

SBA

SOP 50 55

504 LOAN SERVICING and LIQUIDATION

Office of Capital Access
Small Business Administration
October 1, 2013



**SMALL BUSINESS ADMINISTRATION
STANDARD OPERATING PROCEDURE**

SUBJECT: 504 Loan Servicing and Liquidation	S.O.P.		REV
	SECTION 50 55	NO.	

INTRODUCTION

1. Purpose: Update and consolidate SBA policy and procedures on 504 Loan servicing and liquidation.
2. Personnel Concerned: All SBA employees.
3. SOPs Cancelled: SOP 50 50 4 and SOP 50 51 3
4. Originator: Office of Capital Access

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		PAGE 1

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Chapter 1. Introduction

A. Purpose

SOP 50 55 sets out the standard operating policies and procedures of the Small Business Administration (“SBA”) for the administration of 504 Loans that are in “regular servicing” and “liquidation” status.

Note: A 504 Loan moves from “approval” status (governed by [SOP 50 10](#)) to “regular servicing” status when the loan has been closed and the final loan disbursement has been made. It moves from “regular servicing” status to “liquidation” status if the loan is in default and has been classified in liquidation pursuant to Chapter 14 of this SOP.

B. Authority

The policy and procedures set out in this SOP are based on Title V of the Small Business Investment Act of 1958 (15 U.S.C. § 695, et seq.), [Part 120](#) of Title 13 of the Code of Federal Regulations, and applicable [federal debt collection statutes](#), regulations and guidance, including the [Debt Collection Improvement Act of 1996](#) (“DCIA”).

C. General Policy and Goals

Borrowers should repay their 504 Loans in accordance with the terms specified in the Note and other Loan Documents. However, when loan servicing and liquidation activities are necessary, they should reflect a balancing of SBA’s interest in: (1) achieving the goals of the loan program, i.e., helping entrepreneurs start, build and grow viable small businesses; and (2) maintaining the integrity of the loan program, i.e., ensuring that the Agency can maximize its recovery if the Borrower defaults on the loan.

D. Performance Standards

504 Loans must be serviced and liquidated in a diligent, fair but aggressive, commercially reasonable manner, which is free of conflicts of interest and Preferences, and is consistent with prudent lending practices and the SBA Loan Program Requirements in effect at the time the action is taken. ([13 C.F.R. § 120.535](#))

E. Exceptions to Policy

Any Loan Action that conflicts with the use of the word “must” in this SOP, or any other applicable Loan Program Requirement, must be treated as an exception to policy. An exception to policy is only appropriate when the applicable Loan Program Requirement does not adequately address the unique circumstances of a particular loan, and the exception, if granted, would not contravene an applicable statute or regulation. Prior to taking any Loan Action that would conflict with a Loan Program Requirement, written joint-approval of the Director of Financial Program Operations (“OFPO”) and the Director of the Office of Financial Assistance must be obtained by submitting a request through the appropriate SBA Loan Center.

Chapter 2. Definitions

The terms defined below have the same meaning wherever they are used in this SOP. Unless otherwise indicated, defined terms are capitalized wherever they appear.

A. General Terms

1. **504 Loan** means a loan made under Title V of the Small Business Investment Act.
2. **Agency** means the U.S. Small Business Administration (“SBA”).
3. **Agent** means an authorized representative, including an attorney, accountant, consultant, packager, lender service provider, or any other Person representing a loan applicant or a CDC by conducting business with SBA. ([13 C.F.R. § 103.1\(a\)](#))
4. **Appraisal** means: (1) with regard to loan servicing actions pertaining to substitution of collateral, the Loan Program Requirements governing the original collateral for the loan set out in SOP 50 10; and (2) with regard to all other loan servicing and liquidation actions, an expert's written opinion as to the value of property prepared specifically for the CDC and SBA's use with regard to a particular loan, which is obtained in accordance with the requirements listed below. (A shared appraisal, e.g., an appraisal prepared for a Third Party Lender and shared with SBA, does not meet SBA Loan Program Requirements for any 504 Loan servicing or liquidation Loan Action other than one that involves substitution of collateral.)

a. Qualifications of Appraiser

An Appraisal may be performed by an appraiser, broker, auctioneer, retail inventory specialist or other expert, provided that the Person meets the minimum qualifications listed below and a good faith effort is made to use a local expert with actual knowledge of the property and market conditions where it will be sold:

(1) Knowledge and Experience

Has the specific knowledge, training and experience required to develop a professional opinion as to the value of the specific type of property involved;

(2) Licensed, Certified and Bonded

Meets applicable government licensing, certification and bonding requirements;

(3) Independent

Has no conflict of interest with SBA, the CDC or Obligors; and has no financial interest in the property to be appraised, provided, however, that when it is cost-effective, the Person who appraised the collateral may also sell it as long as the sale is widely advertised and otherwise consistent with applicable law. (E.g., an auctioneer may appraise and sell personal property collateral via a public auction that complies with Article 9 of the Uniform Commercial Code.)

b. Appraisal Standards

(1) Real Property

- (a) A real property Appraisal to support a substitution of collateral Loan Action should comply with the appraisal requirements in [SOP 50 10](#) that applied to the original collateral;
- (b) A real property Appraisal should comply with the [Uniform Standards of Professional Appraisal Practice](#) whenever required by prudent lending practices, e.g., to support Loan Actions dealing with release of liens for consideration, Protective Bids, or deeds in lieu of foreclosure, or when it is apparent (based on the tax assessed value, current market conditions, condition of the property, balance owed on prior liens, etc.) that there is equity to secure the SBA loan; and
- (c) In all other cases, (i.e., when neither a specific SBA Loan Program Requirement nor prudent lending practices require an appraisal in compliance with the [Uniform Standards of Professional Appraisal Practice](#)), a real property Appraisal may consist of a broker price opinion (“BPO”) prepared in substantial compliance with the [Broker Price Opinion Board Standards](#). For example, a BPO may be used to support a Loan Action to abandon real property collateral if it is apparent, (based on the tax assessed value, current market conditions, condition of the property, balance owed on prior liens, etc.) that there is little or no equity available to secure the SBA loan.

(2) Personal Property

- (a) A personal property Appraisal to support a substitution of collateral Loan Action should comply with the appraisal requirements in [SOP 50 10](#) that applied to the original collateral;
- (b) A personal property Appraisal should comply with the [Uniform Standards of Professional Appraisal Practice](#) whenever required by prudent lending practices, e.g., to support Loan Actions dealing with unique items of personal property such as coin collections, jewelry, or art work; and
- (c) In all other cases, (i.e., when neither SBA Loan Program Requirements nor prudent lending practices require an appraisal in compliance with the [Uniform Standards of Professional Appraisal Practice](#)), a personal property Appraisal may consist of an auctioneer or other expert's opinion as to value.

c. Report Format

All Appraisal reports should contain the following:

- (1) The appraiser's opinion as to value of the property, including an opinion as to the individual value of any item of personal property valued at \$5,000 or more at the time the loan was made;

- (2) The type of valuation, e.g., liquidation or fair market value, and how the Appraisal is to be used;
- (3) The methodology, standards, resources and markets the appraiser used or relied on;
- (4) A complete and accurate description of the collateral, including its current condition, photographs, and the manufacturer, model, and serial number of significant items of personal property, i.e., items with a Liquidation Value of \$5,000 or more;
- (5) The date and location of the Appraisal inspection, and the effective date of the valuation;
- (6) The appraiser's certification that he or she has no financial interest in the property or conflict of interest with SBA, the CDC or any Obligor; and
- (7) The appraiser's qualifications and signature.

d. Age of Appraisal

Generally, an Appraisal should be less than 120 calendar days old, and must never be more than one year old, at the time SBA or the CDC relies on it to make a decision affecting a 504 Loan.

5. **Associate of the Borrower** means an officer, director, key employee of the Borrower, or a Person who has an ownership interest of more than 20% in the Borrower's business; any entity in which one or more of the foregoing Persons has an ownership interest of at least 20%; or any Person in control of, or controlled by, the Borrower except a Small Business Investment Company licensed by SBA. ([13 C.F.R. § 120.10](#))
6. **Associate of a CDC or Third Party Lender** or other senior lender means an officer, director, key employee, or holder of 20% or more of the value of the CDC, Third Party Lender or other senior lender's stock or debt instruments; an Agent involved in the loan process; or any entity in which one or more of the foregoing Persons, or a Close Relative of any such Person owns or controls at least 20%. ([13 C.F.R. § 120.10](#))
7. **Authorized CDC Liquidator ("ACL")** means a CDC in good standing that has authority to conduct 504 Loan liquidation or litigation pursuant to [13 C.F.R. § 120.975](#). ([13 C.F.R. § 120.10](#))
8. **Borrower** means the Person or Persons who executed the Note evidencing the 504 Loan.
9. **Central Servicing Agent ("CSA")** means the entity that receives and disburses funds among the various parties involved with 504 Loan financing under a master servicing agreement with SBA. ([13 C.F.R. § 120.802](#))
10. **Certified Development Company ("CDC")** means an entity authorized by SBA to deliver 504 Loan financing to small businesses. ([13 C.F.R. § 120.10](#))

11. **Close Relative** means a spouse, parent, child or sibling, or the spouse of a parent, child or sibling. ([13 C.F.R. § 120.10](#))
12. **Computer Tracking System** means the electronic method used by SBA or a CDC to create and maintain a chronological record of the significant activities on a 504 Loan, such as Loan Actions and the substance of telephone calls, meetings or letters regarding the loan.
13. **Conflict of Interest**, whether capitalized or not, means a set of circumstances that creates an actual, apparent, or potential risk that judgment or actions—which should be based on the general policy and goals set out in Chapter 1, Paragraph C—will be unduly influenced by a secondary interest.
14. **Credit Bid** means an offer to purchase at a foreclosure sale submitted by a creditor who, instead of paying cash, will "credit" the bid amount against the debt owed to the creditor.
15. **Debenture** means an obligation issued by a CDC and guaranteed 100 percent by SBA, the proceeds of which are used to fund a 504 Loan. ([13 C.F.R. § 120.802](#))
16. **Default Charges** means all monetary amounts payable as the result of a default on a senior secured creditor's loan, such as prepayment penalties, swap fees, late fees and interest paid at an escalated rate.
17. **Eligible Passive Company ("EPC")** is a small entity or trust, which does not engage in regular and continuous business activities, that leases real or personal property to an Operating Company for use in the Operating Company's business, and which complies with the conditions set forth in [13 C.F.R. § 120.111](#). ([13 C.F.R. § 120.10](#))
18. **Financial Hardship** means an inability to pay for basic living expenses, i.e., the costs that must be paid to obtain the following categories of goods and services necessary for the survival of an Obligor, their spouse and dependents as defined by the most current version of the [Collection Financial Standards](#) published by the Internal Revenue Service: (1) food and clothing; (2) out-of-pocket health care expenses; (3) housing and utilities; and (4) transportation.
19. **Good Faith**, whether capitalized or not, means the absence of any intention to seek an unfair advantage or to defraud another party; i.e., an honest and sincere intention to fulfill one's obligations in the conduct or transaction concerned.
20. **Guarantor** means a Person who executed a Guaranty as security for a Note executed by a Borrower.
21. **Guaranty** means [SBA Form 148 \(Unconditional Guarantee\)](#), [SBA Form 148 L \(Unconditional Limited Guarantee\)](#) or a substantially similar document executed by a Guarantor that contains an unconditional promise to pay the debt owed on a Note if the Borrower fails to pay it.
22. **Including**, whether capitalized or not, means "including but not limited to," i.e., the list is exemplary and not exhaustive.

- 23. Liquidation Plan** means a CDC's written plan outlining the actions that it intends to take to maximize recovery on a specific 504 Loan, which includes the information outlined in the [template](#) accessible from www.sba.gov/for-lenders.
- 24. Liquidation Value** is the likely price collateral will sell for if sold quickly and with limited exposure to potential buyers. An Appraisal is necessary to determine the Liquidation Value of real or personal property collateral unless it consists of:
- a. Cash or Equivalent—the Liquidation Value of cash or cash equivalent items such as retirement accounts, trust funds, life insurance policies with a cash surrender value, certificates of deposit, letters of credit, or other commercial instruments should be the net amount arrived at after deducting verifiable, documented costs such as penalties for early withdrawal; or
 - b. Motor Vehicles and Stock—the Liquidation Value of items that are customarily sold in a recognized market should be based on industry standards. For example, the Liquidation Value of motor vehicles should be based on NADA or Kelley Blue Book value, and the Liquidation Value of publically traded stock should be based on official stock exchange prices.
- 25. Litigation Plan** means a CDC's written plan outlining the court proceedings it intends to initiate or otherwise participate in to maximize recovery on a specific SBA loan, which includes the information outlined in the [template](#) accessible from www.sba.gov/for-lenders as well as any other information or documentation required by Chapter 24, such as the qualifications of the attorney the Lender intends to hire, a copy of the engagement letter, and the justification for, and estimate of, any expense listed in Chapter 24 that is presumed to be unnecessary, unreasonable and non-customary such as the use of multiple law firms, travel, or the appointment of a receiver to perform routine liquidation duties.
- 26. Loan Action**, (formerly known as an SBA Form 327 Action), means an activity or decision regarding a specific SBA loan including a decision to engage or not to engage in a particular activity, e.g., a decision not to enter a Protective Bid at a senior lienholder's foreclosure sale would be a Loan Action.
- 27. Loan Action Record** means the paper or electronic document used to memorialize the decision and justification for a specific Loan Action. It may consist of a memo, email, letter, SBA Form 327 or other document provided that it contains: the Borrower's name and the SBA loan number; the CDC's name and contact information; a reasonable description of the Loan Action; the justification for the Loan Action including an analysis of any Supporting Documentation; and a citation to the applicable SOP provision that provides authority for the proposed Loan Action.
- 28. Loan Authorization** means SBA's written agreement including subsequent modifications thereto, entitled *Authorization for Debenture Guaranty*, which sets out the terms and conditions under which SBA will guarantee the Debenture for a 504 Loan. It is not a contract to make a loan. ([13 C.F.R. § 120.10](#))
- 29. Loan Documents** means the Loan Authorization, Note, Guaranty, lien instruments, and all other agreements and documents related to an SBA loan.

- 30. Loan File**, whether capitalized or not, means the electronic or paper folder dedicated exclusively to storing a hard copy or an electronic copy of all of the Loan Documents (including the collateral documents regardless of whether they are kept in a separate folder) pertaining to a specific SBA loan.
- 31. Loan Program Requirements** means the requirements pertaining to SBA's 504 Loan Program, as issued and revised from time to time, imposed by statutes, regulations, contracts, Loan Authorizations, Debentures, and SBA Notices and forms. ([13 C.F.R. § 120.10](#))
- 32. Must**, whether capitalized or not, means that the action or prohibition is mandatory.
- 33. Non-recoverable Expense** means a cost that is not SBA approved and cannot be recouped by being added to the principal balance of the Note, because, e.g., the cost was not: (a) related to collection of amounts due under the Note, enforcement of the terms of the Loan Documents, or the preservation or disposal of the collateral; (b) necessary, reasonable or customary; or (c) incurred in accordance with prudent lending practices or SBA Loan Program Requirements.
- 34. Non-routine Litigation** means any litigation on a 504 Loan conducted by a CDC (not SBA) where: (a) factual or legal issues are in dispute and require resolution through adjudication (e.g., all Chapter 11 bankruptcy proceedings); (b) legal fees are estimated to exceed \$10,000 in the aggregate; (c) the CDC has a conflict of interest with SBA; or (4) the CDC has made a separate loan to the same Borrower that is not an SBA loan. ([13 C.F.R. § 120.540\(c\)\(1\)](#))
- 35. Note** means the promissory note (e.g., [SBA Form 1505](#)) executed by the Borrower on a 504 Loan.
- 36. Obligor** means every Person with direct liability for repaying an SBA loan, such as the Borrower and any assumptor, and every Person with contingent liability, such as a Guarantor.
- 37. Office of Financial Program Operations ("OFPO")** means the SBA office in charge of administering SBA's loan program operations and managing SBA's loan portfolio.
- 38. Operating Company ("OC")** is an eligible small business actively involved in conducting business operations located on real property owned by an Eligible Passive Company, or which uses in its business operations personal property owned by an Eligible Passive Company. ([13 C.F.R. § 120.10](#))
- 39. Person** means any individual, corporation, partnership, limited liability company, association, unit of government, or other legal entity, however organized. ([13 C.F.R. § 120.10](#))
- 40. Preference** means an arrangement not pre-approved by SBA that gives a CDC a preferred position compared to SBA relating to the making, servicing, or liquidation of a 504 Loan. ([13 C.F.R. § 120.10](#)) E.g., a CDC would receive a Preference if it released the collateral for a 504 Loan in order to use it as security for a non-SBA loan to the same Borrower.

- 41. Project** means the purchase or lease, and/or improvement or renovation of long-term fixed assets by a small business, with 504 Loan financing for use in its business operations. ([13 C.F.R. § 120.802](#))
- 42. Project Property** means one or more long-term fixed assets, such as land, buildings, machinery, and equipment, acquired or improved by a small business with 504 Loan financing for use in its business operations. ([13 C.F.R. § 120.802](#))
- 43. Protective Bid** means an offer made by a secured creditor to pay a designated price for property at a foreclosure sale to "protect" the secured creditor's interest in the property that might otherwise be eliminated by the foreclosure sale.
- 44. Real Estate Owned ("REO")** means real property collateral acquired by a CDC or SBA (formerly referred to by SBA as "COLPUR").
- 45. Recoverable Expense** means an SBA approved, necessary, reasonable and customary cost incurred to collect amounts due under the Note, to enforce the terms of the Loan Documents, or to preserve or dispose of collateral, which according to the terms of the Note, can be recouped by adding it to the principal balance of the loan.
- 46. Recoverable Value** means the net dollar amount that a prudent lender could reasonably expect to recover by liquidating a particular piece of collateral. Recoverable Value is determined by deducting the following amounts from the Liquidation Value of the collateral: (a) the balance owed on senior liens (less amounts waived or subordinated by a Loan Document); (b) Recoverable Expenses associated with any necessary lien foreclosure action; and (c) if the collateral is likely to be acquired by SBA or the CDC at the foreclosure sale (e.g., real property), the expenses associated with the care, preservation and resale of the acquired collateral.
- 47. Routine Litigation** means any litigation on a 504 Loan conducted by a CDC (not SBA) where: (a) no factual or legal issues are in dispute (e.g., non-adversarial matters in a Chapter 7 and undisputed foreclosure actions); and (b) the estimated legal fees do not exceed \$10,000 in the aggregate. ([13 C.F.R. § 120.540\(c\)\(2\)](#))
- 48. SBA Loan Center** means the following SBA facilities:
- a. SBA Commercial Loan Service Center ("CLSC") West**
- Geographic Coverage: SBA Regions 5, 6 (except Arkansas, Oklahoma and Texas) 7, 8, 9, and 10.
- Loan Type and Status:
Fully disbursed 504 Loans in regular servicing and liquidation status.
- Street Address:
801 R Street, Suite 101
Fresno, CA 93721
- Web Site Address: <http://www.sba.gov/FresnoCLSC>

Telephone Numbers:

Phone: (559) 262-4960
Toll Free: (800) 347-0922

Fax Numbers:

Servicing: (202) 481-0483
Liquidation: (202) 481-6481
Express Purchase: (202) 481-0663
Post-Servicing: (202) 481-1756

Email:

Servicing: fsc.servicing@sba.gov
Liquidation: fsc.504liquidations@sba.gov
Express Purchase: fsc.purchasing@sba.gov
Post-servicing: fsc.postservicing@sba.gov

b. SBA Commercial Loan Service Center (“CLSC”) East

Geographic Coverage: SBA Regions 1, 2, 3, 4, and 6 (except New Mexico and Louisiana).

Loan Type and Status:

Fully disbursed 504 Loans in regular servicing and liquidation status.

Street Address:

2120 Riverfront Drive, Suite 100
Little Rock, AR 72202-1794

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Liquidation: (202) 481-6481

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Servicing: lrsc.servicing@sba.gov
Liquidation: lrsc.504liquidation@sba.gov
Customer Service: lrsc.customerservice@sba.gov
Express Purchase: LRSC.ExpressPurchase@sba.gov

49. Seasoned Loan or a loan that is “Seasoned” means that for 18 months after the initial disbursement or 18 months after the final disbursement if it occurred more than six months after the initial disbursement, or if there was a default, the Borrower cured it and for 12 consecutive months following the 18 month post-disbursement period, the Borrower did not:

- a. Fail to make a scheduled loan payment;

- b. Fund a scheduled loan payment from the sale of collateral;
 - c. Have more than three consecutive scheduled full payments deferred; or
 - d. Experience an event of default that required the loan to be classified in liquidation.
- 50. Servicing Request** means a Loan Action requested by a Borrower regardless of whether it is simple (e.g., address change) or more complex such as the Loan Actions covered in Chapters 7 through 13 of this SOP (e.g., subordination of lien position).
- 51. Should**, whether capitalized or not, means that the action is recommended but not required.
- 52. Site Visit Report** means the paper or electronic record documenting the CDC's findings and conclusions after visiting the Borrower's business premises. A post-default Site Visit Report should cover, for example, the CDC's efforts to: determine whether a workout is feasible; identify the collateral available for liquidation; establish the collateral's Recoverable Value; determine whether the Borrower is behind on the rent and whether a liquidation sale of the personal property collateral can be held on-site; determine whether any real property collateral is occupied by a Person other than the Borrower; develop a liquidation strategy; assess any environmental risk associated with the anticipated method of liquidation; and arrange for the care and preservation of the collateral pending liquidation.
- 53. Supporting Document** or "Supporting Documentation" means the original, or a complete and accurate executed copy, (i.e., it must contain all of the required signatures and include all of the addendums thereto), of any document relied upon to reach a decision regarding a Loan Action, e.g., a purchase and sale agreement, Appraisal or Environmental Investigation Report.
- 54. Third Party Lender** means a commercial or private lender, investor or Government Entity that made a loan that is part of the financing for a 504 Loan Project. ([13 C.F.R. § 120.801](#))
- 55. Third Party Lender Agreement** means [SBA Form 2287](#) (*Third Party Lender Agreement*), which memorializes the agreement between the Third Party Lender, SBA and the CDC outlining the parties' rights and responsibilities with regard to a particular 504 Loan.
- 56. Third Party Loan** means a loan made by a Third Party Lender that is part of the financing for a 504 Loan Project.
- 57. Treasury** means the U.S. Department of the Treasury Bureau of Financial Management Service.
- 58. Wrap-up Report** refers to the documentation, whether or not it is entitled "Wrap-up Report," that a CDC must provide to the SBA Loan Center after completing the liquidation of a 504 loan, which includes the information outlined in the [template](#) accessible from <http://www.sba.gov/for-lenders>.

B. Environmental Terms

The definitions of the environmental terms used in this SOP are the same as those used in [SOP 50 10](#), which are located in Appendix 2 of [SOP 50 10](#), the most current version of which is accessible from the [SOP section](#) of SBA's Web site.

Chapter 3. CDC Responsibility and Authority

A. Servicing

Each CDC is responsible for servicing all of the 504 Loans in its portfolio that are classified in regular servicing status.

B. Liquidation

The scope of a CDC's liquidation authority and responsibility is based on its designation as: a Premier Certified Lender Program ("PCLP") CDC; an Authorized CDC Liquidator ("ACL"); or a non-PCLP CDC or a non-ACL. ([13 C.F.R. § 120.975](#))

1. ACLs

A CDC that has received written approval from SBA to act as an ACL is responsible for liquidating all of the 504 Loans in its portfolio ([13 C.F.R. § 120.975\(b\)](#)).

2. PCLP CDCs

- a. ACL PCLP CDCs are responsible for liquidating all of the 504 Loans in their portfolios. ([13 C.F.R. § 120.975\(a\)](#))
- b. Non-ACL PCLP CDCs are responsible for liquidating only the PCLP 504 Loans in their portfolios. ([13 C.F.R. § 120.848\(f\)](#))

Note: A CDC may apply to become an ACL by submitting an application to the appropriate SBA Loan Center, which will review the application and forward its recommendation to the Office of Financial Program Operations for a final decision. (For information on SBA requirements to become an ACL, see [13 C.F.R. § 120.975](#).)

3. Non-ACLs and Non-PCLP CDCs

- a. SBA Loan Centers are primarily responsible for liquidating the 504 Loans that do not fall under the liquidation authority of PCLP CDCs and ACLs.
- b. SBA Loan Centers may authorize non-PCLP CDCs and non-ACLs to liquidate specific 504 Loans on a case-by-case basis.
- c. All PCLP CDCs and non-ACLs should:
 - (1) Serve as the primary contact with the Obligors;
 - (2) Obtain information concerning Third Party Loans;
 - (3) Enforce the terms of the Third Party Lender Agreement;

- (4) Prepare Liquidation Plans;
- (5) Conduct site visits;
- (6) Immediately notify the SBA Loan Center of any foreclosure action, bankruptcy, or other action or omission that could adversely impact the 504 Loan; and
- (7) At the request of the SBA Loan Center:
 - (a) Identify local appraisers, auctioneers and other independent contractors;
 - (b) Attend foreclosure sales on behalf of SBA; and
 - (c) Assist with the care and marketing of REO and acquired personal property collateral.

C. Litigation

1. ACLs and PCLP CDCs, as set forth below, are responsible for conducting all litigation needed to ensure recovery on all of the 504 Loans in their portfolios—including charged-off loans that have not been referred to Treasury pursuant to Chapter 28.
 - a. ACLs—are responsible for conducting all of the litigation needed to ensure recovery on all of the 504 Loans in their portfolio;
 - b. PCLP CDCs—are responsible for conducting all of the litigation needed to ensure recovery on all of the PCLP-approved loans in their portfolio; and
 - c. Non-PCLP CDCs and non-ACLs—do not have general litigation authority and therefore are not responsible for conducting the litigation on the 504 Loans in their portfolio unless the SBA Loan Center has specifically authorized them to handle the litigation on a specific loan as documented by a Loan Action Record that includes the concurrence of the District Counsel responsible for the geographic area where the litigation will occur.
2. After a charged-off loan has been referred to Treasury, SBA has sole authority for managing any litigation that may become necessary. CDCs must immediately notify the SBA Treasury Offset Division (via fax 202-481-0592 or email BirminghamTOPS@sba.gov) of any pending litigation, including bankruptcy filings, so that the loan can be recalled from Treasury and appropriate action taken by SBA legal counsel. Appropriate action may include, for example, referring the loan back to the CDC to handle the litigation under the supervision of SBA legal counsel. (See Chapter 24 for information on litigation, including when SBA's prior written approval of a CDC's Litigation Plan is required.)

D. Decision Making

1. Unilateral Authority

ACLs and PCLP CDCs have unilateral authority to take all necessary action to service and liquidate the 504 Loans they are responsible for, subject to SBA's right to take over the servicing or liquidation of any loan as provided in Paragraph E and except as provided in Subsections 2 and 3 below, provided that the CDC's actions are consistent with the performance standards set out in Chapter 1.

2. Unilateral Actions that Require Notice to SBA

A CDC must provide the appropriate SBA Loan Center with written notice of each substantive unilateral Loan Action taken on a 504 Loan.

3. Actions Requiring Prior SBA Approval

a. All CDCs

All CDCs including PCLP CDCs must obtain SBA's prior written approval before taking any Loan Action that involves:

- (1) Exception to policy;
- (2) Preference or other activities that create a conflict of interest;
- (3) Compromise of the principal loan balance;
- (4) Litigation Plan or amended Litigation Plan;
- (5) Increase in loan amount;
- (6) Acquisition of title to any property in SBA's name;
- (7) Operation or control of a business that handles Hazardous Substances or is located on Contaminated Property;
- (8) Acquisition of title to Contaminated property;
- (9) Transfer, sale or pledge of more than 90% of the loan; or
- (10) Any Loan Action for which SBA's prior written consent is required by another Loan Program Requirement.

b. Non-PCLP CDCs

All CDCs except PCLP CDCs must obtain SBA's prior written approval before taking any Loan Action that involves:

- (1) Implementation of a Liquidation Plan or amendment thereto;

- (2) Substantial alteration of the terms or conditions of any Loan Document including the Loan Authorization. Modification of the terms and conditions of the Loan Authorization are covered by Chapters 7, 8, 9, and 10 of this SOP. They include, for example:
- (a) The terms of the Note;
 - (b) The collateral requirements, and therefore, issues such as:
 - i. Subordination of lien position;
 - ii. Substitution of collateral;
 - iii. Substitution of Guarantors;
 - iv. Release of lien, provided that collateral with a cumulative market value of less than 10% of the Debenture amount or \$10,000, whichever is less, may be released without SBA's prior consent;
 - v. Release of a Guarantor or Co-Borrower;
 - (c) Insurance coverage; and
 - (d) Management covenants.
- (3) Acceptance of a workout agreement;
- (4) Acceleration of the maturity of the Note;
- (5) Deferment that exceed six cumulative monthly payments or 20% of the original loan amount, whichever is less;
- (6) Compromise of any portion of the loan balance;
- (7) Assumption or sale of the loan regardless of the percentage;
- (8) Release of a claim against a standby creditor;
- (9) Purchase or pay off of any indebtedness (other than the 504 Loan) secured by the collateral for a defaulted 504 Loan collateral.
- (10) Protective Bid position or amount; or
- (11) Exercise or release of redemption rights.

4. Where to Send Notices and Requests for SBA Approval

Notices and requests for SBA's prior approval should be sent to the appropriate SBA Loan Center. (See the definition of "SBA Loan Center" in Chapter 2 for a complete list.)

Note: Templates for requesting SBA review and approval of the most commonly requested types of servicing actions are available for CDC use at www.sba.gov/for-lenders. SBA Loan Centers should respond to CDCs' requests for approval of proposed Loan Actions within 15 business days. ([13 C.F.R. § 120.541](#))

5. Requests for Reconsideration

When SBA's prior approval is required, a request for reconsideration of an SBA Loan Center's decision regarding a proposed Loan Action may only be submitted if relevant new facts are provided. The request for reconsideration must be prepared and submitted in accordance with the procedures that applied to the original request.

6. Appeal of Final Decision

a. Liquidation—Liquidation Plan, Loan Action or Expense

The final decision of a SBA Loan Center Director or designee regarding approval of a Liquidation Plan, liquidation Loan Action (e.g., compromise), or liquidation expense that is not related to litigation or environmental risk management, may be appealed to the Director of OFPO (designee of the director of the Office of Financial Assistance ("OFA"), who will consult with the Associate General Counsel for Litigation, provided that the appeal: (1) is in writing; (2) includes a copy of the decision and Supporting Documents; (3) states the reason(s) why the decision is believed to be incorrect; and (4) is submitted within 30 calendar days of the decision. ([13 C.F.R. § 120.542\(d\)](#))

b. Litigation—Litigation Plan or Expense

The final decision of a SBA Loan Center Director or designee regarding approval of a Litigation Plan or expense, (e.g., attorney fees and costs), may be appealed to the Associate General Counsel for Litigation, who will consult with the Director of OFPO, (designee of the Director of OFA), provided that the appeal: (1) is in writing; (2) includes a copy of the decision and Supporting Documents; (3) states the reason(s) why the decision is believed to be incorrect; and (4) is submitted within 30 calendar days of the decision. ([13 C.F.R. § 120.542\(e\)](#))

c. Environmental Risk Management—Denial of Request re Contaminated Property

The final decision of an SBA Loan Center Director or designee denying a request for approval to take title to Contaminated Property or to take over the operation of a business that handles Hazardous Substances or is located on Contaminated Property may be appealed to the Associate General Counsel for Litigation, who will consult with the Director of OFPO, (designee of the Director of OFA), provided that the appeal: (1) is in writing; (2) includes a copy of the decision and Supporting Documents; (3) states the reason(s) why the decision is believed to be incorrect; and (4) is submitted within 30 calendar days of the date of the decision.

E. Use of Independent Contractors

A CDC may hire an independent contractor to perform liquidation (not servicing) duties provided that:

1. The proposed contractor does not have an actual, apparent, or potential conflict of interest with SBA, the CDC, or the Borrower;
2. The services to be performed are not the type of activities that are customarily considered a cost of doing business that should be absorbed as overhead;
3. The CDC is not receiving a servicing fee from the Borrower or another Person; (e.g., payment of servicing fee required under workout agreement); and
4. The CDC obtains the SBA Loan Center's prior written approval of the qualifications of the contractor, the terms and conditions of the engagement contract, and any modifications to the contract.

F. Use of Treasury Checks

1. When Treasury Checks May Be Used

A Treasury check may be ordered from the SBA Denver Finance Center and used in accordance with Chapter 13 to purchase or pay-off a delinquent senior secured loan or to enter a Protective Bid.

2. How to Order a Treasury Check

a. Lead Time

Requests for Treasury checks must be submitted to the SBA Loan Center in sufficient time to allow for review and submission of approved requests to the SBA Denver Finance Center, which normally requires at least ten days lead time to issue a Treasury check.

b. Required Information

A request for a Treasury check must be in writing and must set out (1) the exact amount of the check to be issued; (2) the name, address and Taxpayer Identification Number of the payee; and (3) the reason the check is required. In addition:

(1) Check for Protective Bids

If the Treasury check is for a Protective Bid, the request must indicate that the Person conducting the foreclosure sale will accept a Treasury check rather than a cashier's check, and include copies of the following documents:

- (a) The foreclosure sale notice;
- (b) A current title search or UCC lien search;
- (c) Verification of amount owed to senior lienholders; and

(d) A Post-default Environmental Investigation Report if required by this SOP.

(2) Check for Pay Off or Purchase of Senior Lien

If the Treasury check is to pay off or purchase a Third Party Loan or another loan secured by a senior lien, it must be transmitted to the senior lienholder by means of an escrow letter that contains appropriate instructions concerning the conditions under which the Treasury check can be cashed, e.g., the senior lienholder's note and collateral documents have been assigned to SBA, or the senior lienholder's note has been stamped "paid" and the collateral has been released. In addition, the request must also include a copy of:

- (a) The Third Party Lender Agreement or the agreement with the senior lienholder, if any; and
- (b) The Third Party Lender or senior lienholder's transcript of account, which must document that the purchase or payoff amount is consistent with the limitations, if any, in the Third Party Lender Agreement or similar agreement on Default Charges.

7. Limitation on Dollar Amount

The amount of a Treasury check cannot exceed \$999,999. If the amount needed exceeds \$999,999, an additional check for the remainder must be ordered for an amount that is not exactly the same as the original check or one of the checks may be cancelled.

8. Prevention of Unauthorized Use

Treasury checks must be kept in a secure location and only handled by an authorized SBA or CDC employee, who is either attending the foreclosure sale for which the check was obtained or transmitting the check pursuant to escrow instructions.

9. Disposition of Unused Checks

CDCs must promptly return all unused Treasury checks to the SBA Loan Center, which will promptly return the unused Treasury checks to the SBA Denver Finance Center. Unused Treasury checks should be transmitted by overnight mail, along with an explanation for the return. In no event may unused Treasury checks be kept for more than six months.

G. Recordkeeping

1. General Requirements

All servicing and liquidation Loan Action decisions, including the justification for the decision, must be documented in the Loan File or Computer Tracking System.

2. Loan Action Records and Supporting Documents

Loan Action Records should be dated and kept in the Loan File along with the Supporting Documents, such as Appraisals, credit reports and Environmental Investigation Reports, and any other document relied upon before taking the action memorialized in the Loan Action Record.

3. Correspondence

Copies of all paper and electronic correspondence concerning the loan must be dated and kept in the Loan File.

4. Telephone Conferences and Meetings

Detailed information concerning telephone calls and face-to-face meetings, i.e., date, time, place, Persons in attendance, substance of conversation, etc., must be kept in the Loan File or entered in a Computer Tracking System.

5. Electronically Stored Information

Because electronically stored information may be needed for litigation purposes and is subject to discovery, all electronically stored information should be preserved in its originally created or "native" format along with the related metadata. Upon request by SBA, Lenders must make electronically stored information available to SBA in a timely manner.

6. Loan File Retention

a. General Rule

A CDC must retain its Loan File on a 504 Loan for nine years after the loan is paid in full or for ten years after the loan is charged-off, whichever is applicable.

b. Exception—Litigation Hold

If litigation is reasonably anticipated, appropriate steps must be taken to preserve all potentially relevant information regarding the loan, including electronically stored information. This preservation requirement supersedes the general rule set out in Subparagraph a and means that routine retention and destruction policies must be suspended and a "litigation hold" put on the Loan File and electronically stored information to ensure the preservation of potentially relevant documents and data.

Note: "Reasonable anticipation of litigation" arises when an organization is on notice of a credible threat it will become involved in litigation or anticipates taking action to initiate litigation." Guideline 1. *The Sedona Conference Commentary on Legal Holds: The Trigger & The Process* (Sedona Conference Working Group on Electronic Document Retention & Production, August, 2007.)

H. Loan Monitoring

After a loan has closed, changes often occur that can impact the ability to administer or collect the loan. They include, for example, a Borrower's name change, relocation, or consolidation with another entity; deterioration of the Borrower's financial condition; and changes that affect the value of collateral, such as failure to pay real estate taxes that can become a senior lien on the collateral. CDCs are responsible for monitoring each 504 Loan in their portfolio and for mitigating the risk of loss associated with any change in accordance with prudent lending practices. ([13 C.F.R. §120.970](#)) For example:

1. Name, Address or Legal Structure Changes

In addition to notifying SBA and updating the Loan File or Computer Tracking System, if a change in the name, address, legal structure, etc., of an Obligor or any other relevant Person (e.g., a standby creditor) could impact the ability to collect the 504 Loan, appropriate corrective action must be taken immediately. For example, a UCC-3 should be filed to reflect a name change and preserve the priority of personal property liens; if a Borrower changes its legal structure, generally the new entity should be required to formally assume the 504 Loan; and if an Obligor dies, in addition to collecting the proceeds from any life insurance policy pledged as collateral for the loan, legal action may be necessary to protect the ability to collect the balance owed on the loan.

2. Borrower's Creditworthiness

- a. The Borrower's creditworthiness, i.e., financial and operational condition, should be monitored on an on-going basis to ensure that [early warning signs](#) that the Borrower is in financial trouble are not overlooked. This may be done, for example, through review of financial statements the Borrower is required to submit on a periodic basis, contact with the Borrower via the phone calls or site visits, or review of relevant financial data from sources such as credit reports, credit scores and tax returns.
- b. A primary means for monitoring each loan should be review of delinquency reports generated by the billing/accounting system. If the system flags a loan for an overdue payment, the Borrower should be contacted by telephone or letter to identify and correct potential problems before the loan goes into default.
- c. If the Loan Documents require the Borrower to submit financial statements, the statements should be reviewed and analyzed in a timely manner.
- d. If the financial information provided by the Borrower raises concerns regarding the Borrower's repayment ability, an executed copy of IRS Form 4506-T should be requested, and a transcript of the Borrower's most recent Federal Income Tax return should be obtained and compared to the questionable information.
- e. SBA does not permit CDCs to charge a default interest rate or a separate servicing fee for past due financial statements. ([SOP 50 10](#)) (Submission of the past due financial statements should be required as a condition for considering any future servicing request made by the Borrower.)

Note: If an Obligor files bankruptcy, appropriate action must be taken to protect the ability to collect the SBA loan. See Chapter 24 (*Litigation*) for information on bankruptcy proceedings.

3. UCC Filings

All UCC filings must be monitored, and any document needed to maintain the perfection and priority of the lien securing the 504 Loan must be properly prepared and filed, including, for example, a UCC-3 to continue an existing financing statement. This duty continues regardless of whether the loan has been charged off or the Borrower has filed for Bankruptcy.

4. Taxes and Assessments

Secured 504 Loans should be monitored to ensure that all taxes and assessments, which if unpaid could result in senior liens against the collateral, are paid in a timely manner.

Note: Although state law varies, secured creditors generally do not have the right to redeem collateral after a tax foreclosure sale. Consult legal counsel for case specific information.

5. Insurance

504 Loans should be monitored to ensure that all insurance coverage required by the Loan Authorization is in place throughout the term of the loan. See Chapter 9 for information on force placing coverage if the Obligor has allowed it to lapse.

6. Senior Secured Loans

The loans of other creditors secured by senior liens against the collateral for a 504 Loan should be monitored and timely, prudent, commercially reasonable action must be taken to prevent: elimination of the lien securing the 504 Loan through a foreclosure action by the senior lien holder, or dissipation of the equity available to cover the 504 Loan through, for example, the imposition of Default Charges.

I. Reporting Requirements

1. Quarterly Delinquency Report

A CDC must submit a [quarterly delinquency report](#) to the appropriate SBA Loan Center on each loan in its portfolio that is 60 days or more past due until the Debenture has been purchased. ([13 C.F.R. § 120.830\(f\)](#)) The [format](#) for the report is accessible from www.sba.gov/for-lenders. Quarterly delinquency reports must be submitted no later than 30 days after March 31st, June 30th, September 30th and December 31st.

2. Quarterly Liquidation Status Report

a. Reporting Requirement

Within 15 business days of receiving notice that a Debenture has been purchased, and every 90 days thereafter until a Wrap-up Report has been filed, ACLs and PCLP CDCs must provide the SBA Loan Center with a written liquidation status report that includes, at a minimum, a description of the status of the following:

- (1) Obligors;
- (2) Collateral;
- (3) Workout negotiations;
- (4) Recoveries and expenses incurred;
- (5) Liquidation and litigation proceedings; and
- (6) REO and acquired personal property collateral.

b. Failure to Comply—Referral to OCRM

ACLs and PCLP CDCs who fail to provide timely quarterly status reports may be referred to the SBA Office of Credit Risk Management for appropriate action.

3. Reports to Credit Reporting Agencies

In accordance with the [Debt Collection Improvement Act of 1996](#), CDCs are required to report information to the appropriate credit reporting agencies whenever they extend credit via a 504 Loan. Thereafter, they should continue to routinely report information concerning servicing, liquidation, and charge-off activities throughout the life-cycle of the loan. (See Chapter 28 for more information regarding credit reporting requirements for loans in charge-off status.)

4. Site Visit Report

A Site Visit Report, which should be kept in the Loan File, should be prepared after every visit to the Borrower's business premises regardless of whether the loan is in regular servicing or liquidation status. Non-PCLP CDCs must provide the SBA Loan Center with a Site Visit Report along with their proposed Liquidation Plan. PCLP CDCs must provide the SBA Loan Center with a Site Visit Report along with the first quarterly liquidation report due after Debenture purchase. If a site visit was not conducted, the reason why a site visit was neither necessary nor prudent must be documented in the Loan File and explained in the Wrap-up Report. (See Chapter 16 for information on site visits.)

5. Wrap-up Report

ACLs and PCLP CDCs, as well as non-ACL and non-PCLP CDCs authorized by SBA to liquidate specific 504 Loans, must submit a Wrap-up Report to the appropriate SBA Loan Center upon completion of the liquidation activities associated with each 504 Loan for which they are responsible for liquidating. (See Chapter 28 for information on Wrap-up Reports including SBA's right to charge off the loan balance, refer the loan to Treasury if appropriate, and with regard to PCLP 504 Loans, bill the PCLP CDC for its share of the loss.)

6. Other Reports

CDCs must provide SBA with interim or other types of reports as requested. ([13 C.F.R. § 120.830\(g\)](#))

J. SBA Oversight and Remedies

1. Takeover of Servicing, Liquidation, or Litigation

SBA may, in its discretion, take over the servicing or liquidation, including litigation, of any individual 504 Loan. ([13 C.F.R. § 120.535\(d\)](#)) If SBA elects to do so, the CDC must immediately re-assign any Loan Documents held in the CDC's name to SBA and provide any requested assistance.

Note: SBA may take over the litigation on a 504 Loan handled by CDC's counsel if SBA determines that the outcome could adversely affect SBA's administration of the loan program or that SBA, as a Federal Government agency, is entitled to legal remedies that are not available to the CDC. ([13 C.F.R. § 120.540\(d\)](#)) For example, SBA may take over when: the litigation involves important government policy or program issues; the case appears to have precedential value; the CDC has a conflict of interest; or the legal fees charged by CDC's counsel are not reasonable, necessary or customary.

2. Administrative or Enforcement Action by OCRM

If a CDC fails to properly service or liquidate its 504 Loan portfolio, the SBA Office of Credit Risk Management may take administrative action (e.g., non-renewal of ALP status) or enforcement action pursuant to [13 C.F.R. § 120.1400](#) and [13 C.F.R. § 120.1500](#). (See SOP 50 53 for information regarding SBA's credit risk management policy and procedures.)

3. Reimbursement of Loss Due to CDC Fraud or Negligence

See Chapter 26 [*Reimbursable Loss on 504 Loans*] for information regarding SBA's right to recover the total amount of the Debenture from a CDC that has engaged in fraud, negligence or misrepresentation. ([13 C.F.R. § 120.938\(b\)](#))

Chapter 4. Loan Fees and Loan Payment Administration

This chapter provides SBA policy and procedures with regard to loan fees and collecting and processing loan payments. (See Chapter 25 for information regarding recoveries on loans in liquidation status.)

A. Loan Fees

CDCs may impose the following fees with regard to the 504 Loans in their portfolios:

1. Servicing Fee

a. Pre-Debenture Purchase

Pre-Debenture purchase, a CDC may charge the Borrower a monthly servicing fee in an amount based on a percentage of the unpaid balance of the loan as determined at five-year anniversary intervals. (See [SOP 50 10](#) and [13 C.F.R. § 120.971\(a\)\(3\)](#) for more information.)

b. Post-Debenture Purchase

Post-Debenture purchase, a CDC may charge the Borrower a monthly servicing fee as part of the terms of a workout agreement, (Chapter 17), provided that:

- (1) The loan was approved on or after October 1, 2009;
- (2) The post-Debenture purchase servicing fee is less than or equal to the amount of the pre-Debenture purchase servicing fee;
- (3) The amount of the payment due under the workout agreement that will be applied to the 504 Loan balance is sufficient to ensure that the loan balance will be paid in full no later than ten years after the original maturity date of the loan; and
- (4) The post-Debenture purchase servicing fee payments are not due and payable until the loan has been returned to regular servicing status.

2. Late Fee

a. Monetary Obligations

Pre-Debenture purchase, a CDC may charge the Borrower a late fee on any loan payment received after the fifteenth of the month, provided that the fee does not exceed five percent of the late payment amount or \$100, whichever is greater. ([13 C.F.R. § 120.971\(a\)\(4\)](#))

b. Non-Monetary Obligations

A CDC may not charge a fee or impose a monetary penalty for failure to comply with non-monetary terms of the Loan Authorization. For example, failure to provide annual financial statements within the time specified in the Loan Authorization cannot be used as the basis for imposing a monetary penalty on a 504 Loan.

3. Assumption Fees

A CDC may charge a fee to assume a 504 Loan, provided it obtains SBA's prior written approval and the amount does not exceed one percent of the outstanding principal balance of the loan. (See [SOP 50 10](#) and [13 C.F.R. § 120.971\(a\)\(5\)](#) for more information.)

4. Fees Associated with Out-of-Pocket Expenses

CDCs may pass on to the Borrower the amount of any out-of-pocket expense incurred by the CDC as a direct result of the Borrower's improper action or omission, provided that the expense is consistent with standard industry practice. For example, the fee to repeat an ACH debit that was initially rejected due to non-sufficient funds.

B. Pre-Debenture Purchase Payments on Loans in Regular Servicing Status

1. Payee

Pursuant to the *Servicing Agent Agreement* ([SBA Form 1506](#)), Borrowers are required to make their regular monthly 504 Loan payments to the CSA, and if there is a problem, the CDC is responsible for collecting the scheduled loan payments.

2. Application of Funds

Pursuant to the *CDC Note* ([SBA Form 1505](#)), the CSA is required to apply funds from regularly scheduled loan payments in the following order:

- a. Monthly fees;
- b. Accrued interest; and
- c. Principal.

Note: The CSA retains the payments made by the Borrower in a Master Reserve Account until a semi-annual payment is due on the Debenture.

C. Pre-Debenture Purchase Payments on Loans During and After a Deferment Period

1. Loan Payments During Deferment

Payments are not mandatory during a deferment period, but are preferred because even a small payment will keep the Borrower in the habit of making payments and will also keep the Borrower's pre-authorized debit method of payment active.

2. Catch-Up Plan Payments

Catch-up plan payments should be applied in the following order:

- a. SBA approved loan fees;
- b. Accrued interest,
- c. Principal, and
- d. Late charges.

3. Application of Loan Payments After Deferment

When regularly scheduled payments resume at the end of the deferment period, they should be applied in the same order as other funds from payments received on loans in regular servicing status. (See Paragraph B above.)

D. Post-Debenture Purchase Payments on Loans in Liquidation Status

1. Overview

Payments (as opposed to recoveries) are generally rare after a loan has been classified in liquidation, because the Note has been accelerated and demand has been made for payment of the entire amount due. In those cases where the Borrower is financially able to resume making regularly scheduled payments, the loan should be returned to regular servicing status. (See Chapter 14 for information on returning loans classified in liquidation to regular servicing status, and Chapter 25 for information on how to apply recoveries.)

2. Impact of Accepting Payment on Liquidation Plan

Before accepting any payment—other than payment in full—on a loan in liquidation status, determine whether accepting the payment could cure the default and curtail plans for liquidating the loan. For more information, consult legal counsel.

3. Payee

All post-Debenture purchase loan payments must be made payable to SBA—not the CSA or the CDC. (See Chapter 15 for information on the impact of Debenture purchase.)

4. Application of Funds

Unless the terms of an SBA approved workout agreement or some other legally binding document (e.g., a court approved bankruptcy plan) specifies otherwise, post-Debenture purchase, the funds from a payment on a loan in liquidation status should be applied in the following order:

- a. Principal balance of the loan;
- b. Accrued interest; and

- c. SBA permitted loan fees.

E. Post-Debenture Purchase Payments on Loans Returned to Regular Servicing Status

The provisions in this Paragraph apply when the 504 Loan has been classified in liquidation, SBA has purchased the Debenture, the loan has been returned to regular servicing status, and the Borrower has resumed making regular payments.

1. Payee

All post-Debenture purchase loan payments must be made payable to SBA—not the CSA or the CDC. (See Chapter 15 for information on the impact of Debenture purchase.)

2. Application of Funds

Unless the terms of a legally binding agreement provide otherwise, such as a court approved bankruptcy plan or an SBA approved workout agreement, post-Debenture purchase, funds from payments received on loans returned to regular servicing status must be applied in the following order:

- a. Accrued interest;
- b. Principal;
- c. SBA permitted loan fees; and

Note: For information on SBA permitted loan fees, see Chapter 4 (*Loan Fees and Penalties*) as well as the most current version of [SOP 50 10](#).

- d. Additional principal.

F. Prepayment

The following information applies to 504 Loans prior to Debenture purchase. Post-Debenture purchase, the CSA is no longer involved and the 504 Loan may be prepaid at any time. (For prepayment policies and procedures regarding 503 loans, see the SBA regulations and SOPs in effect at the time the 503 loan was made.)

1. When 504 Loans and Debentures Can Be Prepaid

a. When a Borrower Can Prepay a 504 Loan

Generally, if a Borrower provides the CDC with 45 days prior written notice, the Borrower can prepay its 504 Loan on the third Thursday of any month. (See the *CDC Note* [[SBA Form 1505](#)] and the *Servicing Agent Agreement* [[SBA Form 1506](#)].)

b. When a CDC Can Prepay a Debenture

If the Borrower prepays the 504 Loan, the CDC must prepay the corresponding Debenture with interest and premium. ([13 C.F.R. § 120.940](#)) Generally, if a CDC provides SBA with at least 30 days written notice, the CDC can prepay a 504 Loan Debenture on any semi-annual Debenture payment date prior to the Debenture maturity date. (See the *Development Company 504 Debenture* [[SBA Form 1504](#)].)

2. Prepayment Amount

a. 504 Loan Prepayment Amount

Full, but not partial, prepayment of a 504 Loan is allowed. Pursuant to [13 C.F.R. § 120.940](#), the terms of the *CDC Note* ([SBA Form 1505](#)) and the *Servicing Agent Agreement* ([SBA Form 1506](#)), to prepay the 504 Loan, the Borrower must pay the sum of all of the following amounts due and owing through the date of the next semi-annual Debenture payment:

- (1) Principal balance;
- (2) Interest;
- (3) SBA guaranty fees;
- (4) CSA fees;
- (5) CDC servicing fees;
- (6) Late fees;
- (7) Expenses incurred by CDC for which the Borrower is responsible; and
- (8) Prepayment premium, if owed.

b. Debenture Prepayment Amount

Pursuant to the terms of the *Development Company 504 Debenture* ([SBA Form 1504](#)), to prepay a Debenture the CDC must pay the sum of all of the following amounts due and owing through the date of the next semi-annual Debenture payment:

- (1) Outstanding principal balance of the Debenture;
- (2) Interest accrued and unpaid to the prepayment date; and
- (3) Prepayment premium, if owed.

Note: If the Borrower wires the correct amount to prepay the 504 Loan, the CDC will have the total amount required to prepay the corresponding Debenture.

c. Prepayment Premium Amount

Pursuant to the terms of the CDC Note ([SBA Form 1505](#)), Borrowers who prepay during the first half of the term of the 504 Loan must pay a prepayment premium. The formula for determining the amount of the prepayment premium is specified in the corresponding Development Company 504 Debenture ([SBA Form 1504](#)).

3. Procedure for Prepayment of 504 Loans and Debentures

When a Borrower provides notice that it wishes to prepay a 504 Loan, proceed as follows:

Step 1. Obtain CSA's Estimate of Prepayment Amount

Obtain an estimate of the amount required to prepay the Debenture from the CSA.

Step 2. Schedule Prepayment with CSA

Schedule a date for prepayment of the Debenture with the CSA. (The request must be received by the CSA at least eight calendar days prior to the requested prepayment date.)

Step 3. Send Borrower Prepayment Instructions

Advise the Borrower of the estimated prepayment amount; and provide the Borrower with information regarding the prepayment process.

Step 4. Obtain Exact Prepayment Amount from CSA

Obtain the exact prepayment amount from the CSA. (The information should be available after the sixth business day of the month of prepayment.)

Step 5. Instruct Borrower to Wire Prepayment Funds to CSA

Notify the Borrower of the exact prepayment amount and instruct the Borrower to wire the necessary funds to the CSA no later than noon Eastern Standard Time on the third Thursday of the month in which the prepayment is scheduled.

Note: The CSA will not accept checks. Further, if the CSA does not receive the correct amount on time, it will terminate the transaction and the CDC will need to reschedule the prepayment to the next semi-annual Debenture payment date, which could result in the need for additional funds.

Step 6. Obtain CSA Verification of Payment

Obtain confirmation from the CSA that the Debenture has been paid in full, generally from the CSA's Web site.

Step 7. Request Loan File and Cancellation of Note

Provide the SBA Loan Center with written confirmation that the loan has been paid in full along with a request for the Loan File and the cancelled Note, i.e., the Note marked "Paid in Full."

Step 8. Release the Collateral

After receipt of the Loan File and Note marked as "Paid in Full," release the collateral securing the 504 Loan in accordance with state law requirements.

4. Cancelling or Rescheduling Prepayment Date

Once a prepayment date has been scheduled, if it appears that the Debenture cannot be prepaid as planned, notify the CSA as soon as possible; and cancel the prepayment or follow the procedural steps outlined in Paragraph C above to reschedule it.

G. Paid in Full Loans**1. Definition of "Paid in Full"**

"Paid in full" means that the total amount due on the loan has been paid including principal, interest, and any prepayment penalty, late charges, and Recoverable Expenses. When a 504 Loan is verified as "paid in full", the Note should be cancelled, and the collateral should be released in a timely manner.

2. Procedure for Releasing Collateral

The CDC is responsible for ensuring that the collateral is released in accordance with applicable state law, and that the appropriate Loan Documents are returned to the Borrower. If SBA is holding the collateral documents, the SBA Loan Center will provide the CDC with the necessary documents so that the collateral can be released in a timely manner.

Note: Many states impose significant penalties on creditors who fail to release collateral in strict compliance with state law. Consult legal counsel for state specific release requirements.

Chapter 5. Environmental Risk Management

This chapter sets out SBA policy and procedures for managing environmental risks associated with 504 Loans in regular servicing or liquidation status.

A. Overview

1. Environmental Risks

For secured creditors, the risks associated with Contaminated collateral include, for example:

- a. Impairment of the Borrower's ability to repay the loan due to the high cost of Remediation, regulatory fines and penalties;
- b. Diminishment of the value and marketability of the collateral;
- c. Direct liability for tort claims and Remediation by becoming an owner or operator of the Property, (e.g., by acquiring title at a foreclosure sale or by taking over the operation of the Borrower's business); and
- d. Loss of lien priority if a Governmental Entity cleans up the Property.

2. Definitions

Definitions of the environmental terms used in this SOP, which are capitalized when they appear, are located in Appendix 2 of [SOP 50 10](#), the most current version of which is accessible from the [SOP section](#) of SBA's Web site. The defined terms include, for example, the term "Property," which means commercial real property and does not include personal property or residential real estate.

B. General Requirements

Prudent servicing and liquidation of an SBA loan includes:

1. Conducting adequate due diligence before taking any Loan Action that could result in a loss, or increase the risk of loss, due to actual or alleged presence of Contamination;
2. Monitoring the loan for compliance with the environmental covenants in the Loan Documents, and requiring the Borrower to take appropriate corrective action if necessary; and

Note: Changes in the Borrower's financial condition that could signify an increase in environmental risk include, e.g., regulatory fines discovered while reviewing financial statements. Activities that could signify an increase in environmental risk include, e.g., failure to maintain Engineering Controls or evidence of a Release discovered during a site visit.

3. Compliance with Environmental Laws that allow secured creditors to avoid or significantly limit potential liability.

Note: Many Environmental Laws provide secured creditors with a “safe harbor” from liability as an owner or operator. Two of the most important laws are the [Comprehensive Environmental Response, Compensation, and Liability Act](#) (“CERCLA”) and the [Resource Conservation and Recovery Act](#) (“RCRA”). To qualify for the exemption under CERCLA or RCRA, the most critical requirements are that the secured creditor: (1) hold indicia of ownership primarily to protect its security interest; (2) take no action that could be construed as “participating in the management” of the Borrower’s facility; and (3) attempt to divest itself of Contaminated acquired collateral at the earliest practicable and commercially reasonable time using commercially reasonable means. For Information on the types of activities that constitute “participating in the management” of a facility or UST system, with regard to CERCLA see [CERCLA Lender Liability Exemption: Updated Questions and Answers](#); and with regard to RCRA, see [40 C.F.R § 280.210](#). Consult legal counsel for loan-specific information.

C. When an Environmental Investigation is Required

An Environmental Investigation must be conducted before taking any Loan Action that could result in a loss, or increase the risk of loss, due to the actual or alleged presence of Contamination. For example, an Environmental Investigation must be conducted before:

1. Accepting Property as substitute collateral;
2. Releasing a lien on collateral for substantially less than its estimated Recoverable Value based on unsubstantiated allegations of Contamination;
3. Abandoning collateral, which would otherwise have Recoverable Value, based on unsubstantiated allegations of Contamination;
4. Acquiring title to Property held as collateral, e.g., by purchasing it at a foreclosure sale or accepting a deed-in-lieu of foreclosure;
5. Taking over the operation of a business that uses Hazardous Substances or is located on Contaminated Property regardless of whether the Borrower owns the Property;
6. Selling REO or acquired personal property collateral for substantially less than its appraised value based on unsubstantiated allegations of Contamination; and
7. Abandoning REO or acquired personal property collateral based on unsubstantiated allegations of Contamination.

D. Environmental Investigation Process for Loans in Regular Servicing Status

Environmental Investigations in support of regular loan servicing activities, e.g., substitution of collateral, should be conducted in accordance with [SOP 50 10](#).

E. Environmental Investigation Process for Loans in Liquidation Status

Environmental Investigations in support of liquidation activities, e.g., acquiring Property at a foreclosure sale, should be conducted as follows:

1. Scope of investigation

The amount of due diligence must be prudent based on the loan specific circumstances such as the Property's appraised value, the amount owed on senior liens, the SBA loan balance, the activities conducted at the Property, the results of previous Environmental Investigations, access to the Property, and the cost and time involved.

2. Use of Environmental Professionals

Environmental Investigations on loans in liquidation status must be conducted by an Environmental Professional except for the Environmental Questionnaire ("EQ") portion of an Environmental Investigation that consists of an EQ and Records Search with Risk Assessment ("RSRA").

3. Reliance Letter Requirement

An Environmental Investigation Report prepared by an Environmental Professional must be accompanied by a Reliance Letter unless the Environmental Investigation consists of an EQ and RSRA. (See Appendix 3 to [SOP 50 10](#) for the Reliance Letter template.)

4. General Procedure

Generally, the following steps should be taken to conduct a post-default Environmental Investigation that will provide adequate information for a prudent lender to make an informed decision regarding the risks of Contamination.

Step 1. Order an Environmental Site Assessment ("ESA")

High Risk—If the risk of Contamination appears to be high, begin with a Phase I ESA. Generally, the risk should be considered high if, for example, there are underground storage tanks at the Property, a NAICS Code for a past or present use of the Property matches one on the List of Environmentally Sensitive Industries (Appendix 4 to [SOP 50 10](#)), or past Environmental Investigations have concluded that the Property is Contaminated or that there is a high or elevated risk of Contamination.

Exception for Non-Industrial Condominiums: The Environmental Investigation of a condominium in a non-industrial, multi-unit building may begin with a Transaction Screen or an EQ and RSRA.

Low Risk—If the risk of Contamination appears to be low, begin with a Transaction Screen or an EQ and RSRA.

Step 2. Conduct Additional Necessary, Cost-effective Inquiries

If a prudent lender could not make an informed decision based on the Environmental Investigation Report from Step 1, conduct any additional cost-effective inquiry recommended in the Environmental Investigation Report or otherwise needed to obtain enough information to make an informed decision. For example, when the Property appears to have significant Recoverable Value:

- (1) A Phase I ESA should be conducted if a Transaction Screen or EQ and RSRA shows a high or elevated risk of Contamination;
- (2) Inquiries regarding environmental problems beyond the scope of a Phase I ESA (e.g. asbestos), should be conducted if the problem could have a material effect on the Recoverable Value of the Property;
- (3) A Phase II ESA should be conducted if it is necessary to determine the nature and extent of Contamination identified by a Phase I ESA; and
- (4) A Remediation estimate should be obtained if Remediation is recommended in a Phase II ESA Report.

Note: For guidance on how to prepare a Remediation estimate, see ASTM E2137-06 (*Standard Guide for Estimating Monetary Costs and Liabilities for Environmental Matters*). Note also that SBA officials may request an estimate from the SBA environmental engineers at the SBA [Sacramento Loan Processing Center](#).

Step 3. Additional Requirements for Gas Stations and Dry Cleaners

If, after obtaining a Phase I ESA, a prudent lender would obtain additional information before making a decision regarding Property associated with the operation of a gas station, commercial fueling facility, or a dry cleaner that uses Hazardous Substances, then the Environmental Investigation should also include:

- (1) A Phase II ESA conducted by an independent Environmental Professional with three years of full-time relevant experience who holds a current Professional Engineer's or Professional Geologist's license;
- (2) Any further investigation recommended in the Phase I ESA or Phase II ESA Report;
- (3) An estimate that covers the method, cost and time required for completion of any recommended Remediation; and
- (4) Testing of the equipment related to the operation of the facility.

Note: Generally, if a gas station or dry cleaner has been in operation for five years or more, there is a high probability that the Property is Contaminated.

Step 4. Extra Requirement if Taking Over Business Using Hazardous Substances

(1) Environmental Regulatory Compliance Audit

Generally, an environmental regulatory compliance audit should be conducted prior to taking over the operation of a business that handles Hazardous Substances. The audit should be conducted in substantial compliance with ASTM E2107-06 (*Standard Practice for Environmental Regulatory Compliance Audits*).

Note: Unknown regulatory compliance violations can significantly diminish a secured creditor's estimated recovery. For example, the cost of obtaining licenses and permits needed to operate the business can be substantial, and outstanding regulatory fines and enforcement actions can have a chilling affect on the price potential purchasers are willing to pay for the business assets.

(2) Practice Tip

To avoid "participating in the management" of a Borrower's business and losing the secured creditor liability exemption, it is generally advisable to have a receiver appointed by the court to take possession of the collateral and operate the business. (See Chapter 24 for SBA requirements pertaining to Non-routine Litigation such as receivership proceedings.)

F. Environmental Investigation Reports

The results of an Environmental Investigation must be set out in a written Environmental Investigation Report, which must be kept in the Loan File. An Environmental Investigation Report should be less than 180 calendar days old at the time it is relied on.

G. Remedial Action by a Secured Creditor

Given the complexity of the applicable Environmental Laws and the risks involved, Lenders should obtain a legal opinion from an attorney with Environmental Law expertise before undertaking Remedial action. (See [40 C.F.R. § 280.210\(b\)\(2\)\(i\)\(B\)](#), which deals with participating in the management of underground storage tanks ["USTs"], as an example of the risks and complexity of the law.)

H. Taking Title to Contaminated Property or Control of a Business with Environment Risks

1. When Appropriate

Title to Contaminated Property should not be acquired, and businesses that use Hazardous Substances or are located on Contaminated Property should not be taken over, unless despite the risk of incurring liability as an owner or operator, a prudent lender would do so based on the estimated net recovery.

2. Requirement – SBA's Prior Written Approval

Lenders must obtain SBA's prior written consent before taking title to Contaminated Property or taking over the operation of a business that uses Hazardous Substances or is located on Contaminated Property regardless of whether the Borrower owns the Property.

3. How to Obtain SBA Approval

A written request must be submitted to the appropriate SBA Loan Center.

4. Request Format

The request, which must be accompanied by the appropriate Supporting Documents, must include a thorough analysis of all the relevant factors to determine whether a prudent lender would take the proposed action despite the risks. Such factors and Supporting Documents should generally include:

a. Appraised Value of Collateral to be Acquired

Provide the appraised value of the Property supported by a copy of the post-default Appraisal.

b. Liquidation Value of Collateral to be Acquired

Provide the estimated Liquidation Value of the Property and explain the basis for the estimate.

c. SBA Loan Balance

Provide the SBA loan balance supported by a copy of the transcript of account or other credible evidence of the loan balance.

d. Amount Owed on Senior Liens

Provide a list of senior liens against the collateral, including landlord liens and tax liens, and the amount owed on each, supported by a copy of:

- (1) Schedule B, or equivalent, of the post-default title report;
- (2) A current UCC lien search if the request includes personal property collateral or taking over the operation of a business;
- (3) Any senior lienholder agreement, landlord lien waiver, subordination agreement or other Loan Document that establishes the priority of the liens against the collateral; and
- (4) Transcript of account or similar proof of compliance with any provision in the foregoing documents that requires a senior lender to subordinate any portion of the senior loan to the SBA loan (e.g., Default Charges).

e. Foreclosure Costs

List the foreclosure costs including any extraordinary expenses such as the legal fees and administrative expenses associated with a receivership.

f. Nature and Extent of the Contamination

Provide a summary of the nature and extent of the Contamination supported by copies of the Environmental Investigation Report(s) required by Paragraph E.

g. Clean-up Costs and Liability

Indicate whether Remediation is required or on-going, and:

- (1) If Remediation is not required—attach a copy of the no further action letter, closure letter, or functional equivalent from the responsible Government Entity.
- (2) If Remediation is recommended—attach a copy of any document that: (a) provides a description of the recommended method and cost of Remediation and anticipated completion date; (b) establishes the identity of those responsible for Remediation (e.g., Superfund consent decree); or (c) demonstrates the ability of the responsible party to pay for the cost of Remediation.
- (3) If Remediation is on-going—attach a copy of any document that shows the progress of the cleanup, or that the Person conducting the cleanup has sufficient financial resources to complete it.

h. Secured Creditor Liability Exemptions

Provide a list of applicable liability exemptions that the Person who will take title qualifies for, such as the secured creditor exemption under CERCLA, RCRA or a similar state law, the bona fide purchaser exemption under CERCLA §§ 101(4) and 107(r), or the involuntary acquisition by a government entity exemption under CERCLA § 101(20)(D).

Note: Pursuant to [40 C.F.R. § 300.1105\(a\)\(3\)](#), acquisition of title by SBA through foreclosure or a deed-in-lieu while administering an SBA loan program is considered an "involuntary acquisition."

i. Mitigating Factors

List any mitigating factor and attach a copy of the relevant Supporting Document(s), e.g., an indemnification agreement and the indemnitor's financial statement. Mitigating factors include, for example:

- (1) SBA Environmental Indemnification Agreement—was executed by a Person with sufficient financial resources to cover the cost of Remediation;
- (2) Escrow Account—has been established to cover the cost of a Remediation plan approved by the responsible Government Entity;
- (3) Solvent Government Cleanup Fund—has unconditionally agreed to cover the cost of Remediation; or
- (4) Lender Liability Environmental Insurance—is in place and will cover the cost of Remediation after title is acquired.

j. Tort Liability

Provide information regarding the status and anticipated outcome of any known litigation regarding alleged injury to people, property or natural resources due to Contamination at the Property.

k. Exceptions to Title that Impact Marketability

Review Schedule B (or equivalent) of the post-default title report, and indicate whether there is any recorded covenant, deed restriction or other exception to title that will have a negative impact on the Property's Recoverable Value such as a covenant that requires future owners of the Property to indemnify a major oil company or a deed restriction that prevents future owners from using the Property for any purpose other than to operate a gas station that sells a particular brand of gasoline.

l. Alternative Methods of Recovery

List and analyze the feasibility of alternative methods of collecting the loan balance that involve less risk. At a minimum, this should include (1) the estimated recovery from other collateral and the Obligors; and (2) alternative methods of liquidation that do not require taking title to the Contaminated collateral such as release of lien for consideration, sale of the Note and assignment of the lien to the purchaser, or appointment of a receiver to operate the business until enough money can be recovered to pay-off the loan or the collateral can be sold.

m. Acquired Collateral Divestiture Plan

Provide a description of the plan for disposing of any collateral to be acquired, which includes the holding and resale costs, as well as an explanation of how easy or difficult it will be to resell. For example, have any third parties expressed an interest in purchasing the collateral? Is it currently listed for sale by the owner? If so, why hasn't it sold?

Note: Generally, in order to preserve its liability exemption, a secured creditor is required to try to dispose of Contaminated acquired collateral at the "earliest practicable, commercially reasonable time using commercially reasonable means". For more information, see the applicable Environmental Law. For example, [40 C.F.R. 280.210\(c\)\(2\)\(i\)](#) sets out a "bright line" test under RCRA for determining whether a secured creditor is attempting to sell a gas station in an expeditious manner.

n. Other Relevant Facts or Expenses

List and discuss any other loan-specific relevant facts. For example:

- (1) Remediation by Secured Creditor—Will additional costs be incurred to Remediate the Property prior to listing it for sale? If so, attach a copy of the legal opinion recommended in Paragraph G above, provide a Remediation estimate, and indicate how the costs will be paid;

- (2) Receivership Proceedings—Will a receiver be appointed, for example, to operate the business or sell the collateral? If so, attach a draft Litigation Plan that describes the prior experience and qualifications of the proposed receiver and includes an estimate of costs of the court and receivership proceedings; or
- (3) Emptying and Closing USTs—If there are USTs at the Property and a receiver will not be appointed, indicate whether it will be necessary to empty and close the USTs. (For more information, see, for example, [40 C.F.R. § 280.230\(b\)](#).)

o. Estimated Net Recovery

Provide the estimated net recovery from taking the proposed action based on the analysis of factors “a” through “n” above.

Chapter 6. Servicing Requests

A. General Requirements

Frequently after an SBA loan has been disbursed, circumstances change and give rise to Borrower Servicing Requests. They can range anywhere from a simple request to change a mailing address to a complicated request involving the exchange of collateral. Regardless of the level of complexity, all Servicing Requests must be reviewed, analyzed and acted upon in accordance with prudent lending practices. When responding to a Servicing Request, as long as the Borrower is viable, the goal should be to meet the Borrower's short and long term needs without impairing the integrity of the SBA loan program.

B. Review and Analysis

Generally, the Loan Documents should not be modified unless there has been a material change in the Borrower's circumstances since the loan was made. The Supporting Documents and the level of analysis required to make an informed decision regarding whether the Servicing Request should be denied or approved, and if so, under what conditions, will vary depending on the circumstances. In all cases, the decision must be justified and documented in a Loan Action Record that is independent of any document prepared by a senior lienholder or any other Person with a conflict of interest. The relevant steps listed below should be followed to ensure that each Servicing Request is properly reviewed and analyzed.

1. Document Receipt of the Servicing Request

All Servicing Requests must be entered in a Computer Tracking System or noted in the Loan File.

2. Ensure that the Servicing Request is in the Proper Format

Borrower requests for modification of loan terms or conditions should be in writing.

3. Research the Applicable Loan Program Requirements

a. Requests Concerning Assumption, or Substitution of Collateral or Obligors

Servicing requests on loans in regular servicing status that involve substitution of collateral, substitution of Guarantors, or assumptions are subject to the Loan Program Requirements in effect at the time the loan was made, which are located in SOP 50 10. This includes, for example, those pertaining to Appraisals, Environmental Investigations, and eligibility requirements.

b. All Other Servicing Requests

See Chapters 7 through 13 of this SOP to find the applicable Loan Program Requirements for the Loan Actions most commonly requested.

4. Determine Whether the Servicing Request is Properly Supported

Servicing Requests should be accompanied by the Supporting Documents that a prudent lender would need to make an informed decision. For example:

a. Servicing Requests Involving Credit Issues

Generally, all Servicing Requests that require a credit analysis (e.g., an increase in the amount of the 504 Loan or a prior lien) should be supported by the Borrower's:

- (1) Current financial statement; and
- (2) Federal income tax returns for the last two years.

b. Servicing Requests Involving Collateral

In addition to the financial documents listed above, Servicing Requests that involve collateral, (e.g., subordination, substitution or release of lien), should also be supported by a current:

- (1) Appraisal of the relevant collateral;

Note: See the definition of "Appraisal" in Chapter 2 for SBA Loan Program Requirements regarding Appraisals. Note also, that if a copy of the Third Party Lender's appraisal is sought to supplement the Appraisal submitted with the Servicing Request, pursuant to the terms of the [Third Party Lender Agreement](#), the Third Party Lender must provide it to the CDC or SBA free of charge.

- (2) Lien search, i.e., a title report if the request involves real property; a UCC search if the request involves personal property; and
- (3) Transcript of account or other credible evidence of the balance owed on any senior liens.

5. Obtain Additional Supporting Documents When Necessary

Obtain any additional Supporting Documentation needed to properly analyze and decide whether the Servicing Request should be approved. For example:

a. Credit Report

Generally, a new credit report should be ordered to verify the financial information submitted in support of the proposed Loan Action.

b. Guarantor Financial Statements and Tax Returns

A current financial statement, and federal income tax returns for the past two years should be required from all of the Guarantors—not just the Borrower—when a complete analysis of each Obligor's repayment ability is necessary.

c. Refinance, Purchase & Sale, and Other Relevant Documents

A complete executed copy of all of the relevant documents, (e.g., purchase and sale agreement, escrow instructions, estimated closing statement [HUD-1], seller carry-back note, etc.), must be obtained if the Servicing Request involves the sale or refinance of collateral.

d. Environmental Investigation Report

A Servicing Request must be supported by an Environmental Investigation Report when required by Paragraph C of Chapter 5.

e. Evidence of Authority to Take Proposed Action

Proper evidence should be obtained to establish that each Person whose signature is necessary had the required authority to execute the Loan Documents involved in the Servicing Request, e.g., a board of directors' resolution.

6. Analyze the Borrower's Financial Condition

Analyze the Borrower's financial documents to determine whether the Borrower is viable, i.e., will be able to repay the loan if the request is approved. If the Borrower is viable, proceed to Step 7. If not, the Servicing Request should be denied and more appropriate action taken. (See, for example, Chapter 14 [*Classifying Loans in Liquidation*].)

7. Analyze the Collateral

If the Servicing Request will impact the collateral, a thorough analysis of its Recoverable Value, before and after the requested modification, should be conducted.

8. Check for Problems

The Loan Documents, such as the loan application and collateral documents, as well as the information in the Computer Tracking System should be reviewed to: (1) ensure that the Servicing Request is consistent with the Borrower's previous representations; and (2) ascertain whether there are any non-monetary defaults, collateral deficiencies, or problems with the Loan Documents that need correction.

9. List Conditions for Approval**a. Compliance with Terms and Conditions of Loan**

Approval of a Servicing Request should be conditioned on curing the defaults and correcting any collateral deficiencies or issues with the Loan Documents identified in Step 8. For example, the Obligors should be required to reinstate lapsed insurance coverage, or provide missing Taxpayer Identification Numbers.

b. Adequate Consideration

In order for a change in the Loan Documents to be legally binding, the Borrower must provide consideration, (i.e., something of value), before or at the same time that the Borrower receives the benefit of the requested change. For example, as consideration for granting the Servicing Request, the Borrower could be required to:

- (1) Fix errors in the Loan Documents identified in Step 8;
- (2) Waive defenses to litigation;
- (3) Release lender liability claims; or
- (4) Provide additional collateral.

c. Written Consent of All Obligors

The written consent to any material change in the terms and conditions of the loan must be obtained from each Obligor in order to protect the ability to recover from them in the event of default.

10. Comply with SBA and DOJ Decision Making, Notice and Approval Requirements**a. SBA Requirements**

CDCs must comply with the applicable SBA Loan Program Requirements pertaining to decision-making authority and notice to SBA. (See [13 C.F.R. § 120.536](#) and Chapter 3 for more information.)

b. DOJ Requirements

SBA Loan Centers must obtain approval from Department of Justice (“DOJ”) and the SBA District Counsel responsible for handling the litigation before making any decision that impacts the collateral or liability on a loan classified in litigation that has been referred to DOJ.

11. Comply with the Applicable Recordkeeping Requirements

In accordance with Chapter 3, the response to the Servicing Request must be noted in the Computer Tracking System or Loan File; a copy of the Loan Action Record and Supporting Documents must be kept in the Loan File; and the substance of any telephone calls or face-to-face meetings regarding the Servicing Request must be documented in the Loan File or entered into a Computer Tracking System.

C. How To Obtain SBA Approval of a Proposed Loan Action

If SBA’s prior written approval is required before a Loan Action can be implemented, the CDC should submit a written request, usually in the form of a letter, to the appropriate SBA Loan Center in accordance with the guidelines listed below. (See Chapter 3 for a detailed list of Loan Actions requiring SBA’s prior approval.)

1. Required Documentation

a. Written Request

Requests for approval of a proposed Loan Action should be in the form of a clearly and concisely written letter (or other document) based on an internal credit memorandum. Both the letter and the credit memorandum must be independent of any document or analysis prepared by a senior lienholder or any other Person with a conflict of interest. Although SBA reserves the right to request additional information, the letter should generally include:

- (1) A brief description of the proposed Loan Action;
- (2) The amount funded, date of funding, current balance and status of the loan;
- (3) The current financial condition of the Borrower;
- (4) The justification for the proposed Loan Action, i.e., benefit to the Borrower, CDC and SBA—neither abundance nor lack of collateral alone is sufficient justification for a Loan Action;
- (5) Whether the proposed Loan Action will increase the risk of loss, and if so, any mitigating factor, e.g., the value of SBA's collateral will be increased, or the Borrower's business performance will be improved;
- (6) If the proposed Loan Action will impact the collateral, a summary of prior Loan Actions impacting the collateral and an analysis of the Recoverable Value of the collateral both before and after the proposed Loan Action;
- (7) A summary of prior servicing experience with the Borrower, i.e., loan modifications or problems pertinent to the request; and
- (8) A list of the Obligors and a statement as to whether their consent has been or will be obtained for the proposed Loan Action.

b. Credit Memo and Supporting Documents

A credit memo, which must be independent of any document or analysis prepared by a Person with a conflict of interest such as a senior lienholder, should accompany a request for approval of a proposed Loan Action. Generally, it is not necessary to include a copy of the Borrower's financial statement or the Supporting Documents such as Appraisals, etc., provided that they are adequately analyzed in the credit memo.

2. Where to Submit Requests

Requests for approval of proposed Loan Actions must be submitted to the appropriate SBA Loan Center. (See the definition of "SBA Loan Center" in Chapter 2 for contact information.)

3. SBA Response Time

SBA should respond to a CDC's request for approval of a proposed Loan Action within 15 business days. ([13 C.F.R. § 120.541](#))

Note: SBA will not provide written approval for a proposed Loan Action that the CDC has unilateral authority to take.

D. Implementing Loan Actions

Loan Actions must be implemented in accordance with prudent lending practices, for example, it may be necessary to:

1. Modify Existing Loan Documents

If the Loan Action modifies the terms and conditions of the Note or any other Loan Document, each impacted Loan Document must be properly modified;

2. Prepare New Loan Documents

Any new Loan Document needed to implement the Loan Action must be properly prepared and executed; and

3. Record New or Modified Loan Documents

Whenever necessary, reasonable or customary, the modified Loan Documents as well as any newly prepared Loan Documents must be properly recorded.

Chapter 7. Modification of Note

A. General Requirements

1. Review and Analysis of Request for Modification

Requests for modification of the repayment terms of the Note should be reviewed, analyzed and implemented pursuant to the requirements of Chapter 6 and the provisions of the applicable statutes, regulations and contracts, including the Note and the Debenture.

2. Debenture Purchase

The terms of the Note may not be modified unless SBA has purchased the Debenture, (which was sold to an investor to fund the loan), unless the modification involves a deferment obtained in accordance with the requirements of Chapter 12.

B. Payment Due Date

1. Pre-Debenture Purchase

Pre-Debenture purchase, the date that payments are due under the Note may not be modified. (See page 2 of [SBA Form 1505](#) [*CDC/504 Loan Note*], which states that “Monthly Payments are due on the first business day of each month”.)

2. Post-Debenture Purchase

Post-Debenture purchase, the date that scheduled installment payments are due may be modified to facilitate a workout agreement provided that the general requirements in Paragraph A are met. For example, payments originally scheduled to be made on a monthly basis, may be changed to a quarterly or annual basis if there is justification for the change such as the seasonal or cyclical nature of the Borrower's revenue stream.

C. Installment Amount

1. Pre-Debenture Purchase

Pre-Debenture purchase, the installment amount due under the Note may not be modified unless the modification involves a deferment that meets the requirements set out in Chapter 12.

2. Post-Debenture Purchase

Post-Debenture purchase, the installment amount due under the Note may be modified to facilitate a workout agreement if the general requirements in Paragraph A are met and the new installment amount is sufficient to ensure that the loan balance will be paid in full no later than ten years after the original maturity date of the loan. ([13 C.F.R. § 120.531](#)) (See Chapter 4 for information regarding when a CDC is authorized to add a post-Debenture purchase servicing fee to a modified installment amount.)

D. Interest Rate

1. Pre-Debenture Purchase

Pre-Debenture purchase, the interest rate on a 504 Loan is set by the terms of the Debenture and may not be modified. (See page 2 of [SBA Form 1505](#) [CDC/504 Loan Note].)

2. Post-Debenture Purchase

Post-Debenture purchase, the interest rate on a 504 Loan may be modified to facilitate a workout provided that the general requirements in Paragraph A are met.

E. Maturity Date

1. Pre-Debenture Purchase

Pre-Debenture purchase, the maturity date of a 504 Loan may not be modified.

2. Post-Debenture Purchase

Post-Debenture purchase, provided that the general requirements in Paragraph A are met, the maturity date of a 504 Loan may be extended up to 10 years beyond the original maturity date if the extension will aid in the orderly repayment of the loan. ([13 C.F.R. § 120.531](#))

F. Loan Amount

The amount of a 504 Loan may be increased provided that: (1) the general requirements in Paragraph A above are met; and (2) the increase is in compliance with the general requirements and restrictions in [SOP 50 10](#) with regard to 504 Loan amounts.

Note: The amount owed on a fully disbursed 504 Loan (as opposed to the amount of the loan) may, in some instances, be increased through the addition of Recoverable Expenses to the principal loan balance. See Chapter 25 for information on Recoverable Expenses and when they may be added to principal. The amount owed on a fully disbursed 504 Loan (as opposed to the amount of the loan) may, in some instances, be reduced through a compromise agreement. See Chapter 23 for information on offers in compromise.

Chapter 8. Modification of Collateral Requirements

A. Subordination of Lien Position

Note: SBA Loan Program Requirements prohibit any action that confers a Preference on a CDC.

1. General Requirements

The position of a lien securing a 504 Loan may be subordinated (i.e., lowered) when doing so is consistent with SBA loan servicing goals, i.e., it will help the long or short term needs of the Borrower without unduly impairing the ability to recover on the loan. Requests for subordination should be reviewed, analyzed and implemented pursuant to the requirements of Chapter 6 and the following guidelines:

- a. The proceeds from the new loan, or the increase in the amount of the senior loan, must be eligible for 504 Loan financing. I.e., a 504 Loan may be subordinated if the new money will be used to improve the Project Property or to acquire long-term fixed assets that will serve as additional collateral. A 504 Loan may not be subordinated if the new money will, for example, be used for working capital or personal expenses;
- b. The analysis required by Chapter 6 (*Borrower Servicing Requests*) must include the reason for the subordination and a description of how the new money will be used;
- c. The loan should be Seasoned;
- d. The Borrower should have a satisfactory credit history;
- e. There should be sufficient equity in the collateral to adequately secure the SBA loan after the proposed subordination;
- f. The Borrower should have the ability to repay all of the obligations (according to the terms of the loan agreements), which would be outstanding after the proposed subordination;
- g. The subordination should be limited to a specific amount and should not extend to future advances; and
- h. The terms of the transaction must be set out in a properly executed [subordination agreement](#) in which the lender benefiting from the subordination agrees to:
 - (1) Give SBA the opportunity to cure any default on the lender's loan by providing the CDC and SBA with written notice of any default within 30 days of its occurrence and 60 days prior written notice of the lender's intent to initiate collection activity against the common collateral;
 - (2) Waive all Default Charges on the lender's loan, (Subordinated funds must not be used to pay Default Charges owed to the lender.); and

- (3) Not cross-collateral the loan secured by the common collateral with any other loan held by the lender.

Note: If the subordination impacts an existing Third Party Lender Agreement, the existing agreement must be modified or replaced to reflect the new terms and conditions.

2. Subordination to Facilitate Refinance of a Senior Loan

In addition to the general requirements in Paragraph A.1, the position of a lien securing an SBA loan should not be subordinated to facilitate the refinance of an existing senior loan unless:

- a. The refinancing is on terms that are more favorable to the Borrower;
- b. There is no increase in the principal balance of the loan secured by the senior lien except for necessary, reasonable and customary closing costs;

Exception—With regard to Third Party Loans, the refinanced amount may also include up to 100% of the cost of improvements to the collateral that will maintain or increase its value if an Appraisal of the improved collateral establishes that the loan to value ratio is $\leq 90\%$, provided that SBA reserves the right to require an injection by the Obligors;

- c. The subordination will not otherwise adversely affect the priority of the lien securing the SBA loan. For example, intervening junior lienholders, if any, must not be able to claim priority over the lien securing the SBA Loan as a result of the subordination.

Note: When analyzing a request for subordination to facilitate the refinance of a senior loan, a complete financial analysis may not be necessary if the Borrower has been making timely payments and the refinance terms are more favorable for the Borrower.

3. Subordination to Facilitate a New Loan

In addition to the general requirements in Paragraph A.1, the position of a lien securing an SBA loan should not be subordinated to facilitate a new loan unless:

- a. The new loan is necessary to satisfy a legitimate need such as paying for improvements to the collateral that will maintain or increase its value; and
- b. All other avenues of obtaining the funds have been exhausted.

Example—When the Borrower has another 504 Project for an addition to, or renovation of, an existing 504 Project Property, the existing 504 Loan may be subordinated to the combined original Third Party Loan and the interim construction loan during the renovation period to facilitate the new 504 Project.

4. Subordination to Facilitate Assumption of the Loan

The position of the lien securing a 504 Loan must not be subordinated to a loan that provides funds to an assumptor to acquire the business or assets of an Obligor, unless the acquisition loan includes funds that will be used to make improvements to the collateral that will maintain or increase its value, in which case, the lien securing the SBA loan may be subordinated up to the documented amount spent on the improvements.

B. Inter-creditor Agreements

Requests for execution of an inter-creditor agreement, (i.e., an agreement among creditors who made separate loans to the same borrower with commonality of purpose or collateral, which sets forth the various lien positions and the rights and liabilities of each creditor and its impact on the other creditors), should be reviewed, analyzed and implemented pursuant to the requirements of Chapter 6 and the following guidelines:

1. The inter-creditor agreement should not adversely impact the position of the lien securing the SBA loan;
2. The delineated rights and responsibilities with regard to loan servicing responsibilities, and the remedies in the event of default, should be consistent with prudent lending practices; and
3. Entering into the inter-creditor agreement should not adversely impact the ability to recover on the SBA loan.

C. Substitution of Collateral

1. General Requirements

Requests to allow a substitution of collateral should be reviewed, analyzed and implemented pursuant to the requirements of Chapter 6 and the following requirements and guidelines:

- a. The substitution must be needed to support the business operations of the Operating Company;
- b. The collateral offered in substitution should be similar in nature (e.g., real property for real property) or provide a higher level of confidence (e.g., a certificate of deposit for an account receivable), and have a Recoverable Value that is equal to or greater than the Recoverable Value of the existing collateral based on an appraisal obtained pursuant to the appraisal requirements in [SOP 50 10](#);
- c. If the substitute collateral is commercial real property, adequate due diligence must be conducted to ensure that the risks of Contamination are minimal as required by Chapter 5 (*Environmental Risk Management*);
- d. There should be no more than a nominal increase (i.e., 3.5% or less) in the amount of any proposed senior lien;
- e. The Borrower should have a satisfactory credit history;

- f. The Borrower's current financial statement should reflect that the Borrower has the ability to pay all of its obligations that will be outstanding after the substitution;
- g. There should be sufficient equity in the collateral to adequately secure the SBA loan after the proposed substitution;
- h. The release and substitution must not impair the ability to foreclose upon the remainder of the collateral or collect the loan balance from the Obligor; and
- i. The release of the existing lien(s) or proceeds thereof must be done after or concurrent with the recording of the new lien(s) in the required position of priority and done pursuant to an escrow agreement signed by all of the parties involved in the transaction.

2. Substitution of Residence Held as Collateral

Requests to allow an Obligor to substitute a lien on a new residence in exchange for releasing the lien on the Obligor's existing residence should be reviewed, analyzed and implemented pursuant to the general requirements in Paragraph C.1 above and the following additional requirements:

- a. All of the proceeds from the sale of the Obligor's existing residence, other than the funds needed to pay off senior liens and necessary, reasonable and customary closing costs, must be used to purchase the new residence or placed in an escrow account to facilitate the purchase of a new residence, or used to pay down the 504 Loan;
- b. The amount of equity in the new residence available to secure the SBA loan must be the same as or greater than the amount of equity in the existing residence available to secure the SBA loan;
- c. The release of the existing lien, or proceeds thereof, must be done concurrent with (or after) the recording of the new lien in the required position of priority and should be done pursuant to an escrow agreement signed by all of the parties involved in the transaction; and
- d. The Obligor must provide the title, hazard and flood insurance required by Chapter 9.

D. Substitution of Guarantor

Requests to allow substitution of a Guarantor should be reviewed, analyzed and implemented pursuant to the requirements of Chapter 6 and the following guidelines:

- 1. The financial strength of the proposed substitute Guarantor should be equal to or greater than the financial strength of the existing Obligor;
- 2. Neither the release of the existing Guarantor nor the substitution for the proposed Guarantor should adversely impact the operation of the business; and

3. Substitution of the proposed Guarantor may be conditioned on retention of the original Guarantor for a transitional period (e.g., two years) during which time there must be no material adverse change in the financial condition of the business.

E. Release of Lien without Consideration

Requests for the release of liens on real or personal property collateral without consideration before the loan has been paid in full should be reviewed, analyzed and implemented pursuant to Chapter 6 and the following guidelines and requirements:

1. The loan must be Seasoned;
2. If the release is to facilitate the sale of the collateral, the proceeds from the sale should be used for business purposes only;
3. The release must not confer a Preference on the Third Party Lender;
4. The Borrower must have the ability to repay the SBA loan in full in accordance with the terms of the Note;
5. The release should not materially interfere with the operation of the business or decrease the value of the other collateral securing the loan;
6. The Recoverable Value of the remaining collateral should be sufficient to adequately secure the SBA loan after the proposed release;
7. The release document(s) must not impair the CDC or SBA's interest in, or ability to foreclose upon, the remainder of the collateral; and
8. The release must not occur during the pendency of a senior lienholder foreclosure action (Chapter 13) unless the release is in connection with a short sale approved in accordance with Chapter 20.

F. Release of Lien for Consideration

Requests for the release of liens on real or personal property collateral for consideration should be reviewed, analyzed and implemented pursuant to the requirements of Chapter 6 and the following requirements:

1. General Requirements

- a. The amount of consideration received must be approximately equal to or greater than the Recoverable Value of the collateral, (See Chapter 5 [*Environmental Risk Management*] with regard to the due diligence that must be performed if the collateral is alleged to be worth substantially less than its estimated Recoverable Value due to the alleged presence of Contamination.);
- b. Release of the lien must not jeopardize the ability to maximize recovery on the loan; and

- c. The release must not occur during the pendency of a senior lienholder foreclosure action (Chapter 13) unless the release is in connection with a short sale approved in accordance with Chapter 20.

2. Partial Release of Project Collateral

The 504 Debenture cannot be partially prepaid. Therefore, the proceeds from a partial release of Project Property should be applied to:

- a. Reduce the balance of any loan with a senior position lien on the collateral for the 504 Loan; or
- b. Purchase other fixed assets that will be used to support the Operating Company and serve as additional collateral for the 504 Loan.

3. Practice Tips

a. Trade Fixtures

If the collateral includes a lien on trade fixtures located on real property collateral, e.g., gas station canopies and pumps, the real property lien should not be released unless the personal property collateral has already been liquidated or additional consideration is received for release of the lien on the trade fixtures.

b. Public Auctions

If a public auction of machinery and equipment is planned, the lien on the most valuable items should not be released beforehand since it would impair the ability to attract bidders for the remaining collateral.

G. Release of Guarantor or Co-Borrower

A request for release of a Guarantor or a co-Borrower should be reviewed, analyzed and implemented pursuant to Chapter 6 and the following requirements:

1. Loans in Regular Servicing Status

- a. The loan must be Seasoned;
- b. The release must not conflict with the SBA Loan Program Requirements in [13 C.F.R. Part 120](#) and [SOP 50 10](#) that require Guaranties from specific Persons as a condition for SBA's guaranty of the loan, (e.g., any Person who owns 20 per cent or more of the small business Borrower); and
- c. The release must not: jeopardize the ability to maximize recovery on the loan; shift the risk of loss to SBA; or otherwise harm the integrity of the SBA loan program.

2. Loans in Liquidation Status

- a. The release must be conditioned on receipt of consideration in an amount approximately equal to or greater than the amount that could be collected through enforced collection proceedings from the Guarantor or co-Borrower requesting the release;
- b. The Guarantor or co-Borrower requesting the release should be required to provide the same documentation that is required for an offer in compromise; and
- c. The request for release and accompanying documentation should be reviewed, verified and analyzed pursuant to the requirements of Chapter 20 (*Offer in Compromise*).

Note: If the loan is involved in litigation referred to the Department of Justice ("DOJ"), remember that Obligors cannot be released without prior written approval from DOJ and the SBA District Counsel responsible for handling the litigation. (Chapter 6)

H. Sale of Operating Company

A request to permit an Eligible Passive Company to sell the Operating Company to an unaffiliated third party while retaining ownership of the Project Property and not prepaying the 504 Loan must be processed as an exception to policy (Chapter 1) because such a sale would result in a loan that would have been ineligible for SBA financing when the 504 Loan application was received.

I. Release of Condemnation Proceeds

Requests for release of condemnation proceeds should be reviewed, analyzed and implemented pursuant to the requirements of Chapter 6 and the following guidelines:

1. Payment of Attorney Fees and Costs

Reasonable, necessary and customary attorney fees and costs incurred to obtain fair compensation for the condemned property may be paid from the condemnation proceeds.

2. Condemned Property Replaced

When the condemnation proceeds will be used to replace the condemned property, they should only be released pursuant to an escrow agreement approved by legal counsel that conditions release of the funds on:

- a. Receipt of a perfected lien on the substitute collateral in the required lien position;
- b. Compliance with the title, hazard and flood insurance requirements set out in Chapter 9.

3. Condemned Property Not Replaced

When the condemnation proceeds will not be used to replace the condemned property:

a. Condemnation Proceeds \leq \$5,000

If the amount of condemnation proceeds is relatively insignificant, i.e., \$5,000 or less, and the release will not adversely affect the ability to recover on the 504 Loan, they may be released directly to the Borrower.

b. Condemnation Proceeds $>$ \$5,000

If the amount of condemnation proceeds is more than \$5,000, they should be applied to the principal balance of the Third Party Loan if SBA has not purchased the Debenture, and to the principal balance of the 504 Loan if SBA has purchased the Debenture, and up to \$5,000 may be released directly to the Borrower if the release will not adversely affect the ability to recover on the SBA loan.

Chapter 9. Insurance Coverage

A. General Requirements

All decisions regarding insurance, including the justification for the each decision, must be documented in a Loan Action Record and kept in the Loan File.

B. Mortgagee's Title Insurance

1. Substitute Collateral

When existing real property collateral is released and substitute real property collateral taken, a mortgagee's title insurance policy should be obtained to insure the new lien on the substitute property. (See Chapter 8 for information on substitution of collateral.)

2. Additional Collateral

When real property collateral is taken as additional collateral, whether a mortgagee's title insurance policy should be obtained will vary depending on the circumstances including the amount of equity available in the property to secure the SBA loan.

3. Installment Sale of REO

When REO is sold on an installment basis, a mortgagee's title insurance policy must be obtained to ensure the purchase money lien on the REO. (See Chapter 22 for information on term sales of acquired collateral.)

C. Hazard Insurance

1. Modification of Coverage on Existing Collateral

The hazard insurance coverage requirements set out in the Loan Authorization should not be terminated or reduced unless the insured assets have been sold or have substantially depreciated.

2. Coverage on Substitute or Additional Collateral

When existing collateral is released and substitute collateral taken, the CDC must ensure that the substitute collateral is adequately insured and that the insurance policies contain a mortgagee clause, or substantial equivalent, in favor of SBA or the CDC. (See Chapter 8 for information on substitution of collateral.)

3. Care and Preservation of Collateral and Acquired Collateral

CDCs must take prudent action, on a case-by-case basis, to ensure that all collateral and acquired collateral with Recoverable Value is adequately insured in order to protect the ability to recover on the 504 Loan. (See, for example, Chapter 16 with regard to post-default site visits and Chapter 22 with regard to ownership responsibilities pertaining to acquired collateral.)

4. Forced Placement

If hazard insurance is required by the Loan Documents and the Obligor has allowed the coverage to lapse, the decision whether to force-place insurance should be based on prudent lending practices and made on a case-by-case basis. If coverage is continued by the CDC or SBA, the cost should be treated as a Recoverable Expense.

5. Release of Policy Proceeds

a. General Rule—Collateral Repaired or Replaced

When the CDC or SBA is named as a loss payee on a hazard insurance policy, the proceeds should not be released unless the Supporting Documentation submitted with the request verifies that the insured collateral has been properly repaired or replaced and that no construction or repair related liens have been filed against the property, particularly if the insurance check is for \$100,000 or more.

b. Exception—Controlled Distribution

If a request for release of insurance proceeds is not accompanied by Supporting Documentation establishing that the insured collateral was repaired or replaced, instead of endorsing and delivering the insurance check to the Borrower, disbursement of the insurance proceeds should be controlled and monitored.

(1) Use of Escrow Agent

Generally, insurance proceeds, which are required to be used to repair or replace collateral, should be disbursed pursuant to an escrow agreement approved by legal counsel. An escrow company, the first lien holder or an impartial third party such as an attorney, architect or construction loan officer at a financial institution may serve as the escrow agent.

(2) Progress Payments

Rather than use an escrow agent, a CDC may allow the Borrower to open a federally insured joint savings or custodial account with the CDC; establish a draw schedule based on stages of construction; present paid invoices and lien waivers documenting each stage of construction; and request release of the funds specified in the draw schedule; provided that the CDC verifies that the previous stage of construction was completed and the material and labor involved was paid for before authorizing the next draw on the joint account. (The Borrower should be allowed to retain the interest earned on the funds in the savings account.)

D. Life Insurance

1. Modification of Requirement

The life insurance requirements in the Loan Documents should not be modified or terminated unless the reason for requiring the life insurance policy no longer exists.

2. Use of Escrow Account to Collect Premiums

If an assignment of a life insurance policy is required by the Loan Documents, in order to ensure that the Borrower pays the premiums, an escrow account may be set up to collect the funds needed to pay the premiums on the policy. (See [SOP 50 10](#) for SBA Loan Program Requirements concerning life insurance escrow accounts.)

3. Continuation of Coverage

If an assignment of a life insurance policy is required by the Loan Documents and the CDC receives notice that the required payments have not been made, the decision whether or not to continue coverage should be based on prudent lending practices and made on a case-by-case basis. If coverage is continued, the cost should be treated as a Recoverable Expense.

4. Release of Policy Proceeds

a. General Rule

The proceeds from the assignment of a life insurance policy should be applied to the principal balance of the loan without advancing the payment due date.

b. Exceptions

Depending on the circumstances, all or part of the proceeds of a life insurance policy may be released if, in addition to meeting the requirements for release set out in Chapter 8 Paragraph E (*Release of Lien Without Consideration*) or Paragraph F (*Release of Lien for Consideration*), the death of the insured will have no significant impact on the management of the small business Borrower and:

- (1) The proceeds are needed for a valid business purpose;
- (2) The proceeds are needed to prevent Financial Hardship; or
- (3) Based on the strength of the business, there is no reason to anticipate that the loan will not be repaid in full.

c. Use of an Escrow Account

If the estimated strength of the business is not strong enough to justify release or weak enough to justify immediate application to the loan balance, the insurance proceeds may be placed in an escrow account for distribution at a later date after the CDC has had the opportunity to observe the Borrower's on-going operations and is able to make a prudent decision.

E. Flood Insurance

1. General Rule—Termination or Modification Not Permitted

When an SBA loan is secured by improved real estate, a mobile home or other personal property located in a FEMA-designated special flood hazard area ("SFHA") and the community participates in the National Flood Insurance Program ("NFIP"), the Borrower must maintain flood insurance for the life of the loan. (See the [National Flood Insurance Reform Act of 1994](#) for more information.) This requirement pertains to substitute collateral as well as the original collateral for the loan.

2. Events Triggering Flood Insurance Review

The need for flood insurance, as well as the adequacy of any existing flood insurance coverage, should be reviewed whenever the Borrower requests a servicing action.

3. Forced Placement

If at any time during the life of a loan, real or personal property collateral, which is located in a SFHA, is not covered by flood insurance or is covered by an inadequate amount of flood insurance, the Borrower must be instructed to obtain adequate flood insurance. If the Borrower fails to do so within 45 calendar days, flood insurance must be purchased on the Borrower's behalf at the Borrower's expense. (The cost should be treated as a Recoverable Expense.) All Borrower Servicing Requests should be declined until the Borrower is in compliance with the applicable flood insurance requirements. (See the [National Flood Insurance Reform Act of 1994](#) for more information.)

4. Unavailability of Flood Insurance

If a Borrower had the required flood insurance when the loan was made, but the coverage has lapsed because the community dropped out of the NFIP, documentation establishing why the property is no longer covered by flood insurance must be maintained in the Loan File.

Chapter 10. Modification of Management Covenants

A. General Requirements

Borrowers should comply with the management covenants in the Loan Documents unless modification is consistent with the loan servicing goals set out in Chapter 1. Requests for modification should be reviewed, analyzed and implemented pursuant to the requirements of Chapter 6 and the guidelines set out below.

B. Financial Statements

Loan Document provisions requiring Obligors to submit periodic financial statements, should not be modified (e.g., temporarily or permanently waived; changed from audited to compiled or reviewed; or required less frequently), unless a prudent lender would modify them based on the circumstances. For example, it may be prudent to modify the requirement if:

1. The loan is Seasoned or the requirement would cause Financial Hardship for the Borrower;
2. The waiver is temporary and limited to one year at a time; and
3. The right to reinstate the requirement is reserved and exercised in the event of default.

C. Restrictions on Compensation, Dividends, Fixed Assets, etc.

Management covenants in the Loan Documents pertaining to matters such as limitations on compensation, fixed assets, working capital levels, or dividend payments, should not be modified unless a prudent lender would modify them based on the circumstances. For example, modification may be prudent if:

1. The loan is Seasoned;
2. The maturity date of the Note has not been extended, and payments have not been deferred during the 24-month period before the date of the Borrower's request; and
3. Based on an analysis of the Borrower's cash flow for the past three years, the Borrower will have the necessary cash flow to repay all of its debt including the SBA loan after the modification.

D. Standby Agreements

1. General Rule

Except as provided in Subsection 2 below with regard to equity injections, a standby agreement should not be terminated or modified to allow the Borrower to make full or partial payments to the standby creditor unless a prudent lender would modify or terminate the standby agreement based on the circumstances. For example, modification or termination may be prudent if:

- a. The loan is Seasoned;
- b. Based on an analysis of the Borrower's cash flow for the past three years, the Borrower will have the necessary cash flow to repay all of its debt including the SBA loan after modification or termination; and
- c. There is minimal risk that the Borrower will not be able to repay the SBA loan in full and in a timely manner.

2. Standby Agreement Used as Equity Injection

A standby agreement used in connection with an equity injection required by the Loan Authorization must not be terminated or modified unless the proposed termination or modification is permitted by the applicable Loan Program Requirements in [SOP 50 10](#).

Chapter 11. Assumption or Sale of Loan

A. Assumption

Requests to allow another Person to assume an SBA loan, (i.e., take over the Borrower's legal obligations and benefits under the Loan Documents), should be reviewed, analyzed and implemented pursuant to the requirements in Chapter 6. In addition:

1. Unless the assumption is part of a workout or the loan is in liquidation status, the proposed assumptor must meet the applicable eligibility requirements in [SOP 50 10](#);
2. The proposed assumptor should be the primary owner of the business;
3. The proposed assumptor should have business experience and management skills that are equal to or better than the Borrower's;
4. The proposed assumptor must have a satisfactory credit history;
5. The proposed assumptor must have the ability to repay the SBA loan in full;
6. No collateral should be released;
7. No collateral should be subordinated excepted as provided in Chapter 8, Paragraph A with regard to funds that will be used to make improvements to the collateral that will maintain or increase its value;
8. The proposed assumption must not have a negative impact on the Recoverable Value of the collateral;
9. The proposed assumption should not have a negative impact on the operation of the business;
10. The existing collateral should be adequate to secure the loan; if not and whenever possible, additional collateral should be required as a condition for the assumption;
11. Existing Obligors must not be released without SBA's prior written approval;
12. The terms of the assumption must be set out in a written agreement signed by all of the parties to the agreement;
13. The assumption agreement must include a "due on sale or death" clause that prohibits any future assumption of the SBA loan; and
14. The terms of the assumption must not include a real estate contract, i.e., the seller may not retain title to the property until an agreed upon amount is paid.

<p>Note: See the most current version of SOP 50 10 with regard to the fee that CDCs may charge for an assumption.</p>

B. Sale of Loan in Liquidation Status

A 504 Loan in liquidation status may be sold, provided that in addition to the SBA prior approval requirements in Chapter 3, the following requirements are also met:

1. SBA has already purchased the Debenture;
2. The sale is to a Person other than the Borrower; and
3. The sale price bears a reasonable relationship to the amount that could be recovered through enforced collection proceedings.

Chapter 12. Deferments

A. Overview

A deferment is a temporary solution to a temporary problem. When used appropriately, i.e., when a Borrower is experiencing a temporary cash flow problem, a deferment can enable the Borrower to improve its cash flow so that it can resume payments on its SBA loan. When used inappropriately, i.e., when the Borrower's problems are permanent, a deferment can harm the Borrower, CDC and SBA. Especially if, for example, during the deferment period, the collateral loses its value and the Obligor deplete all of their resources, including the money in their retirement accounts and the equity in their homes, in a futile attempt to turnaround a non-viable business.

Note: Free, confidential technical and management counseling is available to small businesses through the nationwide network of [SCORE](#) Chapters and [Small Business Development Centers](#), [Women's Business Centers](#) and [Veterans Business Outreach Centers](#).

B. General Rule

If the Borrower's cash flow problem is temporary, delinquent payments, as well as full or partial future monthly payments, may be deferred (i.e., postponed without classifying the loan in liquidation) for a stated period of time in order to enable the Borrower to get past the temporary setback. ([13 C.F.R § 120.530](#))

C. General Requirements

Prior to granting a deferment, the CDC must obtain, review and analyze the following documents in order to determine whether the Borrower's cash flow problem is temporary, i.e., whether the Borrower will be able to overcome the cause of its cash flow problem, and be able to make not only regular payments, but also catch-up payments at the end of the proposed deferment period.

1. Statement Documenting Temporary Nature of Cash Flow Problem

A written statement from the Borrower outlining the reason(s) for its cash flow problem, as well as the reason(s) why the Borrower believes that it is a short-term, rather than a long-term, problem.

Note: If the 504 Loan is more than 90 calendar days past due and the Borrower's problems appear to be permanent or long-term, the loan must be classified in liquidation, the Debenture purchased, and more appropriate Loan Actions initiated such as liquidation of the collateral, and if appropriate, compromise with the Obligor. (See Chapters 18-24.)

2. Current Financial Information

a. Financial Statement

- (1) A current financial statement, preferably on [SBA Form 770](#) (*Financial Statement of Debtor*), which should be signed under penalty of perjury and must show the Borrower's assets, liabilities, income and expenses;
- (2) The Borrower's last year-end financial statement; and
- (3) If the Borrower has any affiliates, a current consolidated financial statement;

b. Business Federal Income Tax Returns

A complete copy of the Borrower and each affiliate's business federal income tax return that was filed with the IRS for the past two years or a written explanation as to why a copy is not available; and

c. Personal Federal Income Tax Returns

A complete copy of the personal federal income tax returns that each Guarantor filed with the IRS for the past two years or a written explanation as to why a copy is not available.

Note: Obtaining current financial information at this stage is critical. It is not only needed to make a prudent lending decision regarding the appropriateness of a deferment, but provides valuable information that will be difficult to obtain in the event enforced collection becomes necessary.

D. Deferred Amount

Generally, the amount deferred should not exceed six cumulative monthly payments or 20% of the original loan amount, whichever is less. During the deferment period, the CDC should monitor the Borrower's operations (through phone calls, site visits, monthly financial statement review, etc.) so that at the end of the deferment period, the CDC can determine whether an additional deferment is necessary and prudent. Prior to granting an additional deferment, however, the CDC must have a documented strategy that specifies the justification for a deferment of more than six months.

E. Loan Payments During Deferment Period

Although the full amount of each monthly payment may be deferred if justified, partial payments should be required if the Borrower is able to make them. The amount of any partial payment required during the deferment period must be based on the Borrower's ability to pay as documented by the financial analysis required by Paragraph B above.

F. Interest Accrual

Interest continues to accrue during a deferment period. Generally, at the end of the deferment period, when payments resume, the funds will be applied to accrued interest before principal. (See Chapter 4.) Alternatively, interest may be paid during the deferment period; paid in a lump sum at the end of the deferment period; or deferred to the maturity date of the Note.

Note: If the delinquent Borrower is in active military service, consult legal counsel or SBA's [Office of Veterans Business Development](#) for information regarding the [Servicemembers Civil Relief Act](#) and the [Veterans Entrepreneurship and Small Business Development Act](#).

G. Notice to CSA

Unless SBA has purchased the Debenture, the CDC must notify the CSA of any deferment in order to avoid acceleration of the Note and the need to purchase the Debenture.

H. Catch-up Plan

A plan to repay delinquent or deferred payments should be negotiated whenever a deferment is granted.

1. Catch-up Period

Generally, the loan should be "caught up," (i.e., all delinquent and deferred payments paid in full), prior to the maturity date of the loan, and in no case later than ten years from the effective date of the plan.

2. Payment Terms

A catch-up plan must specify the amount and frequency of the catch-up payments, which generally should be remitted along with the regular payments. It may not include a balloon payment at the end of the deferment period, but it may include lump sums due on other specified dates. (For information on the order in which the funds from catch-up plan payments should be applied to amounts due on the loan, see Chapter 4.)

I. CDC Monitoring During Deferment and Catch-up Period

During the deferment and catch-up period, the CDC must obtain from the Borrower, review, and analyze semi-annual financial statements and year-end tax returns. During this period, the CDC should also monitor the Borrower's operations by other means, such as phone calls and site visits, to ensure that the loan is promptly classified in liquidation if it becomes apparent that the Borrower's cash flow problem is permanent, i.e., the business is no longer viable.

Chapter 13. Delinquent Secured Senior Loans

A. General Requirements

Time is of the essence when a secured senior loan becomes delinquent because statute-specific and agreement-specific deadlines must be met, senior lienholders may impose Default Charges and initiate foreclosure actions, and collateral values can rapidly deteriorate. Therefore, whenever notice of default or foreclosure is received from a Third Party Lender or other senior lienholder:

1. Notify the SBA Loan Center

The SBA Loan Center must be promptly notified so that it has sufficient time to collect the information outlined in Paragraph B (below) and make a well-informed decision with regard to how to protect the equity available for the 504 Loan.

2. Enforce the Third Party Lender Agreement

The notice and subordination requirements in the [Third Party Lender Agreement](#) or other lienholder agreement must be enforced to mitigate the risk of loss on the loan.

3. Mitigate the Loss to SBA

a. Do Not Release the Lien Securing the 504 Loan

After receipt of notice of a senior lienholder foreclosure sale, even if a “no bid” position is justified, the lien securing the 504 Loan must not be released prior to the foreclosure sale unless the request is in conjunction with an arms-length short sale that meets all of the applicable requirements in Chapter 20. (Release of lien not only eliminates SBA’s right to redeem the property in the event it sells for less than anticipated, it eliminates SBA’s right to receive consideration for release of its redemption rights. It also eliminates SBA’s right to collect the excess proceeds from the foreclosure sale in the event the collateral sells for more than the amount owed on the senior lien.)

b. Protect the Equity Available for the 504 Loan

Swift, prudent, commercially reasonable action must be taken to prevent elimination of the lien securing the 504 Loan or dissipation of the equity available to secure it.

4. Monitor Senior Lienholder’s Foreclosure Proceedings

Whenever a senior lienholder initiates foreclosure proceedings, the foreclosure proceedings, including the sale, must be closely monitored.

5. Report the Sale

A report describing all of the relevant facts concerning the sale, including those listed below, should be prepared and promptly (e.g., within seven business days after the sale) submitted to the SBA Loan Center along with a Liquidation Plan or an Amended Liquidation Plan (Chapter 14) that addresses how the collateral will be sold if it was acquired (Chapter 22) or how the loss will be mitigated if it wasn't (Subparagraphs d-h below).

- a. Sale date;
- b. Amount the collateral sold for;
- c. Purchaser's name and contact information;
- d. Amount of unsubordinated debt owed to senior lienholder on the sale date;
- e. Estimated market value of the foreclosed-upon collateral.
- f. Amount of surplus sale proceeds available junior lienholders;
- g. Whether SBA has redemption rights, and if so, the last day to exercise them; and
- h. The impact of the foreclosure sale on the lien position of any other common collateral. (See Paragraph J below.)

B. Procedure for Developing Best Strategy to Protect Junior Lien Securing 504 Loan

When it is apparent that an Obligor is in default on a loan secured by a senior lien on the collateral for a 504 Loan, the following steps, when applicable, should be taken to develop a prudent and commercially reasonable strategy for protecting the equity available for application to the 504 Loan.

1. Review the Loan Documents

Review the Loan Authorization and other relevant Loan Documents to determine what priority the lien securing the 504 Loan had at the time the loan was closed. For example:

a. Real Property Collateral

If the senior lien is on real property collateral, review the mortgage, deed of trust or other lien instrument, assignment of rents, title insurance policy, as well as the Third Party Lender Agreement and any other lienholder, inter-creditor, subordination, non-disturbance or attornment agreement.

b. Personal Property Collateral

If the senior lien is on personal property collateral, review the security agreement, landlord lien waiver, UCC financing statements, and UCC searches, as well as the Third Party Lender Agreement and any other lienholder, inter-creditor or subordination agreement.

2. Order a Current Lien Search

Order a current title report or UCC search to verify the priority of the lien(s) securing the 504 Loan. Alternatively, at a minimum, review the existing title insurance policy or UCC search and gather any other information needed to determine whether there could be any additional liens against the property that could have seniority over the lien securing the 504 Loan, such as liens for unpaid property taxes.

3. Verify the amount Owed on All Senior Secured Liens

Ascertain the exact amount the Obligor owes on all loans secured by a senior lien on the collateral and verify that the amount does not include cross-collateralized loans, advances or Default Charges that were subordinated to the SBA loan pursuant to a [subordination agreement](#), inter-creditor agreement or other Loan Document.

4. Order an Appraisal

Order an Appraisal to obtain up-to-date information regarding the value of the collateral.

Note: See the definition of "Appraisal" in Chapter 2, which includes a broker's price opinion, for SBA requirements pertaining to appraisals. Given the inherent conflict of interest, do not rely solely on an appraisal prepared for an Obligor or another lender with a lien on the same collateral, and exercise caution if the Appraisal was prepared by a broker with whom the collateral, if acquired, will be listed for sale.

5. Determine the Recoverable Value of the Collateral

Calculate the Recoverable Value of the collateral encumbered by the senior lien.

6. Estimate Recovery from All Other Sources

Determine the repayment ability of the Obligors (See Chapter 14.) and the Recoverable Value of any additional collateral.

7. Determine whether the Senior Lienholder Provided Required Notice

If the Third Party Lender or another senior lienholder who signed a lienholder agreement has initiated a foreclosure action, determine whether they complied with the applicable notice requirements in the relevant Loan Documents. (For example, the Third Party Lender Agreement requires the Third Party Lender to provide SBA and the CDC with written notice of a default on the Third Party Loan within 30 days of the event of default and at least 60 days prior to foreclosure on common collateral.) If not, take appropriate action to enforce the SBA and CDC's rights if the agreed upon time is needed to protect the equity in the collateral available for the 504 Loan.

8. Judicial Foreclosure—Notify Legal Counsel

If a notice of judicial foreclosure is received, the legal counsel responsible for handling the litigation should be notified immediately.

9. Analyze Facts, Review Options and Plan Strategy

Based on an analysis of the information collected in Steps 1-8 above, decide which Loan Action or combination of Loan Actions is most appropriate under the circumstances. This commonly includes those listed in Paragraphs C - J below. But, there are numerous other ways to protect the equity available for a 504 Loan in a junior lien position including, for example, a workout (Chapter 17), an assumption or negotiated sale of the 504 Loan to another Person such as a junior lienholder (Chapter 11), foreclosure of SBA's liens (Chapters 20 and 21), a voluntary sale of the collateral (Chapters 20 and 21) or litigation (Chapter 24). Generally, unless the circumstances require a shorter response time to mitigate the risk of loss, the strategy must be developed within 30 calendar days of learning of the default on the secured senior loan.

C. Payment Advances to Bring Senior Secured Loan Current

In order to maximize recovery on a 504 Loan, funds may be advanced to keep the payments on a senior secured loan current if the goal is to:

1. Negotiate a workout and enable an otherwise viable small business Borrower to continue operating;
2. Work with the Obligor and other lienholders to complete a negotiated sale of the collateral, (See Chapter 20 [*Real Property Liquidation*] or Chapter 21 [*Personal Property Liquidation*] for information on short sales, and release of lien for consideration.); or
3. Preserve the equity available for application to the 504 Loan and minimize costs by leaving the senior lien in place and foreclosing the junior lien securing the 504 Loan. (See Chapter 20 [*Real Property Liquidation*] or Chapter 21 [*Personal Property Liquidation*] for information on lien foreclosure.)

Note: See Chapter 3 for information on how to order a Treasury check to purchase or pay-off a delinquent senior secured loan or to enter a Protective Bid.

D. Senior Loan Purchase or Pay Off

When gaining control of the liquidation process is necessary to maximize recovery, especially when doing so would allow an otherwise viable Borrower to retain possession of its business premises so that it can continue to operate and repay the SBA loan, funds may be advanced to purchase or pay off a debt secured by a senior lien, particularly if the senior lienholder offers a discount, and:

1. The risk is justified by an Appraisal and Recoverable Value analysis;
2. The purchase or pay off amount is consistent with any agreement signed by the senior lienholder regarding the subordination of advances and Default Charges;
3. The Obligors are given written notice of the proposed purchase or pay off and their increased financial liability on the SBA loan as a result; and

4. If the Borrower is to retain possession of the collateral: (1) the Borrower has the ability to make the payments on the adjusted SBA loan balance; and (2) purchasing or paying off the loan will improve the Borrower's ability to repay the SBA loan.

E. Judicial Foreclosures

If a senior lienholder initiates a judicial foreclosure action, the legal counsel responsible for handling the litigation should be notified immediately and instructed to take whatever legal action is necessary, reasonable and customary under the circumstances. For example, in addition to, or in lieu of, any of the other options listed in this chapter, legal counsel may:

1. File a disclaimer or an answer;
2. Foreclose the lien securing the SBA loan in the same action; or
3. Cross-claim for judgment against the Obligor.

Note: If SBA has taken over servicing, SBA legal counsel is responsible for managing the litigation in coordination with the local U.S. Attorney's Office, which has final decision-making authority with regard to litigation strategy, credit matters and settlements.

F. Protective Bids

1. When to Enter

A Protective Bid should be entered at a senior lienholder's foreclosure sale if the Recoverable Value of the property is 10% or more of its Liquidation Value, unless abandonment is appropriate, (i.e., Recoverable Value of less than \$10,000 for real property and \$5,000 for personal property collateral), or a prudent lender would not enter a Protective Bid based on the circumstances that are not reflected in the Appraisal, but are documented in the Loan File. (For example, if the collateral has an appraised value of \$100,000, a Liquidation Value of \$80,000, and a Recoverable Value of \$50,000 [i.e., Liquidation value minus the balance owed on senior liens, foreclosure costs, and holding and resale costs] a Protective Bid should be entered because \$50,000 is more than \$8,000 [10% of \$80,000].)

2. Protective Bid Amount

a. Maximum Amount

The maximum amount of a Protective Bid should be the lesser of the balance owed on the 504 Loan or the Recoverable Value of the collateral.

b. Tolerance Range

The amount of a Protective Bid should include a "tolerance range," (i.e., a percentage by which the authorized bidder is allowed to increase or decrease the amount of the Protective Bid depending on unanticipated events at the foreclosure sale). Generally, an acceptable tolerance range is 10% below or above the authorized bid amount provided that it does not exceed the maximum bid amount.

c. Impact on Ability to Collect Deficiency

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

G. “No Bid” Position

1. When a “No Bid” Position is Appropriate

A “no bid” position at a senior lienholder’s foreclosure sale is appropriate when there is justification for abandoning the collateral being foreclosed upon, (i.e., Recoverable Value of less than \$10,000 for real property and \$5,000 for personal property collateral), or the Recoverable Value of the collateral is less than 10% of its Liquidation Value. A “no bid” position may also be justified if based on the circumstances, which are not reflected in the Appraisal but are documented in the Loan File, a prudent lender would not enter a Protective Bid even though the Recoverable Value of the collateral is 10% or more of its Liquidation Value.

2. Failure to Conduct an Environmental Investigation

Failure to conduct the Environmental Investigation required by Chapter 5 does not justify taking a “no bid” position when there is equity that should be protected. In emergency situations, prudent judgment must be exercised and the best possible due diligence under the circumstances must be conducted in order to avoid unnecessary loss.

3. “No Bid” Position Does Not Eliminate the Duty to Maximize Recovery

The fact that a “no bid” position may be appropriate does not necessarily mean that the collateral has no Recoverable Value; nor does it justify taking, or failing to take, Loan Actions that are inconsistent with prudent lending practices or the goal of maximizing recovery on the loan.

a. Pre-foreclosure Sale Methods of Protecting Equity in Collateral

When a “no bid” position will be taken, up until the time of the senior lienholder’s foreclosure sale, a good faith effort must be made to recover or protect the equity in the collateral through other methods such as a workout (Chapter 17), negotiated sale of the loan to another Person such as a junior lienholder (Chapter 11), or a voluntary sale of the collateral (Chapter 20 [real property] or Chapter 21 [personal property]).

b. Post-foreclosure Sale Methods of Recovering Equity in Collateral

After a senior lienholder’s foreclosure sale has taken place, all remaining commercially reasonable methods of recovering on the loan must be considered and exercised including those discussed below, i.e., exercise or release of redemption rights, recovery of excess proceeds from the foreclosure sale; and prompt foreclosure of liens on other common collateral (e.g., equipment) that may have moved up into first-position lien priority after the sale proceeds were applied to the unsubordinated amount owed to the senior lienholder.

H. Redemption Rights

Under federal law, SBA (but not a CDC) has one year from the date of a judicial foreclosure sale to redeem, i.e., buy back, the foreclosed-upon property ([28 U.S.C. § 2410\(c\)](#)). Under state law, the redemption rights associated with a 504 Loan generally stem from SBA's status as a junior lienholder (or the CDC's status as a junior lienholder if the Loan Documents have been assigned to the CDC). Whether junior lienholders have redemption rights varies by state. Consult legal counsel for case specific information and advice.

1. When Redemption is Appropriate

The redemption rights on a 504 Loan should be exercised whenever redeeming the property would be prudent and commercially reasonable. For example, redeeming the foreclosed-upon property would be appropriate if it sold for significantly less than market value at the senior lienholder's foreclosure sale and redeeming (i.e., acquiring) the property and reselling it would maximize recovery on the loan.

2. Release for Consideration

If redemption rights are available under federal or state law but it would not be prudent or commercially reasonable to redeem the foreclosed-upon property, the redemption rights associated with the 504 Loan may be released upon receipt of cash in a lump sum equivalent to 50% of the property's Recoverable Value, but only after the senior lienholder's foreclosure sale has been confirmed.

I. Excess Proceeds from Senior Lien Foreclosure Sales

Generally, as a matter of law, surplus funds generated by a foreclosure sale are paid to the junior secured creditors in accordance with the priority of their liens against the property. Therefore, the following requirements apply whenever the property is not acquired via a Protective Bid at a senior lienholder's foreclosure sale:

1. Ascertain Whether There are Surplus Funds Available for Junior Lienholders

Immediately after the sale, ascertain whether there are excess foreclosure sale proceeds available for distribution to junior lienholders. This includes, for example, scrutinizing the amount paid or credited to the Third Party Lender or other senior lienholder; and checking with the trustee (or other Person) who conducted the foreclosure sale to determine whether surplus funds were generated and if so, where they were deposited, e.g., with the clerk of the local county court.

2. Collect Subordinated Funds Improperly Held by the Senior Lienholder

If the amount paid (or credited) to the senior lienholder included funds that SBA is entitled to by virtue of the Third Party Lienholder Agreement (or other subordination, lienholder or inter-creditor agreement) such as Default Charges or advances that were subordinated to the 504 Loan, make demand on the senior lienholder and promptly collect any funds that should have been applied to the 504 Loan but were not due to the senior lienholder's failure to comply with the subordination requirements in the applicable Loan Document.

3. Collect Excess Sale Proceeds Deposited with the Clerk of the Court

Promptly claim and collect any surplus funds deposited with the clerk of the court (or other Person) that are available for application to the 504 Loan balance by virtue of the position of the lien securing the 504 Loan.

J. Impact of Senior Lien Foreclosure on Other 504 Loan Collateral

After a senior lienholder foreclosure sale, the lien position on other common collateral securing the 504 Loan (e.g., equipment) must be promptly checked to determine whether it has improved as a result of the sale. If so, the collateral must be promptly liquidated in accordance with the requirements in Chapter 20 (*Real Property Liquidation*) and Chapter 21 (*Personal Property Liquidation*). For example, if the proceeds from a Third Party Lender's real property lien foreclosure sale were sufficient to pay the Third Party Lender's loan in full, the Third Party Lender will be required to release its lien on other common collateral such as equipment. As a result, if the lien securing the 504 Loan was in second position on the equipment, it will move up to first position and must be foreclosed as soon as possible to avoid loss or dissipation in value.

Chapter 14. Classifying Loans in Liquidation

A good faith effort should be made to help delinquent Borrowers bring their loans current. But, when a payment default cannot be cured, the Note should be accelerated, demand made on the Obligors, the loan classified in liquidation, the Debenture purchased, and a Liquidation Plan prepared and implemented without delay.

A. When Loans Must be Classified in Liquidation

A 504 Loan must be classified in liquidation when the Note is accelerated.

Note: Acceleration is declaring the full amount of a debt due and payable in the event that the debtor defaults on the terms of an installment payment agreement. Acceleration is permitted in accordance with an acceleration clause included in the payment agreement. For specific on a CDC's right to accelerate, see the Note used to document the 504 Loan ([SBA Form 1505](#)).

B. When the Note Must Be Accelerated

The Note must be accelerated whenever there has been an event of default and it is clear to a prudent lender that the Obligor(s) cannot, or will not, keep the loan current through regularly scheduled payments. (E.g., if the Borrower is more than three months past due on a payment and there is no SBA approved deferment or catch-up plan in place, or the Borrower closes the business and delivers the keys to the CDC, the Note must be accelerated, the loan must be classified in liquidation, and the CDC must promptly request that SBA purchase the Debenture.) ([13 C.F.R. §120.970\(f\)](#) and Paragraph C below.)

C. Debenture Purchase

When a 504 Loan is classified in liquidation, the CDC must immediately request that SBA purchase the Debenture. (See Chapter 15 for more information.)

D. Demand Letters

Note: In the event of a default on a 504 Loan, the Note ([SBA Form 1505](#)) gives the holder the right to accelerate the Note and liquidate the loan "without notice or demand." In practice, however, the collateral documents, (e.g., deed of trust), or applicable state law generally require the creditor to make a formal demand for payment. If litigation is necessary, most courts expect to see a demand letter as part of the evidence offered by the creditor to prove its case.

Unless prohibited by applicable law (e.g., the automatic stay in bankruptcy), when the Note is accelerated:

1. Demand should be made on all of the Obligors for payment of the entire loan balance;
2. Demand letter(s) should be sent via regular mail as well as certified mail or some other method that enables the sender to confirm delivery; and

3. Reasonable efforts should be made to contact any Obligor who fails to respond, either by telephone or email, to determine their intentions with regard to repaying the loan.

E. Skip Tracing

When a loan is classified in liquidation, a good faith effort must be made to locate and collect the loan balance from all of the Obligors including those who are missing or difficult to locate.

F. Obligors in Active Military Service

The military service status of an Obligor must be determined before taking liquidation action that could adversely impact the Obligor; and if an Obligor is in active military service, any action taken must be in compliance with the [Servicemember's Civil Relief Act](#) ("SCRA"), (Appendix to 50 U.S.C. §§ 501-596).

Note: SCRA provides servicemembers relief from certain obligations and temporarily suspends judicial and administrative proceedings and transactions involving civil liabilities when military service affects the servicemember's ability to meet or attend to civil matters. The protections are not automatic. Generally, servicemembers must request them and show that their military service has materially impaired their ability to meet their obligations. Creditors may, however, seek relief in court by proving otherwise. For detailed information, consult legal counsel or SBA's [Office of Veterans Business Development](#), but, simply stated SCRA:

1. Places limitations on foreclosures and interest rates;
2. Requires creditors to forgive interest in excess of 6 percent on certain pre-service debts;
3. Protects servicemembers from default judgments if they fail to appear at trial or respond to a lawsuit because of their military service (50 USC App. § 521);
4. Authorizes the court to stay lien foreclosure actions or adjust the servicemember's obligation to preserve the interests of all parties (50 USC App. § 533);
5. Makes a servicemember's personal assets that were not pledged as collateral unavailable to satisfy a business obligation (50 USC App. § 596);
6. Prohibits creditors from pursuing adverse actions (e. g., notifying credit reporting agencies, denying credit, changing terms) against servicemembers solely because they exercise their rights under SCRA (50 USC App. § 518); and
7. Imposes criminal sanctions on creditors who violate certain provisions of the statute including those pertaining to mortgage foreclosures.

G. Liquidation Plans

A well drafted Liquidation Plan can help ensure the highest possible recovery on a loan in the shortest amount of time.

1. When Required

a. Deadline

All CDCs, including ACLs and PCLP CDCs, should prepare a Liquidation Plan within 30 calendar days of Debenture purchase regardless of whether the CDC or SBA Loan Center is primarily responsible for handling the liquidation.

b. Workout Negotiations—Not an Exception

Generally, during the first few weeks following liquidation classification and Debenture purchase, a workout (Chapter 17) should be negotiated whenever feasible. However, during this same time period, the information and reports needed to liquidate the collateral (Chapters 20 and 21) and enforce collection from the Obligors (Chapters 18, 19 and 24), such as Appraisals, title reports, UCC searches, Environmental Reports, asset searches, credit reports, etc., should be obtained so that in the event an acceptable workout plan cannot be implemented, lien foreclosure and other enforced collection activities can commence without further delay or loss.

2. Format and Content

A Liquidation Plan for a 504 Loan should have a copy of the demand letter attached to it, and should be prepared in accordance with the [template](#) accessible from www.sba.gov/for-lenders. As set out in the template, the following factors should be considered and discussed in a Liquidation Plan:

a. Site Visit Findings

For information on site visits, see Chapter 16. (Non-PCLP CDCs must attach a copy of their Site Visit Report to the Liquidation Plan.)

b. Feasibility of a Workout

For information on workouts, see Chapter 17.

c. Recoverable Value of the Collateral

For information on how to determine the Recoverable Value of collateral, see the definition of Recoverable Value in Chapter 2.

d. Available Methods of Liquidation

For information on collateral liquidation, see Chapter 20 with regard to real property collateral and Chapter 21 with regard to personal property collateral.

e. Routine Litigation

All contemplated Routine Litigation should be included in the Liquidation Plan. For information on litigation, see Chapter 24.

f. Status of Senior Liens

For information on Third Party Loans or other senior liens, see Chapter 13.

g. CDC's Non-SBA Loans to Obligor

All CDCs must disclose whether they have any non-SBA loans to the same Obligor(s), and if so, indicate how the liquidation and litigation expenses and recoveries will be allocated. For information on allocation and approval of expenses and recoveries, see Chapter 25.

h. Obligor's Repayment Ability

Rather than wait until after the primary collateral has been liquidated, when it is apparent that the recovery from the primary collateral will be insufficient to pay the loan in full, fair but aggressive action, including filing suit to obtain a judgment, should immediately be initiated against any Obligor with the ability to pay the loan in whole or in part. Generally, to assess the Obligor's repayment ability, an asset search should be conducted on each Obligor and reviewed along with each Obligor's financial statements, tax returns, credit reports and other relevant financial documents in order to analyze the following factors with regard to each Obligor:

- (1) Recoverable Value of any collateral pledged by the Obligor;
- (2) Exemptions available to the Obligor under state and federal law;
- (3) Amount that could be recovered from the Obligor's non-exempt assets that were not pledged as collateral through enforced collection proceedings, i.e., execution on a judgment;
- (4) Amount of present and potential income that could be obtained through enforced collection proceedings, e.g., administrative wage garnishment;
- (5) Litigative risk, i.e., a real doubt concerning the ability to prevail in court because of legal issues or factual disputes;
- (6) The necessary, reasonable and customary administrative and litigation expenses that would be incurred through enforced collection;
- (7) The time it would take to enforce collection; and
- (8) The likelihood that the Obligor's assets have been or will be concealed or fraudulently transferred.

Note: It is not necessary to allocate the amount of the debt among the Obligors in proportion to any agreement among the Obligors (e.g., a partnership agreement) or court order in a case to which SBA is not a party (e.g., a divorce decree). Also, when using a credit report and other supplementary data sources to determine an Obligor's ability to pay or to decide whether to pursue enforced collection, the supplemental information should be reviewed in terms of the following questions:

- Does the Obligor have other delinquent accounts? (Are other creditors being paid first? Can those payments be restructured to free-up funds for application to the 504 Loan?)
- Does the Obligor own any assets that are available to repay the debt, such as equity in real property, a second car, or a boat? (Can the Obligor sell or get a loan against them to pay the 504 Loan in whole or in part?)
- Is the Obligor employed? If so, by whom? (Can the Obligor's wages be garnished?)
- Are there any current accounts that may soon be paid in full? (Will funds be freed-up for application to the 504 Loan?)
- Does the Obligor have too much debt? (Is bankruptcy likely? Does the Obligor have hidden income?)
- Has the Obligor filed bankruptcy?

3. When a Liquidation Plan Must be Submitted to SBA for Approval

a. General Rule

(1) Liquidation Plan

Except as provided below with regard to emergencies, CDCs, including ACLs must submit a proposed [Liquidation Plan](#) to the appropriate SBA Loan Center for each 504 Loan that was not made under its PCLP authority ([13 C.F.R. § 120.540](#)) within 30 business days of SBA's purchase of the Debenture. A copy of the CDC's Site Visit Report must be attached to the proposed Liquidation Plan.

(2) Amended Liquidation Plan

Except as provided below with regard to emergencies, CDCs, including ACLs, should prepare and submit an amended [Liquidation Plan](#) before taking any action or incurring any expense that materially deviates from its original Liquidation Plan.

b. Exception—Emergency Situations

A CDC may respond to an emergency (e.g., loss or dissipation of collateral), without SBA's written approval of a Liquidation Plan or Amended Liquidation Plan, provided that it:

- (1) Makes a good faith effort to obtain SBA's written approval before undertaking the emergency action;
- (2) Submits a written Liquidation Plan or Amended Liquidation Plan to the SBA Loan Center as soon after the emergency as possible; and
- (3) Takes no further liquidation action without SBA's written approval of the Liquidation Plan or Amended Liquidation Plan. ([13 C.F.R. § 120.540\(f\)](#))

c. SBA Response Time

SBA should respond to a CDC's request for approval of a Liquidation Plan within 15 business days from the date of receipt of the proposed Liquidation Plan. However, if SBA fails to respond in 15 days, the request cannot be deemed approved. ([13 C.F.R. § 120.541\(b\)](#))

H. Assignment of Loan Documents

To commence litigation or to take certain liquidation activities e.g., non-judicial lien foreclosure, the Person taking the action must be the holder of the Note and relevant lien instruments. Therefore, if a CDC's proposed Liquidation Plan includes activities that require the CDC to be the holder of the Note and other Loan Documents, the CDC must include a written request for assignment of all the relevant Loan Documents—not just the Note—with its proposed Liquidation Plan. The assignment should expressly state that any assignment is limited and solely for the purpose of carrying out the Liquidation Plan. The request should include:

1. A list of the specific Loan Documents that should be reassigned.
2. If the liquidation strategy includes Routine Litigation:
 - a. The name, phone number and qualifications of the attorney selected by the CDC to conduct the litigation;
 - b. Whether there is a risk of adverse precedent; and
 - c. The estimated legal fees and costs.
3. If the liquidation strategy includes Non-Routine Litigation, a Litigation Plan pursuant to the requirements of Chapter 24.

I. Payments and Recoveries on Loans in Liquidation Status

See Chapter 4 for information on how to apply payments on loans in liquidation, and Chapter 22 for information on how to apply recoveries.

J. When Loans Should Be Removed from Liquidation Status

Regardless of whether or not the Debenture has been purchased:

1. Returned to Regular Servicing

504 Loans should be removed from liquidation status and returned to regular servicing when regular payments are resumed pursuant to an approved written workout agreement, bankruptcy plan, reaffirmation agreement, assumption, or other written agreement that provides for resumption of regular payments.

2. Paid in Full

SBA loans should be removed from liquidation status and classified as “paid in full” when the debt owed on the SBA loan has been satisfied. (Purchase of the Debenture by SBA should not be confused with payment of the loan by an Obligor or through liquidation recoveries.)

3. Charged-off

SBA loans should be removed from liquidation status and classified as “charged-off” when the remaining loan balance has been charged-off in accordance with the Loan Program Requirements set out in Chapter 28.

Chapter 15. Debenture Purchase

A. When CDC Must Request Debenture Purchase

A CDC must promptly request that SBA purchase the Debenture when a 504 Loan is classified in liquidation. The request must be sent to the appropriate SBA Loan Center and must include the reason for the Debenture purchase request and an explanation as to why a deferment or a catch-up plan is not feasible.

B. Impact of Debenture Purchase on 504 Loan

Purchase of the Debenture results in several changes with regard to the 504 Loan including the following:

1. Limited CSA Services

Post-Debenture purchase, the CSA no longer collects the Borrower's loan payments or makes payments on the Debenture. It does, however, still provide CDCs with post-Debenture purchase accounting services on the loan, which can be accessed through the CSA's Web site.

2. Existing Fees Eliminated

All Debenture-related fees are eliminated, including CSA fees and CDC servicing fees.

3. New CDC Servicing Fee May be Imposed by Workout Agreement

If the loan was approved on or after October 1, 2009, and the other requirements in Chapter 4 are met, the CDC may require that the Borrower pay the CDC a servicing fee as part of the terms of a workout agreement.

4. Prepayment Premium Eliminated

The prepayment penalty is eliminated unless the loan was made under the 503 loan program, in which case the prepayment penalty is added to the principal balance of the loan.

5. Loan Modification Possible

Post-Debenture purchase, the terms and conditions of the 504 Loan may be substantially modified if necessary to maximize recovery on the loan. (See, for example, Chapter 17 on Workouts.)

6. Remittance of Payments and Recoveries to SBA

Because the CSA is no longer involved after SBA has purchased the Debenture, all loan payments and liquidation recoveries must be remitted to SBA. (See Paragraph B of Chapter 4 for information on loan payment administration.)

7. New Loan Number Assigned

A new SBA Loan number is assigned to the 504 Loan and must be used when requesting information or approval of proposed Loan Actions.

Note: With regard to the new loan number assigned to a 504 loan after Debenture purchase, generally, the first seven digits of the original loan number remain the same, the eighth digit changes to a "5" and the last two digits change in sequential order (up to 10), i.e., "05" becomes "06" and "10" becomes "00."

C. Referral to Treasury Offset Program

After Debenture purchase, if the 504 Loan is delinquent, SBA will refer all of the Obligors for inclusion in the [Treasury Offset Program](#) unless they have a valid legal defense for not repaying the loan, such as discharge in bankruptcy, compromise, or the statute of limitations.

Note: Under the [Treasury Offset Program](#), delinquent debt is collected through administrative offset of funds due to Obligors from federal and state sources such as tax refunds, wages, retirement checks and contractor payments. Prior to referring a loan to Treasury, SBA sends an automated letter to the Obligors giving them 60 calendar days to either pay the loan in full or negotiate an acceptable payment plan.

Chapter 16. Site Visits

This chapter provides SBA policy and procedures concerning post-default site visits. With regard to loans in regular servicing status, a site visit should be made whenever warranted by prudent lending practices. All site visits should be documented by a Site Visit Report, which should be kept in the Loan File. (See Chapter 3 for site visit reporting requirements.)

A. When Required

Unless the loan is unsecured, or the aggregate Recoverable Value of the personal property collateral is less than \$5,000 and the Recoverable Value of each parcel of real property collateral is less than \$10,000, a site visit must be conducted:

1. Payment Default—within 60 calendar days of an uncured payment default or sooner if the collateral could be removed, lost or dissipated.
2. Non-payment Default—within 15 calendar days of the occurrence of an adverse event that caused the loan to be classified in liquidation status or sooner if the collateral could be removed, lost or dissipated.

B. Preparation

Prior to conducting a site visit, the steps listed below should be taken when they are applicable and necessary to obtain sufficient information to make prudent lending decisions.

1. Review the Loan Documents

Determine what collateral was required, what collateral was actually taken, and what priority position the liens had when the loan was closed by reviewing the Loan Authorization and other relevant Loan Documents, including for example:

- a. Personal Property Collateral—The security agreement, landlord lien waiver, UCC financing statements, and UCC searches, as well as any senior lienholder, subordination or inter-creditor agreement; and
- b. Real Property Collateral—The mortgage or deed of trust, assignment of rents, and title insurance policy, as well as any senior lienholder, subordination, inter-creditor or non-disturbance agreement.

2. Obtain a Current Lien Search

Obtain a current title report or UCC search to verify the priority of the lien(s) securing the SBA loan.

3. Contact the Landlord

If the collateral is located on leased premises, contact the landlord to determine whether the rent is past due.

4. Contact Local Taxing Authorities

Contact local taxing authorities to determine whether there are delinquent real or personal property taxes that have, or will soon have, priority over the lien securing the SBA loan.

5. Order an Appraisal

a. Personal Property

If the loan is secured and the collateral includes personal property such as machinery, equipment, furniture, fixtures or inventory, hire an auctioneer or other expert to prepare a Liquidation Value Appraisal and to assist with the relevant site visit goals listed below. If the collateral includes unusual personal property that an auctioneer would not ordinarily have the expertise to appraise, e.g., intellectual property, order an Appraisal from an expert with the appropriate qualifications.

Note: To expedite the liquidation process, it is often advantageous to have an auctioneer accompany you on your site visit so that preparations can be made to hold a UCC sale as soon as it is commercially reasonable to do so.

b. Real Property

If the loan is secured and the collateral includes real property, hire a qualified expert to prepare an Appraisal.

Note: See the definition of "Appraisal" in Chapter 2 for SBA requirements pertaining to appraisals. Given the inherent conflict of interest, do not rely solely on an appraisal prepared for an Obligor or another lender with a lien on the same collateral, and exercise caution if the Appraisal was prepared by a broker with whom the collateral, if acquired, will be listed for sale.

C. Goals

During a post-default site visit, a good faith effort should be made to gather sufficient information to accomplish the applicable goals listed below.

1. Inspect and Inventory the Collateral

Prepare a comprehensive written inventory that includes a complete and accurate description of the collateral, including its current condition, photographs, and the serial numbers of significant items of personal property, i.e., items with a Liquidation Value of \$5,000 or more.

2. Establish the Recoverable Value of the Collateral

Determine the amount of expenses that must be taken into consideration to accurately calculate the Recoverable Value of the collateral, such as the cost of any necessary care and preservation measures.

3. Ascertain Whether Real Property Collateral is Occupied

If the collateral consists of real property, find out whether there are occupants who are entitled to notice, who will need to be evicted, or who are paying rent that can be collected and applied to the SBA loan balance.

4. Assess Environmental Risk

Review the Environmental Investigation Report prepared at the time the loan was made, look for potential environmental problems while inspecting the Borrower's business premises, and follow the requirements concerning Environmental Investigations set out in Chapter 5.

5. Develop a Liquidation Strategy

Begin developing a strategy for liquidating the loan. For example, if there is personal property collateral that must be liquidated, determine whether the Borrower and landlord will cooperate so that it can be sold via a public auction held on the Borrower's business premises. (See Chapter 21 for information on public UCC sales.)

6. Ascertain Whether a Workout is Feasible

If Obligors who have not filed for bankruptcy protection are present and cooperative, obtain a copy of the financial records needed to determine whether a workout is feasible. (See Chapter 17 for information on workouts including how to ascertain whether the Borrower is a good candidate for a successful workout.)

7. Repossess the Personal Property Collateral

Unless a workout or a judicial foreclosure action is contemplated, make arrangements to repossess the collateral using self-help methods pursuant to UCC Article 9 if it can be done without a "breach of the peace. If the collateral cannot be repossessed without a "breach of the peace;" consult legal counsel about filing a replevin action to obtain a court order requiring the Obligor to turn-over the collateral.

8. Arrange for Care and Preservation of the Collateral

After acquiring possession or control of the collateral, take prudent and commercially reasonable measures to care for and preserve it until it can be liquidated. For example:

a. Security and Safekeeping

Make arrangements to keep the collateral safe and secure until it can be liquidated. For example, depending on the circumstances, it may be necessary to have the locks changed, hire a caretaker, pay utility bills, or transport personal property collateral to a secure, temperature-controlled storage facility.

b. Insurance

Purchase or maintain appropriate insurance coverage, such as hazard or general public liability insurance pursuant to the requirements in Chapter 9 (*Insurance Coverage*).

c. General Maintenance

Arrange for cost-effective repairs, clean-up, etc., to ensure that the foreclosure sale is commercially reasonable and the collateral sells for the highest possible price.

Chapter 17. Workouts

A. Overview

The term “workout” refers to the debt collection and negotiation process as well as the final plan agreed upon by a creditor and a debtor with regard to how the debtor’s delinquent obligation to the creditor can be “worked out” (i.e., resolved). Generally, a workout agreement restructures the material terms and conditions of the debtor’s delinquent loan in order to: avoid the need for actions such as foreclosure or bankruptcy; enable the debtor to cure defaults and improve repayment ability; and to enable the creditor to maximize recovery on the loan. Because a workout agreement alters the material terms and conditions of the loan, SBA must have purchased the Debenture before a formal workout agreement can be executed. Whenever feasible, a good faith effort must be made to negotiate a workout on a 504 Loan classified in liquidation status.

Note: Free, confidential technical and management counseling is available to small businesses through the nationwide network of [SCORE Chapters](#), [Small Business Development Centers](#), [Women’s Business Centers](#) and [Veterans Business Outreach Centers](#).

B. Required Financial Information

Current financial information is essential in order to make prudent lending decisions regarding the feasibility and structure of a workout agreement. If the Obligors are not willing to provide the following information, workout negotiations should not be pursued.

1. Financial Statement

- a. A current financial statement that should be signed under penalty of perjury and must show the Borrower’s assets, liabilities, income and expenses, e.g., [SBA Form 770](#) (*Financial Statement of Debtor*);
- a. The Borrower’s last year-end financial statement; and
- b. If the Borrower has any affiliates, a current consolidated financial statement;

2. Business Federal Income Tax Returns

A complete copy of the Borrower and each affiliate’s business federal income tax return that was filed with the IRS for the past two years or a written explanation as to why a copy is not available; and

3. Personal Federal Income Tax Returns

A complete copy of the personal federal income tax returns that each Guarantor filed with the IRS for the past two years or a written explanation as to why a copy is not available.

Note: Obtaining current financial statements at this stage is critical. Not only are they needed to make prudent lending decisions regarding the feasibility and structure of a workout agreement, but they also provide valuable information that would be difficult to obtain in the event the workout is unsuccessful and enforced collection becomes necessary.

C. Feasibility Test

To determine whether a Borrower is a good candidate for the workout process, in addition to reviewing the existing Loan Documents, review the financial information required by Paragraph B above, conduct a site visit if feasible, and ascertain whether the Borrower is: (1) competent, i.e., has the necessary technical and management skills to turn the business around; (2) cooperative, i.e., willing to take the necessary action to address the problems that caused the default; (3) acting in good faith, and (4) financially and operationally viable.

D. Timing

If a workout is feasible, negotiations should begin immediately and a final workout plan should be put into effect as soon as possible. If an acceptable workout plan is not in place within a reasonable time, (e.g., 60 calendar days), the next step towards enforced debt collection should be taken.

E. Requirement—New Consideration from Borrower

In order for a workout agreement to be legally binding, the debtor must provide consideration, (i.e., something of value) before or at the same time that the debtor receives the benefit of the workout agreement. For example, in exchange for an agreement to forbear or restructure the loan, the Obligors should generally be required to:

1. Correct Loan Document errors;
2. Waive defenses;
3. Release lender liability claims;
4. Provide additional collateral; and
5. Consent to a speedy and inexpensive method of liquidating the loan if the workout fails. This could include, for example, placing a deed or bill of sale to the collateral in escrow, signing a confession of judgment, or agreeing to waive the automatic stay and to turn-over the collateral if the Obligor subsequently files bankruptcy.

F. Options

The elements of a plan to work out the problems on an SBA loan will vary depending on the circumstances. The final decision, and justification for it, must be documented in the Loan File. The decision should be supported by a credit memo that includes a cash flow and complete liquidation analysis based on the Obligors' current personal and business financial statements required by Paragraph B. The most common workout options are listed below.

1. Forbearance

Enforced collection activities may be postponed for a stated period of time in order to provide the Borrower with an opportunity to improve its cash flow and avoid foreclosure.

2. Reinstatement of Maturity Date

If the Note has been accelerated, the maturity date may be reinstated. (See Chapter 7 for information on maturity date extensions.)

3. Deferment

Delinquent and future payments of principal, interest or both may be deferred for a stated period of time to enable the Borrower to overcome a temporary cash flow problem. (See Chapter 12 for information on deferments.)

4. Modification of Repayment Terms of Note

The repayment terms of the Note may be modified, (e.g., the payment amount or interest rate may be lowered or the maturity date may be extended). See Chapter 7 for information on Note modification.

5. Assumption of Loan

Another Person may assume the loan. (See Chapter 11 for information on assumptions.)

6. Subordination to Working Capital Loan

The priority position of a lien securing the loan may be subordinated to a short-term working capital loan. (See Chapter 8 for information on subordination to a new loan.)

7. Relief on Secured Senior Loan

A loan secured by a senior lien on the collateral securing the SBA loan may be kept current, purchased or paid off. (See Chapter 13 for information on senior liens.)

8. Voluntary Sale of Collateral

The Borrower may be allowed to voluntarily sell all or part of the collateral provided that sale is closely monitored to ensure that it is commercially reasonable and that all of the net proceeds are applied to the principal balance of the SBA loan or used to facilitate the workout. (For SBA Loan Program Requirements pertaining to voluntary sale of collateral, see Chapter 20 with regard to real property collateral and Chapter 21 with regard to personal property collateral.)

<p>Note: The amount of accrued interest or principal owed on an SBA loan may only be reduced through the offer in compromise process. (See Chapter 23 for information on offers in compromise from going concerns.)</p>

G. Agreement Provisions

A workout agreement should be in writing and should include:

1. A list of events of default to date;
2. The consideration for entering into the agreement;
3. Confirmation of the collateral for the SBA loan, which should include the priority of each lien;
4. An acknowledgement that neither SBA nor the CDC is waiving any default, right or remedy by entering into the workout agreement;
5. The forbearance period;
6. The agreed upon workout option(s) such as those listed in Paragraph F;
7. The order in which the funds from payments made under the workout agreement will be applied to the amounts owed on the loan;
8. The events that constitute a default under the workout agreement including the dates by which obligations under the workout agreement must be performed;
9. The consequences of default under the workout agreement, e.g., re-acceleration of the Note and delivery or recording of any deed, bill of sale, or confession of judgment placed in escrow;
10. The amount of the reinstated CDC servicing fee, if any, after the loan is returned to regular servicing status; and
11. The signatures of the CDC and all Obligors on the loan.

H. SBA Approval

1. Non-PCLP CDCs must obtain SBA's prior written approval before entering into a workout agreement.
2. PCLP CDCs must obtain SBA's prior written approval of a workout plan if it includes a compromise of the principal loan balance or some other Loan Action that requires SBA's prior written approval. (See Chapter 3 for information on Loan Actions that require prior SBA approval.)

Chapter 18. Administrative Wage Garnishment

This chapter provides information regarding the collection of 504 Loans in liquidation status through garnishment of the wages earned by a non-Federal Government employee Obligor. (See Chapter 19 for information on offsetting the wages of a Federal Government employee Obligor.)

A. Legal Authority

Wage garnishment is a process whereby an employer withholds money from an employee's wages and pays it to the employee's creditor. Generally, this is done pursuant to a court order. However, as an agency of the Federal Government, SBA (not a CDC) can garnish the wages of an Obligor on a 504 Loan classified in liquidation to satisfy the loan without a court order. This process, known as administrative wage garnishment ("AWG"), is authorized by the [Debt Collection Improvement Act of 1996 \(DCIA\)](#), 31 U.S.C. § 3720D. The U.S. Treasury regulations implementing AWG are located in [31 C.F.R. § 285.11](#). SBA's regulations regarding AWG are contained in [13 C.F.R. §140.11](#), and the [forms](#) required to implement AWG are located on the U.S. Treasury Department's Web site.

B. When to Initiate

Generally, unless filing suit to obtain a judgment against the Obligor is a more appropriate method of maximizing recovery on the loan, AWG proceedings should be initiated as soon as it becomes apparent that a gainfully employed Obligor on a 504 Loan classified in liquidation status is not willing to make a good faith effort to repay the loan.

Note: SBA may, unilaterally or at the request of a CDC, initiate AWG while the CDC (including an ACL or PCLP CDC) is conducting other liquidation activities.

C. Requirements

AWG may be used separately or together with other methods of debt collection and does not preclude compromise. Implementation of AWG is appropriate when all of the following requirements have been met:

1. The Obligor is an individual as opposed to an entity;
2. The Obligor is not a federal employee, (See Chapter 19 for information on federal salary offset.);
3. The Obligor's liability for the loan balance is unlimited or limited to a specified dollar amount;
4. The debt owed on the loan is legally enforceable;
5. The Obligor has not been involuntarily unemployed within the last twelve months; and
6. The Obligor has failed to pay or make satisfactory arrangements to pay the 504 Loan.

D. Garnishment Amount

Generally, the amount that may be garnished is the lesser of the following:

1. Up to 15% of the Obligor's disposable pay; or
2. The amount by which an Obligor's disposable pay exceeds an amount equivalent to thirty times the minimum wage. (See 31 U.S.C. 3720D and 31 C.F.R. § 285.11(i) for more information.)

E. Employee's Rights

The rights of the Obligor with regard to AWG proceedings are set out in [13 C.F.R. §140.11](#). In general, the Obligor has the right to submit a written request to the SBA Loan Center for the relief outlined below.

1. Pre-Garnishment Order

As set out in the pre-garnishment notice that the Obligor-employee will receive, prior to the time a garnishment order is issued, the Obligor-employee has the right to:

- a. Ask to inspect and copy SBA's non-privileged records regarding the debt;
- b. Request a written statement breaking down the amount of the debt;
- c. Request that SBA enter into a written payment agreement to avoid garnishment; and
- d. Request a hearing regarding the existence or amount of the debt, or the proposed repayment schedule including whether it would cause Financial Hardship.

2. Post-Garnishment Order

Once a garnishment order has been issued, the Obligor has the right to request a review of the amount being withheld based on a "material change in circumstances" resulting in Financial Hardship.

3. Post-Financial Hardship Ruling

Once the hearing officer has issued a ruling with regard to Financial Hardship, the Obligor may request a subsequent review of the amount being withheld if the Obligor believes that there has been a "material change in circumstances" since the ruling was issued.

F. Modification Based on Financial Hardship

1. Standard of Review

Generally, a garnishment order may be modified based on a finding of Financial Hardship due to a "material change in circumstances" since the garnishment proceedings were initiated such as a catastrophic illness.

2. Burden of Proof

The Obligor has the initial burden of proving by a preponderance of the evidence that a garnishment order is causing Financial Hardship due to a “material change in circumstances.”

G. Suspension or Termination

1. When Suspension is Required

- a. AWG proceedings should be suspended when doing so is consistent with prudent lending practices, e.g., if the Obligor has entered into a repayment plan with SBA.
- b. AWG proceedings must be suspended upon receipt of notice that the Obligor has filed a petition in bankruptcy.

2. When Termination is Required

AWG proceedings must be terminated if:

- a. The loan has been paid in full;
- b. The debt has been discharged in bankruptcy;
- c. The Obligor has paid an SBA approved compromise amount in full; or
- d. The Obligor is no longer with the employer directed to withhold the Obligor's wages and pay them to SBA pursuant to the garnishment order.

Chapter 19. Federal Salary Offset

This chapter provides information on collecting 504 Loans in liquidation status through garnishment of the wages or other payments earned by a current or former Federal Government employee Obligor. (See Chapter 18 for information on how to garnish the wages of a non-Federal Government employee Obligor.)

A. Legal Authority

If an Obligor on a 504 Loan classified in liquidation status is a current or former federal employee entitled to payments from the Federal Government, SBA (not a CDC) can initiate proceedings to deduct payments owed on the 504 Loan from the Obligor's paycheck. This procedure is known as "salary offset" and is authorized by [5 U.S.C. § 5514](#). SBA's offset regulations are found at [13 C.F.R. § 140.2](#) and [13 C.F.R. §140.3](#).

B. When to Initiate

Generally, federal salary offset proceedings should be initiated as soon as it becomes apparent that a current or former Federal Government employee Obligor on a 504 Loan classified in liquidation status is not willing to make a good faith effort to repay the loan.

<p>Note: SBA may, unilaterally or at the request of a CDC, initiate federal salary offset while the CDC (including an ACL or PCLP CDC) is conducting other liquidation activities.</p>

C. Requirements

Offset may be used separately or together with other methods of debt collection and does not preclude compromise. Implementation of offset is appropriate when all of the following requirements have been met:

1. The Obligor is a current or former civilian federal employee, an employee of the U.S. Postal Service or Postal Rate Commission, or a member of the Uniformed Services or Reserve of the Uniformed Services, who is receiving or entitled to receive funds from the Federal Government such as a salary, retirement benefits, training expenses, or a lump sum payment;
2. The Obligor's 504 Loan is in default;
3. The debt owed on the loan is legally enforceable; and
4. The Obligor has failed to pay or make satisfactory arrangements to pay the loan.

D. Offset Amount

1. Generally, the offset amount should not exceed 15% of the Obligor's disposable pay each payday unless a deduction of a greater amount is necessary to fully collect the debt within the Obligor's remaining period of employment or the Obligor has agreed to a larger percentage in writing.

2. Once begun, federal salary offset should continue until the full amount of the debt has been recovered, the debt is otherwise resolved (e.g., through workout or compromise), or the Obligor's federal employment ceases, whichever occurs first.

E. Employee's Rights

The rights of the Obligor with regard to federal salary offset proceedings are set out in [13 C.F.R. § 140.3](#). In general, the Obligor has the right to submit a written request to the SBA Loan Center for the relief outlined below.

1. Pre-offset

Upon receipt of a Notice of Salary Offset, the Obligor has the right to:

- a. Ask to inspect or copy SBA's records regarding the debt owed on the loan;
- b. Request a written statement breaking down the amount of the debt;
- c. Request that SBA enter into a written payment agreement to avoid offset; and
- d. Unless the amount owed on the loan has been reduced to judgment, request a hearing conducted by the SBA Office of Hearings and Appeals ("OHA") in accordance with the procedures set forth in [13 C.F.R. § 134](#) to dispute: (1) the existence or amount of the debt; or (2) the proposed repayment schedule unless it was established by written agreement between the Obligor and SBA, provided that the request is received no later than fifteen calendar days after receipt of the notice of offset. (OHA will generally issue a written opinion no later than 60 days after receiving the request for a hearing.)

2. Post-offset

Once offset proceedings have been initiated, request a review of the amount of the salary offset based on Financial Hardship.

F. Modification Based on Financial Hardship

1. Standard of Review

Generally, the amount subject to offset may be modified based on a finding of Financial Hardship due to a "material change in circumstances" since the offset proceedings were initiated such as a catastrophic illness.

2. Burden of Proof

The Obligor has the initial burden of proving by a preponderance of the evidence that offset proceedings are causing Financial Hardship due to a "material change in circumstances."

G. Suspension or Termination**1. When Suspension is Required**

- a. Offset proceedings should be suspended when doing so is consistent with prudent lending practices, e.g., if the Obligor has entered into a repayment plan with SBA.
- b. Offset proceedings must be suspended upon receipt of notice that the Obligor has filed a petition in bankruptcy or a timely request for an OHA hearing.

2. When Termination is Required

Offset proceedings must be terminated if:

- a. The loan has been paid in full;
- b. The debt has been discharged in bankruptcy;
- c. The Obligor has paid an SBA approved compromise amount in full; or
- d. The Obligor is no longer entitled to payments from the Federal Government.

Chapter 20. Real Property Collateral Liquidation

A. General Requirements

If an acceptable workout agreement has not been implemented within a reasonable time after Debenture purchase (e.g. 60 calendar days), all collateral for the loan that has Recoverable Value should be liquidated. With regard to real property collateral, if the Recoverable Value of an individual parcel is \$10,000 or more, it must be liquidated unless there is a compelling reason for not doing so. The most common methods of liquidating real property collateral are discussed below.

B. Procedure for Selecting Best Method of Liquidation

Real property collateral must be liquidated in a manner that will maximize recovery in the shortest amount of time. The most appropriate method will depend on the relevant facts, which can be ascertained by following the steps listed below.

1. Check the Military Service Status of the Property Owner-Obligor

Determine whether the property owner-Obligor is in active military service. If so, consult legal counsel regarding the implications of the [Servicemembers Civil Relief Act](#) prior to initiating a lien foreclosure action.

2. Determine the Use of the Property

Determine how the property is used because it may trigger special requirements. For example, if the property is used as an Obligor's primary residence, the requirements set forth in Paragraph C.4.b. below must be met before initiating a foreclosure action. If the property is used for agricultural purposes, state law may require judicial foreclosure and federal law may provide the Borrower with homestead rights. (For information on farmer homestead rights, see [13 C.F.R. § 120.550](#), et seq. and the Consolidated Farm and Rural Development Act.) Finally, if the property is used to operate a gas station, an oil company may have special rights with regard to matters such as notice of default, the right of first refusal, or the ability to control future ownership or use of the property.

3. Review the Loan Documents

Review the Loan Documents to determine whether they impose any restrictions or requirements with regard to the method of foreclosure that can be used. For example, in some states a deed of trust may be foreclosed through non-judicial proceedings, while a mortgage requires judicial foreclosure.

4. Order a Title Report

Order a new title report, or at a minimum, review the existing title insurance policy and gather any other information needed to identify all liens and other encumbrances against the property.

5. Determine the Amount Owed on Senior Liens

With regard to each parcel of real property collateral, determine the amount owed on any debt secured by a senior lien against the property. Then, deduct those amounts from the property's estimated Liquidation Value. If the Recoverable Value still appears to be \$10,000 or more, proceed to Step 6. If not, see Paragraph F below regarding abandonment.

6. Decide How to Handle Each Title Encumbrance

After deducting the amount secured by senior liens, if the collateral appears to have a Recoverable Value of \$10,000 or more, consider the impact, if any, each encumbrance would have on the various methods of liquidation and decide how to handle each encumbrance. For example:

a. Senior Liens

(1) Senior Tax Liens

If there are delinquent real property taxes or assessments secured by a senior lien against the property, consider the possibility of further erosion of equity due to late fees and other penalties, and decide whether to pay them.

(2) Senior Non-tax Liens

If there are senior non-tax liens against the property, decide which of the options for dealing with them listed in Chapter 13 is prudent and commercially reasonable under the circumstances.

b. Junior Liens

(1) Junior Federal Tax Liens

If there are junior federal tax liens against the property, find out the balance owed and ask the IRS for a certificate of discharge, or work with the IRS to reach an amicable resolution as to the amount that should be applied to the tax lien.

(2) All Other Junior Liens

If there are junior liens against the property other than federal tax liens, find out the balance owed and decide whether to eliminate them through foreclosure or to negotiate their release for consideration.

c. Leases

If there are tenants leasing the property, determine whether the lease enhances or diminishes the Liquidation Value and marketability of the property; and whether the lease would survive or be extinguished by a foreclosure sale.

Note: Review *Subordination, Non-disturbance and Attornment Agreements* carefully because they address lender and tenant rights. Typically, the tenant agrees to "subordinate" the lease to the lender's mortgage; and in the event of default by the landlord-Obligor, the lender agrees not to "disturb" the tenant's possession; and the tenant agrees to "attorn," i.e., recognize the lender or foreclosure sale purchaser as the new landlord.

d. Assignments of Rents

If the collateral includes an assignment of rents and a tenant is in possession of any portion of the property, decide whether:

- (1) Collecting the rents pending a workout or foreclosure sale is necessary to maximize recovery;
- (2) Collecting the rents would cure the existing default and prevent foreclosure; and whether
- (3) Requesting the court to appoint a receiver to collect the rents could bar a non-judicial foreclosure action.

e. Covenants, Conditions and Restrictions

If there are other title encumbrances, determine what impact, if any, they will have on the foreclosure process or Recoverable Value of the property. For example, gas station property is often encumbered by special notice of default requirements, purchase options, rights of first refusal, restrictions on how the property can be used, covenants that require future owners to indemnify a major oil company from liability associated with Contamination, and covenants that require future owners to install expensive engineering controls prior to redevelopment.

7. Check Status of Hazard Insurance

If the property is improved, see Chapter 9 for SBA Loan Program Requirements pertaining to ensuring that all collateral with Recoverable Value is adequately insured.

8. Order an Appraisal

Order an Appraisal to obtain up-to-date information on the market value of the property;

9. Assess Environmental Risks

When required by Chapter 5, conduct an Environmental Investigation to obtain the information needed to mitigate the risks associated with liquidating Contaminated collateral.

10. Check Historic Register Status

If the property could have historical value based on its age, integrity and significance, determine whether it is listed on, or eligible for, the [National Register of Historic Places](#) by contacting the [State Historic Preservation Office](#) where the property is located. If so, determine whether the historical significance impacts the Recoverable Value of the collateral.

11. Review Relevant Business Records

When it would be prudent to do so, review the Borrower's books and records showing the cash flow related to the operation and use of the property, and verify that the Borrower's operations were consistent with applicable laws, such as those pertaining to zoning and land use.

12. Consider Need to Collect Deficiency

If the recovery from liquidating a single parcel of real property collateral will not be enough to pay the loan in full, consult legal counsel to determine whether use of a particular method of liquidation, e.g., non-judicial foreclosure or acceptance of a deed in lieu, would bar collection of the deficiency or foreclosure of any remaining collateral.

13. Estimate Time and Costs Involved

Estimate the time and expense associated with each viable method of liquidation. This includes: the time and cost associated with pre-liquidation collateral care and preservation; the liquidation action; and post-liquidation care, preservation and resale if acquiring title to the collateral is anticipated.

14. Estimate Net Recovery

Using the information collected in Steps 1-13, calculate the net amount that could be recovered by utilizing each viable method of liquidation (e.g., those discussed in Paragraphs C – I below) to determine which would yield the highest recovery in the shortest amount of time.

C. Release of Lien for Consideration

See Chapter 8 for information on release of lien for consideration.

D. Voluntary Sale of Collateral by Obligor

An Obligor may be allowed to conduct a voluntary sale of all or part of the real property collateral securing an SBA loan provided that:

1. A voluntary sale would maximize recovery on the loan;
2. The Obligor has possession or control of the collateral;
3. All other lienholders have provided their written consent to the sale;
4. A current Appraisal has been obtained;

Note: See Chapter 2 for SBA requirements pertaining to "Appraisals". Given the inherent conflict of interest, do not rely solely on an appraisal prepared for an Obligor or another creditor with a lien on the same collateral.

5. The Recoverable Value of the collateral has been established;
6. The sale is supervised by the CDC (or SBA if SBA has taken over servicing);
7. The costs of sale are reasonable, necessary and customary;
8. The lien securing the SBA loan is only released in exchange for cash in an amount equal to or greater than the Recoverable Value of the collateral; and
9. All of the net proceeds are applied to the principal balance of the SBA loan.

Note: Consideration may be given to whether the Obligor's cooperation during the liquidation process increased the overall recovery on the loan when analyzing whether a proposed compromise amount is adequate. (Chapter 23)

E. Deed in Lieu of Foreclosure

Real property collateral may be liquidated by accepting a deed in lieu of foreclosure (i.e., a deed by which a debtor conveys fee-simple title to a secured creditor as a substitute for foreclosure) if doing so would maximize recovery on the loan. All deeds in lieu must be accompanied by a written agreement executed by all of the Obligors as to the amount to be applied to the loan balance once title has been transferred. Although accepting a deed in lieu may save time and money, it has inherent risks. For example, it could eliminate the right to collect any deficiency. It could also eliminate the opportunity to foreclose the SBA lien and remove any junior liens before marketing the property as REO. Because state laws vary regarding the impact of accepting a deed in lieu, consult legal counsel before undertaking this method of liquidation.

Note: Most title insurance companies offer deed in lieu of foreclosure services that include not only a new title (commitment) report, but review of title issues, recording of the deed in lieu documents, and issuance of a title policy to the Person to whom the lender sells the property after acquiring it via a deed in lieu.

F. Lien Foreclosure

1. General

Foreclosure is a legal action taken to sell property that was pledged as security for a loan. Since the laws pertaining to the foreclosure of mortgages, deeds of trust, and other types of real property liens vary by state, consult legal counsel to determine which type of foreclosure action is the most appropriate with regard to a particular loan. The two primary methods of real property lien foreclosure actions are judicial foreclosure and non-judicial foreclosure.

2. Primary Residences

Unless the Obligor-owner has engaged in fraud, misrepresentation or other financial misconduct, a good faith effort should be made to reach an agreement covering release of the lien for consideration and compromise of the Obligor's liability for the SBA loan balance prior to initiating a foreclosure action against the Obligor's primary residence. Documentation showing that a CDC has complied with applicable state or federal laws requiring mortgage lenders to work with home owners prior to foreclosure will be considered evidence that a CDC has made a good faith effort to meet the foregoing SBA Loan Program Requirement. (See Chapter 8 for information on release of liens for consideration, and Chapter 23 for information on offers in compromise.)

3. Judicial Foreclosure

Judicial foreclosure requires filing a lawsuit.

a. Advantages

- (1) Deficiency judgment obtainable; and
- (2) Only one action required to foreclose liens and obtain judgment on the Note and Guaranties.

b. Disadvantages

- (1) Higher costs and fees than non-judicial foreclosure;
- (2) More time-consuming than non-judicial foreclosure; and
- (3) The mortgagor and junior lienholders usually have statutory redemption rights.

4. Non-Judicial Foreclosure

Non-judicial foreclosure, which ends with the private sale of the property, is available only if the deed of trust or mortgage securing the loan contains a clause or provision granting a power of sale. Strict compliance with the applicable state statutory provisions governing non-judicial foreclosure is mandatory.

a. Advantages

- (1) Fees and costs are generally lower than judicial foreclosure;
- (2) Takes less time than judicial foreclosure; and
- (3) The mortgagor and junior lienholders usually do not have statutory redemption rights.

b. Disadvantages

- (1) Deficiency judgment may not be obtainable, and

- (2) Judicial action may still be necessary if there are unlawful occupants who need to be evicted.

G. Collection of Rents

If the Loan Documents include an assignment of rents and there are tenants paying rent to an Obligor, consult legal counsel as to the applicable state law regarding the collection of rent pending a workout or foreclosure action. In some cases, this may be accomplished by means of a letter to the tenants. In other cases, a receiver may need to be appointed.

H. Appointment of Receiver

1. When Receiverships are Appropriate

A receiver is a Person appointed by the court to preserve and protect the collateral in connection with, or in lieu of, foreclosure. Receivers should only be used in exceptional circumstances when, for example, to maximize the recovery and minimize loss on a loan, it is necessary to operate the business (e.g., hotel or gas station) until it can be sold or the collateral can be liquidated. The laws governing receiverships vary by state. Generally, however, the court will authorize the receiver to take possession of the property, manage it, collect rents, and take any reasonably necessary action to protect and preserve its value.

2. Approved Litigation Plan Required

The appointment of a receiver involves Non-routine Litigation. Therefore, CDCs must submit a proposed [Litigation Plan](#) and obtain SBA's written approval prior to commencing receivership proceedings. SBA will not approve the appointment of a receiver to perform basic loan liquidation functions, and will not approve or reimburse CDCs for expenses related to unauthorized receiverships. (See Chapter 24 for information on Litigation Plans and Chapter 25 for information on Recoverable Expenses.)

I. Short Sale Approval

A "short sale" is a sale of real property by the owner in which the proceeds from the sale of the property fall short of the balance of the debts secured by liens against the property, and because the owner cannot afford to repay the full amount of the secured debt, the secured creditors agree to release their liens on the real property for less than the total amount that would otherwise be due at closing.

1. Review and Analysis

Servicing Requests for short sale approval should be reviewed, analyzed and implemented in accordance with Chapter 6 (*Borrower Servicing Requests*).

2. General Rule

A short sale should not be approved unless:

- a. The dollar amount of the sale proceeds to be received and applied against the SBA loan balance is approximately equal to or greater than the Recoverable Value of the collateral; and
- b. The Obligor-seller will remain liable for the SBA loan balance, or approval of the short sale is part of a compromise agreement reached in accordance with the requirements of Chapter 23.

Note: Some states have laws that prohibit lienholders from collecting the deficiency if they consent to a short sale. Consult legal counsel for case-specific information and advice. And, follow the requirements set out in Chapter 23 regarding offers in compromise before approving a request that may eliminate the ability to collect the loan balance.

3. Supporting Documents

The Supporting Documents that should be obtained and reviewed in order to reach a prudent decision regarding whether to approve a short sale include the following:

- a. Real estate listing agreement;
- b. Appraisal;

Note: See the definition of "Appraisal" in Chapter 2 for SBA Loan Program Requirements pertaining to real property valuation. Given the inherent conflict of interest, never rely solely on an appraisal prepared for an Obligor or another lender with a lien on the same collateral, and exercise caution if the appraisal was prepared by a broker who will receive a commission from the sale proceeds.

- c. Real estate purchase and sale agreement, short sale and all other addendums;
- d. Current title report;
- e. Senior lienholder, subordination, inter-creditor or other agreement with any other creditor with a lien against the property;
- f. Transcript of account, or functional equivalent, for any loan secured by a senior lien;
- g. Pre-approval letter from the buyer's lender; and
- h. Draft settlement statement (HUD 1).

4. General Requirements

a. Fair Sales Price

The sales price must be fair and justified by an Appraisal;

b. Arms-length Transaction

The sale must be an arms-length transaction. This means, for example, that the purchaser must not be a Close Relative or any Person with a close business or personal relationship with the Obligor-seller; the Obligor-seller must not have any expectation of being able to buy or rent back the property after the closing; and the transaction must be conflict of interest free, (e.g., the real estate broker who prepared the Appraisal justifying the short sale price must not also be entitled to a sales commission when the short sale closes.)

c. Consent of All Secured Creditors

All of the Obligor-seller's creditors with a lien on the property must have consented to the short sale;

d. No Sale Proceeds to Seller

Because the Obligor-seller has no equity in the property, the seller should not receive any funds from the sale proceeds;

e. No Subordinated Amounts to Senior Lienholders

The sale proceeds disbursed to senior lienholders, if any, must not include advances, Default Charges, or any other amount subordinated to the SBA loan by a senior lienholder, subordination, inter-creditor or other agreement;

f. No Sale Proceeds to Junior Lienholders, Unsecured Creditors or Others

No sale proceeds should be disbursed to junior lienholders other than token amounts, i.e., \$500 or less, if necessary for release of lien; unsecured creditors, and any other Person who does not have a senior lien against the property except as provided below with regard to closing costs;

g. No Credits to Buyer

Because short sale property should be sold in "as is" condition, no funds should be credited to the buyer for repairs or any other purpose;

h. No Unreasonable Closing Costs

Generally, since the Obligor-seller has no equity in the property, the seller's closing costs should not be paid from the sale proceeds unless it is necessary under the circumstances, in which case, the amount of any cost that will be paid from the sale proceeds, e.g., real estate commissions, must be reasonable and justified under the circumstances;

Note: Secured creditors, who are asked to accept less than the full amount due to them, can condition their approval of a short sale. For example, their approval can be conditioned on increasing the purchase price, reducing usual and customary sale closing costs such as the amount of commissions paid to realtors, or receiving substitute collateral for the deficiency.

i. Arrangement for Payment of Loan Balance Deficiency

Satisfactory arrangements must have been made for payment of the loan balance that will remain after receipt of the sale proceeds, (i.e., consideration for release of the lien), unless the release is part of a compromise agreement reached with the Obligor-seller pursuant to the requirements of Chapter 23.

J. Credit Bids**1. Requirement**

A Credit Bid should be entered at all real property lien foreclosure sales initiated to foreclose a lien securing an SBA loan, whether the sale is judicial or non-judicial.

2. Credit Bid Amount

To determine the amount of a Credit Bid, the following factors must be considered: (a) Recoverable Value; (b) the SBA loan balance; and (c) need for and ability to collect a deficiency judgment. The Credit Bid amount should be based on the Recoverable Value of the collateral, but should not exceed the loan balance. Further, the entire loan balance should not be bid if doing so would eliminate an otherwise collectible deficiency.

K. Eviction Proceedings

If title to real property collateral is acquired through foreclosure or otherwise and the Obligor-owner refuses to vacate, or there are other Persons unlawfully occupying the premises, it may be necessary to evict them. Eviction laws vary by locality. Consult legal counsel to determine the appropriate course of action.

L. Abandonment

The pursuit of recovery on real property collateral may be abandoned if the collateral has no significant Recoverable Value, i.e., a Recoverable Value of less than \$10,000 per parcel. (See Chapter 5 [*Environmental Risk Management*] for SBA requirements pertaining to the due diligence required before collateral may be abandoned based on unsubstantiated claims that it is Contaminated, because the presence of Hazardous Substances may not significantly impair the market value of the acquired collateral.)

Chapter 21. Personal Property Collateral Liquidation

A. General Requirements

If an acceptable workout agreement has not been implemented within a reasonable time after Debenture purchase (e.g. 60 calendar days), all collateral that has a Recoverable Value should be liquidated. With regard to personal property collateral, if the individual or aggregate Recoverable Value is \$5,000 or more, it must be liquidated unless there is a documented compelling reason for not doing so. The most common methods of liquidating personal property collateral are discussed below.

Note: Prudent action must be taken to avoid loss of collateral or dissipation of collateral value during workout discussions. For example, to ensure that personal property such as machinery and equipment, inventory, furniture and fixtures is liquidated as quickly as possible if a workout is not feasible, it is generally advisable to have an auctioneer accompany you on a site visit (Chapter 16) to inspect and appraise the collateral as soon as the loan is classified in liquidation status. That way, you can make preliminary UCC sale plans that can be implemented without further delay if the need arises.

B. Procedure for Selecting Best Method of Liquidation

Personal property collateral must be liquidated in a manner that will maximize recovery in the shortest amount of time. The most appropriate method will depend on the relevant facts, which can be ascertained by taking the steps listed below.

1. Check the Military Service Status of Property Owner-Obligor

Determine whether the property owner-Obligor is in active military service. If so, consult legal counsel regarding the implications of the [Servicemember's Civil Relief Act](#) prior to initiating a lien foreclosure action.

2. Review the Loan Documents

Review the applicable Loan Documents to begin the process of determining what personal property is available for liquidation, how the liens on that property can be foreclosed, and how much money can be recovered by liquidating it. For example, review the Loan Authorization, security agreements, and lien searches, as well as any deposit account control agreement, assignment, marine mortgage, certificate of title, landlord lien waiver, Third Party Lender Agreement, and any other lienholder, subordination, or inter-creditor agreement.

Note: The law under which a lien was created dictates how it can be foreclosed. For example, if the collateral consists of a lien on equipment or inventory created under [Article 9 of the Uniform Commercial Code](#) ("UCC"), the lien can be foreclosed by conducting a foreclosure sale pursuant to UCC Article 9 ("UCC sale"). On the other hand, if the collateral consists of a common law assignment of a life insurance policy or a marine mortgage, the UCC does not apply and the lien must be foreclosed according to the applicable state or federal law.

3. Order a Lien Search

Verify the priority of the liens securing the 504 Loan by conducting a new lien search. For example, order a current UCC lien search, or follow the steps below to search for liens against special types of property, such as:

a. Motor Vehicles and Small Boats

Check for security interests noted on the certificate of title.

b. Airplanes

Order a title search, (usually through an airplane title service company), from the [Federal Aviation Administration Registry in Oklahoma City, Oklahoma](#), and if the plane is subject to the Cape Town Convention, the international registry in Ireland.

c. Documented Vessels

Order an abstract of title, (usually through a marine title service company), from the U.S. Coast Guard National [Vessel Documentation Center](#) in West Virginia.

d. Tax Liens

Contact the appropriate government entity (generally the county) to determine, and continue to monitor, whether there are liens for delinquent taxes that have priority over the lien securing the 504 Loan and decide whether they should be paid. If there are junior IRS liens against the property, ask the IRS for a certificate of discharge or reach an amicable resolution as to the amount of funds that should be applied to each IRS tax lien.

4. Determine the Amount Owed on Senior Liens

With regard to each type of personal property collateral, determine the amount owed (including unsubordinated Default Charges) on any debt secured by a senior lien against the property, and deduct that amount from the property's estimated Liquidation Value. If it still appears that the property will have an individual or aggregate Recoverable Value of \$5,000 or more, proceed to Step 5. If not, see Paragraph E below regarding abandonment.

5. Review the Relevant Business Records

If the collateral consists of inventory or accounts, review the Borrower's books and records to determine whether there are accounts receivable that can be collected or inventory that can be returned for cash or credit. If so, see Paragraph C.5 below for information on collecting accounts receivable.

6. Check Status of Hazard Insurance

See Chapter 9 for SBA Loan Program Requirements regarding the need to adequately insure collateral with Recoverable Value.

7. Order an Appraisal

Order an Appraisal to obtain up-to-date information on the Liquidation Value of the collateral.

8. Assess the Environmental Risk

If there are Hazardous Substances at the Borrower's business premises, follow prudent lending practices in order to minimize the risk and maximize the recovery on the loan. (See, for example, Practice Tip #4 at the end of Paragraph C.3 below regarding the sale of used chemicals, batteries and tires.) If the collateral includes equipment associated with a gas station or dry cleaner, comply with the requirements in Chapter 5 (*Environmental Risk Management*).

9. Calculate the Time and Costs Involved

Calculate the time and costs associated with each viable method of liquidation. This includes: repossession or replevin; pre-liquidation collateral care and preservation; the foreclosure action; and post-foreclosure care, preservation and resale if acquiring title to the collateral is anticipated. For example, a CDC that intends to initiate a marine mortgage foreclosure action should take into account the costs associated with having the vessel arrested, appointment of a custodian, litigation, acquiring the vessel at the U.S. Marshal's sale, and holding and reselling it.

10. Estimate the Net Recovery

Using the information collected in Steps 1-9, calculate the net amount that could be recovered by utilizing each viable method of liquidation (e.g., those discussed in Paragraphs C – J below.) to determine which would yield the highest recovery in the shortest amount of time.

C. Release of Lien for Consideration

See Chapter 8 for information on release of lien for consideration.

D. Voluntary Sale of Collateral by Obligor

An Obligor may be allowed to conduct a voluntary sale of all or part of the personal property collateral securing an SBA loan provided that:

1. A voluntary sale would maximize recovery on the loan;
2. The Obligor has possession or control of the collateral;
3. All other lienholders have provided their written consent to the sale;
4. An Appraisal has been obtained;
5. The Recoverable Value of the collateral has been established;
6. The sale is supervised by the CDC (or SBA if SBA has taken over servicing);

7. The costs of sale are reasonable, necessary and customary;
8. The lien securing the 504 Loan is only released in exchange for cash in an amount equal to or greater than the Recoverable Value of the collateral; and
9. All of the net proceeds are applied to the principal balance of the SBA loan.

Note: When analyzing whether a proposed compromise amount is adequate, consideration may be given to whether the Obligor's cooperation during the liquidation process increased the overall recovery on the loan. (Chapter 23)

E. UCC Sale

Liens on business assets such as equipment, inventory or fixtures created under *UCC Article 9* may be foreclosed by conducting a UCC sale.

1. Types of UCC Sales

a. Private Sale

A private UCC sale is not open to the general public, usually does not occur at a pre-appointed time and place, and may not be advertised to the general public. Although public sales are preferred, a private UCC sale may be conducted if doing so would maximize recovery on the loan, e.g., when the collateral can be sold as part of the sale of a going concern.

b. Public Sale

A public UCC sale is open to the general public, occurs at a pre-appointed time and place, and is widely advertised. The use of widely advertised public UCC sales is encouraged.

(1) Auction or Retail Sale

The most common type of public UCC sale is a public auction where the collateral is sold to the highest bidder. Another common type is a retail sale of the collateral conducted over a limited number of days during which time the prices are gradually reduced. Retail sales are often followed by a public auction of any remaining collateral.

(2) Sealed Bid Sale

A sealed bid sale is typically advertised to members of the general public who submit confidential bids to be opened at a predetermined time and place. A sealed bid sale differs from a public auction in that it does not allow for interaction between competing bidders.

2. Requirements

a. Possession of the Collateral

The secured creditor must be able to repossess the collateral without a "breach of the peace." ([UCC § 9-609](#)) If not, legal counsel should be consulted to determine whether litigation, such as a replevin action, is appropriate to obtain possession of the collateral.

b. Reasonable Notice of the Sale

Reasonable notice of the sale must be sent to all Obligors and junior lienholders unless the collateral is perishable, threatens to decline speedily in value, or is sold in a recognized market such as the New York Stock Exchange. ([UCC § 9-611](#)) To ensure compliance, notice of the sale should be sent to all of the Obligors and junior lienholders at least ten calendar days prior to the sale. To prove compliance, the Loan File should include a copy of: (1) the post-default UCC lien search verifying the priority of the lien securing the SBA loan and the identity of any junior lienholders entitled to notice; (2) the notice sent to the Obligors and junior lienholders; and (3) proof that the notice was transmitted.

c. Commercial Reasonableness

Every aspect of the sale including the method, manner, time, place and terms must be "commercially reasonable." ([UCC § 9-610](#)) To prove compliance, the Loan File should, at a minimum, contain a copy of the following documents:

- (1) Post-default inventory and Appraisal of the property sold;
- (2) UCC sale brochure and advertisements; and
- (3) Final accounting for the sale that includes the gross amount of proceeds, an itemized list of expenses, including how they were calculated, and the net amount recovered.

Note: A good auction company will keep detailed records of the sale including, for example, a list of registered bidders, the name of each buyer, and the amount paid for each item.

d. Bill of Sale

The bill of sale should state that the personal property is sold "as is" and "without warranties of any kind including those relating to title, possession, quiet enjoyment or the like." (For more information, see [UCC § 9-610](#).)

3. Practice Tips

a. How to Choose an Auction Company

When choosing an auction company, consider the following:

- (1) Is it bonded? Does it have adequate insurance coverage, and the necessary licenses, including a dealer's license if you have titled motor vehicles to sell?
- (2) Is it knowledgeable about the type of collateral you have to sell?
- (3) Does it have experience attracting the appropriate customers for the type of property involved?
- (4) Does it have a good reputation in your area? Check its references.
- (5) If it is not possible to hold the auction on the Borrower's business premises, does the company have a facility where the sale can be held?
- (6) Can the auction company perform all of the duties associated with the auction? For example, can it handle the pre-sale preparation and inspection, the advertising, removal, and clean-up? And, most importantly, can it provide you with accurate records concerning all aspects of the sale?
- (7) Is the proposed fee arrangement reasonable, necessary and customary? When possible, request and compare proposals from several companies. Scrutinize the costs, particularly the advertising budget. Be suspicious of an unusually low advertising budget. Adequate advertising is essential for a successful auction. If you decide to pay the company on a commission basis, try to make sure that it will not also charge a buyer's premium, i.e., a percentage of the final bid amount (generally 10% – 20%) that is added on to the price like a sales tax and goes directly to the auction company as additional compensation.

<p>Note: A buyer's premium can affect your net recovery because not as many people will attend the auction, and those who do will bid lower because they know they will have to pay an extra 10-20% on top of the applicable sales tax.</p>

b. Leased Equipment

If the UCC search reveals that a valuable piece of equipment is leased, find out the residual amount owed on the lease and pay it off if doing so would (1) allow the equipment to be included in the UCC sale; (2) attract more potential buyers to the sale; and (3) maximize recovery on the loan.

c. Purchase Money Security Interests

If the UCC search reveals that another creditor has a purchase money security interest in a valuable piece of equipment, (i.e., the Borrower used another creditor's money to purchase the equipment and granted that creditor a security interest in it), consider inviting that creditor to participate in the UCC sale if doing so would (1) attract more potential buyers to the sale; (2) reduce the costs of sale (because they can be prorated and shared with the other creditor); and (3) maximize recovery on the loan.

d. Used Chemicals, Batteries and Tires

If the collateral includes Hazardous Substances such as used chemicals, batteries or tires, ascertain whether there is a market for it. If so, encourage the Borrower to sell it and apply the net proceeds to the principal loan balance. (See Chapter 8 for information on release of liens for consideration. See the EPA's Website for a [list](#) of companies that purchase reusable hazardous waste.)

F. Judicial Foreclosure

Although the self-help remedies authorized by the UCC tend to be more economical and efficient, personal property liens may also be foreclosed by filing a lawsuit. For example, if the personal property collateral consists of trade fixtures attached to real property collateral and the real property lien must be judicially foreclosed, foreclosing both the real and personal property liens in the same law suit may be appropriate.

G. Collection of Accounts Receivable

When an SBA loan is secured by a lien on accounts receivable, a determination as to whether the pledged accounts have Recoverable Value should be made as soon as possible after an event of default. Thereafter, swift, aggressive action must be taken to collect any accounts with Recoverable Value in a manner consistent with applicable law.

1. Collection by Borrower

The Borrower, who will be liable for any deficiency and is best able to handle disputed claims, may be allowed to collect accounts provided that precautions are taken to ensure that the proceeds are applied to the loan balance.

2. Collection by CDC

In order to protect the right to a deficiency judgment, when it appears that further collection efforts by the CDC would be futile, the Obligors should be provided with written notice of the CDC's intent to cease collection efforts, and given the opportunity to pursue collection of the remaining accounts, provided that precautions are taken to ensure that the proceeds are applied to the loan balance.

3. Set-off of Deposit Account

When a 504 Loan is secured by a lien on a deposit account, on the occurrence of an event of default the CDC should, in compliance with [UCC § 9-607](#) and the terms of any applicable control agreement, ensure that the cash in the deposit account is applied to the 504 Loan balance.

H. Surrender of Life Insurance Policy for Cash Value

When a life insurance policy with a cash surrender value has been assigned as collateral for a 504 Loan and a deficiency exists after all of the other collateral has been liquidated, the policy should be surrendered to the insurance company for the cash value and the proceeds applied to the principal balance of the 504 Loan unless, under the circumstances, it would be more prudent to keep the coverage in place, even if it requires advancing funds to pay the premiums. Premium payments made by the CDC or SBA should be treated as Recoverable Expenses. (See Chapter 25 for information on Recoverable Expenses.)

I. Foreclosure of Lien on Fixtures

A lien on fixtures may be foreclosed pursuant to UCC Article 9 or applicable real property foreclosure law. ([UCC § 9-604](#)) (See Paragraph C.3 above for information on UCC sales. See Chapter 20 for information on real property lien foreclosure.)

Note: A creditor who removes fixtures is responsible to the owner of the real property, other than the debtor, for the cost of repairing any physical damage caused by the removal, but not for any diminution in the value of the real property caused by the absence of the fixtures. ([UCC § 9-604](#))

J. Marine Mortgage Foreclosure

A marine mortgage on a documented vessel can only be foreclosed by filing an admiralty action in the appropriate federal district court, which will issue a warrant for the arrest of the vessel.

K. Credit Bids

1. Non-judicial Foreclosure Sales

Non-judicial personal property lien foreclosure sales, e.g., UCC sales, must be aggressively advertised in order to obtain the highest price and to avoid acquiring title. Generally, unless the collateral has a high estimated Recoverable Value, (e.g., state of the art digital printing equipment), it is not advisable to enter a Credit Bid or to establish a minimum bid or a reserve amount because doing so could have a chilling effect on the bidding.

2. Judicial Foreclosure Sale

A Credit Bid must be entered when a personal property lien securing an SBA loan is judicially foreclosed. To determine the amount of a Credit Bid the following factors must be considered: (a) Recoverable Value; (b) 504 Loan balance; and (c) need for and ability to collect a deficiency judgment. The Credit Bid amount should be based on the Recoverable Value of the collateral, but should not exceed the loan balance. Further, the entire loan balance should not be bid if doing so would eliminate an otherwise collectible deficiency.

L. Abandonment

The pursuit of recovery on personal property collateral may be abandoned if the collateral has no significant Recoverable Value, i.e., the individual or aggregate Recoverable Value is less than \$5,000. The decision and justification for abandoning collateral, including the basis for the Recoverable Value estimate, must be documented in the Loan File. (See Chapter 5 [*Environmental Risk Management*] for SBA requirements pertaining to the due diligence required before collateral may be abandoned based on unsubstantiated claims that it is Contaminated, because the presence of Hazardous Substances may not significantly impair the market value of the acquired collateral.)

Chapter 22. Acquired Collateral

A. Overview

Certain methods of liquidation may result in acquisition of real property collateral (“Real Estate Owned” or “REO”) or personal property collateral. When collateral is acquired, it should be liquidated in a manner that will maximize recovery in the shortest amount of time.

B. Title to Collateral

1. Title to collateral should not be acquired unless it is necessary to maximize recovery on the loan.
2. To avoid taking title to collateral, foreclosure sales should be aggressively advertised in order to attract a large number of potential buyers.
3. SBA and CDC employees, as well as their Close Relatives and Associates must not, directly or indirectly, bid on, purchase or otherwise acquire title to collateral.
4. CDCs that anticipate reselling the collateral, if acquired, within 120 calendar days, should take title in their own name.
5. CDCs that do not anticipate reselling the collateral, if acquired, within 120 calendar days should consult the SBA Loan Center about taking title in SBA's name to take advantage of SBA's property tax exemption status.
6. Title to collateral must not be taken in SBA's name without obtaining SBA's prior written approval. ([13 C.F.R. § 120.536\(a\)\(4\)](#))
7. SBA's ownership of acquired collateral should be reflected on the title as follows: "Administrator, U.S. Small Business Administration, an Agency of the United States Government."
8. CDCs must not take title to Contaminated collateral in their own name—or SBA's name—without SBA's prior written approval. ([13 C.F.R. § 120.536\(a\)\(5\)](#))
9. Title to personal property collateral should not be taken in SBA's name except in unusual circumstances, (e.g., when title to real property collateral will be taken in SBA's name and the personal property is an intricate part of the value of the real property such as a special use manufacturing plant and the equipment needed to operate it).

C. Ownership Responsibilities

Upon acquiring title to real or personal property collateral, the following actions should be taken:

1. Possession and Control

- a. Take possession of the acquired collateral;

- b. Change the locks immediately on vacant buildings. Depending on the circumstances, arrange for additional security if necessary to prevent damage or to avoid liability associated with ownership; and
- c. Begin eviction proceedings if anyone is unlawfully occupying REO and will not leave voluntarily.

2. Inventory

Inventory and photograph all acquired personal property, including property located in and around REO.

3. Accounting

Keep an accurate and complete record of the costs associated with the acquisition, holding and resale of the acquired collateral.

4. Taxes

Monitor and pay taxes and assessments to avoid liens, interest accrual, and penalties.

5. Care and Preservation

- a. Take reasonable steps to prevent deterioration, such as arranging for utility services and essential repairs and maintenance.
- b. When title to collateral is taken in SBA's name, but the CDC is responsible for its care and preservation, the CDC may request a limited power of attorney from SBA to take actions related to the care and preservation of the acquired collateral—but not the sale, transfer, assignment, lease or other permanent or temporary disposition of it.
- c. If the property has historic significance, consult legal counsel and the SBA Loan Center to ensure compliance with Section 106 of the [National Historic Preservation Act of 1966](#).

6. Insurance

See Chapter 9 for SBA Loan Program Requirements pertaining to insurance coverage on acquired collateral.

D. Expense Reimbursement

SBA will reimburse CDCs for reasonable, necessary and customary expenses related to acquired collateral. Requests for reimbursement of such expenses must be submitted to SBA in accordance with the procedures set out in Chapter 25 with regard to Recoverable Expenses.

E. Timeframe for Disposal

Acquired collateral should be disposed of within 12 months of acquisition.

F. Sale

Acquired collateral should be disposed of by sale.

1. Method of Sale

Acquired collateral should be sold by whatever method, (e.g., broker's sale, public auction, sealed bid sale, etc.), will maximize recovery on the loan in the shortest amount of time.

2. Bidding or Acquisition by SBA or CDC Employees

SBA and CDC employees, as well as their Close Relatives Associates must not, directly or indirectly, bid on, purchase or otherwise take title to acquired collateral.

3. Transfer of Title and Closing Costs

a. REO—Quitclaim Deed

Title to REO should be conveyed by means of a quitclaim deed (i.e., a deed that conveys a grantor's complete interest in the property but neither warrants nor professes that the title is valid) except in unusual circumstances where the use of a warranty deed is necessary to maximize the recovery on the loan in the shortest amount of time.

b. Personal Property—Non-recourse Bill of Sale

Acquired personal property collateral should be conveyed by means of a bill of sale that specifies that the property is sold "as is" and "without warranties of any kind including those relating to title, possession, quiet enjoyment or the like."

c. Closing Costs

Buyers should be responsible for all closing costs except in unusual circumstances where payment of the seller's customary share of the closing costs is necessary to maximize the recovery on the loan in the shortest amount of time.

4. Sales Price

The sales price for acquired collateral should be based on an Appraisal. (See the definition of "Appraisal" in Chapter 2 for SBA requirements pertaining to appraisals. See Chapter 5 [*Environmental Risk Management*] for SBA requirements pertaining to the due diligence that must be performed before selling acquired collateral alleged to be worth substantially less than its appraised value due to the alleged presence of Contamination.)

5. Use of Real Estate Brokers

REO may be sold by listing it with a real estate broker provided that:

- a. The terms of the listing agreement are not inconsistent with this SOP;

- b. The listing price is supported by an Appraisal;
- c. The listing broker has a good reputation for selling the type of property involved in the area where the property is located, is properly licensed, and is a member of the most appropriate multiple listing service;
- d. All agreements are in writing and signed by the necessary parties;
- e. The amount of the listing and selling brokers' commissions is reasonable, necessary and customary in the community where the property is located for the type of property involved; and
- f. Neither the listing nor selling broker has an actual, apparent, or potential conflict of interest with regard to the REO, Obligors, SBA or the CDC.

6. Sale to Obligors, Associates or Close Relatives of the Borrower

Acquired collateral should not be sold, assigned or otherwise transferred to Obligors, Close Relatives of Obligors, or Associates of the Borrower for less than the full amount due on the SBA loan unless it is necessary to maximize recovery on the loan and the following conditions are met:

- a. A comprehensive public foreclosure sale of the collateral was held;
- b. A good faith effort was made to resell the acquired collateral to a disinterested party;
- c. The acquired collateral is sold for fair market value;
- d. It is an all cash sale;
- e. If the sale is to an Obligor to repurchase the Obligor's primary residence, the REO will continue to be the Obligor's primary residence; and
- f. The sale will not harm the integrity of the SBA loan program.

7. Purchase Offers

All offers to purchase acquired collateral must:

- a. Be in writing, signed by the party making the offer, and accompanied by a good faith deposit in the form of a cashier's check for at least 5% of the purchase price;
- b. Not be disclosed to other prospective purchasers or their Agents; and
- c. Be reviewed and analyzed based on the sales efforts to date and the value of the property established by an Appraisal.

8. Term Sales

a. When Permitted

Acquired collateral should not be sold by means of a term sale unless doing so is necessary to maximize recovery on the loan.

b. Buyer Pre-qualification

Potential purchasers buying on credit must be pre-approved.

c. Terms of Purchase and Sale

With regard to all term sales, the purchaser must:

- (1) Make a significant down payment, which should be at least 20% of the purchase price;
- (2) Properly execute a promissory note for the balance, which (a) is assignable; (b), has a maturity date that does not exceed 15 years for REO or five years for personal property; (c) has an appropriate interest rate; (d) requires a monthly payment amount that exceeds the amount of interest accrued each month; and (e) contains an acceleration clause that requires the purchaser to immediately pay the entire balance due in the event of default;
- (3) Provide collateral to secure payment of the promissory note in the form of a properly perfected first-position lien on the assets being sold, and when appropriate, properly executed Guaranties;
- (4) With regard to REO, pay for the cost of a mortgagee's title insurance policy; and
- (5) Obtain hazard insurance coverage for the replacement value of the asset(s) being sold that includes a mortgagee clause or equivalent in favor of the CDC (or SBA if SBA has taken over servicing), and any other type of insurance coverage required by statute, e.g., [flood insurance](#), or prudent lending practices.

9. Profit on Sale

Because state laws vary, after the sale proceeds have been applied to the loan balance, legal counsel should be consulted to determine whether there are any state specific laws governing distribution of the surplus. Thereafter, any surplus must be remitted to the SBA Loan Center along with a written explanation for the profit and a recommendation based on the applicable law, regarding how the surplus funds should be distributed, e.g., retained by SBA, paid into the registry of the court, or distributed to junior lienholders.

G. Lease

Generally, acquired collateral should not be leased. However, if it has not sold after a reasonable amount of time (e.g., one year), acquired collateral may be leased if doing so is necessary to maximize recovery on the loan, provided that:

1. A comprehensive public foreclosure sale of the collateral was held;

2. A good faith effort was made to sell the acquired collateral;
3. The terms and conditions of the lease, including the rental rate, are consistent with prevailing market rates and terms;
4. A written lease is used, which is legally enforceable, assignable, allows the acquired collateral to be shown to prospective buyers, and can be terminated on reasonable notice if a favorable purchase offer is received;
5. The acquired collateral is not leased to an Obligor, Close Relative of an Obligor, or an Associate of the Borrower unless a comparable or more desirable proposal cannot be obtained;
6. Leasing the acquired collateral will not harm the integrity of the SBA loan program; and
7. The leased property is inspected at least semi-annually and the inspection findings included in the CDC's quarterly status report on the loan.

H. Abandonment

Acquired collateral must not be abandoned unless abandonment of the specific REO or acquired personal property collateral has been pre-approved by SBA as an exception to policy obtained in accordance with the procedures set out in Chapter 1.

Chapter 23. Offer in Compromise

A. Overview

1. Definition

An offer in compromise is an offer made by an Obligor to pay less than what is owed in full settlement of the Obligor's obligation on their 504 Loan. Submitting the offer does not ensure that it will be accepted. Rather, it begins a process of evaluation and verification by the CDC and SBA. Generally, an offer in compromise will be accepted if it reflects the Obligor's true ability to pay, and will be rejected if the Obligor can pay the loan in full via a lump sum payment or an installment agreement, or if acceptance of the offer would harm the integrity of the SBA loan program.

2. Legal Authority

The general requirements for compromise of a debt owed on an SBA loan are based on [31 U.S.C. § 3711](#) and [31 C.F.R. Part 902](#) (*Standards for Compromise of Claims* – by an agency of the Federal Government).

3. Effect of Compromise with One Obligor on Remaining Obligors

A compromise with one Obligor does not release the remaining Obligors because each is jointly and severally liable, i.e., full payment may be requested from one or all of the Obligors. No attempt should be made to divide payment responsibility between the Obligors or to use the compromise amount with one Obligor as the basis for the compromise amount from another. ([31 C.F.R. § 902.4](#))

4. Finality

An offer in compromise that is approved by SBA is final and conclusive on the Obligor, SBA and the CDC unless it was obtained through fraud, misrepresentation, or mutual mistake of fact.

Note: Acceptance of a compromise offer is considered to be a loss to the Federal Government and may adversely impact the Obligor's ability to obtain future financing from the Federal Government including another SBA loan.

B. When Compromise is Appropriate

1. Business Closed and Collateral Liquidated

- a. Compromise with an Obligor is appropriate after the business has been closed and all of the collateral has been liquidated. However, if the only remaining collateral is a lien on the personal residence of the Obligor making the offer in compromise, compromise negotiations may proceed provided that the Obligor is willing to pay an additional amount as consideration for release of the lien. (Chapter 20)

- b. If the Obligor is unwilling or unable to pay an acceptable amount for release and compromise, rather than extinguish the debt for a nominal amount, compromise negotiations must cease and appropriate action must be taken. (E.g., file suit to foreclose the lien and obtain a deficiency judgment against the Obligor, or abandon the lien, charged-off the loan, and referred the Obligor referred to Treasury for on-going enforced collection efforts.)

2. Going Concern

Compromise with a going concern is only appropriate when the viability of the business concern is at stake and acceptance of the offer will not harm the integrity of the SBA loan program. (See Paragraph D below for detailed information on compromise with a going concern.) The offer in compromise process must not be used as a means for a business that is experiencing temporary cash flow problems to write down its debt. (See Chapters 6-17 for information on tools that can be used to help resolve temporary cash flow problems such as re-amortization, deferment, or a workout.)

C. General Requirements

The general requirements for compromise of a debt owed on an SBA loan are as follows:

1. The loan must be classified in liquidation status;
2. The Person making the offer must not currently be in bankruptcy;
3. The full amount owed on the loan cannot be recovered because:
 - a. The Obligor is unable to pay it in a reasonable time;
 - b. It cannot be collected through enforced collection proceedings within a reasonable amount of time;
 - c. The cost of collection does not justify enforced collection of it;
 - d. There is significant litigative risk, i.e., a real doubt concerning the ability to prevail in court because of legal issues or factual disputes; or
 - e. Given the Obligor's special circumstances, (e.g., illness), paying it would cause Financial Hardship.
4. The Obligor has not engaged in fraud, misrepresentation or other misconduct in connection with the SBA loan;

Note: Whenever there is a concern that an Obligor may have engaged in fraud or other irregular activity in connection with an SBA loan, (e.g., made false statements or submitted false documents), the matter must be reported to the Office of the Inspector General. (Chapter 27). Prudent action under the circumstances may also include consulting legal counsel to determine whether action under Title 31, Chapter 38, *Administrative Remedies for False Claims and Statements* ([31 U.S.C. § 3801-3812](#)) is appropriate. ([Managing Federal Receivables](#), Chapter 7, page 14)

5. Collection of the loan balance is not barred by a valid legal defense such as discharge in bankruptcy or the statute of limitations; and
6. The compromise amount bears a reasonable relationship to the amount that could be recovered in a reasonable amount of time through enforced collection proceedings and is sufficient to protect the integrity of the SBA loan program.

Note: Obligors do not have a “right to compromise” the amount owed on their SBA loan. To protect the integrity of the SBA loan program, Obligors should be referred to Treasury for further collection efforts rather than be allowed to compromise for an amount that is nominal relative to their loan balance. ([31 C.F.R. § 902.2\(e\)](#))

D. Compromise with a Going Concern

In addition to the general requirements in Paragraph C above, the following requirements apply to compromise offers from going concerns:

1. The compromise must be necessary to avoid closure of a small business, i.e., the business must not be able to continue operating under its current debt structure and all other options for remaining viable must have been exhausted including, for example, the sale of non-essential assets and the closure of non-profitable locations;
2. The Borrower must pass the Feasibility Test for a successful workout set forth in Chapter 17;
3. The compromise must be part of an overall debt restructuring plan that involves all of the Borrower’s creditors;
4. The specific details regarding the Borrower’s secured and unsecured debt and debt reduction arrangement with each of its creditors must be set out in a written agreement signed by all of the Borrower’s creditors; and
5. The Borrower’s proposed treatment of the SBA loan must be fair and equitable in comparison to the treatment to be received by the Borrower’s other creditors. This includes, for example, the percentage of debt to be forgiven, whether collateral is provided or retained if the compromise amount is to be paid in installments, and whether other lenders are allowed to participate in an appreciation sharing agreement.

E. Offer and Supporting Documents

Unless the basis for compromise is litigative risk, each Obligor submitting an offer in compromise must submit the following documents:

1. Written Offer

A signed written offer that should refer to the penalties under [18 U.S.C. § 1001](#) for false statements, identify the source of the funds for the offer, and explain any special circumstances that the Obligor would like taken into consideration, such as an illness that is causing Financial Hardship, e.g., [SBA Form 1150](#) (*Offer in Compromise*);

2. Financial Statement

A current financial statement that should be signed under penalty of perjury and must show the Obligor's assets, liabilities, income and expenses, e.g., [SBA Form 770](#) (*Financial Statement of Debtor*). In addition:

- a. Going Concerns—If the Obligor is a going concern, the Obligor's last year-end financial statements must also be provided.
- b. Affiliates—If the Obligor has any affiliates, a current consolidated financial statement (or a current financial statement from each affiliate) must also be provided.

3. Personal Federal Income Tax Returns

A complete copy of the personal federal income tax returns that the Obligor filed with the IRS for the past two years or a written explanation as to why a copy is not available; and

4. Business Federal Income Tax Returns

For each going concern and affiliate, a complete copy of the business federal income tax returns that were filed with the IRS for the past two years or a written explanation as to why a copy is not available.

F. Review and Analysis of Offer

To determine whether an offer in compromise is acceptable, a good faith effort must be made to verify the accuracy of the Obligor's financial disclosure and to evaluate the adequacy of the amount offered.

1. Corroborating Evidence

Independent financial information must be obtained to determine whether the financial information submitted by the Obligor is complete and accurate. At a minimum, this should include a current credit report. ([31 C.F.R. § 902.2](#))

2. Adequacy of Financial Disclosure

At a minimum, a current credit report, as well as the financial information submitted by the Obligor in the past (e.g., the personal financial statement submitted with the loan application) must be compared to the financial information the Obligor submitted in support of the offer in compromise. Any major discrepancies must be investigated and explained. For example, concerns about the accuracy of tax returns submitted with the offer in compromise should be investigated by ordering and comparing IRS transcripts for the same tax years. All efforts to establish the validity of the Obligor's current financial information should be documented in the Loan File.

3. Amount Recoverable Through Enforced Collection

An analysis must be performed to determine the amount that could be recovered from the Obligor in a reasonable amount of time through enforced collection proceedings. It should, for example, take the following factors into consideration:

- a. Recoverable Value of any collateral pledged by the Obligor that has not already been liquidated, such as the Obligor's personal residence;
- b. Exemptions available under state and federal law;
- c. Amount that could be recovered from the Obligor's non-exempt assets that were not pledged as collateral, e.g., by obtaining a judgment and executing on it;
- d. Amount of present and potential income that could be obtained through, for example, garnishment or offset;
- e. Litigative risk, i.e., a real doubt concerning the ability of the CDC or SBA to prove its case in court because of legal issues or factual disputes;
- f. The necessary, reasonable and customary administrative and litigation expenses that would be incurred through enforced collection;
- g. The time it would take to enforce collection; and
- h. The possibility that assets have been or will be concealed or fraudulently transferred.

4. Adequacy of Proposed Compromise Amount

a. Standard of Review

The compromise amount must bear a reasonable relationship to the amount that could be recovered in a reasonable amount of time through enforced collection proceedings and must be sufficient to protect the integrity of the SBA loan program.

Note: Obligors do not have a "right" to compromise the amount they owe on their SBA loan. In this regard [31 C.F.R. § 902.2\(e\)](#) states: "...agencies should consider whether continued collection of the debt, regardless of cost, is necessary to further an enforcement principle, such as the Government's willingness to pursue aggressively defaulting and uncooperative debtors."

b. Minimum Amount

Generally, the compromise amount should be more than \$5,000.

c. Hardship Exception

The compromise amount may be \$5,000 or less if a larger amount would cause Financial Hardship. (See Chapter 2 for the definition of "Financial Hardship".)

d. Obligor's Cooperativeness

When analyzing whether a proposed compromise amount is adequate, consideration may be given to whether the Obligor's cooperation during the liquidation process increased the overall recovery on the 504 Loan.

G. Inadequate Offers

1. Counter Offer

Generally, if an offer in compromise was made in good faith, but the amount offered does not bear a reasonable relationship to the amount that could be recovered in a reasonable amount of time through enforced collection, a good faith effort should be made to arrive at an acceptable amount by countering the offer.

2. Decline Offer and Refer to Treasury

If the Obligor will not agree to an acceptable compromise amount, the offer should be declined; and, as soon as all other cost-effective avenues of collection have been exhausted, a Wrap-up Report should be submitted so that the loan can be charged off and referred to Treasury for offset and other enforced collection efforts. (See Chapter 25 for more information.)

Note: Unacceptable offers and counter-offers should not be forwarded to SBA. See Paragraph I below for information on when offers in compromise must be submitted for SBA's prior written approval.

H. Payment Terms and Conditions

1. Cash Compromise—Preferred

The compromise amount should be paid in one lump sum on a specified date. Generally, payment should be received within 60 calendar days of the compromise approval date.

2. Term Compromise—If Necessary to Maximize Recovery

The compromise amount should not be payable in installments unless installment payments are necessary in order to maximize recovery on the loan. ([31 C.F.R. § 902.2](#)) If the compromise amount is to be paid in installments:

- a. The terms of the compromise must be set out in a written, legally enforceable document;
- b. The amount due under the compromise agreement must be evidenced by a promissory note with a specified maturity date;
- c. Payment of the promissory note should be secured by collateral;
- d. The compromise agreement should prohibit release of the collateral securing the promissory note until the entire compromise amount has been paid in full;
- e. The compromise agreement must provide that in the event of default, the full loan balance, less sums paid on the promissory note, will be reinstated and become immediately due and payable; and

- f. The compromise agreement should provide for remedies in the event of default such as entry of a confession of judgment or delivery and recording of any deed or bill of sale to the collateral securing the promissory note.

I. Obtaining SBA Approval

CDCs must obtain SBA's prior written approval before entering into a compromise agreement that will result in less than full payment of the outstanding principal balance of the loan. ([13 C.F.R. § 120.536\(a\)\(3\)](#)) Requests for approval should be submitted to the appropriate SBA Loan Center utilizing the format set out in the [Offer in Compromise Tab System](#), which is accessible from <http://www.sba.gov/for-lenders>

Note: If a compromise involves settlement of litigation conducted by SBA in conjunction with the U.S. Attorney's Office, the compromise amount must be approved by and paid directly to the Department of Justice ("DOJ").

J. Completing the Compromise Process

After a compromise has been approved by all of the necessary parties, the following actions should be taken:

1. Prepare and obtain the necessary signatures on a mutual release that is effective when the compromise amount is paid in full (i.e., upon payment of the compromise amount, SBA and the Lender will release the Obligor from further non-tax liability on the loan and the Obligor will release SBA and the Lender from all claims and causes of action arising from the loan);
2. Collect the compromise amount; or if the compromise agreement involves installment payments, set up a separate accounting record for the promissory note, properly perfect the lien on any asset offered to secure payment of the promissory note, and reference the note receivable number that SBA will assign to the promissory note account rather than the parent loan number when remitting payments to the Denver Finance Center;
3. Promptly apply the compromise amount to the principal loan balance;
4. Release the appropriate Loan Documents after verifying that the entire compromise amount has been received; and
5. If there is no legal remedy to collect the loan balance (e.g., from another Obligor) after the compromise amount is received, submit a Wrap-up Report so that the remaining loan balance can be charged-off.

Chapter 24. Litigation

This chapter provides guidance with regard to litigation activities and expenses on 504 Loans. (See Chapter 3 regarding CDC litigation responsibility and authority. See Chapter 14 [*Classifying Loans in Liquidation*] regarding requests for assignment of the Loan Documents.)

A. When Litigation is Appropriate

Litigation activities on a 504 Loan should commence as soon as there is sufficient reason to conclude that:

1. Defensive action is necessary to protect the collateral or ability to collect from an Obligor; or
2. Full or partial recovery of the debt can best be achieved through affirmative litigation against an Obligor or to foreclose a lien on collateral.

B. General Requirements

Litigation on a 504 Loan should be:

1. Cost effective;
 - a. Attorney Fees and Costs—Must be necessary, reasonable and customary. (See Paragraph E below for more information.)
 - b. Due Diligence—Adequate due diligence should be conducted prior to taking legal action to collect a 504 Loan to ensure that the contemplated action will be cost-effective.
 - c. Alternative—If the contemplated legal action will not be cost-effective, a Wrap-up Report should be submitted after the collateral has been liquidated so that the loan can be referred to Treasury for enforced collection. (PCLP CDCs may be entitled to a pro-rata share of the net amount recovered by Treasury. For more information, see Chapter 26.)

<p>Note: Litigation expenses that exceed the recovery on affirmative litigation undertaken without an SBA pre-approved Litigation Plan are presumed to be unreasonable. See Paragraph F for more information.</p>

2. Diligently pursued and resolved in a timely manner. For example, if Non-routine Litigation is contemplated, suit should be filed within 30 calendar days of SBA approval of the CDC's Litigation Plan; and while settlement is encouraged, defendant-Obligors should not be given open-ended time frames to make, accept, reject, or counter settlement offers.
3. Conducted in the name of the Person responsible for the litigation, i.e., CDCs are not authorized to conduct litigation in SBA's name;

4. Conducted solely by the Person responsible for handling the litigation, i.e., CDCs must not take any action in litigation proceedings handled by SBA, including filing a proof of claim without SBA's prior written approval;
5. Consistent with the terms of any senior lienholder agreement, i.e., whenever the litigation is in response to an action initiated by a senior lienholder, legal counsel must enforce the pre-litigation notice and subordination requirements in the lienholder agreements, if any, executed by the senior lienholder in order to protect SBA's equity in the collateral and to provide sufficient time to negotiate a workout whenever feasible.

C. Legal Counsel Hired by CDCs

Any attorney selected by a CDC to perform litigation on a 504 Loan must possess the following minimum qualifications:

1. A valid license to practice law in the state where the litigation will be conducted;
2. Expertise in debt collection and bankruptcy law;
3. If complex litigation is necessary, specialized legal expertise and substantial experience conducting the type of proceedings required based on the circumstances of the loan, (e.g., an attorney hired to have a receiver appointed to operate or sell a gas station must have expertise not only in debt collection and bankruptcy law, but also environmental and receivership law and must have prior experience handling gas station receivership cases);
4. Adequate legal malpractice insurance coverage (i.e., at least \$1,000,000/\$1,000,000); and
5. No conflict of interest with SBA, the CDC, an Obligor, senior lienholder, junior lienholder, landlord, competing creditor or any other Person involved in the issues pertaining to the SBA loan.

D. Litigation Plans

1. Purpose

A [Litigation Plan](#) should be prepared prior to taking any material legal action on a 504 Loan because when properly prepared, a Litigation Plan helps ensure that the litigation is cost-effective, necessary, reasonable and customary. It also expedites SBA's review of requests for approval or reimbursement of litigation expenses.

2. Format and Content

A template for preparing a [Litigation Plan](#) for a 504 Loan is accessible from www.sba.gov/for-lenders. Documentation establishing that the proposed attorney meets the requirements of Paragraph B above and a copy of the engagement letter should be attached to the proposed plan. The plan should also include the justification for, and the estimated cost of, any expense that is presumed to be unreasonable, such as those associated with travel, hiring multiple law firms, or appointing a receiver to perform routine liquidation activities. (See Paragraph F.3 below.)

3. When a Litigation Plan Must be Submitted to SBA

a. General Rule

(1) Litigation Plan

Except as provided below with regard to emergencies, all CDCs, including PCLP CDCs, must submit a [Litigation Plan](#) for SBA's written approval prior to initiating Non-routine Litigation. ([13 C.F.R. § 120.540\(c\)](#)) CDCs are not required to submit a [Litigation Plan](#) to SBA prior to initiating Routine Litigation. However, all CDCs must submit a Litigation Plan if a material change arises during the course of Routine Litigation that causes it to be transformed into Non-routine Litigation, e.g., the legal fees exceed \$10,000 in the aggregate. ([13 C.F.R. § 120.540\(c\)](#))

Note: CDCs should include Routine Litigation in the Liquidation Plans they are required to submit to SBA for approval. (See Chapter 14.)

(2) Amended Litigation Plan

All CDCs must submit an amended Litigation Plan to SBA for approval before taking any legal action or incurring any expense that materially deviates from their original Litigation Plan. ([13 C.F.R. § 120.540\(e\)](#)) Material changes are those that, for example, cause approved legal fees to increase by more than 15%.

b. Exception—Emergency Situations

A CDC may take legal action to respond to an emergency without SBA's written approval of a [Litigation Plan](#) or amended Litigation Plan, provided that the CDC:

- (1) Makes a good faith effort to obtain SBA's written approval before undertaking the emergency action;
- (2) Submits a written Litigation or amended Litigation Plan to SBA as soon after the emergency as possible; and
- (3) Takes no further litigation action without SBA's written approval of the Plan or amended Plan. ([13 C.F.R. § 120.540\(f\)](#))

4. How to Obtain SBA Approval

A request for approval of a proposed [Litigation Plan](#) or amended Litigation Plan must be submitted to the appropriate SBA Loan Center.

5. SBA Response Time—No Implied Consent

Generally, SBA will respond to a request for approval of a proposed [Litigation Plan](#) or amended Litigation Plan within 15 business days of receipt of the request. However, if a response is not received within 15 business days, SBA's consent cannot be implied. ([13 C.F.R. § 120.541](#))

6. Appeal of Loan Center Decision

See Chapter 3 for information on how to appeal the final decision of an SBA Loan Center Director or designee regarding approval of a proposed Litigation Plan.

Note: Once an SBA loan has been referred to DOJ, DOJ—not SBA—has final approval authority. This includes issues pertaining to litigation strategy, credit matters, settlement and compromise.

E. Documentation

1. General Requirement

All Routine and Non-routine Litigation activities and decisions must be justified and documented. The documentation, including pleadings and all Supporting Documents, such as letters, financial statements, credit reports, Appraisals, title reports and UCC lien searches, must be kept in the Loan File.

2. Routine Litigation

Unless specifically requested, CDCs are not required to provide copies of pleadings or other documents pertaining to Routine Litigation to the SBA Loan Center except as required by Chapter 25 (*Expenses and Recoveries*) to support requests for approval or reimbursement of Recoverable Expenses.

3. Non-routine Litigation

To enable SBA to effectively monitor Non-routine Litigation conducted by CDCs—and to expedite the review of requests for approval or reimbursement of litigation expenses— at the time a significant pleading or other document is created or received, (e.g., complaints and answers, motions and opposing pleadings, orders and judgments, bankruptcy plans, discharge orders, and Supporting Documents such as letters, financial statements, credit reports, Appraisals, and lien searches), a copy should be submitted to the SBA Loan Center, which will provide a copy to the SBA District Counsel responsible for monitoring the litigation.

F. Attorney Fees and Costs

1. Recoverable Expenses

To be treated as a Recoverable Expense, attorney fees and costs must be: (a) incurred to collect the balance due under the Note, to enforce the terms of the Loan Documents, or to preserve or dispose of collateral; and (b) necessary, reasonable and customary for the community in which the litigation proceedings were conducted.

2. Non-recoverable Expenses

Examples of attorney fees and costs that are Non-recoverable Expenses include, for example, those related to:

- a. Overhead, including for example, conflict of interest determinations, file set up, calendaring, and billing;
- b. Performance of routine loan servicing or liquidation duties such as the preparation of a Liquidation Plan or a Protective Bid analysis;
- c. Assertion of a claim, cross claim, counterclaim, or third-party claim against SBA by a CDC;
- d. Rectifying a CDC error(s) that would justify a demand for reimbursement by SBA under Chapter 26 (*Reimbursable Loss on 504 Loans*);
- e. Defense of an action brought by SBA against a CDC;
- f. Defense of a claim by an Obligor or other Person seeking damages based on a CDC's alleged wrongful action unless SBA expressly directed the CDC to take the alleged wrongful action;
- g. Services rendered by CDC's in-house counsel;
- h. Services pertaining to litigation handled by SBA legal counsel that were not pre-authorized in writing by SBA; or
- i. Any action, which in SBA's opinion, was for the sole benefit of the CDC.

3. Expenses Presumed to be Unreasonable and Non-Recoverable

Litigation expenses related to any of the following categories are presumed to be unreasonable—and therefore Non-Recoverable—unless the CDC provides justification for incurring the expense, which in SBA's opinion, is sufficient to rebut the presumption:

- a. Generic, i.e., non-itemized, bills for attorney fees or costs;
- b. Services billed at an hourly rate that is excessive given the lack of need for special expertise or experience to perform the task, e.g., \$500 per hour to prepare a creditor's claim or other pleading commonly prepared by a paralegal;
- c. Intra-law firm communications and billing by more than one person for the same activity;
- d. Inter-law firm communications and billing by more than one law firm for the same activity when the justification for using more than one law firm was not included in a Litigation Plan that was pre-approved by SBA;
- e. Attorney fees and costs associated with travel that were not justified and itemized in a Litigation Plan that was pre-approved by SBA;

Note: CDCs are expected to hire local legal counsel. SBA recognizes, however, that in unusual circumstances, hiring counsel from another geographic area may be necessary, reasonable and customary. If so, the justification and estimated travel expenses should be included in a Litigation Plan submitted for SBA approval pursuant to Paragraph C.

- f. The appointment of a receiver to perform routine liquidation activities; and
- g. Attorney fees and costs that exceed the recovery obtained in affirmative litigation undertaken without an SBA approved Litigation Plan.

4. SBA Approval of Attorney Fees

All attorney fees and costs incurred in connection with either Routine Litigation or Non-routine Litigation that a CDC seeks to recoup as a Recoverable Expense must be approved by SBA, even if the estimated attorney fees and costs were listed in an SBA approved Litigation Plan.

5. How to Obtain SBA Approval of Attorney Fees

Requests for approval of attorney fees and costs (along with the required Supporting Documents) should be submitted to the appropriate SBA Loan Center pursuant to the procedure set out in Chapter 25 (*Expenses and Recoveries*).

G. Suit for Judgment on Note or Guaranty

1. When Suit Should be Filed

Suit based on the Note or Guaranty should be filed to obtain a judgment against an Obligor when that Obligor:

- a. Does not have a valid legal defense (e.g., discharge in bankruptcy);
- b. Has the ability to pay the SBA loan in full or substantial part;
- c. Is unwilling to pay the loan or to engage in good faith compromise negotiations; and
- d. Litigation would be a cost-effective method of collecting the loan balance.

2. Alternative—Referral to Treasury for Enforced Collection

When litigation will not be pursued, once the collateral has been liquidated, the loan should be charged-off so that SBA can refer it to Treasury for enforced collection. (See Chapter 28 for information on enforced collection by Treasury. See Chapter 14 or Chapter 23 for information on how to access an Obligor's repayment ability and net worth for enforced collection purposes. See Chapter 27 for information on how to report fraud and abuse to the SBA Office of the Inspector General.)

H. Judicial Foreclosure and Deficiency Judgment

Although non-judicial foreclosure is generally preferable, judicial foreclosure may be required by state law or more appropriate under certain circumstances, for example, when the proceeds of a non-judicial foreclosure sale will not be sufficient to pay the loan in full and a deficiency judgment will be needed to collect the balance from the Obligors.

Note: Deficiency represents that portion of a loan that remains outstanding after collateral has been liquidated (converted to cash) and applied to the outstanding balance.

I. Settlement Offers

Offers to settle ongoing litigation should be reviewed, analyzed and processed pursuant to the requirements in Chapter 23 (*Offer in Compromise*).

J. Bankruptcy Proceedings

Note: For general information about federal bankruptcy laws and the bankruptcy process, see [Bankruptcy Basics](#) on the United States Courts Web site.

1. Impact of Automatic Stay

The moment a bankruptcy petition is filed, the automatic stay, (a statutory court order), prohibits creditors from pursuing further collection action against a debtor while the debtor's bankruptcy is pending. Therefore, upon learning that a bankruptcy petition has been filed with respect to an Obligor, (the "debtor" in the bankruptcy proceedings and as used in this Paragraph), legal counsel should be consulted regarding the impact of the bankruptcy filing on any pending or contemplated collection activities. Unless legal counsel determines that the automatic stay, which is imposed at the time a bankruptcy petition is filed, has been lifted or is no longer in effect, collection activity against the debtor must stop immediately. (11 U.S.C. § 362)

2. Suspension of Collection Activity

Upon receipt of notice of a bankruptcy involving an Obligor (including "no asset" Chapter 7 bankruptcies), the Person receiving the notice must immediately notify SBA so that any on-going administrative wage garnishment, off-set, or other enforced collection proceedings can be suspended, and appropriate action can be taken by SBA legal counsel. Generally, the notice should be sent to the SBA Loan Center. However, if the bankruptcy notice concerns a loan that has been charged-off and referred to Treasury, the notice should immediately be sent to the SBA Treasury Offset Division in Birmingham, Alabama, so that the loan can be recalled from Treasury. The notice, which must include the Borrower's name and the SBA loan number, should be faxed or emailed to:

Supervisory Loan Specialist
Treasury Offset Division
Fax: 202-481-0592
Email: BirminghamTOPS@sba.gov
Phone: 1-800-736-6048 Extension 7705

3. Litigation Requirements

If an Obligor files for bankruptcy protection, at a minimum, the following actions should be taken when necessary to protect the ability to recover on the 504 Loan:

- a. File a proof of claim;

- b. Review the debtor's Statement of Financial Affairs and schedules and compare them with the financial documents the debtor provided to SBA and the CDC to determine if there are any material discrepancies with regard to the debtor's alleged assets, liabilities, income or expenses;
- c. Report suspected fraud to the Office of the Inspector General (Chapter 27) and the appropriate Office of the [U.S. Trustee](#);
- d. Monitor the bankruptcy proceedings;
- e. Represent the interests of SBA and the CDC at all hearings where the outcome may adversely affect the ability to collect the 504 Loan balance;
- f. File a motion for relief from the automatic stay when necessary to pursue enforced collection proceedings against the collateral;
- g. File an objection to discharge of the debt owed on the 504 Loan if there is reason to believe that the debtor obtained the loan through fraud, misrepresentation or omission of a material fact, or fraudulently transferred or converted collateral;
- h. File a motion to revoke the debtor's discharge if there is reason to believe that it was obtained through fraud or other acts of impropriety;
- i. Obtain the bankruptcy court's approval of a reaffirmation agreement if the debtor is willing and able to continue paying on the 504 Loan;
- j. Review proposed plans and disclosure statements and file an objection when necessary;
- k. Cast a vote to accept or reject proposed plans based on an analysis of the relevant facts;

Note: SBA's prior written approval is required before a PCLP CDC compromises the principal balance of a 504 Loan or a non-PCLP CDC compromises any portion of a 504 Loan. ([13 C.F.R § 120.536\(a\)\(3\)](#)) Therefore, if a proposed bankruptcy plan calls for the reduction of the loan balance, the CDC handling the litigation may need to obtain SBA's written approval before voting in favor of the plan, but not before voting against it - regardless of whether there are additional Obligors who will remain responsible for the entire loan balance.

- l. Resume collection efforts immediately if the bankruptcy case is dismissed and the 504 Loan is still in default; and
- m. Take any other action that may be necessary and appropriate under the circumstances.

Note: An approved bankruptcy plan only affects the liability of the plan debtor. All other Obligors remain liable for the entire loan balance.

K. Probate Proceedings

In addition to collecting the proceeds from any life insurance policy assigned as collateral, if an Obligor dies, at a minimum, the following actions should be taken when necessary to protect the ability to recover on the 504 Loan:

1. File a creditor's claim in the probate proceedings within the time prescribed by the applicable law;

Note: [31 U.S.C. § 3713\(a\)\(1\)\(B\)](#) gives priority to claims of the United States filed against the estate of an Obligor.

2. Review the inventory of the decedent's estate and compare it with the financial documents the decedent provided to SBA and the CDC to determine if there are any material discrepancies;
3. Report suspected fraud to the SBA Office of the Inspector General (Chapter 27);
4. Monitor the probate proceedings;
5. Represent SBA and the CDC's interests at all hearings where the outcome may adversely affect the ability to collect the 505 Loan balance; and
6. Take any other action that is necessary and appropriate under the circumstances.

L. Enforcement of Judgments

After a judgment has been obtained against an Obligor (the "judgment debtor"):

1. Registration

The judgment, or an abstract thereof, should be recorded in any state or other jurisdictional unit (e.g., territory or foreign country) where the judgment debtor resides or has assets that can be seized and sold to satisfy the judgment;

2. Execution

The judgment debtor's non-exempt assets should be executed on within 90 calendar days of the judgment date; and

3. Assignment to SBA

The judgment should be assigned to SBA if the only, or most cost-effective, way to collect it is to utilize a remedy that is available to SBA—but not the CDC—under the [Federal Debt Collection Procedures Act](#).

M. Application of Litigation Recoveries

Funds recovered through litigation should be applied in the following order:

1. Recoverable Expenses;

2. Principal loan balance; and
3. Accrued interest.

Note: When litigation is handled by SBA legal counsel in their capacity as a Special Assistant U.S. Attorney or by the local U.S. Attorney's Office, DOJ is authorized to collect and retain a 10% surcharge pursuant to Section 3011 of the [Federal Debt Collection Procedures Act](#).

Chapter 25. Expenses and Recoveries

This chapter covers expenses related to collecting sums due under the Note, enforcing the terms of the Loan Documents, and preserving or disposing of collateral. (See Chapter 22 for information regarding expenses related to acquired collateral.)

A. Classification of Expenses

Expenses are classified by SBA as either Recoverable Expenses, which can be recouped, or Non-recoverable Expenses, which cannot be recouped. (See Paragraphs C and D below.) When reviewing CDC requests for expense approval or reimbursement, SBA may determine that an expense is Recoverable or Non-recoverable in whole or in part.

1. Non-recoverable Expenses

Non-recoverable Expenses are costs that cannot be added to the principal balance of the loan. They include, for example:

- a. Any expense that is not related to collection of amounts due under the Note, to enforce the terms of the Loan Documents, or preservation or disposal of the collateral for the loan;
- b. Any fee or cost, or portion thereof, that is not necessary, reasonable or customary;
- c. CDC overhead costs that should be absorbed as a cost of doing business, e.g., telephone calls, photocopying, mileage, meals, etc.;
- d. Fees and out-of-pocket costs (e.g., late fees and NSF charges) that SBA allows CDCs to collect if the loan is current, but does not guaranty (Chapter 4);
- e. Fees and costs incurred by a CDC to have an independent contractor perform routine loan servicing or liquidation duties such as the preparation of a demand letter, Liquidation Plan, Purchase Package, or Protective Bid analysis, or the review of an Appraisal or Environmental Investigation Report; unless the contract and contractor were preapproved by SBA in writing (Chapter 3);
- f. Funds associated with “sharing” an appraisal ordered by another lender, Obligor, or other Person. (See the definition of “Appraisal” in Chapter 2 for SBA Loan Program Requirements pertaining to Appraisals.);
- g. Expenses related to actions, which in SBA’s opinion, were taken for the exclusive benefit of the CDC;
- h. Expenses associated with a claim by an Obligor or other Person seeking damages based on a CDC's alleged wrongful action unless SBA expressly directed the CDC to take the alleged wrongful action; and
- i. The attorney fees and costs listed in Chapter 24 as Non-recoverable Expenses.

2. Recoverable Expenses

As set out in Chapter 2 (*Definitions*), Recoverable Expenses are the SBA approved, necessary, reasonable and customary costs incurred to collect amounts due under the Note, to enforce the terms of the Loan Documents, or to preserve or dispose of collateral, which according to the terms of the Note, can be added to the principal balance of the loan. Recoverable Expenses include, for example:

a. Searches

- (1) UCC lien searches;
- (2) Title reports; and
- (3) Credit and asset search reports.

b. Appraisals and Other Reports

- (1) Appraisals;
- (2) Environmental Investigation Reports; and
- (3) Site Visit Reports prepared by contractors.

c. Litigation Expenses

- (1) Attorney fees; and
- (2) Costs such as court filing fees.

d. Collateral Care and Preservation

- (1) Utility bills;
- (2) Insurance premium payments;
- (3) Caretaker fees;
- (4) Repair bills;
- (5) Real estate and personal property taxes; and
- (6) Expenses related to non-tax senior liens.

B. Recoveries

1. Application of Recoveries

Unless the terms of a workout agreement or some other legally binding document, such as a court order, specify otherwise, recoveries (i.e., funds obtained through liquidation activities) should be applied in the following order:

- a. Recoverable Expenses incurred in the liquidation process;
- b. Principal balance of the loan; and
- c. Accrued interest.

2. Remittance of Recoveries to SBA

The net proceeds of any recovery on a 504 Loan should be remitted to SBA within 15 business days of receipt. If the recoveries are not remitted in a timely manner, the SBA Loan Center may charge interest on the late amount and refer the matter to the SBA Office of Credit Risk Management.

C. Payment of Non-recoverable Expenses Incurred by CDCs

CDCs must pay their own Non-recoverable Expenses. SBA will not pay, reimburse or approve, in whole or in part, Non-recoverable Expenses incurred by CDCs.

D. Recoupment of Recoverable Expenses Incurred by CDCs

Note: The [Prompt Payment Act](#), which requires federal agencies to pay interest and penalties on late payments for contracted expenses, does not apply to payments to CDCs for Recoverable Expenses. See SOP 20 17 and [Subpart 32.9 of the Federal Acquisition Regulation](#) for further information.

1. General Requirement—SBA Approval

Any cost, fee or other amount that a CDC seeks to treat as a Recoverable Expense must be reviewed and approved by SBA pursuant to Paragraph E below.

2. Recoupment Methods

Recoverable Expenses incurred by a CDC should be paid by the CDC and recouped by one of the following methods:

a. Deduction from Recoveries

Recoverable Expenses may be deducted from recoveries on the loan.

b. Reimbursement by SBA

CDCs may ask SBA to reimburse them for Recoverable Expenses that were not paid through deduction from recoveries.

E. SBA Review and Approval

Any cost, fee or other amount that a CDC seeks to treat as a Recoverable Expense must be reviewed and approved by SBA regardless of whether the CDC is seeking reimbursement or has already deducted the expense from recoveries. Requests for approval must be submitted to SBA in accordance with the following requirements:

1. Where to Submit Requests

Requests must be submitted to the appropriate SBA Loan Center.

2. Preferred Format

To expedite the review process, CDCs should organize and submit their requests in the format recommended by the appropriate SBA Loan Center.

3. When Requests May be Submitted

To prevent backups and expedite the review process, requests for reimbursement or for approval of Recoverable Expenses deducted from recoveries may only be submitted at the following times:

a. When Recoverable Expenses Total \$5,000 or More Per Loan

- (1) Requests involving Recoverable Expenses totaling \$5,000 or more per loan may be submitted at any time after Debenture purchase.
- (2) A request involving a Recoverable Expense that is less than \$5,000 must be compiled with other expense requests involving the same loan, and can only be submitted when the aggregate amount totals \$5,000 or more, or at the time the Wrap-up Report on the loan is submitted, whichever occurs first.

b. Submission of Wrap-up Report

All outstanding requests for SBA reimbursement of Recoverable Expenses or approval of expenses deducted from recoveries must be submitted with the CDC's Wrap-up Report on the loan.

4. Multiple Loans—Allocation of Expenses

When a request involves multiple loans to the same Borrower (whether SBA loans or non-SBA loans):

- a. If the expense is related to collateral, the expense (as well as any recovery) must be allocated to the loans according to the priority of the lien securing each loan; and
- b. If the expense is not related to collateral, the expense (as well as any recovery) must be pro-rated and allocated among the loans to which it relates.

5. Contents of Recoverable Expense Request Packages

Requests should include the following items as applicable:

a. CDC Contact Information

CDC's name, address, e-mail address, phone and fax numbers, and Tax Identification Number.

b. Borrower's Name and SBA Loan Number**c. Summary of Expenses**

Multiple invoices must be grouped by the categories set out in Paragraph A.2 of this chapter and summarized in a cover sheet that includes: (1) the date each service was performed; (2) the number of each invoice; (3) the subtotal for each category; and (4) the grand total of all categories.

d. Itemized Invoices

A paper or electronic copy of each invoice must be provided and include: (1) the date of the invoice; (2) a thorough description of the goods or services provided; (3) the date the goods were provided or the services were performed; (4) the amount charged for each service or product provided; (5) the total amount due; and (6) if the invoice is for services billed on an hourly basis, the name, title, hourly billing rate and time spent by each individual who performed services covered by the invoice.

e. Supporting Documents

Recoverable Expense request packages must include a copy of all of the Supporting Documents pertaining to the invoices (e.g., a copy of the Site Visit Report if the invoice is for a site visit) unless they have already been provided to SBA. For example, with regard to litigation expenses, the Recoverable Expense request package must include a copy of the SBA approved [Litigation Plan](#), pleadings and other documents required by Chapter 24 unless they have already been provided to SBA.

6. Denied Expense Approval Requests

CDCs must reimburse SBA for the amount of any expense denied by SBA that the CDC has already deducted from recoveries.

<p>Note: For information on how to appeal the final decision of an SBA Loan Center Director or designee with regard to approval of liquidation or litigation expenses, see Chapter 3.</p>

Chapter 26. Reimbursable Loss on 504 Loans

A. All 504 Loans

Generally, if a CDC defaults on a Debenture sold to fund a 504 Loan and SBA is required to purchase the Debenture, SBA limits its recovery to the payments made on the 504 Loan, the amount recovered through liquidation, and if the loan was funded by a PCLP Debenture, the percentage of the loss that the PCLP CDC is required to reimburse SBA. However, if SBA discovers fraud, negligence or misrepresentation by the CDC, the CDC must reimburse SBA for the entire amount of the Debenture. ([13 C.F.R. § 120.938\(b\)](#))

1. Referral to Office of Credit Risk Management

When SBA has reason to suspect that a CDC has engaged in fraud, negligence or misrepresentation with regard to a 504 Loan, SBA will refer the matter to the Office of Credit Risk Management, which with assistance from the Office of Litigation, will take appropriate action against the CDC.

2. Referral to Office of the Inspector General

In addition to referring the matter to the Office of Credit Risk Management, if SBA discovers fraud or misrepresentation, it will refer the matter to the Office of the Inspector General pursuant to the procedures set out in Chapter 27.

B. PCLP 504 Loans

1. PCLP CDC Reimbursement Requirement

Unless a higher percentage is required by the applicable Loan Program Requirements, a PCLP CDC must reimburse SBA for ten percent of any loss suffered by SBA as a result of a default on a 504 Loan funded by a PCLP Debenture. ([13 C.F.R. § 120.847\(a\)](#)) The PCLP CDC may use its Loan Loss Reserve Fund ("LLRF") for this purpose, but it must replenish the LLRF within 30 days of the withdrawal if the withdrawal causes the PCLP CDC to have insufficient funds to cover its exposure on all of the remaining PCLP Debentures in its portfolio.

2. Calculation of PCLP CDC's Reimbursement Obligation

The amount of SBA's loss and the PCLP CDC's reimbursement obligation is calculated by adding together the amount of principal and interest owed by the Borrower immediately after SBA purchased the Debenture and any Recoverable Expense paid by SBA; deducting from that total the amount of any recovery SBA received after purchasing the Debenture (SBA's loss); and multiplying the dollar amount of SBA's loss by ten percent (CDC's reimbursement obligation) unless the CDC's agreement with SBA specifies that the CDC's reimbursement obligation will be calculated by multiplying SBA's loss by 15 percent, in which case, the reimbursement obligation amount would be 15 percent of SBA's loss—not ten percent.

3. CDC Notification of Reimbursement Obligation

Within 90 calendar days of charging-off the balance of a PCLP 504 Loan, the SBA Loan Center will send the PCLP CDC a letter that sets out:

- a. The amount of the PCLP CDC's reimbursement obligation;
- b. The deadline for payment, i.e., within 30 calendar days of the date of the letter;
- c. How the reimbursement amount was calculated, (Generally, a copy of the transcript of account and Supporting Documents utilized by the SBA Loan Center to calculate the amount should be included.); and
- d. The PCLP CDC's appeal rights pursuant to [13 C.F.R. § 120.847\(h\)\(2\)](#).

4. Appeal Process

The final decision of an SBA Loan Center Director or designee regarding the calculation of SBA's loss and the PCLP CDC's reimbursement obligation may be appealed to the Director of the Office of Financial Program Operations (designee of the Director of the Office of Financial Assistance), who will consult with the Director of the Office of Credit Risk Management, provided that: (1) the PCLP CDC reimbursed SBA for ten percent of any loss amount that is not in dispute within 30 days of the date of SBA's notification letter; and provided further that (2) the appeal: (a) is in writing; (b) includes a copy of the notification letter and Supporting Documents; (c) states the reason why the calculations are believed to be incorrect; and (d) is submitted within 30 calendar days of the date of the notification letter. ([13 C.F.R. § 120.847\(h\)\(2\)](#))

5. Payment Deadline

The PCLP CDC must reimburse SBA no later than 30 calendar days after SBA notifies it of its reimbursement obligation; or, if the PCLP CDC filed a timely appeal, no later than 30 calendar days after issuance of a final decision on the appeal. ([13 C.F.R. § 120.847\(h\)\(1\)](#))

6. Consequences if PCLP CDC Fails to Reimburse SBA

a. Interest and Penalties

Delinquent PCLP reimbursement payments accrue interest and are subject to a monetary penalty of up to six percent as well as processing and handling fees as authorized by [31 U.S.C.](#)

b.

If the PCLP CDC fails to satisfy its entire reimbursement obligation within 30 calendar days of the notification letter or issuance of the final decision on the PCLP CDC's appeal, the SBA Loan Center may transfer funds in the PCLP CDC's Loan Loss Reserve Fund ("LLRF") to SBA to cover the PCLP CDC's reimbursement obligation. ([13 C.F.R. § 120.847\(i\)](#))

c. Issue Demand for Payment

If the PCLP CDC's LLRF does not contain sufficient funds to reimburse SBA, the SBA Loan Center may send the PCLP CDC a written demand for payment of the difference between the amount obtained from the LLRF and the amount still owed on the reimbursement obligation, and the PCLP CDC must pay this amount within 30 calendar days after the date of the demand. ([13 C.F.R. § 120.847\(i\)](#))

7. Post-Reimbursement Recovery on PCLP 504 Loans

If there are recoveries that reduce the amount of SBA's loss after a PCLP CDC has paid its reimbursement amount in full, and provided that the PCLP CDC is otherwise in good standing with SBA, SBA will share the net recovery with the PCLP CDC on a pro-rata basis, i.e., the PCLP CDC will receive ten percent of the net recovery, unless the CDC's agreement with SBA specifies that SBA's loss will be calculated by multiplying by 15 percent, in which case the CDC's share will be 15 percent of the net recovery—not ten percent.

Chapter 27. Inspector General Referrals

A. Duty to Report Irregularities

All SBA officials, CDCs and contractors must be on the lookout for fraud and report any known or suspected irregularities involving SBA programs, program participants, or personnel to the Office of the Inspector General ("OIG"). ([13 C.F.R. § 120.197](#))

B. Irregularities Requiring Referral

Examples of irregularities that must be referred to the OIG include:

1. Loan Application Fraud

False statements made or submitted by a loan applicant with regard to eligibility for SBA financing, for example:

- a. Overstating income;
- b. Understating or failing to disclose liabilities;
- c. Overstating the value of assets offered as collateral;
- d. Failing to disclose criminal records;
- e. Making false statements regarding U.S. citizenship or immigration status;
- f. Misrepresenting the true ownership of a business;
- g. Using false Social Security Numbers;
- h. Creating false work histories;
- i. Submitting altered tax returns; or
- j. Providing fraudulent standby agreements.

2. Loan Closing Fraud

False documents submitted by a loan applicant with regard to a loan closing requirement (e.g., equity injection), for example:

- a. False gift letter or affidavit;
- b. False promissory note and standby agreement; or
- c. False bank statement and cashier's check.

3. Loan Agent Fraud

Actions by Agents who orchestrate, facilitate or otherwise support any of the illegal acts committed by loan applicants, CDCs, or Obligators such as those listed in this chapter.

4. Misuse of Loan Proceeds

Misuse of loan proceeds or any other funds in which SBA has an interest.

5. Conversion of Collateral

Conversion, concealment, vandalism or unauthorized disposal of collateral for an SBA loan.

6. SBA Employee Misconduct

Misconduct by an SBA official, or Close Relative of an SBA official, such as soliciting or accepting a bribe in connection with making, closing, servicing, or liquidating a 504 Loan.

7. CDC Misconduct

Misconduct by a CDC, an Associate of a CDC, an employee of the CDC, or a Close Relative of an employee, such as soliciting or accepting a bribe in connection with making, closing, servicing, or liquidating a 504 Loan.

C. Referral Methods

A referral to the OIG can be made by:

1. Calling the OIG Hotline toll-free at 1-800-767-0385;
2. Completing the on-line [OIG Complaint Submission Form](http://web.sba.gov/oigcss/client/dsp_welcome.cfm) at http://web.sba.gov/oigcss/client/dsp_welcome.cfm and submitting the referral via the Internet; or
3. Mailing the referral to:

U.S. Small Business Administration
Office of Inspector General
Investigations Division, Mail Code: 4113
409 Third Street, SW
Washington, DC 20416

D. Required Information

1. Answers to Basic Questions

A referral to the OIG should include as much information as possible in response to these basic questions:

- a. Who is involved? (Name, occupation, address, phone numbers, email address, etc.)

- b. What occurred and how is SBA involved?
- c. When and where did, or will, the activity take place?
- d. Why does the activity appear to be illegal or improper?
- e. What dollar amount is involved? (E.g., loan amount or value of converted collateral.)
- f. Who can confirm the allegation and how can that Person be contacted?
- g. Who can provide more information?

2. Copies of Relevant Documents

When applicable, copies of documents that support the statements made in response to the above questions should be submitted as part of the referral.

E. Post-referral Responsibility

After referring a matter to the OIG, the Person who made the referral should:

1. Report any new or additional information discovered about the matter to the OIG;
2. Not disclose or discuss the existence of the OIG referral or investigation to any Person other than SBA officials on a need-to-know basis;
3. Coordinate any activities related to the loan with the OIG in order to avoid taking any action that could be detrimental to the investigation or subsequent prosecution; and
4. With OIG approval, and in coordination with the OIG, take appropriate and timely action to maximize recovery on the loan.

Chapter 28. Charge-off and Wrap-up Procedures

A. Charge-off

1. General

Charge-off is an SBA administrative action whereby a loan is moved from “liquidation” status to “charged-off” status. It has no impact on the Obligor’s liability for the loan balance.

2. When Appropriate

Charge-off is appropriate when:

- a. All reasonable efforts have been exhausted to achieve recovery from: (1) voluntary payments on the Note; (2) liquidation of the collateral; (3) compromise; and (4) litigation and other enforced collection activities against all of the Obligors;
- b. The estimated cost of further collection efforts exceeds the anticipated recovery;
- c. The only remaining avenue of recovery is from Obligors who cannot be located or who are unable to pay the loan balance; or
- d. The loan balance is uncollectible due to discharge in bankruptcy (i.e., release of the debtor from any further personal liability for pre-bankruptcy debts), expiration of the statute of limitations (i.e., the passing of the deadline for suing), or the existence of another defense available to the remaining Obligors under state or federal law.

B. Wrap-up Report

The submission of a Wrap-up Report indicates that no further collection action will be pursued, and that the loan is ready for charge-off.

1. When Required

For each 504 Loan classified in liquidation status, a [Wrap-up Report](#) must be prepared and submitted to the appropriate SBA Loan Center within 90 calendar days of completing all reasonable and cost-effective recovery efforts or upon receipt of a request from the SBA Loan Center, whichever occurs first.

2. Consequences of Failure to Submit a Timely Wrap-up Report

If a CDC fails to submit a [Wrap-up Report](#) within the timeframe specified in Subparagraph 1 above, in order to comply with the [Debt Collection Improvement Act of 1996](#), SBA will charge-off the loan balance, refer the loan to Treasury if appropriate, and with regard to PCLP 504 Loans, bill the PCLP CDC for its share of the loss.

Note: If a CDC is unable or unwilling to liquidate its 504 Loan portfolio according to SBA Loan Program Requirements, the matter will be referred to the SBA Office of Credit Risk Management to initiate enforcement action pursuant to [13 C.F.R. § 120.1400](#) and [13 C.F.R. § 120.1500](#). (See SOP 50 53 for additional information regarding SBA's credit risk management policy and procedures.)

3. Contents

A template for drafting a [Wrap-up Report](#) is accessible from <http://www.sba.gov/for-lenders>. It should include the information listed below.

a. Identifying Information

- (1) SBA loan number, Borrower's name, and principal loan balance; and
- (2) CDC's name, contact person's name, phone number and email address.

b. Status of Obligors

A discussion of the status of each Obligor required by the Loan Authorization that includes, when applicable, the following information and Supporting Documents:

- (1) Each Obligor's name, address and Taxpayer Identification Number (Employer Identification Number or Social Security number), whether they are still liable for the loan balance, and if not, the reason why, e.g., compromise or discharge in bankruptcy;
- (2) A copy of the demand letter sent to each Obligor—or an explanation for its absence (e.g., bankruptcy filing);
- (3) A description of the efforts made to locate any missing Obligor(s);
- (4) A description of any efforts made to obtain an offer in compromise from each Obligor still liable for the loan balance; and
- (5) An estimate of the potential recovery from each remaining Obligor based on a current asset search, credit report, or other credible Supporting Document(s).

Note: See Chapter 14 (*Classifying Loans in Liquidation*) and Chapter 23 (*Offer in Compromise*) for information on how to analyze an Obligor's repayment ability.

c. Status of Collateral

A discussion of the status of the collateral required by the Loan Authorization that includes, when applicable, the following information and Supporting Documents:

- (1) List of how, when and by whom (e.g., CDC or Third Party Lender) each significant item or category of collateral (i.e., real property with a Recoverable Value of \$10,000 or more per parcel, and personal property with an aggregate or individual Recoverable Value of \$5,000 or more) was liquidated, the ultimate disposition of the collateral (e.g., sold to a third party or purchased by the Third Party Lender at foreclosure sale), and the amount recovered;
- (2) List of any remaining collateral;
- (3) Justification for abandoning any remaining collateral, and a description of the efforts made to compromise with the owner-Obligor if it includes a lien on a personal residence;
- (4) Summary section of any post-default Appraisal;
- (5) With regard to commercial real property collateral, the summary section of any post-default Environmental Investigation Report or an explanation for why an Environmental Investigation was not required under Chapter 5; and
- (6) Description of the efforts to liquidate any life insurance policy with a cash-surrender value.

d. Status of Liquidation and Litigation Activities

A statement indicating whether there are any liquidation or litigation activities, which are on-going or planned for the immediate future, (e.g., collection of payments under a workout agreement or plans to execute on a judgment).

e. Site Visit Report

A copy of the post-default Site Visit Report, previously approved site visit waiver, or an explanation for why a site visit was not required under Chapter 16.

f. Recoveries

If not previously reported to SBA, a list of all recoveries that includes: the source, amount and date of the recovery; an accounting of how the recovery was applied to the loan balance; a copy of any relevant Supporting Documents; and an explanation for why the recoveries were not reported and submitted to SBA within 15 business days of receipt as required by Chapter 25 (*Expenses and Recoveries*).

g. Expenses

- (1) A list of all expenses incurred to liquidate the loan; and
- (2) A request for approval or reimbursement of any Recoverable Expense that has not already been reviewed and approved by SBA. The request must be accompanied by the Supporting Documents required by Chapter 25 (*Expenses and Recoveries*).

h. Recommendation

A recommendation regarding whether:

- (1) The loan balance should be charged-off;
- (2) Any remaining collateral or acquired collateral should be abandoned;
- (3) The loan should be referred to Treasury for further collection efforts; and whether
- (4) The loan should be referred to the Office of the Inspector General ("OIG") to investigate any suspected fraud or abuse. (See Chapter 27 for information on OIG Referrals.)

C. Referral to Treasury Cross-Servicing Program

Note: Under the [Cross-servicing Program](#), in addition to offset, delinquent debt is collected through the use of a wide variety of tools such as administrative wage garnishment, skip tracing, negotiated repayment plans, use of private collection agencies, DOJ litigation, and preventing receipt of additional federal financial assistance. Prior to referral, SBA sends an automated letter to the Obligor giving them 60 calendar days to either pay the loan in full or negotiate an acceptable payment plan. (See Chapter 15 for information regarding referral for inclusion in the [Treasury Offset Program](#) at the time the Debenture is purchased.)

1. When Referral Required

After charge-off the loan and remaining Obligor must be referred to [Treasury](#) for inclusion in the [Cross-servicing Program](#), ([Debt Collection Improvement Act of 1996](#)) unless further collection is barred by a valid legal defense such as compromise, discharge in bankruptcy, or the statute of limitations.

2. Distribution of Post-Referral Recoveries

With regard to PCLP 504 Loans, SBA shares the net amount recovered on the loan after referral to Treasury with the PCLP CDC on a pro-rata basis provided that the CDC has paid its reimbursement obligation in full and is otherwise in good standing with SBA. (See Chapter 26 for more information.)

3. Post-Referral Servicing

a. Exclusive Authority of Treasury Department

After charge-off and referral of a 504 Loan to Treasury, the Loan File should be retained by the Person originally responsible for liquidating the loan. But, except as provided below with regard to subsequent bankruptcy filings, no one other than Treasury can take any further servicing or liquidation action on the loan. This exclusion applies to both SBA and the CDC.

b. Notice of Bankruptcy Filing or Other Litigation

Upon receiving notice of a bankruptcy filing or other litigation concerning a 504 Loan referred to Treasury, the Person receiving the notice must immediately notify the SBA Treasury Offset Division in Birmingham, Alabama, so that the loan can be recalled from Treasury and SBA legal counsel can take appropriate action in response to the litigation. The notice, which must include the Borrower's name and the SBA loan number, should be faxed or emailed to:

Supervisory Loan Specialist
 Treasury Offset Division
 Fax: 202-481-0592
 Email: BirminghamTOPS@sba.gov
 Phone: 1-800-736-6048 Extension 7705

Note: Regardless of whether the loan was originally serviced by the CDC, after the loan has been referred to Treasury, all subsequent litigation is managed by SBA legal counsel – who may recommend that the loan be referred back to the CDC to handle the litigation under SBA legal counsel's supervision. (Chapter 3)

D. IRS Notification of Cancelled Debt

1. When IRS Form 1099-C Required

[IRS Form 1099-C](#) (*Cancellation of Debt*) must be filed with the IRS and mailed to the Borrower—but not the Guarantors—whenever the principal owed on an SBA loan is \$600 or more; and the loan balance has become uncollectible (e.g., as the result of a compromise).

2. Responsibility for Issuing IRS Form 1099-C

The SBA Denver Finance Center is responsible for providing the Borrower and the IRS with [IRS Form 1099-C](#) for the cancelled portion of an SBA loan.

3. When IRS Form 1099-C Issued

- a. Compromised debt should be reported the calendar year after the compromise amount was paid in full;
- b. Debt discharged in bankruptcy should be reported the calendar year after the discharge; and
- c. Charged-off debt that is not related to compromise or bankruptcy should be reported the calendar year after:
 - (1) The event occurred that rendered the debt uncollectible such as the date the statute of limitations for collecting the debt expired, or
 - (2) The date Treasury completed its collection efforts.

E. Credit Bureau Reporting

SBA is responsible for reporting all charged-off 504 Loans, including PCLP CDCs' share of the loss, to the appropriate credit bureaus and Federal Government delinquent debtor databases, e.g., *Credit Alert Interactive Voice Response System* ("CAIVRS") and *Debt Check*.

Note: [CAIVRS](#) is a HUD-maintained computer information system that enables lenders to learn if an applicant has previously defaulted on a federally-assisted loan from the USDA, SBA, Department of Education, HUD or VA. [Debt Check](#) is a Treasury Department Financial Management Service program that allows agencies and outside lenders to obtain information regarding whether applicants for federal loans, loan insurance, or loan guarantees owe delinquent child support or delinquent non-tax debt to the Federal Government.