a Wrap-up Report to SBA after all cost effective recovery actions are completed, to enable SBA to charge off and refer the remaining balance of the Loan to Treasury for further collection actions, including a suit for judgment filed by DOJ, if warranted. (See Chapter 27 of this SOP for information on Treasury collection actions. See Chapter 15 and Chapter 21 of this SOP for guidance on how to assess an Obligor's repayment ability for legally enforced collection actions. See Chapter 26 of this SOP for guidance on how to report fraud and abuse to the SBA Office of the Inspector General.)

2. Judicial Foreclosure and Deficiency Judgment

Although non-judicial foreclosure is generally preferable, state law may require judicial foreclosure, or certain circumstances support the use of judicial foreclosure. For example, judicial foreclosure is appropriate in some states when the proceeds of a non-judicial foreclosure sale are insufficient to pay the SBA Loan in full and a judgment is needed to collect the deficiency balance of the Loan from the other Obligors.

3. Settlement Offers

Lenders must review, analyze and process offers to settle ongoing litigation pursuant to the requirements in Chapter 21 (Offer in Compromise) of this SOP.

4. Bankruptcy Proceedings

Note: For general information about federal bankruptcy laws, local bankruptcy rules, and local court processes, Lenders should check the website of the local United States Bankruptcy Court.

a. Impact of Automatic Stay on Collection Activities

The moment a bankruptcy petition is filed, the automatic stay stops all lawsuits, foreclosure actions, garnishments, and most collection activities against the debtor. Upon learning that an Obligor has filed a bankruptcy petition (the "debtor" in the bankruptcy proceedings as used in this Subparagraph E.4), , Lenders should consult their legal counsel regarding the impact of the automatic stay on any pending or contemplated collection actions. Unless the Lender's legal counsel determines that the automatic stay is lifted or no longer in effect, all Lender collection actions against the debtor must immediately stop. (11 U.S.C. § 362)

b. Notice Requirements

(1) Pre-charge Off and Pre-Referral to Treasury

Upon receipt of a bankruptcy notice involving an Obligor, including notices pertaining to Chapter 7 "no-asset" cases, the Person receiving the notice must immediately notify the appropriate SBA Loan Center and SBA District Counsel to enable SBA to monitor the bankruptcy case.

(2) Post-Charge Off and Post-Referral to Treasury

Upon receipt of a bankruptcy notice involving a Loan that SBA has charged off and referred to Treasury, the Person receiving the notice must ensure that the automatic stay is not violated by immediately notifying the SBA Treasury Offset Division in Birmingham, Alabama so that SBA may recall the Loan from Treasury and take appropriate action. (SBA has sole responsibility and authority for handling litigation on Loans referred to Treasury). Lenders should fax or email the notice, including the Borrower's name and SBA Loan number, to:

Supervisory Loan Specialist
Treasury Offset Division
Fax: 202-481-5706
Email: BirminghamTOPS@sba.gov
Phone: 1-800-736-6048 Extension 3917

c. Litigation Requirements

If an Obligor files for bankruptcy protection, Lenders must notify the appropriate SBA Loan Center in accordance with Subparagraph 4.b above, and should take the following actions, at a minimum, when necessary to protect the ability to recover on the SBA Loan:

(1) File a proof of claim;

(2) Review the debtor's statement of financial affairs and schedules, and compare them with the financial documents the debtor provided to the Lender and/or SBA to determine if there are any material discrepancies with regard to the debtor's alleged assets, liabilities, income or expenses;

(3) Report suspected fraud to the Office of the Inspector General (see Chapter 26 of this SOP) and the appropriate Office of the U.S. Trustee;

(4) Monitor the bankruptcy proceedings;

(5) Represent the Lender and SBA's interests at all hearings where the outcome may adversely affect the ability to collect the SBA Loan balance;

(6) File a motion for relief from the automatic stay when necessary to pursue enforced collection proceedings against the collateral;

(7) File an objection to discharge of the debt owed on the SBA Loan if there is reason to believe that the debtor obtained the Loan through fraud, misrepresentation or omission of a material fact, or fraudulently transferred or converted collateral;

(8) File a motion to revoke the debtor's discharge if there is reason to believe that it was obtained through fraud or other acts of impropriety;

(9) Obtain the bankruptcy court's approval of a reaffirmation agreement if the debtor is willing and able to continue paying the SBA Loan;

(10) Review proposed plans and disclosure statements and file an objection when necessary;

(11) Cast a vote to accept or reject proposed plans based on an analysis of the relevant facts (subject to obtaining prior SBA written approval to vote in favor of any bankruptcy plan that results in less than full payment of the SBA Loan);

Note: SBA's prior written approval is required before a Lender may compromise the principal balance of an SBA Loan. (13 C.F.R. §120.536(a)(3)) If a proposed bankruptcy plan calls for a reduction or "cram down" of the principal balance owed on an SBA Loan, the Lender handling

the litigation must obtain SBA's prior written approval before voting in favor of the plan (but not before voting against the plan), regardless of whether there are additional Obligors who will remain responsible for the Loan balance. Lenders should submit a Servicing Request for such actions to the appropriate SBA Loan Center.

(12) Resume collection efforts immediately if the bankruptcy case is dismissed and the SBA Loan is still in Default; and

(13) Take any other action that is necessary and appropriate under the circumstances.

5. Probate Proceedings

In addition to collecting and applying the proceeds from any life insurance policy assigned as collateral for an SBA Loan, if an Obligor dies, Lenders should take the following actions, at a minimum, when necessary to protect the ability to achieve a recovery for the Loan:

a. File a creditor's claim in the appropriate probate court within the time frames prescribed by applicable law;

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

b. Review the inventory of the decedent's estate and compare it with the financial documents the decedent provided to the Lender and/or SBA to determine if there are any material discrepancies;

c. Report suspected fraud to the SBA Office of the Inspector General (see Chapter 26 of this SOP);

d. Monitor the probate proceedings;

e. Represent SBA and the Lender's interests at all hearings where the outcome may adversely affect the ability to collect the SBA Loan balance; and

f. Take any other action that is necessary and appropriate under the circumstances.

6. Enforcement of Judgments

a. Recordation of Judgment

After Lenders obtain a judgment against an Obligor, the Lender must record the judgment, or an abstract thereof, in any state or other jurisdictional unit where the

Obligor resides or has assets that the Lender or SBA can seize and sell to satisfy the judgment.

b. Enforcement and Execution of Judgment

Lenders should take all reasonable, necessary, and cost-effective actions to enforce and recover on any judgment obtained against an Obligor (the "judgment debtor") as soon as it is practicable and cost-effective to do so. Lenders should take significant steps to execute upon the judgment debtor's non-exempt assets within 90 calendar days of obtaining the judgment.

c. Assignment of Judgment to SBA

After obtaining a judgment against an Obligor, Lenders must submit a Wrap-up Report to SBA, including an assignment of the judgment to SBA, if the only or most cost-effective way to collect on the judgment is to utilize a remedy that is available to SBA, but not the Lender. For example, SBA may have more favorable collection options and timeframes under the Federal Debt Collection Procedures Act. If SBA services the Loan after guaranty purchase, Lenders must properly assign the judgment to SBA.

F. Application of Litigation Recoveries

Lenders must apply funds recovered through the litigation process in the following order:

1. Recoverable Expenses;
2. Principal Loan balance;
3. Accrued interest.

> **Note:** When litigation is handled by SBA District Counsel in their capacity as a Special Assistant U.S. Attorney or by the local U.S. Attorney's Office, DOJ is authorized to collect and retain a 10 percent surcharge pursuant to Section 3011 of the Federal Debt Collection Procedures Act.

G. Litigation Plan Documentation & Updates

1. General Litigation Plan Requirements

Lenders must justify and document all Routine and Non-Routine Litigation activities. Lenders must keep the documentation, including pleadings and all Supporting Documents such as letters, financial statements, credit reports, Appraisals, title reports and UCC lien searches, in the Lender's Loan File.

2. Routine Litigation

Unless specifically requested, Lenders are not required to provide copies of pleadings or other documents pertaining to Routine Litigation to the SBA Loan Center; except as required by Chapter 23 (Expenses and Recoveries) of this SOP to support requests for approval or reimbursement of Recoverable Expenses.

3. Non-Routine Litigation

Lenders must retain all pleadings (e.g., complaints and answers, motions and opposing pleadings, orders and judgments, bankruptcy plans, bankruptcy motions and opposing pleadings, and discharge orders) and the Supporting Documents, (e.g., letters, financial statements, credit reports, Appraisals, lien searches, etc.) in their Loan File and provide them to the SBA Loan Center and/or SBA District Counsel upon request.

4. Litigation Status Reports – see Chapter 3 Subparagraph F.4 of this SOP.

H. SBA Takeover of Lender-Serviced Litigation (13 C.F.R. §120.540(d))

SBA may take over the litigation for an SBA Loan that the legal counsel hired by a Lender is handling, if SBA determines that it is in SBA's best interest to do so. Situations in which the SBA may take over litigation from a Lender include, but are not limited to, the following:

1. The outcome of the litigation could adversely affect SBA's administration of the Loan program;

2. SBA, as an Agency of the federal government, has legal remedies for the particular case that are not available to the Lender;

3. The litigation involves important government policy or program issues;

4. The case appears to have great precedential value;

5. The Lender has an actual, apparent or potential conflict of interest with SBA; or

6. The legal fees charged by Lender's counsel are not reasonable, necessary or customary.

I. Reimbursement Requests for Debt Collection Litigation Expenses

1. SBA Approval of Debt Collection Litigation Expenses

SBA must provide a written decision for reimbursement of all Debt Collection Litigation Expenses that a Lender actually incurs and seeks to recoup as a Recoverable Expense, even if such attorney fees and costs were anticipated and within the budget of an SBA-approved Litigation Plan. SBA will review such Debt Collection Litigation Expenses in accordance with the standards set forth in Chapter 23 of this SOP, and 13 C.F.R. §120.540 and 13 C.F.R. §120.542.

2. How to Obtain SBA Approval of Debt Collection Litigation Expenses

Lenders must submit requests for reimbursement of Debt Collection Litigation Expenses along with the required Supporting Documents to the appropriate SBA Loan Center for review and approval pursuant to the procedure set out in Chapter 23 (Expenses and Recoveries) of this SOP.

3. Best Practices for Debt Collection Litigation Expense Reimbursement Requests

a. Lenders should include a narrative summary of the litigation in the reimbursement requests they submit with their Wrap-up Report. .

b. Lenders should include a summary tabulation page listing and totaling all the invoices in chronological order.

c. Lenders should also submit the actual invoices in chronological order.

(1) Each invoice should itemize the legal activity, the date undertaken, the attorney/professional who performed the work, a detailed description of the activity, the hourly rate charged, and the time spent. Lender's legal counsel should avoid "block" billing and vague generic descriptions, and itemize time in increments of one tenth of an hour (0.1 hour or six minutes).

(2) The invoices should itemize all other reimbursable legal fees and costs.

d. Lenders should include information on the recoveries realized through the litigation process in their requests for reimbursement of legal expenses.

Chapter 23.
Expenses and Recoveries

This chapter covers expenses that Lenders may incur to collect sums due under the Note, enforce the terms of the Loan Documents, and preserve and/or dispose of collateral for an SBA Loan. See Chapter 20 of this SOP for guidance regarding expenses related to acquired collateral.

A. Classification of Expenses

SBA classifies expenses involving an SBA Loan as either Recoverable Expenses, which are reimbursable by SBA, or Non-Recoverable Expenses, which SBA does not reimburse. (See Paragraphs C and D of this Chapter for additional guidance on Recoverable and Non-Recoverable Expenses.) When reviewing Lender requests for approval and/or reimbursement of expenses, SBA may determine that an expense is Recoverable or Non-Recoverable in whole or in part.

1. Non-Recoverable Expenses

Non-Recoverable Expenses are costs that a Lender may not add to the principal balance of an SBA Loan. These costs include, for example:

a. Any expense that is not related to collection of amounts due under the SBA Loan Note and/or to the preservation or disposal of collateral for the Loan;

b. Any fee or cost, or portion thereof, that is not necessary, reasonable or customary;

c. Overhead costs that Lenders must absorb as a cost of doing business, e.g., telephone calls, photocopying, mileage, meals, etc.;

d. SBA permitted Loan fees, e.g., late payment and NSF fees, which SBA allows Lenders to charge and collect if the Loan is current, but does not guarantee nor reimburse. (See Chapter 4 of this SOP for additional information on Loan fees.);

e. Fees and costs that a Lender incurs to hire an independent contractor or receiver to perform routine Loan servicing and/or liquidation duties such as the preparation of a demand letter, Liquidation Plan, Universal Purchase Package, or Protective Bid analysis, and/or the review of an Appraisal or Environmental Investigation Report;

> **Note:** As set out in Chapter 18 of this SOP, Lenders should use receivers only in unusual situations and only after they have obtained SBA's prior written approval to do so. The appointment of a receiver involves Non-Routine Litigation.

Therefore, Lenders must submit a Litigation Plan for SBA District Counsel approval prior to commencing receivership proceedings. See Chapter 22 of this SOP for guidance on Litigation Plans.

f. Expenses related to actions taken for the sole benefit of the Lender, as determined by SBA in its sole discretion;

g. Expenses associated with a claim by an Obligor or other Person seeking damages based on a Lender's alleged wrongful action, unless SBA expressly directed the Lender to take the alleged wrongful action; and

h. The litigation expenses listed in Chapter 22 Paragraph D.3 of this SOP are examples of litigation expenses that are not covered by the SBA Loan guaranty.

i. Expenses that are not necessary, reasonable, or customary for the geographic area where the expenses are incurred.

j. Costs associated with the care, preservation and resale of acquired collateral are recoverable from the sale proceeds of the acquired collateral if a Lender has credited the SBA Loan for the value of the acquired collateral. Lenders must not add expenses associated with acquired collateral to the balance of the original Loan.

2. Recoverable Expenses

As set out in Chapter 2 (Definitions) of this SOP, Recoverable Expenses are the SBA approved, necessary, reasonable and customary costs for the geographic area where the expenses are incurred to 1) collect amounts due under the Note, 2) enforce the terms of the Loan Documents, or 3) preserve and/or dispose of collateral, which Lenders may add to the principal balance of an SBA Loan according to the terms of the Note. Recoverable Expenses include, for example:

a. Searches

(1) UCC lien searches;

(2) Title reports; and

(3) Credit and asset search reports.

b. Appraisals

(1) Appraisals;

(2) Environmental Investigation Reports; and

(3) Site Visit Reports prepared by contractors.

c. Debt Collection Litigation Expenses

(1) Attorney fees; and

(2) Costs such as court filing fees.

d. Legal expenses and attorney fees, other than Debt Collection Litigation Expenses, which are incurred for Loan servicing and liquidation actions.

e. 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. Liquidation Recoveries

1. Application of Recoveries

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

a. Recoverable Expenses incurred in the liquidation process;

b. Principal balance of the Loan until the principal balance is paid in full;

c. Accrued interest;

d. Permitted SBA Loan fees. (See Chapter 4 of this SOP for additional guidance on the application of Borrower payments on Loans in liquidation status.)

Note: For information on SBA permitted Loan fees such as late payment fees, extraordinary servicing fees, assumption fees, overdraft fees, other out-of-pocket Lender expenses and subsidy recoupment fees that Borrowers may owe to SBA, see the most recent version of SOP 50 10. SBA does not guarantee nor pay the Loan fees that Lenders are permitted to charge Borrowers. Therefore, Lenders must not add permitted Loan fees

to the transcript of account they submit to SBA with their guaranty purchase request.

2. Remittance of SBA's Share of Recoveries

After SBA guaranty purchase, Lenders should remit SBA's pro-rata share of the net proceeds of any recovery or payment they receive for a 7(a) Loan to SBA within 15 business days of receipt, regardless of whether SBA or the Lender has charged off the Loan, until the Loan is either paid in full or is closed out and returned to SBA from Treasury. This applies to Loans that SBA has charged off and referred to Treasury for further collection until Treasury concludes their collection actions and returns the Loan to SBA to issue a 1099-C. (See Chapter 27 of this SOP for additional information regarding SBA's post-Treasury referral actions.) If Lenders do not remit SBA's pro-rata share of the recoveries or payments they receive after guaranty purchase in a timely manner, SBA may charge interest on the late payment amount and refer the matter to the SBA Office of Credit Risk Management for corrective action.

C. Non-Recoverable Expenses Incurred by Lenders

SBA does not pay, reimburse nor approve, in whole or in part, the Non-Recoverable Expenses that Lenders incur for an SBA Loan.

D. Reimbursement of Recoverable Expenses Incurred by Lenders

Note: The provisions of the Prompt Payment Act (31 U.S.C. Chapter 39), which requires federal agencies to pay interest and penalties on late payments for contracted expenses, do not apply to SBA payments to Lenders for Recoverable Expenses. See Subpart 32.9 of the Federal Acquisition Regulation (FAR) for further information.

1. General Requirement—SBA Approval

SBA must review and approve any cost, fee or other amount that a Lender seeks to treat as a Recoverable Expense pursuant to Paragraph E below. While Lenders may incur Recoverable Expenses prior to SBA guaranty purchase, SBA will not reimburse Lenders for Recoverable Expenses until after SBA purchases its guaranty.

2. Reimbursement Methods

Lenders may receive reimbursement for Recoverable Expenses by one or both of the following methods:

a. Deduction from Recoveries

Lenders may deduct Recoverable Expenses from the recoveries they receive from the sale and release of collateral or acquired collateral, and/or the payments they

receive on Loans in liquidation status.

b. Reimbursement by SBA

Lenders may ask SBA to reimburse them directly for SBA-approved Recoverable Expenses that were not paid through a deduction from the recoveries for an SBA Loan.

E. SBA Review and Approval

SBA must review and approve any cost, fee or other amount that a Lender seeks to treat as a Recoverable Expense, including expenses that the Lender has already deducted from recoveries. Lenders must submit requests for SBA approval in accordance with the following guidelines:

1. Where and How to Submit Reimbursement Requests

Lenders must submit all requests for approval of Recoverable Expenses electronically, to the appropriate SBA Loan Center.

2. Preferred Format for Lender Reimbursement Requests

To expedite SBA's review process, Lenders should utilize the Charge Off Tabs/Wrap-up Report template to organize and submit their requests to the appropriate SBA Loan Center.

3. When Lenders May Submit Reimbursement Requests to SBA

Lenders may submit requests for reimbursement or deduction of Recoverable Expenses from liquidation recoveries only at the following times:

a. Submission of Loan Guaranty Purchase Request

Lenders may submit requests for SBA reimbursement of Recoverable Expenses or approval of expenses paid from recoveries with their Universal Purchase Package, or

b. Submission of Wrap-up Report

Lenders must submit all remaining requests for SBA reimbursement of Recoverable Expenses or approval of expenses paid from recoveries with their Wrap-up Report for the Loan.

4. Multiple Loans—Allocation of Expenses

When a request involves multiple loans to the same Borrower (either SBA Loans with different guaranty percentages or non-SBA loans):

a. If the expense is related to collateral, Lenders must allocate the expense (as well as any recovery) to the loans according to the priority of the lien securing each loan (including the division of expenses between loans with a "pari passu" lien position).

b. If the expense is not related to collateral, Lenders must pro-rate and allocate the expense (as well as any recovery) among the loans to which the expense relates.

5. Contents of Recoverable Expense Request Packages

Requests should include the following items as applicable:

a. Lender Contact Information

Lender's name, address, e-mail address, phone and fax numbers, and tax identification number.

b. Borrower's Name and SBA Loan Number

c. Summary of Expenses

Lenders must group multiple invoices by the categories set out in Subparagraph A.2 of this Chapter and summarize them in a cover sheet that includes: (1) the date that each service was performed; (2) the invoice number for each invoice; (3) a subtotal for each category; and (4) the grand total of all categories.

d. Itemized Invoices

Lenders must provide a paper or electronic copy of each invoice that must include: (1) the date of the invoice; (2) a thorough description of the goods or services provided; (3) the date the goods were provided or the services were performed; (4) the amount charged for each service or product provided; (5) the total amount due; and (6) if the invoice is for services billed on an hourly basis, the name, title, hourly billing rate and time spent by each individual who performed services covered by the invoice.

e. Supporting Documents

Lenders must include a copy of all the Supporting Documents pertaining to each invoice, for example, a copy of the Site Visit Report if the invoice is for a site visit, with their Recoverable Expense request package. With regard to litigation expenses, Lenders must include a copy of the SBA-approved Litigation Plan for Non-Routine Litigation, pleadings and other documents required by Chapter 22 of this SOP with their Recoverable Expense request packages, unless the Lender has already provided this information to SBA.

6. Denied Expenses Deducted From Liquidation Recoveries

If SBA denies an expense that a Lender has already deducted from recoveries, the Lender must reimburse SBA for the denied expense within 30 days of Lender's receipt of SBA notification that SBA has denied the expense. SBA will refer Lenders that fail to reimburse SBA for denied expenses or fail to provide documentation acceptable to SBA to support the denied expense within the 30-day notification period, subject to the conclusion of any pending appeal process, to OCRM for appropriate action.

Note: See Chapter 3 of this SOP for guidance on how to appeal the final decision of an SBA Loan Center Director, designee, or SBA Legal Counsel with regard to the approval of liquidation or litigation expenses.

Chapter 24.
Loan Guaranty Purchase Requests

A. SBA Guaranty Purchase Overview

This chapter covers the process Lenders must use to prepare and submit their requests for SBA to purchase the SBA guaranteed portion of a Loan. Pursuant to 13 C.F.R. §120.520, SBA will not purchase the guaranteed portion of a Loan from a Lender unless the Lender has submitted a complete Universal Purchase Package to SBA, which SBA deems to contain sufficient, credible evidence that the Lender made, closed, serviced and liquidated the Loan in accordance with SBA Loan Program Requirements including Prudent Servicing and Prudent Liquidation practices. Lenders must submit purchase requests for PPP Loans in the PPP Loan Paycheck Protection Platform ("Platform"). See Chapter 14 of this SOP for additional guidance on the submission of purchase requests for PPP Loans.

Note: For the purposes of determining Lender compliance with SBA Loan Program Requirements, SBA will apply the requirements of SOP 50 10 and SOP 50 57 in effect at the time of SBA's guaranty purchase review, unless these requirements result in a determination that is more restrictive upon the Lender than the SOP requirements in effect when the Lender action was taken.

In addition, SBA will not purchase the SBA guaranteed portion of a Loan if it has determined that any of the events listed in 13 C.F.R. §120.524 have occurred. (See Chapter 25 of this SOP for additional information on the denial of liability for an SBA 7(a) Loan guaranty.) This chapter also covers the Prudent Liquidation Deadline for resolving a Loan after SBA guaranty purchase.

Note: SBA may purchase the SBA-guaranteed portion of a Loan at any time to protect the interests of the Government and/or the Borrower (13 C.F.R. §120.520). If the Lender fails to request an SBA guaranty purchase in a timely manner, the FTA will request the Lender or SBA to purchase the SBA guaranteed portion of a Loan sold in the secondary market on behalf of the investor (see Secondary Market Participation Guaranty Agreement SBA Form 1086).

B. Interest SBA Pays on Guaranteed Portion of Loan

1. Interest Rate

When SBA purchases the guaranteed portion of a Loan in response to a Lender's request, SBA pays the accrued interest for the Loan as follows:

a. If the Loan Note has a fixed interest rate—SBA pays accrued interest at the rate specified in the Note unless the Loan was made under the SBA Express or Export Express program delivery methods, in which case the interest rate is capped at the maximum interest rate allowed for standard 7(a) Loans as of the date SBA received the original application for the SBA Express or Export Express Loan.

b. If the Loan Note has a variable interest rate—SBA pays accrued interest at the rate in effect on the earliest uncured payment Default date unless the Loan was made under the SBA Express or Export Express program delivery methods, in which case the interest rate is capped at the maximum interest rate allowed for standard 7(a) Loans as of the date SBA received the original application for the SBA Express or Export Express Loan.

> **Note:** The term "earliest uncured payment Default date" means the earliest date that a Borrower has failed to pay the full amount owed on a scheduled installment of principal and/or interest for an SBA Loan. Lenders must apply Borrower payments to the earliest uncured payment default and advance the earliest uncured payment Default date to the next installment due date when payment(s) are sufficient to pay the full amount of the scheduled installment. However, if a Borrower makes a payment after the Lender submits its guaranty purchase request to SBA, Lenders may not advance the earliest uncured payment default date. Instead, Lenders must apply the payment(s) to the principal balance of the Loan, in accordance with guidance provided in Chapter 4 of this SOP. (13 C.F.R. §120.523)

2. Interest SBA Pays to Lenders

a. For 7(a) Loans approved on or after May 14, 2007, SBA pays up to a maximum of 120 calendar days of accrued interest on the SBA guaranteed portion of the Loan.

b. For 7(a) Loans approved prior to May 14, 2007, SBA pays accrued interest to Lenders based on the applicable regulations in effect as of May 13, 2007.

3. Interest Paid to Secondary Market Investors

The Lender or SBA must pay the full amount of accrued interest owed to secondary market investors up to the date of purchase. (13 C.F.R. 120.522(c)) However, if SBA is required to pay a secondary market holder more than 120 calendar days of accrued interest, SBA will bill the Lender to reimburse SBA for the difference between the amount SBA paid and 120 calendar days of accrued interest, unless SBA approves an exception, in its sole discretion. (See Secondary Participation Guaranty Agreement (SBA Form 1086).

C. Lender Annual Service Fee Collection.

1. For Loans approved before December 8, 2004, SBA deducts and retains the Lender annual service fee (also known as the on-going SBA guaranty fee) through the date of guaranty purchase from the guaranty purchase amount SBA remits to the Lender, based on the fee requirements in effect at the time the Loan was approved.

2. For Loans approved on or after December 8, 2004:

a. If a Lender submits a Wrap-up Report acceptable to SBA concurrently with their guaranty purchase request, SBA will retain the Lender annual service fee for a maximum of 120 calendar days from the interest paid to date for the Loan. This SBA fee is based on the requirements in effect at the time the Loan was approved and is deducted from the guaranty purchase amount that SBA remits to the Lender.

b. If a Lender does not submit a Wrap-up Report acceptable to SBA concurrently with their guaranty purchase request, SBA retains the SBA annual service fee the Lender owes through the date of guaranty purchase. This fee is based on the requirements in effect at the time the Loan was approved and is deducted from the guaranty purchase amount that SBA remits to the Lender.

D. Guaranty Purchase Requirements

The following conditions must exist before a Lender may submit a request for guaranty purchase to SBA:

1. Loan is in Uncured Payment Default

Loan must have an uncured payment Default of more than 60 calendar days, unless SBA agrees otherwise in writing. (13 C.F.R. §120.520)

2. Loan is Classified as "In Liquidation" Status

Lenders must classify the Loan as "In Liquidation" on their monthly SBA Form 1502 report.

3. For Loans Sold in the Secondary Market

If the Lender has sold the SBA-guaranteed portion of a Loan in the secondary market, the Lender must either repurchase the Loan through the FTA or submit a request to the appropriate SBA Loan Center for SBA to purchase the Loan from the secondary market investor. All Lender requests for SBA to purchase the guaranteed portion of a Loan from a secondary market investor must include the following Loan Documents,

a. Certified transcript of account;

b. Copy of executed Loan Authorization;

c. Copy of all executed modifications to the Note, if any; and

d. If applicable, the secondary market investor written approval of all modifications to the Note.

4. Collateral Liquidation

Lenders should liquidate all the collateral for an SBA Loan prior to submitting a guaranty purchase request, but must, at a minimum, liquidate the collateral for an SBA Loan as follows:

a. Loans Approved on or after May 14, 2007

For Loans approved on or after May 14, 2007, unless the Borrower filed for bankruptcy protection, the Lender must liquidate all business personal property collateral. SBA considers liquidation of business personal property collateral completed when a Lender has exhausted all prudent and commercially reasonable efforts to collect upon these assets (13 C.F.R. §120.520(a)(1)). See Chapter 19 of this SOP for additional guidance on the liquidation of personal property collateral.

b. Loans Approved Prior to May 14, 2007

For Loans approved prior to May 14, 2007, Lenders must liquidate the collateral according to the requirements of the program delivery method under which the Loan was made (13 C.F.R. §120.520(a)(2)). For example, Lenders must liquidate the collateral for the following Loans prior to submitting a guaranty purchase request:

(1) **LowDoc**—All business personal property securing the Loan, unless the Loan involves prolonged litigation or other circumstances that would extend the liquidation process by more than 90 calendar days past the earliest date that the Lender could otherwise submit its guaranty purchase request;

(2) **EWCP**—All collateral associated with the export transactions financed by the Loan;

(3) **CAPLine**—All working capital assets securing the Loan; and

(4) **SBA Express and Export Express** —All collateral. In addition, Lenders must exhaust all cost-effective means of recovery for the Loan unless:

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

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

(c) The Loan involves prolonged litigation or other circumstances that would extend the liquidation process by more than 90 calendar days past the earliest date that the Lender could otherwise submit its guaranty purchase request.

5. Complete Purchase Package Submission to SBA

Lenders must submit a complete Universal Purchase Package in electronic form to the appropriate SBA Loan Center. For Loans that Lenders have approved or modified in E-Tran, the Lender must ensure that all the terms and conditions of the Loan, including all Loan Actions that modified the terms and conditions of the Loan, are up to date in E-Tran.

a. Contents of Purchase Package

Lenders should prepare a Universal Purchase Package in electronic form in accordance with the instructions issued by the SBA Loan Center to which the Universal Purchase Package is submitted for review and processing as follows:

(1) National Guaranty Purchase Center ("NGPC")

(a) For all 7(a) Loans in the original amount of more than $500,000 (including companion Loans made to the same borrower), CLP, and PLP Loans, Lenders must submit their Universal Purchase Packages to the NGPC. Lenders must use the Universal Purchase Package Tab System, which is accessible from the NGPC guaranty purchase process website, to assemble and organize the required documentation.

(b) For EWCP Loans, Lenders must submit their Universal Purchase Packages to the NGPC. Lenders must use the Universal Purchase Package Tab System, which is accessible from the NGPC guaranty purchase process website, to assemble and organize the required documentation. NGPC will consult with the appropriate USEAC on guaranty Purchase requests for EWCP Loans, as needed.

> **Note:** More information on the SBA guaranty purchase process and the Universal Purchase Package Tab System is available at the NGPC guaranty purchase process website.

(2) Commercial Loan Servicing Centers

(a) For all 7(a) Loans in the original amount of $500,000 or less (including companion Loans made to the same borrower), SBA Express, Export Express, Community Advantage and Pilot Program Loans, Lenders must submit their Universal Purchase Packages to the appropriate SBA Loan

Center, i.e., CLSC West in Fresno or CLSC East in Little Rock. Lenders must use the Universal Purchase Package Tab System accessible from the Fresno and Little Rock web sites to assemble and organize the required documentation. See Chapter 2 of this SOP for additional contact information for CLSC West and CLSC East.

b. Deadline for Submission of Purchase Package

For Loans that SBA has purchased from the secondary market investor, Lenders must submit a complete Universal Purchase Package to the appropriate SBA Loan Center within 45 calendar days of the purchase. In all cases and in order to avoid the expiration of SBA's guaranty, Lenders must submit a Universal Purchase Package to the appropriate SBA Loan Center no later than 180 calendar days after the maturity date of the Loan, or the date the Lender completes the liquidation of a matured Loan. 13 C.F.R. §120.524(a)(8)

E. Prudent Liquidation Deadline for Lender Resolution of an SBA Purchased Loan

Lenders must resolve SBA purchased Loans as set forth in Subparagraphs E.1 thru E.3 below and provide sufficient evidence of resolution, as determined by SBA in its sole discretion, to the appropriate SBA Loan Center within 24 months of the date of SBA guaranty purchase, unless the Lender submits a written request for an extension and SBA approves the Lender's request in writing prior to the expiration of the 24-month Prudent Liquidation Deadline.

Sufficient evidence of resolution includes the following:

1. Loans Returned to Regular Servicing

Lenders must provide SBA with the relevant terms of the agreement under which the Borrower has agreed to resume regular payments, as appropriate evidence of resolution. Lenders must provide this information in writing. The relevant terms of a payment agreement include, but are not limited to:

a. Gross outstanding principal and Interest amounts outstanding,

b. Payment amount,

c. Payment frequency,

d. Interest rate, and

e. Maturity Date

2. Loans Paid in Full

Lenders must remit SBA's pro-rata share of the net liquidation proceeds needed to satisfy the balance owed on the SBA purchased Loan and verify that the Lender has

classified the Loan as "paid in full" in E-Tran.

3. Wrap-up Report

Lenders must submit a Wrap-up Report acceptable to SBA identifying all the Prudent Liquidation actions they completed to resolve the Loan. (See Chapter 27 Paragraph B of this SOP for guidance on what Lenders should include in a Wrap-up Report.)

F. Extensions to the Prudent Liquidation Deadline

1. SBA may grant an extension to the Prudent Liquidation Deadline for an SBA purchased Loan on a case-by-case basis, if extenuating circumstances such as judicial foreclosure, bankruptcy, or the subsequent return of an SBA Loan from regular servicing to liquidation status after guaranty purchase prevents compliance with the original deadline. Lender requests are not final until and unless SBA approves them in writing.

2. Lenders must submit all requests to extend the Prudent Liquidation Deadline for an SBA purchased Loan to the appropriate SBA Loan Center in writing as soon as it becomes apparent to the Lender that an extenuating circumstance will prevent them from complying with the deadline. Lenders should submit their requests no later than 30 calendar days prior to the expiration of any deadline. At a minimum, Lender requests must include:

a. A detailed description of the extenuating circumstance preventing timely liquidation;

b. Supporting documentation evidencing the extenuating circumstance;

c. A reasonable estimate of when the Lender expects to complete the Prudent Liquidation of the SBA-purchased Loan; and

d. A Lender status report for the Loan (see Chapter 3 Paragraph F of this SOP for guidance on Loan status reporting).

3. SBA will review the request and provide a written response to the Lender either granting or denying the extension. If SBA grants the extension request, SBA will provide a new Prudent Liquidation deadline. Once SBA has granted an extension, Lenders must continue submitting Loan status reports to SBA every 6 months. (See Chapter 3 Paragraph F of this SOP for guidance on Loan status reporting.)

4. If the extenuating circumstances supporting the Lender's extension request cease to exist, the Lender must promptly notify SBA and provide a Wrap-up Report within 30 calendar days.

G. Lender Consequences for Failure to Comply with Prudent Liquidation Deadline

SBA will require Lenders that fail to comply with the Prudent Liquidation Deadline for an SBA Loan to repurchase SBA's share of the remaining balance of Loan back from SBA. Additionally, SBA will refer Lenders that fail comply with SBA's Prudent Liquidation

Deadline to the Office of Credit Risk Management for possible enforcement action, including, but not limited to, restriction from future participation in the secondary market for SBA Loans and/or suspension of delegated authority.

H. Practice Tips for Submitting Complete Purchase Packages

1. Submit a Complete Transcript of Account

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

> **Note:** SBA does not guarantee nor pay SBA permitted Lender Loan fees. Therefore, Lenders must not add their Loan fees to the transcript of account they submit to SBA with their Universal Purchase Package.

2. Explain Missing Documents

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

3. Provide Repair Estimate

If a Lender error causes a Material Loss on a Loan, the Lender should acknowledge the error and provide an estimate of the amount needed to fully compensate SBA for the loss, including justification for the estimate. For example, losses related to collateral are based on the Recoverable Value of the collateral. If a Lender did not obtain the required lien on real or personal property, the Lender should provide an estimate of the Recoverable Value that the property would have had at the time of liquidation if the Lender had obtained the required lien, along with a detailed explanation of how the Lender calculated the Recoverable Value. Although a Lender's acknowledgement of its error is not mandatory and the Lender's estimate of Recoverable Value is not binding on SBA, providing both will expedite SBA's Repair analysis and guaranty purchase approval process.

Chapter 25.
Denial of Liability on 7(a) Loan Guaranty

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

Pursuant to 13 C.F.R. §120.524(a), SBA is released from liability on its guaranty of a 7(a) Loan and may, in its sole discretion, refuse to honor a Lender's guaranty purchase request in full or in part, or recover all or part of the funds already paid in connection with a guaranty purchase, whether they were paid directly to the Lender or to a secondary market investor, if the Lender:

1. Failed to comply materially with a Loan Program Requirement;
2. Failed to make, close, service, or liquidate the Loan in a prudent manner;
3. Placed SBA at risk through improper action or inaction;
4. Failed to disclose a material fact to SBA in a timely manner;
5. Misrepresented a material fact to SBA regarding the Loan
6. Sent a written request to SBA to terminate the guaranty;
7. Failed to pay the guaranty fee within the period required under SBA rules and regulations;
8. Failed to request that SBA purchase a guaranty within 180 days after maturity of the Loan. However, if the Lender is conducting liquidation and/or debt collection litigation in connection with a Loan that has matured, SBA is released from its guaranty only if the Lender fails to request SBA to purchase the guaranty within 180 days after the Lender completes its Prudent Liquidation and/or debt collection litigation actions;
9. Failed to use required SBA forms or exact electronic copies, except for 7(a) Loan program delivery methods that allow Lenders to use their own forms, such as SBA Express; or
10. The borrower has paid the Loan in full.

> **Note:** Pursuant to 13 C.F.R.§ 120.520, SBA will not purchase the guaranteed portion of a Loan from a Lender unless the Lender has submitted documentation to SBA that SBA deems sufficient to allow SBA to determine whether purchase of the guaranty is warranted under 13 C.F.R. §120.524.

B. Losses Attributable to Lender Actions or Inactions

1. Material Loss or Harm to Program Integrity

Generally, SBA will not deny liability on a 7(a) Loan guaranty unless the Lender's actions or inactions caused, or could cause, a Material Loss on the Loan. SBA may, however, deny liability on a guaranty in the absence of an actual or potential Material Loss if the Lender's action or inaction is deemed material to the soundness and integrity of the 7(a) Loan program, such as, for example, if the Loan was ineligible for SBA financing or the Lender failed to disclose or misrepresented a material fact to SBA.

2. Losses on Recoveries From Collateral

The amount of a loss attributable to how a Lender handled the liquidation of collateral for a 7(a) Loan is based on the Recoverable Value of the collateral.

3. Projected Losses

If a significant, but not yet quantified loss appears likely, unless SBA has already purchased the Loan from the secondary market investor, the Lender should withdraw its guaranty purchase request and resubmit it when the Lender has completed its liquidation process.

C. SBA Guaranty Repairs

1. Repair Definition

As set forth in Chapter 2 (Definitions) of this SOP, the term Repair means an agreement between SBA and a 7(a) Lender to deduct a specific dollar amount from the funds that SBA pays to the Lender for SBA's guaranty of a Loan, in order to fully compensate SBA for any actual or anticipated loss caused by the Lender's actions or inactions in connection with the Loan. A Repair does not reduce SBA's guaranty percentage nor SBA's pro-rata share of expenses and/or recoveries associated with the Loan.

2. Repair Amount

The net Repair amount is a specific dollar amount that fully compensates SBA for any actual or anticipated loss caused by a Lender's actions or inactions in connection with a 7(a) Loan. Generally, Repair amounts are calculated by multiplying the dollar amount of the loss on a Loan by SBA's guaranty percentage for the Loan (e.g., $50,000 loss x 75 percent guaranty = $37,500 Repair).

> **Note:** In order to expedite SBA's guaranty purchase review process, Lenders are encouraged to include a Repair estimate in their Universal Purchase Package.

3. When a Repair is Appropriate

Except in cases involving gross Lender misconduct (see Subparagraph C.4 below), a Repair is appropriate when the Lender's actions or inactions have caused an actual or

anticipated loss that justifies a partial Denial of Liability by SBA, but instead of SBA formally denying liability, the Lender agrees to allow SBA to deduct a specific dollar amount from the funds that SBA would otherwise owe to the Lender for SBA's guaranty, in order to fully compensate SBA for the loss attributable to the Lender's actions or inactions.

4. When a Repair is Not Appropriate

a. Total Loss on a 7(a) Loan

A Repair is not appropriate if the Lender's actions or inactions have caused a total or near total loss on a 7(a) Loan.

b. Lender Misconduct

A Repair is not appropriate if SBA deems that the Lender's misconduct is material to the integrity and soundness of the 7(a) Loan program.

c. Justified Abandonment of Collateral

A Repair based on a Lender's failure to liquidate personal property collateral is not appropriate if the Lender abandoned the property in accordance with Prudent Liquidation practices and SBA Loan Program Requirements. (See Chapter 19 of this SOP for guidance regarding the abandonment of personal property collateral.)

For example, a Repair for failure to liquidate restaurant equipment (e.g., walk-in freezer, built-in booths, stove hood and related ventilation equipment, pots and pans, etc.) located on leased premises is appropriate if the appraised value of the equipment is $12,000 and the estimated cost of removing, transporting, storing, and selling it is $10,000. Under these circumstances, abandonment is justified not only based on the estimated Recoverable Value of $2,000 (which is less than the $5,000 threshold for abandoning personal property collateral established in Chapter 19 of this SOP), but also the risk of Lender liability for damage done to the leased premises while removing the trade fixtures.

D. Partial Denial of Liability

A partial Denial of Liability is justified if the Lender's actions or inactions caused, or could cause, a Material Loss but less than a total or near total loss on the Loan, and the Lender does not agree to a Repair amount that is acceptable to SBA.

E. Full Denial of Liability

A full Denial of Liability is justified if the Lender's actions or inactions caused an actual or anticipated total or near total loss on the Loan, resulted in SBA guaranteeing an ineligible Loan, or are deemed material to the soundness or integrity of the 7(a) Loan program and the Lender does not voluntarily agree to terminate the SBA Loan guaranty.

F. Voluntary Termination of SBA Guaranty

Lenders may, at any time prior to guaranty purchase, voluntarily request SBA to terminate an SBA Loan guaranty. However, this option is not available when the Lender has sold the guaranteed portion of the Loan in the secondary market.

G. Examples of When a Repair or a Full or Partial Denial of Liability is Justified

Listed below are examples of common Lender deficiencies that can justify an SBA Repair or Denial of Liability in full or in part. This list is not exhaustive and is provided for illustrative purposes only. While current SBA Loan policy requires Lenders to apply the same standard processes they use to originate their similarly-sized, non-SBA guaranteed commercial loans, to the SBA Loans they originate, the examples below provide a basis for determining the extent to which a Lender did or did not comply with its own standards in its handling of a particular Loan.

1. Incorrect SBA Loan Eligibility Determination by a Delegated Lender (Prior to August 1, 2023)

A full Denial of Liability is justified if a delegated Lender made an ineligible SBA Loan prior to August 1, 2023. After August 1, 2023, if SBA determines that the applicant eligibility certification is invalid, SBA will not use this as a basis to deny or repair the Lender's guaranty purchase request. A partial Denial of Liability is justified if a portion of the Loan proceeds were used for an ineligible purpose.

2. Lender Use of Suspended or Debarred Agent(s)

SBA may deny liability in full on a Loan guaranty if a Lender uses the services of a suspended or debarred Agent to administer the Loan at any time during the life of the Loan, even if the actions of the suspended or debarred Agent did not directly cause the business to fail or result in a loss on the Loan.

Note: Information regarding the identity of Agents who have been debarred, suspended, proposed for debarment, excluded, disqualified or otherwise declared ineligible from receiving Federal contracts, assistance and benefits is available to the general public via the System for Award Management maintained by GSA at https://www.sam.gov. In accordance with SOP 50 10, SBA expects Lenders to exercise due diligence and prudent oversight of their employees who are directly involved in the processing, closing, servicing, or liquidation of 7(a) Loans, and third party vendors including Lender Service Providers (LSPs) and other Loan agents. This due diligence and oversight includes the establishment of written policies governing such relationships and monitoring the performance of Loans referred by an Agent or where an Agent provided assistance. SBA will review evidence of such due diligence and oversight of such relationships when conducting lender oversight activities. Federally-regulated Lenders are reminded that they must comply with the requirements of their primary federal financial institution regulator regarding third

party vendors.

3. Early Default Due to Lender Failure to Properly Make or Close an SBA Loan

A full Denial of Liability is justified if a Lender's failure to make or close the Loan in accordance with prudent lending practices and SBA Loan Program Requirements contributed to or allowed an Early Default unless the Lender provides credible evidence that the business failure was for unrelated reasons. For example, Denial of Liability is justified if a Lender, utilizing its delegated authority, made a Loan based on underwriting that was not consistent with prudent lending practices, such as where:

a. The Lender made the Loan even though the Borrower's projected expenses greatly exceeded projected revenues and the Borrower had no other source of income;

b. The Lender made the Loan to a startup business without comparing the Borrower's projected revenue against an industry standard or some other reliable measure including the Lender's own experience making loans to similar businesses;

c. The Lender's original cash flow analysis failed to take into account an identifiable fact or foreseeable risk that could adversely affect the Borrower's ability to repay the SBA Loan, such as the owner's monthly draw;

d. The Lender's original cash flow analysis contained unsound assumptions and/or unjustified and overly optimistic revenue projections, e.g., revenues that were projected to increase by 100 percent in year one even though the industry average maximum annual increase is 25% and the Lender has not provided a realistic explanation for the difference; or

e. The Lender made a material mathematical error in its cash flow calculations, i.e., if the Lender had not made the mathematical error, the Lender would not have made the Loan or would have structured it in a way that would not have led to an Early Default.

4. Early Default and Lender Failure to Use IRS Transcripts to Verify Borrower Financial Information

A full Denial of Liability is justified if there was an Early Default on the Loan and the Lender failed to provide credible evidence that it verified the Borrower's financial information by comparing it to relevant IRS tax return transcripts as required by SOP 50 10. A full Denial of Liability is not justified, however, if the Lender provides credible evidence that the business failure was caused by factors that were unrelated to any financial difficulties the Lender could have identified through the IRS verification process.

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

5. Lender Failure to Ensure Borrower Use of SBA Loan Proceeds as Required by the Loan Authorization

A Repair or a full or partial Denial of Liability is justified if there is a Material Loss on a Loan due to the Lender's failure to ensure that the Borrower used the SBA Loan proceeds as required by the Loan Authorization. Refer to the SOP 50 10 for additional guidance regarding Loan closing documentation that SBA accepts as credible evidence that a Borrower used SBA loan proceeds as required by the Loan Authorization or the terms and conditions that the Lender entered into E-Tran. Lenders may also rely on a post-default Appraisal or Site Visit Report as evidence of the assets that the Borrower was required to use the SBA Loan proceeds to acquire.

a. Examples of When a Repair or a Full or Partial Denial of Liability is Justified

(1) Early Default Due to Borrower Failure to Purchase Key Assets

A full Denial of Liability is justified if there is a total or near total loss on a Loan due to operational problems caused by the Lender's failure to ensure that the Borrower purchased the key assets listed in the "Use of Proceeds" section of the Loan Authorization, resulting in an Early Default on the Loan. For example, a full Denial of Liability is justified if a Lender made a $350,000 Loan to enable a Borrower to purchase the equipment needed to start a new dental practice but failed to ensure that the Borrower purchased the dental chairs, x-ray machines, etc., and as a result, the Borrower could not generate sufficient income to repay the Loan and SBA suffered a total or near total loss on the Loan.

(2) Collateral Not Available for Liquidation and Application to SBA Loan

A Repair or a full or partial Denial of Liability is justified if there is a Material Loss on a Loan due to the Lender's failure to ensure that the Borrower used SBA Loan proceeds as required by the Loan authorization to acquire property that the Borrower was required to pledge as collateral for the Loan, and it is likely that the required collateral would have had Recoverable Value at the time of Loan Default.

In the example in Subparagraph 5.a.(1) above, a repair or partial Denial of Liability is justified if the Lender failed to ensure that the Borrower used the Loan proceeds to purchase the dental practice equipment, resulting in a Material Loss equivalent to the Recoverable Value the equipment would have had if it had been purchased and pledged to secure the Loan.

6. Early Default and Lender Failure to Verify a Required Equity Injection

a. General Rule

If a Lender requires an equity injection and as part of its standard processes for similarly-sized, non-SBA guaranteed commercial loans verifies the equity injection, it must do so for its SBA Loans. However, the Lender may use its discretion to reduce the amount of equity and/or equity injection required if it determines that the Applicant needs leverage that exceeds the Lender's conventional requirements. If a Lender does not require an equity injection as part of its standard processes for similarly-sized non-SBA guarantied commercial loans, SBA will not require the Lender to do so for its SBA loans. Lenders that only make SBA Loans must document their compliance with the policies they submitted to SBA in conjunction with their application to become an SBA Lender. For Loans that finance a change in the ownership of a business, Lenders must provide evidence that the equity injection satisfies SBA requirements for such Loans. (See SOP 50 10 for additional guidance.)

b. Rebuttable Presumption

A Lender's failure to properly document a material portion of any injection of cash or non-cash equity into the Borrower's business that was required by the standard processes the Lender uses for its similarly-sized, non-SBA guaranteed commercial loans, raises a rebuttable presumption that the Early Default was caused by the absence of the required equity injection and justifies a full Denial of Liability on the SBA guaranty. To rebut the presumption, the Lender must provide credible evidence that the primary cause of the Borrower's Default was something other than the lack of the required equity injection, e.g., the death of an irreplaceable Key Employee or an uninsured natural disaster that destroyed the Borrower's business premises and customer base.

c. Examples of Credible Evidence of a Cash Injection

Credible evidence of a cash injection includes:

(1) Documentation showing that a check or wire transfer was processed and that the funds were deposited into an escrow account on the Borrower's behalf or into the Borrower's bank account prior to the initial disbursement of the SBA Loan; or

(2) Documentation showing that the Borrower received the injected funds prior to the initial disbursement of the SBA Loan, such as a copy of a signed third-party escrow settlement statement showing the disbursement to the Borrower or the Borrower's bank account statement showing the deposit of the injected funds.

d. Examples of Unacceptable Evidence of a Cash Injection

A promissory note, gift letter or financial statement on their own, are not credible evidence of a cash injection without corroborating documentation such as the documentation specified in Subparagraph 6.c. above.

e. Examples of Credible Evidence of an Asset Injection

Credible evidence of an asset injection includes, for example, an escrow settlement statement, receipt, or cancelled check, along with corroborating documentation such as a deed or certificate of title, or invoice marked "Paid," which shows that the Borrower owned or acquired the asset needed for the injection prior to disbursement of the SBA Loan, plus credible evidence that the asset was available for use by the Borrower and was not financed with any of the Borrower's other debt if the Lender intends the asset injection to satisfy the Borrower's equity injection requirements.

f. Equity Injection Source

If the Lender or SBA requires an equity injection, the Lender must use the same processes to verify the equity injection it uses for its similarly-sized, non-SBA guaranteed commercial loans.

> **Note:** According to the SBA Office of Inspector General, an increasingly common Loan fraud scheme involves Loan brokers, who in conspiracy with others, arrange to have the amount of a required cash injection deposited into the Borrower's bank account until the Loan is closed. Thereafter, the funds are withdrawn and reused for the same deceptive practice until all the Loans begin to fail and the fraudulent scheme is uncovered. If a Lender suspects that a Borrower has obtained a required equity injection from a fraudulent source, the Lender should report it to the SBA OIG. See Chapter 25 of this SOP for additional guidance.

7. Lender Failure to Obtain Required Lien or Lien Position on Collateral

A Repair or a full or partial Denial of Liability is justified if a Lender failed to obtain the required lien and lien position on the property that the Loan Authorization required the Borrower to provide as collateral for the SBA Loan, and that failure caused, or could cause, a Material Loss on the Loan. SBA will use the aggregate Recoverable Value of the property that the Borrower was required to provide as collateral for the Loan, as the basis for any Repair or Denial or Liability due to the Lender's failure to obtain the required lien or lien position on the property.

8. Lender Failure to Prepare and Use an Adequate List of the Required Collateral

A Repair or a full or partial Denial of Liability is justified if a Lender fails to prepare and utilize an adequate list of the collateral for an SBA Loan and that failure caused, or could cause, a Material Loss on the Loan. SBA will use the aggregate Recoverable Value of the collateral the Borrower was required to provide for the Loan, as the basis for any Repair or Denial of Liability for the Lender's failure to prepare and utilize an adequate list of the required collateral for the Loan.

Note: Lenders should attach a list of the items that reasonably describes the collateral to the security agreement and UCC financing statements to ensure that (1) a security interest "attaches" to the collateral, i.e., the creditor obtains a lien on the items; and (2) the lien is "perfected," i.e., the creditor establishes the priority of its lien over those of competing creditors.

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

A Repair or a full or partial Denial of Liability is justified if the collateral required by the Loan Authorization was present at the time of Loan Default, but the Lender's failure to perfect a security interest in the collateral caused, or could cause, a Material Loss on the Loan.

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

A Repair or a full or partial Denial of Liability is not justified, despite the Lender's failure to prepare an adequate list of collateral when the Loan was made, if all the collateral required by the Loan Authorization was located at the time of Loan Default and liquidated, and all the net proceeds were applied to the principal balance of the Loan, i.e., there was no Material Loss on the Loan.

9. Lender Failure to Conduct a Post Default Site Visit

A Repair or a full or partial Denial of Liability is justified if the collateral required by the Loan Authorization is either unavailable or declines in value due to the Lender's failure to conduct a timely post-Default site visit as required by Chapter 16 of this SOP, and that failure caused, or could cause, a Material Loss on the Loan. SBA will use the Recoverable Value of the required collateral that was either unavailable for liquidation, or the aggregate amount by which the required collateral declined in value due to the Lender's failure to conduct a timely site visit, as the basis for any loss associated with a Repair or Denial of Liability for the Loan.

Note: A UCC sale conducted at the debtor's business premises where the machinery and equipment is set up, connected to an appropriate power source, and easily inspected and tested will usually produce a significantly higher recovery than a sale of the same collateral held off-site, after the machinery and/or equipment is dismantled and moved to

a storage facility due to the lender's failure to conduct a timely site visit and make arrangements with the landlord to conduct an on-site UCC sale.

10. Lender Failure to Conduct Prudent Liquidation of Collateral

a. Examples of When a Repair or Full or Partial Denial of Liability is Justified

A Repair or a full or partial Denial of Liability is justified if a Lender fails to conduct Prudent Liquidation for an SBA Loan and that failure caused, or could cause, a Material Loss on the loan. For example, a Repair or a full or partial Denial of Liability is justified if a Lender:

(1) Failed to safeguard the collateral and the collateral either became unavailable or diminished in value;

(2) Permitted a substantial decline in the value of the collateral due to unnecessary delays or mismanagement of the liquidation process;

(3) Failed to account for items listed on the pre-closing collateral list that were not listed on the post-Default inventory and Appraisal; or

(4) Failed to account for items listed on the post-Default inventory and Appraisal that were not included in the liquidation sale.

b. Example of When a Repair or Denial of Liability is Not Justified

A Repair or Denial of Liability is not justified for a Lender's failure to liquidate personal property collateral if the Lender abandoned the collateral pursuant to Prudent Liquidation practices and SBA Loan Program Requirements. For example, a Repair or Denial of Liability is not justified if a Lender abandons the inventory of a souvenir shop with a Liquidation Value of $10,000 and routine foreclosure/repossession costs of $5,000, if repossession of the collateral would cause a breach of the peace and the Lender provides evidence that a replevin action would, at a minimum, cost an additional $3,000.

11. Loan Actions Resulting in Lender Preference

A Repair or a full or partial Denial of Liability is justified if a Lender takes any Loan Action that confers a Preference onto the Lender, which caused, or could cause SBA to suffer a Material Loss on the Loan or adversely impacts the soundness or integrity of the 7(a) Loan program. For example, if a Lender:

a. Applies recoveries from an SBA Loan to the Lender's non-SBA loans(s) or to another SBA Loan with a lower guaranty percentage in a junior lien position;

b. Releases the collateral for an SBA Loan in order to use it as security for a non-

SBA loan;

c. Subordinates the lien securing an existing SBA Loan to a lien securing the Lender's non-SBA loan or SBA Loan with a lower guaranty percentage, without SBA's prior written approval; or

d. Renews or increases the amount owed on the Lender's non-SBA loan or an SBA Loan with a lower guaranty percentage, after subordinating the lien securing an existing SBA Loan to the lien securing the loan the Lender renewed or increased, without SBA's prior written approval.

Chapter 26.
Inspector General Referrals

A. Duty to Report Irregularities

All SBA officials, Lenders Borrowers contractors and others must report any known or suspected irregularities involving SBA Loan programs, program participants, or personnel to the SBA Office of the Inspector General ("OIG"). (13 C.F.R. §120.197)

B. Irregularities Requiring Referral

Examples of irregularities that SBA officials, Lenders, Borrowers, contractors and others must refer to the OIG include:

1. Loan Application Fraud

False statements made by, or false documents submitted by, Loan applicants or Borrowers regarding their 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 a business;

g. Using false Social Security numbers;

h. Creating false work histories;

i. Submitting altered tax returns; or

j. Providing fraudulent standby agreements.

2. Loan Closing Fraud

False documents submitted to meet Loan closing requirements. This includes, for example, the following types of documents that are often submitted as “proof” that a required equity injection was made:

a. False gift letter or affidavit;

b. False promissory note and standby agreement; or

c. False bank statement and/or cashier's check.

3. Loan Agent Fraud

Actions by Agents who orchestrate, facilitate or otherwise support any of the illegal acts committed by Loan applicants, Lenders, 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 and/or liquidating an SBA Loan.

7. Lender Misconduct

Misconduct by a Lender, an Associate of a Lender, an employee of the Lender or a Close Relative of an employee, such as soliciting or accepting a bribe in connection with making, closing, servicing, and/or liquidating an SBA Loan.

C. Referral Methods

SBA officials, Lenders, Borrowers, contractors, and others may refer matters to OIG by:

1. Calling the OIG Hotline toll-free at 1-800-767-0385;

2. Completing an SBA OIG Complaint Submission Form; 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 Referral Information

1. Answers to Basic Questions

Referrals to 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. Dollar amount 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, SBA officials, Lenders, Borrowers, contractors, and others should submit copies of documents that support the statements made in response to the questions listed in Subparagraph d.1. above, as part of the referral.

E. Post-referral Responsibility

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

1. Report any new or additional information discovered about the matter to OIG;

2. Not disclose or discuss the existence of the OIG referral or investigation with any Person other than SBA officials on a need-to-know basis;

3. Coordinate any activities related to the Loan with OIG in order to avoid taking any action that could interfere with the investigation or subsequent prosecution; and

4. With OIG approval, and in coordination with OIG, take appropriate and timely action to maximize recovery for the Loan.

Chapter 27.
Lender Wrap-up and SBA Charge Off

A. General Requirements

Lenders must submit a Wrap-up Report in electronic form to the appropriate SBA Loan Center for review and approval after all Prudent Liquidation activities are completed and there is little or no likelihood of timely, cost-effective recovery for an SBA Loan. Upon receipt and approval of the Wrap-Up Report by SBA, SBA will charge off and refer the remaining balance of any legally collectable Loan to Treasury for further collection. Lenders must retain their SBA Loan Files in accordance with the retention requirements established by their regulators, or for six years following the date of final disposition of an SBA Loan for SBA supervised Lenders. SBA Lenders must submit all relevant legal, bankruptcy or contractual notices received during the retention period to the appropriate SBA Loan Center for coordination with Treasury collection efforts. Lenders must also cooperate with SBA in the production of collateral release documents as needed, in conjunction with ongoing Treasury collection actions.

B. Lender Wrap-up Report

1. When Wrap-up Report Required

a. Lenders must submit a Wrap-up Report, including an assignment of the Loan Note, personal guarantees, and any judgments to SBA, in electronic form to the appropriate SBA Loan Center for review and approval within 30 calendar days after Prudent Liquidation is completed, or upon receipt of a request from SBA, whichever occurs first. After review and approval by SBA, SBA will charge off and refer any remaining Loan balance and legally obligated parties to Treasury for further collection actions.

b. In addition to the requirement to submit a Wrap-Up Report within 30 calendar days after completion of Prudent Liquidation, or upon request from SBA, Lenders must comply with SBA's Prudent Liquidation Deadline as defined in Chapter 2 of this SOP. SBA's Prudent Liquidation Deadline requires Lenders to prepare and submit an acceptable Wrap-up Report in an electronic form to the appropriate SBA Loan Center no later than 24 months after the date of SBA guaranty purchase, unless SBA approves an extension in writing prior to the expiration of the 24-month period. (See Chapter 24, Paragraphs E and F of this SOP for additional guidance on the Prudent Liquidation Deadline and extensions to the Prudent Liquidation Deadline for Lender resolution of SBA Loans.)

2. Consequences of Failure to Submit a Timely Wrap-up Report

If a Lender fails to submit a Wrap-up Report within the timeframe specified in Subparagraph B.1 above, in addition to referring the Lender to the SBA Office of Credit

Risk Management (OCRM) for possible enforcement action, SBA has the right to require the Lender to repurchase SBA's participation interest in the Loan, or proceed with charge off and referral of the Loan to Treasury for further collection, if appropriate, after the Lender assigns the Loan documents to SBA.

3. Contents of Wrap-up Report

Lenders must submit Wrap-up Reports in electronic form to the appropriate SBA Loan Center for SBA review and approval. All Wrap-up Reports must contain the information outlined in SBA's Wrap-up Report template found on SBA's website, and the following websites:

For loans serviced at the National Guaranty Purchase Center:
https://www.sba.gov/about-sba/sba-locations/loan-guaranty-centers/national-guaranty-purchase-center-herndon-va

For loans serviced at the Fresno or Little Rock Commercial Loan Servicing Centers:
https://www.sba.gov/about-sba/sba-locations/loan-guaranty-centers/commercial-loan-service-centers

C. SBA Loan Charge Off

1. General

SBA charge off is an administrative action whereby SBA reclassifies a Loan from "In liquidation" to "Charge Off" status. SBA charge off has no impact on an Obligor's liability for the Loan balance.

2. When Appropriate

SBA charges off a Loan after receiving, reviewing and approving a Lender Wrap-up Report in which the Lender confirms that it has:

a. Exhausted all Prudent Liquidation actions to achieve a recovery from: (1) voluntary payments on the Note; (2) liquidation of the collateral; (3) compromising the balance owed by the remaining Obligors; and (4) legally enforced collection actions; and

b. Determined that there are no further cost effective-collection actions available to the Lender and the Lender is either unable to locate the remaining Obligors or the remaining Obligors are unable and/or unwilling to repay the outstanding balance of the Loan; or

c. Determined that the Loan balance is legally uncollectible due to (1) a discharge in bankruptcy (i.e., the release of a debtor from any further personal liability for pre-bankruptcy debts), (2) the expiration of the statute of limitations (i.e., the passing of the deadline for suing to collect the Note), or (3) the existence of another valid

legal defense available to the remaining Obligors under state or federal law.

D. Assignment of Loan Documents and Referral to Treasury for Further Collection

1. When Referral Required

After charge off, if further collection is not barred by a valid legal defense such as compromise or discharge in bankruptcy, SBA refers the Loan and remaining Obligors to Treasury within the time period required by the Debt Collection Improvement Act of 1996 for further collection actions.

2. Assignment of Loan Documents to SBA

a. Lenders must assign the Loan Note and any personal guarantees or judgments to SBA in the SBA approved assignment form and submit it to SBA with their Wrap-up Report.

b. SBA may request Lenders to assign certain Loan Documents, including mortgages, judgments, UCCs or other unliquidated collateral documents, to SBA at any time and to record the requested assignment. Upon receipt of such a request, Lenders must assign all requested Loan Documents to SBA within five (5) business days and record the assignment of all requested Loan Documents to SBA in accordance with local practice. Lenders must not assign Loan Documents to SBA outside of the Wrap-Up process unless SBA requests such an assignment in writing. (See Paragraph B of this Chapter for Wrap-Up Report contents, which includes an assignment of the Note to SBA.)

3. Distribution of Post-Referral Recoveries

Lenders must submit any recoveries they receive for Loans that SBA has charged off and referred to Treasury within 15-days of receipt using payment code 172 in http://www.pay.gov/. SBA will remit the Lender's share of any recoveries received from the Treasury collection process (net of Treasury's Loan collection fees) according to the Lender's participation interest in the Loan. Lenders may direct questions regarding the distribution of post-SBA charge off recoveries to the SBA Treasury Offset Division in Birmingham, Alabama at:

Supervisory Loan Specialist
Treasury Offset Division
Fax: 202-481-5706
Email: BirminghamTOPS@sba.gov
Phone: 1-800-736-6048 Extension 3917

Note: Prior to referral, SBA sends an automated due diligence notice to the Obligors giving them 60 calendar days to either pay the Loan in full or negotiate an acceptable payment plan.

The two primary delinquent debt collection programs of the U.S. Treasury are the Treasury Offset Program ("TOP") and Cross-Servicing Program. They are managed by the Debt Management Services division ("DMS") of the Treasury Bureau of the Fiscal Service. Under TOP, delinquent debt is collected through administrative offset of funds due to Obligors from federal and state sources such as tax refunds, wages, retirement checks and contractor payments.

Under the Cross-Servicing Program, in addition to offset (i.e., TOP), 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, litigation, and preventing receipt of additional federal financial assistance.

4. Post-Referral Servicing

a. Exclusive Authority of Treasury Department

After SBA charges off and refers a Loan to Treasury for further collection, the Lender must retain the Loan File in accordance with the guidance provided in Chapter 3, Subparagraph D.5 of this SOP. Except as provided below with regard to post-Treasury referral litigation, no one other than Treasury may take any further servicing or liquidation action on the Loan. This exclusion applies to both SBA and the Lender.

b. Notice of Bankruptcy Filing or Other Litigation

Upon receipt of notice of a bankruptcy filing or other litigation concerning an SBA Loan referred to Treasury, the Person receiving the notice must immediately notify the SBA Treasury Offset Division in Birmingham, Alabama so that SBA may recall the Loan from Treasury and SBA District Counsel can take appropriate action in response to the litigation. Lenders should fax or email the notice, including the Borrower's name and SBA Loan number, to:

Supervisory Loan Specialist Treasury Offset Division Fax: 202-481-5706

Email: BirminghamTOPS@sba.gov

Phone: 1-800-736-6048 Extension 3917

Note: Regardless of whether a Lender originally serviced the SBA Loan, after SBA charges off and refers the Loan to Treasury, all subsequent litigation for the Loan is handled by SBA District Counsel. (See Chapter 3, Paragraph B of this SOP.) However, SBA District Counsel may request a re-assignment of the Loan Documents back to the Lender to handle litigation for the Loan.

E. Credit Reporting

1. Lender Responsibility for Credit Reporting

Lenders must report the combined balance of all SBA Loans, i.e., both Lender and SBA shares, to appropriate credit reporting agencies until they submit a final Wrap-Up Report that is acceptable to SBA. See Chapter 3, Subparagraph F.2 of this SOP for additional guidance on credit bureau reporting.

2. SBA Responsibility for Credit Reporting

SBA reports the combined balance of all Loans after SBA charge off, i.e., both Lender and SBA shares, to appropriate credit reporting agencies and federal delinquent debtor databases, e.g., Credit Alert Verification Reporting System ("CAIVRS").

Note: CAIVRS is an information system maintained by HUD that enables lenders to learn if an applicant has previously defaulted on a federally-assisted loan from the USDA, SBA, Department of Education, HUD or VA.

F. Reporting Cancelled Debt to IRS

1. When IRS Form 1099-C Required

SBA files an IRS Form 1099-C (Cancellation of Debt) in the name of the Borrower only—and not the Guarantors— and notifies the Borrower whenever the principal owed on an SBA loan is $600 or more and the Loan balance has become uncollectible as a result of, for example, compromise, discharge in bankruptcy or the completion of all Treasury collection actions.

2. Responsibility for Issuing IRS Form 1099-C

The SBA Denver Finance Center will issue an IRS Form 1099-C to both the Borrower and IRS for the aggregate amount of the uncollected balance of a charged off SBA Loan. The aggregate amount reported by SBA includes both the SBA and Lender shares of the Loan. SBA complies with IRS reporting requirements by filing a single IRS 1099-C for both the SBA and Lender.

3. When IRS Form 1099-C is Issued

a. SBA reports the uncollected balance of a compromised Loan in the calendar year after the year in which an approved compromise amount is paid in full;

b. SBA reports the uncollected balance of a Loan that is discharged in bankruptcy in the calendar year after the year in which the Loan is discharged; and;

c. SBA reports the uncollected balance of a charged off Loan that is not impacted by compromise or bankruptcy, in the calendar year after the year in which:

(1) An event occurs that renders the Loan uncollectible (e.g., the date the statute of limitations for collecting a Loan expires); or

(2) Treasury completes its collection actions and returns the Loan to SBA.