

SOP 50-10 7

Unprecedented Provisions/Changes

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The recent series of new rules (**Information Notices**) effective in May of 2023 and a dramatically revised **SOP 50 10 7 policy manual** effective in August of 2023 are unprecedented in their depth and breadth and scope, leading to numerous material changes which will impact every SBA lender and most borrowers.

- 1) Elevation of the “change of ownership” loan amount NOT subject to independent appraisal from \$350K to \$500K (great majority of SBA loans are under \$500K)
- 2) SBA is amending restrictions on borrowers using Standard 7(a) [or 7(a) Small and SBA Express] loan proceeds to effect partial changes of ownership to assist small businesses and to expand pathways to ownership, i.e. minority interests may now be bought and sold via SBA-guaranteed financing. Page 98 of the new SOP includes:

- v. **Changes of ownership other than complete changes of ownership or complete partner buyouts (partial change of ownership):** Loan proceeds may be used to fund the purchase of a portion of one or more owner’s interest in the business or of the business itself.
 - a) Both the business and the individual owner(s) who is acquiring the ownership interest must be co-borrowers on the new loan.
 - b) The small business is redeeming a partial ownership interest from one or more owners. All remaining owners are subject to the requirements for guaranties in Section A, Ch. 5, Para. A, Guaranties; however, the percentages of ownership for this requirement will be based on the post-sale percentage of ownership in the business. Note that for ESOP transactions, there is a statutory requirement that if the seller of the employer small business remains as a partial owner, the seller must provide a full, unlimited guarantee regardless of ownership – this statutory requirement cannot be waived.
 - c) The seller may stay on as an owner, officer, director, stockholder, Key Employee, or employee of the business.
- b. If a short transitional period is needed to assist the business, the small business may contract with the seller as a consultant for a period not to exceed 12 months including any extensions. The seller may stay on as an owner, officer, director, stockholder or Key Employee of the business or the ESOP when:
 - i. One or more of the current owners is selling less than their entire percentage of their current ownership; or
 - ii. The purchaser is an ESOP or equivalent trust or a cooperative and is acquiring a controlling interest (51% or more) in the employer business (including when the ESOP or equivalent trust or cooperative is acquiring 100% ownership of the small business).

Additional feedback from the SBA is being sought as to the manner in which such “minority interests” are to be valued, i.e. it must be determined if and how so-called “discounts” for lack of control and for lack of marketability are to be applied.

- 3) Rule changes may allow for the entry of “fintech” companies as Small Business Lending Companies (SBLC’s)

A notice (Information Notice 5000-846818, Community Advantage Small Business Lending Company Conversion) to accept new lender applications in the Small Business Lending Company (SBLC) program. This will also allow the existing program to provide loans to an expanded number of small businesses. SBA will accept applications beginning June 1 until July 31. SBA will name up to three new SBLCs.

- 4) SBA is removing the provisions on affiliation arising from management and control, franchise or license agreements, and identity of interest. SBA is revising § 121.301(f)(1), “Ownership,” to remove the principle of control of one entity over another absent ownership over that entity when determining affiliation (unless operating in same 3 digit NAICS code).
- 5) SBA is anticipating that the final rule will allow SBA Lenders to use a credit scoring model and that this will increase the number of small loans approved while generally decreasing the length of time required to process a loan. Not all lenders will use credit scoring, and those that do will limit credit scoring to small loans.
- 6) SBA revised guidance to state that all 7(a) Small Loan applications will begin with a screening for an SBSS Score. If the Applicant receives an acceptable SBSS Score, the Lender will close and disburse the loan in accordance with the same processes and procedures it uses for its similarly-sized, non-SBA guaranteed loans. FICO® LiquidCredit® Small Business Scoring ServiceSM (FICO® SBSSSM score) is one of the main business credit scores lenders may use. The FICO SBSS score ranges between 0 to 300, with 300 being the highest score. A higher score indicates lower risk. The U.S. Small Business Administration (SBA) requires lenders to use this score to pre-screen certain SBA 7(a) loans:

Current minimum SBSS scores:	
7(a) Small Loans:	155
Community Advantage:	140
Express Bridge Loan Pilot Program:	130

- 7) Change to underwriting guidelines (from list of specific factors to three general factors). SBA Lenders will be required to underwrite SBA loans in the same manner in which the SBA Lenders underwrite their similarly-sized, non-SBA guaranteed commercial loans.

- 8) **SBA is amending the process for reconsideration after denial of a loan application or loan modification request in its 7(a) and 504 Loan Programs to provide the Director, Office of Financial Assistance, with the authority to delegate decision making to designees (same authority granted to SBA Administrator at sole discretion).**
- 9) **The longstanding moratorium on the establishment of new “Small Business Lending Companies” (SBLC’s) has been rescinded.**
- 10) **The SOP removes the personal liquidity of the business owners from consideration as a possible source of funding – which means that the door has been opened for individuals with substantial personal resources to qualify for SBA-backed loans.**
- 11) **Character Determinations and Loans to Businesses with Associates who have Criminal Background: Revised the guidance on loans to businesses with Associates who have criminal backgrounds to conform to regulatory updates to 13 CFR § 120.110(n). Removed the requirement to complete Character Determinations for these individuals.**
- 12) **SBA removed the prohibition using loan proceeds for religious activities and removed the requirement for SBA Lenders to complete SBA Form 1971, “Religious Eligibility Worksheet”.**

Many of these changes are still being debated the more controversial changes leading to what **NAGGL President Anthony Wilkerson** described as a *“bare minimum approach” to lending standards* which increases overall risk exposure and could be devastating to the SBA’s programs and essential role in providing capital to small business owners – particularly in light of what is considered severe understaffing at the Office of Credit Risk Management (OCRM) as reported by the Office of the Inspector General (OIG).

Pertinent SBA Documents

SBA has issued a number of documents intended to implement the regulatory amendments and to make other changes to 7(a) Program Requirements that are not fully covered in the new SOP 50 10 7 program regulations. These include:

- **Information Notice 5000-846818, Community Advantage Small Business Lending Company Conversion (effective 5/1/2023);**
- **Procedural Notice 5000-846607, Implementation of the Final Rule on Affiliation and Lending Criteria for the SBA Business Loan Programs (88 FR 21074, effective May 11, 2023) (notice effective 5/9/2023);**
- **Procedural Notice 5000-846991, Implementation of Removal of the Loan Authorization in accordance with the Final Rule on Small Business Lending Company (SBLC) Moratorium Recission and Removal of the Requirement for a Loan Authorization (88 FR 21890, effective 5/12/2023) (notice effective 5/12/2023);**

- **Information Notice 5000-847027, Issuance of SOP 50 10 7 (effective 5/10/2023); and, • SOP 50 10 7 (slated to take effect on 8/1/2023).**

The new SOP and all prior versions can be downloaded via the following link:

<https://www.sba.gov/document/information-notice-5000-847027-issuance-sop-50-10-7>

NAGGL and representatives within the 7(a) lending industry have applauded SBA's stated mission of focusing on small dollar loans and underserved markets. In fact, 7(a) lending and the program's reach line up exactly with an industry focused on small dollar loans and underserved markets.

According to SBA's own data, **in FY22, the 7(a) Loan Program delivered the following:**

- **FY22 was the highest gross volume year of 7(a) lending in the program's history at \$26.9 billion, with the exception of FY21 during which Congress mandated stimulus provisions of fee waivers and higher guarantees to stimulate volume during a global pandemic and which expired at the end of FY21—FY21 is falsely inflated anomaly data.**
- **Roughly 50% of all loans made were \$150,000 or smaller. Anthony R. Wilkinson | CEO and President | NAGGL | Frisco, Texas 12**
- **Roughly 70% of all loans made were \$350,000 or smaller. • It is estimated that more than 75% of all loans made are small dollar loans, or \$500,000 or smaller, which is the new threshold SBA just set to define small dollar loans (SBA does not publicly provide a breakdown of loans made from \$500,000 or smaller).**
- **Only 7% of all loans made were the largest loans of \$2 million or larger.**
- **SBA's Congressional Budget Justification set the target goal for 7(a) lending to underserved markets at 43%, and actual 7(a) lending in FY22 to underserved markets was 68% of all loans made, far exceeding SBA's goal.**
- **One-third of all loans were to minority borrowers—a number that's steadily on the rise.**
- **25% of our borrowers didn't identify their race or ethnicity, so the actual percentage of loans to minorities is likely higher than the statistics indicate.**
- **African Americans are the fastest growing demographic in the program, with nearly \$1 billion in loans last year alone—nearly a 60% increase since FY17. And so far this year, loans to African Americans are up 52% in units and 72% in dollars compared to last year.**

- **Hispanics totaled \$1.85 billion—more than a 27% increase since FY17. And so far this year, loans to Hispanics are up 91% in units and 98% in dollars compared to last year.**

- **Loans in rural areas totaled roughly 20% of all loans.**

These trends continue in FY23 statistics provided by SBA, year to date, and the current average loan size in the portfolio is roughly \$475,000, below the small dollar loan threshold amount of \$500,000.

In short, we believe that Bizequity can assist both the SBA and lenders to help solidify the foundation of the SBA and provide valuable checks and balances against aggressive loans or inaccurate business valuations in support of both the existing complete change of ownership loans and the soon to arrive partial change of ownership or “minority interest” transactions.

Respectfully,

Scott Gabehart
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