

COMPLETE CONNECT

SOP 50 10 5 (f) Revisions: Credit Underwriting

SBA just recently released the newest version of the SOP 50 10 5 (F), effective January 1, 2014. Even though the new rules don't become effective for another month, now is the time to review, interpret, and commit it to memory. Keep in mind that SBA requires the applicant business to demonstrate that it can repay the proposed SBA debt in a timely manner from its own cash flow (not from secondary sources). However, when making a credit decision to determine viability of a business loan application, there are several other factors besides cash flow that must be analyzed and documented.

Starting on January 1, SBA will have different credit underwriting requirements for smaller loans as compared to what is required for the larger loans (over \$350,000).

Credit Underwriting for Small Loans: up to and including \$350,000

The smaller loans will be pre-screened for a SBA generated credit score via E-Tran (as is required for Small Loan Advantage loans now). If the application receives an acceptable credit score, it may be processed via E-Tran. If the loan application does not receive an acceptable credit score, the lender may submit a Standard 7(a) loan application to the LGPC, OR it can be processed through Express procedures for a 50% guaranty.

The credit memorandum must include:

- 1) Description and history of business
- 2) Management analysis
- 3) Debt service coverage ratio that exceeds 1:1 on a historical or projected cash flow basis
- 4) Global cash flow coverage ratio that exceeds 1:1 on a historical or projected cash flow basis (the lender must document in the loan file the definition or formula used to calculate global cash flow)
- 5) Owner and guarantor analysis

The lender may use their own credit scoring criteria for the applicant, operating company, its associates and guarantors as long as the lender uses the same business credit scoring model for its conventional small business loans. The lender must analyze the strength of the business including characteristics of the account such as internal credit/deposit behavior, credit bureau data, and Small Business Financial Exchange data. This may be conducted using a risk management or credit scoring model if the lender uses such a model for its conventional small business loans. If the lender does not have this ability, the lender must collect and analyze business tax returns.

The lender must determine if the equity and the pro-forma debt/net worth are acceptable based on their conventional lending policies for small business loans. If the lender requires an equity injection conventionally, it must do so for SBA loans.

Credit Underwriting for Large Loans: greater than \$350,000

Lenders must provide a full-blown credit memorandum outlining the following issues:

- 1) Description and history of business
- 2) Management analysis
- 3) Financial analysis of repayment ability based on historical financial statements and/or tax returns and projections
 - a. Debt service coverage must be 1.15:1 or greater on a historical and/or projected basis

- b. Analysis on a global basis, including analysis of affiliated business credit impact and personal guarantor strength
- 4) Pro-forma Balance Sheet analysis
- 5) Ratio calculations for current ratio, debt/tangible net worth, debt service coverage (and turnover ratios, as applicable)
- 6) Analysis of working capital adequacy to support projected sales growth in next 12 months
- 7) Collateral adequacy analysis (based on newly defined fully secured rules)
- 8) Determination of equity injection amount based on type of business, experience of management, and level of competition in the market area

The credit analysis should also include a discussion of competition, seller financing, standby agreements, 90+ day delinquencies, trade disputes, or Federal, State, or local citations.

As applicable, the lender should address:

- Liens, judgments, or bankruptcy filings
- Change of ownership discussion and business valuation analysis
- Franchise agreement review and any credit information provided on franchisor financial history
- Explanation of refinancing of any debts, particularly same institution debt, along with a transcript of account

In summary, SBA has split the credit underwriting criteria between smaller loans (\$350,000 or less) and larger loans (over \$350,000). The lender can lean more on their conventional credit guidelines for smaller loans after they have been credit scored by SBA (SLA process). However, if the loan is over \$350,000, a more thorough analysis that meets SBA credit criteria as it relates to the collateral “fully secured rule,” equity documentation, and a more thorough credit memorandum analysis. Again, these new procedures become effective January 1, 2014.

We assist in consulting and in outsourcing services. As it pertains to the new SOP changes, think of us as a resource to training and technical assistance. To learn more about the all-inclusive SBA lending services of SBA Complete, go to www.sbacomplete.com or call us at 800-801-2378.