

Standard 7(a) – LGPC

Standard 7(a) Loan Guaranty Processing Center (7a LGPC)

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Conference Objective

To help Lenders:

- Better understand LGPC processing req's
- Increase knowledge of 7a LGPC workings
- Increase package accuracy and completeness
- Reduce loan processing time
- Reduce Screen Out Frequency
- Successfully Submit Turnaround Financing Pkgs

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Selected Topics

- LGPC Locations & Resources
- Submission Process
- Screen Outs – How to Limit Them
- Refinancing – Eligibility & Requirements
- Change of Ownership – What is required
- Environmentals & Franchises – What you need to know
- **Financing Turnarounds & Distressed Businesses**
- Odds & Ends
- Questions

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7(a) LGPC Locations

Two 7(a) LGPC sites (but act as one):

262 Black Gold Blvd, **Hazard, KY** 41701

Phone: (606) 436-0801

Fax: (606) 435-2400

and

6501 Sylvan Rd., **Citrus Heights, CA** 95610

Phone: (877) 475-2435 toll free

Fax: (916) 735-1975

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LGPC Web Site

<http://www.sba.gov/aboutsba/sbaprograms/elending/lgpc/index.html>

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Loans Processed at the LGPC

- Standard 7(a),
- S/RLA,
- CAPLines,
- ARC loans,
- Dealer Floor Plan,
- EWCP (application process begins at USEAC),
- International Trade Loans (begins at USEAC).

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Lenders Supported at the LGPC

All 7(a) Lenders can submit applications to the LGPC

Lenders need to have one or more 750s and other agreements:

- 750 – General 7a (this includes SRLA)
- 750b – Short term
- 750ex – Export (for EWCP loans)
- Approved LQS-2 for Standard Asset Based (SAB) Caplines

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Steps For Application Submission

- Step 1:** The Lender determines that it cannot consider the loan request without SBA's guaranty.
- Step 2:** The Lender reviews Applicant's proposal to determine it meets SBA's eligibility and credit requirements. (An **Eligibility Questionnaire** has been provided by SBA and is available at www.sba.gov/banking.)
- Step 3:** Complete the required Borrower and Lender Applications (Form 4- including Schedule A for collateral and Form 4-I or 2301- Parts A, B & C).
- Step 4:** SBA Form 912, Statement of Personal History (Required for all proprietors, partners, officers, directors, and holders of 20 percent or more of the ownership, if a corporation or limited liability company.)

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Steps For Application Submission – Cont.

Step 5: USCIS Form G-845, Document Verification Request (Required for all those who indicate on SBA Form 912 that they are not U.S. citizens.)

Step 6: IRS Form 4506-T

This form must be submitted to the IRS for all existing businesses as well as change of ownerships. (The date of the submission must be completed on the 7(a) Center Guaranty Application Submission Checklist.)

Step 7: Complete Lender's Credit Memorandum that covers points outlined in SOP on page 175 for Regular 7(a) and pages 176 and 177 for Rural Advantage.

Step 8: Compile Personal Financial Statements, Business Financial Statements and any other supporting loan documentation, including Draft Authorization, if possible.

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Submission
Checklist

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Submitting Your Guaranty Request

- Fax to either location, or
- Submit electronically via “SendThisFile” (which works best)
- To use “SendThisFile” on the LGPC website, go to:
 - <http://www.sba.gov/aboutsba/sbaprograms/elending/lgpc/index.html>
- We confirm receipt of all applications by fax or e-mail, and provide you with a Control Number. If you do not receive confirmation within 72 hrs, please contact us.
- Please do not submit application in binders or notebooks (all paper gets shredded)

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Common Screen Out Reasons

- SBA Form 4 incomplete
- Form 4-I missing/incomplete
- 912 form(s) missing
- Affiliate information lacking
- Franchise Agreement not submitted
- Business Valuation not provided or unacceptable
- Personal Financial Stmt lacking or incomplete (e.g. spouse didn't sign)
- Pro-forma Balance Sheet incomplete or missing
- Derogatory Credit (e.g. tax liens) not addressed
- Interest rate adjustment period lacking (on variable rate loans)
- **Ineligible Components** in the Loan (balloons, term, injection, **UOPs**)
- Info required to completed **global CF analysis** lacking
- LOC information incomplete
- Repayment Ability not demonstrated
- Available Collateral not pledged

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Ineligible Uses of Loan Proceeds

- Payments, distributions or loans to an Associate of the applicant except for compensation for services actually rendered at a fair and reasonable rate;
- Refinancing debt owed to an SBIC;
- Floorplan (currently eligible only under Dealer Floor Plan Program);
- Investments in real or personal property acquired and held primarily for sale, lease or investment.
- Payment of Delinquent Taxes. 13 CFR 120.160(d) a) Loan proceeds must not be used to pay delinquent IRS withholding (payroll) taxes, sales taxes or other funds payable for the benefit of others.
- To finance the relocation of the applicant business out of a community, if there will be a net reduction of one-third of its jobs or a substantial increase in unemployment in any area of the country.

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7(a) Loan Application – Form 4i

- Must clearly identify interest rate
 - Fixed or Variable
 - Prime, Peg, or LIBOR
- Requested Financials are a must:
 - Match pro-forma balance sheet on page 2
 - Existing business
 - 3 years of financials plus 1 year of projections
 - Start-up business
 - Minimum 1 year of projections

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S/RLA Screen Out Reasons

- No signature and date on SBA Form 2301, Parts A & B
- Date of Birth, Place of Birth and U.S. Citizen questions in section D1 are left blank of Form 2301, Part A.
- Personal Financial Statement in Section D3 of Form 2301, Part A, is left blank or incomplete.
- Business Indebtedness in Section C of 2301, Part A, not fully completed, when required (especially when business debts are to be refinanced with the proposed SBA loan - includes existing SBA loans).
- Loan terms in section B of Form 2301, Part B, left blank or incomplete.
- Adjustment Period not provided for variable rate loans.
- Use of Loan Proceeds in Section C of Form 2301, Part B, do not add up to the loan amount.
- Collateral pledged in section C of Form 2301, Part B, missing market value, lien balance, and lien holder name(s), when required.

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S/RLA Screen Out Reasons – Cont.

- Physical address of real estate is being purchased, or if loan proceeds are for leasehold improvements, is not provided.
- Lender’s Credit memo/comments on management qualifications, location, competitive factors and feasibility of the business plan incomplete. (Please comment on applicant’s experience, education or skills that give her/him the ability to operate the business. Also include any pertinent business financials (balance sheet(s) and income statement(s).
- Source and amount of applicant’s outside income on Form 2301, Part A, Section D3 missing. (Please comment on continuance of income.)
- S/RLA loan request is not in \$100 increments.
- 100% of business ownership not accounted for. All applicants must complete the “Percentage of Ownership” in section D1 of Form 2301, Part A.

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S/RLA - SBA Form 2301

- Include 6-digit NAICS Code on Form 2301, Part B
- Ensure all business debt is included on Form 2301, Part A, Section C
 - Include no personal debt
- Refinance requests
 - Explain why current loan is on unreasonable terms
 - Show 10% improvement in payments
 - Certification letter and transcript required for Same Institution Debt refi

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Refinancing

- Effective with SOP 50 10 5(B) refinancing must improve cash flow by **only 10%** (to correspond to the similar rule for refinancing in the 504 loan program).
 - This requirement does not apply when refinancing revolving lines of credit or debt structured with a balloon payment.
- 29-day Waivers – What is required
- When refinancing a change of ownership, the business would have had to have been eligible for the loan to purchase the business.

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Refinancing CRC Debt in the Name of the Business

The debt must have been used for business purposes, and the lender must:

- 1) confirming that the credit card is in the name of the business; and
- 2) the borrower has certified that the credit card debt being refinanced was incurred exclusively for business related purposes.

If the business credit card was also used for personal reasons, the small business must identify which purchases were for personal reasons and that amount must be deducted from the credit card balance before applying for the SBA–guaranteed loan.

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Refinancing CRC Debt in the Name of the Individual

The debt must have been used for business purposes, and the lender must:

- 1) confirm which of the credit card obligations were used for business-related purposes;
- 2) Lenders must document the specific business purpose of the credit card debt; and
- 3) the borrower must certify that the loan proceeds are being used only for business-related debt.

Documentation required for refinancing credit card debt includes a copy of the credit card statements and individual receipts for any business expenses in excess of \$100. In all cases, the borrower must certify that the amount that will be refinanced was used exclusively for business expenses.

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Change of Ownership Requirements

An SBA-guaranteed loan may be used to finance a change of ownership that includes intangible assets.

A loan that will result in a change of ownership must be submitted to the LGPC when:

- 1)The purchase price of the business includes intangible assets (including, but not limited to, goodwill, client/customer lists, patents, copyrights, trademarks and agreements not to compete) of more than \$500,000 and
- 2)The borrower and/or seller provide an equity injection of less than **25%** of the purchase price (no waiver is required).

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Seller Equity - Defined

Seller equity is defined as:

Seller take-back financing that is on full standby (principal and interest) for a minimum of 2 years.

The borrower and seller must agree how much equity each will provide. For example, the borrower and seller may each provide half of the equity or the borrower may inject 15% and the seller may carry back 10%.

If loan \leq \$250K, lender can use internal valuation.

If loan $>$ \$250K, or if there is a close relationship between the buyer and seller, lender must use valuation that meets SBA's requirements.

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Refinancing – Seller Take Back Financing

- May not occur sooner than 24 months after the purchase of the business--24 months gives the new owner an opportunity to run the business and file a tax return.
- Must meet one of the reasons for refinancing identified in subpart B, chapter 2, para. IV.D.
- The credit write up must contain the same items as a regular refinance
- No preferences - Example: conventional loan (non-SBA) for real estate and SBA loan for other business assets and working capital.

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Environmental Review

- Environmental concerns must be addressed on all Commercial Real Estate transactions.
- Prior to loan disbursement, Lender must submit Environmental Investigation Report on all commercial properties taken as collateral to SBA for approval. SBA's environmental policies can be found on P.189 of SOP 50 10 5 (B).
- Lender may appeal legal opinion on commercial real estate environmental remediation
 - Environmentalappeals@sba.gov
 - Few decisions are reversed

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Franchises

- Size analysis very important.
- If not on the franchise Registry
 - Submit it early to avoid delay of loan approval
- When submitting a Franchise Agreement:
 - Send in only once
 - Multiple submissions cause Center problems
 - Send to franchise@sba.gov
- PLP/Express review agreements themselves
 - Please do not submit for LGPC review

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Legal - Franchise Review

- If the Franchise is on the Franchise Registry
 - Certificate of “No Change” is required for each new application
- SBA reviews is required if Master Franchise Agreement changes
- Non-franchise business agreements can trigger SBA legal review (i.e. fuel supply agreement, license agreement)
 - Issues could be operational control or fees
- Lenders can appeal franchise review
 - May satisfy objections
- SBA internal reviews do not become precedent and are only good for the given loan

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Financing Turnarounds

Loans to business with Negative Net Worth

- Is a negative net worth a justification for declining a loan?
- No, SBA can guaranty loans to businesses with a negative net worth as long as there is repayment ability (and the business is sound in all other respects).
- Loan approval decisions are based on CF, not NW
- The big issue: **Why is the net worth negative?**

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Some Reasons for Negative Net Worth

- Treasury stock – This is not a reflection on repayment ability, so not a problem.
- Operating losses – Are they a result of substantial non-cash expenses (i.e. depreciation and amortization), but cash flow is positive?
 - If yes, it may not be an obstacle.
- Or, due to losses (that are not due to non-cash expenditures).
 - Was it a one-time occurrence?
 - Is it due to continuing losses?

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Accumulated Losses Due to Operations

- When negative new worth is due to an extraordinary, non-recurring event:
 - If explained in the LCM, and makes sense, it is not a problem.
- When negative new worth due to recurring losses:
 - A MUCH stronger justification is required.
 - If trend is downward, appearance is shifting of risk to SBA (something we don't like) and decline is likely.

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Struggling Businesses With Past Profitability

- If the business has been profitable in the past, has recent losses, and is now improving, loan approval is possible (in some cases).
- These are the ones we want to focus on.
- Factors to Consider:
 - How long has the business been around?
 - How successful were they in the past?
 - How much of a turnaround is required?
 - Have they shown signs of turning around?
 - How many months have they shown improvement?

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Number of Months to Demonstrate a Turnaround

- No SOP minimum, but
- One month does not establish a trend,
- > 3 months (in most cases), more is better
- Industry and Seasonality should be considered
- Is recent trend long enough to support forecast?
 - “Pie in the Sky” forecasts cannot be used
 - All forecasts must be substantiated

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What Makes a Forecast Reasonable?

- Must be based on sound financial analysis
 - What is the sales trend?
 - What adjustments have been made to operations?
 - Any reductions to fixed costs?
 - Just “now they are doing better” will not suffice.
- Minimum debt service coverage – 1:1 plus living expenses (for sole props).

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Derogatory Credit Issues

- Past due State and Federal Income tax:
 - Plan must be firmly in place (promise to SBA not OK)
- Minimum credit score
 - None (only affects how closely we will look at it)
 - Lower score mandates more detailed review in LCM
 - Significant items should always be addressed in the LCM
- How does SBA view past delinquencies?
 - Depends on timing, severity & reasons.
 - More recent & severe credit mandates greater justification
 - A few 30 day accounts several months back is given little consideration.

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Previous Bankruptcy

- Can loan be approved with previous bankruptcy?
 - Yes, provided:
 - The BK has been long enough in the past (no set minimum)
 - There is no post BK derogatory credit
 - There should be some post-BK credit reestablished
 - All other credit factors are strong
 - Note: the reason for the BK could be a factor

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Exceptions to Policy

- Refinance of same institution debt with delinquency within the last 36 months
 - May be approved if only 1 or 2 and not too recently
 - Severity as well as frequency is considered
 - The reason for the delinquency makes a difference
 - A history of late payments (even though not delinquent) will be considered
 - What is required: transcript, summary of past due and delinquent payments, reason for delinquency, copy of the Note (in some cases).

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New Business Startup

- Minimum equity injection:
 - 10% as a general rule, but could be more or less on a case by case basis
 - SBA cannot loan 100%, injection is required
- Collateral value for Inventory and A/R
 - No value can be given, but for existing businesses, it may.

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Approval, Decline & Screen Out Actions

- Approvals go out by fax or email – to notify the lender
- We Priority Mail a signed hard copy of the authorization
- We include a copy of the closing forms and instructions
- Reasons for Decline:
 - Majority are because of policy eligibility
 - Some for repayment and credit issues
 - Some credit issues come from CAVIRS and Debt-Check
- If we need additional information we contact the lender by:
 - Fax, e-mail or a phone call

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Loan Increases

- May be done by the LGPC until 1st disbursement.
- Effective with SOP 50 10 5(B):
 - If the request for an increase is more than:
 - 20% of the original loan amount, **or**
 - 18 months after the original approval date of the loan
- The lender must include with its request, an analysis showing that the purpose of the increase is the same as the original purpose of the loan and that the borrower's cash flow can support the increased payment amount.
- CAPLines and EWCP loans that have a revolving feature: Increases are limited to a one-time increase that does not exceed 33.3%.

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Future Developments

- eTran – 7a Submissions (for all loan types)
- USCIS processing online
- CAVIRS for all

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LGPC References - Review

- Call Center number: (877) 475-2435 (toll free)
- e-mail Box for questions: 7aquestions@sba.gov
- e-mail Box for loan documents and trailing documents:
7aloanprogram@sba.gov
- Document drop off on the website for large documents:
‘SendThisFile’

- LGPC Web Site:

<http://www.sba.gov/aboutsba/sbaprograms/elending/lgpc/index.htm>

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Final Tips When Submitting Your Guaranty Request

- If you have questions, please ask before submitting the application
 - District Office
 - LGPC Call Center (877) 475-2435 (toll free)
 - 7aquestions@sba.gov
- If package contains conflicting information:
 - Explain it in a cover letter

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Questions