

SBA'S NEW SOP 5057 – 7(A) LOAN SERVICING & LIQUIDATION

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What changed? What you need to know.

What we will cover in today's session:

2

- ⑩ Purpose of this new SOP
- ⑩ Where & how to find answers
- ⑩ What ARE the changes in servicing?
- ⑩ Set up & outline of new SOP
- ⑩ What ARE the changes in liquidation?
- ⑩ Some reminders & definitions

A completely new SOP approach!

3

- ⑩ **Unlike other SOP's this NEW 5057 covers BOTH loan servicing AND loan liquidation and dedicated SOLEY to 7a loans.**
- ⑩ Changing the SOP structure from:
 - ⑩ SOP 5050 loan servicing SOP for ALL loans.
 - ⑩ SOP 5051 loan liquidation SOP for ALL loans.

What are the changes in this NEW SOP?

4



- ⑩ The adjustments/changes are listed in the SBA information notice (dated 3/1/13) Control #5000-1262 & are mainly:
 1. **How information is organized**
 2. **Some administrative changes**
 3. **Clarifying definitions.**

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Moving in the right direction....

5

A worthy goal to endeavor to be....

- ⑩ Clear
- ⑩ Complete
- ⑩ User friendly!



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EFFECTIVE March 1, 2013

6

This new “reference book” is evidence that SBA continues in its significant & consistent efforts to modernize the SBA loan process & simplify SBA loan requirements.

- ⑩ All changes up to this point in time are reflected within its pages!
- ⑩ Value added **HELPFUL HINTS** included!

What about the 504 loan program?

7

- ⑩ 504 loans are NOT addressed in the SOP 5057.

⑩ FYI ONLY:

Presently, a draft SOP for the 504 loan servicing & liquidation is in the “works” and

may be released within the next six months????

LOAN SERVICING changes & clarifications.....

8

1st loan servicing change:

⑩ Currently, an early default is defined as a loan “going south” before it is 18 months old.

⑩ Thus, this SOP then clearly defines a SEASONED loan as a loan that has been paying as agreed for over 18 months.

More on the “SEASONED LOAN” definition

9

⑩ **For your later reference, see Page 18 of the new SOP**

“**Seasoned Loan** or a loan that is “Seasoned” means that for 18 months after the initial disbursement or 18 months after the final disbursement if it occurred more than six months after the initial disbursement,

or if there was a default, the Borrower cured it and for 12 consecutive months following the 18 month post-disbursement period, the Borrower did not:

- ⑩ a. Fail to make a scheduled loan payment;
- ⑩ b. Fund a scheduled loan payment from the sale of collateral;
- ⑩ c. Have more than three consecutive scheduled full payments deferred; or
- ⑩ d. Experience an event of default that required the loan to be classified in liquidation.”

Environmental Risk Management

10

2nd loan servicing clarification:

- ⑩ Addresses loans in REGULAR servicing status rather than just in liquidation status.
- ⑩ Refer to page 34 of the new SOP

⑩ **“Environmental Investigation Process for Loans in Regular Servicing Status**

Environmental Investigations in support of regular loan servicing activities, e.g., substitution of collateral, should be conducted in accordance with SOP 50 10.”

Clear instructions for Loan actions!!!

11

3rd clarification:

⑩ As logic would have it, & as a reasonable & prudent lender would: all servicing decision must be **JUSTIFIED & documented**, without any potential appearance of conflict!

⑩ For your reference, SOP 5057 page 47:

“Credit Memo and Supporting Documents

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, should accompany a request for approval of a proposed Loan Action. Generally, it is not necessary to include a copy of the Borrower's financial statement or the Supporting Documents such as Appraisals, etc., provided that they are adequately analyzed in the credit memo.”

LOAN ACTIONS...

12

- ⑩ Previously referred to as:
SBA form 327 actions.
- ⑩ For your reference later, you can see SOP 5057 page 14 on...
- ⑩ Clear, complete LOAN ACTION RECORD:
- ⑩ Memos, Emails
- ⑩ Due diligence, analysis, justification etc. with supporting documentation

Loan action requests response time

13

- ⑩ SBA is to respond to a proposed loan action within 15 days from the date that SBA has received the request.



More on Servicing actions....

14

COMPLETE due diligence for servicing action request.

Recommendation:
maintain a copy in file of the servicing action matrix relied upon at the time of the action request!

- ⑩ Save everyone's time: there is NO need to request approval from SBA if lender can take unilateral action as defined on the matrix.

What if an SBA loan is assumed in a business acquisition transaction?

15

4th adjustment to loan servicing:

- ⑩ **“Subordination to Facilitate Assumption of the Loan**
- ⑩ The position of the lien securing a 7(a) Loan must not be subordinated to a loan that provides funds to an assumptor to acquire the business or assets of an Obligor,

unless the acquisition loan includes funds that will be used to make improvements to the collateral that will maintain or increase its value, in which case, the lien securing the SBA loan may be subordinated up to the documented amount spent on the improvements.”

For your later reference:

⑩SOP 5057 page 54. Paragraph 4

What are our “assumptions” in this “BIZ ACQ” scenario?

16



- ⑩ **An assumed SBA loan may be subordinated to the acquisition loan UP TO the amount of funds used to maintain or increase the collateral value!**

Changes in 7(a) Liquidations policies & procedures

17

1st of 8 changes in liquidation policy & procedures:

Financial Hardship definition clarified utilizing the COLLECTION FINANCIAL STANDARDS published by the IRS....purposes of uniformity, consistency.

⑩ <http://www.irs.gov/Individuals/Collection-Financial-Standards>

Reference SOP page 12, item 14

⑩ “**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.”

Prior to this SOP, “Financial Hardship” was not defined.

18

- ⑩ SOP 5051 3 loan liquidation
- ⑩ “1. General rule: The compromise amount must bear a reasonable relationship to the amount that could be recovered & applied to the SBA loan balance in a reasonable amount of time through enforced collection, and generally should be more than \$5,000.”
- ⑩ “2. The compromise amount may be \$5,000 or less in cases involving valid financial hardship.”

2nd change: Protective Bid – when senior lienholder starts foreclosure proceedings...

19

A Protective Bid should be entered at a senior lienholder's foreclosure sale if the Recoverable Value of the property is 10% or more of its Liquidation Value

unless a prudent lender would not enter a Protective Bid based on the circumstances, which are not reflected in the Appraisal but are documented in the Loan File.

⑩ (2) Protective Bid Amount

(a) Maximum Amount

The maximum amount of a Protective Bid should be the lesser of the balance owed on the SBA loan or the Recoverable Value of the collateral

More on Protective Bids....

⑩ “(b) Tolerance Range

..... Generally, an acceptable tolerance range is 10% above or below the authorized bid amount.

(c) Impact on Ability to Collect Deficiency

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

When NOT to enter a protective bid...

21

....at a senior lienholder's foreclosure sale if the recoverable value of the collateral is **LESS THAN 10%** of its liquidation Value.....

- ⑩ **A NO BID POSITION may also be justified if based on the circumstances, which are not reflected in the Appraisal but are documented in the loan file....A PRUDENT LENDER WOULD NOT ENTER A PROTECTIVE BID EVEN though the recoverable value of the collateral is 10% or more of its liquidation value**

3rd change: Release of Redemption Rights

22

“Release Right of Redemption for Consideration

- ⑩ If redemption rights are available under federal or state law but it would not be prudent or commercially reasonable to redeem the foreclosed-upon property, after the senior lienholder's foreclosure sale has been confirmed, the redemption rights associated with the SBA loan may be released upon receipt of cash in an amount approximately equal to 50% of the property's Recoverable Value.”

- ⑩ “Under federal law, as an Agency of the Federal Government, SBA (but not a 7(a) Lender) has one year from the date of a judicial foreclosure sale to redeem, i.e., buy back, the foreclosed-upon property (28 U.S.C. § 2410(c)). Under state law, SBA and the 7(a) Lender's redemption rights generally stem from their status as a junior lienholder. Whether junior lienholders have redemption rights varies by state. Consult legal counsel for case specific information and advice.
- ⑩ General Rule
- ⑩ The redemption rights on an SBA loan should be exercised whenever it would be prudent and commercially reasonable to do so, for example, when the property sells for less than expected at a senior lienholder's foreclosure sale. “

4th change: When Collateral MUST be liquidated:

23

- ⑩ The recoverable value dollar threshold for when collateral must be liquidated (and cannot be abandoned” has been raised...
- ⑩ **From \$2,500 to \$5,000 for personal property**
- ⑩ **From \$5,000 to \$10,000 for real property**

5th change: Offer in Compromise

24

- ⑩ A comment....as noted within SOP:
- ⑩ “When analyzing whether a proposed compromise amount is adequate, consideration may be given to whether the Obligor's cooperation during the liquidation process increased the overall recovery on the loan.”
- ⑩ Goes to **CHARACTER!**

Back to our 5th change in the area of COMPROMISE

25

⑩ Guidelines added for compromises with **going concerns.**

⑩ **...Which were not listed before...**

For your later reference, see page
119 in new SOP.

To summarize the five points:

1. Compromise must be necessary to avoid business closure
2. Borrower to pass Feasibility test for a successful workout
3. Compromise is part of an overall debt restructure
4. Documented in an executed written agreement
5. Fair & equitable treatment within borrowers treatment of all other creditors. (example: percentage of debt forgiven)

More regarding compromise

26

10 A consideration.....

- 10 “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 the offer does not ensure that it will be accepted. Rather, it begins a process of evaluation and verification by the Lender and SBA. Generally, an offer in compromise will be accepted if it reflects the Obligor’s true ability to pay, and will be rejected if the Obligor can pay the loan in full via a lump sum payment or an installment agreement, **or if acceptance of the offer would harm the integrity of the SBA loan program.**”

6th change: When requests for Recoverable Expenses may be submitted:

27

- ⑩ At submission of loan guaranty purchase request
- ⑩ At submission of wrap up report
- ⑩ When recoverable expenses total \$5,000 or more per loan
- ⑩ For your later reference: See Chapter 22 of this SOP, page 138. not other changes on type of expenses that are recoverable.

Item 7: what is your estimate of SBA repair amount?

28

- ⑩ “Lenders are encouraged to acknowledge errors & to include a repair estimate in their purchase package in order to expedite the repair & guaranty purchase process.”

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DISCLOSURE!***



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Verbiage from the SOP on repair estimate:

29

“If there was a Material Loss on the loan due to Lender error, include an acknowledgment of the error, an estimate of the amount needed to fully compensate SBA for the loss, and the justification for the estimate. For example, since the amount of loss related to collateral is based on its Recoverable Value,

if a required lien was not obtained on real or personal property, provide an estimate of the Recoverable Value that the property would have had if the lien had been obtained, along with a detailed explanation of how the Recoverable Value was calculated.

Although the acknowledgement is not mandatory and the estimate is not binding on SBA, providing both will expedite the Repair and guaranty purchase process.”

Last change #8: LOAN AGENTS!

30

- ⑩ NEVER USE a DEBARRED OR SUSPENDED LOAN AGENT!!!!
- ⑩ RISK IS A FULL GUARANTY DENIAL!
- ⑩ UNLESS lender provides CREDIBLE evidence that the business failed for totally unrelated reasons!!!

A favorite term: REASONABLE & PRUDENT

31

⑩ “...SBA loans must be serviced and liquidated in a diligent, conflict of interest and Preference-free, commercial reasonable manner that is consistent with the Loan Authorization, prudent lending practices and the SBA loan Program Requirements in EFFECT AT THE TIME THE ACTION IS TAKEN....”

⑩ IF the SOP does not say “MUST” in a process, then lenders can utilize their non-SBA commercial loan portfolio servicing & liquidation procedures provided that the procedures are:

Acceptable to the lender’s regulators

Treat the SBA loans the same as their non SBA loan

And are NOT incongruent with ANY SBA REQUIREMENTS

A clarified definition.....

32

- ⑩ What SBA formerly referred to as COLPUR (“collateral purchased”) is now defined as REAL ESTATE OWNED (“REO”)
- ⑩ Real property collateral acquired by a lender or the SBA

FULL CONTACT INFORMATION PROVIDED FOR SBA CENTERS

33

- ⑩ Beginning on page 16 of this new SOP is a list of the centers with several methods of contact.
- ⑩ The two servicing centers: West & East
- ⑩ National Guaranty Purchase Center
- ⑩ Standard 7(a) processing center

“Be yourself, everyone else is already taken...” Oscar Wilde



Chapters of the NEW SOP 5057:

35

- ⑩ Intro
- ⑩ Definition of terms
- ⑩ Lender responsibility & authority
- ⑩ Loan Payment administration
- ⑩ Environmental Risk Management
- ⑩ Servicing requests
- ⑩ Note modifications

The outline, continued...

36

- ⑩ Modification of collateral requirements
- ⑩ Insurance coverage
- ⑩ Modification of Management covenants
- ⑩ Assumption, assignment of sale of loan
- ⑩ Deferments
- ⑩ Delinquent Secured Senior Loans
- ⑩ Classifying loans in liquidation
- ⑩ Site visits

Outline of this SOP...continued

37

- ⑩ Workouts!
- ⑩ Real property
Collateral liquidation
- ⑩ Personal property
collateral liquidation
- ⑩ Acquired collateral
- ⑩ Offer in compromise
- ⑩ Litigation
- ⑩ Expenses & Recoveries
- ⑩ Loan guaranty purchase
requests
- ⑩ Denial of guaranty
- ⑩ Inspector General Referrals
- ⑩ Charge off and wrap up
procedures

SBA loan status terms

38

- ⑩ **Approval** – BEFORE closing & after SBA # assigned
- ⑩ **Regular servicing** – after loan closed & initial disbursement has been made.
- ⑩ **Liquidation** – if loan is in default and has been classified in LIQUIDATION status. See Chapter 14 of the new SOP 5057

Reminders! As if we did not know...but...

39

- ⑩ Lenders are responsible for servicing & liquidation regardless of guaranteed % or if guaranty has been purchased.
- ⑩ For your later reference, see page 22 on in this new SOP for actions that may require notice to SBA or require SBA's approval.

Reminders...

40

- ⑩ General rule on file retention:

At least six years following the final disposition of each loan & Lenders must, of course, to adhere to lender's regulator's requirements.

- ⑩ And, as logic would have it, an exception for loans in litigation....

In conclusion...KEY POINTS to remember:

41

Document , Document

Reasonable & Prudent

Full & Fast Disclosure

- ⑩ When SOP states “YOU MUST”, & you “DO NOT” for what you consider a credible, valid reason why, you must obtain SBA’s approval as an exception to policy before you proceed.

Thank you for tuning in...

42

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Loan Administration/Expertise in SBA Lending

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