

UNITED STATES SMALL BUSINESS ADMINISTRATION
WASHINGTON, D.C.

In the Matter of)	FINAL AGENCY DECISION
)	PERMANENTLY REVOKING
SEM RESOURCE CAPITAL, INC.)	AUTHORITY TO PARTICIPATE IN
)	504 LOAN PROGRAM AND
(Certified Development Company))	PERMANENTLY TRANSFERRING
)	504 LOAN PORTFOLIO

This Final Agency Decision (Decision) relates to SEM RESOURCE CAPITAL, INC. (SEM), a Michigan non-profit corporation authorized by the U.S. Small Business Administration (SBA or the Agency) to participate as a Certified Development Company (CDC) in the Agency's 504 Loan Program.

On September 30, 2013, pursuant to 13 C.F.R. § 120.1600(a)(1), the Agency served SEM with notice of (a) the proposed permanent revocation, pursuant to 13 C.F.R. § 120.1500(a)(3), of SEM's authority to participate in the 504 Loan Program, and (b) the proposed permanent transfer, pursuant to 13 C.F.R. § 120.1500(e)(1), of SEM's 504 Loan Portfolio and all of its pending 504 loan applications to SBA, another CDC or entity designated by SBA (hereinafter collectively referred to as "Notice" or "Notice of Proposed Enforcement Action").

Based upon a review of the record, including SBA records and submissions by SEM, and for the reasons detailed below, the Agency hereby renders its Decision as follows:

- SEM's authority to participate in all aspects of SBA's 504 Loan Program, including all delegations and powers associated therewith, is hereby PERMANENTLY REVOKED pursuant to 13 C.F.R. § 120.1500(a)(3).
- Pursuant to 13 C.F.R. § 120.1500(e)(1), the SBA 504 Loan Portfolio and all of the pending SBA 504 loan applications, and all rights associated therewith (including all processing, closing, servicing, late and other fees received and/or due and payable after the date of this Decision), are hereby TRANSFERRED ON A PERMANENT BASIS to Global Management Services, LLC (as agent for SBA), and such other entity or entities as the Agency shall hereafter direct.
- SBA's Central Servicing Agent, Wells Fargo Bank, N.A., is ordered to withhold from SEM and to transfer all processing, closing, servicing, late and other fees received and/or due and payable on the SBA 504 Loan Portfolio and the pending SBA 504 loan applications to SBA and/or such other entity or entities as the Agency shall hereafter direct.
- SEM is ordered to maintain all databases, records, files and documents associated with its dealings with SBA and its activities as a CDC, and to cooperate fully, allow such

access, provide all such information and documents to, and follow such instructions from SBA and its designated agent, Global Management Services, LLC, as well as Wells Fargo Bank, N.A. (as agent for SBA), as are associated with administering and implementing the foregoing permanent revocation and transfer.

This Decision is effective immediately.

I. SUMMARY OF DECISION

SBA's 504 Loan Program is a key component supporting the Agency's mission to assist small businesses by providing them with needed long-term capital not otherwise available to them to purchase or improve fixed assets or real estate. The purpose of the 504 Loan Program is to encourage economic development within a community. The 504 Loan Program is delivered through authorized CDCs, which act on the Agency's behalf to arrange, close, service and (when necessary) liquidate and collect on 504 Loans. CDCs arrange 504 Loans with pooled funds obtained through SBA from capital markets; CDCs do not use their own funds to make any 504 Loans. All 504 Loans are 100% guaranteed by SBA.

As of October 31, 2013, there are approximately 267 CDCs authorized to participate in SBA's 504 Loan Program with over \$28.8 billion in SBA 504 Loans under management. SEM has been an Agency-authorized CDC for 12 years. As of October 31, 2013, SEM has approximately 255 SBA 504 loans in its portfolio with a total outstanding balance of approximately \$131 million.

SEM is affiliated with a former CDC located in California, EDF Resource Capital, Inc. (EDF).¹ Until sometime in 2013, EDF performed all of SEM's SBA 504 Loan processing, closing and servicing functions under contract. Additionally, SEM owes EDF approximately \$3.4 million on an outstanding note that is due to mature in September, 2014. On December 17, 2012, SBA took enforcement action against EDF by issuing a final agency decision permanently revoking EDF's authority to participate in the 504 Loan Program and permanently transferring EDF's 504 Loan portfolio.

A subset of CDCs applies for and obtains delegated authority from the Agency to make determinations of creditworthiness for the 504 Loans they arrange on the Agency's behalf. (Ordinarily, this determination is reserved to the Agency.) This additional authority is called the "Premier Certified Lender Program," or "PCLP" program. SEM was granted PCLP authority in 2006. As of October 31, 2013, SEM has approximately 56 active (non-purchased) PCLP loans with an outstanding balance of approximately \$21.4 million.

In return for the delegated authority associated with PCLP status, to align incentives, and to reduce taxpayer exposure on 504 Loans arranged on a delegated basis, PCLP CDCs are statutorily required to bear a share of any losses suffered by the Agency on PCLP loans. In SEM's case, its loss-share is either 10% or 15% of the SBA loss on defaulted PCLP loans,

¹ EDF Resource Capital, Inc. a/k/a EDF is not affiliated with another CDC operating in Michigan---Economic Development Foundation a/k/a EDF.

depending when the PCLP loan was disbursed.

To provide a fund to help ensure payment of such loss-share, PCLP CDCs are required to calculate, fund as needed, and maintain a Loan Loss Reserve Fund. A PCLP CDC is liable for its entire loss-share on its PCLP loans whether or not its Loan Loss Reserve Fund has sufficient funds to cover that share; but the Loan Loss Reserve Fund is intended to provide a ready and secure source for payment to SBA in order to help protect the taxpayers from loss. In this respect, CDCs receive substantial fees, throughout the life of a loan, from payments made by borrowers on 504 Loans. PCLP CDCs are expected to husband this fee revenue carefully; to fund their Loan Loss Reserve Fund in a full and timely manner; and to timely pay their agreed share of any losses ultimately suffered by the SBA on PCLP loans. If a PCLP CDC fails to pay its loss-share, SBA may, among other remedies, recover the funds from the CDC's Loan Loss Reserve Fund.

When SEM was granted PCLP authority in 2006, it was required to establish a Loan Loss Reserve Fund equal to 1% of the original principal amount of each of its outstanding PCLP loans pursuant to SBA's Standard Loan Loss Reserve Fund Requirement, 13 C.F.R. § 120.847(b). Starting with the Quarter beginning October 1, 2008, SEM elected to participate in an Alternative Loan Loss Reserve Program, a statutory pilot authorized under section 508(c)(7) of the Small Business Investment Act of 1958, as amended. The Alternative Loan Loss Reserve funding mechanism was just that: an alternative method for funding a loan loss reserve that was risk-based instead of the across the board 1% of the original principal amount of outstanding PCLP loans. The statutory authority for the Alternative Loan Loss Reserve pilot program lapsed on July 31, 2011, and SBA notified SEM that due to the statutory lapse, SEM must contribute to its Loan Loss Reserve Fund an amount sufficient to meet the 1% Standard Loan Loss Reserve Fund Requirement.

In addition to the above requirements, SBA's regulations require that a CDC must maintain the financial ability to operate, defined as being able to sustain its operations continuously, with reliable sources of funds. The financial ability to operate is a core requirement that must be met by all CDCs, but is critical for a CDC that has potential PCLP reimbursement obligations to SBA. Furthermore, as a regulated CDC managing a portfolio of 504 Loans, SEM is subject to an ongoing series of duties requiring prudent and timely management and reporting with respect to the servicing and liquidation of its SBA 504 Loan portfolio.

Contrary to the SBA requirements identified herein, the evidence in the record discloses the following:

1. Instead of remitting faithfully to the Agency all sums due to it, as of the date of this Decision, SEM has failed to pay approximately \$1,584,094.28 (plus interest and penalties) in invoiced PCLP reimbursement obligations.
2. Instead of remitting faithfully to the Agency all liquidation recoveries on defaulted SBA 504 Loans, SEM has failed to remit SBA's share of the approximately \$5.6 million in proceeds from the sale of SBA's collateral, approximately \$278,000 in other liquidation recoveries, and approximately \$623,547 in other funds on

SEM's largest defaulted SBA 504 loan.

3. Instead of servicing and liquidating its largest defaulted SBA 504 loan in accordance with prudent and commercially reasonable lending standards, SEM has allowed its affiliated servicer, EDF, a revoked CDC, to dissipate the liquidation proceeds held in trust for SBA.
4. Instead of maintaining sound financial status, SEM's most recent audited financial statements for the fiscal year ending September 30, 2012 show that SEM is insolvent and SEM's independent auditor has issued a going concern opinion finding that there is "substantial doubt about [SEM's] ability to continue as a going concern."
5. Instead of maintaining sound financial status, SEM's approximately \$3.4 million debt to EDF, a revoked CDC, increases SBA's financial risk.
6. Instead of fully funding its Loan Loss Reserve Fund as required by statute and regulation, SEM has repeatedly failed to adequately fund its Loan Loss Reserve Fund and does not have the ability to contribute the \$261,838.65 currently required to fully fund its Loan Loss Reserve Fund under the Standard Loan Loss Reserve Fund Requirement.
7. Instead of properly evaluating and maintaining its Alternative Loan Loss Reserve Fund, SEM dropped loans from its required Quarterly Reports to SBA and failed to reserve for the dropped loans.
8. From fiscal years 2004 through 2012, SEM, a non-profit corporation, received over \$5,397,129 in fees from its participation in the 504 Loan Program. However, SEM is not currently in a position to manage or discharge its obligations as a CDC going forward. SEM's financial statements reveal that it has no funds or assets with which to discharge its debts and obligations. SBA has invoiced SEM for approximately \$1.64 million based on SEM's loss-share on 11 charged-off PCLP loans. SEM has paid only 2 of the 11 PCLP reimbursement obligation invoices and still owes SBA approximately \$1.58 million (plus interest and penalties). In addition, as of October 31, 2013, SEM has approximately 5 additional purchased PCLP loans in its portfolio with a total outstanding balance of approximately \$3,379,419. SEM's potential 10% PCLP loss reimbursement exposure on the 5 additional purchased PCLP loans totals approximately \$337,942. SEM's Loan Loss Reserve Fund currently contains only approximately \$120,401.35, an amount insufficient to pay current or contingent PCLP reimbursement obligations. SEM admits that it is only able to contribute a total of \$8,000 a month towards its obligations.

On September 30, 2013, SEM was provided with notice of the grounds for this enforcement action and was given an initial 30-day response time to object to the Agency's Notice of Proposed Enforcement Action. SBA granted SEM's request for a 30-day extension from October 30, 2013 to November 29, 2013 to file a written objection to the Notice. On November

29, 2013, SEM submitted a four-page response that does not set forth any grounds to contest the proposed enforcement action and that acknowledges the failures and monetary obligations detailed in the Notice of Proposed Enforcement Action (“SEM’s November 29, 2013 Response” or “SEM’s Response”). Nevertheless, SEM urges SBA to allow it to continue in the 504 Loan Program based on certain alleged mitigating factors, including its qualified staff and management, its commitment to the program, and a proposed minimal monetary contribution to its LLRF.

For the reasons discussed more fully herein, SBA has determined that SEM’s submissions do not justify the ongoing and fundamental failures identified herein. Rather, SEM’s breaches support the following determinations:

1. SEM has failed to comply materially with SBA’s Loan Program Requirement to pay invoiced obligations in a timely manner as required by 15 U.S.C. § 697e(b)(2)(C) and/or 13 C.F.R. § 120.847(h)(2). Thus, SBA has sufficient grounds for the enforcement action pursuant to 13 C.F.R. § 120.1400(c)(2).
2. SEM has failed to comply materially with SBA’s Loan Program Requirement to remit liquidation proceeds and other funds to SBA as required by SBA’s Standard Operating Procedure 50 51 3 (as amended) governing 504 Loan Liquidation. Thus, SBA has sufficient grounds for the enforcement action pursuant to 13 C.F.R. § 120.1400(c)(2).
3. SEM has failed to comply materially with SBA’s Loan Program Requirement to service and liquidate its largest defaulted SBA 504 loan in accordance with prudent and commercially reasonable lending standards as required by 13 C.F.R. § 120.848(a) and 13 C.F.R. § 120.970(a). Thus, SBA has sufficient grounds for the enforcement action pursuant to 13 C.F.R. § 120.1400(c)(2).
4. SEM has failed to comply materially with SBA’s Loan Program Requirement to maintain the financial ability to operate continuously and with reliable sources of funds as required by 13 C.F.R. § 120.825. Thus, SBA has sufficient grounds for the enforcement action pursuant to 13 C.F.R. § 120.1400(c)(2).
5. SEM has failed to establish or maintain a Loan Loss Reserve Fund as required by the PCLP Program pursuant to 13 C.F.R. § 120.847 and 15 U.S.C. § 697e(c)(2). Thus, SBA has sufficient grounds for the enforcement action pursuant to 13 C.F.R. § 120.1400(f)(2).

It is SBA’s determination that these grounds, independently and cumulatively, are sufficient to support the Decision.

The nature, extent and severity of SEM’s breaches and violations, including the dollar magnitude of current obligations and financial risk, along with SEM’s insolvency and inability to correct the deficiencies, and program integrity considerations, warrant the permanent revocation of SEM’s authority to participate as a CDC in the 504 Loan Program. The

revocation of SEM's 504 program authority precludes SEM from continuing to close and service SBA 504 Loans and process pending SBA 504 Loan applications, requiring the permanent transfer of those functions to an entity or entities authorized by SBA to perform such functions in accordance with applicable law. For the above reasons, and based upon the detailed discussion set forth herein, the Agency has decided to affirm and proceed with the proposed enforcement action and renders its Decision as set forth herein.

II. FACTUAL BACKGROUND

A. Overview of SBA's 504 Loan Program

The mission of SBA, an independent Federal agency, is to "aid, counsel, assist, and protect, insofar as is possible, the interests of small-business concerns in order to preserve free competitive enterprise." *See* 15 U.S.C. § 631. SBA carries out this mission, in part, through two flagship loan programs that provide small business concerns with access to capital. One of the SBA loan programs is the 504 Loan Program, authorized by Title V of the Small Business Investment Act of 1958.² *See* 15 U.S.C. § 695 *et seq.* The purpose of the 504 Loan Program is to foster economic development, create or preserve job opportunities, and stimulate growth, expansion and modernization of small business concerns by providing long-term financing not otherwise available to small business concerns for the acquisition, construction, conversion or expansion of fixed assets, including real estate and heavy machinery and equipment. *See* 15 U.S.C. §§ 695(a) and 696(a). SBA's regulations governing the 504 Loan Program are located in Subpart H of Title 13, Part 120 of the Code of Federal Regulations. The outstanding balance of SBA's portfolio of 504 Loans exceeds \$28.8 billion.

SBA does not make loans directly to small business concerns under the 504 Loan Program. *See* 15 U.S.C. § 695. Instead, as required by statute, CDCs deliver SBA's 504 Loan Program to small business borrowers on behalf of SBA. *Id.* CDCs are generally (but not exclusively) non-profit corporations certified and regulated by SBA that are organized to contribute to the economic development of a particular community or region. *See* 13 C.F.R. § 120.820. CDCs receive processing and closing fees for originating 504 Loans on behalf of SBA and servicing fees for servicing 504 Loans on behalf of SBA. *See* 13 C.F.R. § 120.971. There are currently approximately 267 CDCs participating in SBA's 504 Loan Program.

SBA agrees to provide 504 project financing to a small business borrower by issuing an Authorization for Debenture Guarantee--SBA 504 Loan (Loan Authorization) outlining the terms and conditions of the financing. Financing of a 504 project typically has three components:

- A loan from a private Third Party Lender secured by a senior lien covering up to 50 percent of the project cost (Senior Third Party Lender Loan)
- A loan from a CDC (made on behalf of SBA and funded through the CDC's issuance of a 100% SBA-guaranteed debenture) secured by a junior (subordinate) lien covering up to 40 percent of the project cost (504 Loan)

² This program has been operating in various forms since 1958.

- An equity contribution from the small business borrower of at least 10 percent of the project cost (Borrower Contribution)

See 13 C.F.R. § 120.801.

The Senior Third Party Lender Loan is generally closed first, with the small business borrower executing loan documents in favor of the Senior Third Party Lender and the Senior Third Party Lender recording a mortgage or deed of trust in first position on the 504 project property. See 13 C.F.R. § 120.921. The 504 Loan is closed next, with the small business borrower executing loan documents in favor of the CDC and the CDC recording a subordinate mortgage or deed of trust on the 504 project property. See Loan Authorization. At closing, the CDC immediately assigns and delivers the executed 504 Loan documents and recorded subordinate mortgage or deed of trust to SBA. See 504 Debenture Closing Checklist, SBA Form 2286.

No CDC monies are used to fund a 504 Loan. A 504 Loan is funded by the sale of a CDC debenture that is 100% guaranteed by SBA and backed by the full faith and credit of the United States. See 15 U.S.C. § 697 and 13 C.F.R. § 120.801(d). SBA conducts monthly sales of pooled SBA-guaranteed CDC debentures to investors in conjunction with SBA's Central Servicing Agent (CSA), Wells Fargo Bank, N.A.

SBA's CSA collects borrower payments on 504 Loans through monthly Automated Clearing House (ACH) debits. The CSA pays out various fees from the borrower's monthly payment, including servicing fees to the CDC, and holds the remaining monthly payment amount. See Servicing Agent Agreement, SBA Form 1506. The CSA then makes semi-annual payments to the investors on the SBA-guaranteed CDC debentures using the monthly payment amounts collected from the borrowers. *Id.*

If a 504 Loan defaults and the borrower does not resume regular payments within a certain time period, SBA is obligated under the terms of its guarantee to purchase the full amount (principal and accrued interest) of the SBA-guaranteed CDC debenture from the investor holding the debenture.³ See 13 C.F.R. § 120.938. SBA, as the 100% owner of the defaulted 504 Loan, then seeks to recover from the small business borrower through collection activities carried out by SBA or by a CDC on behalf of SBA.⁴ See 13 C.F.R. § 120.975(a).

B. CDC Role in 504 Loan Program and SBA Oversight of CDCs

In order to become a CDC, an entity submits an application to SBA for CDC certification. See 13 C.F.R. § 120.810. Certification by SBA is the sole method for being recognized as a CDC. To be designated as a CDC, the applicant must demonstrate that it satisfies the CDC certification and operational requirements identified in 13 C.F.R. § 120.810(c).

A CDC must be a non-profit corporation with at least 25 members representing government organizations, financial institutions, community organizations and businesses actively

³ SBA uses federal funds for these purchases. See Small Business Investment Act, 15 U.S.C. § 697(g).

⁴ Generally, if the 504 Loan goes into default, the Senior Third Party Lender Loan defaults as well.

supporting economic development in the CDC's Area of Operations.⁵ *See* 13 C.F.R. § 120.822. The CDC must have a Board of Directors chosen from the CDC membership, which is required to meet quarterly and be responsible for CDC staff decisions and actions. *See* 13 C.F.R. § 120.823. A CDC is also required to have full-time professional management and staff to carry out its daily operations. *See* 13 C.F.R. § 120.824. Unless otherwise approved by SBA, a CDC must operate only within its Area of Operations, which generally means the state where the CDC is incorporated. *See* 13 C.F.R. § 120.821. A CDC must maintain the financial ability to operate, which is defined as the ability to "sustain its operations continuously, with reliable sources of funds." *See* 13 C.F.R. § 120.825. Any funds generated by the CDC from 504 Loan Program activity that remain after payment of staff and overhead expenses must be retained by the CDC as a reserve for future operations or for investment in other local economic development activity. *Id.* A CDC must maintain good standing in the CDC's state of incorporation, and have satisfactory SBA performance as determined by SBA in its discretion. *See* 13 C.F.R. § 120.820.

Most importantly, a CDC must comply with all of SBA's Loan Program Requirements. *See* 13 C.F.R. § 120.826. The definition of Loan Program Requirements is found in SBA's regulations as follows:

. . . [R]equirements imposed upon Lenders or CDCs by statute, SBA regulations, any agreement the Lender or CDC has executed with SBA, SBA SOPs, official SBA notices and forms applicable to the 7(a) and 504 loan programs, and loan authorizations, as such requirements are issued and revised by SBA from time to time. For CDCs, this term also includes requirements imposed by Debentures, as that term is defined in § 120.802.

See 13 C.F.R. § 120.10.

SBA is the primary regulator of CDCs.⁶ In order to carry out its regulatory and oversight responsibilities, SBA requires a CDC to submit an Annual Report within 180 days after the end of the CDC's fiscal year and such interim reports as SBA may require. *See* 13 C.F.R. § 120.830(a). If the CDC has a 504 Loan portfolio balance of \$20 million or more, the CDC's annual report must contain audited financial statements, with an auditor's opinion as to the fairness of the financial statements and their compliance with Generally Accepted Accounting Principles (GAAP). *See* 13 C.F.R. § 120.826(c). CDCs are also subject to SBA's risk-based lender oversight regulations contained in Subpart I of 13 C.F.R. Part 120. SBA's oversight of CDCs includes the right to review, inspect and copy all records and documents, and to perform periodic on-site reviews and off-site monitoring. *See* 13 C.F.R. §§ 120.1025 and 1050. Finally, CDCs are subject to SBA's lender enforcement process which is set forth at 13 C.F.R. § 120.1400 *et seq.* Those regulations provide the process and grounds for the Agency's enforcement action against a CDC.

⁵ SBA's regulations grandfathered in for-profit CDCs certified by SBA prior to January 1, 1987. *See* 13 C.F.R. § 120.820. SEM is a non-profit CDC.

⁶ CDCs are not depository institutions, and therefore are generally not subject to periodic examinations by any other federal or state regulatory authority. *See* SOP 51 00, ch. 1, para. 1.

C. SEM Began Participating as a CDC in 2001

SEM is a non-profit corporation organized under the laws of the State of Michigan. On January 11, 2001, SEM filed Articles of Incorporation under its former name, MCDC Resource Capital, Inc.⁷ On November 7, 2001, SBA certified SEM as a CDC and SEM began participating in the 504 Loan Program.⁸ In order to avoid confusion with an unrelated Michigan-based CDC using the acronym “MCDC,” SEM changed its name to SEM REsource Capital, Inc. on April 25, 2002.⁹

SEM is currently headquartered in Livonia, Michigan. SEM’s authorized Area of Operations includes the State of Michigan as well as certain contiguous counties in Ohio.¹⁰ SEM is one of six SBA-approved CDCs currently operating in the Michigan market. Between Fiscal Years 2001 through 2013, SEM’s market share was 18% of the dollar amount of SBA 504 Loans approved in Michigan. As of October 31, 2013, SEM had approximately 255 loans in its SBA 504 Loan portfolio with a total outstanding balance of approximately \$131 million. From fiscal years 2004 through 2012, according to SEM’s annual financial statements, SEM, a non-profit corporation, received approximately \$5,397,129 in fees from its participation in the 504 Loan Program.¹¹

SEM is affiliated with a former CDC located in Folsom, California---EDF REsource Capital, Inc. From the time of SEM’s filing of its Articles of Incorporation in 2001 until 2004, Frank Dinsmore, the CEO of EDF, was also the CEO of SEM. As a condition of granting permanent CDC status to SEM, SBA required SEM to appoint a full-time CEO who was not operating another CDC.¹² Marlies Dinsmore, the spouse of Frank Dinsmore, was appointed CEO of SEM and has been acting in that capacity since 2004. As CEO, Marlies Dinsmore is responsible for overseeing all operations of SEM. Marlies Dinsmore maintains her office in Folsom, California, not in Livonia, Michigan. Her office is located in the same building that houses EDF’s offices.

Since the start of SEM’s participation in the 504 Loan Program in 2001, SEM has contracted with EDF to provide marketing, processing, closing and servicing of SEM’s SBA 504 loans

⁷ See Articles of Incorporation of MCDC Resource Capital, Inc. filed January 11, 2001 with the Michigan Department of Consumer and Industry Services.

⁸ See Letter from Jane Palsgrove Butler, Associate Administrator for Financial Assistance, to Frank Dinsmore, CEO, MCDC Resource Capital, Inc., dated November 7, 2001.

⁹ See Certificate of Amendment to the Articles of Incorporation filed April 25, 2002 with the Michigan Department of Consumer and Industry Services. The unrelated Michigan-based CDC is the Michigan Certified Development Company a/k/a MCDC.

¹⁰ See Administrative Action dated January 26, 2007 (Ohio Local Economic Area Expansion). The counties in Ohio are Fulton, Lucas and Ottawa.

¹¹ See SEM Financial Statements (FY 2004-2012).

¹² See Letter from James Rivera, Associate Administrator for Financial Assistance, to Joseph Vassallo, President of the Board of Directors, SEM REsource Capital, Inc., dated March 26, 2004.

under a Loan Program Services Agreement (EDF Contract).¹³ Under the contract, EDF essentially performed all of SEM's functions as a CDC.

SEM's operations were supported by a line of credit extended to SEM by EDF, evidenced by a Promissory Note (EDF Note).¹⁴ The original amount of the EDF Note was \$100,000. As EDF performed services for SEM under the EDF Contract, the amount allegedly due and unpaid under the EDF Contract was added to the unpaid principal balance of the EDF Note.¹⁵ The EDF Note was amended several times to increase the maximum principal amount. The last amendment to the EDF Note of which SBA is aware was made on September 28, 2012 and increased the maximum amount to \$4 million.¹⁶ By letter to SBA dated April 5, 2013, SEM reported that the balance of the EDF Note was \$3,477,616.65.¹⁷ The EDF Note bears interest at the rate of seven percent per annum. The EDF Note matures on the last day of SEM's thirteenth fiscal year, which is September 30, 2014.

On December 17, 2012, SBA took enforcement action against EDF by issuing a final agency decision permanently revoking EDF's authority to participate in the 504 Loan Program and permanently transferring EDF's 504 loan portfolio to a servicing contractor. On December 21, 2012, the United States District Court for the District of Columbia denied EDF's request for a Temporary Restraining Order enjoining SBA from enforcing the final agency decision.¹⁸ SBA has filed suit against EDF in an attempt to collect over \$17 million owed by EDF to SBA.¹⁹ The matter is still pending and SBA has obtained pre-judgment remedies against EDF under the Federal Debt Collection Procedures Act due to EDF's dissipation of funds.

The EDF Contract provided that SEM could terminate the EDF Contract if SBA revoked EDF's authority to operate as a CDC. On April 5, 2013, SEM notified SBA that it had hired staff to directly manage its SBA 504 Loan portfolio underwriting, closing and servicing functions in-house.²⁰ The staff hired by SEM included four former employees of EDF. Subsequently, in SEM's November 29, 2013 Response to the Notice, SEM notified SBA that it had terminated the EDF Contract and "no longer relies on EDF for any services or other functions."

¹³ See SBA 504 Loan Program Services Agreement between MCDC Resource Capital, Inc. and EDF (October 30, 2001) and SBA 504 Loan Program Services Agreement between SEM and EDF (March 11, 2005).

¹⁴ See Promissory Note between MCDC Resource Capital, Inc. (renamed SEM) and EDF (undated), as amended.

¹⁵ It is SBA's understanding that EDF also paid itself for services rendered under the EDF contract from the processing, closing and servicing fees that SEM received from its participation in the 504 Loan Program. It is also SBA's understanding that Marlies Dinsmore received compensation through her ownership of Capital Closing Services, LLC, a California limited liability company that received a closing fee on each SBA 504 Loan processed by SEM.

¹⁶ See Amendment to Promissory Note between SEM and EDF (as of September 28, 2012).

¹⁷ See Letter from Marlies Dinsmore, CEO, SEM to Michael Simmons, Acting Director, OFA, SBA (April 5, 2013).

¹⁸ See *EDF Resource Capital, Inc. v. United States Small Business Administration*, 910 F.Supp. 280 (D.D.C. 2012).

¹⁹ See *United States of America v. EDF Resource Capital, Inc., et al.*, United States District Court for the Eastern District of California, case no. 2:13-cv-01158-LKK-EFB.

²⁰ See Letter from Marlies Dinsmore, CEO, SEM to Michael Simmons, Acting Director, OFA, SBA (April 5, 2013).

D. CDC Statuses (Regular, ALP and PCLP)

Prior to 1994, all CDCs submitted SBA 504 Loan applications to SBA for SBA review and approval (“Regular” status). This process involved an SBA review of each application to determine if the borrower met SBA’s eligibility requirements, including creditworthiness. Upon approval, SBA would issue a Loan Authorization signed by SBA. In 1994, Congress statutorily authorized SBA to implement two programs to provide qualified CDCs with delegated authority to carry out certain functions previously reserved for SBA. *See* Small Business Administration Reauthorization and Amendments Act of 1994, Pub. L. 103-403, 108 Stat. 4175. Those two programs are the Accredited Lenders Program (ALP) authorized by 15 U.S.C. § 697d²¹ and the Premier Certified Lenders Program (PCLP) authorized by 15 U.S.C. § 697e. SBA’s regulations governing the ALP program are located at 13 C.F.R. § 120.840 *et seq.* SBA’s regulations governing the PCLP program are located at 13 C.F.R. § 120.845 *et seq.*

Upon application, SBA may designate a CDC as an ALP CDC provided that the CDC meets certain statutory and regulatory requirements. *See* 15 U.S.C. § 697d. The ALP CDC designation is for two years, with periodic renewals. *See* 13 C.F.R. § 120.840(e). ALP CDCs are delegated responsibility for thorough credit and eligibility analysis on loan applications. *See* SBA SOP 50 10 5(E), sub. A, ch. 3, para. V.B. SBA relies on the ALP CDC’s credit analysis in making the decision to approve the 504 Loan and to complete the processing of the loan application in a reduced timeframe. When SBA approves a 504 Loan application submitted by an ALP CDC, SBA issues a Loan Authorization signed by SBA. *Id.*

Upon application, SBA may designate a CDC as a PCLP CDC provided that the CDC meets certain additional statutory and regulatory requirements. *See* 15 U.S.C. § 697e. The PCLP CDC designation is for two years, with periodic renewals. *See* 13 C.F.R. § 845(e). Upon approval and at each renewal as a PCLP CDC, the CDC must follow the SBA Loan Program Requirements for the PCLP Program. *See* 13 C.F.R. § 120.846; SBA SOP 50 10 5(E), sub. A, ch. 3, para. V.C. PCLP CDCs have delegated authority to process (underwrite) and close 504 Loans.²² *See* 13 C.F.R. § 845(a). Instead of SBA, PCLP CDCs make the credit decisions on PCLP loan applications. *See* 13 C.F.R. § 120.848. SBA does not review the PCLP CDC’s credit decision. *See* SBA SOP 50 10 5(E), sub. A, ch. 3, para. V.C. The only review that SBA performs on these loan applications is a review of an eligibility checklist submitted to SBA by the PCLP CDC. *See* SBA SOP 50 10 5(E), sub. C, ch. 4, para. III.B. The SBA review of the form is a “quick look” at eligibility intended to provide limited protection to SBA and the CDC from making an ineligible loan. *See* Eligibility Information Required for PCLP Submission,

²¹ The ALP program began as a demonstration program in 1991 before being made permanent by statute in 1994. *See* Small Business Administration Reauthorization and Amendments Act of 1994, § 212, 15 U.S.C. § 697d.

²² Congress modeled the PCLP program after the Preferred Lender Program (PLP) that it authorized by statute (15 U.S.C. § 634(b)(7)) in 1980 for SBA’s other flagship business loan program, the 7(a) program. *See* H.R. Rep. No. 108-153 (2003). Delegating lending functions to SBA lenders allows small business borrowers faster, more efficient, access to capital. When the PCLP CDC Program was authorized, CDCs found the program attractive due to the shortened time period for obtaining SBA approval of 504 Loans. SBA does not perform a credit review on PCLP loan applications. The shortened time period for SBA approval gives PCLP CDCs a competitive advantage over Regular CDCs. This allows the PCLP CDCs to grow their 504 Loan portfolios and increase the amount of origination and servicing fees received by the CDCs.

SBA Form 2234 (Part C). After SBA has determined that the 504 Loan is eligible based on the checklist review, SBA issues a PCLP loan number to the CDC. The CDC then issues a Loan Authorization and signs it *on behalf of SBA*.²³

A PCLP CDC is not required to make all 504 Loans using its PCLP delegated authority. It may elect to submit loan applications to SBA for Regular or ALP processing and approval by SBA. All 504 Loans made by a PCLP CDC using its PCLP delegated authority are treated as “PCLP Loans.” *See* PCLP Loan Guaranty Agreement, para. 2.

PCLP CDCs also have delegated authority to service and liquidate 504 Loans and may be given increased authority to litigate 504 Loans. *See* 13 C.F.R. § 120.848(f). In contrast to Regular CDCs where SBA handles liquidation and collection activities on defaulted 504 Loans, a PCLP CDC must service, liquidate and handle debt collection litigation with respect to all PCLP loans in its portfolio *on behalf of SBA*. *See* 13 C.F.R. §§ 120.848(f) and 120.975.

SBA approved SEM for ALP status for a two-year period starting on April 27, 2006.²⁴ SBA also approved SEM for PCLP delegated authority for a two-year period starting on May 1, 2006.²⁵ As a PCLP CDC, SEM was authorized to approve 504 loans without an SBA review of creditworthiness.²⁶ By approving 504 loans under its PCLP delegated authority, SEM agreed to bear a share of any losses suffered by SBA on those loans. By statute and regulation, SEM is also required to maintain a Loan Loss Reserve Fund for each PCLP loan to cover its PCLP reimbursement obligations. *See* 15 U.S.C. § 697e(b)(2)(C); 13 C.F.R. § 120.847. Under its PCLP delegated authority, SEM made a total of approximately 81 SBA 504 loans.

E. PCLP Reimbursement and Loan Loss Reserve Fund Requirements

In exchange for the delegated authority to approve and make the credit decisions on 504 Loan applications, PCLP CDCs are ordinarily required by statute to reimburse SBA for 10% of any loss sustained by the SBA as a result of a default under a PCLP Loan. *See* 15 U.S.C. § 697e(b)(2)(C). The PCLP CDC is statutorily required to establish and maintain a Loan Loss Reserve Fund sufficient for the CDC to meet its obligations to protect SBA from the risk of loss. *See* 15 U.S.C. § 697e(b)(2)(D). The statute also requires a PCLP CDC to provide a collateral assignment of its Loan Loss Reserve Fund to SBA in order to secure repayment of its PCLP reimbursement obligations. *See* 15 U.S.C. § 697e(c)(3)(A).

By statute, the standard amount of a PCLP CDC’s Loan Loss Reserve Fund ordinarily must be 10% of the PCLP CDC’s exposure (i.e., 10% of the PCLP CDC’s 10% loss reimbursement

²³ *See* Authorization for Debenture Guarantee (SBA 504 Loan).

²⁴ *See* Letter from James Hammersley, Acting Deputy Associate Administrator for Financial Assistance, SBA to Joseph Vassallo, President Board of Directors, SEM (May 19, 2006).

²⁵ *See* Letter from Richard Taylor, Center Director, SBA to Brian Taggart, Regional Manager, SEM (May 22, 2006).

²⁶ SEM’s PCLP authority was scheduled to expire on May 1, 2008; however, there appears to be no written expiration, renewal or revocation of SEM’s PCLP authority on or after such date. SEM continued to make PCLP loans after May 1, 2008.

requirement to SBA on each PCLP Loan). *See* 15 U.S.C. § 697e(c)(2). SBA's regulations require that for each PCLP Loan, the PCLP CDC must ordinarily establish and maintain a Loan Loss Reserve Fund equal to one percent (10% of 10%) of the original principal amount of each PCLP Loan (Standard Loan Loss Reserve Fund Requirement). *See* 13 C.F.R. § 120.847(b). The amount a PCLP CDC must maintain under the Standard Loan Loss Reserve Fund Requirement for each PCLP Loan remains the same even as the principal balance of the PCLP Loan is paid down over time. *Id.* The statute and SBA's regulations provide a schedule for the PCLP CDC to make the required Standard Loan Loss Reserve Fund Requirement deposits for each PCLP Loan, with the full deposit amount required to be made no later than two years after the PCLP Loan closing. *See* 13 C.F.R. § 120.847(e) and 15 U.S.C. § 697e(c).

The purpose of the reserve amount required by the statute is to ensure that there are sufficient funds available, in reserve, for the PCLP CDC to pay its PCLP reimbursement obligation to SBA should the PCLP CDC fail to obtain 100% repayment on a defaulted PCLP 504 Loan after exhaustion of reasonable collection efforts. *See* Cong. Rec. S14229 (1994). The reserve provides SBA with security for the repayment of the PCLP CDC's reimbursement obligations to SBA. *Id.* SBA's regulation requires the PCLP CDC to diligently monitor its Loan Loss Reserve Fund to ensure that it contains sufficient funds to cover its PCLP reimbursement obligation for its entire portfolio of PCLP loans, and within 30 days of the date it becomes aware of a deficiency, make additional contributions to the Loan Loss Reserve Fund to remedy the deficiency. *See* 13 C.F.R. § 120.847(j).

A PCLP CDC's Loan Loss Reserve Fund must be a deposit account (or accounts) with a federally insured depository institution selected by the PCLP CDC. *See* 13 C.F.R. § 120.847(c). A PCLP CDC is required to give SBA a first priority, perfected security interest in the Loan Loss Reserve Fund to secure repayment of the PCLP CDC's reimbursement obligation. *See* 13 C.F.R. § 120.847(d); *see also* 15 U.S.C. § 697e(c)(3)(A). The PCLP CDC must grant to SBA the security interest in the Loan Loss Reserve Fund pursuant to a security agreement between the PCLP CDC and SBA, and a control agreement between the PCLP CDC, SBA, and the applicable depository institution(s) where the Loan Loss Reserve Fund accounts are maintained. *Id.* The control agreement must include provisions requiring the depository institution(s) to follow SBA's instructions regarding withdrawal from the accounts without a requirement for obtaining further consent from the PCLP CDC, and must restrict the PCLP CDC's ability to make withdrawals from the account without SBA consent. *Id.*

After SEM became a PCLP CDC in 2006, it established a Loan Loss Reserve Fund as required by SBA's regulations. On June 23, 2006, SEM executed a security agreement granting SBA a security interest in SEM's Loan Loss Reserve Fund to secure SEM's PCLP reimbursement obligations.²⁷ SEM, SBA and two depository institutions have entered into control agreements acknowledging SBA's security interest in the deposit accounts comprising SEM's Loan Loss Reserve Fund, providing SBA with the ability to direct the disposition of funds in the accounts without further consent by SEM, and prohibiting SEM from withdrawing funds from the

²⁷ *See* PCLP Security Agreement between SEM and SBA (June 23, 2006).

accounts without SBA's prior written consent.²⁸

F. Alternative Loan Loss Reserve Pilot Program

In 2004, ten years after the enactment of the PCLP program, Congress authorized by statute a pilot program permitting qualified PCLP CDCs to use an alternative method to calculate the total sums required to be funded, from time-to-time, into their Loan Loss Reserve Fund. *See* 15 U.S.C. § 697e(c)(7). This Alternative Loan Loss Reserve pilot program allowed PCLP CDCs to use a risk-based approach, like private sector banks, to calculate the required total funding of their Loan Loss Reserve Fund, instead of funding their Loan Loss Reserve Fund using a straight mathematical calculation as required under the Standard Loan Loss Reserve Fund Requirement. *Id.*

A PCLP CDC electing to use the Alternative Loan Loss Reserve pilot program is required to “make such contributions to its Loan Loss Reserve Fund so as to ensure that its Loan Loss Reserve Fund is sufficient, as determined by a qualified independent auditor, for the PCLP CDC to meet its obligations to protect SBA from the risk of loss.” *See* 15 U.S.C. § 697e(c)(7). The PCLP CDC must establish and utilize an “appropriate and effective process for analyzing the risk of loss associated with its portfolio of PCLP Loans and for grading each PCLP Loan made by the company on the basis of the risk of loss associated with such loan.”²⁹ *See* 15 U.S.C. § 697e(c)(7)(F).

In granting PCLP CDCs the authority to calculate their Loan Loss Reserve Fund using a risk-based approach rather than by a straight mathematical calculation as with the Standard Loan Loss Reserve Fund Requirement, Congress determined that it was necessary to compensate for the increased risk by requiring PCLP CDCs electing to use the Alternative Loan Loss Reserve pilot program to agree to reimburse SBA for 15% of the SBA loss on defaulted PCLP Loans, not the 10% required under the Standard Loan Loss Reserve Fund Requirement. *See* H.R. Rep. No. 108-153 at 17 (2003). It appears that Congress increased the reimbursement requirement from 10% to 15% so that the pilot program would not have a subsidy cost and therefore would have no effect on the federal budget. *See* H.R. Rep. No. 108-153 at 7 (2003). Congress also determined that “[t]his exchange of enhanced authority for increased loss exposure is consistent with the intent of the original PCLP, which provided CDCs with delegated loan approval authority in exchange for increased loss exposure.” *Id.* at 17. The 15% loss reimbursement requirement applies to any PCLP Loan disbursed during the calendar quarters in which the PCLP CDC elected to participate in the Alternative Loan Loss Reserve pilot program, regardless of whether the PCLP CDC eventually stops participating in the Alternative Loan Loss Reserve pilot program. *See* 15 U.S.C. § 697e(b)(2)(C).

²⁸ *See* Loan Loss Reserve Fund Deposit Account Control Agreements between SEM, SBA and Zions First National Bank (dated April 1, 2008) and SEM, SBA and West Michigan Community Bank (dated June 23, 2006).

²⁹ For all CDCs, the Board of Directors is required by regulation to adopt an internal control policy that directs the operation of a program to review and assess the CDC's 504 Loan portfolio and that contains loan quality classification standards consistent with the standardized classification systems used by the Federal Financial Institution Regulators. *See* 13 C.F.R. § 120.826(b).

The Alternative Loan Loss Reserve pilot program was originally authorized for two years, but was extended through subsequent legislation. The statutory authority for the Alternative Loan Loss Reserve pilot program eventually lapsed on July 31, 2011. *See* Small Business Additional Temporary Extension Act of 2011, Pub. L. No. 112-17, § 2, 125 Stat. 221 (June 1, 2011). Because of the lapsed statutory authority, PCLP CDCs participating in the Alternative Loan Loss Reserve pilot program are currently required by SBA, consistent with statute and regulation, to establish and maintain a Loan Loss Reserve Fund using the straight mathematical calculation required for a Standard Loan Loss Reserve Fund Requirement under 15 U.S.C. § 697e(c)(2) and 13 C.F.R. § 120.847(b)---i.e., 1% of the original principal amount (face amount) of each PCLP loan in the PCLP CDC's portfolio.

G. SEM Elected to Participate in Alternative Loan Loss Reserve Pilot Program

SEM established a Loan Loss Reserve Fund after it became a PCLP CDC in 2006. Initially, SEM established its Loan Loss Reserve Fund using the Standard Loan Loss Reserve Fund Requirement 1% method. Subsequently, starting with the Quarter beginning October 1, 2008, SEM elected to participate in the Alternative Loan Loss Reserve Fund statutory pilot program.

On a quarterly basis, PCLP CDCs are required to file with SBA a report showing the amount in the Loan Loss Reserve Fund in a form that will readily demonstrate the basis for showing that the amount actually maintained in the Loan Loss Reserve Fund is the amount required to be maintained in the Loan Loss Reserve Fund based upon the applicable funding formula. *See* 13 C.F.R. 120.847(f). The Quarterly Report must also contain copies of bank statements verifying that the Loan Loss Reserve Fund funds are on deposit. *See* PCLP Quarterly Loan Loss Reserve Report, SBA Form 2233. SBA is then able to reconcile the required Loan Loss Reserve Fund amount with the amount reported by the PCLP CDC on its Quarterly Report.

After SEM's election of the Alternative Loan Loss Reserve program, SEM began submitting Quarterly Loan Loss Reserve Fund Reports to SBA that contained the following:³⁰

- Bank statements showing the funded amount of SEM's Loan Loss Reserve Fund
- SEM's Loan Rating Report listing PCLP Loans in its portfolio and SEM's risk-based grading of each of the listed loans
- SEM's calculated Loan Loss Reserve Fund amount based on SEM's Risk-Based Methodology using the outstanding loan balances and the corresponding risk-based grading for each listed PCLP Loan
- A Perry-Smith Report on Credit Classification and Review of Loan Origination and Documentation Requirements for a sample of SEM's PCLP Loans³¹

³⁰ *See* Quarterly Loan Loss Reserve Fund Reports as of December 31, 2008 to September 30, 2012.

³¹ Perry-Smith LLP merged with Crowe-Horwath LLP in November 2011. For ease of reference, Crowe Horwath LLP f/k/a Perry-Smith LLP will be referred to as "Perry-Smith" in this Decision.

H. Statutory Lapse of Alternative Loan Loss Reserve Program and SBA Notice to SEM of Required Compliance with Standard Loan Loss Reserve Requirement

The statutory authority for the Alternative Loan Loss Reserve pilot program lapsed on July 31, 2011. By letter dated March 15, 2013, SBA notified SEM that SEM was required to contribute to its Loan Loss Reserve Fund an amount sufficient to meet the Standard Loan Loss Reserve Fund Requirement. SBA advised SEM that SEM's Standard Loan Loss Reserve Fund Requirement totaled \$418,080 (calculated as of December 31, 2012). Because SEM reported to SBA a Loan Loss Reserve Fund amount of \$170,473.69 as of December 31, 2012, SBA notified SEM that its Loan Loss Reserve Fund had a deficiency of \$247,606.31. Consistent with 13 C.F.R. §120.847(j), SBA notified SEM that it was required to contribute the deficient amount to its Loan Loss Reserve Fund within 30 days of SBA's letter. SEM failed to make the required contribution.

SEM most recently reported a Loan Loss Reserve Fund of \$179,720.37 as of June 30, 2013.³² The amount reported in SEM's Loan Loss Reserve Fund was subsequently reduced on August 9, 2013 by \$59,319.02---the amount paid by SEM to SBA on two PCLP reimbursement obligation invoices using monies in the Loan Loss Reserve Fund.³³ Thus, as of August 9, 2013 there was only \$120,401.35 remaining in SEM's Loan Loss Reserve Fund. Using the Standard Loan Loss Reserve Fund Requirement calculation, as of December 31, 2013, SEM is required to have approximately \$382,240 in its Loan Loss Reserve Fund.³⁴ Based on the amounts reported to SBA by SEM, as of the date of this Decision, SEM's Loan Loss Reserve Fund is deficient by approximately \$261,838.65 under the Standard Loan Loss Reserve Fund Requirement calculation.

I. SBA Loss, PCLP CDC Reimbursement Obligation, and SBA Invoicing Procedures

When a PCLP CDC has concluded the liquidation of a defaulted PCLP Loan and has submitted a wrap-up report to SBA, or when SBA otherwise determines that the PCLP CDC has exhausted all reasonable collections efforts with respect to the defaulted PCLP Loan, SBA will determine the amount of the loss to SBA. *See* 13 C.F.R. § 120.847(h).

SBA then sends an invoice notifying the PCLP CDC of the amount of its PCLP reimbursement obligation to SBA and explains how SBA calculated the loss. *Id.* If the PCLP CDC agrees with SBA's calculations of the loss, it must reimburse SBA for 10 or 15 percent (as the case may be)

³² *See* Quarterly Loan Loss Reserve Fund Report dated as of June 30, 2012. SEM failed to file its September 30, 2013 and December 31, 2013 Quarterly Loan Loss Reserve Fund Reports.

³³ The two PCLP reimbursement obligation invoices paid by SEM on August 9, 2013 were DACZ Industries, Inc. (3179326504) (invoice amount \$14,201.64) and Northern Properties Investment, LLC (2711666504) (invoice amount \$45,117.38).

³⁴ *See* LAMP PCLP Loan Loss Reserve Requirements Report as of December 31, 2013. The amount identified in this report (\$388,070) is reduced by the required 1% of the original balance for the two loans on which SEM paid PCLP reimbursement obligation invoices on August 9, 2013: DACZ Industries, Inc. (3179326504) (reserve requirement of \$1,440) and Northern Properties Investment, LLC (2711666504) (reserve requirement of \$4,390).

of the loss no later than 30 days after SBA sends the invoice to the PCLP CDC. *Id.* If the loan was disbursed before SEM's October 1, 2008 election of the Alternative Loan Loss Reserve, or after the statutory lapse of the Alternative Loan Loss Reserve pilot program on July 31, 2011, then SEM's loss share is 10%. If the loan was disbursed on or after SEM's October 1, 2008 election of the Alternative Loan Loss Reserve and on or before the statutory lapse of the Alternative Loan Loss Reserve pilot program on July 31, 2011, then SEM's loss share is 15%.

If the PCLP CDC disputes SBA's calculations, the PCLP CDC may file a written appeal with SBA within 30 days of the date of the invoice. *Id.* The PCLP CDC must include with the appeal an explanation of its reasons for the disagreement. *Id.* Upon SBA's final decision as to the disputed amount of the loss, the PCLP CDC must pay the invoiced amount that SBA has determined is due and owing. *Id.* A PCLP CDC may use funds in the Loan Loss Reserve Fund, or other funds, to pay the invoice. *Id.*

J. PCLP Reimbursement Obligation Invoices and Associated Loan Loss Reserve Fund Deficiency

As of the date of this Decision, SBA has sent 11 PCLP reimbursement obligation invoices to SEM for a total of approximately \$1.64 million (plus interest and penalties). *See below* Table 1 SEM PCLP Reimbursement Invoices, as of January 10, 2014. SEM has failed to pay all but two of these invoices. As itemized on the next page, SEM owes SBA \$1,584,094.28 in PCLP reimbursement obligations. As of August 9, 2013, there was \$120,401.35 in SEM's Loan Loss Reserve Fund. Therefore, SEM's Loan Loss Reserve Fund, which is intended to provide a ready and secure source for payment to SBA in order to help protect the taxpayers from loss, is short by approximately \$1.46 million in covering SEM's reimbursement obligation on 9 PCLP loans, in addition to the Loan Loss Reserve Fund deficiency discussed above for the remaining PCLP 504 Loans in SEM's portfolio.

Table 1: SEM PCLP Reimbursement Invoices, as of January 10, 2014

Borrower	SBA Loan Number	Date Invoiced	Appealed?³⁵	Date Paid	Invoice Amount³⁶
DACZ Industries, Inc. ³⁷	3179326504	6/8/2012	Yes (denied 3/15/13)	8/9/2013	\$14,201.64
Northern Properties Investment, LLC ³⁸	2711666504	3/29/2013	No	8/9/2013	\$45,117.38
Aljarbo No. 3 Inc. ³⁹	3251796500	3/29/2013	No		\$37,245.39
Donovan & Andre, LLC ⁴⁰	2999576510	3/29/2013	No		\$77,683.61
Farmington Hills Investments, Inc. ⁴¹	2870836504	3/29/2013	Yes (denied in Section IV.A.2.)		\$129,382.45
Mohammed Alissawi ⁴²	2532506507	3/29/2013	No		\$162,824.50 (15% liability)
Blue Marlin/Key Largo ⁴³	3095686009	9/17/2013	Yes (denied in Section IV.A.2.)		\$92,083.24
Green Road Hotels ⁴⁴	2571256006	9/17/2013	Yes (denied in Section IV.A.2.)		\$695,140.24

³⁵ See 13 C.F.R. § 120.847(h) (providing a CDC with 30 days after the date of notification to appeal SBA's determination of SBA loss). Corrected invoices were issued for 5 PCLP loans. Because the bases for the original invoices and the corrected invoices were identical and the corrected invoices only reduced the amount owed to SBA, the time for SEM to appeal is appropriately calculated from the date of the original invoices.

³⁶ SEM's liability is 10% (rather than 15%) of the SBA loss on defaulted PCLP loan unless otherwise noted.

³⁷ See Invoice dated June 8, 2012 for DACZ Industries, Inc. (3179326504); Corrected Invoice dated June 8, 2012 for DACZ Industries, Inc. (3179326504); Appeal Letter from SEM to Leslie Niswander, Deputy Center Director, SBA's Fresno Servicing Center (July 17, 2012); Final Decision on Appeal of PCLP Reimbursement Invoice dated June 8, 2012 re: DACZ Industries, from Michael Simmons, Acting Director, OFA to Marlies Dinsmore (March 15, 2013).

³⁸ See Invoice dated March 29, 2013 for Northern Properties Investment, LLC (2711666504); Corrected Invoice dated March 29, 2013 for Northern Properties Investment, LLC (2711666504).

³⁹ See Invoice dated March 29, 2013 for Aljarbo No 3 Inc (3251796500); Corrected Invoice dated March 29, 2013 for Aljarbo No 3 Inc (3251796500).

⁴⁰ See Invoice dated March 29, 2013 for Donovan & Andre, LLC (SBA Loan Number 2999576510); Corrected Invoice dated March 29, 2013 for Donovan & Andre, LLC (SBA Loan Number 2999576510).

⁴¹ See Invoice dated March 29, 2013 for Farmington Hills Investments, Inc (SBA Loan Number 2870836504); Corrected Invoice dated March 29, 2013 for Farmington Hills Investments, Inc (SBA Loan Number 2870836504).

⁴² See Invoice dated March 29, 2013 for Mohammed Alissawi (SBA Loan Number 2532506507).

⁴³ See Invoice dated September 17, 2013 for Blue Marlin/Key Largo (SBA Loan Number 3095686009).

⁴⁴ See Invoice dated September 17, 2013 for Green Roads Hotel (SBA Loan Number 2571256006).

Table 1 cont'd Borrower	SBA Loan Number	Date Invoiced	Appealed?⁴⁵	Date Paid	Invoice Amount⁴⁶
P&P Hotels ⁴⁷	2939336005	9/17/2013	Yes (denied in Section IV.A.2.)		\$96,849.39
Avery Associates ⁴⁸	2887216502	12/9/2013	No		\$268,981.29 (15% liability)
R.B.SKID- YARD, INC. ⁴⁹	3275636503	1/9/2014	Appeal time expires 2/10/2014		\$23,904.17 (15% liability)
Total Invoiced					\$1,643,413.30
Less Amount Paid					\$59,319.02
Total Due					\$1,584,094.28⁵⁰
Loan Loss Reserve Fund as of 8/9/13					\$120,401.35
Loan Loss Reserve Deficiency On Invoiced PCLP Reimbursement Obligations					\$1,463,692.93

⁴⁵ See 13 C.F.R. § 120.847(h) (providing a CDC with 30 days after the date of notification to appeal SBA's determination of SBA loss). Corrected invoices were issued for 5 PCLP loans. Because the bases for the original invoices and the corrected invoices were identical and the corrected invoices only reduced the amount owed to SBA, the time for SEM to appeal is appropriately calculated from the date of the original invoices.

⁴⁶ SEM's liability is 10% (rather than 15%) of the SBA loss on defaulted PCLP loan unless otherwise noted.

⁴⁷ See Invoice dated September 17, 2013 for P&P Hotels (SBA Loan Number 2939336005).

⁴⁸ During the pendency of the Notice of Proposed Enforcement Action, SBA invoiced SEM for two additional PCLP reimbursement obligations. SBA notified SEM in the Notice of Proposed Enforcement Action that SBA was preparing to invoice SEM for its PCLP reimbursement obligation on the Avery Associates loan. On December 9, 2013, SBA invoiced SEM for Avery Associates (Loan number 2887216502) for \$268,981.29. See Invoice dated October 30, 2013 for Avery Associates (SBA Loan Number 2887216502). Thereafter, one additional PCLP loan was invoiced, R.B.SKID-YARD, INC. (Loan number 3275636503), which is subject to a 15% loss share obligation. See Invoice dated January 6, 2014 for R.B. SKID-YARD, INC. (SBA Loan Number 3275636503).

⁴⁹ See fn. 48.

⁵⁰ In accordance with 31 U.S.C. § 3717, SEM owes SBA interest, and other applicable charges and penalties on the delinquent amounts. The current interest rate on delinquent debt is 1%. In addition, a penalty charge of 6% has been assessed on all invoices delinquent for more than 90 days.

K. Summary of SEM PCLP Reimbursement Obligations Due to SBA

As of the date of this Decision, SEM owes to SBA the following amounts for which SBA has demanded payment, but that remain unpaid by SEM:

Unpaid PCLP Reimbursement Obligation on 9 Invoices	\$1,584,094.28 plus interest and penalties
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SEM’s obligations referenced in this Decision reflect what is currently due and payable. As of October 31, 2013, SEM has approximately 5 additional purchased PCLP loans in its portfolio with a total outstanding balance of approximately \$3,379,419.⁵¹ SEM’s potential 10% PCLP loss reimbursement exposure on the 5 additional purchased PCLP loans totals approximately \$337,942. Additionally, there are approximately 56 other PCLP loans in SEM’s portfolio. Losses will continue to emerge and develop in SEM’s PCLP loan portfolio, and SBA will continue to bill SEM for its PCLP reimbursement obligations on losses after the date of this Decision.

L. The Green Road Hotels, LLC Loan

On December 8, 2006, SEM approved a PCLP 504 Loan to borrower Green Road Hotels, LLC (SBA Loan No. 2571256507) in the amount of \$2,000,000 (Green Road Hotels Loan).⁵² The Green Road Hotels Loan is SEM’s largest defaulted 504 Loan, with an outstanding balance of approximately \$6,951,402.35 (including Care and Preservation of Collateral (CPC) Expenses) as of September 10, 2013.⁵³ Under the EDF Contract, SEM’s affiliated servicer, EDF, was responsible for the servicing of the Green Road Hotels Loan.

The Green Road Hotels Loan project was financed by a loan from the Senior Third Party Lender, Zions First National Bank (Zions Bank), secured by a first lien in the original amount of \$4,283,750 on the project collateral; a 504 loan from SEM/SBA secured by a second lien in the original amount of \$2 million on the project collateral; and the borrower’s equity contribution.⁵⁴ SEM’s portion of the project was 100% SBA-guaranteed. The project collateral for the Green Road Hotels Loan was a Hawthorne Suites hotel located in Ann Arbor, Michigan.

On April 15, 2009, Zions Bank filed an action in the Circuit Court for Washtenaw County, Michigan seeking the appointment of a Receiver over the borrower, Green Road Hotels, LLC.⁵⁵ On June 10, 2009, SBA issued a CPC check in the amount of \$4,418,392 payable to Zions Bank

⁵¹ The five purchased PCLP loans are CHRISTENSEN FIBERGLASS LLC A M, Loan number 2723266009; M AND M SOUTH HAVEN LLC, Loan number 2857356007; RELIANCE GROUP OF HOTELS LLC, Loan number 2959436008; DIEHL'S PARTY STORE, Loan number 3151406001; and FOUR POINTE INVESTMENTS LLC, Loan number 3157916002.

⁵² See ELIPS Loan Information for Borrower Green Road Hotels, LLC, Loan No. 2571256507.

⁵³ See Invoice dated September 10, 2013 for Green Road Hotels Loan (Loan No. 2571256006).

⁵⁴ See 13 C.F.R. §120.801; Authorization for Debenture Guarantee for Green Road Hotels Loan (Loan No. 2571256006) dated December 8, 2006.

⁵⁵ See Plaintiff’s Motion for Approval of Disposition of Personal Property Collateral and Transfer of Real Property in Case No. 09-437-CK in the Michigan Circuit Court for the County of Washtenaw.

to allow SEM's affiliated servicer, EDF, to purchase the first lien held by Zions Bank on the project collateral.⁵⁶ Upon receipt of the SBA check, Zions Bank assigned the loan documents for its Senior Third Party Loan to SEM's affiliated servicer, EDF.⁵⁷ On June 12, 2009, the Circuit Court for Washtenaw County, Michigan entered an order appointing a Receiver for Green Road Hotels, LLC.⁵⁸ On June 16, 2009, SEM's affiliated servicer, EDF, without SBA's authorization, assigned the Zions Bank loan documents to SEM's related party, Redemption Reliance, LLC (Redemption), a for-profit loan servicing company owned 100% by EDF's CEO, Frank Dinsmore, who is also the spouse of SEM's CEO, Marlies Dinsmore.⁵⁹

On June 10, 2009, SBA issued another CPC check in the amount of \$623,547 payable to SEM's affiliated servicer, EDF, to be used by SEM's affiliated servicer, EDF, for the payment of delinquent property taxes and hotel flag fees on SBA's collateral.⁶⁰ SEM's affiliated servicer, EDF, failed to use the \$623,547 as required by SBA and instead transferred the funds, without SBA's authorization, to SEM's related party, Redemption.⁶¹

On April 29, 2010, SEM's related party, Redemption, took title to SBA's collateral by foreclosure sale.⁶² On February 3, 2012, SEM's related party, Redemption, sold SBA's collateral to a third party purchaser for approximately \$5,600,000.⁶³ In September, 2012, SEM's related party, Redemption, received additional liquidation proceeds from the Receiver in the amount of approximately \$278,000.⁶⁴ Pursuant to SBA's Standard Operating Procedure 50 51 3 (as amended),⁶⁵ SEM was required to remit to SBA, within 15 business days of receipt, SBA's share of the liquidation recoveries on the Green Road Hotels Loan. SEM failed to do so.

SBA made repeated demands on SEM's affiliated servicer, EDF, and related party, Redemption, for remittance of the Green Road Hotels Loan liquidation proceeds and the unused CPC funds.⁶⁶ Additionally, in a March 15, 2013 letter, SBA demanded that SEM immediately

⁵⁶ See United States Treasury Checks payable to Zions Bank by SBA, Check Numbers 3151-54293311 through 3315 dated June 10, 2009.

⁵⁷ See Agreement Regarding Sale of Loan for Green Road Hotels, LLC between EDF and Zions Bank dated June 10, 2009.

⁵⁸ See Motion to Approve Receiver's Final Report and Request for Instructions Regarding Remaining Receivership Funds, page 3, dated July 30, 2012, in Case No. 09-437-CK in the Michigan Circuit Court for the County of Washtenaw.

⁵⁹ See Assignment of Note and Mortgage between EDF and Redemption dated June 16, 2009.

⁶⁰ See United States Treasury Check payable to EDF by SBA, Check Number 3151-54293316 dated June 10, 2009.

⁶¹ See Letter from Leslie Niswander, Deputy Center Director, SBA to Frank Dinsmore, CEO, EDF (November 10, 2011) demanding payment of the \$623,547; Letter from Frank Dinsmore, CEO, EDF to Leslie Niswander, Deputy Center Director, SBA (February 24, 2012) providing that the funds are being retained by EDF; *see also* Five Star Bank Business Checking Account for Redemption Reliance, Account Number 2205102 as of March 29, 2013.

⁶² See Sherriff's Deed on Mortgage Sale to Redemption for Green Road Hotels, LLC dated April 29, 2010.

⁶³ See Real Property Transaction Record 3535 Green Ct, Ann Arbor, MI 48105-1579.

⁶⁴ See Motion to Approve Receiver's Final Report and Request for Instructions Regarding Remaining Receivership Funds, page 3, dated July 30, 2012 in Case No. 09-437-CK in the Michigan Circuit Court for the County of Washtenaw.

⁶⁵ See SOP 5051 3, Chapter 19, Expenses and Recoveries, B.3, p. 131.

⁶⁶ See Letter from Gary Wamhof, Acting Center Director, SBA to Frank Dinsmore, CEO, EDF (July 22, 2011); Letter from Leslie Niswander, Deputy Center Director, SBA to Frank Dinsmore, CEO, EDF (February 16, 2012); Letter from Brent Ciurlino, Director, OCRM, SBA to Frank Dinsmore, CEO, EDF (December 17, 2012); Letter

turn over to SBA all liquidation proceeds and unused CPC expenses for this loan and provide SBA with the certain reports relating to the loan including a detailed accounting of the liquidation recoveries.⁶⁷ SEM failed to turn over the liquidation recoveries to SBA and failed to provide the requested information. While acknowledging its obligation on the Green Road Hotels Loan, SEM asserted that it cannot obtain any information or the funds relating to this loan.⁶⁸

It is SBA's understanding that SEM's related party, Redemption, transferred some or all of the proceeds of the sale of SBA's collateral and the Receiver's distribution to SEM's affiliated servicer, EDF, in December, 2012.⁶⁹ It is also SBA's understanding that SEM's related party, Redemption, continues to hold the approximately \$623,547 in unused CPC funds in a Redemption bank account.⁷⁰ Further, it is SBA's understanding that SEM's affiliated servicer, EDF, dissipated a substantial portion of the proceeds of the sale of SBA's collateral by using the funds to pay EDF's general creditors and by transferring funds to several law firms as retainers.⁷¹

M. SEM's Financial Status

The most recent audited annual financial statements provided by SEM are those for SEM's fiscal year ending September 30, 2012.⁷² SEM's fiscal year 2012 financial statements were prepared by the independent auditing firm of Gallina LLP.⁷³ The auditor's report states that SEM "has suffered recurring losses and has a net asset deficiency."⁷⁴ SEM's auditor further determined that "[t]hese conditions raise substantial doubt about [SEM's] ability to continue as a going concern."⁷⁵ SEM's auditor made the finding of insolvency and issued the going concern opinion absent any consideration of the approximately \$1,584,094.28 (plus interest and penalties) in PCLP reimbursement obligations SEM owes to SBA, SEM's approximately \$337,942 contingent liability for future PCLP reimbursement obligations on purchased PCLP loans, and the additional \$261,838.65 Loan Loss Reserve Fund contribution required by statute

from Brent Ciurlino, Director, OCRM, SBA to Frank Dinsmore, Redemption (January 2, 2013); and Letter from Eric Benderson, SBA OGC, to Jerry Stouck, Esquire and David Callet, Esquire (February 1, 2013).

⁶⁷ See Letter titled "Notice of Required Reports and Other Action" from Michael Simmons, Acting Director, OFA, SBA to Marlies Dinsmore, CEO, SEM (March 15, 2013).

⁶⁸ See Letter from Joseph Vassallo, Board Chairman, SEM to Michael Simmons, Acting Director, OFA, SBA (March 25, 2013); Letter from Joseph Vassallo, Board Chairman, SEM to Michael Simmons, Acting Director, OFA, SBA (April 5, 2013), and Letter from Marlies Dinsmore, CEO, SEM to Michael Simmons, Acting Director, OFA, SBA (April 5, 2013).

⁶⁹ See January 18, 2013 letter from Jerry Stouck, attorney for EDF, to Brent Ciurlino, Director of the Office of Credit Risk Management.

⁷⁰ See Five Star Bank Business Checking Account for Redemption Reliance, Account Number [REDACTED] as of March 29, 2013.

⁷¹ See "Account QuickReport" for EDF, indicating transactions and balances for EDF from December 17, 2012 to April 15, 2013.

⁷² SEM's fiscal year 2013 financial statements are due by regulation 180 days from the end of the prior fiscal year which is March 29, 2014. See 13 C.F.R. § 120.830.

⁷³ See SEM Financial Statements for FY 2012.

⁷⁴ See *id.* at 2.

⁷⁵ See *id.*

and regulation.⁷⁶

SEM's auditor explained in Note 1 of its report that "no calculation of the required loan loss reserve has been performed" because the statutory authority for the Alternative Loan Loss Reserve pilot program has lapsed and SEM has revised its methodology and reserves "pending further direction from SBA." SBA has since provided direction to SEM in a letter dated March 15, 2013 which stated that SEM was required to contribute to its Loan Loss Reserve Fund an amount sufficient to meet the Standard Loan Loss Reserve Fund Requirement of 1%.⁷⁷

SEM's auditor also wrote in Note 6 of its report that SEM has not recorded contingent liabilities because SEM has taken exception with SBA's method of loss recognition of PCLP loans and the outcome of discussions between SEM and its legal counsel is not known at this time. SEM did not take exception with SBA's method of loss recognition as outlined in the Notice of Proposed Enforcement Action even though SEM had the opportunity to object to such proposed determinations. SBA finds for the reasons stated herein that the identified PCLP reimbursement obligations are due and owing to SBA by SEM.

SEM's financial statements for fiscal year ending September 30, 2012 further show an accumulated Net Deficit of \$3,392,703, which represents an increase in SEM's Net Deficit in the amount of \$507,819 from the prior fiscal year. These financial statements also show that SEM's indebtedness to its affiliate, EDF, increased by \$465,410, to a total of \$3,386,660 in fiscal year 2012, which exceeds available assets by more than \$3,000,000. SEM's tax returns for fiscal year 2012 reflect these same net assets and indebtedness.⁷⁸

As required by SBA, SEM also provided its interim (unaudited) financial statements for the first quarter of fiscal year 2013 (as of December 31, 2012) which shows further deterioration in its net deficit of \$82,139.71, resulting in an accumulated Net Deficit of \$3,474,840.89. In addition, as of December 30, 2012, SEM's reported indebtedness to its affiliate, EDF, increased by \$90,956 from fiscal year 2012 to a total of \$3,477,616.65.⁷⁹ As noted above, the EDF Note matures on September 30, 2014.

III. ENFORCEMENT ACTION HISTORY

A. Administrative History

On March 15, 2013, SBA sent SEM a "Notice of Required Reports and Other Action."⁸⁰ In the March 15, 2013 letter, SBA identified numerous serious issues of SEM's non-compliance with SBA's Loan Program Requirements, required SEM's response to those issues, and required

⁷⁶ See *id.* at 8, Notes 1 and 6.

⁷⁷ See Letter titled "Notice of Required Reports and other Action" from Michael Simmons, Acting Director, OFA to Marlies Dinsmore, CEO, SEM (March 15, 2013).

⁷⁸ See SEM Tax Returns for year ended September 30, 2012.

⁷⁹ See Letter from Marlies Dinsmore, CEO, SEM to Michael Simmons, Acting Director, OFA, SBA (April 5, 2013).

⁸⁰ See Letter titled "Notice of Required Reports and Other Action" from Michael Simmons, Acting Director, OFA, SBA to Marlies Dinsmore, CEO, SEM (March 15, 2013).

other action by SEM. Many of the grounds set forth in support of the proposed enforcement action against SEM and this Decision were identified by SBA as serious non-compliance issues in the March 15, 2013 letter. The March 15, 2013 letter advised SEM that if it failed to address the outstanding non-compliance issues and take the required action, SBA would consider such failure to constitute material non-compliance with SBA's Loan Program Requirements under 13 C.F.R. § 120.1400(c)(2).

Specifically, the March 15, 2013 letter cited the following: (1) approximately \$2.6 million in current and future potential financial obligations to SBA related to SEM's PCLP reimbursement obligations on 14 PCLP loans; (2) SBA's share of approximately \$5.6 million in unremitted liquidation proceeds from the sale of collateral on SEM's largest defaulted loan; (3) approximately \$901,000 in other monies owed to SBA related to SEM's largest defaulted loan; and (4) \$247,606.31 required to cure SEM's Loan Loss Reserve Fund deficiency. The March 15, 2013 letter also required reports and other action regarding SEM's compliance with SBA's Loan Program Requirements including (1) having adequate professional staff subsequent to the revocation of EDF's authority to participate in SBA's 504 Loan Program; (2) submission of audited financial statements for fiscal years 2011 and 2012; (3) reports and financial statements to demonstrate SEM's financial ability to sustain operations; (4) compliance with the Standard Loan Loss Reserve Fund Requirement of 1% of the original principal amount of the PCLP Debenture for the life of the loan; (5) Alternative Loan Loss Reserve deficiencies and under-reporting of loans in SEM's Loan Loss Reserve Fund reports to SBA; and (6) liquidation recoveries related to the sale of the collateral on Green Road Hotels Loan.

SBA received responses to the March 15, 2013 letter from SEM on March 25, 2013 and April 5, 2013. The March 25, 2013 response from SEM's Board Chairman provided SEM's audited year-end financial statements for 2011 and 2012, as well as interim financials for December 21, 2012.⁸¹ The April 5, 2013 letter from SEM's Board Chairman admits deficiencies such as "inadequate reserves and funds [] owed to the SBA for defaulted loans" and expresses a desire to come into compliance and meet with SBA.⁸² The April 5, 2013 letter from SEM's CEO sets forth various responses, including the identification of staff hired by SEM (many of whom are former EDF staff), provides financial information, commits to a \$3,000 per month Loan Loss Reserve Fund contribution, does not address other Loan Loss Reserve Fund deficiencies, and acknowledges SEM's obligations on the Green Road Hotels Loan.⁸³

SBA carefully considered the March 25, 2013 and April 5, 2013 responses and the submissions referenced therein prior to proposing this enforcement action and, based on a review of those documents, as well as SBA's records, SBA determined that SEM's responses did not adequately address all of SEM's serious non-compliance issues, SEM failed to take the action required by the March 15, 2013 notice, and SEM is in material non-compliance with SBA's Loan Program Requirements. Based on that determination, SBA issued the Notice of Proposed Enforcement Action.

⁸¹ See Letter from Joseph Vassallo, Board Chairman, SEM to Michael Simmons, Acting Director, OFA, SBA (March 25, 2013).

⁸² See Letter from Joseph Vassallo, Board Chairman, SEM to Michael Simmons, Acting Director, OFA, SBA (April 5, 2013).

⁸³ See Letter from Marlies Dinsmore, CEO, SEM to Michael Simmons, Acting Director, OFA, SBA (April 5, 2013)

B. Notice of Proposed Enforcement Action

On September 30, 2013, SBA issued a Notice of Proposed Enforcement Action to SEM.⁸⁴ In accordance with the procedure required by 13 C.F.R. § 120.1600(a)(1), the Notice advised SEM that SBA was proposing the permanent revocation of SEM's authority to participate in SBA's 504 Loan Program, pursuant to 13 C.F.R. § 120.1500(a)(3), and the permanent transfer of all of SEM's existing SBA 504 loan portfolio and all of SEM's pending SBA 504 loan applications to SBA, another CDC or entity designated by SBA, pursuant to 13 C.F.R. § 120.1500(e)(1).⁸⁵

The Notice set forth the following grounds for the proposed enforcement action:

- A. 13 C.F.R. § 120.1400(c)(2) - Failure to comply materially with SBA's Loan Program Requirements, including the failure to (1) pay invoiced obligations in a timely manner, (2) remit liquidation proceeds and other funds to SBA, (3) service and liquidate its largest PCLP 504 loan in accordance with prudent and commercially reasonable lending standards, and (4) maintain the financial ability to operate.
- B. 13 C.F.R. § 120.1400(c)(2) - Failure to establish or maintain a loan loss reserve fund as required by the PCLP, including failure to (1) comply with Loan Loss Reserve Fund deposit requirements to fully fund its Loan Loss Reserve Fund and (2) fund a Loan Loss Reserve Fund for each PCLP Debenture, adequately file Quarterly Reports and fund any known deficiencies.
- C. 13 C.F.R. § 120.1400(c)(4) - Not performing servicing and liquidation actions in a commercially reasonable and prudent manner.
- D. 13 C.F.R. § 120.1400(c)(9) - SBA's determination that SEM has increased SBA's financial risk.

As required by 13 C.F.R. § 120.1600(a)(1)(i), the Notice set forth in reasonable detail the underlying facts and reasons for SBA's proposed enforcement action.⁸⁶ The Notice was issued after consideration and evaluation of SBA records relating to SEM, as well as SEM's submissions, including the March 25, 2013 and April 5, 2013 letters.⁸⁷ The Notice addressed SEM's assertions finding them unconvincing and lacking merit.⁸⁸ The Notice was signed by Brent Ciurlino, Director of SBA's Office of Credit Risk Management.⁸⁹

SBA advised SEM that pursuant to 13 C.F.R. § 120.1600(a)(2)(i), SEM had the right to object to the proposed enforcement action by filing a written objection with SBA within 30 calendar days of receipt, and that the objection must (1) set forth all grounds known to SEM to contest

⁸⁴ See Letter from Brent Ciurlino, Director, SBA Office of Credit Risk Management, to Marlies Dinsmore, SEM, SEM CEO (September 30, 2013).

⁸⁵ See *id.* at 1.

⁸⁶ See generally *id.*

⁸⁷ See generally *id.*

⁸⁸ See generally *id.*

⁸⁹ See *id.* at 23.

the proposed enforcement action, (2) set forth all mitigating factors, and (3) include documentation that SEM believes is most supportive of the objection.⁹⁰ SBA also advised SEM that pursuant to 13 C.F.R. § 120.1600(a)(2)(iii), SEM could request within 30 days of receipt of the Notice a clarification of the reasons given by SBA in the Notice.⁹¹ Further, SBA advised SEM that pursuant to 13 C.F.R. § 120.1600(a)(2)(iv), SEM could request within 30 days of receipt of the Notice additional time to respond to the Notice.⁹²

C. SEM’s Request for a Meeting and SEM’s Response to the Proposed Enforcement Action

On October 16, 2013, SEM requested a meeting with SBA to discuss the matters addressed in the Notice.⁹³ In that request, SEM stated that it understood “the existence of certain non-compliances on the part of SEM” and expressed the “desire to meet with SBA personnel to promptly bring SEM back into full compliance with every requirement of the SBA 504 Program.”⁹⁴

In response, on October 22, 2013, SBA notified SEM of SBA’s decision not to meet with SEM at that time to discuss the Notice. SBA reminded SEM of SBA’s regulation which permits a CDC to submit a written objection to the Notice within 30 calendar days of receipt of the Notice, for SBA’s full consideration during the enforcement action process. SBA also reminded SEM that, pursuant to regulation, SEM’s written objection must set forth in detail all grounds known to SEM to contest the proposed action and all mitigating factors, and must include documentation that SEM believes is most supportive of its objection.

Thereafter, on October 23, 2013, SEM responded with a renewed request for a meeting and a request for a 30-day extension from October 30, 2013 to November 29, 2013 to file a written objection to the Notice. As the basis for the request for extension, SEM stated that it initially chose not to engage legal counsel in the hopes that SBA would meet with SEM. On October 25, 2013, SBA granted SEM’s request for a 30-day extension, noting SBA’s concern with SEM’s failure to plan ahead to meet the deadline imposed by regulation.

⁹⁰ *See id.* at 19-20.

⁹¹ *Id.* at 20.

⁹² *See id.* at 20-21.

⁹³ *See* Letter from Joseph Vasallo, Board President, SEM to Brent Ciurlino, Director, OCRM, SBA (October 16, 2013).

⁹⁴ *See id.*

On November 29, 2013, SEM submitted a four-page response to the twenty-three page Notice of Proposed Enforcement Action (defined above as “SEM’s Response”). SEM did not include any documents in support of its response. SEM’s Response generally “acknowledges [the] regulatory non-compliances cited in the Notice.” SEM’s Response also renews its request to meet with SBA and claims that SEM is committed to addressing the non-compliance matters. Although SEM asserts that its “[r]esponse sets forth any grounds asserted to contest the proposed action as well as mitigating factors,” SEM’s Response fails to include any grounds to contest the proposed action. SEM’s Response does provide the following alleged mitigating factors that SEM believes warrants its continuance as a participant in the 504 Loan Program:

1. “SEM maintains a qualified and independent full-time professional management and staff qualified by training and experience to market the 504 Loan Program, package and process loan applications, close loans, service and liquidate its loan portfolio, and sustain a sufficient level of service and activity in SEM’s Area of Operations, all in compliance with 13 CFR § 120.824. SEM has terminated its Loan Program Services Agreement with EDF REsource Capital, Inc., and no longer relies on EDF for any services or other functions.
2. Since terminating its relationship with EDF, SEM has demonstrated the ability to operate successfully on an independent, cash-flow positive basis. SEM can continue to do so while working with SBA to address the regulatory non-compliances outlined in the Notice.
3. The employees and Board of Directors of SEM are deeply committed to the core mission to which SEM has always been dedicated, namely the delivery of the SBA 504 Loan Program to one of the most underserved geographic areas of the United States. It was with that core mission in mind that SEM began its operations in early 2001, only after inquiring with SBA as to the most underserved area of the country for the provision of SBA 504 loans. And, SEM is successfully fulfilling that core mission at a time during which it is as important as it has ever been. Since the time that SBA approved SEM for participation in SBA’s 504 Loan Program in the greater southeast Michigan area, due in large part to SEM’s efforts over the past ten plus years, 504 lending has become a strong economic engine in the creation of businesses and jobs throughout the greater Detroit area and the rest of the State of Michigan.
4. SEM recognizes that its Loan Loss Reserve Fund (“LLRF”) is currently underfunded and also recognizes its obligation to reimburse losses sustained by the government on Premier Certified Lender Program (“PCLP”) loans. Because SEM is operating on a cash-flow positive basis and has continually cut costs to maximize the efficiency of the business, SEM is able to make significant monthly contributions toward those obligations, and is currently adding \$3,000 per month to its LLRF. We are prepared to immediately make increased payments in the amount of \$8,000 per month and we anticipate being able to further increase that contribution amount after the

implementation of certain upcoming expense cuts. SBA will be deprived of the benefit of these significant payments if SBA terminates SEM's participation in the 504 Loan Program."

SEM does not set forth any grounds to contest the failures and monetary obligations detailed in the Notice of Proposed Enforcement Action, yet it urges SBA to allow it to continue in the 504 Loan Program based on certain alleged mitigating factors, including a qualified staff and management, a commitment to the program and a proposed minimal monetary contribution to its Loan Loss Reserve Fund.

For the reasons discussed more fully herein, SBA has determined that the alleged mitigating factors set forth by SEM are insufficient to overcome or justify the ongoing and fundamental failures identified herein.

IV. GROUNDINGS FOR ENFORCEMENT ACTION

A. SEM has failed to Comply Materially with SBA's Loan Program Requirements to Pay Invoiced Obligations in a Timely Manner as Required by 15 U.S.C. § 697e(b)(2)(C) and/or 13 C.F.R. § 120.847(h). Thus, SBA has sufficient grounds for the Enforcement Action pursuant to 13 C.F.R. § 120.1400(c)(2)

In Section I.a. of SBA's Notice, SBA charged SEM with the failure to comply materially with SBA's Loan Program Requirements to Pay Invoiced Obligations in a timely manner as required by 15 U.S.C. § 697e(b)(2)(C) and/or 13 C.F.R. § 120.847(h). The record shows that this charge is sustained. *See supra* at Section II.I.

As of the date of this Decision, SBA has invoiced SEM for a total of \$1,643,410.83 on SEM's PCLP reimbursement obligation on 11 PCLP loans.⁹⁵ *See* SEM PCLP Reimbursement Obligation Invoices Chart, as of January 10, 2014, *supra* at Section II.I. SEM has paid SBA for only 2 of these PCLP reimbursement obligation invoices in the amount of \$59,319.02. *See id.* Therefore, as of the date of this Decision and despite SBA demand, SEM has failed to timely pay to SBA a total of \$1,584,094.28 (plus interest and penalties) in PCLP reimbursement obligations on 9 PCLP loans as required by 15 U.S.C. § 697e(b)(2)(C) and 13 C.F.R. § 120.847(h). *See id.*

SEM's Loan Loss Reserve Fund, which as of August 9, 2013 contains approximately \$120,401.35, is supposed to secure SEM's payment obligations to SBA on these invoices. However, even if SBA were to apply all of the funds in the Loan Loss Reserve Fund to the outstanding invoices, SEM would still owe SBA \$1,463,690.46 in unpaid invoices and would have nothing in its Loan Loss Reserve Fund to protect against loss for the additional 56 performing PCLP loans in SEM's portfolio. In addition, there are 5 purchased PCLP loans with a total 10% reimbursement obligation of approximately \$337,942 that could be invoiced by SBA and owed by SEM.

⁹⁵ Appeals are pending on four PCLP loans and the appeals have been denied herein. *See* Section IV.A.2. below.

1. SEM's Response to the PCLP reimbursement obligations owed to SBA

SEM's November 29, 2013 Response generally "acknowledges regulatory non-compliance" and recognizes the PCLP reimbursement obligations which form the basis for this ground.⁹⁶ Specifically, SEM admits "its obligations to reimburse losses sustained by the government on [PCLP] loans."⁹⁷ Indeed, SEM paid SBA on August 9, 2013 on two PCLP reimbursement obligations invoices totaling \$59,318.

While SEM expresses interest in coming into compliance with SBA's requirements and thus paying the remainder of the PCLP reimbursement obligations, SEM has failed to pay any additional invoices, and SEM's financial statements and additional financial obligations (the Standard Loan Loss Reserve Fund Requirement deficiency) reveal SEM's inability to pay such invoices. *See* Sections IV.B, D and E below. SBA finds SEM's Response inadequate and unconvincing.

2. SEM's pending appeals on four PCLP reimbursement invoices are denied

By separate letters all dated October 17, 2013, SEM appealed, pursuant to 13 C.F.R. § 120.847, its PCLP reimbursement obligations on 4 of the 9 outstanding invoiced PCLP loans.⁹⁸ SBA has reviewed the appeals and has denied each appeal for the reasons discussed below.

a. Farmington Hills Investments, Inc. Loan

SBA's regulation at 13 C.F.R. § 120.847(h) provides a CDC with 30 calendar days after SBA's notification to the CDC of its PCLP reimbursement obligation to appeal SBA's determination of loss. The invoice notifying SEM of its PCLP reimbursement obligation on the Farmington Hills Investments, Inc. loan was sent by SBA and received by SEM on March 29, 2013. The invoice set forth the basis for SBA's determination of loss on this loan. On June 27, 2013, SBA issued a corrected invoice. Because the bases for the original invoice and the corrected invoice are identical and the corrected invoice simply reduced the amount owed to SBA, the time for SEM's appeal was appropriately calculated from the date of the original invoice or 30 days from March 29, 2013. However, even if the appeal period were to be determined from the date of the corrected invoice, SEM's appeal is untimely. Thirty days from the June 27, 2013 corrected invoice date is July 29, 2013. SEM's did not file its appeal until October 17, 2013, thus it is out of time.

Notwithstanding SEM's untimeliness and without waiving any right to reject SEM's appeal on that sole basis, SBA finds that SEM's reasons for the appeal are without merit. SEM's appeal is based on its assertion that the Farmington Hills Investments, Inc. loan is paid in full. SEM is

⁹⁶ *See* SEM's Response at 3 and 4.

⁹⁷ *See id.*

⁹⁸ *See* Appeal Letters from Marlies Dinsmore, SEM CEO to Leslie Niswander, SBA Deputy Center Director, Commercial Loan Servicing Center (October 17, 2013). The loans and amounts appealed were: Farmington Hills Investments, Inc. (2870836504) for \$129,382.00; Blue Marlin/Key Largo (3095686009) for \$92,083.24; Green Roads Hotel (2571256006) for \$695,140.24; P&P Hotels (2939336005) for \$96,849.39.

incorrect. The loan is not paid in full and was charged off by SBA with an outstanding balance of \$1,465,497.⁹⁹ In support of its appeal, SEM has provided a copy of an e-mail where an SEM employee inquired regarding the status of the original pre-debenture purchase loan number for the Farmington Hills Investments, Inc. loan. However, once a 504 Loan is classified in liquidation and SBA purchases the debenture, SBA assigns a new loan number for accounting purposes (SBA changes the last three digits of the original loan number to create the new loan number).¹⁰⁰ When the new loan number is created, SBA's system shows the original loan number as paid in full due to the debenture purchase. SBA's system reflects the outstanding balance due on the purchased loan under the new loan number, a process of which SEM is aware due to its many years of participation in the 504 Loan program.

Thus, SEM's reasons for the appeal are without merit.

b. P&P Hotels/Paul Yoo Loan

In support of its appeal of the P&P Hotels/Paul Yoo invoice, SEM asserts that "the stated amount of the 'loss ultimately sustained by the Agency' is not yet known or ascertainable." SEM also adds that it "has not exhausted all reasonable collection efforts with respect to the 504 loan because it is still actively negotiating terms for an Offer in Compromise with the Loan obligors" and that "in fact, one or more of such obligors have made additional payments on the outstanding Loan, thereby reducing the amount of any ultimate loss on the Loan."

SBA records reflect that SBA purchased the debenture for this loan on May 1, 2010 and the Senior Third Party Lender subsequently foreclosed on the collateral.¹⁰¹ On January 16, 2013, SBA received \$5,000 for the release of its redemption rights.¹⁰² Despite SEM's assertions, SBA's records do not reflect the receipt of any offer in compromise and further do not reflect the receipt of any recent payments from the obligors on the loan. Instead, SBA has appropriately determined that SEM has exhausted all reasonable collection efforts with respect to this loan. SBA has properly charged off the loan and referred it to the Department of Treasury pursuant to the requirements of the Debt Collection Improvement Act of 1996, 31 U.S.C. § 3716(c). Should SBA receive any future recoveries on the loan, the amount due on SEM's PCLP reimbursement obligation will be adjusted to reflect the recoveries.

Thus, SEM's reasons for the appeal are without merit.

c. Blue Marlin/Key Largo Loan

In its appeal of the Blue Marlin/Key Largo invoice, SEM also asserts that "the stated amount of the 'loss ultimately sustained by the Agency' is not yet known or ascertainable." SEM adds that it "has not exhausted all reasonable collection efforts with respect to the 504 loan because it is

⁹⁹ See ELIPS Loan Information for Borrower Farmington Hills Investments, Inc. (SBA Loan No. 2870836504).

¹⁰⁰ See SOP 50 55, Chapter 15, Paragraph B(7).

¹⁰¹ See ELIPS and CLCS Loan Information for Borrower Paul Yoo (SBA Loan Nos. 2939336005 and 2939336506).

¹⁰² See CLCS Loan Information for Borrower Paul Yoo (SBA Loan No. 2939336506).

awaiting SBA's approval of an offer to purchase the SBA Promissory Note" and that "the amount of any approved purchase of the Promissory Note will necessarily reduce the amount of any ultimate loss on the Loan." While SEM did submit a request for SBA approval of a Note purchase offer, SEM failed to provide additional documentation required by SBA.¹⁰³ As a consequence, SBA declined the proposed Note sale request on October 31, 2013.¹⁰⁴ Based on SEM's failure to provide the requested documentation, SBA's determination that SEM has exhausted all reasonable collection efforts is appropriate and SBA has properly charged off the loan and referred it to the Department of Treasury pursuant to the requirements of the Debt Collection Improvement Act. Should SBA receive any future recoveries on the loan, the amount due on SEM's PCLP reimbursement obligation will be adjusted to reflect the recoveries.

Thus, SEM's reasons for the appeal are without merit.

d. Green Road Hotels Loan

On September 17, 2013, SBA sent SEM an invoice for its PCLP reimbursement obligation on the Green Road Hotels Loan. The invoiced amount is \$695,140.24. SBA calculated the amount of the invoice based on 10% of the principal loss of \$6,911,449.28 and 10% of the interest loss of \$39,953.07. The amount of the principal loss includes the CPC expenses discussed above that SBA incurred in connection with the purchase of the Zions Bank loan and the funds provided to SEM's affiliated servicer, EDF, for payment of delinquent taxes and flag fees on the collateral. Although SEM's affiliated servicer, EDF, and related party, Redemption, are each holding substantial recoveries and funds from the liquidation of this loan, those recoveries and funds cannot be credited to the loan account until they are remitted to SBA as required. In its appeal, SEM states that it "does not have possession of or control over such proceeds." However, SEM has the ability to direct its affiliated servicer, EDF, and its related party, Redemption, to remit the liquidation recoveries and funds to SBA. Upon receipt of the liquidation recoveries and funds, SBA will adjust the amount due on SEM's PCLP reimbursement obligation. Until such time as that occurs, the amount stated in the invoice is the amount due on SEM's PCLP reimbursement obligation.

In its appeal, SEM also refers to a letter dated July 12, 2013,¹⁰⁵ where it asserts that it believes that "there is at least one solvent guarantor of this loan." SEM further states that it is pursuing collection efforts against the guarantor and expects to deliver an offer in compromise or workout agreement to SBA "in the near future." Despite SEM's assertions, SBA's records do not reflect the receipt of any offer in compromise or workout agreement in the six months since

¹⁰³ See October 21, 2013 e-mail from SBA's Julia Young to Chad Browning of SEM requesting: Personal Financial Statement SBA Form 770 for all guarantors; personal FED tax returns for the past two years for all guarantors; business FED tax returns for the past two years for ongoing business concerns; last year-end and current financial statements; current financials for all affiliates; comprehensive financial analysis; and recommendation from CDC. The deadline for this information was October 30, 2013. SEM did not submit the required documentation.

¹⁰⁴ See CLCS Loan Information for Borrower Key Largo, LLC (SBA Loan No. 3095686510).

¹⁰⁵ See Letter from Marlies Dinsmore, CEO, SEM to Leslie Niswander, Deputy Center Director, SBA (July 12, 2013).

that letter was written. Instead, SBA has determined that SEM has exhausted all reasonable collection efforts with respect to this loan and SBA has properly charged off the loan. Should SBA receive any future recoveries on the loan from the guarantor, the amount due on SEM's PCLP reimbursement obligation will be adjusted to reflect the recoveries.

Thus, SEM's reasons for the appeal are without merit.

e. Conclusion on Appeals

For all of the foregoing reasons, SEM's appeals on the above 4 PCLP reimbursement obligation invoices have been denied.¹⁰⁶

3. SBA's Final Decision on Ground A - 13 C.F.R. §120.1400(c)(2) - Failure to Comply Materially with SBA's Loan Program Requirement to Pay Invoiced Obligations in a Timely Manner as Required by 15 U.S.C. §697e(b)(2)(C) and/or 13 C.F.R. § 120.847(h)

The record shows that SEM owes SBA \$1,584,094.28 (plus interest and penalties) in invoiced PCLP reimbursement obligations. SEM's pending appeals on four of those invoices have been denied for the reasons stated above. In SEM's Response, it acknowledges its obligations to SBA, but has failed to pay these obligations.

For the foregoing reasons, it is SBA's final decision that SEM has failed to pay invoiced obligations in a timely manner as required by 15 U.S.C. § 697e(b)(2)(C) and/or 13 C.F.R. 120.847(h) and has thus failed to comply materially with SBA's Loan Program Requirements.

B. SEM has failed to Comply Materially with SBA's Loan Program Requirements to Remit Liquidation Proceeds and other Funds to SBA. Thus, SBA has sufficient grounds for the Enforcement Action pursuant to 13 C.F.R. § 120.1400(c)(2)

In Section I.b. of SBA's Notice, SBA charged SEM with the failure to remit liquidation proceeds and other funds to SBA as mandated by SBA's Loan Program Requirements. Specifically, SBA charged SEM with failing to remit to SBA its share of the approximately \$5.6 million in liquidation proceeds from the sale of SBA's collateral, approximately \$278,000 in other liquidation recoveries, and approximately \$623,547 in unused CPC funds on the Green Road Hotels Loan, SEM's largest defaulted SBA 504 loan, in accordance with SBA's SOP 50 51 3 (as amended) governing 504 Loan Liquidation. That requirement obligates SEM to remit to SBA, within 15 business days of receipt, SBA's share of the liquidation proceeds recovered on this loan. The record shows that this charge is sustained. *See supra* at II.I.

¹⁰⁶ See Memorandum from Linda Rusche, Director, SBA Office of Financial Assistance, to Brent M. Ciurlino, Director, Office of Credit Risk Management (January 30, 2014).

1. SEM failed to set forth any grounds to contest its non-compliance on the Green Road Hotels Loan

SEM's November 29, 2013 Response does not set forth any grounds to contest its non-compliance arising from its failure to remit the liquidation recoveries and other funds on the Green Road Hotels Loan. Although SEM asserted in an April 5, 2013 letter to SBA that it is unable to obtain information or funds related to this loan, SEM no longer makes this assertion in its Response. SBA sufficiently addressed SEM's assertion in the Agency's Notice and found this assertion lacking in merit, citing to documentary evidence that provides information contrary to SEM's assertion. *See* Notice, at 11.

SEM stated in its April 5, 2013 letter to SBA that it is unable to obtain information or funds related to Green Road Hotels Loan because "SEM has no legal relationship to, control over or affiliation with Redemption Reliance, LLC."¹⁰⁷ However, as stated in SBA's Notice, by letter dated January 18, 2013, attorneys for SEM's affiliated servicer, EDF, advised SBA that "substantially all [liquidation proceeds] funds previously held by Redemption Reliance have been paid to EDF."¹⁰⁸ SEM did not deny that it can obtain funds and information from EDF, its former loan servicer and agent, and therefore fulfill its requirement to remit liquidation proceeds to SBA.¹⁰⁹ Moreover, SEM's affiliated servicer, EDF, admitted its obligation to remit all funds due to SBA for the Green Road Hotels Loan, stating in a letter dated February 24, 2012 to SBA that the "receiver who had been operating the hotel has 120 days to finalize the accounts, and EDF will remit the appropriate funds to SBA thereafter."¹¹⁰ Additionally, SEM's Chief Executive Officer (CEO), Marlies Dinsmore, is the spouse of Frank Dinsmore, Redemption's 100% owner and EDF's CEO, and her office is located in the same building housing the offices of EDF and Redemption. Therefore, SEM should be in a position to obtain these funds and remit them to SBA as required.

As stated in SBA's Notice, SBA rejects SEM's previous assertion that it is unable to obtain information or funds related to Green Road Hotels Loan. SEM has not set forth any grounds to contest SBA's rejection.

2. SBA's Final Decision on Ground B - 13 C.F.R. §120.1400(c)(2) - Failure to Comply Materially with SBA's Loan Program Requirement to Remit Liquidation Proceeds and other funds to SBA as Required

The record shows that SEM is required to remit to SBA its share of the approximately \$5.6 million in proceeds from the sale of SBA's collateral, approximately \$278,000 in other liquidation recoveries, and approximately \$623,547 in unused CPC funds on the Green Road Hotels Loan.

¹⁰⁷ *See* Letter from Marlies Dinsmore, CEO, SEM to Michael Simmons, Acting Director, OFA, SBA (April 5, 2013).

¹⁰⁸ *See* Letter from Jerry Stouck and David P. Callet, Greenberg Traurig, LLP, to Brent Ciurlino, Director, OCRM, SBA (January 18, 2013).

¹⁰⁹ *See id.*

¹¹⁰ Letter from Frank Dinsmore, CEO, EDF to Leslie Niswander, Deputy Center Director, SBA (February 24, 2012).

For the foregoing reasons, it is SBA's final decision that SEM has failed to remit liquidation proceeds and other funds to SBA and has thus failed to comply materially with SBA's Loan Program Requirements.

C. SEM has failed to Comply Materially with SBA's Loan Program Requirements to Service and Liquidate its Largest PCLP 504 loan in accordance with Prudent and Commercially Reasonable Lending Standards as Required by 13 C.F.R. § 120.848(a) and 13 C.F.R. § 120.970(a). Thus, SBA has sufficient grounds for the Enforcement Action pursuant to 13 C.F.R. § 120.1400(c)(2)

In Section I.c. of SBA's Notice, SBA charged SEM with failure to service and liquidate its largest defaulted PCLP 504 loan in accordance with prudent and commercially reasonable lending standards as mandated by SBA's Loan Program Requirements. The record shows that this charge is sustained. *See supra* at Section II.J.

1. SEM's Response fails to set forth any grounds to contest its non-compliance regarding the servicing and liquidation of the Green Road Hotels Loan

As discussed above, SEM made the Green Road Hotels Loan, a PCLP 504 Loan. SEM contracted with its affiliate, EDF, a revoked CDC, to service SEM's loans, including the Green Road Hotels Loan. SEM permitted its affiliated servicer, EDF, to assign the first lien loan documents that SBA purchased from Zions Bank to SEM's related party, Redemption, without SBA's authorization. SEM also permitted its affiliated servicer, EDF, to transfer \$623,547 in funds for the payment of CPC expenses to SEM's related party without SBA's authorization. Despite numerous written demands by SBA, SEM, SEM's affiliated servicer, EDF, and SEM's related party, Redemption, have refused to deliver SBA's share of the approximately \$5.6 million in proceeds from the sale of SBA's collateral, the other liquidation recoveries and the unused CPC funds. Additionally, it appears that SEM's affiliated servicer, EDF, has dissipated a portion of the liquidation proceeds.¹¹¹

In the March 15, 2013 letter, SBA demanded that SEM immediately turn over to SBA all liquidation proceeds and unused CPC expenses for this loan. In the same letter, SBA also required, pursuant to 13 C.F.R. § 120.830, that SEM provide SBA with the following reports relating to the Green Road Hotels Loan: (a) a detailed accounting of the use of the \$5,041,939 in CPC expenses disbursed by SBA on the loan; (b) a detailed accounting of all receivership activities on the loan; (c) a detailed accounting of all proceeds, funds or recoveries received by Redemption, EDF, or any related party on the loan from any source, including the third party purchaser, the Receiver, Zions Bank, or any obligor; (d) a report containing copies of bank statements verifying the account of all proceeds, funds or recoveries on the loan; (e) a detailed accounting of all expenses incurred by Redemption, EDF or SEM in connection with the liquidation of the loan; and (f) a report stating whether EDF has transferred any of the proceeds,

¹¹¹ See "Account QuickReport" for EDF, indicating transactions and balances for EDF from December 17, 2012 to April 15, 2013.

funds or recoveries on the loan to any creditor to pay obligations unrelated to the loan, and, if so, a detailed accounting of such transfers.

In its April 5, 2013 response, SEM claimed that it lacked knowledge about and control over the Green Road Hotels Loan liquidation proceeds and other funds, and that it could not prepare the required reports because it could not obtain the necessary information.¹¹² SEM's admission is evidence that it has failed to manage the servicing and liquidation of its largest 504 loan in accordance with prudent and commercially reasonable lending standards. By failing to retain control over the liquidation proceeds from its largest loan, claiming that it has no ability to obtain information regarding the liquidation of this loan, and further by allowing its affiliated servicer, EDF, to dissipate liquidation proceeds held in trust for SBA instead of remitting the proceeds to SBA as required, SEM has failed to act in accordance with prudent and commercially reasonable lending standards as required by SBA regulation.

SEM's November 29, 2013 Response does not set forth any grounds to contest the foregoing. Rather, SEM generally "acknowledges regulatory non-compliance," and instead sets forth the following alleged mitigating factors with regard to the issue of servicing and liquidation:

SEM maintains a qualified and independent full time professional management and staff qualified by training and experience to market the 504 Loan Program, package and process loan applications, close loans, service and liquidate its loan portfolio, and sustain a sufficient level of service and activity in SEM's Area of Operations, all in compliance with 13 C.F.R. § 120.824. SEM has terminated its Loan Program Services Agreement with EDF Resource Capital, Inc. and no longer relies on EDF for any services or other functions.

See Notice at 2 and 4. SEM does not provide any specific information related to its process for the servicing and liquidation of its loans. Neither does SEM provide any specific information regarding the Green Road Hotels Loan in response to the grounds identified in the Notice.

Essentially, SEM argues that because it allegedly now does not contract or use EDF for any services or other functions, SBA should disregard SEM's prior admitted (and continuing) violations and find that SEM's now alleged implementation of prudent and commercially reasonable lending standards should moot any prior violations. In addition, SEM has not provided any evidence that it has in fact implemented prudent and commercially reasonable lending standards.

Regardless of the veracity of SEM's general assertions, SEM's prior failures to implement prudent and commercially reasonable lending standards resulted in mismanagement of its largest defaulted PCLP 504 loan, which has led to SEM's failure to pay SBA its share of approximately \$5.6 million in proceeds from the sale of SBA's collateral, approximately \$278,000 in other liquidation recoveries, and approximately \$623,547 in unused CPC funds on the Green Road Hotels Loan. SBA rejects SEM's assertions.

¹¹² *See* Letter from Marlies Dinsmore, CEO, SEM to Michael Simmons, Acting Director, OFA, SBA (April 5, 2013).

2. SBA's Final Decision on Ground C – 13 C.F.R. §120.1400(c)(2) – Failure to Service and Liquidate its Largest PCLP 504 loan in accordance with Prudent and Commercially Reasonable Lending Standards as Required by 13 C.F.R. § 120.848(a) and 13 C.F.R. § 120.970(a)

The record shows that SEM failed to service and liquidate its largest defaulted PCLP 504 loan in accordance with prudent and commercially reasonable lending standards as mandated by SBA's Loan Program Requirements. As of the date of this Decision, SEM has failed to provide information requested by SBA on this loan and SEM has failed to demonstrate adequate handling of this loan. By failing to retain control over the liquidation proceeds from its largest defaulted loan, claiming that it has no ability to obtain information regarding the liquidation of this loan, and further by allowing its affiliated servicer, EDF, to dissipate liquidation proceeds held in trust for SBA instead of remitting the proceeds to SBA as required, SEM has failed to act in accordance with prudent and commercially reasonable lending standards as required by SBA regulation. SEM does not dispute SBA's charges related to the Green Road Hotels Loan.

For the foregoing reasons, it is SBA's final decision that SEM has failed to service and liquidate its largest defaulted PCLP 504 Loan in accordance with prudent and commercially reasonable lending standards as required by 13 C.F.R. § 120.848(a) and 13 C.F.R. § 120.970(a) and has thus failed to comply materially with SBA's Loan Program Requirements.

D. SEM has failed to Comply Materially with SBA's Loan Program Requirement to Maintain the Financial Ability to Operate as Required by 13 C.F.R. § 120.825. Thus, SBA has sufficient grounds for the Enforcement Action pursuant to 13 C.F.R. § 120.1400(c)(2)

In Section I.d. of SBA's Notice, SBA charged SEM with the failure to comply materially with SBA's Loan Program Requirement to Maintain the Financial Ability to Operate as required by 13 C.F.R. § 120.825. The record shows that this charge is sustained.

13 C.F.R. § 120.825 requires that a CDC must maintain the financial ability to operate. The regulation defines the financial ability to operate as follows: "A CDC must be able to sustain its operations continuously, with reliable sources of funds (such as income from services rendered and contributions from government or other sponsors)." See 13 C.F.R. § 120.825. The financial ability to operate is a core requirement that must be met by all CDCs, but is critical for a CDC that has potential PCLP reimbursement obligations to SBA.

1. SEM is insolvent

As stated above, in Section II.L., based on SEM's financial statements as of September 30, 2012, SEM's auditor determined that SEM "has suffered recurring losses and has a net asset deficiency" and that SEM's financial condition "raise[s] substantial doubt about [SEM's] ability

to continue as a going concern.”¹¹³ SEM’s auditor made the finding of insolvency and issued the going concern opinion absent any consideration of the approximately \$1,584,094.28 (plus interest and penalties) in PCLP reimbursement obligations SEM owes to SBA, SEM’s approximately \$337,942 in contingent liabilities for future PCLP reimbursement obligations on purchased PCLP Loans, and the additional \$261,838.65 Loan Loss Reserve Fund contribution required by statute and regulation.¹¹⁴

Furthermore, SEM’s interim (unaudited) financial statements for the first quarter of fiscal year 2013 (as of December 31, 2012) show an increase in accumulated Net Deficit from September 2012, resulting in an accumulated Net Deficit of \$3,474,840.89. These financials also fail to take into consideration the approximately \$1,584,094.28 (plus interest and penalties) in PCLP reimbursement obligations SEM owes to SBA, the additional contingent PCLP loss reimbursement obligations, and the additional \$261,838.65 Loan Loss Reserve Fund contribution required by statute and regulation. In addition, as of December 30, 2012, SEM’s reported indebtedness to its affiliate, EDF, has increased by \$90,956 from fiscal year 2012 to a total of \$3,477,616.65.¹¹⁵ The EDF Note matures on September 30, 2014.

2. SEM’s Response regarding its financial ability to operate

In its November 29, 2013 Response, SEM does not set forth any grounds to contest SBA’s finding that SEM has failed to demonstrate the financial ability to operate, but does set forth as an alleged mitigating factor an assertion that “[s]ince terminating its relationship with EDF, SEM has demonstrated the ability to operate successfully on an independent, cash-flow positive basis. SEM can continue to do so while working with SBA to address the regulatory non-compliances outlined in the Notice.” For the reasons stated herein, SBA finds SEM’s argument unconvincing.

SEM did not provide any documentation with its November 29, 2013 Response to support its assertion. The only financial documentation relevant to this contention was submitted by SEM prior to SBA’s Notice. SEM’s April 5, 2013 letter provided a “Summary of Cash Flows identifying the basis upon which SEM will maintain its operations.” Attached to the April 5, 2013 letter were SEM’s Cash Flow Forecasts for FY 2013 and 2014. SEM’s Cash Flow Forecast for FY 2013 projected an ending cash balance of \$263,188 as of September 30, 2013. SEM has failed to provide SBA with any financial statements showing SEM’s actual cash flows and ending cash balance for FY 2013. Moreover, as stated in SBA’s Notice, SEM’s projected cash flows failed to take into consideration any payments to SBA for the \$1,584,094.28 (plus interest and penalties) in PCLP reimbursement obligations and reflected a mere \$3,000 a month contribution to its Loan Loss Reserve Fund deficiency of \$261,838.65. The projections also failed to take into consideration SEM’s obligation on the EDF Note of approximately \$3,477,616.65 (as of April 5, 2013) that is due to mature on September 30, 2014.

¹¹³ SEM’s fiscal year 2013 financial statements are due by regulation 180 days from the end of the prior fiscal year which is March 29, 2014. See 13 C.F.R. § 120.830. SBA has not yet received these financial statements.

¹¹⁴ See *id. generally*.

¹¹⁵ See Letter from Marlies Dinsmore, CEO, SEM to Michael Simmons, Acting Director, OFA, SBA (April 5, 2013).

What is evident from SEM's financial statements is that SEM would not be able to continue to operate its business if it properly honored its obligations to SBA under the Loan Program Requirements with which it agreed to abide, paid all funds due and owing to the Agency and properly funded SEM's Loan Loss Reserve Fund.

3. SBA's Final Decision on Ground D - 13 C.F.R. § 120.1400(c)(2) - Failure to Comply Materially with SBA's Loan Program Requirement to Maintain the Financial Ability to Operate as Required by 13 C.F.R. § 120.825

The record shows that SEM is insolvent. SEM does not have the financial ability to operate as required by SBA's regulations. For the foregoing reasons, it is SBA's final decision that SEM has failed to maintain the financial ability to operate as required by 13 C.F.R. § 120.825 and has thus failed to comply materially with SBA's Loan Program Requirements.

- E. SEM has failed to Establish or Maintain a Loan Loss Reserve Fund as Required by 13 C.F.R. § 120.847 and 15 U.S.C. § 697e(c)(2) by failing to comply with the Loan Loss Reserve Fund deposit requirements to fully fund its Loan Loss Reserve Fund. Thus, SBA has sufficient grounds for the Enforcement Action pursuant to 13 C.F.R. § 120.1400(f)(2)**

In Section II.a. of SBA's Notice, SBA charged SEM with the failure to establish or maintain a Loan Loss Reserve Fund as required by the PCLP Program by failing to comply with the Loan Loss Reserve Fund deposit requirements to fully fund its Loan Loss Reserve Fund. The record shows that this charge is sustained.

Under the PCLP Program, SEM is required by statute to maintain and fully fund a Loan Loss Reserve Fund for each PCLP 504 loan it makes until such time as the loan is paid in full.¹¹⁶ SEM is currently required under the Standard Loan Loss Reserve Fund Requirement to maintain an amount equal to one percent of the original principal amount of each PCLP debenture issued by SEM for the life of the loan.¹¹⁷ SEM is also required by regulation to replenish its Loan Loss Reserve Fund in the amount paid to SBA out of its Loan Loss Reserve Fund.¹¹⁸ The record shows that SEM has failed to comply with these requirements.

1. SBA's Prior Demand to SEM for adequate funding of the Loan Loss Reserve Fund

As a result of the lapse of authority for the Alternative Loan Loss Reserve and pursuant to its statutory authority, SBA notified SEM by letter dated March 15, 2013 that SEM was required to contribute to its Loan Loss Reserve Fund an amount sufficient to meet the Standard Loan

¹¹⁶ See 15 U.S.C. § 697e(b)(2)(C); 13 C.F.R. § 120.847.

¹¹⁷ See 15 U.S.C. § 697e(c)(2); 13 C.F.R. § 120.847(b).

¹¹⁸ See 13 C.F.R. § 120.847(j).

Loss Reserve Fund Requirement.¹¹⁹ SBA calculated this amount for SEM's portfolio, notifying SEM in the March 15, 2013 letter that SEM's Standard Loan Loss Reserve Fund Requirement totaled \$418,080 (calculated as of December 31, 2012).¹²⁰ Because SEM reported to SBA a Loan Loss Reserve Fund amount of \$170,473.69 as of December 31, 2012, SBA notified SEM that its Loan Loss Reserve Fund had a deficiency of \$247,606.31. Consistent with 13 C.F.R. §120.847(j), SBA's March 15, 2013 letter notified SEM that it was required to contribute the deficient amount to its Loan Loss Reserve Fund within 30 days of SBA's letter.¹²¹ As of the date of this Decision, SEM has failed to make the required deposit into its Loan Loss Reserve Fund. SEM most recently reported a Loan Loss Reserve Fund of \$179,720.37 as of June 30, 2013.¹²²

Thereafter, upon SEM's request, SBA authorized the payment of two PCLP invoices from the Loan Loss Reserve Fund on August 9, 2013.¹²³ SBA advised SEM that although it was allowing payment of the invoices, SEM was obligated, pursuant to 13 C.F.R. §120.847(j), to replenish its Loan Loss Reserve Fund in the amount paid (\$59,318) by September 9, 2013.¹²⁴ As of the date of this Decision, SEM has provided no evidence that it has complied with this replenishment requirement.

2. SEM's November 29, 2013 Response relating to the funding of its Loan Loss Reserve Fund

In its November 29, 2013 Response, SEM admits the Loan Loss Reserve Fund "is currently underfunded" and states that it "is currently adding \$3000 per month to its Loan Loss Reserve Fund" and is "prepared to immediately make increased payments in the amount of \$8,000 per month and we anticipate being able to further increase that contribution amount after the implementation of certain upcoming expense cuts. SEM will be deprived of the benefit of these significant payments if SBA terminates SEM's participation in the 504 Loan Program."¹²⁵ SEM admits it is unable to deposit the statutorily required amount into its Loan Loss Reserve Fund Accounts as required.

3. SEM's Loan Loss Reserve Fund is insufficient

Under the Standard Loan Loss Reserve Fund Requirement (1% of the original principal amount

¹¹⁹ See Small Business Additional Temporary Extension Act of 2011, Pub.L.No.112-17, § 2,125 Stat.221 (June 1, 2011); SEM admits that the ALLR statutory pilot lapsed, but incorrectly stated in a February 5, 2013 letter to SBA that the authority for the ALLR statutory pilot lapsed in September 2006; See 15 U.S.C. § 697(c)(7)(D); Letter titled "Notice of Required Reports and other Action" from Michael Simmons, Acting Director, OFA to Marlies Dinsmore, CEO, SEM (March 15, 2013).

¹²⁰ See Letter titled "Notice of Required Reports and other Action" from Michael Simmons, Acting Director OFA, SBA to Marlies Dinsmore, CEO, SEM (March 15, 2013).

¹²¹ See *id.*

¹²² See Letter from to Marlies Dinsmore, CEO, SEM to Gerald Moore, District Director, SBA (August 15, 2013).

¹²³ The two loans were DACZ Industries, Inc. (3179326504) in the amount of \$14,20164 and Northern Properties Investment, LLC (2711666504) in the amount of \$45,117.38.

¹²⁴ See Email dated August 7, 2013 from Leslie Niswander, Deputy Center Director, SBA to Marlies Dinsmore, CEO, SEM.

¹²⁵ *Id.* at 3.

of its PCLP loans under 13 C.F.R. § 120.847(b)) that now apply to SEM due to the Alternative Loan Loss Reserve Program statutory lapse, SEM is required, as of December 31, 2013, to have approximately \$382,240 in its Loan Loss Reserve Fund accounts.¹²⁶ The most recent Quarterly Report SEM submitted to SBA (as of June 30, 2013) indicates that SEM's Loan Loss Reserve Fund had a balance of \$179,720.37 but that amount was reduced by \$59,319.02 paid on two loans on August 9, 2013. Therefore, SEM's Loan Loss Reserve Fund contains \$120,401.35 and it is deficient by \$261,838.65. As of the date of this Decision, SEM owes SBA a total of \$1,584,094.28 in PCLP reimbursement obligations. Thus, on billed invoices alone, SEM's Loan Loss Reserve Fund is insufficient to pay the obligations owed to SBA by \$1,463,690.46.

SEM is required by regulation to diligently monitor its Loan Loss Reserve Fund to ensure that it contains sufficient funds to cover its reimbursement obligation for its entire portfolio of PCLP loans, and within 30 days of the earlier of either (1) the date it becomes aware of a deficiency or (2) the date it receives notification from SBA of a deficiency, make additional contributions to the Loan Loss Reserve Fund. *See* 13 C.F.R. § 120.847(j). SEM's Loan Loss Reserve Fund does not contain sufficient funds to cover SEM's reimbursement obligation on just the 9 PCLP loans for which SBA has billed SEM and which SEM has not paid as of the date of this Decision. In addition, there are 5 additional purchased PCLP loans with reimbursement obligations of approximately \$337,942 that could be invoiced by SEM. Lastly, there are approximately 56 other PCLP loans in SEM's portfolio on which losses may continue to emerge and develop and for which SBA would continue to bill SEM after the date of this Decision. Thus, SEM has failed to maintain a Loan Loss Reserve Fund as required by the PCLP Program.

4. SBA's Final Decision on Ground E – 13 C.F.R. § 120.1400(f)(2) – Failure to Establish or Maintain a Loan Loss Reserve Fund as Required by the PCLP Program by failing to comply with the Loan Loss Reserve Fund deposit requirements to fully fund its Loan Loss Reserve Fund

The record shows that SEM's Loan Loss Reserve Fund is insufficient by \$261,838.65 under the Standard Loan Loss Reserve Fund Requirement. For the foregoing reasons, it is SBA's final decision that SEM has failed to establish or maintain a Loan Loss Reserve Fund as required by the PCLP Program.

- F. **SEM has failed to Establish or Maintain a Loan Loss Reserve Fund as Required by 13 C.F.R. § 120.847 by failing to fund for each PCLP Debenture, file Quarterly Reports and make additional contributions. Thus, SBA has sufficient grounds for the Enforcement Action pursuant to 13 C.F.R. § 120.1400(f)(2)**

In Section II.b. of SBA's Notice, SBA charged SEM with the failure to (1) fund a Loan Loss Reserve Fund for each PCLP Debenture that SEM has issued, (2) file Quarterly Reports with SBA in a form that readily facilitates reconciliation of the amount actually maintained in SEM's Loan

¹²⁶ *See* Agency PCLP Loan Loss Reserve Requirements Report as of December 31, 2013. The amount identified in this report (\$388,070) is reduced by the required 1% of the original balance for the two loans paid August 9, 2013: DACZ Industries, Inc. (3179326504) (\$1,440) and Northern Properties Investment, LLC (2711666504) (\$4,390).

Loss Reserve Fund with the amount required to be maintained and (3) make additional contributions to SEM's Loan Loss Reserve Fund to remedy any known deficiency. The record shows that this charge is sustained.

1. SEM's failure to respond to SBA's Notice with regard to this Ground

SEM's November 29, 2013 Response generally "acknowledges regulatory non-compliance" and admits the Loan Loss Reserve Fund "is currently underfunded."¹²⁷ SEM's November 29, 2013 Response does not dispute any of the facts supporting this ground for revocation. It does not dispute that it failed to fund a Loan Loss Reserve Fund for each PCLP Debenture that SEM has issued, that it failed to file Quarterly Reports with SBA in a form that readily facilitates reconciliation of the amount actually maintained in SEM's Loan Loss Reserve Fund with the amount required to be maintained or that it failed to make additional contributions to SEM's Loan Loss Reserve Fund to remedy any known deficiency.

2. SEM failed to fund its Loan Loss Reserve Fund for each PCLP loan, to file Quarterly Reports with SBA and remedy the Loan Loss Reserve Fund deficiency

Under the PCLP Program, the "Loan Loss Reserve Fund is the accumulation of deposits that a PCLP CDC must establish and maintain for *each* PCLP Debenture that it issues."¹²⁸ SBA's regulation also requires that a PCLP CDC "must periodically report to SBA the amount in the Loan Loss Reserve Fund in a form that will readily facilitate reconciliation of the amount maintained in the Loan Loss Reserve Fund with the amount required [to be maintained.]" The same regulation further requires that a "PCLP CDC" must diligently monitor the Loan Loss Reserve Fund to ensure it contains sufficient funds to cover its Exposure for its *entire portfolio* of PCLP Debentures" and "[i]f, at any time, the Loan Loss Reserve Fund does not contain sufficient funds, the PCLP CDC must, within 30 days of the . . . date it becomes aware of this deficiency . . . make additional contributions to the Loan Loss Reserve Fund to make up this difference."¹²⁹ The record shows that SEM has failed to comply with all of these requirements.

Even prior to the lapse of the Alternative Loan Loss Reserve statutory pilot program on July 30, 2011, SEM's Loan Loss Reserve Fund was deficient because SEM was not in compliance with its own risk-based approach for determining the required balance for its Loan Loss Reserve Fund. SEM's December 31, 2010 Quarterly Report submitted to SBA stated that under its risk-based approach, SEM calculated required indicated reserves of \$514,256 for 78 PCLP 504 loans.¹³⁰ The Quarterly Report showed that SEM had on deposit in its Loan Loss Reserve Fund only \$165,995, a deficiency of \$348,261 under SEM's risk-based approach.

SEM's September 30, 2012 Quarterly Report submitted to SBA stated that under its risk-

¹²⁷ See Notice at 3 and 4.

¹²⁸ 13 C.F.R. § 120.847(a) (emphasis added).

¹²⁹ 13 C.F.R. § 120.847(j).

¹³⁰ See SEM's December 30, 2010 Quarterly Report

based approach (the authority for which had lapsed statutorily) SEM had on deposit in its Loan Loss Reserve Fund a total of \$167,340 for 64 PCLP 504 loans.¹³¹ Instead of depositing \$346,916 in its Loan Loss Reserve Fund in order to fully fund its Loan Loss Reserve Fund in the amount of \$514,256 as required under its risk-based approach, it appears that between December 31, 2010 and September 30, 2012, SEM dropped 12 defaulted PCLP 504 loans in the total amount of approximately \$14 million (with a potential PCLP reimbursement obligation exposure of at least \$1.4 million) from its Loan Loss Reserve Fund and its reports to SBA.¹³² SEM attempted to avoid the large deposit obligation required under its risk-based approach by removing the 12 defaulted loans from its reserve calculation and its reports to SBA.

As a result, SEM repeatedly failed to report loans on its required Quarterly Reports to the Agency and failed to maintain a reserve for the dropped loans. SEM's Quarterly Report as of December 31, 2012 does account for all of the PCLP 504 loans in its portfolio; however, this does not excuse SEM's prior failures to account for all of its PCLP 504 loans, its misleading submissions to SBA, and its failure to fully fund its Loan Loss Reserve Fund as required under its risk-based approach.

3. SBA's Final Decision on Ground F - 13 C.F.R. § 120.1400(f)(2) – Failure to Establish or Maintain a Loan Loss Reserve Fund as Required by the PCLP Program

The record shows that SEM failed to (1) fund an Loan Loss Reserve Fund for each PCLP Debenture that SEM has issued, (2) file Quarterly Reports with SBA in a form that readily facilitates reconciliation of the amount actually maintained in SEM's Loan Loss Reserve Fund with the amount required to be maintained and (3) make additional contributions to SEM's Loan Loss Reserve Fund to remedy any known deficiency. For the foregoing reasons, it is SBA's final decision that SEM has failed to establish or maintain a Loan Loss Reserve Fund as required by the PCLP Program.

V. CONCLUSION

It is SBA's final decision to permanently revoke SEM's 504 program authority and to permanently transfer SEM's 504 loan portfolio and 504 loan applications based on the grounds set forth in SBA's Notice of Proposed Enforcement Action to SEM as follows:

1. SEM has failed to comply materially with SBA's Loan Program Requirement to pay invoiced obligations in a timely manner as required by 15 U.S.C. § 697e(b)(2)(C) and/or 13 C.F.R. § 120.847(h)(2). Thus, SBA has sufficient grounds for the

¹³¹ See SEM's September 30, 2012 Quarterly Report

¹³² 13 C.F.R. § 120.847(a) (emphasis added). Compare SEM's September 30, 2012 Quarterly Report with SEM's December 31, 2010 Quarterly Report. The dropped loans are as follows: Green Road Hotels, LLC (2571256006); Avery Associates, LLC (2887216001); Alissawi Transportation, Inc. (2532506006); P&P Hotels, Inc. (2939336005); M and M South Haven, LLC (2857356007); Blue Marlin, LLC (3095686009); Donovan & Andre (2999576009); Christensen Fiberglass, LLC (2723266009); Farmington Hills Investments (2870836003); Northern Properties Investment (2711666003); Aljarbo No. 3, Inc. (3251796010); and DACZ Industries, Inc. (3179326003).

enforcement action pursuant to 13 C.F.R. § 120.1400(c)(2).

2. SEM has failed to comply materially with SBA's Loan Program Requirement to remit liquidations proceeds and other funds to SBA as required by SBA's Standard Operating Procedure 50 51 3 (as amended) governing 504 Loan Liquidation. Thus, SBA has sufficient grounds for the enforcement action pursuant to 13 C.F.R. § 120.1400(c)(2).
3. SEM has failed to comply materially with SBA's Loan Program Requirement to service and liquidate its largest PCLP 504 loan in accordance with prudent and commercially reasonable lending standards as required by 13 C.F.R. § 120.848(a) and 13 C.F.R. § 120.970(a). Thus, SBA has sufficient grounds for the enforcement action pursuant to 13 C.F.R. § 120.1400(c)(2).
4. SEM has failed to comply materially with SBA's Loan Program Requirement to maintain the financial ability to operate continuously and with reliable sources of funds as required by 13 C.F.R. § 120.825. Thus, SBA has sufficient grounds for the enforcement action pursuant to 13 C.F.R. § 120.1400(c)(2).
5. SEM has failed to establish or maintain a Loan Loss Reserve Fund as required by the PCLP Program at 13 C.F.R. § 120.847 and 15 U.S.C. § 697e(c)(2). Thus, SBA has sufficient grounds for the enforcement action pursuant to 13 C.F.R. § 120.1400(f)(2).

It is SBA's determination that the foregoing grounds, either individually or in the aggregate, are sufficient to support the Decision. SBA's Notice of Proposed Enforcement Action set forth two additional grounds: (1) not performing servicing and liquidation in a commercially reasonable and prudent manner, and (2) actions that have increased SBA's financial risk. Because those two additional grounds overlap with the grounds for SBA's Decision, SBA sees no reason to address the two additional grounds.

In view of the foregoing, from and after the date hereof, SEM shall no longer have the authority to participate as a CDC in the 504 Loan program. The revocation of SEM's 504 program authority precludes SEM from continuing to close and service its 504 Loan portfolio and process pending 504 Loan applications. Revocation of SEM's 504 program authority therefore requires transfer of its 504 Loan portfolio and its pending 504 Loan applications and all rights associated therewith, including all related processing, closing and servicing functions and the right to receive processing, closing, servicing and late fees, to an entity or entities authorized by SBA to perform such functions in accordance with applicable law. The power to order such a transfer as an incident to an enforcement action is expressly reserved to the Agency by regulation. *See* 13 C.F.R. § 120.1500(e)(1).

In making this Decision, SBA has been guided by the following principles: (1) protection of the integrity of the SBA 504 Loan Program and the protection of taxpayers from a lending partner (SEM) who has failed to comply with applicable law, regulations and SBA Loan Program Requirements; (2) SBA's evaluation of the impact of the identified grounds and the proposed

actions on the identified risk to the SBA 504 Loan portfolio of SEM; and (3) the inability of management and/or the Board of Directors of SEM to accomplish immediate action to mitigate the serious issues identified herein dictates more severe enforcement action.

A formal enforcement action is warranted because the record demonstrates, *inter alia*, that there are significant problems in SEM's systems or controls, substantial law violations, serious compliance problems, and serious reporting failures. Although SEM may have contributed in the past to SBA's mission through a demonstrated commitment to credit gap lending and meeting the needs of underserved markets, it has become apparent that SEM's current financial status, the magnitude of unpaid obligations to SBA and SEM's financial entanglement with EDF, a revoked CDC, have significantly increased the risk to the SBA 504 Loan Program. SBA has determined that the five remaining SBA-approved CDCs doing business in Michigan will be able to adequately serve the Michigan market after the departure of SEM. Accordingly, the nature, extent and severity of SEM's breaches and violations, including the dollar magnitude of current obligations and financial risk, along with SEM's insolvency and inability of SEM's management and board to correct the deficiencies, and program integrity considerations, all warrant the permanent revocation of SEM's authority to participate as a CDC in the 504 Loan Program and require the permanent transfer of SEM's SBA 504 Loan portfolio.

VI. NOTICE OF APPEAL RIGHTS

Pursuant to 13 C.F.R. § 120.1600(a)(5), SEM may appeal this Decision only in the appropriate federal district court.

Dated at Washington, D.C. this 31st day of January, 2014.

_____/s/_____
Brent M. Ciurlino
Director
Office of Credit Risk Management